CONTINENTAL SEMINAR OF THE ASSOCIATION OF AFRICAN CENTRAL BANKS (AACB) ON THE THEME "MONETARY POLICY FRAMEWORKS IN AFRICA IN A CHANGING FINANCIAL LANDSCAPE"

Nairobi, Kenya, 13– 15 May 2015

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CONCLUSIONS AND RECOMMENDATIONS

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1. INTRODUCTION

The 2015 AACB Continental Seminar was held in Nairobi, Kenya, from 13 to 15 May 2015, on the theme "Monetary Policy Frameworks in Africa in a Changing Financial Landscape". Fifty-five (55) participants from twenty-three (23) member central banks and eight (8) regional and international institutions attended the Seminar.

The Executive Secretary of the AACB in his introductory remarks and on behalf of the Chairman of the AACB, Mr. Rameswurllal Basant Roi, Governor of the Bank of Mauritius, expressed deep gratitude to Honourable Dr. Haron Sirima, Deputy Governor of the Central Bank of Kenya (CBK), for hosting the Seminar as well as for the excellent arrangements made. He commended the remarkable participation from AACB member central banks as well as from African and international institutions, as a testimony of their strong determination to contribute decisively in tackling the challenge of monetary integration in Africa.

He mentioned that the 2015 Continental Seminar on the theme "*Monetary Policy Frameworks in Africa in a Changing Financial Landscape*" was taking place in a context where African countries like other developing countries are facing, along with the consequences of the 2007-2009 international financial crisis, profound changes in the financial landscape, characterized notably by a process of increasing interactions between national financial systems at continental and international levels as well as diverse financial innovations. These changes result from a series of factors, particularly the intensification of international capital flows, the use of information and communication technologies, as well as the acceleration of financial innovations with the advent of new financial products. Moreover, the years and decades ahead would witness more transition in the financial landscape requiring central banks to continuously reform and adjust monetary policy frameworks and strategies. Therefore, it seemed relevant for the African Central Banks, within this context, to discuss notably the need to address the evolving challenges of monetary policy, the requirement to rethink its objectives, its instruments, its transmission mechanisms, its responses to financial stability considerations, and its strategic orientations with regard to the establishment of a future African Central Bank (ACB).

2. OPENING CEREMONY

Dr. Haron Sirima, Deputy Governor of the CBK chaired the ceremony and delivered the opening speech. He recalled that the Abuja Treaty committed member countries to harmonize their monetary, financial and payment policies to further the attainment of the objectives of the African Union. In this regard, the East African Sub-region has made notable progress on the path of regional integration. The East Africa Monetary Union Protocol was signed and ratified by all the five member countries, harmonized policy framework agreed upon and key legislative bills, including establishment of an East Africa Monetary Institute, the precursor of the East Africa Central Bank are at advanced stage of enforcement. These actions are major steps towards the formation of the African Central Bank.

Further, the Deputy Governor noted that the changing financial landscape has challenged underpinnings of monetary policy frameworks and its implementation tools. The global economic and financial environment is transiting to a new phase, with the US preparing to exit from unconventional monetary policy and the Eurozone moving in the opposite direction. The tightening of US monetary policy will increase funding costs to the African region, heighten the risk of reversal of capital flows and exert exchange rate pressures. The vulnerability of the region to terms of trade shocks, mainly reflecting food and fuel price shocks, would further complicate the implementation of monetary policy. Whereas the financial sector in the African Continent has deepened due to technological innovations, the expected stronger monetary transmission mechanism is weakened by structural factors that keep interest rate spreads wide and lending rates high and slow to react to central bank policy signals. A clear understanding of the most appropriate monetary policy framework is thus required to yield optimal results under the fast changing economic and financial landscape.

3. STRUCTURE OF THE SEMINAR

The Seminar was structured as follows. Eminent speakers addressed delegates on three sub-themes and representatives from selected central banks shared experiences on their countries/regions, with respect to the main theme. Then, three break-out sessions were organized to discuss on selected topics in order to take stock of the current monetary policy frameworks and to make appropriate recommendations on the way forward for the considerations of Governors.

3.1. PLENARY SESSION 1: EVOLVING FINANCIAL LANDSCAPE AND MONETARY POLICY FRAMEWORKS IN AFRICA

3.1.1. Mr. Armando Morales, Resident Representative of the International Monetary Fund in Kenya made a presentation on the "*Changes in the Financial Landscape: Role of Monetary Policy and Monetary Operation Frameworks in Africa*". He reviewed the recent trends in the global financial landscape, highlighting the easing financial conditions in both advanced in emerging market economies since October 2014. He commented on how policy easing in the Eurozone, the expected tapering in the US and the lower oil prices have led to exchange rate realignments. Mr. Morales mentioned that risks to global financial stability are rotating and more visible in emerging markets. He noted that African economies are also experiencing currency pressures, albeit with varying degrees. However, inflation remains basically under control and low income countries including African countries are moving away from rigid anchors. He highlighted the main changes in monetary policy frameworks notably the shift towards forward-looking monetary policy, better communication policy and more open capital accounts. The scope of a good monetary policy framework rested on clear central banks' mandate; price stability as a central bank's goal; the need for clear signals to guide liquidity management decisions; clear communication about central banks' intentions; and the need for transparency and independence. He concluded by stating that continuous improvement of the monetary policy frameworks would prepare countries in a volatile world and embark on the much awaited progress in developing financial market.

3.1.2. Mr. Alain Vandepeute, Advisor in Monetary Policy and Payment Systems at AFRITAC East made a presentation on financial stability and monetary policy framework in Africa. He underscored that prior to 2008, central banks focused on achieving price stability but after 2008, a new mandate of central bank emerged in the form of financial stability. Mr. Vandepeute commented on a three-steps approach for a financial stability framework: (i) an assessment to bring together macroeconomic, monetary, financial market, supervisory and regulatory input; (ii) coherent structure for the analysis of financial stability issues; and (iii) the ultimate goal of preventing problems from occurring or to resolve them if prevention fails. Broadly, financial stability covers financial market infrastructure; crisis management framework; strong supervision and macroprudential measures. The channels through which monetary policy can affect financial stability was discussed as well as the interaction between macroprudential tools and monetary policy. Three major changes in Africa on monetary policy and financial stability were identified: regional integration, pan African banking and mobile payment.

3.1.3. Prof. Sylvanus Ikhide, Professor of Development Finance at the University of Stellenbosch Business School in Cape Town, South Africa, reviewed the international experiences and lessons for Africa with regards to changing financial landscape, financial crises and monetary policy. He said that the global financial crisis has re-opened the debate about monetary policy and institutions and reviewed the aspects of conventional monetary policy (CMP). Prof. Ikhide highlighted the monetary policy responses to the recent global financial crisis and the lessons learned from the implementation of unconventional monetary policy (UMP) measures by the US Fed and ECB. He specifically referred to Brazil's monetary policy response to the crisis. He compared and contrasted CMP and UMP. He assessed the objectives of MP-PLUS, a combination of exceptionally low policy interest rate and unconventional policy measures. Prof. Ikhide questioned the relevance of UMP for Africa and highlighted the pre-conditions for using MP-PLUS. He reviewed the debate on rule vs. discretionary monetary policy and assessed the advantages using rule based monetary policies. He also commented on central bank independence and put up cases for and against this independence. He also reviewed the roles of price and financial stability for central banks and the role of monetary policy with regards to asset price bubbles.

3.2. SUB REGIONAL EXPERIENCES

Experiences of nine (9) central banks on their monetary policy frameworks and implementation were shared with the participants.

4. BREAK-OUT SESSIONS

Delegates were called to deliberate on three topics through break-out sessions:

Break-out Session I: Monetary policy frameworks in Africa: Stocktaking, Challenges and Future Direction

Key observations:

1. A majority of member countries use monetary targeting framework while a few have moved to a hybrid framework or to inflation targeting either formal inflation targeting or its variants such as inflation targeting lite. A majority of member countries adopted the new frameworks whilst still under IMF-supported program.

2. Many central banks have in place Monetary Policy Committees (MPC). Membership of MPC in some central banks is fully internal, but other central banks include external members from Government and private sector. Some central banks already have in place separate financial stability committees alongside MPCs.

3. The transmission mechanism of monetary policy appears not to be well established empirically. In cases where studies have been carried out, weak interest rate transmission has been observed. Banks' interest rates respond little to changes in money market rates. Exchange rate channels appear relatively strong and the expectations channel is becoming significant.

4. In most countries, thin and shallow markets prevail. Few countries have well-functioning interbank foreign exchange markets. Limited instruments (Treasury bills, bonds, forex and repos) are available.

5. Majority of the countries have managed float exchange rate regimes with a few still on fixed exchange rate regimes. Some countries have liberalised their capital accounts in order to enhance effectiveness of their monetary policy. A majority of countries still retain controls on their capital accounts.

6. The relationship between monetary aggregates and inflation has become weak over time. Central banks are grappling with excess liquidity issues and liquidity management is costly. Inflation is largely driven by exogenous supply shocks relating to drought and terms of trade.
7. Unpredictability of government flows mainly on expenditure side complicates liquidity forecasting and monetary policy management in general.
8. In most countries, gaps in analytical, modeling and forecasting capacity as well as data quality prevail.

Recommendations

i. The AACB Secretariat should survey member countries to take stock of their monetary policy frameworks.

ii. Monetary policy is a dynamic process and countries may consider moving towards forward-looking monetary policy framework, such as inflation targeting and hybrid frameworks, keeping in consideration country specific conditions, central bank independence, availability of reliable and timely data, and developed inflation forecasting models.

iii. Coordination between fiscal and monetary policies is critical to ensure growth and inflation objectives.

iv. Governments should strive to provide statutory operational independence to central banks.

v. Countries could consider appointing external members with relevant expertise to their MPC as these members bring in their experiences as well as perspectives.

vi. Financial market reforms are needed to improve the transmission mechanism of monetary policy.

vii. Workshop/Seminar should be arranged to learn more on transmission mechanisms of monetary policy.

viii. Opening up capital accounts would help in the advancement of domestic capital markets.

ix. Effective communication strategies to manage inflation expectations.

x. Countries should develop strong databases with high frequency data, including leading indicators, to help sharpen forecasts.

xi. Capacity building in modeling is needed. Countries should consider adopting IMF's Forecasting and Policy Analysis (FPAS) which is ideal for policy analysis and forecasting.

xii. Rule-based monetary policy should be in place to guide decisions while retaining room for some constrained discretion depending on specific circumstances.

Break-out Session II: Adapting Monetary Policy Frameworks & Strategies to the Specific Circumstances and Realities of African Financial Systems: Stakes and Limits

Key observations:

1. There is need for the monetary policy frameworks of AACB countries to converge in line with on-going integration initiatives in the region. But it must be noted that countries are different and there is need to allow some structural reforms which may take 3 to 10 years. Convergence can be per region but must target a common goal.
2. A monetary policy framework should address price stability; financial stability and promote sustainable economic growth.
3. The financial system is made up of commercial banks which is not enough to promote growth.
4. Exchange rate policy is important in the conduct of monetary policy.
5. The basic principles to underpin monetary policy frameworks are: efficiency, credibility, flexibility, accountability and transparency.

Recommendations:

i. There is need to change the legal framework to allow the central bank to reform monetary policy frameworks. Central banks must obtain the buy-in of politicians to reform them.

ii. There is need to establish development banks and other financial institutions to promote inclusive growth.

iii. The Central banks should promote financial inclusion and financial literacy.

iv. There is need to develop a legal framework to regulate and promote the growth of money and capital markets.

v. Central banks, in collaboration with the relevant authorities, should establish and reform non-bank financial institutions, such as stock exchange, bond exchange, insurance, pension and other retirement funds, unit trusts, foreign exchange market, futures market, national payments systems, companies act, deposit insurance, revenue authority, public finances management acts.

vi. Central banks should ensure that there is explicit legal mandate on price stability in the Central Bank Act.

vii. AACB central banks could consider adopting model central bank law similar to the one used by central banks in SADC. SADC model law was supported by ECB, IMF, BOE and legal experts.

viii. Central banks should not target both the exchange rate and the inflation rate. They should strive to ensure that they have one objective for one policy instrument.

ix. The limitation of central bank lending to government has an impact in developing the financial market. Central banks can consider limiting their financing of the budget deficit through some sort of a rule.

x. Central banks should ensure that monetary policy targets are achieved and communicate effectively with the public. There must be pre-announcement on how central banks deal with shocks. Monetary policy outcomes must also be communicated to public through publications and presentations. There should be public outreach programmes by central banks on monetary policy outcomes.

Break-out Session III: Key Changes in the Financial Landscape and Implications for the Conduct of Monetary Policy in Africa

Key observations:

1. Financial innovations have significantly changed the financial landscape in many African countries. This manifests, among others, in the development of payment systems and adoption of different types of electronic money such as credit/debit cards; e-purse; and mobile money payments.
2. Development of microfinance has increased financial inclusion by covering a large number of the unbanked population. Microfinance institutions are growing massively and these have also brought about tremendous changes in the financial landscape.
3. There is an increase in shadow banking and non-bank financial institutions.
4. The global financial crisis brought real concerns on mechanisms to strengthen banking soundness and achieve financial stability.
5. Regional economic integration has necessitated the need to adapt the financial landscape to the new efforts for expanding pan African banks and advancing financial ties among different groupings. With the existence of excess liquidity in some countries and regional groupings there is need to further mitigate liquidity shortages in other countries and regions with the necessary arrangements and methods of channeling liquidity on the basis of cooperation and integration.
6. African countries are increasingly liberalizing capital accounts.
7. Islamic finance is massively growing in African countries.

Recommendations:

i. Central banks should have changing toolkits when financial landscape is changing and ensure that they stay ahead of the curve to understand how these changes can support an effective monetary policy and challenges thereof.

ii. Regulation and supervision are essential for mobile payments and all forms of e-money. An appropriate legal framework is critically important for managing the mobile payments. It is advisable to build operational resiliency and maintain confidence on advanced payment systems.

iii. African central banks are encouraged to conduct a study on the impact and relevance of e-money developments in their domestic economies, including cross-border transactions and consider their implication for monetary policy.

iv. African central banks are requested to strengthen capacity building for better understanding of economic modelling techniques.

v. Central banks should use higher frequency data for monetary policy analysis and forecasting. Consistent and reliable data is a pre-requisite.

vi. Fiscal dominance represented the main cause behind deviations in monetary targets; there is a need for more fiscal discipline.

vii. Adopting a single Government (or public Treasury) account, by which all the Government expenses and receipts would transit, will help reduce excess liquidity in banking system and improve fiscal and monetary performance, as excess reserves hinder the adoption of suitable monetary policy framework. Oil and foreign aid represent the source of excess liquidity in many countries; this requires more appropriate methods to allocate resources to productive sectors.

viii. A reliable public debt management will help promote efficient open market operations and the development of Government bonds secondary market, with the optimal size of bonds and marketable securities. It is recommended to use the yield curve for monetary policy implementation. The development of financial markets can help reduce the crowding out effect of the government and give more space to reduce the fiscal dominance.

ix. Central banks must develop the tools and mechanisms for increasing financial deepening.

x. Central banks should focus on achieving banking soundness and financial stability as a prerequisite for better managing monetary policy and containing the negative impacts of the financial crisis. Banking supervision and monitoring with new methods of stress testing and early warning signals is virtually important. Improving macroprudential supervisory capabilities are also vital.

xi. Central banks, in collaboration with national statistics agencies, should adopt different methods to measure inflation, and to isolate inflation generating as a result of monetary expansion from other types of inflation; this requires identifying headline, core and imported inflation.

Nairobi, Kenya, 15 May 2015