Annex 1

ASSOCIATION OF AFRICAN CENTRAL BANKS (AACB)

37th ORDINARY MEETING OF THE AACB

(Port-Louis, Mauritius, August 23, 2013)

DRAFT REPORT ON THE SYMPOSIUM FOR YEAR 2012 ON THE THEME « CHALLENGES OF COMMODITY PRICES AND CAPITAL FLOW VOLATILITY FOR AFRICAN CENTRAL BANKS »

(Algiers, Algeria, August 29, 2012)

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1. INTRODUCTION

1.1. The Association of African Central Banks (AACB) held its traditional Symposium on the 29^{th} August 2012 in Algiers (Algeria) on the theme « *Challenges of commodity prices and capital flow volatility for African Central Banks* » as a prelude to the 36^{th} Ordinary Meeting of the Assembly of Governors that was scheduled to take place on 30^{th} August 2012.

2. OPENING CEREMONY

2.1. The highlights of the opening ceremony were the four addresses delivered respectively by Mr. Mohammed Laksaci, Governor of the Banque d'Algérie and Vice Chairman of the AACB, Dr. Maxwell Mkwezalamba, Commissioner for Economic Affairs at the Africa Union Commission (AUC) representing the Chairman of the AUC, Mr. Charles Chuka, Governor of the Reserve Bank of Malawi and Chairman of the AACB, and His Excellency Karim Djoudi, Minister of Finance of the People's Democratic Republic of Algeria, who officially opened the proceedings.

2.2. Mr. Mohammed Laksaci expressed his gratitude to the Hon. Minister for having accepted to chair the opening ceremony of the Symposium and proceeded to thank all the participants for honouring the invitation extended by the Banque d'Algérie in order to deliberate on crucial issues facing African Central Banks.

2.3. Governor Laksaci stated that the persistence of the global financial crisis over the last five years had generated new challenges for Central Banks including that of financial stability in relation to heightened financial volatility. For African Central Banks these challenges are combined with those related to commodity price volatility and in some cases the volatility of capital flows.

2.4. Turning to the Banque d'Algérie, Mr. Laksaci noted that prudent macroeconomic management from the early 2000 has consolidated the resilience of the Algerian economy up against external shocks despite her dependence on exports from the hydrocarbons sector.

2.5. Thus, in spite of the surge in the importation of goods and services, the early redemption of the public debt at a more sustained rythm between 2004 and 2008 enabled the consolidation of external financial stability before the global financial crisis broke out. Also, due to a prudent management, the official reserves reached appreciable levels which enabled the country to face shocks linked to the volatility of commodity prices. Further, with the accumulation of fiscal savings in the Stabilization Fund, fewer enterprises sought bank financing which dropped to a very marginal level in a context of structural excess liquidity on the currency market.

2.6. The Vice-Chairperson of the AACB also pointed out that the combination of micro prudential controls and the strengthening of the instruments of control and supervision has contributed to the enhanced stability and solidity of the Algerian banking system. He concluded by noting that commodity price volatility whose impact on domestic prices has been heightened by the dysfunctional domestic markets, remains a challenge to the conduct of the Banque d'Algérie's monetary policy.

2.7. On behalf of H.E. Dr. Jean Ping, Chairperson of the AUC, Dr. Maxwell Mkwezalamba commended AACB's good quality work to promote monetary integration in the continent. He also thanked the Governor of the Banque d'Algérie, the Government and the People of the People's Democratic Republic of Algeria for their warm and fraternal welcome accorded to the Symposium's participants.

2.8. He underscored the relevance and timeliness of the theme of the Symposium in the light of recent and current developments in the international economic environment, especially the pursuit of volatility observed both on the capital and commodity markets. He said that these movements which may not be driven by changes in the macroeconomic fundamentals, play an important role in the decision making process. He illustrated this by the positive impact of capital inflows and rising commodity prices on economic growth rates in African countries between 2001 and the onset of the global financial and economic crisis. He said, however, that the volatility in commodity prices and capital flows that followed the global financial and economic crisis, has had a negative impact on macroeconomic stability of a number of African countries. Further, during the energy and food crises, many African countries experienced sharp increases in inflation which resulted in real exchange rate appreciation.

2.9. The Commissioner emphasized the need for a policy shift aimed at addressing the detrimental effects of the volatility in commodity prices and capital flows with central banks at the centre of policy prescriptions. In this regard, he wished that the discussions positively contribute to the conduct of monetary and exchange rate policy in Africa, as well as contribute to the on-going work on the establishment of the African Central Bank (ACB) and the single common currency.

2.10. Mr. Chuka thanked the Algerian authorities for their warm and fraternal welcome accorded to the Symposium's participants. He particularly hailed the presence of Honourable Minister Djoudi in the opening ceremony of the Symposium. He said that this evidences the unwavering commitment of Algeria to the achievement of Africa economic and monetary integration in Africa. He also thanked the Governor of the Banque d'Algérie and the staff of this institution for the excellent arrangements made for the success of the annual meetings. Further, he acknowledged the presence of the representatives of central banks and those of other African and international institutions.

2.11. Mr. Chuka then underscored the relevance and timeliness of the theme of the Symposium in connection with the recent global economic crisis. He observed that there are signs that African economies are recovering from the aftermath of the global crisis, owing among others, to increased investment flows towards Africa. The AACB's Chairman, however, drew the participants' attention to factors which can jeopardize the pursuit of this favourable trend, especially the increasing volatility observed on the capital and commodity markets.

2.12. He stated that capital volatility and commodity prices volatility are the main current challenges to the design and implementation of monetary policy. In this regard, he wished that the discussions contribute to recommendations that could help address these challenges.

2.13. Mr. Karim Djoudi began by expressing his gratitude to the Assembly of Governors for having chosen Algeria to host the Symposium. He then hailed the participants to the forum before embarking on the validity and relevance of the theme. In substance, he dwelt on the challenges arising from the recent developments in the global economic environment and called for the implementation of appropriate fiscal and monetary policies. To this end, he expressed his confidence in the capacity of the Governors of Central Banks to address the challenges of commodity price volatility and capital flows.

2.14. The Minister for Finance shared the Algerian experience. He reminded his audience of the economic policies that had contributed to the resilience of the Algerian economy. These were mainly the steps taken towards diversification in a bid to reduce the dependency of the Algerian economy on oil. These efforts led to significant growth in production by non hydrocarbon sectors. He also mentioned the debt policy characterized by the anticipated reduction in foreign commitments, the flexible exchange rate policy conducted by the Banque d'Algérie, the prudent management of currency reserves that led to an accumulation of external resources and the sterilization by the State of surplus tax revenues.

2.15. The Minister further underscored Algeria's clear vision and firm commitment to the concretization of a united and integrated Africa. This vision has led to the solidarity extended to some African countries where Algeria has participated in debt relief under the HIPC initiative (Highly Indebted Poor Countries). In this connection, the Minister expressed the desire for the fast tracking of the monetary integration process underway in Africa.

2.16. He wished the forum fruitful deliberations that would contribute to enhancing the resilience of African economies before declaring the Governors' 2012 Symposium officially open.

3. PLENARY SESSION ONE

3.1. Introduction

3.1.1. This session was held under the chairmanship of Mr. Rundheersing Bheenick, Governor of the Bank of Mauritius. The session discussants were Dr. Louis Kasekende, Deputy-Governor of the Bank of Uganda, and Mr. Luca Abaga Nchama, Governor of the Banque des Etats de l'Afrique Centrale (BEAC). The proceedings covered the theme on "*Volatile Global Commodity Prices and Capital Flows: Implications for Monetary Policy by African Central Banks*" presented by Professor A. Ghoufi of the University of Biskra (Algeria).

3.2. Summary of the presentation

3.2.1. Prof. A Ghoufi's presentation encompassed the following four areas: (i) the definition, origin and impact of volatility, (ii) commodity price volatility, (iii) commodity price fluctuations and the macroeconomic volatility of African economies and (iv) commodity volatility and African monetary policies in the wake of the 2008 crisis.

3.2.2. From this presentation, it emerged that volatility is expressed through rapid and major variations of economic variables that are difficult to forecast over time. It is mainly due to low levels of the price elasticity of supply and the demand for goods. It affects resource allocation, the capacity of economic players to make decisions as well as the profitability and viability of small scale projects. Further, global price volatility hampers the control of the major macro-financial equilibria as well as monetary and financial stability.

3.2.3. Concerning the volatility of commodity prices, erratic developments have been observed in three major phases over the last forty years: (i) a sustained commodity price increase phase notably oil and gas in the 1970s, (ii) a price slump phase during the 80 and 90s decades which plunged commodity exporting economies with a high absorption capacity into a deep recession and (iii) a phase of sustained price increase during the first decade of the 21^{st} century.

3.2.4. African economies are generally exposed to the volatility of export prices as well as to that of import prices. The external accounts are the main vectors for the transmission of the impact of commodity price fluctuations. The extent of the transmission depends on several factors such as the level of structural dependency on the commodity, the systemic and institutional framework, the pro-cyclical and anti-cyclical nature of economic and fiscal policies, the exchange rate regime and the degree of capital account openness.

3.2.5. The analysis of commodity price volatility and monetary policies in Africa was based on the cases of Algeria and the economies of the member States of the West African Monetary Union (WAEMU).

3.2.6. The Algerian economy is characterized by its structural dependency on hydrocarbons and a weak openness of the capital account. The pro-cyclicality of the fiscal policy is reflected in the establishment of a revenue stabilization fund financed by oil tax revenues surplus. As for the monetary policy, the main objectives are price stability, financial stability and the creation of conducive conditions for the sustained growth of economic activity. In this connection, the Banque d'Algérie has implemented inflation targeting and floating exchange rate policies.

3.2.7. The 2008 crisis came in a context notably characterized by excess liquidity in the primary banks. The 2009 shock, in the wake of the September 2008 global financial crisis, mainly led to the deterioration of macro-economic indicators. However a reversal trend occurred with higher oil prices that followed in 2010 and 2011. The intervention by the Banque d'Algérie in the exchange markets and the monetary policy appropriate to the prevailing context for implementation succeeded to a large extent in stabilizing inflation.

3.2.8. In the case of WAEMU, the major monetary policy objective of the Banque Centrale des Etats de l'Afrique de l'Ouest (BCEAO) is the maintenance of price stability within the zone which has adopted a fixed exchange rate regime. The economies in the zone are characterized by high macroeconomic volatility linked to their sensitivity to the fluctuations of commodity prices. The WAEMU is not highly integrated into the global financial system. Its relatively small financial market is also characterized by flush liquidity. In a certain respect, the fiscal policy is pro-cyclical.

3.2.9. The financial shock of 2009 led to a lower GDP growth rate combined with diminished inflationary pressures which facilitated the adoption by the BCEAO of an accommodative monetary policy. The recovery of economic activity accompanied by a moderate rise in inflation occurred in 2010. In 2011, WAEMU experienced several shocks including the Ivorian crisis and above all the global recession deeper than the 2009 one. Despite high volatility as well as the increase and variety of shocks experienced by WAEMU during the post 2008 period, the BCEAO monetary policy largely succeeded in stabilizing the internal and external value of its currency and in guaranteeing the resilience of this zone to economic shocks.

3.2.10. On the whole, despite the extent of the economic shock experienced in 2009 and the ensuing economic downturns, and given the institutional framework and the macro-financial context specific to Algeria and to the WAEMU member countries, the monetary policies of both the Banque d'Algérie and the BCEAO largely succeeded in stabilizing the economic cycle arising from commodity price fluctuations. However, doubts linger over the future developments regarding commodity prices.

3.3. Summary of the Discussions

3.3.1. Following the presentation by Prof. Ghoufi, the Deputy Governor of the Bank of Uganda, one of the discussants in session two noted the difference in response under a fixed exchange regime and a flexible exchange regime. He proposed that the debates highlight appropriate responses to the impact of volatility of global commodity prices, the applicability of monetary aggregate targeting and the consideration of growth imperatives in the conduct of monetary policy.

3.3.2. On his part, the Governor of the BEAC emphasized the importance of sound coordination between monetary and fiscal policies. He then examined the transient or permanent nature of volatility as currently observed and advocated, in both cases, for Central Bank intervention. Discussing the impact of volatility on African economies, especially those of the Economic Community of Central African States (CEMAC), he pointed out the good performance of indicators in these countries despite the non compliance by some CEMAC member countries with the convergence criteria.

3.3.3. The comments that followed the presentation by the discussants emphasized the following issues:

- The impact of capital flows from emerging countries on demand and the respective roles of Governments and Central Banks in the formulation and implementation of palliative measures;
- The effectiveness of Central Bank intervention in cases of inflation linked to external shocks;
- The Banque d'Algérie's response to external shocks and the importance and influence of oil on the Algeria's economic growth;
- The impact of the creditor position of oil companies on the intervention by Central Banks.

3.3.4. The facilitators' responses to concerns raised by participants may be summarized as follows:

3.3.5. To the question on the response by the Banque d'Algérie to external shocks, Prof. Ghoufi explained that the monetary policy instruments adopted by the Institution are 7 days to one month term deposits. He noted that the instruments have given satisfactory outcomes and called for their refinement. He also emphasized the need to promote African economic integration by learning from lessons of the European experience.

3.3.6. The Deputy Governor of the Bank of Uganda highlighted the challenge to African economies of the development of appropriate price stabilization instruments. He spoke of the cost of inflation control especially when shouldered by the Central Banks within the framework of exchange rate regulation in order to mitigate the impact of price volatility.

3.3.7. The Governor of the BEAC noted that the maintenance of monetary stability over the medium and long-term is necessary as a confidence building measure aimed at economic entrepreneurs. To this end, the BEAC handles the recycling excess liquidity by channeling surplus States' resources to those in need of financing.

3.3.8. In concluding the session, the Governor of the Bank of Mauritius noted that the reforms undertaken by African countries prior to the financial crisis stood them in good stead for the volatility of capital flows. He also drew the attention of the gathering to the highly volatile nature of short-term capital.

4. PLENARY SESSION TWO

4.1. Introduction

4.1.1. This session was held under the chairmanship of Mr. Charles Chuka, Governor of the Reserve Bank of Malawi (RBM). The session discussants were Mr. Nahr Millison, Deputy Governor of the Bank of Ghana, and M. Tiemoko Meyliet Koné, Governor of the BCEAO. The proceedings focused on the theme "*The Impact of Volatile Commodity Prices on Financial Stability in Africa*" presented by Professor A. Filardo, Expert at the Bank for International Settlements.

4.2. Summary of the presentation

4.2.1. The highlights of Pr. Filardo's presentation were (i) the driving factors of commodity price volatility in recent years, and (ii) the implications of this new environment for African central banks.

4.2.2. Concerning the driving forces of the recent commodity price volatility, the speaker said that though part of this volatility has been of a transitory nature, the relative shift in economic gravity away from the advanced economies to the emerging market and developing economies, the spread of financial globalization and financialisation of commodity markets indicate a more permanent change in the state of affairs. He said that globalisation trends call for shift from country-centric policy frameworks to more globe-centric policy frameworks. He added that the response to future commodity prices shocks depends crucially on the source driving these shocks. In the case of a supply shock, the focus must be on the impact of the rise in commodity prices on inflation expectations. However, soaring global commodity prices in recent years was the result of a persistent global demand shock, which has to be addressed by the tightening of monetary policy. However, operationalising this policy measure at the national level is not easy because global demand shock is perceived as an external supply shock by national policy makers.

4.2.3. With respect to the policy implications for African central banks, Pr. Filardo pointed out monetary and macroprudential policy responses, communication policy and central bank governance.

4.2.4. In terms of monetary policy, the speaker mentioned, among others:

- a greater weight on headline inflation than on core inflation when there is evidence of global demand shocks;

- more attention to core inflation, in case of commodity prices surge due to supply shock and frothiness due to speculation associated with commodity market financialisation;

- easing monetary policy as long as medium-term inflation expectations remain anchored in net importer countries and a somewhat tighter monetary policy stance in net exporters, in regards of the impact of weather-related food price shocks on macroeconomic fluctuations in Africa.

4.2.5. Concerning macroprudential policies, the speaker recommended especially for commodity producing economies, the use of macroprudential tools and more specifically the establishment of strong counter-cyclical fiscal programmes, and investment of the sovereign wealth fund in foreign assets. He recommended also transaction taxes, greater efficiency and stability of payment systems and effective systemic regulation to address speculation related to the financialisation of commodity.

4.2.6. In the realm of Communication policy the speaker advised for clarity of message for public and cooperation between central banks.

4.2.7. With respect to Central bank governance the speaker noted the steps taken by African central banks especially the adoption of the macroprudential approach in addition to the microprudential one and called for more efforts.

4.3. Summary of the Discussions

4.3.1. In his comments, Deputy-Governor Nahr made proposals geared to addressing the "Boom-Bust" Conditions of Commodity prices. These included setting up stabilization measures for non- oil commodities as well as resorting to hedging tools and forward contracts. He also said that political and civil society pressures can make it difficult to implement tightened policy aimed at dealing with upward swings in commodity prices. As to downswings in commodity prices, he said that they should be anticipated and dealt with accordingly.

4.3.2. On monetary and macro prudential policies grounds, Deputy-Governor Nahr stressed the need to put much weight on headline inflation than on core measures of inflation in the case of global demand shocks, and to develop robust forecasting frameworks. He also referred to Ghana's experience to emphasize the importance of coordination of policies among regulatory agencies. Finally, he advised the streamlining of Central Banks' communication strategy in order to get the public to go along with them in their policy implementation.

4.3.3. For his part, Mr. Koné underscored, from the outset, the points of convergence between his views and those expressed by Pr. Filardo. The first point highlighted the explanatory factors underlying price fluctuations. These included, on the one hand, the factors underlying price fluctuations observed in the commodity markets in the 1970s and 1980s which were essentially due to supply-side shocks amplified by expansionary fiscal and monetary policies and on the other, the current dynamics which are closer to demand-side shocks. The second point refers to the macro-economic impact of volatility depending on whether the country is a net exporter or a net importer of basic commodities as well as the difference in the nature of policies applied to each case.

4.3.4. However, on the amplifying effect of monetary policy on the volatility of commodity markets as explained by Pr. Filardo, Mr. Koné noted that the impact of African Central Banks' action was quite weak due to the embryonic nature of African capital markets. He advocated the indispensable coordination between monetary and fiscal policies in response to the rise in the prices of agricultural commodities, the supply of which is particularly sensitive to climatic conditions. Finally, he recommended that given the recurrent shocks, there was need to build the capacity of African Central Banks in terms of monetary and macro prudential policy development and implementation, and to enhance cooperation between these institutions.

4.3.5. Participants' comments centred mainly on:

- the low effectiveness of economic measures within a context of social tensions;
- the instruments at the disposal of the African Central Banks to counter volatility;
- the modalities of policy coordination in the context of a globalized economy and the effectiveness of monetary policy action on institutions beyond the remit of Central Banks.

4.3.6. The answers to the comments made can be summarized as follows:

- Most developed countries, in reinforcing the effectiveness of their monetary policies, have opted to establish financial stability committees comprising the monetary authorities as well as bodies entrusted with the regulation of non-bank institutions;
- Economic entrepreneurs should be sensitized to the need for financial stability and on their responsibility in this field. Recourse to legislation to impose discipline might prove indispensable.

4.3.7. As he concluded the session, the Governor of the RBM praised the high quality of both the presentations and the ensuing debate.

5. PLENARY SESSION THREE

5.1. Introduction

5.1.1. This session was presided over by Mr. Saddek Omar Elkaber, Governor of the Central Bank of Libya. The session discussants were Mr. Sheku S. Sesay, Governor of the Bank of Sierra Leone, and Dr. Lounceny Nabe, Governor of the Banque

Centrale de la République de Guinée. The proceedings focused on the theme "*Short Term Capital Inflows and Sustainability of the Current Account Balance*" presented by Dr. Michael Atingi-Ego, Senior Adviser at African Department at IMF and Dr. Elias Ngalande, Executive Director of the Macroeconomic and Management Institute, (MEFMI).

5.2. Summary of the presentation

5.2.1. The highlights of Dr. Atingi-Ego's presentation were (i) Capital flows to Africa and their main underlying factors, and (ii) policy options in the face of heightened volatility in capital flows.

5.2.2. The analysis of private capital inflows showed that Africa has experienced capital flows comparable to those in other emerging and developing countries, considering the economic size of the recipient African countries. However, compared to that of the emerging and developing countries, the structure of capital flows to Africa flows shows a larger share of foreign direct investment (FDI) and a relatively lower level of net portfolio flows.

5.2.3. Volatility of capital flows to Africa is broadly comparable to that in other emerging and developed economies. Contrary to net capital flows, gross in-and-outflows, particularly portfolio flows, have continued to increase in the aftermath of the global crisis. As in other emerging and developing economies, four factors linked to the development in the global environment may explain the behavior of capital flows to Africa. These are: (i) liquidity conditions and yields in advanced countries; (ii) global economic performance and the associated behavior of commodity prices; (iii) appetite for risk; and (iv) investors' interest for diversification into new markets.

5.2.4. Beyond these exogenous factors, the trends of capital flows to Africa are also explained by country and region-specific factors. These include improved economic fundamentals, the strength of economic, financial and institutional reforms, and commitment to macroeconomic discipline. Strong commodity prices and political factors may also explain the observed behavior of capital flows.

5.2.5. Capital flows are typically beneficial for receiving countries. They can potentially promote investment and growth by expanding the pool of financing resources. But sudden reversals or even stops of capital flows can also be detrimental to macroeconomic stability.

5.2.6. Macroeconomic policies constitute the first line of defense against surging capital inflows and sudden stops of rapid outflows. Among the various macroeconomic policy tools at hand are the exchange rate, foreign exchange reserves, monetary policy interest rates, and fiscal policy. However, selecting appropriate responses can be challenging, given uncertainties associated with the causes, persistence, and possible effects of the flows.

5.2.7. Additional policy tools should be used if traditional macroeconomic policies prove to be insufficient. These can be classified in two separate groups: (i) capital flow management measures, including capital controls and macroprudential measures designed to influence capital inflows directly; and (ii) other macroprudential measures, which are designed to ensure resilience and soundness of financial institutions.

5.2.8. The presentation made by Dr. Ngalande was articulated around five main areas. These are (i) the characteristics, determinants and composition of capital inflows, (ii) the trend in capital flows to Africa, (iii) the capital inflows and the current account sustainability, (iv) the policy implications of short-capital inflows and (v) the experiences and lessons for Africa.

5.2.9. It emerged from the presentation that capital inflows are reflected in net international indebtedness of the private and the public sectors associated with widening current account deficits. They are accompanied by resurgence in economic growth and accumulation of international reserves. They also bring about inflationary pressures, exchange rate volatility, real exchange rate appreciation, stock market bubbles and excessive expansion in domestic credit. The reversal of short term capital leads to a financial crisis. Capital flows are made up of capital account and or financial transactions. Financial account transactions comprise foreign purchases of domestic securities, FDIs, portfolio investments, and loans from foreign banks.

5.2.10. Though global capital flows have expanded fairly rapidly over the past three decades, very little has been destined to Africa. Capital flows to developing countries are largely composed of FDIs which have lower relative volatility. FDIs are attracted by factors such as strong macroeconomic fundamentals. They have scope to directly expand investment in the real sector and are stable over time. On the other hand short-term flows tend to be attracted by high relative short-term interest rates and to be associated with excess consumption, which may be unsustainable.

5.2.11. Capital flows to Africa, particularly external borrowing are geared to financing current account deficit. However, reliance on external debt may lead to high interest payments and unsustainable current account deficit. Further, the reversal of short-term capital inflows can destabilize the current account balance through foreign exchange.

5.2.12. Policy responses include avoiding the expansion of high powered money through sterilisation of excess liquidity. They include also inducing current account deficits to offset net capital inflows, through trade liberalisation.

5.2.13. On the basis of the lessons learnt from the recent experiences, African countries can, in the event of an increase in short-capital inflows, allow expansion of base money but control the growth of the broad money through tight monetary policy. Selective credit policy can also be used to channel money to productive sectors. The inflationary effects of the expansion of broad money can also be prevented through fiscal contraction.

5.3. Summary of the Discussions

5.3.1. In his comments the Bank of Sierra Leone's Governor, one of the session's discussants, first summarized the presentation made by Pr. Filardo. He emphasized the positive and negative effects of capital inflows, the impact of outflows, the merits of FDIs and the policy responses suggested by the speaker.

5.3.2. He also shared Sierra Leone's experience. He said that Sierra Leone is a small open economy dependent on donor support and export of few minerals. Its monetary policy programme is a Monetary Aggregate Targeting policy framework. The Central Bank has recently introduced a monetary policy rate to signal monetary policy stance and anchor inflation expectations at lower levels which has resulted in steady improvement in inflation since the start of 2012. The Central Bank envisages increasing recapitalization which would assist in strengthening monetary policy with the view to, among other, deepening the inter-bank market. As far as the exchange rate policy is concerned, Sierra Leone, which implements the IMF Article VIII, operates a floating exchange rate. The Central Bank does not directly target the exchange rate but target monetary aggregates to influence price, output and exchange rate. The country has little problems with short term capital flows but with expansion in mining activities, this may become an issue.

5.3.3. Coming back to the issues addressed in the presentation Governor Sesay underscored the need to also consider the fiscal side, namely countercyclical policies, which should complement monetary and exchange rate policies.

5.3.4. In his statement, Dr. Nabe indicated that in several emerging and developing countries, foreign capital inflows arise from growth-based export strategies or come as a result of macro-economic reforms likely to enhance stability and make these countries more attractive. On the other hand, massive inflows of capital in the African countries have often been perceived from the angle of the advantage these provide to their economies especially as a cushion against balance of payment crises and major exchange rate fluctuations.

5.3.5. The capital inflows observed in Africa prior to the first financial crises are comparable to those in some emerging countries. Africa's good performance was due to both internal and external factors. However, if the accumulation of foreign reserve has its advantages, high levels of reserves could prove to be a source of serious macroeconomic instability. Thus, in a bid to reduce their vulnerability as regards major movements of capital, the countries of the continent should pursue structural reforms, the implementation of sound fiscal policies and the proper coordination of fiscal and monetary policies.

5.3.6. After the discussants, the other participants made comments on the following issues:

- The impact of capital volatility: it was suggested that in carrying out an analysis of capital volatility, a distinction should be made between long and short term capital. The latter does not only have a higher degree of volatility but has weak impact on economic growth;

- The quality of statistics: in view of the foregoing, it is necessary to set up a statistical system for the correct and timely capture of the nature and extent of capital flows;

- The cost of capital volatility: speakers noted that the instability of capital can be damaging to the economy. Furthermore, policies aimed at mitigating the incidence of short term capital flows such as interventions on exchange markets or sterilization measures can prove to be highly onerous. It might be necessary to revert to a mechanical readjustment of the national currency parity;

- The need to take into account fiscal objectives in the quest for palliative measures in order to determine the country's absorption capacity and for better guidance to be undertaken.

6. PLENARY SESSION FOUR: AACB SUB-REGIONS' EXPERIENCES

6.1. Introduction

6.1.1. This session was chaired by Dr. R. A. Matlanyane, Governor of the Central Bank of Lesotho. The session dicussants were Mr. Oduetse A. Motshidi, Deputy-Governor of the Bank of Botswana, and Mr. Sid'Ahmed RAISS, Governor of the Banque Centrale de Mauritanie. Four presentations were given on Sub-regions' experiences by the South African Reserve Bank (SARB), Banque des Etats de l'Afrique Centrale (BEAC), the National Bank of Rwanda and the Bank of Namibia.

6.2. Summary of the presentations

6.2.1. The SARB's experience

6.2.1.1. The presentation made by Mrs. Linda Motsumi, Head of the Balance of Payments Division of the SARB indicated that South Africa has one of the most liquid currencies among emerging market economies (EMEs), which contributes to volatility in the movements of the South African rand. During 2010, South Africa, like other EMEs, experienced large capital inflows accompanied by a rapid currency appreciation. These developments had benefits, including helping to keep the balance of payments surplus, to preserve external stability and to put a downward pressure on inflation. However, they created challenges including, inter alia, uncertainty amongst export-oriented industries and exposure to the risk of potential capital reversals because of the short-term nature of much of capital flows to South Africa.

6.2.1.2. Following the assessment of these inflows South Africa chose to sterilise them and to liberalise controls on outflows despite sterilisation costs and at a time of budgetary pressures. South Africa also used "macroprudential" tools that helped to address the various risks related to capital flows. SARB reduced its interest rate as its inflation rate stood at low levels. Further, budget surplus recorded toward the end of the pre-crisis boom period as a result of counter-cyclical fiscal policy enabled South Africa to provide a stimulus during the recession. Regarding exchange, SARB has a market-oriented policy and used the opportunity of rand strength to increase the pace of reserve accumulation in line with its strategy which aims at mitigating external vulnerabilities.

6.2.1.3. As far commodity as prices volatility is concerned, South African exporters of mining commodities have somewhat been affected by the decline in international commodity prices, since the second half of 2011. Alongside this, declining volumes of mining production resulted in the decrease in export earning of mining products and partly contributed to the widening of the current account deficit over the period.

6.2.1.4. While the volatility is undesirable the flexibility of the exchange rate proves to be an important buffer in some instances.

6.2.2. The BEAC's experience

6.2.2.1. The case of the BEAC was tabled by Mrs Florence Limbio, 1st Deputy Director for International relations. Her presentation covered four areas, namely: (i) a review of the CEMAC institutional framework, (ii) recent economic developments at CEMAC, (iii) price trends and determinants in the CEMAC region and (iv) monetary policy implications.

6.2.2.2. The main thrust of her presentation was that CEMAC monetary policy is conducted by the BEAC with the main objective being price stability and appropriate foreign reserve levels. The CEMAC currency is pegged to the euro at a fixed exchange rate.

6.2.2.3. An analysis of recent economic trends in the CEMAC region mainly highlights accelerated economic activity during 2011. The impetus came from massive capital inflows and high export prices attributed to the rise in export product prices especially petroleum which represents the bulk of CEMAC foreign sales despite the growing importance of other products.

6.2.2.4. In the aftermath of the sharp increase in prices observed in 1994 in relation to the reorganization of the parity of the CFA franc to the French franc, inflation dropped up to 1999. It has been kept under control since then with episodic increases. On the whole, the main determinants for inflation in the CEMAC are its inertia component, imported inflation and exchange rate dynamics.

6.2.2.5. For the CEMAC countries, the implications of commodity price rises are closely linked to Franc Zone mechanisms. Due to the CEMAC institutional and management mechanisms, strong prices for the commodities exported by the members of the Community have led to budget surpluses for the oil producing countries and steady growth of the BEAC's external assets. For the past ten years, this has also led to the sound improvement of bank liquidity. These developments come with challenges linked to the optimal management of foreign reserves and to member state cash flows as well as excess liquidity in the banking system.

6.2.2.6. In this respect, the BEAC regularly sterilizes capital inflows in order to prevent adverse effects. The Bank has also mooted the establishment of sovereign funds. Furthermore, it has proposed several new investment products notably term deposits ranging from three months to five years. Finally, as regards excess bank liquidity, the BEAC and other sub regional monetary authorities have embarked on the modernization of the CEMAC economic and financial environment mainly through the establishment of capital markets and the opening up of the monetary market to several players.

6.2.3. <u>The National Bank of Rwanda's experience</u>

6.2.3.1. The experience of the National Bank of Rwanda was presented by Ambassador Claver Gatete, Governor of this institution. The presentation highlighted the background of developments in commodities and capital markets, the commodities market and capital flow volatility and the related challenges for developing countries.

6.2.3.2. Concerning the background, it appears from the presentation that most low income countries recovered from the global crisis. However, there is a need to reinforce the resilience of these economies which might be jeopardized by downside risks emanating from a loomy global outlook. These include the increased volatility displayed by commodity markets in recent years due to a series of changes in global supply and demand patterns as well as short term shocks in key commodity and raw material markets.

6.2.3.3. About the factors driving the developments on commodity markets the presentation pointed out the changes in global economic conditions. Other causes mentioned, as far as developing countries are concerned, include strong seasonal patterns of agricultural production, structural factors such as demographic growth, and the impact of climate change, and that of developments in world prices.

6.2.3.4. On capital flow it was said, capital flows volatility is generally higher in developing economies than in advanced economies. This undermines the developing countries' ability to achieve their development goals due to difficulties to properly design and implement fiscal policies. Further, maintaining monetary stability become very challenging in this context.

6.2.3.5. To conclude, Governor Gatete advised on the need for coordination of budgetary and monetary policies.

6.2.4. <u>The Bank of Namibia's experience</u>

6.2.4.1. The presentation on Bank of Namibia's experience was made by Mr. Ebson N. Uanguta, Deputy- Governor of this Institution. It showed that Namibia is a relatively open economy based on the export of raw materials particularly those of the mining sector. The country is therefore highly vulnerable to commodity price volatility. The recent volatility particularly affected the economy. This is reflected in the decrease in GDP in 2009 due to the drop in the terms of trade.

6.2.4.2. However, the Namibian economy has rapidly recovered from the 2008 crisis. Owing to the performance of the secondary and tertiary sectors its average economic growth rate for the period 2010-2012 (4.6%) was significantly above the growth rate of population.

6.2.4.3. The underlying factor explaining Namibia's growth resilience has been the diversification of the economy reflected in the increasing shares of the secondary and tertiary sectors in the GDP. In contrast, the share of the primary sector, which was formally the base of the economy, has dramatically decreased. Further, though the Central Bank implemented a restrictive monetary policy, it established a special programme to support economic growth.

6.2.4.4. Concluding his presentation the Deputy-Governor highlighted the persistent effects of the crisis. Therefore, he underscored the need to carry out an in-depth reflection on the nature of macroeconomic fiscal and monetary policies. He also called for a regional approach to addressing the challenges facing central banks.

6.3. <u>Summary of the Discussions</u>

6.3.1. Mr. Oduetse A. Motshidi, one of the discussants, underscored the similarities of problems facing the Central Banks as well as the palliative measures adopted. In sharing his country's experience, he indicated that during the crisis, owing to its weak linkage to the global financial system, the Botswana financial sector was only lightly affected as opposed to the mining sector which bore the brunt of the impact. In response to the shock, public spending cuts were instituted. Furthermore, the level of previously accumulated reserves helped mitigate the impact of the shock. The Deputy-Governor ended by highlighting the importance of communication.

6.3.2. The statement by the Governor of the Banque Centrale de Mauritanie (BCM) was about the measures taken by the Bank regarding the volatility of commodity prices as well as capital flows.

6.3.3. From the first part of the statement it emerged that Mauritania is structurally exposed to commodity price volatility for both exports and imports. Between 2007 and 2012, the country experienced commodity price volatility, the worst case scenario occurring in 2007/2008 when the price of energy and food products rose within the context of stagnant export product prices. However, over the 2010-2011 period, the impact of a higher energy bill was largely offset by the surplus generated from the rise in export product prices which led to a significant improvement in the balance of payments current account. But this favourable situation brought challenges such as those linked to growth, balanced pubic accounts, appreciating exchange rates and price stability. In this context, the BCM implemented an accommodative monetary policy to forestall the aggravation of the impact of higher energy and food products prices on domestic demand. Owing to this policy, inflation was contained to acceptable limits. Furthermore, the flexible exchange rate promoted by the BCM helped mitigate the incidence of commodity price volatility, preserve the competitive edge of the economy and enhance foreign exchange reserves.

6.3.4. The second portion of the statement indicates weak capital inflows (an average of 12% of the GDP), predominantly comprising medium and long-term official loans and foreign direct investment. However, foreign direct investment has risen significantly over the last few years owing to an improved investment climate and high commodity prices. Despite its adherence to Article VIII of the Articles of Agreement of the IMF, Mauritania has maintained controls on capital transactions. As a result, the Mauritanian economy is less exposed to the volatility of capital flows.

6.3.5. The ensuing debate highlighted the need for a case-by-case analysis of volatility. In substance, it was suggested that on price volatility, there should be a distinction made between imported inflation and endogenous inflation for a better adaptation of palliative measures. They also emphasized the need for a coordinated approach at the national and regional levels for the prevention and management of the effects of volatility.

6.3.6. It was also pointed out that there is need for Central Banks to see to it that economic entrepreneurs have a correct perception of the messages underlying the instruments as applied.

6.3.7. The debate also emphasized the urgency of stepping up the process towards the establishment of the African Monetary Fund and the African Central Bank. The need for the reform of the IMF Articles of Agreement to ensure better management of the priorities of African countries was also mentioned.

6.3.8. The Chairperson of the session noted the complementarity between the presentations on the theoretical aspects of the overall theme and the presentations made by the Central Banks on their experiences.

7. CONCLUSION

7.1. In his concluding remarks to the Symposium, the Chairman of the AACB noted the relevance and validity of the theme of the Symposium. He went on to praise the rich discussions which highlighted the challenges facing Central Banks, the need for the coordination between fiscal and monetary policies and enhanced Sub-Regional integration.