Hirko and Associates (HALO) Legal and Regulatory Measure Update

National Bank of Ethiopia Announces Major Monetary Policy Reforms: Credit Cap Removed and Policy Rate Increased to 16%

COMPREHENSIVE LEGAL UPDATE

LEGAL AND REGULATORY MEASURE UPDATE

National Bank of Ethiopia Announces Major Monetary Policy Reforms

1. Introduction

The National Bank of Ethiopia (NBE), through its Monetary Policy Committee (MPC), announced a comprehensive package of monetary policy reforms following its seventh regular meeting held on 13 July 2026 (Hamle 6, 2018 E.C.). The decisions, subsequently approved by the NBE Board of Directors, represent one of the most significant developments in Ethiopia's monetary policy framework since the commencement of the country's macroeconomic reform program in July 2024.

These reforms complete Ethiopia's transition from a monetary policy regime primarily reliant on direct administrative controls to one based on market-oriented interest rate instruments. In announcing the reforms, NBE Governor Dr. Eyob Tekalign emphasized that the removal of the credit growth cap should not be interpreted as a relaxation of monetary policy. Rather, it constitutes a change in the monetary policy instrument while maintaining an overall tight monetary stance designed to contain inflation.

2. Removal of the Credit Growth Cap

One of the most significant policy decisions is the complete removal of the temporary credit growth cap previously imposed on commercial banks. The credit cap had originally been introduced as an extraordinary measure to curb excessive credit expansion during periods of high inflation by limiting annual lending growth. Although the permissible growth threshold had gradually increased over the past two years, the National Bank has now concluded that the measure has fulfilled its intended purpose.

According to the Monetary Policy Committee, Ethiopia has now reached a stage where inflation management can be achieved through indirect market-based instruments, particularly interest rate policy, rather than through administrative lending restrictions. The removal of the credit cap therefore signifies the completion of the country's transition toward a modern interest rate-based monetary policy framework rather than a relaxation of monetary discipline.

3. Increase in the Policy Interest Rate

To ensure that the removal of the credit cap does not lead to excessive credit expansion, the National Bank simultaneously increased its benchmark policy interest rate from 15 percent to 16 percent. This represents the first adjustment to the policy rate since the introduction of the interest rate framework in July 2024, while the existing policy rate corridor remains unchanged.

The increase is intended to offset any expansionary effects arising from the removal of lending restrictions and to reinforce the National Bank's commitment to maintaining price stability. The Monetary Policy Committee has emphasized that these two measures should be viewed together as components of a coordinated policy package designed to maintain an appropriately restrictive monetary stance.

4. Introduction of Targeted Reserve Requirements

The National Bank has also introduced a targeted reserve requirement mechanism that enables it to impose additional reserve requirements on individual commercial banks based on periodic assessments of their loan-to-deposit ratios. Unlike the previous credit cap, which applied uniformly across the banking sector, this framework allows supervisory interventions to be directed at institutions whose lending activities may contribute disproportionately to inflationary pressures.

This approach enhances regulatory flexibility by enabling the National Bank to respond to institution-specific risks while avoiding unnecessary restrictions on the banking sector as a whole. The improved liquidity position currently observed across the banking industry provides a favourable environment for implementing this more targeted supervisory framework.

5. Reduction of the Foreign Exchange Commission

As part of the broader policy package, the National Bank reduced the foreign exchange commission from 2.5 percent to 1.5 percent. This measure is intended to reduce the cost of foreign exchange transactions, lower import-related expenses, and limit the transmission of rising international prices into domestic inflation.

The reduction also supports the development of a more efficient and competitive foreign exchange market by reducing transaction costs for businesses engaged in international trade.

6. Reduction of the Foreign Exchange Surrender Requirement

The National Bank further reduced the mandatory foreign exchange surrender requirement applicable to goods exporters from 50 percent to 30 percent. Consequently, exporters are now permitted to retain up to 70 percent of their export proceeds, thereby increasing their access to foreign currency for the procurement of imported inputs, capital equipment, and the settlement of other external obligations.

This reform is expected to enhance export competitiveness, strengthen confidence in Ethiopia's foreign exchange market, improve price discovery, and contribute to deeper foreign exchange market development.

7. Implications for Commercial Banks

The removal of the credit growth cap grants commercial banks greater flexibility in determining the size and composition of their lending portfolios. However, this increased operational freedom is balanced by a higher policy interest rate and the introduction of targeted reserve requirements, both of which are intended to ensure prudent credit expansion.

Commercial banks should therefore reassess their lending strategies, monitor their loan-to-deposit ratios carefully, and prepare for more institution-specific supervisory measures. The policy changes are also expected to increase competition among banks by removing previous constraints on balance sheet expansion while preserving macroeconomic stability.

8. Implications for Borrowers

Borrowers are likely to experience a mixed impact from the reforms. On one hand, the removal of the credit cap is expected to improve access to financing by reducing credit rationing and expanding banks' lending capacity. On the other hand, the increase in the policy interest rate may lead to higher borrowing costs as commercial banks adjust their lending rates in response to the tighter monetary policy stance.

Consequently, borrowing conditions may increasingly vary across financial institutions depending on each bank's liquidity position, lending strategy, and regulatory requirements.

9. Implications for Exporters and Importers

Exporters stand to benefit significantly from the increased foreign exchange retention allowance, which provides greater flexibility in managing foreign currency resources and financing international business operations. The reduction in the foreign exchange surrender requirement also enhances export competitiveness and strengthens confidence in Ethiopia's foreign exchange regime.

Importers likewise benefit from the reduction in the foreign exchange commission, which lowers the cost of accessing foreign currency and may help reduce import-related expenses. These measures are expected to moderate the pass-through of international price increases into domestic inflation while improving overall efficiency in foreign exchange transactions.

10. Implementation and Transitional Arrangements

The National Bank has confirmed that the credit growth cap was always intended to serve as a temporary transitional measure during Ethiopia's migration toward an interest rate-based monetary policy framework. Its removal therefore marks the successful completion of this transition rather than a shift toward expansionary monetary policy.

The newly introduced targeted reserve requirement framework will be implemented through subsequent directives and detailed operational guidelines, which the National Bank is expected to issue in due course. The Monetary Policy Committee will continue monitoring economic developments and is scheduled to hold its next regular meeting at the end of September 2026 unless changing economic conditions require an earlier review.

11. Legal and Regulatory Framework

The Monetary Policy Committee adopted these decisions pursuant to the authority conferred upon it under Article 23 of the National Bank of Ethiopia Revised Establishment Proclamation No. 1359/2025. Under this proclamation, the Committee is mandated to formulate monetary policy recommendations for approval by the National Bank's Board of Directors.

The implementation of these reforms is expected to be supported through amendments to relevant National Bank directives, additional regulatory guidance, and continuous supervisory oversight by the National Bank.

12. Practical Considerations for Stakeholders

Financial institutions, exporters, importers, and borrowers should carefully assess the practical implications of these reforms and adjust their operational strategies accordingly. Commercial banks should review their lending policies and liquidity management practices, exporters should maximize the benefits of increased foreign exchange retention, and importers should take advantage of lower transaction costs in managing international trade operations. Borrowers should also evaluate the impact of higher interest rates on financing costs while exploring the improved credit opportunities arising from the removal of lending restrictions.

13. Conclusion

The National Bank of Ethiopia's latest monetary policy reforms represent a significant milestone in the modernization of Ethiopia's financial system. By removing the temporary credit growth cap, increasing the policy interest rate, introducing targeted reserve requirements, and easing foreign exchange regulations, the National Bank has completed its transition toward a modern market-based monetary policy framework.

Collectively, these reforms seek to preserve macroeconomic stability while promoting greater efficiency in financial intermediation, improving foreign exchange market functioning, supporting export competitiveness, and maintaining the National Bank's commitment to reducing inflation to sustainable single-digit levels over the medium term. Financial institutions and businesses should closely monitor forthcoming implementation directives and adapt their operations to align with the evolving regulatory environment.