

Africa Development Week

African Central Bank Governors' Round Table

Theme: Monetary and exchange rate policy and Africa's debt burden and sustainability

3 April 2016, Addis Ababa, Ethiopia

Opening

The Moderator set the tone for the discussions by reminding participants that on the back of volatility in global markets and the slowdown in China, 2015 had proved to be the worst year for Africa financially since 1980. The Moderator noted that domestic conditions were also in the spotlight in addition to external shocks, since sovereign debt was a mirror of the health of African economies. She highlighted the critical role of central banks in dealing with external shocks, and foreseeing and managing domestic financial shocks.

In his welcoming remarks, the Executive Secretary of the ECA cautioned that sustained declines in commodity prices implied the advance of some countries and the decline of others that could alter global structural relationships and longer-term equilibrium real exchange rates, and also complicate development policy choices. He highlighted the central role played by currency policy in determining all other prices in the economy and underlined the critical role played by central bankers as custodians of this policy. He noted that using currency and monetary policies involved trade-offs that needed to be carefully managed with a view to fostering optimal long-term developmental impacts. He emphasised the availability of different policy options and mixes that could be applied under different national initial conditions while also highlighting common challenges faced by African countries, such as structural impediments, vulnerability to external shocks and the importance of building fiscal and external buffers. He concluded by stating that diversification and industrialization remain the best means in the long run for countries to reduce their vulnerability to the adverse growth effects from external shocks. He invited central banks to align their policy interventions to the African transformative policy agenda of structural transformation and industrialization.

Presentation

In addition to outlining the objectives and focus areas of the round table, the presentation on monetary and exchange rate policy, and debt burden and sustainability in Africa provided the current context on Africa's growth story and the major economic policy challenges Africa faces today. It reiterated the challenges flowing from the global economic slowdown and commodity booms and busts; the presence of increasing fiscal imbalances and inflationary pressures driven by tight domestic supply conditions and exchange rate pass-through effects; the inability of current rates of economic growth to generate adequate employment and foster sustainable levels of poverty reduction; and the urgent need to mobilize financing to close the infrastructure investment gaps that threatens Africa's development agenda. The presentation also offered policy solutions and lessons, such as the need to prioritise financial development and institutions that support, develop and regulate markets in other sectors in order to improve the effectiveness of monetary policy signals and their transmission; the need to be cognisant of the negative impacts

of exchange rate movements and the nature of external shocks on the efficacy of available monetary policy instruments; the need to develop bond markets for long-term finance and explore new instruments, such as digital finance (which presented significant potential in terms of developing African payments systems, fostering financial inclusion, providing valuable information on the savings patterns, and contributing to overall financial market development).

Round table discussion I: *Monetary and exchange rate policy direction in Africa*

The discussion highlighted the importance of economy-specific factors in conditioning policy choices on monetary and exchange rate policies in Africa. For instance, in one country, the large importation bill for food and manufactured goods tended to deepen the external imbalance such that the central bank opted to intervene on the exchange market to minimize the depreciation of the national currency with a view to safeguarding macroeconomic stability. In several cases healthy foreign exchange reserves were an important factor in facilitating such a policy stance and there were a number of examples mentioned of central banks using foreign and fiscal reserves to smooth exchange rate volatility. In other cases, the role of monetary and exchange rate policies in resolving external and endogenous shocks was discounted in view of prevailing political instability that had depleted foreign reserves and the inability to attract FDI and borrow externally due to unfavourable risk profiles.

Cautions were raised against relying on monetary policy to achieve what it could not in the light of the limited efficacy of available instruments and in an environment characterized by dual balance of payments and fiscal deficits, which rendered monetary policy a blunt instrument. Some participants argued strongly against interventions in currency markets arguing rather in favour of safeguarding the critical role played by currency corrections as a stabilizing mechanism in the presence of structural deficits in an economy. It was further argued that adopting such a stance offered the best way to safeguard long-term development by eliminating the dangers of running down foreign reserves in a failed bid to shore up weak currencies. In this context, participants were cautioned against viewing all currency depreciations as bad for the economy. This viewpoint launched a lively debate on whether central banks could realistically stand by in the face of political and public pressure to intervene against currency depreciations. The prevalence of fiscal dominance (and political dominance) and poverty in many African economies were highlighted as exerting tremendous pressures in favour of currency interventions and sovereign debt accumulation. It was also noted that inflation targeting generally offered the easiest course of action for central banks in Africa as they had more instruments available to intervene and could thus readily apply themselves effectively to manage it.

Round table discussion II: *Debt burden and sustainability*

This segment highlighted the differences amongst African economies in terms of their history and experience with indebtedness, their current debt burdens and profiles, and their ability to access multilateral and bilateral credit, as well as the risks associated with the changed structure and maturity of debt profiles in Africa. For instance, some governments were faced with a significant external debt overhang, whereas others were not either because of a policy choice to rely on domestic sources of credit or an unfavourable risk profile that necessitated greater reliance on domestic sources of credit. Others did not qualify under the HIPC or other similar initiatives and had to devise various strategies to repay their historical debt. Alternatively, the example of sub-regional economic communities such as the eight countries that shared a central bank in West Africa, illustrated how that kind of arrangement has privileged domestic debt, as

only two of the member countries were in a position to mobilise external debt and the shared central bank is rendered insulated from the problem of fiscal and political dominance. Member Governments thus mobilize resources through sovereign bonds on the interbank market and the central bank rather extend refinancing to commercial banks.

There was a brief discussion on the merits of domestic debt versus external debt. Some participants were of the view that external debt was more problematic in the context of weak African currencies or where the bulk of export receipts were not earned in hard currencies whereas external debt repayments required hard currency. Others expressed the viewpoint that domestic debt was the true mirror of the health of an economy. It was quite evident that positions were very much conditioned by country-specific factors and that there was more than one answer to this question. The debate also included a discussion on whether or not African economies possessed sufficient savings to justify a prioritisation of domestic debt over external debt. The perception that domestic resource mobilization was limited by limited saving in Africa was questioned. It was pointed out that there was a wealth of unused savings held by institutions such as pension funds in Africa that belied this popular notion. It was noted that many sources of credit remained untapped in Africa because of a dearth of appropriate instruments to tap the savings potential and that the success of domestic bond issues in countries such as Egypt and Ethiopia were testament to that fact. It was recommended that domestic resource mobilization efforts be expanded to encompass the design of innovative instruments for domestic resource mobilization, including digital finance and linking the informal sector to formal finance.

It was noted that the dominant trend in Africa was a move towards sovereign debt comprised in the majority of private debt. In some countries private debt was estimated to account for up to 60 percent of sovereign debt. Central banks were sensitised on the potential negative implications arising from accumulating large private debt because it was associated with fundamentally shorter maturity periods and very few prospects for renegotiation when compared to bilateral and multilateral debt.

A fair number of participants from central banks were of the view that central banks should actively concern themselves about developmental goals and there was general recognition that governments will be seeking to accumulate more debt in order to finance transformation agendas. In this context, cautions were sounded with respect to public private partnerships, which were seen to amount to a little more than public debt in Africa because governments were too often extending unjustified guarantees to the private sector under the guise of public-private partnerships.

Round table discussion III: *Building resilience to manage external shocks in African economies*

The discussion noted that Africa had made notable progress towards building resilience before the 2008/9 financial crises as evidenced by improved macroeconomic management, accumulated reserves, reduced dependency on single commodities, and reduced debt ratios. However, buffers had been eroded in many cases by recent heavy investments in infrastructure and countercyclical responses to the crises. In addition, it was noted that the current global economic slowdown was much less favourable for the accumulation of reserves, which meant that much caution was needed when contracting sovereign debt.

The discussion again highlighted the issue of fiscal and political dominance in that external debt was too often not contracted for purposes of financing developmental investment. Countries

were sensitised to the need to adjust to the new normal of sustained volatility in economic and financial markets by making the necessary investments in strong institutions to cope with the new environment. The discussion also revisited tensions around using foreign reserves to defend currencies, with the view expressed that this amounted to a short-term measure. In this context, long-run measures for resilience were seen as hinged on effecting structural changes to African economies. Participants were in agreement that the best path to attaining resilience was through productive investments that could not only assure the means for debt repayments but also healthy reserves and the basis for continued growth into the future underpinned by economic diversification and structural transformation. The importance of targeting inclusive growth and the restructuring of financial systems to realize that goal.

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