UNWINDING UNCONVENTIONAL MONETARY POLICIES: IMPLICATIONS FOR MONETARY POLICY AND FINANCIAL STABILITY IN AFRICA

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From the outset in these remarks, I wish to stress the extent to which uncertainty is deeply engrained in almost every aspect of this discussion. When (if at all) will the unwinding of unconventional monetary policies commence; what will trigger it; who will undertake it; and what form will it take? These questions, among others, must be addressed to gain some insight into how unwinding these policies may impact on monetary policy and financial stability in Africa. As for answers, on some of the pertinent issues we can form a (reasonably) clear assessment; but, for others, the fog of uncertainty may prove impenetrable. As I shall explain in more detail shortly, the importance of institutional development that supports effective risk-based assessments as an integral part of policy making is paramount; and this can be difficult, in an environment where politicians and the public at large crave certainty, especially perhaps from central banks.

To further underline this point, the extent of this prevailing climate of uncertainly has once again been demonstrated by recent events, which have delayed any further engagement in the unwinding process. The only major central banks that have seriously been contemplating tightening monetary policy in the near term, the United States Federal Reserve (Fed) and Bank of England, have now retreated; the latter decisively so in the wake of the Brexit referendum result, the repercussions of which are likely to reverberate for years to come.

At the same time, the European Central Bank (a late convert to unconventional policies) has only recently accelerated further its programme of bond purchases, while the Bank of Japan may also be considering additional stimulus measures. Overall, outside perhaps the USA, unwinding is not seriously on the current agenda that is dominated elsewhere by commitments to do "whatever it takes" to restore growth and ward off deflation.

In the circumstances, I might go further and question whether the label "unconventional" is still appropriate for measures, quantitative easing (QE) in particular, that have been part of the policy mainstream for the best part of the past decade. At a time when the "secular stagnation" hypothesis that the global

economy is mired in a situation where a prolonged period of ultra-low inflation, inadequate investment and depressed growth appear increasingly plausible, is QE not part of what increasingly appears to be a "new normal" for monetary policy? Even if a phase of policy tightening were to commence in the near future by one or more major central banks, both the Fed and the Bank of England have indicated that they will initially only engage with interest rate increases, leaving balance sheet reduction to a later stage. Thus, in practical terms we are mainly considering the capacity of monetary authorities in Africa to respond appropriately to any gradual programme of upward interest rate adjustments by major central banks, most probably the Fed Reserve, and even then, only at a modest pace. Why should this appear so threatening?

A clear point of reference here is the so-called "taper tantrum", that followed the surprise announcements in May and June 2013 by the then-Fed Chairman, Ben Bernanke, that asset purchases under the "QE3" programme could soon be curtailed due to the optimistic prognosis for the US economy. In turn, this sparked a sharp upward movement in US bond yields and the US dollar exchange rate.

To that extent, despite the "tantrum" label, the market response was in large part "rational" to a signal that QE was coming to an end, just as the original introduction of QE had pushed bond yields and the US dollar downwards. But it understandably heightened concerns in emerging markets, including in Africa, pointing to the potential for destabilising capital flows and exchange rate movements as well as squeezing the credit and liquidity that could, in turn, adversely affect trade flows. Indeed, the speed at which this "rationality" caused markets to respond was a further cause for alarm, as was the impression that the Fed was basing monetary policy decisions with global implications purely on domestic economic considerations.

To be forewarned is to be forearmed, and we should reflect on what lessons can be learned from this episode. In particular, what has changed in the past three years that has added or subtracted from the risks of renewed policy tightening?

In the most optimistic scenario, of course, policy tightening by major central banks would be a sign of renewed, sustained growth in the world economy and, thus, generally benign in its impact. Rate increases to head off renewed inflationary pressures would be welcome as would asset sales by central banks to mop up liquidity. In this optimistic account, we might

also note that the "taper tantrum" was perhaps itself overdone, given that, QE3 was subsequently tapered and brought to a close with little obvious disruption.

However, it is unlikely that any serious observer see this "costless" scenario as realistic. In the words of the Chinese trade minister, Gao Hucheng, speaking to his G20 colleagues in July this year, prospects for global recovery are "...complicated and grim...global trade is dithering, international investment has yet to recover...the global economy has yet to find the propulsion for strong and sustainable growth."

This "grim" outlook has certainly impacted on sub-Saharan Africa for which growth of only 1.6 percent in 2016 is forecast by the IMF (Fund), down from 5.1 percent in 2014, the year in which the Fund felt sufficiently confident of continental prospects to host its "Africa Rising" conference in Mozambique. Despite ultra-loose monetary conditions, with slowing growth and falling commodity prices enthusiasm for emerging market assets was already waning. So it is unsurprising that, in late 2015, as the Fed prepared for the first interest rate increase for almost a decade, the Bank for International Settlements warned that vulnerability of emerging

markets to developments in the US was greater than at the time of the original “taper tantrum”.

In Africa, therefore, low commodity prices, together with the impact of any sustained slowdown in China, loom large. But this matters less to decision makers at the Fed, who are guided more by generally positive news on employment trends in the US. Recently, it does appear that the negative impact of global headwinds has played a greater role in Fed decision making, where such considerations have clearly been a factor in first delaying the initial interest rate increase and then the timing of subsequent adjustments. As the “secular stagnation” hypothesis continues to gather credence, any dilution of hawkish sentiment through greater caution over moving quickly to a process of “normalising” policy, would certainly be welcome. But this may still not be enough to allay concerns that the impact on emerging markets of domestic monetary policy decisions is viewed by policy makers in those countries largely as collateral damage that remains outside their mandate.

This concern is aggravated by two further considerations. First, major central banks continue to struggle in effectively communicating their intentions. The 2013 “tantrum” was not so

much the result of a possible decision to restrict the extent of QE3, but that this possibility caught markets by surprise. Since then, market expectations in the US have consistently been dovish compared to more hawkish sentiments among Fed governors. Conversely, the ECB has at times struggled to convince markets of its commitment to sufficient monetary stimulus. The continuing potential for markets to be "surprised" was again indicated by the "Bund tantrum" in April 2016 or, more recently, the spike in yields of May 2016 on news that the Fed was considering a further interest rate increase.

The second concern is that research by the IMF suggests that, since the financial crisis, markets are generally more susceptible to episodes of extreme volatility. Among other causes, this can arise from limited and sometimes poorly matched liquidity across a more diverse range of investment products and intermediaries, itself partly the result of the search for yield following the introduction of QE. If so, the potential for contagious spill overs from policy decisions and other developments in major economies is amplified further. Such market hypersensitivity is hardly comforting in conditions of pervasive uncertainty, especially where demand for riskier assets continues to depend largely on the inherently unstable "bad news is good news" paradigm that is prevalent since the

financial crisis and introduction of ultra-loose monetary policies.

It is important however, not to take the risk of "contagion" too far, to the extent central banks and other policy makers in Africa start to see themselves as victims, at the mercy of decision makers (and the response of markets) in major economies. It is here that one cannot overemphasise the importance of policy makers in Africa to continue the good work of recent years and do everything possible to get correct policy fundamentals in place with respect to underpinning macroeconomic and financial stability. As Moody's Investors Service has recently observed when commenting on the "Brexit" result, the countries most exposed to market volatility and shifts in investor perceptions are those with large current account deficits financed primarily by short-term capital flows. In turn, such deficits are symptomatic of other misalignments in the domestic economy including excessive consumption (typically credit-fuelled) by either the public or private sectors.

Thus, as noted earlier, adequate attention is necessary to ensure that risk-based planning is not only fully integrated into policymaking, but also that this is apparent to outside observers. As the Governor of the Bank of England, Mark Carney, recently observed:

> "If you haven't identified the risks, you don't have credibility when you assert resilience... You have to come straight with people about where the risks are and then have a clear plan to address them......You can't wish things away; that perpetuates a financial crisis...."

In this respect, central banks in Africa are generally quite well-placed, having been proactive in recent years in strengthening institutional support for effective monetary policy formulation together with more explicit attention to the issue of financial stability. But this remains work in progress and some of the policy measures (especially those that support financial stability) have yet to be implemented in practice. Effective policy communication is also a challenge in Africa where, in many cases, the absence of a

financially literate media can further muddle the intended message.

There is also a need to encourage a greater commitment to transparency in the process of fiscal planning. This is especially so for supporting debt sustainability where the timely availability of full and accurate information is essential to maintain credibility. More generally, countries should make a serious commitment to improve national statistics in line with dissemination standards overseen by the IMF. After all, these standards were put in place with the explicit objective of improving access to international markets.

Finally, let me say a few words on the relevance of unconventional monetary policies for possible future use by African central banks. Here, my advice is very clear and simple: let's not even think about it, for three reasons. First, unconventional policies were adopted as a last resort in a context where the potential for traditional policy instruments was largely exhausted; this is not the case in African countries where both inflation and interest rates remain at levels where conventional policies continue to

have traction. Second, in developed economies, with deep and diverse financial markets, including for government debt, QE was targeted at further lowering long-term interest rates, and even then came in for much criticism. In Africa, where such markets are not typical, any move in that direction would inevitably be seen as a means of monetising government debt, with all the associated negative connotations in terms of stoking future inflation and ducking the challenge of mobilising domestic revenue. Third, the use of QE in Africa to boost domestic demand would distract from addressing more fundamental issues that constrain the effective promotion of inclusive growth and returning to the more sustainable paradigm that "good news is good news".