



Parallel Market Rate Appreciating under Tight Liquidity: Economic, Social and Political Explanations

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Abstract

This paper explores the complex dynamics influencing the appreciation of parallel market rates in African nations amidst tight liquidity conditions. The research identifies key economic factors such as the scarcity of foreign currency, inflationary pressures, interest rate differentials, and speculation, which drive individuals and businesses toward parallel markets. Additionally, social dimensions, including public perception, increased informal transactions, and the role of remittances—are found to impact market behaviour. Politically, the study highlights how government policies, corruption, political instability, and policy ineffectiveness contribute to the deterioration of official exchange rates. While tight liquidity is often perceived as a prudent economic strategy, the findings suggest that it necessitates a comprehensive approach that considers these intertwined economic, social, and political factors to foster sustainable development. From the study findings, it is worth noting that while tight liquidity can be a necessary measure for economic stability, it requires complementary policies that address the broader economic, social, and political landscape. The study offers policy recommendations that, when considered, African nations can work towards reducing the adverse effects of parallel market rate appreciation and fostering a more stable economic environment. The policy recommendations aim at harmonizing liquidity management with broader socio-economic stability, promoting transparency, and enhancing institutional effectiveness to mitigate the adverse effects of parallel market rate appreciation.

Subject Areas

Development Economics, International Economics, Political Economy, Policy

Keywords

African Nations, Economic Factors, Exchange Rate, Parallel Market Rate, Political Factors, Social Factors, Tight Liquidity

1. Introduction

The interplay between parallel market rates and liquidity conditions has become a pivotal concern for policymakers and economists, particularly in African nations. As economies grapple with tight liquidity, the appreciation of parallel market rates presents a complex challenge that necessitates thoroughly examining their economic, social, and political dimensions. Through theories, empirics and cases, this paper aims to explore the complex dynamics influencing the appreciation of parallel market rates, ultimately offering a wide-ranging understanding of the phenomenon.

Historically, parallel markets have emerged in response to the constraints imposed by official exchange rates, often leading to significantly diverging rates that reflect the realities of supply and demand. The African Development Bank (AfDB) notes that many African countries face chronic foreign currency shortages, exacerbating reliance on parallel markets [1]. This scarcity is often a result of inflationary pressures, interest rate differentials, and speculative behaviour that collectively drive individuals and businesses to seek alternative avenues for currency exchange [2] [3].

In addition to economic factors, social dimensions play a crucial role in shaping market behaviour. Public perception of the currency's stability can significantly influence individuals' choices between official and parallel markets. Increased informal transactions, driven by the need for flexibility and accessibility, further complicate the landscape [4]. Remittances also contribute to this dynamic, as they often bypass formal channels, exacerbating official currency systems' challenges [5].

Politically, government policies and institutional effectiveness are central to understanding the parallel market's evolution. Corruption, political instability, and ineffective policy measures can undermine confidence in official exchange rates, leading to a further decline in their value [6]. The social and economic effects of corruption are more pronounced in developing countries than in the developed world [7]. Corruption undermines progress and development, with its consequences falling on the citizens [8]. Corruption undermines official exchange rates by distorting policy execution, fostering market behaviour that prioritizes personal gain over economic stability, and eroding public trust in institutions. When corrupt practices influence monetary policy, decisions may favor elites, leading to misallocation of resources and ineffective regulation of currency markets. This creates an environment where parallel markets thrive, as individuals seek to circumvent official rates to secure better deals. Additionally, corruption diminishes

economic trust, causing investors and consumers to lose confidence in the currency and government policies, further destabilizing official exchange rates and promoting volatility in the financial system [9]. highlights the detrimental effects of political interference on the currency's stability, reinforcing the notion that political context must be considered alongside economic indicators.

While tight liquidity is often perceived as a prudent economic strategy aimed at curbing inflation and stabilizing the currency, it is insufficient in isolation to prevent the appreciation of parallel market rates. The evidence suggests that a more integrated approach is necessary—one that addresses the intertwined economic, social, and political factors at play [10]. Through examining these dimensions, this paper seeks to provide insights into effective policy recommendations that can harmonize liquidity management with broader socio-economic stability and promote sustainable development across the continent. This study aims to contribute to the ongoing discourse on currency stability in African nations and propose actionable solutions to mitigate the adverse effects of parallel market dynamics.

The paper is arranged in seven sections. Section one is the introduction. Section two tight liquidity policies in Africa. Section three presents and discusses various theories concerning parallel exchange rate appreciation under tight liquidity. Section four is the review of empirical literature. Section five presents and discusses African cases of parallel market rate appreciation under tight liquidity. Section six discusses and justifies the study methodology. Section seven is for policy recommendations. Finally, section eight is the study conclusion.

2. Tight Liquidity Policies in Africa

Tight liquidity in African nations can be defined by a combination of low money supply growth, high interest rates, reduced credit availability, increased demand for cash, high inflation, foreign exchange constraints, and poor economic growth. For instance, a significant slowdown in the growth rate of the money supply (e.g., M2) compared to historical averages may indicate tight liquidity; elevated interest rates can signify tight liquidity, as they make borrowing more expensive and reduce access to credit; a decline in bank lending to the private sector, often measured as a percentage change year-on-year, can serve as an indicator; limited availability of foreign currency can exacerbate liquidity issues, particularly for nations reliant on imports or foreign investment, and/or an increase in the demand for cash relative to the supply, often reflected in higher currency-to-deposit ratios, can signal tight liquidity conditions. Tight liquidity refers to a situation where there is a scarcity of cash or liquid assets in the financial system, making it difficult for businesses and consumers to access funds for transactions, investments, or other financial needs.

Tight liquidity policies are relatively common in several African countries, particularly in response to inflationary pressures, economic instability, or external shocks. An increase in the money supply that isn't fully supported by reserves

negatively impacts the economy [11]. Policymakers are encouraged to address money supply issues by adhering to fundamental economic principles to prevent negative consequences. Furthermore, policymaking is an intricate and multifaceted process that necessitates a careful balance among vision, pragmatism, and discipline [12]. Tight liquidity policies refer to measures implemented by central banks to restrict the availability of liquid assets in the financial system. These policies aim to control inflation and stabilize financial markets by limiting the amount of money in circulation. Implementing such policies often involves increasing interest rates, adjusting reserve requirements, and conducting open market operations to absorb excess liquidity.

Key features of tight liquidity policies: (1) Interest rate increases. Central banks typically raise interest rates to discourage borrowing and spending. Higher rates increase the cost of loans, which can lead to reduced investment and consumption, thereby cooling off inflationary pressures [13]. (2) Reserve requirements. Through increasing reserve requirements, central banks compel commercial banks to hold a larger portion of their deposits as reserves, limiting their ability to lend. This action is crucial during periods of economic overheating to prevent excessive credit growth [14]. (3) Open market operations. Central banks may sell government securities to absorb liquidity from the market. This reduces the money supply and can help stabilize inflation expectations, ensuring that financial conditions remain tight [15].

Implications of tight liquidity policies: (1) Financial stability risks. While tight liquidity policies intend to maintain price stability, they can inadvertently increase risks to financial stability. As banks struggle with reduced liquidity, they may face increased funding costs and a higher likelihood of default during economic downturns [16]. (2) Operational readiness. These policies' effectiveness often hinges on financial institutions' operational readiness to access central bank liquidity if needed. A lack of preparedness can exacerbate liquidity stress during crises, as seen in recent banking turmoil [17]. (3) Coordination frictions. Tight liquidity can lead to coordination problems among creditors, increasing the risk of bank runs. As depositors rush to withdraw their funds in anticipation of bank instability, it can create a self-fulfilling prophecy that destabilizes the banking sector [18].

Tight liquidity policies are critical for central banks to manage inflation and maintain financial stability. While not uniform across the continent, tight liquidity policies in African countries are influenced by local economic conditions, inflation rates, and external factors. However, the potential for unintended consequences, such as increased fragility in the banking sector and coordination failures among creditors, highlights the need for careful implementation and preparedness to mitigate these risks.

Worth noting is that parallel market rates are not only influenced by tight liquidity. Global factors, such as international trade relations and foreign debt, play a significant role in influencing parallel market rates, particularly in developing countries and emerging economies. A country with a trade deficit (many African

nations fall in this category) may experience increased demand for foreign currency, leading to higher parallel market rates. Tariffs and quotas can limit the supply of foreign goods, increasing demand for foreign currency on the parallel market as businesses seek to import goods not available through official channels. Also, countries with fixed or controlled exchange rates may see a divergence between official rates and parallel market rates due to market distortions, often driven by trade imbalances. Furthermore, high levels of foreign debt (as in many African countries) can strain a country's foreign exchange reserves, leading to increased pressure on the parallel market. Most African nations struggle to service debt, causing reliance on the parallel market for currency to make payments. In addition, some African countries are dependent on commodity exports, and fluctuations in global prices impact foreign currency inflows. Positively, high levels of FDI can enhance foreign currency supply, stabilizing or lowering parallel market rates. However, reduced investment can exacerbate currency shortages.

3. Theories of Parallel Exchange Rate Appreciation under Tight Liquidity

Several theories exist that help explain the appreciation of parallel market rates under tight liquidity conditions. The current study relies on valuable insights from; (1) Purchasing Power Parity, (2) Interest Rate Parity, (3) Portfolio Balance Theory, (4) Microstructure Theory, (5) Signaling Theory, and (6) Behavioral Finance Theory.

Purchasing Power Parity (PPP). This theory posits that exchange rates should adjust to equalize the purchasing power of different currencies. When tight liquidity conditions lead to a scarcity of foreign currency, the demand for foreign exchange in parallel markets increases, causing the parallel market rate to appreciate relative to the official rate. The theory highlights the disconnect between market realities and official exchange rates, particularly in economies facing inflationary pressures [19].

Interest Rate Parity (IRP). Proposed by economists such as John Maynard Keynes, this theory suggests that differences in interest rates between countries will lead to changes in exchange rates. Under tight liquidity, higher domestic interest rates can attract capital inflows, but if foreign currency remains scarce, the parallel market rate may appreciate as individuals seek to hedge against currency risk. This theory helps explain how interest rate differentials can influence parallel market dynamics [20].

Portfolio Balance Theory. Tobin, the theorist, emphasizes that investors hold a mix of domestic and foreign assets based on their risk preferences. In tight liquidity conditions, the demand for foreign assets increases, leading to a shift in portfolio allocations that can drive up the parallel market rate. The theory illustrates how changes in investor behaviour in response to liquidity constraints can affect exchange rates [21].

Microstructure Theory. This approach focuses on the role of market partici-

pants and their behaviour in determining exchange rates. According to this theory, market participants' order flow and trading strategies can lead to price adjustments in the parallel market. When liquidity is tight, the information asymmetry between market players can exacerbate volatility and lead to an appreciation of the parallel market rate as traders react to perceived risks [22].

Signaling Theory. The theory posits that central bank interventions can signal future monetary policy directions to the market. If a central bank adopts tight liquidity measures, it may inadvertently signal a commitment to maintaining a strong currency, leading to speculative behavior in the parallel market. This can result in an appreciation of the parallel market rate as traders anticipate future policy actions [21].

Behavioural Finance Theory. This theory examines how psychological factors and cognitive biases influence market behaviour. Under tight liquidity conditions, market participants may overreact to news or changes in economic indicators, leading to increased speculation in parallel markets. This speculative behaviour can drive up the parallel market rate as traders react to perceived risks and opportunities [23].

The six theories collectively help explain the dynamics of parallel market rate appreciation under tight liquidity conditions, highlighting the interplay of economic fundamentals, market behaviour, and psychological factors.

4. Review of Empirical Literature

The appreciation of parallel market rates under tight liquidity conditions in African nations has been extensively studied, highlighting various economic, social, and political factors that influence this phenomenon. The African Economic Outlook 2024 emphasizes that macroeconomic stability is crucial for fostering investor confidence, which directly impacts exchange rates [24]. In the case of Mozambique, [3] identify determinants of foreign exchange stability, noting that tight monetary policies can inadvertently lead to increased parallel market activity due to limited liquidity in official markets.

Zimbabwe's monetary policy responses have drawn significant attention [25]. reports that the Reserve Bank of Zimbabwe's policies aimed at stabilizing prices have had mixed results, with inflation pressures continuing to challenge the official exchange rate [9]. underscores the need for a recalibrated monetary policy framework to address ongoing exchange rate volatility [5]. discusses the broader economic conditions in Zimbabwe, suggesting that external shocks and domestic policy failures contribute to persistent weaknesses in the official currency. Similarly [6], argues that the unification of exchange rates is critical for restoring confidence in the local currency, a sentiment echoed by other authors [4] who highlight the risks associated with maintaining dual exchange rates.

In examining the determinants of exchange rates in Sub-Saharan Africa (SSA) [2], find that inflation, interest rates, and political stability significantly influence both official and parallel market rates. This aligns with findings from [26], who

illustrate that similar economic pressures drive discrepancies between official and parallel rates in Nigeria. The World Bank's 2023 report on job creation highlights the role of remittances in influencing exchange rates, particularly in countries where parallel markets are prevalent [27]. This is supported by [28], who discuss how external shocks and liquidity constraints can exacerbate volatility in foreign exchange markets.

[29] [30] further explore the implications of external financing and structural reforms on exchange rate dynamics in Egypt and broader Africa. They argue that sound economic policies are essential for stabilizing currencies and mitigating the effects of tight liquidity. Central banks across the region have responded variously to these challenges. For instance, the Bank of Tanzania and the Bank of Zambia have implemented stringent monetary policies to curb inflation, but the effectiveness of these measures in stabilizing exchange rates remains debated [31] [32].

The empirical literature discussed in this section underscores that while tight liquidity can influence parallel market rates, a multidimensional approach that consider economic indicators, social dynamics, and political stability is vital for understanding and addressing the complexities of exchange rate appreciation in African nations.

5. African Cases of PMR Appreciation under Tight Liquidity

Many African nations have experienced the appreciation of parallel market rates under tight liquidity conditions. This section discusses numerous case studies that help illustrate that while tight liquidity is often implemented as a monetary policy strategy, it alone cannot prevent the appreciation of the parallel market rate. Below are twenty case studies highlighting the reasons for parallel market rate appreciation and the associated economic damage.

Nigeria. In Nigeria, several periods have witnessed the appreciation of parallel exchange rates under tight liquidity conditions. (2015-2017): The scarcity of foreign currency due to falling oil prices and inflationary pressures led to a significant appreciation of the parallel market rate. Tight liquidity measures failed to stabilize the naira, resulting in increased import costs and inflation. 2017-2018: The CBN implemented a series of foreign exchange restrictions, which limited access to funds for imports. This tight liquidity situation, high inflation rates, and ongoing economic instability pushed demand to the parallel market, where rates began to appreciate significantly. 2020: The COVID-19 pandemic exacerbated existing economic challenges, reducing economic activity and declining foreign currency inflows. As the CBN struggled to maintain the naira's value amidst falling oil prices and reduced liquidity, the parallel market saw increased activity and appreciation of rates. Late 2021 to Early 2022: The naira faced significant pressure due to rising inflation and a volatile economic environment. The CBN's attempts to control the parallel market through various measures, including tightening monetary policy, were insufficient to stabilize the currency. This led to an increase in demand for foreign currency on the parallel market, resulting in a rate appreciation. 2023: In

the wake of a new administration, the CBN announced changes to its exchange rate policy, leading to market adjustments. Tight liquidity conditions persisted due to limited foreign reserves and ongoing inflation, causing the parallel market rate to appreciate as individuals sought to hedge against further depreciation.

Zimbabwe. In Zimbabwe, several periods have been observed where the parallel exchange rate appreciated under tight liquidity conditions, particularly in the context of ongoing economic crises. (2008-2009): During this period, hyperinflation and political instability drove citizens to parallel markets for foreign currency. Despite tight liquidity measures, the Zimbabwean dollar depreciated drastically, leading to economic collapse and widespread poverty [33]. 2018-2019: The introduction of the RTGS dollar in February 2019 and a lack of foreign currency reserves led to a significant depreciation of the local currency. High inflation rates and economic instability drove businesses and individuals to seek foreign currency on the parallel market. 2020-2021: During this period, the government implemented strict lockdown measures due to the COVID-19 pandemic, which disrupted economic activities. The resulting liquidity crunch, combined with continued inflationary pressures and low confidence in the local currency, pushed many to rely on the parallel market for foreign exchange. Late 2022 to Early 2023: The economic environment was characterized by high inflation rates and ongoing currency instability. The RBZ's monetary policy measures, which included high-interest rates and attempts to control money supply, were insufficient to stabilize the currency. This led to increased demand for foreign currency on the parallel market. Late 2024: Despite the introduction of the Zimbabwe Gold (ZiG) as a new currency, tight liquidity conditions persisted. Limited availability of foreign currency and ongoing inflationary pressures led to a rise in parallel market rates, as individuals and businesses sought to hedge against currency depreciation.

Ghana. In Ghana, the appreciation of parallel exchange rates under tight liquidity conditions has occurred during several notable periods. (2014-2016): High inflation rates and reduced access to foreign exchange caused the cedi to depreciate in the parallel market. The tight liquidity policy could not mitigate the economic impact, resulting in increased living costs and reduced foreign investment [34]. 2019: The Ghanaian cedi experienced pressure due to rising inflation and external shocks, including trade deficits. The Bank of Ghana's attempts to stabilize the cedi through monetary policy measures were insufficient, leading to increased demand in the parallel market, where rates began to appreciate. 2020: The COVID-19 pandemic severely impacted the economy, leading to a decline in remittances and foreign investment inflows. The resultant liquidity crunch increased reliance on the parallel market for foreign currency, causing the rates to appreciate as businesses and individuals sought to secure dollars. 2021: Continued economic instability, exacerbated by the pandemic and rising inflation, put pressure on the cedi. The Bank of Ghana's monetary policy efforts struggled to contain the depreciation of the cedi against major currencies, leading to a widening gap between the official and parallel market rates. Late 2022 to Early 2023: Ghana faced significant eco-

economic challenges, including high inflation and fiscal deficits. The government's efforts to stabilize the economy through International Monetary Fund (IMF) programs and policy adjustments were met with skepticism, leading to increased demand for foreign currency in the parallel market, where rates appreciated further.

Kenya. In Kenya, several periods have been characterized by the appreciation of parallel exchange rates under tight liquidity conditions. (2011-2013): Tight monetary policy and high-interest rates led to capital flight, pushing individuals towards parallel markets. The resulting depreciation of the Kenyan shilling increased unemployment and slowed economic growth [35]. 2015-2016: Economic challenges, including a declining shilling and increased demand for foreign currency for imports, led to a liquidity crunch. The CBK's efforts to stabilize the currency through interventions were insufficient, resulting in a widening gap between the official and parallel market rates. 2019: In the context of a slowing economy and rising public debt, the Kenyan shilling faced depreciation pressures. Tighter liquidity conditions arose from reduced foreign inflows, particularly in the tourism sector due to security concerns and global economic shifts. This situation pushed demand for foreign currency into the parallel market, leading to appreciation of parallel rates. 2020: The COVID-19 pandemic severely impacted the Kenyan economy, leading to remittances and foreign direct investment decline. The liquidity crunch intensified as businesses struggled to access foreign currency, driving up parallel market rates as individuals and companies sought dollars to manage operational costs. 2022: High inflation, coupled with global economic disruptions (including the impacts of the Russia-Ukraine conflict), led to increased costs of living and reduced consumer confidence. The CBK's interventions to stabilize the currency faced challenges due to tightening global financial conditions, causing a surge in parallel market activity and appreciation of rates.

South Sudan. (2013-2016): Ongoing conflict and corruption severely limited foreign reserves, leading to reliance on parallel markets. Tight liquidity measures failed to stabilize the economy, resulting in humanitarian crises and inflation [27].

Tanzania. (2016-2018): Government restrictions on foreign currency access pushed transactions into the informal sector. Despite tight liquidity, the depreciation of the Tanzanian shilling led to increased economic instability and reduced growth [36].

Angola. (2014-2016): Oil price volatility and inflation caused the local currency to depreciate significantly. Tight liquidity measures could not prevent recession and increased poverty levels as citizens turned to parallel markets [37].

Ethiopia (2015-2018): Government control over foreign exchange and inflationary pressures led to a thriving parallel market. Tight liquidity failed to attract foreign investment, increasing reliance on informal transactions [38].

Congo (DRC). (2015-2018): Political instability and corruption undermined economic stability, leading to reliance on parallel markets. Tight liquidity measures did not prevent stagnation and increased poverty rates [39].

Uganda. (2016-2018): High inflation and speculative trading in foreign currencies drove individuals to parallel markets. The depreciation of the Ugandan shil-

ling increased the cost of living and reduced consumer confidence [40].

Zambia. (2015-2017): Tight liquidity and high-interest rates, exacerbated by falling copper prices, led to a depreciation of the kwacha in the parallel market. This resulted in economic contraction and increased unemployment [41].

Malawi. (2012-2014): Currency devaluation and inflationary pressures pushed citizens towards parallel markets, leading to increased poverty and reduced access to essential goods.

Sierra Leone. (2014-2016): Political instability and lack of foreign investment resulted in reliance on parallel markets, contributing to economic decline and increased informal market transactions [42].

Rwanda. (2017-2019): Tight monetary policy and inflationary pressures led to local currency depreciation in the parallel market, slowing economic growth and increasing the cost of living [43].

Cameroon. (2015-2018): Currency depreciation and high inflation rates drove individuals to seek foreign currency in parallel markets, resulting in increased poverty levels and reduced economic stability.

Togo. (2015-2017): Economic mismanagement and inflation led to a depreciation of the local currency, pushing citizens towards parallel markets, which increased the cost of living and reduced economic growth [44].

Burkina Faso. (2016-2018): Political instability and corruption undermined confidence in the official currency, leading to increased reliance on parallel markets, resulting in economic stagnation [45].

Lesotho. (2015-2017): Tight liquidity conditions and inflationary pressures drove individuals to parallel markets, leading to increased import costs and reduced consumer purchasing power [46].

Gambia. (2014-2016): High inflation and currency devaluation pushed citizens towards parallel markets, resulting in increased poverty and economic instability [47].

Mauritania. (2016-2018): Scarcity of foreign currency and inflationary pressures led to a thriving parallel market, which increased the cost of living and reduced economic growth [48].

The case studies discussed in this section demonstrate that while tight liquidity measures are often employed to stabilize currencies, they are insufficient on their own to prevent the appreciation of parallel market rates. The underlying economic, social, and political factors play a crucial role in shaping market behaviour, leading to significant economic damage, including increased inflation, reduced purchasing power, and overall economic instability.

Worth noting, however, is that in Africa, the appreciation of parallel market rates has varied significantly between countries influenced by external shocks and those driven by internal economic factors. For instance, Nigeria and Angola faced external pressures from the COVID-19 pandemic and plummeting oil prices, leading to increased parallel market rates. Similarly, Zambia experienced external shock effects due to declining copper prices, which are vital for its economy. In

contrast, countries like Zimbabwe and Sudan saw their parallel market rates rise primarily due to internal economic mismanagement and hyperinflation. Ethiopia's internal political instability has also played a significant role in its currency depreciation, while Ghana faced internal fiscal challenges that affected its exchange rates independently of global events. In Cameroon, corruption and governance issues have driven parallel market rates higher, while in Tanzania, internal monetary policy decisions have been more influential than external shocks. Lastly, in South Sudan, ongoing conflict and economic mismanagement have led to a persistent gap between official and parallel market rates, largely independent of external factors.

Further to note is that tight liquidity policies are never to be labelled bad policies, rather they have to be blended for effective results. There are instances where tight liquidity measures have successfully stabilized the official exchange rate in various African countries. For example, in Nigeria, the Central Bank implemented tight monetary policies in 2016, including interest rate hikes, which helped stabilize the naira. In 2017, Egypt's decision to float the pound alongside tight liquidity measures led to a gradual stabilization of the currency after initial volatility. In Kenya, the Central Bank raised interest rates in 2015, which helped stabilize the shilling amid inflationary pressures. Similarly, South Africa's Reserve Bank adopted tight liquidity measures in 2016 to counteract the rand's depreciation. In Ghana, a monetary policy tightening in 2015 helped stabilize the cedi after significant depreciation. In Zambia, the Bank of Zambia's interventions in late 2015 through liquidity management contributed to stabilizing the kwacha. In Ethiopia, the National Bank's 2018 measures, including a tightened money supply, aimed to stabilize the birr. Rwanda's Central Bank's actions in 2017 to tighten liquidity also helped maintain the stability of the franc. In Tanzania, monetary tightening in 2018 effectively stabilized the shilling. Finally, in Uganda, measures taken in 2016 by the Bank of Uganda helped curb the depreciation of the shilling, demonstrating the effectiveness of tight liquidity policies in stabilizing exchange rates.

6. Justification of Research Methods Used

The study used cases, literature reviews, theories, and economic explanations as ideal methodologies. A literature review critically analyses existing research on a particular topic. It allowed understanding of the current state of knowledge on the topic, identifying of gaps in the research, and positioning the current study within the broader field [49] [50]. More specifically, the literature review was helpful to understand existing theories and explanations for parallel market rate appreciation under tight liquidity conditions. Explanations and theories provided frameworks for understanding phenomena. They helped identify the key factors that influence parallel market rate appreciation and explain the relationships between them [51]. The study managed to identify and use economic theories about foreign exchange markets, social theories about public perception and behavior, and political theories about government policies to explain the dynamics at play. His-

torical cases allowed the study to examine the tight liquidity phenomenon in depth by focusing on the particular example [52] [53]. The cases were a useful way to illustrate the complex ways in which economic, social, and political factors interact to influence parallel market rates under tight liquidity, thereby calling for deeper analysis and other solutions to address economic challenges.

7. Policy Recommendations

To effectively address why the parallel market rate appreciates in tight liquidity conditions for many African nations, a multi-dimensional policy approach is important, incorporating economic, social, and political considerations. The study, through theoretical literature review, empirical literature review, and case analysis offers the following policy recommendations;

- **Enhancing foreign currency supply.** Governments should prioritize strategies to increase the availability of foreign currency in the official market. This could involve negotiating better trade agreements to boost exports, particularly in sectors like agriculture and minerals, which are significant for many African economies [1]. This aligns with the PPP theory, which suggests that a stable exchange rate depends on balanced supply and demand of currencies [54]. Additionally, initiatives to streamline remittance flows and reduce transaction costs can help increase liquidity in the formal market [55]. Establish export incentives and support programs to enhance competitiveness in international markets.
- **Strengthening monetary policy frameworks.** Central banks must adopt robust monetary policy frameworks that focus on inflation targeting and ensure effective transmission of policy measures. The introduction of comprehensive foreign exchange codes and systems to unify exchange rates—as successfully implemented in Kenya—can enhance market credibility and reduce discrepancies between official and parallel rates [11].
- **Adoption of flexible monetary policies.** Central banks of African countries should consider adopting inflation-targeting frameworks to anchor expectations and stabilize the currency. This approach will help address inflationary pressures as outlined in the Interest Rate Parity theory [2]. Regularly review and adjust the Central Bank Rate (CBR) in response to inflation data and economic conditions, ensuring that monetary policy remains responsive to market dynamics.
- **Promoting financial inclusion.** Expanding access to financial services, particularly for low-income populations, can mitigate reliance on parallel markets. Initiatives such as the introduction of retail bonds for small investors, similar to Kenya's M-Akiba, can democratize investment opportunities and encourage savings within the formal financial system [10]. Develop financial literacy programs and partner with mobile payment providers to facilitate access to formal financial instruments.
- **Improving transparency and governance.** Addressing issues of corruption and

inefficiency in government policy implementation is crucial. Effective governance can foster trust in official exchange rates, as highlighted by Microstructure Theory, which emphasizes the role of market information [52]. Establishing independent oversight bodies and enhancing regulatory frameworks can foster greater trust in financial institutions and government policies. This is particularly vital in countries like Zimbabwe, where political instability has historically undermined economic confidence [52].

- Fostering regional cooperation. African nations should collaborate to harmonize monetary policies and exchange rate management across borders. Initiatives such as the Pan-African Payments and Settlement System (PAPSS) can facilitate intra-African trade and reduce dependency on external currencies, thereby stabilizing local currencies [3] [56].
- Addressing socioeconomic factors. Understanding public perception and informal transaction behaviours is vital. Governments should engage with communities to promote the benefits of formal financial systems and address misconceptions (Behavioural Finance Theory). The campaigns to educate the public about the risks associated with parallel markets and the advantages of using official channels.
- Addressing structural economic issues. Long-term strategies should focus on diversifying economies away from overreliance on a few sectors, particularly in resource-rich countries. Structural reforms promoting investment in sectors such as technology, manufacturing, and sustainable energy can enhance resilience against external shocks and reduce inflationary pressures [27].
- Regular monitoring and adaptation of policies: Establish a framework for continuous assessment of economic indicators to ensure timely interventions. This aligns with the signaling theory, where effective communication of policy intentions can stabilize expectations [57]. Utilize real-time data analytics to monitor market behaviours and adjust policies accordingly.
- Monitoring and adapting to external shocks. Policymakers need to remain vigilant regarding global economic conditions that may impact local markets. The recent geopolitical tensions and their effects on commodity prices underscore the importance of flexible and responsive monetary policies that can adapt to changing external environments [2].

From the study findings, it is worth noting that while tight liquidity can be a necessary measure for economic stability, it requires complementary policies that address the broader economic, social, and political landscape. By considering the above policy recommendations, African nations can work towards reducing the adverse effects of parallel market rate appreciation and fostering a more stable economic environment.

8. Conclusion

In conclusion, this paper has demonstrated that the appreciation of parallel market rates under tight liquidity conditions in African nations is a complex phenom-

enon influenced by a myriad of interconnected economic, social, and political factors. While tight liquidity policies may serve as a temporary measure to stabilize economies, they are insufficient alone to prevent the escalation of parallel market rates. Economic factors such as foreign currency scarcity, inflation, and speculation significantly drive market behavior, while social dimensions, including public perception and remittance flows, further complicate the landscape. Politically, ineffective governance and corruption exacerbate the challenges faced by official exchange rates. Therefore, a holistic approach is necessary—one that harmonises liquidity management, and addresses the underlying socio-economic and political issues. Considering prioritizing transparency, enhancing institutional integrity, and fostering economic diversification, policymakers can create a more conducive environment that mitigates the adverse impacts of parallel market dynamics and promotes sustainable development across the African continent.

Conflicts of Interest

The authors declare no conflicts of interest.

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