<u>Association of African of Central Banks:</u>
<u>Central Bank Governors Symposium on "Unwinding Unconventional Monetary Policies: Implications for Monetary Policy and Financial Stability in Africa"</u>

Remarks
by
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Protocol Observation.

Good morning Ladies and Gentlemen.

I am humbled and honored to speak before this distinguished audience today. I applaud the Association of African Central Banks (AACB) for regularly organizing symposiums of Governors of African central banks to discuss and share experiences on monetary, banking and financial issues of current interest that affect the region. At the IMF, we see this sharing of experiences as a form of peer learning by those who keep their ears close to ground and deal with these issues on a daily basis. We therefore value and have very high respect of the outcomes of such meetings. To the extent that these issues touch on the core mandate of the Fund, we appreciate the invitation by the AACB to listen to the symposium deliberations to better understand the issues on the ground and also offer our thinking on some of them. Against this background I would like to offer a few thoughts related to this years' symposium theme "Unwinding unconventional monetary policies: implications for monetary policy and financial stability in Africa" which perhaps is appropriate given that the 2016 economic performance in the continent is expected to show the region in the midst of its most challenging economic period in some 25 years. Questions abound as to how this can be reversed including the role of monetary policy in managing the forces of globalization that have contributed to the recent weak performance in the continent. My remarks are based on staff thinking, related IMF policy papers, country experiences and previous speeches by Fund management on related topics, specifically, these will focus on ***unwinding*** of unconventional monetary policy (UMP).

As a recap, UMP was adopted by advanced economies was to

1) **Restore the functioning of financial markets and intermediation** (targeted liquidity provision)**:** and
2) **Provide further monetary policy accommodation at the Zero Lower Bound.** forward guidance and quantitative easing
3) These two aimed at ensuring macroeconomic stability.

Risks/disadvantages

1) The unprecedented scale and prolonged period over which UMPs have been deployed raises concern of **build-up of financial risks in AEs** (by encouraging risk taking).
2) UMP helped stabilize the economy, but by doing so it could have **delayed and reduced the incentive to carry out other required fiscal, structural and financial sector reforms.** UMP might have created an over-reliance on monetary policy.
3) **Time inconsistency and central bank credibility:** This could happen if central banks find it difficult to control short-term rates as they try to reduce the size of their balance sheet by offloading long-term assets in their books with possible implication on asset prices.

Spillovers from AEs on EMS and LIC's:. Better economic outcomes in AEs helped support activity in EMs and LICs as well although large capital inflows posed significant management challenges. Increased dollar liquidity somehow lowered borrowing costs, allowing some governments to run larger deficits and build up debt. **The danger is that in the absence of prudent policies that strengthen a country's fundamentals, vulnerabilities quickly build up during accommodative monetary policy period leaving these countries exposed in episodes of unwinding.**

1. Impact on EMs and LICs of UMP Unwinding

Some capital flow reversal and currency depreciation is inevitable for countries including those in Africa as advanced economies tighten monetary policy. The risks of financial instability and excessive volatility arising from the unwinding of UMP are not trivial.

2. **Why:** Sudden reversal of capital flows combined with shallow and underdeveloped markets and other market imperfections can lead to excessive market volatility, large depreciations, sharp fall in asset prices, and credit crunches. As asset prices fall, the financial sector could suffer with increasing NPLs and shrinking capital buffers which could further amplify shocks and impact adversely on the real sector. This can be worsened if the period of loose policy had resulted in build-up of foreign currency exposures; in this case currency depreciation can severely weaken balance sheets. The extent of the impact would certainly depend on the extent to which a country is "**exposed**" and "**resilient**" to these inflows.

3. **Difficult monetary policy trade-offs**: Large outflows following unwinding of UMP can pose difficult policy trade-offs i.e choice of right policy mix to reduce outflows while not causing recessionary tendencies.in the economy.

With the recent relatively strong U.S. recovery together with the divergence of monetary policy paths in advanced economies, **the US dollar has strengthened.** This is putting pressure on countries whose exchange rate regimes are linked to the dollar but yet conduct a substantial share of their external trade in other currencies. The US dollar appreciation is also exerting pressure on balance sheets of banks, firms, households and sovereigns that borrow in dollars but have assets or earnings in other currencies.

4. Taper tantrum in May-June 2013 when Chairman Bernanke suggested that the Fed may reduce asset purchases later in the year was such an episode which led to big swings in asset prices and pressures on exchange rates. To date there is some evidence show that following the taper tantrum of 2013, **spreads increased overall in SSA countries** but much less for those that had stronger fundamentals measured by smaller current account and fiscal deficits. Finally, in 2013 6 SSA countries issued a total of $6.3 billion.in Eurobonds; 2014 and 2015 saw 7 countries issued a total of $7.9 billion and $6.8 billion respectively. In comparison, **2016 has been a very dry year with only one country issuing $1.25 billion worth of Eurobonds**. Whether this is linked to UMP unwinding events isn't easy to tell as yet. **But the rollover risks are real, might be harder and/or require higher rates and the bad news is that the taper-tantrum might not be a one-off as there is still substantial uncertainty about the timing and pace of rate increases in the US and also about unwinding of UMP in Europe and Japan yet to come.**

5. Policy Tools to Tackle Unwinding

1) **Better communications from advanced economies** regarding their unwinding plans can help reduce market volatility and allow central banks in non-UMP countries to better prepare for the unwinding.
2) **Good fundamentals** can increase resilience and provides more policy room during unwinding. Evidence exists in EMs and in Africa that countries that had already addressed economic vulnerabilities (smaller current accounts and budget deficits) before the taper-tantrum fared better during the taper-tantrum and witnessed smaller increases in spreads.
3) **Interventions:** Subject to fundamentals being strong, if market volatility emerges then central banks can intervene to reduce it. Exchange rate movements should be allowed to respond to fundamentals and central bank interventions minimized to the extent possible if a country is running large deficits or has suffered from a terms of trade shock.
4) **Prudential policies** can be used to tackle inflows. How about reversal? Should central banks consider loosening prudential norms to tackle contractionary effects of outflows? Probably not as financial sector stability might be at risk with currency depreciation and balance sheet effects.

Role of the Fund

In principle, the Fund could facilitate international policy coordination to improve global outcomes by mitigating cross-border externalities from UMP in addition to its implementation and exit. The Fund can also provide a global perspective on these policies via surveillance, advise on policy buffers to mitigate adverse potential effects and objective analysis of the potential gains from international policy cooperation.

6. Monetary and Fiscal Policy Mix in the Face of Tapering

i) How should fiscal policy respond in the face of tight financing conditions which put the budget under pressure? **Rationalizing expenditure**

ii) Should the policy mix be countercyclical? **Infrastructure financing?**

Before I conclude I would like to touch on an issue **I read in the concept note for this symposium i.e. should African countries consider using UMPs? To answer this question, it is important to first understand why AEs used UMP, and determine whether the conditions in Africa warrant the use of similar policies. We should also bear in mind the current risks faced in AEs as a result.** Given our still nascent understanding of UMPs and the fact that traditional monetary policy tools can still be deployed in SSA this has to be well though through.

Whatever the objectives are for African countries to pursue UMP, we should be mindful of the limited arsenal of instruments at the disposal of central banks and whether these can handle the widened objectives on a sustainable basis. Asking the central bank to boost long-run growth using UMP for development finance should be considered in the context of possible risks that could undermine the central banks credibility and result in unanchored inflation expectations, increased uncertainty, and higher inflation and output volatility. Development financing by central banks could also run counter to monetary policy stance. Instead serious attention could be paid to policy coordination where fiscal and structural policies focus on directly promoting long-term growth as monetary policy is best suited to provide a nominal anchor (and cannot effectively influence real variable in the long-run).

T**he recent experience of Brazil during the global financial crisis illustrates some of the risks associated with EM central banks having multiple inconsistent objectives, especially developmental goals. On the other hand, the experience of India in the same period could possibly highlight why central banks in EM should focus on their traditional roles.**

Conclusion

In conclusion, UMP largely succeeded in achieving their domestic goals and were effective given the financial turmoil that prevailed; restored market functioning and decreased long term bond yields; and though still debatable, growth and price stability also benefited. The rest of the world experienced mixed effects with large capital flows raising asset prices in EM and spreads across a number of SSA narrowing but management of these inflows remaining problematic. The taper-tantrum is likely to live on as there is still substantial uncertainty about the timing and pace of rate rises in US and on the timing of the unwinding of UMP in Europe and Japan which could have some significant implications for EM and LIC. To this extent, the first line of defense of these group of countries is to ensure that good fundamentals are in place to increase resilience and provide more policy room during unwinding. The Fund stands ready to offer policy advise to countries on these issues.