PMRC
Policy Monitoring and Research Centre

PMRC ANALYSIS OF THE MONETARY COMMITTEE STATEMENT - 3RD QUARTER OF 2019

November 2019

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DEFINITION OF TERMS

EXCHANGE RATE: An exchange rate is the value of one nation's currency versus the currency of another nation or economic zone.

GROSS DOMESTIC PRODUCT - GDP: Gross Domestic Product (GDP) is the total monetary or market value of all the finished goods and services produced within a country's borders in a specific time period.

INFLATION: Is a quantitative measure of the rate at which the average price level of a basket of selected goods and services in an economy increases over a period of time.

OVERNIGHT INTERBANK RATE: The overnight rate is the interest rate at which a depository institution (generally banks) lends or borrows funds with another depository institution in the overnight market. In many countries, the overnight rate is the interest rate the central bank sets to target monetary policy.

OVERNIGHT LENDING FACILITY (OLF): A lending facility is a mechanism that central banks use when lending funds to primary dealers such as banks, broker-dealers, or other financial institutions

POLICY RATE: The central bank policy rate (CBPR) is the rate that is used by central bank to implement or signal its monetary policy stance. It is most commonly set by the central bank policy making committees (e.g. Open Market Committee).

REAL GDP: Real gross domestic product (GDP) is an inflation-adjusted measure that reflects the value of all goods and services produced by an economy in a given year, expressed in base-year prices,

MAJOR HIGHLIGHTS

- At its Meeting held on November 18 – 19, 2019, the Monetary Policy Committee (MPC) decided to raise the Policy Rate by 125 basis points to 11.50% from 10.25 %.
- In arriving at the decision, the Committee took into account:
  a. The rise in inflation
  b. The need to restore macroeconomic stability

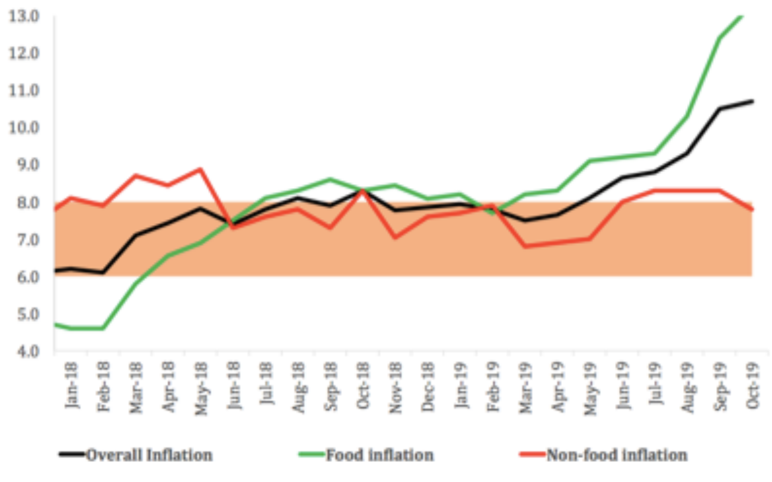
Figure 1. Inflation outcomes (%)

	Q3 2019 Outcome (Quarterly Averages)	Q2 2019 Outcome (Quarterly Averages)	Q3 2019 End-period	Q2 2019 End-period
Overall Inflation	9.5	8.1	10.5	8.6
Food Inflation	10.7	8.9	12.4	9.2
Non-food Inflation	8.3	7.3	8.3	8.0

Source: BOZ, November 2019

In September 2019, Fitch Solutions Group Ltd, a UK affiliate of Fitch Ratings had projected that the Bank of Zambia (BoZ) would implement further monetary tightening over the coming quarters in an effort to contain inflationary and exchange rate pressures. Two months later, this is happening. On November 18 – 19, 2019, the Monetary Policy Committee decided to raise the Policy Rate by 125 basis points to 11.50%.

Figure 2: Inflation Developments, year on year (y-o-y) (%)



Source: BOZ (2019) Governors MPC, Presentation

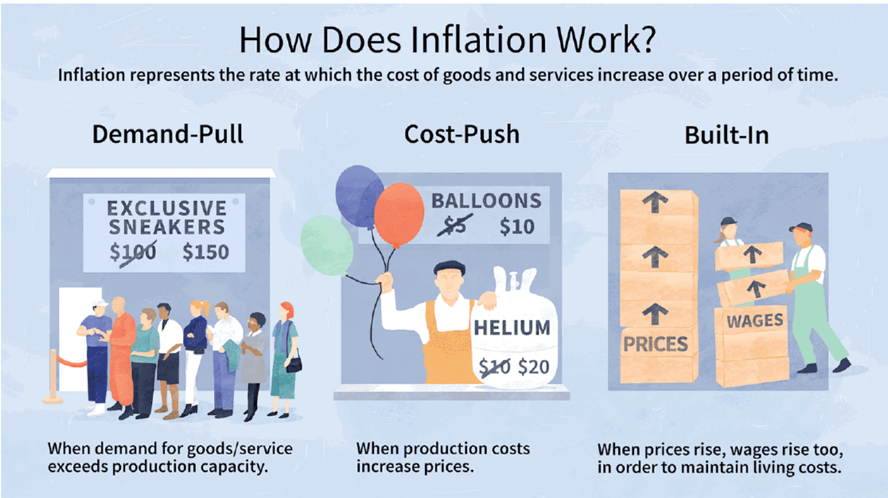
On account of heightened upside risks, inflation is projected to remain above the upper bound of the 6-8% target range over the entire forecast horizon (Q4 2019 – Q3 2021).

It was further **stated that the challenges and risks that have contributed towards the current economic challenges include;**

1. **Persistent high food prices;**
2. **Electricity shortages leading to extended load shedding;**
3. **Slower than anticipated progress on fiscal consolidation;**
4. **High external debt service payments**.

WHAT IS INFLATION?

> *Inflation is a quantitative measure of the rate at which the average price level of a basket of selected goods and services in an economy increases over a period of time. It is the constant rise in the general level of prices where a unit of currency buys less than it did in prior periods. Often expressed as a percentage, inflation indicates a decrease in the purchasing power of a nation's currency."*



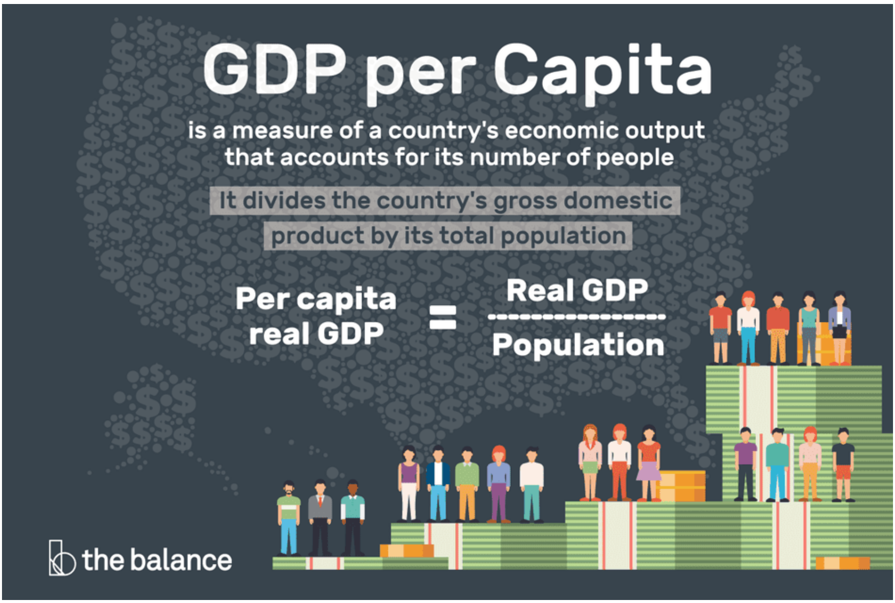
Source: Melissa Ling {Copyright} Investopedia, 2019

The reality remains that we need to increase our FOREX Profile by promoting non-traditional exports, remittances and Foreign Direct Investment into the country as a

way of building FOREX reserves. Foreign exchange reserves play an important role in stabilizing the economy of any country.

WHAT ABOUT GDP?

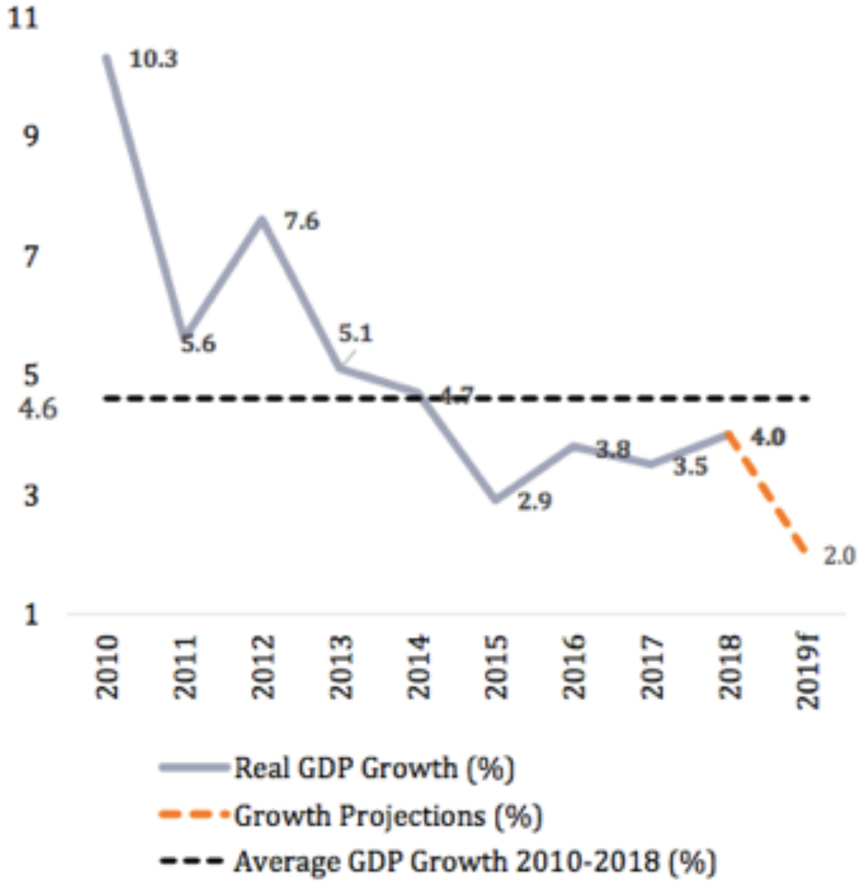
In 2019, GDP was projected to significantly **decline to about 2.0% from 4.0% in 2018 premised on projected contraction in agriculture, constrained electricity generation, and lower than anticipated mining output**. It must be mentioned that most of the pressures facing the economy are either due to exogenous shocks or. Clearly, the challenges have been attributed to and we have to focus on rectifying the prevailing situations in these sectors listed. **Electricity deficit has negatively affected productivity and this has been revealed by reduced output among others**. The challenge therefore remains with cushioning the effects of the electricity deficit and also ensuring that we expedite on upcoming projects but also implement measures to provide electricity. The discussions around this has suggested several avenues that have to be exploited such as, **solar farms, mini hydros, geothermal among others. The IDC must come on board to actualize investments into these sources especially under the confines of Public Private Partenerships (PPPs)**. Overall, this calls for concerted efforts by all economic agents to get back on an upward and strong growth path.



Source: © The Balance, 2018

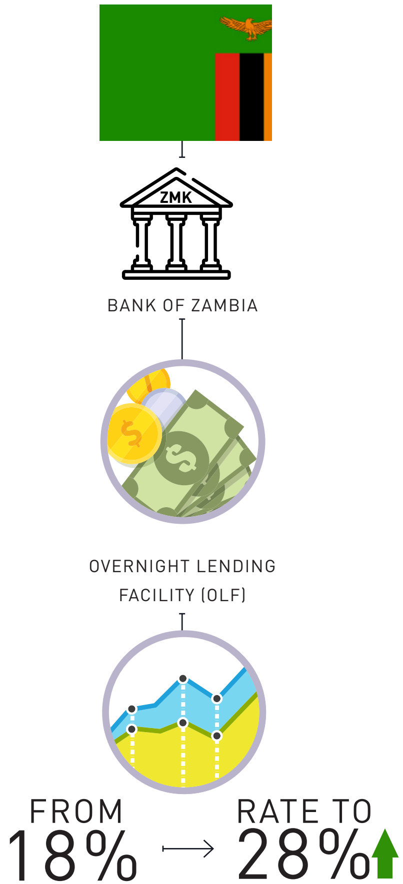
The past 5 years have registered an average GDP of 4.7 % currently, we may close the year at 2.0% and that is low. **Clearly this needs interventions and new strategies from both monetary, fiscal and policy angles to redirect towards a path of economic recovery, as stipulated in the Zambia Plus Economic Recovery Plan**. It is a further culmination of the performance of economic sectors; which have also been affected by the power crisis.

Figure 3: Annual GDP Growth (Percent)



WHAT ELSE WAS HIGHLIGHTED IN THE MPC STATEMENT?

On 14 November 2019 the Bank of Zambia raised the Overnight Lending Facility (OLF) rate to 28% from 18%. BOZ stated that; the increase in the OLF rate was aimed at instilling stability in the market and reining in inflationary pressures. With the 125 basis points increase in the Policy Rate to 11.50%, the OLF rate will be 16.5 percentage points above the Policy Rate and remains at 28%.

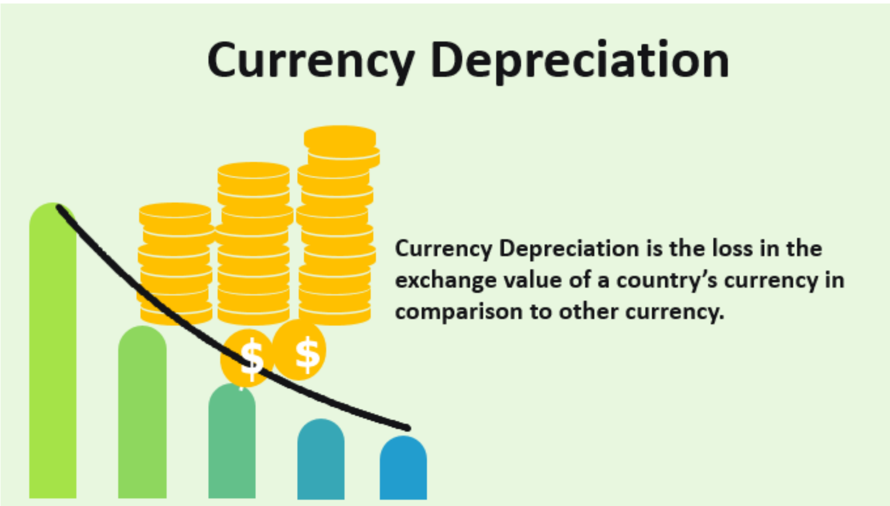


Money supply (M3) growth slowed down further to 6.0%, y-o-y, in September 2019 from 15.4% in June 2019. The slowdown was due to the decline in the growth of credit in both private sector and Government

THE KWACHA?

The Kwacha has come under pressure and has depreciated against the US dollar. As of November 19, 2019, **the Kwacha was trading at about K14.00 due to increased demand for petroleum and fertilizer imports as well as adverse market expectations associated with electricity imports to help mitigate the shortfall in domestic supply**.

THE KWACHA



Source: https://www.wallstreetmojo.com/currency-depreciation/

WHAT CAUSES CURRENCIES TO DEPRECIATE?

a. Easy monetary policy and high inflation are two of the leading causes of currency depreciation.

b. Additionally, inflation can lead to higher input costs for export which makes a nation's exports less competitive in global markets, which widens the trade deficit and causes the currency to depreciate.

We observe that the electricity deficit has also contributed towards increased demand for petroleum imports. Further, we are currently in the farming season and with the onset of the rains, there has also been huge demand for farming inputs such as fertilizers. Additionally, we have also paid out about US$ 27million for electricity imports. Clearly, all these three mean that we have in essence taken FOREX out of the economy in exchange for these essentials that have a bearing on the social economic welfare of the citizens. **This means that the Kwacha has as a result depreciated against major currencies**. The challenge therefore, now is to balance between societal necessities and the effect of depreciation and inflation. This calls for new strategies to maximize foreign investments and attract investors into the country.

Despite high external debt service payments, gross international reserves (GIR) rose to **US$1.5 billion at end-September 2019 (equivalent to 1.8 months of import cover), from US $1.4 billion (equivalent to 1.7 months of import cover) in June 2019**

CONCLUSION

As PMRC, we have maintained that monetary policy interventions alone may not be sufficient to address prevailing economic challenges and to restore macroeconomic stability. It must be complemented by corrective fiscal and structural policy measures. Every sector needs to play their part. We need to ensure compliance with austerity measures and ensure that they are adhered to. We also need to halt some of the current infrastructure projects all being simultaneously done and relieve the treasury. Priorities need to be emphasized and committed to and this calls for an integrated plan to actualize this. To complement the steps taken by from the monetary side, the fiscal side should also act by ensuring **prioritized and tight expenditure controls, enhance domestic revenue mobilization and overall ensure strict adherence to austerity measures as outlined by the Government**.

We observe that the Bank of Zambia had anticipated the prevailing challenges and has indeed offered the same remedies but in view of the challenges we are currently facing as an economy, which BOZ itself has highlighted, there may be need to change strategy. This is because the Kwacha is not favorable against other major currencies, international reserves are low, GDP growth has been projected to be at only 2.0% and also the reality of loadshedding and its negative impact on economic productivity means that BOZ needs a change of strategy. **As a country, we need to make a resolve and determine to get the International Monetary Fund (IMF) bailout package among other interventions** to the economic challenges currently being faced. From the fiscal side, Ministry of Finance (MOF) needs to provide regular updates to the citizenry that will help to dispel misconceptions and also dispel negative speculations. This is a concerted approach and all state and non-state actors need to work together on this front. The IMF package should be a matter of priority in view of the challenges being faced. **An IMF agreement would offer a stronger signal of Zambia's commitment to fiscal adjustment and would also mitigate external debt servicing risks as Zambia approaches repayments of a USD750 million Eurobond in 2022 and another USD1.25 billion bond due in 2024.Aside the package that must be pursued, we should also seek further technical assistance (from IMF) to widen our options base.**

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Unlocking Zambia's Potential
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