

report

STAY THE COURSE IN TURBULENT TIMES: Old and New Challenges for Central Banks

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8th Conference of the Governors of Mediterranean Central Banks, organised by the Hrvatska narodna banka, the Banco de España, the Organisation for Economic Cooperation and Development (OECD), the European Institute of the Mediterranean (IEMed) and the Union for the Mediterranean (UfM).



On 14th February 2024, the **Hrvatska narodna banka**, the **Banco de España**, the **Organisation for Economic Cooperation and Development (OECD)**, the **European Institute of the Mediterranean (IEMed)** and the **Union for the Mediterranean (UfM)** co-organised the VIII Conference of Mediterranean Central Banks in Split, Croatia. The event, under the title, “**Stay the Course in Turbulent Times: Old and New Challenges for Central Banks**”, brought together Central Banks governor of Croatia, Spain, Portugal, Malta, Slovenia, as well as the Vice-President of the European Central bank, and representatives from the OECD, the IMF, universities, and the private sector.

In recent years, the Mediterranean Central Banks conference has emerged as a leading platform for dialogue and collaboration on economic and financial matters in the Euro-Mediterranean region. This forum has facilitated essential dialogue between governors and senior representatives of central banks from both sides of the Mediterranean, connecting them with policymakers, private sector representatives, and academics to address key economic and financial concerns in the region.

This year, the conference addressed the challenges of Central Banks in maintaining stability and credibility amidst difficult times, be it high global uncertainty and inflation brought by geopolitical tensions, supply-chain disruptions, climate change and global warming. Additionally, it highlighted the significance of women's economic participation, emphasising the need for enhanced efforts in financial inclusion.

In this context, challenges faced by the euro area economy due to unprecedented shocks, including elevated inflation and uncertain economic conditions, were addressed in the keynote speech. The first session with Central Banks' governors stressed the importance of maintaining central bank credibility amidst uncertainty was emphasised, along with the role of monetary policy in reducing inflation. Additionally, the need for close monitoring of economic indicators, potential risks posed by vulnerable sectors, and the importance of fiscal and structural policies



in supporting growth were discussed. Lastly, the significance of financial integration in the EU and the necessity for policymakers to focus on medium-term growth prospects to ensure the future prosperity of the euro area and the EU were stressed.

Moving forward, various experts from international organisations, academia, and the private sector were invited to address the remaining themes of the conference. In so doing, they first emphasised the importance of women's economic participation for comprehensive economic development, highlighting the critical role of financial inclusion and financial literacy in empowering women economically. Participants suggested implementing appropriate policies and recommendations from different organisations and showcasing best practices as potential solutions. Lastly, participants delved into the financial risks posed by climate change, particularly in Mediterranean countries, stressing the importance of assessing and supervising climate risks in the financial sector and exploring policy actions to mobilise green funding for mitigation and adaptation efforts.

Following welcoming remarks by **Boris Vujčić**, Governor of the Hrvatska narodna banka, **Pablo Hernández de Cos**, Governor, Banco de España, **Senén Florensa**, Executive President of the European Institute of the Mediterranean (IEMed), **Nasser Kamel**, Secretary General of the Union for the Mediterranean (UfM) and **Luiz de Mello**, Director of the Country Studies Branch of the Economics Department at the Organisation for Economic Cooperation and Development (OECD), a keynote speech was given by **Luis de Guindos**, Vice-President of the European Central Bank

KEYNOTE SPEECH: Monetary policy, financial stability and medium-term growth in the euro area

In his keynote speech opening the 8th Annual Conference of Mediterranean Central Banks, Luis de Guindos, Vice-President of the European Central Bank (ECB), discussed the significant challenges and strategic responses in the euro area concerning monetary policy, financial stability, and medium-term growth. He highlighted that the euro area had recently faced unprecedented economic

shocks, driving inflation to historic highs and creating substantial uncertainty. To counter this, the ECB initiated an aggressive cycle of interest rate hikes aimed at returning inflation to its 2% medium-term target. Mr. de Guindos stressed the importance of maintaining the ECB's credibility during such turbulent times.

Luis de Guindos outlined the ECB's monetary policy framework, which is based on assessing the inflation outlook, underlying inflation trends, and the transmission of monetary policy to the real economy. Recent data indicate a decline in inflation, with expectations for further easing as energy shocks and supply bottlenecks fade. However, he cautioned that risks remain, including persistent wage pressures, resilient profit margins, and potential geopolitical tensions, particularly in the Middle East, that could impact energy prices.



Regarding financial stability, Luis de Guindos expressed concerns about the impact of higher interest rates on the debt servicing capacity of highly indebted firms, especially in the real estate sector. He noted that while the euro area banking system has shown resilience due to strong regulation, there are risks to bank profitability from weak lending growth and rising funding costs.

Looking ahead, the Vice-President of the ECB warned that the euro area's medium-term growth potential may slow due to disappointing productivity growth,

declining capital investment, and negative demographic trends. He called for fiscal and structural policies to complement monetary policy, emphasising the need for investments in research, digitalisation, and sustainable production to enhance competitiveness. He also stressed the importance of deepening financial integration within the EU to support long-term growth and investment.

SESSION I: Central Bank's Credibility in Times of Elevated Inflation

The first session of the conference focused on evaluating the credibility of central banks, particularly in the context of recent inflationary episodes and the monetary policy response.

It began with a reflection by governors on whether central banks have indeed lost credibility due to recent inflationary pressures. The Central Bankers expressed differing views but generally leaned towards the notion that central banks have not necessarily lost their reputation. Arguments supporting this view included observations of maintained positivity in European citizens' perceptions of the European Central Bank and the understanding that inflationary shocks were primarily caused by exogenous factors such as energy prices and geopolitical tensions, that are well beyond the control of central banks.



Various factors influencing central bank reputation were then highlighted, including the handling of inflation expectations, communication strategies, as well as consumers' perception. Speakers discussed the impact of inflation expectations on market reactions and emphasised the importance of clear communication to manage expectations effectively. Concerning consumers' perception, these were recognised to often include biases and aligning consumer expectations with actual inflation rates was identified as a clear challenge.

The significance of communication strategies in maintaining central bank credibility was then emphasised, noting the importance of clear and consistent messaging to stakeholders. The balance between forward guidance and data-driven approaches in monetary policy decisions was also discussed and the need for transparency in policy actions to build and sustain credibility was highlighted.

Additionally, the session touched upon the role of fiscal policy and its coordination with monetary policy in addressing economic challenges. As such, it underscored the importance of maintaining policy consistency and targets to preserve central bank credibility, as changing mandates or targets was viewed as potentially detrimental to it and to long-term stability. Speakers then cautioned against deviating from established targets, such as the 2% inflation target, and emphasised the need for clear mandates to guide central bank actions.



The positivism shared by the participants reflected a consensus that, despite challenges, their actions in response to elevated inflation were effective. They attributed the inflationary episode to extraordinary external shocks, such as the Covid-19 pandemic and the Russian aggression, rather than domestic economic factors.

Credibility in terms of adhering to the 2% inflation target was reiterated, with participants highlighting rapid policy adjustments to preserve it. They also discussed the importance of managing market expectations, noting the need for coherence between central bank actions and market reactions to avoid disruptive volatility.

Furthermore, data dependence emerged as a crucial aspect of policymaking, with participants advocating for a flexible approach to decision-making in response to evolving economic conditions. They emphasised the need to communicate data dependency effectively to stakeholders, balancing responsiveness with stability, but also acknowledged challenges in communicating policy decisions to different audiences, highlighting the need for clear and consistent messaging.

Regarding market credibility, participants acknowledged the importance of respecting market dynamics while remaining vigilant against irrational behaviour. They emphasised the need for dialogue and information exchange with market participants to ensure alignment between central bank policies and market expectations.

The impact of monetary policy on emerging markets, particularly in the Mediterranean region, was also addressed. Concerns were raised about capital flight and inflationary pressures resulting from global policy tightening, underscoring the interconnectedness of economies and the need for coordinated responses.

Overall, the conference session provided insights into the multifaceted challenges facing central banks in navigating complex economic environments, highlighting the importance of credibility, data dependence, and effective communication in achieving policy objectives.



SESSION II: Fostering women's economic participation in the Mediterranean: successful policies for in-depth transformations

The commitment to fostering cooperation and development in the Mediterranean region, particularly in enhancing financial inclusion and supporting women in fintech, was endorsed by the UfM Ministerial Declaration of Madrid. Challenges persist in terms of entrepreneurship and labour market participation, especially for women in the MENA region. Indeed, a significant financial gap of \$11.7 trillion between men and women was estimated by the World Bank, highlighting disparities in access to finance. Women's financial inclusion is hindered by various barriers such as collateral requirements, inheritance laws, and cultural perceptions. In the MENA region, less than 40% of women have access to financial accounts and services due to discriminatory social institutions and legal disparities. Efforts are required to ensure equal opportunities for all genders and efficient allocation of financial resources to foster inclusive and sustainable development.

As such, increased access to finance for women could unleash their entrepreneurial spirit and promote gender equality, leading to greater decision-making power and participation in economic development. While there are small initiatives that

contribute to enhancing financial access, there remains a pressing need to scale up and multiply these efforts, especially by adopting a regional and global approach.

In Morocco, gender disparities persist in financial inclusion. For instance, only 14% of inactive women have a bank account compared to 34% of men. Additionally, 35% of female entrepreneurs find it more challenging to access financing. Consequently, high levels of female inactivity serve as a significant barrier, despite employed women almost reaching the same level as men in terms of financial inclusion. Factors such as low education levels, social constraints, and cultural influences all contribute to women's limited access to financial services. The National Financial Inclusion Strategy (SNIF) aims to address these disparities, with initiatives focusing on targeting women as a priority group. Financial education is integrated into various domains, and initiatives, like the Moroccan Foundation for Financial Education (FMEF), align with OECD recommendations. Programmes introduced in schools and through mass media also contribute to reaching diverse audiences.

In Tunisia, despite some progress in financial inclusion, significant gaps remain due to conservative monetary policies and low levels of financial literacy. Efforts to address these challenges include allocating dividends to non-financial support programs and promoting adaptation of financial products to reach underrepresented segments. In addition, initiatives targeting NEETs and introducing financial education



in schools also aim to bridge these gaps. There, Central Banks play a crucial role in providing financial support and implementing guarantee schemes, requiring stronger coordination among stakeholders for effective reforms.

Furthermore, a new project, undertaken by the OECD and the EU Commission, and aiming to enhance access to finance for women in SEMed countries, was highlighted. Its focus is particularly on women entrepreneurs in Algeria, Egypt, Jordan, Lebanon, Libya, Morocco, and Palestine, as it aims to improve women's financial inclusion, especially those facing restricted access to financial resources and services. In doing so, the project seeks to foster the exchange of good practices and peer-learning, as well as policies promoting women entrepreneurship, financial literacy, and financial consumer protection. Various stakeholders, including ministries, Central Banks, and support networks for women entrepreneurs are actively engaged in this project.

In fact, the promotion of women's empowerment through financial education and consumer protection is emphasised by the OECD framework. Other recommendations of the framework also include enhancing access to financial services for SMEs, with a particular emphasis placed on collecting and sharing data to tailor financing strategies to address the specific needs of businesses owned by women.



Yet, while there are small initiatives that contribute to enhancing financial access, there remains a pressing need to scale up and multiply these efforts, especially by adopting a regional and global approach. Central Banks play a crucial role in promoting financial inclusion for women through the implementation of policies and frameworks. Examples from countries like Bangladesh, Ghana, and India demonstrate the importance of their interventions in this regard. Digital financial inclusion, particularly through mobile money accounts, offers a cost-effective solution to empower women economically.

Moreover, guarantee schemes are implemented for risk mitigation, and it is important to support and promote these instruments. Central banks are also instrumental in regulating and overseeing digital finance and fintech. Yet, this requires stronger coordination among stakeholders to expedite banking reforms by the Central Bank and to reduce regulatory constraints on financial institutions. Addressing these challenges requires regulatory reforms, including those related to microinsurance, and the adoption of gender-sensitive policies by Central Banks and policymakers.

Finally, awareness and education are crucial for Banks' effectiveness in promoting financial independence and literacy. Crowdfunding platforms could also play a significant role in enhancing financial access and inclusion, providing alternative financing options for individuals and businesses, especially those from marginalised communities. Data, including the role of AI, is essential for understanding financial inclusion dynamics. In addition, Central Banks' financial literacy programs and their continuous collaboration with other institutions are necessary to enhance social rights' reforms and promote gender-sensitive guarantee schemes, reaching out to excluded groups.

SESSION III: Integrating Climate Risks into Financial Systems: Challenges and Opportunities

This third session underscored the critical need to address climate change within the financial sector, highlighting its profound implications for monetary policy, financial regulation, and overall economic stability. As climate change accelerates,

its effects are increasingly recognised as significant risks to the financial system, making a comprehensive integration of climate-related challenges into financial frameworks a necessity.

Central banks and financial regulators are increasingly grappling with the task of managing climate-related financial risks, which are broadly categorised into physical and transition risks. Physical risks refer to the direct impacts of climate events such as floods, droughts, and other extreme weather phenomena that can severely disrupt economies and damage assets. For instance, the session highlighted the potential for a flood in Bangladesh to significantly impact the financial sector, a risk that has already been examined through recent stress tests evoked by a participant. On the other hand, transition risks arise from the shift toward a low-carbon economy, which can lead to abrupt changes in asset valuations, market dynamics, and regulatory frameworks. The session delved into the complexities of managing these risks, particularly how sudden policy shifts, such as the implementation of carbon pricing, could destabilise sectors heavily reliant on fossil fuels.



In response to these challenges, central banks are adopting climate stress tests to assess the resilience of financial institutions under various climate scenarios.

These tests are designed to evaluate both physical and transition risks over extended time horizons, sometimes stretching to the end of the century. However, significant challenges remain, particularly the scarcity of detailed data and the need for advanced modelling techniques. Accurate stress testing requires granular data on the location and vulnerability of physical assets, as well as projections of future climate hazards. This data is often difficult to obtain, especially in low-income countries, which complicates the efforts of central banks to conduct thorough assessments. The session also noted that existing economic models, such as computable general equilibrium models, need to be adapted and combined with climate-specific models to simulate the economic impacts of transition risks accurately.

The discussion also turned to the critical issue of climate finance, emphasising the vast gap between current funding levels and what is needed to meet international climate goals, such as those outlined in the Paris Agreement. To achieve net-zero emissions by mid-century, substantial investments in green technologies and renewable energy are necessary, with estimates cited by a speaker suggesting that investment in these areas must dramatically increase by 2030. However, ongoing disputes over the definition of climate finance, with different countries and regions interpreting it in various ways, were stressed. For example, while organisations like the OECD have established definitions, developing countries often view climate finance through a different lens, particularly when considering historical emissions and responsibilities.

International cooperation was emphasised as vital in overcoming the financial risks posed by climate change. Coordinated efforts are essential to develop consistent standards for climate finance, share critical data, and align regulatory approaches across borders. The speakers highlighted the need to pay particular attention to developing countries, which are often the most vulnerable to climate impacts and face significant challenges in building the capacity to manage these risks. International support is crucial in providing these countries with the resources and expertise they need to protect their economies from the devastating effects of climate change.

In addition to climate change, the session addressed the often-overlooked issue of biodiversity loss and its economic consequences. Biodiversity underpins many economic activities, and its collapse could have severe financial implications. A participant called for a broader approach to financial risk assessments, incorporating biodiversity alongside climate considerations, acknowledging that the loss of biodiversity could destabilise economies in ways that are currently underappreciated.

Throughout the session, the role of central banks in integrating climate risks into financial systems was a recurring theme. Central banks are not only conducting climate stress tests but are also beginning to incorporate climate-related risks into their broader financial stability frameworks. The session discussed how central banks can play a pivotal role in supporting the mobilisation of climate finance, particularly by ensuring that financial resources are effectively directed towards sustainable investments and adaptation efforts.

The session concluded by recognising the progress made in integrating climate risks into financial systems but emphasised that much work remains to be done.



There is an urgent need for enhanced data collection, improved modelling methodologies, and greater international cooperation. Speakers called for sustained, collaborative efforts among central banks, financial regulators, governments, and international organisations to build a resilient financial system capable of supporting the global transition to a sustainable, low-carbon economy. This will require not only technical advancements but also a commitment to addressing the broader socio-economic challenges posed by climate change and biodiversity loss.

CONCLUSION

The VIII Conference of Mediterranean Central Banks, titled “Stay the Course in Turbulent Times: Old and New Challenges for Central Banks,” organised in Split, Croatia, provided a crucial platform for governors and representatives of central banks across the Mediterranean region to engage in meaningful dialogue on the pressing economic and financial challenges of our time.

Throughout the conference, participants emphasised the critical importance of central bank credibility in navigating the current landscape of elevated inflation and geopolitical tensions. The discussions underscored the effectiveness of recent monetary policies in managing inflationary pressures, while also highlighting the need for clear communication strategies and coordinated fiscal policies to sustain market confidence and economic stability. The dialogue further expanded to the interconnectedness of economies within the Mediterranean region, particularly the impact of global policy tightening on emerging markets, where coordinated responses are essential to mitigate potential risks.

The conference also delved into the economic participation of women in the Mediterranean, a theme of crucial importance for fostering inclusive growth. Participants recognised the significant barriers that women face in accessing financial services, particularly in the MENA region, and called for enhanced efforts in financial inclusion and literacy. The role of central banks in promoting these initiatives was highlighted, with examples of successful policies from

various countries underscoring the potential for transformative change when financial systems actively support gender equality.

A pivotal session focused on the integration of climate risks into financial systems, marking a critical discussion on the future of central banking in the face of climate change. The participants stressed the necessity of incorporating climate-related risks into financial stability frameworks and the urgent need for international cooperation to mobilise the substantial funding required for mitigation and adaptation efforts. The challenges of data scarcity and the need for advanced modelling techniques were acknowledged, as was the importance of addressing the broader socio-economic impacts of climate change, including biodiversity loss.

In conclusion, the event highlighted the need for continued cooperation and dialogue among Mediterranean central banks, particularly in addressing shared challenges such as inflation, financial inclusion, and climate change. Governors and representatives alike recognised that the path forward would require not only technical innovation and robust policy frameworks but also a collective commitment to regional and global collaboration. The conference concluded with a call to strengthen these ties, emphasising the importance of sustained engagement to navigate the turbulent times ahead and to build a resilient, inclusive, and sustainable future for the Mediterranean region. To that end, the governors agreed to meet again next year at a ninth conference of Mediterranean central banks.

