



**BANK OF ZAMBIA**

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**MONETARY POLICY COMMITTEE STATEMENT**

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***Bank of Zambia (BoZ) Policy Rate lowered to 11% and Statutory Reserve Ratio reduced to 9.5%***

*The Monetary Policy Committee (MPC), at its Meeting on 8 and 9 August 2017, decided to reduce the Policy Rate by 150 basis points to 11.0% from 12.5% and the Statutory Reserve Ratio by 300 basis points to 9.5% from 12.5%. In arriving at this decision, the Committee noted that annual overall inflation ended the second quarter at 6.8%, up from 6.7% at the end of the first quarter, but importantly well within the medium-term target range of 6 – 8%. In addition, the inflation forecasts indicate that it will remain at current levels for the remainder of the year and trend towards the lower bound of the target range over the medium-term. Economic activity picked up in the second quarter of 2017. Credit to the private sector registered some growth, ending almost a year of contraction, while lending to Government slowed down. Both yield rates on Government securities and commercial banks' interest rates declined during the review period, although lending rates remained high. Government's commitment to contain the budget deficit and overall debt as well as reducing domestic arrears to planned levels remains critical to consolidating macroeconomic stability. The Bank of Zambia will closely monitor domestic and external sector developments and stands ready to implement appropriate monetary policy measures to maintain price and financial system stability and ultimately support diversification and higher economic growth.*

***Inflation remained broadly stable and within the medium-term target range***

Annual overall inflation ended the second quarter at 6.8%, up from 6.7% at the end of the first quarter, but importantly well within the medium-term target range of 6 – 8%. The marginal increase in inflation was largely due to the upward adjustment in electricity tariffs, which were, in May 2017, increased by 50% on average. The pass-through from the continued appreciation of the Kwacha against the U.S. dollar and the seasonal increase in the supply of some food items moderated inflationary pressures in the second quarter. During this period, non-food inflation increased to 8.0% from 6.6% while food inflation declined to 5.8% from 6.7%.

Subsequent to the end of the quarter, annual inflation declined to 6.6% in July, largely driven by lower food prices. Monthly inflation in July was -0.1%, the lowest monthly rate since October 2011. The year-to-date inflation in July stood at 3.2%.

***Interbank rate kept within the Policy Rate corridor***

Following the reduction in the Policy Rate and the statutory reserve ratio in May 2017, the overnight interbank rate declined to 12.2% at end-June 2017 from 13.0% at end-March 2017, as liquidity conditions eased. Other factors that contributed to the easing in liquidity conditions included net Government spending and BoZ purchases of foreign exchange to build-up



international reserves. To maintain the interbank rate within the Policy Rate corridor of 11.5-13.5%, BoZ conducted appropriate open market operations.

### ***Demand for Government securities remained high and yield rates continued to decline***

In the second quarter of 2017, demand for Government securities remained high, as reflected by the subscription rates for Treasury bills and Government bonds that stood at 122% and 170%, respectively. The sustained high demand was largely driven by eased liquidity conditions and higher participation by non-resident investors. This helped Government meet much of its financing needs. As a result, the stock of Government securities rose to K42.0 billion from K38.3 billion in the first quarter. The non-residents' preference continued to be in Government bonds and their holdings of Government securities increased by 9.0% to K7.5 billion in the second quarter, representing 17.9% of the total stock.

Yield rates on both Treasury bills and Government bonds continued to decline, reflecting increased demand. The weighted average Treasury bills and Government bonds yield rates dropped to 14.1% and 19.9% in June 2017 from 16.6% and 20.4% in March 2017, respectively.

### ***Commercial banks' lending rates fell marginally; private sector credit showed signs of recovery while money supply increased further***

Commercial banks' nominal lending rates continued to decline, albeit marginally, to 26.6% in June 2017 from 28.8% in March 2017. The lowest and highest lending rates declined to 8.0 – 37.0% range in June 2017 from 10.0 – 38.5% in March 2017. The decline in lending rates reflected the further easing of the monetary policy stance in May 2017.

For negotiated deposits, improved liquidity conditions drove interest rates down to a range of 6.0 – 29.5% in June from 11.0 – 31.0% in March. The average savings rate for amounts below K100 and the 180-day deposit rate for amounts exceeding K20, 000 were unchanged at 1.9% and 11.0%, respectively.

Total domestic credit expanded at the same rate of 6.5% as in the previous quarter to K55.6 billion. This was driven by continued lending to Government, albeit at a reduced pace of 11.3% compared to 18.1% previously, and an uptick in credit to the private sector by 1.6%, after almost a year of contraction. This reflects in part continued improvement in liquidity conditions, decline in lending rates, and willingness by banks to lend as growth prospects brighten.

Money supply grew by 2.0% to K47.8 billion in the second quarter. Increased credit to the Government and the growth in private sector credit accounted for the rise in money supply.

### ***Domestic economic activity improved***

For the quarter under review, available real sector and business survey data indicate that economic activity improved<sup>1</sup>. Output in selected sectors, such as, mining, manufacturing, and energy recovered. In addition, labour demand rose, induced by higher output and capacity utilisation. Purchasing activity among firms also expanded in line with improving client demand<sup>2</sup>.

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<sup>1</sup> Bank of Zambia Quarterly Survey of Business Opinions and Expectations, August, 2017

<sup>2</sup> Stanbic Zambia Purchasing Managers Index (PMI), July, 2017.



### ***Global economy showing signs of recovery***

The global economy is showing signs of recovery due to improvements in trade, services and manufacturing. In 2017 and 2018, global growth is projected to increase to 3.5% and 3.6%, respectively from 3.2% in 2016<sup>3</sup>. Much of this growth is expected to come from emerging markets and developing economies whose growth is projected at 4.6% and 4.8% in 2017 and 2018, respectively.

### ***Current account deficit widened***

The current account deficit widened to US\$274.4 million in the second quarter from US\$146.3 million in the previous quarter as imports expanded and export earnings fell marginally. Total imports grew by 8.5% to US\$1,844.4 million, while export earnings fell by 3.0% to US\$1,936.0 million on account of a fall in non-traditional exports. Nevertheless, copper export earnings increased slightly, supported by higher realised prices. The deficit was financed by a surplus on the financial account.

Gross international reserves increased to US\$2.4 billion (representing 3.3 months of import cover), up from US\$2.3 billion in the previous quarter.

### ***Exchange rate remained relatively stable***

During the quarter under review, the exchange rate of the Kwacha against the U.S. dollar remained relatively stable, with an appreciation bias. The Kwacha appreciated by 4.5% against the U.S. dollar to K9.32, supported largely by improved supply of foreign exchange from the mining sector and non-resident investors in Government securities. The market was also characterised by positive sentiments arising from relatively low and stable inflation and higher copper prices, among other factors.

### ***Achieving fiscal consolidation remains central to anchoring macroeconomic stability***

For the year to June 2017, the preliminary budget deficit, on a cash basis, at 2.5% of GDP, was lower than the projection of 3.6% of GDP. However, increased reliance on domestic financing of the budget deficit continues to constrain private sector borrowing. Government's commitment to contain the budget deficit and overall debt as well as reducing domestic arrears to planned levels therefore remains critical to consolidating macroeconomic stability.

### ***Macroeconomic environment improving, but challenges to growth remain***

Inflation forecasts indicate that it will remain at current levels for the remainder of the year and trend towards the lower band of the 6-8% target range over the medium-term. This takes into account the recent reduction in fuel prices, the announced increase in electricity tariffs in September 2017 and is predicated on the implementation of fiscal consolidation measures over the forecast horizon. Moreover, risks to inflation are, on balance, currently assessed to favour low and stable inflation. The bumper maize harvest during the 2016/17 farming season, and relative stability in the exchange rate of the Kwacha, on the back of the recovery in commodity prices, especially for copper, are expected to support low inflation.

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<sup>3</sup> IMF World Economic Outlook (WEO) Update, July, 2017



Over the medium-term, economic growth prospects are expected to improve, with GDP growth for 2017 and 2018 revised upward to 4.3% and 5.1% from 3.9% and 4.6%, respectively. The upward revision reflects mainly increased agricultural output, recovery in electricity generation as well as higher mining output supported by better prices and electricity supply. However, challenges to growth and the financial sector remain. These include high interest rates, low credit growth, high non-performing loans, and structural weaknesses in the financial sector.

### ***The MPC Decision***

The MPC at its August 8-9, 2017 Meeting, taking into account the above factors, arrived at the following decisions:

1. *Lower the Policy Rate by 150 basis points to 11.0% from 12.5%; and*
2. *Reduce the Statutory Reserve Ratio by 300 basis points to 9.5% from 12.5%.*

In particular, guided by the continued decline in inflation and projections indicating that it will remain well anchored within the medium-term target range of 6-8% over the forecast horizon (next eight quarters), the MPC considered the following:

- The prevailing high real lending rates, which continue to constrain access to credit, especially by the productive sectors of the economy;
- Low growth in credit to the private sector;
- Subdued economic growth; and
- Risks to the stability of the financial sector.

In the implementation of monetary policy, BoZ will continue to strengthen the ***forward looking monetary policy framework***, anchored on the Policy Rate as the key signal. Changes in the Policy Rate will continue to be guided by inflation outcomes and forecasts as well as progress in fiscal consolidation. The Bank of Zambia will closely monitor domestic and external sector developments and stands ready to implement appropriate monetary policy measures to maintain price and financial system stability and ultimately support diversification and higher economic growth.

The next MPC Meeting will take place on November 20 – 21, 2017.

Issued by



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