The Bulletin

OMFIF

September 2018
Vol.9 Ed.8

- Hippolyte Fofack on Africa's Continental Free Trade Area
- John Mourmouras on Greece's bail-out exit
- In conversation with Maria Ramos
- Pauline Anaman on Ghana's oil funds
- Diwa Guinigundo on Asian integration
- Marcelo Giugale on green bonds

AFRICA CONNECTED

Reforms and integration across the continent

OMFIF

State of the union

A worldwide series of OMFIF meetings focusing on the US economy

28 September 2018, New York

The OMFIF Foundation

A decade of quantitative easing: assessing the effectiveness of an unconventional monetary policy tool

After a prolonged but relatively slow global recovery, 10 years since the collapse of Lehman Brothers, this meeting analyses the effectiveness of the widespread use of a traditionally unconventional monetary policy tool: quantitative easing.

Confirmed speakers: Stanley Fischer, Vice-Chair, Board of Governors of the Federal Reserve (2014-17), **Natacha Valla**, Deputy Director General, European Central Bank, **Mark Sobel**, US Chairman, OMFIF, **Nathan Sheets**, Head of Global Economic Research, PGIM, **Seth Carpenter**, Chief US Economist, UBS, **Christopher Smart**, Head, Macroeconomic and Geopolitical Research, Barings, **Barry Eichengreen**, Professor of Economics, Berkeley School of Economics, **Rasmus Rueffer**, Permanent Representative in Washington, European Central Bank, **Fabio Natalucci**, Deputy Director, Monetary and Capital Markets Department, International Monetary Fund, **Ben Broadbent**, Deputy Governor, Bank of England

08:30 -13:00. Venue: **Lotos Club, 5 E 66th St, New York, NY 10065, US**

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3 October 2018, London

Analysing the US economic outlook

A City Lecture with Charles Evans, president and chief executive officer of the Federal Reserve Bank of Chicago and member of the Federal Open Market Committee. The lecture will cover developments in the US economy, monetary policy changes and macroeconomic trends.

Speaker: Charles Evans, President and CEO, Federal Reserve Bank of Chicago

11:00-12:45.
Venue: **Pewterers' Hall, Oat Lane, London EC2V 7DE**

8 October 2018, Singapore

The OMFIF Foundation

US economy and monetary policy

An OMFIF Foundation City Lecture with James Bullard, president and chief executive officer of the Federal Reserve Bank of St Louis and member of the Federal Open Market Committee. The lecture will cover developments in the US monetary policy, interest rate outlook and wider economic implications.

Speaker: James Bullard, President and CEO, Federal Reserve Bank of St Louis

17:00-18:30. Venue: **Lee Kuan Yew School of Public Policy, Lobby, Oei Tiong Ham Building**
469C Bukit Timah Rd, Singapore 259772

For more information or to register visit: **omfif.org/meetings/us**

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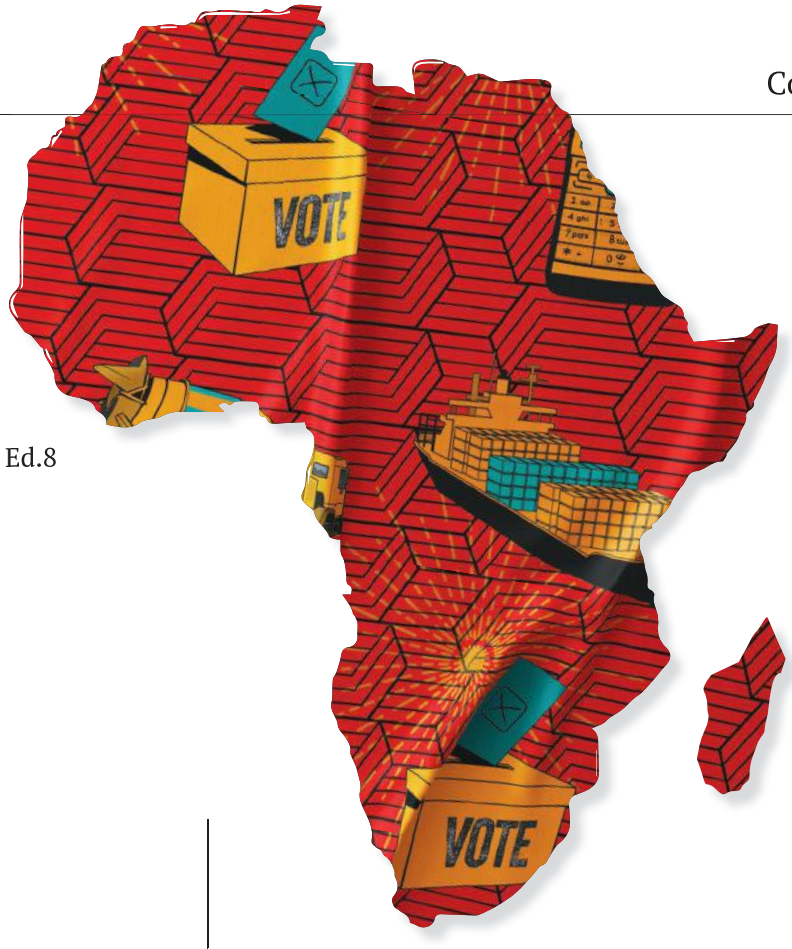

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Dialogue on world finance and economic policy

THE Official Monetary and Financial Institutions Forum is an independent think tank for central banking, economic policy and public investment – a non-lobbying network for best practice in worldwide public-private sector exchanges. At its heart are Global Public Investors – central banks, sovereign funds and public pension funds – with investable assets of $36tn, equivalent to 45% of world GDP.

With offices in London and Singapore, OMFIF focuses on global policy and investment themes – particularly in asset management, capital markets and financial supervision/regulation – relating to central banks, sovereign funds, pension funds, regulators and treasuries. OMFIF promotes higher standards, performance-enhancing public-private sector exchanges and a better understanding of the world economy, in an atmosphere of mutual trust.

Membership

Membership offers insight through two complementary channels – Analysis and Meetings – where members play a prominent role in shaping the agenda. For more information about OMFIF membership, advertising or subscriptions contact membership@omfif.org

Analysis

OMFIF Analysis includes commentaries, charts, reports, summaries of meetings and The Bulletin. Contributors include in-house experts, advisers network members and representatives of member institutions and academic and official bodies. To submit an article for consideration contact the editorial team at analysis@omfif.org

Meetings

OMFIF Meetings take place within central banks and other official institutions and are held under OMFIF Rules. A full list of past and forthcoming meetings is available on www.omfif.org/meetings. For more information contact meetings@omfif.org

OMFIF Advisers Network

The 173-strong OMFIF advisers network, chaired by Meghnad Desai, is made up of experts from around the world representing a range of sectors: monetary policy; political economy; capital markets; and industry and investment. They support the work of OMFIF in a variety of ways, including contributions to the monthly Bulletin, regular Commentaries, seminars and other OMFIF activities. Membership changes annually owing to rotation.

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Africa connected

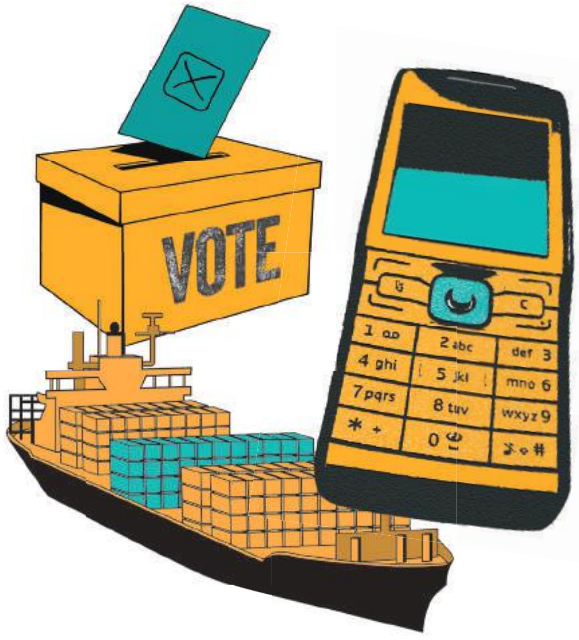
At a time when advanced economies across the globe are struggling with weak demographics, declining long-term growth rates and a rising debt burden, Africa stands out as a continent of opportunity. The region is rich in natural resources, with a young and growing population and sense of hopeful dynamism. But it also remains exposed to outside risks and domestic structural barriers, complicating the popular 'Africa rising' narrative.

This edition of The Bulletin explores the nuances behind Africa's divergent economic prospects. Contributors look at initiatives such as the Continental Free Trade Area and the establishment of an African common market, as well as individual countries' efforts to leverage technology and innovative financing to promote integration. Connecting the region's fragmented economic communities is a priority.

Central banks, sovereign funds and public pension funds at the heart of OMFIF's network have an important role to play in promoting deep, liquid and efficient capital markets. These are necessary to facilitate the maturing of African economies as they diversify away from a dependence on natural resources. This has been a major area of focus for OMFIF. Next month we launch the second edition of the Absa Africa Financial Markets Index. The index, to be presented at the International Monetary Fund-World Bank Group meetings in Bali in October, provides a quantitative and qualitative assessment of Africa's financial markets.

'Connecting the region's fragmented economic communities is a priority.'

The AFMI launch is one of several meetings that OMFIF is organising on the fringes of the IMF-WBG meetings. We are proud to continue a strong partnership with the Fund, and this month it is our pleasure to welcome Mark Sobel, the US Treasury veteran and former US representative at the IMF, to OMFIF as US chairman.



Danae Kyriakopoulou
Chief Economist and Head of Research

»17 July, Singapore

Expanding sustainable finance market

'WATER sustainability is key to long-term planning in Singapore, in line with increasing momentum in the area of sustainable finance in Asia,' according to Jacqueline Loh, deputy managing director of the Monetary Authority of Singapore, at OMFIF's second Global Public Investor Symposium with the Bank for International Settlements. The meeting focused on combating climate change and promoting sustainable finance. Luiz Awazu Pereira da Silva, deputy general manager of the Bank for International Settlements, spoke about the importance of maintaining networks between central banks, along with the history of sustainable finance in central banking. Speakers also included John Hewson, chairman of the Asset Owner Disclosure Project, and Yeo Lian Sim, vice-chairman of the Task Force on Climate-related Financial Disclosures.

Mark Sobel becomes OMFIF US chairman

OMFIF is strengthening its US operations by appointing Mark Sobel, a veteran US Treasury official at the forefront of financial diplomacy for two decades, as US chairman. He will work with OMFIF in dealings with private and public sector organisations and provide OMFIF members with insight and analysis.

Yosuke Kawakami joins advisory board

YOSUKE Kawakami, former Japanese director at the European Bank for Reconstruction and Development, joins the OMFIF advisory board after a 35-year career in public finance, financial markets, regulation and supervision, as well as international finance and trade.

»11 July, London

Diversity improves outcomes

'IMPLEMENTING measures that ensure greater diversity increases the pool of talent and reduces the impact of unconscious bias,' according to a panel on the participation of women in the digital economy. Speakers included OMFIF's Danae Kyriakopoulou and Chris Ostrowski. The meeting was organised by the Bank Indonesia and the Indonesian embassy in London as part of the agenda for the forthcoming IMF-World Bank Group meetings in October.

»10 July, London

Future UK-EU trade relations

OMFIF convened a discussion with Martin Donnelly, former permanent secretary in the UK department for international trade, and Alan Winters, director of the UK Trade Policy Observatory at the University of Sussex. The meeting focused on UK-Europe trade relations and how to ensure business continuity after Brexit.

»14 August, Singapore

Shared objectives on global growth

AMID tension around trade and migration and a resurgence in nationalism, governments around the world, including the US and China, still profess shared objectives of creating jobs and growth, according to Jonathan Fried, personal representative of Canadian Prime Minister Justin Trudeau to the G20.

»17 July, Singapore

Green bonds and low-carbon finance

OMFIF held the Asia launch of *Global Public Investor 2018*, the annual report focusing on public sector asset ownership and management across 750 official institutions around the world. Along with presenting the key findings of the research, the discussion focused on investment trends in the public sector and how Asian global public investors are performing. Moderated by David Marsh, chairman of OMFIF, speakers included Frank Scheidig, global head of senior executive banking at DZ BANK, and Michael Barrow, director general of the private sector operations department at the Asian Development Bank.

FORTHCOMING MEETINGS

»Tuesday 11 September, London

The need for expansionary monetary policy

A roundtable discussion with **Stefan Ingves**, governor of Sveriges Riksbank. The discussion will focus on monetary policy, shrinking balances sheets, the outlook for the krona, central bank independence and euro area integration.

»Tuesday 11 September, London

Enhancing the innovator-regulator conversation

A roundtable discussion with **Martin Moloney**, special adviser on policy and risk at the Central Bank of Ireland. The meeting will focus on how regulators and innovators applying advanced technologies in financial services can collaborate better.

»Wednesday 19 September, London

UK's macroeconomic outlook

A breakfast discussion with **Silvana Tenreyro**, member of the Monetary Policy Committee at the Bank of England. Topics will focus on unconventional monetary policy, productivity in the UK and implications of central bank policy divergence amongst leading world economies.

»Friday 28 September, New York

A decade of quantitative easing

Ten years since the collapse of Lehman Brothers, this meeting analyses the widespread use of quantitative easing and its effectiveness. Speakers include **Stanley Fischer**, former vice-chair of the board of governors of the Federal Reserve, and **Seth Carpenter**, chief US economist at UBS.

For details visit omfif.org/meetings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AFRICA CONNECTED

Continental Free Trade Area will catalyse transformation of the continent

Hippolyte Fofack
African Export-Import Bank

In a world in which competitiveness is a key determinant of sustainable growth and trade performance, consolidating existing but fragmented economic communities has become essential. One major example is the Continental Free Trade Area, which will establish a common market in Africa and catalyse economic transformation and effective integration of the region into the global economy.

Earlier this year, 44 of the 55 African Union states signed up to the CFTA agreement. Five additional countries, including South Africa, joined during the 31st Ordinary Session of the Assembly of the African Union held in Mauritania in July 2018. The 49 signatories account for more than 86% of total African trade and around 77% of the continent's GDP.

Beyond enhancing the competitiveness of African economies, the CFTA has the potential to buttress the forces for convergence in the world economy.

The CFTA has emerged at a time when the impact of competitiveness on trade and development has increased significantly, reaching stratospheric levels in the era of globalisation. Several factors contributed to this emphasis on competitiveness, not least the increasing role of innovation and technological content of manufactured goods, as well as globalisation of economic opportunities and trade. The CFTA is also coming together at a time of creeping protectionism, when leading economies are adopting mercantilist systems that treat the size of trade surpluses as a measure of economic performance. This has been illustrated recently by the escalation of punitive tariffs and retaliations, trade wars between large economies and the marginalisation of the World Trade Organisation as more countries move away from the rules-based system that has enabled robust, sustainable and free-flowing global trade.

In this beggar-thy-neighbour global economic landscape, competitiveness has perhaps become even more important for countries striving to integrate into the global economy. Only the most competitive are expanding their share of the global market. These economies have emerged as 'active globalisers', those most able to take advantage of the benefits of globalisation to sustain their growth and trade performance. In contrast, the least competitive economies have become 'passive globalisers', victims of globalisation that supply the raw materials and natural resources required to expand the manufacturing output of active globalisers.

Passive globalisers are disproportionately more vulnerable to the adverse effects of globalisation. These include such risks as the increased speed of global transmission of negative shocks, swings >>

in commodity prices and long-term deterioration in the terms of trade for commodities. Over time, these risks have stifled the aspirations of lagging nations, most of which are locked in vicious cycles of excess growth volatility and structural balance of payment crises.

In Africa these risks have been exacerbated by a host of constraints to competitiveness and trade. These include non-tariff and regulatory barriers such as border delays, burdensome customs and inspection procedures, as well as multiple licensing regimes and the rise of national transit bonds along key routes. In addition to a large financing gap and infrastructure deficit, African businesses have had to contend with these constraints that raise transaction costs and limit the movement of goods, services, labour and capital across borders.

As a result, trading among African countries has been more costly and time-consuming than in any other region of the world. While the average cost of importing a container within the region is around $2,500, the same costs $900 in the East Asia and Pacific region and $1,500 in Latin America and the Caribbean.

Removing barriers

Although the structure of production and the direction of trade inherited from the colonial model of resource extraction have played major roles, the prevalence and scale of non-tariff barriers and market fragmentation help to explain why African countries trade more with the rest of the world than with each other. Intraregional trade accounts for around 15% of total African trade, against 68% in Europe and 58% in Asia.

Uniting Africa through the CFTA will establish one of the world's largest free trade areas in terms of number of countries, people and market size. The agreement will cover a market of 1.2bn people with a GDP of $2.5tn and combined consumer and business spending of more than $4tn. This will help raise the competitiveness of African economies and enhance their integration into the global economy as active globalisers. Measures such as cross-listing firms on different stock markets and the establishment of credit reference bureaus could raise access to finance in a region where fragmentation has impeded private sector growth.

Besides the implications for financial markets, consolidating regional economic communities to establish one of the world's largest free trade areas could boost the competitiveness of African economies through other channels. These include technology transfers, cross-border investment and industrial development in a context of increasing economies of scale, diversification of sources of growth and the expansion of intra-African trade.

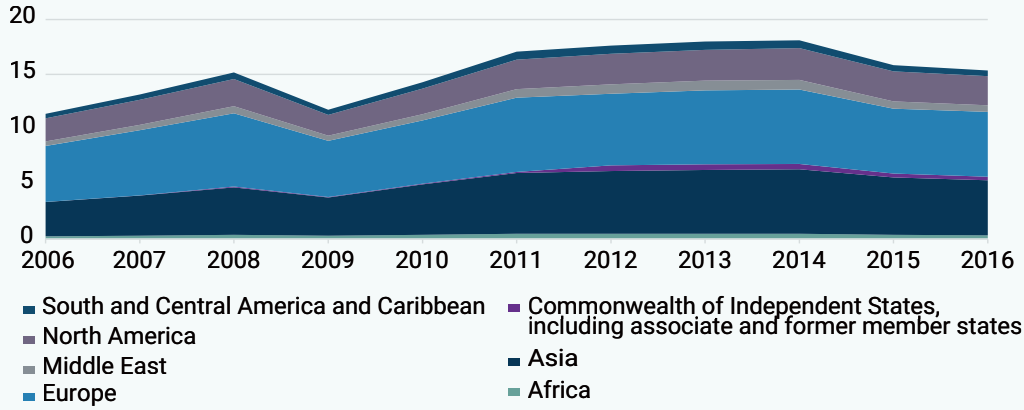
Preliminary estimates of the expected benefits of the CFTA for trade performance and regional integration are positive and significant. Intra-African trade, largely dominated by industrial products and manufactured goods, could increase by more than 52% above the baseline a decade into the implementation of the CFTA. It could even double over the same period if the reforms envisaged under the CFTA are complemented by robust trade facilitation measures. Economies of scale created by the establishment of a larger continental market could lower production costs and encourage inward foreign direct investment and cross-border investment. The benefits of this would include greater technology transfers and strengthened regional value chains in a context of expanding intraregional trade in intermediate and capital goods.

'Factory Africa'

The development of regional value chains would raise African economies' competitiveness and enhance their integration into the global economy. Data show that, despite the increased outsourcing of activities involved in the production of a good to several countries, much of the value-added distribution in global value chains remains in regional blocs. 'Factory Europe', 'Factory North America' and 'Factory Asia' are the regions where these value chains are primarily concentrated. In time, the emergence of 'Factory Africa' and the improved integration of Africa-based businesses into the global economy will help set the

African trade significantly below that of other regions

World merchandise trade of WTO members, $tn, by region



Source: WTO secretariat
Note: World trade is calculated as an average of exports and imports of merchandise trade

world on a path towards truly global value chains.

Realising Africa's potential has been markedly difficult, partly as a result of artificial trade barriers and the fragmentation of markets inherited from the colonial development model. The CFTA will help overcome these limitations and boost the competitiveness and integration of African economies.

Making this transition will depend on the speed and ability of countries and emerging corporate leaders to overcome hurdles on a path towards structural transformation. Regardless of geography, technological advances as well as improved infrastructure have been fundamental for cost reduction and efficiency gains in the development of regional and global value chains. African countries must more vigorously adopt these innovations.

The benefits of regional integration will be greatly enhanced if the CFTA principles are supplemented by non-border reforms. These should include measures to liberalise services trade, investment provisions, intellectual property rights protection and the harmonisation of standards and regulations. These are all essential for reducing trade costs between countries within the region. Beyond raising regional trade intensity, the CFTA could unleash forces for African dynamism and position the continent as a globally competitive export-processing platform. ●

Hippolyte Fofack is Chief Economist of the African Export-Import Bank.

Free movement protocol raises questions for integrationist Africa

Max Roch
OMFIF

IN the West, the election of US President Donald Trump, Britain's planned departure from the European Union and the electoral success of populist parties in Italy, Germany and much of eastern Europe signal the resurgence of nationalist politics. Protectionism and an affinity for hard borders are back. Other parts of the world, however, are adopting market-orientated initiatives appealing to the centre ground of politics, most notably Africa.

In March 2018, 44 African nations signed the Kigali Declaration in Rwanda that brings the region one step closer to deep and meaningful integration. This complements advances made in the establishment of the Continental Free Trade Area. This has been made possible by Africa's shift to technocracy. Abiy Ahmed and Nana Addo, the leaders, respectively, of Ethiopia and Ghana, among others, are setting a radically new and propitious tone for the future. Unlike their predecessors, they are keen to stave off dependence on state-owned enterprises and foreign aid, and are demonstrating a sincere commitment to regional integration and co-operation.

Cross-border regulatory alignment in the Economic Community of West African States has increased. Nigeria, for instance, as a member of the West African Monetary Zone will co-operate with Benin in the French-speaking West African Economic and Monetary Union on a $4.5bn border facility to increase trade flows.The Bank of Central African States, which serves as the central bank of six countries, now oversees the unified Douala Stock Exchange after Cameroon and Gabon came to an agreement over their competing securities bodies. The removal from power of Jacob Zuma in South Africa, Robert Mugabe in Zimbabwe and José Eduardo Dos Santos in Angola signifies a shift in southern Africa away from the revolutionary comrades of yesteryear.

However, one overlooked aspect that requires further debate is that only 30 countries adopted the Free Movement Protocol, the third tenet intended to complement the Kigali Declaration and CFTA. The protocol, it is hoped, would lead eventually to the creation of a 'borderless' Africa.

Questions must be asked about the necessity of freedom of movement in the early stages of the CFTA and whether the ostensible benefits outweigh the obstacles that such a debate is likely to bring up. In the light of continuing conflicts in the region, mass migration, climate change, political uncertainty and rising refugee numbers, many countries are opposed to opening borders.

Around 26% of the world's refugees (around 18m people) are in sub-Saharan Africa, and this excludes the myriad economic migrants who would emerge as a result of a borderless continent. It is possible that uninhibited adoption of the CFTA and the opening of borders may give rise to the same nationalist groundswell that is threatening the US and Europe. ●

Max Roch is Research and Policy Analyst at OMFIF.

Africa's smart island

Mauritius government's strategy to create continent's new fintech hub

Danae Kyriakopoulou
OMFIF

Mauritius's economic transformation is one of Africa's biggest success stories. From a relatively unsophisticated agriculture-based economy dependent on commodities such as sugar, it grew into a manufacturing hub excelling in the production of textiles. Now, the island operates a flourishing services-based economy driven by tourism and finance.

This has helped Mauritius enjoy one of the highest levels of GDP per capita in the region, as well as maintain steady macroeconomic conditions. Unemployment is low, business and consumer confidence are buoyant, and economic growth has averaged just below 4% per annum between 2001-18. International recognition followed, with rating agencies deeming its outlook as 'stable'. Mauritius has been placed as one of the top performers in Africa for metrics such as the World Economic Forum's Global Competitiveness Index, the World Bank's Ease of Doing Business rankings and the Africa Financial Markets Index, produced by OMFIF in association with Absa.

However, Mauritius's economic success should not be an excuse for it to relax its efforts. Now is the time to explore new areas of growth and set up the infrastructure to service them.

Embracing fintech

One area for development is fintech, as economies in Africa increasingly use technology to support the financial services industry.

So far, fintech in Africa has largely focused on mobile payments, with services such as M-Pesa in Kenya attracting praise globally. Mauritius can compete on this level by focusing on alternative aspects of fintech. One example is microlending. Using fintech to create space for the provision of microcapital to individuals and small business owners, who are often overlooked by traditional lenders, can allow these customers to grow their businesses.

Mauritius's government is responding by boosting the island's status as an African fintech hub. In 2016 the Society for Worldwide Interbank Financial Telecommunication chose Mauritius as one of the two locations for its annual Startup Challenge, attracting more than 500 delegates from 40 countries and 89 entries for the competition. Another occasion was the UK-Mauritius fintech conference in January 2017, organised with the British High Commission. Earlier this year it was announced that the island's financial services commission is considering establishing a sovereign fintech fund.

To excel in fintech, first-class infrastructure is essential. The government is investing in the Indian Ocean Exchange Cable system, a project that is expected to be completed in 2019. It will be Mauritius's third independent undersea cable but the first open-access one, enabling it to be used by all licensed operators and to connect to any future undersea cables on the east coast of Africa. The improved infrastructure is expected to increase the use of bandwidth by reducing the price of internet access. This will enhance the ability of African and Indian business communities to connect quickly and cheaply across a reliable network, ranging from the undersea cable to data centres and cloud platforms.

Smart cities

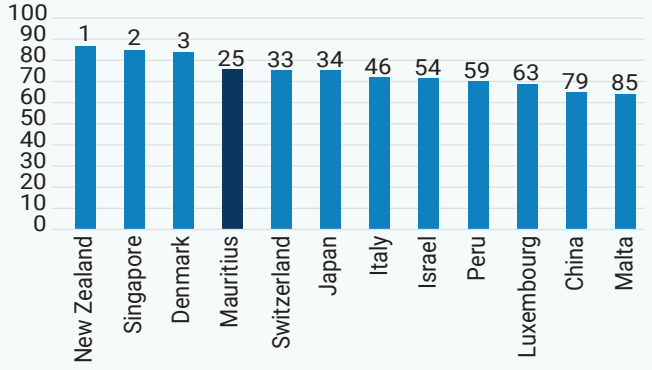
The third cable initiative forms part of the government's broader strategy for 'smart' cities. The Smart City Scheme is a wide-ranging project aiming to create better infrastructure for those working and living in Mauritius in order to attract investment and strengthen its status as a business and financial hub.

The scheme, set up under the Investment Promotion Act 2000, involves the creation of 16 smart cities, five technology parks, and a new cyber-city at a cost of several hundreds of millions of dollars. This is expected to create around 50,000 new jobs.

The scheme embodies the principles underpinning Mauritius's ambitions to become not only a finance hub, but also a leader in the development and integration of technology with financial services, ranging from financial literacy education and retail banking to new areas of investment and crypto-currencies. ●

Danae Kyriakopoulou is Chief Economist and Head of Research at OMFIF.

Mauritius business system rivals advanced economies
Ease of doing business index, % score, and rank



Source: World Bank, OMFIF analysis

Putting Ghana's petrodollars to good use

Policy-makers must bolster rules on country's oil funds

Pauline Anaman
Africa Centre for Energy Policy

Policy-makers agree that Ghana's oil resource wealth should be shared equitably between the country's current and future generations through the Ghana Heritage Fund. The GHF provides an endowment to support development when the oil has been depleted. In line with legislation on how to disseminate this wealth, not less than 30% of oil receipts will be paid to the GHF after disbursement to the national oil company and the budget. The same share is applied to excess oil receipts.

There are clear rules on investment and withdrawals. The GHF only invests in qualifying instruments and, within one year of the oil reserves being depleted, will be consolidated along with the Ghana Stabilisation Fund into a single fund to support future budgets, called the Ghana Petroleum Wealth Fund. At 15-year intervals beginning 2026, parliament may review this restriction and transfer portions of the accrued interest to any of the funds established under the Petroleum Revenue Management Act.

Some have raised concerns that investments by the GHF in offshore instruments only serve to build up the economies of other countries at Ghana's expense, and that the quantum of returns is minimal. Reports by the Ghanaian ministry of finance show that between 2011-17 the GHF invested around $323.7m, representing 8% of total oil receipts, in financial instruments for paltry returns of only $21.1m. Meanwhile, the country accrued debts on the international market at high cost. Investing domestically in human capital and physical assets is essential to boost the economy and generate greater benefits for current and future generations.

Project problems

The International Monetary Fund has reported that, compared to financial assets, the benefits of investing savings in economic infrastructure, education and healthcare could be substantial for African countries that suffer from a scarcity of human capital and physical assets. Evidently, increasing public investment can bolster GDP growth in developing countries. However, this can only be achieved under the correct conditions, and require a country to implement detailed development strategies and strong public financial management systems. This may prove problematic for Ghana.

Up to 70% of oil receipts after disbursement to the NOC are intended to support annual budgetary expenses on public investments. These amounted to $1.6bn between 2011-17, representing just 38.2% of total oil receipts. While it is nearly impossible to track the socio-economic returns of these expenditures, audits by the Africa Centre for Energy Policy reveal that spending on many selected capital projects is neither necessary nor executable within the proposed budget or timeframe. Many projects have been stopped because of unsatisfactory consultations with supposed beneficiaries, poor planning (including financing), weak monitoring, and politics. The few completed projects have not provided clear evidence on financial and social returns.

Entrusting future generations' meagre share of oil wealth to the current generation for domestic investment is likely to make the former worse off. It is unsurprising that citizens opposed the government's plan to use the GHF, and not other sources of capital, to fund free secondary school education.

Though fraught with complexities, using the GHF to make offshore investments may be the best course of action in the short to medium term, at least until the government strengthens the necessary legislation and optimises the use of oil revenue in Ghana. After all, to borrow a lesson from the Bible, 'To whom much is given, much is expected.' ●

Pauline Anaman is Head of Policy at the Africa Centre for Energy Policy.

Risks of Belt and Road in Africa

Options limited for recipient countries looking to close infrastructure gap

Kat Usita
OMFIF

As China's cross-border Belt and Road initiative gains momentum, apprehension over its impact continues to build. Early on, some observers accused China of unduly exerting influence on other countries in the guise of infrastructure assistance. It is increasingly apparent that the risks to recipient African economies in particular are substantial, but their governments are left with little choice.

Chinese contractors credit their speed in building transport and energy infrastructure to their extensive construction experience, having been part of China's industrial boom. However, the more telling aspect is Beijing's willingness to offer African countries financing with no conditions, apart from that Chinese firms undertake the projects.

In contrast, projects sponsored by western governments and development agencies tend to include policies around anti-corruption, transparency and competitive tenders. They also devote a great deal of time to investigating a project's feasibility and financial viability to ensure that it will not be overly reliant on subsidies once operational. These constraints often delay project delivery, which makes Chinese assistance an appealing alternative for African governments committed to delivering new infrastructure.

Risky business

Five years since the Belt and Road was launched, advocates can point to examples of moderate success in Africa, with more on the way. Kenya, Ethiopia and Nigeria have new rail lines. Djibouti has an ambitiously expanded megaport and a new international airport, as well as a railway that connects it to Ethiopia's capital, Addis Ababa. Another megaport will be built in Bagamoyo, a small fishing town in Tanzania, to ease container traffic in Dar es Salaam. It will take several years of use before one can properly measure the full economic benefits of this new infrastructure. Meanwhile, the risks are self-evident.

Tanzania, Ethiopia and Kenya have growing external debt, although the levels remain manageable at this time. Djibouti's foreign debt has ballooned to nearly the same size as its economy, reaching 87% of GDP in 2017. Much of this was used to finance Belt and Road projects.

Strategically located on the Horn of Africa, Djibouti is home to China's first overseas naval base, as well as the only permanent US naval base on the continent. That China has established a military presence in a country that owes it a great debt is unsurprising. The more important question is whether Djibouti will reap enough benefits from improved trade and transport links to make its impending debt crisis worthwhile, and if China will provide assistance should it not.

No stopping China

Even if African economies connected to the Belt and Road can manage their debt well and maximise growth opportunities spurred by new infrastructure, concerns remain over China's ability to deliver. A study by the Financial Times shows that top Chinese overseas contractors are nearly four times more leveraged than their non-Chinese counterparts. While this may not give a full picture of contractors' financial health, it confirms suspicions that the Belt and Road is at least as much about Chinese firms' gain as it is about helping countries close their infrastructure gaps.

87%

Percentage of GDP to which Djibouti's foreign debt ballooned in 2017

In July, Chinese President Xi Jinping visited Senegal, Rwanda, South Africa and Mauritius, his fourth visit to Africa since taking office in 2013. The trip demonstrates China's commitment to broadening its presence across the continent; until now Beijing has focused most of its efforts on East Africa.

As there seems to be no curbing the programme, outsiders are instead finding ways to align their own objectives with the Belt and Road. The World Bank has undertaken a series of studies examining the policies needed to minimise recipient countries' economic risks. It can also assist governments in looking after vulnerable sectors and communities affected by Belt and Road projects, such as fishing communities who will be displaced by massive port projects, to give just one example. Other governments and institutions intent on aiding Africa may want to start doing the same. ●

Kat Usita is Economist at OMFIF.

Promise and peril for Ethiopia's new leaders

Capital markets key to sustaining country's essential reforms

Ben Robinson
OMFIF

In October 2017 the central bank of Ethiopia increased interest rates by 200 basis points to stem capital outflows. At the same time, the government devalued the birr by 15% in an attempt to boost exports, narrow the large current account deficit and gain some much-needed foreign currency. In the end it was not enough to quell public resentment; in April, Hailemariam Desalegn resigned as prime minister of Africa's second most populous country.

His successor, Abiy Ahmed, has embarked on a widespread programme of economic and political reform. This places Ethiopia among a handful of African countries, including South Africa, Zimbabwe and Angola, that have recently rid themselves of incumbent leaders in pursuit of better governance and accountability.

So far, Ethiopia has gone further and faster than the rest in revising its fortunes. Abiy has signed a peace accord with neighbouring Eritrea, marking an end to decades of hostility. The government has announced a large-scale privatisation scheme to attract foreign investment to the country's aviation, energy and telecommunications industries, among others. Reforms to the dominant power of the security services are intended to improve governance across all areas of public life. Zimbabwe, by contrast, has made a shakier start under the new regime. Elections in July were marred by violence and accusations of fraud, while senior members of the previous regime have stayed in key posts.

Volatility on all fronts

The difficulties facing reformers in Addis Ababa remain substantial. A violent flare-up in the ethnically Somali east of the country in August underscores tensions in Ethiopia's diverse population. The Tigrayan and Amhara minorities feel threatened by some reforms undertaken by Abiy, the first prime minister from the majority Oromo group. In June, Abiy was targeted by a grenade attack, reputedly made by some members of the intelligence services.

Ethiopia also faces a difficult external environment. The peace agreement with Eritrea is far from assured, with the country's dictator, Isaias Afwerki, an unreliable partner. Landlocked Ethiopia relies on ports in Somalia, Djibouti and (after the peace deal) Eritrea. This makes trade expensive – sending goods by road from Addis Ababa to Djibouti costs more than shipping them from Djibouti to east Asia – and vulnerable to political developments. A rising dollar and risks of an escalating global trade war don't help.

Adding to these difficulties, Chinese investment, at around $15bn over the last decade, has fallen drastically. An agreement with the United Arab Emirates to provide $3bn in loans and investment helps a little. But with government debt at 60% of GDP and imports outweighing exports by a factor of four-to-one (both legacies of the previous government's debt-fuelled investment programme, not all of it well-spent), this is insufficient to ease the foreign currency shortage.

> 'Ethiopia's population is large and young, the economy grew by more than 10% per year on average between 2005-16, and it has a nascent but significant manufacturing sector.'

Finding new capital

With a reformist leader and a peace agreement with its neighbour, Ethiopia is well placed to make the necessary changes to strengthen its economy. The population is large and young, the economy grew by more than 10% per year on average between 2005-16, income per capita rose fourfold in the same period, and it has a nascent but significant manufacturing sector.

Given its persistent current account deficit and the drying up of external financial flows, the government must find capital from new sources. Ethiopia's growth rate, underpinned over the last decade by considerable public spending, is unsustainable and has fallen recently. Private sector investment is necessary to maintain growth and attract foreign capital.

To aid this process, the country needs to develop a local capital market. Ethiopia is the largest emerging economy without a domestic securities exchange (beyond one for commodities). As the government seeks to reduce the state's role in the economy, a domestic bourse will prove essential. However, capital market development has not been a focus of Abiy's reforms, which may create obstacles for the government's wider proposals.

Easing the country's foreign exchange shortage and tackling its large debt burden will be vital to ensuring reform efforts are kept on track and not disrupted by social unrest or economic volatility. The promise – and the peril – facing this large and important country make it a key one to watch. ●

Ben Robinson is Deputy Head of Research at OMFIF.

Building an inclusive Africa

Maria Ramos, chief executive officer of Absa Group, and OMFIF's chief economist **Danae Kyriakopoulou** discuss the development of capital markets across Africa, growth in major West and East African economies and the impact of digital innovation on financial inclusion.

Danae Kyriakopoulou: How do you see Africa's prospects in the context of a changing geopolitical environment? From US President Donald Trump's unilateral, 'America first' policies, to China's move towards multilateralism and greater integration in the global economy, how is Africa positioned?

Maria Ramos: At a subregional level, positive developments in Zimbabwe and Mozambique hold the potential of creating an economic upswing. In the markets where Absa operates outside South Africa, we expect real GDP growth to achieve 5.0% in 2018. But growth momentum across sub-Saharan Africa will remain fragile and uneven.

The International Monetary Fund is predicting GDP growth of 3.4% in sub-Saharan Africa this year. But this figure hides considerable differences among countries in the region. Some of the largest countries – Côte d'Ivoire (7.3%), Ghana (6.3%), Kenya (5.4%), Ethiopia (8.4%) – are expected to grow at a pace of between 5%-8.5%.

At the same time, the external environment is expected to offer only limited support. Recent improvements in commodity prices will not be enough to address existing imbalances in resource-intensive countries. US monetary policy normalisation could further tighten external financing conditions, which would probably result in higher financing costs for African countries. Moreover, a reorientation of trade agreements and alliances will present new risks and opportunities for the continent. The outlook is also clouded by the incidence of drought, pests and security issues.

In general, I think Africa has a unique opportunity to push through necessary structural reforms. These include initiatives to reduce market distortions and create an environment conducive to foreign direct investment. Fiscal and monetary policy instruments have run out of runway.

DK: Which countries in Africa do you expect to deliver surprises, both positive and negative, from an economic and financial point of view in 2018-19?

MR: On the positive side, we will continue to see growth in major western and eastern African economies. One the negative side, growth in South Africa will continue to disappoint.

I also think we will continue to see digital and mobile-based financial solutions come to the fore, given the demographic shifts and rising mobile penetration across the continent.

DK: How do you see the role of financial markets in this narrative? We have witnessed important changes over the past year such as the introduction of South Africa's 'twin peaks' and Kenya's Nairobi International Financial Centre Act. What do you see as the most important areas of progress for African capital markets and what are the key areas for improvement?

MR: Financial markets have a critical role to play in Africa's economic growth. The IMF recently identified domestic revenue mobilisation as one of the most pressing policy challenges facing sub-Saharan Africa.

The Fund's report states that, despite substantial progress over the last two decades, sub-Saharan Africa still has a markedly low government revenue to GDP ratio. As the main mechanism through which governments and private sector players access capital markets, the financial markets have a critical role to play in addressing this. In the light of pressures in the external global environment and highly constrained fiscal frameworks, increasing private investment is critical for the region to achieve sustainable growth and improve social outcomes.

The most important area of progress in this respect has been in policy certainty. This, along with political stability, is critical to unlocking private investment. For instance, there has been a return to political stability in South Africa, but huge challenges remain from a policy standpoint, not just in financial regulation but across other important sectors of the economy, such as mining and healthcare.

DK: What about financial inclusion? Some countries in Africa are seeing huge improvements in that respect thanks to the role of technology and the digitalisation of financial services. But most of the population remains unbanked. What role can banks like Absa play in improving financial inclusion?

MR: Financial inclusion is obviously tremendously important for Africa's development. There is a huge role to play not just for financial services providers but also governments and public sector players.

Financial inclusion – particularly driven by digital innovation – enables a series of other social and economic interventions that improve livelihoods and boost incomes. However, digital services in themselves are not a cure-all – they require favourable complementary conditions to generate substantial impact.

For instance, research undertaken by the Pathways for Prosperity Commission on Technology and Inclusive Development at Oxford university indicates that digital services bridge distances and reduce the

‘Financial inclusion – particularly driven by digital innovation – enables a series of other social and economic interventions that improve livelihoods and boost incomes.’

threshold for profitable delivery of financial services, for example through mobile payments, where traditional brick and mortar services could not do so viably. They also allow people to link directly in new ways with businesses, with much lower transactions costs, providing access to cheaper goods or services.

At Absa, we have made financial inclusion a key component of our citizenship agenda and are investing heavily in initiatives to increase financial education across our markets. In Kenya, we have launched Timiza, an app-based personal loan platform which has disbursed loans to around 2m customers in just four months. Timiza is yet another example that delivery and payback of credit is easier and cheaper through mobile phones.

Perhaps to conclude, I think that governments, multilateral development finance agencies, private sector and civil society players all have a role in unlocking Africa’s potential. The work that we are doing with OMFIF on the Absa Africa Financial Markets Index to highlight and educate market participants about the opportunities presented by the continent is a critical initiative in this respect. I am very optimistic about Africa’s economic future and, working together, we can realise her promise. ●

Profile

Education: Earned a bachelor of commerce from the University of the Witwatersrand in 1986 and a master of science in economics from the University of London.

Career: Ramos is the chief executive officer of Absa Group. Before coming to Absa in 2009 she was the group chief executive of Transnet Limited, the South African state-owned rail, pipeline and ports agency. From 1996-2003, Ramos served as South Africa’s director general of the National Treasury for its first post-apartheid government.

Worldview

This month's expert analysis

US at odds with fintech philosophy

Steps being taken to overcome fragmented regulatory framework

Oliver Thew
OMFIF

The US has many advantages that makes it an attractive market for financial technology companies. This includes large amounts of capital and tech-familiar investors, as well as a highly skilled workforce and millions of consumers. Well-organised regulation, however, is not one of the benefits. The US has a complex and fragmented regulatory framework for financial services, with rule-making, supervisory and enforcement power dispersed across numerous federal agencies, and competencies distributed between states and the federal government.

It can take several months and cost thousands of dollars in legal expenses for a company to set up in just one state, let alone operate in multiple jurisdictions. If a company wants to work across state boundaries, it will need separate licences for each state and be subject to differing rules.

This cumbersome and expensive process is entirely at odds with fintech, which is constantly developing at a rapid pace. It also hinders the scalability of start-ups that cannot afford the costs associated with multiple regulatory requirements. As a result, many fintech companies are forced to partner with larger incumbents, who have the resources and experience to operate across state lines. However, this model limits competition and innovation in the market. More importantly, it deters fintech companies from establishing in the US and pushes them towards other markets with more accommodating regulation. For instance, the European Union established its e-money licence, the UK has granted dozens of banking licences to challenger banks, and numerous Middle Eastern countries have adopted specific initiatives to regulate digital payment services.

Unwieldy complexity not only makes the US regulatory environment more difficult for fintech companies to navigate, it is also a major barrier to the development of a coherent fintech policy. The diffusion of regulators means that multiple agencies may have a stake in considering certain fintech matters, and interagency competition can hinder policy coordination.

For example, the Securities and Exchange Commission and Commodities and Futures Trading Exchange are competing to oversee the regulation of crypto-assets, with the former ruling over exchanges and the latter over instruments. This regulatory arbitrage contradicts the coordinated response required to protect consumers, markets and financial stability. The problem is not limited to Washington; state and federal regulators often clash over fintech. Put simply, as the rest of the world takes measures to facilitate innovation of products and services, the US risks losing out by failing to remove unnecessary barriers and provide clarity.

Positive steps

After years of lagging behind other countries, the US is taking steps to address its fragmented regulatory framework. In July, the US Treasury released a report identifying improvements that will better support fintech and foster innovation. It includes over 80 recommendations for federal and state agencies, as well as potential Congressional action.

One recommendation endorses the fintech charter developed by the Office of the Comptroller of the Currency. Hours after the report was published, the OCC announced that it will start taking applications for a special purpose charter for fintech companies focused on banking. However, the charter only applies to fintech companies engaged in payments and loans, avoiding deposit-taking companies.

Regarding sandboxes – testing grounds for new business models that are not protected by existing regulation or supervised by agencies – the Treasury is recommending Congress to act if regulators cannot create a single-point, uniform sandbox. A week after the report, Arizona opened the first fintech sandbox in the US. The state also included a provision that would allow Arizona sandbox participants to operate in other jurisdictions that establish similar programmes.

In addition to the Treasury report, OCC announcement and Arizona sandbox, the US Consumer Financial Protection Bureau joined the UK Financial Conduct Authority and 10 other regulatory agencies as part of the Global Financial Innovation Network. This builds on proposals from earlier in 2018 to create a cross-jurisdictional fintech sandbox.

The signs are promising, though there is still a long way to go. The OCC will face numerous challenges to its new charter from state regulators and lobbying groups. The SEC and New York state regulator have already rebuffed Arizona's sandbox proposal. The Treasury report has opened a discussion that will hopefully lead to major revisions of existing rules and regulatory approaches. Yet turning the recommendations into actions will demand a concerted and collaborative effort from federal regulators and state authorities with input from incumbents and fintech companies. ●

Oliver Thew is Business Development Manager at OMFIF.

Threat of 'currency bullying'

US current account deficit rises as global imbalances worsen

Otaviano Canuto
Advisory Council

On 24 July the International Monetary Fund released its 2018 External Sector Report, its latest assessment of the current account balances of the world's 30 largest economies. There was no major change relative to previous years, and the configuration of global surpluses and deficits that has prevailed since 2013 endures. However, there are reasons to expect more abrupt alterations ahead, particularly in the light of US fiscal easing at a time of high employment in the country. In the context of US-led trade wars, as well as recent bouts of Chinese exchange rate depreciation, it is possible that currencies will be subjected to their own war or 'currency bullying'.

After the substantial escalation prior to – and the unwinding in the aftermath of – the 2008 financial crisis, the absolute sum of surpluses and deficits has remained close to 3.3% of global GDP over the last few years. The generally stable landscape has featured some changes in composition. China's current account surpluses have gradually diminished, while Japan, euro area debtor countries and oil exporting countries have moved in the opposite direction. For deficit countries, while the US remains the major case, emerging market economies have displayed divergent trajectories: Brazil, India, Indonesia, Mexico and South Africa have repaired their fragility at the time of the 2013 'taper tantrum', while Argentina and Turkey have weakened.

Asymmetric macroeconomic policy among advanced economies since 2013 has impacted the balances. While some economies, such as Germany, Japan, the Netherlands, have combined large surpluses with weak domestic demand, the UK and US have seen stronger recoveries in domestic demand.

In the US, the expansionary effects of last year's tax cuts boosted second quarter GDP growth to 4.1%, the fastest in almost four years. Although exports are rising fast, the US current account deficit is poised to rise.

Forthcoming shocks

For six years now the authors of the External Sector Report have compared actual current account balances and real effective exchange rates with those that would reflect medium-term fundamentals and desired policies. A country is classified as being 'stronger' when its current account balance is larger than that 'consistent with fundamentals and desirable policies'.

Last year, Germany, the Netherlands, Singapore and Thailand were said to be 'substantially stronger', showing current account gaps above four percentage points of GDP. Malaysia was 'stronger', with a gap of 2-4 percentage points. China, Korea and Sweden were 'moderately stronger', at 1-2 percentage points.

Conversely, Argentina, Belgium, Saudi Arabia, Turkey and the UK were 'weaker', with negative current account gaps in the 2-4 percentage points range. Canada, France, Russia, South Africa, Spain and the US were 'moderately weaker', with gaps of between 1-2 percentage points of GDP. Within the euro area, large positive gaps (Germany, the Netherlands) have cohabited asymmetrically with negative gaps (Belgium, France, Spain).

In October, the US Treasury will report to Congress on 'macroeconomic and foreign exchange policies of major trading partners'. A country may be named a 'currency manipulator' if it meets three criteria: certain levels of bilateral trade surplus with the US, the country's overall current account surplus, and one-sided foreign exchange interventions aimed at maintaining depreciation. Japan, Taiwan and China were all labelled as currency manipulators at different times in the late 1980s and the early 1990s.

No countries are currently labelled as currency manipulators by the US, though China, Japan, Korea, Germany, India and Switzerland are on a 'monitoring list' because they are classified as fulfilling one or two of the three criteria. There are suggestions that this list will be increased, although no country is expected to meet all three criteria and be named a currency manipulator in the next report.

The renminbi depreciated sharply in July and August, partially reversing the course of appreciation that started in mid-2017.

The Institute of International Finance has suggested that Chinese authorities might be adopting a 'neglect' stance as a signal amid the trade battles with the Trump government. It also highlights risks of substantial capital outflows, with corresponding shocks to China's and other economies' financial markets.

The possibility of mutually damaging financial volatility in the US and China may limit the extent of 'currency bullying' being used as a proxy in the countries' trade war. Nonetheless, rhetoric from Washington is likely to remain clamorous as the US trade and current account deficits rise and global imbalances worsen. ●

Otaviano Canuto is an Executive Director of the World Bank and a Member of the OMFIF Advisory Council. The opinions expressed in this article are his own.

Five proposals for post-programme Greece

Investment shock needed for sustainable growth after eight years of hardship

John Mourmouras
Bank of Greece

After eight years of hardship, Greece is finally emerging with renewed optimism from this difficult time. The factors behind this positive trend are the sacrifices of the Greek people and the solidarity of Athens' European partners. This has been manifested in the unprecedented volume of loans (€240bn) given to Greece on truly concessional terms, including markedly low rates and long maturities.

Although the international economic environment is relatively volatile at the moment, I have long believed that the Greek case is manageable for an exit from the memorandums of understanding in late August without a precautionary credit line. Such an exit would be similar to the cases of Portugal, Ireland and Cyprus, countries with similar adjustment programmes.

This option was confirmed by the Eurogroup of finance ministers in its decision of 21 June, which secures the full sustainability of Greece's public debt until 2032 and leaves open the possibility of additional longer-term debt relief measures.

The decision provides for a further deferral of European Financial Stability Facility interest and amortisation by 10 years, as well as the return of profits on Greek bonds held by euro area central banks starting in 2018. The post-programme surveillance framework aims to ensure the completion of key structural reforms initiated under the European Stability Mechanism programme against agreed deadlines and provides for close monitoring of Greece's economic, fiscal and financial situation.

Either the cash buffer option, whereby the country holds enough cash to be able to support itself for around two years without needing to raise funds on capital markets, or the precautionary credit line option are short term. The real question is what comes after the first post-memorandum year.

Policy-makers must focus on conditions for Greece to achieve a sustainable return to capital markets. I would like to make five proposals that could make such a return feasible in the near future.

Returning to markets

First, in the light of adverse capital market conditions, political developments in Italy and uncertainty in global trade relations, the government will need to increase the buffer as much as possible to shield the Greek economy for the next two years. Thankfully, policy-makers have already taken such measures on board. In July the government increased the buffer to €24.1bn, sufficient to guarantee Greece's gross financing needs until August 2020.

Second, regaining the investment grade held in 2008 is as important as ensuring debt sustainability. My proposal is to set up a new advisory task force to help obtain the investment grade as soon as possible by presenting roadshows abroad to investors and analysts. This should be at the top of Greece's policy agenda over the next two years. Its significance is comparable to meeting the Maastricht nominal criteria that allowed the country to enter the euro area.

Third, during the reinvestment period the European Central Bank may examine the eligibility of Greek government bonds under its public sector purchase programme. The ECB commented in June that it is ready to keep up reinvestments for 'an extended period of time' after the programme ends in December. This has clear benefits for the cost of borrowing of both sovereign, bank and corporate debt.

Fourth, the government, in co-operation with the Bank of Greece, should publish a plan detailing measures and dates for the full lifting of capital controls. No return to markets can be permanent or credible while such controls are still in effect. This would help win back the trust of depositors and facilitate the return of around €20bn hoarded domestically, in informal depots and safety deposits, while also boosting investor confidence.

Fifth, a key requirement for a permanent return to capital markets is the sustainable recovery of the Greek economy with growth greater than 2%. Given the prolonged fiscal consolidation and private disinvestment that has taken place, the country needs an investment shock. I would reaffirm a proposal I made in the summer of 2014, which links reduced primary surplus targets with a drastic gradual reduction of corporate tax rates in line with the fiercely competitive corporate tax rates applied by Greece's neighbours.

If such steps are taken, Greece will soon be able to draw a line under the last eight years of economic hardship and move into a much more confident future. ●

> 'The government should publish a plan detailing measures and dates for the full lifting of capital controls. No return to markets can be permanent or credible while such controls are still in effect.'

John Mourmouras is Senior Deputy Governor of the Bank of Greece.

Mitigating the impact of global risks on Asia

Regional integration provides natural hedge against international perturbations

Diwa Guinigundo
Bangko Sentral ng Pilipinas

At the time of the Asian financial crisis 20 years ago, currencies depreciated sharply. Asian countries defended themselves by drawing down currency reserves.

The 1997-98 crisis revealed major fault lines in the region's financial system. Significant reforms were implemented to address these weaknesses. Then, 10 years later, the 2008 financial crisis generated spillover effects from advanced economies. This exposed unresolved weaknesses in Asian economies, and highlighted regulatory policy gaps that contributed to financial vulnerability.

In response, policy-makers expended considerable effort to strengthen and deepen capital markets and make Asian economies more resilient to shocks. These reforms laid the foundation for sustained high growth in the region. However, the International Monetary Fund has drawn attention to the threat of recession after major central banks have started tightening monetary policy. Hence the policy agenda for fortifying Asia's financial and capital markets has become more relevant than ever.

Asia is susceptible to risks emanating from the pace of advanced economies' monetary policy normalisation, in addition to geopolitical risks, protectionist policies and consequences of sustained low global inflation. At the same time, greater regional and global financial interconnectedness could precipitate the rapid transmission of financial risks across borders.

Regional integration

Analysts today are witnessing a kind of contagion, not across national jurisdictions but in the form of greater interlinkages between real economies and financial markets. The 2008 crisis is an example of how adverse shocks in the financial system could amplify output fluctuations in the real economy.

Enhancing co-operation between authorities in the region will enable Asia to withstand the risks associated with the increasingly interconnected world economy. It is a vexed question whether now is the right time to pursue deeper integration, when the rapid pace of globalisation is exposing countries to external shocks amid a rise in populist politics around the world.

In my view, the pursuit of stronger regional integration provides a natural hedge against the perturbations in the global economy. It offers numerous benefits and opportunities in terms of market size and market access. However, one must be mindful of the diversity of Asian economies in terms of their economic conditions as well as legal and structural limitations. This will make the practical task of economic integration more difficult.

Deeper capital markets

To optimise the benefits of integration, there is a need to further deepen capital markets in Asia. It has long been recognised that a key feature of any developed capital market is depth; it engenders stability, and stability attracts committed investors.

Deep capital markets support efficient resource allocation by complementing bank lending, and serve as an alternative source of industry financing. They also help manage risks and strengthen responses to future crises. Policy-makers should bolster national and regional regulatory and supervisory frameworks as well as institutional capacities, including resolution mechanisms for interconnected regional banks. Local currency bond markets must be reinforced, and existing financial safety nets should be strengthened to guard against contagion and spillover effects.

Today, Asia stands strong – with higher foreign reserves, healthier financial systems and stronger regulations, as well as healthy fiscal space. But future crises cannot be ruled out. The events of 1998 and 2008 will continue to haunt Asian markets, especially when combined with increased procyclicality of financial cycles and growing global interconnectedness. While difficult, policy-makers can minimise vulnerability through capital market reform.

Policy-makers must engage in comprehensive policy discussions and exchange information to ensure they cover all possible perspectives and eventualities. Drawing on the expertise of market players, academics and international institutions would provide unalloyed benefits for Asia. ●

Diwa Guinigundo is Deputy Governor of Bangko Sentral ng Pilipinas.

Reinterpreting the laws of economics

We should focus on context of central bank actions, not 'universal theories'

Łukasz Hardt
Narodowy Bank Polski

There is a continuing debate among economists about the so-called missing inflation phenomenon. In developed countries, unemployment has decreased on average by 2.6 percentage points since 2013, while core inflation has risen by only 0.1 percentage points. In central and eastern European countries, the situation is even more striking: unemployment is down by 5.5 percentage points and core inflation down by 0.3 percentage points. Historically, there has been an inverse relationship between unemployment and inflation, as illustrated by the Phillips curve.

Several factors can help explain the mix of low inflation and low unemployment or why the new Keynesian Phillips curve is nearly flat. First, some researchers claim that in recent years prices and wages have become less sensitive to changes in GDP dynamics. Second, many companies' market power – the extent to which a company can influence the price of an item by exercising control over its demand or supply – has decreased, so it is less easy for them to transfer higher costs to prices.

Third, globalisation and integrated markets have stimulated price competition and made it easier for companies to relocate parts of their business to countries with lower production costs. Fourth, the scale of underutilisation of the factors of production may be higher than usually estimated. Some researchers suggest that the new Keynesian Phillips curve is less flat when using the difference between hours worked and hours people would like to work as a measure of labour slack.

Fifth, labour unions are in decline, lowering workers' market power. Sixth, access to the internet lowers search costs and makes it easier to compare prices than before, so it is more difficult for sellers to raise prices. Further insights can be added to this mix, such as those stressing the persistence of low inflation expectations.

Humble economics

These theoretical insights have an important bearing on economic practicies. This is especially the case when inflation is low in the presence of both expansionary monetary policies and relatively positive economic conditions. For example, can one still teach students, for instance, that 'when the real interest rate is low, there are greater incentives to borrow [and invest]', as is set out in the seminal textbook *The Economics of Money, Banking and Financial Markets?*

Such a statement may still be valid when properly interpreted. First, a ceteris paribus ('all other things being equal') interpretation is not right, since such readings are either empirically false or trivially true. Second, probabilistic readings (such as the proposition that lower rates raise the probability of a rise in investments) are problematic, because A may cause B while at the same time lowering the probability of B occurring.

One solution is to consider the difference between type-level and token-level events. In the context of monetary policy, one can say that lower interest rates typically make higher investments more probable. However, at the token level one can at the same time say that, for instance, in Poland in 2018, lowering rates will not lead to a rise in investments. Analysts must look beyond the probabilities.

It may be more accurate to claim that 'the ability to raise investments is a prototypical property of lowering interest rates, and this remains true even if as a result of some major changes in economies one can hardly notice instances of lower costs of borrowing making investments higher.' If the economic world is the world of potentialities and not actualities, then such a reading seems attractive.

Therefore, rather than teaching students ceteris paribus clauses, it would be better to use ceteris normalibus ('all other things being normal') statements, such as 'expansionary monetary normally leads to a rise in inflation'.

A reinterpretation of economic laws moves us towards more humble economics. As Harvard professor Dani Rodrik puts it in his *Economics Rules* book, 'Economics is a social science, which means that the search for universal theories and results is futile. Policy-makers should not be afraid to say that the nature of lower interest rates is to stimulate investment. Sometimes they produce that result, and sometimes not. What economists should focus on is the context of central banks' actions rathen than the search for an ideal set of rules that is always true in all circumstances. ●

> '"Economics is a social science, which means that the search for universal theories and results is futile."'

Łukasz Hardt is a Member of the Monetary Policy Committee of Narodowy Bank Polski and is Associate Professor of Economics at the University of Warsaw.

The pros and cons of 'green' bonds

On balance, a smart instrument

Marcelo Giugale
World Bank

A growing number of investors wish to make profits and do good at the same time. They want their portfolios, or part of their portfolios, to support environmental, social and governance causes. Why not promise them that, if they buy your bonds, the money will be used to install solar panels? Why not show that their investment will have a positive 'impact' on the climate? This should expand the pool of potential buyers, make borrowing cheaper, and burnish the reputation of all involved. That is the insight behind 'green bonds'. Or 'social bonds', to help the poor. Or 'blue bonds', to protect coral reefs. By some estimates, $200bn of these 'thematic bonds' were issued last year. But, does it all pan out in practice?

Measuring impact

Start with the downsides. First, green bonds are actually not cheaper – you do not save by promising to use the proceeds in a certain way. Why? Because investors look at your credit rating to tell you what interest rate they will charge. Whether you spend on solar panels or oil drills does not change your creditworthiness, at least not in the short term.

Second, money is fungible. As an investor, you may think that you are financing the purchase of solar panels but, if the borrowing government or corporation already has the money to pay for those panels, you would be freeing its resources to do something else. Green bonds may in fact finance national monuments or company cars. Hopefully, they won't. But you cannot rule it out if you do not see a borrower's entire expenditure plan. This comprehensive reporting can be time-consuming and costly.

Third, the combination of fiscal austerity and promises to bond buyers may have unintended consequences. A government may commit to greater spending on a worthy item, like cleaning up polluted beaches. But, if it also has a ceiling on its budget deficit, forcing more expenditure on beaches could come at the cost of cutting on, say, sanitation. Whether that trade-off is right or wrong is better decided by parliamentarians, not financiers.

Fourth, it is not easy to measure 'impact'. Even when the proceeds of a bond can be shown to increase a particular expenditure, proving that the extra spending has a desired impact is complex. Proper evaluations take time and money, and the results may be disappointing or may not be available before the bonds come due. Will investors then feel let down and close their checkbooks next time around or, worse, sue? I have not found record of bond-holders taking a country or a firm to court for defaulting on spending pledges. But it is technically possible.

Fifth, over time, linking bond proceeds to specific public expenditures can lead to more expensive funding, or even underfunding. If thematic bonds proliferate, investors will be able to choose what part of the fiscal budget they finance. Schools, hospitals and road maintenance may be popular. But, who will want to fund tax collection, regulation and prisons? Shouldn't those less desirable bonds pay a higher return? Not clear.

Alternative funding sources

So, if price, fungibility, austerity, identification and earmarking are such a problem, why bother with thematic bonds? The answer can be summarised in two words: signalling and diversification. When a public official or a private CEO commits to an additional expenditure, they are telling the world how ready they are to make it a priority. They are also speaking of budget stability: this one item will not be cut during rainy days. And they are implicitly accepting scrutiny in everything else they do – transparency spills over. It is an effective way of using finance to drive policy.

Signals of commitment also help mobilise others to the cause. Multilateral organisations like the World Bank find this useful. Their very existence is based on a 'theme' – ending poverty through sustainable development, in the case of the Bank. Their internal systems are set up for evaluation and public accountability. When they issue bonds, the proceeds can easily be associated with thematic results. This gives investors a ready-made supplier of impact.

Which brings us to diversification. As more bond buyers vie to be – or to be seen as – ESG-friendly, they become an alternative funding source for borrowers. It is not a small alternative: since the creation of the Principles for Responsible Investment in 2006, the number of global financial institutions that are signatories has grown twentyfold, to more than 2,000. They have around $80tn in assets under management.

With those pros and cons in mind, are these bonds something you would recommend for the average government, company, or institution? Yes, with three provisos: keep them to a small proportion of your total financing, use them only for things that are really important to you, and be alert to the evolution of this market. The cost-benefit analysis of tapping this type of finance will progressively tilt in its favour. From design to disclosure, common standards will arise and investors will feel more comfortable with them. Some functions will be taken over by specialists – one day, credit rating agencies may issue 'green ratings'. Valuable track-records and brands will be built. Better to stay tuned. ●

Marcelo Giugale is the Director of Financial Advisory and Banking at the World Bank.

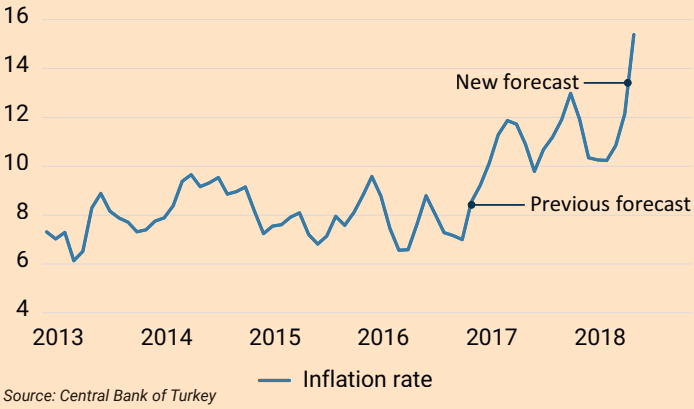
The chart

Each month we take a look at a chart from the world's central banks. This month, the Central Bank of Turkey.

At the end of July the Turkish central bank raised its 2018 inflation forecast to 13.4%, five percentage points higher than its outlook in April. A weakening currency and fears of a loss of central bank independence have contributed to this sharp increase. The lira has lost one-fifth of its value against the dollar since January and fell a further 4.2% in the week the central bank decided to hold interest rates at their low level, adding to inflationary pressures experienced throughout the year. The decision not to raise rates, despite a jump in consumer price inflation to a 14-year high of 15.4% (more than three times higher than the official 5% target) in June, has led investors to worry about the independence of the central bank. President Recep Erdogan, a self-proclaimed 'enemy' of high rates, has granted himself the executive power to appoint rate-setters at the central bank.

Turkey's central bank significantly increases inflation forecast

Consumer price index, annual change, %

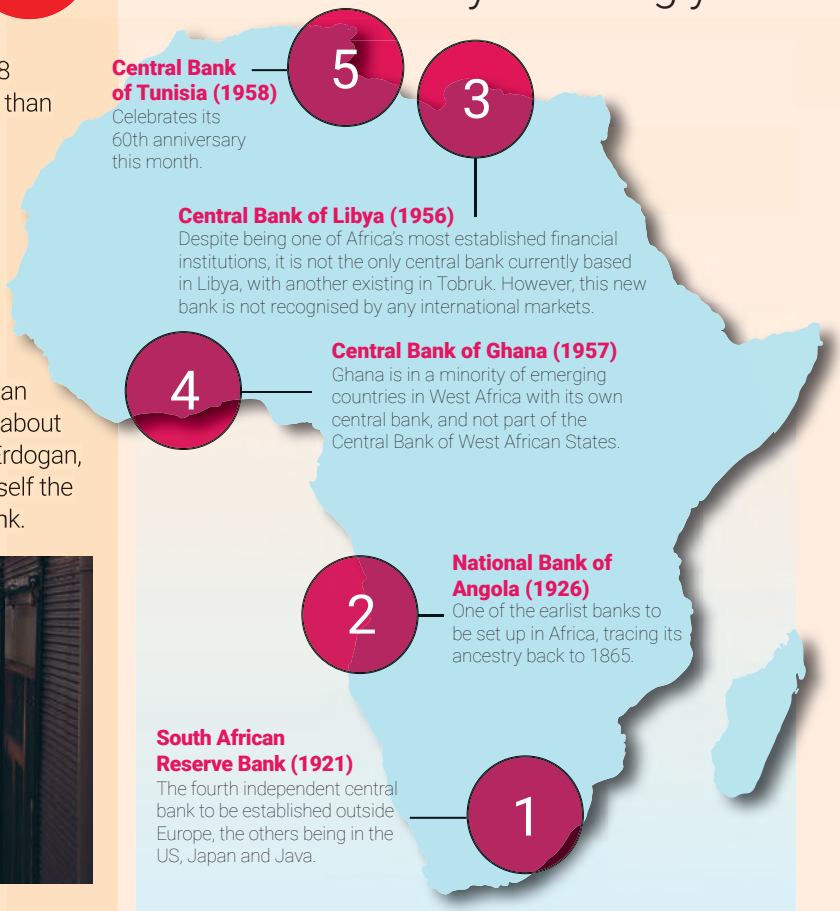


Source: Central Bank of Turkey

The numbers

African central banks

by founding year



6	Central Bank of Nigeria	1959
=	Central Bank of West African States	1959
=	Bank Al-Maghrib (Morocco)	1959
9	Central Bank of Somalia	1960
=	Central Bank of the Republic of Guinea	1960
=	Central Bank of Sudan	1960
12	Central Bank of Egypt	1961
13	Bank of Algeria	1962
14	Bank of Sierra Leone	1963
=	Bank of Zambia	1963
16	National Bank of Ethiopia	1964
=	National Bank of Rwanda	1964
18	Reserve Bank of Malawi	1965
19	Bank of the Republic of Burundi	1966
=	Central Bank of Kenya	1966
=	Bank of Mauritius	1966
=	Bank of Tanzania	1966
=	Bank of Uganda	1966
24	Central Bank of The Gambia	1971
25	Bank of Central African States	1972
26	Central Bank of Madagascar	1973
27	Central Bank of Swaziland	1974
=	Bank of Eritrea	1974
29	Bank of Botswana	1975
=	Bank of Cape Verde	1975
=	Central Bank of Mauritania	1975
=	Bank of Mozambique	1975
=	Central Bank of São Tomé and Príncipe	1975
34	Central Bank of Lesotho	1978
=	Central Bank of Seychelles	1978
36	Central Bank of Djibouti	1979
37	Central Bank of the Comoros	1981
38	Bank of Namibia	1990
39	Central Bank of the Congo	1997
40	Central Bank of Liberia	1999
41	Bank of South Sudan	2011

Africa narrative falls short of ambitions

Julian Frazer

PAUL Kenyon's *Dictatorland* is, at first glance, an encouragingly substantial contribution to the literature on Africa. Indeed, for readers unacquainted with the continent's history, it is occasionally revelatory.

The book's subtitle, *The Men Who Stole Africa*, refers equally to ignoble colonists, apathetic multinationals, western intelligence services and the despots who were either installed or propped up by these groups. It is a dejected narrative in which, almost without exception, heroes fall while villains triumph or escape judgement.

Dictatorland tells an important and sadly underrepresented story. It is a shame, then, that Kenyon's book is so easy to fault.

I became concerned on just the second page, home to the first of several spelling errors and editorial discrepancies. Smaller blunders are easier to forgive, though it is not long before their frequency begins to grate. The appearance of more substantive mistakes, however, make clear that *Dictatorland* required much more thorough proofing before it went to print. In one section we are introduced to Nnamdi Azikiwe, the first president of Nigeria. We are told that he was commonly referred to as 'Zik'. Yet, only five lines later, his moniker is misspelled as 'Zic', only to be corrected on the next page, on which 'Zik' is referenced seven times. This simply should not be allowed to happen. Perhaps more shameful still is the sporadic use of US English – Kenyon, an award-winning journalist who burnished his reputation working for the British Broadcasting Corporation, should do better.

> 'A dejected narrative in which, almost without exception, heroes fall while villains triumph.'

Such criticisms may seem trivial or superficial, but they leave the impression of, at best, poor proofreading and, at worst, slapdash writing. Readers are left hoping that essential facts and figures were treated with greater care and attention.

Then there is the matter of clichés. In an excerpt on the Soviet Union's interest in improving relations with the Congo, Kenyon writes that this prospect was 'scaring the living daylights' out of officials in Washington. Throughout the book, numerous people are described as being a 'bear of a man', while anybody with facial fair on his chin is said to have 'a bramble of beard'. Worn out metaphors do nothing but spoil the flow of the narrative.

Kenyon is able to redeem himself partly with passages of effervescent writing. On the execution of Patrice Lumumba, the first democratically elected president of the independent Republic of the Congo, Kenyon writes: 'And there he lay, beneath the loose orange earth, Congo's great hope, dead at the age of 35.' In the chapter on Equatorial Guinea, readers are told about the 'moon-glare on broken tin roofs; gouged strips of mud linking one scatter of shacks to another; silent Spanish churches thick with mould; the embers of a fire where soldiers sleep beside the high defensive walls of the Presidential Palace.'

Fragments like this elevate parts of *Dictatorland* to heights rarely reached by works of historical nonfiction. Kenyon's use of first-hand accounts, making the best use of his journalistic talents, likewise lends the book a compassion that might otherwise be eroded in a narrative so full of atrocities that readers risk being 'blunted by numbers too large to comprehend'. It is unfortunate that production errors often spoil these passages.

Colonial scramble

When promoting *Dictatorland*, Kenyon said he wanted the book to 'tell the story of the continent with all the colour, all the intrigue, all the human stories that make it what it is today'. It is a grand ambition, and one which he fails to live up to.

Dictatorland focuses on just seven countries, tracing the exploitation of gold, diamonds, oil and cocoa. While these may be the most historically intriguing natural resources, Kenyon makes almost no mention of cobalt, an essential component in the production of the rechargeable batteries in our ubiquitous smartphones and laptops. Little, too, is written about modern slavery in Africa, let alone the Atlantic slave trade. In fact, for Kenyon, the history of the continent only seems to begin in the 1870s, when Europeans began in earnest to ensnare 'the most glittering of Africa's jewels'. While I never expected *Dictatorland* to offer a comprehensive account of the civilisations that ruled the continent in the centuries preceding the 'scramble for Africa' by Britain, Belgium, France and others, the absence of any substantive copy on its precolonial history is maddening. One wishes that Kenyon had instead fixated on just one story, such as the prevalence of child labour in west Africa's cocoa farms, which he writes about with great care and insight.

It seems, by the end, that even Kenyon was almost ready to admit defeat. In his endnotes, he writes that 'Africa cannot be tamed into word', and that writers face a choice. They either 'survey the entire continent from the highest point', or they 'plunge beneath the jungle canopy and focus on a single rare and colourful bloom'. In trying to do both, Kenyon fails to achieve either. ●

Julian Frazer is Senior Editor at OMFIF.

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Advisers network poll

Protecting current auditing structure

Recent 'big four' controversy minor compared to their long-term value

Keeping the 'big four' accountancy firms together ( ), or reviewing them ( ), % of responses

This month's poll focuses on the UK's top accountancy firms. Participants were asked: **'With many people attributing at least some of the blame for the collapse of services firm Carillion to the 'big four' UK accounting firms, should their oligopoly on the audit market be reviewed?'**

Of those who responded to the advisers network poll, 70% believe the four firms should be allowed to maintain their control over the market. They suggest their multinational presence provides a broad and effective network of services, while the competition between the four is enough to provide reasonable fees for customers.

Others stated that capable regulation and greater accountability is essential to maintaining these standards. This is expanded on by the 30% of advisers who suggest the big four firms should be reformed, expressing concerns over recent controversies. However, the practicality of such reform was cited as a major obstacle.

The social media poll echoed these conclusions, with 75% of respondents feeling that the big four should stay together.

Auditing failures are simply due to management weaknesses that can be corrected. The growth of these firms is a challenge to deliver increasingly effective services to the financial system generally.

Peter Gray, Berkeley Capital

Auditors should lose their license if the quality of their auditing is below acceptable standards. And large fines should be considered.

Jens Thomsen, formerly Danmarks Nationalbank

The issue is improving the quality and integrity of the audit process. More competition would be more likely to cut audit fees than achieve these aims.

Colin Robertson, SW1 Consulting

No, but audit firms and their partners should be made more accountable in in case of gross negligence.

Olivier Rousseau, Fonds de réserve pour les retraites

No. Four firms should be enough to provide competition if properly regulated and supervised.

Irena Asmundson, California Department of Finance

October's question:

When Christine Lagarde's term ends as managing director of the International Monetary Fund, should her successor be someone from an emerging market?