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21st Meeting of the COMESA Committee of Governors of Central Banks

18-19 November, 2015
Lusaka, Zambia

REPORT OF THE TWENTY FIRST MEETING OF THE COMESA COMMITTEE OF GOVERNORS OF CENTRAL BANKS

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A. INTRODUCTION

1. The 21st Meeting of the COMESA Committee of Governors of Central Banks was held from 18-19 November 2015 in Lusaka, Zambia. Governors reviewed the activities that were undertaken by COMESA Monetary Institute (CMI) and the COMESA Clearing House for enhancing monetary cooperation in the region and endorsed a 2016 Work Plan for the two COMESA institutions.

B. ATTENDANCE OPENING OF THE MEETING, ELECTION OF THE BUREAU, ADOPTION OF THE AGENDA AND ORGANISATION OF WORK

2. The meeting was attended by Governors and Experts from Central Banks of Burundi, Congo (DR), Djibouti, Egypt, Kenya, Madagascar, Malawi, Rwanda, Sudan, Swaziland, Uganda, Zambia and Zimbabwe. PTA Bank, COMESA Secretariat, COMESA Clearing House and COMESA Monetary Institute also attended the meeting. The list of participants is at Annex 2.

Opening of the Meeting *(Agenda item 1)*

3. Dr. Bwalya K.E. Ng'andu, Deputy Governor of the Bank of Zambia, made a statement. In his statement he welcomed the delegates to Lusaka, Zambia. He highlighted the current challenges faced by the COMESA region emanating from unfavourable external environment which included lower international commodity prices, slow down of the Chinese economy, and disorderly global asset reallocation, amongst others. He underscored the importance of deeper monetary and financial integration for improved performance of the region's economy. He stated that Central Banks in the region could not afford to be complacent, as the risks related to global monetary policy and macroeconomic developments remained high given the globalized nature of the world economy. He also emphasized that a regional approach to financial sector development is key to diversifying risks across member countries to increase greater competition and efficiency.

4. The Secretary General of COMESA, in his statement, emphasized that monetary cooperation programmes at the regional level are building blocks for achievement of continental integration. He, therefore, proposed to make monetary cooperation as a Tripartite (COMESA, EAC and SADC) agenda for speeding up continental integration which is currently being pursued by the Association of African Central Banks (AACB). This he said will avoid duplication of efforts due to overlapping membership. He also emphasized the importance of the region's involvement in supranational and global value chains as well as international production aimed at high value products that can access global markets. He pointed out that industrialization can diversify the region's dependence on commodity trade and emphasized the importance of collective thoughts to come up with a good industrialization policy for the region. He underscored the importance of prudent fiscal policies and financial intermediation for making the region a zone of macroeconomic stability and enhancing integration. He stated that the speedy implementation of the Regional Payment and Settlement System (REPSS) will significantly contribute to the expansion of intra COMESA trade. He, therefore, urged all member Central Banks to expeditiously use REPSS for payment for their intra-COMESA transactions.

5. Mr. Jean-Louis Kayembe Wa Kayembe, Director General, Banque Centrale du Congo on behaf of his Governor, Mr. Déogratias Mutombo Mwana Nyembo, presented a report on the activities of the Bureau in 2015. In his report, He highlighted activities which were undertaken by the COMESA Monetary Institute (CMI) and COMESA Clearing House (CCH). These included workshops, trainings and research activities which were undertaken by CMI and activities undertaken by CCH for the operationalization of the Regional Payment and Settlement System (REPSS). He commended the Bureau for their valuable support. He requested the Governors to continue their support during his continuing chairmanship in 2016.

6. Dr. Louis Austin Kasekende, Deputy Governor, Bank of Uganda, passed a vote of thanks on his behalf and on behalf of all Governors and delegates. He thanked the Guest of Honour, the Deputy Governor of the Bank of Zambia and the Secretary General of COMESA for finding time to grace the meeting. He thanked the Government of Zambia for the warm hospitality accorded to Governors and delegates since their arrival in Lusaka. He emphasized the importance of consolidating the Tripartite arrangement and that the success of Tripartite was a shared responsibility. He further emphasized the superiority of regionalism over individualism. He urged member Central Banks to speedily implement the Regional Payment and Settlement System (REPSS).

Election of the Bureau *(Agenda item 2)*

7. Governors agreed on the continuation of the same Bureau which was elected in 2014. The Bureau comprises of the following:

Chairperson	:	Central Bank of Congo DR
First Vice Chair	:	Reserve Bank of Malawi
Second Vice Chair	:	Central Bank of Burundi
First Rapporteur	:	Central Bank of Djibouti
Second Rapporteur	:	Central Bank of Sudan

Adoption of the Agenda and Organisation of Work *(Agenda Item 3)*

8. Governors adopted the following agenda:

1. Opening of the Meeting;
2. Election of the Bureau;
3. Adoption of the Agenda and Organisation of Work;
4. Consideration of the Report of the 21st Meeting of Experts on Finance and Monetary Affairs on the following:

   I. Status of Implementation of Decisions of the 20th Meeting of the COMESA Committee of Governors of Central Banks;
   II. Status Report on the Implementation of the Regional Payment and Settlement System (REPSS);
   III. Report on the Activities of the COMESA Monetary Institute;
   IV. Report on Macroeconomic Developments in COMESA region in 2014;
   V. Report of the Thirteenth Meeting of the Monetary and Exchange Rates Policies Sub-Committee on the following:

a) Studies on the following:

(i) The Effects of Fiscal Policy on the conduct and transmission mechanism of monetary policy; and
(ii) The Challenges of dollarization in selected countries in the region.

b) Trainings on the following:

(i) International Reserve Management;
(ii) Macroeconomic Modelling and Forecasting; and
(iii) Advanced Panel Data econometrics.

c) Work Plan of the Monetary and Exchange Rates Policies Sub-Committee for the year 2016.

VI. Report of the Meeting of the COMESA Financial System Development and Stability Sub-Committee on the following:

a) Status of Implementation of the Recommendations of the 9th meeting of the Financial System Development and Stability Sub-Committee
b) Report by member countries on the Implementation of Assessment Framework for Financial System Stability;
c) Reports on the following Trainings/workshops:

(i) Modelling and Forecasting Volatility in Financial Markets within Multilateral Framework;
(ii) Financial Stability, Systemic Risk Assessment and Macroprudential Policy;
(iii) Validation workshop of a Guideline for Appropriate institutional and governance framework for implementation of macroprudential policy in the COMESA region;
(iv) Work Plan for the Financial System Development and Stability Sub-Committee for 2016.

5. Presentations on Topical Subject(s) of Direct Interest to the Governors
6. Any Other Business
7. Adoption of the Report and Closure of the Meeting

C. PROCEEDINGS OF THE MEETING

Consideration of the Report of the 21st Meeting of Experts on Finance and Monetary Affairs *(Agenda item 4)*

Status of Implementation of Decisions of the 20th Meeting of the COMESA Committee of Governors of Central Banks *(Agenda item 4(I))*

9. Governors noted the status of implementation of the decisions of the 20th meeting of the COMESA Committee of Governors of Central Banks which is contained in Annex 1 of this report.

10. Governors commended the good performance achieved in 2015 in the implementation of the previous decisions of Governors.

Status Report on the Implementation of the Regional Payment and Settlement System (REPSS) *(Agenda item 4(II))*

11. The Executive Secretary of the COMESA Clearing House, Mr. Mahmood Mansoor, made a presentation under this agenda item. In his presentation, he reported the progress made in the implementation of the Regional Payment and Settlement System (REPSS) and the activities carried by the COMESA Clearing House to enhance implementation.

12. Governors recalled that the Fifteenth Summit of the COMESA Authority of Heads of State and Government, held in Lilongwe, Malawi on 14-15 October 2011 had, inter alia, "Urged all Central Banks and Stakeholders in the COMESA Region to aggressively market and use the Regional Payment and Settlement System (REPSS) in order to enhance intra-regional trade."

13. Governors noted that the COMESA Authority of Heads of State and Government at its Eighteenth Summit held in Addis Ababa, Ethiopia from 30 to 31 March 2015, continued to urge Member States and their respective Central Banks to sensitise their stakeholders on the utilisation of the Regional Payment and Settlement System for the benefit of the entire region, particularly through their respective Commercial Banks Associations/Unions, Chambers of Commerce and Industry, Exporters and Importers Associations. The Authority, pursuant to Article 73 of the COMESA Treaty, further urged Member States to use the COMESA Clearing House in order to generate resources for the COMESA Fund which will be used to leverage funding from cooperating partners for sustainable funding of COMESA programmes (vide Communiqué of the Eighteenth Summit of the COMESA Authority of Heads of State and Government, Addis Abba, Ethiopia 31 March 2015).

14. Governors also noted that the Council of Minister's directives to Member States to settle all payments in respect of all transactions in goods and services conducted within COMESA through the Clearing House Regional Payment and Settlement System (REPSS) also acted as a boost to the system.

15. Governors took note of the working of REPSS where importers and exporters deal with their local commercial banks for trade documentation. The importer's payment to the exporter is then channelled through the Central Bank of the importer to the Central Bank of the exporter using the REPSS platform.

16. Governors noted the benefits of REPSS which included the following:

i) It guaranteed prompt payment for exports as well as other transfers;
ii) It eliminated mistrust among traders as there is Central Bank involvement. This in turn increased trade within the region;
iii) It reduced foreign funding as the amount to be paid at the end of the day by a participant was on a net basis;
iv) It eliminates collateral requirements as Central Banks are directly involved in the system and trade is mainly amongst members; and

v) Confirmation of letters of credit is not required under the system.

17. Governors were informed that there are currently 8 Central Banks that are live on the system, namely, Central Banks of DRC, Kenya, Malawi, Mauritius, Rwanda, Swaziland, Uganda and Zambia.

18. Governors noted the following recommendations of the 3rd REPSS User Group meeting held in Kinshasa in February 2015:

i) Field 50 of the MT103 should capture the details of the ordering customer and not the ordering commercial bank. This is important to ensure compliance with Anti Money Laundering regulations.
ii) Explore ways of making available financing facilities within REPSS just like it happens within RTGS. This will give the system a major boost and allow for smooth flow of payments.
iii) Implement the use of the queueing facility on the system to address issue where the transactions sent to REPSS are rejected due to the time lag of funding the settlement account. Queueing will allow the transaction to be placed on hold until the funds have been received at the Settlement Bank. CCH to engage BOM and look at what possibilities can be explored and implemented. Inputs from Central Banks will also be sought by CCH.
iv) Payments to a country that is closed due to a public holiday be processed as normal for application of funds on the next day on the local RTGS.
v) Central Bank of Kenya to share with other Central Banks on any new reversal of funds procedures from an automated set up perspective.
vi) Euro transactions to be funded at the time of processing to avoid the current negative charges on Euro balances levied by European Central Banks.
vii) CCH to send a monthly report of activities on the REPSS platform. The report should include an exception report with reasons for rejection to avoid such occurrences.

19. REPSS performance from January to October 2015 was presented to Governors. A total of 162 transactions totalling US$4,6 million and 15 transactions totalling close to Euro 70,000 had been successfully processed on the system.

20. Governors recalled that REPSS provides a smooth flow of payments for such trade and with cross border payments costing around **US$ 600 million per year**, the platform allows reduction in such costs with the resulting savings channelled to other economically beneficial projects within COMESA. Such cost savings would induce all users to make REPSS the preferred payment option going forward.

21. Estimates show that the region would save an amount of at least **US$ 122 million in 2015**, when channelling intra-COMESA import transactions through the Regional Payment and Settlement System (REPSS), where no confirmation of Letters of Credit is required.

22. REPSS enables the building of trust and confidence amongst traders and commercial banks of the region and facilitates the transacting under documentary collections (ICC Publication no. 522) and ultimately on open accounts (under which

over 80% of trade is carried out in Europe), where the opening of Letters of Credit would no longer be required. This would save the region an estimated amount of **US$ 458 million in 2015** under documentary collections/open account trading. Further, such trust will in future promote trade among countries in the region thus increasing trade significantly.

23. The availability of a smooth and fast payment platform will increase trade which is projected to grow by 6% between 2015 and 2020.

24. With an increase in intra-COMESA imports from **US$ 10.9 billion in 2013** to a projected amount of **US$ 16.4 billion in 2020** our region would make an estimated savings of **US$ 572 million in 2020** if the totality of the payment for that trade is channelled through REPSS.

25. Governors were informed that the REPSS User Group agreed on the setting up of a COMESA Oversight Committee whose purpose would be:

1) Self-assessment to identify points of operational weaknesses in REPSS and correct them in a pro-active manner;
2) Identify various risk issues and concerns; and
3) Follow International standards of CPSS-IOSCO principles for “Financial Market Infrastructure” which mitigate risks in a collective manner.

26. The User Group had come up with the REPSS Oversight Committee Framework and comments from some Central Banks on the proposal would be discussed at the next User Group Meeting prior to its submission for consideration and approval by the Bureau.

27. Governors noted the focus for 2015 with regards to REPSS as follows:

i) There is tremendous support for the system from all stakeholders. Training and sensitisation continues to be carried out by Central Banks, COMESA Clearing House and COMESA with a view to explaining the functionalities of the system, presenting its objectives and benefits, training Central Bank Staff, getting buy-ins of commercial banks and stakeholders and ensuring Central Banks and commercial banks readiness.

ii) REPSS use will grow as the Central Banks of Egypt and Sudan begin live operations in 2015 and join the Central Banks of DRC, Kenya, Malawi, Mauritius, Rwanda, Sudan, Swaziland, Uganda and Zambia already live on the system. It is also very important for those Central Banks that have not yet completed their preparations to go live, to do so in earnest.

28. Governors also noted the following comments and suggestions of the experts:

(i) The current status of implementation for the Central Bank of Congo should be updated to show that several transactions have been processed on the system;

(ii) The Bank of Uganda should be shown as being live and actively transacting on the system;

(iii) The Central Bank of Sudan will be completing the final tests for live operations and is expected to speedily start to transact on the system not later than 31st December, 2015;

(iv) The Central Bank of Egypt is currently finalizing the necessary technical work and will be completing the final tests for live operations. It has scheduled to start to transact on the system by the end of January 2016;

(v) As part of its internal preparations, the Central Bank of Madagascar is in the process of completing technical studies required for the interfacing of REPSS with its RTGS to enable Straight Through Processing (STP). The findings of the study will chart the next steps to be adopted by the Central Bank of Madagascar with the regards to the implementation of the system;

(vi) The Central Bank of Burundi is currently carrying out the required testing on the system and will be completing its internal preparations prior to conducting the final tests for live operations. It will also be holding the sensitisation workshop and training of its staff on the system during the first quarter of 2016;

(vii) The Central Bank of Djibouti will be starting its preparations for sensitisation during the first quarter of 2016;

(viii) The Bank of Uganda and the Central Bank of Kenya are actively transacting on the system. There is, however, need for the Secretariat to come up with a uniform and well-crafted message that clearly depicts the benefits of making and receiving payments through REPSS and the respective Central Banks. This message should then be sent to all Central Banks for customisation and issue to their respective print media.

DISCUSSION

29. Governors noted the proposal of the Secretary General of COMESA with regards to going beyond the crafting of uniform messages for stakeholders and for making available at commercial banks relevant documentation for effecting transactions through REPSS.

30. Governors were informed that documentation relating to REPSS and a REPSS Application Form for use by bank customers were made available to Central Banks for distribution to their respective commercial banks. They will be resent to Central Banks for appropriate action.

31. Governors underscored the need to work effectively and efficiently with the business community for increased use of REPSS.

32. Governors also noted that discussions were being held with the President and the Chairman of the PTA Bank with a view to making available trade finance facilities through REPSS for use by Central Banks and their commercial banks.

COMMENDATIONS

33. ***Governors commended:***

- ***i) La Banque Centrale du Congo for going Live on REPSS in April 2015;***
- ***ii) The Central Bank of Sudan for expediting the completion of final tests for live operations and for planning to speedily start to transact on the system not later than 31st December, 2015;***
- ***iii) The Central Bank of Egypt for working on the finalization of the necessary technical work and scheduling to start live operations by end of January 2016;***
- ***iv) The Central Bank of Madagascar for scheduling to complete all technical work on REPSS with a view to expediting its internal readiness and internal and external sensitisation of the system for live operations;***
- ***v) The Central Bank of Burundi for carrying out the required testing on the system and for completing its internal preparations prior to conducting the final tests for live operations and requests speedily holding of the sensitisation workshop and training of its staff;***
- ***vi) The Central Bank of Djibouti for scheduling to hold a Sensitisation Workshop and completing its internal preparations and training of its staff during the first quarter of 2016; and***
- ***vii) Commended the Central Banks of Kenya, Mauritius and Uganda for their relentless efforts in getting more transactions channelled through REPSS.***

DECISIONS

34. ***Governors noted the above Progress Report on the Implementation of REPSS and decided as follows:***

- ***i) Requested Central Banks live on REPSS to continue channelling their cross border trade payments through REPSS by liaising with their respective commercial banks in identifying such transactions and targeting importers and exporters for further transactions;***
- ***ii) Urged Central Banks that are not yet live on REPSS to expedite their preparations as the success of the system depends on the volume of trade across borders;***
- ***iii) Requested the Secretariat to come up with a uniform and well-crafted message that clearly depicts the benefits of making and receiving payments through REPSS and the respective Central Banks. This message should then be sent to all Central Banks for customisation and issue to their respective print media;***
- ***iv) Requested the Chairman and the President of the PTA Bank to make available trade finance facilities on REPSS for utilisation by Central Banks and their commercial banks; and***

v) Documentations relating to REPSS and the REPSS application form for use by bank customers should be resent to Central Banks for appropriate action.

Report on the Activities of the COMESA Monetary Institute *(Agenda item 4(III))*

35. Governorsnoted the following activities of CMI which were carried out in 2015:

Trainings:

36. The Institute organised the following trainings:

(i) Macroeconomic Modelling and Forecasting in collaboration with Bank of England;
(ii) Advanced training on Panel Data;
(iii) International Reserve Management in collaboration with Central Bank of Egypt;
(iv) Modelling Volatility in Financial Markets within a Multivariate Framework;
(v) Financial Stability, Systemic Risk and Macroprudentilal Policy.

Research Activities

37. The Institute conducted research on the following:

(a) Effects of Fiscal Policy on the Conduct and the Transmission Mechanism of Monetary Policy, using experts from member Central Banks. A workshop was held to validate the research papers. The Final papers will be published as a knowledge product in 2016.
(b) Roles of Fiscal policy for Enhancing Domestic Resource mobilisation.
(c) Macroeconomic developments in the COMESA region in 2014.

Other Activities

(i) Prepared a Guideline for Appropriate Institutional Governance Framework for Implementation of Macroprudential Policy in the COMESA region;

(ii) Prepared a knowledge product on research papers, which were undertaken in 2014. The knowledge product will be published in 2016.

(iii) Prepared the proceedings of a workshop on microfinance development which was organized by CMI with financial and technical assistance from African Development Bank and Alliance Forum which will be validated by microfinance practitioners in early 2016 and will be published as a knowledge product. The book will also contain a model microfinance strategy for the region.

(iv) Made all the necessary technical and logistical preparations to hold the COMESA Monetary Cooperation Meetings and the Inaugural meeting of the Convergence Council.

38. Governors took note of the above activities and commended the COMESA Monetary Institute for the good performance achieved in 2015 by implementing all the activities in its 2015 Work Plan.

Report on Macroeconomic Development by Member Countries in 2014 *(Agenda item 4(IV))*

39. Governors noted the following, progress made in macroeconomic convergence in 2014:

a) Major Developments in Macroeconomic Indicators in 2014

(i) Average Growth in COMESA Region in 2014 was 6.4% up from 6.3% in 2013. Major factors that affected growth in 2014 are the following:

- Increased trade and investment ties with emerging economies;
- Greater domestic demand underpinned by new, urbanizing consumers with rising income, and public investment on infrastructure. External demand has remained mostly subdued in most countries, because of unsatisfactory performance in exports due to reduced demand from advanced and emerging economies.
- Improved Economic Governance and management;
- Increase in investment-This not only boost short term demand but more importantly its positive supply effects improve growth potential over the longer term.
- Improved business environment which enhances long-term growth prospects.
- Supply side is mostly driven by agriculture, extractive industries, construction and services. Manufacturing remains small in most countries by lack of skilled labour, poor transport infrastructure and unrealistic and expensive energy.
- Lower oil prices.
- The medium term outlook for the region's growth is subject to among others to the following risks and uncertainties.

  - Slowdown in global growth
  - Instability in global commodity prices;
  - Weather related shocks that can affect agriculture.

(ii) Low commodity prices negatively impacted the growth performance of commodity exporting member countries.

(iii) Savings rate in most COMESA member countries is below 20% of GDP. This resulted from the fact that large proportion of the population is not connected to the Financial system; and therefore has no access to savings instruments. It is necessary

to generate an adequate level of domestic savings in order to ensure higher level of sustained investment.

(iv) A number of COMESA member Countries record investment performance of less than 20% of GDP. This is not sufficient to move the economies into virtuous cycle of higher investment and higher growth.

(v) Inability to create enough jobs for increasing labour force- - This requires increase in investment in both the public and private sector as well as adequate human capital with sufficient skills;

(vi) The region's average fiscal deficit excluding grants as a percentage of GDP widened from 6.8% in 2013 to 9.1% in 2014. This resulted from among other things, the increased spending on investment on infrastructure and pro poor programmes. Other factors which lead to deteriorating fiscal balance include among others, weak public spending controls and deteriorating relations of some countries with foreign donors.

(vii) Region wide inflation declined marginally from 8.0% in 2013 to 7.4%% in 2014. This is explained by:

- Lower oil prices
- Relatively lower global food prices;
- Improved domestic food supply in a number of countries
- Prudent macroeconomic policies in many member countries;
- Some countries experienced an increase in annual inflation rate due to exchange rate depreciation.

(viii) Monetary policy in most member countries focused on controlling inflation. In 2014 some member countries were able to tap international market by issuing bonds denominated in foreign currencies member countries.

(ix) Significant depreciation of currencies were seen in a number of member countries primarily due to widening current account deficit. Widening current account deficits resulted from: persistent trade imbalances; and in some cases late disbursement of external aid flows. This mainly resulted from high public sector demand for foreign exchange to finance big public investment projects, a strong dollar and high demand for foreign exchange from the local corporate sector. The countries were exchange rates were under pressure, responded by tightening monetary policy.

(x) In 2014, the average level of external reserves for the COMESA region was sufficient for 3.64 months of imports of goods and services which is less that what is required in COMESA macroeconomic convergence criteria.

(xi) The overall assessment of progress made in macroeconomic convergence in COMESA in 2014 shows that the fiscal criteria was missed by 7 out of 19 member countries. Assessment of the inflationary situation in 2014 indicates that 7 countries missed the criteria. Level of international reserves were missed by 13 countries, The assessment shows that the performance of

COMESA in respect of compliance with the secondary criteria as regards to the use of indirect monetary policy instruments, moving towards market determined exchange rates; adherence to the Core Principles of Bank Supervision and Regulation and adherence to the Core Principles for Systematically Important Payment Systems were in the right direction.

40. Governors noted that some member countries do not submit their reports on time and consequently CMI had to use alternative sources of data to analyze the progress made in macroeconomic convergence. Governors also underscored the importance of reporting by member countries to CMI, the most recent developments in macro variables that are readily available such as inflation rate, exchange rate, level of external reserves, among others.

41. Governors noted the following structural policy measures that will enable the achievement of sustained real growth and macroeconomic stability:

- Continuous improvement in business environment, political and economic governance, and economic management to enhance productivity in sectors where a member country has comparative advantage.
- Address deficits in infrastructure, technology and human capital by mobilizing domestic resources innovatively. This can be accomplished by, for example, improving public sector management; combating tax evasion and illicit financial flows, deepening financial system, issuing infrastructure bonds; developing sovereign wealth funds, e.t.c.
- Accelerating regional integration and enhancing the implementation of the Tripartite Free Trade Area arrangement, to boost intra-regional trade in manufactured goods.
- Shifting resources from low to high productivity sectors of the economy is crucial to moving the region's economy towards higher productivity sectors, thereby boosting job creation and reducing the informal sector.
- Expanding the financial system to reach the majority of citizens through appropriate innovative financial reforms.
- Adequate human capital, i.e, skilled people who work with technologically advanced investment goods and enterpreneurs with innovative skills and the ability to find new business opportunities.
- Broadening the tax base and improving tax administration.

DECISION

42. ***Governors urged all Central Banks to submit their end of year reports to CMI by 1st July of the following year. The reports should also include recent developments in macro-economic variables which are readily available such as exchange rate, inflation rate, adequacy of international reserves, amongst others.***

Report of the Thirteenth Meeting of the Monetary and Exchange Rates Policies Sub-Committee (Agenda item 4(V))

43. Governors noted the following from the report of the Monetary and Exchange Rates Policies Sub-Committee:

The Effects of Fiscal Policy on the Conduct and Transmission Mechanism of Monetary Policy *(Agenda Item 8 a(i))*

44. Governors were informed that research papers were prepared by experts from Central Banks of Burundi, Egypt, Kenya, Malawi, Mauritius, Rwanda, Swaziland, Sudan, Uganda, Zambia and Zimbabwe. The papers focused on the following:

(i) Key features of the operational framework for fiscal and monetary policy and interaction between fiscal and monetary policies;
(ii) Theoretical and empirical literature on the different channels through which fiscal policy can affect monetary policy;
(iii) Trends in fiscal performance including trends on dependence on foreign borrowing and grants;
(iv) Review of existing legal and institutional development which are necessary in order to avoid fiscal dominance and to ensure effective coordination of monetary and fiscal policies;
(v) Challenges facing the existing fiscal policy regime;
(vi) Empirical analysis of the channels in which fiscal policy affects monetary policy; and
(vii) Recommendations.

45. Governors noted the following salient features of the research papers:

A. Key features of Fiscal and Monetary Policies in COMESA member countries in recent years

(1) Fiscal Policy

46. Governors were informed that the following are key features of fiscal policy in selected countries:

(i) Many countries introduced Public Finance Management System (PFM). PFMs require that the budget is comprehensive by including all financial operations of the Government. Thus both the current and capital budget should be included under one budget and aid and debt, as well as other off-budget items (including contingent) must be captured in the budget. Such a comprehensive sweep of the budget would facilitate coordinating fiscal policies within a macroeconomic policy framework and enable assessment of the sustainability of fiscal policies over the short and medium term. Having a robust PFM by member countries is one of the requirements of the COMESA Multilateral Fiscal Surveillance Framework.
(ii) Many Member countries are making significant progress in preparing their budgetary policies within a comprehensive medium term financial management framework, comprising a set of four separate

frameworks: A Medium Term Fiscal Framework (MTFF), a Medium Term Budget Framework (MTBF) and Medium Term Expenditure Framework (MTEF). The COMESA Multilateral Fiscal Surveillance Framework is based on the availability of all the four components of the Medium Term Financial Management Framework. However, their development in member countries is constrained due to insufficient availability of data, and capacity for data analysis which could only be built from the medium to long run.

(iii) The institutions and laws governing fiscal policy are enshrined in legislation and often derived from constitution.

(iv) All countries have legal systems that define functions and responsibilities of the Ministry of Finance in the country's debt management process. This also specifies the limit of indebtedness and guarantees that the country can undertake. This strengthens fiscal discipline in the country and ensures that the country remain on a prudent fiscal path.

(v) Many member countries undertook the following tax reforms:

- Significant attempt has been made by most member countries to reduce reliance on the taxation of international trade and to shift the tax system toward domestic transactions and sources of income.
- VAT was introduced in almost all member countries. Tax reforms have also been instrumental in shifting excises from a specific to an *advalorem* valuation basis.
- Almost all countries have simplified and improved the equity and efficiency of their personal income taxes by scaling down the highest marginal rates, reducing the number of rates, and reducing exemptions and deductions.
- Tax administration in almost all countries has improved through better training and salaries and conditions of service for revenue collection personnel. Special emphasis was placed on providing adequate trained manpower and other infrastructural facilities to enable the attainment of revenue potential.

(vi) Some countries use countercyclical interventions when the economy is below or above potential growth path. Countercyclical expenditures involves increasing public spending when the economy is growing below its long run potential, and decreasing it when output rises close to potential and is threatening to cause resource scarcities that provoke inflationary pressures.

(2) Monetary Policy

47. Governors observed that the following are key features of monetary policy in selected member countries:

(i) The overriding objective of monetary policy for most central banks is price stability. Other objectives pursued by many central banks in the region in recent years include financial stability and economic growth.

(ii) Most COMESA member countries removed exchange controls and adopted a more flexible exchange regime.

(iii) Most countries moved from direct to indirect monetary management. This includes establishment of open market operations for monetary policy purposes and to improve liquidity management. Some countries introduced framework for repurchase and reverse repurchase transactions. In some countries for example Mauritius, Key Repo Rate (KPR) acts as a policy rate to signal its monetary policy stance.

(iv) Many countries still use base money or reserve money as operational target in the conduct of monetary policy while broad money has been used as the intermediate target with inflation being the ultimate target.

(v) Many countries are embarking on modernizing their monetary policy framework with the ultimate objective of adopting an inflation targeting monetary policy framework. Some countries have introduced policy rates. The motivations for modernizing the monetary policy regime are to enhance market participants understanding of the monetary policy stance and to strengthen the monetary policy transmission channel, particularly the interest rate channel.

(vi) Some countries like Mauritius, Kenya and Swaziland are making remarkable attempts on inflation targeting approach in the conduct of monetary policy.

(vii) Most central banks have Monetary Policy Committees with diverse membership.

(3) Channels of Interaction between Monetary and Fiscal Policy

48. Governors also noted that the following are direct and indirect channels through which fiscal policy affects monetary policy in selected countries:

(i) Fiscal policy influences demand pressures and thus impacts inflation, via both direct spending by government and changes to private disposable income (through taxation and the benefit system). In particular, through the monetization of the fiscal deficits, fiscal policy undermines monetary policy as it fuels inflationary pressures. Even in the absence of monetization by the central bank, higher deficits may cause inflation, as the government's borrowing requirements will increase the net credit demands, drive up interest rates and crowds out private investment. The resulting reduction in economic growth would lead to a decrease in the amount of goods available for a given level of cash balances, causing higher price levels;

(ii) Fiscal policy affects monetary policy directly through indirect taxes. If governments resort to substantial increases in indirect taxes-sales taxes, value added tax - this would have a direct impact on prices through the wage- price spiral;

(iii) Perceptions and expectations of huge budget deficits, and resulting large borrowing requirements are likely to trigger a lack of confidence in the economic prospects, posing risks to financial system stability;

(iv) On the external side, there are risks of too much dependence on foreign funding of domestic debt, arising from unsustainable fiscal deficit. This may result in exchange rate and/or balance of payment crisis which are worrisome to central banks;

(v) Fiscal policy affects monetary policy through both domestic and public debt depending on its sustainability. If market participants perceive the growth in domestic/public debt as unsustainable, the credibility of the overall policy mix is reduced and interest rates will rise. Also, adverse shocks to external indebtedness tend to shift the long run interest rate spreads. Wider interest rates spreads lead to higher yields on government bonds and to higher commercial interest rates.

(4) Coordination of fiscal and monetary policies

49. Governors took note of the following findings on the coordination of monetary and fiscal policies in selected COMESA member countries:

- For most countries there is weak coordination of fiscal and monetary policies;
- For some countries like Mauritius and Rwanda there is structured well-functioning coordination between monetary and fiscal policies;
- For some countries (Mauritius and Egypt) the central bank have institutional and instrument independence for the conduct of monetary policy.

B. Challenges for Implementation of Fiscal and Monetary Policies

(1) Fiscal Policy

50. Governors observed that the following are some of the challenges for fiscal policy implementation in selected COMESA member countries:

(i) Low level of private savings partly because of low income levels due to high levels of poverty.
(ii) A sizeable portion of most developing economies is non-monetized, rendering fiscal measures of the government ineffective and self-defeating.
(iii) External shocks on commodity prices such as oil, copper price shocks and external debt in most member countries affect the stance of fiscal policy.
(iv) In a number of countries, fiscal policy effectiveness is hindered by the difficulty to generate direct tax revenues; the inefficient collecting schemes of taxes; low rates of taxes on property; and a decline in taxes on international trade due to tariff reductions, trade agreements, and discretionary exemptions.
(v) Lack of statistical information as regards the income, expenditure, savings, investment, employment etc. This makes it difficult for the public authorities to formulate a rational and effective fiscal policy.
(vi) Fiscal policy requires efficient administrative machinery to be successful. Most developing economies have corrupt and inefficient administrations that fail to implement the requisite measures vis-à-vis the implementation of fiscal policy.
(vii) Gaps in the legal and institutional framework governing fiscal policy in some countries.

(viii) Significant powers and responsibilities given to the Minister of Finance which could create fiscal dominance and thereby render monetary policy ineffective.
(ix) Huge external debt which result in serious repayment difficulties.
(x) Huge increase in recurrent expenditure such as wages and salaries, interest payment on domestic debt, subsidies, grants and social benefits expenditure.
(xi) In some countries, the government crowds-out the private sector and distorts any investment and development prospects because of the limited financial resources.

(2) Monetary Policy

51. Governors also noted that the following are some of the challenges of implementation of Monetary Policy in selected COMESA member countries:

(i) For some countries, there is no central bank independence and there is lack of transparency in monetary policy conduct and implementation:

- No publication of the discussion of the MPC and MPAC.
- No provision for external membership in the MPC, and no provision for the publications of inflation forecasts to guide expectations.
- The tenure of the governor and board members are not protected in constitution thereby creating vulnerability of the Banks' independence.

(ii) In some countries, increased domestic borrowing has led to higher market lending rates and the crowding out of the private investment.
(iii) In some countries, currency outside banks or chronic excess liquidity posed serious challenges to the effectiveness of monetary policy.

(3) Empirical Results

52. Governors further noted that the following are some of the empirical findings of the studies:

(i) Test for Fiscal Dominance (FD)

- In some countries (Sudan, Zambia and Zimbabwe) there is some evidence of fiscal dominance for some periods.
- In some countries (Egypt, Swaziland) fiscal deficit has a long run statistically significant relationship with inflation and output. In Egypt, a shock to the real government's expenditure plays a stimulating role to the economy via its persistent negative impact on interest rate and its continuous positive influence on output and prices. In Mauritius, fiscal policy has significant impact on inflation and other macroeconomic variables, and there is evidence of government spending being supportive of private investment through multiplier effects on aggregate demand and business optimism.

(ii) Effect of Fiscal Stance on Monetary Transmission Mechanism

- In Zambia shocks to fiscal deficits leads to rising interest rates (Treasury bill rate, Inter-bank rates and the average lending rates), interest rate spreads, and depreciation of the real effective exchange rate. Fiscal policy was mostly counter-cyclical in the period 1994-2003 while it was pro-cyclical from 2003 to 2014.
- In Zimbabwe, the effects of fiscal policy shocks on money supply and interest rates are positive. Inflation dynamics have largely been influenced by inflation persistence and other factors besides fiscal and monetary policy variables. Large proportion of the variation in economic activity is explained by fiscal policy shock.
- In Mauritius and Sudan, money supply and exchange rate had noticeable impact on inflation. In Sudan, output growth played a crucial role in reducing inflationary pressures.

DISCUSSION

53. Governors noted the comments of the validation workshop that some of the research papers did not meet the required standard and needed to be revised. They also noted that the revised final papers will be submitted to CMI. They, therefore, agreed that all the recommendations could only be considered after the finalization of the research work.

DECISION

54. ***Governors decided that recommendations from the research work would be considered after submission of the final papers.***

Challenges of Dollarization to COMESA Member Countries *(Agenda item 8 a(ii))*

55. Governors noted the following definition and various facets of dollarization:

- Dollarization occurs when a country adopts the currency of another as a legal tender (not necessarily restricted to the US Dollar). The domestic money is either replaced or used in parallel with the foreign currency.
- There are various forms in which dollarization can happen, which include asset, liability, partial and full dollarization.
- Official full dollarization occurs where a Government endorses, through political consensus, a foreign currency as having the exclusive status of legal tender in a country and abandons the use of its national currency.
- With full dollarization, a country completely gives up control of monetary and exchange rate policy; and
- Semi-official dollarization refers to a situation where both the local and the foreign currencies are used as legal tender.

A. Causes of Dollarization in COMESA region

(i) Large macroeconomic imbalances and hyperinflation;
(ii) Financial repression and capital controls;
(iii) Underdeveloped financial markets - domestic borrowers contract debt in foreign currencies in response to the lack of domestic currency alternatives in incomplete financial markets.

B. Costs of dollarization

(i) Immediate loss of monetary policy autonomy and the benefits of seigniorage (the profits accruing to the monetary authority from its right to issue currency – buy back "stock" of domestic currency or giving up future seigniorage earnings gained by issuer country unless there is agreements to share the same).
(ii) Country also lose the "exit option" to devalue in face of major exogenous shocks (Berg and Eduardo, 2000).
(iii) Dollarization also increases the susceptibility of the host country's economy to shocks in the anchor country.
(iv) The Central Bank loses the lender of last resort function – Central banks lacks instruments to influence monetary aggregates and anchor private sector expectations of inflation.
(v) Dollarization may lead to loss of political sovereignty.
(vi) For a country with a small export base, dollarization also leads to liquidity problems and hence lowers economic growth (Nota and Sakupwanya, 2013).
(vii) Liquidity risk - Sudden changes in investor and depositor perceptions about the health of the banking system may result in a deposit run and compromise international reserves holding.
(viii) Balance sheet risks - tend to arise in cases of partial dollarization. Banking sector vulnerabilities may be heightened because of direct exchange rate risks that result from currency mismatches in banks' balance sheets.
(ix) The absence of monetary and exchange policy - may induce more volatility of GDP, and exposes the economy to shocks and other vulnerabilities that the Central Bank and Government are not able to offset.
(x) Dollarization may disable the Central Bank and Government to issue domestic financial instruments, resulting in limited money market and inter-bank trading activities.
(xi) Under dollarization, the flexibility to use exchange and monetary policy is limited, and with it also, the inability of authorities to implement counter-cyclical measures.

C. Benefits of Dollarization

(i) Dollarization being an irreversible institutional change leads to lower inflation, fiscal responsibility and transparency.
(ii) Reduces country risk premium on foreign borrowing, obtaining lower interest rates and leads to higher investment.
(iii) Inability of the Central Bank to embark on expansionary monetary policies also bestows a measure of confidence in the economy, thereby

helping to lock away damaging and often self-fulfilling inflation expectations.

(iv) The absence of currency risk helps to eliminate externally induced banking and financial crises.

(v) The absence of seignorage induces more fiscal discipline, while the absence of a lender of last resort induces banks to seek for alternative contingent funds. This gives a competitive edge to international banks over domestic banks inducing a more stable international banking system.

(vi) Dollarization makes economic integration easier, establishes a firm basis for a sound financial sector and thus promote strong and steady economic growth.

(vii) Dollarization also bring about a closer integration in financial markets

(viii) Dollarization avoids currency and balance of payments crises. Without a domestic currency there is no possibility of a sharp depreciation, or of sudden capital outflows motivated by fears of devaluation.

(ix) By definitively rejecting the possibility of inflationary finance through dollarization, countries strengthen their financial institutions and create positive sentiment toward investment, both domestic and international.

56. ***Governors noted the following recommendations from the study:***

(i) ***There is need for countries to avoid policies that may lead to stagflation and severe macroeconomic disruptions which precipitates the need for dollarization.***

(ii) ***Successful de-dollarization requires implementation of an appropriate mix of sound macroeconomic policies, market-based incentives, and microprudential measures including:***

a) Active bank supervision to ensure that banks fully cover their foreign currency loans positions

b) Having a higher reserve requirement on foreign currency liabilities helps make such liabilities more costly

c) Maintaining a sufficient level of international reserves

d) Regulations to encourage use of local currency (e.g. prices to be denominated in local currency)

e) Policies that promote use of the local currency for payments through convenient and lower-cost services than for foreign currency

f) Moving toward risk-based supervision could help better monitor risks taken by banks in extending credit.

Training on International Reserve Management *(Agenda Item 8 b(i))*

57. Governors were informed that the training was held in Cairo, Egypt from 19th to 30th April 2015 in collaboration with Central Bank of Egypt.

58. Governors noted that the training covered the following topics: International Reserve Management Guidelines; Repurchase Agreement, Derivatives and SWAPS, Performance Measurement Tools; Bonds basics; Financial Risk Management;

Active/Passive Bond Portifolio Management, Forwards and Futures; Benchmark Selection; Value at Risk (VaR); Risk Budgeting; Risk Measurement; Strategic Asset Allocation (SAA); and Managing External Managers Portifolio.

59. Governors were informed that all presentations were followed by hands-on practical exercises using Excel Spread Sheet using as an example, the experience of Central Bank of Egypt. During the discussions, participants shared their country experiences. The presentations on Repurchase Agreements, derivatives, swaps, Financial Risk Management, Forward and Futures were followed with demonstrations using slides from Bloomberg.

60. Governors noted that the participants appreciated the depth of the training. It was also observed that participants gained a deeper practical as well as theoretical understanding of international reserve management.

61. Governors agreed that the knowledge shared and the networking gained by participants will enable them to effectively implement international reserve management policies in their respective countries.

62. Governors noted that participants appreciated the study visit to the Central Bank of Egypt Reserve Management Unit where they were exposed to live trading on the Bloomberg Screen.

63. Governors observed that the feedback from participants indicates the following key outcomes were achieved by the training:

(i) It provided hands on training, knowledge sharing and networking between COMESA Member States' central banks on international reserve management;
(ii) It provided a deeper understanding of best international reserve management practices; and
(iii) It enhanced the skills of the participants to provide effective policy advice and decision making in the field of international reserve management.

64. Governors thanked Central Bank of Egypt for supporting CMI in organizing the training on international reserve management.

65. Governors noted that Central Bank of Egypt offered again to support CMI to organize training on liquidity, interest rates and exchange rate risks management in 2016. The rationale for the offer was the importance of mitigation of major risks in day-to-day operations of central banks.

66. Governors thanked the Central Bank of Egypt for the continuous valuable support for capacity building in member countries.

Decision

67. ***Governors decided that CMI should organise a training on liquidity, interest rates and exchange rate risks management for Central Banks in collaboration with Central Bank of Egypt in 2016.***

Training on Modelling and Forecasting Time Series and Panel Data *(Agenda item 8 b(ii))*

68. Governors were informed that CMI organised the training from 2nd to 13th February 2015, in Kampala, Uganda. Drawing on the theory and on practical applications, the trainings were structured as follows:

a. 2nd to 6th February 2015, training on Time Series Econometrics facilitated by Centre for Central Banking Studies (CCBS) experts from Bank of England;
b. 9th to 13th February 2015, training on panel econometric facilitated by COMESA regional experts

69. Governors noted that the overall objective of the training was to develop capacity of staff involved in modelling and forecasting in Central Banks and Ministries of Finance in COMESA member countries. More specifically, the course aimed at:

a. Providing hands on training on time series and panel data econometrics to participants using EVIEWS 8.
b. Enhancing the understanding of how to assess the applications of time series and panel data analysis reported in applied economics literature.
c. Deepening know how on the use of time series and panel data sets to conduct research.
d. Contributing to knowledge sharing and networking between COMESA member states on Macroeconomic Modelling and Forecasting.

70. Governors were informed that the following topics were covered under each training:

a) Training on Modeling and Forecasting Time Series facilitated by Center for Central Banking Studies (CCBS) of Bank of England, 2-6th February 2015.

(i) Time series modeling;
(ii) Vector Auto-regressions (VARs) and Structural VARs
(iii) Modelling unobserved economic components
(iv) GARCH Models and Stochastic Volatility
(v) Conditional Point , range and density forecasting with VARS

b) Training on Panel Econometrics

(i) Regression analysis with individual-specific (and time specific) hetrogeniety (fixed and random effect models;
(ii) Dynamic models for panel data;
(iii) Non-stationary panels: Unit root and cointegration analysis

71. Governors were also informed that the presentations were followed by hands on training and guided group exercises using EVIEWS 8. The objective of group

exercises was to ensure that the participants have gained the required skills. Presentations were also made to the plenary by the groups.

72. Governors noted that the training provided the participants with the necessary analytical tools on modeling both time series and panel data.

73. Governors also noted from the feedback from the participants that the training will contribute to enable member countries to:

a. Design, formulate and implement economic policy measures based on empirical evidence;

b. Develop their own macroeconomic modelling framework; and

c. Develop specific models such as monetary transmission mechanism, fiscal deficit management etc.

DECISION

74. ***Governors decided that CMI should continue organizing training on Macroeconomic Modelling and Forecasting in collaboration with the Centre for Central Banking Studies (CCBS) of the Bank of England and other Centres of Excellence in other regions, in order to increase the outreach of the training to more staff from Central Banks and Ministries of Finance in the region.***

Work Plan of the Monetary and Exchange Rate Policies Sub-Committee for 2016 *(Agenda item 8(c))*

75. Governors approved the Work Programme for the year 2016 for CMI as outlined in the table below.

No.	Theme	Activity	Responsibility	Completion Date
1.	Promote Monetary Integration	(i) Country Specific Study on the Impact of External Shocks on Effectiveness of Monetary Policy; (ii) Lessons from Euro Debt Crisis and Implication for COMESA Monetary Integration Programme (iii) Knowledge product On "The Effects of Fiscal Policy on the Conduct and Transmission Mechanism of Monetary Policy in selected COMESA Member countries (iv) Estimating and forecasting volatility in short-term exchange rate using the GARCH models (v) Analysis of direct and spill-over effects of exchange rate volatility on inflation using GARCH models (vi) Country Specific Studies on the recent experience on mitigating the effects of exchange volatility on member countries' economies (vii) Training on corporate governance for Central Banks	CMI KSMS, US Treasury and CMI	June 2016

2.	Capacity building	(i) Training on Macroeconomic Modelling and Forecasting in collaboration with Bank of England (ii) Training on Advanced Panel Data Analysis with special application on (a) Channels of monetary transmission mechanism; (b) Interest rate spread (iii) Training on liquidity, interest rates and exchange rate risks management for Central Banks in collaboration with Central Bank of Egypt.	CMI & Bank of England CMI & Central Bank of Egypt	June 2016

Report of the Tenth Meeting of the Financial System Development and Stability Sub-Committee *(Agenda item 4 (VI))*

Report on the Status of Implementation of the recommendations of the 9th meeting of the Financial System Development and Stability

76. Governors noted that the Draft Manual for assessing SHIELDS to all member countries was not prepared due to very huge data requirements. They also noted that the 10th Meeting of the Financial System Development and Stability Sub-Committee recommended the use of simpler tools such as the Financial Index and Cobweb diagram. Governors noted that the alternative approaches are not replacements to SHIELD rating which is a better tool for undertaking forward looking financial stability assessment.

DECISIONS

77. ***Governors decided as follows:***

(i) CMI should work with the Bank of Uganda and the Reserve Bank of Malawi who volunteered to pilot the implementation of S.H.I.E.L.D.S before rolling out its application to other Central Banks; and

(ii) CMI should request IMF for technical assistance for the organisation of a workshop on Enhanced General Data Dissemination Standard (EGDDS). This might also address the heavy data requirements of S.H.I.E.L.D.S rating.

78. Governors noted the following from the Report of the Meeting of the Financial System Development and Stability Sub-Committee:

Report by Member Countries on Implementation of the COMESA Assessment Framework for Financial System Stability *(Agenda item 4(VI)(a))*

79. Governors noted that delegates from member countries had reported on the status of implementations by member countries of the COMESA Assessment Framework for Financial System Stability as contained below in table 2. Governors noted the following from member countries reports:

(i) Most COMESA member states have set up Financial Stability Units;

(ii) The member states are at various stages of setting up the Financial Stability Committees;

(iii) Implementation of Forward looking Financial Stability Reports was still work in progress for most Member countries; and

(iv) Member states are at different levels of compliance to the revised Basel Core Principles on Effective Banking Supervision.

Table 2: Status of Implementation of the COMESA Financial Stability Assessment Framework by 8 Member States

No.	Task	Activity	Completion Date	Status of Implementation	
				Implemented	Work In Progress
1	Financial Stability Unit	Establish a Financial Stability Unit	June 2015	Burundi, Egypt, Kenya, Sudan, Madagascar, Malawi, Swaziland Uganda, Zimbabwe, DRC, Zambia	
2	Financial Stability Committee	Establish a multi-disciplinary Financial Stability Committee	June 2015	Burundi, Egypt, Kenya, Malawi, Swaziland Uganda, Madagascar, Sudan, Zimbabwe, Zambia	DRC
3	Develop action plan for implementation of COMESA Framework for Financial Stability Assessment	Prepare Forward looking Financial Stability Reports	30 June 2015		Burundi, Egypt, Kenya, Malawi, Swaziland, Uganda, Madagascar, Sudan, Zimbabwe, DRC, Zambia
		Implementation of macro-prudential policies[1]	30 June 2015		Kenya, Egypt Malawi, Swaziland, Uganda, Madagascar, Sudan, Zimbabwe, DRC, Zambia
4	Report on Compliance to the revised Basel Core Principles on	Extent of Compliance to the revised Basel Core Principles on Effective Banking Supervision[2]	30 June 2015		Egypt, Kenya, Malawi, Swaziland, Uganda, Madagascar,

[1] This requires clarity in overall/final objective/mandate of macroprudential policy, identification of key risks/triggers, Mapping, monitoring indicators and stress testing and having a robust Policy toolkit/instruments including counter cyclical buffers.
[2] Member countries will provide extent of compliance, none compliance or none applicability of the revised core principles before the next sub-committee meeting.

	Effective Banking Supervision				Sudan, Zimbabwe, DRC, Zambia
5	Financial Stability Reports.	Electronic Submission of Financial Stability Reports to COMESA Monetary Institute (CMI).	30 June 2015	Malawi, Madagascar, Uganda, DRC	Swaziland, Sudan, Egypt Kenya, Zimbabwe
6	Financial Soundness Indicators	Electronic submission of Financial Soundness Indicators (FSIs) to COMESA Monetary Institute (CMI).	30 June 2015	Egypt, Swaziland, Sudan, Uganda, DRC	Malawi, Kenya, Madagascar, Zimbabwe

80. Governors noted that the Sub-Committee had appreciated the significant improvement of country reports with enough details that enabled member countries to learn from one another. It also noted that the Sub-Committee agreed that future reports should assess compliance to the revised Core Principles for Effective Banking Supervision clearly stipulating extent of compliance, non-compliance or none applicability.

DECISIONS

81. ***Governors decided as follows:***

(i) Future reports should provide details on compliance to the revised Core Principles for Effective Banking Supervision clearly stipulating extent of compliance, non-compliance or none applicability.

(ii) Member Central Banks should submit Financial Soundness Indicators to CMI by 30th June every year for the preceding year to enable CMI post it on its website.

Training on Modelling and Forecasting Volatility in Financial Market within a Multivariate Framework *(Agenda item 4 (VI) b(i))*

82. Governors noted that the training was designed to address salient features of financial markets volatility especially in less developed countries, where the financial markets are less developed and the cost of adjusting to changes in the economic environment is higher. Governors were informed that volatility in financial markets generates uncertainty which increases the associated level of risk and could therefore, have a major impact on financial stability and economic growth. As a result, it is a major concern in risk management and monetary policy making, among others. In view of the above, the overall objective of the training was to enable participants acquire appropriate analytical skills and rigour in modelling and forecasting volatility in financial markets. This is expected to contribute to minimization of the adverse effects of uncertainty in financial markets on macroeconomic management in particular and economic development in general.

83. Governors also noted that presentations were made on the following:

(i) Introduction to Financial market volatility and to modelling financial market volatility.
(ii) Modelling Conditional Volatility: the ARCH, GARCH, ARCH-M, GARCH-M and IGARCH Models, and models of Asymmetry (the TGARCH, EGARCH, PARCH and CGARCH models), and departure from Gaussianity, and stochastic volatility.
(iii) Estimation of the ARCH and GARCH effects, and related models, using both the popular ordinary least squares (OLS) and Maximum Likelihood techniques.
(iv) Modelling multivariate GARCH.
(v) Forecasting conditional volatility (in theory and practice) and forecast performance evaluation.
(vi) Group exercises and presentations.

84. Governors were informed that the presentations were supported by illustrations using relevant case studies. Hands on training using EVIEWS-8 as well as supervised group exercises using country specific financial data were also carried out.

85. Governors were also informed that each group made presentations on the outcomes of group exercises. This clearly demonstrated that the training had equipped the participants with the necessary analytical skills and rigour in dealing with volatility in financial markets.

86. Governors took note that the participants proposed a training to be held in 2016 on Modelling volatility in financial market with particular emphasis on forecasting and multivariate framework.

DECISIONS

87. ***Governors decided that CMI should organize training in 2016 on:***

(i) ***Modelling volatility in financial market with particular emphasis on forecasting and multivariate framework; and***

(ii) ***Econometrics and statistical techniques for Banks' supervisors and Financial Stability Practitioners.***

Training on Financial Stability, Systemic Risk and Macroprudential Policy *(Agenda item 4 (VI) b(ii))*

88. Governors were informed that the main objective of the training was to equip the participants with appropriate analytical skills and rigour on macroprudential tools relevant to COMESA member countries.

89. Governors noted the following salient points of the training under three themes namely, Assessment of Financial Stability, Systemic Risk Assessment and Macroprudential Policy.

(a) Assessment of Financial stability

90. Governors noted that the topics covered in this session included among others, monitoring financial stability in developing economies, the design of Financial Stability Reports, communication strategy and banking theory on crisis management and resolution.

91. Governors noted the following key lessons learnt under this topic:

(i) The importance of having Forward Looking Financial Stability Reports including; identification and quantification of (systemic) risks, and the ability to motivate action to prevent or mitigate systemic risks.
(ii) How to design crisis management and resolution plan. Participants were provided with hands on training on crisis resolution.

DECISIONS

92. ***Governors decided as follows:***

(i) Member States Central Banks should attempt to move towards the standardisation of Financial Stability Reports. The proposed new risk focused and forward looking financial stability report may be organised as per the following suggested outline:

Chapter 1: Overview and Executive Summary

Chapter 2: Economic and Financial Conditions: (Domestic and External) vulnerabilities to the outlook;

Chapter 3: Main Risk Scenarios (e.g. Stability implications of external demand shocks or liquidity problems on the banking system); future prospects, risks and stress tests.

Chapter 4: Conclusions and Policy recommendations: This should be recommendations for preventing systemic problems or dealing with them if prevention fails. This section may also review developments in macroprudential policy since the preceding report.

Appendix I: Special Topic: This should delve more deeply but concisely into important existing vulnerabilities and sources of risks or policy challenges.

Appendix II: Statistical Tables: Financial Soundness Indicators and consolidated balance sheet of the banking sector.

(ii) Member Central Banks should have an institutional framework to translate financial stability analysis to policy making.

(iii) CMI should conduct a study to benchmark and provide guidelines for the design of Forward-Looking Financial Stability Reports.

(b) Systemic risk assessment

93. Governors noted that the topics covered in this session included systemic risk monitoring and assessment; interconnectedness and contagion in the financial system. In addition, the stress testing of the financial system was also discussed. Practical exercises on liquidity and cash flow based stress testing were conducted. Theoretical aspects of financial risk cycles and financial stability; and approaches to mitigating systemic risk were discussed. The training also discussed identification and monitoring Systemically Important Financial Institutions. This also included practical exercises on identification of Domestic Systemically Important Banks (DSIB's). Further discussion centred on interconnectedness and contagion in the financial system. Hand on training on assessing the impact of contagion in the financial system was also conducted. Further capacity building work involved training on tools for systemic risk assessment. Hands on exercises on developing a cobweb model and financial stability indices were conducted.

94. Governors took note of the following lessons which were learnt under this topic:

(i) Importance of cross-border cooperation and coordination in assessing systemic risk.
(ii) Identification of DSIB's is vital.
(iii) The importance of making use of tools that address emerging risks in the country.
(iv) The need for a framework to conduct assessments and update them on a regular basis.
(v) Need to develop a flexible policy response to mitigate emerging macroprudential risks.

DECISIONS

95. ***Governors decided as follows:***

(i) ***Member countries should undertake work to determine their Domestic Systemically Important Banks (DSIB's) and design appropriate policies to manage risks that could be posed by these institutions.***

(ii) ***There should be cross-border cooperation and coordination in assessing systemic risks.***

(c) Macroprudential policy

96. Governors noted that this session discussed in detail macroprudential policy including aspects of implications of macroprudential policy and procyclicality with particular reference to developing countries. Participants learnt key issues in macroprudential surveillance as well as the different macroprudential measures that are being employed. The theoretical aspects of macroprudential analysis and practical challenges were also investigated.

97. Governors noted that the following key issues were identified during the training under macroprudential policy:

(i) Macroprudential oversight is meant to complement rather than replace microprudential supervision.
(ii) Macroprudential oversight encompasses an analytical component aimed at the timely detection of systemic risk.
(iii) Macroprudential oversight also includes a policy component aimed at the timely mitigation of systemic risk through financial regulation and/or ad hoc policy measures.
(iv) Institutional arrangements should be put in place to specify responsibilities, powers and interagency coordination.
(v) There is need to build robust analytical underpinnings for macroprudential policymaking because effective mitigation of systemic risk requires policymakers to monitor, measure and evaluate systemic risk.
(vi) An operational framework is essential to implementing macroprudential policy.
(vii) The framework should merge all the key aspects of the financial system, including banking institutions, the insurance and pension sectors, financial markets and payment systems.

DECISION

98. ***Governors decided as follows:***

(i) ***Member countries should have Institutional arrangements which specify responsibilities, powers and interagency coordination to undertake macroprudential surveillance;***

(ii) ***Member states should start compiling necessary data that is needed for macroprudential analysis;***

(iii) ***The Institutional arrangement should merge all the key aspects of the financial system, including banking institutions, the insurance and pension sectors, financial markets and payment systems***

(iv) ***CMI should organize trainings in 2016 on:***

(a) Basel III and Macroprudential Surveillance; and
(b) Application of stress testing in the financial system;

Validation workshop on Guidelines for Institutional Framework for Implementation of Macroprudential Policy in the COMESA Region *(Agenda item 4 (VI) b(iii))*

99. Governors noted the following key highlights of the Guidelines:

(i) Three key pillars of a Macroprudential Policy Framework are:

(a) An analytical framework aimed at identification and monitoring of systemic risk.
(b) An institutional framework aimed at ensuring a decisive and timely policy response for if and when intervention is needed. Important issues to be considered and made clear within the framework include designation of mandates and powers, issues of accountability, coordination mechanisms and decision-making processes.
(c) Once both the analytical framework and institutional framework are put into place, a set of policy measures aimed at mitigating the build-up of systemic risk can then be implemented.

(ii) Three main categories of Institutional Models for implementation of Macroprudential policy are:

(a) Full integration model where all financial regulatory and supervisory functions rest with the central bank. By having full integration of macroprudential policy under one roof, the management provides incentives for proactive delivery of information to the Board. However, full integration hands a lot of power to the central bank, which is already responsible for monetary policy.

(b) Partial integration model involves close integration between the central bank, the prudential regulator, and the regulator of systemically important financial institutions. The central bank therefore retains a strong role in systemic risk mitigation, but not full responsibility. With this model, the central bank retains access to relevant prudential data and expertise, helping risk identification. Risk mitigation is also clearly assigned to one body – the committee. On the other hand, the creation of a separate, dedicated macroprudential committee is at the expense of reduced coordination with monetary policy, potentially leading to a suboptimal policy mix.

(c) Separation model with much greater degree of institutional separation between the central bank and other supervisory agencies. The central bank is responsible for oversight of the payments system and control over the reserve requirement, but has no direct power over macroprudential tools. The identification and mitigation of risk is a multi-agency effort under this group of models. A key weakness with this model is that having multiple institutions dilutes the accountability for systemic

risk – when multiple agencies are cooperating for the desired policy outcome, no one agency is fully responsible if the cooperation fails. This can lower the incentive to cooperate in the reduction of systemic risk.

100. Governors also noted the following key aspects of the proposed institutional frameworks:

(i) A number of mechanisms to address weaknesses of institutional models are suggested. When a single agency has strong and independent powers, the use of these powers must be constrained. This can be achieved through the mandate of the policymaker, the accountability framework, and the composition of the decision making committee.
(ii) A major weakness in several models is the risk of delayed decision making. Where committee membership is large, the risk is increased. Having a clear distinction between the set up for macroprudential policy and that of crisis management reduces the need for Treasury involvement. While Treasury involvement in crisis management is crucial, strong Treasury involvement in macroprudential policy can be costly.
(iii) Full cooperation between the various agencies is needed for successful macroprudential policy, yet across several models there is the potential for a lack of cooperation. Establishing a formal coordinating committee can help to alleviate this risk.
(iv) Another challenge is that of policy coordination; a policy that may stabilise the financial sector in terms of macroprudential stability may not fit well with a policy aimed at say, price stability requiring inter agency policy coordination.

101. Governors noted the following observations of the validation workshop:

(i) The importance of taking into account cross border macroprudential issues that may arise especially when institutions being supervised have presence across borders.
(ii) The Guidelines addressed broad issues but lack clarity in proposing a clear institutional framework for COMESA region.
(iii) A disclaimer should be included at the beginning, specifying that while several of the approaches suggested in the Guidelines refer to studies and works carried out in other regions, COMESA Member Countries should therefore identify areas in the Guidelines that are best applicable to their economies.
(iv) The Guidelines should provide broad solutions to the challenges/weaknesses faced by COMESA Member countries in operationalising the three stylized institutional framework for macroprudential policy. More specifically, the Guidelines should provide solutions to the challenges identified in terms of tools, instruments and indicators that member countries can apply in line with the appendix on the experience of EAC attached to the report.

(v) The Guidelines should propose a legal framework that will empower financial regulators in COMESA Member Countries to apply macroprudential policy. The title should reflect both legal and institutional aspects in order to align it with the body of the text.

(vi) The Guidelines should be subjected to further review by sending the document to COMESA Member Central Banks for comments before the next Governors meeting.

(vii) The Guidelines should provide a more comprehensive menu of applicable tools in the analytical framework.

102. ***Governors noted the following recommendations of the validation workshop:***

(i) ***The Consultant should revise the Guidelines taking into account the observations made in paragraph 92 above.***

(ii) ***The Guidelines should clearly spell out in details the Institutional and legal framework for the 3 stylized models that could be relevant for COMESA member.***

(iii) ***The Guidelines should clearly stipulate solutions to the weaknesses/ challenges of the Proposed Framework.***

Work plan for Financial System Development and Stability Sub-Committee for the Year 2016 *(Agenda item 4 (VI) b(iv))*

103. Governors approved the 2016 work plan for the Sub-Committee which is contained in the table below.

No.	Task	Activity	Responsibility	Completion Date
1	Financial Stability Unit	Establish Financial Stability Unit	Member Central Banks	June 2016
2	Financial Stability Committee	Establish a multi-disciplinary Financial Stability Committee	Central Banks that have not established	June 2016
3	Action Plan	Develop in-country Action Plan for Implementation of COMESA Framework covering: • Development of capacity on sound Macroprudential analysis; • Forward Looking Financial stability reports; • Implementation of macroprudential policies	Member Central Banks	June 2016
4.	Submission of Forward Looking Financial Stability Reports	Electronic submission of Financial Stability Assessment Reports to the Secretariat for posting onto the COMESA website	Member Central Banks	September 2016

5	Financial Soundness Indicators	Electronic submission of Financial Soundness Indicators (FSIs) for banking sector to the Secretariat for posting onto the COMESA website	Member Central Banks	September 2016
6	Compliance to the Revised Basel Core Principles	Report Compliance based on Revised Core Principles	Member Central Banks	September 2016
7	Capacity Building and other activities	Conduct training on the following: (i) Basel III and Macroprudential Surveillance; and (ii) Application of stress testing in the financial system; (iii) Modelling volatility in financial market with particular emphasis on forecasting and multivariate framework (iv) Econometrics and statistical techniques for Banks' Supervisors and Financial Stability Practitioners	CMI/Member Central Banks	August 2016
8	Studies	(i) Finalization of the Guidelines on Institutional and legal framework for the 3 stylized models that could be relevant for COMESA member countries (ii) Piloting of the implementation of S.H.I.E.L.D.S;	CMI CMI / Bank of Uganda / Reserve Bank of Malawi	August 2016 October 2016

Presentations on Topical Subject(s) of Direct Interest to the Governors (*Agenda item 5)*

104. A representative of the Central Bank of Burundi made a presentation on "Bank Lending Channel (BLC) in Burundi: Bank level data evidence". The highlights of the presentation are the following:

- The **Bank Lending Channel** BLC is understood to be the main determinant in Monetary Transmission in Developing countries.
- The study used bank level data to investigate the Bank Lending Channel in Burundi. The choice of Bank level data allows exploring the heterogeneity of the Banking system which cannot be addressed by aggregate data.
- The study applied a Dynamic Panel Model.
- The study's hypothesis is that if the BLC exists a restrictive Monetary policy could lead banks to alter their loans function and reduce credits.
- The findings of the study are the following:

  - Bank loans respond to interest rates rather than monetary targeting.

- Bank loans in Burundi are negatively related to the rate on 3 months T Bills and refinancing rate. However interactions of these indicators with banks characteristics are not significant save the interaction between the rates and capital ratio hinting thereby that well capitalized banks tend to invest in Government securities.

DISCUSSION

105. Governors pointed out that the prevailing commercial banks preference in most member countries to buy Treasury Bills rather than lending to the private sector has a crowding out effect and complicates the transmission mechanism especially the bank lending channel. It was observed that, it is important to address the transmission channel of monetary policy from bank credit to the ultimate target (inflation). The paper was, therefore, considered as work in progress. The Central Bank of Kenya offered to share experiences with the author as he proceeds in the finalization of the paper. Governors asked the author to share the final paper with all member Central Banks.

Any Other Business *(Agenda item 6)*

106. Governors thanked the Kenya School of Monetary Studies for offering to organize a training in 2016 on Corporate Governance for Central Banks in collaboration with US Department of Treasury and CMI.

107. Governors noted with concern the prevailing turbulence in exchange rate of currencies in a number of member countries. Governors decided that CMI should organize a workshop in 2016 for central banks experts to share experiences on the measures they are putting in place to mitigate the adverse effects of exchange rate volatility of currencies in their economies.

Adoption of the Report and Closure of the Meeting *(Agenda item 7)*

108. The meeting adopted the report with amendments.

109. Dr. Bwalya K.E. Ng'andu, Deputy Governor-Operations, Bank of Zambia, passed a vote of thanks. In his statement, he thanked all Governors and delegates for their active participation and the Chairman for the excellent manner in which he steered the meeting. He also thanked the Secretary General of COMESA for his tireless efforts in enhancing integration in COMESA. He further expressed his appreciation to the COMESA Clearing House and the COMESA Monetary Institute for the high quality reports produced and for the efficient manner in which the meeting was serviced.

110. Dr Ng'andu further emphasized the importance of diversification of exports, fiscal discipline, capacity to mitigate the negative effects of external shocks and the implementation of REPSS. He said that all the above would enhance regional integration. He wished Governors and delegates safe journeys back home.

111. In closing the meeting, the Chairman also thanked Governors and the delegates for their valuable contribution and wished them safe journeys back home.

ANNEX 1

STATUS OF THE IMPLEMENTATION OF THE DECISIONS MADE BY THE 20th MEETING OF THE COMESA COMMITTEE OF GOVERNORS OF CENTRAL BANKS

MATRIX OF DECISIONS AND REQUIRED ACTIONS

Section	Decision	By Whom	By When	Status	TRAFFIC LIGHT
Page 11, Para 45	Decisions related to the Implementation of REPSS	COMESA Clearing House (CCH); and Member countries		Progress on the implementation of REPSS will be reported in detail as an agenda item.	
Page 16, Para 51	(i) Member Central Banks should provide all data and information related to macroeconomic management at the latest by July 31 of each year. If data is not obtained from contact persons in member Central Banks by this date, CMI should send reminders and seek assistance from top management of member Central Banks	CMI	September 2015	Most countries submitted their reports.	**YELLOW**
	(ii) Directed the CMI to provide a technical paper on how to harmonise the macroeconomic convergence criteria for three RECS, namely, COMESA, EAC and SADC			Work in Progress in collaboration with experts group of the AACB	**YELLOW**

Page 17, Para 58	i) CMI to conduct training in Reserve management in 2015 in collaboration with Central Bank of Egypt.	CMI in collaboration with Central Bank of Egypt	April 2015	Done	**GREEN**
	ii) COMESA Monetary Institute (CMI) to set up web platform where the Central Banks in the region can actively share and exchange ideas after training. This will help to address skill gaps or audit skills and tackle challenges that may emerge when participants implement skills which they obtained from such training.			The web Portal is being designed by IT Division in COMESA Secretariat	**YELLOW**
Page 18, Para 62	i) CMI should conduct training in 2015 in Modelling and Forecasting in collaboration with Bank of England. ii) CMI should consider organizing trainings in modern monetary analysis tools such as DSGE models in preparation for the migration to Inflation Targeting frameworks.	CMI in collaboration with Bank of England	March 2015	Done. Will organise training on DSGE Models in 2016 in collaboration with Bank of England	**GREEN**

Page 20 and 21 Para 68	i) Instructed CMI to undertake a study which addresses the challenges of dollarization in selected countries in the region.	CMI	June 2015	Done. The study was submitted to Monetary and Exchange Rates Policies Sub-Committee in October, 2015	**GREEN**
	ii) Experts from member states to finalize the studies by incorporating the comments from the validation workshop by 31st December, 2014 and CMI should upload the final studies in its website			Done. The research papers are being edited. After editing they will be published as a knowledge product	**GREEN**
Page 21 Para 73	Governors approved the following work Programmes of the Monetary and Exchange Rates policies Sub-Committee: a) Undertake research on the effects of Fiscal Policy on the conduct and Transmission Mechanism of Monetary Policy	CMI	September 2015	Country specific research were undertaken by staff assigned by member central banks. The studies were validated in a workshop in October 2015	**GREEN**
	b) Undertake trainings on the following (i) Macroeconomic Modelling and forecasting in collaboration with Bank of England; (ii) Training of advanced Panel Econometrics (iii) Training on International Reserve Management in collaboration with Central Bank of Egypt	CMI	June 2015	Done	**GREEN**

Page 30 para 96	i) The consultant to finalize the manual by 28th February, 2015 and to include a clear step by step practical approach for SHIELDS implementation using numerical data. The Manual should also provide a stylized sample solution.	CMI and member countries	June 2015	CMI should work with the Bank of Uganda and the Reserve Bank of Malawi who volunteered to pilot the implementation of S.H.I.E.L.D.S before rolling out its application to other Central Banks;	**YELLOW**
Page 31 para 97	Governors approved the following Work Plan of the Financial System Development and Stability Sub-Committee 1. Trainings on: i) Modelling and Forecasting volatility in Financial Markets in a Multivariate Framework ii) Financial Stability, systemic risk assessment and macroprudential policy;	CMI	September 2015	All the trainings were successfully held.	**GREEN**
	2. Preparation of: Guideline for appropriate institutional governance framework for implementation of macroprudential policy in the COMESA region			The Guideline on institutional framework for macroprudential policy was validated by a workshop held from 2nd to 4th September 2015 in Nairobi, Kenya. It will be finalised after incorporating the comments of the workshop before end November 2015.	**YELLOW**

KEY: Green - Completed activity, **Yellow** - Work in progress, **Red** - Activity not done

ANNEX 2
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