AFRICAN UNION
الاتحاد الأفريقي

UNION AFRICAINE

UNIÃO AFRICANA

Speech delivered at the Symposium of the 36th Ordinary Session of the Association of African Central Banks Governors

on the theme

"Challenges of Commodity Prices and Capital Flow Volatility to African Central Banks"

by

Dr. Maxwell M. Mkwezalamba

Commissioner for Economic Affairs

African Union

29th August, 2012

Excellency the Minister of Finance of the People's Democratic Republic of Algeria

Mr. Charles Chuka, Governor of the Reserve Bank of Malawi and Chairperson of the Association of African Central Banks (AACB)

Mr. Mohamed Laksaci, Governor of the Banque d'Algerie and Vice-Chairperson of the AACB

Honourable Governors

Mr. Samuel Meango, Executive Secretary of the AACB

Distinguished Ladies and Gentlemen

I am delighted to address this year's Symposium of the Association of African Central Banks on behalf of the H.E. Dr. Jean Ping, Chairperson of the African Union Commission.

Allow me to begin by commending and congratulating you for the good quality work so far of the Association of African Central Banks in support of the integration of the continent, particularly with regard to monetary integration. As you are aware, there is no doubt that integration remains a key strategy for Africa to transform from a continent of mainly least developed and developing countries to a strong united bloc of developed nations and a global force.

Please allow me also to take this opportunity to thank the Government and the People of the Republic of Algeria, our hosts for this Symposium, for the warm and fraternal welcome accorded to us since our arrival in this beautiful city of Algiers. In this regard, I wish to commend Mr. Mohammed Laksaci, Governor of the Banque d'Algerie, and the Management and Staff of Banque d'Algerie for the excellent arrangements made for the success of the Symposium. Furthermore, I wish to thank you all for having made it to Algiers to participate at this important Symposium.

Excellency, Honourable Governors, Distinguished Ladies and Gentlemen

It is always with great pleasure that the African Union Commission participates at your Annual Symposia. It is with even greater pleasure to do so, for me personally, both due to your commitment to move forward resolutely on the path of integration of the continent and the relevance of your discussions to African specific and global contemporary issues. The theme of this Symposium, "Challenges of Commodity Prices and Capital Flow Volatility to African Central Banks" is testimony to this.

Indeed, when in August 2011 you chose the theme for this year's Symposium, I was convinced that there could not have been a more relevant choice and my opinion has not changed since. As a matter of fact, this conviction has been borne out by the current events unfolding in the international economic environment today.

Volatility observed both on the capital and commodity markets continues to be a reality that central bankers have to grapple with in the conduct of monetary and exchange rate policy. This is certainly not easy, and you are better placed, Honourable Governors, to attest to this. The difficulty is often with the impact that the movements in these markets can have on your main objectives, including maintaining low and stable inflation and exchange rate stability. The irony is that these movements are not driven by changes in the macroeconomic fundamentals, while at the same time, they play an important role in your decision making process.

We all know that the fast economic growth rates that African countries enjoyed between 2001 and the onset of the global financial and economic crisis was mainly a result of improved macroeconomic management on the continent, but was also supported by strong capital inflows and rising commodity prices.

You may recall that there was a substantial surge in commodity prices, including those of fuel and minerals, between 2002 and 2008 that had a significant positive impact on incomes and growth in many African countries. The food crisis of 2008 that resulted in rising food prices and food price volatility exhibited from 2010 have also negatively impacted on African economies.

You may also recall that net private capital inflows to Africa increased significantly in the period before the on-set of the global financial and economic crisis in 2008. For instance, net private capital inflows to Africa, which are mainly in the form of Foreign Direct Investment, increased from US$5 billion in 2001 to approximately US$58 billion in 2009, whereas Africa’s share (excluding North Africa) of net capital inflows to developing countries increased from 5 percent in 2007 to 8 percent in 2009. In addition, net portfolio capital inflows to Africa also rose.

However, following the global financial and economic crisis, capital inflows have become very volatile. There were particularly strong flows into equity and bonds in 2010 and an abrupt stop in 2011. Other investment flows also experienced the same volatility with some foreign investors withdrawing from Africa.

The volatility in commodity prices and capital flows has had a negative impact on macroeconomic stability. The large foreign currency reserves that African central banks had accumulated prior to the global financial crisis were drawn down in order to supply foreign currency liquidity to local markets to compensate for the withdrawal of foreign private capital. In addition, falling commodity prices have resulted in declining terms of trade and worsening trade balances, depreciating exchange rates, and reduced government revenues and gross domestic product (GDP) growth rates for the major commodity exporters.

On the other hand, during the energy and food crises, many African countries experienced sharp increases in inflation owing to the high weight of food and energy in their consumption baskets. This increase in inflation resulted in real exchange rate appreciation, both in countries with floating and fixed exchange regimes. Given that maintaining low and stable inflation and exchange rate stability are among the core monetary and exchange rate policy objectives, the interventions of African central banks are necessary to prevent second round effects of higher commodity prices, including spill-over into inflation expectations and rising wages.

Excellency, Honourable Governors, Distinguished Participants

In view of the fore-going, the need for a policy shift aimed at addressing the detrimental effects of the volatility in commodity prices and capital flows with central banks at the centre of policy prescriptions cannot be over-emphasized. These issues have been extensively discussed in other fora, including at the Joint Annual Meetings of the AU Conference of Ministers of Economy and Finance and Economic Commission for Africa (ECA) Conference of Ministers of Finance, Planning and Economic Development and at the G2O Summits.

The policy recommendations, however, have tended to focus more on addressing structural issues. The organization of this Symposium, therefore, provides you, Central Bank Governors, with an opportunity to exchange experiences and best practices on how African central banks can effectively support efforts aimed at dealing with the challenges of commodity price and capital inflow volatility. These discussions should positively contribute to the conduct of monetary and exchange rate policy in Africa, as well as contribute to our on-going work on the establishment of the African Central Bank and the single common currency.

In conclusion, I wish this AACB Symposium on the theme “Challenges of Commodity Prices and Capital Volatility to Central Banks” successful deliberations.

I thank you for your kind attention.