# Njuguna Ndung'u: Exchange rate and monetary policy nexus

Remarks by Prof Njuguna Ndung'u, Governor of the Central Bank of Kenya, at the official opening of the 1st Annual Research Seminar on "Exchange rate and monetary policy nexus", organized by the Kenya School of Monetary Studies, Nairobi, 1 October 2013.

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Invited Guests;

Members of the Monetary Policy Committee;

Researchers;

Distinguished Guests;

Ladies and Gentlemen:

Good morning. I am pleased to join you this morning at the official opening of the Research Seminar on "Exchange Rate and Monetary Policy Nexus" organized by the Research Centre at KSMS.

I am delighted that KSMS took the initiative to organize this event which provides an important avenue to share ideas and knowledge, and for researchers to receive input from the financial sector players on research needs of the sector.

Ladies and Gentlemen, why the focus on the exchange rate? As so often in recent years, I will take, as my starting point, the global crisis of 2009–2010, and the risk reassessments that banks, investors, researchers and decision-makers all over the world were forced to make as a result of the crisis. Legacies of this crisis amid continued globalization is significantly reshaping the global and regional economic and financial landscape. This new landscape seems to be characterised by:

1. Volatile capital flows, prompted by cyclical shifts in flows of funds in response to new risks and opportunities;
2. Greater interconnectedness, between financial institutions as well as between the real and financial sectors;
3. Lower global economic growth, with the centre of economic gravity shifting towards emerging and frontier markets especially in Asia, Africa, and Latin America;
4. Currency wars with potential for emerging markets currencies entering the accepted reserve currency range.

These impending structural changes pose a number of challenges to emerging markets, including Kenya. From the viewpoint of monetary authorities, there are two especially pressing policy issues that potentially arise from these changes.

First, more volatile capital flows combined with greater financial interconnectedness translate into a growing risk to financial stability;

Second, there are implications for management of the exchange rate policy and the macro-economy given the increasingly large and volatile financial flows. Under a flexible exchange rate regime, large swings in capital flows can generate excessive exchange rate fluctuations which may in turn undermine macroeconomic stability. These challenges are real for Kenya.

In addition to the above two challenges, the lower global growth puts pressure on the sustainability of the export-led growth model, hence the need to look for new markets just as emerging markets have done to move away from traditional market enclaves.

The policy issue is then the determination of the appropriate role of exchange rate policy, with a view to facilitating an appropriate structural adjustment process that promotes long-run and sustainable growth.

The theme of today's Seminar is timely as Kenya's economy readies for take-off. Policymakers need to find a flight path through the lingering risks.

Ladies and gentlemen, several papers that link monetary policy actions and the exchange rate policy have been lined up for presentation today. These include research that looks into factors that explain exchange rate movements, the extent of real exchange rate misalignment and the relationship between the real exchange rate and exports. We will also get presentations on papers that develop indices that can serve as an early warning system for currency and macro-economic crises. 4

As Kenya aspires to be the regional financial hub; and is indeed currently regarded as so, one of the pillars for maintaining this regional leadership is also being on the frontier of research information for the financial sector. A well known fact is that a financial boom can trigger an overvaluation of a currency if adjustments do not take place over time. The Kenya School of Monetary Studies is well placed to provide this leadership and it is challenged to do so. Therefore, these types of Seminars should be the norm on an annual basis. But filtering policy conclusions that can be used for policy direction remain the most important objective.

As I conclude, I thank the participants present, including those that have travelled from far for this seminar. I hope the handful of issues addressed in the contributions today will provide the basis for a rewarding discussion.

Once gain – you are all very welcome!

It is my pleasure to declare this workshop officially opened.

Thank you.