NAVIGATING EXCHANGE RATE DYNAMICS: STRATEGIES FOR KWACHA STABILITY AND ECONOMIC RESILIENCE IN ZAMBIA

PRESS STATEMENT

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The appreciation and depreciation of a currency, such as the Kwacha, against major foreign currencies, particularly the US dollar, are pivotal aspects of a country's economic dynamics. Understanding the factors influencing these fluctuations and their economic implications is essential for policymakers, investors, and the general public. In the Zambian context, the exchange rate, represented as the quantity of Kwacha required to purchase foreign currency such as one US dollar for instance, plays a crucial role in shaping economic activities and overall prosperity.

The recent depreciation of the Kwacha, evidenced by its decline to approximately K27 (as of early February 2024) representing a 58% decrease in value to the US dollar beginning July 2023, was primarily attributed to imbalances in the demand and supply of foreign exchange. High demand for the dollar, driven by the need for imports, external debt servicing, and other obligations, outpaced the available supply, exerting downward pressure on the Kwacha. Additionally, delays in concluding debt restructuring with private creditors contributed to a reversal of portfolio capital flows, further exacerbating the currency's depreciation.

A significant contributing factor to the depreciation was the decline in copper production, Zambia's primary export revenue source, coupled with a reduction in copper prices on the global market. Operational challenges and adverse weather conditions led to a decline in copper production, resulting in reduced export revenues from the mining sector. Consequently, reduced export earnings strained foreign exchange reserves and contributed to the Kwacha's depreciation.

To address the challenges posed by the depreciating Kwacha and stabilize the exchange rate, the Bank of Zambia (BoZ) implemented various monetary policy interventions. These interventions are aimed at minimizing the negative impacts of a weak Kwacha on the economy, particularly on critical sectors reliant on imports for production inputs. Measures such as market support injections totalling USD215.5 million and an increase in the statutory reserve ratio from 17% to 26% were implemented to bolster the Kwacha and enhance its stability.

Additionally, at its meeting held on February 12-13, 2024, the Monetary Policy Committee (MPC) decided to increase the Policy Rate by 150 basis points to 12.5 percent, an increase of 3.25% from February 2023. The decision was informed by a further increase in inflation in the fourth quarter of 2023, and the current forecast showing inflation moving even further away from the 6- 8 percent target band. However, continuous heightening of the Monetary Policy Rate (MPR) as a means to cushion the local currency against forex fluctuations could have adverse effects on production in the economy. A higher MPR increases the cost of borrowing for businesses, which can lead to reduced investment and decreased consumer spending, ultimately impacting production levels. Moreover, elevated interest rates may discourage borrowing for productive activities such as capital investment and expansion, constraining business growth and innovation. Therefore, while monetary policy actions may be necessary to stabilize the currency, Government must carefully balance the objectives of exchange rate stability with the imperative of supporting economic production and growth.

In the short term, these monetary policy measures provide vital support to the Kwacha, preventing further depreciation and mitigating predatory adverse effects on the economy. However, sustained appreciation and stability of the Kwacha requires broader structural and policy reforms in the medium to long term. Increasing and diversifying exports, particularly in sectors beyond copper mining, are essential for reducing reliance on a single commodity and enhancing foreign exchange earnings.

Moreover, addressing operational challenges in the mining sector, attracting foreign direct investment (FDI), and promoting economic diversification initiatives are crucial for sustainable economic growth and exchange rate stability. Medium to long-term measures such as infrastructure development, investment in human capital, and regulatory reforms to improve the business environment are vital for fostering economic resilience and reducing dependency on external factors influencing the exchange rate.

Furthermore, mitigating climate-related risks, such as prolonged dry spells affecting agricultural productivity and hydroelectric power generation, is imperative for ensuring food security and energy sustainability. Investing in climate-resilient infrastructure and adopting sustainable agricultural practices can help mitigate these risks and reduce vulnerabilities to external shocks, ultimately supporting exchange rate stability and overall economic development.

Sustaining the appreciation of the Kwacha and achieving exchange rate stability requires a multifaceted approach encompassing short-term monetary interventions, medium-term structural reforms, and long-term economic diversification strategies. By addressing underlying structural weaknesses, enhancing export competitiveness, and promoting sustainable development initiatives, Zambia can foster economic resilience and position itself for sustained growth and prosperity.

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