Changes in the Financial Landscape: Role of monetary policy and monetary operation frameworks in Africa

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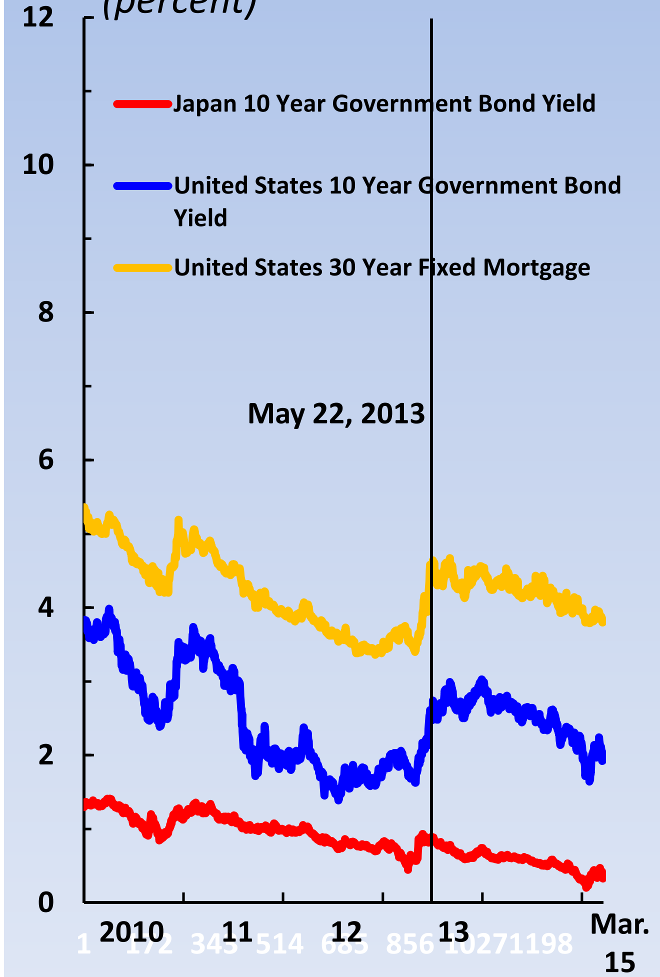
Outline

- Recent trends in the global financial landscape
- Performance of African frontier economies.
- What explains performance? LICs and Africa.
- Role of Monetary Policy Frameworks.
- Conclusions.

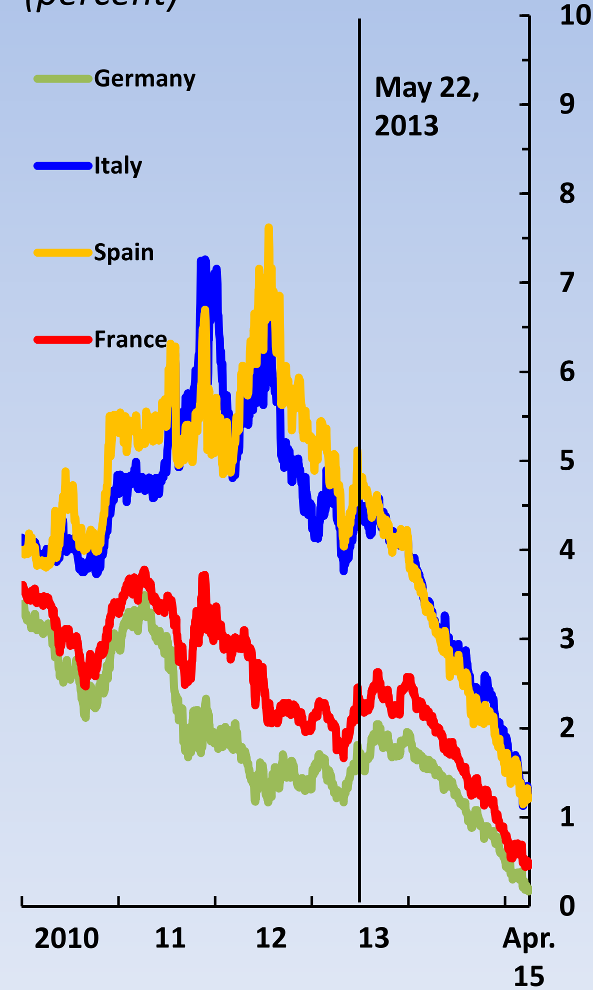
In both advanced and emerging market economies, financial conditions have eased since October 2014

Key Interest Rates
(percent)

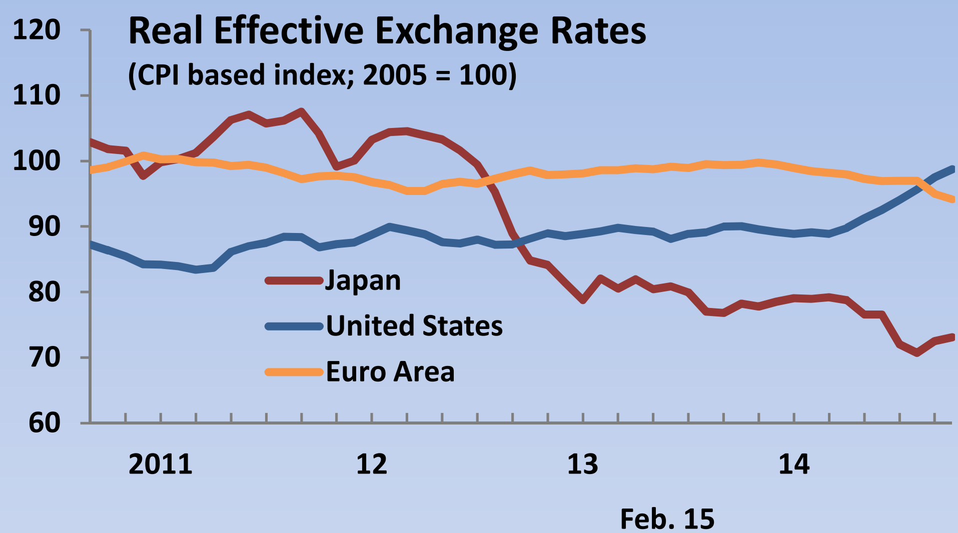


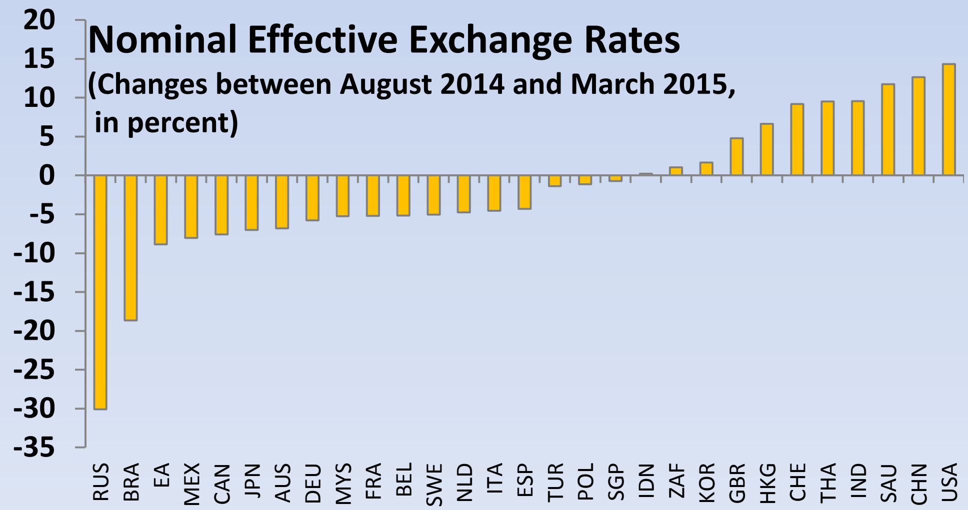
Equity Markets
(national currency)

Government Bond Yields
(percent)



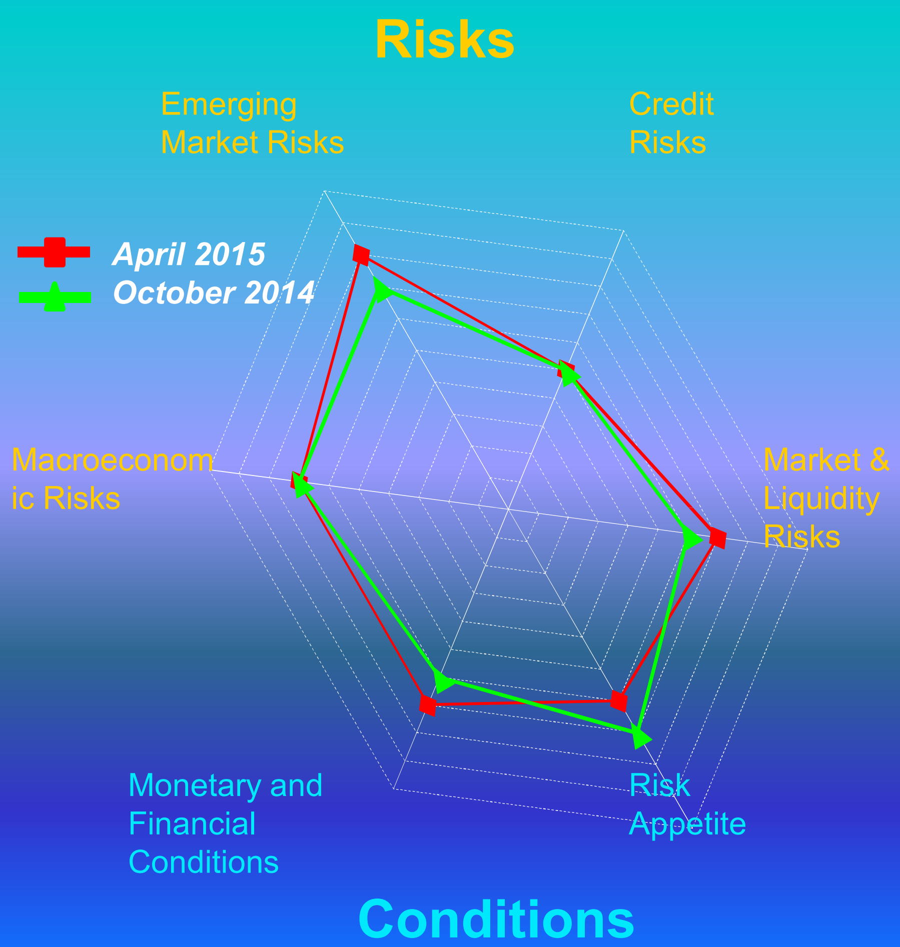
Easing in Europe, expected tapering in US, and lower oil prices have led to exchange rate realignments





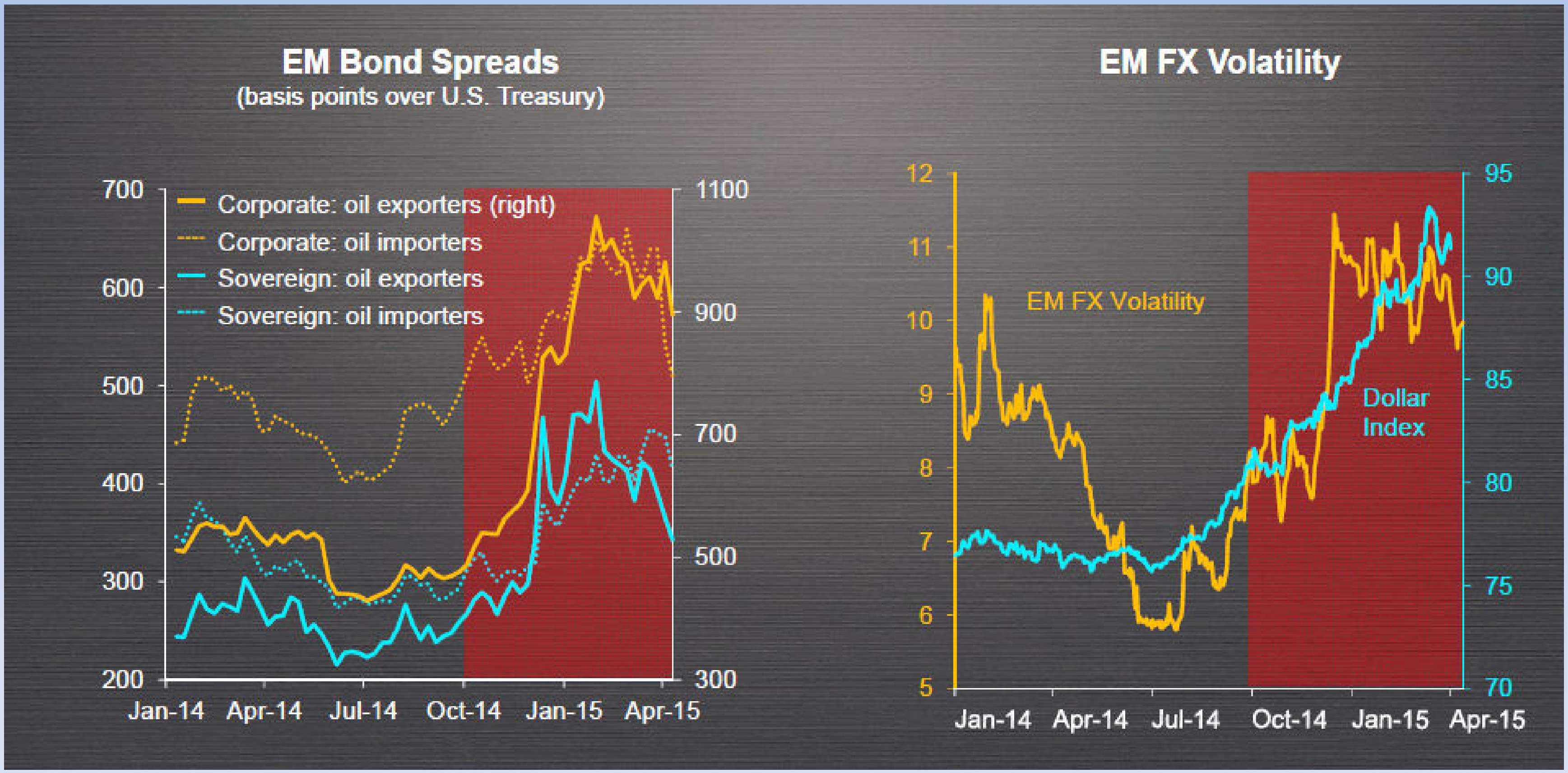
Sources: Global Insight; IMF, *International Financial Statistics database*

Risks to Global Financial Stability are rotating

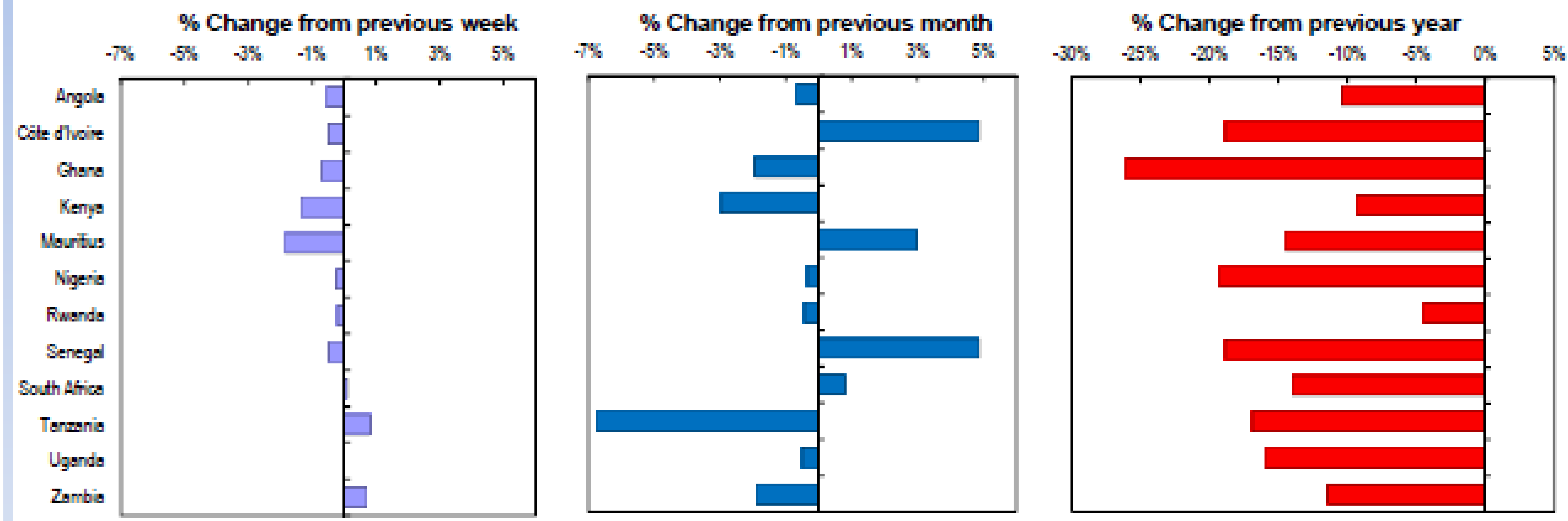


Away from center signifies higher risks, easier monetary and financial conditions, or higher appetite

And spreads and volatility are higher

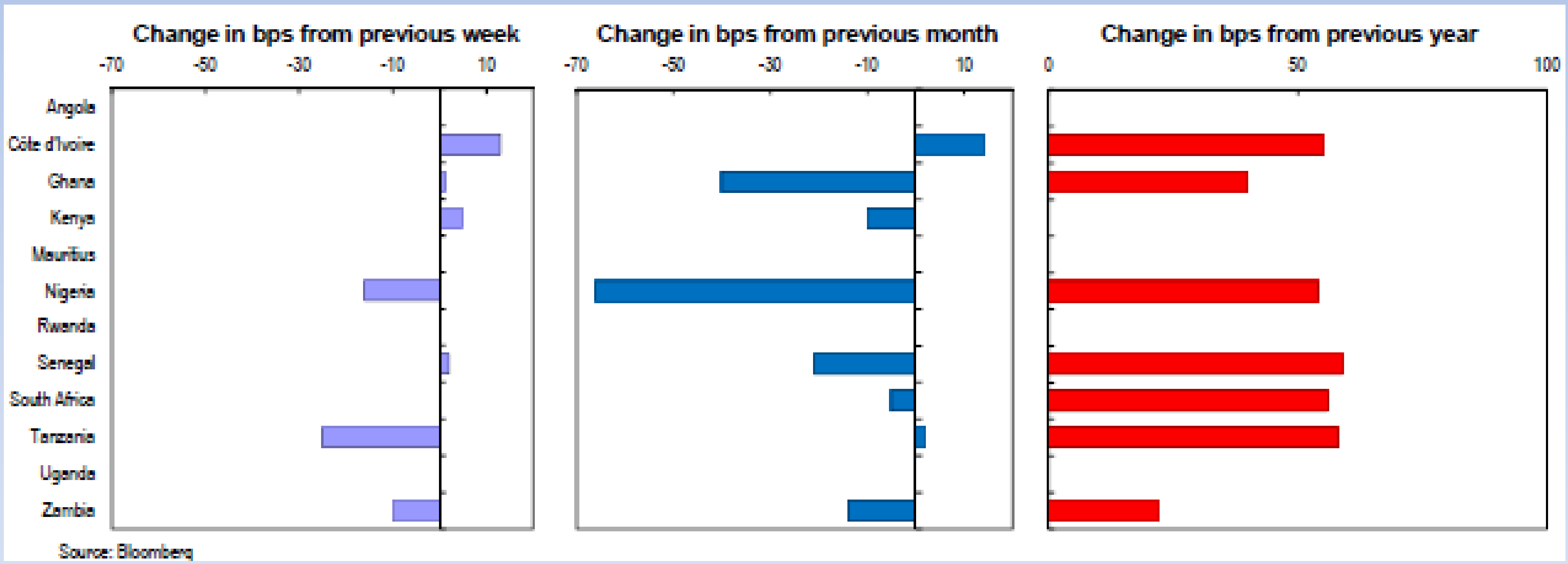


Africa also experiences currency pressures, with differences among countries

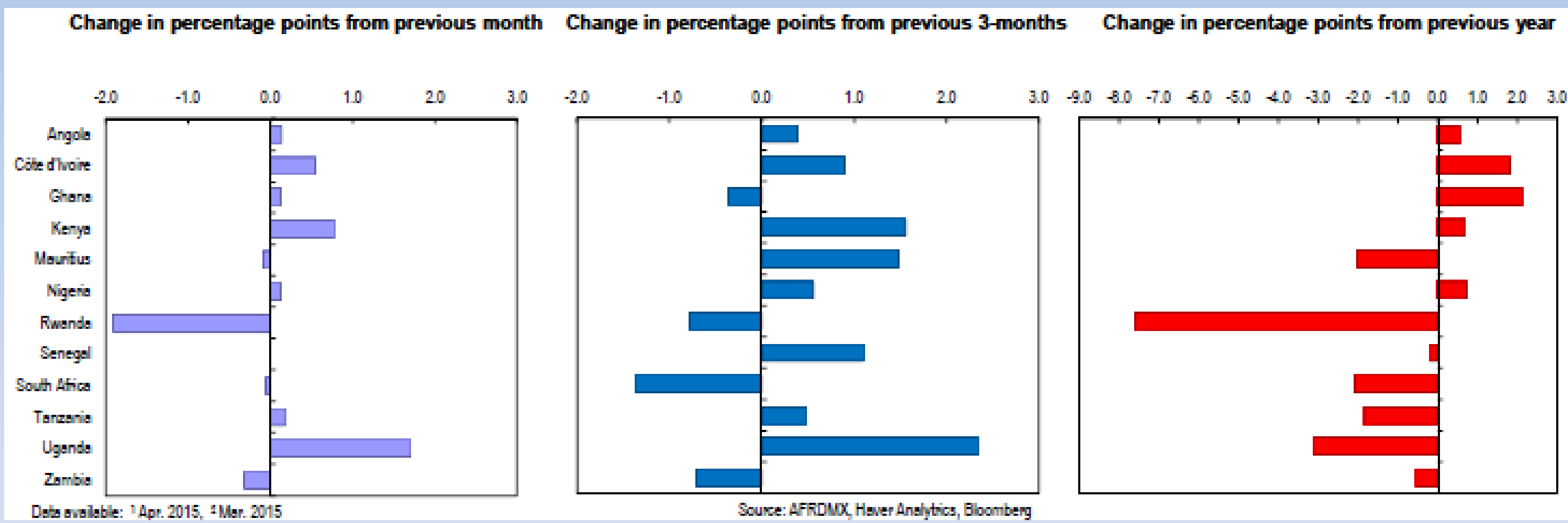


Source: Bloomberg

And bond spreads are also increasing.



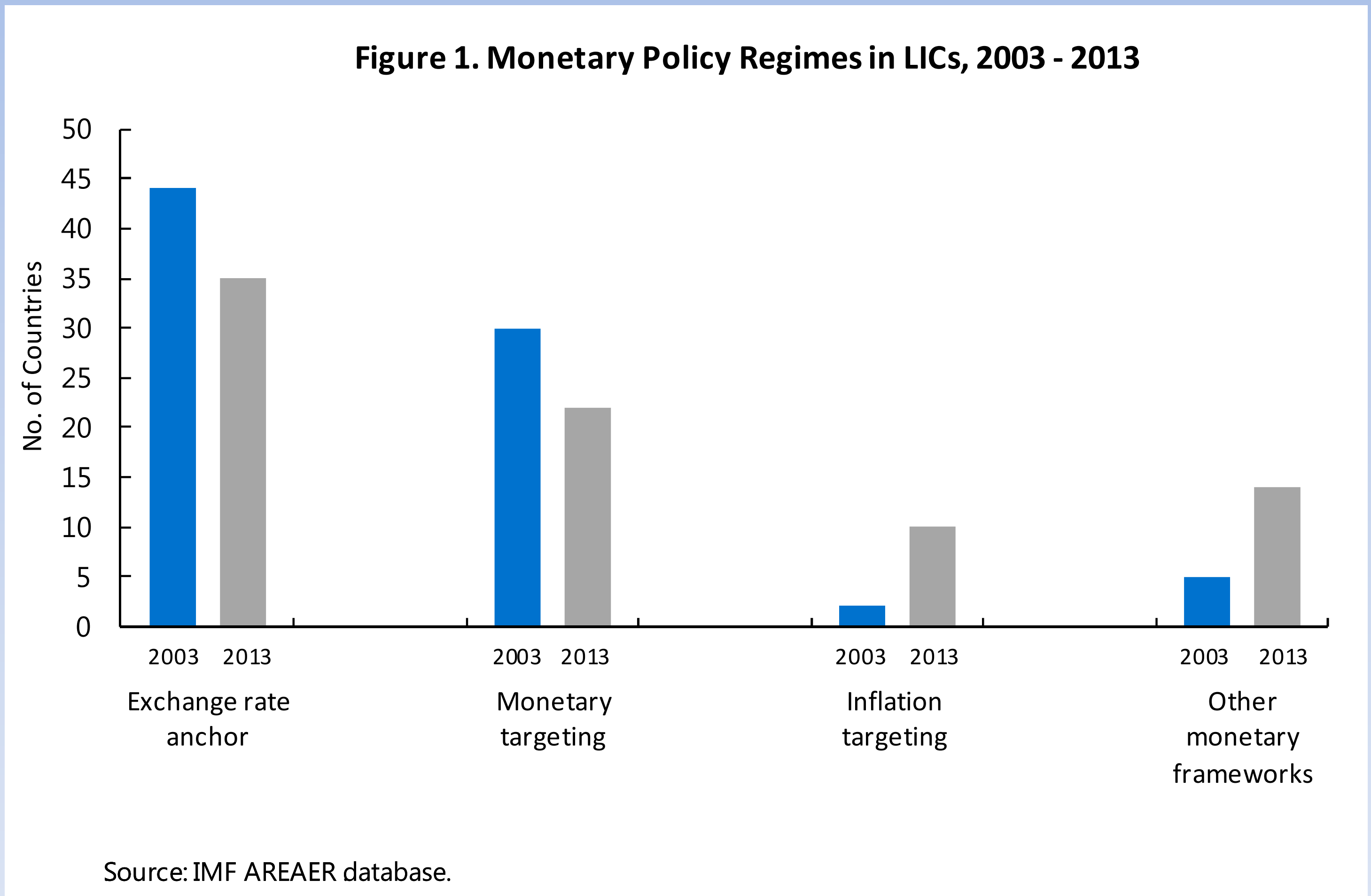
But inflation is still basically under control



What is different?

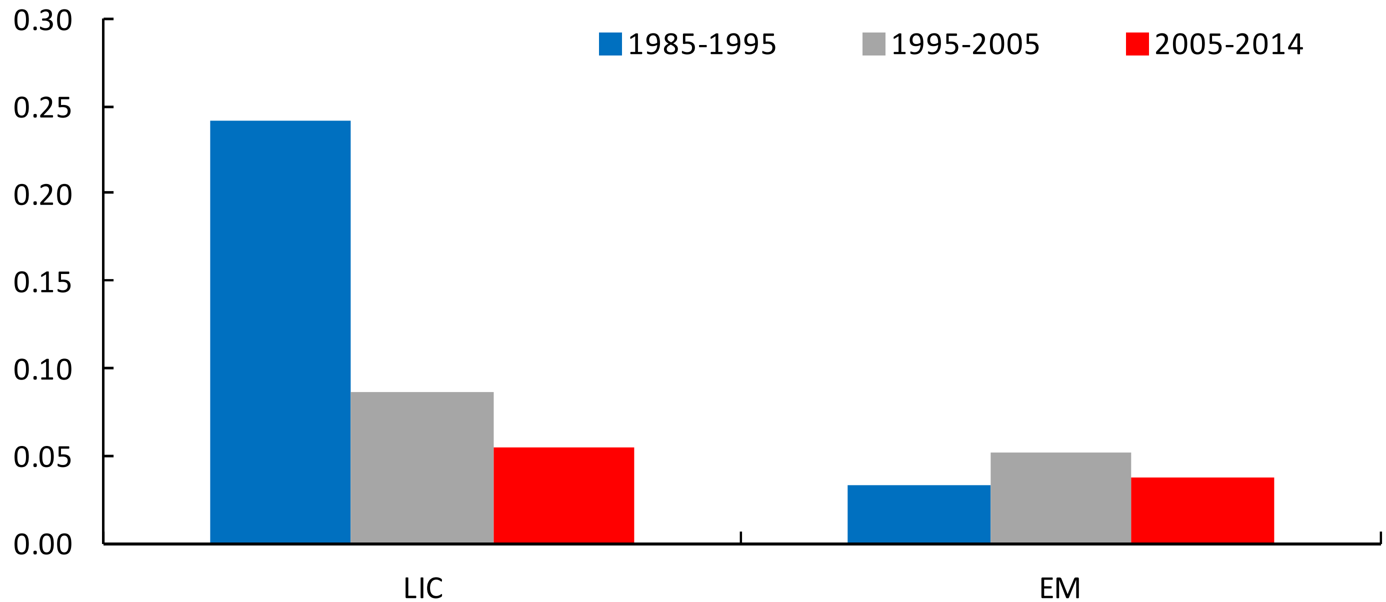
- More financial integration with the rest of the world.
- More reliance on markets.
- Better macroeconomic management.
- Deeper financial markets.
- Result:
  - Market conditions more closely aligned with global markets, but…
  - Policies more effective in preserving macroeconomic stability, better supporting growth.

LICs, including African countries, are moving away from rigid anchors.



Intervention in foreign exchange markets is down to emerging markets levels

Figure 2. Intervention to Foreign Exchange Market Index in LICs and EMs[1]

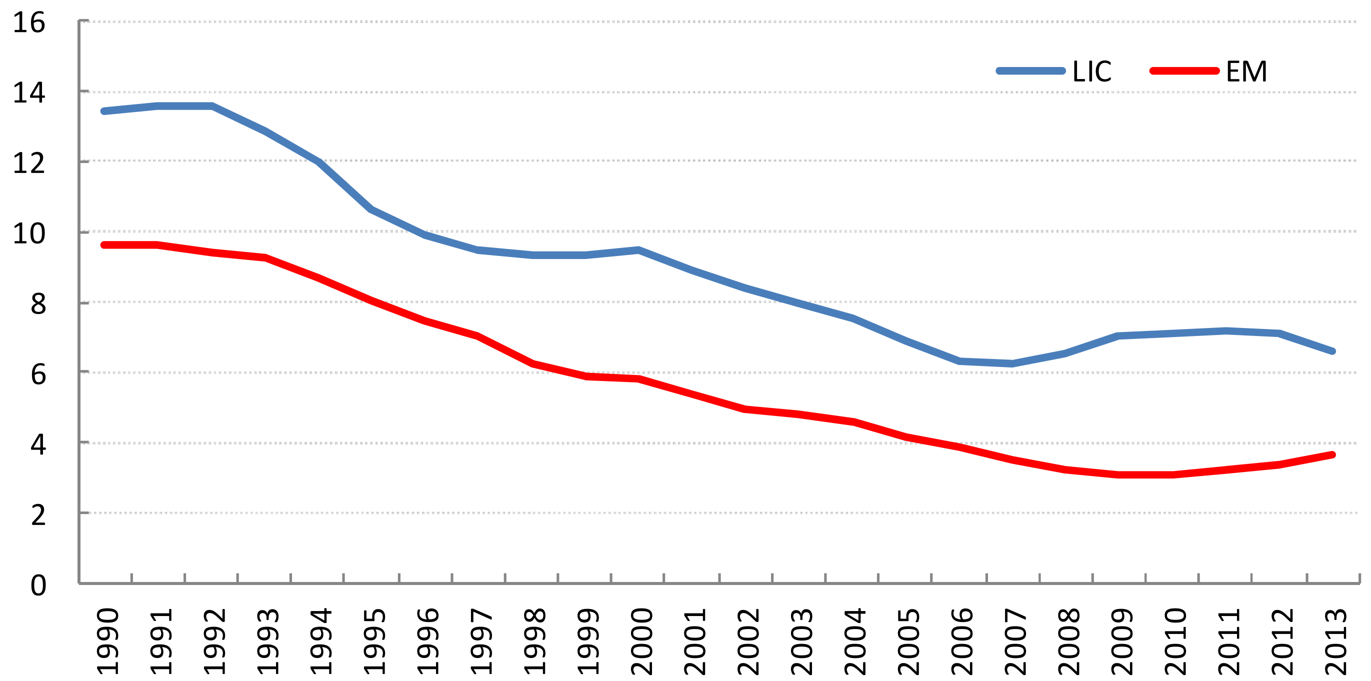


[1] Following Levy Yeyati et. al. (2013), the index is calculated as the annual average absolute change in net international reserves relative to the monetary base in the previous quarter, both in US dollars.

Source: IFS and IMF staff calculations.

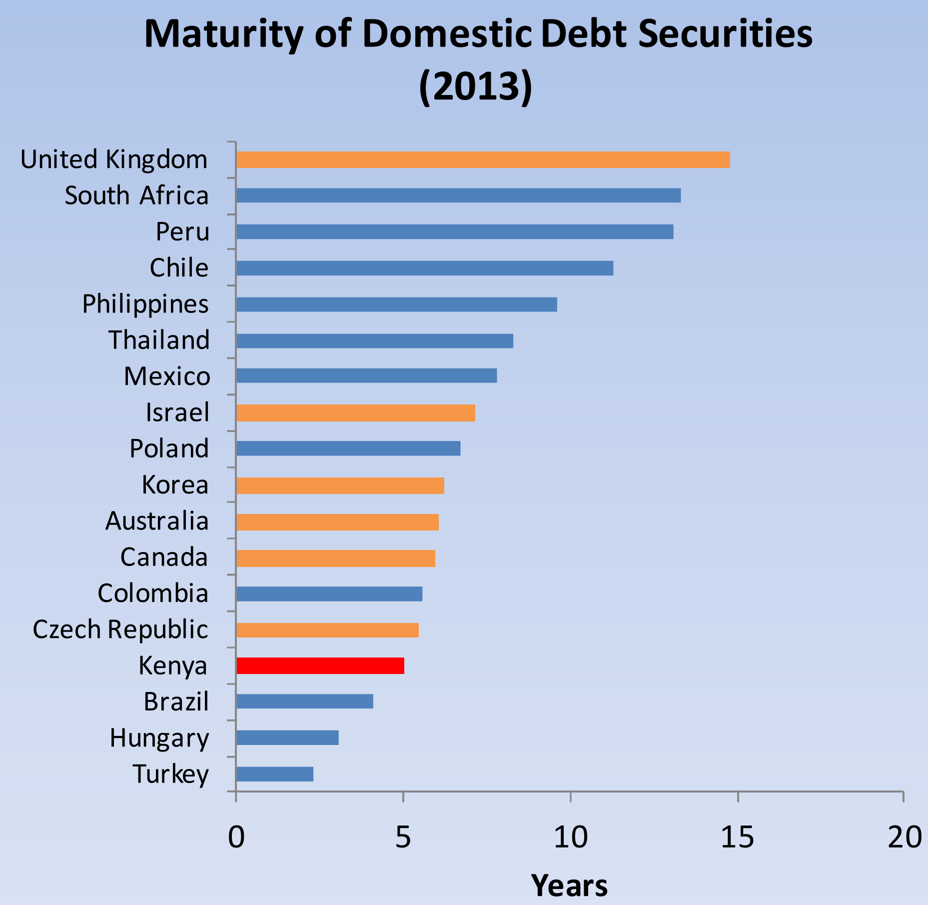
Central Bank credit to government has declined, but has remained higher than in emerging markets.

Figure 3. Central Bank Credit to Government in LICs and EMs
(5 year moving averages, in % of GDP)



Source: IFS and IMF staff calculations.

Developing government securities markets is a pending task, Kenya shows that it is not impossible



Changes in Monetary policy frameworks

- More open capital account.
- Better communication with public.
- Gradual shift to forward-looking monetary policy.
  - Concerns because of frequent and large supply shocks.
  - High weight of agricultural products in consumer basket.
  - Data weaknesses, especially to assess expectations.
- However, none of these concerns justify not to move towards a more effective monetary policy framework.

Scope of monetary policy framework

- Institutional and legal structure: Clear central bank mandate.
- Central Bank priority goal: Price stability.
- The specification of intermediate and operational targets should be “as forward-looking as possible.”
- Instruments and operating procedures. Clear signals to guide liquidity management decisions.
- Clear communication about central bank intentions.
- Transparency and independence help create favorable conditions.

2010 transparency scores (Dincer and Eichengreen, 2014)

Top 5	Bottom 5
South Africa (8.5 out of 15)	Angola (1 out of 15)
Namibia (7.5 out of 15)	Malawi (2 out of 15)
Kenya (7 out of 15)	Ethiopia (2.5 out of 15)
Ghana (7 out of 15)	Tanzania (2.5 out of 15)
Mauritius (6.5 out of 15)	Zambia (2.5 out of 15)

2010 independence scores (Dincer and Eichengreen, 2014)

Top 5	Bottom 5
Kenya (0.67 out of 1)	South Africa (0.15 out of 1)
Sierra Leone (0.67 out of 1)	Uganda (0.28 out of 1)
Lesotho (0.62 out of 1)	Mozambique (0.34 out of 1)
Tanzania (0.56 out of 1)	Namibia (0.36 out of 1)
Angola (0.52 out of 1)	Zambia (0.36 out of 1)

Take aways

- Easing of global financial conditions will continue, with gradual correction in the US:
  - Exchange rate re-alignment, exacerbated by lower oil prices.
  - Expectation of higher interest rates, especially long term.
- Exchange rate and interest rate trends has led to lower risk appetite, with impact on market conditions and risks, affecting EM and LICs.
- Room for maneuver thanks to achieved macro stability.

Take aways (cont.)

- Changing conditions make use of exchange rate anchors and monetary targets more complicated (except for countries peg to the Euro, to some extent).
- Continuous progress in improving monetary frameworks will prepare countries for a more volatile world.
- More decisive progress needed in developing domestic securities markets and moving towards forward-looking monetary policy.
- Efforts to improve monetary policy frameworks should follow a holistic approach.

GRACIAS!