The effectiveness of macroprudential policies during the Covid-19 pandemic in sub-Saharan Africa[1]

Executive summary

Macroprudential policies have attracted considerable attention in the aftermath of the Great Financial Crisis (GFC). An important part of the lessons learnt from the GFC, which started in 2007 in the United States and affected financial systems around the world, was the need to adopt a macroprudential perspective in the oversight and regulation of the financial industry. An associated lesson was understanding that macroprudential policies could be employed to increase the resilience of financial institutions and reduce the amplitude of the financial cycle.

The Covid-19 pandemic was a test case for the effectiveness of macroprudential policies. Over 10 years after the start of the GFC, financial authorities had a broader toolkit to respond to the next global shock to the financial sector, ie the outbreak of the Covid pandemic in early 2020. Macroprudential instruments appeared especially well suited to respond to the pandemic, given the temporary nature of the source of stress. Where macroprudential policies had been put in place in the years prior to the pandemic, granting authorities the flexibility to adjust them during times of crisis, authorities could respond to the pandemic by relaxing macroprudential requirements. They could subsequently tighten such requirements again once the worst of the pandemic's effects were over.

The objective of this paper is to assess the effectiveness of macroprudential policies deployed in response to the Covid-19 pandemic in a sample of African countries. Although the pandemic was a truly global shock, studies on the effectiveness of the macroprudential response have tended to focus on advanced economies. To the extent that the impact of macroprudential policies during the pandemic may be affected by idiosyncratic aspects of the structure of the domestic banking sector – such as the types of financial firms, intensity of banking penetration and degree of financial inclusion – the findings of such studies may not be directly applicable to countries with different banking sector structures. In this light, this paper explores the impact of macroprudential policies on bank lending in Africa. It focuses on the African countries that most actively used macroprudential instruments prior to and during the pandemic. As a result, the paper focuses on Mauritius, South Africa and the eight countries in the West African Economic and Monetary Union (WAEMU).[2] All selected countries released macroprudential instruments in response to the pandemic, especially Mauritius and South Africa.

The paper finds evidence of the effectiveness of macroprudential policies in responding to the pandemic. Macroprudential policies were employed to maintain bank lending throughout the worst phase of the pandemic. In the analysis, the relaxation of macroprudential requirements is shown to have had a positive effect on bank lending flows in the selected countries, and the impact is generally stronger than in normal, ie non-pandemic, times. The effect is, however, not homogeneous, and is stronger in the

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[2] Members countries are Benin, Burkina Faso, Côte D'Ivoire, Guinea-Bissau, Mali, Niger, Senegal and Togo.

case of WAEMU. Possible concerns about capital flight and inflation triggered an early reversion of accommodative macroprudential policies in South Africa and Mauritius, likely dampening the effectiveness of the macroprudential response in those jurisdictions.

As authorities complete their macroprudential toolkits, some general lessons can be drawn. Authorities in the selected African countries responded swiftly to the pandemic, and in alignment with major economies elsewhere. Timeliness may have helped to increase the effectiveness of the response and would be an important criterion to consider in future times of stress. Second, macroprudential policies were not used in isolation, and their combination with monetary and other policies at the outset of the pandemic may have enhanced their effectiveness. Such consistency across policy domains was more challenging in the exit phase, and it requires careful coordination across policy domains. Third, while there is evidence of the impact of macroprudential policies on lending, the limitations of the macroprudential toolkit at the authorities' disposal may have affected the countries' capacity to respond. Jurisdictions that have yet to complete their macroprudential toolkit would benefit from doing so as this would provide the relevant authorities with additional levers with which to respond to possible future shocks.