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Procedia Economics and Finance 38 (2016) 378 – 395

Procedia Economics and Finance

www.elsevier.com/locate/procedia

Istanbul Conference of Economics and Finance, ICEF 2015, 22-23 October 2015, Istanbul, Turkey

# Monetary and Exchange Rate Policy for Financial Stability and Growth in MENA Countries

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**Abstract**

Using the exchange rate as a nominal anchor is very successful for taking control of inflationary expectations. The countries in the MENA region switching to a more flexible exchange rate regime will mitigate the effects of external shock. Establishing Monetary Union emerges as an alternative of flexible exchange rate and inflation targeting preference for the MENA countries. As take in to account the whole findings, we cannot mention the existence of a co-ordination between all of MENA countries in terms of inflation, growth, monetary expansion and budget performance. Therefore we can say that monetary union is an inappropriate choice of exchange for countries of the region and MENA region has not complied with OCA criteria yet.


Peer-review under responsibility of the Organizing Committee of ICEF 2015.

*Keywords:* *MENA, Exchange Rate System, Inflation Targeting, OCA Area, OCA Index.*

*JEL Codes:E42 E44 E52 E61 F41 F45*

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Peer-review under responsibility of the Organizing Committee of ICEF 2015.
doi:10.1016/S2212-5671(16)30210-6

## 1. Introduction

The purpose of this study is to examine the exchange regimes and monetary policy regimes, with particular attention to five emerging market economies in the MENA region – Egypt, Jordan Lebanon, Morocco and Tunisia and oil- producing country – Iran to focus whether they need to consider choosing more flexible exchange rate under inflation targeting. Both emerging markets and advanced economies increasingly opened their borders to financial flows. Broadly accepted consensus that emerging market economies that integrated with global financial cycle should adopt inflation targeting and move more flexible regimes. This discussion is based on trilemma which if there are free capital flows, only floating exchange rate regimes allows independent monetary policy. Other considerations is based on the theory of optimal currency areas, including terms of trade, size of the economy, trade and financial openness, level of dollarization, are also important for the choice of exchange rate regimes.

Countries choosing for greater flexible regimes needs to choose nominal anchor for their monetary policy frameworks to stabilize inflation expectation. Many emerging market economies are opting to choose inflation targeting under flexible exchange rate arrangements. The characteristics of many small open emerging market economies distinguished monetary policy implementing from advanced economies. Small open economies face several challenges to do implementing monetary policy. These challenges are: i) weak monetary policy credibility in with respect to both pro-cyclicality of monetary policy and sovereign risk ii) fiscal dominance issue, iii) to deal with financial dominance and iv) greater exposure to sudden stop of capital flows.

We attempts to these countries have in meeting the preconditions for a successful float and inflation targeting. We then focus on inflation targeting and more flexible exchange rate have been key factors behind to move to counter-cyclical policies that helps to countries deal with economic upswings; insulating external shocks so do contribute to financial stability and economic growth

This is what we plan to do this paper exploring the structural differences of MENA countries. So they allowed us to evaluates why these countries have been subject to monetary and fiscal policy that is procyclical rather than countercyclical. The rest of the paper is as follows. Section II reviews the literature on choosing exchange rate regimes in emerging markets and also touches MENA countries take into account the global financial cycle. Section III We draws a attention exchange rate and monetary policy challenges for emerging market economies especially considering MENA countries. Next section discussing is Monetary Union an option for MENA. Section V we discussed monetary policy response in the region after the global financial crisis. Section VI concludes

## 2. Exchange Rate Arrangements and Monetary Policy Frameworks: A MENA Focus

Mexico (1994); Indonesia (1997); Korea (1997); Malaysia (1997); Thailand (1997), Russia (1998); Brazil (1999); Ecuador (2000); Argentina (2000) and Turkey (2001) It is seen that since the early 1990s the exchange rate and monetary policy regimes preferences of currency and banking crises experiencing emerging market economies are located on the main axis of the economic debates.* The lesson learned from these crises is, in emerging market economies that are open to international capital flow, fixed exchange rate regimes are vulnerable to crises and this regime is not sustainable. After bad experiences, inflation targeting with flexible exchange rate regime strategy, as in the example of Turkey, is being implemented in order to achieve price stability in the emerging market economies. In light of the international experience, today this policy in both developed and developing countries is relatively credible.

* According to World Economic Outlook report published in April '2014 by International Monetary Fund (IMF), the number of emerging and developing market economies in the world is 153. The Middle East and North African countries which are the subject of our study are divided into two groups: oil-exporting and oil-importing countries. According to IMF data sets Algeria, Bahrain, Iran, Iraq, Kuwait, Libya, Oman, Qatar, Saudi Arabia, United Arab Emirates and Yemen are the petroleum exporting countries. Petroleum exporting countries are: Afghanistan, Djibouti, Egypt, Jordan, Lebanon, Mauritania, Morocco, Pakistan, Somalia, Sudan, Syria and Tunisia. Some heavily indebted countries (Afghanistan, Mauritania and Sudan) and low-income developing countries (Djibouti and Yemen) according to IMF (2014a: 163) are not included in our research.