2020 BNR Policy Seminar

Theme: Monetary policy in times of crisis: Global perspectives and local realities

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OPENING REMARKS

Ms. Anna Breman, Deputy Governor, Sveriges Riksbank

Mr. Gaston Gelos, Assistant Director and chief of the Monetary and Micropudential policies division, IMF

Mr. Romain Veyrune, Deputy Division Chief, IMF's monetary and capital markets department

Mr. Papa Lamine Diop, Executive Secretary of the Association of African Central Banks (AACB)

Distinguished Guests representing the International Monetary Fund, and Central banks of Sweden, Tanzania, Kenya, South Sudan, Burundi, Uganda, Guinea, Zambia, Liberia and the Central Bank of West African States.

Good afternoon,

It is my privilege to welcome you all to the 2020 edition of our NBR Policy Seminar. This meeting couldn't come at a more critical time.

In the late 2019, what started as a sharp external shock in China-linked supply chains has turned into a prolonged global economic downturn, the likes of the 2008 global financial crisis (GFC) or even the 1929 great depression.

As major economies cope with the second devastating downturn in just over a decade, what lessons does the past hold for today's policymakers?

I will start by drawing some parallels between the current recession and the recent GFC of 2008.

As we all know, the 2008 GFC resulted from an endogenous shock, following declining credit standards in the US mortgage market, which culminated into a massive credit crisis, freezing financial markets and drying up liquidity. This triggered series of central bank support to liquidity amidst credit crisis.

While the global economy was facing a slower recovery, central banks cut and held interest rates at historically low levels for a prolonged period in an attempt to stimulate economic growth. However, in some parts of the world, the massive injections resulted in spikes in debt levels, and the overburdened sovereign and corporate debts resulted into a significant reduction in asset quality.

Unlike the 2008 GFC, the coronavirus crisis originated from an exogenous shock of public health crisis. Moreover, financial systems around the world were in reasonably good health at the outset of the coronavirus crisis when compared to the 2008 GFC.

In the contemporary economic history, crises triggered by exogenous shocks have been quickly absorbed by healthy financial systems, with growth resuming smoothly once the disruption ended. Therefore, when the Covid-19 crisis first hit, most global economic models optimistically predicted a rapid economic rebound in the second half of the year.

However, with fears of a second wave of infection and extended lockdowns, hopes for a faster recovery are fading away. Concerns are therefore mounting over the risk that the exogenous shock of the coronavirus crisis will trigger endogenous tremor in sovereign and corporate debt markets.

The silver lining to the obscure economic situation is that many central banks and governments appear to have learned lessons from the GFC. As result, monetary and fiscal policy responses to the current crisis have been much more rapid and (in some cases) innovative. In most cases, the emergency packages rolled out by central banks and governments during the coronavirus crisis exceed those enacted in 2009.

For example, the Federal Reserve has stepped in with a broad array of actions to limit the economic damage from the pandemic. As you heard recently, the Fed Chairman Jerome Powell announced a major policy shift to “average inflation targeting”, meaning that they will be more inclined to allow inflation to run higher than the standard 2% target before hiking interest rates. This was an addition to other measures that were already in place, including a near-zero interest rate accompanied with a strong forward guidance (to put more downward pressures on the long end of the yield curve).

Also, there were additional measures put in place to support the functioning of financial markets, as well as various facilities to encourage bank lending, provide direct support to businesses, and support households and consumers. The Fed also provided additional support for state borrowing (e.g. using the municipal liquidity facility) and cushioned money market from international pressures.

Similar rescue packages have also been offered by central banks in other advanced economies and emerging markets.

So what about African central banks? Are we doing enough to counter the effects of the coronavirus crisis?

As we know, most central banks in Africa responded to COVID-19 crisis by deploying a variety of monetary policy tools, including lowering policy rates, reducing capital requirements, providing various liquidity support measures to the banking sector, allowing loan deferrals and refinancing frameworks for distressed firms, and introducing new support measures for mobile money and digital finance.

However, the recent uptick in inflation in most African economies casts doubts on the durability and sufficiency of some of the measures taken by central banks. Let us not forget that, months before the outbreak of the pandemic, the growth and inflation outlooks of this region were grappling with multiple threats, including heavy rains and the invasion of locust swarms that were destroying crops and the livelihoods of millions of African smallholder farmers.

Such supply shocks are expected to exacerbate inflation in the coming months, putting further pressure on the exchange rate and providing another hit to economic activity alongside the impact of the coronavirus. Indeed, by making it particularly difficult for suppliers to get inputs to rural farmers in time for planting season and triggering additional post-harvest losses (as unsold and rotting food accumulates on farms), some policy responses to curb the outbreak of COVID-19 have potentially undermined the recovery in both food production and distribution systems.

The effect of COVID-19 related public health measures on inflation goes beyond the food inflation. Recently in Rwanda we have experienced a transport fare spike as a result of policy measures to observe social distancing in public transport. A similar shock could occur in any other subsector that capitalize on economies of scale to offer low-cost services (e.g. schools).

Therefore, one can legitimately ask if African central banks can cut interest rates further under such an inflationary (or rather stagflationary) environment and still limit the scope to allow further exchange rate depreciation. Further interest rate cut can only be justified on the basis of lower pass-through (where it exists).

Also, multiple shocks could destabilize the financial system in most Sub-Saharan economies that are major exporters. The global economic slowdown, the oil price collapse and the US dollar’s strength are expected to bring their currencies under acute pressure, sparkling financial instability, hence, posing a challenge to the transmission of monetary policies. With the heightened corporate default risk, most liquidity released by monetary policy responses to the coronavirus (as well as emergence fiscal packages enacted in the form of concessional credit lines) will hardly achieve intended results.

The effects of monetary policy during crises differ significantly from those in normal times. With that being said, despite different challenges that lie ahead, let us take this

opportunity to use this platform to listen to the experiences of central banks in advanced economies and discuss their relevance for local realities, and also define and brainstorm policies that can stabilize the economies of African countries during this crisis.

Again as mentioned before, this seminar under the theme "Monetary policy in times of crisis: Global perspectives and local realities" could not have come at any other pressing moment.

As I conclude, I would like to thank everyone for their precious time in being part of this brief but informative discussion, and also highlight the need to strengthen our collaboration during this crisis period.