ASSOCIATION DES BANQUES CENTRALES AFRICAINES

ASSOCIATION OF AFRICAN CENTRAL BANKS

ASSOCIATION OF AFRICAN

CENTRAL BANKS (AACB)

45th ORDINARY MEETING

OF THE ASSEMBLY OF GOVERNORS

(Livingstone, Zambia, August 4, 2023)

2023 SYMPOSIUM OF GOVERNORS ON THE THEME:

« RECURRENCE OF SHOCKS AND MACROECONOMIC IMPLICATIONS FOR AFRICAN ECONOMIES: CHALLENGES AND PROSPECTS FOR CENTRAL BANKS »

(Livingstone, August 3, 2023)

REPORT

ACRONYMS

AACB: Association of African Central Banks

AfCFTA: African Continental Free Trade Area

ACH: Automated Clearing House

AMCP: African Monetary Cooperation Program

AU: African Union

AUC: African Union Commission

BoZ: Bank of Zambia

CBDC: Central Bank Digital Currency

CBG: Central Bank of The Gambia

CBL: Central Bank of Liberia

DLT: Distributed Ledger Technology

EAC: East African Community

ECOWAS: Economic Community of West African States

Fed: US Federal Reserve

GDP: Gross Domestic Product

IMF: International Monetary Fund

IPF: Integrated Policy Framework

LDCs: Least Developed Countries

MEFMI: Macroeconomic and Financial Management Institute of Eastern and Southern Africa

MSME: Micro, Small, and Medium-Sized Enterprises

NBR: National Bank of Rwanda

NGFS: Network for Greening the Financial System

QE: Quantitative Easing

RBZ: Reserve Bank of Zimbabwe

RECs: Regional Economic Communities

RTGS: Real Time Gross Settlement System

SSA: Sub-Saharan Africa

STC: Specialized Technical Committee

UIP: Uncovered Interest rate Parity

WAEMU: West African Economic and Monetary Union

EXECUTIVE SUMMARY

The 2023 AACB Governors' Symposium took place in Livingstone, Zambia, on August 3, 2023. The event aimed to facilitate discussions among Central Bank Governors, policymakers, international institutions, and academics regarding the macroeconomic implications for African economies and the implementation of monetary policy in the presence of recurrent shocks. The Symposium featured four plenary sessions on the following themes:

1. Enhancing the Effectiveness of Monetary Policy in the Presence of Prevalent Supply Shocks;
2. Role of Central Banks in Enhancing the Resilience of African Economies in the Face of External Shocks;
3. Exogenous Shocks and Monetary Policy Transmission Mechanisms: Challenges for Central Banks and the Way Forward;
4. Experiences sharing on the main theme of the Symposium.

The sessions were facilitated by Governors and Experts and followed by panel discussions.

Over the past 25 years, African economies have faced a series of external shocks, such as the Asian financial crisis in 1997, the global financial crisis of 2007-2008, the Ebola virus outbreak in West Africa from 2014 to 2016, the COVID-19 pandemic spanning 2020-2022, the Russian-Ukrainian war since 2022. These events have significantly hampered African economic growth and development by causing disruptions in trade and transportation, reducing tourism, investment, and productivity, and escalating healthcare expenditures.

Central Banks have responded to various crises, especially recent external shocks. However, it is imperative to recognize that the effectiveness of Central Banks' responses depends on several factors, including the nature of the shocks, initial conditions, and country-specific characteristics. Such characteristics may include the depth of foreign exchange markets, the vulnerability of corporate balance sheets to exchange-rate risk in the presence of high external debt levels, and the risk of inflation expectations becoming unstable. Unstable inflation expectations can trigger a harmful cycle of high inflation amid exchange rate depreciation.

In countries with deep (i.e., well-established) financial markets, employing policy rate and flexible exchange rates is appropriate when dealing with supply shocks. Supply shocks can impact overall inflation, exchange rate depreciation, and future inflation expectations. In such scenarios, intervention by the monetary authorities in the foreign exchange market could help stabilize macroeconomic variables to restore equilibrium.

Given the challenges posed by external shocks, the mobilization of domestic resources is crucial. Prioritizing the structural transformation of economies is essential. This transformation would enable African countries to increase exports, thereby enhancing their currencies while reducing dependence on imports and enhancing the resilience of African economies in the face of external shocks.

In response to the exogenous shocks of recent decades, Central Banks have successfully used unconventional monetary policy tools, including quantitative easing (QE), forward guidance, and substantial reductions in interest rates to help combat inflationary pressures and counter the slowdown in growth. For example, during the COVID-19 pandemic, Central Banks implemented various of regulatory and monetary policy measures. These included regulatory easing and monetary interventions such as lowering key interest rates, adjusting reserve requirements, conducting foreign exchange interventions, and facilitating targeted lending. These proactive steps aided in stabilizing economies but also led to expanding Central Banks' balance sheets.

Although these unconventional monetary policy measures taken by the monetary authorities in past crises helped calm financial markets and restore their full function, lowered interest rates, and facilitated credit lending to households and businesses, some actions, notably the unprecedented interest rate reductions during the global financial crisis and the COVID-19 pandemic, did not yield the anticipated results. This is because of the incomplete transmission of these successive reductions to the real sector in Africa. This situation underscored the complexity of monetary policy transmission mechanisms, which depend on several factors. Among these factors are the high level of excess reserves in many African countries, substantial budget deficits financed mainly by Central Banks, and weaknesses within African financial systems.

Relying solely on monetary policy to address economic shocks is insufficient to achieve the Central Banks' objectives, particularly in the face of exogenous shocks. It is imperative that monetary and fiscal policies are harmonized and their executions are well coordinated. In addition, amidst recurring exogenous shocks, the actions undertaken by Central Banks must be complemented by clear and precise communication. This clear communication is essential to enhance the effectiveness of monetary policy transmission mechanisms.

At the end of the Symposium, the following key recommendations were made:

1. There was a strong call for coordination between monetary and fiscal authorities to enhance the effectiveness of monetary policy measures. This coordination is essential in responding to future shocks and achieving desired objectives, as demonstrated during the COVID-19 pandemic;

2. Central Banks and Governments were encouraged to address challenges in implementing monetary policy, focusing on bolstering transparency within Central Bank actions and enhancing the credibility of the country's legal institutions;

3. Recognizing the substantial impact of macroprudential policy regulations in curbing shocks within domestic economies, there was a call for monetary authorities to develop macroprudential regulations aimed at mitigating risks related to credit shocks on a continental level. This entails not only relying on macroprudential regulations but also reshaping the overall financial resilience framework across African economies;

4. Central Banks should be increasingly independent and improve communication with the public on the decisions made. Strengthened communication not only fosters public confidence but also reinforces the understanding of the monetary authorities' ability to effectively manage the economy during exogenous shocks;

5. Monetary authorities were encouraged to help establish development banks to contribute to more sustained growth. In this regard, policymakers were urged to review the mandate of the Central Bank to also include that of a development player;

6. In dealing with exogenous shocks, Central Banks were advised to manage these shocks effectively to maintain price and financial stability as well as economic growth. In this regard, Central Banks should enhance research activities and invest in high-frequency data collection systems, which are crucial for monitoring real-time economic conditions, enabling a better understanding of monetary policy transmission mechanisms;

7. Given the weaknesses of the African financial system, policymakers were urged to prioritize financial sector reforms by deepening the continent-wide capital market, improving financial infrastructure, enhancing banking sector stability, and promoting financial inclusion to strengthen monetary policy transmission mechanisms.

1. INTRODUCTION

The Association of African Central Banks (AACB) Governors' Symposium took place at the AVANI Resort Hotel, Livingstone, Zambia, on August 3, 2023. The symposium was held under the theme "Recurrence of Shocks and Macroeconomic Implications for African Economies: Challenges and Prospects for Central Banks", and served as a precursor to the 45th Ordinary Meeting of the Assembly of Governors, held on August 4, 2023. A total of 124 participants (See Annex), including Governors and senior Officials of Central Banks, as well as senior Officials of partner institutions and regional and international organizations, were in attendance. The Symposium focused on discussions related to implementing monetary policy in the face of recurring shocks and the associated challenges related to monetary policy transmission mechanisms to the real sector. Distinguished resource persons, including Governors and Speakers, etc. presented papers, followed by in-depth discussions. This report provides a summary of the Symposium's proceedings.

2. OPENING CEREMONY

The opening ceremony was marked by four (4) speeches that were delivered respectively by Dr. Denny H. Kalyalya, Vice-Chairperson of the AACB, Honourable Governor of the Bank of Zambia, His Excellency Ambassador Albert M. Muchanga, Commissioner for Economic Development, Trade, Tourism, Industry, and Minerals, African Union Commission (AUC), Mr. Buah Saidy, AACB Chairperson, Honourable Governor of the Central Bank of The Gambia (CBG), and Honourable Dr. Situmbeko Musokotwane, MP, Minister of Finance and National Planning, representing His Excellency Mr. Hakainde Hichilema, President of the Republic of Zambia.

Dr. Kalyalya first welcomed all participants to Livingstone, the tourist capital of Zambia. After 58 years since the Association was founded, he expressed great honour to host the AACB Annual Symposium for the first time.

The AACB Vice-Chairperson emphasized the timeliness of the Symposium's theme in light of global challenges faced over the past four years, including the COVID-19 pandemic, climate and commodity price shocks, political instability, and the Russian-Ukrainian war. These shocks have intensified in frequency and scale, significantly impacting African economies and the African Monetary Cooperation Program (AMCP). Dr. Kalyalya highlighted the severe macroeconomic implications, disrupting economic growth, hindering poverty reduction efforts, impeding continent-wide development, and slowing progress towards macroeconomic convergence. He identified Africa's vulnerability due to over-reliance on commodity exports, making economies susceptible to external shocks, reducing fiscal space, and constraining responses to crises. Climate change, political instability, and conflicts were cited as significant challenges, contributing to reduced economic output, high inflation, and unemployment. Central Banks face immense difficulties in maintaining price stability in such turbulent environments.

In conclusion, the Honourable Governor of the Bank of Zambia hoped that the conclusions of deliberations during these Meetings would help the monetary and fiscal authorities formulate policies to mitigate these shocks and contribute to price and overall macroeconomic stability across AACB Member Countries.

After welcoming all participants to the Symposium, Mr. Saidy, AACB Chairperson, raised the timeliness of the Symposium's theme, emphasizing the profound macroeconomic implications of global shocks, particularly impacting African nations amid the COVID-19 pandemic and the Russian-Ukrainian war. These crises led to increased debt servicing burdens, balance-of-payments pressures, rising inflation, growing financing gaps, and limited fiscal space, hindering sustainable and inclusive growth in African economies. He highlighted projections indicating a slowdown in Africa's real GDP growth to just over 3.0 percent in 2023, down from 3.5 percent in 2022 and 4.7 percent in 2021, according to the IMF and United Nations World Economic Outlook.

Mr. Saidy emphasized the cross-border propagation of shocks affecting individual countries, regional integration efforts, trade networks, and investments. Understanding these linkages is crucial for effective policy responses. He warned against overreliance on a single sector or external factors, suggesting diversification by investing in high-growth sectors, promoting innovation, strengthening domestic value chains, and recognizing the vital connection between climate change and economic prosperity. Extreme weather events impact vulnerable populations and pose uncertainties for the Continent’s future.

In closing, the Honourable Governor of the Central Bank of The Gambia emphasized the importance of collaboration between Central Banks and fiscal authorities. He suggested that Central Banks should cooperate with fiscal authorities to channel additional resources toward funding strategic development projects within their respective mandates.

His Excellency Amb. Albert M. Muchanga expressed his deep gratitude to His Excellency Mr. Hakainde Hichilema, President of the Republic of Zambia, represented by the Minister of Finance and National Planning, and to Dr. Denny Kalyalya, Honourable Governor of the Bank of Zambia, for the warm welcome and hospitality extended to the participants in Livingstone, the tourist capital of Zambia. On behalf of His Excellency Dr. Moussa Faki Mahamat, Chairperson of the African Union Commission, he also saluted the participants and wished them a successful outcome of the Annual Meetings.

The AUC Commissioner highlighted the Symposium’s timely theme addressing multiple shocks from climate change, public health threats like the COVID-19 pandemic, and geopolitical tensions leading to supply chain disruptions, rising inflation, and possible recessions. These challenges impede Africa's inclusive growth and sustainable development, necessitating urgent solutions for economic recovery, stability, growth, and resilience. He noted the African Ministers' call for increased collaboration between African Central Banks and AUC, emphasizing the need for deeper cooperation to enhance domestic resource mobilization efforts, as discussed during the 6th Session of the Specialized Technical Committee (STC) of the African Union (AU) held in Nairobi, Kenya, from July 17-21, 2023.

To conclude, Mr. Muchanga invited the AU Member States to continue stepping up efforts to develop more robust public financial management systems that improve revenue mobilization and strengthen monetary and exchange rate policy frameworks, bank supervision, and governance. He also called on the Governors to endorse the draft Statutes of the African Monetary Institute (AMI) to accelerate the achievement of the targets set in the African Monetary Cooperation Program (AMCP). Furthermore, he advocated for more stock exchanges and countries participating in the African Exchanges Linkage Project (AELP), launched on December 7, 2022.

Dr. Situmbeko Musokotwane, MP, Honourable Minister of Finance and National Planning, representing the President of the Republic of Zambia, His Excellency Mr. Hakainde Hichilema, welcomed all participants to Livingstone for the 45th AACB Annual Meetings. He underscored the significance and timely relevance of the theme of the 2023 Symposium as economies continue to face the effects of various shocks, notably the COVID-19 pandemic, the Russian-Ukrainian conflict, and the escalating impacts of climate change. In this regard, he called upon participants to draw insights from their respective experiences and actively contribute towards strengthening policy formulation and implementation in the context of shocks.

In addition, Dr. Musokotwane emphasized the need for Central Banks to cultivate a state of preparedness for potential shocks, given the unpredictable nature of their occurrence. He highlighted that this is particularly crucial for Africa, which remains at heightened risk from the next unforeseen crisis due to its vulnerable economic status.

In closing, the Honourable Minister called on Central Banks to play an active role in advancing economic growth as it could help mitigate Africa's exposure to shocks. He expressed his desire for the deliberations to yield substantive and impactful discussions among participants. He declared the Symposium officially opened.

3. KEYNOTE SPEAKER

In his opening speech, Mr. Abebe Aemro Selassie, Director of the African Department at the International Monetary Fund (IMF), emphasized the rising concern about public indebtedness in Africa in recent years. He pointed out the delicate issue of exchange rates, highlighting how significant and sudden changes can impact people's relative income and wealth. Mr. Selassie outlined four key factors that have hindered the quality of growth, developmental progress, and poverty reduction in Africa, underscoring the need for calibrated monetary and exchange rate policies:

- ✓ Sub-Saharan Africa's (SSA) low share of world exports (1.7 percent in 2019 compared to 1.5 percent in 2000) despite relatively strong growth and the improvement in many other development indicators in the years prior to COVID-19;
- ✓ The large current account deficits of SSA countries due to the high investment needs in priority areas (health, infrastructure, education, etc.) have attracted massive capital inflows in the region seeking better returns following the unconventional monetary policy easing measures taken by the Central Banks of advanced countries during the recent crises;
- ✓ A relatively low contribution of exports to growth, particularly for commodity-exporting countries compared with other regions of the world;
- ✓ The exclusion of some SSA countries from capital markets, the considerable rise in the cost of financing, and the deterioration in the terms of trade for the vast majority of SSA countries over the last two years led to a low level of reserves similar to the situation that prevailed in the 1980s for many of them.

In addition, Mr. Selassie stated that five main arguments are often advanced to fight against pressures to depreciate the exchange rate.

Firstly, in most Developing Countries (DCs), the exchange rate is the most visible and essential price in the economy. Therefore, it helps anchor expectations and facilitate planning, investment, and consumption decisions. Economic agents find it difficult to make informed decisions when the exchange rate fluctuates significantly beyond a specific range. In this regard, minimizing large fluctuations in the exchange rate and maintaining it within a specific and stable range is advisable.

Secondly, exchange rate depreciations can exacerbate inflationary pressures, especially in African countries, which are net importers of fuel and food. The rapid impact of exchange rate depreciations on domestic prices becomes evident when the prices of imported goods rise. This characteristic has unfolded in recent years due to external shocks, leading to substantial increases in commodity prices and elevated global inflation, coupled with significant tightening of global financial conditions. Furthermore, Mr. Selassie also noted that the extent to which exchange rate depreciation affects domestic prices depends on overall monetary and fiscal conditions. Even if a country possesses substantial foreign exchange reserves for intervention for some time, its effectiveness in limiting the impact of inflation depends on well-calibrated monetary and fiscal policies. In this regard, only the overall macroeconomic policy framework, particularly the monetary policy framework and its credibility can significantly impact inflation's pass-through rather than the exchange rate change.

Thirdly, devaluations can lead to a contractionary effect on economic activity by increasing the prices of imported goods, thus reducing investment and curbing production in specific crucial sectors. Imported goods are complementary rather than substitutes in the production process, so companies may have to cut back production when their prices rise. In the 1980s, many African countries faced adverse terms of trade shocks and depreciated their currencies to preserve foreign exchange reserves and boost exports. However, despite significant depreciations, exports grew little because (i) the export sector is too small to give a significant boost to growth, and (ii) structural, often physical, barriers to trade were not removed. Significant depreciations have been necessary to achieve the desired results in this context. It is important to note that exchange rate depreciation pressures are commonly observed when there is a current account deficit, which is typical in SSA.

Fourthly, exchange rate depreciations have significant adverse effects on a balance sheet. In addition to the two previous arguments against exchange rate depreciations on current transactions mentioned above, exchange rate adjustments also have valuation effects on external liabilities. For example, a significant devaluation proportionally increases the local currency value of external liabilities. For companies, households, and even the public sector, whose income is mainly in local currency, this can significantly increase indebtedness and the burden of debt servicing. In cases where the financial sector, in particular, has a prominent open foreign exchange position, the situation can be even more worrying.

Fifthly, exchange rate depreciations lead to socio-political disruptions. Another characteristic of the exchange rate is that it is used as a barometer of national economic well-being. The higher the exchange rate, the better the economy is considered to be performing. Conversely, the lower the exchange rate, the less efficient the economy is. Thus, exchange rate adjustment has considerable political importance and economic consequences.

In closing his speech, Mr. Selassie noted that policy-making in African countries is challenging, unlike in advanced economies. He stressed the need to avoid some policy choices that would involve fighting exchange rate depreciation, even when it is justified, and the cost of preventing it is so high.

4. FIRST SESSION

4.1 Introduction

This session on the theme "*Enhancing the Effectiveness of Monetary Policy in the Presence of Prevalent Supply Shocks*" was chaired by Mr. Lesetja Kganyago, Honourable Governor of the South African Reserve Bank (SARB), and presented by Dr. Andrew Berg, Deputy Director of IMF Institute for Capacity Development. The panel comprised Honourable Rwangombwa John, National Bank of Rwanda (NBR) Governor, and Professor Robert Mudida, Director of the Research Department, Central Bank of Kenya (CBK).

4.2 Summary of the presentation

Dr. Berg's presentation focused on the role of monetary policy in the face of supply shocks, food inflation, agricultural shocks, foreign exchange intervention, and the IMF's Integrated Policy Framework (IPF).

The presenter noted that supply shocks are particularly prevalent in developing countries, including Africa. He added that periods of high inflation tend to be accompanied by meager output in developing countries, in contrast to high-income countries where high inflation tends to be accompanied by relatively high output, consistent with the idea that inflation in these countries is mainly demand-driven.

He highlighted the limitations of monetary policy since it cannot cancel out the direct adverse effects of a supply shock (such as a bad harvest) on production. However, it could help mitigate the impact and prevent further worsening of the situation.

Referring to an IMF study published in 2015, the presenter argued that a coherent, forward-looking regime with exchange rate flexibility could help countries conduct effective monetary policy, particularly to minimize the cost of supply shocks. The main idea is that monetary policy should stabilize inflation expectations. The goal is to maintain a stable and predictable inflation rate, especially over the medium term, while keeping output as stable as possible. This requires clear objectives, operational autonomy with accountability, along with clear and effective communication to justify deviations from the target and ensure credibility.

In order to implement an inflation-targeting monetary policy framework, the Central Bank should meet the following principles:

- ✓ Have a clear mandate and operational independence, with public accountability;
- ✓ Pursue price stability as the primary medium-term objective of monetary policy, with a numerical inflation target guiding the Central Bank’s actions and its communications;
- ✓ Consider implications of monetary policy for economic activity and financial stability;
- ✓ Have a clear and effective operational framework and forward-looking strategy; and
- ✓ Communicate transparently and promptly.

Furthermore, the presenter indicated that exchange rate pass-through, i.e., the magnitude of inflation resulting from a given nominal exchange rate depreciation, tends to be considered a profound characteristic of the economy. He pointed out that exchange rate pass-through depends on the economy’s structural characteristics, including the share of imports in consumption, the nature of the shock and, most importantly, the nature and credibility of the policy regime. For example, a monetary policy shock in a floating exchange rate regime should be 100 percent pass-through in the long term since it cannot permanently change the real exchange rate level. Conversely, an adverse shock to the commodity export prices that leads to a sharp depreciation in the exchange rate may not necessarily result in a persistent or significant rise in inflation. If the monetary policy regime is credible, the increase in headline inflation should reflect this temporary surge in import prices. Expected inflation does not need to change, leading to a low pass-through effect.

In addition, the presenter added that monetary targeting appears to be the most commonly used operational framework in African countries, among other nominal anchors. However, even theoretically, monetary targeting is not appropriate to address supply shocks. In the advent of a poor harvest, for example, the price level rises, as does the demand for money. Monetary targeting would keep the currency constant, leading to a sharp and probably unjustified rise in interest rates. Money targeting is, in practice, implemented flexibly, with frequent significant misses of money targets. This flexibility could help avoid counterproductive responses to supply or money demand shocks if policymakers could identify the type of shock and react accordingly. But this is very hard to do in practice. In any case, this flexibility makes the whole regime hard, even impossible, to understand and communicate, thus impairing the transmission of monetary policy signals and, more broadly, the evolution of the regime over time and the financial system.

The presenter also argued that using the exchange rate as a nominal anchor has enormous advantages. The exchange rate is a visible and potentially effective nominal anchor and a driver of inflation. Thus, exchange rate stability may help contain inflation, but the sustainability of the anchor may require higher interest rates despite a contraction in output.

Moreover, one of the crucial issues when addressing food inflation and agricultural shocks is which variable to target between core (baseline or fundamental) inflation and headline inflation. It was argued that it is more appropriate to target core inflation since an increase in food prices calls for increasing the relative prices of food. Stabilizing core inflation while allowing food prices to rise achieves the appropriate relative price change with the least macroeconomic disruption.

The main problem with focusing on core inflation or leaving out first-round effects and considering only second-round effects is that it is easy to unanchor inflation expectations when faced with rising headline inflation, particularly for countries still implementing a flexible exchange rate regime. In a regime that is not entirely credible, headline inflation can result in higher expectations of core inflation and, therefore, widespread wage and rising prices that require a response from monetary authorities.

In such a forward-looking regime, it could be helpful to explicitly examine the different components of inflation and Gross Domestic Product (GDP) when the Central Bank draws up inflation forecasts. It would be advisable to split GDP mainly into agricultural and non-agricultural components, as food inflation is not associated with positive movements in agricultural GDP, given the predominance of supply shocks. In this regard, the Central Bank must consider the temporary or seasonal variations in food prices. It must also adopt a global approach and pay particular attention to the risk of expectations drift or the transmission of overall inflation to core inflation. Based on this analysis, food inflation is less persistent, less related to aggregate demand or monetary policy stance, and not a significant driver of inflation expectations. Food inflation often has large and predictable seasonal fluctuations, and analysis of these factors should provide a better understanding of when monetary authorities should respond to food or other inflation in a forward-looking way, as well as communicate this to the public.

However, to realize the full benefits of a credible forward-looking regime, time and sustained effort should be given to strengthening the analytical capabilities of Central Banks to collect and assimilate high-frequency data on activity, expectations, and other useful information and to develop effective operational frameworks. To this end, the presenter indicated that the IMF is ready to contribute to this capacity-building effort so that monetary authorities can respond appropriately to supply shocks.

In addition, Dr. BERG noted that in the foreign exchange market, only some African countries apply a full floating exchange rate regime. Many emerging countries have allowed their exchange rates to depreciate in response to the adverse shocks to capital accounts after the global financial crisis. Still, many have also sold currencies, while some have implemented capital flow and macroprudential measures and, in some cases, interest rate hikes. To provide more concrete guidance on the management of supply shocks and the role of foreign exchange intervention, IMF staff developed the Integrated Policy Framework (IPF). One of the main conclusions is that the appropriate policy response depends on the nature of the shocks, initial conditions, and the country's characteristics, including the foreign exchange market depth, the sensitivity of corporate balance sheets to exchange-rate risk in the event of high levels of external debt, and the risk of inflation expectations becoming unanchored, leading to a vicious circle of high inflation in the context of exchange rate depreciation.

Indeed, in a country with deep financial markets, it is generally appropriate to use the policy rate in the presence of supply shocks and to allow exchange rate flexibility. Given that supply shocks can affect overall inflation, exchange rate depreciation, and future inflation expectations, an intervention by monetary authorities in the foreign exchange market could help restore stability.

However, it should be noted that foreign exchange intervention may not substitute for appropriate monetary and fiscal policy, as underlying imbalances may require monetary policy to be tightened, while unanchored expectations may justify the sale of foreign exchange reserves. This could lead to the need for a much larger adjustment later when reserves are depleted, and the credibility of monetary authorities could be undermined. Furthermore, a lax fiscal policy may lead to increased imports and the need for foreign borrowing, raising the risk premium and depreciating the exchange rate, especially if foreign exchange markets are shallow. Selling reserves to counter this depreciation could delay and worsen the final adjustment. Moreover, supply shocks generally call for accurate adjustment, including the real exchange rate, especially if they are persistent, and it is dangerous to delay adjustment by defending an overvalued exchange rate.

In addition, excessive reliance on foreign exchange intervention to stabilize the exchange rate may discourage the development of foreign exchange markets, leading to shallower markets. Extreme exchange rate stability can also give domestic banks a false sense of security about exchange rate risk by encouraging them to borrow abroad in dollars without hedging against the exchange rate risk.

On the other hand, interventions in the foreign exchange market can make the system more obscure by making it easy for observers to conclude that the exchange rate is the nominal anchor. It can be difficult, especially at the start of a flexible regime, to distinguish between a flexible parity and a floating regime that employs intervention as an additional instrument used occasionally.

In conclusion, the presenter argued that a transparent and forward-looking monetary policy regime with a flexible exchange rate still appears to be a good way of absorbing supply shocks while anchoring inflation expectations. However, he added that challenges must be overcome, including the clarity and credibility of the exchange rate regime that these tools can pose.

4.3 Summary of panel discussions

Two Central Banks (Rwanda and Kenya) led the panel discussions.

Like other countries, Rwanda and Kenya have been hit hard by the exogenous shocks of recent years, notably the COVID-19 pandemic and the Russian-Ukrainian war.

In Rwanda, a food-importing country, the inflation rate rose sharply, from 0.8 percent in 2021 to 13.9 percent in 2022, due to the combined effect of several factors, including the war in Ukraine, the COVID-19 pandemic, and the end of fuel subsidies, as well as the poor agricultural performance recorded in 2022.

When confronting these shocks, the monetary authorities responded promptly to mitigate their effects or to curb them. For example, the National Bank of Rwanda has continued its tightening monetary policy, raising its key rates from 5 percent to 6 percent in August 2022 to counter rising inflationary pressures while preserving consumer purchasing power.

Overall inflation in Kenya averaged 7.7 percent in 2022 compared to 6.1 percent in 2021, mainly reflecting increases in food and fuel inflation. The rise in overall inflation mainly reflected developments in global prices of key commodities, particularly fuel, wheat, edible oils, and fertilizers, which rose sharply due to supply disruptions due to the war in Ukraine. Domestic food inflation was also driven by reducing a supply of key food items such as maize due to depressed rains. There has been a transition in the operational framework of monetary policy towards inflation targeting. Countries interested in this experience were invited to access the White Paper titled *Modernization of the Monetary Policy Framework and Operations* published on the CBK website. In the forward-looking monetary policy framework, price stability is the primary objective of monetary policy, and the inflation target is provided by the Ministry of Finance at the beginning of the financial year.

As Central Banks, the Panelists emphasized the need to understand African economies to combat imbalances effectively, ensure greater resilience in the event of shocks, and use the instruments available to monetary authorities. In this respect, the Central Bank should be increasingly independent and strengthen its communication to explain the decisions taken to the public. Furthermore, the Panelists insisted on the complementarity between monetary and fiscal policies to ensure their effectiveness.

In addition, they stressed the importance of measuring inflation expectations following the example of the Central Bank of Kenya, where bi-monthly surveys of the financial and non-financial are undertaken. Through the surveys, the Central Bank can obtain feedback and better understand the mechanisms by which monetary policy is transmitted to the real sector and the impact of its policies on the economy.

4.4 Conclusion of the Chairperson

Closing the session, the Chairperson invited Central Banks to take measures to deal with the shocks affecting their economies. He also recalled that monetary policy alone was not enough to achieve the objectives assigned to the Central Bank, especially in the presence of exogenous shocks. In this regard, he called for coordinating monetary and fiscal policies. Furthermore, the Chairperson stressed that the Central Bank's actions must be supported by clear and precise communication to ensure that mechanisms for transmitting monetary policy are more effective.

5. SECOND SESSION

5.1 Introduction

Mr. John Panonetsa Mangudya, Honourable Governor of the Reserve Bank of Zimbabwe (RBZ), chaired this session. The theme, *" The Role of Central Banks in Enhancing Resilience of African Economies in the Face of External Shocks",* was presented by Professors Victor Murinde and Athina Petropoulou, Centre for Global Finance, University of London. The panel consisted of Mr. Aivo Handriatiana Andrianarivelo, Honourable Governor of Banky Foiben'i Madagasikara, and Dr. Patrick Ndzana Olomo, OIC Economic Policy and Sustainable Development Division, African Union Commission (AUC).

5.2 Summary of presentations

The presentations by Professors Murinde and Petropoulou generally focused on external shocks in Africa, the ways by which global credit market shocks are transmitted to financial systems in African countries, and specific macroprudential regulations are tailored to enhance the resilience of African economies in the face of global credit shocks, and the way forward for Central Banks.

Over the past 25 years, African economies have faced a series of external shocks, such as the Asian financial crisis in 1997, the global financial crisis of 2007-2008, the Ebola virus outbreak in West Africa from 2014 to 2016, the COVID-19 pandemic spanning 2020-2022, the Russian-Ukrainian war since 2022. These events have significantly hampered African economic growth and development by causing disruptions in trade and transportation, reducing tourism, investment, and productivity, and escalating healthcare expenditures. During these crises, the IMF financed Governments directly.

In response to crises causing liquidity squeeze and higher external borrowing costs for countries, major Central Banks effectively utilized various monetary policy tools, including Quantitative Easing (QE) involving large-scale purchase of assets and Forward Guidance, which emphasized clear communication about the Central Bank's outlook and policy intentions. For example, for COVID-19, Central Banks took wide-ranging regulatory (regulatory loosening) and monetary policy (policy rate and reserves requirement cut, FX intervention, target lending, etc.) responses that increased their balance sheets.

Based on research, Central Banks used other tools to deal with external shocks, such as loan financing programs, negative policy rates, and yield curve control. Furthermore, they subsidized bank lending through cheap long-term funding, leading to lowered bank funding costs, promoted lending, and improved monetary policy pass-through to the real economy.

Moreover, many Central Banks in Sub-Saharan Africa faced severe obstacles due to a combination of external and domestic challenges, including:

- Collapse in commodity prices. Hence, growth has fallen sharply, and inflation is rising due to exchange rate depreciation;
- Depletion of Central Banks' international reserve cushions;

- Sudden reversal of capital inflows that could lead to a significant and disorderly depreciation of the local currency, with adverse implications on inflation and financial stability;
- Persistent weakness in Government cash flow management makes it difficult for Central Banks to manage liquidity conditions adequately.

However, the Russian-Ukrainian war triggered the supply chain disruption. Indeed, Africa's heavy reliance on food imports made the Continent extremely vulnerable to rising food prices that surged in Africa by an average of 23.9 percent in 2020-22, the highest since the 2008 global financial crisis. Furthermore, 15 African countries imported over 50 percent of their wheat products from Russia or Ukraine in 2020. Six countries (Eritrea, Egypt, Benin, Sudan, Djibouti, and Tanzania) imported over 70 percent of their wheat from the region.

Moreover, the crisis had direct and indirect impacts on Africa. Direct effects include trade disruption, food and fuel price spikes, macroeconomic instability, and security challenges. Indirect effects of the crisis include imported inflation, difficult energy transitions, and a potential geopolitical realignment.

In a theoretical context, the role of Central Banks was discussed. It was highlighted that Central Banks facilitate financial flows between households, banks, businesses, Governments, and the global market within a flow of funds framework. Additionally, Central Banks supervise and regulate banks to ensure transparent information, aiding financial institutions and markets in addressing pricing risks. Furthermore, Central Banks help establish fast and efficient payment and collection systems, such as national and cross-border payment systems.

On the other hand, the presenters stated that according to economic theory, exogenous shocks in the international credit market are transmitted to the African countries' financial systems through the following three main channels:

- The banking network theory which argues that the structure of global bank interconnection plays a crucial role in financial contagion across banks;
- The identified channels for the transmission of international credit shocks, namely housing prices, exchange rates, and asset prices; and
- The commodity price cycles, an indirect transmission channel, work through their interaction with cross-border bank capital flows.

Empirical econometric models using data on bank capital flows, credit cycles, and commodity prices in Least Developed Countries (LDCs) have confirmed the positive effect of cross-border bank capital flows on these countries' credit cycles, and the transmission channel of commodity prices.

Empirical results also show that regulating macroprudential policies mitigates the propagation of shocks into the domestic economy. Furthermore, they reveal that depending on the type of regulation, different degrees of mitigation of the adverse effect of cross-border banking capital flows are observed. Consequently, prudential regulation tools that work efficiently should be identified. These include:

- Tools aimed at dampening credit cycles;
- Tools targeting the reduction of foreign exposures; and

- Tools for preserving the safety of financial institutions (e.g., enhancing institutional capacity and bank liquidity).

However, it is noticed that prudential regulation focusing on borrowing conditions could be more efficient.

Given these empirical results, the presenters recommended adapting regulations to support economic recovery and strengthen financial resilience. In this regard, they called for macroprudential regulations to manage the risks associated with global credit shocks. Thus, the way forward for Central Banks, beyond macroprudential regulations, is towards re-designing the architecture for financial resilience in African economies.

Regarding the way forward for Central Banks, the presenters indicated that a new wave of pan-African banks has emerged, consistent with the African Continental Free Trade Area (AfCFTA) strategy for intra-African trade in financial services. For example, in the West African Economic and Monetary Union (WAEMU), studies show that the increased presence of pan-African banks has contributed to strengthening bank stability, increasing competition in the credit market, promoting financial inclusion of Micro, Small and Medium-Sized Enterprises (MSMEs), and helping strengthen bank liquidity.

Furthermore, the presenters argued that the future of bank regulation must recognize peer-to-peer trust, monitoring, and market discipline. For example, research on Kenya showed a stable inverse relationship between interbank activity and bank risk levels. But, if a bank continues to increase its net interbank position up a certain level, the impact on bank risk is reversed from risk-reducing to risk-increasing.

Moreover, they indicated that Central Bank independence, in all its forms, is a critical component of the architecture of a modern financial system, including:

- Personnel independence to limit the Government's influence on the Central Bank board's membership or tenure;
- Financial independence to restrict the Government's use of Central Bank's loans to fund its expenditures; and
- Policy independence to select and implement targets and instruments for monetary policy.

Central Banks should also provide an enabling regulatory environment to support the FinTech revolution, which profoundly impacted African economies, driving positive changes and contributing to various aspects of economic development. For Example, some companies revolutionized the provision of financial services in Kenya (like M-Pesa, Cellulant, and BitPesa) and Nigeria (Flutterwave and Paystack), providing access to financial services for unbanked and underbanked populations and stimulating entrepreneurship.

In the 1990s, efforts to modernize national payment and settlement systems began in most African countries with Automated Clearing Houses (ACHs) to improve cheque clearing between banks, the Real Time Gross Settlement System (RTGS), etc. FinTech innovations are now designed for efficient cross-border payment systems.

The presenters showed that the introduction of Central Bank Digital Currency (CBDC) can have several advantages because of the opportunities it creates. CBDCs can, inter alias, improve the efficiency and security of payments using DLT technology and enhance trust in the monetary system. CBDCs can relax the effective lower bound constraint on nominal interest rates and promote macroeconomic stability by substituting for cash. Furthermore, CBDC could mean a partial shift of deposits from commercial banks towards Central Banks. Initially, banks’ liabilities decline while those of Central Banks increase. However, once the Central Bank can lend all the CBDC deposits to banks, an increase in CBDC, which does not require reserve holdings, can enhance financial stability by increasing credit supply and lowering nominal interest rates. In October 2021, Nigeria issued a CBDC (eNaira), becoming the first African country and the second in the world after the Bahamas.

Moreover, the presenters indicated that the risks from climate change to the economy have many potential impacts:

- Physical risks (extreme weather events and gradual changes in climate);
- Transition risks (policy, technology, and consumer preferences).

In this regard, many African Central Banks are members of The Network for Greening the Financial System (NGFS). Central Banks also incorporate climate-related risks into their financial stability assessments and guide financial institutions in managing climate-related risks.

In addition, the presenters indicated that Africa is vulnerable to climate change and natural disasters, disrupting agricultural production, exacerbating food insecurity, and damaging infrastructure. For instance, Mozambique Cyclone Idai (2019) caused about 1.54 billion US dollars in total damage, reflecting lost income in producing goods and services and additional costs to re-establish production.

Central Banks should introduce climate considerations in their financial risk assessment tools (including stress tests) and prudential policies and deliver on their price and financial stability mandates in the climate crisis era. Indeed, when Central Banks buy green corporate bonds as part of a green QE program, they place downward pressures on the yields of green bonds, which positively affects the cost of borrowing for green projects. Ultimately, what Central Banks will do to support a green transition will depend on what their mandate allows, how it is interpreted, and their willingness to act.

The presenters argued that Africa has a stark choice: responding together (regional) or in competitive strategy (e.g., beggar-thy-neighbour).

5.3 Summary of Panel Discussions

The Banky Foiben'i Madagasikara and the African Union Commission (AUC) conducted the Panel discussions.

The two Panelists noted the high exposure of African countries to exogenous shocks, notably the COVID-19 pandemic, geopolitical conflicts, climate change, etc. Facing this situation, they recalled the commitment and willingness shown by the Ministers at the meeting of the African Union (AU) Specialized Technical Committee (STC) on Finance, Monetary Affairs, Economic Planning, and Integration to fight durably against these shocks through the reinforcement of the resilience of African countries.

In this regard, they called on fiscal and monetary authorities to play a crucial role in the structural transformation of African economies to effectively address exogenous shocks. The strategy should be based on increasing exports and reducing imports. To achieve this, incentives should be provided to stimulate domestic production.

Furthermore, the Panelists indicated that assessing the performance criteria of the African Monetary Cooperation Program (AMCP) showed that among the primary convergence criteria, the inflation rate is the one that raises tremendous challenges. In this regard, they called for increasing exports by producing more to lower the inflation rate, which is still high in most African countries.

In this context, the authorities in Madagascar have taken measures to support the private sector to stimulate domestic production. To this end, guarantee funds were encouraged to set up in the country to facilitate access to credit for the private sector to increase domestic production, especially of vanilla, whose sector was facing severe difficulties. This policy also aimed to reduce inflation, which stood at 8.0 percent in 2022, compared with 4.2 percent before COVID-19.

Moreover, the Banky Foiben'i Madagasikara should fight against currency depreciation through currency diversification. In this regard, refined gold has been sold to obtain foreign currency for payments. This policy has reduced pressure on the domestic currency.

In conclusion, the presenters invited African States to invest in growth-generating sectors to significantly reduce their dependence on the outside world, which could help reduce the inflationary pressures African countries are experiencing. Drawing on the Abuja Treaty, which was intended to establish the institutions of the African Union, the presenters called for the establishment of eco-systems to foster the structural transformation of our economies. They stressed the need to use appropriate tools to drive development. They also noted the importance of the African market, which comprises 55 countries, with an estimated population of over 3 billion in a few years - one of the world's largest markets, ahead of China and India combined in population. For its part, the African Union Commission demonstrated its commitment to putting in place the tools needed to create the wealth required to achieve the objectives of Agenda 2063.

5.4 Conclusion of the Chairperson

The session Chair emphasized that the mobilization of domestic resources is key, given the challenges raised by external shocks. He highlighted the structural transformation of our economies, which would help us export more to boost the foreign currencies of African countries. He also called for conserving foreign currency through a reduction in imports.

6. THIRD SESSION

6.1 Introduction

Chaired by Dr. John Panonetsa Mangudya, Honourable Governor of the Reserve Bank of Zimbabwe (RBZ), this session focused on "*Exogenous Shocks and Monetary Policy Transmission Mechanisms: Challenges for Central Banks and the Way Forward*". The presentation was delivered by Dr. Louis Kasekende, Executive Director of the Macroeconomic and Financial Management Institute of Eastern and Southern Africa (MEFMI). The panel was composed of Honourable Jolue Aloysius Tarlue, Governor of the Central Bank of Liberia, Mr. Rogério Lucas Zandamela, Honourable Governor of the Banco de Moçambique, and Dr. Wilson T. Banda, Honourable Governor of the Reserve Bank of Malawi.

6.2 <u>Summary of presentations</u>

The presentation by the Executive Director of MEFMI mainly focused on examining the monetary policy transmission mechanism in Africa, several key aspects, including the effectiveness of transmitting monetary signals to the economy, an analysis of the recent exogenous shocks that have hit the Continent, and the corresponding measures adopted by Central Banks in response, as well as the effectiveness of monetary policy among MEFMI Member Central Banks, and constraints to the monetary transmission mechanism.

While Africa benefitted from the reforming economies, its more robust integration into the World economy increased its vulnerability to exogenous shocks. In the last two decades, African economies have suffered from the transmission of adverse shocks from several crises, including the terms of trade shocks associated with the food and oil price crisis of 2007-08, etc. In this evolving environment, the implementation of monetary policy becomes challenging.

In this context, the approach to conducting monetary policy in Africa has undergone a significant transformation in recent decades. Previously, the focus was primarily on managing inflation, but it has expanded to foster financial stability and support economic growth. To realize these diverse objectives, Central Banks utilize key monetary policy instruments, notably open market operations, the discount rate, and reserve requirements. Reserve money or short-term interest rates are employed as operating targets, and broad money serves as the intermediate target. However, the application of these instruments varies from one Central Bank to another.

The main objective for most Central Banks remains price stability, with output stabilization and financial stability as secondary objectives. To effectively pursue these goals, a well-defined monetary policy framework highlights the institutional arrangements established to guide the Central Bank's operations. The choice of a monetary policy framework depends on several factors, including the structure of the economy, the level of development of the financial system, and the preferences of the Central Bank. Generally, monetary authorities use three primary monetary policy frameworks: exchange rate targeting (22 Central Banks), monetary targeting (14 Central Banks), and inflation targeting (5 Central Banks). Furthermore, a more hybrid approach of a transition from monetary targeting to inflation targeting is employed by some Central Banks (3).

Regardless of the monetary policy framework adopted by a Central Bank, it is crucial for policymakers to know the impact of changes in monetary policy instruments on inflation and output and the timing and size of such effects. In this regard, it is vital to understand monetary policy transmission mechanisms. There are six (6) main channels through which monetary policy is transmitted, including:

- ✓ *The interest rate channel* is the most direct channel of the monetary transmission mechanism. The Central Bank increases (decreases, respectively) the interest rate to make it more expensive (cheaper, respectively) for businesses and consumers to borrow money. This can lead to decreasing (rising, respectively) investment and spending, which can then slow down (boost, respectively) aggregate demand and economic activity. However, one crucial aspect of this channel is that the Central Bank has direct control only over the short-term nominal interest rate. Still, real spending decisions are only affected by changes in the real interest rate. Thus, the slow adjustment of the price level, commonly referred to as the price stickiness, is ultimately the significant factor determining the effectiveness of this channel;

- ✓ *The money channel* is a transmission mechanism through which changes in monetary policy affect economic activity by influencing the money supply. The critical assumption of this channel is that changes in reserve money are transmitted to broad money through the money multiplier and that banks can create money through the lending process (i.e., inside money);
- ✓ *The asset price channel* works through the wealth effect. When the Central Bank increases (decreases, respectively) the interest rate, it can lead to decreasing (increasing, respectively) the asset prices, such as the price of stocks and bonds. This can reduce (increase, respectively) the wealth of households and businesses, leading to decreasing (increasing, respectively) spending. The permanent income hypothesis, which links asset prices to consumption, plays a vital role;
- ✓ *The exchange rate channel* works through the price of imported goods and services. When the Central Bank increases (decreases, respectively) the interest rate, it makes domestic assets more (less, respectively) attractive than foreign assets. It thus leads to increasing (decreasing, respectively) the demand for local currency and an appreciation (depreciation, respectively) of the currency. This appreciation (depreciation, respectively) makes imported goods and services less (more, respectively) expensive, leading to decreasing (rising, respectively) inflation. The extent to which monetary policy can affect movements in the exchange rate is primarily influenced by the theory of uncovered interest rate parity (UIP), suggesting that the expected future changes in the nominal exchange rate are related to the difference between the domestic and foreign interest rates. This means that if the interest rate in one country is higher than that in another, the first country's currency is expected to appreciate against the second country's currency. The Central Bank can use UIP to influence exchange rates by changing interest rates;
- ✓ *The expectations channel* assumes that modern monetary policy is premised on forward-looking frameworks, which also believe that economic agents have rational expectations. It works through the way people form expectations about the future. When the Central Bank changes the interest rate, it can signal to consumers about the future direction of monetary policy. This can affect people's expectations about inflation, economic growth, and other economic variables. This channel mainly operates in developed economies with well-functioning and deep financial markets. Additionally, most African countries lack survey-based measures of inflation expectations;
- ✓ *The credit channel* of monetary policy is a transmission mechanism through which changes in monetary policy affect economic activity by influencing the availability and cost of credit. This channel is often referred to as an amplifier of traditional monetary channels rather than a stand-alone mechanism. It can be quite an essential channel in times of financial stress. Asymmetric information in financial markets provides the basis for the credit channel of monetary transmission. The credit channel works through two main channels:
    - o *The balance sheet channel* refers to the notion that changes in interest rates affect borrowers' balance sheets and income statements. In this channel, when the Central Bank raises its interest rates, it can decrease the value of borrowers' assets, such as stocks and bonds, making it more difficult for borrowers to repay their loans. Furthermore, it can make it more expensive for them to borrow new money. As a result, the supply of credit can decrease, which can lead to a decrease in investment, aggregate demand, and economic activity; and

- *The bank lending channel* refers to the idea that changes in monetary policy may affect the supply of loans disbursed by depository institutions. In this channel, when the Central Bank raises interest rates, the amount of reserves that banks hold can decrease, making it more difficult for banks to lend money to borrowers, leading to more expensive loans. As a result, the credit supply can decline, decreasing investment, aggregate demand, and economic activity.

Empirically, research into monetary policy transmission mechanisms in Africa remains mixed. While some studies show that monetary policy signals are transmitted to the real sector to varying degrees across countries, other research reveals that transmission is either insignificant or very weak. Furthermore, most of these studies indicate that transmission mechanisms are more complex in African countries than in developed countries due to several factors, such as the underdevelopment of the financial system, the importance of the informal sector, and the high level of excess reserves, as well as the dominance of taxation in many African countries. Despite these challenges, studies highlight the potential effectiveness of monetary policy in influencing economic activity, motivating Central Banks to enhance its efficacy.

Furthermore, some studies showed that the interest rate channel (Ibrahim and Dambazau (2017))[1] is the most prominent transmission mechanism in African countries. Research (Davoodi, Dixit, and Pinter (2013))[2] made on the East African Community (EAC) revealed that exchange rate and credit channels were important for Kenya, credit channel for Rwanda, and interest rate in Burundi. Other more recent research (Olusegun and Omolade (2022)[3]) pointed out that the exchange rate channel is persistently a vital mechanism that significantly influences the variables of the real economy in the Economic Community of West African States (ECOWAS) countries.

Generally, to strengthen monetary policy transmission mechanisms, these studies recommended that policymakers prioritize financial sector reforms through improving financial infrastructure, enhancing banking sector stability, and promoting financial inclusion.

During the previous crises mentioned above, Central Banks responded by adopting many measures to ease monetary conditions. These included unprecedented interest rate cuts to zero or negative levels, unlimited liquidity provision, targeted lending, asset purchases, reserve requirement adjustments, and foreign exchange intervention to combat inflationary pressures and counter the slowdown in growth.

Although these unconventional monetary policy measures taken by monetary authorities during previous crises helped restore national financial markets, reduce interest rates, and facilitate the lending of credit to households and businesses, some of them, particularly the unprecedented reduction in interest rates during the global financial crisis and the COVID-19 pandemic, did not have the expected effects because these successive reductions were not fully transmitted to the real sector in Africa due notably to:

- High level of excess reserves in many African countries due to its low sensitivity to interest rate variations, which reduces the effectiveness of monetary policy;

1/ Ibrahim, A., & Dambazau, A. B. (2017): « The impact of monetary policy on economic growth in Nigeria », Journal of Economic Studies, 44(3), 417-436.

2/ Davoodi, H., Dixit, S., & Pinter, G. (2013): « Monetary Transmission Mechanism in the East African Community: An Empirical Investigation ». IMF Working Papers 13/39, International Monetary Fund.

3/ Famoroti Jonathan Olusegun & Adeleke Omolade (2022): "Impact of monetary policy transmission mechanism in West African countries," Studia Universitatis Vasile Goldis Arad – Economics Series, Sciendo, vol. 32(1), pages 20-42, March.

- Significant financing of budget deficits by the Central Bank, which can subordinate monetary policy to fiscal actions and increase the level of inflation regarding the monetary creation that it induces;
- Weaknesses in financial systems, partly reflecting the underdevelopment of the African financial system.

In conclusion, the presenter noted that in the presence of exogenous shocks, Central Banks must effectively manage them to maintain price and financial stability and economic growth, requiring Central Banks to have a good understanding of monetary policy transmission mechanisms. In this regard, Central Banks must strengthen research and invest in high-frequency data collection systems to monitor economic conditions in real time. Monetary authorities should also intensify their efforts to enhance the transmission mechanism so that signals can reach businesses and households more efficiently. Furthermore, they can sometimes use a combination of monetary policy called the « integrated policy framework » proposed by the IMF[4] (2020), consisting of exchange rate interventions, capital controls, and macroprudential policies.

Moreover, the African Central Banks should efficiently coordinate their actions with Governments in responding to any future shocks to achieve the desired objectives, as seen during the COVID-19 pandemic. In addition, efforts should be made to develop more profound and more competitive financial markets to ensure that changes in policy instruments are transmitted to market interest rates and credit to the private sector. Central Banks should also improve their communication with the public to build confidence in the monetary authorities and their ability to manage the economy in the advent of exogenous shocks.

6.3 Summary of Panel Discussions

The panel discussions were led by three Central Banks (Liberia, Moçambique, and Malawi).

Their presentations highlighted the recurrence of exogenous shocks in Africa. In West Africa, some countries have also recently experienced geopolitical shocks (Burkina, Mali, Guinea, Niger, etc.), with the consequences particularly affecting Liberia, which was hit hard by the Ebola virus in 2014.

More specifically, these shocks led to rising fuel and food prices, resulting in significant budget deficits in Liberia. The situation has been more challenging in this country, where two currencies coexist: the US dollar (70 percent) and the local currency (30 percent). Therefore, the Central Bank of Liberia (CBL) takes measures to de-dollarize the economy, as the dollar is controlled and regulated by the US Federal Reserve (Fed) and not by the CBL. The successful coordination of monetary and fiscal policies has brought inflation down to single digits (7.6 percent in 2022). In addition, projects such as the PAPSS should help strengthen regional integration in payment systems, boosting optimism for the future.

Moçambique also experienced a debt crisis in 2016, which led to a loss of control over the exchange rate, with the currency depreciating by up to 65 percent. To curb this crisis, the Central Bank raised its key interest rate to 600 basis points and helped bring inflation down to 5.6 percent in less than a year, and the exchange rate went down by 17 percent before stabilizing. Given the identical political cost, the Central Bank could have adopted a gradual approach, but the Banco de Moçambique opted for a single large-scale increase. The approach

[4]/ International Monetary Fund (2020): « A Difficult Road to Recovery », Chapter 2 in IMF's Regional Economic Outlook, October.

adopted by the Central Bank enabled the expected results to be achieved relatively quickly, unlike the gradual approach, where the results would be expected in 3 to 4 years.

Moreover, the Government of Moçambique recently increased salaries in this country as part of the implementation of the Single Salary Table reform. The Government collected funds from the public through the sale of public securities, mainly acquired by banks. Rising wages, along with food supply constraints emanating from the Russian-Ukrainian war, led to inflation, which directed monetary authorities to raise key interest rates by 400 basis points. It was found that this increase was insufficient to curb potential inflationary pressures from the banking system's excess liquidity in the banking system. In this context, the Central Bank raised reserve requirements to 39 percent. These measures have decreased the inflation rate from double-digits (12.1 percent in August 2022) to 4.9 percent in August 2023. Given these developments, the Government's countercyclical policy should be noted, which points to a lack of fiscal responsibility laws for effective coordination between Moçambique's monetary and budgetary Authorities.

Malawi has faced multiple exogenous shocks, including the impact of COVID-19, the war in Ukraine, and two severe cyclones in 2022. These challenges led to a significant economic decline, with GDP growth dropping sharply from 4.6 percent in 2021 to 0.8 percent in 2022. The country experienced high inflationary pressures, reaching 20.9 percent in 2022. Furthermore, the reserves amounted to 1.2 months of imports in 2022, leading to a 25 percent devaluation of Kwacha in May 2022 to consolidate the depleting foreign exchange reserves and curb inflation.

In response to these inflationary pressures, the Central Bank of Malawi also gradually raised its main interest rate from 14 percent in 2022 to 24 percent in 2023. Furthermore, Small and Medium-sized Enterprises (SMEs) were supported through loans. The gloomy environment has also led the Reserve Bank of Malawi to finance the budget deficit up to 6.9 percent of the previous year's tax revenues in 2022.

Because of the economic situation marked by the recurrence of exogenous shocks, the Panelists noted the importance of supporting economic growth. However, this falls outside the priority mandate of the Central Banks, which is price stability.

In conclusion, it was pointed out that, in addition to the Central Banks, Governments also have their part to play in resolving the consequences of exogenous shocks. In this respect, the Panelists called for coordinated action between Central Banks and Governments to ensure the effectiveness of monetary policy measures. They also stressed the importance of Africa's independence and greater Continental integration. Finally, they also highlighted other challenges to be addressed in implementing monetary policy, notably transparency in the actions of the Central Bank and the credibility of the country's judicial institutions.

6.4 <u>Conclusion of the Chairperson</u>

The session's Chairperson noted the richness of lessons learned from the experiences of these three countries. He added that effective domestic measures should be taken to tackle the effects of external shocks to prevent African States from being overwhelmed by them, notably the importance of domestic resource mobilization in dealing with external shocks, regional integration (i.e., through payment systems), Central Bank independence, as well as fiscal and monetary policy coordination. He recommended pursuing Continent-wide initiatives such as the payment systems integration project and the development of FinTech, which could help strengthen African economies and consolidate international reserves.

7. FOURTH SESSION

7.1 Introduction

Dr. Francis Chipimo, Deputy Governor for Operations at the Bank of Zambia, chaired this session, which focused on the experience related to the central theme of the Symposium. The paper was presented by Dr. Samuel Munzele Maimbo, Vice-President of Budget, Performance Review, and Strategic Planning at the World Bank.

7.2 Summary of presentation

The presenter noted the prevalence of external shocks in recent years, which hurt African economies. He revealed that the World Bank has spent more than USD 93 billion on effectively planning to combat these shocks over the past 5 years.

Furthermore, he considered that economic planning has become highly uncertain in connection with the prevalence of external shocks affecting forecasts.

The presenter noted a difference between current and past crises. He argued that current crises are creating tremendous disruption in value chains worldwide. According to estimates, 150 million lives are at risk today, with potential consequences for the energy transition and rising energy costs, despite the contracts signed by developed countries for coal mines in Europe, for example. In this regard, the presenter argued that Africa has to look at the trade deals, forward contracts on energy being signed, and their impacts 10 to 15 years from now because energy matters for all African countries. With proper planning and intervention, African economies could avoid a situation of zero access to energy in the coming years. Thus, measures must be implemented to manage the availability and cost of energy for future generations.

In addition, the presenter called for joint efforts on the African Continent to prevent most countries from being distressed by 2030, given the debt burden. Indeed, debt is another area of concern for African economies. The number of countries in debt distress has reached its highest in 50 years, requiring serious attention. Taking the example of Zambia, which was in debt distress, he pointed out that the Zambian Government, through the Ministry of Finance and National Planning, and the Bank of Zambia were commended for achieving debt restructuring under the G20 defined Framework, even though it took long to reach a debt restructuring deal.

The presenter noted the resilience of African financial systems over time in the face of several shocks. He pointed out that Africa has not had frequent and severe banking crises due mainly to the commendable work of the Continent's Central Banks. In this regard, he argued that Central Banks should not just limit themselves to price and financial system stability functions (existing mandate) but should consider going beyond the traditional practice given the nature of the current shocks, which are more pronounced and affecting all facets of decision making. Furthermore, Central Banks should consider what is happening to energy transition and energy contracts globally.

He also mentioned the challenges of fiscal dominance and argued that Africa's relatively low economic growth was linked to inadequate tax revenue mobilization. This situation increased the proportion of African countries in debt distress. He noted the low level of concessional financing in Africa (2.5 percent) and encouraged the search for funding at concessional rates. In this respect, he invited African States to take appropriate measures to boost tax revenues, which could reduce recourse to Central Bank financing. However, he called on monetary authorities seeking their independence to support the private sector, giving greater impetus to industrial policies.

In addition, the presenter emphasized the importance of the role of the private sector. In this regard, he highlighted private sector development as another area of focus, as development aid from multilateral has significantly dropped over the years. Indeed, he recalled that 2,011 development agencies specialized in financing work on the Continent in collaboration with the World Bank. He pointed out that in 2019, the number of multilateral financing institutions increased by 539 without significantly raising the financing volumes. In Ethiopia, for example, 205 financing institutions are working there, yet the challenges of private sector financing remain. He also noted the insufficiency of investment in most African countries, except for a few countries such as South Africa, Egypt, etc., which receive significant investment flows. Thus, he maintained that despite the proliferation of development aid institutions, the issue of financing has become increasingly political. Therefore, it is vital to look at the type of investment flows coming into the country and adequately assess the existing policies and instruments.

In this regard, he called on Central Banks to become more involved in financing the private sector, which could be one of the main engines of growth and thus enable the Continent to develop. Therefore, beyond their known core mandate, Central Banks must incorporate issues such as easing access to finance by Small and Medium Enterprises (SMEs) and growth, contributing to the employment of millions of graduates entering the labour force.

The presenter underlined that the digitization and technology sectors must be prioritized. The issue of digitization is another area of focus that is shaping the current and future economic landscape. He stated that 84 percent of the African population has access to digital technology (3G and 4G) while a small proportion (3 to 8 percent) does not use the technology for their transactions. In this regard, he advocated for efforts to increase the use rate or access to digital on the Continent through promotional actions.

In conclusion, the presenter argued that there is a need for a paradigm shift in the way Central Banks support the development agenda on the Continent. With all the tools and resources at their disposal and other institutions, there is a need to make concerted efforts to win this cross-continent race for the coming generations. The AACB must be commended for their remarkable work and resilience in supporting the African economies in the face of shocks. The Association should also get involved in the ongoing discussions about the Continent's development and work closely with the private sector in these developmental discussions to raise the voice of Africa.

7.3 Summary of the discussions

Following the presentation, the concerns raised by participants focused mainly on the Central Bank's support for the private sector, financial inclusion, and the mobilization of domestic resources rather than concessional debt.

Participants pointed out that Central Banks are not suited to drive structural reform as this was more in the sphere of the fiscal authorities, who have a much greater mandate to formulate policies to that extent. However, they called on Central Banks to support the private sector, following the example of the Bank of Canada, which reaches out to new businesses to help them succeed. They pointed out, however, that the Central Bank's primary mission remains the fight against inflation, which limits its scope for action.

They argued that the key to private sector development is the implementation of structural reforms aimed to promote the private sector. It was pointed out that these actions fall within the scope of the political authorities, not the Central Bank's objectives. However, some participants felt that the Central Bank should expand beyond its core mandate and be more proactive, in contrast to its current passive behavior. The monetary authorities should help create and support development banks, particularly in Zambia, where the latter are often faced with security and guarantee problems. Such support would boost the private sector's ability to contribute to more sustained growth. For some participants, the mandate of the Central Bank, a development actor, should be changed to make it proactive, as inflation is just a means, not an end.

Furthermore, financial inclusion is another area of concern to the participants. As such, it was commented that Central Banks must continue driving this process to ensure that a larger population is included financially despite the strides made. In addition, it was highlighted that financial inclusion issues are within the realms of Central Banks. However, Central Banks, by nature, are not suited to dealing with issues of mobilizing finance directly, given the limited nature of tools at their disposal. Moreover, the monetary authorities should continue their good work, which should be augmented by the existing digital technology tools available. Furthermore, Central Banks in developing countries must still voice out and participate in some of these conversations without necessarily giving up their core mandate because some of the issues have implications for the effectiveness of monetary policy.

In addition, it was indicated that Central Banks need more tools to deal with financing issues directly. At the same time, Central Banks are institutions that the public looks to regarding knowledge of what is happening in the economy. Therefore, they need to be more proactive in their communication with the public, especially on debt issues resulting from decisions made by the Government, which bears budgetary responsibility along with the attendant risks. Although concessional financing is desirable, it should be noted that it represents debts to be repaid. To mitigate Africa's indebtedness, it would be necessary to adopt appropriate measures to increase the mobilization of domestic resources. In this respect, after noting the weaknesses of the African financial system, the participants called on the relevant authorities, notably Governments, to focus on deepening the Continent-wide capital market.

7.4 Conclusion of the Chairperson

In conclusion, the session's Chairperson thanked the presenter for his insightful presentation and the audience for participating actively and bringing out critical issues bordering on the main theme of the Symposium. He also commended the richness of the debates and invited the participants to continue their reflections on the subjects addressed.

8. RESOLUTIONS OF THE SYMPOSIUM

1. To ensure the effectiveness of monetary policy measures, monetary and fiscal authorities were urged to coordinate their actions in responding to any future shocks to achieve the desired objectives, as seen during the COVID-19 pandemic. Central Banks should also improve their communication with the public to build confidence in the monetary authorities and their ability to manage the economy in the advent of exogenous shocks.

2. Central Banks and Governments were encouraged to put in place measures to meet the challenges in implementing monetary policy, notably ensuring transparency in the actions of the Central Bank and building the credibility of the country's judicial institutions.

3. Given the mitigating effects of macroprudential policy regulation on the propagation of shocks in the domestic economy, regulation should be tailored to support economic recovery and strengthen financial resilience. In this regard, monetary authorities have been urged to design macroprudential regulations to manage the risks associated with credit shocks on a Continental scale. Thus, beyond macroprudential regulations, they could redefine the architecture of financial resilience in African economies.

4. Central Banks should demonstrate their ability to understand African economies to effectively combat imbalances and ensure greater resilience of these economies from shocks, using the instruments available to the monetary authorities.

5. Given the security and guarantee problems often faced by African development banks, the monetary authorities were encouraged to help create and support development banks. Such support would boost the private sector's ability to contribute to more sustained growth. In this regard, policymakers were invited to review the mandate of the Central Bank, which is also a development player, to make it more proactive.

6. In the presence of exogenous shocks, Central Banks were urged to manage the shocks effectively to maintain price and financial stability, and economic growth. In this regard, Central Banks must strengthen their research capacity and invest in high-frequency data collection systems to monitor economic conditions in real time. The monetary authorities should also intensify their efforts to enhance the transmission mechanism so that signals can reach businesses and households more efficiently.

7. Given the weaknesses of the African financial system, efforts should be made to develop more profound and competitive financial markets to ensure that changes in policy instruments are transmitted to market interest rates and credit to the private sector. In this respect, Policymakers were urged to prioritize financial sector reforms by deepening the Continent-wide capital market, improving financial infrastructure, enhancing banking sector stability, and promoting financial inclusion to strengthen monetary policy transmission mechanisms.

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