COLLEGE OF BUSINESS AND ECONOMICS

SCHOOL OF COMMERCE

DEPARTMENT OF ACCOUNTING AND FINANCE

MSc in Corporate Finance (specialty in Investment Management) Program

Towards Understanding Floating Exchange Rate: Unveiling Challenges and Opportunities for Competitiveness in Ethiopia's Commercial Banking Sector

A Thesis Submitted to the College of Business and Economics School of Commerce in Partial Fulfillment of Requirements for the Degree of Master of Science in Corporate Finance (specialty in Investment Management)

By
Yohannes Birhanu Mamuye

Advisor
Tenkir Seifu (PhD)

June 2025
Addis Ababa, Ethiopia

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Declaration

I, the undersigned hereby declare that the thesis entitled **"Towards Understanding Floating Exchange Rate: Unveiling Challenges and Opportunities for Competitiveness in Ethiopia's Commercial Banking Sector"** is my original work. I have carried out this study independently with the supervision and guidance of the research advisor, Tenkir Seifu (Ph.D.). Any sources used in this thesis have been properly acknowledged. Moreover, this study has not been submitted for the award of any Degree in this or any other institution.

Declared By:

Name: Yohannes Birhanu Mamuye

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Certification

This is to certify that Yohannes Birhanu Mamuye has done a study entitled **"Towards Understanding Floating Exchange Rate: Unveiling Challenges and Opportunities for Competitiveness in Ethiopia's Commercial Banking Sector".** This study is his original work and all the sources of materials used for the research project paper have been properly acknowledged.

Advisor:

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Signature: 

Date: 02/08/2025

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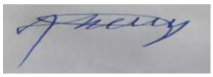
Abdu Mohammed (Ph.D.)  **02/08/2025**

External Examiner **Signature and Date**

Acknowledgement

First and foremost, my sincere gratitude goes to my advisor, **''Tenkir Seifu (PhD)'',** for his wise advice, feedback and unrelenting support during the research and writing process. His guidance and experience influenced the quality and scope of this study and played a big role in my professional as well as academic growth.

I am also very much grateful to the respondents, **''Senior Banking Professionals'',** who gave their time, experience and expertise for this study. Their involvement and the input they provided enriched the findings of this study and gave insight about the challenges and opportunities of floating exchange rates in the emerging financial sector of Ethiopia.

Last but not least, I would like to thank my wonderful parents, **''Birhanu Mamuye and Asrate Kebede'',** for their love, inspiration and faith in education. As an only child, I am forever in their debt for the sacrifices and endless encouragement they gave me throughout all these study years. Their passion for education and availability in my life has been a source of motivation and inspiration since forever.

Abstract

The study assessed the challenges and opportunities in the transition of Ethiopia's to a floating exchange regime in terms of the competitive conditions of the commercial bank sector. By adopting a mixed-methods approach, the study gathered primary data from 113 senior banking professionals representing six major commercial banks and the National Bank of Ethiopia through structured questionnaires to analyze the data using descriptive statistics such as graphical representation, mean, standard deviation, and supplemented by qualitative interviews and secondary sources. The study found that the transition has contributed more sophistication in operations, particularly in strategic planning, foreign exchange risk management, liquidity, and profitability. Although the floating system can potentially align more with the international markets and more diversified revenues, current capacity of Ethiopian banks for absorbing associated risks remains low. Customer response to currency movements is also now more sensitive, and thus banks have to be capable of responding in a faster, data-based manner. The study also showed that even though initial guidelines have been issued by regulatory bodies, existing frameworks have proved to be only partially effective in the control of exchange rate volatility. Commercial banks in the country must, therefore, have specialized treasury departments, enhance internal tools of risk measurement, and install sophisticated hedging instruments such as forwards, options, and swaps. Continuing professional education and client awareness regarding currency risks are also imperative. Furthermore, the National Bank of Ethiopia has to accord topmost priority to supporting a local derivatives market, improving data disclosure, and introducing adaptive regulatory policies for smooth transition. Overall, the study emphasized the importance of harmonized co-operation among financial institutions and regulators to address the evolving nature of exchange rate while preserving banking industry competitiveness.

Keywords: Floating Exchange Rate System, Commercial Banks, Opportunities, Challenges, and Competitiveness

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Acronyms

ECMA	Ethiopian Capital Market Authority
EX	Exchange Rate
FDI	Foreign Direct Investment
FX	Foreign Exchange
IMF	International Monetary Fund
NBE	National Bank of Ethiopia
NIESR	National Institute of Economic and Social Research
OECD	Organization for Economic Co-operation and Development
PPP	Purchasing Power Parity
TZS	Tanzanian Shilling
UGX	Ugandan Shilling
UK	United Kingdom
US	United States

Chapter One

Introduction

1.1 Background of the Study

A country's exchange rate framework can have a major influence on trade, inflation, foreign investment and the overall expansion of the economic system. Especially for economies seeking to remain stable in the face of external shocks, the floating exchange rate regime, which adjusts to the value of a currency according to supply and demand forces in the foreign exchange market, has proved to be a flexible and resilient framework compared to other systems (Krugman & Obstfeld, 2021; Frankel, 2010). The adoption of floating exchange rates in emerging economies has garnered significant debate due to the trade-offs between flexibility and stability that have major short-run impacts on economic performance. Supporters of this regime claim that it enables adjustment of external balance and greater independence in monetary policy. Critics desperately remember the inherent challenges; especially inflationary pressures, rates of the currency and economic volatility prospects (Calvo & Reinhart, 2002). Nevertheless, the work by Friedman (1953) and Krugman and Obstfeld (2021) highlight one of the most important tools in responding to external shocks is currency flexibility, making exchange rate a variable.

The adoption of the flexible exchange rate regime in South Africa and other African countries (i.e., Kenya and Ghana) tends to cause short-run inflationary pressures as well as depreciation. Such challenges are, however, usually addressed by sound policy packages which have a tendency of attracting foreign direct investment and increasing trade competitiveness (IMF, 2019; Brixiová & Ndikumana, 2020). Other studies show that export diversification, developed institutions, and efficient risk management are key tools for insulating the negative impacts of exchange rate changes. Calvo and Reinhart (2002), however, make the case for "fear of floating," which reflects the aversion of many developing nations to adopt complete currency flexibility due to fear of destabilizing financial markets and macroeconomic vulnerabilities.

The exchange rate mechanism of the Ethiopian currency has for long been in the spotlight of debate. The NBE had adopted a managed float system with strong intervention by the government. Certain inefficiencies to economic outcomes resulting from this strategy include perennial shortfalls in foreign exchange, growing differences between official and black-market exchange

rates, and loss in export competitiveness (World Bank, 2021; Kiyota, 2017). The financial sector, also responsible for managing trading finance and foreign exchange transactions, has equally not been exempted from the ensuing inefficiencies (NBE, 2021). The circumstances have also been compounded by the presence of a thriving black market in foreign exchange that has constrained the capacity of conventional financial institutions to provide competitive services while dissipating the confidence of the public in them (Alemu et al., 2022). It is expected that the new system of floating exchange rates to which Ethiopia has recently switched will have a profound impact on the commercial banking industry, which is crucial to the country's economic advancement. While benefits such as improved competitiveness of trade and foreign investment inflows that such a shift can yield, there also lies a vital risk, among which are high inflationary pressures and exchange rate volatility.

1.2 Statement of the Problem

The operation of floating exchange rate systems poses significant challenges and opportunities to financial institutions. In a floating exchange rate system, the value of a currency is determined by supply and demand in the foreign exchange market and therefore is extremely volatile. The volatility of such a system has significant implications for financial institutions, relating to their profitability, exposure to risk, and general competitiveness. While floating exchange rates ease automatic adjustment of external shocks and thereby increase the efficiency of financial markets, some authors contend, others note the risks of exchange rate volatility, especially for financial institutions in underdeveloped financial markets (Mishkin, 2009). There is a call for improved appreciation of how financial institutions can manage the challenges of floating exchange rates in ways that they can remain competitive, as reflected by the continued debate in the literature.

Volatility of exchange rates is among the most pressing issues that accompany floating exchange rates and has the potential to destabilize the financial stability of banks and other financial intermediaries. Banks in Kenya have been severely affected by foreign exchange rate fluctuations, which have caused volatile profits and higher costs in terms of hedging policies, according to Otieno (2017). For banks, the volatility can have an impact on interest rate spreads, loan costs, and overall financial well-being, and thus long-term investment planning becomes challenging. Likewise, Galbis (1993) described that floating exchange rate countries tend to experience

financial instability as they lack the instrument needed for monetary policy to slow down the rate of currency depreciation. For banks with large foreign liabilities, this is especially troublesome as currency depreciation could raise the cost of servicing foreign debt and even lead to liquidity issues.

The other major issue of concern is the effect that floating exchange rates have on interest rate volatility and inflation. Since central banks utilize interest rate changes as a function of currency movement, exchange rate volatility tends to make its mark in the development of monetary policy. For lending and investment firms in particular, this makes it an uncertain environment. Interest rate volatility is generally higher in countries with floating exchange rates, as in the work of Calvo and Reinhart (2002), and has the possibility of increasing investment option uncertainty and lending rates. Currency depreciation can further cause inflationary pressures, which increase the cost of imported goods and reduce the purchasing power of consumers. To keep their lending portfolios stable and to deal with inflation-related risks, financial institutions in such situations have to devise flexible strategies.

Capital flows and investment choices are also impacted because of unstable exchange rates. Financial sector liquidity and credit availability can be deformed by sudden outflows or inflows of capital because of uncertainty of exchange rates. Literature has a view that floating exchange rate regimes can induce speculative capital flows that, without controls, would result in financial crises (Brooks, 2024). Because capital flight can result in liquidity shortages, which decrease lending capacity, banks operating in the emerging economies are more exposed. Alternatively, currency appreciation-driven capital over-flows could cause asset bubbles, thereby increasing the financial system's vulnerability. In order to provide stability to the finances against exchange rate volatility, better risk assessment models must be devised.

Despite such disadvantages, banks and financial institutions can obtain a range of benefits to improve their competitiveness because of floating exchange rates. One such benefit is the ability to generate more foreign exchange trading revenues. Large volumes of forex trading have financial institutions and banks that can exploit changes in currencies to profit from arbitrage and speculative transactions (Tenoy, 2021). Floating exchange rates make the forex market dynamic, and this enables institutions to provide hedging products and foreign exchange services that appeal

to business and household clients who want to reduce risk. Furthermore, floating exchange rates promote financial innovation since institutions innovate new financial products meant to address currency risks. As a result, the financial arena is rendered more advanced, making organizations that take advantage of such prospects more competitive.

There is also a further possibility within the broader autonomy of monetary policy management. Under a fixed exchange regime, central banks have to place a high value on exchange rate stability, too often at the cost of more imprecise economic goals such as job creation and price restraint. But de-linked from a currency, a free system of exchange rates enables policymakers to respond to domestic economic conditions via the management of the money supply and interest rates. Banks stand to benefit quite considerably from the stability of the macroeconomic regime this freedom gives, and it reduces systemic risk without stifling credit growth. Because floating exchange rate nations can absorb currency fluctuations without depleting foreign exchange reserves, Brooks (2024) stated that because floating exchange rate nations can absorb currency fluctuations without depleting their foreign exchange reserves, their financial systems tend to be more resilient to external shocks.

Moreover, flexible exchange rates facilitate foreign investment and financial market expansion. A floating exchange rate system has the ability to attract foreign investment if managed effectively because it gives investors' confidence in the stability of the economy of the country. As stated by Otieno (2017), volatility of the exchange rate was used by Kenyan financial institutions as a leverage to lure foreign investors who want to gain from appreciation trends of currency. Because of the increased liquidity in domestic markets brought about by this capital flow, banks are able to lend and provide investment opportunities more. Moreover, financial institutions create more complex financial products and risk management techniques in response to exchange rate volatility, which eventually makes the overall financial sector stronger.

In summary, floating exchange rates present financial institutions to different risks such as exchange rate volatility, exchange risk, and possible fears on the part of investors, yet simultaneously present a chance for the expansion of market, policy ease, and returns. The competitiveness of financial institutions under an arrangement of floating exchange rates to a great extent rest on their potential to control risk, provide creative financial instruments, and

accommodate evolutionary regulatory frameworks. An appreciation of these dynamics is crucial for financial institutions that want to make sense of the intricacies of the global financial landscape and maintain their competitive advantage.

However, empirical research into the very impact of the system of floating exchange rates upon Ethiopia's commercial banking is clearly lacking, despite the growing worth of this policy reform. While literature does not yet present a qualitative assessment of how banks can be capable of utilizing potentialities of increased competitiveness and to reduce risks linked to the exchange rate volatility. Furthermore, key aspects like consumer attitudes, regulatory support, and the role of technology in risk control are yet to be fully understood.

Therefore, in this study efforts were made to bridge these shortcomings by analyzing dynamics of floating exchange rates and its implications on Ethiopia's commercial bank industry competitiveness. It attempted to identify key challenges, opportunities, and strategic ways to make the sector robust to contribute to economic growth sustainably in the nation. Without this kind of knowledge, the commercial banking sector risks being ill-prepared to ride out the subtleties of such a transformation, and its role as a cornerstone of Ethiopia's economy may be jeopardized.

1.3 Research Questions

While conducting this study, the researcher tried to answer the following research questions:

- What challenges do Ethiopian commercial banks face under a floating exchange rate system?
- What opportunities does a floating exchange rate system offer to enhance the competitiveness of Ethiopian commercial banks?
- What are the observed patterns of customer behavior under a floating exchange rate system?
- What is the current state of the regulatory environment in facilitating the adaptation of Ethiopian commercial banks to a floating exchange rate system?

1.4 Objectives of the Study

1.4.1 General Objective

The general objective of this study is to assess the challenges and opportunities posed by a floating exchange rate system to the competitiveness of Ethiopia's commercial banking sector.

1.4.2 Specific Objectives

To achieve the above-mentioned general objective, this study intended to provide answers to the following specific objectives:

- To examine the major challenges that Ethiopian commercial banks encounter under a floating exchange rate system.
- To assess the opportunities provided by a floating exchange rate regime for enhancing competitiveness in Ethiopia's commercial banking sector.
- To describe the patterns of customer behavior under a floating exchange rate system.
- To assess the current state of the regulatory environment in facilitating the adaptation of Ethiopian commercial banks to a floating exchange rate system.

1.5 Significance of the Study

For the Ethiopian commercial banking sector, adoption of a floating exchange rate system is both a blessing and a curse given the nation's advancement towards liberalized trade and financial policies. The study is useful in identifying the impact of exchange rate volatility on the competitiveness, risk management orientation, and profitability of Ethiopian commercial banks. In terms of the analysis of exchange rate volatility and impacts on financial stability and operational efficiency, this study aimed to impart knowledge to Ethiopian commercial banks in dealing with issues of a floating exchange rate system and making sound financial decisions. Besides, the study is expected to give strategic suggestions that will be helpful to Ethiopian commercial banks in managing currency risk and enhancing operational efficiency in the face of exchange rate volatility. By identifying the key challenges and opportunities in a floating exchange rate system, the study assists Ethiopian commercial banks in managing risks like exposure to exchange rate fluctuations. The study also identified possible advantages like the capacity to attract

foreign investment, regional market access improvement, and the offering of more competitive foreign exchange services. To that end, the study advises Ethiopian commercial banks to adopt policies that will aid in optimizing their performance and neutralize the exchange rate volatility-driven risks.

The study also carried significant implications for the NBE in making policies against the uncertainties caused by the exchange rate volatility. The study findings assist in increasing the strength of the Ethiopian commercial banking sector and making it stable from the overall economic point of view. Through the evaluation of the impact of floating exchange rates on Ethiopian commercial banks' competitiveness, this study is able to develop evidence-based suggestions that will guide the NBE towards making the Ethiopian commercial banking sector more competitive as well as sustain economic growth. Besides, the study is in a position to advise other policymakers and financial regulators on the economic and regulatory reforms needed to stabilize the financial sector against exchange rate volatility. By identifying the sectors where Ethiopian commercial banks are least resilient, the study presented policy measures that can be used to minimize risks and aid the sector's long-term stability.

Beyond its policy relevance, the study is also expected to fill a glaring gap in the existing literature on exchange rate dynamics and the competitiveness of Ethiopia's banking sector. Owing to limited research on this subject, the study encourages further research into the general implications of exchange rate policies for Ethiopia's financial system.

In summary, the study is not only expected to address the challenges posed by floating exchange rates but also expected to offer a comprehensive framework for enhancing the resilience and competitiveness of Ethiopia’s commercial banking sector in an increasingly globalized economy. The findings will contribute to the body of knowledge on the economic effects of floating exchange rates, offering useful lessons to researchers, financial analysts, policymakers, and stakeholders in the economic and financial policy-making of Ethiopia. Last but not least, this study will guide the Ethiopian commercial banking sector to adapt to a floating exchange rate regime, stabilizing its operations and long-term growth.

1.6 Scope of the Study

The study aimed at investigating the issues and prospects generated by the implementation of floating exchange rates, specifically their impact on the competitiveness of Ethiopia's commercial banking sector. The study area was in Addis Ababa, the capital city of Ethiopia, where the headquarters of the major commercial banks and financial institutions of Ethiopia are found. Addis Ababa is the central place for policy-making and decision-making in the banking sector.

The population of this study was six large commercial banks: Commercial Bank of Ethiopia, Awash Bank, Dashen Bank, Zemen Bank, Bank of Abyssinia, and Oromia Bank. These banks were deliberately selected by the researcher due to their substantial foreign exchange generation and transactions during the fiscal year 2023/2024, and hence they are the key institutions that are expected to bear higher exposure to risks associated with the newly adopted floating exchange rate system. The remaining banks were not part of the study as they are thought to be less exposed to exchange rate volatility and may lack the necessary resources to effectively handle the risks involved as much as the selected banks. Additionally, the study involved the National Bank of Ethiopia (NBE) as part of the target population to obtain more information and opinions. This inclusion is expected to bring value to the analysis and also increase the understanding of the impacts of the floating exchange rate system.

Data for the study were gathered through a combination of questionnaires and interviews with executive managers and department directors who are directly involved in exchange rate risk management, strategic planning, and financial decision-making in the selected banks. These key individuals ought to be capable of providing valuable information on how their respective institutions respond to the challenges of a floating exchange rate regime, namely managing currency risk, liquidity, and foreign exchange exposure. Their experience yields insights into the deeper understanding of the impact of exchange rate volatility on banking operations, especially foreign trade, capital flows, and foreign investment. Interviews with NBE directorates were also utilized to gather additional information and opinions, enhancing analysis further. This approach ensures proper understanding of the impact of exchange rate policies on banking operations and decision-making procedures in Ethiopia's commercial banking sector.

1.7 Limitations of the Study

The study is not short of limitations. Firstly, although the study claimed to examine the overall impacts of exchange rate movements on Ethiopia's commercial banking sector, it does not quite provide a close examination of specific incidences of foreign exchange loss or the individual financial implications for specific banks resulting from exchange rate volatility. Secondly, the special characteristics of the Ethiopian commercial banking industry and the regulatory environment in this industry can narrow the applicability of the findings of the study to other environments or to non-commercial banks in Ethiopia. Additionally, due to the recency of the policy implementation, the study did not incorporate quantitative data on bank performance to statistically measure the effects of exchange rate movements. As a result, it remained largely descriptive and lacked correlation-based analysis that could have provided more robust empirical insights.

1.8 Definition of Terms

- **Floating Exchange Rate:** A floating exchange rate system is a system where the value of a country's currency is determined by market forces without any direct intervention by the central bank or government. The currency value fluctuates based on supply and demand in the foreign exchange market.
- **Commercial Banking Sector:** The commercial banking sector comprises financial institutions that provide different banking services such as the acceptance of deposits, lending, and offering other financial services to governments, businesses, and individuals. They are profit-oriented banks and provide their services to retail and corporate customers.
- **Competitiveness:** In the case of commercial banking, competitiveness is used to mean the ability of a bank to deliver services that capture clients, maintain profitability, and ensure long-term growth despite competitive pressures from other financial institutions.
- **Foreign Exchange Risk:** Foreign exchange risk is the risk of loss of financial resources because of fluctuation in the exchange rate of currencies. In the case of banks, the risk is all the more relevant while dealing with international transactions, foreign loans, or foreign currency deposits.

- **Liquidity:** Liquidity in banking refers to the ability of a bank to meet its short-term financial obligations, such as withdrawals and lending, without incurring financial loss. Banks need to have adequate liquidity to allow them to remain stable, especially when there are exchange rate fluctuations.
- **Profitability:** Profitability refers to the capability of the bank to generate revenues from its operations after bearing all costs. It is an important indicator of financial well-being of a commercial bank and can be affected by various factors such as exchange rate variations and market conditions.
- **Regulatory Environment:** The regulatory environment is the system of policy, law, and regulation provided by the government or central banks which determines how the commercial banks have to function. It has a significant influence on how the banks can react towards changing financial systems such as a floating exchange rate.
- **Behavior of the Customer:** Customer behavior refers to the action and decision of individuals or companies in their dealings with banks. In the scenario of a floating exchange rate system, this would refer to customer decisions on foreign currency deposits, loan demand, and frequency of foreign exchange transactions.
- **Exchange Rate Fluctuations:** Exchange rate fluctuations refer to the changes in the value of a country's currency against other currencies. These can influence the banking position of banks and customer conduct, particularly foreign currency deposits and loans.

1.9 Organization of the Study

This study consists of five chapters. Chapter one introduces the research topic, providing an overview of floating exchange rate dynamics and how such relates to the commercial banking industry in Ethiopia. It provides a statement of the research problem, questions, and aims, as well as establishing the significance of the study in the context of Ethiopia's evolving economic landscape. Additionally, this chapter covers the scope, limitations, general layout of the thesis, and offers definitions of the key terms.

Chapter two is an elaborate literature review, covering existing theory, concepts, and empirical studies on floating exchange rates and their implication for the banking sector. It highlights the threats and promises of exchange rate volatility for both industrialized and developing economies.

Chapter three describes the research methodology, which encompasses the research design, data collection methods, and procedures for selecting the sample. It defends the adopted methodology, describes the data collection instruments, and prescribes the steps for data analysis and interpretation to achieve the research objectives and determine the validity of the study.

Chapter four emphasizes data discussion and analysis. The chapter presents the findings of the data collected using surveys, interviews, or other suitable methods. Analysis emphasizes the issues and opportunities created by floating exchange rates to Ethiopia's commercial banking industry and how these are likely to affect the competitiveness of the industry. The findings are cross-referenced with existing literature for the sake of placing the findings in context.

Finally, chapter five concludes the study by summarizing the main findings and giving recommendations to the stakeholders, such as policymakers and commercial banks. The chapter gives directions for future research with a direction for future studies to examine the impact of floating exchange rates on the banking sector in Ethiopia and other comparable economies.

Chapter Two
Literature Review

2.1 Introduction

This chapter structures the literature review in four sections: Introduction, Theoretical Review, Empirical Review, and Literature Gap. The theoretical review deals with definitions, theory, merits, and demerits of floating exchange rates. The empirical review mentions international evidence from other researchers regarding the limitations and potential of floating exchange rates. The literature gap implies the areas that have not yet been researched and emphasizes the necessity of additional research on the implications of floating exchange rates on emerging economies.

2.2 Theoretical Review

2.2.1 Banking and Financial Institutions

A bank is generally defined as a financial institution that accepts deposits from the public, provides loans, and offers other financial services in line with regulatory requirements (Szulczyk, 2014). A bank's primary functions are to facilitate deposits and lending, currency exchange, and stabilize finance by provision of liquidity. A bank also lends, but this is customarily secured by laws such as the Winding-up Act if and when a receiver or liquidator is appointed (Patterson, 1917). Besides, banking can involve offering financial services and products beyond the traditional deposit and loan-based models, often beyond the boundary of a conventional regulatory scope (Faggini et al., 2016).

Banking encompasses more than just deposit-taking and lending; it also includes financial intermediation that responds to exchange rate fluctuations. In a system with variable exchange rates, banks confront both obstacles and possibilities. Currency fluctuations, for example, have an impact on foreign exchange transactions, trade financing, and currency risk management, affecting the banking sector's competitiveness directly (Choudhry, 2018).

2.2.2 Exchange Rate and Exchange Rate Regimes

An exchange rate regime is the way a country controls its currency with respect to other foreign currencies. It designates how the exchange rate should be set by the forces of the market or government intervention. To manage exchange rates, countries adopt different exchange rate regimes and all of these come under three broad categories:

Fixed Exchange Rate Regime: In this system, the nation's currency is pegged at a specific rate to a prominent currency or set of currencies. The foreign exchange market is managed by the intervention of the central bank so that the currency stays at the set rate. This regime, despite its ability to provide certainty and stability to foreign trade, does not have full freedom for monetary policy in the country (IMF, 2019).

Floating Exchange Rate Regime: Currency value under a floating exchange rate system is decided by market forces such as demand and supply and not explicitly by the central bank intervention. The system provides greater autonomy in monetary policy but exposes the economy to exchange rate instability (Krugman & Obstfeld, 2017).

Managed Float (Hybrid) Exchange Rate Regime: A managed float system incorporates elements of fixed and floating exchange rates. In this system, the currency is allowed to fluctuate within a market-determined range, but the central bank intervenes on occasion to stabilize it or prevent undue volatility. This regime provides a balance between the flexibility of a floating system and the stability of a fixed system (Faggini et al., 2016).

2.2.3 Monetary Model of Exchange Rate Determination

The assumption of the Monetary Model of Exchange Rate Determination is that monetary factors—specifically, relative money supplies, interest rates, and inflation rates across nations—have the greatest impact on exchange rates. The theory assumes that in order to achieve equilibrium in the foreign exchange market, currency rates react to shifts in such monetary fundamentals. The theoretical foundation of this model is the Quantity Theory of Money that states inflation is caused by an increase in money supply and will eventually affect the exchange rate. The model also takes into account purchasing power parity, or PPP, that exchange rates will move to reverse national price movements. Criticisms as well as empirical evidence have been offered for this theory. The

use of the monetary model is important for banks, especially under floating exchange rate regimes when exchange rate volatility has the potential to be very dangerous.

Financial institutions can utilize the model's implications to hedge foreign exchange risk, predict movements in exchange rates, and construct hedging strategies. Institutions that were aware of the monetary model implications had a greater advantage to hedge risks and maximize currency holdings in nations with floating exchange rates, according to Zakaria and Ahmad (2009). The model's shortcomings, in this case the region of short-run exchange rate volatility and its dependence on the presumption of stable money demand functions, which can be skewed by other marketplace forces like speculative bubbles and abrupt changes in investors' mindsets, are weighed against its usefulness. The applicability of the monetary model to real-world circumstances has been estimated in current studies. For example, Ibhagui (2019) examined how the floating exchange rate regimes have influenced the predictive ability of the monetary model in the long run and discovered that the exchange rate-monetary variable relationship continued to hold.

In sub-Saharan Africa, where relative changes in money supply had a predictable effect on exchange rate movements, this relation was especially significant. The monetary model failed to account for exchange rate behavior regularly when non-floating exchange rate regimes were taken into account, i.e., the regime type is a significant determinant of exchange rate dynamics. Moreover, Afat, Gómez-Puig, and Sosvilla-Rivero (2015) also tested the performance of different monetary models in different Organization for Economic Co-operation and Development (OECD) countries and concluded that even though the flexible price model was able to fit long-run fluctuations in exchange rates, its explanatory power for future events was negated when short-run factors like geopolitical risks and speculative demand were significant.

2.2.4 Asset Market (or Portfolio Balance) Model

The Asset Market (or Portfolio Balance) Theory of exchange rate determination is highly specific to the role that the financial assets play in determining currency prices. It believes that exchange rates are determined by demand and supply of one country's financial assets relative to the other country's financial assets. Whereas the Monetary Model, which essentially revolves around money supply and its relationship with inflation, the Asset Market Model proposes that investors' appetite for alternative asset classes such as government papers, equities, and other financial instruments

can be seen influencing exchange rates. This model illustrates that demand for the currency of a nation rises and currency appreciation occurs when its assets are viewed more favorably—for example, since they offer more returns, fewer risks, or better market situations. Depreciation can occur when investors withdraw money into the assets of other nations when the assets of a nation lose appeal.

The applicability and limitation of the Asset Market Model to regimes of floating exchange rates have been emphasized by recent research. Chinn and Frankel (2021) are just some examples of researchers that, empirically, examined to what extent the asset market model accounted for exchange rates in developed economies. They discovered that the model's predictive power weakened during times of calm market conditions, but it did assist in providing good indications of currency movement when there were times of financial crisis. This indicates that the model is better during times of more financial crisis, like a financial crisis or sudden changes in world market mood. Similarly, De Grauwe and Ji (2020) also discovered that the investors' expectations about the economy in the future rather than economic fundamentals themselves were responsible for the movements in the Eurozone exchange rate. This discovery is a testament to the asset market model's emphasis on investor behavior and expectations in determining exchange rates.

Under the scenario of emerging economies, Sula and Zhuang (2021) examined the ways exchange rate volatility and portfolio investment in South Asian nations. Exchange rate volatility was mainly driven by the movement of foreign investors' portfolios, induced by a shift in macroeconomic policy and interest rates. The Asset Market Model gave a more realistic exchange rate determination model in open capital account and less regulated capital countries, particularly in floating exchange rate systems. That is something institutions that have dealings with these markets need to know because investor sentiment and capital flows control them directly.

2.2.5 Opportunities of Floating Exchange Rates for Banks

For banks, the unstable nature of floating exchange rates can yield a variety of advantages, from diversification of currencies and risk mitigation to promoting innovation in financial products. The different advantages that can be enjoyed by banks from a system of floating exchange rates are examined here, with specific reference to international financial integration and competition.

A. Currency Diversification and Risk Mitigation

For banks, floating exchange rates offer an opportunity to diversify their foreign currency portfolios. Banks can capitalize on favorable exchange rate swings by having assets and liabilities in multiple currencies. Furthermore, products like currency swaps, forwards, and options, which are widely available in a floating exchange rate regime, can help manage foreign currency risk more effectively. They enable banks to counter the potential negative effect of exchange rate volatility on their operations, enhancing financial stability and long-term sustainability (Black, 2007). Hedging currency risks through sophisticated hedging techniques gives banks a competitive advantage, especially in uncertain financial conditions.

B. Improved Financial Integration

Floating exchange rates can be a source of financial integration opportunities, particularly in emerging markets. Banks have greater access to international financial markets without stringent exchange rate controls, allowing cross-border capital flows and investments. Greater financial integration may result in increased liquidity, easier access to foreign funds, and more competitive financial products. Banks in emerging economies that are part of the international financial system are fortunate to diversify their portfolios and enhance profitability by introducing products based on the global market situation (Obstfeld & Taylor, 2004).

C. Increased Profitability through Exchange Rate Volatility

While exchange rate volatility can be seen as a problem, it also offers banks scope to boost profits. Foreign currency-exchanging banks, for example, can earn profits by dealing in changes in currency market prices through speculative trading. Banks can profit from foreign exchange markets by being able to predict and capitalize on short-term currencies' price volatility. Furthermore, foreign currency-providing banks have the power to charge higher commissions and fees when exchange volatility is high, thereby increasing revenue flows (Brunnermeier, 2009).

D. Facilitating Cross-Border Banking Services

Floating exchange rates provide enormous flexibility to cross-border banking operations. As exchange rates are market-determined, banks can better estimate the value of foreign assets and

liabilities, which can facilitate planning and conduct of international operations. Besides, the abolition of fixed exchange rate restrictions allows banks to provide competitive services to foreign investors and improve their global operations while providing them with improved mechanisms for hedging against currency risks. Banks that can negotiate floating currency rate fluctuations well are in better positions to promote global (Shin, 2011).

E. Facilitating International Trade and Investment

Flexible exchange rates result in international trade and investment, providing business opportunities for banks. Exchange rates are based on demand and supply, thus affecting export and import prices. This can directly benefit banks with services that enable international trade such as letters of credit, trade financing, and currency conversion. The floating exchange rate system also allows banks to lead customers through the complexities of exchange rate volatility when they invest abroad. Moreover, countries with more flexible exchange rates attract more foreign direct investment (FDI), which increases the need for financial services like investment banking and foreign exchange (Kohli, 2010).

F. Promoting Financial Stability through Flexible Adjustment Mechanisms

One of the main advantages of floating exchange rates is their capacity to serve as an automatic economic stabilizer for a nation. The exchange rate can rapidly adapt to changes in supply and demand when an economy experiences shocks. To the banks, this adaptability minimizes the need for expensive government and central bank intervention to keep the exchange rate where it is. Therefore, floating exchange rates yield a longer-run resolution of macroeconomic disequilibria and enable institutions to function in a more secure financial environment. Planning, forecasting, and investment skills are improved through stability, which is beneficial to shareholders and customers alike (Ghosh et al., 2002).

G. Encouraging Innovation in Financial Products

In the banking sector, floating exchange rates can encourage financial product innovation. As currency fluctuations cannot be predicted, banks can devise new financial instruments that are fit for their clients' needs. Foreign exchange dealing platforms, risk management derivatives, and multi-currency accounts are a few examples of such instruments. Globalized trade and investment

have increased the demand for novel financial products, thus compelling banks to provide innovative products that can serve the changing needs of their global clients. Banks are also being pushed into innovation and adjusting to new financial trends by the creation of digital currencies and block-chain technology, both of which are subject to fluctuations in exchange rates (Baker & Kynge, 2018).

2.2.6 Challenges of Floating Exchange Rates for Banks

For banks, floating exchange rates possess several advantages, but at the same time they possess several challenges that affect their stability, functioning, and profitability. Challenges faced by banks in a system of floating exchange rates are dealt with in this section, and of particular concern here are challenges in the form of high volatility, risk exposure, regulatory challenges, and risk of financial flow instability.

A. Exchange Rate Volatility and Uncertainty

Instability and uncertainty of currency prices are among the foremost issues faced by banks operating under a system that has floating exchange rates. In these systems, market forces are what decide the exchange rate, and therefore result in sudden drastic changes in the price of currency. For banks in general, and especially those handling foreign exchange, foreign trade, and investments, the uncertainty could lead to higher uncertainty. Such volatility undermines the stability and profitability of banks. Volatility in currency can cause loss by adversely affecting the value of assets and liabilities denominated in foreign currency. Banks also suffer from uncertainty of future cash flows due to volatility in exchange rates, and thus it is not easy to place liquidity and capital requirements. To offset the negative effects of currency volatility, banks are also compelled to invest in sophisticated risk management techniques like hedging and derivatives (Frankel & Rose, 2002).

B. Increased Operational Costs

The need for special financial products and services to handle currency risk in an economy with a variable exchange rate often comes at the cost of increased operating costs for banks. Banks need to develop and implement more sophisticated foreign exchange management systems to handle currency rate fluctuations. These systems tend to need heavy investment in advanced financial

products, experienced personnel, and hardware. Also, the profitability of banks is minimized by hedging and managing exposure to currency through costs, particularly in instances of unpredictable or adversely affecting exchange rate movements. These heightened operating costs may burden resources and hinder less diversified or smaller banks to successfully operate within the global financial system (Aizenman & Noy, 2009).

C. Impact on Credit Risk and Loan Portfolio Management

Banks can be limited in controlling their credit risk and loan books because of the instability of floating exchange rates. Credit or loans given to foreign borrowers can be influenced by large exchange rate movements, particularly if loans are foreign currency-denominated. For instance, the capability of borrowers to pay back loans may be eroded if the domestic currency drops in value significantly, making it more likely to default. Management of the risk of lending to foreign borrowers or foreign assets is another challenge faced by banks. Large exchange rate fluctuations can depreciate the bonds or foreign currency-denominated loans and thus the credit risk of the lending bank is enhanced. Bank stability is also threatened by an increase in non-performing loans and loan defaults (Campa & Goldberg, 2002).

D. Regulatory and Supervisory Challenges

Inequitable and inconsistent regulatory mechanisms to handle currency fluctuation risks are typically found in flexible exchange rate countries. Exchange rate volatility implies that domestic regulatory agencies may not effectively observe and supervise foreign exchange markets. Besides, most underdeveloped country regulatory agencies may lack the ability and capacity to supervise banks that operate a floating exchange rate mechanism. Systemic risk may arise from banks taking on excessive risk or disregarding fundamental risk management concepts due to this regulatory gap. Regulatory arbitrage, in which banks take advantage of loopholes in regulation to engage in high-risk undertakings that undermine their financial stability, can also be empowered by a weakening regulatory framework (Berger, Hasan, & Zhou, 2009).

E. Currency Mismatches and Balance Sheet Risks

Currency mismatches between liabilities and assets are an important concern for banks, especially for those in countries where there are floating exchange rates. When a bank's assets and liabilities

are both denominated in a different currency, such mismatches arise, leaving the bank vulnerable to exchange rate risks. A depreciation of the local currency would, for example, imply higher debt servicing charges for the bank and balance sheet problems if its assets are in the local currency while its liabilities are in foreign currencies. Such currency differences are especially painful in times of volatile exchange rates. If the value of the local currency sharply declines, banks are unable to fulfill their commitments, and increased foreign currency-denominated liability costs can erode profit margins. Banks must watch their currency position carefully and make arrangements so that their foreign currency assets and liabilities are properly matched to reduce this risk (Eichengreen & Hausmann, 2005).

F. Increased Speculative Risk and Market Manipulation

The increased likelihood of market manipulation and speculative risk is another issue caused by floating currency rates. Speculative trading, wherein investors and traders attempt to profit from fleeting fluctuations of currency prices, is encouraged by the continuous exchange rate volatility. Banks are also subject to speculative attacks that cause destabilization of markets and cause liquidity crises, especially those that deal with foreign currency markets. Speculative actions by investors and traders sometimes cause market manipulation, in which large investors manipulate exchange rates to collect profits. These manipulations can have the ability to enhance volatility and make banks' risk even more adverse. Besides, speculative risks may promote the possibility of exchange rate shock surprises, and these can agitate the banking system as well as the broader economy (Krugman, 1999).

G. Potential for Capital Flight

Capital flight is another key issue associated with floating exchange rates, especially where economies are inferior or still developing. When exchange rates vary substantially, devaluation is threatened and this creates the country to lose domestic as well as foreign investors' capitals in search of security and stability. This capital flight would reduce the available liquidity for domestic institutions, and it would become more difficult to fund projects and businesses within the country. Capital flight presents banks with difficulties since it will cause liquidity reduction, increased costs of borrowing, and making it challenging to uphold capital adequacy ratios. Moreover, the absence of foreign investment may have a detrimental effect on economic growth and stability, which

would consequently limit the possibilities of banks to thrive in the domestic economy (Mishkin, 2009).

2.3 Empirical Review

The exchange rate regime is one of the most important policy choices for an economy, since it has a deep impact on trade, investment, and overall competitiveness. Exchange rates have a direct impact on macroeconomic stability and cross-border economic activity by dictating the relative prices of currencies. Politicians, economists, and researchers over the last decades have been debating the mechanics of floating exchange rate regimes in very fine detail. Adjustable and market-determined, floating exchange rates present challenges as well as opportunities for nations seeking to improve their economic competitiveness.

After the failure of the Bretton Woods system in the 1970s, the floating exchange rate regime gained general acceptance. Floating regimes allow market forces to set exchange rates, as opposed to fixed exchange rate regimes where the currency of a nation is pegged to some value or foreign currency. A system has frequently been supported for its resistance to external shocks and monetary policy insulation (Obstfeld & Rogoff, 1995). But it also exposes economies to severe risks that may erode macroeconomic stability, including increased volatility, speculation attacks, and exchange rate misalignments (Eichengreen, 2008).

The main benefit of the floating exchange rate system is that it is flexible, and it enables economies to adjust to shifting global economic circumstances. Through the ability to let currencies adjust based on reactions to trade imbalance as well as capital flows, nations such as the United States and Canada have set examples of how floating mechanisms can help in enabling the sustenance of competitiveness in foreign markets (Choudhry, 2018). But flexibility is costly because exchange rate volatility can interfere with trade and investment decisions, especially in countries with less developed financial systems (Levy-Yeyati & Sturzenegger, 2003).

Floating currency management is particularly challenging for emerging markets. While the regimes can make currencies depreciate during recessions and thus improve the competitiveness of exports, they need robust institutional settings to keep inflationary pressures and speculative capital flows in check (Calvo & Reinhart, 2002). For aspiring countries that want to be more

integrated and competitive economically, a shift to a floating exchange rate regime is sometimes seen as a conscious strategic decision. However, because it entails quite radical changes in monetary policy, exchange rate management, and financial market infrastructure, the shift must be well planned (Obstfeld et al., 2005).

A. Eurozone Countries

The European Central Bank (ECB) controls the Euro (EUR), the common currency of the nations that make up the Eurozone. Because of the integrated monetary system, the internal exchange rates within member states are fixed, though the Euro has a floating exchange rate system when compared to other international major currencies like the US dollar and the Japanese yen. This hybrid format is a first global in that it unites the features of fixed exchange rates under the Eurozone and variable exchange rates in the foreign markets (ECB, 2023).

The Eurozone has been able to absorb external economic shocks in the form of movements in global commodity prices and financial crises because of the mechanism of floating exchange rates. It has also enhanced the competitiveness of the exports of the Eurozone by allowing currency depreciation in phases of recession, which has been beneficial for nations like Germany and the Netherlands that have high export-led economies (Smith & Martin, 2023). The monetary union is facing difficulties because of the varying economic performance of the member nations.

According to the research, the lack of national monetary policies has added to the difficulty of regulating the competitiveness of nations such as Greece, Italy, and Spain. Moreover, fluctuations in the exchange rate of the Euro relative to other currencies may affect the inflation rates and prices of imports within the bloc. In the floating regime, tightening the budget cooperation and structural reforms are the central issues to raise the competitiveness and resilience of the economies of the Eurozone (Johnson, 2024).

B. United States

Since 1971, when the Bretton Woods system collapsed, the United States has had a floating exchange rate system. Without government intervention in the guise of a managed exchange rate, this system lets market forces determine the value of the US dollar. Inflation, trade balances, geopolitical developments, and interest rates set by the Federal Reserve are just some of the dozens

of factors that determine the value of the dollar. The US has managed to survive foreign shocks and have more room for economic policy as a result of the floating exchange rate regime, based on Federal Reserve observation (2023). Notwithstanding this, the value of the dollar can be susceptible to movements, especially when there is a financial crisis across the world so that investors will seek refuge in holdings like the US dollar and cause it to appreciate, while presenting problems to US exports. However, by reducing the price of US products on foreign markets, dollar depreciation can increase US trade competitiveness, hence benefiting export-oriented sectors.

In order to control the risks that are inherent in currency fluctuations, US banks have fashioned complex financial products as a result of the operating dynamics of a floating exchange rate regime. To assist businesses and investors to reduce the risks of exchange rates, banks such as JPMorgan Chase and Citibank provide a range of foreign exchange products such as currency hedging products and derivatives. Because they have a buffer to shield them from volatile currency swings, US companies can now export and invest overseas with greater ease thanks to these financial tools. The US financial industry has been leading the way in creating and providing these hedging tools, which has enhanced American companies' competitiveness in the international economy, according to the Bank for International Settlements (2022). And since there is the necessity for the dollar all around the world, which maintains its value in foreign exchange, having the US dollar as the global leading reserve currency naturally gives a competitive edge.

Furthermore, there are also some benefits to the floating exchange rate system of the US, and foremost among them is the retention of economic flexibility. By letting the currency move with market forces, the US also evades the rigidity of the fixed exchange system of rates which would necessitate constant intervention. A floating exchange rate also enables the nation to adjust more readily to external shocks like a global recession or financial crisis and deal with inflationary pressures. Krugman and Obstfeld (2020) argue that the US flexible exchange rate system has rendered the nation more competitive by rendering its exports more responsive to react to modifications in demand across the globe. US exports are more appealing to foreign buyers when the currency is weaker, which improves the balance of trade. This process has been especially useful in times of uncertainty for the global economy, as a declining dollar can stimulate economic growth by increasing demand for American products and services overseas.

Despite the benefits of a floating exchange rate system, the U.S. has several issues which can make it less competitive in the long run. The existing trade deficit is one of the main issues that, unless balanced by adequate foreign capital inflows, can cause the dollar to decline. Additionally, exchange rate volatilities may lead to inflationary pressures, especially on imports, which can reduce the domestic consumer's purchasing power. According to Glick and Rose (2021) findings, while the US dollar itself doesn't fluctuate much compared to other currencies, on specific instances there may be large swings that can exert a large impact on the economy, such as in those sectors depending heavily on imports or supply chains from abroad. Second, the US also has growing threats from regional free trade agreements and the rising economies of emerging markets, potentially threatening the dollar's hegemony and affecting the status of the country within the global economy. The US can be compelled in the future to adopt more balanced actions towards controlling its currency exchange rate and striking a balance between its internal economic goals and the ability to compete globally.

C. United Kingdom

Under the floating exchange rate regime used in the United Kingdom, market forces establish the exchange value of the British pound (GBP). The pound is free to float relative to other currencies, and the regime was implemented in 1992 following the UK's exit from the European Exchange Rate Mechanism. Although its pivotal function in guiding monetary policy and curbing inflation, the Bank of England (BoE) does not intervene in foreign exchange markets directly to determine the exchange rate, but instead allows supply and demand to determine the exchange rate. A floating exchange rate of the UK, according to the Bank of England (2023), gives room for flexibility that allows the economy to react to external shocks such as the price of oil, international trade conditions, or financial crises. Therefore, a myriad of domestic and international factors determines the value of the pound, which in turn determines the competitiveness of UK imports and exports. For example, a depreciating value of the pound may increase the appeal of UK exports to overseas consumers, thereby making British goods more competitive in global markets.

The value of the exchange rate of the UK has an effect on the competitiveness of the UK internationally, especially on the import and export trade. Technology, manufacturing, and farming are some areas that would be helped by the devaluation of the pound as it would make British

goods more competitive in foreign markets. However, a higher power for the pound would make imports cheaper but make UK exports less competitive and thus impact the trade balance. The export performance of the UK is extremely sensitive to exchange rate movements, as noted in a study by Bayoumi et al. (2021), which found that a 10% depreciation of the pound raises volumes of exports by a significant margin. In addition, the Bank of England (2022) further notes that currency rate changes directly impact inflation, specifically on import prices. In Carter and Pomeroy (2020), UK firms should be able to shift prices and optimize for efficiency so they can compete.

Despite the benefits of a floating exchange rate, volatility in the exchange rate threatens the UK economy severely. The extreme currency volatility has implications for foreign investment and inflation, especially in sectors heavily dependent on stable exchange rates, like manufacturing, retail, and finance. Businesses and investors are also exposed to further uncertainty due to ongoing vulnerability of the pound to politics, including trade negotiations and government policy shifts, according to a National Institute of Economic and Social Research (NIESR, 2021). Concerns regarding UK medium-term competitiveness have also heightened as an outcome of the Brexit debacle, most importantly in light of the possible decline in the value of the pound. As noted by Thomas and Williams (2023), since the UK is exposed to the European market and depends greatly on foreign investments, it has made the government act to ensure it addresses the issue of currency rate fluctuations in a manner that supports continuity of economic advancement. UK policymakers are making a shift to having trade arrangements as well as ensuring diversification of the economy to reduce risks and enhance resilience against currency fluctuation.

D. Brazil

Brazil fundamentally transformed its monetary policy when it floated its exchange rate regime in 1999 in a bid to improve economic responsiveness and competitiveness within the global marketplace. Since then, the Brazilian real (BRL) has been market-led, raising the level of currency volatility. From the financial aspect, the same has been a serious problem for it, while it brought responsiveness. Brazilian financial institutions like Banco Bradesco have designed highly advanced foreign exchange (forex) instruments in order to absorb the risk posed by such movement, according to studies. They offer risk management solutions for their business and retail

clients through guarding against the resulting losses that emanate from real market volatility (IMF, 2020).

With all these advancements still, the central bank of Brazil continues to take measures to guarantee stability is provided. The central bank steps into action through operations in the market to siphon out extra volatility and achieve stability in the financial system while there are high changes in currencies. Maintaining the entire economy against the negatives like capital outflow or pressure from inflation has been viewed as to require the measure. Evidence indicates that such steps result in a more stable global trade and investment climate, making the Brazilian financial sector more competitive (World Bank, 2022). Although there are cautionary words from some economists that if central bank intervention is too excessive, it will distort market forces and induce inefficiencies, this also raises questions regarding the long-run viability of such steps (Das, 2023).

Brazil's experience with a variable exchange rate system is of both advantage and disadvantage to its competitiveness in the international market. On the advantage side, Brazilian exporters are benefited by the ability to control the exchange rate at will, increasing the competitiveness of their products whenever the real value falls. But when the currency has sensational declines, the normal fluctuations might deter foreign investment and disrupt commercial flow (IMF, 2020). Pereira et al. (2022) contend that the capacity of the Brazilian banking system to innovate new financial products has been instrumental to ensuring competitiveness amid exchange rate uncertainty. The firms can however, grow at home and abroad using these products to protect themselves from any loss. But the use of the intervention of central banks implies that there must be equilibrium between government intervention and the forces of the market for stabilizing the currency for Brazil to achieve maximum competitiveness.

E. Nigeria

There has been an imperative shift in monetary policy in Nigeria achieved through the adoption of the floating exchange rate regime since 2016. The incentive for the shift to a more liberal exchange rate was to normalize the foreign exchange crises that have been exacerbated by the volatility in the oil price, which carries a massive influence in the Nigerian economy. Since oil is the major export of the country, its revenue impacts the value of the naira directly. A floating exchange rate exposes the currency to high volatility even though it provides more flexibility, contends the

International Monetary Fund (IMF, 2020). It is most conspicuous during periods of low oil prices because this is likely to subject the naira to depreciation and expose the economy to the effects of external shocks. Odumodu (2022) discovers that Nigeria's dependence on oil revenues highlights the need for diversifying the economy to absorb external shocks on the exchange rate. However, with complementary measures being instituted to address structural issues, the flexibility of the floating exchange rate system gives Nigeria the capacity to develop further towards a more robust and diversified economy.

Nigerian banks like Access Bank have put in place innovative products designed to cover against exchange risks to cushion the naira volatility. The commodities, such as foreign exchange futures, help businesses cover against any loss resulting from volatile exchange rates. The instruments have also been utilized by Access Bank and other institutions to trigger stability in international trade and promote the inflow of FDI into Nigeria. These financial product innovations have significantly elevated the degree of competition for banks in Nigeria compared to recent reviews (Adebayo et al., 2021). These innovations enable the banking industry to better deal with currency risks and thus propel economic growth through upholding investor trust and promoting domestic and international business.

Despite the strategic hedging by Nigerian banks, the Nigerian banks are still plagued by serious issues with currency rate volatility. Volatility has been a mixed bag for the Central Bank of Nigeria's (CBN) sporadic efforts to stabilize the naira through maintaining foreign exchange reserves and altering interest rates. Despite such actions bringing momentary stability, more recent contributions by Olabode (2022) posit that they do not address the root structural problems—such as the over-reliance of Nigeria's exports on oil—fueling uncertainty in currency rates. In protecting the country from external shocks, Nigeria's economic institutions will diversify their economies' bases as well as implement wider strategies in the future. These may include expanding non-oil exports and deepening more robust financial markets.

F. EGYPT

Egypt shifted to a floating exchange rate system in 2016 to improve its foreign exchange reserves and stabilize its economy. The two main reasons the nation had grave money shortages before this were a fixed exchange rate regime and falling foreign investment. For purposes of strengthening

foreign reserves, the luring of FDI, as well as stifling the illicit foreign exchange market, the Egyptian pound was set to be floated (IMF, 2018). However, the float towards the exchange rate has also come with immense volatility, such that the pound has seen substantial depreciations, particularly in response to political tensions as well as foreign shocks in terms of hikes in commodity prices globally (World Bank, 2020). These fluctuations have had a big effect on inflation, which has been a major issue for businesses and consumers, especially in an economy as dependent on imports for necessities.

The Egyptian banking industry has had to undergo a quick adjustment to these volatilities, and to reduce the impact of volatility on their businesses, they have invested in foreign exchange risk management tools such as currency derivatives and hedging. The large banks, such as Commercial International Bank (CIB) and the National Bank of Egypt, have come up with advanced solutions to help businesses deal with their foreign exchange risk exposure. By providing stability in the trade financing and boosting investors' confidence, these products have been very important in enhancing the competitiveness of Egyptian banks (Al-Mansour and El-Sayed, 2021). For keeping the confidence of the market and stabilizing the pound, the Central Bank of Egypt (CBE) has intervened in the foreign exchange market occasionally as well. By preventing excesses in currency fluctuations, particularly in situations of increasing inflation as well as political instability, the measures have worked towards making the banking system work efficiently in spite of adversity from overseas.

But the regime of floating exchange rates has also unleashed a number of challenges to Egypt's competitiveness in the global environment. The fluctuation of the pound has tended to cause rising inflation and higher costs for businesses that depend on imported goods, impacting both domestic consumers and foreign trade. In addition, the pound's devaluation has also reduced the purchasing power of Egyptian families, thus slowing down local consumption. However, despite all these, scholars like Hassan and Abdelrahman (2022) believe that Egypt can be rendered more competitive in the long run by weaning its economy from over-reliance on foreign exchange reserves and diversifying the same. Together with stronger institutional underpinnings, a more diversified economy will enable Egypt to better withstand the external shocks that still afflect its banks and currency.

G. South Africa

Being open to the forces of supply and demand in the foreign exchange market through oversensitivity to a freely floating exchange rate regime, the South African Rand (ZAR) is susceptible to the forces of supply and demand. Financial stability and inflation targeting are prioritized through oversensitivity of South African Reserve Bank above currency valuation through direct oversensitivity. Studies have indicated that this strategy has registered great advantages, including being an insurance against global shocks such as world financial crises and fluctuations in commodity prices (SARB, 2023).

Empirical evidence demonstrates that the flexibility of the Rand has helped South Africa maintain its competitiveness in the global market, particularly in manufacturing and mining sectors. For instance, during economic depression periods, currency depreciation has been beneficial to export-oriented businesses by reducing the price of products from South Africa in the foreign market (Smith & Botha, 2023). But the volatility of the Rand has regularly led to economic instability that has eroded investor confidence and pushed up costs of imports. This has, for industries which heavily depend on raw materials which are imported, presented problems too.

Domestic economic policy, global commodity price exchange rate volatility, and speculative behavior have all played a part. There are required to be strong risk management techniques to address these problems. There must be diversification of the economy and deepening of the financial markets by South Africa since policy suggestions recently to diminish the impact of exchange rate volatility and to maintain the advantage of a floating system (Dlamini, 2024). In the long run, improving the coordination of fiscal and monetary policy could stabilize the Rand and improve the economic competitiveness of South Africa.

H. Ghana

The Ghana Cedi (GHS) is the currency of Ghana and its exchange rate floats, being regulated by the Bank of Ghana. The regime has allowed the nation to respond to price changes in commodities in the rest of the world, equalize trade deficits, and shield itself from outside shocks. Dependence on this solid foundation by Ghana has made major export business like cocoa and gold competitive, thus enhancing foreign exchange revenues appreciably (Bank of Ghana, 2023).

Despite all these benefits, there are still challenges with the floating system in Ghana. Speculative trading, political instability, and structural economic factors like humongous foreign debt and budgetary deficits have all contributed to the high volatility of the Cedi. The subsequent inflationary pressures due to such volatility have reduced purchasing power and increased the cost of living, especially for the poor (Mensah & Ofori, 2023).

The Bank of Ghana has entered the foreign exchange market and tightened monetary policy in a bid to stabilize the Cedi. Although these measures have provided short-term relief, economic growth is usually sacrificed in the process. Long-term measures to increase economic resilience and reduce the adverse effects of currency rate changes are structural changes like diversification of the export base, diversification away from commodity exports, and boosting domestic manufacturing (Owusu & Addo, 2024). Long-term economic growth further depends on strengthening risk management infrastructure and enhancing foreign exchange market transparency.

I. Kenya

Kenya operates a freely floating exchange rate regime that allows the Kenyan Shilling (KES) to be determined by market forces under the Central Bank of Kenya's management. The regime provides the country with the capacity to adapt to external shocks, such as changes in global commodity prices and global financial market volatility. The government has supported economic stability, and this has enabled Kenya to be competitive in key sectors such as agriculture and tourism (Central Bank of Kenya, 2023).

The agricultural exports, represented by tea, coffee, and horticulture, have been supplemented by the floating system and continue to be foreign exchange-earning sources. Nevertheless, because Kenya is largely dependent on foreign borrowing, volatility of the Shilling has presented itself as a challenge for companies depending on imports as well as for debt servicing. Kenya's economic growth usually gets hit by severe inflationary pressures and high import bills for products that are fundamentals to the economy, including petroleum and machinery after sharp currency depreciations (Mwangi & Wanjiru, 2023).

Kenya has concentrated on consolidating its macroeconomic policy framework and improving the transparency of the foreign exchange market to meet the above challenges. Two recent policy measures to promote industrial competitiveness are export commodity diversification and investment in infrastructure. According to Wachira and Omondi (2024), enhancing monetary and fiscal policy coordination is also regarded as a key strategy in exchange rate risk management and ensuring economic stability. Kenya has a lot to learn from other nations with similar frameworks as it strives to cope with the challenges of a variable exchange rate system.

J. Tanzania

The currency of Tanzania, Tanzania shilling (TZS), operates on a floating exchange rate system that is controlled by the Bank of Tanzania. The regime allows the value of the currency to be determined by market forces, though the central bank intervenes sometimes to regulate high volatility. Tanzania has benefited from this arrangement in its bid to maintain its export market competitiveness, especially for cashew nuts and coffee (Bank of Tanzania, 2023).

Although the floating regime provides room for flexibility, Tanzania has also been subject to currency rate volatility with potential effects on inflation rates and import costs. For example, the country's infrastructure development plan has seen increased import costs of machinery and petroleum due to TZS fluctuations. Compounding the problem for entrepreneurs and regulators, speculative transactions in the foreign exchange market have at times increased volatility (Massawe & Mushi, 2023).

As a way of addressing such challenges, Tanzania has focused on attempts aimed at expanding its export diversification platform and enhancing monetary efficiency. Curbing currency volatility's adverse impacts and economic competitiveness is also said to encompass developing banking sector reforms as well as making sure that there is transparency within the foreign exchange market (Mwinyi, 2024).

K. Uganda

The floating exchange rate system is used by the Bank of Uganda for the Ugandan Shilling (UGX). The floating exchange rate system has allowed the UGX to respond to market forces, thereby allowing the economy to respond to external shocks and to changes in the global economy. The

floating system has assisted in maintaining the competitiveness of Uganda in the export markets, particularly in coffee, which is one of the major foreign exchange earners (Bank of Uganda, 2023).

Notwithstanding all these benefits, volatility of exchange rates is still a disadvantage in Uganda. The increase in prices brought about by the UGX fluctuations constantly puts living expenses high, lowering household spending power. Further, manufacturing and energy are industries that are most reliant on importation that are highly susceptible to currency devaluation as their imported fuel and inputs prices will be higher (Mutebi & Kamya, 2023).

Monetary tightening and exchange market intervention have been among the measures implemented in Uganda in efforts to counter the negative implications of exchange rate variability. Long-term adjustments need structural adjustments in forms of export diversification as well as indigenous industry strengthening. Policy coordination as well as improving the infrastructure in the financial market should also be emphasized in a move that can enhance the potential to provide stability as well as durable economic expansion of a floating exchange rate regime (Nankunda, 2024).

2.4 Literature Gap

Several international research studies have discussed the problem and benefits of having a floating exchange rate system, its impacts on economic growth, financial stability, and efficiency in the market. However, domestic research studies in Ethiopia have not completely assessed the impact of a move to a floating exchange rate regime on enhancing the competitiveness of the country's commercial banking sector. How prepared Ethiopian commercial banks are for such a development is hard to say, and it is difficult to determine if they will be able to compete in a more dynamic exchange rate regime.

Additionally, there are no local studies that critically examine whether Ethiopian commercial banks utilize advanced banking products and services required to manage a floating exchange rate system. Bank capability to deal with exchange rate risks often depends on the availability and usage of state-of-the-art risk management tools, internet banking facilities, and hedging products of the foreign exchange type. However, there is hardly any empirical research on the way Ethiopian commercial banks are applying such advanced financial technologies in order to manage exchange

rate risk avoidance. Such a knowledge gap hinders appropriate comprehension of the degree to which the Ethiopian commercial banking sector is capable of reacting to potential foreign exchange shocks.

The other significant gap in the literature is that there has been very little work on the ability of the financial system to handle risk under a floating exchange rate system. Ethiopian commercial banks in fact are faced with structural and operational issues that limit them from responding sufficiently to exchange rate fluctuations. A stable financial foundation with efficient foreign exchange markets, risk management systems, and regulatory protection is required for guaranteeing a smooth shift to a floating exchange rate regime. However, very little literature is available examining whether such financial infrastructure, required to support the kind of volatility implied by a floating exchange rate system, exists in Ethiopian banks. Additional research must be conducted in order to evaluate how such banks can develop their ability to deal with exchange rate risks and stability in the financial system.

Moreover, the technological and policy shifts required to facilitate the introduction of a floating exchange rate system are not discussed elaborately. The policy measures that are required, for example, the intervention role of monetary authorities in currency stabilization are most significant to policymakers who want to initiate exchange rate reforms. An analysis of the regulatory system, i.e., foreign exchange controls, liquidity management, and financial market regulation, might yield some interesting facts regarding how the commercial banking sector of Ethiopia can position itself to adapt to a floating exchange rate system.

Bridging such knowledge gaps is essential for identifying the challenges and opportunities associated with adopting a floating exchange rate in Ethiopia. Future studies can offer valuable insights to policymakers, financial institutions, and regulators to support a smooth transition, maintain financial stability, and enhance competitiveness in the banking sector. Accordingly, this study aimed to contribute to filling the existing gaps in the current body of knowledge.

Chapter Three
Research Methodology

3.1 Introduction

This chapter provides an overview of the research methodology employed in this study. It is a roadmap to the remainder of the sections, explaining how the research questions and objectives were to be achieved. The methodology chapter is significant in the sense that it renders the research systematic, reliable, and reproducible. It contains the research design and methodology, data sources, population and sampling methods, data collection tools, data analysis methods, tests of validity, and the level of interpretation.

The research methodology depends on the type of research problem, objectives of the study, and the type of data required. The research design and approach ensure that the findings are valid and can be applied to the environment under study. The following sections provide full explanations of the methodology adopted for this study, discussing each research process step by step.

3.2 Research Approach

The study employed mixed methods, combining quantitative as well as qualitative methods of analyzing the risks and opportunities for floating exchange rate regimes in consideration of their potential impacts on commercial banking competitiveness in Ethiopia. Quantitative analysis was directed towards estimating the impacts of floating exchange rates on important banking indicators like foreign exchange risk management, liquidity, and profitability from commercial banks. Standard questionnaires were employed in collecting quantifiable data from banking professionals, providing robust analysis of these critical subjects. Besides quantitative analysis, qualitative approach provided underlying insight into how Ethiopian commercial banks respond to preventing the challenges caused by exchange rate volatility. This component involved semi-structured interviews with bank directors and executives in order to understand the mechanisms of adaptation in the industry and avenues for increased competitiveness under a system of floating exchange rates.

3.3 Research Design

Descriptive research design was employed in the current study in order to systematically assess the connection between floating exchange rates and competitive forces in Ethiopia's banking industry. The research design is particularly suitable for capturing broad trends and identifying exact nuances so that overall performance and strategic position of the sector could be comprehensively appreciated as influenced by exchange rate volatility. With this design, the study provided a structured evaluation of the most significant determinants of bank competitiveness under an exchange rate volatility environment. The qualitative results were also enriched to present richer understanding into the challenges and opportunities introduced by exchange rate volatility, contributing to a more comprehensive appreciation of the topic.

3.4 Data and Data Source

The study used primary data and secondary data to enable extensive analysis of the opportunities and challenges of Ethiopian commercial banks in floating exchange rate systems. The primary data were collected using structured questionnaires from banking experts, recording quantifiable information on the impacts of floating exchange rates on some of the most important bank indicators such as foreign exchange risk management, liquidity, and profitability. Furthermore, semi-structured interviews with directors and executives of banks were held with a perspective to gaining qualitative information on the measures taken by banks with a perspective to mitigating exchange rate volatility and improving competitiveness.

Secondary information for the study were gathered from various authentic sources, including the National Bank of Ethiopia's and other central banks' annual reports, annual reports of local banks, academic journals, policy documents, reference textbooks, online resources, and past research studies. They provided contextual data about the Ethiopian commercial banking sector, historical trends in exchange rate regimes, and global best practice in floating exchange rate regime management. By integrating primary and secondary data, the study offered a firm foundation for analyzing the intricate relationship between exchange rate regimes and competitiveness.

3.5 Population and Sampling Size

The target population of this study included six largest commercial banks: Commercial Bank of Ethiopia, Awash Bank, Dashen Bank, Zemen Bank, Bank of Abyssinia, and Oromia Bank. These banks were selected in particular keeping their enormous foreign exchange receipts and transactions during the 2023/2024 financial year in mind and hence would be the ones most prone to the risk created by the newly introduced floating exchange rate system. The remaining banks were excluded because they will have minimal exposure to exchange rate fluctuations and may not have the capacity to manage such risks. The National Bank of Ethiopia (NBE) also included as it provides additional insight and comprehension, expanding the analysis and enhancing the knowledge base about the implications of the floating exchange rate system.

From the organizational charts displayed on their respective websites and their 2023/24 annual reports, the population amounts to 342 employees. To obtain the study population in a stable representation, proportional quota sampling method was applied. Proportional quota sampling is a type of sampling where groups of people are divided based on their percentage in the population of study, which allows for accurate depiction of the population according to their nature (Nikolopoulou, 2022). By using this method, the study was able to depict the Ethiopian commercial banking industry in diversity and proportional representation.

Out of this population, the central bank (NBE) comprised around 7.6%, whereas the remaining 92.4% were the six commercial banks. In order to calculate the sample size needed from this population, Yamane's (1967) formula used as follows:

$$\boldsymbol{n = \frac{N}{1 + N(e)^2}}$$

Where: n = sample size required

N = number of people in the population

e = allowable error

For a total population of 342 employees and an assumed margin of error (e=7%), the calculated sample size was:

$$n = \frac{342}{1 + 342(0.07)^2}$$

n=128

From the total sample size of 128, 10 respondents represented the NBE, while 118 respondents were proportionally allocated among the six commercial banks. The distribution of the sample for each commercial bank is presented in Table-3.1.

Table 3. 1 Sample Selection

No.	Bank Name	Executives	Directors	Population	Sample
1	National Bank of Ethiopia	6	20	26	10
2	Commercial Bank of Ethiopia	16	20	36	14
3	Awash Bank	20	65	85	32
4	Dashen Bank	15	53	68	25
5	Zemen Bank	10	27	37	14
6	Bank of Abyssinia	13	39	52	19
7	Oromia Bank	16	22	38	14
	Total	**96**	**246**	**342**	**128**

Source: Own survey, 2025

3.6 Data Collection Method

As mentioned in the data and data source sub-section of the methodology, a mixed-method approach was used in this study where primary and secondary sources of data collection combined for a comprehensive treatment of the process of floating exchange rates in Ethiopia. The study gathered primary data through structured questionnaires and in-depth interviews with the relevant stakeholders, including senior management officials from Ethiopian commercial banks and policymakers at the National Bank of Ethiopia.

The questionnaire of this study was constructed based on relevant literature and results of other earlier studies. It was organized by the researcher in an orderly and harmonious manner in order to receive useful data for the study. The questionnaire included five parts. The first part captured demographic and professional details of the commercial bank executives and directors, i.e., age, gender, level of education, employment status, and experience. This helped in establishing the foundation on the applicability and knowledge of respondents to guarantee validity and richness in the data obtained. The remaining part discussed the important themes in the study with a focus on key issues about floating exchange rates. It specifically investigated the challenges associated with their adoption, the opportunities for enhancing competitiveness, the impacts on customer demand, and the regulatory frameworks that support adaptation.

In-depth interviews accompanied the questionnaire with qualitative data from few executives, directors, and policymakers. These interviews furnished revealing opinions concerning the policy implication, regulatory considerations, and strategic decision of an implementing a floating exchange rate scheme in Ethiopia and further enhancing knowledge concerning the concerns in question.

Secondary data were obtained from a reservoir of expert reports, policy briefs, and reports from National Bank of Ethiopia, international financial institutions, and commercial banks of Ethiopia. Through an integration of secondary and primary data, this study aimed to deliver an integrated evidence-based analysis of the opportunities and challenges offered by float exchange rates in Ethiopia. The study made informed decisions available to policymakers, financial institutions, and stakeholders to guide decision-making and strategic planning for the effective management of exchange rates within the Ethiopian banking sector. This research ultimately aimed to recommend policy guidance enabling Ethiopia's transition towards a more competitive and stable exchange rate regime.

3.7 Methods of Data Analysis

This study employed both qualitative and quantitative approaches to investigate information on floating exchange rates movements and their problems and prospects for competitiveness of the commercial banking sector. Data analysis and interpretation were undertaken using SPSS software via tabulation, frequency distribution, and statistical analysis. Questionnaire statistics collected

were illustrated using tabulation and frequency distribution in order to identify trends and patterns that prevail in respondent perceptions concerning floating exchange rates exerting an impact on banking operations. Descriptive analysis was utilized to describe and summarize data, thus unveiling a comprehensive account of the issue in question.

In addition, qualitative data from interviews was used to complement the findings to offer more detail on the workings of floating exchange rate mechanisms and how they influence the banking sector. By integrating both qualitative and quantitative approaches, this suggested methodology ensured a balanced and thorough analysis, combining numerical precision with contextual depth. This enabled the study to generate evidence-based conclusions and pragmatic solutions to address the challenges and leverage the opportunities presented by floating exchange rate volatility in banking.

3.8 Validity and Reliability Test

3.8.1 Validity Test

As Cooper and Schindler (2003) validity refers to the extent to which a test measures what we actually wish to measure. In the mixed-methods research, validity is very essential for decreasing faults that might arise from measurement difficulties in the research study. The questionnaires were prepared based on the relevant literature review and by adapting from previous scholars in the area of my topic. To ensure validity, the researcher conducted a pilot test in which a sample questionnaire was tested for 10 respondents in the target population before final distribution of questionnaires to make the questionnaire more accurate and to get feedback before distributing it to the respondents. Then, adjustments were taken to the questionnaire items based on the comments of the respondents. Besides, the researcher consulted the university advisor to get advice and make the necessary changes.

3.8.2 Reliability Test

According to Kothari (2004), a measuring instrument is reliable if it measures what it is supposed to measure consistently. Cranach's alpha is a reliability coefficient. It is widely used as an index of the internal consistency or reliability of a psychometric test score for a sample of test-takers. According to Zikmund, Babin and Griffin (2010), scales with coefficient alpha between 0.8 and

0.95 are considered to have very good quality, Scales with coefficient alpha of 0.7 to 0.8 are considered to have good reliability, and coefficient alpha of 0.6 to 0.7 is considered fair. reliability.

To ensure the reliability of the data instrument, statistics analysis was conducted to analyze the internal consistency of the instruments used. Cronbach's was used as an examination indicator when determining the reliability of the measurement scale of the pilot test. Through the reliability test, it was ensured that all the items in the pilot questionnaire were reliable as evident from the score of 0.71. Accordingly, the responses obtained for all the variables used in this study were found to be reliable for data analysis.

Table 3. 2 Reliability Test

No.	Variables	Cronbach's Alpha	No. of Items
1	Challenges of Floating Exchange Rate	0.708	11
2	Opportunities of Floating Exchange Rate	0.721	10
3	Customer Behavior under Floating Exchange Rate	0.719	4
4	Regulatory Support under Floating Exchange Rate	0.705	4

Source: Own computation, 2025

3.9 Scale Used for Interpretation

The study employed a Likert scale rating system to interpret mean values from data analysis, which categorized responses into pre-defined class intervals displayed in Table 3. 3. The analysis enabled detection of respondent consensus levels regarding multiple dimensions of floating exchange rate dynamics and their banking sector impacts. The Likert scale provides a method for achieving structured data interpretation by enabling clear identification of respondents' perception strength. The following table illustrates the Likert scale used to classify the degree of responses:

Table 3. 3 Likert Scale Threshold

Range	Interpretation
1 --- 1.8	Very High
1.81 --- 2.6	High
2.61 --- 3.4	Neutral
3.41 --- 4.2	Low
4.21 --- 5	Very low

Source: (Best & Khan, 1997)

This scale allowed for consistent and uniform interpretation of data to determine significant challenges and opportunities of floating exchange rate systems in the banking system. The categorization is utilized to determine the level to which each factor is agreed, which is used in the overall analysis and recommendations.

3.10 Ethical Considerations

The study followed codes of ethics with regards to data collection, analysis and presentation. The primary ethical concerns of independent participation, informed consent, confidentiality and data security was closely adhered to during this study.

Voluntary completion of the survey questionnaire was guaranteed, and the participants were provided with clear information on the objectives of the study and how their answers would be utilized. Informed consent was obtained from all participants before administering the questionnaires.

For maintaining confidentiality, no personally identifiable information was collected, and all responses were anonymized while tabulating and reporting. Data from surveys has been securely stored and were used solely for purposes of academic research in the framework of this thesis. In addition, due care was taken so that the questionnaire wording and subsequent analysis did not mislead or intimidate respondents in any way.

In compliance with academic integrity, all secondary data and literature materials employed have been properly cited and credited. The researcher also committed to reporting findings objectively regardless of whether they support or refute the anticipated outcomes.

Chapter Four

Data Analysis and Findings

4.1 Introduction

This chapter presents the data analysis, research findings, and a discussion and interpretation of the results, based on the standards outlined in Chapter Three by Best and Kahn (1997). To examine the challenges and opportunities of floating exchange rate in the Ethiopian commercial banking sector, the researcher employs a combination of tables, figures, and qualitative analyses derived from the research process.

4.2 Response rate

For collecting primary data, the researcher distributed a total of 118 questionnaires to six selected commercial banks. Of these, 113 questionnaires were completely filled and returned, making a valid response rate of approximately 95.76%. The remaining five questionnaires included three that were incomplete and two that were not returned, making a non-response or invalid rate of 4.24% as provided in Table 4.1. The 95.76% satisfactory response rate is discovered statistically reliable for the inference-making concerning the population under study. Moreover, all the directors at the National Bank of Ethiopia were tried by the researcher for interviewing. However, four among ten available directors were convinced and joined an interview.

Table 4. 1 Response Rate

Bank Names	Expected Questionnaires	Returned and Valid Questionnaires	Percentage
Commercial Bank of Ethiopia	14	13	93
Awash Bank	32	31	97
Dashen Bank	25	25	100
Zemen Bank	14	14	100
Bank of Abyssinia	19	17	89
Oromia Bank	14	13	93

Source: Own survey, 2025

4.3 General information about the respondents

The general information includes the gender of respondent, age, education level qualification, occupation with management background, and total work experience in a banking sector. Similarly, as indicated in Table 4.2 below, the majority of the leadership positions in the bank are held by individuals aged between 35 to 45 years, taking up 47.79% of the total. It is even more prevalent among women since 65.38% of them fall in this age group, which is a greater percentage of women leaders in their mid-career stage. Among males, most of them also belong to the 35–45 age group (42.53%), followed by the 46–55 years old (33.33%). Overall, workers under the age of 35 make up only a small percentage (13.27%) of the total, so there would not be a great deal of leadership represented by younger employees. Though they comprise only 8.85% among those over 55 years of age, this could be indicative of retirement relocation or leadership inclination from young to middle age within the institution. These statistics indicate a leadership population which is mostly professionals at the most mature and experienced stages of their working lives.

Table 4. 2 Background of the Respondents (Age and Gender)

Gender	Age				
	<35	**35-45**	**46-55**	**>55**	**Total**
Male	12	37	29	9	87
	13.79%	42.53%	33.33%	10.35%	100.00%
Female	3	17	5	1	26
	11.54%	65.38%	19.23%	3.85%	100.00%
Total	**15**	**54**	**34**	**10**	**113**
	13.27%	**47.79%**	**30.09%**	**8.85%**	**100.00%**

Source: Own survey, 2025

Table 4. 3 Background of the Respondents (Education and Occupation)

Educational Background	Your Position in this bank		
	Executive Manager	**Department Director**	**Total**
BA/BSC Degree	0	4	4
	0.00%	100.00%	100.00%
MSc/MA	12	97	109
	11.01%	88.99%	100.00%
Total	**12**	**101**	**113**
	10.62%	**89.38%**	**100.00%**

Source: Own survey, 2025

From the above statistics in Table 4.3, the implication is that the majority of the leaders in the bank—i.e., Executive Manager and Department Director—are Master's degree (MSc/MA) holders. Among the 113 people occupying these positions, 109 (96.46%) are MSc/MA holders, while 4 (3.54%) possess a BA/BSc degree. Most significantly, 12 of the Executive Managers possess a Master's degree, suggesting that this educational level is either a minimum requirement or a preference for executive-level leadership positions at the bank. Of the 101 Department Directors, 97 have an MSc/MA and only 4 have a BA/BSc degree, indicating that while a Bachelor's degree would remain acceptable at director level, a Master's degree is highly preferred. This split overall indicates the preference of the bank for higher degree qualifications in occupying key managerial and leadership positions.

Taking a closer look at Table 4.4, it is clear that most of the individuals in charge at the bank are not more than 10 years into management. In fact, 81.42% of the group (52 less than 5 years and 40 with 5–10 years) fall into this category. Of Executive Managers, 91.66% have fewer than 10 years' experience as a manager, of which 33.33% have fewer than 5 years' and 58.33% have between 5 to 10 years. This may indicate that by far the majority of executives are very inexperienced at being a manager, which may suggest promotion from within or in-house reorganizing recently. Similarly, 80.20% of Department Directors also have less than 10 years of management experience. There are only 1.77% of leaders in total with more than 20 years of management experience, a composition of leadership consisting of more mid-career managers rather than veterans. One can say the trend is indicative of the bank's efforts to build and develop the next generation of managers.

Table 4. 4 Background of the Respondents (Occupation and Management Experience)

Your Position in this bank	Work experience in this management				
	<5	5-10	10-20	>20	Total
Executive Manager	4	7	1		12
	33.33%	58.33%	8.34%	0.00%	100.00%
Department Director	48	33	18	2	101
	47.53%	32.67%	17.82%	1.98%	100.00
Total	**52**	**40**	**19**	**2**	**113**
	46.02%	**35.40%**	**16.81%**	**1.77%**	**100.00%**

Source: Own survey, 2025

From Table 4.5, it can be presumed that the majority of individuals who are in leadership roles within the bank are experienced within the banking sector, as 49.56% of them have been working for 10 to 20 years. Among Department Directors, they represent the most significant share (46.54%), indicating an enormous number of experienced professionals in mid-level leadership. Contrarily, the Executive Managers show a slightly higher degree of experience with 75% of them having more than 20 years of service within the banking sector. This would mean that chief executive roles tend to be held by individuals who have extensive industry experience and long-term service. Just a minute percentage of the total leadership team (10.62%) possess less than 5 years of experience within the bank, depicting the industry practice of utilizing experience to occupy leadership roles. Overall, the data is indicative of the bank valuing to a large extent significant sector-specific experience, especially executive level, and working towards the development of a high percentage of directors with between 5 to 10 years' experience, which shows a fair balance of experienced and budding leaders.

Table 4. 5 Background of the Respondents (Occupation and Bank Related Experience)

Your Position in this bank	Work experience in the banking sector				
	<5	5-10	10-20	>20	Total
Executive Manager	0	1	2	9	12
	0.00%	8.33%	16.67%	75%	100.00%
Department Director	12	33	47	9	101
	11.88%	32.67%	46.54%	8.91%	100.00
Total	**12**	**34**	**49**	**18**	**113**
	10.62%	**30.09%**	**49.56%**	**9.73%**	**100.00%**

Source: Own survey, 2025

4.4 Perceived impact of Floating EX on the Ethiopian Banking Sector

The respondents were asked to rate the significance of the impact of a floating exchange rate on the Ethiopian banking industry. The following table presents their ratings of its significance.

Table 4. 6 Perceived Impact of Floating Exchange Rate on the Ethiopian Banking Sector

Impact Level	Freq.	Percent	Cum.
Very Significant	94	83.19	83.19
Significant	17	15.04	98.23
Moderate	2	1.77	100.00
Minimal	0	0	
Not Significant	0	0	
Total	**113**	**100.00**	

Source: Own survey, 2025

Table 4.6 shows that the majority of the respondents (83.19%) perceive the impact of a floating exchange rate as "Very Significant." It means that operating businesses under a floating exchange rate regime is perceived to have a material impact on commercial banks, risk management, and competitiveness in the overall Ethiopian economy. Fewer numbers of 15.04% believe the impact is "Significant," i.e., they do hold the belief in the impacts of the new exchange rate arrangement but perhaps do not feel that it to be as clearly transformative.

Only 1.77% of the respondents view the impact as "Moderate," i.e., having a little impact on the banking industry. No one of the respondents claimed the effect was "Minimal" or "Not Significant," which supports the point that the floating exchange rate has had very huge impacts on Ethiopian banks. Overall, the results exhibit extensive agreement that the shift to a floating exchange rate regime impacts greatly on the bank sector in Ethiopia as most of the respondents indicated its very significant and significant impact.

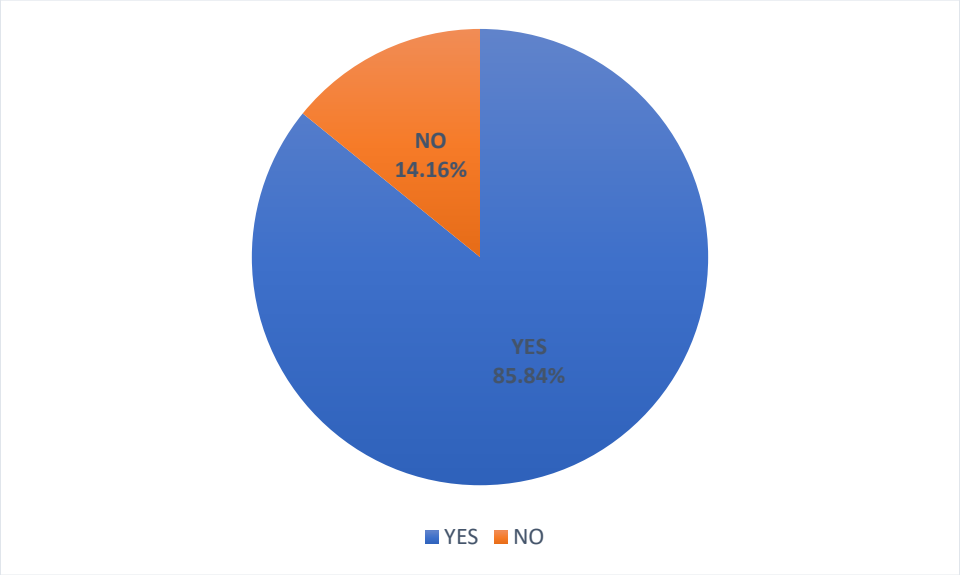
4.5 Respondents' Perspectives on the Difficulties Faced by Ethiopian Banks Under a Floating Exchange Rate

A questionnaire was used to assess the difficulties caused to Ethiopian commercial banks by a floating exchange rate. Based on available data in Figure 4.1, the overwhelming majority of the respondents (85.84%) are of the view that Ethiopian commercial banks face challenges under a floating exchange rate system. This implies that the transition to a floating exchange rate has presented complications in the banking system, necessitating banks to adapt their risk management operations and practices to ensure financial stability.

At the same time, fewer (14.16%) of the respondents do not regard these issues to be so important, i.e., for some, the impact of a floating exchange rate would not be that bad or some banks could easily manage it.

Overall, the findings indicate that most of the respondents view the floating exchange rate to pose significant risks to Ethiopian commercial banks in managing foreign exchange risk, profitability, and liquidity.

Figure 4. 1 Respondents' Perspectives on the Difficulties Faced by Ethiopian Banks Under a Floating Exchange Rate



Source: Own survey, 2025

4.6 Challenges of Floating exchange rate

According to the survey, there are a number of challenges faced by Ethiopian commercial banks under a floating exchange rate regime. The most emphasized of these issues by the respondents is the increased volatility of the exchange rate, which has made foreign currency transactions by banks to be effectively managed more difficult. Currency movement volatility has led to increased operational uncertainty, affecting profitability and financial planning. Almost all the survey takers agreed that such volatility is going directly to target the banks' cash flow streams and the banks' susceptibility to foreign exchange risk.

Bank executives and department directors' interviews confirmed these survey findings and provided further insight into the operational issues. Some of the interviewees pointed out that frequent fluctuations in the exchange rate necessitate continuous adjustment of pricing models, interest rates, and liquidity plans—a process involving heavy resources and added expenses. Banks also find it difficult to make precise predictions about their profits because the trends are continuously distorted by market volatility. This uncertainty not only affects short-term financial results but also undermines long-term investment decisions and growth planning.

Yet another pressing concern presented in the interviews is the absence and high cost of hedging

instruments in the Ethiopian market. Without cheap, available financial products such as forwards, futures, and options, banks are subject to unexpected movement of currencies. Furthermore, there is a dire lack of institutional capacity and technical expertise in managing exchange rate risk under a floating regime. Most banks largely rely on elementary techniques such as reserve holding or currency matching exposures, which do not suffice under a highly turbulent market. The weakness leaves the sector vulnerable to systemic shocks under economic stress outside the rest of the world.

The interviewees also had concerns about the impact of floating exchange rates on liquidity and management of capital. As foreign currency values continue to change, banks increasingly struggle to have a fixed level of foreign currency reserves. This volatility prevents them from fulfilling international payment obligations in a timely manner, especially in a situation where demand for foreign currencies is usually greater than the supply. Besides, exchange rate volatility hinders maintaining competitive interest rates on foreign currency deposits and loans in order to affect customer confidence and market positioning.

Finally, respondents to the survey and interview participants alike emphasized regulatory and policy support as central. Many argued that the regulatory climate has fallen behind in keeping pace with the trend toward a floating regime. A dearth of clear guidelines, flexibility in oversight, and particular risk-reduction policies increases the commercial bank's workload. Participants recommended that the National Bank of Ethiopia improve its role in regulating exchange rate impacts, offering hedging products, and building the technical skills of the financial institutions. Without such reforms, Ethiopian commercial banks may continue to be under severe constraint in dealing with the complexity of a floating exchange rate system.

Table 4. 7 Challenges of Floating Exchange Rate (Mean and Standard Deviation)

Challenges	Obs	Mean	Std. Dev.	Min	Max
It is not simple for our bank to manage exchange rate risk under a floating regime.	113	1.74	.741	1	5
Floating exchange rates contribute to the volatility of foreign currency transactions at the expense of our bank profitability.	113	2.33	1.064	1	5
Exchange rate fluctuations make it difficult for our bank to predict future earnings.	113	1.81	.714	1	5
Uncertainty in the movement of exchange rates requires frequent readjustments of our	113	2.24	.938	1	5

Challenges	Obs	Mean	Std. Dev.	Min	Max
bank's strategies, which is an added operating cost.					
Floating exchange rates increase the difficulty of our bank maintaining stable liquidity levels.	113	1.70	.743	1	5
Our bank has difficulty maintaining foreign currency reserves with exchange rate uncertainty.	113	1.45	.534	1	3
Our bank often experiences delays in foreign currency settlements due to exchange rate fluctuations.	113	1.81	.625	1	5
Floating exchange rates complicate the determination of competitive interest rates for foreign currency deposits and foreign currency loans.	113	1.83	.801	1	5
Market-provided hedging instruments are not sufficient or too costly to achieve effective exchange rate risk management.	113	1.73	.630	1	5
Exchange rate fluctuations negatively impact our bank trade financing business.	113	1.81	.718	1	5

Source: Own survey, 2025

Table 4. 8 Challenges of Floating Exchange Rate (frequency)

Challenges	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	Total
It is not simple for our bank to manage exchange rate risk under a floating regime.	43	61	5	3	1	113
Floating exchange rates contribute to the volatility of foreign currency transactions at the expense of our bank profitability.	27	44	22	18	2	113
Exchange rate fluctuations make it difficult for our bank to predict future earnings.	36	66	8	2	1	113
Uncertainty in the movement of exchange rates requires frequent readjustments of our bank's strategies, which is an added operating cost.	26	45	33	7	2	113
Floating exchange rates increase the difficulty of our bank maintaining stable	48	55	7	2	1	113

Challenges	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	Total
liquidity levels.						
Our bank has difficulty maintaining foreign currency reserves with exchange rate uncertainty.	64	47	2	0	0	113
Our bank often experiences delays in foreign currency settlements due to exchange rate fluctuations.	31	76	4	1	1	113
Floating exchange rates complicate the determination of competitive interest rates for foreign currency deposits and foreign currency loans.	39	61	7	5	1	113
Market-provided hedging instruments are not sufficient or too costly to achieve effective exchange rate risk management.	38	71	2	1	1	113
Exchange rate fluctuations negatively impact our bank trade financing business.	37	65	8	2	1	113
Total	**389**	**591**	**98**	**41**	**11**	**1130**

Source: Own survey, 2025

4.6.1 EX Risk Management Difficulty

From statistics provided in Table 4.7 and 4.8, the overwhelming majority of the respondents (91.15%) concurred (53.98%) or strongly concurred (38.05%) that it is not simple for their bank to manage exchange rate risk under a floating regime. A percentage of the participants (4.42%) rather had a neutral answer, while only 2.65% disagreed and an even smaller percentage (0.88%) strongly disagreed with the statement. These figures point to a general agreement by the respondents that exchange rate risk is hard to control in such a monetary environment. The mean score obtained for this item is 1.74, and the standard deviation is 0.741, which points to low variability of responses and strong central tendency toward agreement. Adhering to the rating scale and the interpretation guide, this mean value suggests a generally affirmative perception, validating the claim that exchange rate management is a typical challenge in a floating system. The minimum and maximum scores of 1 and 5, respectively, also confirm that although most

concur on the difficulty, there are a couple of deviant perceptions but statistically insignificant.

This accord implies that the floating exchange rate regime imposes operational and strategic stresses on Ethiopian commercial banks, particularly in terms of managing risks. The challenges of forecasting currency movements, stabilizing foreign currency reserves, and harmonizing financial strategies with unstable market conditions indicate the need for enhanced capacity and regulatory assistance. Therefore, banks can be compelled to adopt more sophisticated risk management systems and seek technical assistance to deal with the complexities of the floating system.

4.6.2 Negative Impact on Profitability from Foreign Currency Volatility

The majority of the respondents (62.85%) either strongly agreed (23.08%) or agreed (38.94%) that floating exchange rates are the cause of volatility in foreign currency transactions that affect their bank's profitability. Approximately a fifth (19.47%) had no opinion, and a minority (15.93%) disagreed, and as few as 1.77% strongly disagreed with the statement. These results disclose that most of the respondents are aware of the adverse effects of the floating exchange rate fluctuations on profitability, although with certain difference of opinion among the players in the industry. The mean rating for this item is found to be 2.33 on a standard deviation of 1.064. Based on the threshold established for the Likert scale, this mean score places the result in "1.8 and 2.6" range, meaning that the majority of participants perceive floating exchange rates as playing a major role in foreign currency transactions' volatility and, consequently, bank profitability. The comparatively large standard deviation indicates considerable variation in responses, that whereas many of the respondents have something in common, there is nevertheless significant divergence as to how banks as a category feel the effects of exchange rate volatility.

With a mean of 2.33, the implication is overwhelmingly that most respondents have a grave concern with exchange rate-induced volatility due to floating exchange rates affecting their bank profitability, as being differently perceived by each bank. Implication, therefore, is that banks can need reevaluation of their foreign exchange risk management strategies, potentially towards adoption of more sophisticated hedging strategies against the negative impact of currency rate fluctuations. In conclusion, even though most of the participants confirm the adverse impact of floating exchange rates on profitability, the extent of concern differs. The findings highlight the

need for more focus on stabilizing foreign currency trades and volatility control, particularly against the backdrop of a more active exchange rate regime.

4.6.3 Earnings Forecasting Challenges

According to the data from Table 4.7 and 4.8, the overwhelming majority of the respondents (91.21%) either agreed (58.41%) or strongly agreed (31.86%) that it becomes difficult for their bank to foresee future revenues with the volatility of exchange rates. Only a very small percentage (7.08%) was neutral, while a very small percentage (2.65%) disagreed and an even smaller fraction (0.88%) strongly disagreed. These results suggest that the majority of respondents concur that the fluctuations in exchange rates represent the most important barrier to having a good earnings forecast. The mean score for this item is 1.81 and the standard deviation is 0.714. Based on Likert scale interpretation, this mean score falls under the "1.8 and 2.6" level, which supports the conclusion that a majority of the respondents do perceive the task of predicting future earnings due to volatility in the exchange rate as an important problem. The quite low standard deviation means that responses are very similar with very minimal respondents giving appreciably diverse views.

From the mean score of 1.81, it is clear that exchange rate volatility is seen as a major threat to future earnings estimation by the majority of respondents. This reflects the need for more effective risk management practices and forecasting models to help reduce the uncertainty arising from volatile exchange rates. In conclusion, the survey showed decisively that exchange rate volatility ranks among the most significant problems compromising accurate earnings forecasts for Ethiopian commercial banks. With such concurrence being overwhelming, it is important for banks to enhance their skill to navigate currency risk and apply more effective forecasting methods to address the volatile exchange rate environment.

4.6.4 Strategy Readjustment Costs

A large proportion of the respondents (62.85%) either agreed (39.82%) or strongly agreed (23.01%) that exchange rate uncertainty requires constant readjustments of their bank's strategies, which leads to extra operating costs. A large proportion (29.20%) was indifferent to this problem, while a smaller proportion (6.19%) disagreed, and an extremely small proportion (1.77%) strongly disagreed. These results show that most of the respondents recognize the expense of operations that are involved in the re-adjustments of strategy due to uncertainty of exchange rates. The mean

rating on this item is 2.24, and the standard deviation is 0.938. Based on the interpretation of the Likert scale, this mean rating falls in the "High" category, and therefore most of the participants mark uncertainty of exchange rates as a critical issue that necessitates constant strategic adjustments. The standard deviation reflects a certain level of variation in responses, with some of the respondents showing less concern or opposition to this issue.

Given the mean response value of 2.24, one can notice that most of the respondents consider frequent changes in strategy as a serious added cost for their banks. This implies that volatility in exchange rates has a serious impact on the operational efficiency of banks, adding cost by way of the need for continuous adaptation to changing market trends. In conclusion, the survey results indicate that volatility in the movement of exchange rates is a great challenge for Ethiopian commercial banks and requires incessant readjustments in strategy that add to operational costs. Given the sense of urgency in this challenge, it would be imperative that banks consider options for stabilizing their approaches and reducing the need for repetitive revisions, perhaps with better forecasting and risk management policies.

4.6.5 Liquidity Stability Issues

According to the data in Table 4.7 and 4.8, the overwhelming majority of the respondents (91.15%) agreed that floating exchange rates make it more difficult for their bank to maintain stable levels of liquidity by agreeing (48.67%) or strongly agreeing (42.48%). Only 6.19% remained open-minded about the matter, and a still smaller proportion (2.65%) disagreed, and even fewer (0.88%) strongly disagreed. These results indicate that most of the respondents recognize the challenge of liquidity stability under floating exchange rates. The mean value for this item is 1.70 and has a standard deviation of 0.743. As per the Likert scale interpretation, the mean of this question falls under the "Very High" category and thus the majority of the participants have it in mind that this problem is a very big issue. Standard deviation reveals quite low variability in answer, which suggests widespread agreement among the respondents in relation to how difficult it is to have stable liquidity with floating exchange rates.

As the mean response of 1.70 shows that a majority of respondents consider it highly challenging to guarantee liquidity stability amid volatile exchange rates, it automatically follows that the problem must force banks to implement more sophisticated techniques of liquidity management

to deal with the risks involved in exchange rate volatility. In short, the results of the survey decisively point out that floating exchange rates create a great challenge to Ethiopian commercial banks in maintaining stable levels of liquidity. Since the problem is commonly known, the banks should enhance their liquidity management systems, perhaps by enhanced forecasting, hedging strategies, and more flexible operating plans to control exchange rate changes.

4.6.6 Foreign Currency Reserve Management Difficulty

From the information presented in Table 4.7 and 4.8, an overwhelming majority of the respondents (98.23%) either agreed (41.59%) or strongly agreed (56.64%) that it is difficult for their bank to maintain foreign currency reserves when there is uncertainty with regard to exchange rates. A small proportion (1.77%) was neutral, and no one disagreed or strongly disagreed with the statement. This suggests a definite consensus among the respondents that exchange rate volatility is a serious issue to foreign exchange reserve management. The mean response score is 1.45 with a standard deviation of 0.534. Using the Likert scale cut-offs, this mean is within the "Very High" range, indicating that the majority of respondents consider the difficulties in having such reserves under exchange rate uncertainty to be a very great problem. The low standard deviation further suggests that the answers converged very close to the mean, further demonstrating the level of consensus regarding this problem.

In light of the mean of 1.45, one can see that the majority of banks face enormous challenges in holding foreign currency reserves amidst fluctuating exchange rates. Such an issue would likely contribute to increasing operating risks and call for additional actions to be in a position to effectively deal with reserve levels amidst uncertainty. In conclusion, the survey results clearly indicate the problem of Ethiopian commercial banks in managing foreign currency reserves due to exchange rate volatility. The problem is an indication of the need for improved risk management practices, such as more dynamic reserve management methods and more advanced forecasting methods, to mitigate the negative impact of exchange rate volatility on foreign currency reserves.

4.6.7 Settlement Delays due to Exchange Fluctuations

According to the information given in Table 4.7 and 4.8, an extremely high proportion of respondents (94.69%) agreed (67.26%) or strongly agreed (27.43%) that their bank often experiences foreign currency settlement delays due to exchange rate volatility. Very few (3.54%)

were neutral, and only a negligible proportion (1.77%) disagreed and an even smaller proportion (0.88%) strongly disagreed with the statement. This is truly manifest in the fact that the majority of the respondents confess that foreign currency settlement delays are a common feature, which is highly related to exchange rate movements. The mean score for the answer is 1.81 with a standard deviation of 0.625. From the threshold points of the Likert scale, the mean score derived falls in the range "High," which means that the majority of the respondents perceive such delays as serious issues, but not very overwhelming. The comparatively low standard deviation shows that the answers are quite uniform, with the majority of respondents having a similar view of the challenge.

These results describe a problem that has been faced by Ethiopian commercial banks in dealing with the settlement of foreign currency in the context of unstable exchange rates. Delayed settlement would impact the efficiency of operations of the bank and may generate additional operating costs. The level of agreement among respondents, being high, suggests this is an everyday problem for banks. In general, the survey findings point out a matter of serious concern for banks to cope with foreign exchange settlement arising from exchange rate fluctuations. Such an issue may call for improved risk management tools, such as more accurate forecasting and enhanced cooperation with international counterparties, to restrict delays and their impact on banking operations.

4.6.8 Interest Rate Pricing Challenges

According to the evidence presented in Table 4.7 and 4.8, the overwhelming majority of respondents (88.50%) were in strong agreement (34.51%) or agreement (53.98%) that floating exchange rates make it hard to obtain competitive interest rates for foreign currency deposits and foreign currency loans. A minority (6.19%) were in the middle, and only a small percentage (4.42%) disagreed and an even smaller percentage (0.88%) strongly disagreed with this assertion. This captures a general consensus by the respondents that exchange rate volatility is a significant challenge in determining competitive interest rates for foreign currency-linked financial products. The mean response score is 1.83, and the standard deviation is 0.801. Based on the Likert scale's thresholds, this mean response falls in the "High" category and could suggest that the participants perceive this challenge as of significant concern but not overwhelming. The standard deviation indicates that although the majority of participants concur, there is some variation from the strength of their agreement and some responses indicating less concern about this being a problem.

This result puts into question the complexity brought about by floating exchange rates into the foreign currency deposit and loan interest rate-setting. Exchange rate movement uncertainty can bring about complexity in setting competitive rates because exchange rate volatility can directly affect the foreign currency banking products' cost and return. The complexities can negatively affect the bank's foreign exchange business profitability and stability. In conclusion, the survey results show that floating exchange rates present a major challenge to Ethiopian banks to be competitive in offering interest rates on foreign currency deposits and loans. This may require improved risk management tools and methods to deal with exchange rate volatility so that banks remain competitive in the foreign currency market as well as protect their margins.

4.6.9 Inadequate Hedging Instruments

According to the data provided in Table 4.7 and 4.8, a high proportion of the participants (96.90%) either strongly agreed (33.63%) or agreed (62.83%) that hedging tools offered by the market are insufficient or too costly to achieve efficient exchange rate risk management. Only 1.77% of the participants were neutral, while another 1.77% disagreed or strongly disagreed with the statement, and this is a negligible level of disagreement. The mean of the answers is calculated as 1.73 with a standard deviation of 0.63. This mean, by the previously agreed Likert scale interpretation cut-offs, would be in the "Very High" range. This clearly indicates that the respondents overwhelmingly consider the unavailability or exorbitant price of hedging instruments as a critical threat to managing exchange rate risk.

This finding indicates that there is a critical gap in the domestic financial market to offer low-cost, effective, and affordable hedging instruments. Lack of effective or affordable instruments to hedge currency risk may expose banks to excessive volatility that can affect profitability as well as the soundness of banks. Overall, the findings indicate a universal consensus among the respondents that the prevailing market-based hedging instruments are weak or overly expensive. This requires policy attention, aimed at increasing the availability, efficiency, and affordability of exchange rate risk management instruments in order to increase banking sector resilience.

4.6.10 Adverse Impact on Trade Finance

Based on the information presented in the table, an overwhelming percentage of the respondents (90.26%) agreed (57.52%) or strongly agreed (32.74%) that movements in exchange rates

negatively impact their bank's trade finance business. Just 7.08% of the participants were neutral, while a minimal percentage (2.65%) disagreed (1.77%) or strongly disagreed (0.88%) with the statement. The calculated mean score of 1.81 and standard deviation of 0.718 indicate that the overall attitude is in the "High" category according to the established Likert scale cut-offs. Although only slightly above the cut-off point for the "Very High" category, the result still illustrates a high and consistent consensus among respondents of the disruptive effect of exchange rate volatility on trade financing activities.

This means that changes in currency value are a real threat to banks that participate in trade financing, in a way that can affect costs of transactions, repayment, and overall financial stability. It also means that banks risk foreign exchange loss or inefficiency when they conduct international trade. In conclusion, the evidence shows that there is a great concern among members in financial institutions that exchange rate fluctuations are an actual challenge to trade finance activities. This indicates a need for better foreign exchange risk management processes and policy intervention to offset such adverse effects.

4.7 The role of Floating EX in enhancing the competitiveness of Ethiopian commercial banking sector

The question was posed to the respondents if they believe there are opportunities under a floating exchange rate regime to enhance the competitiveness of Ethiopia's commercial banking sector. As shown in Figure 4.2, the majority of the respondents (63.72%) believe that the opportunities are available under a floating exchange rate regime to enhance the competitiveness of Ethiopia's commercial banking sector. What this implies is that the majority see the installation of a floating exchange rate as means of stimulating growth, increasing efficiency in local banks, stimulating market-based pricing, and bringing more competitiveness to the international financial market.

Conversely, 36.28% of the respondents don't perceive such possibilities, and this is meant to imply that part of the population feels that a floating exchange rate will not necessarily make the sector more competitive or even might have impediments to growth.

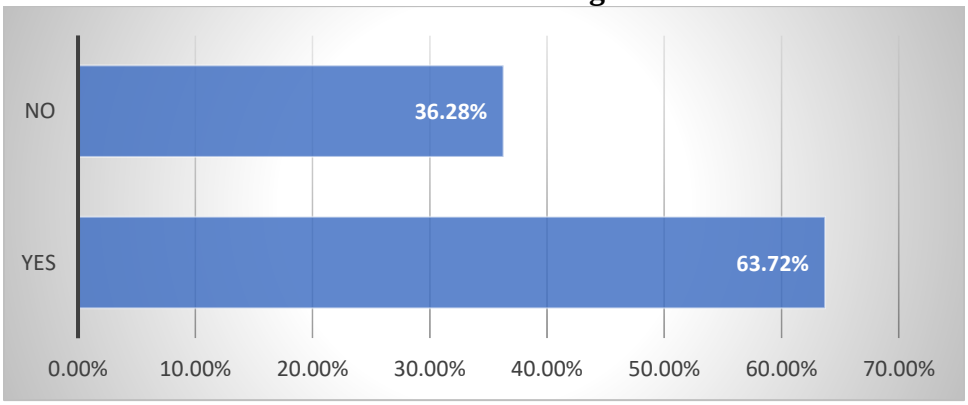
In conclusion, while the majority of the respondents are optimistic about the potential impact of a floating exchange rate on enhancing competitiveness, there are still a considerable number who

are negative towards its contribution to the positive development of Ethiopia's commercial banking industry.

Consistently, empirical data based on both quantitative information and qualitative interviews highlight that the floating exchange rate plays a very crucial role in enhancing the competitiveness of the Ethiopian commercial banking sector. By allowing market forces to determine the value of the local currency, floating exchange rates expose banks to a more dynamic and volatile financial environment. This forces banks to enhance their operational efficiency, design sophisticated foreign exchange risk management solutions, and invest in real-time financial technology. These assist not just in mitigating risks but also stimulate innovation toward the design of diversified financial products and services, particularly trade finance and remittance businesses.

Furthermore, the adoption of a floating exchange rate system will cause Ethiopian banks to move towards best global practices. It will force them to organize their treasury function in a better way, improve foreign exchange transaction capacity, and price foreign currency-denominated products competitively. As banks fight in terms of delivering superior services and hedging currency risks more effectively, the sector as a whole becomes more resilient and attractive. It may attract foreign capital, enhance customer confidence, and encourage stronger integration of the financial sector of Ethiopia with the global community, ultimately leading to national banking industry growth and modernization.

Figure 4. 2 The role of Floating EX in enhancing the competitiveness of Ethiopian commercial banking sector



Source: Own survey, 2025

4.8 Benefits of Floating exchange rate

The survey results indicated that imposition of a floating exchange rate regime in the commercial banks of Ethiopia has great scope for enhancing financial performance and stability. Some of the key advantages found were greater pricing flexibility, improved responsiveness to market conditions, and improved capability to allocate foreign exchange funds in an efficient manner. Respondents also acknowledged that floating rates enable banks to deal more effectively with supply and demand situations of the currency market and allow for clearer and more competitive determination of exchange rates. This will enable artificial distortions of currency valuation to be minimized as well as maintain a fairer and more responsive financial system.

Similarly, insights from interviews with banking professionals and directors emphasized that floating exchange rates would prompt domestic banks to develop more effective risk management systems and to expand their foreign currency business. Being able to hedge against fluctuations in exchange rates, diversify currency pools, and respond immediately to developments abroad were considered imperative steps toward modernization. Moreover, floating exchange rates would encourage deeper financial market integration with global financial markets, foreign direct investment, and financial innovation in bank products tailored to international trade and cross-border payments. Consequently, this exchange rate regime is not only regarded as a macroeconomic tool but also as a structural change driver of Ethiopia's commercial banking sector.

Table 4. 9 Benefits of Floating Exchange Rate

Benefits	Mean	Std. Dev	Min	Max	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	Total
The ability to adjust exchange rates freely enables our bank to offer better services to international clients.	2.01	.773	1	5	28	60	22	2	1	113
The floating exchange rate system creates opportunities for higher profits through currency trading and arbitrage.	2.63	.847	1	4	8	45	41	19	0	113

Benefits	Mean	Std. Dev	Min	Max	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	Total
Foreign exchange operations contribute significantly to our bank's overall revenue under a floating exchange rate system.	2.26	.933	1	4	26	44	31	12	0	113
The floating exchange rate system allows our bank to diversify their risk exposure across multiple currencies.	2.65	1.059	1	5	14	39	40	12	8	113
A floating exchange rate regime improves the efficiency of currency conversion services provided by our bank.	1.82	.735	1	4	40	55	16	2	0	113
Exchange rate fluctuations provide opportunities for our bank to expand into new markets.	2.11	.849	1	5	28	51	29	4	1	113
The flexibility in exchange rates reduces the risk of currency crises that could impact our bank.	2.17	.718	1	5	19	58	34	2	0	113
Our bank has improved its ability to adjust to global economic changes due to a floating exchange rate system.	2.16	.774	1	5	19	63	26	4	1	113
Our bank benefits from the ability to adjust pricing strategies based on real-time exchange rate movements.	2.19	.689	1	4	16	62	33	2	0	113

Source: Own survey, 2025

4.8.1 International Client Services Improvement

From the above statistics, a vast majority (77.88%) of the respondents either agreed (53.10%) or strongly agreed (24.78%) that their bank can better serve foreign customers with the freedom to

set exchange rates. 19.47% were indifferent, while only a few (1.77%) disagreed and an infinitesimal 0.88% strongly disagreed with the above statement. The mean response was recorded at 2.01 with a deviation of 0.773, indicating reasonably close consensus among the participants with rather moderate difference in responses.

Following the standardized Likert scale interpretation, the mean score of 2.01 is categorized in the "High" agreement category (1.8 – 2.6). This indicates that the majority of banking professionals value flexible exchange rate mechanisms for maximizing international service delivery. The provision of dynamically varying rates is, however, perceived as an influential factor in addressing cross-border financial customers better. This comment accentuates the operating advantage of a floating exchange rate system to the competitiveness, responsiveness, and satisfaction of customers within Ethiopia's commercial banking industry.

4.8.2 Profit Opportunities from Currency Trading

According to the provided statistics, 46.90% of the respondents consented (39.82%) or strongly consented (7.08%) that the system of floating exchange rate provides greater possibilities for profit through currency arbitrage and trading. A very large 36.28% of the respondents were not sure, reflecting hesitations or uncertain results of such a benefit. Another 16.81% of the respondents did not consent but to an extent of disagreement rather than a strong disagreement. The mean calculated value is 2.63 with a standard deviation of 0.847.

The mean score of 2.63 falls under the "Neutral" category (2.6 – 3.4) in accordance with the given Likert scale interpretation, and that implies that respondents neither strongly embraced nor rejected the profitability of floating exchange rate mechanisms based on trading and arbitrage, on average. Though nearly half of them saw the opportunity, the large proportion of neutral and disagreeing responses suggest that banks may be constrained by regulatory obligations, market inefficiencies, or inability to undertake such opportunities on a regular basis. Thus, the results suggest a moderate and conservative approach towards profit generation based on exchange rate volatility in the commercial banking industry of Ethiopia.

4.8.3 Revenue Contribution from FX Operations

A substantial majority of respondents (61.95%) agreed that foreign exchange operations constitute

a major portion of the overall income of their bank in a floating exchange rate regime, while 38.94% agreed and 23.01% strongly agreed. Conversely, 27.43% of the participants were in the middle ground such that they neither agreed nor disagreed. A lesser percentage (10.62%) disagreed, and no respondent disagreed strongly. The mean score of this item is determined at 2.26 and the standard deviation is 0.933.

According to the traditional Likert scale interpretation, the mean of 2.26 falls under the "High" category (1.8–2.6), which suggests that the majority of respondents perceive foreign exchange operations as a major source of banking revenue in a floating exchange rate system. The relatively wide standard deviation suggests some difference of opinion, perhaps arising from differences in institutional ability, market interaction, or experience in forex business. Overall, the findings are consistent with a broad but not necessarily universal interpretation of the cost savings derived from currency operations in the context of liberalized exchange rate regime.

4.8.4 Risk Diversification across Currencies

A substantial proportion of the respondents (46.90%) agreed (34.51%) or strongly agreed (12.39%) that the floating exchange rate system enables their bank to diversify exposure to risk through the use of several currencies. However, nearly as high a proportion (35.40%) was not sure, reflecting some degree of ambiguity or mixed experience with this benefit. Conversely, a lesser but still considerable proportion of survey respondents disagreed (10.62%) or strongly disagreed (7.08%) with the statement.

The estimated data mean is 2.65 with the standard deviation of 1.059. This mean, according to the pre-established Likert scale interpretation, is in the "Neutral" category (2.6–3.4). This indicates that, as a group, the respondents neither agreed nor disagreed strongly with the perceived advantage of risk diversification under a floating exchange rate system. The fairly high standard deviation also indicates substantial difference of opinion, maybe a result of the disparity in the foreign exchange market exposure of banks or their business ability to succeed in currency risk management.

4.8.5 Currency Conversion Efficiency

The majority (84.96%) of the respondents also had a positive view on how a regime of a floating

exchange rate would impact the effectiveness of the foreign currency conversion service of their bank. 48.67% completely agreed and 35.40% strongly agreed with it. Only 14.16% were in the middle, and barely any of them (1.76%) disagreed and not a single person strongly disagreed.

The mean value of 1.82, with a standard deviation of 0.735, falls in the "High" category according to the established Likert scale breakpoints (1.8–2.6). This indicates a very positive attitude towards the role of floating exchange rates in enhancing currency conversion efficiency. The low standard deviation shows that most participants share the same view, highlighting the consensus that exchange rate flexibility results in more efficient and competitive currency exchange services. The trend reflects an overall positive view regarding the benefit of a floating exchange rate system in banking operation.

4.8.6 Market Expansion through EX Fluctuations

The vast majority of respondents (70.8%) agreed (45.1%) or strongly agreed (25.7%) that exchange rate movements provide opportunities for their bank to penetrate new markets. Only a modest percentage (25.7%) were neutral, and an extremely low percentage (4.4%) disagreed and an ineffectual fraction (0.9%) strongly disagreed with the statement.

The mean of 2.11, with a standard deviation of 0.849, is in the "High" category based on the Likert scale (1.8–2.6). This indicates that the majority of respondents believe that exchange rate volatility creates good prospects for market expansion. The relatively low standard deviation suggests that the responses were grouped closely around the mean, reflecting a shared opinion among participants. Overall, the results highlight that exchange rate volatility is considered as a potential chance for growth and expansion, particularly in emerging market frontiers.

4.8.7 Reduction of Currency Crises Risk

An extremely high proportion of the respondents (68.1%) agreed (51.3%) or strongly agreed (16.8%) that the exchange rate flexibility reduces the risk of currency crises that can impinge upon their bank. Extremely low proportions (16.8%) were neutral, extremely low proportions (1.8%) disagreed, and no respondents strongly disagreed.

The mean value of 2.17 with a standard deviation of 0.718 falls below the "High" grade as per the Likert scale (1.8–2.6). This indicates that most of the respondents are of the view that exchange

rate flexibility plays a significant part in averting currency crisis risks. The relatively low standard deviation indicates that there is general consensus among the respondents on the issue. Generally speaking, these findings describe the good outlook that exchange rate flexibility affords with a buffer against potential currency crises and ensuring the bank's stability when such an event occurs.

4.8.8 Global Economic Changes Adaptability

Most (72.6%) respondents agreed (55.8%) or strongly agreed (16.8%) that their bank's ability to keep pace with international economic trends has been enhanced by a system of floating exchange rate. A very small percentage (23.9%) was neutral, a very small percentage (4.4%) disagreed, and a very small percentage (0.9%) strongly disagreed with the statement.

The mean is 2.16, and the standard deviation of 0.774 that falls in the "High" band (1.8–2.6) of the Likert scale. This means that most of the respondents would concur that the floating exchange rate regime would facilitate their bank's response to a shift in the world economy. The fact that the standard deviation is low means that views on this are tightly grouped with a high agreement level among the respondents. Therefore, the results indicate the perceived positive contribution of the floating exchange rate regime in rendering the bank quick and responsive to change in the world economies.

4.8.9 Dynamic Pricing Strategy Benefits

A significant proportion of respondents (69.9%) agreed (54.87%) or strongly agreed (15.93%) that the bank is improved with real-time exchange movement to base changing pricing strategy on. Fewer (29.2%) were neutral regarding this, and a small minority percentage (1.8%) disagreed with it. No topics strongly disagreed.

The mean score at 2.19, on a standard deviation of 0.689, places the observation in the exceedingly "High" range of 1.8–2.6 on the Likert scale. This indicates a general favorable view of the bank's ability to adjust its pricing model relative to real-time movement of exchange rates. The relatively low standard deviation suggests that most respondents have a similar view regarding the benefit, bearing witness to a consensus regarding the usefulness of this competence in terms of enhancing the operating flexibility of the bank. Therefore, it is possible to assume that respondents are confident about this factor being highly beneficial for the competitiveness and market

responsiveness of the bank.

4.9 Perceived Impact of Exchange Rate Fluctuations on Customer Behavior in the Banking Sector

Respondents were asked to assess the influence of a floating exchange rate on customer behavior within the banking sector. As can be seen in Figure 4.3, a vast majority of respondents (87.61%) believe that movements in exchange rates have a strong influence on customer behavior. This implies that exchange rate changes are likely to affect customers' financial decisions, including savings, foreign currency transactions, remittances, and investment activities.

On the contrary, only 12.39% of respondents do not see exchange rate movement as having a significant impact on customers' behavior. This indicates that a minority of respondents think that the impact is negligible or customers are less responsive to exchange rate movement.

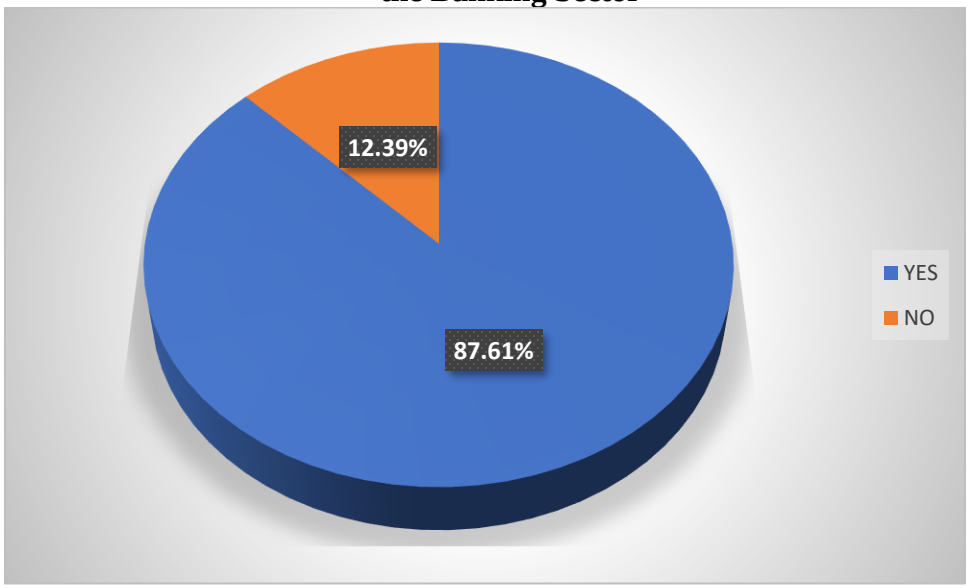
It was disclosed by the bank executives and department heads during the interview that shifts in exchange rates have a significant impact on customer behavior, especially when they are discussing foreign currency, deposits, and credits. Everyone agreed that customers usually place a higher amount of money into their foreign currency accounts in the situation of an uptrend or if the exchange rates are volatile, this way they can be sure that their money will be secure. Furthermore, these days the transaction volume of currency exchange has also increased, as customers are seeking to take advantage of the situation by swapping for the best rates and also for the convenience of international trade. Conversely, the extreme rates, which are also inconsistent, make people become extra cautious respondents, etc. This can result in loan requests being inconsistent as borrowers are concerned about any repayment discontinuities associated with currency risks.

It was also the opinion of the interviewees that the fluctuation of exchange rates too much is the one which will most likely lose the customers' trust in the banking industry. There exists a possibility that the abrupt changes can create some worries among the public which, as a result, will influence the hesitancy of some of them in asking for loans or engaging in transactions. This kind of ambiguity does not match with the long-term financial plans of the customers and therefore, they start to question the feasibility of using foreign currency. The banks, instead of following the

pattern blindly, noticed that it is better to have a two-way channel and some tools of making customers aware of possible exchange rate risks. Additionally, this can also contribute to the rebuilding of trust and hence more regular foreign currency product usage, even in a situation of instability.

In summary, the study reveals that exchange rate volatility plays a major role in shaping customer behavior within the Ethiopian banking sector. This emphasizes the importance of banks to closely monitor exchange rate movements and align their strategies to be able to respond more effectively to customers in a volatile currency market.

Figure 4. 3 Perceived Impact of Exchange Rate Fluctuations on Customer Behavior in the Banking Sector



Source: Own survey, 2025

Table 4. 10 Impact of EX Fluctuations on Loan Demand, Deposit Base and FX Transactions

Impact on customer behavior	Mean	Std. Dev	Min	Max	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	Total
Our bank's foreign currency deposit base is influenced by changes in exchange rates.	1.79	.687	1	3	41	55	17	0	0	113
Foreign exchange transactions with our customers have	1.82	.684	1	4	36	63	12	2	0	113

Impact on customer behavior	Mean	Std. Dev	Min	Max	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	Total
increased due to exchange rate flexibility.										
Loan demand has been influenced significantly by the fluctuations in the exchange rate.	1.94	.711	1	4	31	59	22	1	0	113

Source: Own survey, 2025

4.9.1 Foreign Currency Deposit Base Sensitivity to EX fluctuations

Most of the respondents (84.96%) concurred (48.67%) or strongly concurred (36.28%) that their bank's foreign currency deposit base is sensitive to exchange rate movements. There was a smaller subgroup (15.04%) that was neutral, and no responses were received where the participant disagreed or strongly disagreed with the statement. The mean of 1.79, with a standard deviation of 0.687, falls in the "Very High" range (1.0–1.8) as per the Likert scale interpretation. This indicates a highly positive perception by the respondents regarding the sensitivity of foreign currency deposits to exchange rate changes.

The low standard deviation also reflects high consensus among the participants. Hence, it can be inferred that exchange rate volatility is a vital determinant of customer behavior—foreign currency deposit choice—highlighting the importance of effective currency risk management and best pricing by the bank.

4.9.2 Growth in FX Transactions due to Rate Flexibility

An overwhelming majority of the respondents (87.61%) concurred (55.75%) or strongly concurred (31.86%) that customers' foreign exchange transactions increased due to exchange rate flexibility. A minority segment (10.62%) remained neutral, while only a infinitesimal segment (1.77%) did not concur, and no strongly dissenting opinions were expressed. The mean score of 1.82 with the standard deviation of 0.684 is in the category of "High" as per the interpretation of the Likert scale. This implies an overall positive perspective of the impact of exchange rate flexibility on volume of customer transactions.

As regards the low mean and narrow dispersion, it is apparent that the majority of the respondents

see that exchange rate flexibility has influenced customer behavior greatly positively, leading to increased foreign exchange transactions. This means more market-based and flexible exchange rate systems could lead to more customer participation in FX transactions, and this would be opportunities and challenges for the treasury and risk management functions of the bank.

4.9.3 Loan Demand Sensitivity to EX fluctuations

The majority of respondents (79.65%) either agreed (52.21%) or strongly agreed (27.43%) that the demand for loans has been significantly impacted by the exchange rate movement. In contrast, 19.47% of the respondents were neutral, while a paltry 0.88% disagreed and no one strongly disagreed with the statement. The mean score of 1.94, along with the standard deviation of 0.711, falls in the "High" category based on the Likert scale cut-off. This represents a general consensus among respondents acknowledging the effect of exchange rate fluctuations on loan demand.

This feedback is indicative of exchange rate volatility significantly influencing customer borrowing behavior. The movement in rates is likely to influence the risk and cost perceptions of borrowing, particularly for loans linked to foreign currency or relating to imports-exports. Thus, banks are required to observe exchange trends and adjust lending processes to manage inherent risks while maintaining responsiveness to the needs of their customers.

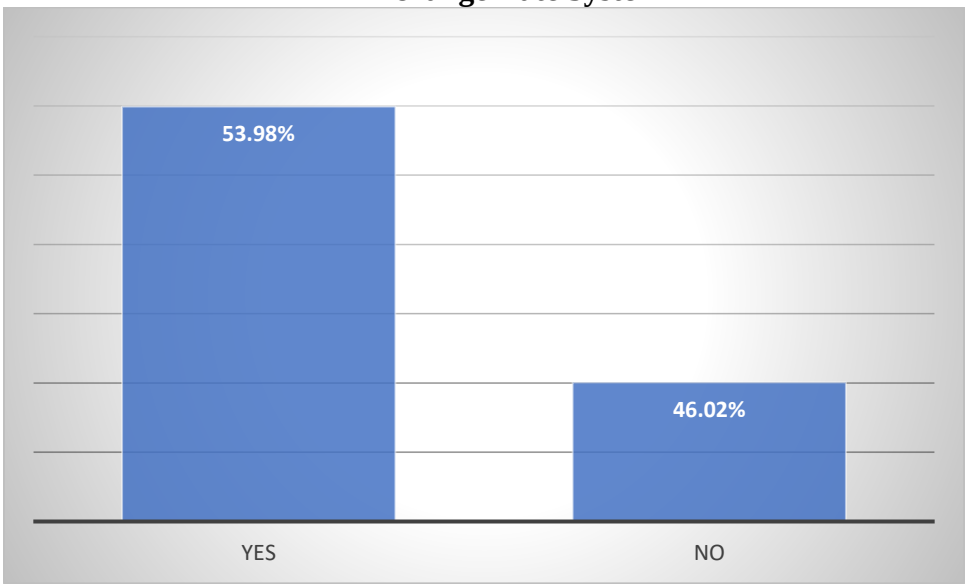
4.10 Perceptions of Regulatory Support for Ethiopian Banks Under a Floating Exchange Rate System

The survey sought to evaluate whether the existing regulatory regime is capable enough to facilitate Ethiopian commercial banks in adapting to a floating exchange rate system. According to Figure 4.4, respondents are of the view that the existing regulatory system facilitates banks sufficiently in adapting to the challenges and forces of a floating exchange rate system by 53.98%. This means that over half of the respondents believe in the efficiency of regulatory bodies and policies to guarantee a smooth transition.

However, a large percentage of respondents (46.02%) expressed the opposite view that they do not believe the regulatory environment is supportive enough. This wide divergence identifies potential concerns or perceived deficiencies in regulatory measures, enforcement, or responsiveness to banks' needs in operating a more uncertain exchange rate regime.

In conclusion, while there is a reasonable level of confidence in the regulatory framework, the nearly even split of responses points to the need for further strengthening and reforming of the regulatory framework to see to it that all commercial banks are sufficiently supported in adapting to the floating exchange rate regime.

Figure 4. 4 Perceptions of Regulatory Support for Ethiopian Banks Under a Floating Exchange Rate System



Source: Own survey, 2025

Data from the interviews with senior commercial bank officials showed that the regulatory environment was effective in aiding the transition to the floating Exchange rate system, but some banks had reservations. They were of the belief that although the NBE had supported them with more updated risk management guidelines, more engagement in the supervision process, and also aiming liquidity at the needy, the support was still at its primary stage of evolvement. A few bank leaders stated that in most cases, while the regulatory structures were actually available, they were just after-the-event instead of before-the-event measures hence resulting into reoccurrence of the foreign exchange risk during periods of volatility. Also, the interviewees made it clear that the banking regulations that have been put up clearly do not allow commercial banks to be competitive in the new liberalized FX market. They emphasized that the set procedures are so stringent and also the late adaptation of changes in the exchange rate have also been a limitation in banks to exploit market opportunities. At the same time, the executives pointed out that although the NBE has taken some steps in the introduction of some measures such as the market-based rate-setting

and the improvement in reporting requirements, these efforts have to be backed by the flexibility on the side of regulators and also the strengthening of institutional capacity. There was a unanimous view that for the floating exchange rate system, not only the old one but also a new dynamic, transparent, and the new regulatory, consultative approach was needed for building the strength and competitiveness of the system.

On the other hand, frequent interviews with NBE Directorates underscore that the recent changeover to a floating exchange rate system is a radical deviation from the monetary policy setup in Ethiopia. Since central bank officials contend, the reform has added the flexibility and responsiveness of monetary policy instruments so that the National Bank of Ethiopia (NBE) can respond more adequately to inflationary pressures and bring domestic economic fundamentals in sync with the outside world. They noted that the float regime has helped to enable the central bank's capacity for absorbing external shocks, especially by allowing the exchange rate to move freely without consuming foreign reserves. Nevertheless, they noted that the transition has brought in new intricacies of having to align market expectations and maintain monetary stability.

On the challenge front, NBE officials admitted that commercial banks have faced heightened risk due to the sharp volatility in exchange rates, especially on fronts involving foreign currency exposures, trade finance, and asset pricing. In an attempt to offset such risks, the central bank has strengthened its supervisory strength, increased liaison with financial institutions, and conducted targeted liquidity provision when necessary. The guidelines on risk management have also been updated in an attempt to allow banks to enhance their shields against currency mismatches.

Regulatory frameworks, on the other hand, include the NBE having initiated multiple reforms to calm the foreign exchange market. This includes the enhanced FX reporting obligations, enhanced monitoring of compliance, and a more market-based rate-setting process of the exchange. Executive managers were able to ascertain that these were part of an overall policy shift towards creating a robust and transparent foreign exchange market pivotal in maintaining macro-financial stability.

Finally, the NBE believes there are diverse opportunities under the floating exchange rate system. Its view is that it can catalyze the development of a more liquid, competitive foreign exchange market and as a result attract more foreign direct investment and mobilize remittances. It also

views this as a key step towards further deepening the financial sector, where enhanced price discovery and risk-adjusted returns would be able to spur innovation in financial products as well as enhance access to finance. Generally, directors and managers expressed cautious optimism, emphasizing the need for strong institutional coordination, sustained capacity building, and gradual implementation to ensure the success of the reform.

4.11 Regulatory Support and Flexibility in Managing EX Risk

Table 4. 11 Role of the Regulatory Environment under Floating Exchange Rate

Role of the regulatory environment	Mean	Std. Dev	Min	Max	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	Total
Our bank receives adequate support from the regulatory authorities for managing exchange rate risk.	2.34	.972	1	5	26	41	33	12	1	113
Regulatory policies facilitate our bank's competitive positioning under a floating exchange rate.	2.81	.996	1	5	8	42	28	33	2	113
The regulatory environment is flexible enough to adapt to frequent exchange rate changes.	2.94	1.038	1	5	8	32	40	25	8	113

Source: Own survey, 2025

4.11.1 Regulatory Support for EX Risk Management

A large majority of the respondents (59.29%) disagreed (36.28%) or strongly disagreed (23.01%) that their bank is well-supported by the regulatory institutions in managing exchange rate risk. In addition, 29.20% were neutral in their answer, and 11.50% expressed dissatisfaction—10.62% disagreed, and 0.88% strongly disagreed. The mean score of 2.34 and standard deviation of 0.972 is in the "High" category of the Likert scale. This indicates overall positive sentiment by respondents towards regulatory support their institutions get in controlling exchange rate risk.

Nevertheless, the relatively larger standard deviation and high neutral share reflect heterogeneity of experiences and room for improvement in regulatory interventions. Reinforcement of institutional coordination, improvement in policy clarity, and guidance in a timely manner may build further confidence in regulatory frameworks.

4.11.2 Impact of Regulatory Policies on Competitive Positioning

The majority (44.25%) agreed (37.17%) or strongly agreed (7.08%) that regulation allows operation of a floating exchange rate by their bank. However, a large majority (30.97%) disagreed, and a majority (24.78%) were neutral, disagreeing by 29.20% and strongly disagreeing by 1.77%. The mean of 2.81 and standard deviation of 0.996 placed responses in the "Neutral" category according to the Likert scale interpretation. This signifies an ambivalent attitude among respondents while a majority perceive an overall conducive regulatory environment, a considerable minority does not.

The high standard deviation communicates variability of perception, which could be a function of variability of policy application, diversity of institutional capacity, or ambiguity of regulatory guidelines. Whereas support by regulation is known to a certain extent, the conclusions are that greater clarity, consistency, and engagement on behalf of regulatory authorities are needed for enhancing banks' competitive standing within a floating exchange rate regime.

4.11.3 Flexibility of Regulatory Environment to Exchange Rate Changes

There was a fairly consistent agreement on whether or not the regulation is adaptive enough for frequent movements of exchange rates. More specifically, 35.40% agreed (28.32%) or strongly agreed (7.08%), and an identical number were doubtful—30.97% disagreed and 7.08% strongly disagreed. A further 35.40% were uncertain, with strong ambiguity or diversified experience within institutions. The mean score of 2.94 places the result firmly within the “Neutral” band using Likert scale cut points, and a standard deviation of 1.038 illustrates a broad dispersal of opinion among respondents.

This evidence captures a snapshot which, although a majority of respondents see a similar flexibility with regulation, a substantial number either are uncertain about it or are doubtful. Such a spread would be an indicator of non-homogenous application of policy, disparate interpretation

of regulation provisions, or variations of flexibility by sectors. With such findings, it is certain that greater transparency, communication, and responsiveness by regulation authorities would be needed so that confidence would be generated and see that the framework is adequately adaptive so that it would react favorably with regard to ongoing exchange rate uncertainty.

Chapter Five

Summary, Conclusion and Recommendation

5.1 Summary of major findings

The research findings provide an in-depth evaluation of how the shift to a floating exchange rate system has impacted the Ethiopian commercial banking sector, both positively and negatively. The majority of the respondents were men, aged between 35 and 55 years, and in terms of representation, represent a mature and experienced working age within the bank. The majority of respondents were in high-level positions such as executive managers and department directors, and most of them had a master's degree, which means that the information gathered reflects well-educated opinions from experienced experts. From a learning background point of view, most respondents had substantial experience in management for less than ten years, but a very substantial proportion had more than ten years of experience in banking, particularly executive managers, so their views on exchange rate regime change are irrevocably connected to both strategic and operational experience.

The first key finding is the very high level of perception among banking experts that the floating exchange rate system poses serious challenges to the industry. The biggest share (more than 85% of the respondents) holds the view that the floating exchange rate system has posed significant challenges, especially with regard to exchange rate risk management, stable liquidity and foreign currency reserve management, and maintaining stable profitability. Such issues have been most prominently observed in operations like foreign exchange transactions, planning strategies, liquidity management, and ability to predict earnings, all of which form the cornerstone of sustained banking performance. In addition, exchange rate volatility was also found to delay settlements in foreign currency, prevent the competitive pricing of foreign currency loans and deposits, as well as have a negative impact on trade finance operations. The overwhelming number of participants also cited the increased risk and volatility associated with exchange rate movements, which put further operational and financial pressures on banks. Furthermore, a majority of participants agreed that exchange rate volatility hedging tools available from the market are either not effective or too expensive, putting banks under pressure to buffer themselves from exchange rate volatility. These views reveal that even if risk management frameworks could

be set, they are not yet sufficiently robust enough to deal with the pace and fluctuation of a floating regime.

Despite these challenges, the majority (63.4% of the respondents) acknowledged that floating exchange rates also have new opportunities. They believed that the system could enhance the competitiveness of the banking sector of Ethiopia. The majority indicated that the openness of exchange rates allows banks to enrich their services to foreign clients and creates windows of profit through arbitrage and foreign currency trading. However, such perceived benefits were also tempered with caution since respondents were generally only moderately hopeful of their banks' current ability to capitalize on such opportunities, citing lack of know-how, infrastructure, or regulatory support. Some of the respondents agreed that exchange rate flexibility has allowed their banks to diversify risk, expand currency conversion services, and break into new markets. Moreover, some respondents also noted that flexibility in exchange rates allows banks to better adjust to global economic trends and provides a framework for developing adaptive pricing strategies. Nevertheless, these opportunities appear to be overshadowed by the more immediate operational and financial difficulties that banks must navigate in the current environment.

Another major insight that emerged from the study is the influence of exchange rate fluctuations on customer behavior. Most (88% of the respondents) observed that changes in the exchange rate directly influence foreign currency deposit volumes, the frequency of foreign exchange transactions, and even loan demand. Customers appear to be more exchange rate-sensitive, reacting to perceived directions in currencies by changing savings, remittance, and investment behavior. This sensitivity allows clients to closely observe rate moves and respond with adjustment financial decisions themselves, prompting banks to respond faster with changing product and customer contact strategies. Evidence suggests that banks must build more effective market intelligence and customer platforms in order to serve clients optimally in an open currency world.

Finally, the study found a divided view regarding the adequacy of the regulatory framework to support banks under the new regime. While a minority of respondents felt that existing regulatory regimes are effective in offering support, many others questioned the flexibility and effectiveness of current policies. While some of the respondents reported appropriate intervention and participation of regulatory agencies, others questioned the sufficiency of the current legal and

institutional environments to keep up with persistent and unpredictable changes in the exchange rate. Backing of competitive positioning and risk management by regulations were perceived as not being equally strong, and therefore policy reforms might be necessary in order to be able to adapt more easily.

5.2 Conclusion

In light of the findings, it can be understood that the adoption of a floating exchange rate system has introduced a very high degree of complexity and risk into the business environment of Ethiopian commercial banks, and these are primarily focused on foreign exchange risk management, liquidity management, and profitability. While the system has the potential for further convergence with global market mechanisms and offers potential channels for revenue growth and competitiveness, the existing banks' capacity to absorb the associated risks appears presently to be limited. Issues of heightened foreign exchange volatility, diminished precision of forecasting, tensions in liquidity, and absence of hedging mechanisms have been subjecting tremendous stress to the financial stability of banks. Most banks still need to synchronize their risk management approaches in a way that would be sufficient for the handling of this regime shift.

Furthermore, the behavior of customers has been increasingly exposed to exchange rate volatility, supporting the need for banks to adopt more dynamic and data-driven decision-making. Although regulatory bodies provide some level of support, the existing framework is considered to be only partially effective with doubts about adaptability and flexibility in responding to ongoing exchange rate volatility. The regulatory framework must be strengthened to allow for sustainable banking sector development and resilience under the floating exchange rate system.

In nutshell, the Ethiopian banks have the opportunity to reposition during this transition to benefit from the opportunities of the floating exchange rate regime. However, this transition demands collaboration among regulatory authorities and banks in building a strong, adaptable banking system that will thrive under market-determined exchange rates. Ultimately, the banking sector in Ethiopia will survive the macroeconomic reforms based on its ability to adapt, innovate, and implement far-sighted strategies for minimizing risk and maximizing new opportunities.

5.3 Recommendations

In light of the findings', targeted recommendations are proposed for both local banks and regulatory bodies to strengthen the resilience of Ethiopia's commercial banking sector under a floating exchange rate regime.

Local Banks:

- Banks need to create professional treasury departments with dedicated foreign exchange experts to track world currency markets around the clock and implement timely hedging techniques. Exhort these groups to engage in regional and global banking forums to compare best practices and exchange knowledge on managing floating exchange rate regimes.
- Banks should encourage frequent interaction and cooperation of their treasury, risk, finance, and compliance teams to deliver a consolidated exchange rate risk framework. Inter-departmental workshop sessions can allow shared perception of currency-risk exposure and enable swift, collective decision-making once the market evolves.
- Banks ought to consider investing in the development of more sophisticated risk management systems to contain exchange rate uncertainty. Some of these include enhancing foreign exchange risk analysis capacity, constantly refining risk mitigants, and integrating sophisticated forecasting models to improve earnings predictability. Such systems ought to be capable of providing stress testing, scenario planning, and simulation models to better forecast currency fluctuations.
- In light of reported inadequacy and costliness of available hedging products, banks also need to invest in hedging products like forwards, options, and swaps by entering into partnerships with foreign financial institutions to gain access to more varied currency derivatives at reasonable prices. Additionally, the banks should also develop proprietary hedging products tailored to local market and client needs.
- Banks should conduct regular professional training in international finance, risk management certification courses, and simulation exercises to key personnel to train them with the knowledge needed to manage floating rate conditions effectively. Enhance staff competence to handle currency volatilities and to develop innovative financial instruments. Training treasury personnel in hedging tool usage like forwards, options, and swaps will

make banks more effective in hedging exposures.

- In view of customers' extreme sensitivity to exchange rate volatility, banks also need to roll out awareness programs—e.g., seminars, webinars, and online materials—to get customers on board with rate dynamics, risk management, and product selection. Enhanced advisory services to focused clients can enhance confidence and trigger adoption of tailor-made foreign exchange solutions.

Regulatory Bodies:

Being a policy-making institution, the National Bank plays a crucial role in this issue. Therefore, the following points would be recommended by the researcher:

- The National Bank should encourage the growth of a dynamic local interbank foreign exchange derivatives and hedging market, with a centralized FX derivatives clearinghouse. This will have to be established through the issue of specific regulatory guidelines, the offering of incentives for participation by domestic banks and foreign banks, and the opening up of transparent price discovery channels. The National Bank should also facilitate the licensing of derivative trading platforms and the entry of reliable international clearinghouses. An unambiguously defined legal framework covering derivative transactions is central to reducing counterparty risk and enhancing market liquidity depth allowing banks to more effectively manage currency risks.
- The National Bank should introduce a fast-track process of approval for emerging hedging products and fintech innovations to enable timely reaction to evolving market conditions. The National Bank should also provide regulatory flexibility, technical assistance, and advisory services to help banks to adapt in transitioning to a floating exchange rate system. Establish center of excellence support units to serve as knowledge-sharing channels and guidance centers for industry players.
- The National Bank should institute arrangements which require transparent and timely disclosure of exchange rates, FX market direction, and monetary policy evolution. Reliable information is needed by banks to craft responsive and agile approaches. Further, require regular, standardized reporting on foreign currency exposures, hedging activity, stress test outcomes, and liquidity measures. Make public aggregate data on market exposures and flows to inform policy, reduce information asymmetry, promote market discipline, and

increase investor confidence. Coordinate more broad policies for capital flows and currency hedging to minimize arbitrage opportunities and promote regional financial stability.

- The National Bank should collaborate with the Ethiopian Capital Market Authority (ECMA) in designing a liquidity facility that enables banks to borrow short-term money against capital market instruments. The facility can include arrangements like repurchase agreements, short-term corporate bonds, and regulated interbank lending facilities. Its implementation would reduce the liquidity pressures on account of exchange rate movements. The structure would incorporate transparent pricing instruments and efficient controls to contribute to market efficiency and accountability. By diversifying funding sources and having reduced dependence on FX-denominated obligations, the banks' solvency and resilience can be strengthened. Smooth financial intermediation will be guaranteed through an operational liquidity facility. Moreover, development of a well-established domestic capital market ecosystem will enhance overall stability of the financial system. The National Bank should collaborate with the Ethiopian Capital Market Authority also need to concentrate on investor protection and education in order to gain confidence in the new financial system.
- The National Bank should also form a special liaison department to engage with banks frequently on foreign exchange risk practices. Hold open forums, workshops, and knowledge-sharing programs to promote best practices and build confidence between regulators and the market players. These activities will provide the foundation for information sharing in accordance, policy harmonization, and harmonized response to systemic risks of exchange rate volatility. Quarterly forums with banking sector representatives can help gather feedback and address emerging challenges and opportunities.
- The National Bank needs to work together with industry associations to offer specialized training programs to bank professionals and regulators in exchange rate risk management and advanced currency risk measuring methods. Invite banks, fintech companies, educational institutions, and international financial institutions to work together to co-develop new financial products. Regulators' sandboxes can enable testing of new solutions in a sandboxed environment. Also, work with other regulators in the East African

community to harmonize foreign exchange policy and promote cross-border banking integration.

With the adoption of these recommendations, local banks will be able to better address the higher risks as well as exploit the potential of a floating exchange rate regime. Meanwhile, regulatory bodies can establish a supportive climate that matches market discipline with prudent regulation, hence fostering the long-term competitiveness and stability of the Ethiopian banking sector.

5.4 Direction for future research

In light of the recent adoption of a floating exchange rate system in Ethiopia and the lack of empirical research in the area, there is still much room for further academic research. Researchers are encouraged to further pursue this line of research by encompassing other banks that have experienced the impacts of the floating exchange rate system. This will act to further support and add to this study's conclusions, towards a better overall comprehension of the implications of the new exchange rate mechanism for the banking sector. Besides, even though a descriptive research design was applied in this study to explore the challenges, opportunities, and regulatory impacts of the floating exchange rate regime, the future studies could benefit from the use of more rigorous statistical techniques, which include inferential statistics. This way, it would be achievable to carry out deeper analysis and the results generalize. Overall, additional studies are required for the advancement of evidence-based policy-making and financial planning for Ethiopian financial institutions amid the nation's ongoing economic reforms.

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Appendices

Appendix one: Survey Questionnaire 1

COLLEGE OF BUSINESS AND ECONOMICS

SCHOOL OF COMMERCE

Department of Corporate Finance: Specialty in Investment Management

Survey Questionnaire

Dear Respondents,

I am conducting a research study entitled ***"Towards Understanding Floating Exchange Rate: Unveiling Challenges and Opportunities for Competitiveness in Ethiopia's Commercial Banking Sector"*** to fulfill the partial requirement of a Master of Science (MSc.) degree in Corporate Finance: Specialty in Investment Management. The research is done purely for research purposes; besides, its findings are expected to benefit the Commercial Banks of Ethiopia by providing meaningful insights so as to help improve their performance and competitiveness in a floating exchange rate regime. All such information witnessed will be used purely for research purposes and will be dealt with solely on a confidential basis. Thus, your genuine, unique, and timely response is a valuable input to the quality and successful execution of the study. It will take around 15-20 minutes to complete the survey.

Much appreciation in advance for your cooperation and timely response!!!

Instruction

- ✓ The questionnaire consists of five (5) parts. Please read the questions carefully before answers.
- ✓ In order to answer the question, put a right sign (√) for each question to indicate your response.
- ✓ If you need further information, you can contact the researcher via telephone number*+251-930-650222* or email yohannesbirhanu165@gmail.com.

I. Part One: Demographic Information

1.1. Gender

- Male ☐
- Female ☐

1.2. Age

- Less than 35 Years ☐
- 35-45 Years ☐
- 46-55 Year ☐
- Over 55 Years ☐

1.3. Your educational qualification

- BA/BSC Degree ☐
- MSc/ MA ☐
- PhD ☐

1.4. Your Position in your bank

- Executive Manager (Chief) ☐
- Department Director ☐

1.5. Your year of experience in this management position

- < 5 years ☐
- 5-10 years ☐
- 10-20 years ☐
- Over 20 years ☐

1.6. Your year of experience in the banking sector

- < 5 years ☐
- 5-10 years ☐
- 10-20 years ☐
- Over 20 years ☐

1.7. How significant is the impact of a floating exchange rate on the Ethiopian banking sector?

- Very significant ☐
- Significant ☐
- Moderate ☐
- Minimal ☐
- Not significant ☐

II. Part Two: Challenges under a Floating Exchange Rate System

2.1. Do Ethiopian commercial banks face challenges under a floating exchange rate system?

- Yes ☐
- No ☐

2.2. How would you rank the main challenges faced by Ethiopian commercial banks in the following areas under a floating exchange rate system?

Please make an (√) in the respective box.

The scale below will be applicable as Five-point scales ranging from "Strongly Agree" to "Strongly Disagree"

	Responses				
	Strongly Agree (1)	**Agree (2)**	**Neutral (3)**	**Disagree (4)**	**Strongly Disagree**
2.2.1 It is not simple for our bank to manage exchange rate risk under a floating regime.					
2.2.2 Floating exchange rates contribute to the volatility of foreign currency transactions at the expense of our bank profitability.					
2.2.3 Exchange rate fluctuations make it difficult for our bank to predict future earnings.					
2.2.4 Uncertainty in the movement of exchange rates requires frequent readjustments of our bank's strategies, which is an added operating cost.					
2.2.5 Floating exchange rates increase the difficulty of our bank maintaining stable liquidity levels.					
2.2.6 Our bank has difficulty maintaining foreign currency reserves with exchange rate uncertainty.					
2.2.7 Our bank often experiences delays in foreign currency settlements due to exchange rate fluctuations.					
2.2.8 Floating exchange rates complicate the determination of competitive interest rates for foreign currency deposits and foreign currency loans.					

2.2.9 Market-provided hedging instruments are not sufficient and too costly to achieve effective exchange rate risk management.					
2.2.10 Exchange rate fluctuations negatively impact our bank trade financing business.					

III. Part Three: Opportunities under a Floating Exchange Rate System

3.1. Do opportunities exist for enhancing the competitiveness of Ethiopia's commercial banking sector under a floating exchange rate regime?

- o Yes ☐
- o No ☐

3.2. How would you rank the benefits provided by a floating exchange rate regime for the commercial banking sector?

Please make an (√) in the respective box.

The scale below will be applicable as Five-point scales ranging from "Strongly Agree" to "Strongly Disagree"

	Responses				
	Strongly Agree (1)	**Agree (2)**	**Neutral (3)**	**Disagree (4)**	**Strongly Disagree (5)**
3.2.1 The ability to adjust exchange rates freely enables our bank to offer better services to international clients.					
3.2.2 The floating exchange rate system creates opportunities for higher profits through currency trading and arbitrage.					
3.2.3 Foreign exchange operations contribute significantly to our bank's overall revenue under a floating exchange rate system.					
3.2.4 The floating exchange rate system allows our bank to diversify their risk exposure across multiple currencies.					

3.2.5	A floating exchange rate regime improves the efficiency of currency conversion services provided by our bank.					
3.2.6	Exchange rate fluctuations provide opportunities for our bank to expand into new markets.					
3.2.7	The flexibility in exchange rates reduces the risk of currency crises that could impact our bank.					
3.2.8	Our bank has improved its ability to adjust to global economic changes due to a floating exchange rate system.					
3.2.9	Our bank benefits from the ability to adjust pricing strategies based on real-time exchange rate movements.					

IV. Part Four: Customer Behavior under a Floating Exchange Rate System

4.1. Is there a significant change in customer behavior in the banking sector during exchange rate fluctuations?

- o Yes ☐
- o No ☐

4.2. How would you rank the impact of exchange rate fluctuations on the following customer behaviors?

Please make an (√) in the respective box.

The scale below will be applicable as Five-point scales ranging from "Strongly Agree" to "Strongly Disagree"

		Responses				
		Strongly Agree (1)	**Agree (2)**	**Neutral (3)**	**Disagree (4)**	**Strongly Disagree (5)**
1.2.1	Our bank's foreign currency deposit base is influenced by changes in exchange rates.					
1.2.2	Foreign exchange transactions with our customers have increased due to exchange rate flexibility.					
1.2.3	Loan demand has been influenced significantly by the fluctuations in the exchange rate.					

V. Part Five: Role of Regulatory Support under a Floating Exchange Rate System

5.1 Is the current regulatory environment supportive of Ethiopian commercial banks adapting to a floating exchange rate system?

- o Yes ☐
- o No ☐

5.2 How would you rank the role of the regulatory environment in addressing the following areas related to the floating exchange rate system?

Please make an (√) in the respective box.

The scale below will be applicable as Five-point scales ranging from "Strongly Agree" to "Strongly Disagree"

	Responses				
	Strongly Agree (1)	**Agree (2)**	**Neutral (3)**	**Disagree (4)**	**Strongly Disagree (5)**
1.2.4 Our bank receives adequate support from the regulatory authorities for managing exchange rate risk.					
1.2.5 Regulatory policies facilitate our bank's competitive positioning under a floating exchange rate.					
1.2.6 The regulatory environment is flexible enough to adapt to frequent exchange rate changes.					

1.3 Please add any additional information you believe is necessary to provide in relation to the opportunities and difficulties that current floating exchange rate policy offer to Ethiopian commercial banks.

Thank you very much!!!

Appendix two: Interview Question 1

Interview questions for commercial banks of Ethiopia's Directors and Executive Managers

1. What are the greatest challenges that your bank is confronted with to manage/balance foreign exchange risk, liquidity, and profitability within the existing exchange rate system?
2. What, in your view, are the opportunities of the floating exchange rate system for Ethiopian banks to become more competitive, acquire new customers, or achieve a larger market share?
3. How do movements in exchange rates affect foreign currency deposit demand by customers, loan demand, and foreign exchange transactions, and how do exchange rate movements affect customer confidence?
4. How effective has the current system of regulation proved in enabling your bank to adjust to the regime of floating exchange rates, and how can this be enhanced?

Interview questions for NBE's Directors and Executive Managers

1. How has the introduction of a floating exchange rate regime influenced the monetary policy instruments and efficiency of the central bank?
2. What are the most important challenges that commercial banks have faced because of fluctuations in exchange rates, and how has the central bank assisted them in mitigating these risks?
3. Are there regulatory frameworks or policy changes to help decrease exchange rate volatility and protect the stability of the banking system?
4. What are the opportunities seen by the central bank for the banking sector under a floating exchange rate system in terms of foreign exchange market development and financial sector deepening?