



Macroeconomic Policies and Financial Sector Deepening: Getting the Framework Right



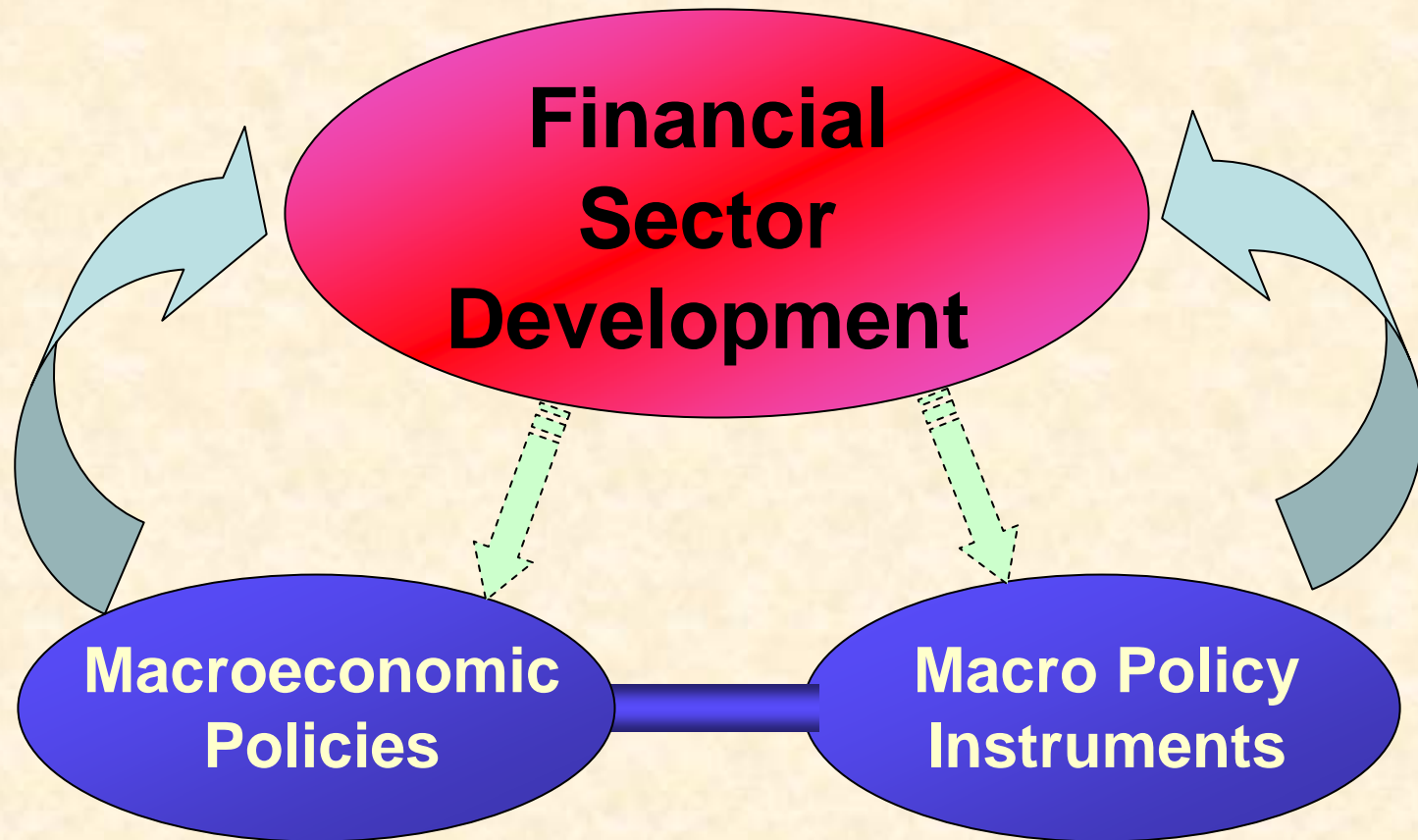
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Financial Sector Deepening

1. Links with Macro Framework
2. Monetary Policy
3. Fiscal Policy, Taxation, and borrowing
4. Capital flows
5. Conclusions

Financial Sector and Macro Links

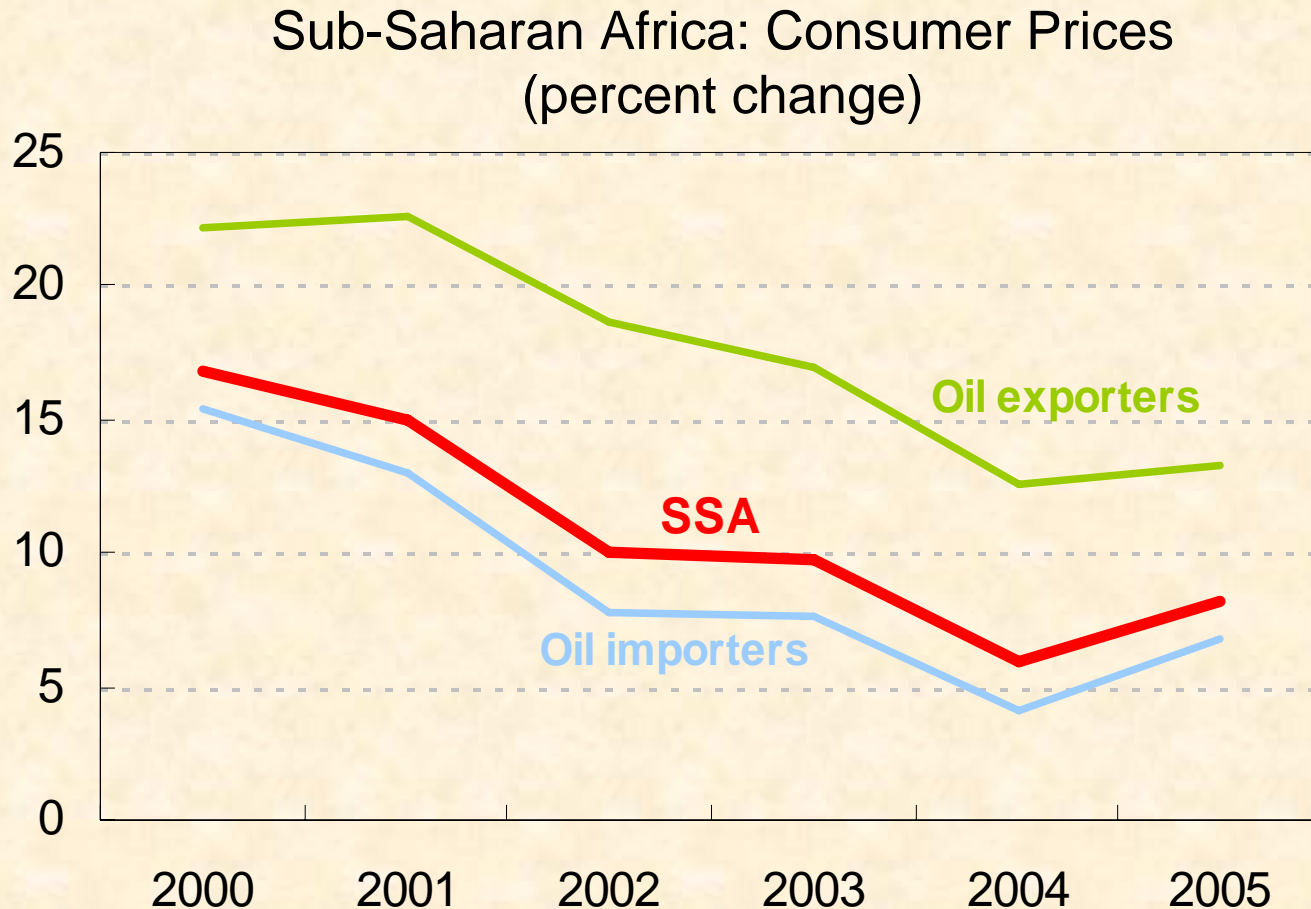


Monetary Environment and Financial Sectors

- High inflation creates uncertainty
- Rapid changes in monetary stance make business decision difficult
 - Monetary expansion → Rapid credit expansion, weaker bank portfolios
 - Monetary tightening → Constrains new credit, limits bank profitability

Monetary Policy Environment has improved...

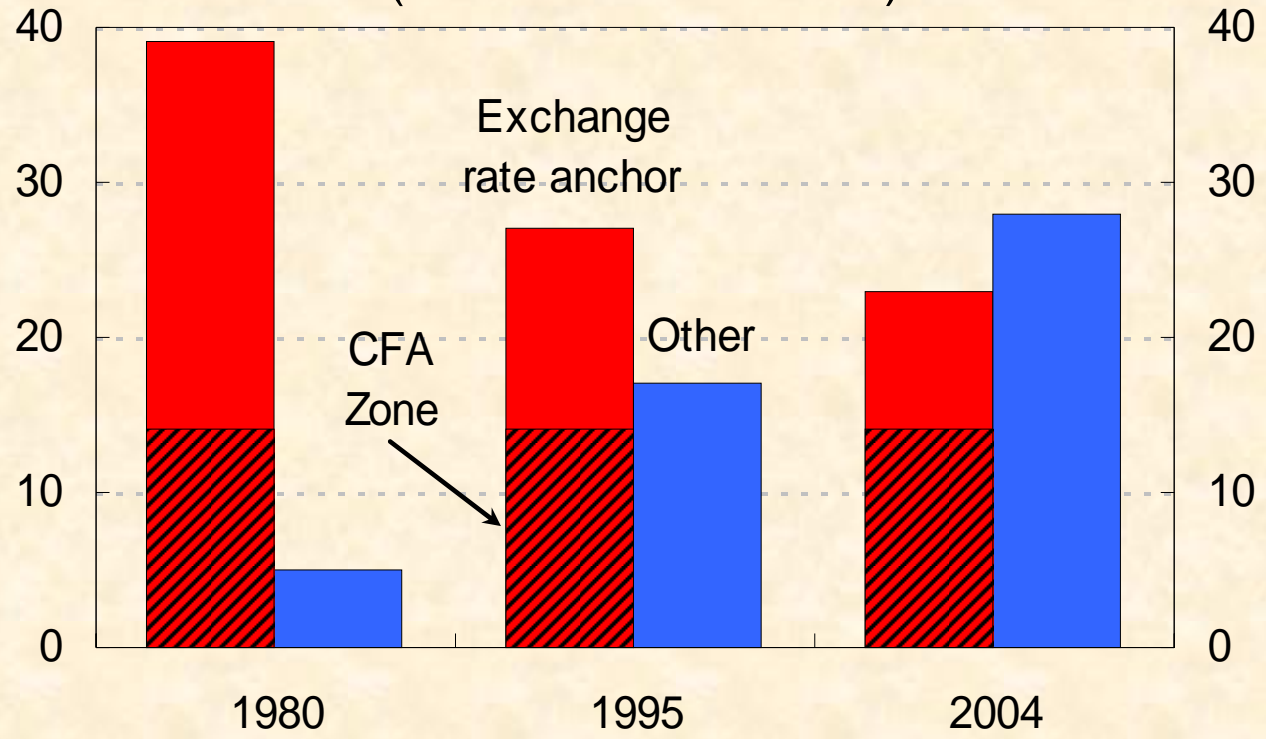
● Inflation declined ...



Monetary Policy Environment has improved... (Cont.)

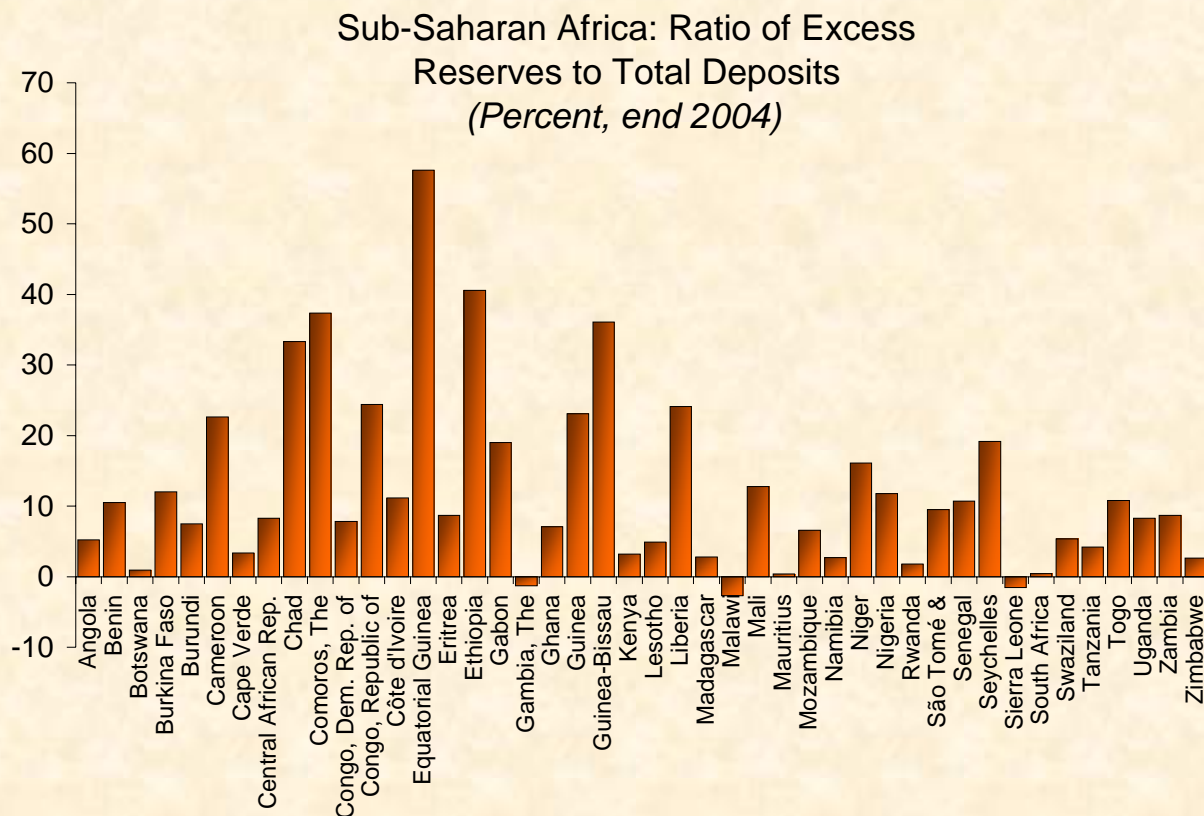
- Many countries moved away from an exchange rate anchor

Sub-Saharan Africa: Anchor for Inflation
(Number of countries)



...but concerns remain

● Excess liquidity prevails in many countries

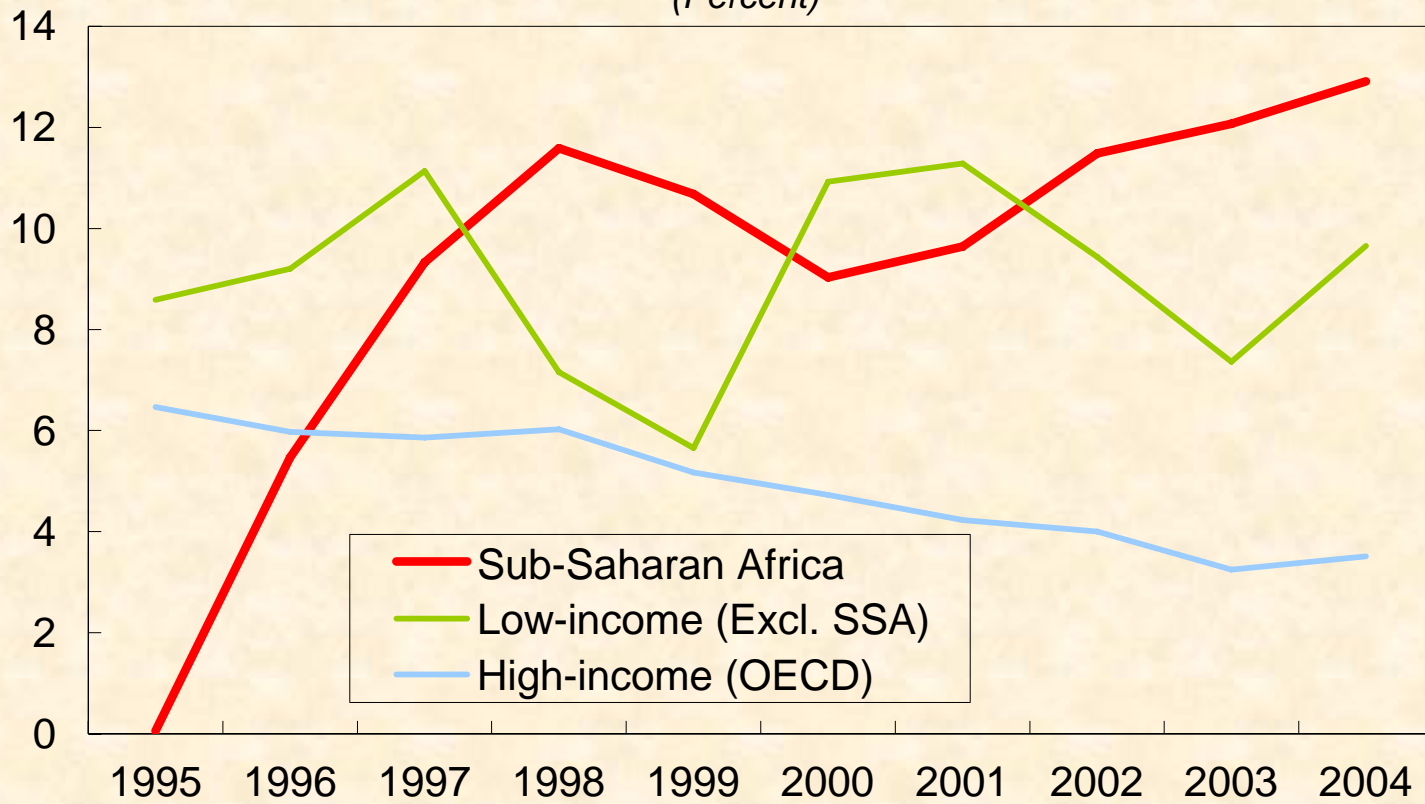


Source: IMF staff calculations.

...but concerns remain (cont.)

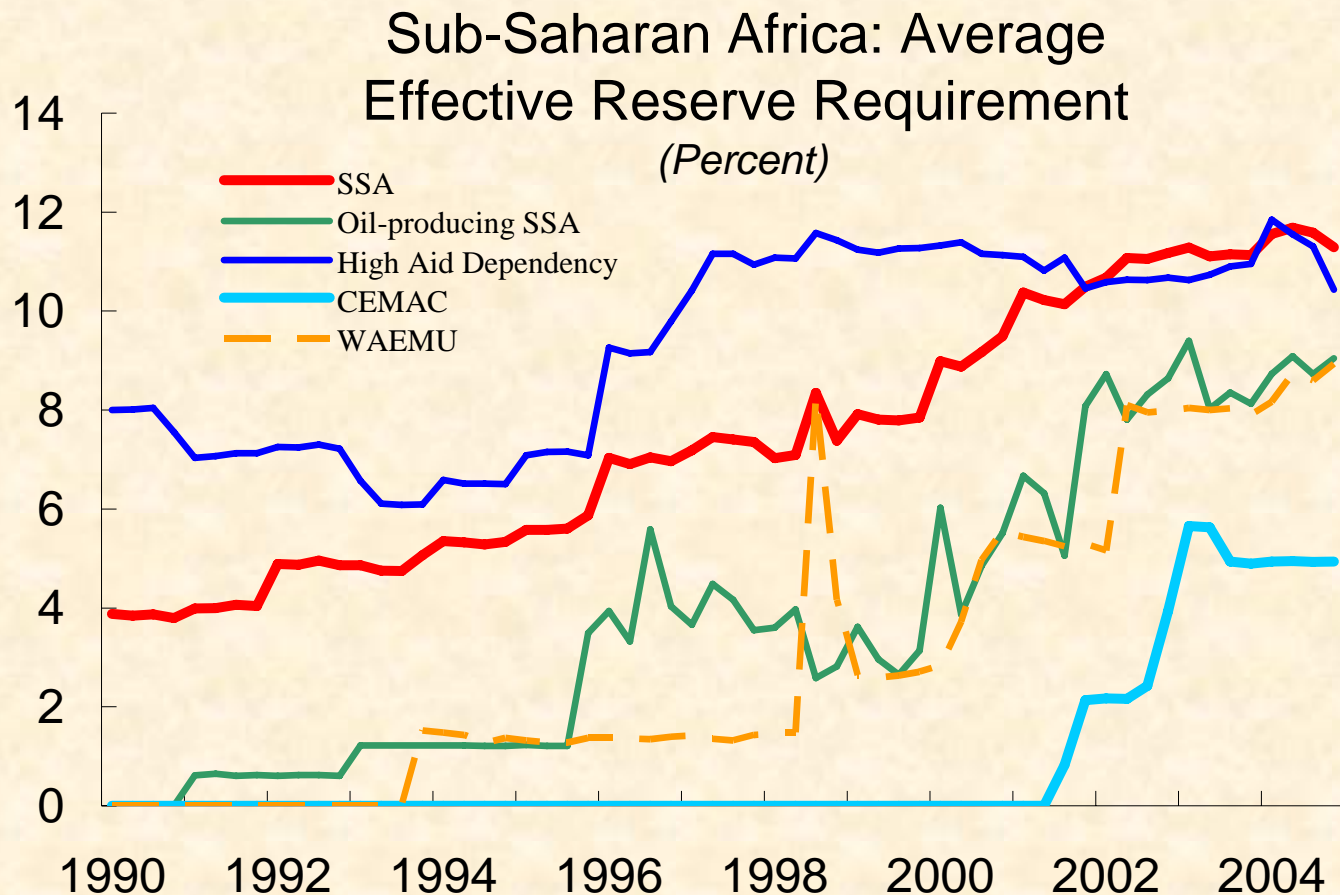
● Real lending rates are high

Sub-Saharan Africa and Comparator Groups:
Real lending rates in SSA versus Rest of the World
(Percent)



Reserve requirements in SSA

- Levels are high, costly for banks



Source: IMF staff calculations.

Market based instruments

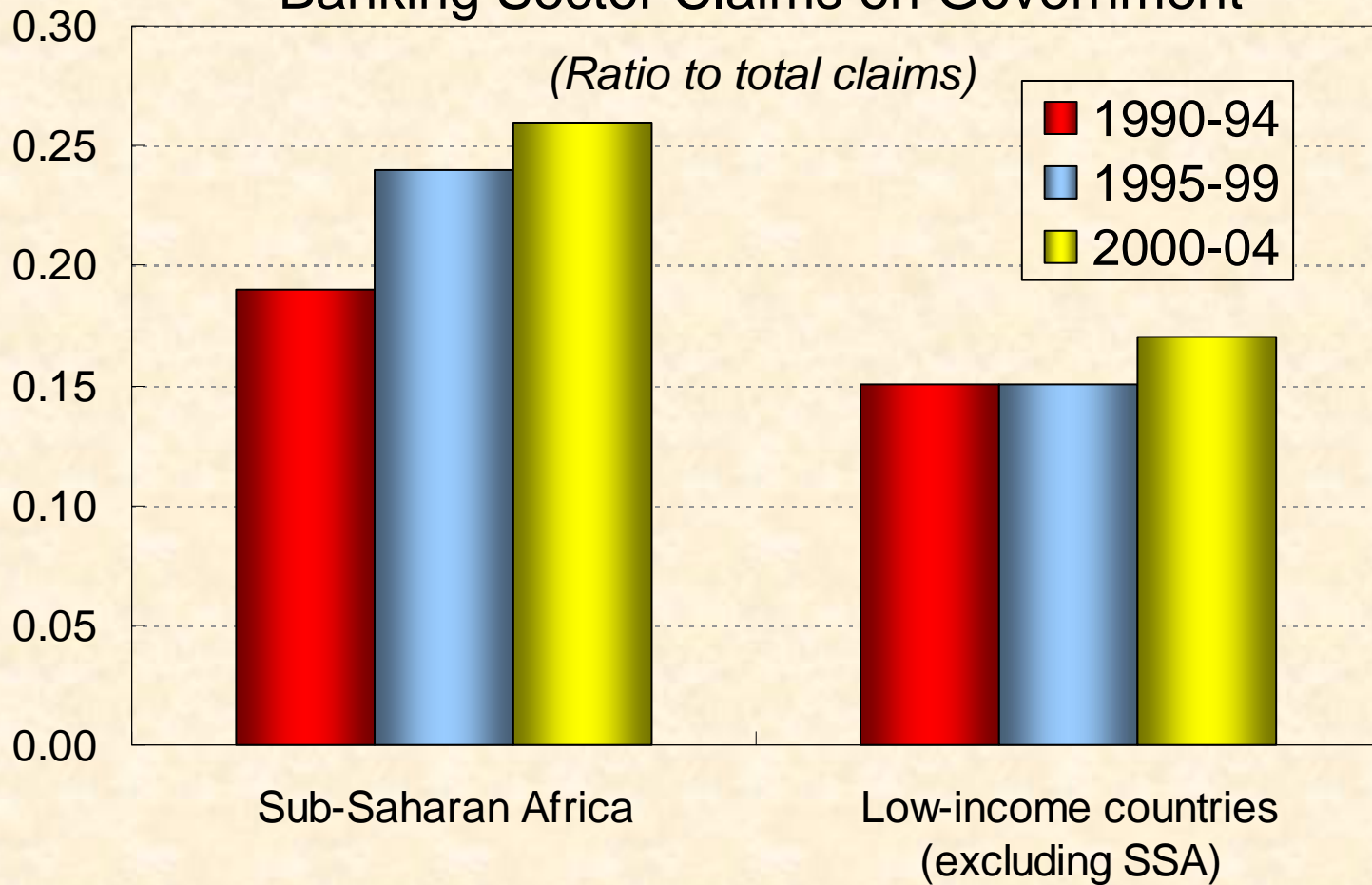
- Marketable securities issued in more than 20 AFR countries, but
 - Often not for monetary policy use
 - Central Banks concerned about profitability
 - Limited secondary markets

Fiscal Policy: Direct and Indirect Links to Financial Sector Development

- Fiscal policy is linked with financial stability and development
 - Excessive domestic borrowing
 - macroeconomic instability lowers banks' willingness and ability to lend
 - crowds out private sector lending

Domestic borrowing in Africa is higher than in other regions and increasing

Sub-Saharan Africa and Comparator Groups:
Banking Sector Claims on Government



Fiscal Policy: Indirect links through market development

- Trend to more TB markets in Africa
- Market based borrowing supports market development
 - TBs help establishment of a yield curve
 - TBs support collateralized lending

Market development and Government Debt

- New empirical research: beneficial effects decline
 - Small amounts of debt have positive effects on financial deepening
 - Large amounts of debt reduces efficiency of financial sector

Taxation of financial sectors

- Major source of income/profit taxes
- Restrictions impose additional costs
- High taxes and high restrictions lead to disintermediation

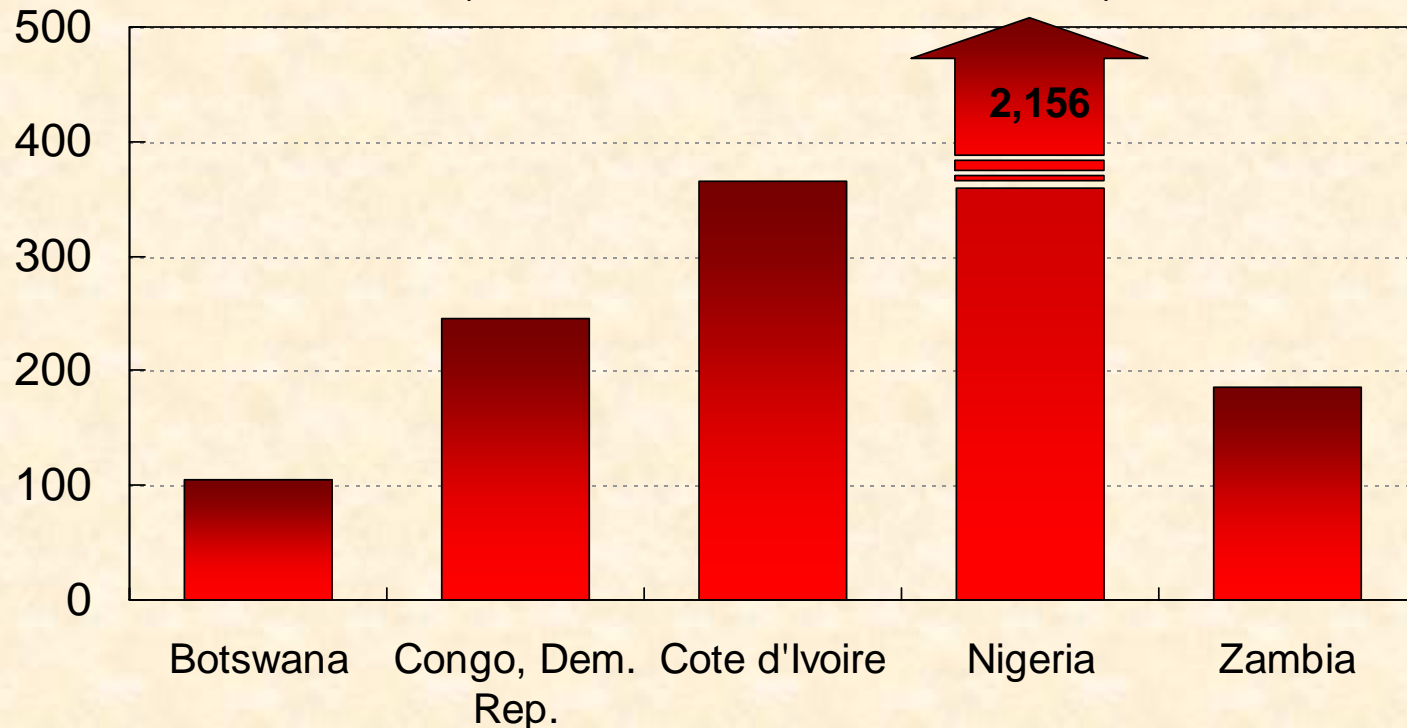
Capital Flows

- Most AFR countries still have controls on financial flows. They
 - Reduce vulnerability to shocks
 - Limit pressures on financial sectors
 - But capital controls slow financial reform

Capital Flows

- Recent capital inflows may indicate a fundamentally changed environment

Debt Trading Volume in Selected SSA Countries
(1st. Half of 2006, US\$ millions)



Conclusions

AFR countries have made progress. Steps to complete the agenda:

- Monetary Policy

- Address excess liquidity

- Improve the range of instruments

- Reduce fiscal and regulatory distortions

- Prepare for more capital flows

Thank you !
