report

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weathering the storm, spurring the recovery

A View from the Mediterranean Countries

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CENTRAL BANKS AT THE FRONTLINE OF THE COVID-19 CRISIS: WEATHERING THE STORM, SPURRING THE RECOVERY

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Conference of the Governors of Mediterranean Central Banks organised by the Banco de España, the Central Bank of Tunisia, the Organisation for Economic Cooperation and Development (OECD), and the European Institute of the Mediterranean (IEMed)

On 28 June 2021, the Banco de España, the Central Bank of Tunisia, the Organisation for Economic Co-operation and Development (OECD), and the European Institute of the Mediterranean (IEMed), organised the VI Conference of Mediterranean Central Banks. After the success of the last five Conferences held in Barcelona (2014, 2017), Rabat (2015), Tunis (2018) and Madrid (2019), this sixth edition counted with the first-ever participation of 10 Central Banks from the Mediterranean region, which were represented by their Governors, and the presence of high-level representatives of the European Central Bank. With the aim to foster a comprehensive dialogue on the economic and financial situation of the Mediterranean region, this VI Conference allowed organisers and participants to take a very important step forward in the ambition to strengthen cooperation ties and enhance knowledge-sharing among partner Mediterranean central banks, which is of outmost importance especially in times of crisis.

The event was organised online due to the COVID-19 pandemic. The opening session counted with the participation of **Pablo Hernández de Cos,** Governor of Banco de España, **Marouane El Abassi,** Governor of the Central Bank of Tunisia, **Senén Florensa,** President of the Executive Committee of the European Institute of the Mediterranean (IEMed) and **Luiz de Mello,** Director of the Policy Studies Branch, Organisation for Economic Co-operation and Development (OECD), as co-organisers. Their welcoming remarks were followed by a keynote speech by **Fabio Panetta,** Executive Board Member of the European Central Bank (ECB).

The conference evolved around a keynote speech and two main sessions which were devoted to the role of Mediterranean central banks during and after the post-COVID-19 crisis. The first session, which was chaired by Governor Hernández de Cos, discussed the monetary policy responses to the COVID-19 crisis in the Mediterranean region and highlighted the lessons learned during these past months. It counted with interventions by **Rosthom Fadli,** Governor of the Bank of Algeria, **Ignazio Visco,** Governor of Banca d'Italia, **Abdulrahim Breish,** Head of External Portfolios Unit at the Central Bank of Libya, and **Mário Centeno,** Governor of Banco de Portugal.

The second session was chaired by Governor El Abassi and was devoted the role of Central Banks in aligning the post-pandemic economic recovery with the principles of sustainable development in the region. Participants discussed the role of central banks in face of climate-related risks and their contribution to sustainable development, mainly through green finance and financial inclusion. The Governor of the Central Bank of Egypt, **Tarek Hassan Amer,** the Governor of the Bank of Greece, **Yannis Stournaras,** the Governor of the Central Bank of Malta, **Edward Scicluna,** and the Director of Economic Studies at Bank Al-Maghrib (Morocco), **Mohamed Taamouti,** delivered their remarks on the issue and debated ways to enhance cooperation between their institutions.

The conference was closed by the concluding remarks of Governor El Abassi and Governor Hernández de Cos as co-organisers, followed by **Nasser Kamel,** Secretary General of the Union for the Mediterranean, who offered the support of his institution in fostering Euro-Mediterranean dialogue and cooperation in the field of finance.

Monetary-fiscal interactions on the way out of the crisis

The economic crisis provoked by the measures to fight the spread of the COVID-19 pandemic has given way to an unprecedented response driven by monetary and fiscal policies in advanced economies. As highlighted by the keynote speaker, for the first time in decades, both monetary and fiscal policies are working together to stimulate demand. According to him, this cooperation between monetary and fiscal policies shows the way to exit the persistent liquidity trap - insufficient demand, weak inflation, and low interest rates - in which the EU has found itself. Importantly, this cooperation has nothing to do with a loss of central bank independence as far as monetary-fiscal interactions remain consistent with the central bank's goals,

Indeed, the pandemic has prompted a massive fiscal response aimed at supporting the loss of revenues among firms and households and avoiding the destruction of the productive capacity. Meanwhile, the monetary policy implemented by the European Central Bank (ECB) has lowered real interest rates to historically low levels. As remarked by the keynote speaker, this policy mix, added to the positive perspectives introduced by the Next Generation EU (NGEU) recovery instrument, is breaking with the past combination of monetary and fiscal policies that was not adjusted to the reality.

The speaker therefore called for taking advantage of the current upswing, both in terms of growth and inflation, which opens a window of opportunity to escape the liquidity trap and re-anchor the expected medium-term inflation to the 2% target of the ECB. For that, an extra fiscal stimulus (equivalent to 1.6% of GDP) targeting productive investment will need to be prolonged to return to the pre-pandemic growth path by 2022. This fiscal effort will be complemented by the critical role of the monetary policy which should continue to absorb the shock of the pandemic while refraining from prematurely reducing the pace of asset purchases.

The commitment of the ECB to an expansionary monetary policy was recalled, notably to keeping low interest rates and its policy of asset purchases until the inflation outlook firmly converges to the 2% aim. This should encourage government of pursue wise expansionary fiscal policies in the EU.

Finally, it was stressed that unconventional policies, which have proven very useful throughout the COVID-19 crisis, should be retained in the post-pandemic period. There is indeed the opportunity to bring the euro area economy closer to its full potential thanks to an innovative and flexible monetary policy, the right monetary-fiscal interactions, and the Next Generation EU tool.

"Central banks' crucial responses to the COVID-19 crisis: An overview of monetary policies across the Mediterranean region"

The COVID-19 pandemic has prompted governments across the Mediterranean to take severe measures to curtail socioeconomic activities. Lockdowns, quarantines, social distancing, closure of sea and land borders, and suspension of flights, are among the restrictions implemented by governments to fight the pandemic that have all contributed to a severe recession and disruption of the economies of Euro-Mediterranean countries. Unlike the 2008 global financial crisis, the economic shock triggered by the COVID-19 pandemic was exogenous, with effects mainly on services more than manufacturing.

In that context, the economies of Southern and Eastern Mediterranean countries have been hit particularly hard. Already weaken by political instability (Libya, Tunisia, Algeria) and macroeconomic imbalances, they have greatly suffered from falling touristic revenues and remittances, both being fundamentals to sustain their balance of payments.

For rentier economies like Algeria and Libya, the COVID-19 crisis had had a far greater impact when the oil counter-shock of April 2020 led to a severe drop in global crude oil prices. As a result, the Libyan GDP dramatically contracted by 55,7% in 2020, in addition to a drastic deterioration of the foreign currency reserves and an increase in public debt.

The downturn triggered by the pandemic threatened to affect the banking and financial sector, notably through an increased risk of defaults of financial institutions, prompting central banks to intervene.

Weathering the storm: preserving financial stability, securing credit flows

Indeed, central banks across the Mediterranean have played a crucial role in confronting the crisis, safeguarding financial stability, and preventing even more extreme scenarios. They have preserved the ability of banks to lend while being a fundamental vehicle for support measures such as guarantees to reach households and businesses. They have also relaxed refinancing conditions and implemented micro and macro-prudential measures to manage the balance between the measures to support the economy and the prevention of risks linked with accumulating on the balance sheet of financial institutions. In this context, it was made clear that the measures taken by central banks in the Euro-Mediterranean area have succeeded in preventing a generalised tightening of credit and averting the risk of a spiralling crisis. In that sense and as stressed in the keynote speech, attention was drawn on the fact that the monetary policies of Central Banks across the Mediterranean have been complementary to the very significant fiscal measures (social transfers, subsidises, credit guarantees and liquidity) deployed by governments.

Governors highlighted the monetary policy response of the European Central Bank, which was extremely prompt to react through emergency programmes of asset purchases and ample refinancing operations that ensured the continuous flow of credit to the Euro area economies. It was noted that financial stability in the EU has also benefited from the efforts made to introduce regulatory reforms following the 2008 global financial crisis (raising bank capitalisation, reducing the stock of non-performing loans, improving liquidity conditions).

In countries such as Libya, the central bank has also had an exceptional role in pursuit of financial and economic stability and the general viability of the country's economy. The Central Bank of Libya has notably provided the funding for the state general budget ($19.2 billion), as well as foreign currencies to meet the needs of the local market for imports. In support of the efforts to fight the health consequences of the pandemic, central banks have also opened special credit lines for the purchase of medical supplies. Finally, they have promoted the digitalisation of financial services as a means to reach businesses and households and maintain the economic activity despite the movement restrictions in the most critical moments of the pandemic.

Participants have also noted the return of multilateralism and the strengthening of international cooperation witnessed throughout the pandemic. They welcomed the role of international financial institutions, especially the International Monetary Fund (IMF) in strengthening the global economy and providing substantial liquidity support. A good example of these multilateral efforts is the $650 billion allocation of the IMF's Special Drawing Rights (SDRs) to help boost global reserves and providing space for necessary fiscal expenditures to exit the crisis. Multilateral development banks have also contributed to mitigate the crisis by deploying fresh emergency measures, including $8 billion financial support to the MENA region, according to the figures mentioned during the conference.

Challenges on the road to recovery: the role of central banks

More than a year after the outbreak of the COVID-19, economies across the Mediterranean were still challenged by the successive waves in pandemic infections, the emergence of new variants, and the uneven pace of the vaccination campaigns. In this context of permanent uncertainty, central bankers from both shores of the Mediterranean conveyed the message that support measures would have to be withdrawn gradually. Monetary policy should in fact remain sufficiently accommodative to maintain favourable financing conditions that allow the recovery to take firm root. They insisted that the withdrawal of public intervention should be gradual and contingent on the state of the economy, based on a cautious and vigilant approach. At the same time, banking supervision would need to ensure a balance between the need to continue providing liquidity to the economy and safeguarding against risks. Indeed, it was acknowledged that non-performing loans will increase, although less dramatically than envisaged.

In the Euro-Mediterranean, the recovery was expected to be clearly asymmetrical. While European countries were well advanced in their efforts to immunize their populations against the COVID-19, Southern and Eastern Mediterranean countries have kicked off their vaccination campaigns with more delay and at a lower pace.

Moreover, European countries have launched the Next Generation EU (NGEU) Fund, which was considered an unprecedented and decisive tool that would allow for a quicker recovery. Based on solidarity with the issuance of large-scale supra-national public debt, it has a transformative ambition for the EU economies that aims at tackling structural weaknesses, stimulate private investment, and modernise economies. According to the European governors, with the NGEU, the pandemic has proven to constitute an opportunity to deepen the European project that would enable the union to emerge stronger from the crisis. They have called to go further in the economic and financial integration of the EU to better prepare to future crises by devising a permanent macroeconomic stabilisation mechanism to complement the single monetary policy, concluding the banking union with a fully mutualised European Deposit Guarantee Fund, and finally implementing a true integrated European capital markets union.

While European countries benefit from a more favourable economic and financial outlook, Southern and Eastern Mediterranean countries will have to grapple with persistent economic uncertainties and with limited fiscal space to finance support measures. Given this context, participants warned that emerging countries were likely to be confronted with the spillovers of the monetary policies adopted by advanced economies. According to them, the tightening of the monetary policy in the US or the EU might come at the time when the monetary policy of developing countries will be called to maintain a certain degree of monetary accommodation. They could therefore be confronted with rising international interest rates.

Consequently, it was agreed that the ECB should not be complacent with any risk or effect that its policies could entail, and which could impact the EU internally and its southern neighbours. To avoid such spillovers, it was also stressed that Southern and Eastern Mediterranean countries need to take measures to improve market conditions and infrastructures.

Nevertheless, it was acknowledged that the exposure to spillovers is different from one country to another: while countries like Algeria and Libya with oil revenues were poorly integrated to international markets, countries such as Tunisia have had to resort to international markets to meet their financing needs.

In the context of higher public debt levels generated by the pandemic, international cooperation in the Mediterranean to ensure access to financing at an affordable cost, as well as the massive and quick roll-out of vaccines for Southern Mediterranean partner countries will be critical to avoid the entrenchment of greater inequalities between the northern and the southern shores of the Mare Nostrum.

"Looking ahead: The central banks' roadmap to promote a sustainable post-COVID-19 recovery in the Mediterranean region"

When looking ahead to pave the way for recovery, it has been argued that the current crisis constitutes a major turning point that can be used to advance towards a more sustainable model of development. Aligning economic recovery with the principles of sustainable development appears to be the new roadmap of international organisations, the EU and a number of Mediterranean countries in the post-COVID-19 era.

Central banks will be at the centre stage of the post-COVID-19 recovery process in the Mediterranean countries, and therefore in a position to contribute to foster a sustainable, inclusive, green, and digital agenda in their respective countries. While addressing macroeconomic and financial stabilisation needs, central banks' policies will be key players to accelerate the sustainability transitions.

Although the main responsibility to address sustainable development issues lies in governments' mandates through public policy implementation, especially tax, subsidies, and investment policies, there was a clear consensus among the participants who considered that Mediterranean central banks cannot remain passive in front of such challenges. Given that their mandate consists in creating as much financial and macroeconomic stability as possible through low inflation targets, central banks have a role to play in mitigating the financial consequences of climate change, while fostering the green transition, and creating the conditions for a more inclusive growth through financial inclusion, the digital transition, and reducing income inequalities, through supervisory and non-monetary tools available to them.

The role of Mediterranean central banks in face of climate change

Climate change is considered the biggest challenge of the 21st century. The impact of rising temperatures will be felt in the Mediterranean Basin, which is one of the most vulnerable regions worldwide. Mediterranean central banks have become increasingly aware of the risks that climate change entails for the financial and economic stability, to the point that it has become a strategic priority issue for most of them. Participants indeed acknowledged that climate-related risks have the potential to significantly impact price stability, creating sudden market price corrections, economic downturns, and threats to financial stability. The gradual transition plans and the implementation of policies aiming at mitigating climate change may also generate distortions that should be addressed, especially if not implemented in a timely and cost-effective manner.

Understanding the scope of these impacts and developing forecast models are critical to design as of now adequate policy responses within the central banks' mandate. The panellists stressed that their institutions are well equipped to perform complex modelling of risks and uncertainties, which are key for assessing the impacts of climate change on their balance sheets, as well as the associated credit market and operational risks. However, the current data gaps on climate related risks are a crucial issue that was impeding to accurately reflect them in the evaluations of entities and credit ratings, possibly leading to cases of mispricing. Enhancing supervisory and modelling tools, as well as the disclosure and exchange of reliable information and data, could help address this concern voiced by the participants. The Bank of Greece established a research centre focusing on climate change to that end. Multiplying stress tests was considered to be important to understand and prepare central banks' policies to the impact of climate change.

Central banks contributing to accelerating the green transition in the Mediterranean Basin

As highlighted by all participants, central banks' policies can become key enablers to accelerate the sustainability transition by scaling up green finance and steering credit towards sustainable investments. Speakers exposed that central banks across the region have already taken steps to contribute to green their economies and will continue to support global efforts towards that end. Over the last years, they have strengthened their social corporate responsibility initiatives for a low-carbon economy, while establishing and being active members of the Network of Central Banks and Supervisors for Greening the Financial System (NGFS) and the Sustainable Banking Network (SBN). They have developed green macro-prudential tools within their regulatory frameworks, as well as differentiated capital requirements to disincentivise investment into carbon intensive assets, while reducing exposure to assets entailing high carbon intensity. In turn, Mediterranean central banks have increased their exposure to green and social bonds in their internally managed portfolios.

In Tunisia, the Central Bank has been building upon the national sustainable development strategy to implement policies aiming at boosting the development of renewable energies and the circular economy. The Central Bank of Tunisia has also recently established Corporate Social Responsibility practices that will help the banking system to adapt to green financing standards while accelerating the green transition.

Being part of the Egyptian national green bond committee aiming at developing an active market for Egyptian green financial assets, the Central Bank of Egypt has also adopted a proactive stand. It launched for instance an initiative to finance the replacement of polluting vehicles with natural gas vehicles. In addition, a successful issuance of green bonds for a total of $750 million took place in September 2020, being Egypt the first MENA country to do so.

However, more can and should be done in the years to come to meet the challenge. Yet, funding remains the main concern voiced by participants from the Southern and Eastern Mediterranean countries. Indeed, the necessity to shift to a low-carbon economy was perceived as an additional financial burden for countries facing more demanding development challenges, higher poverty levels, and higher borrowing costs. In this context, all participants agreed that more solidarity and cooperation are needed across the Mediterranean to give the possibility to all countries of the Basin to successfully transition towards a green economy. More coordination between Mediterranean central banks to discuss the specific means to bridge this funding gap with international financial institutions operating in the region, especially the European Investment Bank, was repeatedly called for by participants in the meeting.

Mediterranean central banks' contribution to sustainable development goals

Enhancing access to finance for small businesses and households was also mentioned as one of the main contributions that Mediterranean central banks can make towards achieving the Sustainable Development Goals (SDGs). Financial inclusion is indeed a pillar of macroeconomic stabilisation policies to foster inclusive growth and reduce income inequalities. Central banks have launched initiatives to promote access to finance and financial education over the last years, but participants highlighted that the COVID-19 pandemic is making action even more urgent than before.

At the same time, it was acknowledged that the crisis has provided a momentum to accelerate the digital transformation, notably in the financial sector with clear benefits in terms of financial inclusion. Some important projects have been completed by central banks, especially those related to the establishment of mobile payment mechanisms for social benefits during the pandemic, which succeeded in getting citizens and businesses closer to financial systems. Likewise, the importance to promote a recovery fostering the digital transition was stressed as a mean to help communities improve their standards of living through increased access to financial services. Nevertheless, some participants warned against the potential significant risks associated with fintech and digital currencies, notably in terms of digital divide and cybersecurity.

Conclusions

The VI Conference of Mediterranean Central Banks entitled "Central Banks at the Frontline of the COVID-19 Crisis" provided an outstanding opportunity for governors and representatives of central banks of both shores of the Mediterranean Basin to share their views and their insights on the role that their institutions have played throughout the COVID-19 crisis and what should be done to spur a sustainable recovery. In their intervention, they stressed the exceptional role played by the monetary policies in safeguarding financial stability and ensuring the continuation of credit flows to the economy. In that sense, the financial system was part of the solution to the crisis.

In a context of uncertainties regarding the end of the pandemic, governors and representatives of Mediterranean central banks also considered that monetary policy should continue to help maintain favourable financing conditions, to allow the recovery to become firmly established. They voiced their concerns regarding the asymmetry of the recovery in the region and the possible spillovers that monetary policies in advanced countries could generate for Southern and Eastern Mediterranean countries.

Central banks in the region can undoubtedly play a relevant role to foster a sustainable, inclusive, green, and digital development in their respective countries. This is what was highlighted during the second session of the meeting, with governors stressing that maintaining financial and macroeconomic stability implies addressing climate-related risks, promoting the greening of the financial system, and finally reducing inequalities and fostering inclusive growth through financial inclusion and education. A number of steps have been taken by all central banks across the Mediterranean. But for efforts to be scaled up, the funding gap among Southern and Eastern Mediterranean countries will have to be tackled.

Therefore, and in order to effectively address challenges related to the post-COVID-19 economic recovery, governors and representatives of Mediterranean central banks repeatedly showed their desire to strengthen their cooperation. They warmly welcomed once again the opportunity offered by the Conference of Mediterranean Central Banks to exchange views and called for an intensification of the dialogue initiated during the meeting. To that end, it was notably suggested that meetings convening both governors of central banks and ministers of finance within the framework of the 5+5 Dialogue would be a highly beneficial step forward in strengthening regional cooperation in the field of finance. Central bankers also called for enhancing their coordination as a Euro-Mediterranean community to raise the attention of international financial institutions on the specific funding needs of the region, which are necessary, not only to secure a sustainable post-COVID-19 recovery, but also to avoid creating a greater divide between the North and the South of the Mediterranean, and eventually to contribute to foster a genuine Euro-Mediterranean integration.