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The role of Central Banks in present times. Monetary and exchange rate policies in the Mediterranean countries

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In this first session of the Conference, we will address the implications of the present situation of the global economy for central banks and, more specifically, how should central banks in the Mediterranean region manage their monetary and exchange rate policies in the present context.

Before giving the floor to our distinguished speakers let me say a few words about the global economic policy environment and the implications for monetary and exchange rate policies. The latest data tend to confirm that the global recovery is firming, including in core advanced economies, even if the rates of growth continue to be rather modest. Inflation is also coming back.

In this context, and after the prolonged period of ultra-expansionary monetary policies that goes back to the global financial crisis, we are witnessing what seems to be the beginning of a shift in the policy mix in advanced economies, at least by now in the US, a shift towards a normalization of monetary policy and a somewhat more expansionary fiscal policy.

But this change in the policy mix points to the end of the so far very relaxed financial conditions at the global level; and this, in turn, may have adverse collateral consequences, mainly in the domain of financial stability, in both advanced and emerging market economies, especially if the change does not take place slowly enough. Indeed, the mere expectation of the shift in the policy mix has been one important driver behind recent increases in bond yields in mature economies and the appreciation of the US dollar. In the same way, as highly accommodative monetary policies in major advanced economies generated major challenges for policymakers in emerging market economies, the exit from such policies can have important repercussions, as previous episodes of market volatility confirm.

In this context, it seems relevant to address the issue of how central banks in the Mediterranean region should cope with the potential spillovers from these policy changes in advanced economies, taking into account the different monetary and exchange rate strategies that they follow. Many countries in the South Mediterranean shore have historically relied on stable exchange rates as the nominal anchor for monetary policy, although some of them have moved or are moving towards more flexible exchange rate regimes and inflation targeting frameworks, under the advice of international financial institutions.

While there is no specific recommendation regarding the choice of the exchange rate strategy and each country will need to weigh the pros and cons of pegging versus exchange rate flexibility, we must be aware of the limitations that domestic policies have in dealing with the spillovers from external policies and events. These are clear in the case of countries with fixed exchange rates which, depending on the openness of their capital accounts, have to accept the monetary policy stance of the reference country.

But countries with more flexible exchange rates are not shielded either. Although they can disentangle their monetary conditions by allowing the depreciation of the exchange rate, this would have side effects on inflation. And the likely swings in capital flows can have implications for financial stability, as emerging market economies have repeatedly experienced. Indeed, some of them have been forced to tighten monetary conditions in a procyclical way to counter inflationary pressures, and have used their buffers of international

reserves and implemented macro-prudential and capital control measures in order to preserve financial stability. In any case, tighter dollar funding conditions, in particular, are challenging for emerging market economies with high levels of dollar denominated debt.

This is why it has been argued that the traditional “trilemma” in international finance (i.e., in a financially integrated world it is impossible to have at the same time free capital mobility, fixed exchange rates and independent monetary policy) has been transformed into a “dilemma” by the existence of a so called “global financial cycle”, whereby an independent monetary policy pursuing domestic policy objectives (controlling inflation and promoting growth) is possible if and only if the capital account is managed. In these conditions, sound fundamentals and the use of traditional macroeconomic (fiscal and monetary) policies may not be enough; authorities may eventually need also to resort to macroprudential and capital flow management instruments to smooth financial cycles and capital flows.

Finally, another reflection from the recent experience goes to the central banks in core advanced economies: the importance of better internalizing the global spillovers of their monetary policy decisions. While it is not possible to coordinate monetary policies, given the mandates of these central banks, they should consider the effects of their decisions on the rest of the world in their decision making, as the spillovers have the potential to raise financial instability problems in other countries, and the spillback effects will hit back on their own economies.

Without further ado, we are honoured to have with us today three very experienced representatives of the central bank community of the Mediterranean region to address these issues:

Mr. Abdellatif Jouahri, Governor of the Bank Al Maghrib.

Mr. Mario Vella, Governor of the Central Bank of Malta.

Mr. Mustapha Kamel Nabli, Former Governor of the Central Bank of Tunisia.