MONETARY POLICY COMMITTEE STATEMENT FOR THE FIRST QUARTER OF 2020

Governor's Presentation to the Media

May 20, 2020

Bank *of* Zambia

OUTLINE OF PRESENTATION

1. Decision of the Monetary Policy Committee
2. Global Economic Growth
3. Domestic Economic Activity and Outlook
4. Inflation Outturn and Outlook
5. Monetary Operations
6. Government Securities Market
7. Interest Rates
8. Domestic Credit
9. Money Supply
10. Fiscal Policy
11. Foreign Exchange Market
12. Selected Commodity Prices
13. Current Account
14. Gross International Reserves
15. Conclusion

DECISION OF THE MONETARY POLICY COMMITTEE

At its Meeting held on May 18–19, 2020, the Monetary Policy Committee decided to reduce the Policy Rate by 225 basis points to 9.25%.

Key factors the Committee took into account in arriving at its decision were as follows:

- **the need to mitigate the adverse effects of the COVID-19 pandemic on financial sector stability, economic activity and ultimately on people's lives and livelihoods;**

- **a significant deterioration in economic activity, with the economy projected to record the first contraction in 2020 since 1999 on account of the COVID-19 pandemic;**

- **moderation in inflation on account of expected improvement in maize output and subdued domestic consumer demand. This is despite the projected inflation path being higher than the upper bound of the 6-8% target range; and**

- **the need to compliment the measures already taken by the Bank aimed at supporting economic activity.**

GLOBAL ECONOMIC GROWTH

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The outbreak of COVID-19 pandemic is having an unprecedented impact on human life and livelihoods as well as economic activity across the world.

In an effort to curb the spread of the virus, governments have responded by implementing several measures, including widespread lockdowns. These have resulted in the disruption of global supply chains and induced economic contraction.

Due to COVID-19, the global economy is projected to contract sharply to -3.0% in 2020, but recover to 5.8% in 2021.

Downside risks to global growth outlook include:

- **possibility of an extended period of the COVID-19 pandemic;**
- **prolonged supply chain disruptions;**
- **a resurgence in the US-China trade war; and**
- **uncertainty about the future of the UK-EU trade relationship.**

Source: IMF World Economic Outlook for January and April 2020 Update, Focus Economics

GLOBAL ECONOMIC GROWTH

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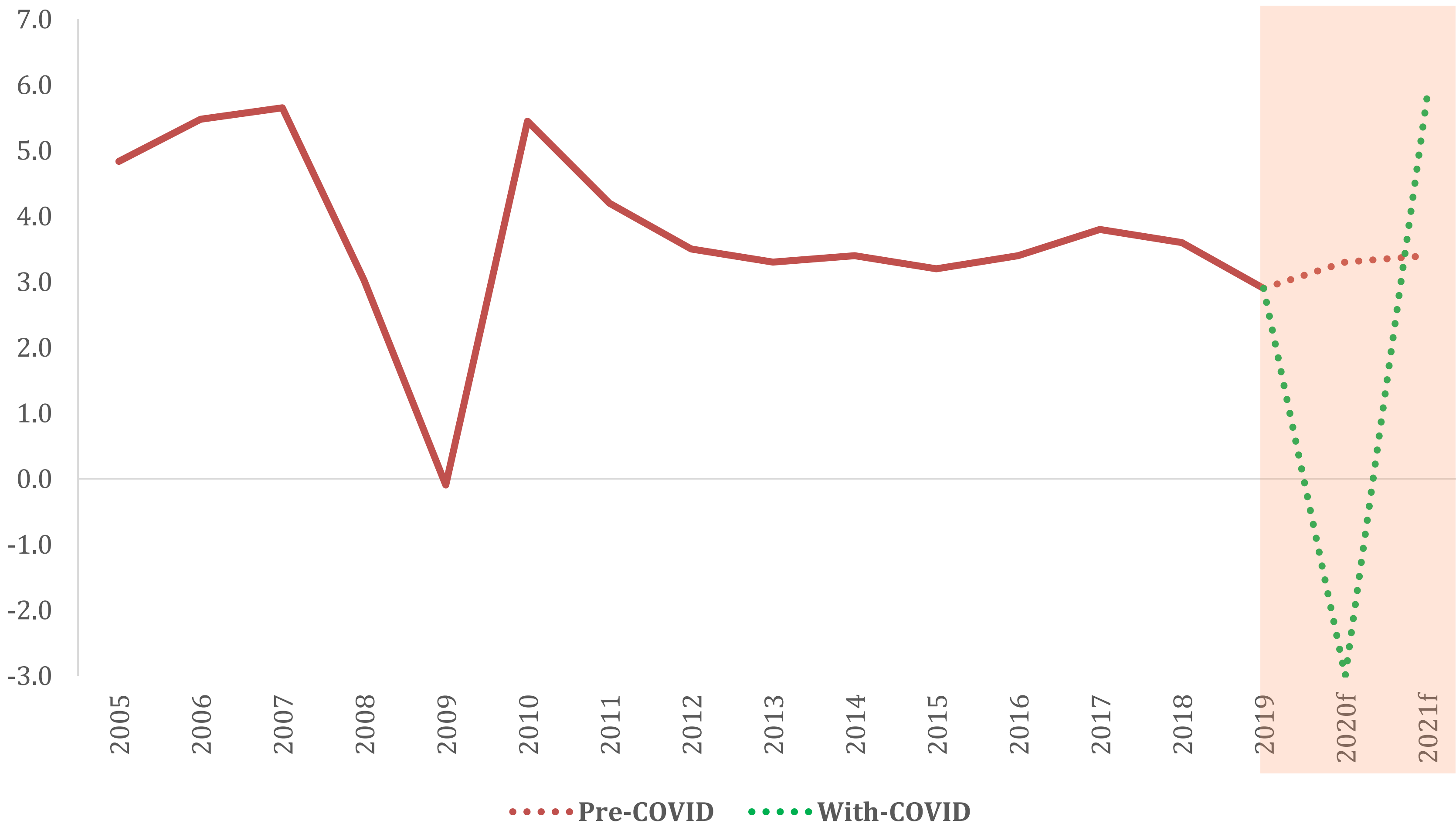
Figure 1: Pre and With-COVID-19 Global GDP Growth Projections (annual, percent)



Source: IMF World Economic Outlook for January and April 2020 Update, Focus Economics

DOMESTIC ECONOMIC ACTIVITY AND OUTLOOK

- **Economic conditions worsened in the first quarter of 2020, with the volume of services, new orders and profitability all registering historic lows (First Quarter 2020 Bank of Zambia Quarterly Survey of Business Opinion and Expectations);**

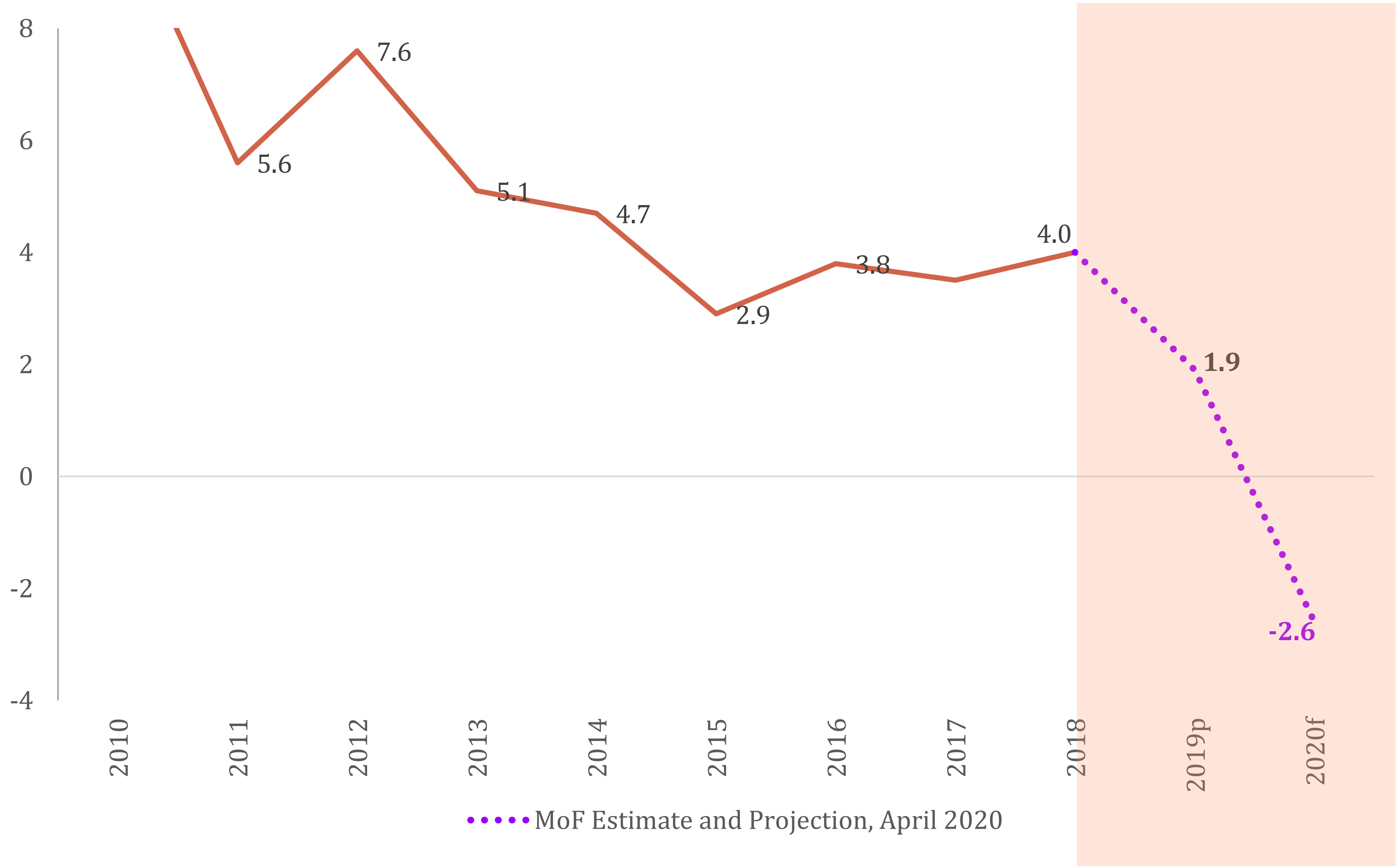
  Business conditions in the private sector are reported to have deteriorated as output and new orders sharply declined on account of falling consumer spending and company shutdowns associated with COVID-19 (Stanbic Bank Zambia Purchasing Managers Index);

  With the COVID-19 pandemic, the already challenged domestic macroeconomic environment has worsened. Economy is projected to contract by 2.6% in 2020, the lowest in 20 years, from a growth of 1.9% in 2019; and

  Underlying this outlook is the projected contraction of output in tourism, wholesale and retail trade, construction, manufacturing, mining as well as electricity sectors.

DOMESTIC ECONOMIC ACTIVITY AND OUTLOOK

Figure 2: Annual Real GDP – Actual and Forecast (%), 2010-2020



INFLATION OUTTURN AND OUTLOOK

Inflationary pressures persisted in the first quarter of 2020 driven by increases in retail fuel pump prices and electricity tariffs, the pass-through from the sharp depreciation of the Kwacha against the US dollar, and the rise in food prices.

Figure 3: Inflation projections and outcomes (%)

	Q1 2020 Projections	Q1 2020 Outcomes	Q4 2019 Outcomes	Q1 2020 End-period	Q4 2019 End-period
Overall Inflation	**12.2**	**13.5**	**11.1**	14.0	11.7
Food Inflation	**15.9**	**15.5**	**14.0**	15.2	15.2
Non-food Inflation	**8.2**	**11.2**	**7.8**	12.7	7.8

In April 2020, annual inflation rose to 15.7% largely due to the lagged pass-through from the sharp depreciation of the Kwacha against the US dollar that led to the increase in prices of especially imported goods.

INFLATION OUTTURN AND OUTLOOK

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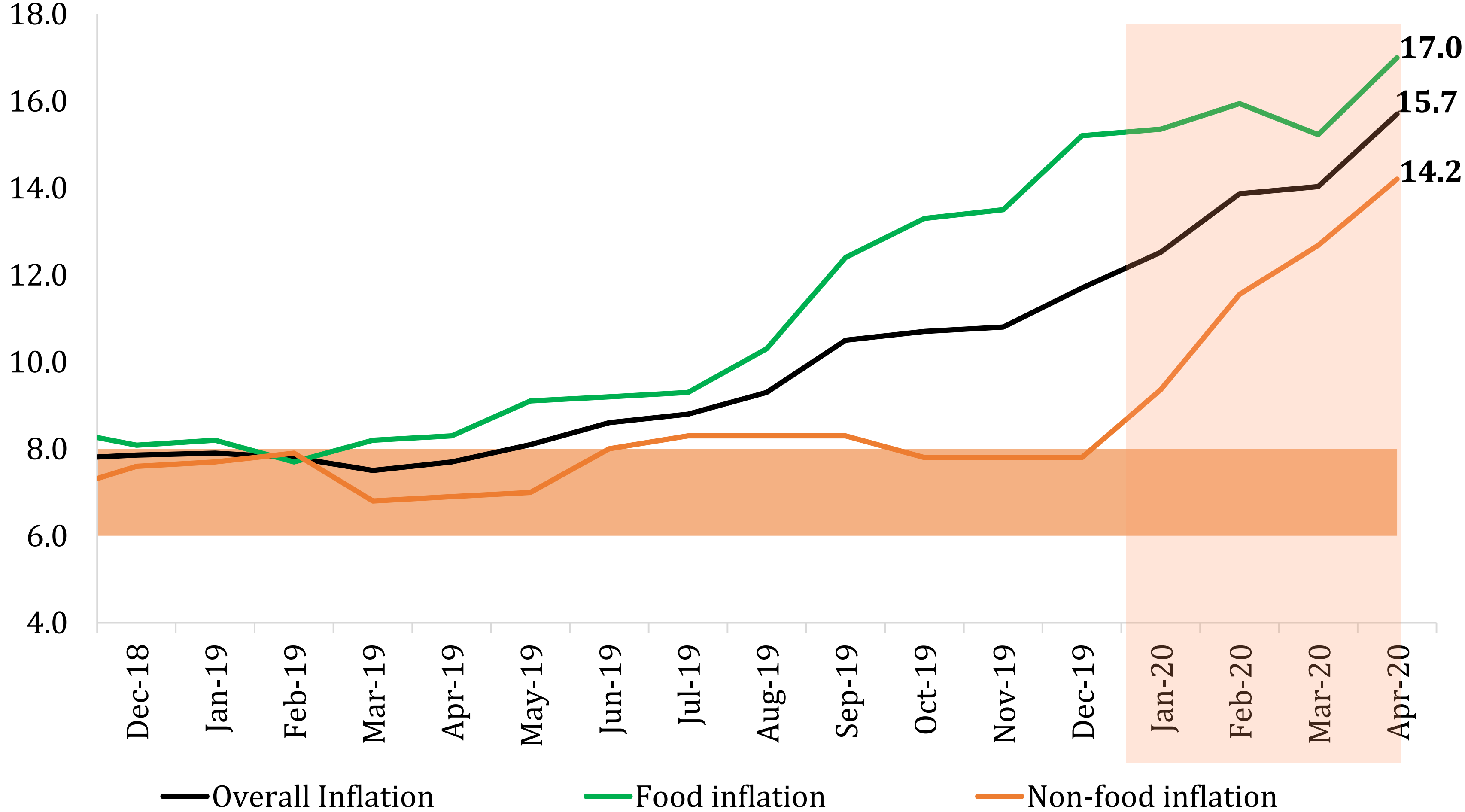
Figure 3: Inflation Developments, y-o-y (%)



Source: Zambia Statistics Agency (ZSA)

INFLATION OUTTURN AND OUTLOOK

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- **Although the projected inflation path is higher than the February 2020 MPC forecast, it will trend towards the upper bound of the 6-8% medium-term target range at the end of the forecast horizon.**

- **Underlying this projection are:**
  - **persistently high fiscal deficits;**
  - **rising external debt service payments;**
  - **high production costs; and**
  - **deterioration in the global economy, which is likely to dampen copper prices and export earnings.**

Inflation could, however, decline faster than anticipated premised on the expected improvements in maize output and subdued domestic consumer demand in light of the COVID-19 pandemic.

MONETARY OPERATIONS

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The overnight interbank rate edged up to a quarterly average of 12.61% in the first quarter of 2020 from 11.44% in the fourth quarter of 2019.

Despite the elevated interbank rate, offsetting open market operations were not conducted in order to help stem extreme exchange rate pressures that emerged during the period.

As a result, the interbank rate was maintained above the upper bound of the Policy Rate Corridor of 10.50% to 12.50% throughout the quarter.

MONETARY OPERATIONS

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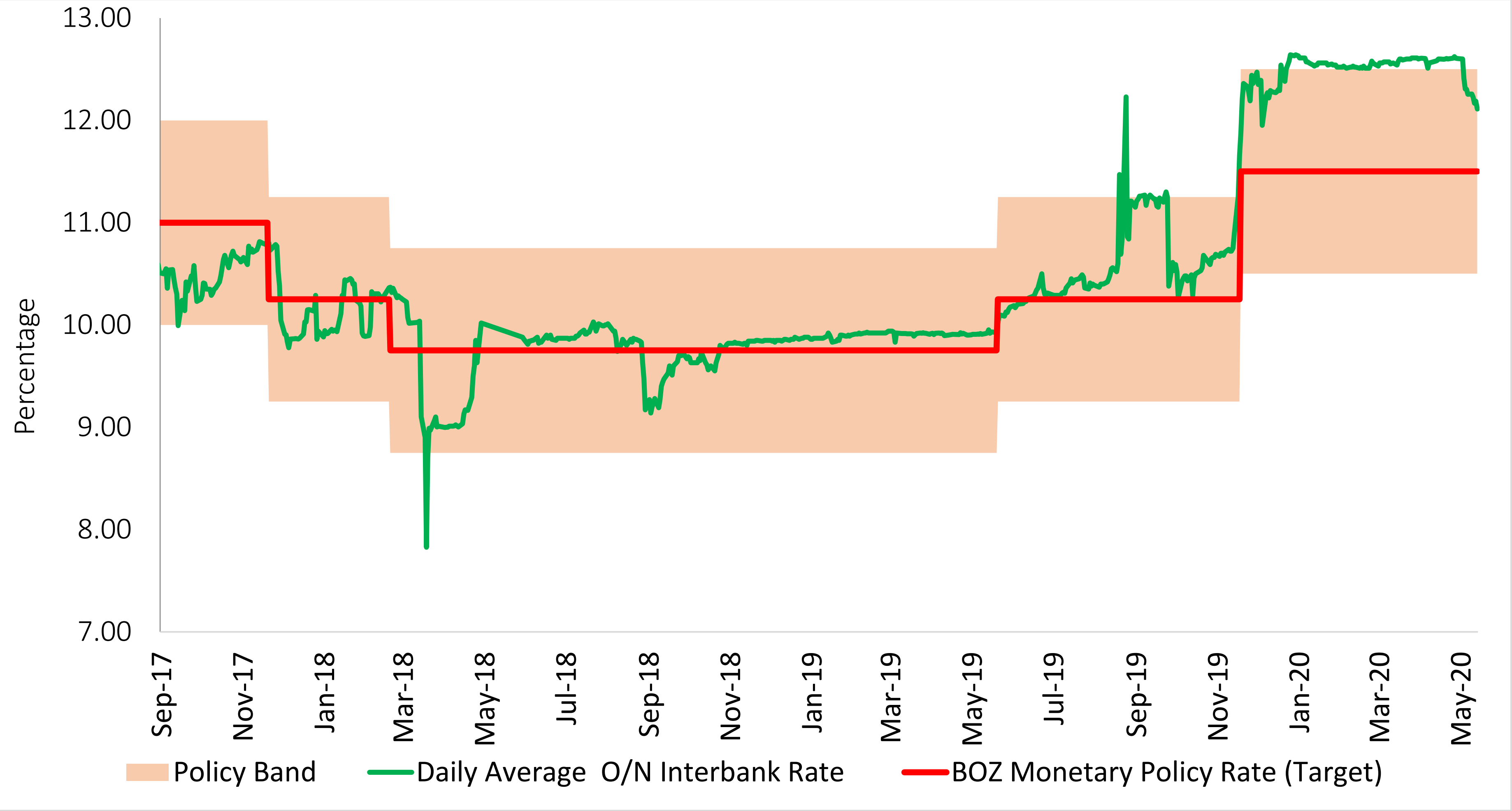
Figure 4: Interbank Rate and BoZ Policy Rate (%)



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The banks' aggregate current account balance declined mainly due to net Government spending and Government securities.

Figure 5: Liquidity Influences (K' billion)

	2019 Q2	2019 Q3	2019 Q4	2020 Q1
Opening balance	2.2	0.9	1.8	2.0
Net Govt. spending	-4.2	-2.7	-1.1	-2.3
BoZ FX influence	1.9	4.1	0.1	1.6
CIC	-1.2	0.0*	-0.3	0.4
Change in SR deposits	0.2	-0.5	-1.0	0.0
OLF	0.0	0.6	0.1	-0.3
Net Government securities influence	0.0	1.0	2.4	-0.4
Open market operations	1.5	-1.5	0.0	0.2
Miscellaneous	0.4	0.2	0.0	0.3
Closing balance	0.9	1.8	2.0	1.2

GOVERNMENT SECURITIES

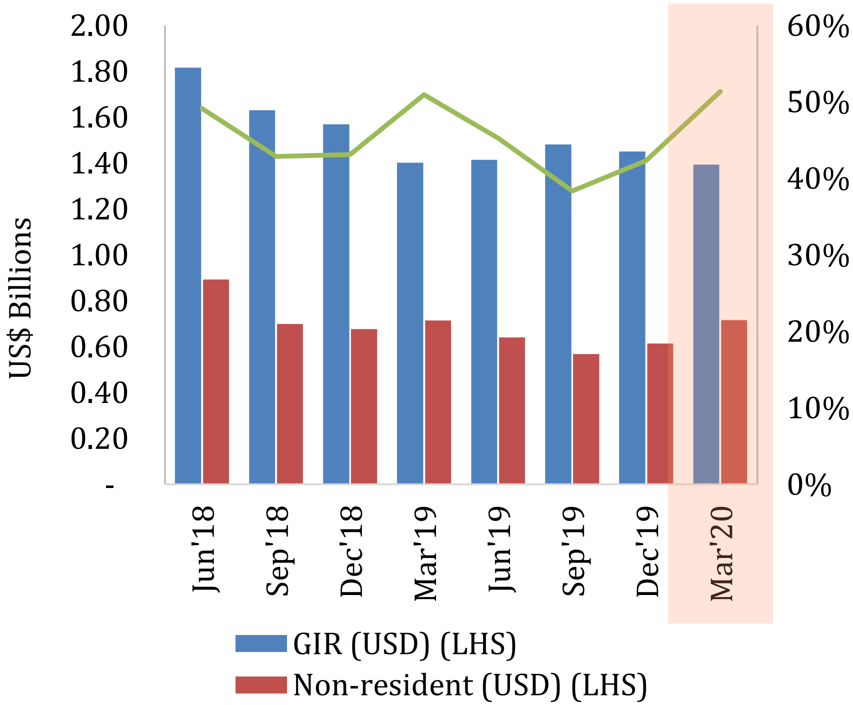
Demand for Government securities remained low largely due to tight liquidity conditions.

Table 6: Demand for Govt. Securities (K' billion)

	Amount on Offer	Amount Received	Subscription Rate (%)
T-bills			
2019Q4	5.7	5.2	91
2020Q1	6.7	5.6	84
Bonds			
2019Q4	3.3	1.4	42
2020Q1	3.3	0.9	27

Source: Bank of Zambia

Chart 7: Non-Resident holdings of Government Securities as percent of GIR



Source: Bank of Zambia

GOVERNMENT SECURITIES MARKET

The stock of Government securities (at face value) rose to K86.9 billion from K80.2 billio reflecting rising Government financing needs.

Non-resident investors holdings increased to K12.9 billion from K8.8 billion in part due secondary market purchases.

Figure 8: Govt Securities Holdings (K 'bln)

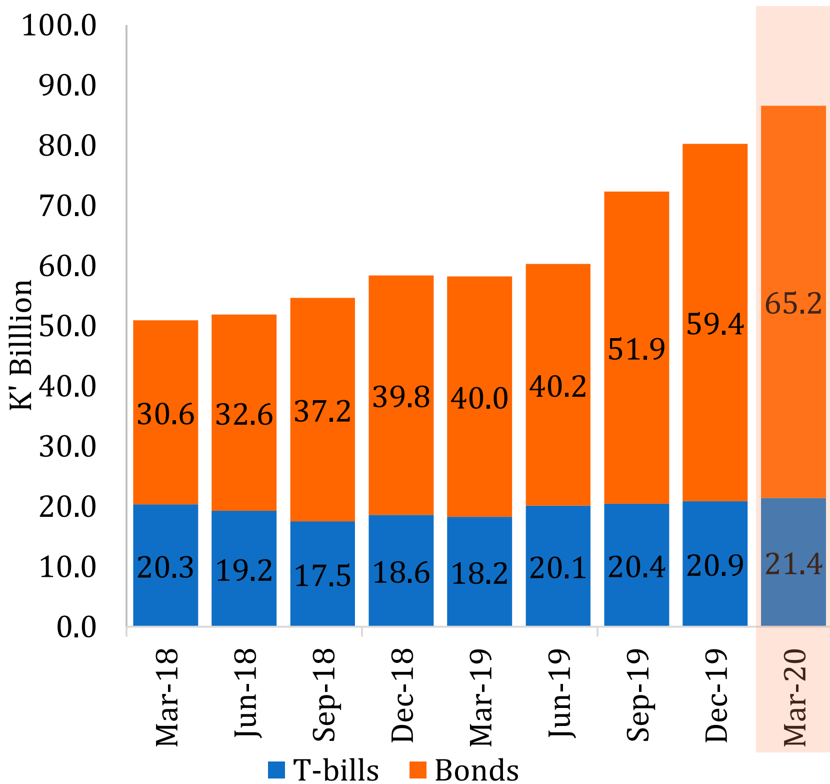
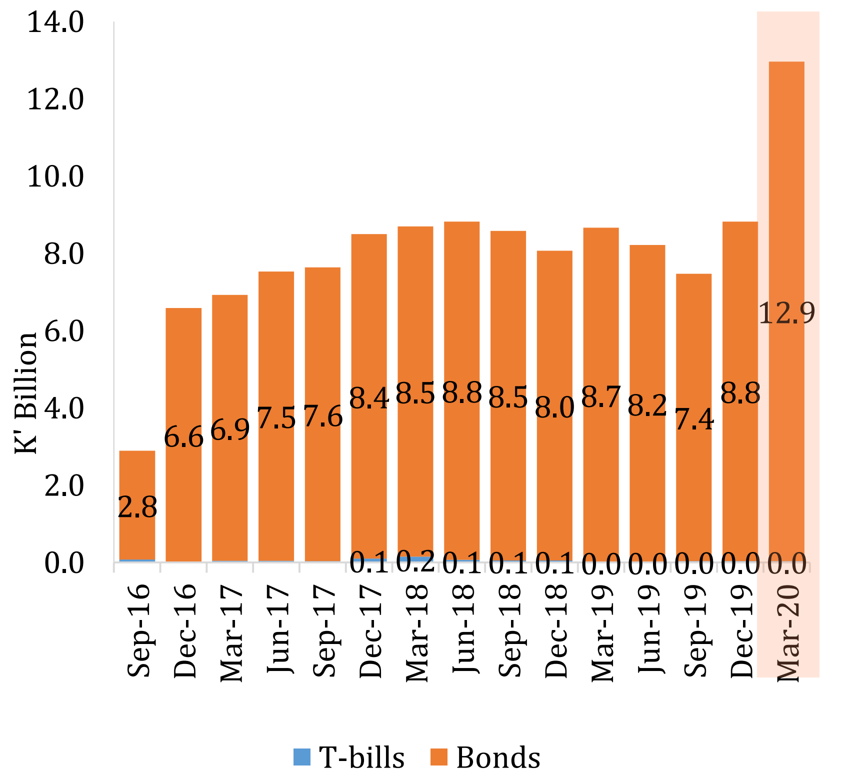


Figure 9: Holdings of Government Securities by Non Residents (K' bln)



INTEREST RATES

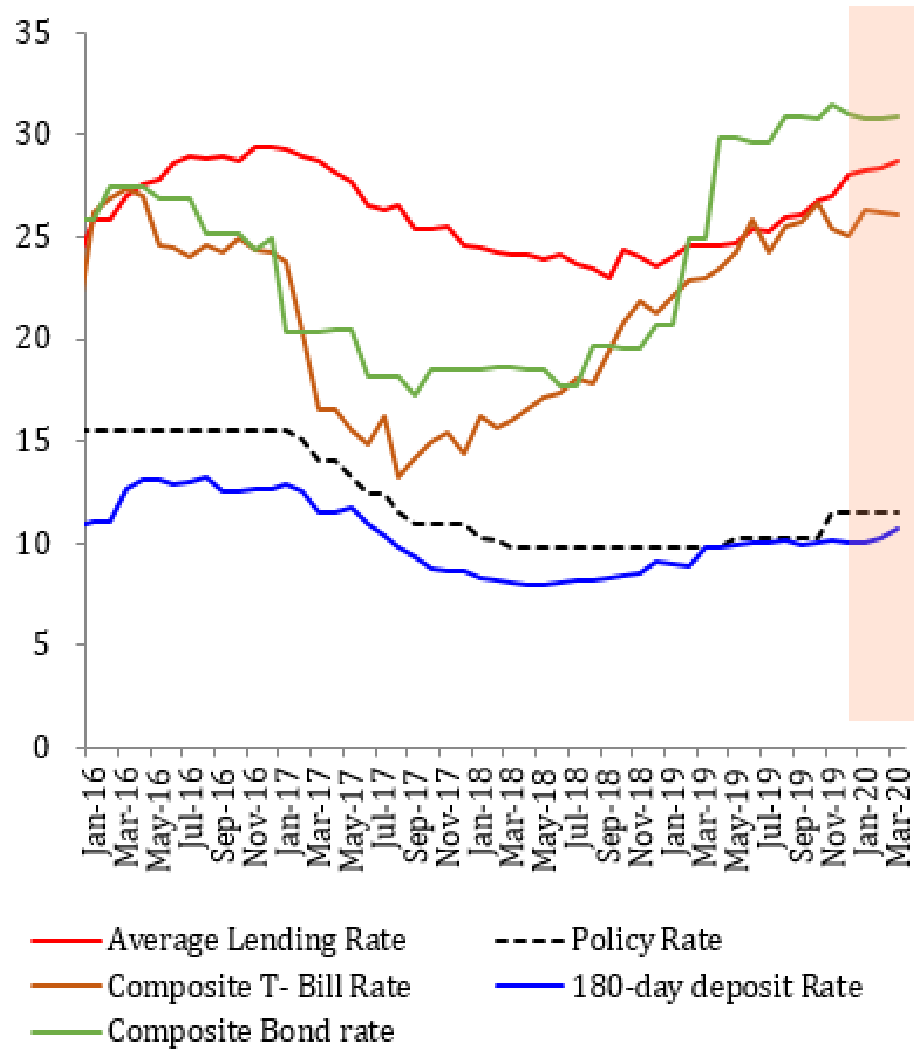
Interest rates rose, reflecting sustained tight liquidity conditions, high domestic financing requirements by the Government and rise in inflation.

The composite Treasury bill yield rate rose to 26.2% from 25.7% while that for Government bonds marginally declined to 30.8% from 31.1%.

Commercial banks' nominal average lending rate rose to 28.8% in March 2020 from 28.0% in December 2019.

Savings rates for 180-day deposits rose to 10.7% from 10.1%.

Figure 10: Nominal Interest Rates (%)

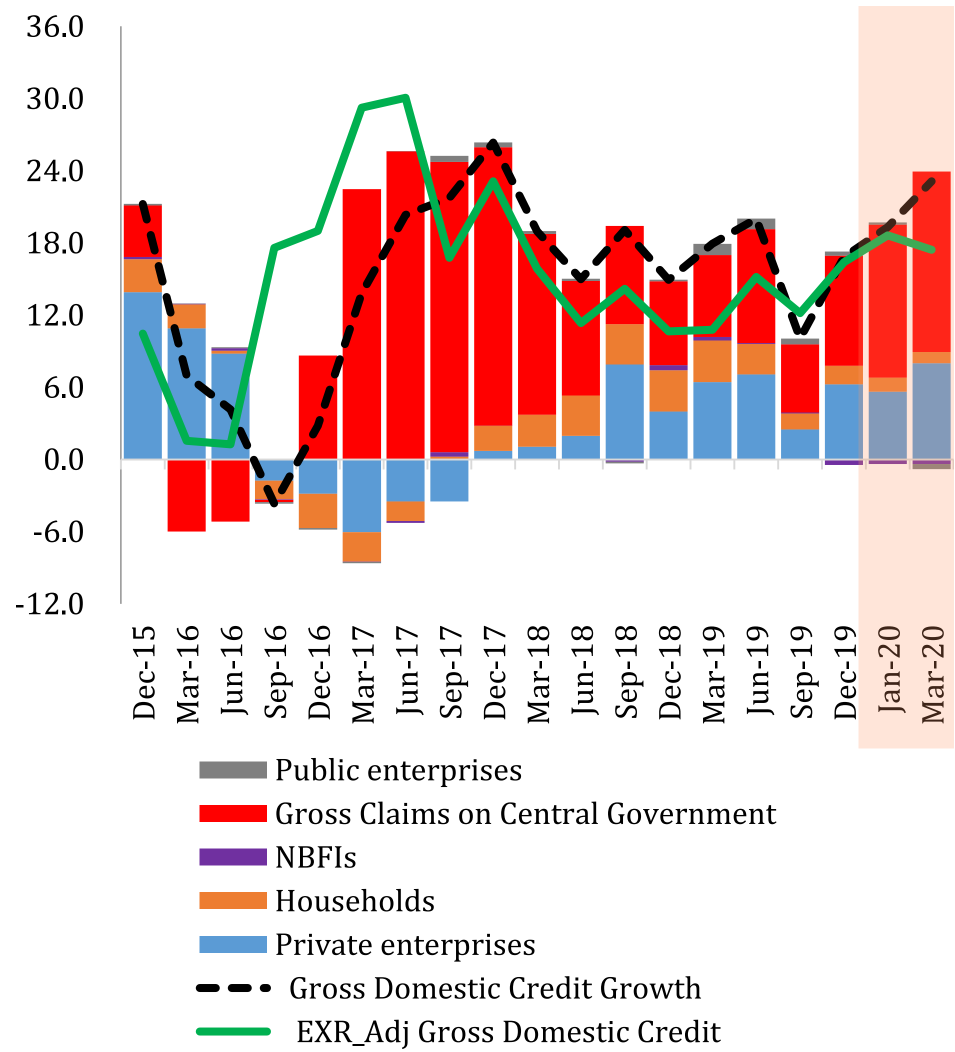


DOMESTIC CREDIT

Credit to the private sector grew by 19.5% year-on-year in March 2020 from 17.2% in December 2019 on account of increased demand for working capital by corporates for bridge financing occasioned by the build-up in Government arrears.

Credit to Government, mainly in form of Government securities, expanded at a faster rate, growing by 28.6% year-on-year compared to 17.2% in December 2019.

Figure 11: Contribution to Y/Y Domestic Credit growth

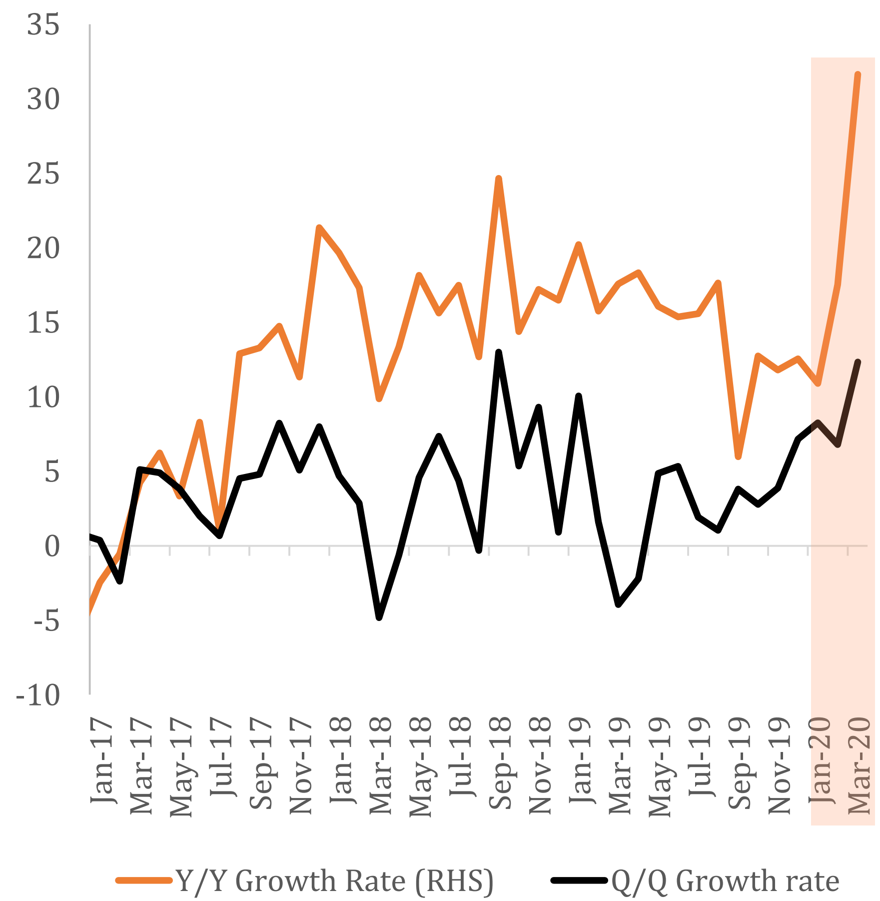


MONEY SUPPLY

In March 2020, money supply grew by 31.3%, year-on-year, compared to a y-o-y growth rate of 12.5% in December 2019.

The growth in money supply largely reflected the expansion in domestic credit and valuation effects following the sharp depreciation of the Kwacha against the US dollar.

Figure 12: Money Supply Growth



FISCAL POLICY

Fiscal pressures are expected to heighten in 2020 as revenue performance is adversely affected by COVID-19 while spending to combat the unprecedented virus rises.

Ministry of Finance estimates revenue reduction of K14.8 billion as a result of the COVIDE-19.

Additional spending pressures relating to external debt service which have been exacerbated by the recent sharp depreciation of the Kwacha against the US dollar.

In this regard, the fiscal deficit in 2020 is bound to exceed the 5.5% Budget target.

FOREIGN EXCHANGE MARKET

The Kwacha was relatively stable over the first two months of the year following the tightening of monetary policy in November and December 2019.

However, in March 2020, the Kwacha came under intense pressure, reflecting the unresolved macroeconomic challenges associated with high debt service and debt levels, rising fiscal deficits as well as declining foreign reserves.

The sovereign credit rating downgrade further weighed on the Kwacha.

The COVID-19 outbreak compounded these exchange rate pressures.

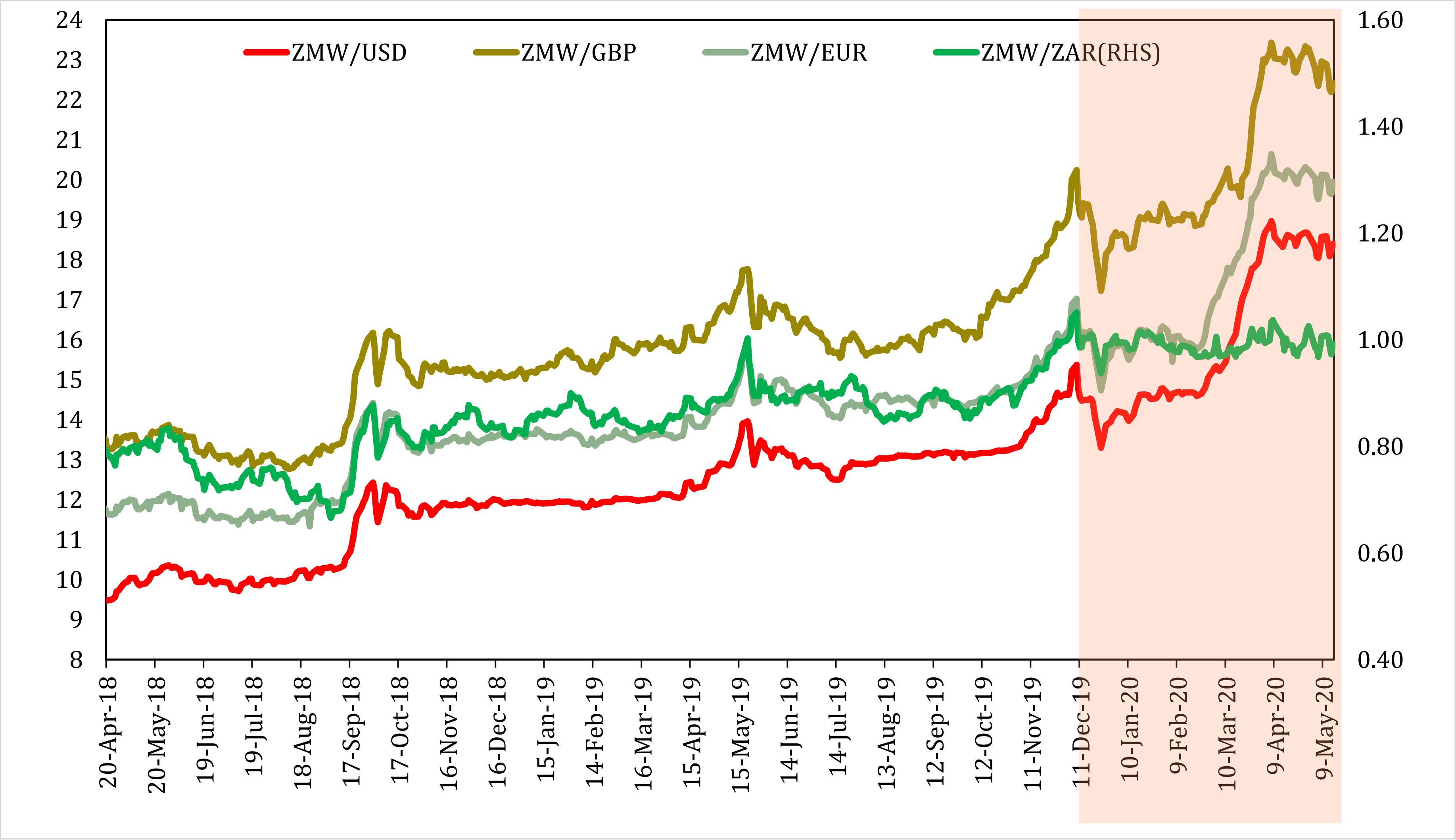
During the period, the Kwacha depreciated by 9.6% against the US dollar to a quarterly average of K15.18/US dollar, and ended the quarter with a year-to-date rate of depreciation of 28.9%.

Figure 13: Exchange Rates

Period	ZMW/USD	ZMW/GBP	ZMW/EUR	ZMW/ZAR
Q4 2019 Average	13.85	17.84	15.34	0.94
End of period (Dec 2019)	14.05	18.55	15.78	1.00
Q1 2020 Average	15.18	19.39	16.71	0.99
End of period (March 2020)	18.11	22.44	19.86	1.01
Quarterly average % change	9.6	8.7	8.9	5.1
End of period % Change	28.8	20.9	25.8	1.5

FOREIGN EXCHANGE MARKET

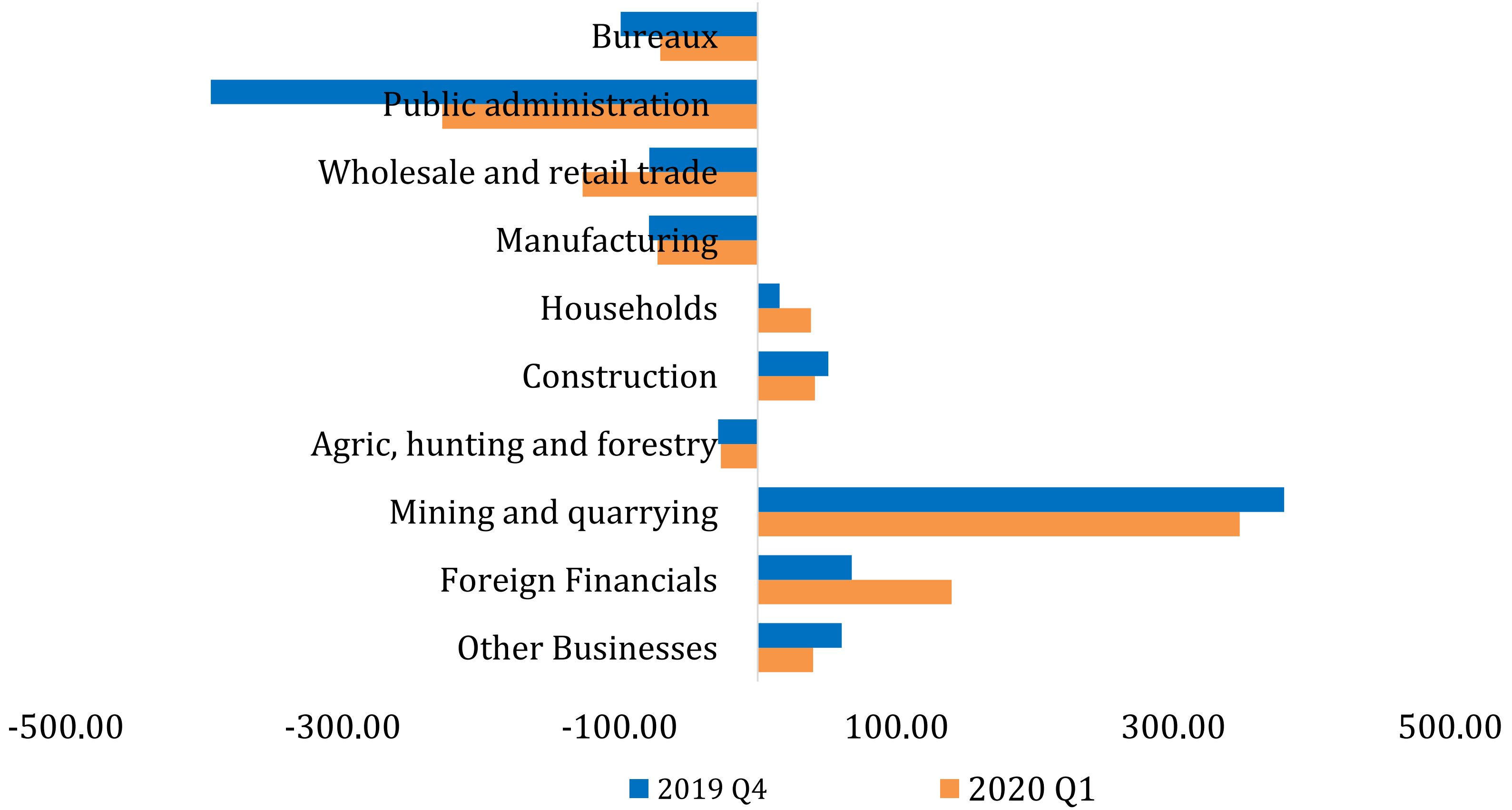
Figure 14: Nominal Exchange Rates



FOREIGN EXCHANGE MARKET

The mining and foreign financials sectors continued to dominate the supply side while public administration and wholesale and trade sectors accounted for a larger share on the demand side.

Figure 15: Foreign Exchange Net Supply by Sector (US$')



SELECTED COMMODITY PRICES

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Copper and crude oil prices declined while selected agriculture commodity prices increased due to supply chain disruptions as a result of trade restrictions.

Figure 17: Commodity Prices

	2018 Q4	2019 Q1	2019 Q2	2019 Q3	2019 Q4	2020 Q1
Copper Price (US$/ton)	6,164.0	6,226.0	6,113.0	5,803.0	5,898.0	5,634.0
Oil Price (Dubai) (US$/barrel)	66.8	63.4	67.0	60.9	61.4	50.7
Wheat (US$/ton)	209.4	211.5	201.7	189.0	204.5	216.3
Maize Price (US$/ton)	162.8	167.5	175.9	170.1	166.8	167.6
Cotton (US$/kg)	1.9	1.8	1.8	1.6	1.7	1.6
Sugar (US$/kg)	0.29	0.28	0.28	0.27	0.28	0.30
Soya beans (US$/ton)	374	377	353	366	380	378

CURRENT ACCOUNT DEVELOPMENTS

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The current account surplus expanded by US$122.3 million (0.5% of GDP) in the first quarter of 2020 from US$78.2 million (0.3% of GDP) in the fourth quarter of 2019.

The rise in the surplus was due to significant improvements in net exports as import compression gained momentum.

Figure 18: Balance of Payments (Quarterly Change - US$ million)

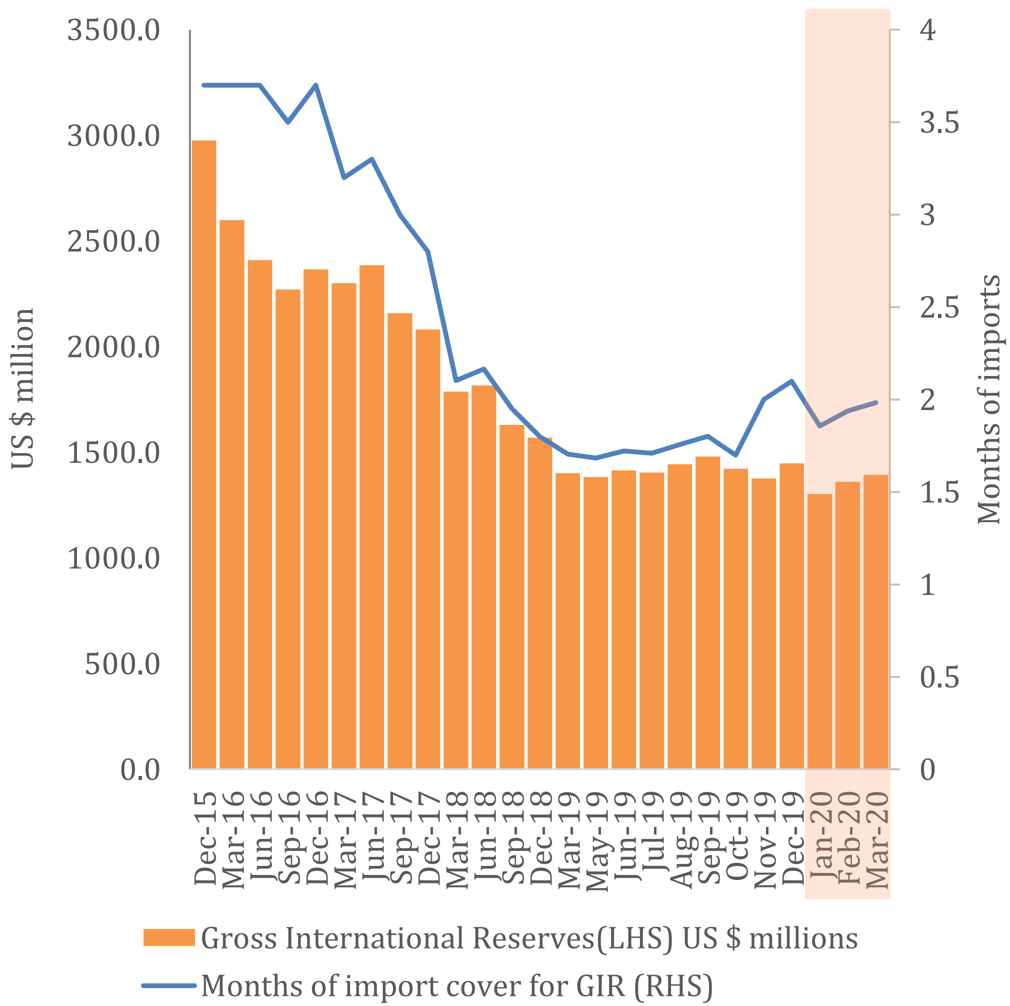
	Q4 2018	Q1 2019	Q2 2019	Q3 2019	Q4 2019	Q1 2020
Current Account Balance	**112.2**	**-7.2**	**2.2**	**73.5**	**78.2**	**122.3**
Balance on Goods	-98.7	288.2	206.0	-4.1	254.3	342.8
Total Goods Exports	**2,094.6**	**1,926.6**	**1,885.1**	**1,612.3**	**1,822.0**	**1,652.5**
Copper	1,480.9	1,431.9	1,320.3	1,013.8	1,228.6	1,187.3
Cobalt	17.5	3.3	0.0	0.0	39.4	1.0
Gold	36.9	43.2	46.0	50.1	57.1	49.5
NTEs	541.7	429.4	500.1	529.6	478.2	395.9
Total Imports	**2,193.3**	**1,638.4**	**1,679.2**	**1,616.4**	**1,567.8**	**1,309.7**
Primary Income	309.3	-225.2	-131.8	100.3	-143.3	-158.5
Secondary Income	70.2	77.0	81.4	82.9	81.1	33.6
Services Account	-168.7	-147.2	-153.4	-105.7	-113.9	-95.5
Capital Account	16.3	17.9	39.9	19.5	19.3	23.1
Financial Account	112.5	188.4	-46.1	-82.4	173.5	176.8
Net Errors/Omissions	-59.5	16.3	-17.2	-110.7	2.3	-87.2
Overall Balance	**43.5**	**161.3**	**-70.9**	**-64.7**	**73.8**	**118.6**
Change in Reserve Assets	-72.0	-163.9	44.0	62.1	-85.9	-116.0

GROSS INTERNATIONAL RESERVES

At end-March 2020, Gross International Reserves declined to US$1.40 billion (equivalent to 2.0 months of import cover) from US$1.45 billion (equivalent to 2.1 months of import cover) at end-December 2019.

The decline in reserves was moderated by net foreign exchange purchases amounting to US$144.2 million, of which US$49.7 million was mineral royalty.

Figure 19: Gross International Reserves (US$ mln)



CONCLUSION

The MPC decided to lower the Policy Rate by 225 basis points to 9.25%. In arriving at the decision, the Committee took into account:

- the need to mitigate the adverse effects of the COVID-19 pandemic on financial sector stability, economic activity and ultimately on people's lives and livelihoods despite projected inflation being higher than the medium-term target range;

- Significant deterioration in economic activity, with the economy projected to be in a recession in 2020 on account of the COVID-19 virus; and

- the need to compliment the broad measures taken by the Bank to support economic activity.

The Committee calls for strengthened collaboration and concerted efforts by all stakeholders to effectively deal with the COVID-19 shock and its effects. In this context, implementation of fiscal and structural reforms that deliver inclusive and sustainable growth remains an urgent imperative.

THANK YOU

GOD BLESS…

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