Bank *Of* Zambia

MONETARY POLICY COMMITTEE STATEMENT

Bank of Zambia (BoZ) Policy Rate maintained at 9.75%

The Monetary Policy Committee (MPC), at its May 14 – 15, 2018 Meeting, decided to maintain the Policy Rate at 9.75%. After trending downwards for seven consecutive quarters, annual overall inflation edged up in the first quarter of 2018, but remained within the 6–8% target range. Inflation rose to 7.1% in March 2018 from 6.1% in December 2017, driven mainly by the upward adjustment in fuel prices and the subsequent increase in transportation costs, as well as a seasonal reduction in supply of some food items, particularly vegetables and maize grain. Current projections indicate that inflation will rise above 7% during the second and third quarters of 2018, but decline thereafter towards the lower bound of the 6-8% target range over the forecast horizon. Real sector indicators[1] show a steady pickup in annual economic growth, although growth remains fragile. Weak credit growth to the private sector, mainly driven by higher than programmed budget deficits, high lending rates, and rising non-performing loans, is a key contributor to this fragility. The Bank will continue to closely monitor domestic and external sector developments and stand ready to implement appropriate measures to maintain price and financial system stability, and to support economic growth.

Inflation edged up, but projected to remain within the target range

After trending downwards for seven consecutive quarters, inflation edged up in the first quarter of 2018, rising to 7.1% in March from 6.1% in December 2017, but importantly, remained within the 6–8% target range. The upward adjustment in fuel prices and the subsequent increase in transportation costs were the key drivers of inflation. In addition, the seasonal reduction in the supply of some food items, particularly fresh vegetables and maize grain, contributed to the rise in inflation. The continued rise in prices of fresh vegetables pushed annual overall inflation to 7.4% in April 2018.

Inflation is projected to rise above 7% during the second and third quarters of 2018, but thereafter decline towards the lower bound of the 6-8% target range over the remaining six quarters of the forecast horizon. However, risks to this inflation outlook are skewed to the upside and include lower crop production in the 2017/2018 agriculture season, higher than programmed fiscal deficits and public debt, as well as faster than expected increases in crude oil prices. Anticipated higher copper prices are expected to moderate these inflationary pressures through the exchange rate channel. Despite these risks, inflation is projected to remain within the target range of 6-8% over the forecast horizon.

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

Interbank rate maintained within the Policy Rate Corridor

Following the reduction in the Policy Rate in February 2018 to 9.75% from 10.25%, the overnight interbank rate closed the quarter at 9.01% from 9.94% at end-December 2017 and was within the Policy Rate Corridor of 8.75% to 10.75%. To maintain the interbank rate within the Policy Rate Corridor, the Bank of Zambia conducted contractionary open market operations.

Demand for Government securities rebounded

In the first quarter of 2018, demand for Government securities rose, driven mainly by higher participation of non-resident investors on account of attractive yield rates and relative stability in the exchange rate. Subscription rates for Treasury bills and Government bonds averaged 92.9% and 144.2%, up from 81.9% and 108.8%, respectively.

Resident investors continued to be the major holders of Government securities. However, non-resident investors' holdings of Government securities continued to increase, albeit at a slower pace, rising by 2.4% to K8.7 billion. This represented 17.1% of the total stock of Government securities. Longer tenors remained the non-resident investors' preferred securities due to their relatively higher real yield rates. Importantly, this also signals their confidence in Zambia's growth prospects.

As at end-March 2018, the stock of Government securities stood at K50.9 billion, up from K48.4 billion at end-December 2017.

Generally, interest rates continued on a declining path, but lending rates remained elevated

Commercial banks' average nominal lending rate declined slightly to 24.1% in March 2018 from 24.6% in December 2017. Excluding outlier rates, the average nominal lending rate declined to 21.4% from 21.7% over the same period. Nonetheless, at this level, lending rates are considered too high to support economic growth. Moreover, elevated Government deficits, high yield rates on Government securities, and rising non-performing loans continue to favour lending to Government by the banking sector thereby constraining private sector credit growth.

Outstanding deposit rates on wholesale funds remained high. The highest interest rate on these funds was unchanged at 25% in March 2018. However, the savings rate for 180-day deposits for amounts exceeding K20,000 declined marginally to 8.1% from 8.6%.

The weighted average yield rate on Treasury bills edged up to 15.9% from 15.0%, while that for Government bonds remained unchanged at 18.6%.

Private sector credit and money supply contracted

Growth in total domestic credit slowed down in the first quarter of 2018, growing only by 1.3% compared to the 4.9% registered in the fourth quarter of 2017. During the period, lending to Government expanded by 1.7% compared to 5.3% previously. On the other hand, credit to private enterprises contracted by 3.5% against an expansion of 8.3% in the fourth quarter. The contraction in Kwacha denominated loans largely accounted for this outturn.

Money supply contracted by 4.8% in the first quarter of 2018 compared to a growth of 8% in the fourth quarter of 2017. At end-March 2018, money supply was K51.5 billion, down from K54.1 billion at end-December 2017. The contraction in money supply was primarily attributed to a reduction in net foreign assets, mainly due to external debt service.

Fiscal performance

In the wake of the recent Debt Sustainability Analysis (DSA), the preliminary fiscal deficit of 6.1%[2] of GDP for 2017 is now likely to be revised upwards. In view of this, the 2018 Budget estimates are also likely to undergo some revisions. It should be noted that higher than programmed fiscal outcomes in 2018 would heighten risks to macroeconomic stability. As of now, preliminary data for the first quarter of 2018 indicate that the budget deficit, on a cash basis, at approximately 1.5% of GDP, is in line with the programmed target.

Global economic growth momentum continues

The global economic growth momentum continued and is projected to remain strong in the medium-term supported by accommodative global financial conditions and expansionary fiscal policy in the US. In 2018 and 2019, global growth is projected at 3.9% from 3.8% in 2017. Growth in Zambia's main trading partners[3] is expected to pick up and positively contribute to the country's growth outlook and the narrowing of its current account deficit.

Current account deficit narrows

Preliminary data[4] indicate that Zambia's current account deficit narrowed to US$139.2 million in the first quarter of 2018 from US$241.5 million in the fourth quarter of 2017. This was mainly attributed to lower earnings on investments relating to non-residents and a higher trade surplus. The trade surplus rose following relatively higher export earnings, which grew by 5.0% to US$2,550.9 million, driven by increases in realised copper prices and export volumes. Imports increased at a slightly slower pace of 4.9% to US$2,429.7 million. The current account deficit was financed by a drawdown of gross international reserves, which declined to US$1.8 billion at end-March, representing 2.1 months of import cover, from US$2.1 billion, equivalent to 2.9 months, in December 2017.

The Kwacha strengthened against the US dollar

The Kwacha appreciated against the US dollar by 2.4% to K9.7931 in March 2018 on the back of net supply of foreign exchange and a generally weaker US dollar. The major net suppliers of foreign exchange remained mining companies and non-resident investors in Government securities.

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[2] Ministry of Finance 2017 Annual Economic Report.
[3] These include China, South Africa, Congo DR, Euro Area, and the United Kingdom.
[4] Central Statistical Office, Zambia Revenue Authority, Ministry of Finance, Bank of Zambia.

Domestic economic activity picked up and outlook remains positive despite challenges

Real sector indicators show a steady pickup in economic activity[5] in the first quarter of 2018 and economic outlook remains positive. The rise in economic activity is mainly attributed to the ramp up in copper production, robust growth in cement production, and the rise in tourist arrivals and electricity generation. For the year as a whole, real GDP is projected to grow by 5.0%, premised on expected expansion in mining, manufacturing, and tourism sectors.

Growth prospects, however, remain fragile in light of persistent contraction in credit to the private sector due to crowding out effects associated with high fiscal deficits, public debt and lending rates as well as rising non-performing loans. Going forward, hastened full implementation of the fiscal consolidation and structural measures in line with the Economic Sustainability and Growth Programme (ESPG) and the 7th National Development Plan (7NDP) is critically important to foster and maintain macroeconomic stability.

The MPC Decision

Taking into account the above factors, the MPC at its May 14 – 15, 2018 Meeting, decided to maintain the Policy Rate at 9.75%.

The MPC assessed that the Policy Rate at the current level is appropriate. This is also in line with the projections indicating that inflation will remain within the 6-8% target range over the forecast horizon despite the recent rise in inflation. In addition, the MPC considered:

- Higher than programmed fiscal deficits and rising public debt;
- Fragile economic growth evidenced by subdued credit growth to private enterprises; and
- The need to strengthen the resilience of the financial sector to domestic and external shocks.

Future decisions on the Policy Rate will be guided by inflation outcomes and forecasts, as well as fiscal performance.

The Bank will continue to closely monitor domestic and external sector developments and stand ready to implement appropriate measures to maintain price and financial system stability and ultimately support economic growth.

The next MPC Meeting is scheduled for August 20 – 21, 2018.

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[5] Measured on a year-on-year basis.