



**AFRICAN EXPORT-IMPORT BANK
BANQUE AFRICAINE D'IMPORT-EXPORT
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**STATEMENT OF JEAN-LOUIS EKRA
PRESIDENT, AFREXIMBANK, SPECIAL GUEST SPEAKER
AT THE 2009 AFRICA INVESTMENT FORUM
HOLDING IN ISTANBUL - TURKEY**

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**Statement of Jean-Louis EKRA,
President, Afreximbank, Special Guest Speaker**

**At the 2009 Africa Investment Forum
Holding in Istanbul- Turkey, October 4, 2009**

Distinguished Chairpersons

Honorable Ministers

Governors of Central banks

Fellow Bankers

Ladies and Gentlemen of the Press

Distinguished Ladies and Gentlemen

I take this opportunity to convey my utmost gratitude to the organizers of this Forum, the *AnnualMeetingsDaily* and its Chairman Chief Ikechi Emenike in particular, for inviting me to the 2009 Africa Investment Forum to share with participants my thoughts on this important contemporary subject: *“Employing African Resources for Africa’s Development”*. When I received the invitation to speak at this Forum, I readily accepted for two reasons: first, the issue I was asked to speak about is at the heart of Afreximbank’s Third Strategic Plan, which, among others, encourages the pursuit of Pan African Initiatives/Partnerships that make sense as a self reliance strategy for our continent; and second, I thought the Forum provides a very

useful platform for the Bank to share with policy-makers and other development partners our view on how to harness Africa's abundant resources to support Africa's development with reference to the use of part of Africa's large and growing foreign exchange reserves to address essential trade and project finance needs of the continent in these challenging times.

The discussions we are having today is very timely given the emerging tendency of financial isolationism; a tendency fostered by current global economic crisis that has made regulators in the major money centers to pressure their banks to look inwards. These events have made it critical to develop mechanisms that will enable Africa cope with the funding constraints that are beginning to emerge.

There are many observers out there who wonder whether Africa has the resources needed to move forward in terms of socio-economic development; who doubt whether African economies, as a group, could grow and develop without continued massive external financial assistance and grants in particular; and who question the efficacy of an African collective self reliance given the history of wars and civil strifes in the continent.

To those "*doubting Thomases*" I dare say that Africa is endowed with sufficient human and material resources, which if appropriately harnessed, could sustain its socio-economic development

Africa is generally considered as a “capital deficient” continent; a continent with limited capacity to transform its economies and societies without massive external financial support. While this characterization may be true when viewed from long term investment needs of the continent it is however, interesting to note that as at end of December 2008 and end of June 2009, the continent held with largely non-African banks foreign exchange reserves of about US\$ 462 billion and US\$ 427 billion respectively. This amount of external reserves compares favorably with the estimated annual external financing of US\$ 64 billion (or US\$ 640 billion over a 10 year period) required to support critical projects and programmes of the NEPAD (New Partnership for Africa’s Development) Initiative.

The current global financial crisis and the virtual dry- up of credit in international financial markets have made it imperative for countries and/or regions to begin to rely on internally generated resources and/or home grown solutions to survive. That compelling realization dictates that Africa also begins to harness all of its resources, including its huge external reserves to meet essential trade and project finance needs that are now difficult to be funded from external sources. Why should Africa, which is generally classified as a capital-importing continent, hold so much reserves outside the continent and yet require external financial assistance to close its financing gaps at this critical moment? An objective evaluation of this

paradox requires a critical review of the theory and statistics relating to the subject of foreign reserves.

Distinguished Ladies and Gentlemen, let me start by putting into appropriate context the *“rationale for holding foreign exchange reserves”*. Economic literature suggests that external reserves are needed to:

- a) Smoothen inter-temporal domestic consumption by inter-temporal stabilization of imports;
- b) assist relevant government in meeting its foreign exchange needs and external debt obligations; and
- c) deal with national disasters or emergencies that may require significant imports that deviate from trend.

It is worth noting, however, that reserves are an expensive insurance mechanism, with costs coming from many different - and often difficult to quantify - sources. Economic theory therefore emphasizes the need for rational cost/benefit analysis in reserve management and the need to match marginal returns with marginal costs for holding any additional unit of foreign exchange reserves.

The pertinent question that derives from this proposition therefore is: how much should a country or continent hold to meet these external payment needs? Economic literature identifies two relevant benchmarks for measuring reserve adequacy. These measures are:

(i) Reserves to Imports Ratio.

(ii) Reserves to short-term external debt Ratio.

Reserve to Imports ratio measure suggests that foreign exchange reserves worth three to four months of imports could be considered as adequate for a country. *Reserves to Short-term external debt*, which is generally referred to as the Greenspan-Guidotti Rule (named after Allan Greenspan and Pablo Guidotti, a former Argentine finance official), requires developing countries to hold foreign exchange reserves equivalent to all external debt obligations falling due within one year.

Our next question is: how does Africa's current level of external reserves measure up to these Reserve Adequacy Benchmarks?

Research results available to Afreximbank show that:

- The number of African countries with Months of Import Cover (MIC) of less than 4 (which is considered less adequate) fell from 25 in 2000 to 18 in 2008;
- The number of countries with Months of Import Cover equal to 4 but less than 8 (sufficiently adequate) rose to 18 in 2008, from 13 in 2000;
- Those with Months of Import Cover of 8 or over twice the minimum requirement rose from 11 in 2000 to 13 in 2008; and
- Despite the current global economic and financial crises, the Months of Import Cover for African economies, as a group,

averaged 9.25 months at the end of December 2008 ---- *far higher than the 3-4 Months Adequacy Benchmark..*

Drummond and Dhasmana in their research work published by IMF in 2008 and titled “Foreign reserve adequacy in Sub-Saharan Africa” concluded that Africa was holding external reserves far in excess of what is required to protect itself in Terms of Trade(TOT) shocks. ¹

With regards to Reserves to Short-Term Debt Measure which is the most widely preferred benchmark for measuring vulnerability to capital account crises, studies also show that Africa’s external reserves covered its short-term obligations between 6.1 – 24.7 times during 2000-8 as against the necessary benchmark of unity.

From the foregoing, it is obvious that Africa as a group, is presently holding “excess” reserves.

Considering that foreign exchange reserve is a leakage out of the circular flow of income, and that the current international deposit rates are near zero whereas borrowing margins have in many cases increased by ten-fold, it follows that there is a strong justification for Africa to work out a safe and efficient way of recycling its reserves within Africa. The concept of recycling is an interesting one given the concentration of Africa’s external reserves in a few countries. In this regard, more than 70% of reserves are held by 5 countries. An arrangement that will enable the large reserve holders to lend some

¹ For more on this work, see Drummond, P. and Dhasmana, A. (2008) “ Foreign Reserve Adequacy in Sub-Saharan Africa,” *IMF Working Paper* WP/08/150 IMF: Washington D.C.

of them to the reserve deficit countries in a remunerative and low risk manner will not only improve Africa's access to hard currency financing but will also help restrain hard currency outflows from Africa. It is against this backdrop, distinguished Ladies and Gentlemen, that Afreximbank is presently actively working with its African partner institutions on an initiative that will make part of the continent's huge external reserves available for the financing of viable trade and project ventures in Africa as a contribution to on-going efforts at promoting sustainable economic growth and development in the continent.

We believe that such an arrangement will contribute to Africa's response to episodic shocks of the type the world is currently experiencing. We also believe that it offer surplus reserve-holding African countries an opportunity to diversify their risk and improve the returns on their reserve holdings; facilitate economic and monetary integration; and help intra-trade in reserves as surplus reserve holders can use it to pay their exporters exporting to reserve deficit countries and book an amortizing loan against the deficit countries to be repaid over time.

Our expectation is that our discussions of today will contribute to a re-think of existing arrangements regarding the management of Africa's foreign exchange reserves, a process we start promoting very actively in July this year at the 15th meeting of Afreximbank Advisory

group on Trade Finance and Export development in Africa. We believe that it is sub-optimal for Africa to have such huge amount of financial resources tied up in accounts with several non-African banks that earn close to nothing while African countries go cap-in-hand in search of external financial resources to fund much needed capital investments to support production. We fully subscribe to the view that African resources must be used to support Africa's efforts at maintaining sustainable growth and development of its economies in that, as the adage goes, "charity begins at home". We believe that the key challenge is how to deal with the risks surplus reserve holders may perceive from this arrangement. We in Afreximbank see this challenge as an opportunity and believe that working with others, especially the African Development Bank, a risk efficient product that will be attractive to Africa governments and central banks can be developed and implemented. The time for action is now. Our continent cannot afford to miss the opportunity the current environment provides for action.

Thank you all for listening.

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Istanbul, Turkey

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