Bank of Zambia

## MONETARY POLICY COMMITTEE STATEMENT

### *Monetary Policy Committee holds the Policy Rate at 9.75%*

*The Monetary Policy Committee (MPC), at its February 18 – 19, 2019 Meeting, decided to maintain the Policy Rate at 9.75%. Although moving towards the upper bound, inflation is projected to remain within the target range of 6-8% over the forecast horizon[1]. While some indicators[2] show positive growth in economic activity, growth continues to be subdued. Credit to the private sector remained constrained and contracted in the fourth quarter of 2018, underpinned by elevated lending rates and persistently higher than programmed fiscal deficits. Preliminary data for 2018 indicate a higher fiscal deficit than the target. By maintaining the Policy Rate at 9.75%, monetary policy is also intended to support financial sector stability and economic growth. However, to support sustainable macroeconomic stability and achieve higher growth, prompt and effective implementation of fiscal adjustment measures remains critical.*

### *Inflation edges up, but remains within target range*

Annual overall inflation edged up to an average of 8.0% in the fourth quarter of 2018 from 7.9% the previous quarter. Pass-through effects of the depreciation of the exchange rate of the Kwacha against the US dollar, the increase in transport costs, following the 21.3% upward adjustment in fuel prices, and reduced supply of selected food items were the major contributing factors. Average inflation at 8.0% in the fourth quarter was 0.7 percentage points lower than the forecast.

In October, inflation rose to 8.3%, breaching the upper bound of the target range, but reverted into the target range much faster than earlier projected. Inflation closed the year at 7.9%. In January 2019, it remained at 7.9%.

Over the forecast horizon, inflation is projected to remain within the 6-8% target range, although at an elevated level. However, upside risks to the inflation projection dominate and they include persistently higher than programmed budget deficits and debt service payments as well as deterioration in the current account balance and the decline in international reserves. These are likely to impact inflation mainly through the exchange rate and expectations channels.

### *Interbank rate contained within the Policy Rate Corridor*

In line with the monetary policy stance, the overnight interbank rate was contained within the Policy Rate corridor. It averaged 9.79% in the fourth quarter, up from 9.73% the previous quarter.

---

[1] The forecast horizon or period is the first quarter of 2019 to the fourth quarter of 2020.

[2] Bank of Zambia Composite Index of Economic Activity (CIEA) and the December 2018 Stanbic Bank Zambia Purchasing Managers Index (PMI).

***Demand for Government securities picks up slightly***

Demand for Government securities picked up during the fourth quarter of 2018 as commercial banks and institutional investors rolled over maturing Treasury bills on account of relatively higher yields. The subscription rate for Treasury bills increased to 88.0% from 68.0%. On the other hand, at 33.0%, the subscription rate for Government bonds remained broadly unchanged.

Relative to end-September 2018, the stock of outstanding Government securities increased by 6.8% to K58.5 billion at end-December 2018. Non-residents held K8.0 billion, representing 13.7% of the outstanding stock, down from 14.3% at end-September 2018. Government securities held by non-residents continue to be concentrated in Government bonds.

***Lending, savings, and yield rates edge up***

Commercial banks' average nominal lending rates edged up to 23.6% in December 2018 from 23.0% in September. Excluding outliers[3], the average lending rate rose to 21.8% in December 2018 from 21.2% in September. This was despite the Bank of Zambia maintaining a relatively accommodative monetary policy stance during the period.

Yield rates for both Treasury bills and Government bonds rose to quarterly averages of 21.5% and 19.9% from 18.5% and 19.6% in the third quarter, respectively. The increase was largely attributed to relatively tight liquidity conditions and the high risk premium, induced mainly by the sovereign credit rating downgrade[4].

The savings rate for 180-day deposits for amounts exceeding K20,000 rose to 9.1% in December from 8.3% in September. Over the same period, the highest interest rate on outstanding negotiated deposits increased further to 22.1% from 18.5%.

***Credit to private enterprises contracts and money supply growth slows down***

Total domestic credit growth slowed down to 1.3% in the fourth quarter of 2018 from 9.9% in the third quarter. This outturn was on account of the contraction in credit to private enterprises and a slowdown in lending to Government, reflecting relatively tight credit conditions. Credit to private enterprises contracted by 4.6% against an expansion of 19.2% in the third quarter. Lower foreign currency lending to the construction, real estate, mining and manufacturing sectors pulled down credit growth to private enterprises. Growth in credit to Government slowed down to 3.3% in the fourth quarter against an expansion of 6.2% the preceding quarter.

Foreign currency denominated loans and advances contracted by 2.4% against a growth of 10.2% the preceding quarter. However, Kwacha denominated loans expanded further by 4.7% compared to a growth of 3.7% during the third quarter, driven mainly by the easing in loan conditions and increased credit limits on personal loans by some financial institutions. On the whole, credit to the private sector remains constrained by relatively high Government borrowing. The subdued credit growth is likely to continue to dim economic growth prospects.

Money supply (M3) growth slowed down to 0.9% from 13.0% in the preceding quarter of 2018, reflecting declining international reserves. On an annual basis, M3 growth reduced to 16.5% in December 2018 from 24.7% recorded in September.

---

[3] These are banks with the highest and lowest lending rates.

[4] Fitch downgraded Zambia to B- from B+ in October 2018.

***Fiscal deficit remains elevated***

Preliminary data for 2018 indicate that the fiscal deficit, on cash basis, is likely to be slightly lower than the 2017 Budget outturn of 7.8% of GDP. However, this will be higher than the 2018 target. To support sustainable macroeconomic stability and achieve higher economic growth, prompt and effective implementation of fiscal adjustment measures, therefore, remains critical.

***Global growth positive, but lower than earlier projected***

Growth of the global economy in 2018 at 3.7% was lower than the 3.8% recorded in 2017, largely on account of a faster than projected slowdown in advanced economies and some emerging market economies. Global growth prospects remain positive, albeit lower than earlier projected owing to expected negative effects of the United States-China trade war and tightening global financial conditions. Consequently, global growth forecasts were revised downwards to 3.5% and 3.6% for 2019 and 2020, respectively[5]. The slowdown in growth in Zambia's major trading partners is likely to depress copper prices and moderate growth of the country's export earnings.

***Current account records a deficit***

Preliminary data[6] indicate that the current account recorded a deficit of US $328.1 million against a surplus of US $160.8 million in the third quarter of 2018 owing to unfavourable performance of the balances on primary income, services, and goods sub accounts.

The deficit on the balance on goods[7] account of US $98.7 million was due to a reduction in export earnings against a growth in imports. Export earnings declined by 8.5% to US $2,094.6 million mainly due to lower copper and non-traditional export earnings (NTEs). Copper exports declined by 9.1% to US $1,480.5 million, driven by a reduction in export volumes. At US $541.7 million, NTEs were 7.2% lower than the preceding quarter due to a decline in earnings from cotton, electricity, burley tobacco, and cane sugar. Imports grew by 4.7% to US $2,193.3 million on account of increased importation of iron products and vehicles.

The current account deficit was financed by a surplus on the financial account and a draw down in international reserves.

Gross international reserves declined to US $1.57 billion (representing 1.8 months of import cover) from US $1.63 billion (1.9 months of import cover) recorded at end-September 2018. External debt service payments were the primary drivers of the drawdown in international reserves. The decline was moderated by net purchases of foreign exchange by the Bank of Zambia and mineral royalty tax receipts[8] amounting to US $109.6 million in the fourth quarter of 2018. Net foreign exchange purchases from the market for 2018 amounted to US $346.0 million compared to US $402.6 million in 2017.

***The Kwacha depreciates against the US dollar***

The Kwacha depreciated by 15.3% against the US dollar to a quarterly average of K11.89 per US dollar from K10.31 per US dollar in the third quarter. The depreciation was mainly on account of a higher net demand for foreign exchange, mainly for oil procurement. In addition, the strengthening of the US dollar,

[5] IMF, WEO, January 2019

[6] Central Statistical Office, Zambia Revenue Authority, Ministry of Finance, Bank of Zambia.

[7] Trade data was revised by the Central Statistical Office after adjusting for imports of cobalt ores from the Democratic Republic of Congo (DRC). The revised data was aligned to the International Monetary Fund's Balance of Payments Manual 6 Standards.

[8] Mineral Royalty US$80.6 million

triggered by the hike of the Federal Funds Rate, and negative market sentiments arising from Zambia's credit rating downgrade, contributed to the weakening of the Kwacha.

***Domestic economic growth remains low with heightened downside risks***

Indicators of economic activity[9] suggest positive year-on-year growth in the fourth quarter, albeit at a reduced pace. Growth was on the back of increased mining output, electricity generation, consumer spending, and tourist arrivals.

Real GDP is projected to grow by about 4.0% in 2019. The mining, manufacturing, construction, and wholesale and retail trade sectors are expected to continue to be the major sectors driving growth in the near-term, supported by relatively stable power supply. Downside risks to the growth outlook include delayed effective implementation of fiscal adjustment measures by Government, weak credit growth, and lower than anticipated copper prices.

***The MPC Decision***

The MPC, at its February 18 – 19, 2019 Meeting, decided to maintain the Policy Rate at 9.75% taking into account all the above factors.

In particular, inflation is projected to remain within the 6-8% target range over the forecast horizon, although at an elevated level.

The MPC also took into consideration the continued need to minimise potential vulnerabilities in the financial sector and to support economic growth.

**Decisions on the Policy Rate will continue to be guided by inflation forecasts and outcomes as well as progress in the execution of fiscal consolidation measures. Should the upside risks to inflation materialise and push inflation above the target range, the Committee may adjust the Policy Rate upward.**

The next MPC Meeting is scheduled for May 20 – 21, 2019.

Issued by

Denny H Kalyalya (Dr)

**GOVERNOR**

February 20, 2019

[9] The Bank of Zambia Composite Index of Economic Activity (CIEA) indicates real GDP growth of 3.9% in the fourth quarter of 2018.