East AFRITAC
INTERNATIONAL MONETARY FUND
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Link between Financial Stability and Monetary Policy in Africa

Europian Union
UKaid from the British people
german cooperation
European Investment Bank
Government of Canada Gouvernement du Canada
Australian Government Department of Foreign Affairs and Trade

- **Part I: Link between Financial Stability and Monetary Policy after the 2008 Crisis**

- **Part II: Regional Integration in Africa, Pan African banks and mobile payments: Impact for Monetary Policy and Financial Stability**

The role of Central Banks before/after 2008

- Before 2008: Concentrated on Price stability
- 2008 crisis: Price stability does not ensure macroeconomic stability
- After 2008: New mandate for Central Bank: Financial Stability

Key Elements in a Framework for Financial Stability (Three steps approach)

- Assessment that brings together macroeconomic, monetary, financial market, supervisory, and regulatory input.

- Coherent structure for the analysis of financial stability issues to:
  - (i) foster early identification of potential risks and vulnerabilities;
  - (ii) promote preventive and timely remedial policies to avoid financial instability,
  - (iii) resolve instabilities when preventive and remedial measures fail.

- Ultimate goal of such a framework is to prevent problems from occurring or to resolve problems if prevention fails.

Coverage of financial stability

- Financial Market Infrastructures
- Crisis management framework
- Strong Supervision
- Macroprudential

Financial market infrastructure and monetary policy

- FMIs contribute to financial development and deepening/ and improve the transmission mechanism
- FMIs concentrate risk and can be sources of financial shocks or a channel through which these shocks are transmitted across domestic and international financial markets.
- Oversight of payment and settlement systems is a central bank function
- New international standards In 2012, were issued for FMIs, i.e. the CPMI-IOSCO Principles for Financial Market Infrastructures (PFMI)

Crisis management framework and monetary policy

- Proper tools to resolve failing banks and other systemic financial institutions in an orderly manner, without unnecessarily exposing taxpayers to risk of loss and causing wider economic damage.

- One of the key areas for financial sector crisis management framework is Emergency Liquidity assistance (ELA) policies and procedures

Crisis management tool and monetary policy tool have distinct features

Central Bank Liquidity Providing Operations

Normal Times		Systemic Shock	Idiosyncratic Shock
Bilateral Overnight Facility	*Multilateral* Open Market Operations (OMOs)	*Multilateral* Unconventional Monetary Policy	*Bilateral* LOLR
Payments system objective Counterparty initiative Automatic access High quality collateral Penal rate	**Monetary policy objective** Central Bank initiative High quality collateral Policy rate (ST), market rate (LT)	**Financial Stability objective** Central bank initiative Expanded collateral, longer tenure… Normally when impaired monetary policy transmission mechanism	**Financial stability objective** Counterparty initiative Central bank discretion Less liquid collateral Penal rate Increased supervisory intrusion & conditionality

Macroprudential and Monetary policy

- Monetary policy focuses on aggregate demand, price and output stability

- Macroprudential policies target sources of threats to financial stability (Knowledge still incomplete)

- Side effects that one policy has on the objectives of the other

- Policy coordination can improve outcomes but there are risks

Institutional set up

- **Monetary and prudential functions under the central bank's roof**
  - **Advantages**: inherent interest of Central Bank, access to information; more thorough monitoring of markets and the macro economy; faster decision-making, CB ultimate source of liquidity
  - **Risk:** concentration of multiple and sometimes conflicting objectives in one institution can muddy its mandate, complicate accountability, and reduce credibility.
- **Safeguards are needed**
  - Institutional frameworks need to distinguish between the two policy functions through separate decision-making, accountability, and communication structures.

Channel through which Monetary policy can affect Financial Stability

- Borrower balance sheet channel (tighter policy-higher default)
- Risk taking channel (accommodative policy)
- Risk shifting channel (lenders shifting to more risky assets)
- Asset price channel (under accommodative policy)
- Exchange rate channel (capital flows for small open economy)

Interaction between Macro prudential tools and monetary policy

- **Macroprudential tools can**
  - Complement monetary policy action reducing the need for sharp policy action
  - Address adverse side-effect of monetary policy on financial stability
  - Target specific systemic risk
- **Combination of monetary and macro prudential policies can moderate financial cycles contributing to macroeconomic stability**

Impact of three major changes in Africa on monetary policy and financial stability

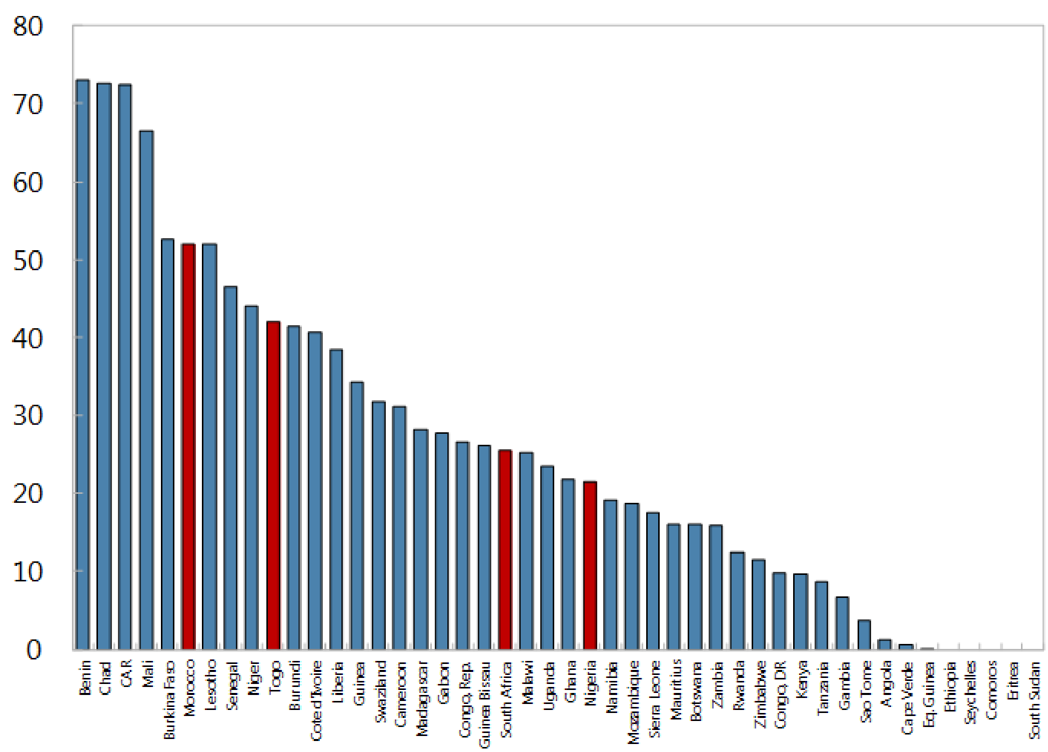
- **Regional Integration such as EAC integration**
- **Pan African banking**
- **Mobile payment**

Increasing integration of financial markets in Africa is promoted by regional initiatives such as EAC:

- EAC capital account liberalization
- Important steps are under way towards harmonizing the regulatory environment for financial banking and services.
- Preparations have begun for a common payment and settlement system for the five member states, which would allow settlement in local currencies
- Integration government debt markets,
- Going forward, harmonization of monetary policy instruments

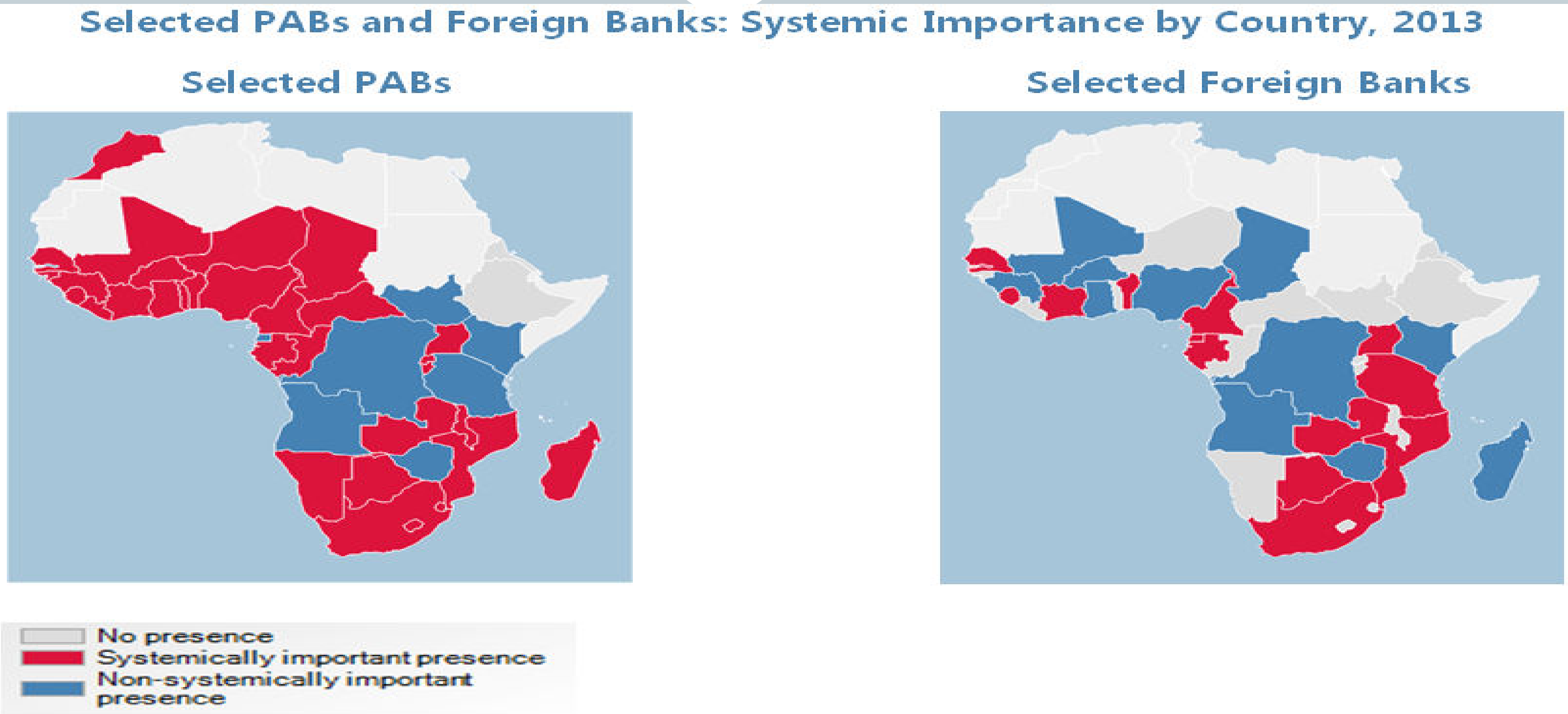
Pan African Banks start dominating in many host countries

SSA and Morocco: PABs' Share of Total Bank Deposits by Country, 2013



Sources: Annual Reports, Bankscope, and bank websites.
Note: Highlighted columns indicate the home countries of the seven major PABs.

Pan-African banks now have a more significant footprint in Africa than foreign banks



Sources: Annual reports, Bankscope and IMF staff estimates.
Note: Systemically important presence includes subsidiaries and parents with a deposit share of more than ten percent of banking system deposits.

.. But created channels for possible contagion and scope for regulatory arbitrage

Pan African Banking groups=Financial deepening

- Due to higher competition, know how
  - Improve intermediation margin
  - Improve access to financial service
  - Promote Financial innovation
  - Better interest rate channel
  - Deeper foreign exchange market
  - Impact on credit channel (broader credit access, higher loan to deposit ratio)

Need to address the increase risk on financial stability

- Prove regulatory and supervisory frameworks for PABs:
  - Establish supervisory colleges for main PABs and enhance functioning of existing colleges
  - Intensify collaboration between home and host supervisors for licensing and ensure MoUs feature full information exchange
  - Implement consolidated supervision and ensure bank holdings are fully regulated and supervised
  - Create an oversight committee of key home supervisors to discuss pan-African bank issues
  - Strengthen governance and ownership structures, including by ensuring that fit-and-proper criteria are applied
  - Broaden home/host joint inspections
  - Start work on cross border crisis management and resolution issues

Major impact of mobile payment on monetary policy

- Increase competition
- Increase significantly financial inclusion
- Lower transaction costs
- Increase savings
- Reduce cash in circulation
- Impact on monetary policy

Need to balance development versus stability objectives

- Strong legal framework
- Financial integrity (AML)
- Fund safeguarding
- Operational resiliency (confidence, cyber attack)
- Payment systems (strong growth implies stronger oversight)

Links

- IMF, 2014, Staff Guidance Note on Macroprudential Policy
- Main note
- Detailed Guidance on Instruments
- Considerations for Low Income Countries

- IMF, 2013, "Key Aspects of Macroprudential Policy"
- KE site on macroprudential policy
- IMF Working Paper (13/168): Monitoring Financial Stress

Thanks