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The path to resilience in a challenging macro-financial landscape

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Good morning. It is a great pleasure to be here and chair the opening session of the 19th Basel Committee on Banking Supervision-Financial Stability Institute High-level Meeting on Banking Supervision for Africa, which I expect will feature a very stimulating set of discussions today and tomorrow.

The global economy is at an inflection point. The end of the most synchronised and most significant monetary policy tightening in recent memory is near. Central banks in some emerging market economies (EMEs) have already lowered their policy rates. Central banks in other countries, including many in Africa, have been on hold and have signalled that policy rates have probably reached their peak (Graph 1).

After reaching record high levels of inflation during the post-pandemic recovery, disinflation is now largely on track. To be sure, some of the contributing factors were easy, one-off gains, such as the rapid decline of food and energy prices and, with the normalisation of supply chains, of goods prices more generally. But there are also encouraging signs that central bank actions succeeded in avoiding an entrenchment of high inflationary dynamics. Stickier inflation categories, such as services, have shown improvements, and there is no clear evidence of wage-price spirals or de-anchoring of inflation expectations (Graph 2).

There appears to be a good chance of a soft, or at least softish, landing. The global economy slowed down in 2023, but not to the extent that many had feared (Graph 3). Historically speaking, the progress on the inflation front came at a relatively small cost in terms of slower GDP growth or higher unemployment. Notwithstanding some episodes in several advanced economies, the financial system also fared well. EMEs, as a whole, have shown remarkable resilience, owing to the improved policy frameworks and prompt response by many EME central banks to inflationary pressures. Some actually reacted faster than their counterparts in advanced economies.

So far, so good. What are the risks?

Inflation is *lower*, it is not *low*. Average inflation in advanced economies still exceeds 3%. In EMEs excluding some chronically high inflation cases, it is just above 4%. In Africa, average inflation remains in the double digits, still the highest levels seen since 2000 (Graph 4).

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Bringing inflation back to central bank targets may require going a last mile, and there is the risk of having to go an "extra mile". Upward pressure on prices could re-emerge, if, for example, the global economy gets hit by new large adverse supply shocks. Rising geopolitical tensions, especially in the Middle East, can affect some regions, like Africa, particularly hard through renewed energy price spikes and flight to safety. A significant climate event or supply chain disruption could have a similar adverse effect on inflation.

Another risk to the outlook comes from the possibility that the current slowdown in growth may turn out to be deeper and more protracted than expected. The baseline is for growth to recover in 2024. But monetary policy tightening can take time to have its full effect and medium-term potential growth can be disappointing, including from scarring effects of Covid-19, low productivity growth or evolving labour market dynamics.

Under a scenario of disappointing growth, **financial amplification channels are likely to kick in, often in ways that are very difficult to envisage beforehand.** Part of the financial system resilience so far owed to fixed rate loans, which help cushion the short-run effect of rising rates. If the repricing of these loans were to happen in conjunction with a pickup in unemployment, the financial system would need to be able to absorb higher delinquency rates and credit losses.

As has often happened in the past, **investors in major advanced economies may end up retrenching under such circumstances.** Such retrenchment would be very challenging for EMEs, especially for those with large debt burdens which are also dependent on international capital flows – such as many in Africa. Countries in sub-Saharan Africa, in particular, have high levels of external debt, at more than 30% of GDP. A third of this external debt is held by commercial banks (Graph 5).

Maintaining adequate fiscal space and access to affordable development financing is a daunting challenge in this picture. Debt servicing as a proportion of GDP has increased rapidly, on the back of higher rates and public debt-to-GDP ratios, which are expected to rise above pre-pandemic levels at around 65% in 2024. Some countries spend a large portion of their tax revenue on interest payments, more than the 18% threshold that the IMF and World Bank consider to be sustainable. Moreover, many African economies saw their currencies lose considerable value against major reserve currencies in 2023, weighing on their increasing share of government debt denominated in foreign currency (Graph 6). Adding to these complications is the maturing of bonds and loans in the next few years. A "wall of maturity" awaits public as well as private sector borrowers on a global scale (Graph 7). For instance, African economies will need to roll over in 2024 more than 200 billion dollars, corresponding to more than a quarter of their total debt coming due through 2029.

Large financing needs generate additional micro-prudential challenges for local banks. In 2023, the three major international credit rating agencies downgraded some of the large economies in Africa. Debt restructuring negotiations are ongoing in several cases. These may generate additional forex pressure, market volatility and liquidity risk for local banks, as international investors become more reluctant to invest in the local economies.

Policymakers will need to navigate these difficult waters. Building resilience and maintaining attractiveness as a place for investment in the face of these trends will require policymakers to find and apply a complex policy mix.

Monetary policy will need to prioritise the inflation fight, until it is decisively won.

Fiscal policy will need to get smart, broadening the tax base while rationalising expenses to make room for vital investments in society's future.

EME banking supervisors will need to continue efforts to make banking supervision more intrusive and forward-looking, as very challenging and disruptive changes are already putting the sustainability of banks' business models to the test. Financial supervision should also more forcefully embrace the principle of risk sensitivity, by adjusting resources and actions to the profile of each institution. These efforts would pay off in facing the challenges to come by enhancing the banking system's safety and soundness, which were instrumental during the Covid crisis.

Global banking resolution and crisis management frameworks will need to be further enhanced and operationalised to increase banks' loss-absorbing capacity, to provide timely liquidity support and more generally to make the regional financial safety net more solid, more flexible and ready to act across borders.

Given the increasing migration flows and the speed at which our society embraces financial technology, **enhancing the access to safe and secure cross-border payments** seems to be another priority. And that is especially true for Africa: the region remains one of the most expensive in the world in which to send payments both in and out.

Importantly, **international cooperation** will be as crucial as ever to lift debt pressures and geopolitical tensions, as well as to mobilise climate action and financing.

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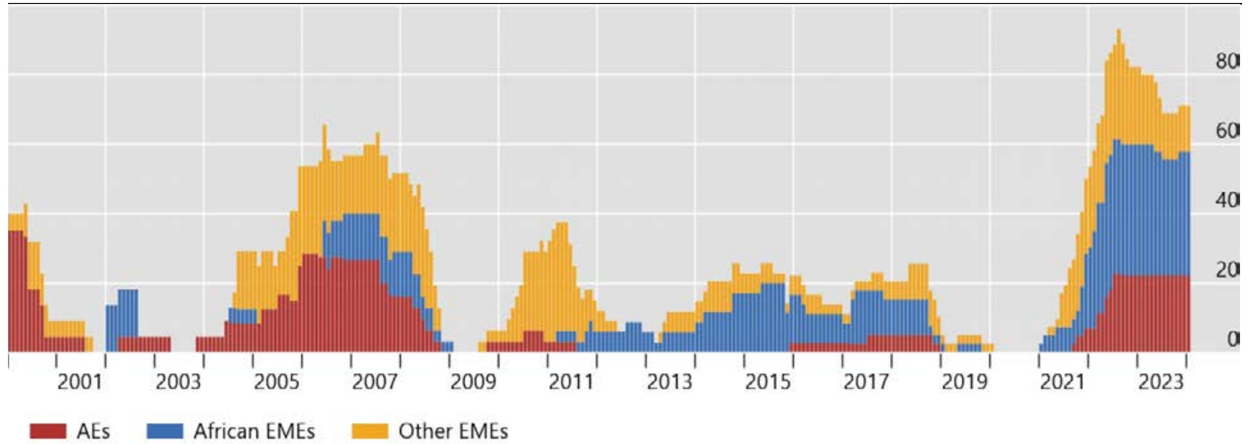
The end of the most synchronised monetary tightening in recent memory[1]

As a percentage of central banks

Graph 1



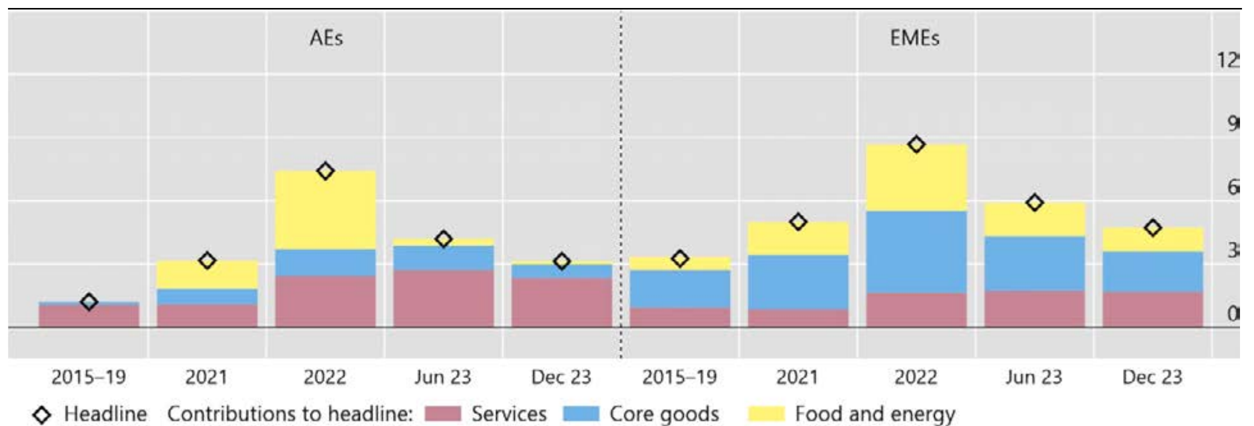
[1] For each country, tightening episodes are identified as months between the trough and peak in the policy rate around periods when the seven-month centred moving average of the policy rate is increasing. Episodes in which the policy rate increases by less than 1 percentage point or more than 20 percentage points, or episodes that last less than six months or more than 48 months, are excluded from the analysis. Based on data for 11 advanced economies (AEs), 20 African emerging market economies (EMEs) and 16 other EMEs from Jan 2000 to Jan 2024 (subject to availability).

Sources: P Cavallino, G Cornelli, P Hoerdahl and E Zakrajšek, "'Front-loading' monetary tightening: pros and cons", *BIS Bulletin*, no 63, 2022; national data; BIS.

Disinflation is on track, and owes in large part to goods, rather than services[1]

Year on year, in per cent

Graph 2

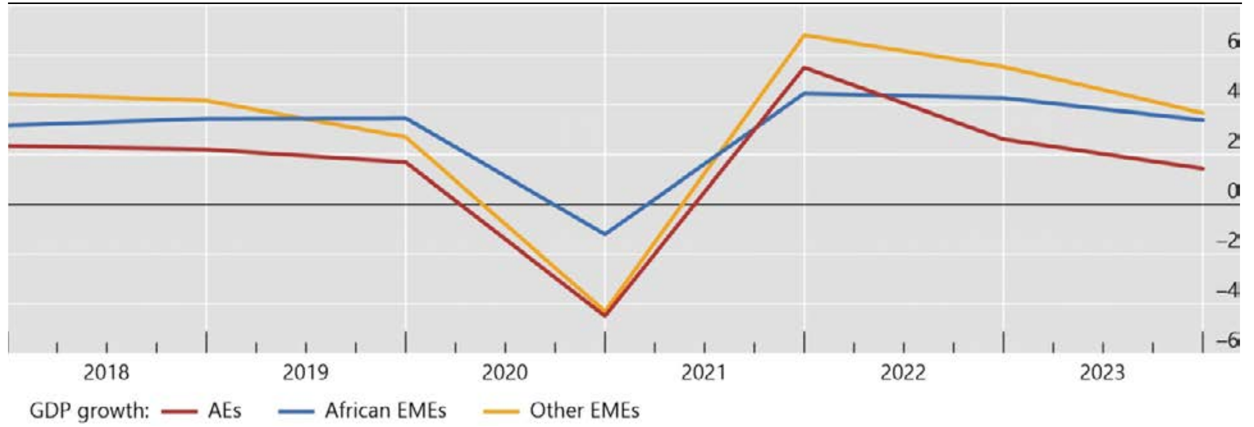


[1] Simple averages for the years. GDP-PPP weighted averages for: AEs = CA, CH, DK, EA, GB, JP, NO, SE and US; EMEs = BR, CL, CO, CZ, HU, IL, KR, MX, PE, PH, PL, SG and ZA. Core goods = goods excluding food and energy.

Sources: OECD; Refinitiv Datastream; national data; BIS.

GDP growth has slowed down, but not as much as feared[1]

Year on year, in per cent — Graph 3

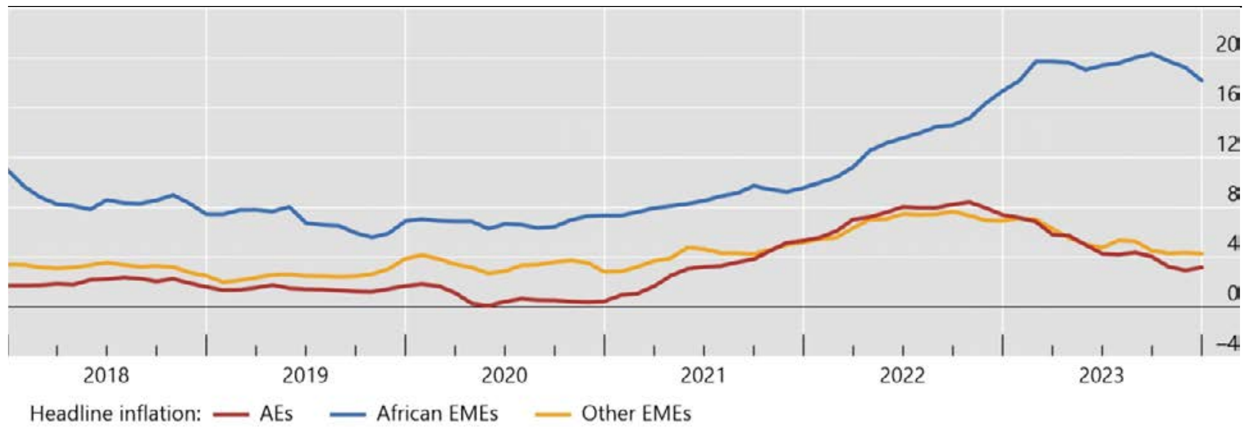


[1] GDP-PPP weighted averages for 11 AEs, 34 African EMEs and 24 other EMEs (not including CN). 2023 values are IMF forecasts.

Sources: IMF, *World Economic Outlook*, October 2023; BIS.

Inflation is lower, but it is not low[1]

Year on year, in per cent — Graph 4



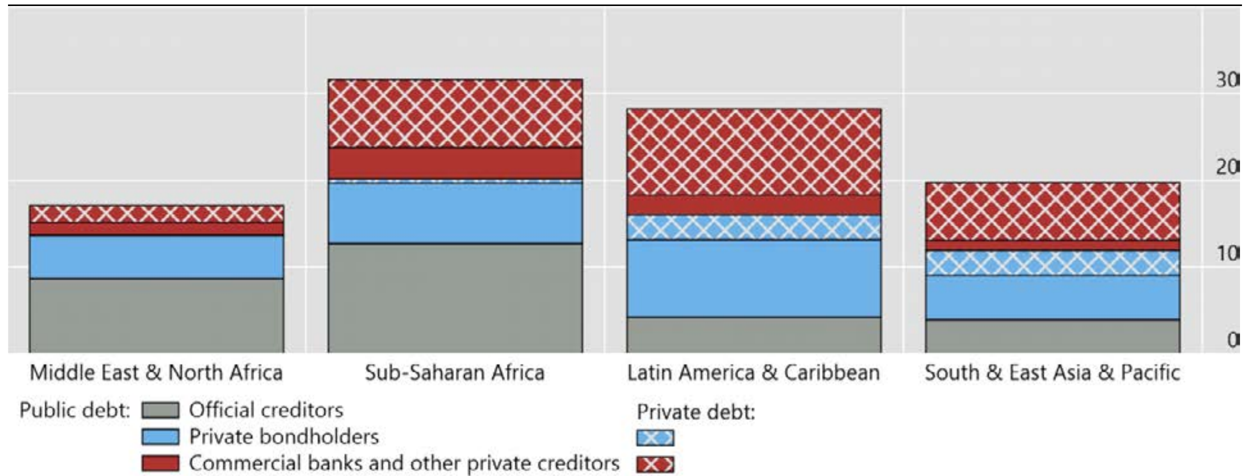
[1] GDP-PPP-weighted averages for 11 AEs, 24 African EMEs and 20 other EMEs (not including CN).

Sources: Refinitiv Datastream; national data; BIS.

Sub-Saharan Africa has a high level of external debt, a third of which is held by commercial banks[1]

In per cent of GDP

Graph 5

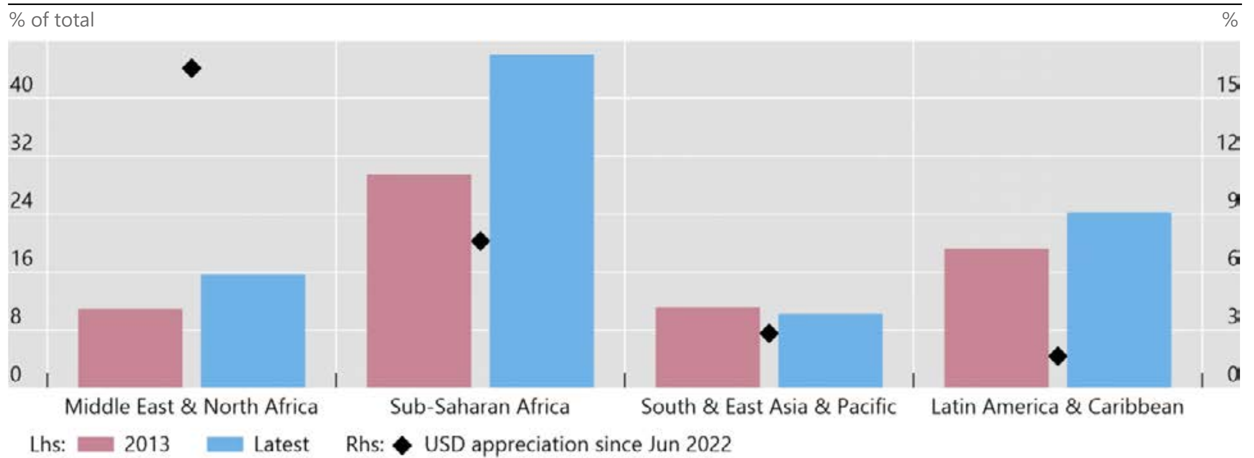


[1] Long-term external stock of public (and publicly guaranteed) and private non-guaranteed debt by region (excluding high income countries).

Sources: World Bank, International Debt Statistics; BIS.

African currencies lost value against major currencies in 2023, while the share of foreign currency-denominated government debt increased[1]

Graph 6

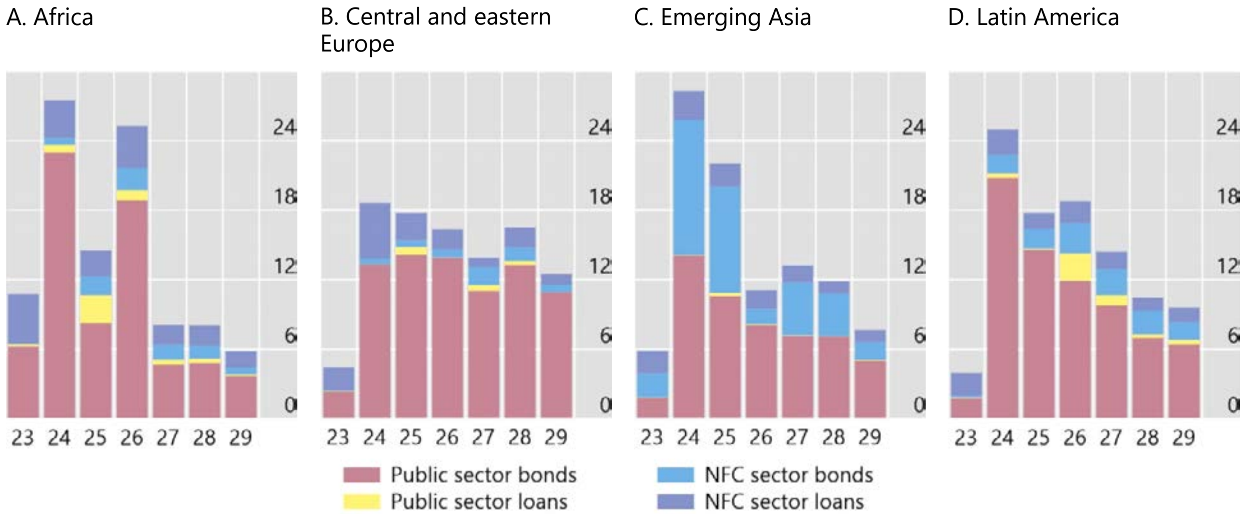


[1] GDP-PPP weighted averages for regions. Excluding high income countries.

Sources: S Arslanalp and T Tsuda, "Tracking global demand for emerging market sovereign debt", *IMF Working Paper*, 2014; Refinitiv Datastream; BIS.

Large amounts of debt will need to be rolled over in the next few years[1]

In per cent of total amount due Graph 7



[1] Sums across six African, three central and eastern European, eight Asian and five Latin American EMEs. Expressed as share of total amount due across all instruments in 2023–29. NFC = non-financial corporate.

Sources: IIF; BIS.