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Central Bank Background Papers On Monetary Policy Frameworks In The Arab Countries

AMF-BIS Fourth Working Party Meeting on Monetary Policy in the Arab Region

Arab Monetary Fund
Abu Dhabi, United Arab Emirates
31 May, 2-1 June 2021

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Foreword

Papers collected in this volume were written for the Fourth Working Party on Monetary Policy in the Arab region organized jointly by the Arab Monetary Fund (AMF) and the Bank for International Settlements (BIS) in a virtual format on May 31, 1, June 2, 2021. The meeting was attended by participants from 27 Central Banks and monetary authorities, of which twelve Central Banks from outside the Arab region.

The meeting provided an opportunity to review and discuss many important issues related to monetary policies in Arab countries. Discussed topics covered recent economic and financial market developments and their implications for banks in the Arab Region, and the role of monetary policy in mitigating the impacts of COVID-19 and supporting economic recovery in coordination with fiscal and macroprudential policies. In addition, the meeting included a special session on Central Banks Digital Currencies (CBDCs) and their implications for monetary policy.

Papers included in this document shed light on the operational frameworks and implementation of monetary policy in 2020 and have been prepared by high-officials responsible for monetary policy in thirteen Arab Central Banks and Monetary Authorities.

On the experiences of Arab countries adopting fixed exchange rate regimes, the paper of **The Central Bank of Jordan (CBJ)** referred to the role of monetary policy in overcoming the repercussions of the COVID-19 Pandemic. The Central Bank of Jordan has adopted a stimulus package that amounted to JD 2.7 billion (equivalent to USD 3.7 billion), or about 8.6 percent of GDP, to support economic sectors, SMEs, and households. This stimulus package included measures of easing credit conditions, enhancing liquidity, protective and other prudential procedures aimed to safeguard the resilience of the Jordanian banking sector and domestic economic fundamentals.

CBJ acted responsively and swiftly to mitigate the unfavorable risks and ease the uncertainty using conventional and unconventional monetary tools. This helped mitigate Jordan's economy from the deeper negative repercussions and achieve the CBJ's primary mandate of preserving monetary and financial stability, focusing on its nominal anchor representing by maintaining the fixed exchange rate stability of the Jordanian dinar.

It has also succeeded in maintaining a sound and robust banking system, greatly capable of withstanding shocks and high risks. Thanks to the high level of capital adequacy ratio, which is considered one of the highest in the region, in conjunction with comfortable liquidity and banking profitability levels.

In conclusion, the policies and measures implemented by the CBJ have proven its efficiency and effectiveness in managing and controlling crises outcomes, regardless of their origin, eager to stimulate and preserve economic growth and employment level as an ultimate objective.

The COVID-19 Pandemic, and the challenges associated with it, did not inhibit **the Central Bank of the UAE (CBUAE)** from undertaking reforms toward implementing the new Dirham Monetary Framework amid an uncertain global outlook. The main benefits of this Dirham Monetary Framework are three-fold:

(1) Introduce and consolidate liquidity provision and drainage facilities to ensure short-term market interest rates align to US levels helping to support the FX peg.

(2) Provide a clear distinction between Standing Facilities and Open Market Operations to improve CBUAE capacity and manage liquidity to support market development and collateralization while maintaining the FX peg.

(3) Create incentives for Deposit-Taking Financial Institutions to proactively manage their day-to-day liquidity stance and encourage money market developments in the UAE.

In response to the COVID-19 Pandemic, the Central Bank of the UAE adopted a comprehensive stimulus package to support the UAE economy and financial system. The Targeted Economic Support Scheme (TESS) comprises all targeted temporary measures to address the repercussions of the COVID-19 Pandemic in the UAE. The total amounts of the measures added up to AED 256 billion, consisting of AED 50 billion capital buffer relief, AED 50 billion zero cost funding support facility to banks in exchange for targeted relief to their retail and corporate customers affected by the COVID-19 Pandemic, AED 95 billion liquidity buffer relief, and a reduction of the reserve requirements on demand deposits by half for all banks from 14 percent to 7 percent. The collective support measures aimed at providing support to banks’ lending to the UAE economy and their liquidity management.

The paper of **The Central Bank of Bahrain (CBB)** sheds light on the Government and the Central Bank measures in response to the COVID-19 virus through introducing several policies aimed at reducing the spread of the virus, as well as financial measures aimed at mitigating the potential economic impact of the crisis. The CBB introduced measures to contain the financial repercussions of the COVID-19 included:

- Reducing the legal reserve requirement ratio.
- Providing retail banks with concessionary repo arrangements for up to 6 months at zero percent on a case-by-case basis.
- Reducing BHD deposit and lending facilities interest rates.

By implementing the policy mentioned above measures, the CBB managed to help the economy absorb the shock of the current crisis by keeping borrowing affordable for all banks operating in the Kingdom and supporting the banking system liquidity. The Monetary Policy Committee (MPC) is following the developments. It meets every week to discuss and prepare recommendations to apply the necessary monetary policy tools that support the economy.

In response to the outbreak of COVID-19 and in line with the global and domestic developments in 2020, **the Saudi Central Bank** lowered its policy rates in two steps by 125 bps in March 2020. Moreover, the Saudi Central Bank uses the statutory reserve requirements to influence the money supply. Furthermore, the monetary policy decision to inject SAR 50 billion into the banking system has enhanced the banking sector's liquidity and enabled banks to continue providing credit facilities to the private sector. Moreover, SAMA activated Open Market Operations (OMOs) in early 2020. The OMOs complement the current issuance program of SAMA Bills and consist of liquidity auctions with a 1-week to 1-month maturity.

Monetary indicators point to ample liquidity levels, as the broad money supply measured by (M3) has surpassed SAR 2 trillion, recording an increase of 8.3 percent in 2020, the highest annual growth rate since 2015. The main drivers for this growth in 2020 were government spending and credit expansion to support economic recovery. The central bank decisions have supported banking system liquidity to facilitate credit provision to the private sector. Private sector credit growth recorded an increase of 14.3

percent by end-2020 (year on year), with a notable recovery in the most impacted sectors during mid-2020, such as the commerce and services sectors.

Going forward, the Saudi Central Bank has decided to extend the deferred payments program until the end of June 2021 to continue enabling MSMEs adequate access to funding, which in turn will support the economic recovery. The Central Bank has also announced the extension of the Guaranteed Financing Program for one year to end on March 14, 2022, as another support lever for MSMEs to overcome the challenges that have arisen from the COVID-19 crisis.

The Saudi Central Bank is conducting regular assessments of economic developments and the performance of the support measures to:

(1) evaluate the need for further action,
(2) to consider the possible impact of prolonged use of the support measures, and,
(3) to plan for their gradual unwinding.

The **Central Bank of Iraq (CBI)** paper sheds light on efforts exerted to restore economic and financial stability. The Iraqi economy faced two shocks in 2020 due to the sharp decline in the international oil prices and the spread of the COVID-19 Pandemic, which impacted macroeconomic indicators in Iraq. The CBI had taken many measures to mitigate the severe effects of the COVID-19 and reduction in oil prices and revenues as follows:

- Discounting around (26) Trillion ID of the treasury bills to finance the budget deficit during the second half of 2020.
- Devaluation of the local currency by the end of 2020 provides extra funds to the Ministry of Finance (the owner of oil revenues) to maintain the foreign reserves to support economic activities and competitiveness and reduce imports.
- Reducing the interest rates charged for loans provided through the CBI's lending initiatives and postponing installments to promote the private sector economic activities and reduce the probability of default.
- Extending the amount and maturity of loans from the CBI's lending initiatives to encourage private-sector production.

The CBI will maintain its core objectives for price stability, financial stability, and promoting economic development. It can do so through its adequate foreign reserves and by introducing new criteria to assess the soundness of the banking sector.

Even though **the Palestine Monetary Authority (PMA)** does not conduct a comprehensive monetary policy in common sense, due to the absence of a national currency, it made a relentless effort to enhance capabilities and place the requirements for formulating and conducting monetary policy future. Including the expected issuance of the new central bank law in the future to strengthen its independence and provide the legal environment for developing and implementing a comprehensive monetary policy.

From the early stages of the spread of the Pandemic in Palestine, PMA has issued series of proactive instructions, mainly focused on supporting and injecting additional liquidity in the economy to meet any emergency obligations, including supporting the liquidity needs of the banks themselves.

The proactive measures also include the intervention for the first time by using one of the monetary policy tools available to PMA. That is injecting additional liquidity by launching the "Estidama Program" to support the most affected enterprises from the Pandemic.

In due course, PMA has adopted an ambitious plan that describes and explains the structure and principles of work that will govern its future during the next five years. The plan gives more attention to the concept of digital transformation, enhancing the use of electronic financial products and electronic payment tools and enhancing capabilities in areas that ensure the PMA maintains the monetary and financial stability and contributes to the Palestinian economy's sustainable growth.

Qatar Central Bank (QCB) paper refers to the efficiency of the monetary policy measures adopted to overcome the implications of the COVID-19 Pandemic. Given the framework, QCB responded to the Pandemic by cutting its policy rates and augmenting its liquidity-providing facilities. Consequently, the interest rate structure, including deposit and lending rates of banks, in the economy declined significantly along with ample primary liquidity in the banking system. These monetary stimuli helped in sustaining bank credit growth at double digits and support the recovery of the non-hydrocarbon sector since the third quarter of 2020.

Monetary policy implementation has made significant progress, which anyway is an ongoing process. In this regard, there are scopes for further developments such as market developments, inter-bank and government securities market, and strengthening of liquidity management and forecasting framework.

The Central Bank of Kuwait (CBK) took preemptive monetary and macroprudential measures to contain the economic shock. As a result, banks succeeded in maintaining a high degree of asset quality, supported by strong financial soundness indicators that weathered severe conditions and confirmed the banking sector's ability to withstand shocks.

The measures introduced by the CBK in terms of accommodative monetary policies and regulatory policies geared to bolster bank credit growth and promote economic activity amid the Pandemic have resulted in continued growth in credit facilities despite last year's markets closures. At the end of December 2020, the Net Credit Facilities Balance, on a consolidated level, amounted to KD 51.8 billion, an increase of 4.3 percent from December 2019. This growth in credit facilities started during March 2020, coinciding with the CBK's decision to bring down the Discount Rate to an all-time low of 1.5 percent.

While it looks to the future with optimism, the CBK shall continue to diligently monitor economic and banking conditions so that the economy is safely overcoming this period. It also continues to strive to bolster monetary stability and financial stability, which are vital requirements, though not sufficient on their own, for sustainable economic stability.

The CBK welcomes all government efforts in expediting the implementation of comprehensive reforms of the complex and deeply rooted structural economic imbalances. So long as oil-based revenues dominate, current expenditures grow, and effective corrective measures remain absent, the State's general budget will stay under an accumulated financial deficit. Therefore, it is of utmost importance to address these challenges to sustain prosperity and develop the national economy to preserve the rights of present and future generations.

The Banque Du Liban (BDL) paper indicated that the pressing regional and local challenges that have hindered the Lebanese economy for the past few years had incited the BDL to resort to unconventional monetary policy tools to boost economic and social development.

During the period (2013-2019), BDL stimulus packages have amounted to USD 7.2 billion and have targeted productive sectors (40 percent) and the housing sector (60 percent). Together with the exemption of banks from reserve requirements and government loan subsidies, these incentives have led to the injection of almost USD 16 billion to support economic activity since 2009. The importance of these catalyst endeavors lies in their sizable contribution to real GDP and their momentum in job creation.

Amid the challenging circumstances Lebanon was facing in 2020, BDL has been deploying all measures to help the economy survive, protect depositors' money at Lebanese banks. These measures also aimed at supporting businesses to ensure that workers still have jobs to return to and provide assistance to individuals and companies affected by the Beirut Port explosion.

To help the Lebanese industries, BDL announced in March 2020 the decision to launch the "Lebanese Economy Oxygen Fund" in partnership with Lebanese banks and in coordination with the Association of Lebanese Industrialists and the Ministry of Industry. The rescue initiative aims to extend short-term credit facilities to help small and medium-sized Lebanese industrial firms financing raw material imports. The rescue initiative raised around USD 750 million with the support of BDL, international investors, development finance institutions, and family offices.

Currently, there are three pillars to restore confidence: the first is to prepare a budget with a reduced deficit, the second is to negotiate with the lenders, especially after the state inability to repay its international debts, and the third the need to reform the banking system.

On the experience of Arab countries with more flexible exchange rate regimes, the paper of **the Central Bank of Algeria** referred to the current challenges facing monetary policy implementation. With the double shock that Algeria is facing, the first being external (related to the fall in oil prices) and the second being both internal and external (impact of COVID-19 on the national and global economies), the Bank of Algeria needs to strengthen its role as lender of last resort to meet the financial needs of the commercial banks. In addition, some questions have been raised about the use of unconventional monetary policy instruments, in particular about the extent of their effectiveness in supporting the banking system and consequently growth and, more importantly, the future consequences of these massive financings on inflation. Moreover, the recent adoption of a regulatory framework for Shariah-compliant Finance and the proliferation of such products in the banking system poses a significant challenge of developing an arsenal of Sharia-compliant instruments for the conduct of monetary policy in this context.

The fiscal dominance and reliance on central bank financing of the budget deficit represent another challenge that interferes with monetary policy in Algeria. Accordingly, a prudent fiscal policy needs to be adopted simultaneously that the Bank of Algeria should implement the monetary policy with the ultimate goal to achieve price stability. Furthermore, the recent events proved that there is a limit to what monetary policy alone can do, and we probably reached that limit now. Hence, there is a need for a global consensus about implementing monetary policy in a future context.

The Central Bank of Tunisia (CBT) paper indicated that the unprecedented health crisis combined with a heavy legacy of structural problems and persistent socio-political instability, and an unfavorable international environment weighed heavily on economic growth and the budget deficit, which stood at all-time highs. In this context, monetary policy played a very active role in helping to limit the impact of the health crisis on the national economy by easing inflationary pressures due to a tightening cycle that characterized the period 2017-2019. What followed was a phase of loosening dictated by the need to ward off the shock generated by the Pandemic, thanks to the downward outlook for inflation.

The CBT cut its key rate twice, respectively, in March (100 basis points) and September 2020 (50 basis points), bringing it down from 7.75 percent to 6.25 percent. This energetic action was accompanied by a set of measures aimed at meeting banks' needs in liquidity to pave the way for an economic recovery once the Pandemic was over. These measures were reinforced by other measures to preserve financial stability, particularly by easing credit conditions and reducing financial burdens for businesses and individuals. The measures taken in terms of monetary policy made it possible not only to provide the banks with the necessary liquidity, as evidenced by the absence of tensions on the money market rate but also to cope with the disturbances generated by the economic fallout from the COVID-19 crisis on monetary policy transmission.

The paper of the **Central Bank of Egypt (CBE)** sheds light on the successful experience of Egypt in implementing the inflation targeting regime (IT) and the Economic Reform Program during the period (2016-2019). The paper refers to some recent challenges facing the implementation of monetary policy, including the need to ensure the coherency of data received from various government entities/stakeholders and the increasing uncertainty resulting from the COVID-19 crisis. As the CBE and the government join efforts to provide an environment supportive of low, stable, and predictable inflation, the Coordinating Council on monetary policy, headed by the Prime Minister, was established for the first time in January 2005 to enhance consistency between monetary and fiscal policies. Coordination between the central bank and the government is essential as some of the vital factors that influence inflation dynamics fall under the government's mandate. In the new law, the coordination Council sets a mechanism to coordinate between the CBE's Monetary policy and the government's fiscal policy. Nevertheless, the coordination between the government and the CBE is held entirely with respect to the independence of the CBE.

The outbreak of the COVID-19 Pandemic started to impact Egypt by mid-March 2020. To face the health crisis, the CBE responded swiftly and proactively to ease monetary conditions and anchor inflation expectations to help mitigate the economic and social impacts emanating from the Pandemic while maintaining macroeconomic stability. The CBE has instituted several conventional and unconventional tools, ranging from interest rates cuts, credit initiatives to key economic sectors, measures to boost domestic liquidity, and support for non-performing companies and individuals.

Based on this recovery pattern and anchored inflation expectations, annual headline inflation rates are expected to continue recording single digits. The rate is expected to be arithmetically affected by unfavorable base effects related to the normalization of monthly inflation rates in 2021. Still, it will continue hovering around the inflation target's mid-point of 7 percent in 2022.

The paper of **Bank Al-Maghrib** indicated that the Moroccan economy is predicted to bounce back to an upward trajectory, bolstered by the expected global economic recovery and fiscal and monetary stimulus, and easing of restrictions. In 2021, and according to BAM's June 2021 forecasts, growth is expected to rebound to 5.3 percent, driven by a 3.6 percent increase in the value-added of non-agricultural activities and a 17.6 percent rebound in the agricultural sector. In 2022, growth is expected to consolidate to 3.3 percent, with a further improvement in the pace of non-agricultural activities to 3.8 percent and a 2 percent drop in agricultural value-added.

Against this background, and considering other temporary factors related to higher oil and some imported food prices, inflation is expected to accelerate yet remaining at moderate levels, standing at 1 percent in 2021 and 1.2 percent in 2022. While the outlook is still surrounded by a very high level of uncertainty and the Pandemic continues to spread, monetary policy will face several challenges in the months and years ahead. The review of monetary policy frameworks undertaken by many central banks recently may already need an update as a rapidly changing economic environment is underway.

The emerging issues of Central bank digital currencies, green finance, and the risks of fiscal dominance in a context of persistently high public debt levels are some of the main challenges facing monetary policy. Uncertainty may also be persistent with significant implications for formulating monetary policy decisions and their transmission to the real economy. The difficulties of measuring inflation during lockdowns due to the significant and sudden change in the structure of households' consumption is another illustration of the kind of unpredictable changes that may surge with substantial implications for the conduct of monetary policy. More generally, the rapid economic activity developments highlight the need for timely and granular data to assess the economic situation and predict its pattern to underlying monetary policy decisions.

In conclusion, the meeting served to give policymakers much food for further reflection. Although specific national circumstances differ, there are many common elements in formulating monetary and financial policies so Central banks can learn much from each other.

AMF-BIS Fourth Working Party Meeting on Monetary Policy in the Arab Region

Background Paper on Monetary Policy

The Hashemite Kingdom of Jordan

The Central Bank of Jordan

Prepared by

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Deputy Governor

Abu Dhabi, United Arab Emirates
31 May, 01-02 June 2021

Monetary Policy Implementation in The Hashemite Kingdom of Jordan

1. Background

COVID-19 Pandemic crisis and measures to contain the rapidly contagious infectious cases resulted in a dramatic consequence of disrupting economic and social activities. However, since the encouraging signs of readily available vaccines and vaccination campaigns worldwide and in Jordan, the economic outlook had improved.

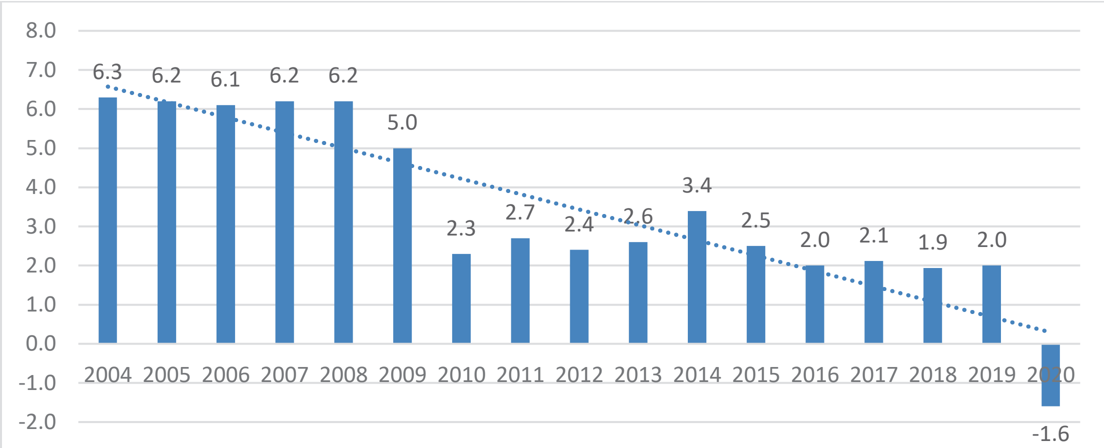
The vague economic outlook and uncertainty surrounding the recovery path are unusual, particularly with the newly identified COVID strains. It is also highly dependable on the evolution of the Pandemic and the response of economic sectors.

Accordingly, the projection of economic contraction rate was highly subjective to alter, following the developments and the response of economic players. As a result, the International Monetary Fund (IMF) estimation to Jordan resulted in a contraction projection of 2 percent in 2020.

2. Recent Economic Developments

Over the last decade, Jordan has become an attractive destination for foreign investment, thanks to the availability of skilled labor and stable macroeconomic, monetary, and financial environments. However, the headwinds of unfavorable exogenous shocks and challenges, related to persistent geopolitical tensions in neighboring countries, the influx of refugees into the kingdom, lacking oil production, and the surge in energy imports because of unremitting interruptions in the flows of the natural gas from Egypt, lastly, the global COVID-19 Pandemic, had cumulatively impacted the growth rate.

Graph 1: Real GDP Growth Rate in Jordan



During the last decade, the economic performance of the Jordanian economy has witnessed a double-digit rate during the period (2004-2008), following a strong surge of new firms financed by foreign and local capital, the growth rate during this period span averaged around 6.2 percent.

However, in the aftermath of the global financial crisis, the economic growth has slowed down and stayed at a persistent lower rate after that. In fact, this was a result of several exogenous shocks. Consequently, the growth rate during the span time (2009-2019) averaged at 2.6 percent.

Unfortunately, the emerging Pandemic in early 2020 distorted the global economic growth and upward trend, developed a parallel shock at the supply and demand sides and resulted in socio-economic consequences comprising declining production growth, supply chain, employment creation, economic activities, behavioral and behavioral social life worldwide.

Jordanian economy was not an exception; the Pandemic resulted in unprecedented challenges, unlike all other previous crises, despite its sanitary origin. The Pandemic adverse economic sequences and global spillover effects were colossal compared to the fiscal and monetary spaces. Nevertheless, fiscal, and monetary authorities have implemented a large advance, emergency measures, and stimulus packages vindicated to support sustainable and resilient recovery to firms and households.

Consequently, real gross domestic product (GDP) contracted to 1.6 percent in 2020, compared to IMF projections to contract by 2 percent in 2020, with expectations of turning into a growth rate of 2.0 percent and 2.7 percent in 2021 and 2022, respectively.

Yet, these challenges did not impede the political and economic reform process as a road map for inclusive economic development and welfare, including the Extended Fund Facility (EFF) provided by the IMF during March 2020.

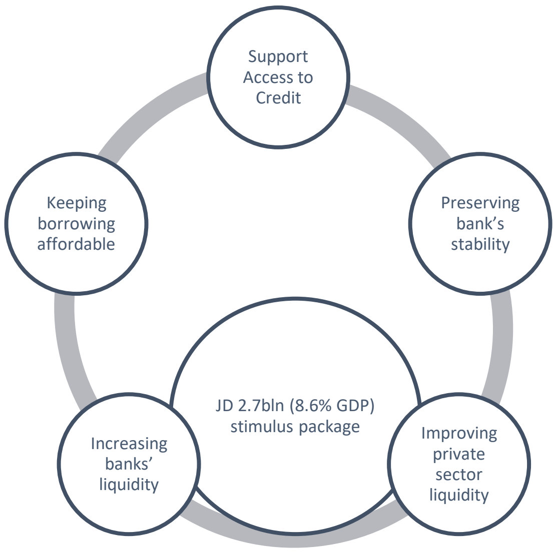
The monetary authority presented by the Central Bank of Jordan on its side has implemented an extraordinary stimulus package amounted to JD 2.7 billion (equivalent to USD 3.7 billion), or about 8.6 percent of GDP, keen to support economic sectors, SMEs, and households. This stimulus intervention can be summarized in the below table.

Table 1: CBJ Interventions Measures in Monetary Value

Intervention Measure	Injected Amount JD (million)	Injected Amount as a percentage of estimated GDP 2020 (31,025 million)
Reduce Regulatory Reserve Ratio from 7 percent to 5 percent	550.0	1.8
Grant a loan to the Jordanian Guarantee Corporation	300.0	1.0
Conduct Outright purchases	254.0	0.8
Conduct various tenors of REPO agreement	850.0	2.7
SMEs support program	700.0	2.3
Total	2654.0	8.6

The toolkit included measures of easing credit conditions, enhancing liquidity, protective and other prudential procedures aimed to safeguard the resilience of the Jordanian banking sector and domestic economic fundamentals, which can be grouped in the following main pillars stipulated in the graph 2.

Graph 2: CBJ Intervention Main Pillars



CBJ acted responsively and swiftly to mitigate the unfavorable risks and to ease the uncertainty through using conventional and unconventional monetary tools. This helped mitigate Jordan's economy from the deeper negative repercussions and achieve the CBJ's primary mandate of preserving monetary and financial stability, focusing on its' nominal anchor presented by maintaining the fixed exchange rate stability of the Jordanian dinar.

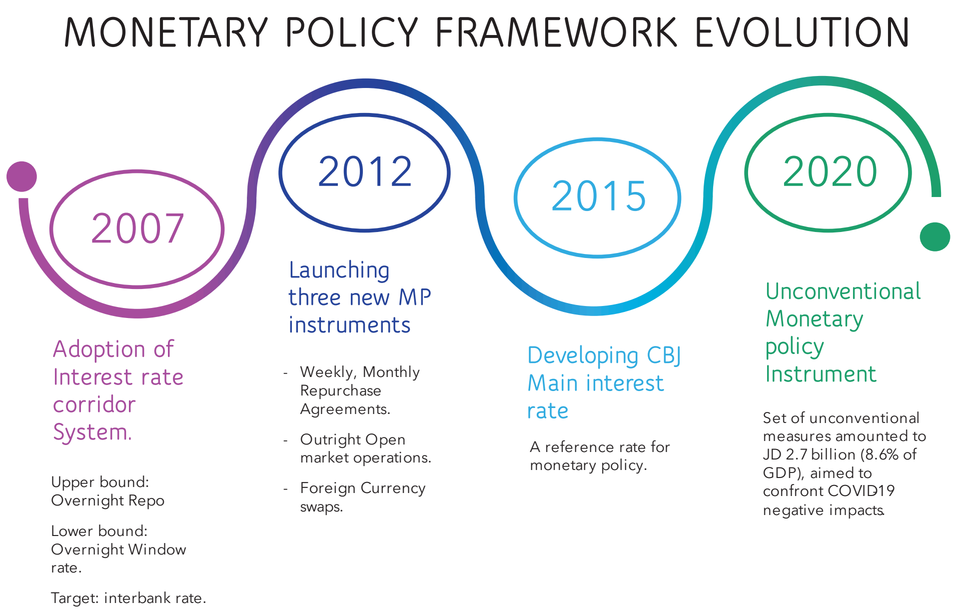
It has also succeeded in maintaining a sound and robust banking system, greatly capable of withstanding shocks and high risks. Thanks to the high level of capital adequacy ratio, which is considered one of the highest in the region, in conjunction with comfortable liquidity and banking profitability levels.

In conclusion, the policies and measures implemented by the CBJ have proven its efficiency and effectiveness in managing and controlling crises outcomes, regardless of its origin, eagerness to stimulate and preserve economic growth, and employment level as an ultimate objective.

3. The Operational Framework of Monetary Policy: The Latest Developments

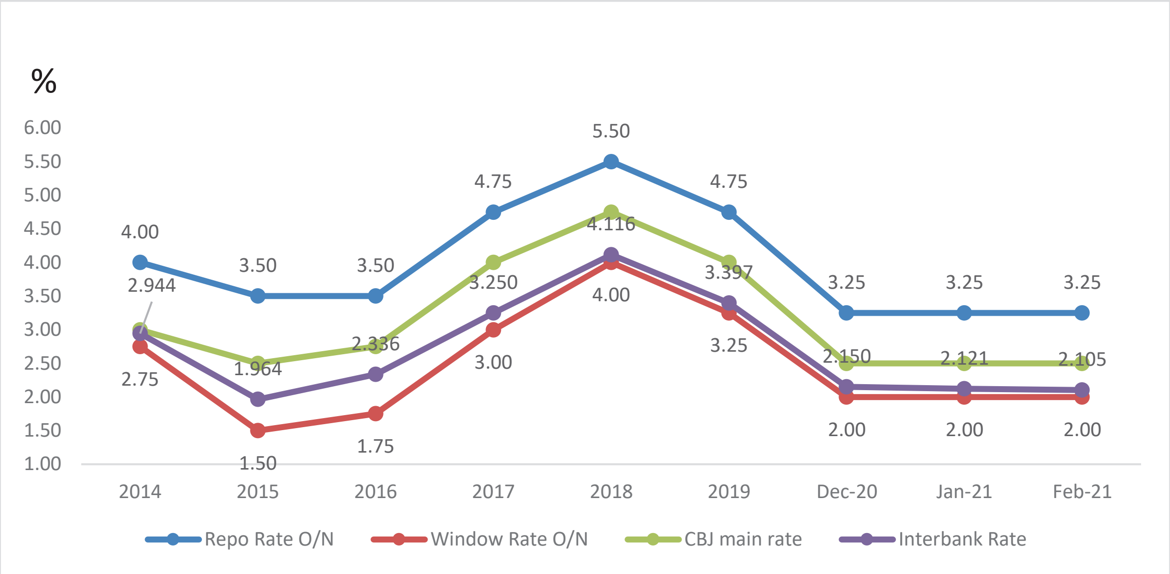
In order to achieve its primary mandate – maintaining monetary and financial stability – the CBJ uses a set of monetary policy instruments and procedures, which form the operational framework.

Graph 3: Monetary Policy Framework Evolution



The CBJ adopted the interest rate corridor system (IRC) in 2007. Under this system, there are upper and lower interest bounds within which the CBJ targets the interest rate in the interbank market. The upper bound reflects the rate at which banks can borrow from the CBJ through the overnight repurchase agreement, and the lower interest bound is the rate at which banks can deposit their excess money at the CBJ through the overnight window rate.

Graph 4: Corridor System in Jordan



In addition, the CBJ also signals its monetary policy stance to the money market by creating the weekly repurchases agreements as the CBJ main interest rate in 2015, through which other benchmark rates will be determined.

Over the last decade, the CBJ has activated various instruments of unconventional monetary policy tools. For instance, in 2011, the CBJ's launched a program to finance value-added economic sectors, with a favorable lending rate, which amounted to JD 1.2 billion (equivalent to US 1.7 billion). In addition to launching foreign currency swaps with foreign banks and international development banks operating in Jordan.

The CBJ succeeded in maintaining its dual mandates and its nominal anchor of exchange rate stability since October 1995. The peg exchange rate regime has proved its efficiency and suitability to the Jordanian economic environment and helped build a comfortable level of foreign reserves. Several internal and external studies, including IMF studies, show that the exchange rate of the Jordanian Dinar is broadly in line with its medium-term fundamentals, and the real exchange rate is stable around its long-term equilibrium with no evidence of misalignments.

4. The Implications of Global COVID-19, Domestic Economic and Financial Developments on Monetary Policy Implementation

In early 2020, the global economy was hit hard, with an unusual crisis like no another. The unique origin of the sanitary crisis formalized its unusual characteristics, causing unprecedented shocks and challenges in terms of economics, social and financial aspects.

The threatening of lives and livelihoods directed worldwide governments to take precautionary measures, including curfews for a long time, causing a parallel paralyzed demand and supply side, resulting in a unanimous trend to implement exceptional initiatives, and supporting programs to the most vulnerable economic groups. Monetary authorities have been highly involved, taking proactive sequence and series of measures guided at providing liquidity in the market.

Therefore, as the last global financial crisis of 2008-2009, the ongoing global crisis shares the demonstrated and essential role of central banks worldwide, resembling the accommodative monetary policy using conventional and unconventional monetary tools.

At the onset of the Pandemic, CBJ has taken numerous procedures and unordinary initiatives to help economic sectors and households withstand the Pandemic's negative impact without causing an excessive currency supply. Thus, ensuring that liquidity is at efficient ample. These measures include:

- Cutting interest rate on all monetary policy instruments twice during March 2020, by a total of 150 basis points, except for the overnight window facility, which was cut by 125 basis points.
- Reducing regulatory reserve ratio from 7 percent to 5 percent.
- Activating Repo market agreements with different tenors range from a week until a year.
- Conducting outright open market operations.

Crucially, the CBJ also acted swiftly to facilitate access to credit to encounter market dysfunction and contain risks through the following initiatives:

- Launching a new finance program amounted to JD 700 million (which was enlarged by an additional JD 200 million in early 2021), directed to SMEs, including craftsmen, professional and individual firms, with a favorable ceiling interest rate of 2 percent and flexible repayment tenors. The program aimed to finance SMEs in terms of operating capital and expenses, including payrolls.
- Modifying the CBJ refinancing program, which amounted to JD 1.2 billion by reducing the program interest rates to become 1 percent instead of 1.75 percent for all projects inside Amman governorate, and 0.5 percent instead of 1 percent for projects for all other governorates, as well as expanding the maturity of all advances to become 10 years of which 2 years as a grace period, increasing the advances ceiling to become JD 3 million to all economic sectors, and JD 4 million for renewable energy, tourism, and transportation sectors. Lastly, the program was expanded to include the export sector within the targeted sectors. (Industry, tourism, agriculture, renewable energy, information technology, transportation, health, technical and vocational education, engineering, and consulting).

In order to support vulnerable economic sectors and households, the CBJ decided to strengthen their liquidity through:

- Allowing all licensed banks to postpone due installments during the lockdown extended from March to May 2020, as well as to perform debt reschedule for their clients without considering it as a loan restructuring and with no commissions or delay interest charges.
- According to the continuous review of domestic economic performance, CBJ decided to postpone all installments due to its refinancing programs until the end of 2021.

- Allowing banks to postpone all installments due to their most impacted clients, including individuals and businesses, until the end of 2021, following a specific criterion.
- For further enhancing economic sectors liquidity positions, CBJ implemented a toolkit procedure regarding returned checks, which included a reduction in period inclusion in the blacklist and reducing the check return and settlement commission from JD 40 to JD 5.

On the level of macroprudential policies and to maintain the resilience of the Jordanian banking sector, the CBJ decided to:

- Postpone banks dividends distribution payment during 2020, aiming to strengthen banks capital. This step was in line with international trends to empowering the sector withstanding the shock.
- Directing operating banks to update their continuity business plans to respond smoothly to the new dynamics, use hygienic and idle cash, and fill up their ATMs in the kingdom.

5. Conclusion

COVID-19 Pandemic unleashed and affirmed the strong resilience of the global financial system compared to the last financial crisis, supported by the regulatory reforms implemented and coherent monetary policy tools and stance, including the introduction of macroprudential tools and financial stability mandate during the last decade.

Banking sectors entered the crisis in better shape and strong fundamentals, including the Jordanian banking sector. In fact, even under adverse scenarios within vulnerability and stress testing analysis, the sector financial indicators remained robust and above the international standards, which allowed the sector to continue its medium role of lending the real economy.

AMF-BIS Fourth Working Party Meeting on Monetary Policy in the Arab Region

Background Paper on Monetary Policy

The United Arab Emirates

The Central Bank of the UAE

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Abu Dhabi, United Arab Emirates
31 May, 01-02 June 2021

Monetary Policy Implementation in The United Arab Emirates

1. Background

The Central Bank of the UAE’s (CBUAE) statutory monetary policy objective is to maintain the soundness and stability of the monetary system in the UAE to ensure stability and required confidence in the national economy. To do so, the CBUAE shall determine monetary tools and operational means for the achievement of monetary policy objectives, including policies relating to the management of the exchange rate of the national currency and money markets in the UAE.

The CBUAE’s new framework for its operations in the UAE Dirham money markets, named the Dirham Monetary Framework, serves that objective. The design of the main pillars of this framework and related operational set-up is centered towards the overriding monetary policy objective of maintaining the peg of the UAE Dirham to the US Dollar.

2. The Operational Framework of Monetary Policy: The latest developments

As a reflection of the Central Bank of the UAE’s continuous efforts to achieve its monetary policy objectives and to foster money market developments in the UAE, the year 2020 was marked by the endorsement of the new Dirham Monetary Framework by the Board of Directors.

The main benefits of this Dirham Monetary Framework are three-fold:

1. Introduce and consolidate liquidity provision and drainage facilities to ensure short-term market interest rates align to US levels helping to support the FX peg.

2. Provide a clear distinction between Standing Facilities and Open Market Operations so as to improve CBUAE capacity to manage liquidity to support market development and collateralization while maintaining the FX peg; and
3. Create incentives for Deposit-Taking Financial Institutions to proactively manage their day-to-day liquidity stance and encourage money market developments in the UAE.

3. The Implications of Global, Regional, and Internal Economic and Financial Developments on Monetary Policy Implementation

The COVID-19 Pandemic, and the challenges associated with it, did not inhibit the Central Bank of the UAE from undertaking reforms toward implementing the new Dirham Monetary Framework amid an uncertain global outlook.

Given the pegged regime, the Central Bank of the UAE continued with its policy of aligning domestic money market rates with prevailing USD rates. Moreover, the USD/AED spread remained narrow throughout the crisis, which was supported by the readiness of the CBUAE to intervene in the FX market and the credibility of the CBUAE's policy to maintain the peg. During the year 2020, the USD/AED rate fluctuated within a narrow band between 3.6731 and 3.6727 AED per US dollar.

4. The Efficiency of Monetary Policy Measures in Mitigating the COVID-19 Impact and Supporting Economic Recovery

In response to the COVID-19 Pandemic, the Central Bank of the UAE adopted a comprehensive stimulus package to support the UAE economy and financial system. The Targeted Economic Support Scheme (TESS) comprises all targeted temporary measures to address the repercussions of the COVID-19 Pandemic in the UAE.

The total amounts of the measures added up to AED 256 billion, consisting of AED 50 billion capital buffer relief, AED 50 billion zero cost funding support facility to banks in exchange for targeted relief to their retail and corporate customers affected by the COVID-19 Pandemic, AED 95 billion liquidity buffer relief, and a reduction of the reserve requirements on demand deposits by half for all banks from 14 percent to 7 percent. The collective support measures aimed at providing support to banks' lending to the UAE economy and their liquidity management.

The decision to reduce the reserves requirements for demand deposits by half for all banks led to an injection of liquidity of about AED 61 billion in order to support banks' liquidity management and lending to the UAE economy. The TESS also consists of AED 50 billion from the CBUAE funds through collateralized loans at zero cost to all banks operating in the UAE and of AED 50 billion funds freed up from banks' capital buffers, to facilitate the provision of temporary relief from the payments of principal and interest on outstanding loans for all affected private sector companies and retail customers in the UAE.

5. Monetary Policy Implementation: Main Challenges and Reforms

The following steps were taken towards the implementation of the new Dirham Monetary Framework:

First, the Central Bank of the UAE introduced a new deposit facility (effective 12 July 2020) for banks operating in the UAE named "Overnight Deposit Facility – ODF". The ODF became the prime facility for managing surplus liquidity in the UAE banking sector to replace the issuance of one-week Certificates of Deposit.

With the introduction of the ODF, the general stance of the CBUAE's monetary policy is now signaled through the interest rate of the ODF (Base Rate), which becomes the main policy rate of the CBUAE. This Base Rate, which is anchored to the US Federal Reserve's Interest on Excess Reserves (IOER), also provides the effective interest rate floor for overnight money market rates.

In this regard, this new facility supports banks operating in the UAE in proactively managing their day-to-day liquidity and aligning overnight money market rates with the Base Rate in normal market conditions. With effect from 12 July 2020, the Base Rate has been ten basis points.

Second, the Central Bank of the UAE launched new regulations on reserve requirements (effective 28 October 2020) for deposit-taking licensed financial institutions. With the introduction of these new regulations, the length of the reserve maintenance period has been extended from 7 to 14 days, providing an incentive for these institutions to manage their day-to-day liquidity more flexibly and efficiently by taking advantage of the new reserve averaging mechanism.

On top of that, deposit-taking licensed financial institutions are allowed to draw on their reserve balances held in the CBUAE on any day up to 100 percent for daily settlement purposes or to deal with any swings on overnight money market rates while ensuring that they meet the average daily requirements over a 14-day reserve maintenance period.

Third, the Central Bank of the UAE launched a new securities issuance program (effective 11 January 2021) to licensed financial institutions and eligible investors, named Monetary Bills (M-Bills). The launch of the M-Bills program provided the central bank with the opportunity to establish the robust infrastructure required to manage liquidity and provide a stable collateralized source of funds to banks and financial institutions operating in the UAE. These securities are auctioned and traded through Bloomberg's primary and secondary market solutions and settled through a local platform, compliant with international standards, built and operated by Euroclear Bank.

The set-up of such infrastructure to promote the development of a local market for securities denominated in UAE Dirham and thus will contribute to establishing the risk-free pricing benchmark (yield curve), stimulating further domestic market activities.

6. Conclusion

The CBUAE set up a roadmap for the implementation of the Dirham Monetary Framework. As part of the implementation roadmap of the Dirham Monetary Framework, which will continue for the year 2021-2022, the CBUAE will introduce the Intraday Liquidity Facility (ILF), restructure the standing credit facilities (Marginal Liquidity Facility & the Collateralized Murabaha Facility), introduce the Contingent Liquidity Insurance Facility (CLIF), introduce fine-tuning open market operations, and establish new indices to support the Dirham Monetary Framework.

AMF-BIS Fourth Working Party Meeting on Monetary Policy in the Arab Region

Background Paper on Monetary Policy

The Kingdom of Bahrain

The Central Bank of Bahrain

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31 May, 01-02 June 2021

Monetary Policy Implementation in The Kingdom of Bahrain

1. Background

Under Article 3 of the Central Bank of Bahrain (CBB) and Financial Institutions Law 2006 (the CBB Law)[1], one of the objectives of the Central Bank of Bahrain (CBB) is to set and implement the monetary, credit, and other financial sector policies. According to Article 4 (2) of the CBB Law, the CBB has a duty and power to draw and implement the appropriate monetary policies to achieve the Kingdom's general economic goals and maintain the stability of the Bahraini currency and the monetary system. Accordingly, the ultimate targets of the monetary policy are to support sustainable economic growth while ensuring the stability of the Bahraini dinar and the monetary system.

2. Bahrain's Monetary Policy Framework

Monetary Policy Objectives

The CBB monetary policy operations aim to ensure that the liquidity situation in the banking sector is appropriate. The Bahraini dinar liquidity of the retail banks consists mainly of the clearing account balances they hold with the CBB. These balances, which can be traded between banks in the money market, fluctuate from day to day, mainly due to the Government's conversions of US dollar to finance its domestic expenditure. The retail banks' purchase of US dollars from the CBB changes the amount of currency in circulation and changes in the banks' reserve balances with the CBB.

1 The Central Bank of Bahrain and the Financial Institutions Law 2006 (CBB Law) was promulgated on 6 September 2006 with the issuance of Legislative Decree No 64 of 2006, which repealed Legislative Decree No 23 of 1973, establishing the Bahrain Monetary Agency (BMA), and Legislative Decree No 17 of 1987 regarding insurance companies and organizations.

The CBB Monetary Policy Committee (MPC) meets every week to closely monitor the local and international economic and financial developments; liquidity conditions (vital to the effective transmission of monetary policy instruments towards achieving the ultimate targets). MPC makes recommendations to the CBB Board/senior management on appropriate policy measures (including monetary policy instruments and the interest/profit rates on government debt securities and facilities offered by the CBB) to ensure the achievement of the operational targets of the monetary policy.

Pegged Exchange Rate: The Nominal Anchor for Monetary Policy

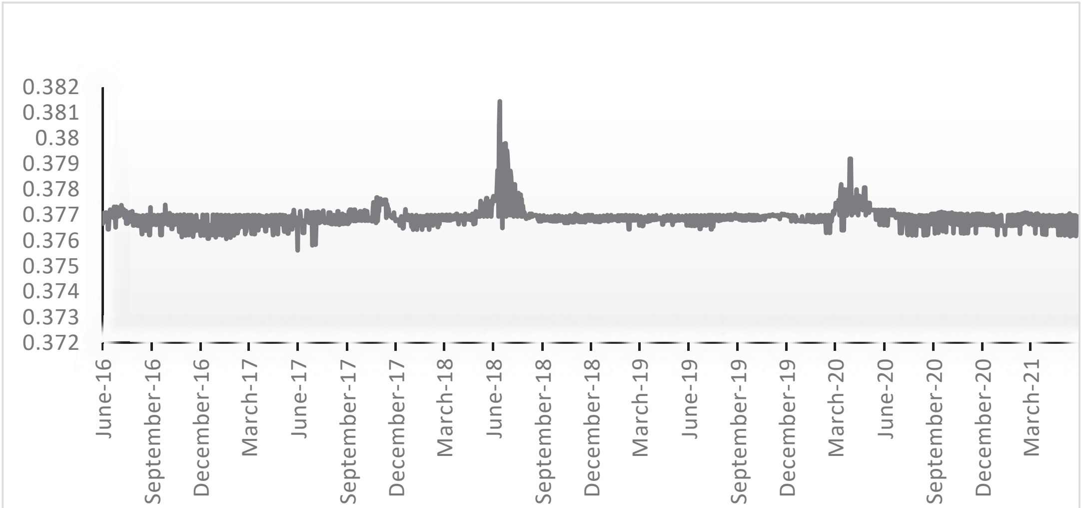
Bahrain is a country with an open economy with no restrictions on capital movements, foreign exchange, foreign trade, or foreign investment. Since 2001, Bahrain pegged its currency, the Bahraini dinar, to the US dollar (1 Bahraini dinar is equal to 2.659 US dollars[1]), and this exchange rate peg provides an anchor for monetary policy (Please see graph 1.1).

As per Article 19 (b) of the CBB Law, the amount of foreign exchange reserve permanently maintained by the CBB in regular times should not be less than 100 percent of the currency's value in circulation.

This pegged exchange rate regime helped the Bahraini dinar to remain stable, supporting sound macroeconomic management. It is also vital to ensure investor confidence in the smooth and effective functioning of financial markets, and thereby Bahrain to further improve its status as a financial center in the region. The credibility gained by the exchange rate peg has complemented the monetary policy implementation.

[1] According to Royal Decree No. 48 issued in December 2001.

Graph 1.1: Bahraini Dinar Exchange Rate



Interest Rate Policy

Since Bahrain has free capital movement and a pegged exchange rate regime, the CBB closely aligns the CBB key policy interest rate on the one-week deposit facility to the fed funds rate. However, the CBB has resorted to fix its policy rates with a suitable differential in favor of the Bahraini dinar, to manage Bahraini dinar liquidity in the domestic market (Please see graph 1.2). The CBB key interest rate guides the interest/return rates for its standing facilities provided to retail banks (including Islamic banks), short-term interest rates in the Bahrain money market, and deposits and lending rates that banks offer to their customers. The CBB policy interest rates that prevailed on 13th June 2021 are given in Table 1.1.

Graph 1.2: Key Policy Interest Rates

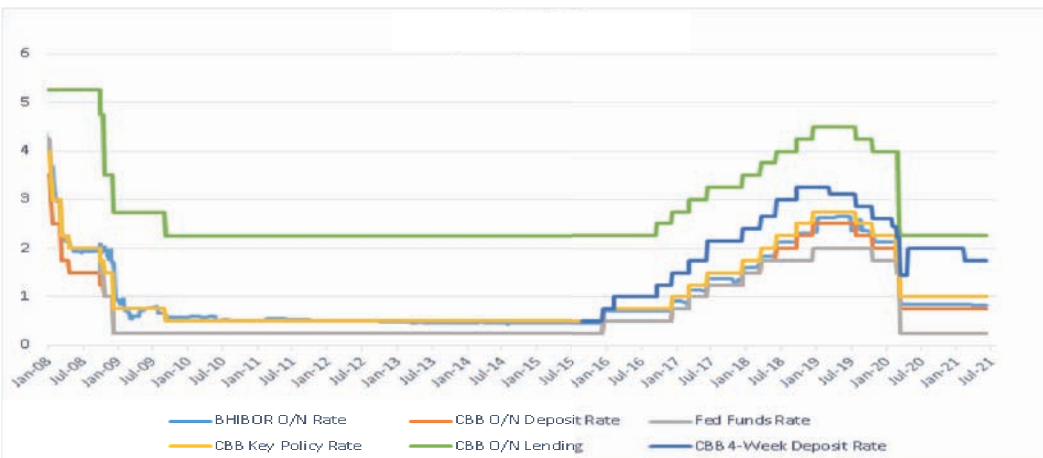


Table 1.1
The CBB policy interest rates as of 13th June 2021

No.	Facility	Interest rate %
1	CBB key policy rate	1.0
2	One-week deposit rate	1.0
3	One-week Wakalah rate	1.0
4	Overnight deposit rate	0.75
5	Overnight Wakalah rate	0.75
6	Four-week deposit rate	1.75
7	Overnight lending rate	2.25
8	Overnight Repo rate for borrowing against government treasury bills/ Sukuk-al-Ijara	2.25

Monetary Policy Instruments

Currently, the CBB has in its toolkit a wide array of tools to implement the suitable monetary policy to ensure smooth and effective functioning during the previous crises.

1. Buying and Selling BD at The Official Exchange Rate

The CBB offers a foreign exchange facility implying that it stands ready to buy the USD at the official exchange rate of 0.375 and sell USD at 0.377. The CBB's monetary policy accommodates the banks' Bahraini dinar liquidity needs, mainly by buying/selling US dollars at the official buy and sell exchange rates. These US dollar purchases/sales have a bearing on the liquidity positions at the clearing accounts of banks at the CBB and thereby on the monetary base (MO).

2. CBB Standing Facilities

The CBB offers a set of deposit and lending standing facilities in BD to all retail banks. At the end of each working day, the facilities are available at their discretion to manage their excess/shortage of BD liquidity. The interest rate on the one-week deposit facility is the CBB key policy interest rate. Currently, the CBB offers overnight, one-week, and four-week deposit facilities. Also, a secured overnight lending facility to retail banks against their deposit with the CBB or against their holding of Government of Bahrain Treasuries and Bonds. In the event of pressure on the BD/USD exchange rate, the CBB can either increase or decrease the interest rates offered on its deposit and lending facilities. Therefore, rising deposit facility rates would attract BD liquidity to the economy, while lowering it will increase dollar supply to retail banks through CBB dollar sales. As the dollar appreciates and the dinar exchange rate faces downward pressure, it would be best to increase rates on the facilities (by a small margin) to keep BD liquidity in the domestic market.

3. Reserve Requirement

All retail banks operating in Bahrain are required to maintain reserves deposited at the CBB amounting to currently 3 percent of the value of non-bank deposits denominated in Bahraini dinars. The CBB can set and change the reserve requirement rate if necessary. The reserves are not remunerated. The required reserves are held at specific reserve accounts at the CBB and cannot be used for other purposes. The reserve requirement system contributes to adjust the overall credit and BD liquidity.

The reserve requirement is another liquidity tool that can be used to absorb exchange rate pressure. The CBB can modify its reserve requirement policy by increasing/decreasing reserve requirements, injecting and removing BD liquidity into or from the market. The reserve requirement is not considered an active monetary policy instrument for day-to-day liquidity management, and its main purpose is to address structural liquidity issues.

4. Open Market Operations

According to article 29-A2 of the CBB's law, the CBB is permitted to buy and sell government debt in the secondary market. Such an operation enables the central bank to manage the BD liquidity in the market and influence interest rates.

5. FX-Swap Facility

Banks that need BD could access the CBB for FX swaps, where banks can exchange their USD to BD with a pre-agreed tenor of one week, one-month, three-month, six months, and twelve months.

The swap points are adjusted as part of the monetary policy tools available to the CBB and are used to inject or withdraw BD liquidity into the system.

CBB Response to COVID-19 Pandemic

On 11th March 2020, the World Health Organization declared COVID-19 a global Pandemic. The COVID-19 outbreak is currently having an adverse impact on the global economy, the severity and duration of which is difficult to predict. The COVID-19 Pandemic has shown some extremely challenging impacts on different sectors of the global economy, including energy, tourism, foreign and domestic trade, transport, health, and education. The Pandemic crisis was followed by another crash in oil market prices that reached their lowest level since 1998. In common with most other countries, the COVID-19 virus affected Bahrain.

Impact of the COVID-19 Crisis

The COVID-19 crisis has thrown global markets into a volatile state, prompting countries to find an optimal way to navigate their way through. Governments and banks in many jurisdictions have introduced extraordinary measures to alleviate the financial and economic impact of COVID-19. Authorities have pro-actively intervened to calm markets by taking decisive and coordinated actions and making necessary policies to mitigate the impact of difficult economic and financial trade-offs. As the situation develops further, more action will be required, which may require coordination at the national and international levels. Monitoring, containing, and mitigating the effects of the virus are top priorities to provide stability to the global economy and financial markets, boost confidence, and prevent deep and prolonged economic effects.

Tools Used During the Crisis

Since the onset of the crisis, many countries have adopted quick measures to cope with the spillover effect of the crisis. Containment and protective measures such as quarantines, travel banes, border closures, curfews, and social distancing have been imposed by many countries. However, these measures have had great impacts on the economic activity and hence, on growth. Moreover, if the crisis continues for a longer period, it could challenge authorities' power to maintain the soundness, robustness, and continuity of the financial sector.

Central banks have intervened by introducing stimulus and preventive measures in their respective jurisdictions. In many countries, central banks were struggling to inject liquidity into the banking sector by reducing the costs of monetary policy instruments and compulsory cash reserves. It has also strengthened the loan guarantee system in support of the productive sectors, which has helped the banking sector postpone loans to individuals and corporates.

The Government and the Central Bank of Bahrain (CBB) have taken several measures in response to the COVID-19 virus by introducing some policies to reduce the spread of the virus and financial measures aimed at mitigating the potential economic impact of the crisis.

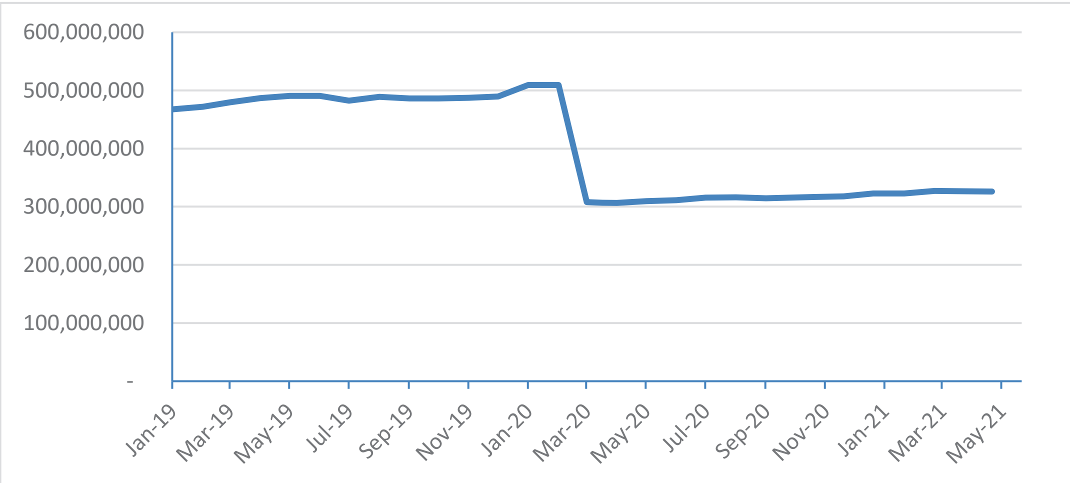
The CBB issued a number of directives to preserve the health and safety of citizens, residents, and workers in the financial sector, since the beginning of the global outbreak of COVID-19, as part of the preventative measures taken by the Government of the Kingdom of Bahrain to contain the virus. A number of key policy responses (including fiscal, monetary, and macro-financial) were also issued to mitigate any implications on customers of financial services, financial institutions, and merchants affected by COVID-19 and protect the stability of the financial sector in the Kingdom of Bahrain.

3. CBB’s Monetary Policy Measures as Part of Precautionary Efforts to Contain COVID-19

On the 18th of March 2020, the Central Bank of Bahrain introduced regulatory measures to contain the financial repercussions of the COVID-19. These Monetary policy measures included:

- The required reserve percentage has been reduced from 5 percent to 3 percent in March 2020. The total Banks' Reserve Requirement balance outstanding in December 2020 was BD 322.857 million, compared to BD 489.789 million in December 2019, with a 34 percent decrease (Graph 1.3).

Graph 1.3 : Required Reserve



- CBB provided retail banks concessionary repo arrangement up to 6 months at zero percent on a case-by-case basis. Any licensee requiring the CBB's concessionary repo arrangement was required to submit their cash flow projection until the end of 2020 for CBB's assessment and consideration. The total value of zero interest REPO transactions was BD 230 million for conventional banks and BD 241.242 million for Islamic banks during the year 2020.

- The interest rates on the BHD deposit and lending facilities were adjusted. On 16th March 2020, the BHD deposit and lending rates were cut by 75 bps. The one-week deposit facility rate was cut from 1.75 percent to 1.00 percent, the overnight deposit rate from 1.50 percent to 0.75 percent, the four-week deposit rate from 2.20 percent to 1.45 percent, and the CBB lending rate from 2.45 percent to 1.70 percent.

- On 30th April 2020, the interest rates on the BHD deposit and lending facilities were adjusted. The Four-week BHD deposit rate was increased from 1.45 percent to 2.00 percent and the overnight lending rate was increased from 1.70 percent to 2.25 percent.

- On 16th February 2021, the interest rate on the BHD deposit rate was adjusted. The four-week BHD deposit rate was decreased from 2.00 percent to 1.75 percent.

4. Conclusion

By implementing the policy mentioned above measures, the CBB managed to help the economy absorb the shock of the current crisis by keeping borrowing affordable for all banks operating in the Kingdom and supporting the banking system liquidity. The Monetary Policy Committee (MPC) is following the developments. It meets every week to discuss and prepare recommendations to apply the necessary monetary policy tools that support the economy.

AMF-BIS Fourth Working Party Meeting on Monetary Policy in the Arab Region

Background Paper on Monetary Policy

The Republic of Tunisia

The Central Bank of Tunisia

Prepared by

Mrs. Rym Kolsi

Director General of Monetary Policy

Abu Dhabi, United Arab Emirates
31 May, 01-02 June 2021

Monetary Policy Implementation in The Republic of Tunisia

1. Background

In 2020, the Tunisian economy was hard hit by the fallout of the COVID-19 Pandemic; at the time, it just embarked on a stabilizing process meant to address macroeconomic imbalances. The economy's contraction recorded in 2020, which was about 8.8 percent, was the worst since Independence, thus compromising the economy's chance of a quick recovery. This performance resulted from worsening twin deficits accumulated over the past decade and aggravated by the total followed by the partial lockdown decided by the Government at the start of March 2020, when the first contaminated cases were identified.

The challenging domestic environment was coupled with a turbulent external landscape, either because of geopolitical unrest or the propagation of the Pandemic worldwide. Several export-oriented sectors suffered decreasing external demand as the manufacturing sector and others were deeply affected by sanitary measures, especially the transport and tourism sectors.

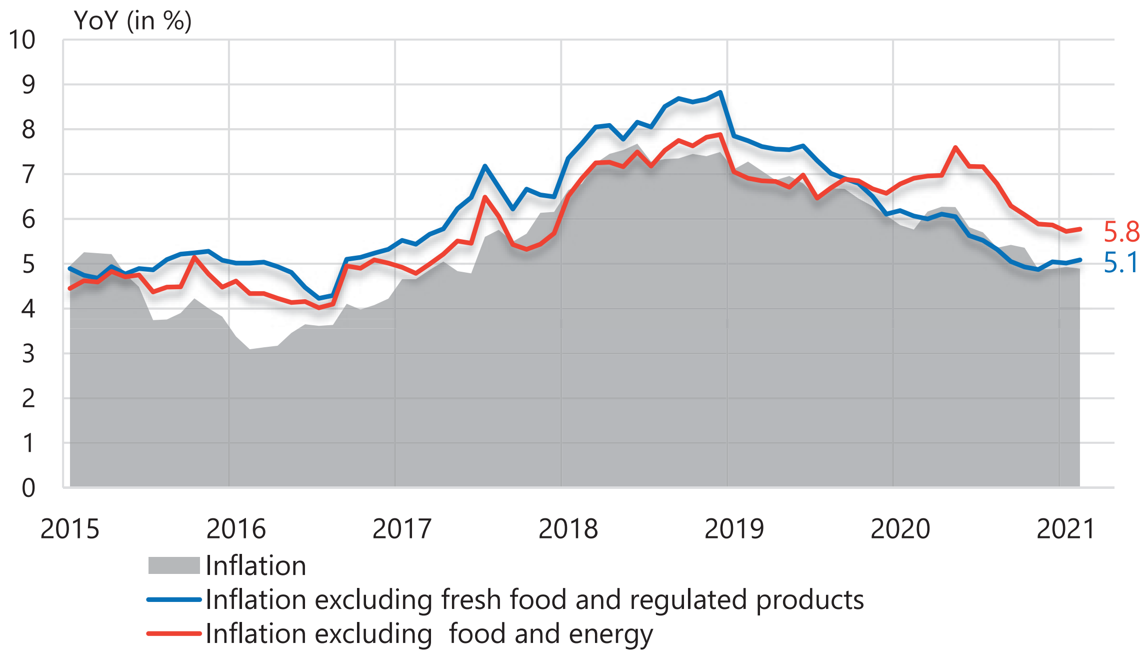
In that challenging context, the Central Bank of Tunisia (CBT), which is in charge of preserving price stability, had to provide the banking sector with enough liquidity to pursue financing the economy at the time the threat of a credit crunch was growing. A set of courageous measures were taken along with the easing of monetary policy through the cut of the key interest rate on two occasions to mitigate the COVID-19 impacts, while inflation was on a downward trend.

For the forthcoming period, the main challenge is to restore a sounder economic environment to pave the way for recovery and more inclusive growth. Lessons learned from the Pandemic showed that digitalization is a must to overcome the situations of lockdown and boost transactions and make them more transparent. Rethinking the jobs of tomorrow is possible today.

2. The Operational Framework of Monetary Policy: The Latest Developments

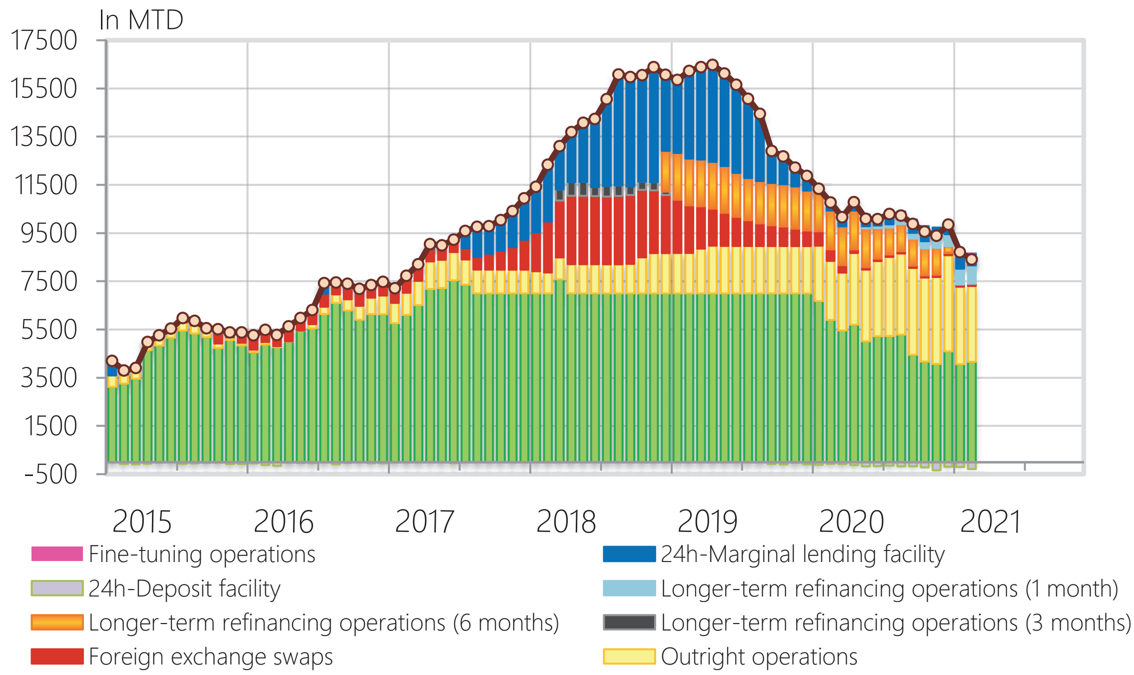
As the result of tightening monetary policy over the 2017-2019 period, the inflation rate embarked on a downward trend. It gradually decreased all along 2020 to a lowest of 4.9 percent in December vs. 5.9 percent at the start of the year (Cf. Figure 1). Since then, it stood stable at 4.9 percent in January and February 2021, then decreased to the lowest of 4.8 percent in March 2021.

Figure 1: Trends in headline inflation and core inflation



This tightening process, combined with the adoption in late 2018 of a loan-to-deposit ratio, has positively impacted the total volume of refinancing, which decreased significantly from a highest of TND 16.5 billion on average (April 2019) to TND 9.6 billion (December 2020). (Cf. Figure 2). Currently, the total volume of refinancing is at 8.455 MTD (March 2021).

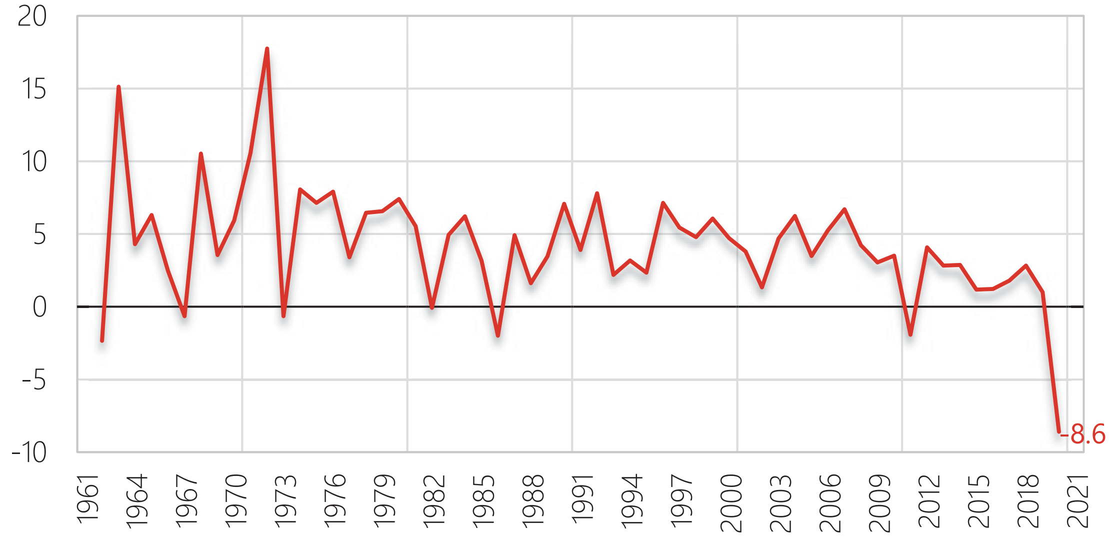
Figure 2: Trends in total volume of refinancing



With the outbreak of the Pandemic of COVID-19, and its quick spread worldwide, Tunisia evolved in a challenging environment. The economic situation was deeply affected by sanitary measures that the Government has taken. A total lockdown was decided from March 20th to May 5th, followed by a targeted partial lockdown until June 4th. Consequently, the GDP of 2020Q1 contracted by 2.1 percent YoY and further deteriorated over 2020Q2 (with a contraction of 21.3 percent). For the year 2020, as a whole, the economy has contracted by an unprecedented rate since independence reached 8.8 percent. This compares to a contraction of 1 percent in 2019. (Cf. Figure 3).

This underperformance severely reduced potential output in 2020 in relation to the multitude of supply shocks (drop in the production capacity of several sectors, deterioration in productivity, etc.) and demand (rise in unemployment, contraction in the economic growth, Decrease in foreign demand, deterioration of the investment sentiment, etc.). Given the historic collapse of economic activity in 2020, the output gap widened significantly.

Figure 3: GDP Percentage Change (at 2010 constant prices)



To cope with the prospected negative impact of the Pandemic on the banking sector, and therefore on the economy, the Central Bank of Tunisia took a set of measures. Some of them are prudential measures to preserve financial stability (Cf. Table1).

Given the lockdown, many measures were also taken to boost e-payments, thus avoiding files at banks. These measures concern the free-of-charge of cash withdrawals at ATMs.

Table 1: Prudential Measures to Preserve Financial Stability

	Taken measures	The rationale of the measure	The reference of the measure
For monetary policy purposes	100 bps cut in key interest rate to 6.75 percent	Lighten financial costs supported by corporates to preserve their activity, and consequently the banking sector soundness.	CBT' Board decision (March 17th, 2020)
	Conditions of liquidity provision eased	To cope with liquidity tightening and preserve the well-functioning of the interbank market	
	Eligible collateral for refinancing operations eased	New assets accepted as collateral for refinancing	
	Additional 50 bps cut in key interest rate to 6.25 percent.	To further support corporates, thus	CBT' Board decision (September 30th, 2020)

	Taken measures	The rationale of the measure	The reference of the measure
		preserving the banking sector soundness.	
For financial stability purposes	Postponement of the holding of ordinary general meetings of banks beyond the legal deadline of April 30th, 2020, due to total lockdown.		Note to banks
	Suspension of the distribution of dividends for the 2019 financial year	Build up counter-cyclical reserves to strengthen banks' resilience to shocks.	Note to banks and lending institutions n°2020-17 of April 1st, 2020
	Ban on the repurchase by banks of their own shares		Note to banks and lending institutions n°2020-17 of April 1st, 2020

3. The Implications of Global, Regional, and Internal Economic and Financial Developments on Monetary Policy Implementation

Global economic activity was disrupted in 2020 by the strong spread of the coronavirus Pandemic and by the measures taken worldwide to limit its propagation. Moreover, the year was marked by the rise in uncertainties linked to Brexit and the aggravation of trade conflicts between the United States, China, and the European Union, and the rising geopolitical tensions between the EU and Russia.

IMF[1] Global growth forecasts have expected the global economy to contract by 3.5 percent in 2020 (vs. growth of 2.8 percent in 2019). Significant contraction characterized both advanced economies (-4.9 percent in 2020 vs. +1.6 percent in 2019) and emerging and developing countries (-2.4 percent vs. +3.6 percent). The Euro Zone, Tunisia's main trading partner, suffered a deep decline in activity (-7.2 percent in 2020 vs. +1.3 percent in 2019).

As for inflation, the rapid spread of COVID-19 exerted disinflationary pressures in 2020 in the main advanced economies. Between January and December 2020,

[1] "World Economic Outlook Update" - IMF - January 2021.

the general price level fell by 0.3 percent in the Eurozone compared with an increase of 1.4 percent in 2019 due to sluggish demand and the continued appreciation of the euro against the US dollar.

World prices of raw materials and commodities, which collapsed at the beginning of 2020, gradually recovered at the end of the year, thanks to the launch of vaccination campaigns, which is essential to stimulate global demand. Oil prices crossed the mark of USD 50 per barrel in December 2020, supported by the combination of a rebound in global demand (cold snap in Europe and Asia) and a reduction in supply from OPEC and its allies.

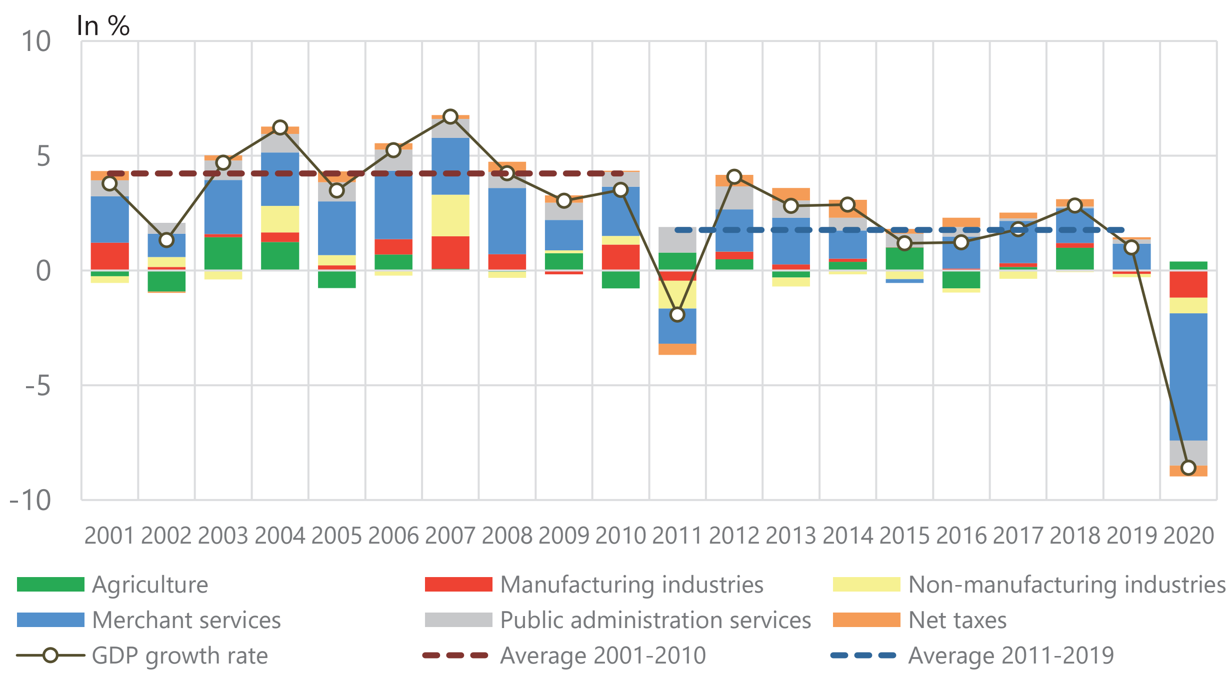
According to the latest projections from the International Energy Agency, global demand is expected to increase by 5.5 million barrels per day in 2021, after a contraction of about 8.8 million barrels per day contraction in 2020; a recovery which mainly reflects the effectiveness of budgetary and monetary support programs to deal with the health crisis. In this context of a global economic recession, the main central banks have opted for ultra-accommodative monetary policies to mitigate the extent of the repercussions of the crisis.

In Tunisia, economic activity was marked in 2020 by an unprecedented recession in the wake of the COVID-19 Pandemic. GDP growth, expressed at constant 2010 prices, first contracted by -2.8 percent (Q/Q) in the first quarter, in line with the introduction of strict containment measures at the start of the last ten days of March, and then sank into recession, in Q2-2020, by 19 percent (Q/Q) in relation with the total containment decreed during the second quarter. After this historical fall, the third quarter was that of the technical rebound, with a growth rate of 19.4 percent (Q/Q) (Figure 4).

The latest economic indicators for the fourth quarter of 2020 refer to a contraction in the GDP level due to the resurgence of the second wave of the Pandemic. This relapse would have been driven mainly by the underperformance of the agricultural sector, the mining, chemical, and petroleum refining sectors, and specific extroverted sectors, namely, tourism, transport, and the textile, clothing, and leather industries.

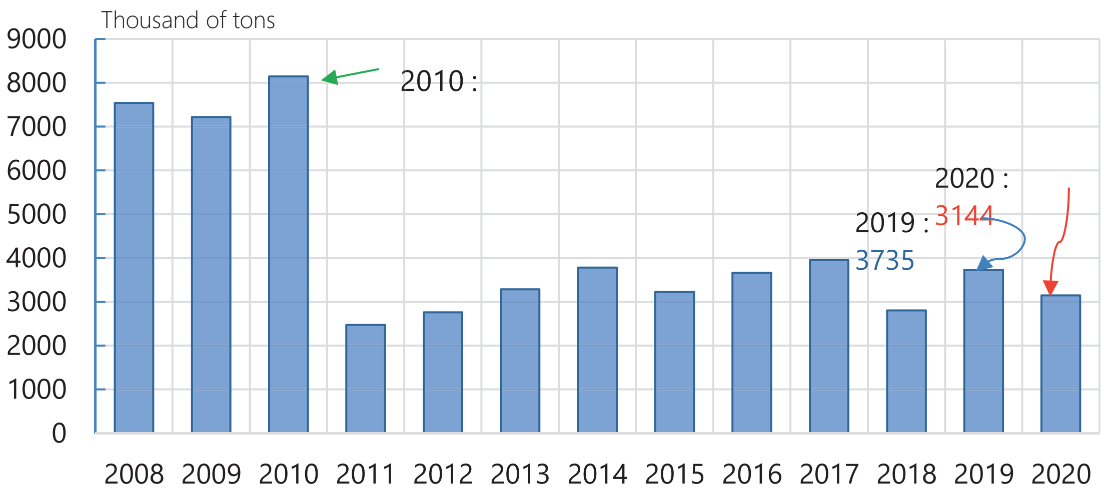
Over 2020, the agricultural sector performed well. The olive oil harvest was exceptional during the 2019/2020 season with a production of 2,000 thousand tons, up +185.7 percent compared to the previous campaign (700 thousand tons) and + 23.1 percent compared to the 2017/2018 season (1,625 thousand tons). Likewise, the record date harvest made a positive contribution to agricultural value-added, with 332 thousand tons for the 2019/2020 season, against 288 thousand tons the previous season and 305 thousand tons in 2018. The agricultural sector's contribution to overall GDP would have been more significant had it not been for the drop in cereal production in 2020 than the 2018/2019 campaign, i.e., 15.3 million quintals against 23.8 million quintals.

Figure 4: Sectoral Contributions to Growth



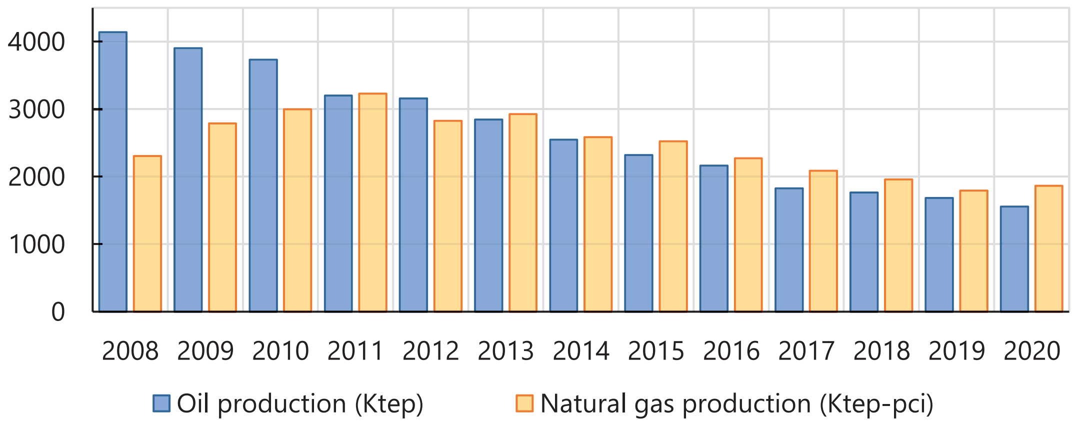
As for the manufacturing industries, the activity would have contributed negatively to GDP growth in 2020 due to the deterioration of activity in the main exporting branches, namely, the mechanical and electrical industries, and those of textiles, clothing, and leather, to which would be added the contraction of activity at the level of chemical industries. Also, the activity of the chemical industries would have dragged down the growth of 2020, following the drop in phosphate production and disruptions in the transport of raw phosphate to the factories of the chemical group.

Figure 5: Production of Phosphate



For the non-manufacturing industries, the activity has experienced a decline in 2020, in the wake of persisting difficulties in mining basins and oil sites and the fall in activity in the "building and civil engineering" sector. Regarding mining activity, phosphate production fell by 15.8 percent in 2020 to stand at 3,144 thousand tons against 3,734.6 thousand tons in 2019 (Figure 5). As for the energy sector, the downward trend in crude oil production continued in 2020, connected with the stoppage of production in some oil fields (Figure 6).

Figure 6: Production of Oil and Natural Gas

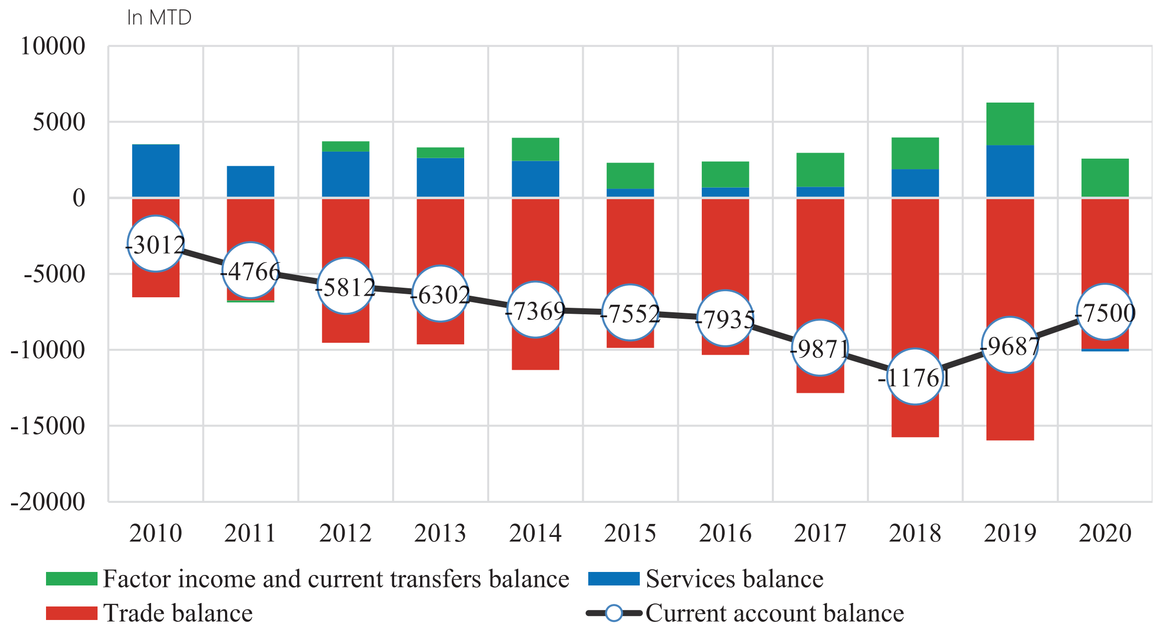


The market services sector would have been strongly affected by the restrictions relating to the closure of air and sea borders for passengers, the almost total stoppage of rail and road passenger traffic, and the closure of hotels, cafes, and restaurants with a drastic drop in the flow of tourists and Tunisians living abroad. The tourism and air transport indicators showed an apparent deterioration in 2020 (by 82.1 percent for the entries of non-residents, 81.1 percent for bed nights, 75.3 percent for the number of air passengers, and 66 percent for the number of air flights, compared to the previous year).

Inflation continued its downward trend in 2020, falling from 5.9 percent in January to 4.9 percent in December, to stand at 5.6 percent on average over the year compared to 6.7 percent recorded in 2019. Also, core inflation (excluding fresh food and regulated prices) was down.

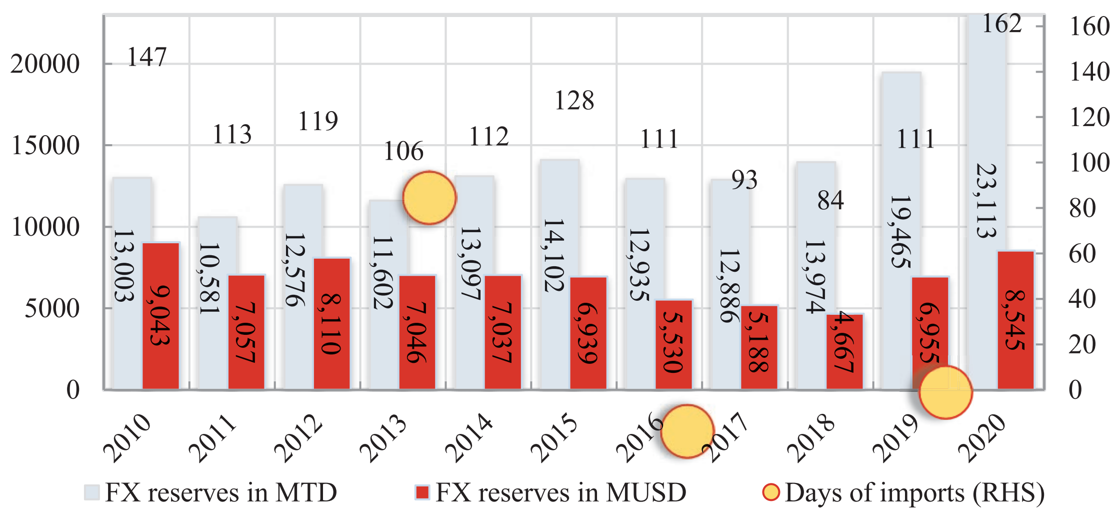
The marked decrease in the trade deficit in 2020 to reach 9,927 MTD or 9 percent of GDP, compared to a deficit of 15,955 MTD or 14 percent of GDP in 2019, contributed significantly to the contraction of the deficit of the current account balance. Thus, the current deficit fell from 9,686 MTD (or 8.5 percent of GDP in 2019 to 7,500 MTD (or 6.8 percent of GDP) in 2020 (Figure 7).

Figure 7: External Sector Main Balances



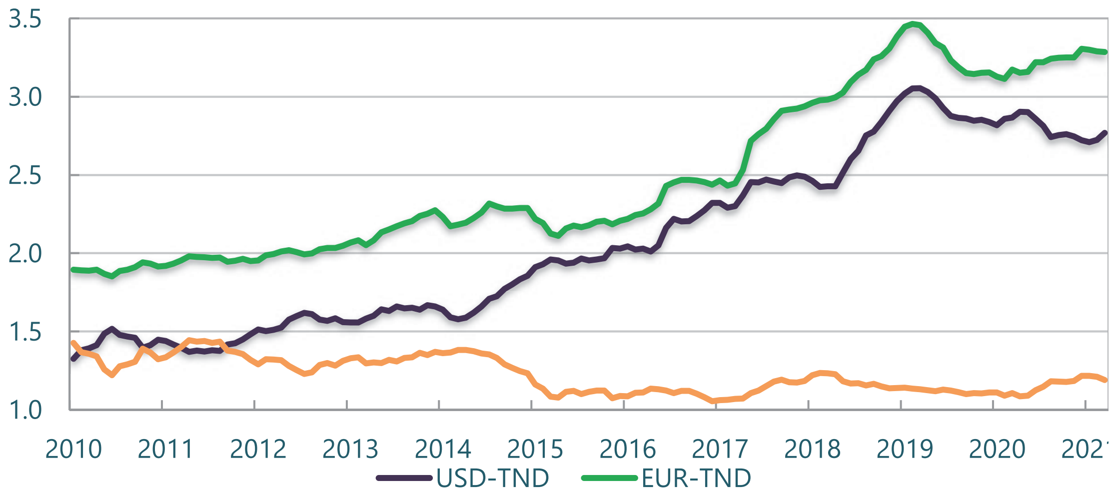
Foreign exchange reserves stood at USD 8,545 Million (or 162 days of import) at the end of 2020. This compares to USD 6.955 Million and 111 days of imports in 2019 (Figure 8).

Figure 8: Foreign Exchange Reserves



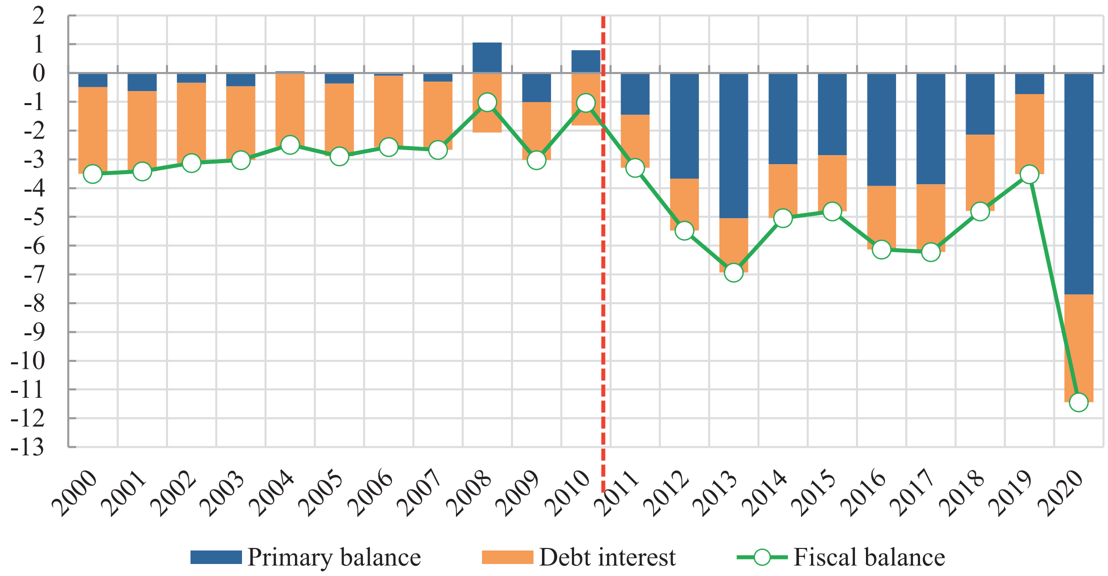
Regarding the exchange rate, the appreciation of the Tunisian dinar against the main currencies, which started in April 2019, benefiting from the monetary policy tightening, has continued until the end of 2020 for the US dollar and stopped in June 2020 for the Euro, giving way to a slight depreciation during the second half of the year. On an annual average, the price of the dinar appreciated by 4.3 percent against the dollar and by 2.4 percent against the Euro in 2020 (against depreciation of 9.8 percent and 4.8 percent, respectively in 2019) (Figure 9). The good performance of the dinar exchange rate and the significant drop in international prices of commodities, mainly energy, was quickly transmitted to the various components of the price chain.

Figure 9: Exchange Rates



At the budget level, the year 2020 was challenging. The cost of the Pandemic was assessed at about 5 percent of GDP. This resulted from decreasing tax revenue in line with the declining activity, combined with social support for families in need. Consequently, the budget deficit picked up to 11.4 percent of GDP (Figure 10).

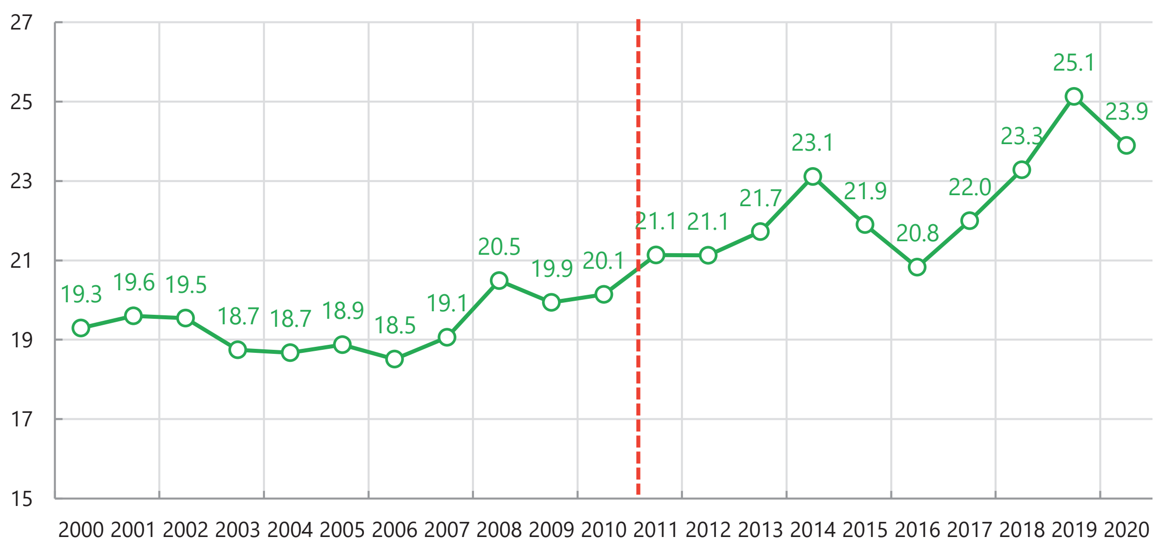
Figure 10: Fiscal Balance



To cope with the increasing fiscal deficit, the Government adjusted upward a set of regulated prices to ease pressure on subsidies. These comprised electricity, water, and, more recently, oil prices.

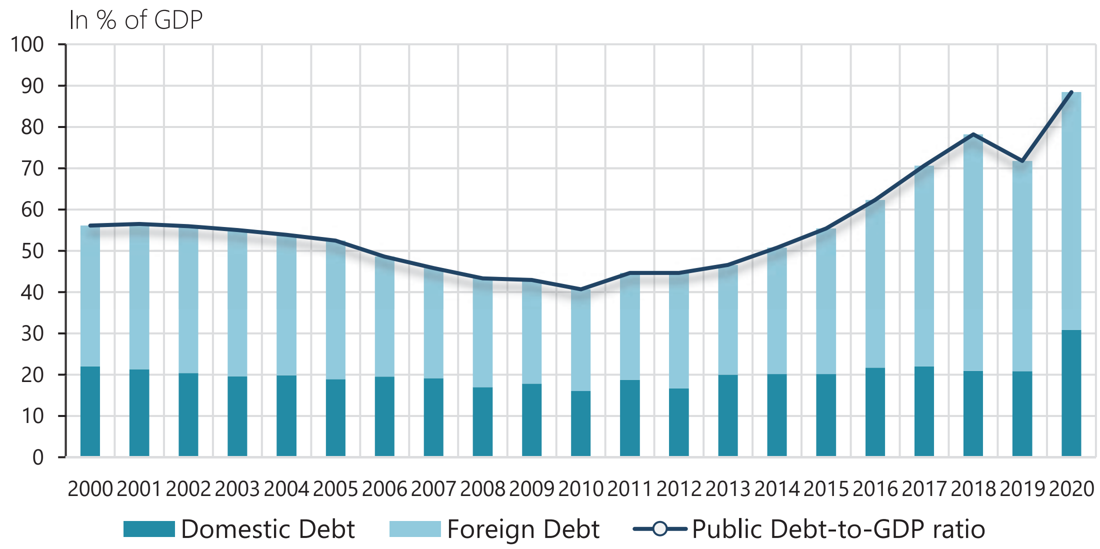
Despite its decrease, the tax burden remained high in 2020, compared to levels registered over the past decade.

Figure 11: Tax Burden



The Tunisian government handled the crisis cautiously, considering financial constraints. Nevertheless, the double effect of the increase in expenditure and revenue contraction has resulted in a widening of the budget deficit and more significant additional financing needs with a deterioration in public debt ratios, all in a critical context marked by difficulties accessing the international, domestic financial market. (Figure 12).

Figure 12: Public Debt Ratio



4. **The Efficiency of Monetary Policy Measures in Mitigating the COVID-19 Impact and Supporting Economic Recovery**

The unprecedented health crisis combined with a heavy legacy of structural problems, along with persistent socio-political instability and an unfavorable international environment, weighed heavily on economic growth and the budget deficit, which stood at all-time highs. In contrast, the demand shock, on the one hand, and the fall in international commodity prices, on the other hand, have significantly contributed to the reduction of pressures on external payments, despite the sharp contraction in exports of goods and the decline of tourism receipts.

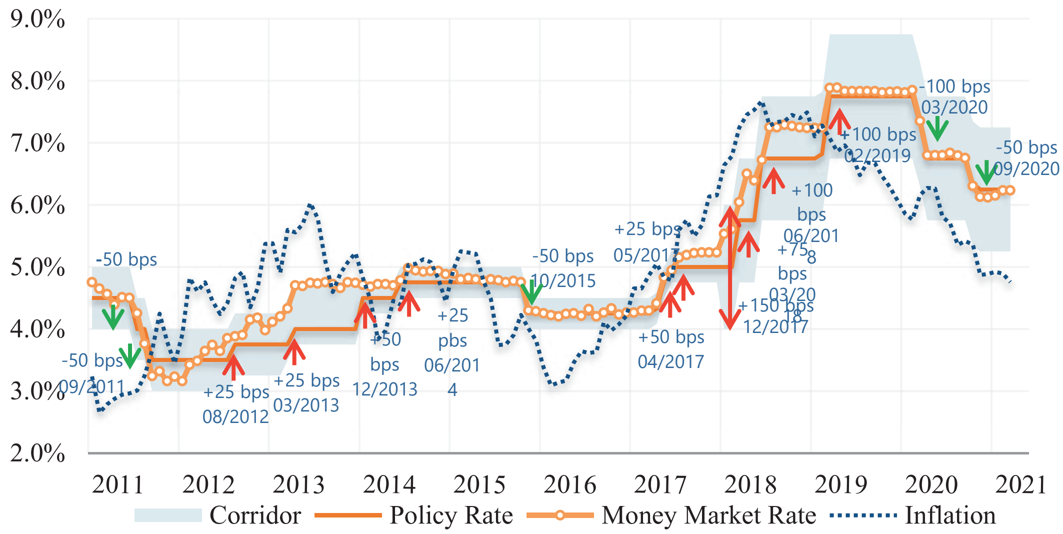
In terms of consumer prices, the year 2020 marked the continuation of the disinflationary trajectory started at the beginning of 2019. Indeed, the inflation rate stood at 4.9 percent at the end of 2020, i.e., the lowest level reached since June 2017. This development was supported, among other things, by the easing of pressure on foreign currency reserves and the good performance of the dinar exchange rate against the main currencies.

In this context, monetary policy played a very active role in helping to limit the impact of the health crisis on the national economy by easing inflationary pressures due to a tightening cycle that characterized the period 2017-2019. What followed was a phase of loosening dictated by the need to ward off the shock generated by the Pandemic, thanks to the downward outlook for inflation.

Indeed, the Central Bank cut its key rate twice, respectively, in March (100 basis points) and September 2020 (50 basis points), bringing it down from 7.75 percent to 6.25 percent. (Figure 13). This energetic action was accompanied by a set of measures aimed at meeting banks' needs in liquidity to pave the way for an economic recovery once the Pandemic was over. These measures were reinforced by others to preserve financial stability, particularly by easing credit conditions and reducing financial burdens for businesses and individuals.

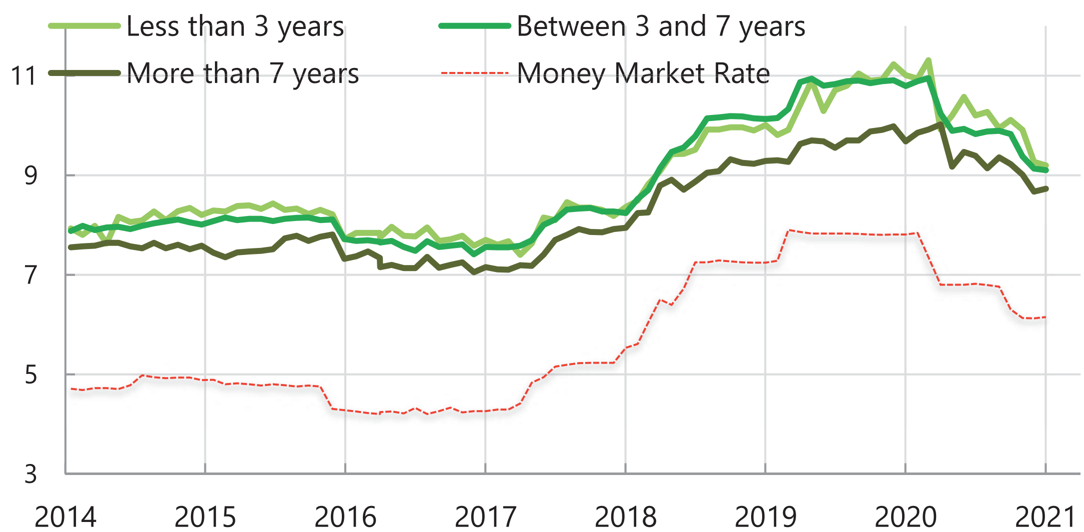
The measures taken in terms of monetary policy made it possible not only to provide the banks with the necessary liquidity, as evidenced by the absence of tensions on the money market rate but also to cope with the disturbances generated by the economic fallout from the COVID-19 crisis on monetary policy transmission.

Figure 13: Trends in CBT Rates and Inflation



As a consequence of monetary policy easing, lending conditions relaxed somewhat, especially after the first decision in March 2020. Both households and corporates benefited from these measures. The 172 bp decrease in the money market average rate (TMM) has affected conditions on less-than-three years lending (-167 bps) and more-than-seven-years loans (-118 bps) for households particularly (Figure 14).

Figure 14: Lending Conditions for Households (%)

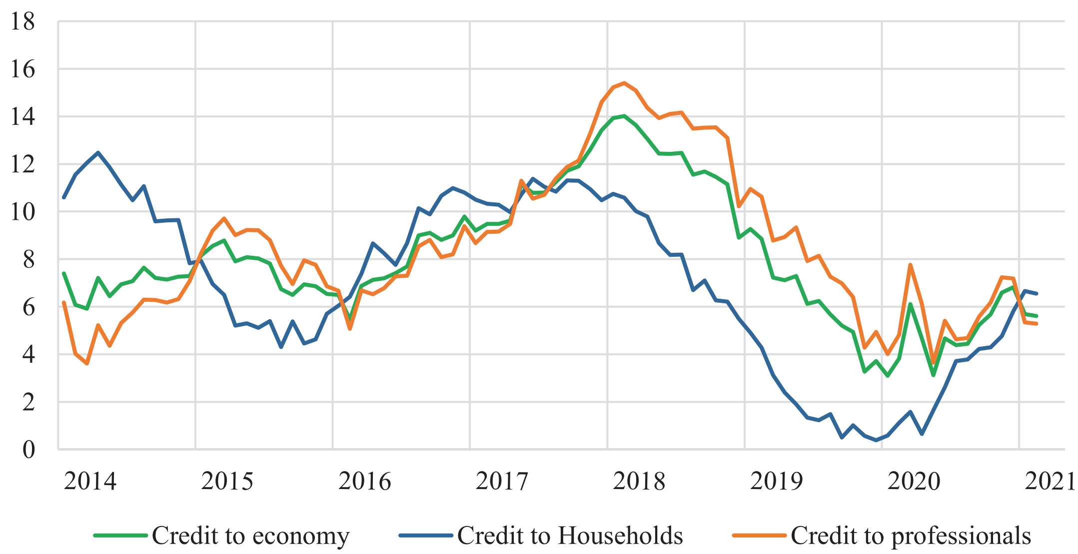


The impact was more important for corporates as rates decreased by 226 bps on average between March and December 2020 (Figure 15).

Figure 15: Lending Conditions for Corporates (%)

By easing credit conditions, the Central Bank aims to stimulate demand for credit (Figure 16) to support economic recovery at a time when the effects of the Pandemic have strongly affected activity, resulting in an unprecedented recession.

Figure 16: Trends in Credit to the Economy (%)



5. Main challenges and reforms

Prospectively, the economic recovery will strongly depend on the vaccination process. About 400,000 citizens have received the vaccine, but the Government aims to reach 4 million people before June 2021.

In the short term, it is expected that different industries would continue to be unevenly affected by the Pandemic and the restrictions aimed at limiting its spread for a few more months. The dynamic of economic growth expected for the first half of 2021 would be supported mainly by industrial activity. Despite health restrictions posted in the last quarter of 2020, a production rate is now close to the pre- Pandemic level.

Beyond that, the hypothesis on the future epidemiological evolution is that vaccination would make it possible to curb the epidemic and gradually lift restrictions nationally and internationally. As a result, the activities most constrained by containment measures, particularly for the hotel, restaurant, and transport sectors, representing more than 11 percent of GDP, could gradually recover from the second half of 2021.

Unlike previous crises, the COVID-19 crisis is an exogenous shock that simultaneously affected aggregate supply and demand, inducing a deep recession in the real economy. The inflationary impact of the fall in supply, which is likely to boost prices upward, has been offset, to a large extent, by the historic contraction in demand due to a large extent to restrictions on the mobility of people, teleworking, reductions in income, job losses, and rising unemployment.

The Central Bank of Tunisia, which is in charge of preserving price stability, would continue to be vigilant to the future development of inflation and would spare no effort to fight as a priority against any resurgence of inflationary pressures. At the same time and given its mandate to contribute with other parties to financial stability, the Central Bank of Tunisia encourages banks to support the recovery in the framework of their leading role in terms of financing the economy.

6. Conclusion

The fallouts of the COVID-19 Pandemic, assessed in terms of SWOT analysis, revealed that the Tunisian economy has many strengths but faces many challenges that it must overcome.

The challenges that need to be remedied are the difficult situation of public enterprises and social security funds, the subsidy system which weighs down public finances, the difficult situation in mining areas, and many others. For the forthcoming period, it is essential to put the economy on a growth track and implement the structural reforms needed to raise the potential GDP.

However, there are many opportunities to be seized to improve social well-being. Win the bet of digitization, adopt cash transfers instead of price targeting, which has proven to be counterproductive, relax foreign exchange regulations so that they favor the internationalization of the Tunisian company, and boost trade with neighboring countries can only resume growth.

AMF-BIS Fourth Working Party Meeting on Monetary Policy in the Arab Region

Background Paper on Monetary Policy

People's Democratic Republic of Algeria

Bank of Algeria

Prepared by

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Director of Loans and Banking Organization

Abu Dhabi, United Arab Emirates
31 May, 01-02 June 2021

Monetary Policy Implementation in The People's Democratic Republic of Algeria

1. Background

Algeria is a natural resource-rich country. With more than 90 percent of the country's exports of goods being hydrocarbons., Algeria is highly dependent on energy prices. Since that, the Algerian economy has had to deal with a number of external shocks, including the last one caused by the COVID-19 crisis.

During the last decade, the conduct of monetary policy faced many challenges, including the need for an analytical framework to determine the level of equilibrium real effective exchange rate in the context of those external shocks.

In addition, in 2010, the mandate of the Bank of Algeria has been adjusted and supplemented by Order no 10-04 to set price stability as the objective of the monetary policy. Since then, the inflation targeting inherent in the new monetary policy framework becomes crucial.

2. The Operational Framework of Monetary Policy

The mandate of the Bank of Algeria has been set by Order 10-04 relating to money and credit, article 35 of which adds the price stability to the ultimate monetary policy goals assigned to the Bank of Algeria, including ensuring monetary and financial stability.

The instruments used in implementing monetary policy had been fixed by the Council of Money and Credit, which is the monetary authority; it determines the monetary objectives, particularly in regard to changes in monetary and credit aggregates and sets the monetary policy instruments based on projections developed by the Bank of Algeria.

In the conduct of monetary policy, the interventions of the Bank of Algeria are made within a regulatory framework, namely:

Open market operations

Open market operations on the money market are carried out on the initiative of the Bank of Algeria, which also decides on a fixed or variable rate to be applicable to these transactions. Open market operations may have maturities of seven (07) days (standard weekly transactions) up to twelve (12) months (longer maturity operations).

The instruments used under open market transactions include three categories:

- Reverse transactions: Transactions by which the Bank of Algeria buys or sells eligible papers under repurchase agreements or grants loans against eligible assets as collateral. Reverse transactions are used for the monetary policy transactions below:
  - Main refinancing operations,
  - Refinancing operations for longer periods,
  - Fine-tuning operations,
  - Structural operations.
- Outright transactions: Transactions by which the Bank of Algeria buys or sells eligible assets outright on the market. Such operations are only used under structural and fine-tuning transactions.
- Collection of deposits without collateral: Banks may be invited by the Bank of Algeria to place liquidity as remunerated deposits at the Bank of Algeria through invitations to tender. Such transactions are made in order to absorb liquidities on the market. The deposits accepted are for a fixed term and no collateral is given by the Bank of Algeria in exchange for the deposits.

Standing facilities

They are intended to provide or withdraw liquidity from banks. These transactions are carried out on the initiative of banks and aim to indicate the orientation of monetary policy and frame the overnight money market interest rates. There are two types of facilities:

- The marginal lending facility allows any bank to obtain from the Bank of Algeria, against submission of eligible papers, overnight liquidity at a predefined rate.
- The deposit facility: Eligible banks may use the remunerated deposit facility to make overnight deposits at the Bank of Algeria at a predefined rate.

Rediscount operations

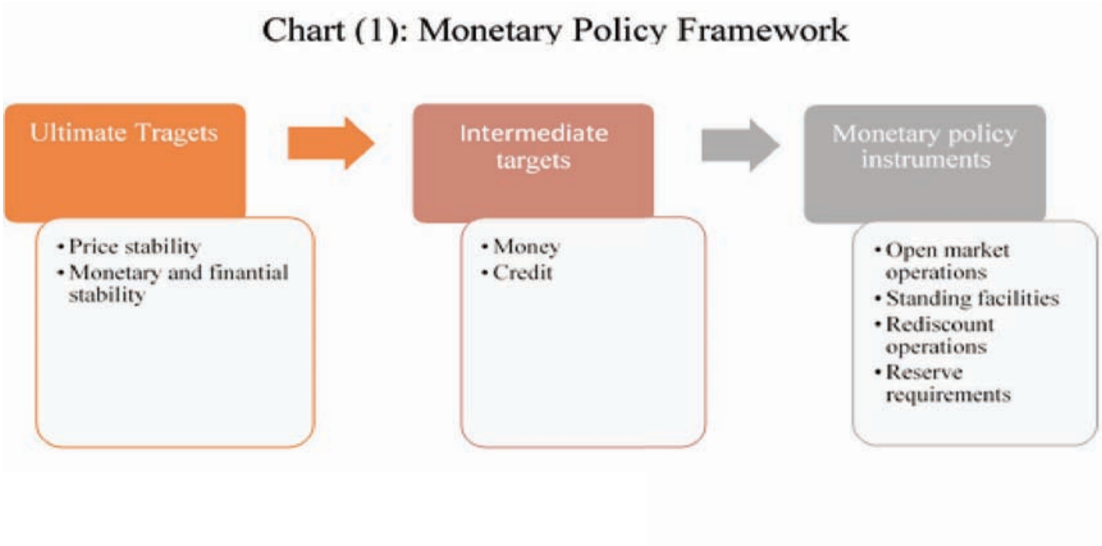
The Bank of Algeria may carry out discount transactions on government securities issued or guaranteed by the State, in favour of banks and financial institutions, including:

- Short-term Treasury bills with a maturity equal to or lower than one year.
- Medium-term Treasury bills with a maturity of two to five years.

The Bank of Algeria may also rediscount short and medium-term private bills representing trade operations and credit transactions carried out by banks and financial institutions. The Bank of Algeria may also grant advances and credits to banks for one year and over. These credits shall be guaranteed by pledges of treasury bills and bonds, gold, foreign currencies, or private papers eligible for rediscount.

Reserve requirements

Banks are required to hold minimum mandatory reserves on accounts at the Bank of Algeria. These reserves are constituted based on their liabilities collected and/or borrowed in Algerian dinars and liabilities resulting from off-balance-sheet transactions except when these liabilities are due to the Bank of Algeria. The rate of the constitution of these reserves is set at between 0 percent and 15 percent. Within this range, the effective rate is set according to the monetary policy objectives by the Governor of the Bank of Algeria.



Monetary policy measures taken to mitigate the impact of COVID -19

Following developments relating to the health crisis of COVID-19 and its impact on the banking system and on the economy, the Monetary Policy Operations Committee decided to:

- Lower the key policy rate of the Bank of Algeria applicable to main refinancing operations by 50 basis points (0,5 percent), to set it at 3 percent instead of 3,5 percent.
- Reduce the rate of the minimum reserves from 10 percent to 2 percent during the whole period which, released a significant additional amount of liquidity.
- Raise the refinancing threshold of negotiable public securities by the Bank of Algeria, as follows:
  - Securities with residual maturities of less than one year: from 90 percent to 95 percent.
  - Securities with residual maturities of 1 year to 5 years: from 80 percent to 90 percent.
  - Securities with residual maturities equal to or greater than 5 years: from 70 percent to 85 percent.
- Increase in the refinancing thresholds for negotiable public securities that the Bank of Algeria accepts as eligible collateral for monetary policy

operations has enabled banks to increase their refinancing capacity with the Bank of Algeria.

The decisions taken allowed to free up additional liquidity for the banking system and, thus, make additional resources available to banks and financial institutions to support the economy financing at a reasonable cost.

3. Monetary Policy Implementation: Main Challenges and Reforms

With the double shock that Algeria is facing, the first related to the fall in oil prices and the second being the impact of COVID-19 on the national and global economies, the Bank of Algeria needs to strengthen its role as lender of last resort to meet the financial needs of commercial banks. In addition, some questions have been raised about the use of unconventional monetary policy instruments, particularly about the extent of their effectiveness in supporting the banking system and consequently growth and, more importantly, the future consequences of these massive financings on inflation. Moreover, the recent adoption of a regulatory framework for Shariah-compliant Finance and the proliferation of such products in the banking system poses a significant challenge of developing an arsenal of Sharia-compliant instruments for the conduct of monetary policy in this context.

The fiscal dominance and reliance on central bank financing of the budget deficit represent other challenges that interfere with monetary policy in Algeria. Accordingly, a prudent fiscal policy needs to be adopted simultaneously that the Bank of Algeria should implement the monetary policy with the ultimate goal to achieve price stability. Furthermore, the recent events proved that there is a limit to what monetary policy alone can do, and we probably reached that limit now. Hence, there is a need for a global consensus about implementing monetary policy in a future context.

AMF-BIS Fourth Working Party Meeting on Monetary Policy in the Arab Region

Background Paper on Monetary Policy

The Kingdom of Saudi Arabia

The Saudi Central Bank

Prepared by

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The Deputy Governor for Research and International Affairs

Abu Dhabi, United Arab Emirates
31 May, 01-02 June 2021

Monetary Policy Implementation in The Kingdom of Saudi Arabia

1. Background

Following a period of robust economic growth during the period (2010-2015), with growth exceeding 5 percent on average, the Saudi economy has undergone significant changes in a relatively short period. Benefiting from the ongoing economic reforms taken by the Saudi government since 2015, the economic performance has shown its ability to absorb economic shocks resulting from oil price volatility.

More recently, the Saudi economy faced a dual shock on the back of the outbreak of COVID-19 and the decline in oil price. However, the Saudi economy proved resilient, reflecting its ongoing structural economic developments supported by the Vision 2030 Realization Programs. Fiscal policy, the main driver of the domestic economy, has long resorted to a countercyclical policy stance, which played a crucial part in supporting economic growth.

In addition, the proactive and prompt actions taken by the Saudi Central Bank and other governmental authorities to support the private sector have helped the Saudi economy overcome the depth of the crisis. Following a steep economic downturn in the first half of 2020, the economy started recovering in the second half of that year and is projected to continue its recovery path in 2021, even though the magnitude is still conditional on different factors, including a sound global recovery.

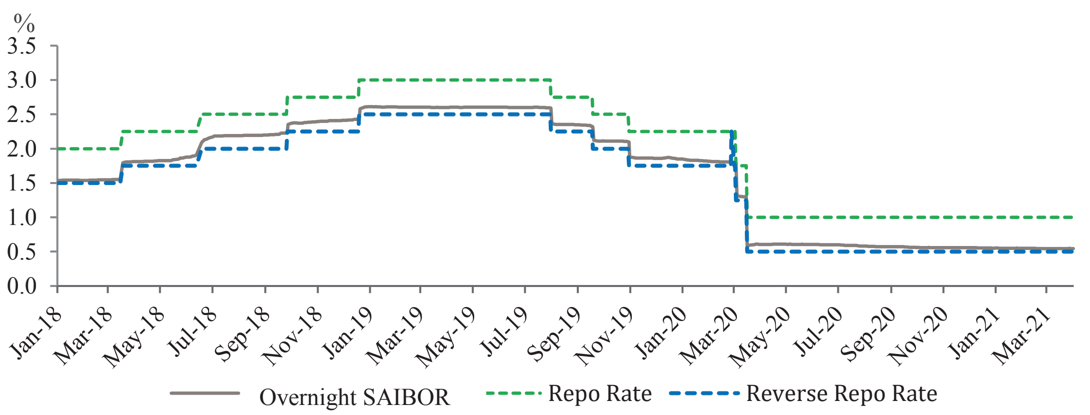
2. The Operational Framework of Monetary Policy: The Latest Developments.

Monetary policy in Saudi Arabia is anchored by the fixed exchange rate of the Saudi Riyal to the U.S. Dollar. The Saudi Central Bank (SAMA) remains committed to the nominal anchor as its monetary policy objective to maintain monetary and financial stability to support economic growth. The fixed exchange rate policy remains the optimal strategic choice that has served the Saudi economy well, keeping inflationary pressures in check.

Given the financial structure of the Saudi economy, SAMA's liquidity management plays an essential role in contributing to safeguarding the stability of the banking system and supporting economic growth. SAMA's monetary policy toolkit includes policy rates, statutory reserve requirements, open market operations, direct deposits, and foreign exchange swaps.

The policy rate corridor is comprised of the repo rate (the upper bound) and the reserve repo rate (the lower bound). SAMA determines the range of domestic interest rates by setting the repo and reverse repo rates relative to US policy rates. Within this range, the money market interest rate, i.e., the benchmark Overnight Saudi inter-bank offered rate (SAIBOR) changes accordingly.

Figure(1): Policy Rates

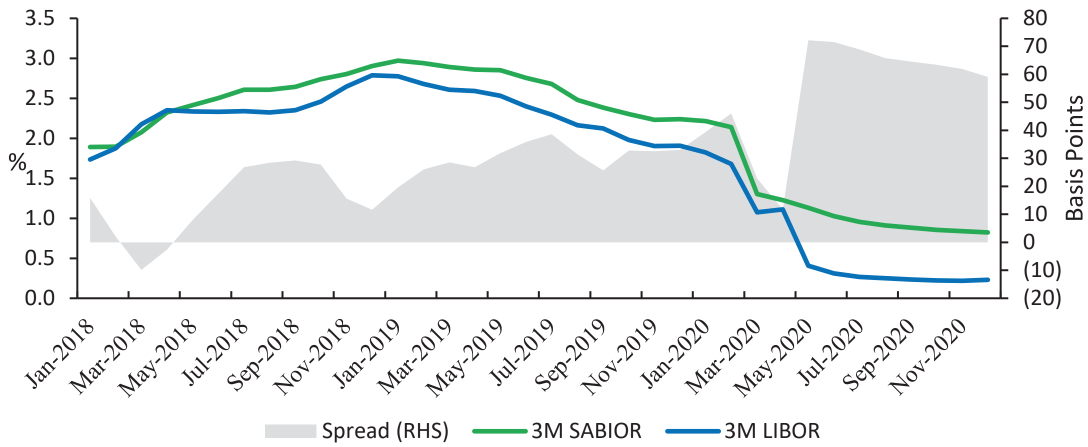


Source: Saudi Central Bank, and Refinitive.

More recently and in response to the outbreak of COVID-19 and in line with the global and domestic developments in 2020, SAMA lowered its policy rates in two steps by 125 bps in March 2020. The repo and reverse repo rates were accordingly reduced to 1 percent and 0.5 percent, respectively. Moreover, SAMA uses the statutory reserve requirements to influence the money supply. Currently, banks are required to maintain cash reserves equivalent to 7 percent of demand deposits and 4 percent of time and saving deposits.

Following the policy interest rate cuts, the three-month Saudi interbank offered rate (SAIBOR) gradually declined to reach 0.8233 percent by end-2020 from 2.2170 percent in early 2020. The three-month interest differential between the SAIBOR and the USD LIBOR reached around 59 basis points in favor of SAIBOR, compared to 39 basis points in early 2020.

Figure (2): 3M SAIBOR vs. LIBOR



Source: Saudi Central Bank and Refinitive.

Monetary indicators point to ample liquidity levels, as the broad money supply measured by (M3)[1] has surpassed SAR 2 trillion, recording an increase of 8.3 percent in 2020, the highest annual growth rate since 2015. The main drivers for this growth in 2020 were government spending and credit expansion.

Additionally, banks' excess reserves as approximated by banks' net repurchase agreements and outstanding SAMA Bills increased to a record average of SAR 90 billion, supported by the central bank's decision to inject SAR 50 billion into the banking system (in June 2020) as well as SAMA's Private Sector Financing Support Program (launched in March 2020).

[1] M1 comprises currency outside banks and demand deposits, and M2 comprises M1 and time & saving deposits. While other deposits comprise residents' foreign currency deposits, marginal deposits for LCs, outstanding remittances, and banks Repo transactions with the private sector.

3. The Implications of Global, Regional, and Internal Economic and Financial Developments on Monetary Policy Implementation.

Due to COVID-19 developments, the demand for the USD surged, while funding constraints were evident in March 2020. However, the swift actions by the central banks eased the pressure. Consequently, the USD/SAR witnessed only a mild and short period of volatility, returning to normal targeted levels during Q2 2020. Despite massive capital outflows witnessed in some emerging economies resulting from the outbreak of COVID-19 and the high uncertainty level, the Saudi financial system remained resilient against the volatility of global financial developments.

Several key factors have mitigated the crisis's impact on outflows, including the robustness and resilience of the Saudi financial system and its compliance with SAMA's prudential requirements. The latter had ensured that the financial system could approach the Pandemic from a position of strength. In addition, the swift actions taken by the monetary, financial, and fiscal authorities in Saudi Arabia helped to ease the economic impact of the COVID-19 crisis.

It is worth noting that the National Financial Stability Committee (NFSC) is the main channel in which the coordination between fiscal and monetary authorities takes place. Such coordination proved to be essential in light of the unprecedented nature of the crisis.

4. The Efficiency of Monetary Policy Measures in Mitigating the COVID-19 Impact and Supporting Economic Recovery

On 14 March 2020, SAMA announced a Private Sector Financing Support Program (see the table below for the details). It aims at enhancing financial stability, enabling the financial sector to support the economic recovery, particularly by granting funding support to the micro, small and medium-sized enterprises "MSMEs" sector. The purpose of this program is to mitigate the impact of the preventive health measures by reducing the burden of cash flow fluctuations, supporting working capital, maintain employment levels, and enabling economic sectors to recover from the current crisis. Additionally, the program was designed to support the government's efforts to combat the COVID-19 crisis and mitigate its expected financial and economic impacts on the private sector.

Furthermore, the monetary policy decision to inject SAR 50 billion into the banking system has enhanced the banking sector's liquidity and enabled banks to continue providing credit facilities to the private sector. This decision aimed to help banks revise or restructure their private sector loans with no additional charges, support the plans to maintain employment levels in the private sector, and provide free certain e-banking services.

Moreover, SAMA activated Open Market Operations (OMOs) in early 2020. The OMOs complement the current issuance program of SAMA Bills and consist of liquidity auctions with a 1-week to 1-month maturity. They are conducted to manage liquidity in the domestic banking system consistent with SAMA's mandate. OMOs aim to address the short-term liquidity fluctuations and imbalances in system liquidity, influenced by seasonal, cyclical, and structural factors.

Table 1: Adopted Measures to Mitigate the COVID-19 Impact and Support Economic Recovery

Programs	Description	Utilization as of (March 18th)	Expected expiry
Deferred Payments Program	The program aims to support banks and financing companies to defer their MSMEs' payments due for a period of six months.	SAR 124 billion	June-2021
Guaranteed Financing Program	The program provides concessional finance for MSMEs by granting loans from banks and finance companies to the MSME sector to support business continuity and sector growth in a way that contributes to supporting economic growth and maintaining employment levels in these enterprises.	SAR 8.2 billion	Q1-2022
Loan Guarantee Program	The program supports banks and financing companies to relieve MSMEs from their finance costs of the KAFALA Program in order to minimize finance costs for entities eligible to utilize those guarantees.	SAR 144 million of fees	Ended – Dec, 2020

Supporting fess of points of sale and e-commerce	The program aims to support participants in the payment's ecosystem in the Kingdom, and to ensure the continuity of growth and expansion in providing safe and effective payment services. The program targeted all stores and entities in the private sector for a period of 6 months, with SAMA bearing the cost of these fees to payment service providers participating in the national system.	1.275 billion	Ended – Sep 2020

The Saudi Central Bank has decided to extend the deferred payments program until the end of June 2021 to continue enabling MSMEs adequate access to funding, which will support the economic recovery. The Central Bank has also announced the extension of the Guaranteed Financing Program for one year to end on March 14, 2022, as another support lever for MSMEs to overcome the challenges that have arisen from the COVID-19 crisis.

The central bank decisions have supported banking system liquidity to facilitate credit provision to the private sector. Private sector credit growth recorded an increase of 14.3 percent by end-2020 (year on year), with a notable recovery in the most impacted sectors during mid-2020, such as the commerce and services sectors.

The Saudi Central Bank is conducting regular assessments of economic developments and the performance of the support measures to:

- Evaluate the need for further action,
- Consider the possible impact of prolonged use of the support measures,
- Plan for their gradual unwinding.

AMF-BIS Fourth Working Party Meeting on Monetary Policy in the Arab Region

Background Paper on Monetary Policy

The Republic of Iraq

The Central Bank of Iraq

Prepared by

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Vice Governor

Abu Dhabi, United Arab Emirates

31 May, 01-02 June 2021

Monetary Policy Implementation in The Republic of Iraq

1. Background

The Iraqi economy faced double health and economic shocks in 2020 due to the spread of COVID-19 and the significant decline in international oil prices. The spread of the virus caused a great shutdown and curfew. The sharp decline in the global oil price led to a significant decrease in oil receipts. At the same time, the lockdown has negatively impacted most economic activities, especially transportation, tourism, restaurants, and other activities. These shocks compound difficult conditions that have been prevailing for several months. It could push a segment of the population into poverty because of losing their jobs.

The Iraqi policymakers have to deal with this crisis and save lives and support economic activities. The reduction in oil revenues as the main source of the Iraqi government in 2020 was the main obstacle. Therefore, the Iraqi government took many actions to restore the Iraqi economy by increasing internal borrowing to finance the high budget deficit and the Iraqi currency's devaluation. In addition, the government issued a White Paper for economic reform and adopted some other policies to support economic recovery.

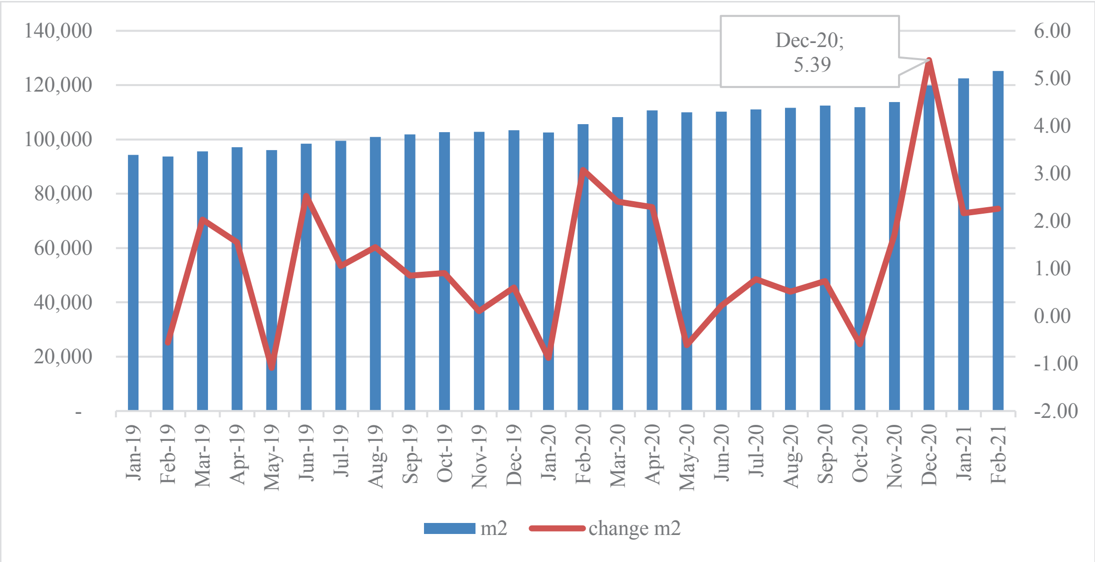
The monetary policy carried a huge burden to maintain economic and financial stability. The CBI has reduced the legal reserve requirement from 15 percent to 13 percent, postponed loan settlements for CBI's lending initiative for 6 months, reduced the CBI's lending interest rate, and introduced a new CBI lending initiative that amounted to ID 5 trillion. These measures are supposed to inject enough liquidity into the economy and spurring private sector activities.

2. Development and Trends of Key Macroeconomic Indicators

1- The broad money supply (M_2):

The broad money supply (M2) increased from (94,253) Billion ID in Jan 2019 to (125,222) Billion ID in Feb. 2021, as shown in Figure (1). The M2 has registered an increase of about 32 percent between Jan 2019 and Feb. 2021. The main reason behind the M2 growth was the increase in the issued currency, which raised from (44,374) billion ID in Jan 2019 to (70,742) Billion ID in Feb 2021, which registered increases of about (60) percentage. This sharp increase in issued currency due to the discount of Treasury Bills by the Central Bank of Iraq issued by the Ministry of Finance to the state-owned banks during the second half of 2020 to finance the budget deficit aftermath the decline in the oil revenues during the year of 2020.

Figure (1): Changes in M2



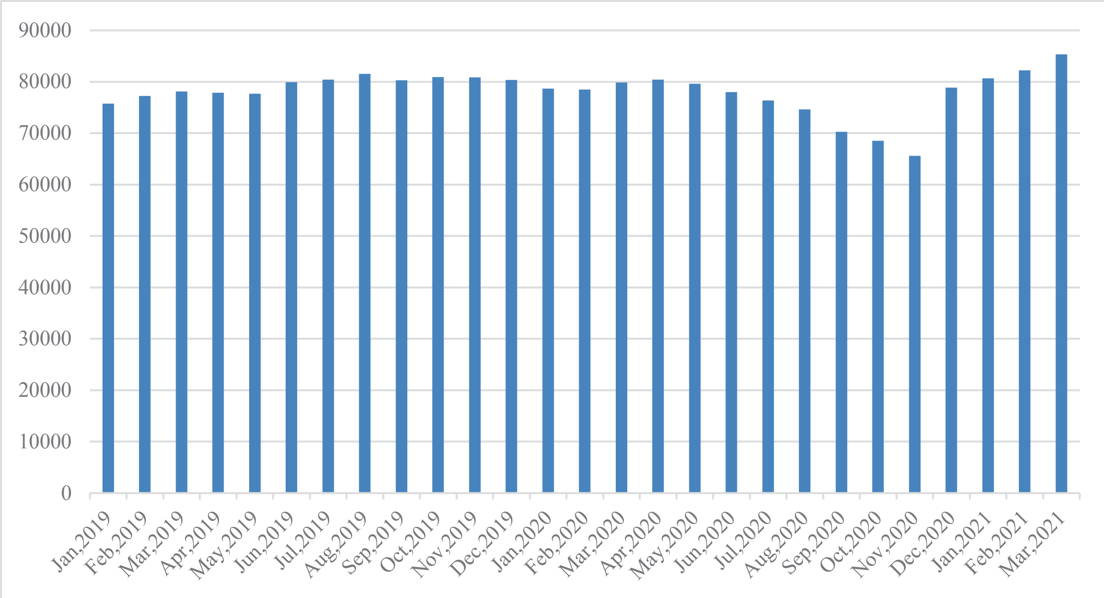
2- Foreign reserves:

The level of foreign reserves is one of the most important indicators that reflect the status of the balance of payments, the stability and prosperity of the economy, and the success of monetary policy to maintain local currency value.

Figure 2 shows that the net foreign reserve changed over the period from Jan 2019 until Mar. 2021. It showed an apparent decline during the year 2020. It declined from (80,423) Billion ID as in Apr. 2020 to (65,593) Billion ID as in Nov. 2020 with a decrease of about 18.4 percent for the same period. The noticeable decrease in the foreign reserve in 2020 is attributed to the sharp decline in the international oil prices from about USD 70 in Jan. 2020 to about USD 20 in Apr. 2020 [1] and the associated reduction in oil revenues.

[1] https://www.opec.org/opec_web/en/data_graphs/40.htm

Figure 2: Net Foreign Reserves (Billion ID)



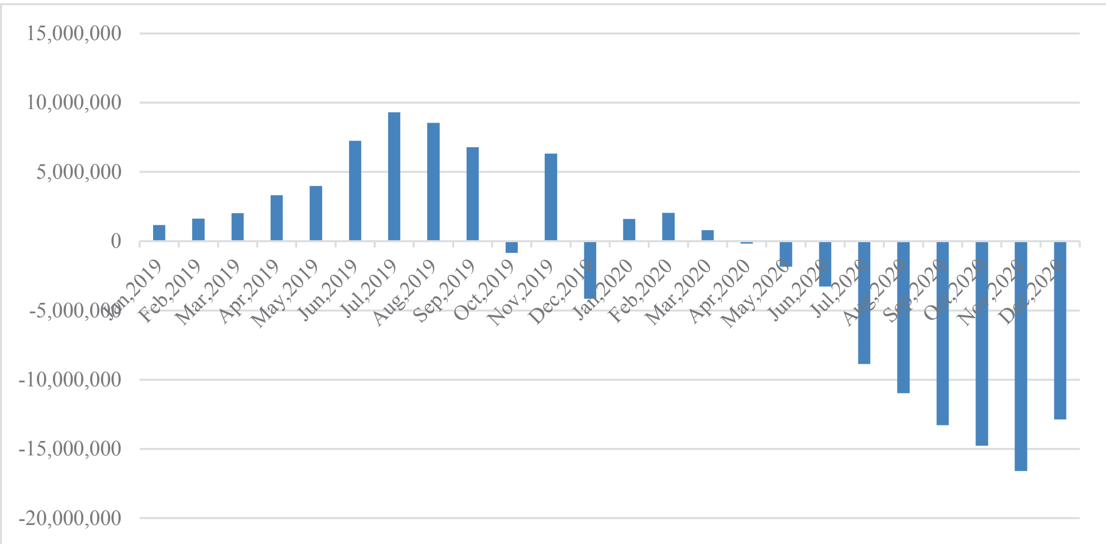
There is a strong and direct nexus between the international oil prices and revenues and the foreign reserves at the Central Bank of Iraq due to the structure of Iraqi economy, which depends heavily on the oil revenues. The Central Bank of Iraq uses the foreign currency window to sterilize the oversized currency in circulation via selling the foreign currency to the merchants and industrialists to finance their imports and the passengers. At the same time, the CBI buys foreign currency from the Ministry of Finance at a fixed price to finance its expenditures.

In 2020, the amount purchased from the Ministry of Finance declined from USD 58,851 Million in 2019 to USD 30,730 Million in 2020, which decreased by about 48 percentage. At the same time, the selling of foreign currency was also decreased from USD 51,127 Million in 2019 to USD 44,082 Million in 2020, registered a decrease of about 14 percentage. The gap between the purchase and sale of foreign currency was positive in 2019 and led to an increase in the foreign reserve of about USD 7,724 Million. However, the gap was negative in 2020, which lead to reducing the foreign reserves by about USD 13,352 Million.

2 Budget Deficit

Figure 3 clearly shows the changes in the status of the public budget in Iraq, which moved from the surplus during 2019 to a deficit during 2020. The main reason for this noticeable deficit was the massive decline in the revenues of about 41.25 percent from ID 107,566,995 million in 2019 to USD 63,199,689 Million in 2020. The main source of public revenues is the oil revenues, and as shown before, the decline in the oil price and revenues causes the increase in the budget deficit.

Figure 3: Government Budget Balance (Million ID)



To meet the shock of the increase in expenditures, especially for the health sector alongside the normal public spending during the Pandemic of COVID-19 during the year of 2020 and the reduction in the international oil prices and exports, the Ministry of Finance issued Treasury Bills which purchased by the state-owned banks and discounted at the Central Bank of Iraq. This issue of treasury Bills was legalized by the Iraqi Parliament, which approved two laws for internal borrowing. The first law approved borrowing ID 15 trillion in July 2020, and the second law approved borrowing ID 12 trillion ID in November 2020.

3 Devaluation

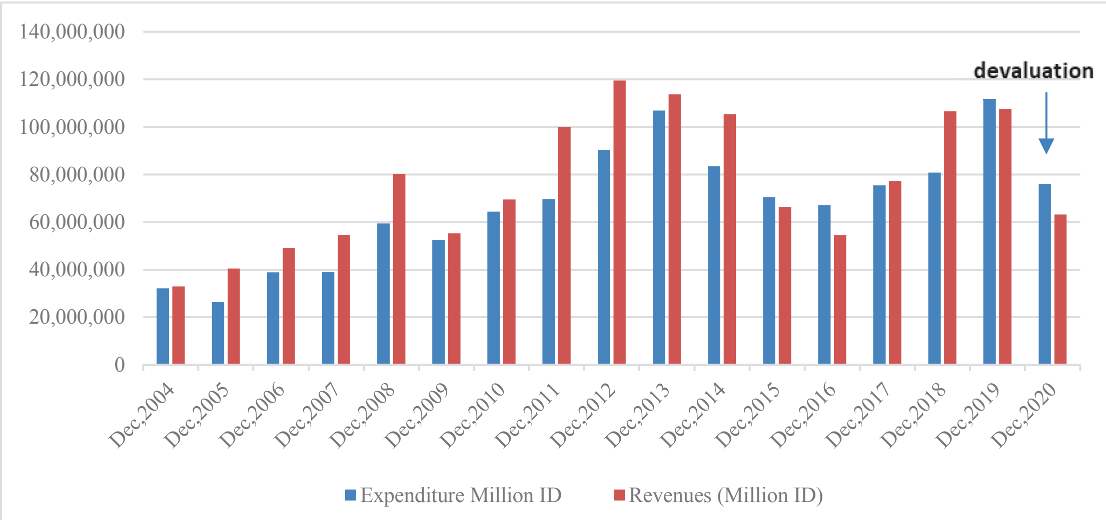
The idea of devaluation of local currency always arises when the economy faces financial shock, especially when the international oil prices decline. During the last decade, when the Iraqi economy faced financial shock in 2014-2015 due to the decline of the international oil prices alongside the increase of expenses to internal conditions, there was an idea to devaluate the local currency. Still, it had not been adopted even when the foreign reserves have declined. Moreover, in the following years, foreign reserves have been accumulated, and the support of devaluation almost disappeared.

However, the Iraqi economy again faces another financial shock in 2020 due to the international oil price shock of 2020 alongside the increase in health expenditures to mitigate the negative effect of COVID-19 and the inability of the Iraqi government to pay the public sector salaries on time. In this context, the Iraqi government introduced the White Paper for economic and financial reform in the second half of 2020. The White Paper has mentioned many times the support to devaluate the local currency to long-lasting economic and financial reform.

All the above-mentioned factors have paved the way to raise the idea of devaluation of the local currency again. Intensive discussions were made by the Central Bank of Iraq and the Ministry of Finance (the owner of foreign currency) to set the new exchange rate. The decision of devaluation has been taken and approved by the government and identified in the public budget (pricing the oil revenues in US dollar against an amount of Iraqi Dinar, e.g., 1 US dollar = 1182 ID). This official fixed exchange rate is essential in calculating the total revenues in the local currency. The new exchange rate was officially announced on 19th December 2020 by the Central Bank of Iraq. The local currency exchange rate against the US dollar was increased from 1182 ID per US dollar into 1450 ID per US dollar.

Figure 4 clearly shows the link between the financial conditions of the government and the support for the devaluation of the local currency. It indicates that the devaluation of local currency arises whenever the public deficit increases, and the revenues face external shock. In addition, in the long period (2004-2014) when the revenues, especially from the oil exports, were greater than the expenditures, the appreciation views were dominated.

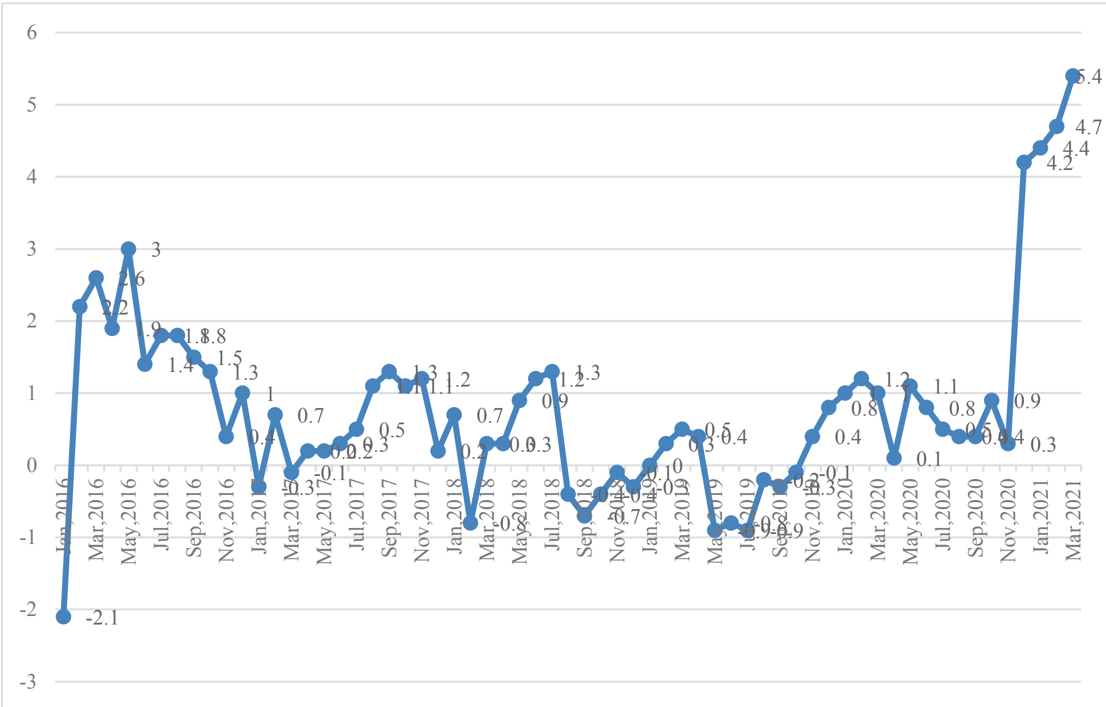
Figure 4: Public Revenues and Expenditures



4 Inflation Rate

The Central Bank of Iraq uses the exchange rate as a nominal anchor of inflation. It succeeded in doing so through the window of selling foreign currency by selling foreign currency to the private sector via banks, primarily to finance the imports. This mechanism could stabilize the inflation at a low level, as shown in figure 5. However, the same figure also reveals an increase in the inflation rate during the first quarter of 2021 due to the devaluation undertaken at the end of 2020, which reached 5.4 percent as in March 2021. In the aftermath of the announcement of devaluation on 19/12/2020 by the CBI, all prices of imported goods have increased at the same level of devaluation, which was about 22 percent from 1200 ID per one US dollar into 1470 ID per one US dollar.

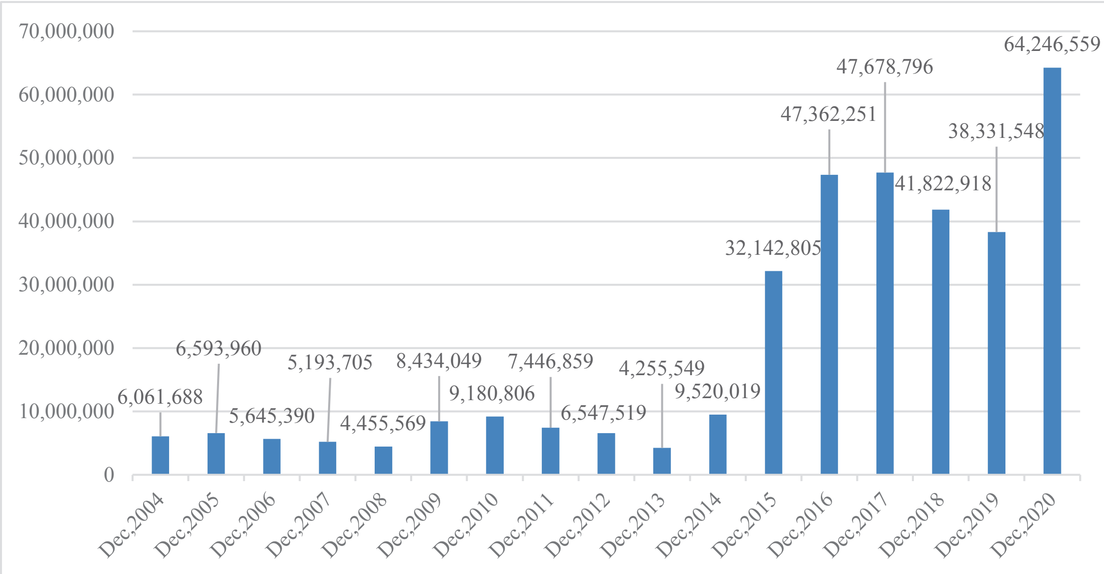
Figure 5: Core Inflation 2012=100



5 Internal Debt

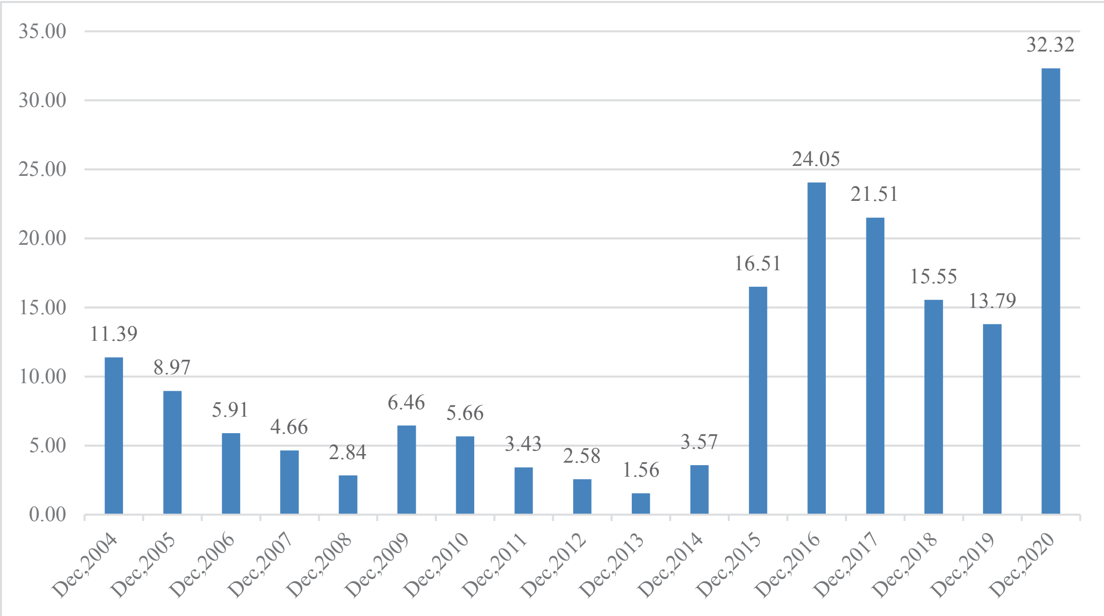
Internal debt is one of the most important economic indicators which reflect the financial sustainability and the strength and stability of the economy. The Iraqi internal debt has increased dramatically during the last 15 years, reflecting the level of fiscal discipline and the structural imbalance in the Iraqi economy, mainly depending on the oil sector. The internal debt was hiked by more than 950 percent during the period (2004-2020), as shown in figure 6. The increasing trend of the internal debt since 2015 reflects the previous economic policies which could not utilize from the budget surplus during the period (2004-2014), as shown in figure 4. The Iraqi economy could not benefit from the increase in the international oil prices and revenues due to directing public revenues into consumption from imports and not to rebuild the country from ruin.

Figure 6: Internal Debt



The internal debt was highly increased in 2020 to finance the budget deficit. The ratio of internal debt to GDP increased from 11 percent in 2004 to its highest level reaching 32 in 2020, as shown in figure 7. Most of the internal debts are treasury bills usually purchased by the state-owned banks and discounted at the CBI, which means a new currency issue. The newly issued currency will lead the base money to increase and negatively and indirectly affect the foreign reserves at the CBI.

Figure 7: Internal Debt to GDP (%)



2- Monetary Policy Response to the COVID-19

The monetary policy played a key role in mitigating the adverse effects of the COVID-19 through the quick response of taking several measures undertaken by the CBI to provide adequate liquidity to the economy through:

(1) Reducing the reserve requirements from 15 percent to 13 percent for six months, and it will be amended every six months. This action provided liquidity amounted to around (1,181) Billion ID during the first six months for the period from April 2020 into September 2020.

(2) Postponing the loan instalments for the CBI initiatives for six months. This action provided liquidity amounted to around (14,811) million ID. This action also mitigated the potential risks of default by borrowers during the Pandemic and closed most of the economic activities of the private sector.

(3) Lowering the interest rate on loans of its initiatives and extending its maturity as explained in Table 1.

Table 1: Measures to lower interest rates of CBI lending initiatives

<table>
<tr><th colspan="2">1 trillion initiative</th><th>Old Interest Rate</th><th colspan="2">New Interest Rate</th></tr>
<tr><th colspan="5">For small and Medium Enterprises</th></tr>
<tr><td colspan="2">1-20 Million ID loan</td><td>5</td><td colspan="2">5.5</td></tr>
<tr><td colspan="2">21-1000 Million ID loan</td><td>7</td><td colspan="2">4.5</td></tr>
<tr><th colspan="5">For Real Estate Loan</th></tr>
<tr><th>Old amount</th><th>New amount</th><th>Old Interest Rate</th><th>New Interest Rate</th><th>Old Maturity</th></tr>
<tr><td>75 million ID Loan</td><td>100 million ID Loan</td><td>5.3</td><td>3.1</td><td>10</td></tr>
</table>

Note: all interest rates include the interest rate charged by the banks, the interest rate charged by the Iraqi Company for Loan Guarantees, and the fees charged by the CBI.

(4) Introducing a new initiative with an amount of ID 5 trillion in 2021 to finance the Large, Medium, and Small Enterprises with more lending facilities, particularly long maturity up to 20 years and very low-interest rate compared to the market rate. This initiative will direct loans to the private sector via state-owned banks.

3- Conclusion

The Iraqi economy faced two shocks in 2020 due to the sharp decline in the international oil prices and the spread of the COVID-19 Pandemic, which impacted macroeconomic indicators in Iraq. The CBI had taken many measures to mitigate the severe effects of the COVID-19 and reduction in oil prices and revenues as follows:

- Discounting around ID 26 trillion of the treasury bills to finance the budget deficit during the second half of 2020.
- Devaluation of the local currency at the end of 2020 to provide extra funds to the Ministry of Finance (the owner of oil revenues), to maintain the foreign reserves to support economic activities and competitiveness and reduce imports.
- Reducing the interest rates charged for loans provided through the CBI's lending initiatives and postponing instalments to promote the private sector economic activities and reduce the probability of default.

- Extending the amount and maturity of loans from the CBI's lending initiatives to encourage private-sector production.
- The CBI will maintain its core objectives for price stability, financial stability, and promoting economic development. It can do so through its adequate foreign reserves and by introducing new criteria to assess the soundness of the banking sector.

AMF-BIS Fourth Working Party Meeting on Monetary Policy in the Arab Region

Background Paper on Monetary Policy

The State of Palestine

The Palestine Monetary Authority

Prepared by
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31 May, 01-02 June 2021

Monetary Policy Implementation in The State of Palestine

1. Background

Palestine is one of the smallest countries in the MENA region, opened for 5.1 million Palestinians living in an area of 6,220 km2, of which 5,860 km2 is the area of the West Bank, and 360 km2 in the area of Gaza Strip. Around 60 percent of the population, or 3.1 million, are living in the West Bank, and 40 percent or 2.0 million are living in Gaza Strip [(1)], one of the highest population densities (5,689 persons per square kilometer).

The Palestinian economy is ruled by the free economy principles that guarantee the freedom of economic activity, with market mechanisms as the main engines of the economy [(2)]. The economic environment is highly risky, involves monetary forces in the form of policy decisions taken externally. Together with a range of non-monetary factors such as restrictions placed over the years on Palestinian trade (both internal and external closures) and employment, in addition to the fluctuation and declining of external aid flows.

Moreover, the Palestinian economy operates in the absence of a national currency [(3)], which precludes a comprehensive monetary policy formulation. Thus, without monetary policy, Palestinians have no control over the domestic money supply, with little influence on domestic interest rates, exchange rates, inflation, and assets prices, which affected its main economic indicators and the financial and monetary stability.

This background paper intends to shed light on the implications of some key aspects of monetary and financial stability.

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(1) Estimated population in Palestine mid-year by governorate, 1997-2021, Palestinian Central Bureau of Statistics (PCBS), 2017.

(2) Article 21, paragraph 1 of the Amended Palestinian Basic Law, 2003, and its amendments for 2005.

(3) Instead, four main foreign currencies are circulating in the Palestinian market: the US dollar-USD, the Jordanian dinar-JD, the New Israeli shekel-ILS, and to a lesser extent the Euro.

2. The Implications of Global, Regional, and Internal Economic and Financial Developments on Monetary Policy Implementation

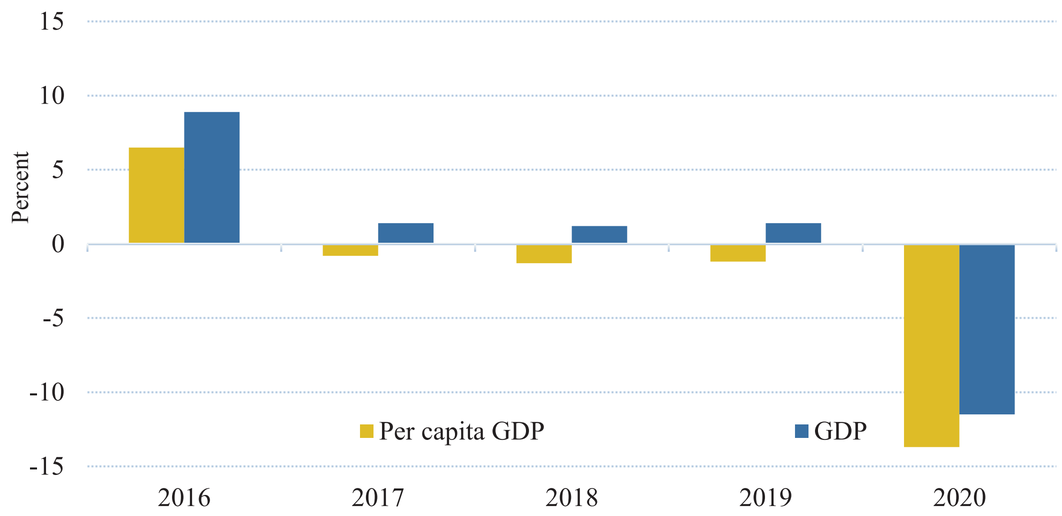
During 2020, the world economy experienced exceptional conditions considering the spread of the Pandemic (COVID-19) and its large-scale effects on several levels. On the one hand, the Pandemic affected global supply chains, international trade, consumption, investment, and manufacturing activities, raised uncertainty levels and lowered consumer and investor confidence. On the other hand, the imposed restrictions on many economic activities affected tourism, transportation, trade, manufacturing, and other economic activities.

Given the global economic downturn that resulted from the Pandemic, many countries adopted monetary and financial stimulus packages of hundreds of millions of dollars, which contributed to a significant rise in global indebtedness levels. With the availability of vaccines by the end of 2020, hopes for a gradual global recovery during 2021 and 2022 have revived. However, this potential recovery remained highly uncertain, with significant risks surrounding the path of the Pandemic and vaccines or the outbreak of global debt crises, which may require more proactive interventions to enhance the path of recovery and global economic growth .

On the Palestinian level, the economy witnessed one of the worst conditions in 2020 in more than two decades due to the dual shock resulting from the Pandemic outbreak and the unfavorable economic conditions that tightened fiscal space.

This situation led to a noticeable decline in economic performance, where the economy shrunk by 11.5 percent (the largest since 2002), bringing the real GDP down to about USD 14.0 billion—causing more deterioration in the standard of living, measured by GDP per capita income which declined by 13.7 percent, to about USD 2,914.

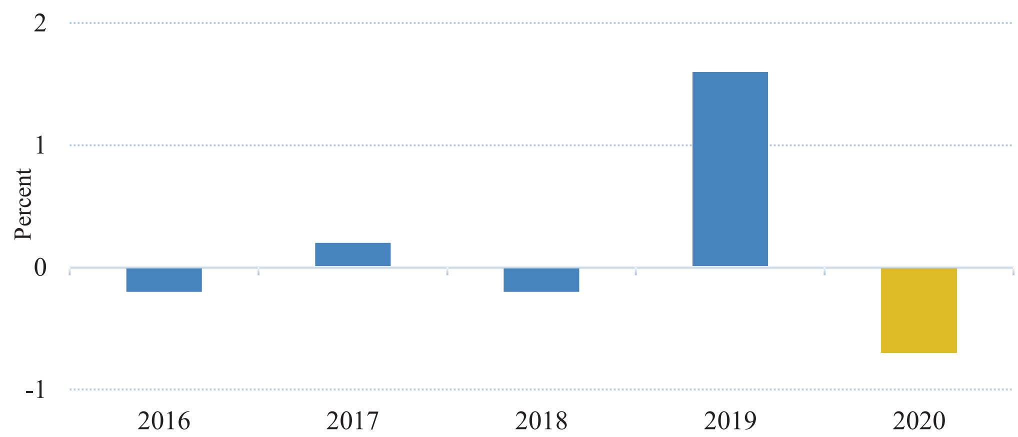
Figure 1: Annual GDP and per capita GDP, 2016-2020



Source: Palestinian Central Bureau of Statistics (PCBS).

On the one hand, and due to the decline in economic activities and aggregate demand, the general level of prices in Palestine decreased (deflation) by 0.7 percent.

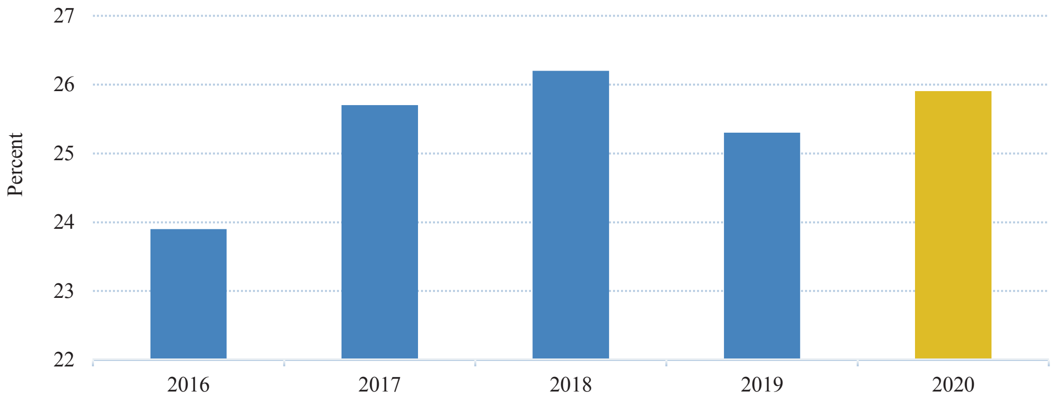
Figure 2: General price levels (inflation rates), 2016-2020



Source: PCBS.

Moreover, this level of economic performance increased pressures on the labor market, pushing more persons to unemployment, which is already high. This is one of the major challenges facing the Palestinian economy, especially in the Gaza Strip. In light of the weakness of most economic activities, the economy is not only not being able to create new job opportunities but also lost about 46,000 jobs from the existing ones, pushing the unemployment rate up to around 30 percent of the total labor force.

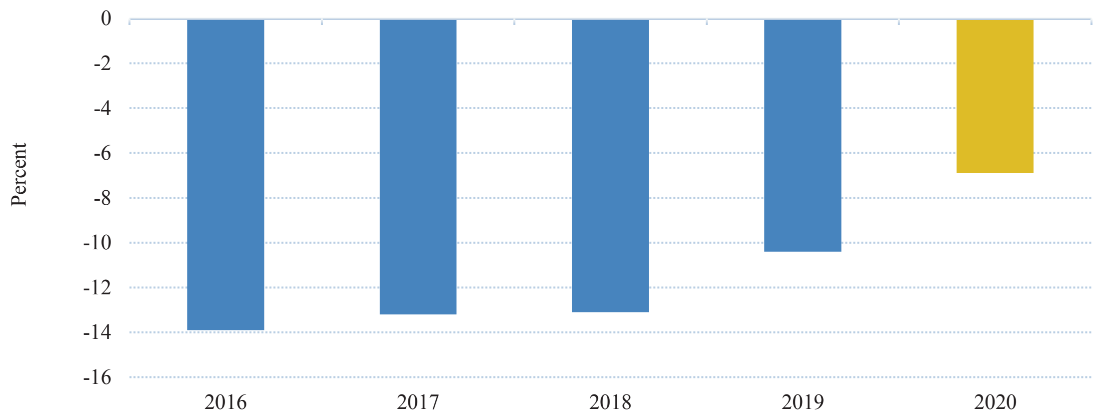
Figure 3: Annual unemployment rates, 2016-2020



Source: PCBS.

In addition, the 2020 crisis added more pressures on government finance, causing more imbalances in the form of deficits, arrears, and debt. Due to the weaknesses of economic activities, public revenues declined at a time where public expenditures increased to mitigate the impact of the crisis. With the inability of the government to fulfill its obligations, the overall budget deficit rose to about 3.8 percent of GDP. In addition to the increase in arrears by about 14.5 percent on the one hand, and became more dependent on borrowing, especially internal borrowing from the banking sector, which ultimately increasing the government debt (in dollar terms) by 30.6 percent than it was a year ago.

Figure 4: Overall budget deficit and Government debt as a percentage of GDP, 2016-2020

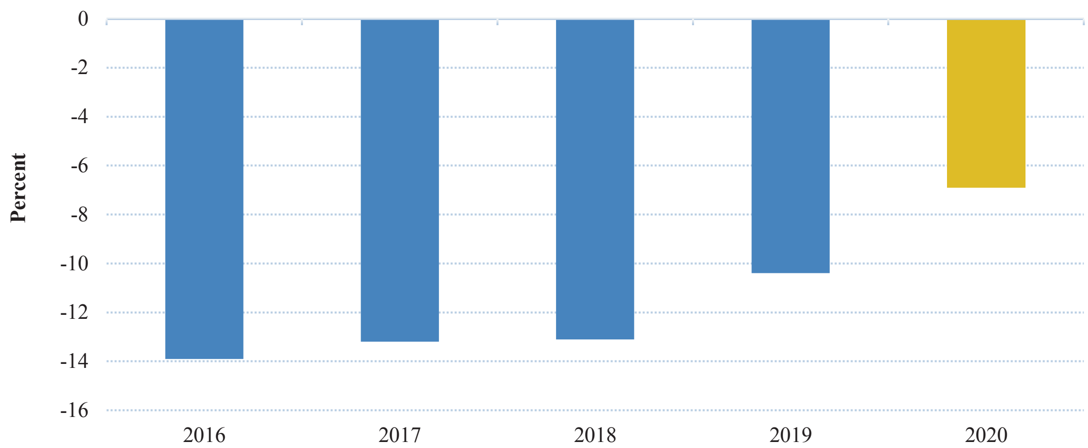


Source: Palestinian Ministry of Finance.

The external sector was the only exception. The current account deficit in the balance of payments has witnessed a remarkable improvement, decreasing by

39.7 percent compared to the level recorded in 2019 or about 6.9 percent of the GDP. This is mainly due to the improvement in the trade balance (as imports decline by a greater percentage than exports).

Figure 5: Current account deficit as a percentage of GDP, 2016-2020

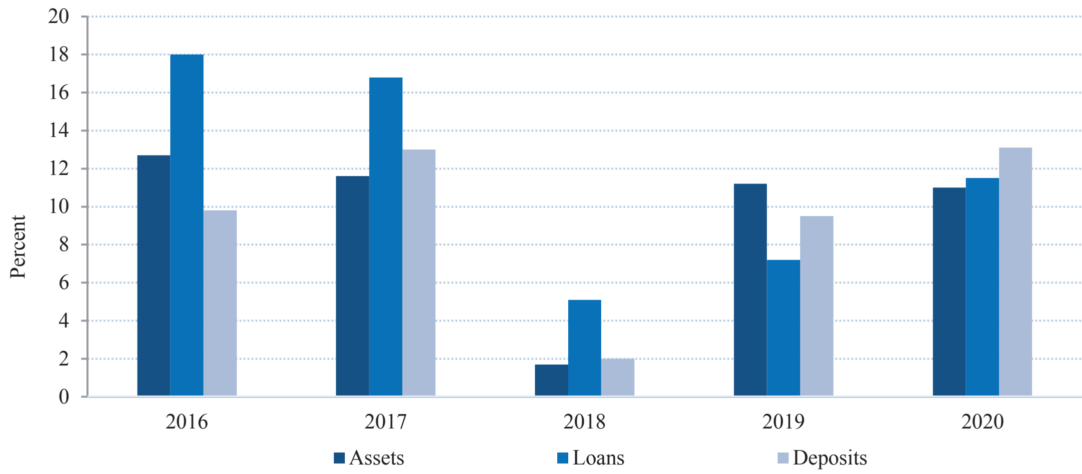


Source: PMA and PCBS.

As for the banking sector, the financial indicators of the banking sector refer to an increase in the total assets by 11.0 percent over what it was in 2019, up to USD 19.9 billion. The increasing public confidence also reflected in a significant increase in deposits, which amounted to USD 15.1 billion, an increase of about 13.1 percent, mainly invested in the local economy, in the form of the credit portfolio, it witnessed an increase of about 11.5 percent, up to about USD 10.1 billion.

However, increasing exposure towards the public sector and the increase in defaulted loans, in addition to the significant decline in profitability, represent the most prominent impacts of the crisis on the banking sector. Where loans granted to the public sector increased by around 42 percent, NPLs up to 4.2 percent, and profitability of the banking sector declined by 37.3 percent, compared with the previous year.

Figure 6: Some banking sector indicators (growth rates), 2016-2020



Source: Palestinian Ministry of Finance.

3. The Operational Framework of Monetary Policy: The Latest Developments

The Arab-Israel peace negotiations held in 1993 led to the interim peace treaty between Palestine and Israel, followed in 1994 by signing the Paris Protocol, which regulates the economic relationship between the two parties [1].

Paris Protocol includes provisions regarding the monetary arrangements in Palestine during the transitional period and the possibility of issuing a Palestinian currency, which postponed to the stage of final status negotiations. Instead, a multi-currency monetary system was introduced, where three main currencies were circulating in the Palestinian economy: the New Israeli Shekel (NIS), the US Dollar (USD), the Jordanian Dinar (JD), and the Euro to some extent.

The Palestine Monetary Authority (PMA), the Central Bank of Palestine, was established to serves a broad range of central banking functions, most prominently: to ensure the safety of the banking sector, maintain monetary

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[1] The Palestine-Israel peace accord, signed on September 13, 1993, while Paris Protocol was signed on April 29, 1994.

stability, and encourage economic growth in Palestine by the general policy of the government [(1)].

PMA is also tasked with the management and investment of its foreign reserves in a manner, which gives priority to safety and liquidity over profits and secures a satisfactory level of foreign currency reserves. In addition, PMA is monitoring domestic currency exchange and deposit and lending interest rates, and making necessary operational decisions, especially occasional interventions to provide and secure necessary short-term liquidity in the desired currencies to banks.

However, without a domestic currency, the available policy tools are still limited and mainly used for prudential purposes, leaving PMA with no control over the domestic money supply, with little influence on domestic interest rates and inflation. In addition, with the lack of a domestic money market, domestic government securities, PMA does not conduct open market operations.

Therefore, the credit channel remains the main transmission channel of monetary policy. Due to the limited set of policy instruments, monetary policy can influence the credit supply to the private sector by altering bank lending incentives and the composition of banks' loan portfolios. Moreover, PMA can influence the economy through its prudential regulations and available policy tools, including reserve requirements, and placed some of these reserves at commercial banks to support liquidity.

4. The Efficiency of Monetary Policy Measures in Mitigating the COVID-19 Impact and Supporting Economic Recovery

Although the ability of the PMA to intervene is limited compared to what other regional and global central banks have done, due to the absence of a national currency and the lack of monetary policy tools, PMA took many proactive measures to mitigate the effects of these crises. Whether by financing the government and enabling it to address the imbalances resulting from the clearing

(1) Law No. (2) for 1997, about the establishment of the Palestine Monetary Authority.

revenue crisis, or by providing the required liquidity to the banks and specialized lending institutions, or by providing funds with favorable terms and conditions for the various activities and sectors of the economy, through "Estidama Program"[1] in addition to other measures.

From the early stages of the spread of the Pandemic in Palestine, PMA has issued series of proactive instructions, mainly focused on supporting and injecting additional liquidity in the economy to meet any emergency obligations, including supporting the liquidity needs of the banks themselves, in addition to other instructions related to the Cheques in Circulation, and loans granted.

The liquidity support injected into the economy through banks, to meet the financing needs, for both the public and private sectors has been channeled through the following:

(1) Injecting additional liquidity of about USD 1.5 billion by postponing monthly loan installments for all borrowers until the end of 2020 enables individual borrowers and project owners to use liquidity to cover emergency expenses and compensate for the shortfall caused by closures and loss of income sources.

(2) Injecting additional USD 100 million by reducing cash liquidity ratio at banks by 1 percent.

(3) Supporting the liquidity of Islamic banks by about USD 50 million.

The proactive measures also include the intervention for the first time by using one of the monetary policy tools available to PMA. That is injecting additional liquidity through launching "Estidama Program" to support the most affected enterprises from the Pandemic by providing Financing of USD 300 million through banks on favorable terms and conditions. This program's cost does not

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1 It was established to provide Financing for projects aimed at enhancing the sustainability of the Palestinian economy, including medium, small, and micro-enterprises (MSMEs), covering wide segments of various economic sectors.

exceed 3 percent (the lowest lending cost in Palestine), with a grace period of up to 12 months for all sectors and 24 months for tourism.

At the end of 2020, the PMA's Board of Directors decided to introduce the second stage of this program, under the name of "Estidama Fund" a permanent one. The aim of this fund goes beyond the recovery from impacts of the Pandemic to encouraging sustainable economic growth, though providing finance to various economic sectors, with special attention to SMEs enterprises, and by supporting youth and entrepreneurs, empowering women, and investing in the social economy, productive economic sectors, and integration into the digital economy.

Undoubtedly, the set of measures taken by the PMA have directly contributed to mitigating the impacts of the Pandemic on the economy and moving gradually toward the path of recovery and growth. In this context, the PMA's forecasts for 2021 indicate the possibility of the economy achieving a growth rate of around 4 percent (compared with a contraction of 11.5 percent in 2020), with an expected improvement in the level of per capita income by about 2 percent, (compared with a decline of 13.7 percent in 2020) (1). However, this recovery remains fragile and subject to some potential risks, which may result from the path of the Pandemic (inability to contain the Pandemic, due to the shortage of vaccines, or the emergence of new mutations that need to new vaccines), in addition to the renewed economic challenges.

5. Monetary Policy Implementation: Main Challenges and Reforms

The implementation of monetary policy in Palestine faces several challenges, most prominent are as follows:

- Political challenges.
- Absence of a national currency.

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(1) Quarterly Economic Forecasts Report for Q2 2021, PMA, May 2021.

- Fragile relationship between banks operating in Palestine and correspondent banks.
- Incomplete legislative structure, which hinders the passage of laws, compounded by the absence of specialized financial courts.
- Lack of control over borders and crossings, associated with obstacles on access and movement.

In due course, PMA continues to safeguard the banking sector's stability, to develop more instruments for economic and financial monitoring and analysis, conducting a continuous periodic assessment of risks to mitigate their effects. Using many early warning indicators, stress tests, interbank contagion tests, enhanced effective risk-based supervision, issuing relevant regulatory instructions, building up more reserves and capital buffers, and taking further measures in the area of money laundering and terrorism financing strengthening the use of modern financial techniques.

However, the year 2020 represents an excellent opportunity to reduce cash transactions, move toward digital payments, and promote electronic means of transactions. Accordingly, PMA launches its electronic clearance system for all currencies circulating the economy and licensed five companies in the field of electronic payment services, including e-wallet services and prepaid cards. In addition, PMA creates an Innovation Regulatory Sandbox to support and enable entrepreneurs, innovations, and financial technology companies to test their innovative and creative ideas.

6. The road ahead

The long-term goals represent the focus of the PMA monetary authority's future aspirations. In due course, PMA has adopted an ambitious plan that describes and explains the structure and principles of work that will govern its future during the next five years—benefiting from the experiences of a large group of central banks around the world.

The plan gives more attention to the concept of digital transformation, enhancing the use of electronic financial products and electronic payment tools and enhancing capabilities in areas that ensure the PMA maintains the monetary and financial stability and contributes to the Palestinian economy's sustainable growth.

To this end, the plan includes a set of strategic initiatives to ensure enhancing its capabilities in the banking sector's supervision, providing economic advice to the government on macroeconomic issues, and managing the payments system. Among the most prominent strategic initiatives and priorities are the following:

- Establishing electronic financial services by supporting and developing innovative financial services and enhancing cybersecurity capabilities.
- Enhancing the efficiency of payment systems by developing a strategy for electronic payments on the one hand and licensing electronic payment services companies on the other hand.
- Maintaining the integrity and effectiveness of the financial system in general and the banking sector through strengthening supervisory capabilities and macroprudential policies.
- Encouraging diversity in government financing through developing strategies for government debt.
- Supporting and encouraging financial inclusion by focusing on the appropriate mechanisms to deal with unbanked segments.
- Stimulating economic activity and economic growth by providing several incentives to the banking sector to target many strategic activities and sectors.
- Supporting and promoting ways to increase remittances, especially expatriates, and encourage the flow of investments to Palestine.
- Continuing the necessary preparations for the issuance of the national currency when the political and economic conditions are appropriate for that. However, whether traditional or digital, the issue of currency

continues to have great attention from the PMA to overcome the problems created by the current monetary arrangements.

7. Conclusion

In line with PMA's main objectives, it devotes excellent attention to banking sector stability through continuous assessment of the risks and mitigating their impacts by promoting effective risk-based supervision within a modern regulatory framework and providing robust payment and credit structures. Monitoring compliance with laws and regulations, particularly governance instructions and the AML/CFT Law. Reinforcing oversight and regulatory frameworks to implement Basel II and III standards and promoting the use of a wide range of prudential limits and ceilings, including the required reserves ratios and the requirement for minimum capital and liquidity ratios, and restricts credit concentration.

In general, PMA adopts a regulatory framework in line with the recommendations and principles of the Basel Committee, corporate governance, and best practices of mergers and acquisitions to keep the banking sector safe and sound.

On the other hand, and even though PMA does not conduct a comprehensive monetary policy in common sense, due to the absence of a national currency, it made a relentless effort to enhance capabilities and place the requirements for formulating and conducting monetary policy in the future. Including the expected issuance of the new central bank law in the future to strengthen its independence and provide the legal environment for formulating and implementing a comprehensive monetary policy.

Appendix:

Main Economic Indicators, 2016-2020

Indicator	2016	2017	2018	2019	2020*
Output and Prices	**(Annual percent change)**				
Real GDP (2015 market prices)	8.9	1.4	1.2	1.4	-11.5
Real Per capita GDP	6.5	-0.8	-1.3	-1.2	-13.7
Inflation rate	-0.2	0.2	-0.2	1.6	-0.7
Unemployment Rate	**(Percent of labor force)**				
Palestine	23.9	25.7	26.2	25.3	25.9
Consumption, Investment and Saving	**(Percent of nominal GDP)**				
Final consumption	111.4	109.4	110.9	110.7	112.6
Gross capital Formation	25.5	27.0	27.3	26.4	22.9
Saving	-11.4	-9.4	-10.9	-10.7	-12.6
Public Finance	**(Percent of nominal GDP)**				
Total revenues	23.7	23.0	22.2	20.1	23.2
Of which: Foreign Aid	5.0	4.5	4.1	2.9	3.1
Total expenditures	25.2	25.1	24.2	22.5	26.5
Overall balance (Excl. foreign aid)	-2.1	-2.5	-2.9	-3.3	-3.8
Overall Balance (Inc. foreign aid)	2.9	2.0	1.2	-0.5	-0.7
Government public debt	16.1	15.8	14.6	16.3	23.5
Arrears accumulation	20.7	20.3	21.0	22.8	28.7
External Sector	**(Percent of nominal GDP)**				
Exports of Goods and Services	14.3	15.7	16.0	15.5	16.0
Imports of Goods and Services	51.1	52.7	55.4	53.5	51.1
Income from Abroad, net	12.3	13.2	17.1	17.7	16.4
Current transfers, net	10.6	10.6	9.2	9.9	11.8
Current Account	-13.9	-13.2	-13.1	-10.4	-6.9
Monetary Sector	**(Annual percent change)**				
Banks Assets	12.7	11.6	1.7	11.2	11.0
Direct Credit Facilities	18.0	16.8	5.1	7.2	11.5
Customer Deposits	9.8	13.0	2.0	9.5	13.1
Ownership Equity	14.9	12.4	1.1	3.3	-0.7
memorandum items					
Real GDP (USD Million,2015 = 100)	15,211.0	15,426.9	15,616.2	15,829.0	14,015.4
Per capita real GDP (USD)	3,489.8	3,463.1	3,417.7	3,378.3	2,913.4
Nominal GDP (USD Million)	15,405.4	16,128.0	16,276.6	17,133.5	15,561.3
Al-Quds Stock Market Index (point)	530.2	574.6	529.4	526.0	471.3
Exchange rate (USD/NIS)	3.84	3.60	3.59	3.56	3.44

* Preliminary data subject to change.
Source: PMA & PCBS.

AMF-BIS Fourth Working Party Meeting on Monetary Policy in the Arab Region

Background Paper on Monetary Policy

The State of Qatar

Qatar Central Bank

Prepared by

Ms. Al Anood Binali
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Abu Dhabi, United Arab Emirates
31 May, 01-02 June 2021

Monetary Policy Implementation in The State of Qatar

1. Background

Qatar is a small open economy highly dependent on revenue from hydrocarbon exports. However, significant economic diversification has been taking place through its National Development Strategies under the ambitious "Qatar National Vision 2030". The share of hydrocarbon in real GDP is high at a little less than 40 percent currently, though this has declined from about 50 percent a decade ago.

The monetary policy framework adopted in Qatar is an outcome of this nature of the economy: a small open economy highly dependent on revenue from hydrocarbon exports whose global prices are denominated in the US dollar (USD). In such an economy, a currency peg system is often the monetary policy framework on the consideration that it is more appropriate in providing macroeconomic stability. Since hydrocarbon is the main source of revenue priced in the USD, the natural choice of the currency peg is the USD. In this regard, IMF (2018) continued to emphasize that "The peg to the US dollar continues to serve Qatar well, providing a clear and credible monetary anchor."

Thus, the monetary policy framework of Qatar Central Bank (QCB), which is a currency peg with the USD, is currently fixed at 1USD=3.64QR. The framework is an inherited one from the erstwhile Qatar Monetary Agency in 1993. Under this monetary policy framework, QCB is entrusted with the function to 'preserve money value and ensure monetary stability, among others, under the 'Law of the Qatar Central Bank and the Regulation of financial Institutions' issued by virtue of Law no (13) of 2012.

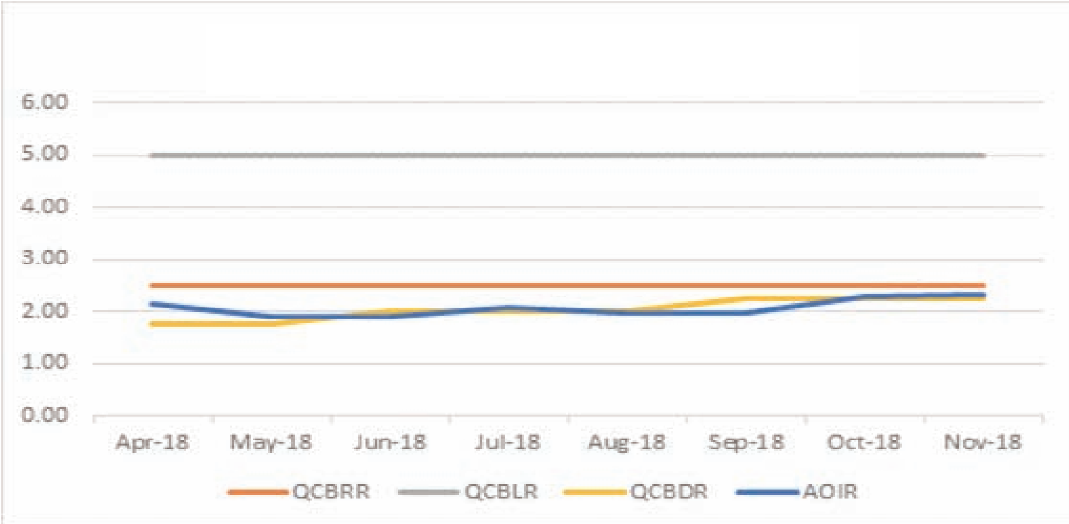
2. The Operational Framework of Monetary Policy: The Latest Developments

Any monetary policy framework has an accompanying operational framework/procedure known as the nuts and bolts of day-to-day monetary policy operation. The basic operating framework has remained the same during the last few years. Interest rate setting through policy rates changes is the main instrument of QCB's monetary policy. Policy rates are set to guide/manage the operating target –average overnight interbank rate (AOIR) – to the desired level to sustain the parity between QR and the USD.

Three policy rates exist viz., the QCB Deposit Rate (QCBDR), the QCB Lending Rate (QCBLR), and the QCB Repurchase Rate (QCBRR). These are the policy rates at which QCB carries out its liquidity management operations. Liquidity is absorbed from the banking system with the deposit facility at QCB at the QCBDR, up to a prescribed limit for each bank currently equivalent to the required reserves. On the other hand, QCB injects liquidity through a repurchase transaction at QCBRR, collateralized lending by QCB to banks. There is another standing uncollateralized lending window by QCB to banks at a penal rate at the QCBLR. The QCBDR forms the floor and QCBLR as the ceiling of these three rates.

Since the banking system typically/operates in liquidity surplus conditions, the operating framework is a floor system, i.e., QCBDR guides the AOIR. Thus, liquidity management operations aim to align the AOIR to the QCBDR for further transmission to various market-determined interest rates. An illustrative structure of policy rates and AOIR based on actual data is in Chart-1, where QCBDR is the floor rate to the AOIR in most of the normal times.

Chart-1: Policy rates Structure



Source: Monthly Monetary Bulletin, QCB, Various Issues.

Besides these three liquidity management tools, there are three more instruments used by QCB to modulate more durable liquidity in the banking system:

(1) QCB manages shorter-term durable liquidity through net issuances of treasury bills (T-bills) given the redemption schedules. Whenever fresh issuances of T-bills exceed redemptions, there is liquidity absorption and vice versa.

(2) QCB manages durable structural liquidity through auctions of Treasury bonds (including Sukuks) given the redemption schedule. Like T-Bills, whenever fresh issuances exceed redemptions, there is liquidity absorption and vice versa.

(3) QCB also manages structural liquidity by prescribing the required reserve ratio, which requires banks to keep a specific ratio of their average total deposits as an interest-free balance with QCB daily. Raising the ratio absorbs liquidity and vice versa.

As mentioned above, the basic structure of the operational framework has remained unchanged during the last few years. However, there have been policy rates responses to international and domestic developments. In this regard, the monetary policy response to the Pandemic is a little special given its uniqueness. Given the currency peg system with the US dollar as the anchor currency, the policy rates mostly respond to the policy rate moves of the US Federal Reserve. With the sharp cut in its policy rate by the US Federal Reserve to near-zero level and renewal of its quantitative easing program, and to provide the necessary monetary stimulus to the domestic economy, QCB also cut its policy rates in March 2020. Thus, QCB reduced QCBDR and QCBRR twice in March by 50 basis points each to 1 percent. Similarly, QCB reduced the QCBLR twice in March by 75 and 100 basis points to 2.5 percent. Since then, there have been no rate changes.

Interestingly, QCB also introduced a new additional liquidity facility for the banks in March 2020, which is temporary. This is the special repo at zero rate to enable banks to sustain credit flows to sectors vulnerable to the Pandemic. This new facility, which was initially for six months, had its extension twice, in September by three months and again in December 2020 by another six months, after reviewing the impact of the Pandemic on the economy.

With regard to the management of durable structural liquidity, the required reserve ratio had remained the same since April 2017, when there was a 25-basis points reduction in it. The auctions of T-bills were also neutral to shorter-term durable liquidity as fresh issuances exactly matched redemption amounts during the entire 2020. However, there were large-scale injections of durable longer-term liquidity since there were no fresh issuances of T-bonds (including Sukuks) while a large amount matured during 2020. Because of these liquidity operations, the primary liquidity in the banking system increased sharply since March-April 2020 and continues to be, so far.

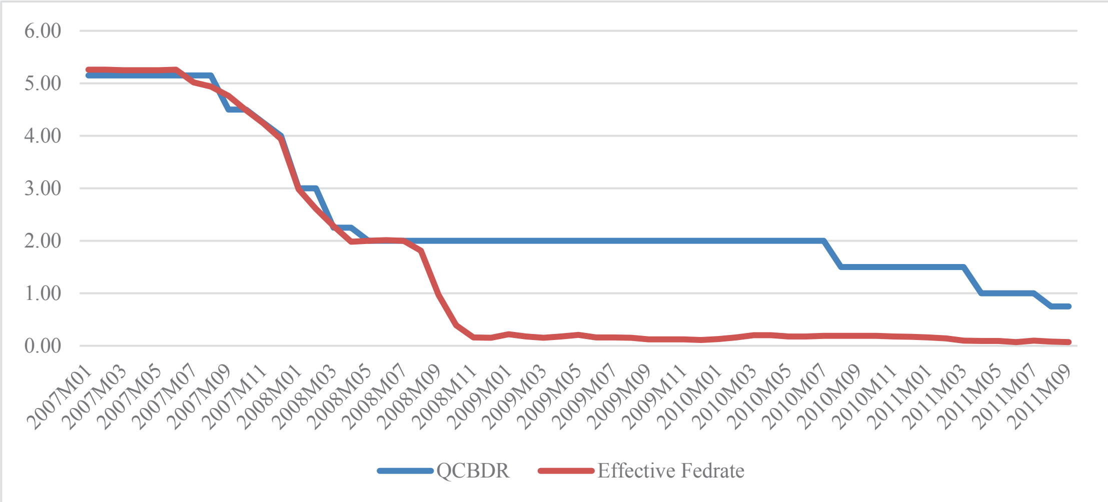
3. The Implications of Global, Regional, and Internal Economic and Financial Developments on Monetary Policy Implementation

With free capital mobility under a fixed exchange rate system, global and regional developments have major implications on domestic monetary policy implementation. The well-known ‘Impossible Trinity or ‘Trilemma’ theory of Mundell-Fleming says that a central bank cannot freely set its policy rates when there is free capital mobility under a fixed exchange rate framework. This is not only of theoretical relevance but also in practice (see, for example, Obstfeld, Shambaugh, and Taylor, 2005). Thus, most of the time, setting policy rates must follow the rate moves of the anchor economy, which in the case of Qatar is the US, as mentioned above. Otherwise, there will be capital inflows/outflows and put pressure on the currency peg. In this regard, the pressure arising from capital outflows would be more biding than the pressure arising from inflows. Because in the former, there would be a loss of reserves to defend the peg, which has a definite limit. However, there would be a gain of reserves to defend the peg in the latter case, whose associated liquidity, and monetary implications one can perhaps manage with relatively lesser challenges. Thus, under normal circumstances, one perhaps follows rate hikes in the anchor country more strictly than rate cuts. Because not following rate hikes would likely lead to outflows against likely inflows of not following rate cuts.

Similarly, the developments in the region also have implications in the setting of domestic monetary policy, given the similarity in nature of the economies. The diverse developments amongst the countries in the region could lead to portfolio readjustments within the region, which needs to be given due considerations. However, since almost all the neighboring economies also peg their currencies to the US dollar, the policy rate responses of the US Federal Reserve largely synchronize the policy rates movements in the region.

Having said the above limitations, internal economic and financial developments do matter and are given due considerations. This would reflect in the quantum of changes in the three policy rates supplemented by other liquidity management tools. For instance, in the aftermath of the global financial crisis, when the US Federal Reserve successively cut its policy rate to near-zero levels, QCB did not reduce to the same extent and kept the QCBDR at 2 percent during May 2008 June 2010. Because QCB was trying to reduce the double-digit inflation, it reduced the QCBDR to 0.75 percent in three steps of 50 bps, 50bps, and 25 bps in August 2010, April 2011, and August 2011, respectively, when the inflation subsided (Chart-2).

Chart-2 : Gap Between QCBDR and Effective Fedrate



Source: Monthly Monetary Bulletin, QCB, Various Issues.

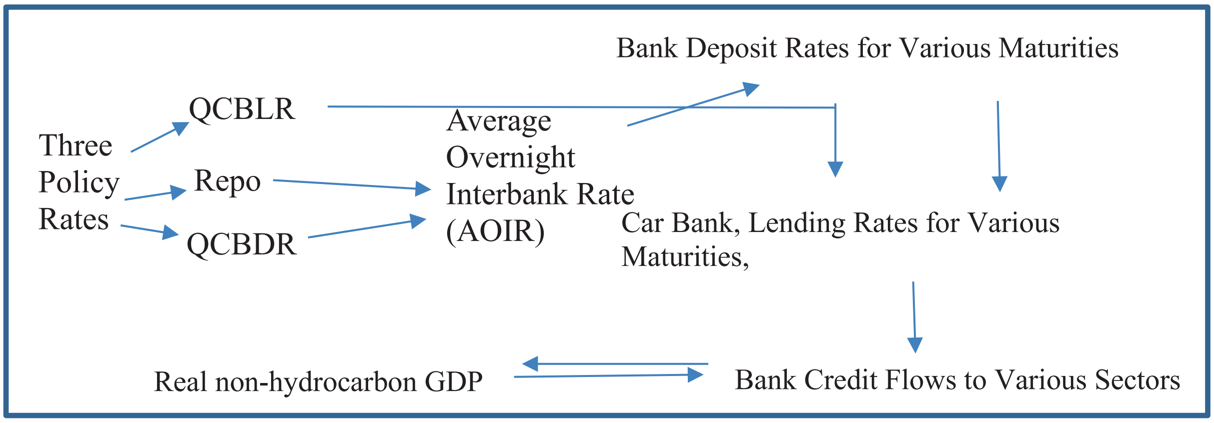
This higher gap between QCBDR and effective Fed rate had its liquidity implications. There was an interest rate arbitrage opportunity, which led to capital inflows for deposits with QCB at the QCBDR. Thus, during this period, QCB imposed a ceiling on QMR deposits equivalent to each bank's required reserves that remain until date. This QMR deposit limit, in a sense, is a form of discouraging/controlling excessive capital inflows, which in the framework of "Trilemma" provides some degree of independence in policy rate setting.

4. The Efficiency of Monetary Policy Measures in Mitigating the COVID-19 Impact and Supporting Economic Recovery

The monetary policy essentially would provide the necessary stimulus by lowering the cost of credit/fund and ensuring enough liquidity to smoothen the flow of credit/fund in the economy. As mentioned above, to provide the necessary support to economic recovery, QCB cut the QCBDR and QCBRR by 100 bps and the QCBLR by 175 bps in March 2020. A special repo at zero rate remains until date with significant outstanding in helping banks sustain credit flows to vulnerable sectors to the Pandemic.

Thus, the efficiency of these monetary measures would reflect on their transmission to other market rates and credit flows, which would help the real sector, particularly the non-hydrocarbon sector, which in turn has feedback on demand for bank credit. Chart-3 below provides a very simplified credit channel of monetary policy transmission. Empirical examination using time series data from monthly monetary bulletin and GDP data from the Ministry of Planning and Statistics validates monetary policy transmission described in Chart-3.

Chart-3: Transmission Channel of Monetary Policy



Source: Author's depiction.

Thus, one may gauge the efficiency of monetary policy measures by the decline in interest rate structure in the economy, sustenance of credit flows, and performance of the non-hydrocarbon sector. The transmission of lower monetary policy rates to the various spectrum of interest rates in the banking sector is visible.

Transmission of more than 100 bps of the QCBDR reduction to inter-bank rates and bank deposit rates was already observed by the end of 2020 (Chart-4 and 5). A significant transmission to various lending rates also took place, though lesser than deposit rates (Chart-7).

However, due to highly easy primary liquidity conditions, transmissions to shorter-term inter-bank rates, particularly to AOIR, have been higher due to a conscious policy decision. In this regard, the special repo at zero rates has been an essential factor for this easy primary liquidity in the banking system.

Chart-4: Transmission to Inter-Bank Rates

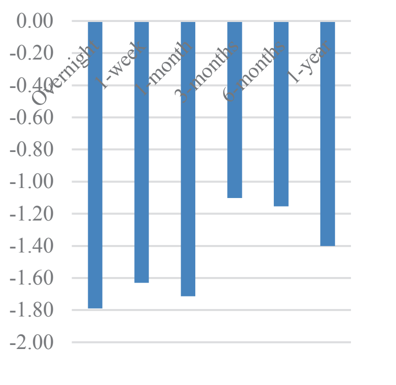


Chart-5: Transmission to Deposit Rates

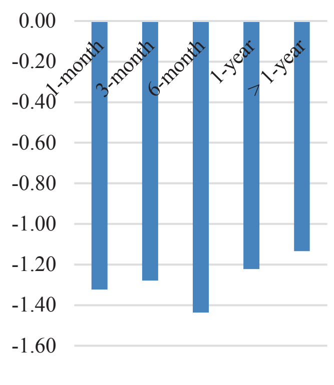
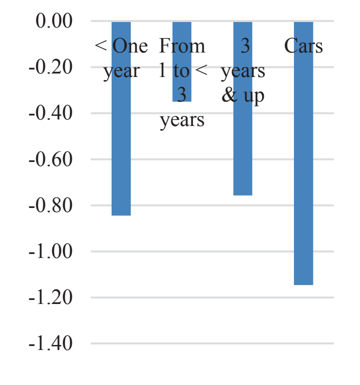
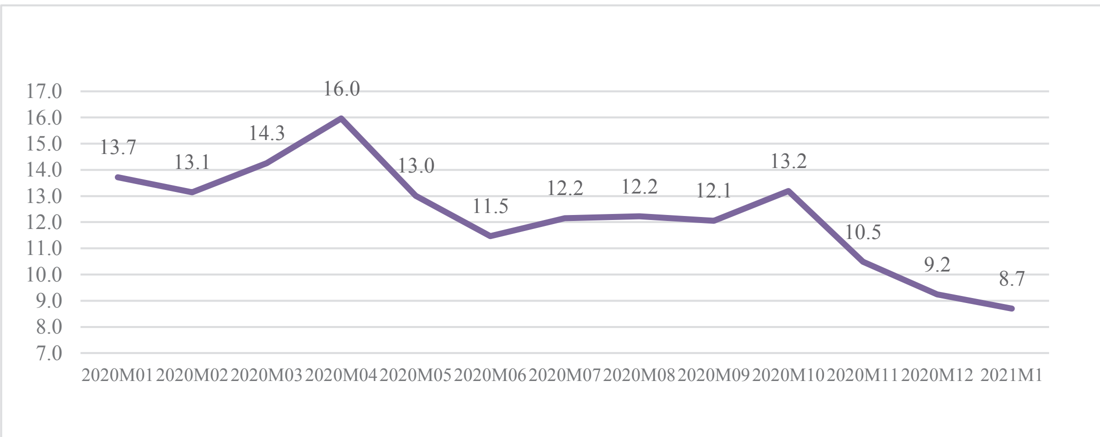


Chart-6: Transmission to Lending Rates



Lower lending rates lead to higher credit growth, other things remaining the same. Combined with measures to sustain bank credit flows through the National Credit Guarantee program operated through Qatar Development Bank and special repo at zero rates introduced to lessen the adverse economic impact of the Pandemic, domestic bank credit had been in double digits through much of the lockdown period. There has been some deceleration in recent months, but the pace of growth remains fast given the corresponding pace of bank deposit growth.

Chart-7: Domestic Credit Growth (Y-o-Y)



Source: Qatar Central Bank.

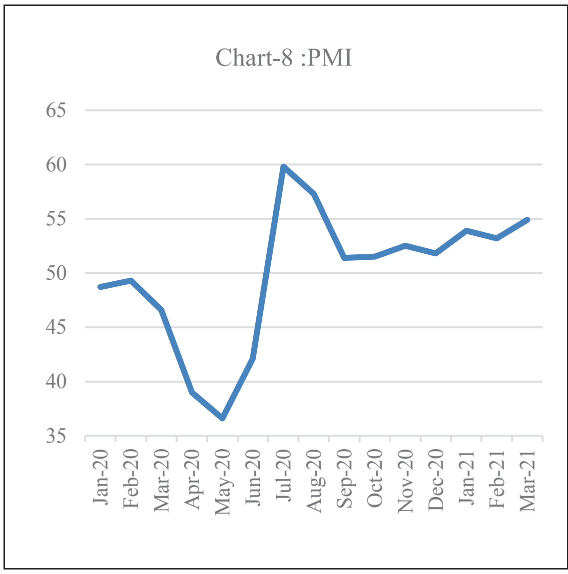
Thus, given the empirical evidence that bank credit helps in the growth of the non-hydrocarbon sector, it may not be too far-fetching in stating that the monetary policy stimulus would have played an important role in the observed recovery of the economy. A sharp recovery in Q-o-Q GDP growth took place in Q3-2020, led by the non-hydrocarbon sector, though it moderated in Q4

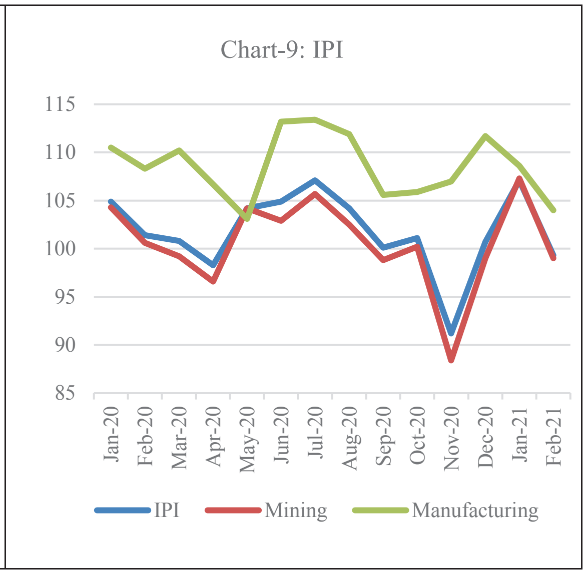
(Table-1). The other way to put it is that without the monetary policy stimulus, the economic recovery would not have been observed.

Table-1: Growth in GDP (Q-o-Q) (%)

	GDP	Hydrocarbon	Non-Hydrocarbon
2019-Q4	-1.2	-4.6	0.9
2020-Q1	-2.3	2.9	-5.2
2020-Q2	-6.3	-2.5	-8.8
2020-Q3	5.5	0.7	8.7
2020-Q4	-0.5	-4.3	1.9

The recovery in Q3 and Q4-2020 would likely sustain going forward, as indicated by high-frequency data. The purchasing managers' index (PMI) for manufacturing remains in the expansionary zone since July 2020 and with a rising trend during 2021 so far (Chart-8). IPI, however, shows a setback in February 2021 but would likely resume an upward trend in line with the PMI (Chart-9).





5. Monetary Policy Implementation: Main Challenges and Reforms

Monetary policy implementation has made a lot of progress over the last decade. Even though the peg system remains the appropriate framework as alluded to above, when business cycles do not synchronize with the anchor economy, monetary implementation could at times be challenging. There have been instances of such situations as cited above in the immediate aftermath of the global financial crisis when the US Federal Reserve successively cut interest rates to near Zero. Still, QCB had to keep on hold at 2.0 percent for two years due to overheating of the economy. There have been opposite instances, such as during 2017-18 when the US Federal Reserve started raising interest rates while the Qatari economy faced a downturn with economic blockade as an essential factor. However, until the achievement of more profound diversification of the economy, the current monetary policy framework would remain relatively more appropriate. It will have to face any associated challenges during its implementation.

Another challenge is the thinness of the inter-bank market, which needs further development for a better monetary policy transmission. QIBOR, developed by QCB with Bloomberg in 2012, has been important in guiding and developing the overnight interbank rate. There is also the need to develop other sectors of the financial markets as well. Because deepening domestic financial markets is crucial to the transmission of policy signals and promotes saving and investment, in this regard, improving the functioning and liquidity of the secondary market in domestic government securities is extremely important.

Because yield in government securities often provides the benchmark for other market rates. Thus, developing a reliable yield curve while providing a reliable benchmark for corporate issuances would help in monetary policy transmission and liquidity management. Liquidity management is at the forefront of monetary policy implementation for its effective transmission. In this regard, QCB has made substantial progress through better coordination and flow of information on liquidity with government and government institutions. Scope, however, still exists to further upgrade liquidity management by improving liquidity monitoring and forecasting exercises.

6. Conclusion

Currency peg with the USD continues to be the monetary policy framework of QCB. The framework is more appropriate for a small open economy highly dependent on hydrocarbon exports priced in the USD. The monetary operating procedure sets policy rates and aligns the overnight inter-bank market to the main policy rate through liquidity management operations to defend the peg. However, in this framework, international and regional developments have significant implications on monetary policy implementation. Because policy rates need to be largely set in tandem with the anchor economy, which puts pressure on the currency peg through interest-rate sensitive capital flows, in this regard, an unsynchronized business cycle is a significant challenge in monetary policy implementation.

Given the framework, QCB responded to the Pandemic by cutting its policy rates and augmenting its liquidity-providing facilities. Consequently, the interest rate structure, including deposit and lending rates of banks, in the economy declined significantly along with ample primary liquidity in the banking system. These monetary stimuli helped sustain bank credit growth at double-digit and recover the non-hydrocarbon sector since the third quarter of 2020. Monetary policy implementation has made significant progress, which anyway is an ongoing process. In this regard, there are scopes for further developments such as market developments, inter-bank, and government securities market, and strengthening of liquidity management and forecasting framework.

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AMF-BIS Fourth Working Party Meeting on Monetary Policy in the Arab Region

Background Paper on Monetary Policy

The State of Kuwait

Central Bank of Kuwait

Prepared by

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31 May, 01-02 June 2021

Monetary Policy Implementation in The State of Kuwait

1. Overview

The Central Bank of Kuwait's (CBK) monetary and regulatory policies have faced a very exceptional year since the beginning of the Coronavirus Pandemic. The bank has directed all its efforts to counter the negative impact of the Pandemic using all available tools, and without abandoning its main objectives aimed at maintaining both monetary and financial stability, supporting the economic sectors to contain the shock and providing a supportive environment to safeguard confidence in the national economy and stimulating its ability to recover from the effects of the crisis. In this regard, the CBK adopted expansionary monetary policies to address the Pandemic's effects. The discount rate was reduced to historically lower levels reaching 1.5 percent, followed by a reduction in the repo rate and intervention rates in the money market, reflected in the decline of all domestic interest rate indicators during 2020 compared to the previous year. As a result, the banking sector had successfully weathered the first year of the crisis. CBK will continue to diligently and proactively monitor developments that could affect financial stability.

This paper is organized as follows: following this overview in Section I, Section II describes liquidity conditions and monetary policy framework. Section III is devoted to the operational framework of monetary policy developments. Section IV highlights monetary Policy implementation challenges and reforms. A brief conclusion is provided in Section V.

2. Liquidity Conditions and Monetary Policy Framework

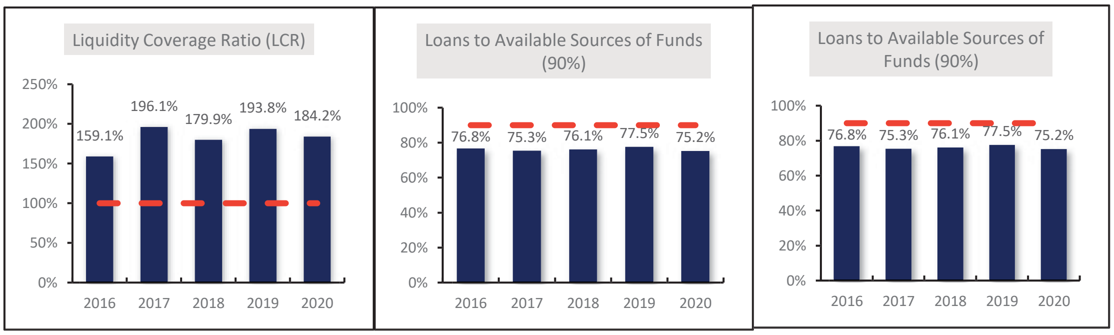
Monetary policy in Kuwait is set and implemented by the CBK in accordance with Law No. 32/1968 concerning Currency, the Central Bank of Kuwait, and the Organization of Banking Business. Its primary objective is to maintain monetary stability using direct and indirect monetary policy instruments to keep inflation, domestic and imported, in check. A related objective mandated by the Law is that monetary policy is conducted in such a manner as to assist the social and economic progress and the growth of national income. This section provides an outline of liquidity conditions and monetary policy framework in the State of Kuwait.

a. Liquidity Conditions

Despite the recent challenging operating environment due to the COVID-19 outbreak resulting in an economic and financial crisis, Kuwaiti banks continued to show strong financial soundness indicators in terms of capital adequacy and liquidity ratios. At the end of December 2020, the Capital Adequacy Ratio (CAR) was at 19.0 percent, comfortably above the CBK's mandated minimum of 13.0 percent and the Basel Committee on Banking Supervision's (BCBS) requirement of 10.5 percent. Although the CBK had allowed banks to use their capital conservation buffers, they continued to operate without resorting to this option owing to their strong CARs. Moreover, CAR improved from 2019's 18.5 percent, mainly due to banks bolstering their regulatory capital through increased international issuances. These issuances are eligible for inclusion in the calculation of the capital base according to BCBS's standards. This indicates the high level of confidence in Kuwaiti banks internationally.

When it comes to liquidity ratios, the banking sector is still seeing an abundance of Liquidity. Kuwait's banking system has operated in an environment of excess reserves for a number of years due to large oil revenues. Effective liquidity management frameworks are crucial to address liquidity fluctuations, facilitate monetary policy implementation, and avoid liquidity imbalances. Local banks are in a solid position to absorb relatively large liquidity shocks. Banks are able to meet liquidity regulation requirements with ease. As of 2020, Kuwaiti banks remain well above the minimum required 100 percent for LCR (184.2 percent) & NSFR (115.3 percent). Regulatory Liquidity reached 27.5 percent against a minimum of 18 percent. Loans to Available Sources of Funds recorded around 75.2 percent as of the end of 2020, below the maximum of 90 percent.

Figure 1: Some Banking Sector Liquidity Indicators



b. Monetary Policy Framework

The primary tool of monetary policy is the discount rate to which are linked, within specified margins, the maximum limits of interest rates on Kuwaiti Dinar (KWD) lending transactions at the banking and financial system units of the country. Other tools that the CBK has at its disposal include direct intervention in the money market through taking/placing deposits, issuing public debt instruments, issuing CBK Bonds, Repos, etc.

As defined in Paragraph (A) of Article (41) of the previously mentioned Law No. 32/1968, the Discount Rate is "the interest rate charged by the Central Bank of Kuwait (CBK) against the discount or rediscount of commercial papers, provided that these shall mature within one year from discount or rediscount by the Bank".

Paragraph (D) of Article (26) of the CBK Law states that "within the provisions of this Law, the Board of Directors shall exercise the full powers necessary to perform its duties, and particularly, shall fix the rates of discount, rediscount, interest, and commission to be charged by the Bank on loans, advances, and discount of commercial papers." Worth noting is that CBK's Board of Directors' resolution No. 3/220/1995, issued on 30 January 1995, has waived the minimum interest rate limits on deposits and saving accounts while maintaining the maximum limits of interest rate on loans.

In light of the above-mentioned, CBK's disclosed Discount Rate is considered a central rate to which the maximum limit of the contractual interest rate on the KD loans is linked to within narrow margins. Hence, CBK's Discount Rate increase entails an equal increase in the maximum limit of interest rate on the KD loans and vice versa. By CBK Board of Directors' resolution No. 29/338/2008, issued on 23 March 2008 on the maximum limits of the annual contractual interest rate, the maximum limit of interest rate on consumer loans and installment loans granted in KD may not be more than 3 percent over CBK's discount rate. Installment loans shall be granted against fixed rates, provided that the applicable interest rate shall be reviewed every five years during the loan tenor.

In accordance with this resolution, the terms concerning the maximum limit of interest rate on all forms of commercial lending and other forms of lending denominated in KD shall not exceed 2.5 percent over CBK's discount rate for lending transactions denominated in KD and which tenor does not exceed one year, while the annual interest rate ceiling on KD shall not exceed 4 percent over CBK's discount rate for lending transactions denominated in KD and which tenor exceeds one year. The linking of the maximum limit on the interest rate on lending transactions denominated in KD became effective by CBK Board of Directors' resolution No. 30 issued on November 1988.

In this respect, CBK's Discount Rate is determined by monitoring the domestic and global economic, monetary, and banking conditions and indices of general economic performance, oil sector performance, and developments in credit and deposits growth indices. Accordingly, the CBK adjusts the Discount Rate either upward or downward to achieve the CBK's monetary policy goals to support monetary and financial stability and enhance sustained economic growth in the national economy.

On the other hand, some of the domestic economic structural characteristics shape the economic environment within which the tools and goals of the monetary policy of the CBK operates. These are mainly the small size of the Kuwaiti economy and its sensitivity to the changes in the global markets, free movement of funds with other countries, and its openness to the outside world in terms of reliance on oil revenues, as well as its reliance on goods and services imported from other countries. In this economic environment, CBK is keen on framing and implementing its monetary policy to support monetary and financial stability, control imported inflationary pressures, and enhance sustained economic growth aiming towards economic and social development.

3. Operational Framework of Monetary Policy: The latest developments

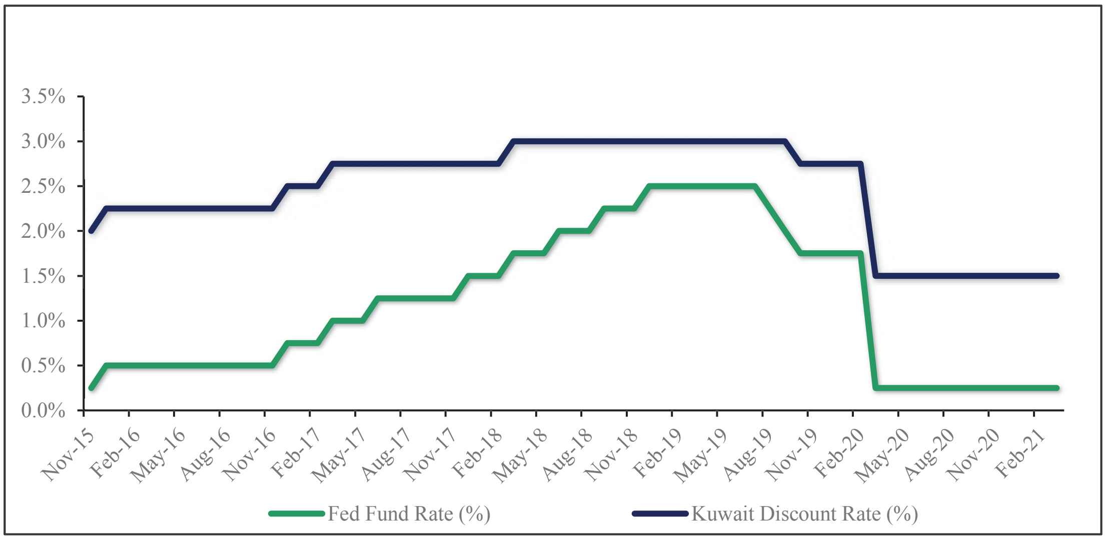
The CBK continued its efforts in the area of monetary policy in line with local economic developments and global market developments. The CBK's efforts aimed to strengthen monetary and financial stability, promote a supportive environment to inspire confidence in the national economy, and stimulate economic growth. In addition, the CBK reiterated its keenness to reinforce the competitiveness and attractiveness of the national currency, which is considered a store of domestic savings and is the main currency used in domestic lending extended by local financial institutions to the various sectors of the national economy.

a. CBK Discount Rate

The U.S. Federal Reserve (FED) made two exceptional cuts in March 2020 of 50 bps on March 3, 2020, and another 100 bps on March 15, 2020, to counter the economic repercussions in the wake of the spread of coronavirus (COVID-19). In August 2020, the FED announced that it would begin targeting average inflation of 2 percent rather than making a 2 percent fixed goal. This decision allows the FED to keep policy rates low for longer, a move that will stimulate growth and reduce unemployment.

In light of the economic conditions resulting from the repercussions of the Pandemic, the CBK on March 4, 2020, reduced the discount rate by 25 bps, followed by a further 100 bps on March 16, 2020. Accordingly, the discount rate is at its historic low of 1.5 percent. The CBK aims to reduce the cost of lending to all economic sectors, individuals, and institutions, to promote an environment conducive to economic growth that will encourage demand for borrowing, stimulate economic activity and raise asset values, stimulate aggregate demand, and maintain monetary stability and financial stability, taking into account also maintaining the competitiveness and attractiveness of the Kuwaiti Dinar.

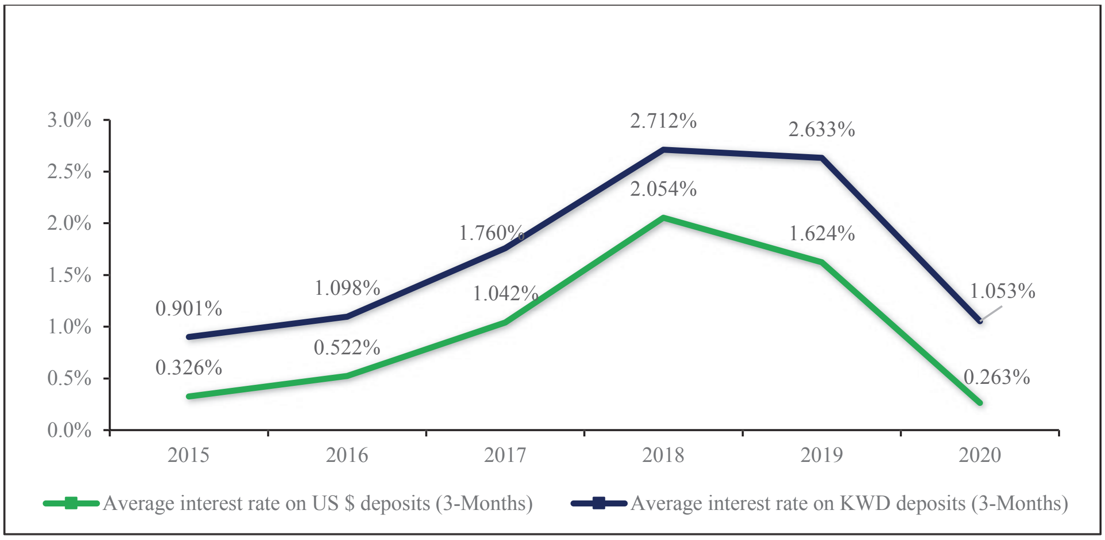
Figure 2: Discount Rate (Kuwait) & Fed (USA)



It is worth noting that since 2015, the FED raised interest rates eleven times (once in 2015, once in 2016, thrice in 2017, four times in 2018, and twice in 2019). In addition, it reduced interest rates twice in 2020. Despite the FED's decisions, the CBK only changed its discount rate seven times within the same period and skipped the other seven of the Fed's hikes and reductions in the interest rate. The CBK rate decisions signal its commitment to maintaining the continued attractiveness of the Kuwaiti Dinar as a store of domestic savings; this is a fundamental objective of CBK's monetary policy.

The average interest rate on KWD deposits for 3-month was 1.053 percent as of the end of 2020, lower by 1.58 ppts compared to the interest rate of 2.633 percent as of the end of 2019. KWD interest rate on 3-month deposits remains higher than the interest rate on local USD deposits with a similar term, which was 0.263 percent as of the end of 2019. The 3-month interest rate spread between rates on KWD deposits and USD deposits remained steady at an average of 62 bps between the years 2015 - 2020.

Figure 3: Average Interest Rates on Deposits (3 Months)
KWD vs USD



b. REPO Rate

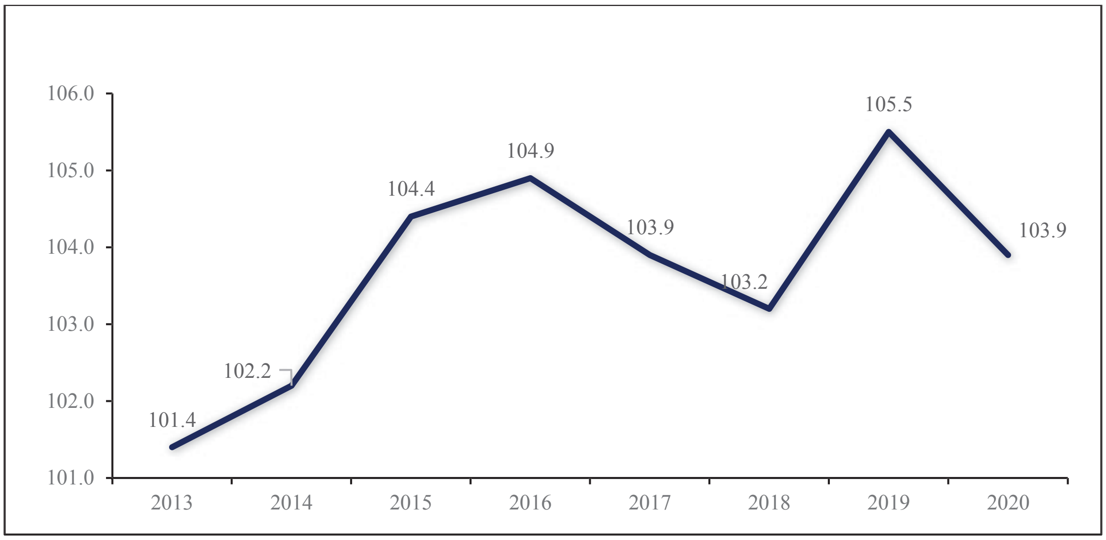
The CBK has reduced the repo rate and the money market intervention rates, which comprise integrated measures that enhance the cash flows between the banking sector and the sectors of the national economy, thus enhancing the demand for loans to avoid any economic downturn. In this regard, the CBK reduced intervention rates by 0.125 percent in all terms of the interest rate structure up to 10 years. This includes repurchase operations (repo), CBK bonds, direct intervention tools, and public debt instruments.

Exchange Rate Stability

Fundamentally sustainable economic growth and appropriate macro policies, both fiscal and monetary, constitute the pillars of exchange rate stability. More specifically, the maintenance of the competitiveness and attractiveness of the

KWD as the store for domestic savings and investment remains the highest priority for the CBK, which is committed to taking all actions necessary to safeguard the competitiveness of the national currency. The Nominal Effective Exchange Rate (NEER) slightly declined to reach 103.9 as an average of 2020 compared to the previous year. The calculated NEER shows that the KWD retained its nominal purchasing power of currencies despite the recent retraction.

Figure 4: NEER Imports Weights (100=2010)

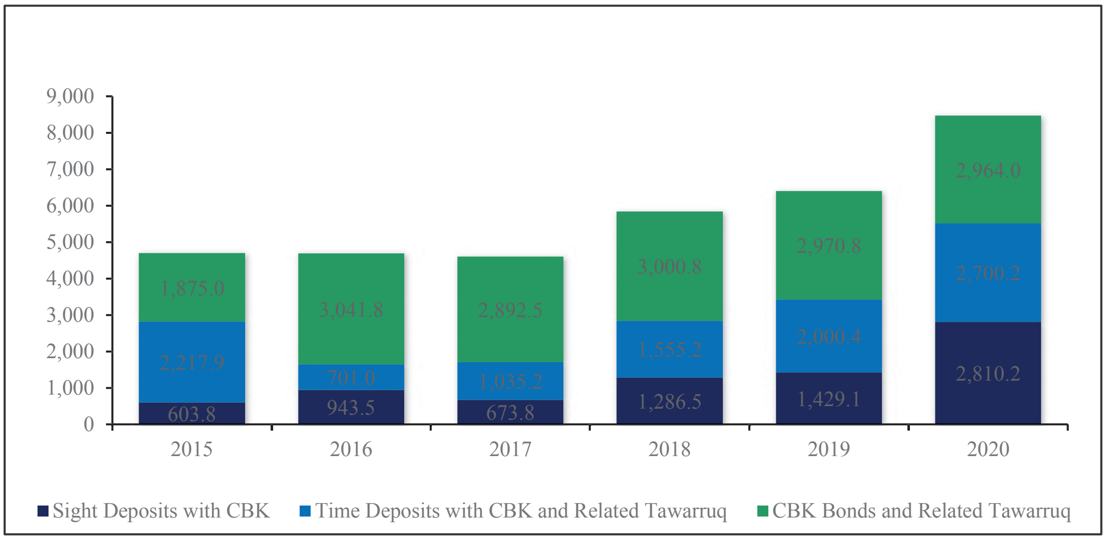


c. Money Market Developments

The CBK has a set of tools to manage liquidity. The CBK issues short-term bonds (3-Month and 6-Month), standing deposits, and extends credit facilities to banks. CBK bonds are issued with the amounts, rate, and price determined by the CBK, and the issuances are taking place whenever necessary. The CBK can also engage in repurchase and foreign exchange swap operations and overnight lending facilities, but these are not frequently used due to the abundance of liquidity in the system.

Amid liquidity conditions in the banking sector and the non-issuance of government debt, absorption by the CBK during 2020 increased by 32.4 percent compared to 2019. In particular, the share of sight deposits with the CBK surged against bonds and related tawarruq, accounting for 33 percent of the total absorptions in 2020 compared to 22 percent in 2019. In principle, CBK's monetary operations continued to maintain sufficient systemic liquidity while smoothing out fluctuations caused by periodic variations in the volume of funds introduced or withdrawn from the banking system.

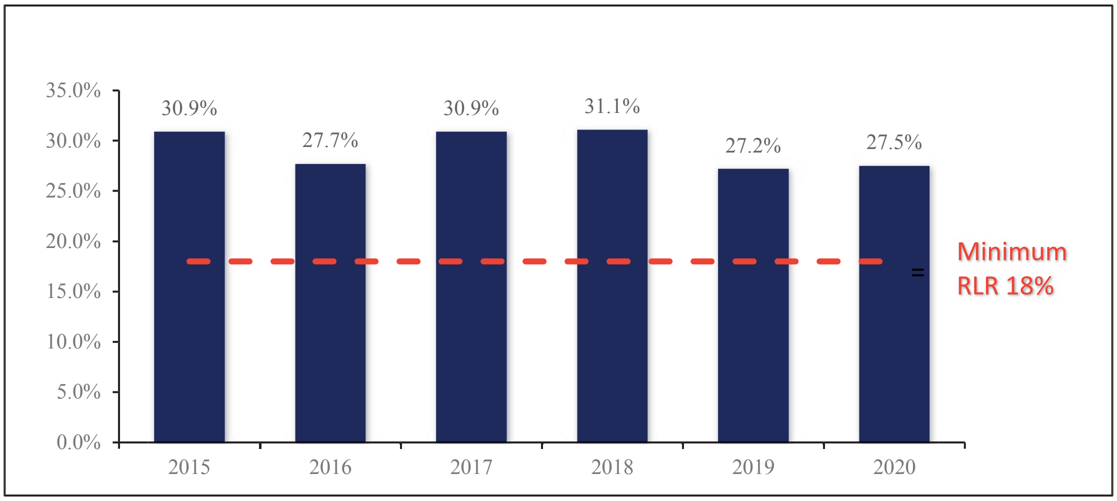
Figure 5: CBK's Absorption Tools



The KWD interbank offered rate declined sharply during 2020, especially after the CBK slashed its discount rate in March 2020. The interbank one-month offered rates closed the year at 1.188 percent, notably lower than its 2019 closing at 2.537 percent.

The Regulatory Liquidity Ratio (RLR) for Kuwaiti banks was 27.5 percent as of the end of 2020, well above the required minimum of 18 percent. The RLR requires the banks to hold liquidity against all KWD customer deposits. They can hold this liquidity in the form of reserves held in their account at the CBK, time deposits at the CBK, and CBK and MoF bonds. Further, they are required to have a minimum holding of each instrument set at 3, 3, 6, and 6 percent of liquid assets held against the RLR, respectively.

Figure 6: Bank’s Regulatory Liquidity Ratio



4. Monetary Policy Implementation: Main Challenges and Reforms

In addition to being a health crisis, last year's global Pandemic-induced economic crisis was unprecedented in its scope, depth, and impact on economic and financial conditions. The austere lockdown measures shocked both supply and demand, sending global economies into recession and causing a surge in unemployment. Governments intervened as central banks maintained highly accommodative monetary policies to contain the crisis.

The CBK proactively pursued accommodative monetary and macroprudential policy geared towards increasing lending and financing capacities for banks to counter the effects of the Pandemic on the economic and banking system, all within an integrated scheme of measures that protect the banking and financial sector. This is in line with the main mandates of the CBK to maintain both monetary stability and financial stability.

Foremost among the pillars of the CBK's macroprudential policy and instruments in recent years, and within its preemptive, forward-looking measures, was enhancing risk management in the banking sector, bolstering the capital bases, and building precautionary provisions. This is in addition to implementing the Basel III standards that serve as a comprehensive and integrated package to enhance banks' financial soundness indicators, strengthen their positions, and further ensure conditions needed to maintain financial stability through increasing both capital adequacy and quality, enabling greater shock absorbing abilities. The Basel reforms package also urges diverse additional capital buffers and liquidity standards to enhance banks' ability to counter liquidity pressures and enhance the stability of their financing structures. This is to be added to other standards related to enhanced governance and reduction of risky exposures to financial and real estate markets.

Despite the effects of the Pandemic on economic and banking conditions, banks succeeded in maintaining a high degree of asset quality, supported by strong financial soundness indicators that weathered severe conditions and confirmed the banking sector's ability to withstand shocks.

This can be attributed to the constant allocation of provisions to counter requirements of non-performing loans write-offs and the accumulation of such provisions, which act as buffers and support banks' financial positions. This, in turn, enables banks to continue serving all sectors of the domestic economy competently and in a balanced manner, taking into account the interests of all concerned parties.

Specifically, loan loss provisions charged on the banks' income statements reached about KD 852 million in 2020. In contrast, the increase in the overall value of banks' available provisions reached KD 403 million, indicating the utilization of the remaining balance towards bad-debt write-offs.

Non-Performing Loans (NPLs) ratio, which could have spiked due to closures and dampened economic activity both in Kuwait and in countries where Kuwaiti banks operate, increased by 0.5 percent amid the unprecedented crisis from 1.5 percent in 2019 to 2.0 percent in 2020. Furthermore, this figure remains at historically low levels, inspiring even more confidence in the banking sector's strength.

Meanwhile, NPL Coverage Ratio (provisions to NPLs) dropped from 271 percent to 222 percent, mainly due to utilizing these provisions towards the purposes for which they had been created. The ratio remains at healthy levels, boosting asset quality and serving as an additional buffer to counter any potential worsening in the credit portfolio that may arise if the Pandemic persists.

The measures introduced by the CBK in terms of accommodative monetary policies and regulatory policies geared to bolster bank credit growth and promote economic activity amid the Pandemic have resulted in continued growth in credit facilities despite last year's markets closures. At the end of December, the Net Credit Facilities Balance, on a consolidated level, amounted to KD 51.8 billion, an increase of 4.3 percent, and KD 2.1 billion from December 2019. This growth in credit facilities started during March 2020, coinciding with the CBK's decision to bring down the Discount Rate to an all-time low of 1.5 percent.

As was the case with most other world economies, the Pandemic impacted the Kuwaiti banking sector's operating environment. Banks faced challenges in profitability, which resulted in their net income slipping from KD 964 million in 2019 to KD 495 million in 2020, a drop of 48.7 percent.

The drop in net income was partially due to a decline in operating revenues and the consolidation of provisions, which accounted for the direct effects of the Pandemic on the economy and the possibility of further market closures amid uncertainty and new waves of infections. This would detrimentally impact clients' ability to meet their debt obligations and thus requires additional provisions to counter any possible increase in NPLs or depreciation of investment assets. Kuwaiti banks' initiative of introducing moratoriums for consumer, housing, and credit card installments also had a hand in weighing down on profitability.

Overall, The CBK shall maintain its firm supervision of the banking sector while also maintaining vigilance and a composed hedging approach so that banks remain able to provide their services to all segments of the domestic economy efficiently and without disruption as the crisis is far from over.

And while it looks to the future with optimism, the CBK shall continue to diligently monitor economic and banking conditions so that the economy is safely overcoming this period. It also continues to strive to bolster monetary stability and financial stability, which are key requirements, though not sufficient on their own, for sustainable economic stability.

Lastly, the CBK welcomes all government efforts in expediting the implementation of comprehensive reforms of the complex and deeply rooted structural economic imbalances. So long as oil-based revenues dominate, and current expenditures grow, and effective corrective measures remain absent, the State's general budget will remain under an accumulated financial deficit, and therefore it is of utmost importance to address these challenges to sustain prosperity and develop the national economy in a way that preserves the rights of present and future generations.

5. Conclusion

The recent global Pandemic-induced economic crisis was unprecedented. Governments intervened as central banks maintained highly accommodative monetary policies to contain the crisis. The CBK took preemptive monetary and macroprudential measures to contain the economic shock, as a result banks succeeded in maintaining a high degree of asset quality, supported by strong financial soundness indicators that weathered severe conditions and confirmed the banking sector’s ability to withstand shocks.

AMF-BIS Fourth Working Party Meeting on Monetary Policy in the Arab Region

Background Paper on Monetary Policy

The Republic of Lebanon

Banque Du Liban

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31 May, 01-02 June 2021

Monetary Policy Implementation in The Republic of Lebanon

1. Overview

The global monetary policy landscape is witnessing huge transformations due to the coronavirus (COVID-19) outbreak. The severe blow that the Pandemic has dealt to markets and economies globally has prompted governments and Central Banks around the world to intervene in various ways and develop new measures as emergency remedial.

Amid these global challenges and shifts, Central Banks may have to reshape the conduct of monetary policy to address the rapidly changing technologies and evolving consumer preferences. However, monetary policy needs to be well-coordinated with fiscal policy to better target assistance to hard-hit sectors of the economy.

According to the IMF, the global economy is set to lose over USD 22 trillion between 2020 and 2025 due to the impacts of the coronavirus Pandemic. Global growth contraction for 2020 is estimated by the IMF at 3.5 percent (reflecting stronger-than-expected momentum in the second half of 2020). The global economy is projected to grow by 5.5 percent in 2021 and 4.2 percent in 2022. As for inflation, it is expected to remain subdued during 2021–22.

Real GDP is projected to fall by 4.1 percent in 2020 in the MENA region and 5 percent in the Arab world, while the average annual inflation is projected at 6.2 percent.

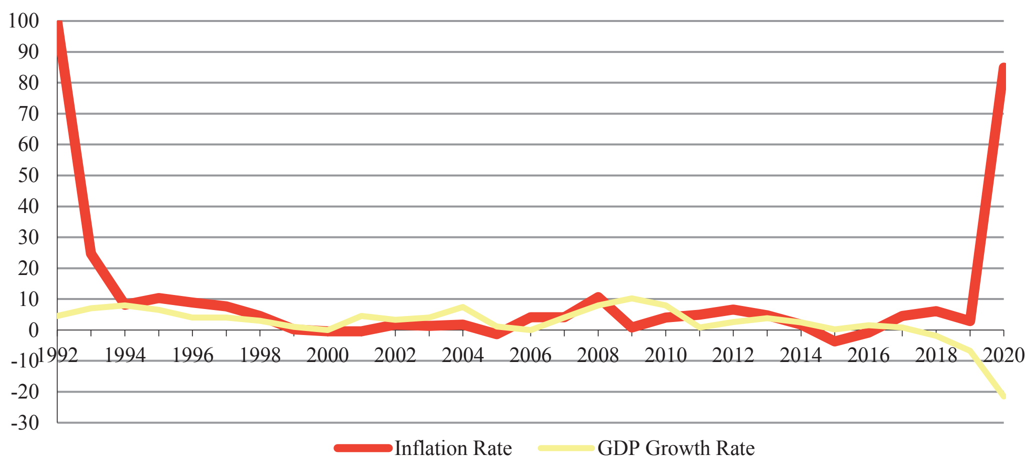
As for Lebanon, it is worth noting that the economy has been struggling with severe internal and external crises for several years now and well before the coronavirus Pandemic.

Since 2011, the Lebanese economy has not been shielded from political tensions, security challenges, and regional unrest combined with the burdens of the Syrian crisis. The outbreak of nationwide anti-government protests in October 2019 has further exacerbated the economic environment, cutting deeper into Lebanon's main economic indicators such as foreign investment, consumption, tourism, and real estate.

In summary, Lebanon has been living multiple shocks in the past few months, starting with the liquidity crisis that erupted in the last quarter of 2019 , followed by the government's decision to discontinue payments on all its outstanding US dollar-denominated Eurobonds in March 2020, the COVID-19 Pandemic imposing lockdowns in the country starting the second quarter of 2020, and the Beirut port explosion in August 2020 which caused major destruction in the Lebanese capital and led to the resignation of the government.

The Lebanese economy has indeed plunged into a severe contraction across all economic sectors, combined with an unprecedented surge in prices. According to the IMF's updated October 2020 forecast, GDP growth in Lebanon has been projected to fall by 25 percent in 2020, while BDL has estimated growth contraction at 21.5 percent in 2020. The end-of-year inflation for 2020 was forecasted at 145 percent against 7.0 percent in 2019, raising the average inflation to 85.5 percent.

Figure 1: Inflation Rate versus GDP Growth Rate

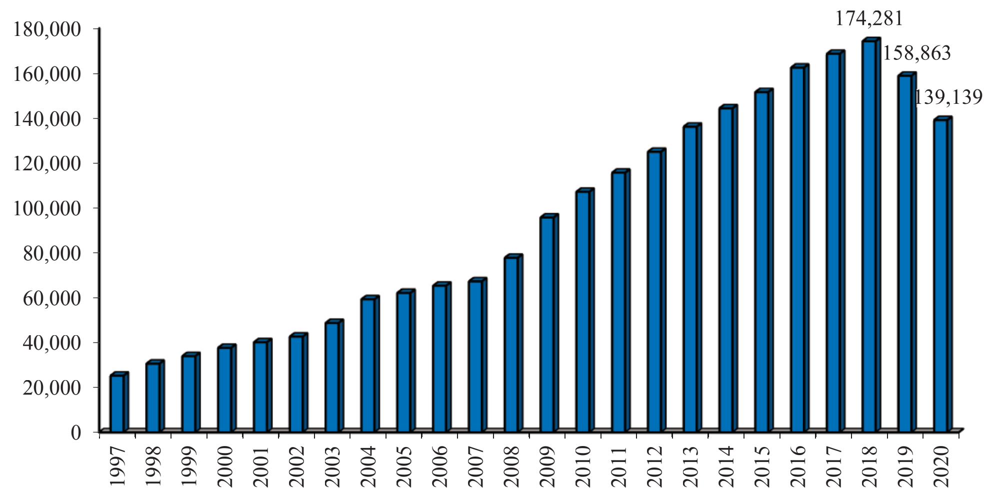


Source GDP: CAS till 2019, BDL estimation for 2020

At the monetary level, the year 2020 and the first trimester of 2021 were marked by a massive decline in capital inflows, a drastic shortage of US dollars, and a sharp depreciation in the value of the local currency, hitting as high as LBP 14,000 to the US Dollar in the parallel market. The Central Bank is still maintaining the official rate of LBP 1507.5 in bank transactions and for critical imports such as medicine, fuel, and wheat while allowing bank withdrawals at a rate of LBP 3,900 to the dollar. As a result, BDL's assets in foreign currencies have fallen dramatically from USD 37.3 billion at the end of December 2019 to USD 24.1 billion at the end of December 2020.

As for the banking sector, operating conditions had worsened during 2020, which weighed on the country's ability to attract external funds, coupled with the deteriorated economic situation and business environment. Total banking activity has witnessed both deposit and loan contractions. The consolidated assets of banks declined by 13 percent over the year to reach USD 188 billion at the end of December 2020. Total deposits registered a contraction of 12 percent in 2020. The deposit dollarization ratio reached a new high of 80.4 percent at the end of December 2020 compared to 76 percent at the end of December 2019.

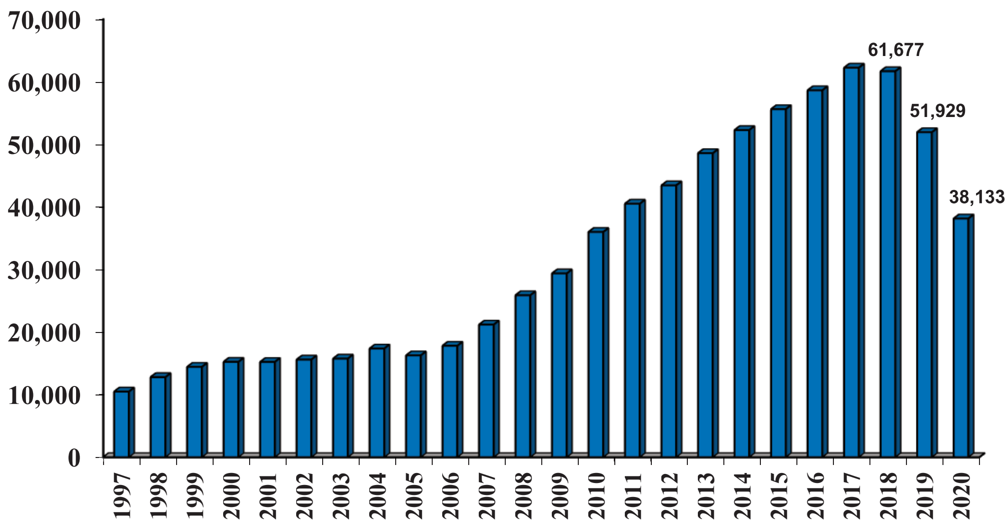
Figure 2: Total Private Sector Deposits of Commercial Banks (in millions of USD)



Source: Banque Du Liban.

In parallel, bank loans to the private sector dropped by 26 percent to reach USD 38 billion at end Décembres 2020, with the loan dollarization ratio witnessing a slight decline to stand at 59.6 percent.

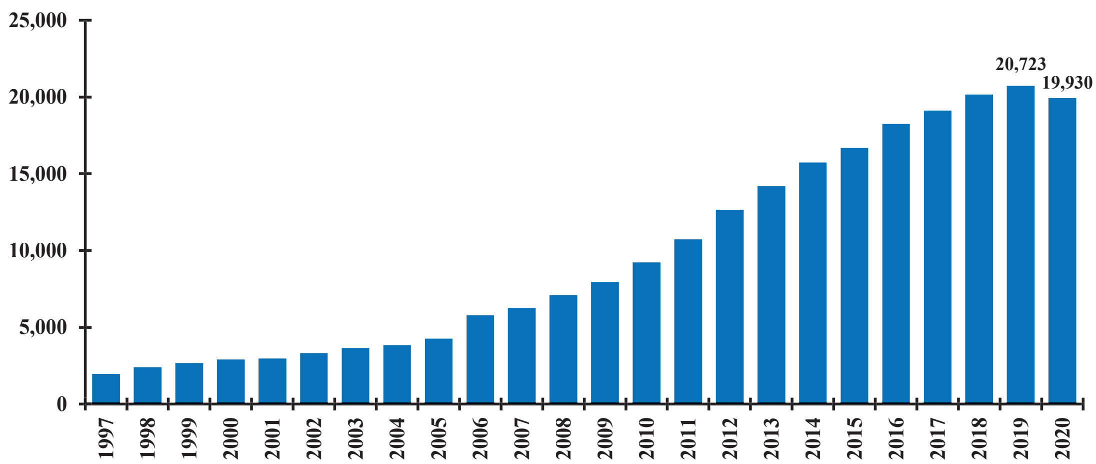
Figure 3: Total Banks' Loans to the Private Sector (in millions of USD)



Source: BDL

In terms of capitalization, banks' equity decreased by 3.8 percent to reach USD 19.9 billion at the end of December 2020. As per BDL's latest circulars, banks are in the process of recapitalizing or increasing their capital, depending on their needs, by the first quarter of 2021.

Figure 4: Commercial Banks' Equity (in millions of USD)



Source: Banque Du Liban.

2. The Operational Framework of Monetary Policy in Lebanon

BDL has been committed to ensuring the basis for sustained social and economic growth through achieving the objectives of maintaining exchange rate and interest rate stability, developing money and financial markets, enhancing payment systems and money transfer operations, managing liquidity, targeting inflation, and contributing to the management of public debt.

To fulfill its mandate and particularly safeguarding monetary and economic stability, the BDL resorts to conventional tools and nonconventional ones when needed.

Therefore, the pressing regional and local challenges that have hindered the Lebanese economy for the past few years have incited the BDL to resort to unconventional monetary policy tools to boost economic and social development.

During 2013-2019, BDL stimulus packages have amounted to USD 7.2 billion and have targeted productive sectors (40 percent) and the housing sector (60 percent). Together with the exemption of banks from reserve requirements and government loan subsidies, these incentives have led to the injection of almost USD 16 billion to support economic activity since 2009. The importance of these catalyst endeavors lies in their sizable contribution to real GDP and their momentum in job creation.

Moreover, BDL launched in August 2013 a new initiative enabling banks to contribute, for the first time, to equity financing of startup companies, incubators, accelerators, and venture capital. By issuing its circular 331, BDL was the first institution to foster the Lebanese knowledge economy on a national scale by motivating the banking sector to invest around USD 600 million in startups.

BDL has also persisted in implementing major regulatory measures consistent with international best practices during the past years. The most significant of these measures can be highlighted as follows:

- Enhancing Financial Inclusion.
- Reinforcing banks' reserves consistency with IFRS 9 standards.
- Strengthening corporate governance.
- Enhancing transparency and protecting against cybercrime acts.

BDL was able to fulfill its mandate very smoothly until 2019 by having recourse to both the conventional and unconventional monetary policies aforementioned. But the unprecedented challenges that Lebanon had to face simultaneously at all levels throughout 2020 till now made a shift in BDL monetary policy priorities.

3. The Implications of Global, Regional, and Internal Economic and Financial Developments on Monetary Policy Implementation and the Efficiency of Monetary Policy Measures in Mitigating the COVID-19 Impact and Supporting Economic Recovery

Amid the challenging circumstances that Lebanon is facing, BDL has been deploying all measures to help the economy survive, protect depositors' money at Lebanese banks, support businesses to ensure that workers still have jobs to return to and provide assistance to individuals and companies affected by the Beirut Port explosion.

BDL measures aimed at easing the burden of successive crises on individuals, institutions, and economic sectors:

- Since the beginning of the liquidity crisis in September 2019, the Central Bank of Lebanon has sought to find mechanisms through Lebanese banks that allow the provision of liquidity in dollars to import hydrocarbons, wheat, pharmaceuticals, medical equipment, and milk for babies and raw materials used in the manufacturing of medicine after importers of these vital products complained about the dollar shortage.
- To help the Lebanese industries, BDL announced in March 2020 the decision to launch the "Lebanese Economic Oxygen Fund" in partnership with Lebanese banks and in coordination with the Association of Lebanese Industrialists and the Ministry of Industry. This rescue initiative

aims to extend short-term credit facilities to help small and medium-sized Lebanese industrial firms finance raw material imports by raising around USD 750 million with the support of BDL, international investors, development finance institutions, and family offices. This fund will be a Europe-based platform with a mix of fintech and credit facilities. It will constitute a permanent solution for importing raw materials, following the recent introduction by BDL of a temporary USD 100 million import facility for the industrial sector in February 2020.

- In the same context, BDL issued a circular in May 2020 informing banks that it would supply them with 90 percent of the value of raw materials imported in foreign currencies to use industries in Lebanon.
- In an effort to lessen the hike in the prices of essential food commodities and in coordination with the Ministry of Economy and Trade, BDL issued a circular in May 2020 informing banks operating in Lebanon that it would provide them with foreign currencies to finance the import of basic food items and raw materials necessary for the food industry in the country.
- Regarding interest rates, the Central Bank of Lebanon issued several circulars in which it reduced the interest rates on bank deposits in Lebanese pounds and US dollars, and it asked banks to reflect the decline in deposit interest rates on the Beirut Reference Rate (BRR). BDL also reduced the interest rates imposed on several types of loans, mostly on mortgages.
- To help the country's smallest depositors survive these exceptionally difficult times, BDL announced in April 2020 exceptional measures related to cash withdrawal from small accounts at banks in Lebanon. BDL's new circular allows clients to withdraw, through a specific mechanism, the total amount they have in Lebanese pounds in all their accounts at a bank, provided that the aggregate amount they have does not exceed LBP5,000,000 or the equivalent of USD 3,000 in any foreign currency.

- BDL also announced in April 2020 that banks would be exempt from mandatory reserve requirements and other compulsory placements at the BDL against "fresh fund" transfers from abroad in foreign currencies and against cash deposits, whether in Lebanese pounds or foreign currencies. To benefit from these exemptions, the banks must allow their customers to use their funds (transferred from abroad or deposited in cash) freely in all kinds of banking transactions, including transfers abroad and cash withdrawals as well as payment card operations in Lebanon and abroad.
- In another circular issued in February 2021 and in order to restore confidence in the banking sector, BDL asked banks to deposit the equivalent of 100 percent of the value of the aforementioned "funds" in cash with it or with its correspondents abroad in an account free from any obligation.
- In an effort to help depositors access their funds in foreign currencies, BDL requested from all commercial banks in Lebanon to allow their customers, who wish to make cash withdrawals from their dollar or other foreign currency accounts, to withdraw their money in Lebanese pounds at a rate set by BDL (currently LBP 3,900 to the dollar). The circular issued by BDL in April 2020 added that the Central Bank will buy the foreign currencies resulting from each transaction effected accordingly by the concerned bank. Only customers having accounts of more than USD 3000 can benefit from this circular.
- With the start of the lockdown in Lebanon as a result of the outbreak of the Coronavirus in March 2020, and to help the Lebanese companies and employees survive the economic impact of this Pandemic, BDL asked banks and financial institutions operating in the country to extend, exceptionally and on their responsibility, loans in Lebanese pounds or US dollars to clients that already have credit facilities and that are unable to meet their obligations during March, April, May and June 2020. These facilities will not be subject to any fee, commission, or interest, and they will only be extended to pay the monthly settlements of an existing loan

and/or to cover the salaries, operating expenditures, or production-related spending for enterprises, while the repayment period will be five years.

- In the same context, BDL provided support to individuals and businesses affected by the Beirut Port explosion on the 4th of August through its basic circular that allowed banks to extend exceptional loans that are not subject to any interest or commission and that can be repaid over five years.
- Again, to alleviate the burden on banks' clients that were negatively affected by the COVID-19 outbreak, BDL issued a circular in August 2020 asking banks to refrain from downgrading the loan classification of these borrowers in case they missed payments of interest and/or principal on their loans. It also said that banks should not consider these developments as an indicator of an increase in the clients' risk profiles, but it noted that borrowers must be identified as "still a going concern". In addition, the circular indicated that banks should reclassify to 'Stage 3' (default) the loans of clients who have been significantly affected by the Pandemic and who suspended their operations.
- Furthermore, BDL issued a circular in August 2020 allowing banks' clients residing in Lebanon to settle the payments of retail loans and housing loans denominated in US dollars in Lebanese pounds based on the official exchange rate of LBP 1,507.5 per US dollar and under certain conditions specified in the circular.

BDL measures aimed at strengthening the banking sector:

- In the past few months, BDL has issued a series of circulars aiming to strengthen banks' conditions in terms of securing liquidity and capital requirements and restoring confidence in the Lebanese banking sector. The most significant of these circulars can be highlighted as the following:
- In a move to revive the Lebanese banking sector activity, BDL issued Basic Circular 154 in August 2020, asking banks to conduct a fair

evaluation of their assets and liabilities to be able to meet all capitalization, solvency, and liquidity requirements, as well as to resume regular business activities and banking operations. In order to boost the banks' liquidity, the circular instructed banks to urge depositors who transferred more than USD 500,000 abroad as of July 1, 2017, to deposit funds in a "special account" frozen for five years and equivalent to 15 percent of the transferred amount. The circular also applies to banks' Chairpersons, board members, large shareholders, CEOs, and customers identified as Politically Exposed Persons, who are asked to transfer back 30 percent of any amount transferred abroad. It said that the amounts deposited into the "special accounts" will be exempt from reserve requirements and mandatory placements at BDL. Further, the circular noted that by the end of February 2021, each bank should have an external account at foreign correspondent banks that is not subject to any obligations in foreign currency and that has funds equivalent to at least 3 percent of the aggregate amount of the bank's total deposits in foreign currencies as of end-July 2020. In parallel, the circular indicated that each bank should seek the approval of BDL to recapitalize or increase its capital, depending on its needs, by the first quarter of 2021. In addition, the BDL circular indicates that banks can provide depositors with an option to convert their deposits into shares in the bank's capital or into "redeemable, tradable and convertible perpetual bonds".

- In the same context, and to further strengthen the banking sector, BDL asked banks to refrain from distributing dividends for financial years 2019 and 2020. It also requested banks to increase their capital by the equivalent of 20 percent of their CET1 as at the end of 2018.
- Again, in August 2020, BDL asked each bank to build a capital conservation buffer of 2.5 percent of its risk-weighted assets. It mandated that a bank's CET1 ratio must reach a minimum of 7 percent, its Tier One ratio has to be at least 8.5 percent, and its Total Capital ratio must reach a

minimum of 10.5 percent when incorporating the capital conversation buffer.

- In November 2020, and to further boost banks' capital, BDL modified the Basic Circular related to the capital adequacy regulatory framework for banks operating in Lebanon. The new circular allows banks to book exceptionally, under Tier Two Capital, one-third of the capital gains arising from the revaluation of their fixed assets held in settlement of debt (Article 154 of the Code of Money and Credit) under specified conditions.

4. Conclusion

Since its inception, the Central Bank of Lebanon has been keen on safeguarding the national currency and maintaining financial and economic stability. And it never spared any efforts to ensure the resilience and soundness of the Lebanese economy in general and the financial sector in particular.

Nevertheless, the situation in Lebanon is becoming complicated, and it could worsen if a new government is not quickly formed because confidence must be restored to reach economic recovery.

Currently, there are three pillars to restore confidence: the first is to prepare a budget with a reduced deficit, the second is to negotiate with the lenders, especially after the state inability to repay its international debts, and the third the need to reform the banking system.

However, to ensure sustainable economic recovery and pave the way for real inclusive growth, other factors play an essential role: the need for political stability and a working government that will undertake several structural reforms and set a viable economic plan in coordination with international institutions to revamp infrastructure, enhance the quality and quantity of public services, simplify administrative procedures, enforce fiscal discipline, reform the energy sector, among others.

Once a recovery plan is initiated, and reforms are launched, the international community will pledge financial support, and the Central Bank will be ready to help the economy according to the prerogatives given to it by the Code of Money and Credit. This will be done in accordance with the new government recovery plan and goals.

To conclude, 2020 has been a year of great change and disruption all over the globe. Thorough planning and implementation of sustainable strategies are keys to overcoming the challenges ahead of us and enabling the economy and the financial sector to regain slowly but steadily their well-being.

AMF-BIS Fourth Working Party Meeting on Monetary Policy in the Arab Region

Background Paper on Monetary Policy

The Arab Republic of Egypt

The Central Bank of Egypt

Prepared by

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Abu Dhabi, United Arab Emirates
31 May, 01-02 June 2021

Monetary Policy Implementation in The Arab Republic of Egypt

1. Preface and Institutional Framework

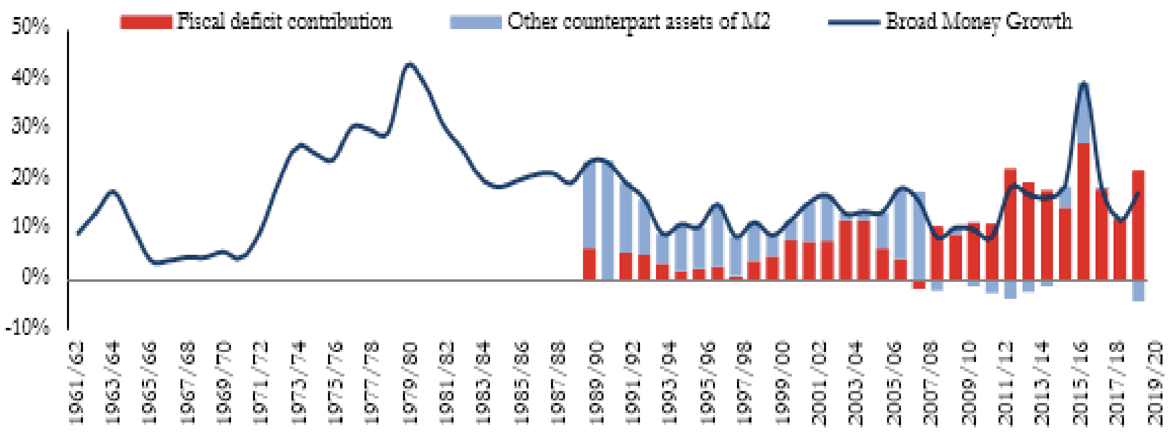
The Central bank of Egypt (CBE) shall work on monetary and banking system soundness and achieve price stability within the context of the state's general economic policy, according to the new Central Bank Act no. 194 of 2020. In order to achieve price stability, the central bank shall be concerned with formulating and implementing the monetary policy, issuing financial papers and instruments commensurate with the nature of its mandate, and engaging in open market operations (OMO).

The price stability objective of the CBE can be expressed in terms of two components: first, minimizing deviations of inflation from the level considered consistent with price stability (inflation gap). Second, minimizing the volatility of real economic activity with respect to its full capacity utilization (output gap).

2. Brief Background of Egypt's Macroeconomic Situation prior to Reform

Over Egypt's recent economic history, headline inflation recorded double-digit figures since the fiscal year 1964/65 (see figure 1), with few exceptions, notably in the disinflation periods of 1964/65 to 1967/68 (pre-1967 war), 1991/92 to 2000/01, and finally post Egypt's economic reform (2017/18 till present). Indeed, Egypt's annual M2 growth continued to record double-digit growth rates since 1962, hovering around an average of seventeen percent, most of which originated from the double-digit fiscal deficit contribution to money growth at least since the early 2000s (see figure 1). Furthermore, Egypt's real interest rates were negative during most of the period since the 1970s and up until 2016, except during the 1990s and the beginning of the 2000s, coinciding with the only significant disinflation period in Egypt's economic history declining M2 growth.

Figure 1. Contribution to M2 growth (In p.p., y/y)



Source: MoF, CBE, International Monetary Fund's International Finance Statistics and Government Finance Statistics
Databases, and Monetary Policy Sector's Calculations.
Note: Data for the overall and primary fiscal deficit were gathered from three different sources and aggregated together as follows: the MoF starting Fiscal year 2001/02 to fiscal year 2019/20, International Monetary Fund's Government Finance Statistics Database starting from fiscal year 1989/90 to 1998/99. Any remaining periods were gathered from hard copies of the CBE's Annual Reports.

The disinflation during the 1990s and the beginning of the 2000s further coincided with a contained fiscal deficit at levels not witnessed during the past twenty years (see figure 2). Since the beginning of the 2000s, inflation continued to be on an upward trend despite witnessing a business cycle with a boom and bust in economic activity that was amplified by three significant cost shocks, notably the international commodity price surge in 2006-2008, the exchange rate depreciation in 2003 and the exchange rate depreciation in late 2016 (see figure 3). The pickup in inflation since the beginning of the 2000s also coincided with increased M2 growth, which recorded an average of fifteen percent, while real GDP growth and inflation averaged five percent and ten percent, respectively. During that period, the fiscal deficit resumed its leading contribution to M2 growth.

Figure 2. Fiscal indicators versus headline inflation (In percent, y/y, average of period, unless otherwise specified)

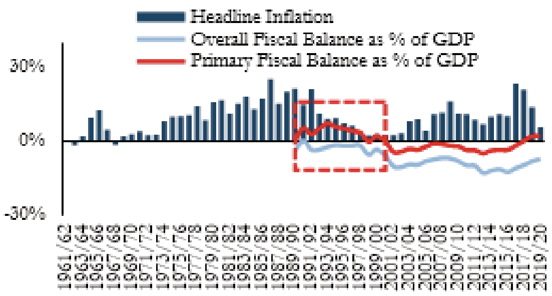
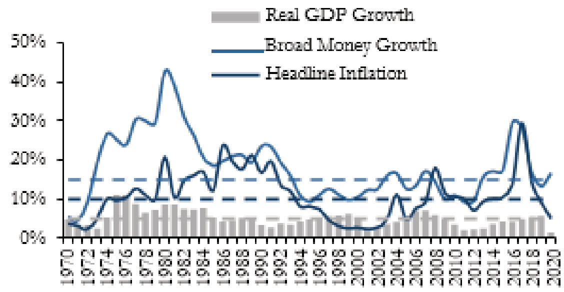


Figure 3. M2, Real GDP and headline inflation (In percent, y/y)



Source: MoF, CBE, International Monetary Fund's International Finance Statistics and Government Finance Statistics Databases, Monetary Policy Sector calculations.

Note: Data for the overall and primary fiscal deficit were gathered from three different sources and aggregated together as follows: the MoF starting Fiscal year 2001/02 to fiscal year 2019/20, International Monetary Fund's Government Finance Statistics Database starting from fiscal year 1989/90 to 1998/99. Any remaining periods were gathered from hard copies of the CBE's Annual Reports.

In order to achieve a different outcome than that observed over history, several measures had to be implemented. Notably, 1) inflation targets need to continue being explicitly announced and set on a declining path to anchor inflation expectations and achieve price stability over the medium term. 2) The foreign exchange market needs to remain liberalized for the exchange rate to act as a shock absorber, maintain competitiveness and avoid the build-up of external imbalances. 3) Fiscal policy needs to remain tight to reduce debt to sustainable levels and have room for counter-cyclical policies. 4) Structural policies need to complement stabilization policies to increase the economy's growth potential. These four pillars were embedded in Egypt's economic reform program that was initiated in 2016.

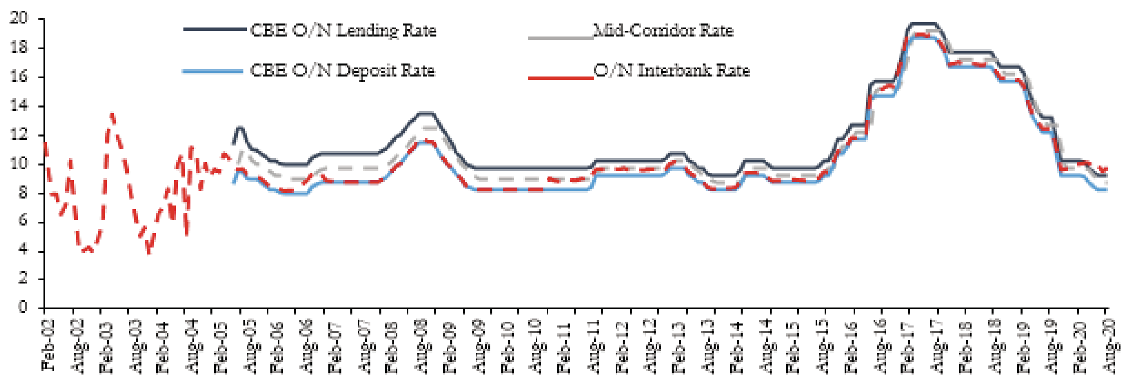
3. CBE's Transition to an Inflation Targeting Framework

In June 2005, as a step towards transitioning to an inflation-targeting regime, the CBE's operational target for monetary policy shifted towards a price target, defined as the O/N interbank bank rate, from a defined quantity target as excess reserves. The CBE launched two O/N standing facilities, one for deposits and one for loans, which represent a corridor within which the O/N interbank rate fluctuates, thus limiting its volatility (see figure 4). The policy stance is implemented using indirect policy tools, such as open market operations, but reserve requirements may also be employed if warranted. To signal its policy stance, the CBE announces changes to the corridor rates, in addition to the rate of the main operation, which was launched in 2013 (REPO or deposit auctions) according to the liquidity situation in the market.

To further support its effort to transition to an inflation-targeting framework, the CBE constructed its core inflation measure that has been published monthly since October 2009 on the CBE website and analyzed in the monthly inflation notes since then.

Core inflation published by the CBE is derived from headline inflation using the exclusion method of items that exhibit high volatility through removing the direct effect of price movements in those items. Accordingly, core inflation is viewed as a complementary indicator to headline inflation in order to distinguish underlying inflationary pressures from transitory movements. By publicly communicating core inflation measures, the CBE aims to improve transparency and better anchoring inflation expectations by improving the understanding of the inflation dynamics and preventing the passthrough of transitory shocks from having a permanent impact.

Figure 4. O/N interbank rate and the CBE's policy rates (In percent, annualized)



Source: CBE.

Furthermore, the CBE also devised a section on monetary policy on its website dedicated to increasing communication and transparency regarding the CBE's intention to transition to an inflation-targeting regime.

Despite these positive steps, the description of the monetary policy regime during that time (2005 to 2016) could be expressed as a regime with an implicit rather than explicit nominal anchor, given that quantitative inflation targets and target achievement horizons were not announced between 2005 and 2016.

In November 2016[1], Egypt launched a homegrown economic reform program, supported by a three-year Extended Fund Facility by the International Monetary Fund, to address macroeconomic imbalances. It included monetary policy reform which incorporated the lessons learned from Egypt's economic history. The foreign exchange market has been liberalized so that the exchange rate acts as a shock absorber to maintain competitiveness and to avoid the build-up of external imbalances. The CBE remains committed to the floating exchange rate regime. As discussed in the communication section below, improved communication by CBE to the stakeholders has been addressed.

In addition, inflation targets have been announced and set on a declining path to anchor inflation expectations and to discipline monetary policy. The current inflation target for 2022 Q4 has been set at 7 percent (±2 percentage points on average), down from 9 percent (±3 percentage points on average in 2020 Q4), which was not achieved[2] and down from 13 percent (±3 percentage points on average in 2018 Q4) which was successfully achieved.

Accordingly, policy rates are set to ensure positive real interest rates consistent with achieving the inflation targets along the disinflation path set to achieve price stability while preserving macroeconomic stability. The containment of inflation further supports the competitiveness of Egyptian goods and services and thus

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1 The Monetary Policy Committee will assess its Monetary Policy framework every five years.

2 More information about reasons of deviation would be tackled in the section of the impact of COVID-19 on Egypt's economy.

reduces medium-term pressures on the exchange rate. Nevertheless, temporary deviation of inflation from the targeted level can sometimes occur due to the first-round effects of some exogenous shocks outside the scope of monetary policy. In these cases, the monetary policy need not react to these temporary deviations and will accept the divergence of actual inflation from the announced inflation target. However, if these exogenous shocks lead to second-round effects that spill over to more generalized price increases and a permanent impact on medium-term inflation expectations, then the CBE's Monetary Policy Committee could respond to avoid such a spill-over.

To signal its policy stance, the CBE continues to rely on short-term interest rates. Accordingly, the CBE hiked key policy rates by a cumulative seven percentage points (in November 2016, May, and July 2017) to tighten real interest rates and ensure that the increase in inflation rates post the economic reform program is transitory and does not pass through to permanently higher inflation expectations. As a result of the real tightening of policy rates (using forward-looking inflation), the disinflation process has been successful, allowing the CBE to cut key policy rates by a cumulative 10.5 p.p. (February & March 2018, February & August & September & November 2019, and March, September & November 2020). The latter policy rate easing includes three percentage points of policy rate cuts during an unscheduled monetary policy committee meeting in mid-March 2020 as a preemptive action to counter the expected slowdown in economic activity as a result of COVID-19. These gradual policy rate cuts were done to ensure real interest rates remain positive to sustain the disinflation process and anchor inflation expectations.

Moving forward, the CBE will continue to transition to a flexible inflation targeting framework, in accordance with the liberalization of the foreign exchange market by setting several inflation targets along the disinflation path.

4. Challenges to the Conduct of the CBE's Monetary Policy

The list below includes some, but not all, the major challenges to the conduct of the current monetary policy framework:

a) Data issues, like in many countries, present a key obstacle for monetary policy, especially regarding sometimes the coherency of data received from various government entities/stakeholders.

b) The emergence of COVID-19 poses a great degree of uncertainty which is challenging for monetary policy.

5. CBE's Communication Policy

A well-planned communication policy has become a key instrument for many central banks. It improves the effectiveness of monetary policy through anchoring expectations of different agents via tailoring messages to multiple audiences, mainly the public, domestic and external participants of financial markets, the government as well as the domestic private sector. This is done in a way that is consistent with the required economic trajectory intended by monetary policy, especially with the increasing adoption of inflation targeting framework as a monetary policy regime and its requirement to communicate policy targets and forecasts. Increased transparency and accountability about objectives and policies are believed to reduce uncertainty by economic agents and help anchor long-term inflation expectations. Indeed, enhanced transparency is related to higher levels of credibility, self-disciplined policymakers, and the predictability of policy actions, all of which can improve the efficacy of monetary policy.

On that basis, there has been an ongoing effort to increase transparency and reinforce CBE's communication policy. Different communication tools have been used in order to increase transparency from different aspects in line with the IMF Central Bank Transparency code (CBT)[1]. Law No. 194 for 2020 identifies the main objectives of the CBE. The official website of CBE states the description of its monetary policy framework[2] and tools used. Monetary Policy Committee meetings' calendar is publicly announced at the beginning of each year and the committee members.

In addition, a written press release, which is published following each Monetary Policy Committee meeting, has been enriched with main developments that occurred since the previous Monetary Policy Committee meeting, as well as an assessment of current and future economic conditions. This aims at communicating the Monetary Policy Committee's decision in a timely manner while providing the rationale of the committee's decision. Since May 2017, it also includes an announcement of an explicit numerical inflation target, target band, and achievement horizon, which is consistent with the CBE's price stability mandate set by law.

Moreover, to further enhance transparency, monetary policy reports were published since March 2017 on a regular basis. They include the analytical materials that provide the foundation for Monetary Policy Committee's policy decisions, such as initial economic conditions, current inflation outlook, and underlying assumptions.

Furthermore, a monthly inflation note is published regularly, which analyses the main drivers and changes of headline and core inflation rates. This is intended to help explain to the public the recent developments related to the CPI, which is the measure of inflation targeted by the Monetary Policy Committee.

All publications are accessible through the CBE's website in English and Arabic and frequently circulated by foreign and local news outlets. Besides, as part of its commitment to transparency, different macroeconomic and financial data

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[1] The CBT is a voluntary code composed of a comprehensive, central bank-focused set of principles and practices based on five pillars. https://www.imf.org/en/Publications/Policy-Papers/Issues/2020/07/29/The-Central-Bank-Transparency- Code-49619.

[2] The CBE is currently updating its monetary policy framework on the CBE website.

relevant to monetary policy conduct are also published and available to the public through the CBE's website and are regularly updated. Moreover, since Egypt is a member of the Special Data dissemination Standard (SDDS) since 2004, the CBE publishes data related to it on its website in accordance with the SDDS guidelines and time deadlines.

In order to extend the outreach of messages, different infrequent communication channels have been tapped as well to reinforce engagement with main stakeholders. Different educational presentations domestically and internationally have taken place by CBE's staff. In addition, the number of public interviews by CBE's senior management through different media outlets to deliver main messages as needed has increased.

All these efforts have been reemphasized through the new central bank and banking sector law. In accordance with the new law:

- The CBE publishes its decisions pertaining to the implementation of monetary policy, supervision, and regulation via official publications in line with the guidelines and timeframes that the CBE's Board of Directors sets. These decisions are published on the CBE's website in addition to the official Egyptian Gazette.
- The CBE's Governor notifies the Egyptian House of representatives each fiscal year of the general framework of monetary policy when the House of representatives discusses the draft general budget of the government and when the House of Representatives is discussing the General Plan for Economic and Social Development.
- The Governor also notifies the House of Representatives of any amendments to the general monetary policy framework whenever they occur during the fiscal year.

6. Coordination Policy with the Government

As the CBE and the government join efforts to provide an environment supportive of low, stable, and predictable inflation, the Coordinating Council on monetary policy, headed by the Prime Minister, was established for the first time in January 2005 to enhance consistency between monetary and fiscal policies. Coordination between the central bank and the government is essential as some of the vital factors that influence inflation dynamics fall under the government's mandate. In the new law, the coordination Council sets a mechanism to coordinate between the CBE's Monetary policy and the government's fiscal policy. Nevertheless, the coordination between the government and the CBE is held entirely with respect to the independence of the CBE.

In this regard, the Cash Coordination Committee (CCC) was established. The CCC is an inter-agency technical committee established to strengthen the communication channel between the Ministry of Finance (MoF) and the CBE.

Furthermore, the new law stipulates:

- The CBE's Governor presents a regular report every three months to the President of Egypt and the Prime Minister, which includes analysis for the monetary, credit, and banking sector developments, in addition to outstanding stocks of external debt during the period set in the report, after approval from the CBE's Board of Directors.
- The CBE's Governor also presents an annual report that is approved by the CBE's Board of Directors, within three months of the end of every fiscal year, to the President of Egypt, the Prime Minister, and the House of Representatives, regarding monetary and credit conditions in Egypt.

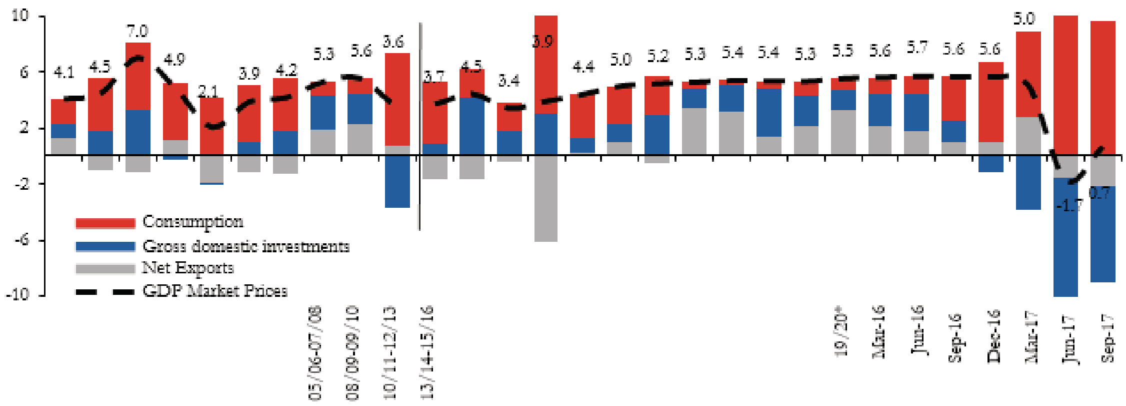
7. Economic Implications of COVID-19

7.1 Implications of COVID-19 on domestic macroeconomic conditions

In 2018/19 and prior to the outbreak of the COVID-19 Pandemic, the Egyptian economy grew at 5.6 percent, recording the highest growth rate for GDP at market prices since 2007/08. This growth rate was sustained up until 2019 Q4 (see figure 5). In the following quarter (2020 Q1), growth inched downwards to 5.0 percent, as it was partially impacted by the adoption of global travel restrictions and lockdown measures.

The full Pandemic impact on GDP growth was realized in 2020 Q2, as containment measures were enacted globally and domestically, negatively impacting real GDP, which dropped by 1.7 percent, with negative contributions stemming from net exports and gross domestic investments. With the relaxation of the partial lockdown measures as of June 30th, 2020, GDP growth started to gradually recover, recording 0.7 percent, and picking up to a preliminary 2.0 percent during 2020 Q3 and Q4, respectively. Meanwhile, consumption contributed positively towards overall GDP growth at market prices throughout 2020 despite the COVID-19 Pandemic, playing a substantial role in mitigating the accompanying negative shock on the economy.

Figure 5. Contribution to GDP Growth at Market Prices (in p.p., y/y)



Source: Ministry of Planning and Economic Development */ Preliminary figure

7.2. Inflation Developments

Average annual headline urban inflation recorded 5.0 percent during 2020 (Calendar Year-CY), compared to 9.2 percent in 2019 and 14.4 percent in 2018, marking the lowest rate recorded since 2005. This comes as annual headline urban inflation recorded an average of 5.2 percent during 2020 Q4, which came below the target lower band of six percent as was announced in December 2018. Given the balance of risks, the CBE undertook several preemptive measures as highlighted already to support economic activity while remaining consistent with achieving its price stability objective over the medium term.

The subdued inflationary environment which led to the deviation from the announced target was largely a result of the combined impacts of: (i) the outbreak of the COVID-19 Pandemic and its resulting government containment measures on economic activity and the accompanied unprecedented level of uncertainty on people's behavior as well as (ii) the successful implementation of government measures to avoid any supply-chain induced shortages in the market.

At the onset of the COVID-19 Pandemic outbreak in Egypt, the annual headline and core urban inflation rate accelerated temporarily, as seen in April 2020; however, this increase mainly reflected the short-lived hoarding behavior of food items in light of the containment measures, which coincided with the seasonal price increases of Ramadan[1]. Since then, underlying inflationary pressures have remained broadly muted. Both annual headline and core inflation declined in Q2, bottomed down in Q3, and then picked up to some degree in Q4 2020 (see Figures 6 and 7). The slight pickup was affected by a transitory supply shock in tomatoes, unfavorable base effect, and possibly the easing of the containment measures, yet the annual rate remained below the lower target band and before annual rates remaining broadly stable by February 2021. Accordingly, the impact of the COVID-19 outbreak became deflationary in 2020, with inflationary concerns not materializing, unlike what was witnessed shortly at the beginning of the Pandemic in Egypt and in some other countries. This reflected the slowdown of economic activity induced by the containment measures and the repercussions of the shock both domestically and globally.

[1] Ramadan shifts around fifteen days each year which leaves its impact on annual rates of a month earlier.

Figure 6. Headline and core CPI Inflation
(in percent, y/y)

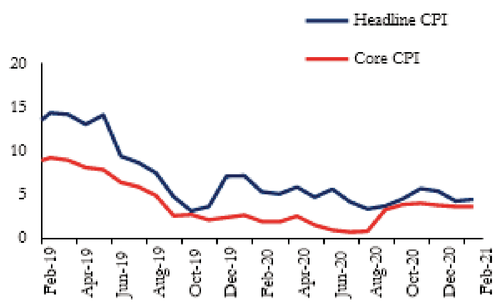
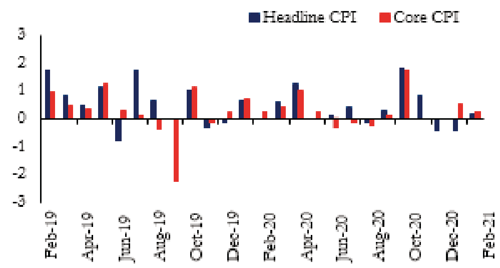


Figure 7. Headline and core CPI Inflation
(in percent, m/m)



Source: CAPMAS and The Central Bank of Egypt calculations

Historically, food inflation has been the main driver of headline inflation in Egypt. However, the subdued inflationary pressures were particularly evident in food inflation since May 2020 (except for November 2020, where it was affected by a transitory supply shock in tomatoes before its reversal in the following two months). In fact, food inflation recorded consecutive negative monthly readings since May 2020, except only for October 2020 and November 2020, driven mostly by volatile food items and by core food items as well but to a lesser extent. While the food and beverages group remains the largest component in the CPI basket, its weight declined from 39.9 percent to 32.7 percent with the release of the tenth CPI series starting from September 2019 data. Accordingly, food inflation has been impacted by the release of the new series and its linking methodology to the 9th series. In addition, lower food inflation reflected the impact of structural factors to improve supply chains as well as ongoing measures to avoid any supply shortage as for example, it was announced by the ministry of finance that around EGP six billion were allocated during FY 2019/2020 to purchase additional quantities of basic commodities[1]. It was also

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[1] Half-year review of state budget report published on the ministry of finance website https://mof.gov.eg/ar/posts/stateGeneral-Budget/60586f7779ec1d00094b40e3/%D8%A7%D9%84%D8%AA%D9%82%D8%B1%D9%8A%D8%B1-%D8%A7%D9%84%D9%86%D8%B5%D9%81-%D8%B3%D9%86%D9%88%D9%8A-%D9%84%D9%84%D8%A3%D8%AF%D8%A7%D8%A1-%D8%A7%D9%84%D9%85%D8%A7%D9%84%D9%8A

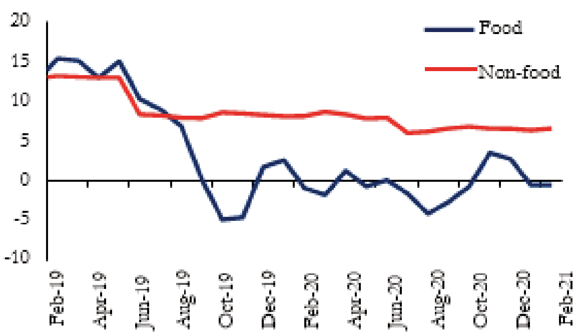
affected by containment measures, which included a partial curfew and the closure of hotels and restaurants (before being lifted gradually but did not reach full capacity back yet), and its effect on domestic inventory levels. Furthermore, according to studies released by CAPMAS[2], households resorted mainly to consuming cheaper food sources and lowering their weekly consumption of meat, poultry, and fish in response to the impact of COVID-19 on lowering their incomes.

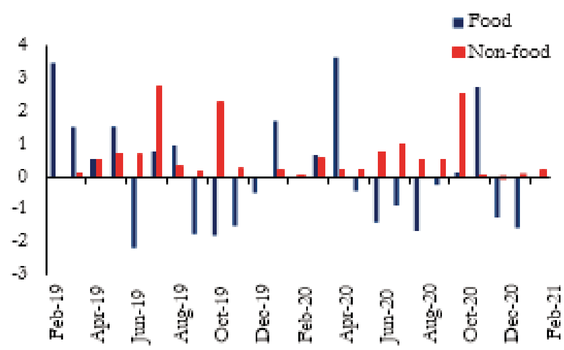
Regarding annual non-food inflation, after hovering around 8 percent level till June 2020, it mainly declined and bottomed down in July 2020, mainly due to lower annual contribution of regulated and services items affected by favorable base effects before the latter picked up by September 2020 and remained stable since then. Annual non-food inflation is now broadly stable, around 6.6 percent (see Figures 8 and 9).

Figure 8. Food and Nonfood Inflation (In percent, y/y)

Figure 9. Food and Nonfood Inflation (In percent, m/m)

Source: CAPMAS and The Central Bank of Egypt calculations.





8. CBE measures in response to the COVID-19 Pandemic: to mitigate the COVID -19 impact and support economic recovery:

The outbreak of the COVID-19 Pandemic started to impact Egypt by mid-March 2020. To face this health crisis and its impact domestically and globally, the CBE responded swiftly and proactively to ease monetary conditions and anchor

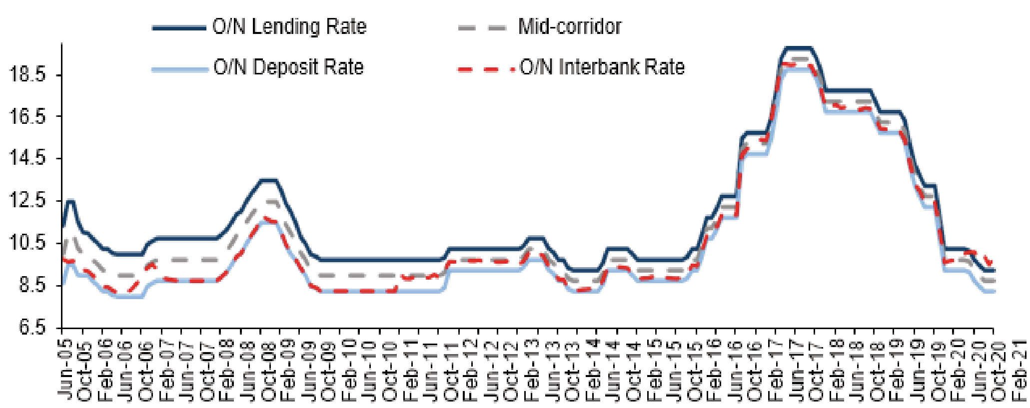
2. For full reports: https://capmas.gov.eg/Pages/StaticPages.aspx?page_id=7233

inflation expectations to help mitigate the economic and social impacts emanating from the Pandemic while maintaining macroeconomic stability. The CBE has instituted several conventional and unconventional tools, ranging from interest rates cuts, credit initiatives to key economic sectors, measures to boost domestic liquidity, and support for non-performing companies and individuals.

8.1. Key Policy Rate Cuts

In an unscheduled meeting on the 16th of March 2020, key policy rates (overnight deposit rate, overnight lending rate, and the main operation rate) were cut by 300 basis points. The rates were cut further by 100 basis points during 2020 (50 basis points in each meeting of September and November 2020) in response to the moderation of the inflation outlook. The overnight deposit rate, overnight lending rate, and the main operation rate stand at 8.25 percent, 9.25 percent, and 8.75 percent, respectively (see figure 10).

Figure 10. O/N interbank rate and the CBE's policy rates
(In percent, annualized)



Source: CBE

8.2. Credit Initiatives

The CBE also cut the interest rate on its three credit initiatives launched in December 2019 and January 2020 from the previous 10 percent to 8 percent (on a declining basis) and announced new initiatives (see table 1).

Table (1): CBE's credit Initiatives	
i. Industrial, Agricultural, and Construction Private Sector Initiative	- Under this initiative, EGP 100 billion has been allocated through banks at an interest rate of 8 percent (on a declining basis) to support the private sector in the industrial, agricultural, and construction sectors. The initiative aims to grant credit facilities to finance the purchase of raw materials, production supplies, machinery, and equipment, in addition to workers' salaries and other utilities expenses. - Furthermore, the CBE added Small and Medium Enterprises (SMEs) whose annual turnover ranges from EGP1 million up to less than EGP50 million as well as well as micro finance to individuals and micro enterprises to the initiative at an interest rate of 5 percent.
ii. Mortgage Finance Initiative for Middle-in- come Class	- Under this initiative, EGP 50 billion have been allocated through banks to mortgage finance for the middle-income class at an interest rate of 8 percent on a declining basis for a period of 20 years. - Furthermore, a new presidential mortgage finance initiative for low and middle-income classes worth EGP 100 billion has been launched at an interest rate of three percent (on a declining basis) for a maximum period of thirty years.
iii. Tourism Sector Initiatives	- The CBE raised the amount allocated to the initiative to EGP 50 billion, up from the previously allocated EGP 5 billion at an interest rate of 8 percent on a declining basis over 15 years to aid hotel renovations and touristic transport fleets, and to finance six months' payroll of tourism sector workers and dues to suppliers. - The CBE tourism initiative also directed banks to extend the postponement of dues on tourism sector companies by another year, to end in December 2021, for a maximum period of three years without delayed interest.

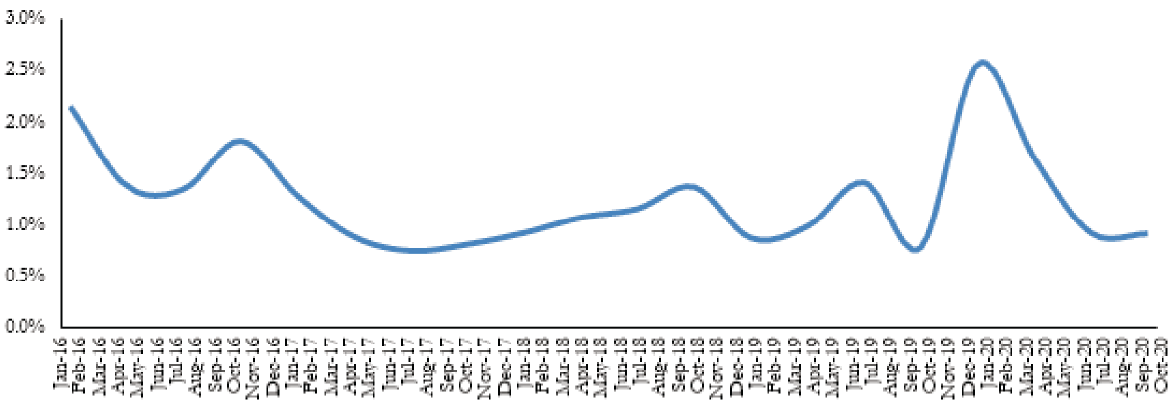
8.3. CBE Equity Support Fund

Among CBE liquidity support measures, the CBE announced an EGP 20 billion equity support fund in March 2020. The equity support fund aims to provide the required liquidity in the secondary equity market at times when there are unjustified selling pressures from the macroeconomic and fundamental analysis perspective, preserve the stability of the securities listed on the Egyptian stock exchange, and preserve the stock prices reflection of the associated company's performance indicators on the medium and long term.

It is important to note that the mandate of the CBE Equity support fund is not to determine price trends but to only intervene during times when price trends do not reflect the fundamentals due to heightened periods of uncertainty and selling pressure. The CBE fund has successfully decreased volatility and increasing traded volume while utilizing only a small portion of the announced EGP 20 bn.

The notion that the CBE is monitoring and focusing on decreasing non-fundamentally driven market volatility has increased investors' confidence despite the minimal trading volumes that the CBE utilized. Since introducing the CBE portfolio, the market has exhibited a declining standard deviation proving volatility has been decreasing. In Q4 2020, Egyptian equity market volatility is currently close to its lowest volatility levels in the last five years (See figure 11).

Figure 11. Egyptian Stock Exchange Historical Volatility (In percent)



Source: Money and Capital Market department analysis.

8.4. Other Measures

In addition, the CBE undertook several measures to boost liquidity post-COVID-19 outbreak to ease liquidity constraints in the market, which can be summarized as follows:

- Deferment of all credit dues for all customers (corporates, SMEs, or individuals) for six months starting March 2020, as well as exemption from any late interest fees or additional fines for late payments.
- A debt relief initiative for nonperforming individuals (with debt less than EGP 1 million) and companies (with less than EGP 10 million).
- Amendment to credit registry rules, including canceling the blacklist for enterprises, negative list for individuals, and lifting the ban on dealing with nonperforming clients.
- Increasing the limit for electronic payments via mobile phones for individuals and corporations and exempting fees and commissions

applicable to the fees of points of sale, electronic wallets, and withdrawals from ATMs until the end of December 2020.

- Availing the necessary credit limits to finance the imports of strategic commodities and support the sectors strongly affected by COVID-19 and exempting these sectors from cash covers until March 2022.
- Increasing the number of ATMs, point of sales, and other electronic payment methods to reduce cash transactions and exemption from local transfer fees.
- In addition, CBE allowed banks to open accounts for clients who lack certain documents with the National ID to facilitate accounting opening procedures.

9. Outlook and Conclusion

Global economic activity continues to show varying paces of recovery across countries and economic sectors, as the impact of the COVID-19 Pandemic continues to weigh on the outlook. Prospects for global economic recovery remain contingent on the scale of distribution and the efficacy of vaccines. Global economic and financial conditions are expected to remain accommodative and supportive of economic activity over the medium term, although global yield curves have steepened recently. Meanwhile, international prices for oil, food, and other commodities have surged to post- Pandemic highs, with the level of uncertainty increasing regarding their future price trajectories. The surge in international oil prices was driven mainly by supply-side developments, while the increase in the prices of other commodities stemmed from both supply and demand side factors.

Based on this pattern of recovery and anchored inflation expectations, annual headline inflation rates are expected to continue recording single digits. The rate is expected to be arithmetically affected by unfavorable base effects related to the normalization of monthly inflation rates in 2021. Still, it will continue hovering around the inflation target's mid-point of 7 percent in 2022.

AMF-BIS Fourth Working Party Meeting on Monetary Policy in the Arab Region

Background Paper on Monetary Policy

The Kingdom of Morocco

Bank Al-Maghrib

Prepared by

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Director of the Economic Department

Abu Dhabi, United Arab Emirates
31 May, 01-02 June 2021

Monetary Policy Implementation in The Kingdom of Morocco

Introduction

The year 2020 has seen dramatic health and economic crisis as a direct result of the COVID-19 Pandemic. Governments across the world pursued an expansionary fiscal policy, and central banks adopted extra-loose monetary policies, lowering policy rates to historically low levels, injecting massive liquidity, and supporting credit lending – especially to micro, small, and medium enterprises (MSMEs). Several among them in advanced economies that started normalizing their monetary policies before the COVID-19 Pandemic had to cut their policy interest rates and further expand their unconventional monetary policy measures. Others in emerging markets had adopted, for the first time, unconventional monetary policies, particularly in the form of asset purchasing programs.

In Morocco, the response of national authorities to the Pandemic has been timely and unprecedented in terms of size and scope. They reacted swiftly, closing the country's borders, shutting down schools, imposing restrictions on economic and social activities, and a strict nationwide lockdown starting from March 20th. In parallel, they have adopted large-scale fiscal policy measures to support households and corporates and limit the economic impact of the Pandemic. In addition, despite fierce international competition for access to vaccines, Morocco was among the first countries to launch a vaccination campaign as early as January 2021. For its part, Bank Al-Maghrib (BAM) has devised a comprehensive response, activating a set of instruments in all its areas of intervention.

These efforts and mobilization at all State levels have mitigated the Pandemic crisis's human, social, and economic impact. Still, the country has nevertheless recorded more than 440 thousand infections and 7 thousand deaths by the end of 2020. The country has also recorded the largest contraction of its GDP in 2020 since the beginning of the compilation of national accounts

I- The authorities' response to the crisis

Immediately after the first COVID-19 infection was detected in Morocco, the authorities closed the borders and educational establishments and imposed restrictions on some economic and social activities. The Government declared a health emergency, which was extended several times, and set a strict lockdown starting from March 20th. The lockdown has been lifted gradually starting from June 10th, 2020 in some parts of the territory and in the whole country from June 25th, 2020. In parallel to these restrictions, several policy measures to support households and businesses and to stimulate the economy were implemented. In this respect, the authorities' response has been provided through three main instruments:

- The creation of a special fund for the management of the COVID-19 Pandemic. This fund has mobilized a budget of MAD 33.7 billion in a wave of solidarity of businesses and citizens and an initial budget allocation of MAD 10 billion.
- The establishment, on March 11th, of an Economic Watch Committee (EWC) to monitor the evolution of the economic situation, take appropriate measures in terms of supporting sectors hurt by the crisis, and preserve the purchasing power of affected households. The main decisions taken by this committee are presented in the Appendix.
- The adoption of an amended finance law, with three priorities, namely i) supporting the gradual recovery of the economy; ii) safeguarding employment; and iii) accelerating the implementation of administrative reforms.

In addition to these measures, Morocco has been among the first countries to launch the anti- COVID vaccination campaign. Significant progress has been made despite fierce international competition for access to vaccines. As of the end of June 2021, nearly a third of the total population has been vaccinated. In addition, and to allow people who have received both doses of the vaccine to move between cities and travel abroad without prior authorization, a vaccine pass was introduced on June 7th, 2021.

II- Bank Al-Maghrib's monetary policy measures

1. The conduct of monetary policy in a context of uncertainty

The monetary policy during 2020 has been carried out in unusual conditions marked by very high levels of uncertainty, along with very rapid and unpredictable changes in health and economic conditions.

It is worth noting that despite this context, Bank Al-Maghrib released its forecasts and other publications in line with the preannounced schedule.

The Board of BAM held its first meeting of the year 2020 on March 17th, before the government has declared a health emergency. Furthermore, BAM's projections have been finalized before COVID-19 was declared a Pandemic by the WHO on March 11th. These projections were based on the assumptions that the virus will be contained, and its economic impact will be limited. The Bank was projecting a low inflation rate and a moderate deceleration of non-agriculture economic growth. However, the Bank has emphasized the large uncertainty surrounding its projections related to the spread of the pandemic around the world and the availability of a medical solution for the virus, suggesting possible update of its forecasts before the next Board meeting. In this context, the Board has decided to cut its policy rate by 25 basis points (bps) to 2 percent to support the economy.

By the end of the first quarter, the spread of the virus has pushed authorities worldwide to impose drastic restrictions on the population's mobility and economic and social activities. The world economy was then set to face the worst economic recession since World War II.

Against the backdrop of this crisis, BAM has indeed revised, before its second meeting of the year, its forecasts twice, using a sectoral approach – which takes into consideration, mainly, the impact on each branch of economic activity of the restrictions adopted by the authorities to contain the virus. These forecasts have indicated a significant worsening of the domestic economic situation, yet the forecasts' uncertainty remained exceptionally high.

Meanwhile, Bank Al-Maghrib has implemented several easing measures. It has expanded the list of collaterals eligible for its refinancing operations to debt securities issued by public institutions and corporates or by Funds of Collective Investments in Securitization and claims on the State or public institutions. The refinancing potential of banks has tripled to MAD 450 billion – that is around 42 percent of GDP. The Bank has also expanded its Funding for lending-type program targeting MSMEs to include operating credits and has increased the program's frequency from quarterly to monthly.

During its meeting of June 16th, 2020, the Board decided to cut its policy rate by 50 bps, to 1.5 percent; and fully relax the banks' legal reserve requirement. At the same time, BAM announced the implementation of two new credit refinancing lines: the first one benefits new and rescheduled loans granted by banks to microcredit associations; the second one is the "Wakala Bil Istitmar" concluded by conventional banks in favor of participatory banks.

BAM's projections underlying all these decisions have shown a sharp contraction of the economic activity in 2020, followed by a rebound in 2021. The inflation rate was expected to remain at a moderate level of 1 percent in 2020 and 2021 – as a result of the combined effect of weakening demand and low energy prices on the one hand and supply disruptions of some goods, on the other hand.

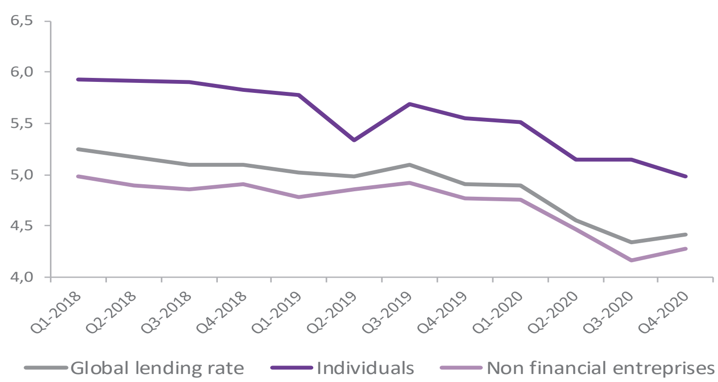
During September and December Board meetings, growth and core inflation forecasts have been gradually adjusted downward, considering the evolution of the health situation, the authorities' response, and less favorable quarterly growth figures. The monetary conditions remained accommodative, ensuring adequate financing of the economy.

Taking stock of this outlook, assessing the transmission of monetary policy decisions, and the preliminary estimation of the impact of the measures implemented by the EWC, the Board has decided to keep the policy rate unchanged at 1.5 percent.

1. Transmission of monetary policy decisions

The cuts of the policy rate in March and then in June 2020 have resulted in lower interest rates across all markets. Despite a significant rise of risk, lending rates on credits to the non-financial sector decreased from an average of 4.91 percent in Q4-2019 to 4.42 percent in Q4-2020. The rates applied to individuals have decreased by 57 pbs to 4.98 percent, those to businesses have decreased by 49 pbs to 4.28 percent – rates applied to MSMEs have decreased by 119 pbs to 4.49 percent. Furthermore, due to preferential conditions granted under the "Intelaka"[1] program, individual entrepreneurs have benefited from the largest rates' decline – it averaged 135 pbs for liquidity facilities and 341 pbs for equipment loans.

Figure 1. Lending rates
(%)



To support the Intelaka program, BAM has set an unlimited refinancing facility at a subsidized rate of 1.25 percent for bank loans, both on operating and investment credit. The Bank has also relaxed the regulatory capital requirements applied to banks for their loans to VSEs under this program. It has also set up – in consultation with the Ministry of Finance, the Central Guarantee Fund, and the banking system – a monitoring system to assess progress towards achieving the objectives of this program.

[1] The "Intelaka" program was launched following Royal instructions in February 2020 – just before the outbreak – by BAM and the Government in collaboration with the banking system to promote the funding of "auto-entrepreneurs," young project holders, young innovative corporates, and export-oriented very small enterprises. It is based on an entrepreneurship fund, with an initial budget of MAD 6 billion, over a period of 3 years provided in equal parts by the State and the banking sector. Two guarantee tools and one financing line have been provided at preferential conditions, namely: "Damane Intelak", "Damane Intelak Al Moustatmir Al Qaraoui", and Start-TPE.

Regarding the deposit rates, the downward trend continued in 2020, but to a lesser extent than the one recorded by the policy rate and lending rates. They decreased by 16 bps to 2.56 percent on average for 6-months deposits and by 14 bps to 2.87 percent for 12-months deposits. The minimum rate for passbook accounts has also decreased by 12 basis points to 1.77 percent in 2020 and by an additional 50 basis points to 1,27 percent in the first semester of 2021.

Despite an exceptional increase in its financing needs in 2020 due to the context of the COVID-19 Pandemic, the Treasury benefited from favorable conditions on the domestic sovereign debt market, with a drop of 68 bps in rates on its borrowings to 2.29 percent, on average. In addition to the cuts in the policy rate, this significant drop in sovereign rates was due to the Treasury's massive recourse to external borrowing, which has relieved pressure on the domestic market. These developments have been reflected in the secondary market, which saw a clear – almost parallel – downward shift of the yield curve.

Figure 2. Deposit rates
(in percent)

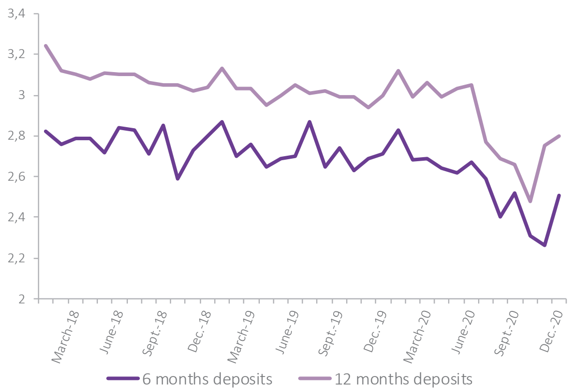
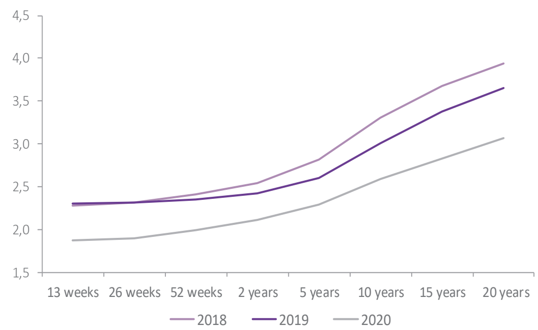


Figure 3. Yield curve on the secondary market (in percent)



Despite the sharp contraction in economic activity, bank credit maintained a sustained pace. Its growth settled at 4.4 percent, instead of 5.3 percent in 2019, with a slowdown from 5.5 percent to 3.8 percent in the pace of the credit to the non-financial sector. The ratio of bank credit to GDP has increased by 8.3 percentage points to 87.9 percent, but this is due mainly to the 5,5 percent contraction of nominal GDP in 2020. This performance was supported by the measures implemented by the EWC, as well as the benefits granted under the "Intelaka" program.

Indeed, at the end of 2020, 49,489 "Damane Oxygène" loans were granted for a total amount of MAD 17.7 billion, and the disbursed loans benefiting from "Relance" guarantees totaled MAD 35.3 billion. The "Oxygène" and "Relance" guarantee schemes benefited 54 percent of cases to SMEs, 18 percent to Micro enterprises, and 28 percent to intermediate-sized corporates and large corporations. By sector of activity, 29 percent of the volume of loans went to the retail sector, 28.5 percent to industry, 15 percent to construction, and 8 percent to services.

Figure 4. Bank credit growth
(in percent)

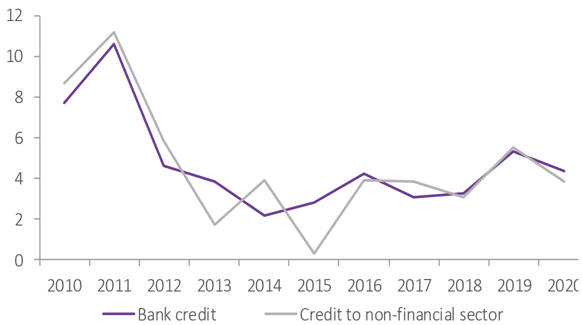
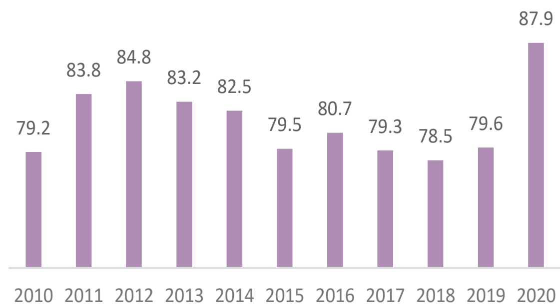
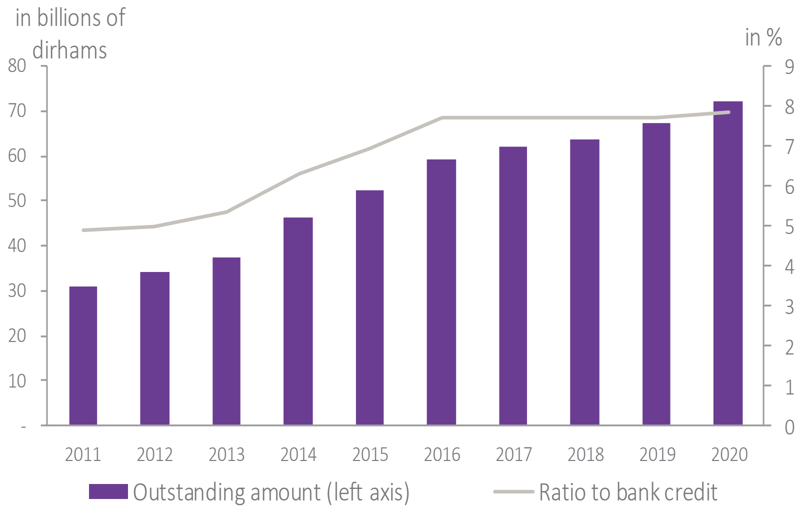


Figure 5. Bank credit to GDP ratio
(in percent)



Regarding "Intelaka" program, the amount of loans granted reached MAD 2.7 billion and benefited 15,085 beneficiaries at the end of December 2020. By size, 59 percent of the financing granted are less than or equal to 100 thousand dirhams, 27 percent between 100 thousand and 300 thousand dirhams, and the rest of the loans exceeded 300 thousand dirhams. The loans granted benefited individual entrepreneurs for 45 percent and micro enterprises for 55 percent. Investment credits represented 90 percent of the granted financing, against 10 percent for operating credits. By sector of activity, 25 percent of the loans were intended for the trade sector, 14 percent for agriculture, 13 percent for industry and services, 10 percent for tourism, and 8 percent for construction. Nevertheless, the strong contraction of economic activity in 2020 has been reflected in the banks' credit portfolio quality, with non-performing loans rising significantly by 14.7 percent to MAD 80.2 billion. Their ratio to the outstanding bank credit increased from 7.6 percent to 8.4 percent, increasing from 10.8 percent to 11.6 percent for private corporates and from 8.6 percent to 9.8 percent for households.

Figure 6. Non-performing loans



I- Other measures set by Bank Al-Maghrib

In addition to monetary policy measures, BAM has undertaken several actions in all its areas of intervention. On the prudential policy side, it has temporarily relaxed some of its regulatory requirements to allow banks to increase credit supply.

This includes (i) the authorization to overpass the liquidity ratio; (ii) the relaxation of the capital conservation buffer by 50 bps over 12 months; (iii) reducing the regulatory thresholds to 8.5 percent for the Tier 1 ratio and 11.5 percent for the solvency capital ratio; (iv) the authorization to defer the provisioning of credits that will be subject to a moratorium under the June 2020 order; (v) the temporary relaxation of the rules for the classification and provisioning of overdue loans to microfinance associations; and (vi) the suspension, for leasing companies, of depreciation allowances over the period of the moratorium. This derogation has been extended to tourism sector under the program contract from which it benefits.

In parallel, to ensure the safeguarding of the resilience of the banking system, BAM has undertaken macro stress tests, which showed contained risk for bank solvency.

On the exchange rate policy and reserve management side, the main priority was to prevent any shortage of reserves that may result from unexpected shocks on the balance of payments. The main measure carried out was a drawing on the IMF's precautionary and liquidity line[1] (PLL) on April 7 for an amount equivalent to SDRs 2.15 billion, or around 3 billion dollars. This amount was deposited at Bank Al-Maghrib to finance potential needs of the balance of payments.

On its part, the Government mobilized bilateral and multilateral loans amounting to 25.4 billion dirhams as of December 2020 and issued sovereign bonds on the international financial market of one billion euros in September 2020 and 3 billion dollars in December 2020.

This has helped dispel any concerns about the exchange regime reform and facilitated the transition to its second phase that was underway. The latter was initiated on March 9, 2020, and consisted of a further widening of the fluctuation band of the dirham from ± 2.5 percent to ± 5 percent, while maintaining the basket of currencies unchanged (composed of 60 percent of the euro and 40 percent of the US dollar).

Another important consequence of the crisis is the significant increase in the demand for cash, due mainly to cash transfers under the "Tadamon" operation, as well as to the wave of purchases preceding the announcement of the lockdown. Banknote withdrawals from BAM reached MAD 15.6 billion in March, MAD 12 billion in April, MAD 10.6 billion in May, 6.4 billion in June and almost MAD 21 billion in July. The net withdrawals during 2020, which totaled MAD 52,5 billion, represent nearly three times those recorded throughout 2019.

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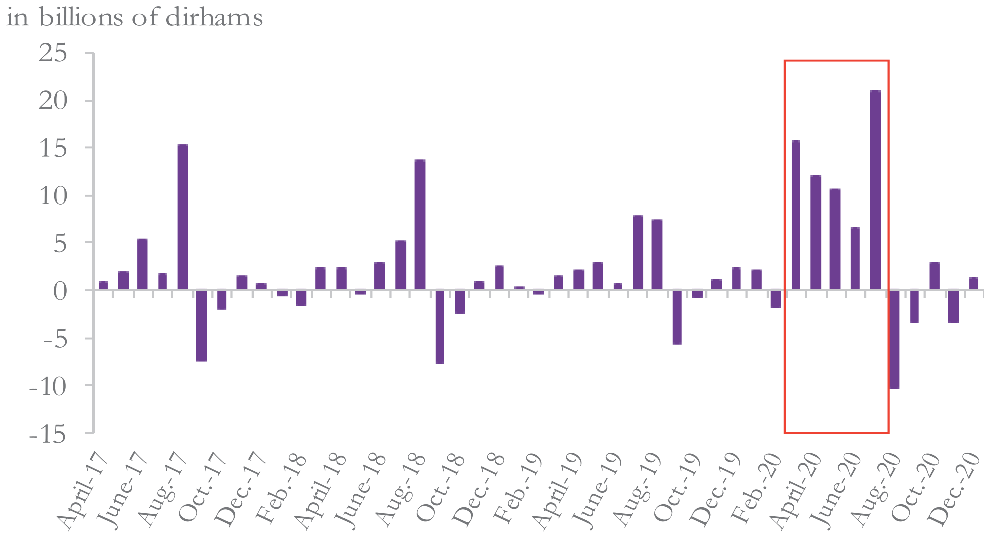
[1] It is worth noting that the first agreement under the PLL was concluded in 2012 and has since been renewed three times.

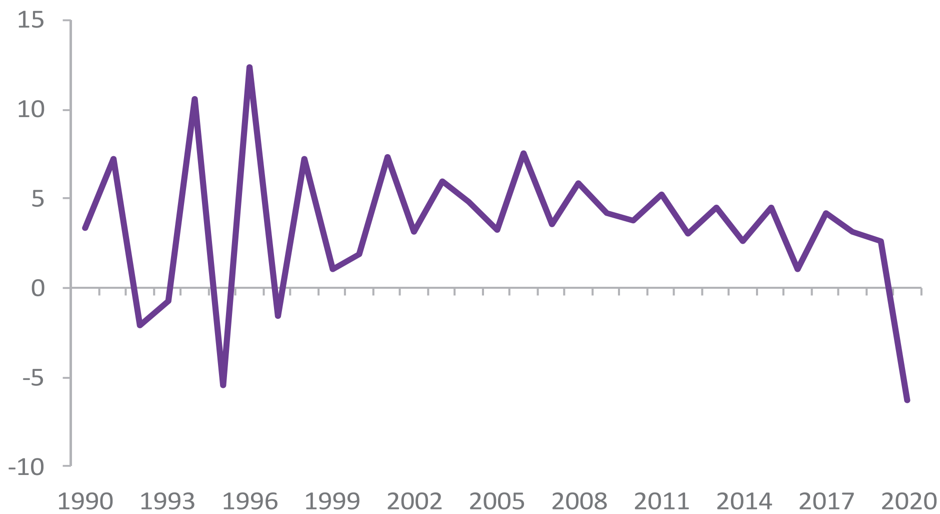
Figure 7. Evolution of banknote withdrawals from BAM



IV- The economic situation in 2020

The various support measures taken by the authorities have mitigated the economic and social impact of the Pandemic, but the shock remains of an exceptional scale. In 2020, the Pandemic, combined with unfavorable weather conditions for the second year in a row, led to a 6.3 percent contraction in real GDP, the largest since the compilation of the national accounts.

Figure 8. GDP growth (in percent)



The situation has deteriorated sharply on the labor market, with a loss of 432 thousand jobs, concentrated mainly in the agricultural and service sectors. More than 100 thousand workers had withdrawn from the market, leading to a significant decline in the participation rate to 44.8 percent. Under these circumstances, the unemployment rate rose to 11.9 percent at the national level and to 15.8 percent in urban areas.

Regarding inflation, the significant weakening in demand and disruptions to the global supply chains caused by the Pandemic had led to disinflationary and inflationary pressures, respectively. This dual shock had resulted in low levels of inflation which averaged 0.7 percent over 2020.

The weakening of economic activity had also a significant impact on public finances. The fiscal deficit widened to 7.6 percent of GDP, against 4.1 percent in 2019, due mainly to a drop-in tax receipts and specific Treasury financing and a significant increase in investment expenditures.

Faced with the sharp rise in financing needs, and in addition to the increase in its borrowings on the domestic market, the Treasury had massive recourse to external resources for a record amount of MAD 62.9 billion. Under these conditions, the direct public debt has increased significantly in both its domestic and external components, reaching a total equivalent of 76.4 percent of GDP.

Figure 9. Debt of the Treasury
(in percent of GDP)

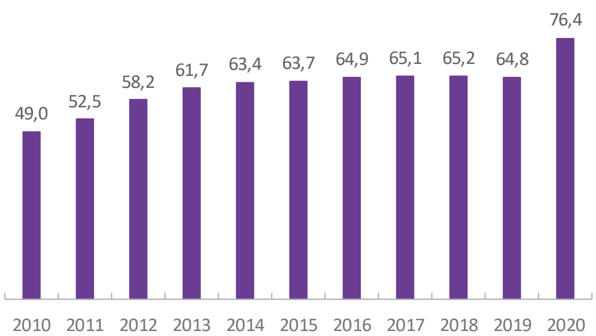
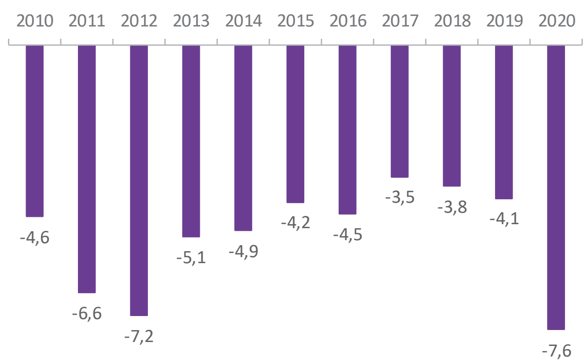


Figure 10. Fiscal deficit
(in percent of GDP)



The crisis has also hardly hit foreign trade. Weak foreign demand and imposed restrictions led to a strong contraction in goods exports, particularly for textiles and leather and aeronautics. Tourism receipts recorded an unprecedented drop of 53.7 percent. Still, with the sharp decline of imports and the resilience of remittances from Moroccans living abroad, the current account deficit has narrowed to 1.5 percent of GDP down from 3.7 percent in 2019.

Figure 11. Current account balance (in percent of GDP)

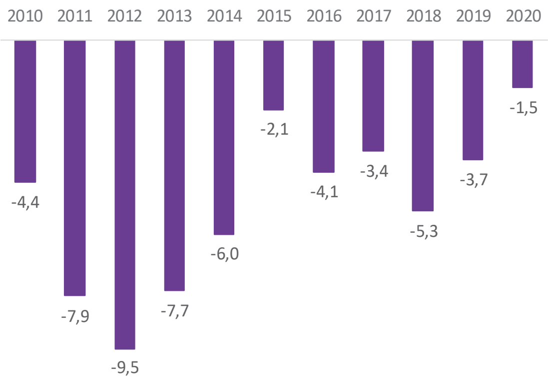
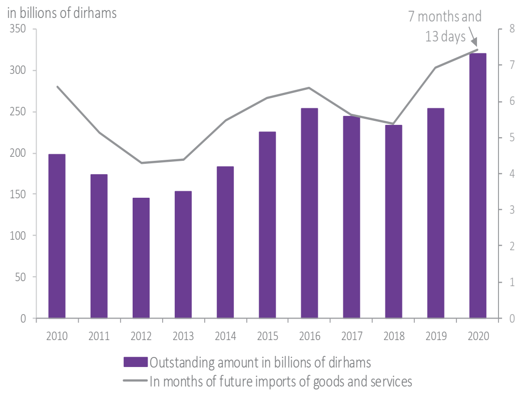


Figure 12. Official Reserve Assets



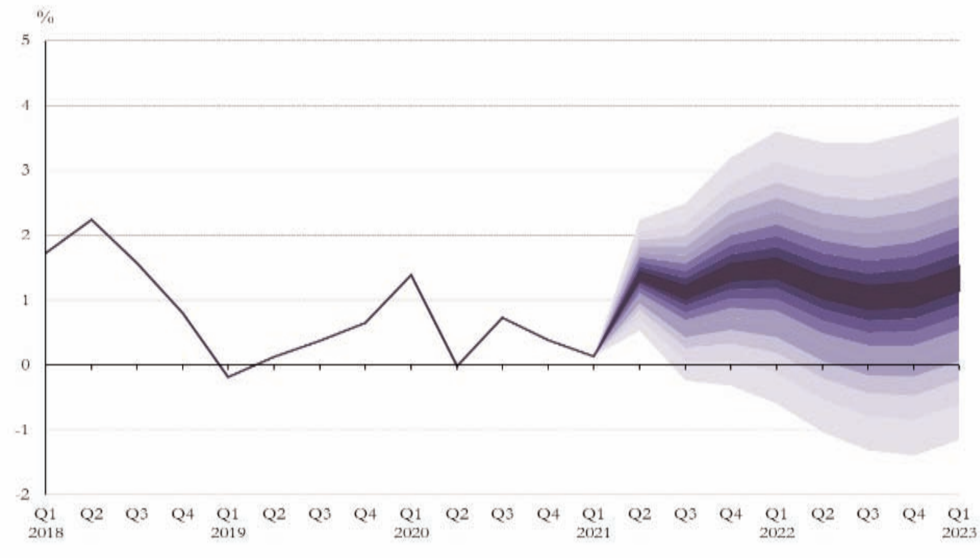
As to the financial account, FDI receipts decreased to the equivalent of 2.5 percent of GDP, the lowest level since 2004. The external financing mobilized by the Treasury and the drawing on the PLL enabled the official reserve assets of Bank Al-Maghrib to evolve at comfortable levels ending the year at MAD 320.6 billion, representing coverage of 7.4 months of future imports of goods and services.

V- Economic outlook and challenges ahead for monetary policy

The Moroccan economy is predicted to bounce back to an upward trajectory, bolstered by the expected global economic recovery, fiscal and monetary stimulus, and easing of restrictions. In 2021, and according to BAM's June 2021 forecasts, growth is expected to rebound to 5.3 percent, driven by a 3.6 percent increase in the value-added of non-agricultural activities and a 17.6 percent rebound in the agricultural sector. In 2022, growth is expected to consolidate to 3.3 percent, with a further improvement in the pace of non-agricultural activities to 3.8 percent and a 2 percent drop in agricultural value-added.

Against this background, and considering other temporary factors related to higher oil and some imported food prices, inflation is expected to accelerate yet remaining at moderate levels, standing at 1 percent in 2021 and 1.2 percent in 2022. Its core component would increase from 0.5 percent in 2020 to reach 1.2 percent in 2021 and 1.5 percent in 2022. The inflation outlook is subject to several upside risks. In particular, a persistent rise of commodity prices and inflation abroad may put upward pressure on domestic consumer prices.

Figure 13. Inflation forecasts (Q2 2021 - Q1 2023)



While the outlook is still subject to a very high level of uncertainty and the Pandemic continues to spread, monetary policy will face several challenges in the months and years ahead. The review of monetary policy frameworks undertaken by many central banks recently may already be in need of an update as a rapidly changing economic environment is underway.

The emerging issues of Central bank digital currencies, green finance, and the risks of fiscal dominance in a context of persistently high public debt levels are some of the main challenges facing monetary policy. Uncertainty may also be persistent with significant implications for formulating monetary policy decisions and their transmission to the real economy. The difficulties of measuring inflation during lockdowns due to the significant and sudden change in the structure of households' consumption is another illustration of the kind of unpredictable changes that may surge with important implications for the conduct of monetary policy. More generally, the very quick developments in economic activity highlight on another side the need for timely and granular data to assess the economic situation and predict its pattern to base monetary policy decisions.

Appendix:
Main Covid-19 response measures

Social support measures adopted by the EWC:

- The payment of a monthly allowance of MAD 2,000 while preserving the benefits related to Compulsory Health Insurance (CHI) and family allowances for affiliates of the National Social Security Fund (NSSF) who have stopped working partially or completely.
- The payment of allowances ranging from MAD 800 to MAD 1,200 monthly to households whose working members are not affiliates of the NSSF. This operation called "Tadamon" has benefited to nearly 5.5 million households, 45 percent of which in rural areas.
- Payment of social security contributions for NSSF affiliates was suspended, and late payment surcharges canceled.
- Exemption from lease fees for tenants of *Habous*[1] premises intended for commerce, services, and housing.
- The exemption from income tax, and any additional allowance paid to NSSF members by their employers, up to 50 percent of the average net monthly salary.
- The deferral by 3 to 4 months of credit payments for households facing financial difficulties as a result of the crisis.

Economic support and stimulus measures adopted by the EWC:

- The deferral of bank loan and leasing repayments for businesses affected by the crisis.
- The setting up of additional operating lines of credit to corporations. These loans are guaranteed by the Central Guarantee Fund (CGF) up to 95 percent, at BAM's policy rate increased by 200 basis points.
- For self-employed entrepreneurs, the granting of a zero-interest loan of an amount equivalent to three-months turnover, with a ceiling of MAD 15,000.

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[1] Immobilization of the bare ownership of a property in perpetuity or in time and allocation of its enjoyment to a public or private charity.

- The extension, if requested, of the deadlines for tax payments for businesses with a turnover of less than MAD 20 million.
- The suspension of tax audits and third-party notices.
- The acceleration of payments by governmental institutions and businesses in favor of businesses having government contracts.
- The suspension of social charge payments for businesses.

Regarding the economic recovery phase, the main measures are related to:

- The implementation of a Government guarantee mechanism to finance the post-crisis recovery phase, for public and private corporates impacted by the Pandemic. Thus, new guarantee products for loans at BAM's policy rate plus 200 basis points with a repayment period of up to 7 years, including a 2-year grace period have been launched:
    - "Relance TPE" for which the state guarantee amounts to 95 percent, covers loans to VSEs with a turnover of less than 10 million dirhams.
    - "Damane Relance", with a state guarantee ranging from 80 percent to 90 percent depending on the size of the company. For public corporates, the state guarantee is 100 percent.
    - "Damane Relance Promotion Immobilière". The credit guaranteed by this new product, capped at MAD 50 million per project, is aimed at funding projects that have already benefited from a real estate promotion credit, as well as to those that have relied on self-financing.

On August 6th, 2020, the following agreements were signed for the implementation of the stimulus measures:

- A pact for economic recovery and employment:
    - The State has committed to mobilizing MAD 120 billion for the recovery.
    - The General Confederation of Moroccan enterprises (CGEM) committed to preserving at least 80 percent of jobs, reducing inter-firm debt, promoting "made in Morocco" and ensuring compliance with good governance practices.

- The banking sector should facilitate the distribution of funds and support the “Intelaka” program's revival.

➢ A program contract for the restoration of the tourism sector in the post- COVID 19 era, running from 2020 to 2022:

- The Government undertakes until December 31st, 2020, to grant a lump-sum compensation of MAD 2,000 to employees and trainees of the sector declared to the NSSF; and to extend the suspension of the payment of social charges as well as the deadline for the repayment of overdrafts obtained within “Daman Oxygène” framework until December 31st, 2021.
- The private sector committed to retaining at least 80 percent of jobs, improving the tourism offer, and providing NSSF coverage to undocumented workers.
- The "Damane Relance hôtellerie", a guaranteed product, has been launched with a state guarantee ranging from 80 to 90 percent.

➢ Two additional program contracts were signed on October 5th, 2020, with events and catering industries, and with the amusement park and gaming industries.

Regarding the amending finance act, the key measures that had been adopted are:

- An additional MAD 15 billion investment spending under the general budget has been programmed to promote the revival of economic activity.
- In the same vein, upward adjustments of import tariffs have been imposed to several finished products to encourage domestic production.
- A system has been put in place that allows the State to give a guarantee for public corporates to contract a loan dedicated solely to the payment of their debtors among the VSMEs.

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