Bank *Of* Zambia

## MONETARY POLICY COMMITTEE STATEMENT

***Bank of Zambia (BoZ) Policy Rate lowered to 9.75% and Statutory Reserve Ratio reduced to 5.0%***

*Annual inflation has trended downwards since March 2016 following the significant tightening of monetary policy in November 2015. With inflation falling within the target range and projections consistently pointing to low inflation, the Monetary Policy Committee (MPC) commenced the easing cycle in February 2017. This policy stance was and is still intended to also support growth and promote financial system stability.* ***As inflation is currently projected to remain around the lower bound of the 6–8% target range over the next eight quarters, the MPC, at its Meeting on February 19–20, 2018, further lowered the Policy Rate by 50 basis points to 9.75% from 10.25%. The Statutory Reserve Ratio was also further reduced by 300 basis points to 5.0% from 8.0%.*** *This was to provide a firm basis for the Policy Rate as the key signal for the monetary policy stance. Economic activity has continued to improve, but growth remains below potential. Interest rates have broadly maintained a downward trend although commercial banks' lending rates remain high. Credit to the private sector also continued to improve, but modestly. Preliminary data for 2017 indicate that the Government's fiscal deficit (on a cash basis), at 6.1% of Gross Domestic Product (GDP), was below the 2017 Budget target of 7.0% of GDP. Containing the budget deficit and the overall debt, including domestic arrears, to sustainable levels remain critical to consolidating macroeconomic stability. The Bank of Zambia will closely monitor domestic and external sector developments and stands ready to implement appropriate measures to maintain price and financial system stability and ultimately support economic diversification and growth.*

***Inflation continued on a declining trend and projected to remain within the target range***

Annual overall inflation ended the fourth quarter at 6.1%, down from 6.6% at the end of the third quarter, and was at the lower bound of the target range of 6–8%. The decrease in inflation was due to the fall in both food and non-food inflation to 4.8% and 7.5% from 5.0% and 8.4%, respectively. The sustained supply of food items, particularly for maize grain and products, explained the fall in food inflation. The relatively lower fuel prices compared to the corresponding period in 2016, largely accounted for the decline in non-food inflation. In January 2018, annual overall inflation rose slightly to 6.2% mainly on account of increases in housing, furnishing and household equipment inflation.

Over the next eight quarters, inflation is projected to trend around the lower bound of the target range. In terms of risks to the projected inflation, the MPC assessed the balance of these to be on the upside. The risks include projected higher crude oil prices and potentially lower agricultural output due to poor distribution of rainfall in the southern part of the country. Notwithstanding these upside risks, inflation is projected to remain well anchored within the target range of 6–8%.

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

Following the reduction in the Policy Rate in November 2017 to 10.25% from 11.0% and the ensuing open market operations conducted by the Bank of Zambia, the overnight interbank rate declined to 9.94% at end-December 2017 from 10.4% at end-September 2017. This rate was well within the Policy Rate corridor of 9.25–11.25%.

***Demand for Government securities moderated***

Demand for Government securities moderated in the fourth quarter as subscription rates for Treasury bills and Government bonds averaged 92% and 150% from 106% and 185%, respectively. The decrease in demand was in part due to the reduction in exposure by some banks to Government securities in order to meet their liquidity obligations. The stock of Government securities rose to K48.4 billion from K45.3 billion in the third quarter. Holdings of Government securities by non-residents continued to rise, increasing by 10.3% to K8.4 billion, representing 17.6% of the total stock. Government bonds continued to be the preferred securities for non-resident investors.

***Interest rates continued on the downward trend, but lending rates remain high***

Average nominal lending rates for commercial banks declined to 24.6% in December 2017 from 29.2% in December 2016. Over the fourth quarter of 2017, average lending rates declined marginally by 0.8 percentage points from 25.4% in September. The highest lending rate also fell to 35.8% from 39.5%. However, at these levels, lending rates are too high to support the productive sectors of the economy, continue to constrain credit growth, and contribute to the current high non-performing loans. There is therefore room for commercial banks to significantly lower lending rates.

Deposit rates have continued to decline, with the highest interest rate on wholesale deposits declining to 25% in December 2017 from 27% in September 2017. At this level, wholesale rates are, however, also contributing to the high cost of credit. With respect to the savings rate for 180-day deposits for amounts exceeding K20,000, they declined to 8.6% from 9.4%. Given the current level of inflation, the real return on savings remains positive and should therefore encourage saving.

In contrast to lending and savings rates, the weighted average yield rate on Government bonds edged up to 18.6% from 17.2% while that for Treasury bills was virtually unchanged at 15%.

***Money supply increased, but private sector credit remains subdued***

Money supply growth was sustained in the fourth quarter of 2017 and accelerated to an annual growth rate of 21.4% in December from 13.3% in September. This reflected a rise in domestic credit and the accumulation of net foreign assets by the banking sector. At end-December, money supply was K54.1 billion, up from K50.1 billion at end-September.

Total domestic credit growth reduced in the fourth quarter mainly on account of slower growth in lending to Government. Domestic credit grew by 4.9% to K61.8 billion compared to 6.1% in the third quarter. Despite registering three successive quarters of positive growth, commercial bank lending to the private sector remained subdued at 4.5% in the fourth quarter of 2017 compared to 3% in the third quarter.

***Domestic economic activity improving and outlook remains positive, but challenges remain***

Available real sector and business survey[1] data indicate that economic activity continued to improve in the fourth quarter and the economic outlook remains positive. Output in selected sectors, such as mining and energy continued to expand. Overall, business conditions improved further as evidenced by increases in output, new orders, and higher sales that induced demand for labour[2].

GDP growth for 2018 and 2019 is projected at 5.0% and 5.4%, respectively. Underlying these projections is mainly the anticipated expansion in mining and manufacturing output. The recovery in electricity generation is also expected to support increased production. However, this growth remains below potential, constrained mainly by the cost of credit, high fiscal deficits, and structural weaknesses in the financial sector.

***Fiscal deficit for 2017 narrows***

For 2017, preliminary data indicate that the budget deficit on a cash basis, at 6.1% of GDP, was lower than the 2017 Budget target of 7% of GDP. Stepped up revenue collection and maintaining Government expenditures within planned levels in 2018 and over the medium-term will be critical to the narrowing of fiscal deficits and the consolidation of macroeconomic stability. Lower fiscal deficits are also essential in reducing Government yield rates, commercial bank lending rates, and in boosting extension of private sector credit to support the growth and diversification of the economy.

Some progress with fiscal reforms has been made, notably by the publication of the Medium Term Debt Strategy and the commitment to regularly publish debt reports. Work to revise the Public Finance Management Act and the Loans and Guarantees Authorisation Act and to enact a new Planning and Budgeting Bill has also advanced.

***Global economic recovery sustained***

The global economy continued to strengthen and is expected to remain robust in the medium-term as commodity prices increase and global trade expands. In 2018 and 2019, global growth

[1] Bank of Zambia Quarterly Survey of Business Opinions and Expectations, December, 2017.
[2] Stanbic Zambia Purchasing Managers Index (PMI), January 4, 2018.

projection has been revised upward to 3.9% from 3.6% and 3.7%, respectively from a preliminary outturn of 3.7% in 2017[3]. The upward revision is mainly attributed to the better growth prospects in advanced economies, favourable global financial conditions, and strong sentiments that are expected to help maintain the recent growth in global demand.

***Current account deficit narrows***

Preliminary data[4] indicate that the current account deficit narrowed significantly to US$18.5 million in the fourth quarter of 2017 from US$554.2 million in the previous quarter. This was largely on account of strong growth in exports and a substantial improvement in the primary account. Total exports grew by 21.8% to US$2,429.7 million while imports increased by 5.4% to US$2,177.4 million. Higher realised copper prices and export volumes have continued to support export earnings. A decline in retained earnings by the private sector contributed to the reduction in the deficit on the primary income. The current account deficit was financed by a surplus on the financial account and a drawdown of international reserves. At end-December 2017, gross international reserves declined slightly to US$2.1 billion from US$2.2 billion in the previous quarter. In terms of import cover, reserves remained virtually unchanged at approximately 3.0 months.

***Exchange rate depreciated in the fourth quarter but remained relatively stable in 2017***

During the fourth quarter of 2017, the Kwacha depreciated by 6.8% against the US dollar to K10.03 mainly on account of sustained demand for petroleum products and adverse market sentiments in part due to delays in concluding an IMF programme. However, for the year as a whole, the exchange rate remained relatively stable, depreciating by almost 1.0% against the US dollar. This was supported mainly by improved foreign exchange earnings due to higher commodity prices.

***The MPC Decision***

The MPC, at its February 19 – 20, 2018 Meeting, taking into account the above factors, decided to:

1. Lower the Policy Rate by 50 basis points to 9.75% from 10.25%; and
2. Reduce the Statutory Reserve Ratio by 300 basis points to 5.0% from 8.0%.

In arriving at this decision, the MPC was particularly guided by the low inflation outturn and projections that it will remain well within the medium-term target range of 6–8% over the forecast horizon (next eight quarters). In addition, the MPC considered the following:

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

[3] IMF World Economic Outlook (WEO) Update, January, 2018.
[4] Central Statistical Office, Zambia Revenue Authority, Ministry of Finance, Bank of Zambia.

In the implementation of monetary policy, the Bank of Zambia 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 measures to maintain price and financial system stability and ultimately support economic diversification and growth.

The next MPC Meeting is scheduled for May 14 – 15, 2018.

Issued by

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