Bank *of* Zambia

MONETARY POLICY COMMITTEE STATEMENT FOR FIRST QUARTER 2019

Governor's Presentation to the Media

22 May, 2019

INTRODUCTION

The presentation is structured as follows:

1. **Decision of the Monetary Policy Committee**
2. **Overview**
3. **Global economic developments**
4. **Domestic economic developments**
5. **Macroeconomic outlook**
6. **Conclusion**

MONETARY POLICY DECISION

At its Meeting held on 20 – 21 May 2019, Monetary Policy Committee decided to raise the Policy Rate by 50 basis points to 10.25%.

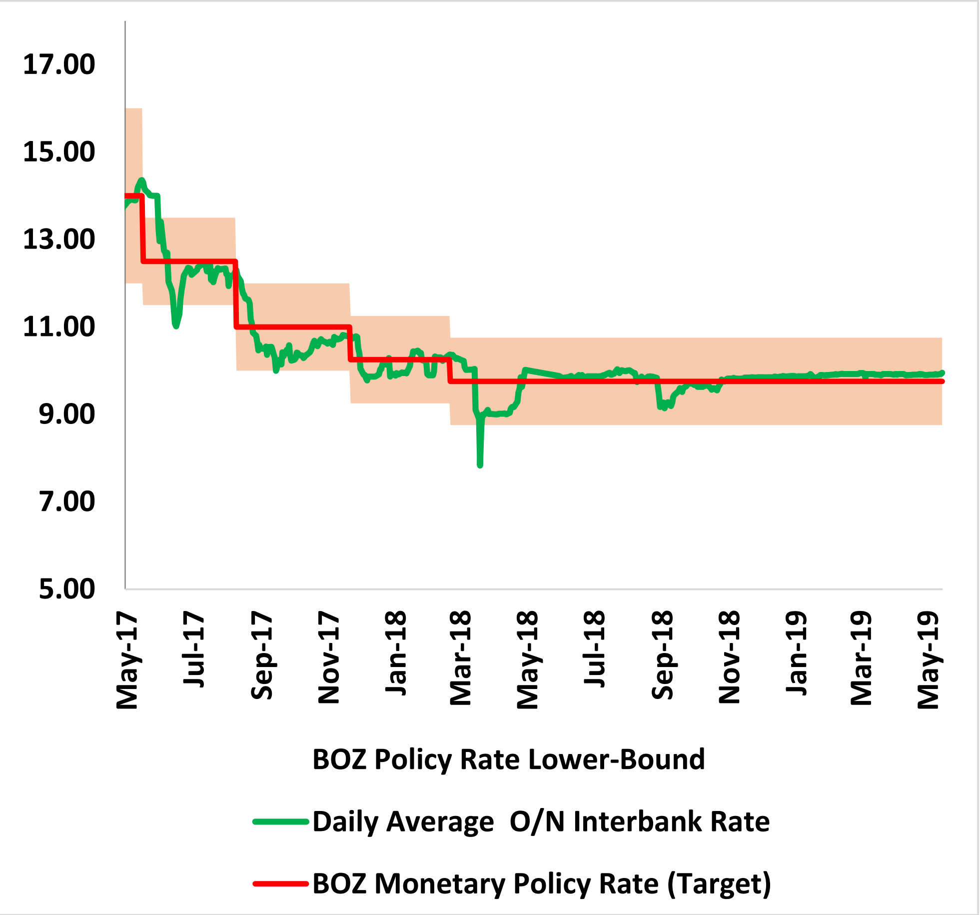
In arriving at the decision, the Committee took into account the following factors:

- **A build-up of inflationary pressures in the economy, with inflation projected to remain above the 8% upper bound of the 6-8% target range over the next eight quarters;**
- **Heightened volatility in the exchange rate of the Kwacha against major foreign currencies, with potential to further increase inflation; and,**
- **Slow progress towards fiscal consolidation as reflected in rising domestic arrears, public debt and external debt service payments.**

OVERVIEW

- In Q1 2019, monetary policy continued to focus on keeping inflation within the 6-8% target range.
- This was to be achieved by containing the interbank rate within the Policy Rate Corridor through appropriate monetary operations.
- During the quarter, the interbank rate remained within the Policy Rate Corridor, though it rose slightly to an average of 9.90% from 9.79% in the previous quarter.

Figure 2: BoZ Policy Rate and the Interbank rate (%)



Source: Bank of Zambia

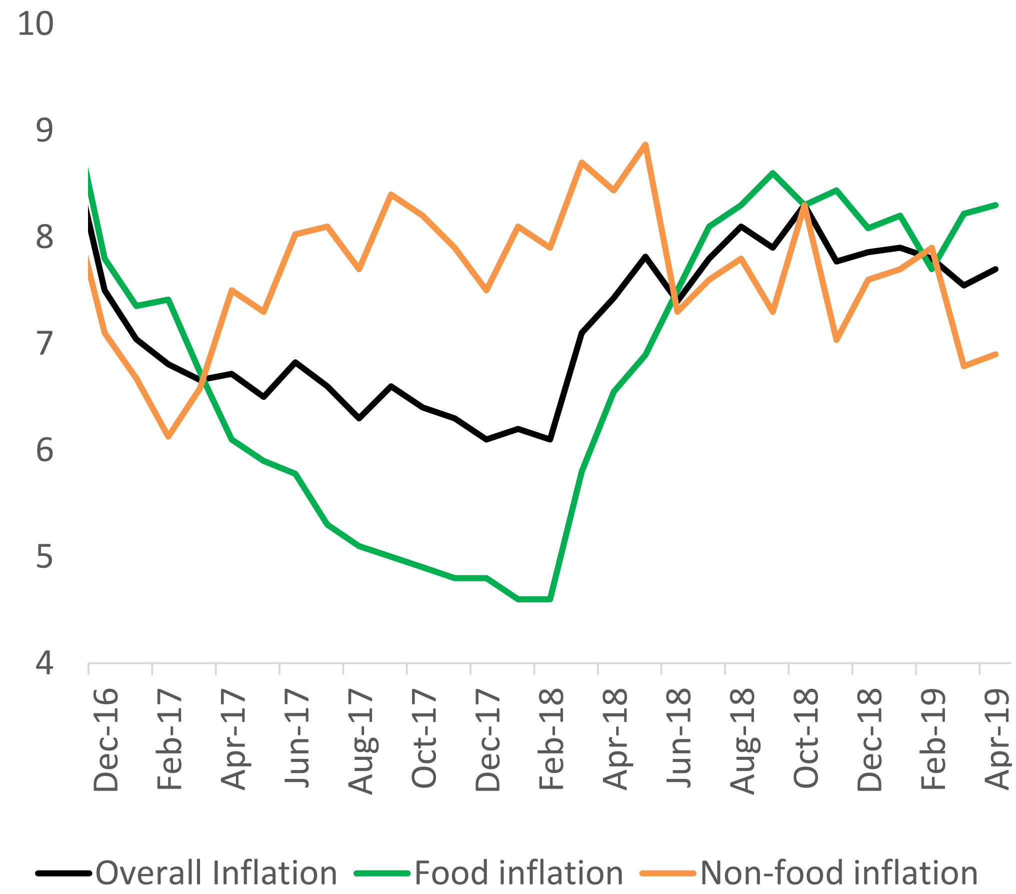
OVERVIEW

Inflation trended downwards to an average of 7.7% in the quarter under review from 8.0% in the fourth quarter of 2018.

Increased supply of selected food items and reduction in fuel prices were key in reducing inflation during the review period.

However, in April 2019, inflation edged up to 7.7% from 7.5% in March as both food and non-food inflation rose by 0.1 percentage points to 8.3% and 6.9%, respectively.

Figure 1: Inflation (Annual Change, %)



Source: Central Statistical Office and Bank of Zambia

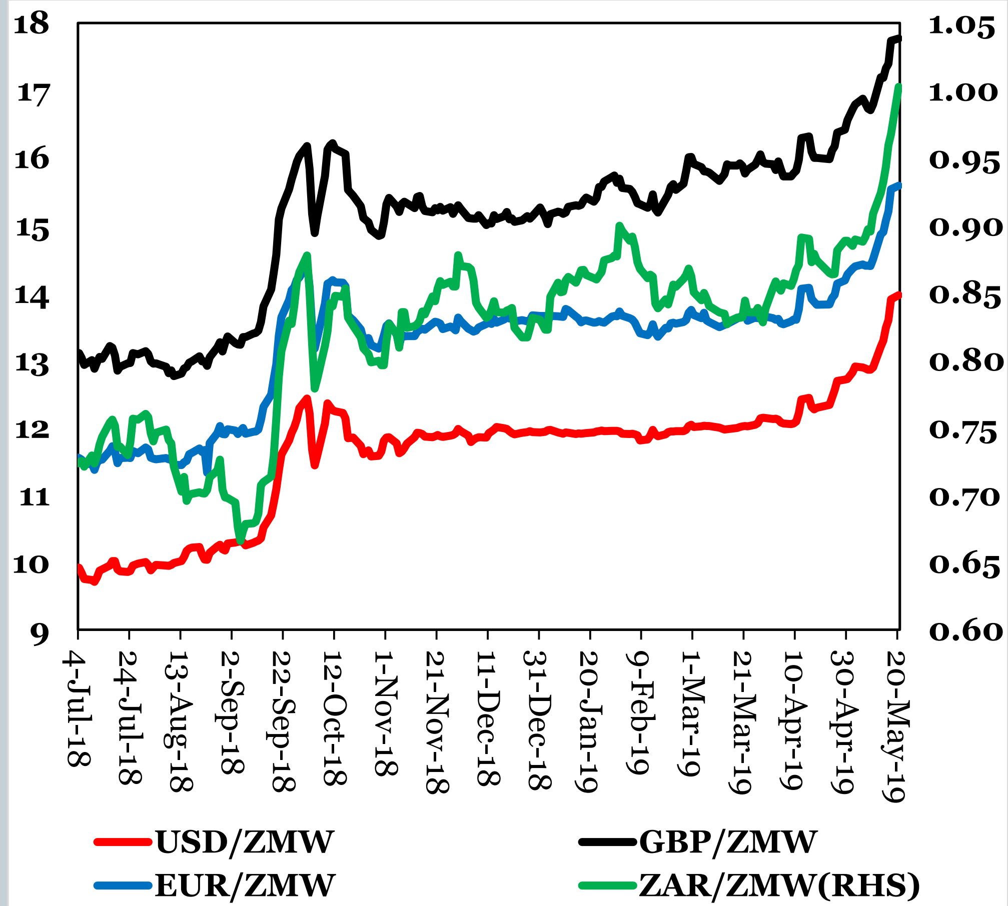
OVERVIEW

- **In Q1, the Kwacha was stable, marginally depreciating by 0.6% against the US dollar to an average of K11.95/US dollar from K11.89.**

- **However, since the beginning of the Q2, the Kwacha has come under severe pressure, depreciating by 14.9% against the US dollar to levels of around K14.00/US$.**

- **The recent depreciation is due to elevated demand for petroleum imports, reduced supply and negative market sentiments.**

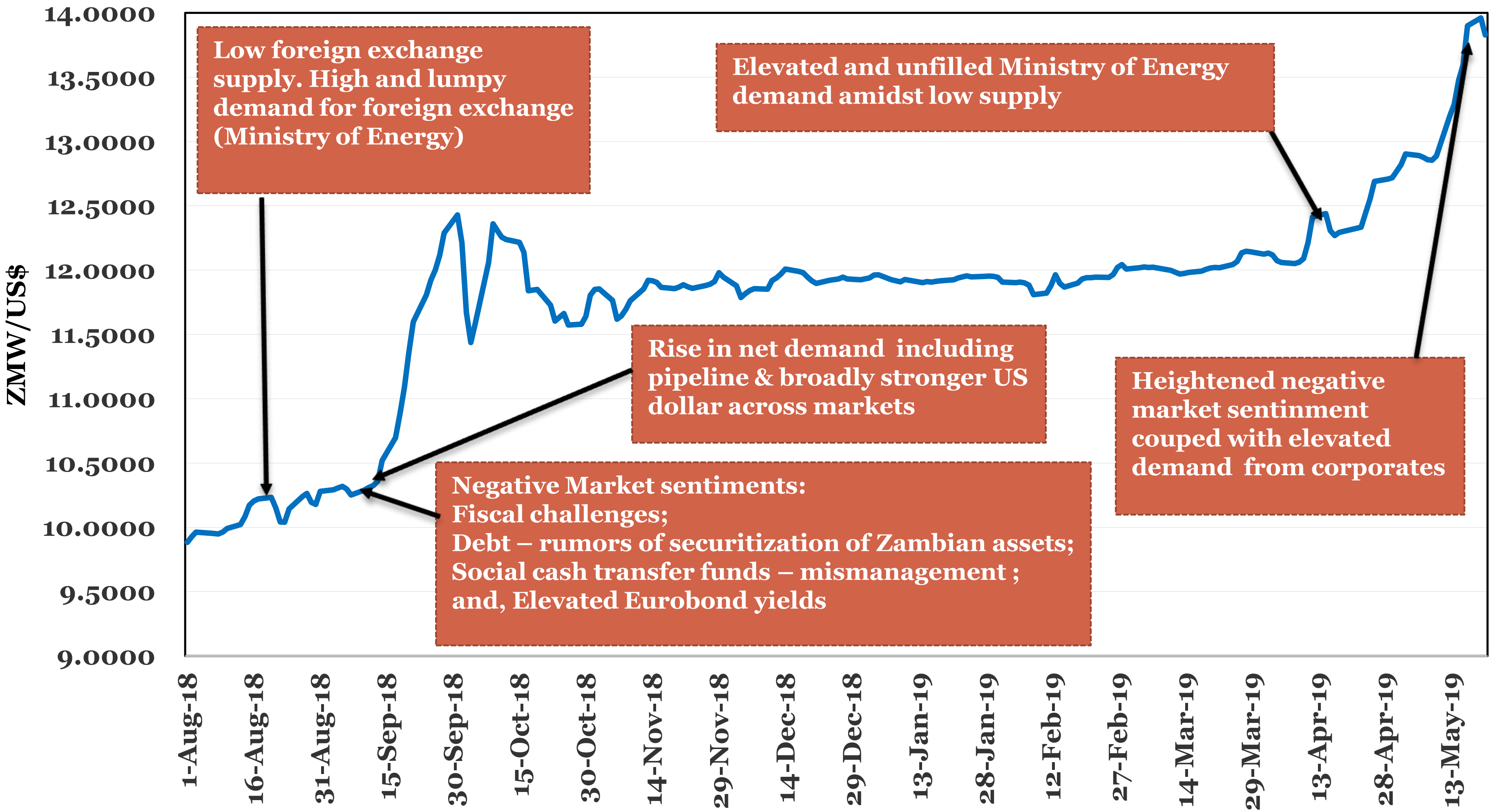
Figure 3: Nominal Exchange rate developments



Source: Bank of Zambia

OVERVIEW

Figure 4: Exchange rate developments – key factors



GLOBAL ECONOMIC DEVELOPMENTS

In Q1 2019, preliminary data suggest that global growth was stronger than anticipated due to favourable growth in some advanced economies.

However for 2019, global growth was revised downwards to 3.3%, from the earlier forecast of 3.6% in January 2019; in 2020, projected growth is unchanged at 3.6% (WEO April 2019 Update).

- **Underlying the downward revision in global growth in 2019 are:**
  - **Effects of on-going trade wars, principally between the United States and China;**
  - **Slower growth momentum in several economies, particularly in Europe; and,**
  - **Delays in concluding Brexit.**

GLOBAL ECONOMIC DEVELOPMENTS

In Q1 2019, copper prices held up, but crude oil prices declined on fears of softening global demand. The price of maize grain rose while that of wheat declined.

Table 1: Commodity Prices

	2018 Q1	2018 Q2	2018 Q3	2018 Q4	2019 Q1
Copper Price (US$/ton)	6,957.0	6,881.0	6,118.0	6,164	6,226
Oil Price (Dubai) (US$/barrel)	64.0	71.8	74.0	66.8	63.3
Wheat (US$/ton)	189.3	204.9	208.8	221.6	212.6
Maize Price (US$/ton)	163.7	173.3	157.9	162.8	167.5
Cotton (US$/kg)	2.0	2.1	2.1	1.91	1.82
Sugar (US$/kg)	0.3	0.3	0.3	0.3	0.3
Soya beans (US$/ton)	426.0	436.0	370.0	374.0	378.0

Source: World Bank

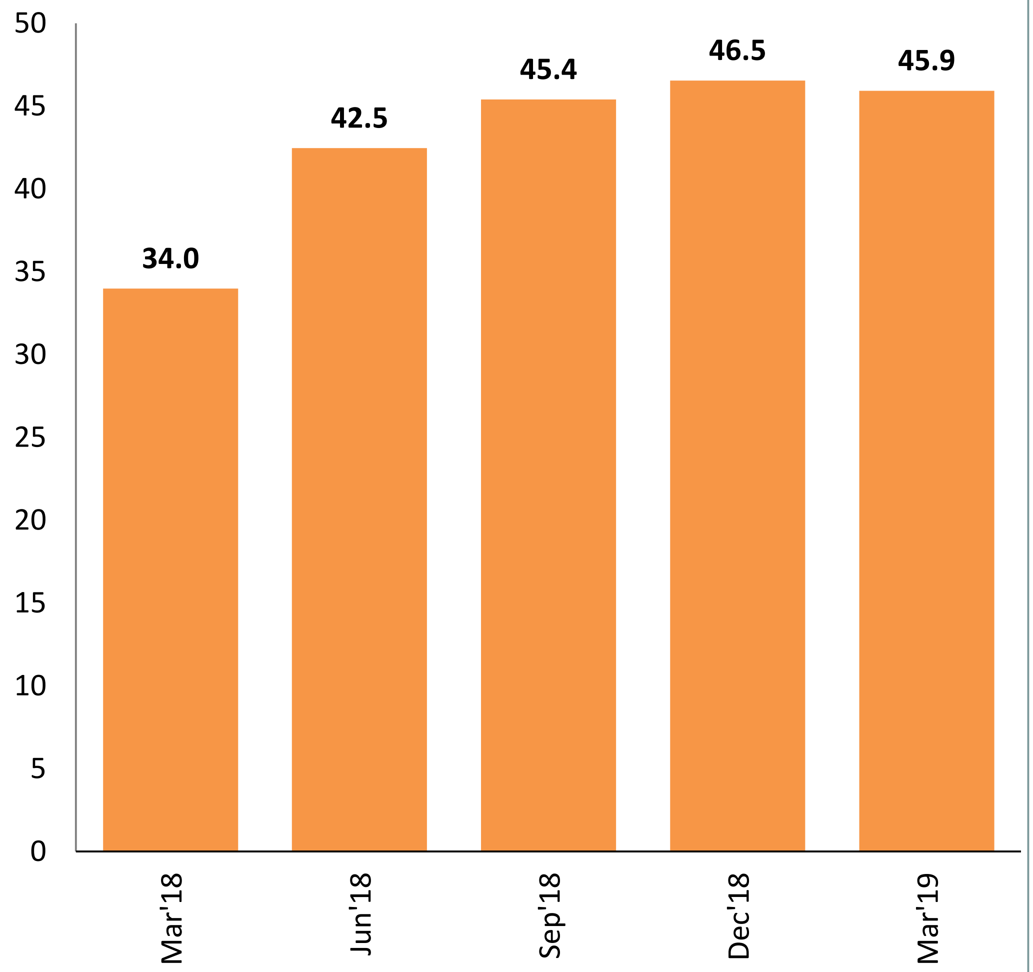
DOMESTIC ECONOMIC DEVELOPMENTS
Monetary Policy Operations

Market liquidity, measured by aggregate current account balance, closed at K2.1 billion from K1.4 billion (Table 2).

Net Government securities maturities, BoZ foreign exchange purchases and currency deposits boosted the liquidity.

In the interbank market, the volume of funds traded declined to K45.9 billion from K46.5 billion.

Figure 5: Interbank Trading Activity (K'bln)



Source: Bank of Zambia

DOMESTIC ECONOMIC DEVELOPMENTS
Monetary Policy Operations

Table 2: Key Liquidity Influences (K'bln)

	2018 Q2	2018 Q3	2018 Q4	2019 Q1
Opening balance	0.8	1.1	**2.5**	**1.4**
Net Govt. spending	1.9	-0.9	**-0.1**	**-3.8**
BoZ FX influence	1.9	1.0	**0.4**	**1.3**
CIC	-1.0	0.2	**-0.7**	**1.0**
Change in SR deposits	-4.2	-1.0	**-1.0**	**-0.5**
OLF	-1.9	-0.7	**-0.6**	**-0.1**
Net Government securities influence	2.3	2.2	**0.4**	**2.4**
Open market operations	1.1	0.4	**0.0**	**0.0**
Miscellaneous	0.0	0.2	**0.6**	**0.2**
Closing balance	1.1	2.5	**1.4**	**2.1**
Average Liquidity	0.8	1.0	**0.9**	**1.1**

Source: Bank of Zambia

DOMESTIC ECONOMIC DEVELOPMENTS
Government securities market

Demand for Government securities at auctions generally remained weak during Q1 2019.

Table 3: Government Securities Auctions

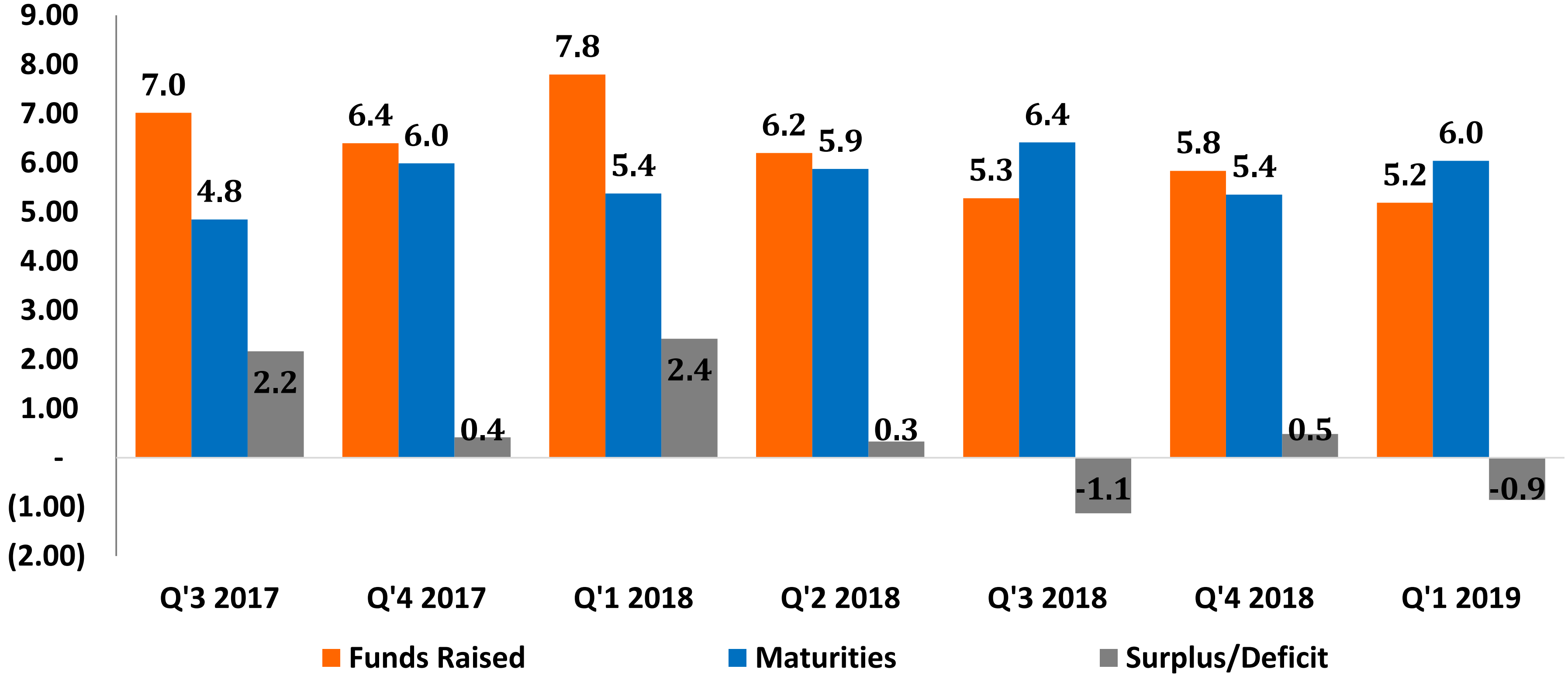
	Amount on offer	Amount Received	Subscription rate (%)
	Treasury bills		
2018Q4	6.7	5.9	88
2019Q1	5.7	5.2	91
	Government Bonds		
2018Q4	3.3	1.1	33
2019Q1	1.7	0.5	29

Source: Bank of Zambia

DOMESTIC ECONOMIC DEVELOPMENTS
Government securities market

Totals funds raised from the auctions fell to K5.2 billion (at cost) from K5.8 billion (at cost) in the previous quarter. This was against maturities of K6.0 billion, resulting in a deficit of K0.9 billion.

Figure 6: Government Securities (K'bln)

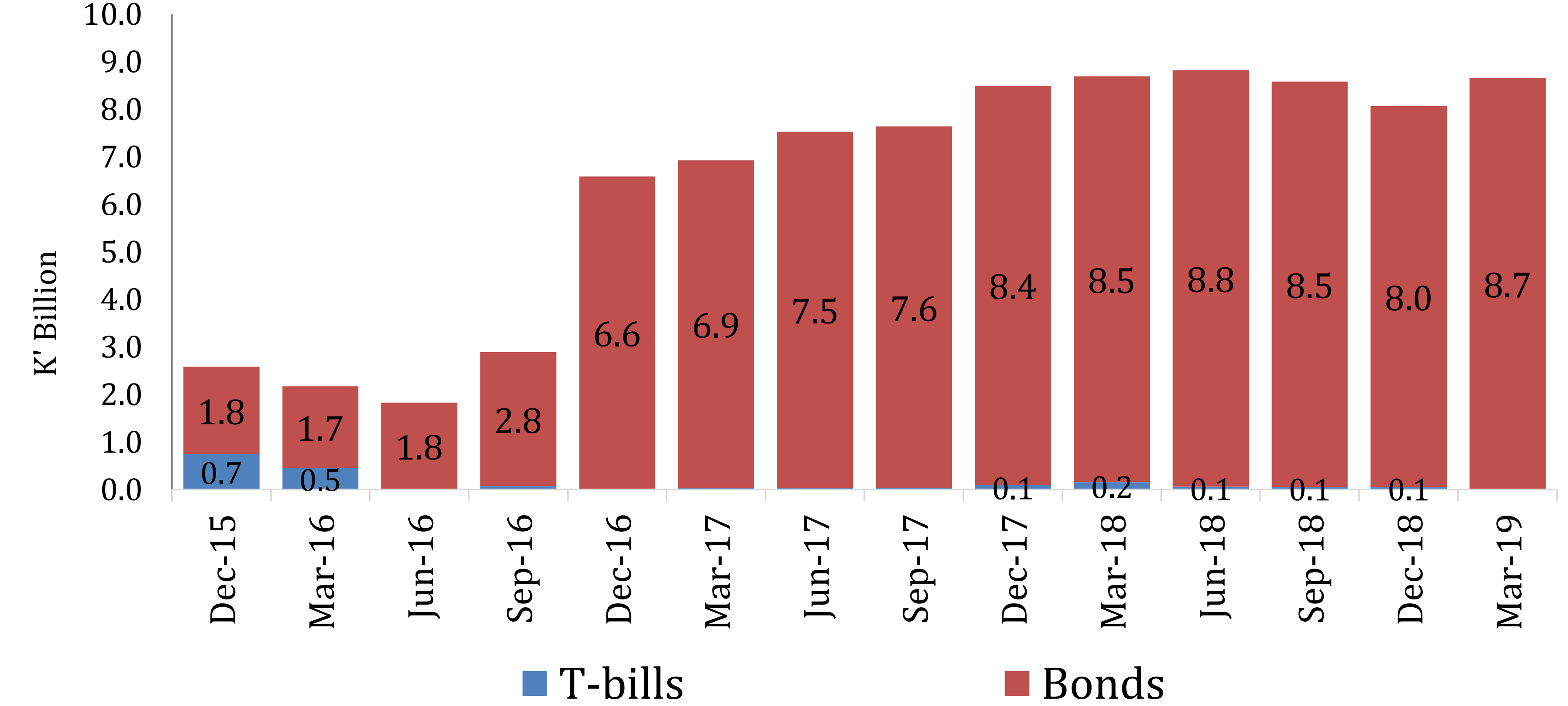


Source: Bank of Zambia

DOMESTIC ECONOMIC DEVELOPMENTS
Government securities market

Non-resident holdings of Government securities rose by 8.1% to K8.7 billion. All their holdings were in Government bonds.

Figure 7: Non-resident Holdings of Government Securities (K'bln)

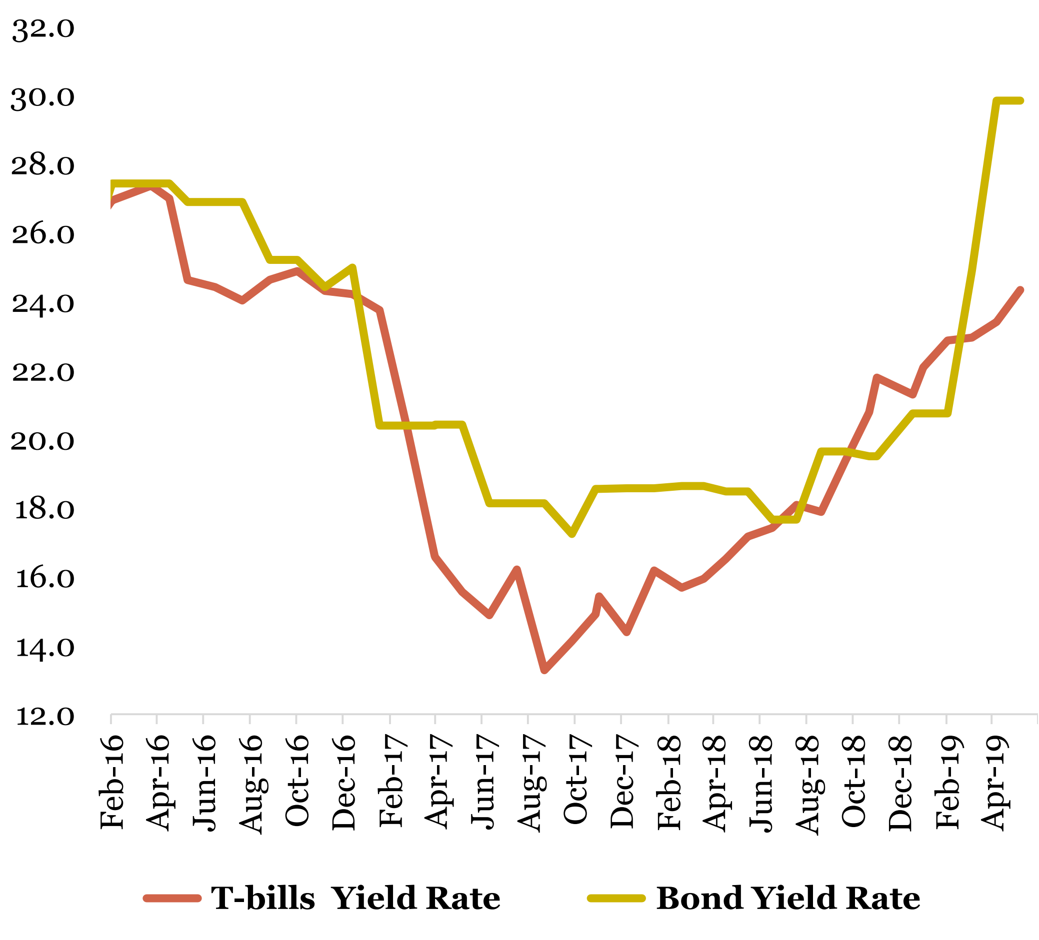


Source: Bank of Zambia

Yield rates on both Treasury bills and Government bonds rose to quarterly averages of 24.34% and 24.89% from averages of 21.58% and 20.75% in the fourth quarter, respectively.

The rise was due to relatively tight liquidity conditions and negative market sentiments associated with Zambia's sovereign credit rating down grade in February 2019.

Figure 8: Government securities yield rates (%)



Source: Bank of Zambia

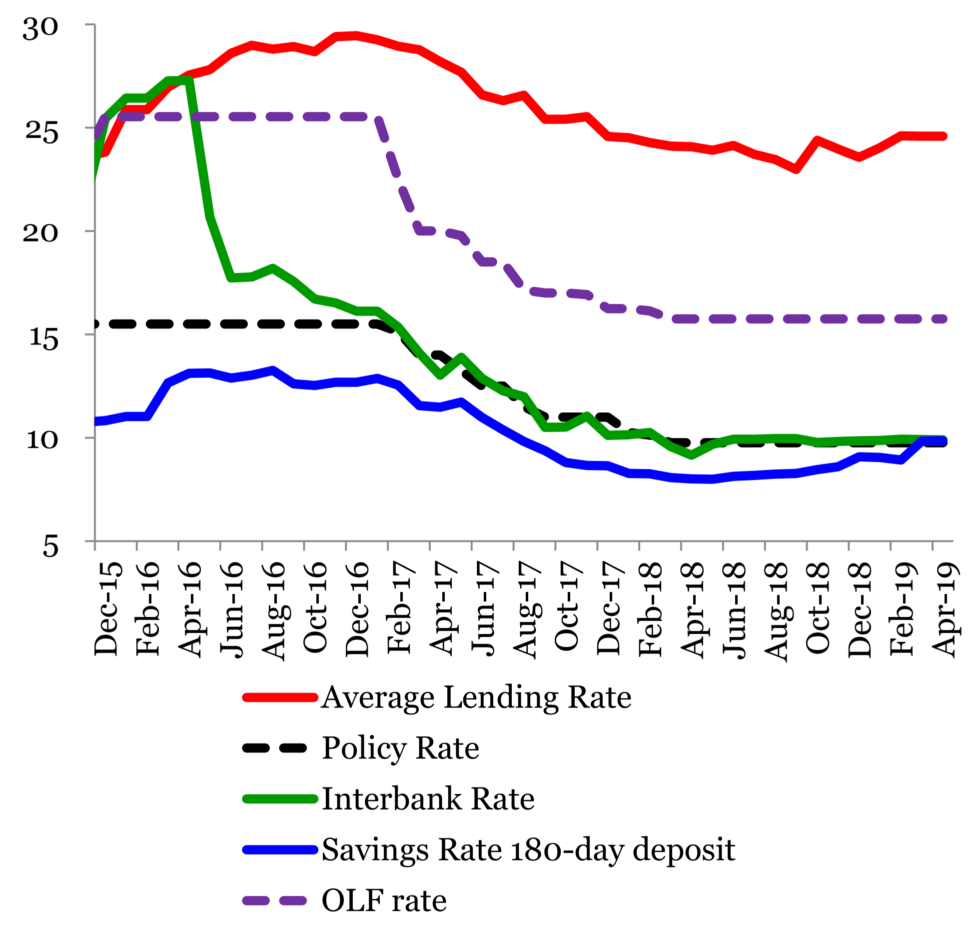
Banks' Nominal Interest Rates

Interest rates edged up on account of the increase in the cost of funds and higher yield rates on Government securities.

Banks average lending rate rose to 24.6% in Mar 2019 from 23.6% in Dec 2018; Range of lending rates on new large loans widened to 10.3%-34.5% from 10.0-28.0%) in December.

The average savings rate for 180-day deposit also rose to 9.8% from 9.1% in Dec 2018.

Figure 9: Nominal Interest Rates (%)



Source: Bank of Zambia

Money supply and credit

Total credit grew by 2.9%, up from a growth of 1.3% as lending to Government, private enterprises and households expanded.

Excluding Government, credit grew by 4.8% compared to a contraction of 0.9% in the previous quarter.

Growth in credit to Government fell to 1.1% in the first quarter from 3.3% in the preceding quarter.

Credit growth to private enterprises was 5.0% compared to a contraction of 4.6% while growth in credit to households rose to 2.8% from 2.3%.

Table 4: Domestic Credit Growth, Quarterly percent changes)

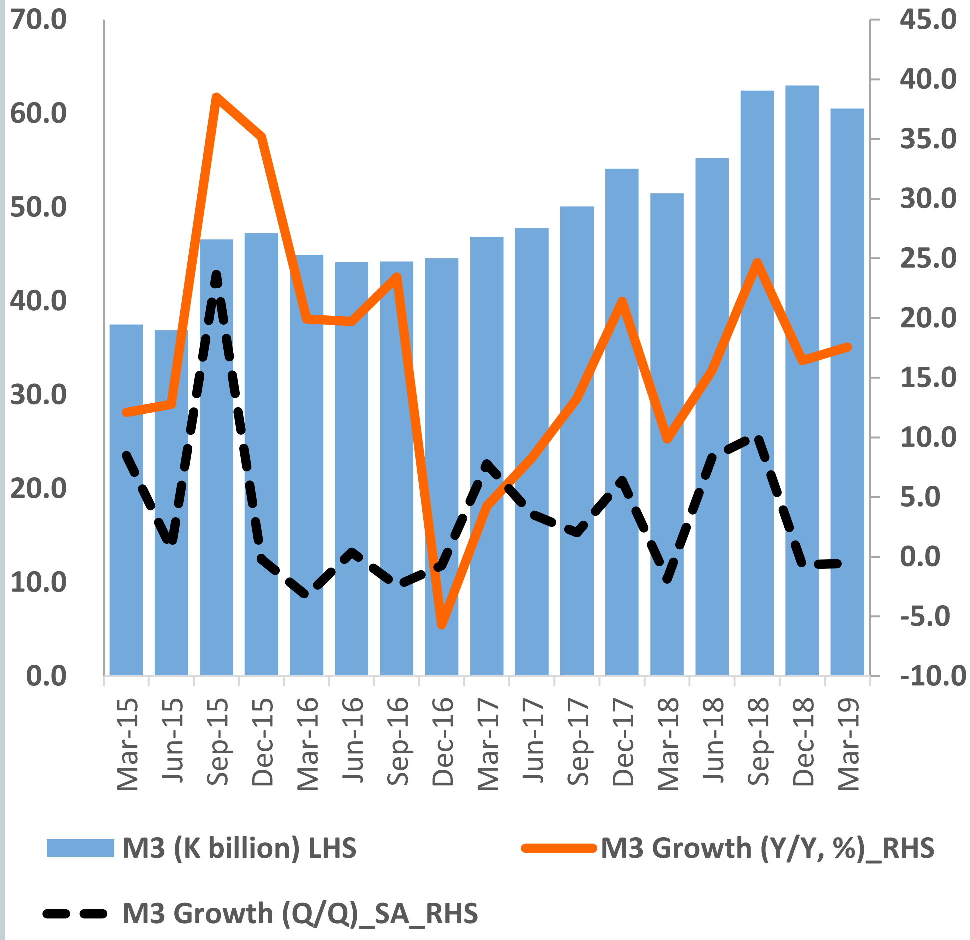
	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019
Total Credit (Incl.Govt)	0.3	2.9	9.9	**1.3**	**2.9**
Total -(Excl. Govt)	-1.3	5.0	14.3	**-0.9**	**4.8**
Government	1.7	1.3	6.2	**3.3**	**1.1**
Public Enterprises	-18.7	9.7	8.6	**22.4**	**86.3**
Private Enterprises	-3.5	4.7	19.2	**-4.6**	**5.0**
Households	3.1	5.3	7.5	**2.3**	**2.8**
NBFIs	-13.6	1.4	20.4	**80.1**	**-22.6**

Source: Bank of Zambia

DOMESTIC ECONOMIC DEVELOPMENTS
Money supply and credit

- **Money supply (M3) contracted by 3.9% in the quarter under review compared to a growth of 0.9% in the previous quarter.**
- **The contraction was on account of a decline in net foreign assets and a draw down in commercial banks offshore deposits.**
- **On a year-on-year basis, money supply growth picked up to 17.6% from 16.4% in the previous quarter.**
- **The contraction in money supply growth is indicative of continuing challenges in sustaining strong economic activity.**

Figure 10: Money Supply



Source: Bank of Zambia

DOMESTIC ECONOMIC DEVELOPMENTS
Foreign Exchange Market

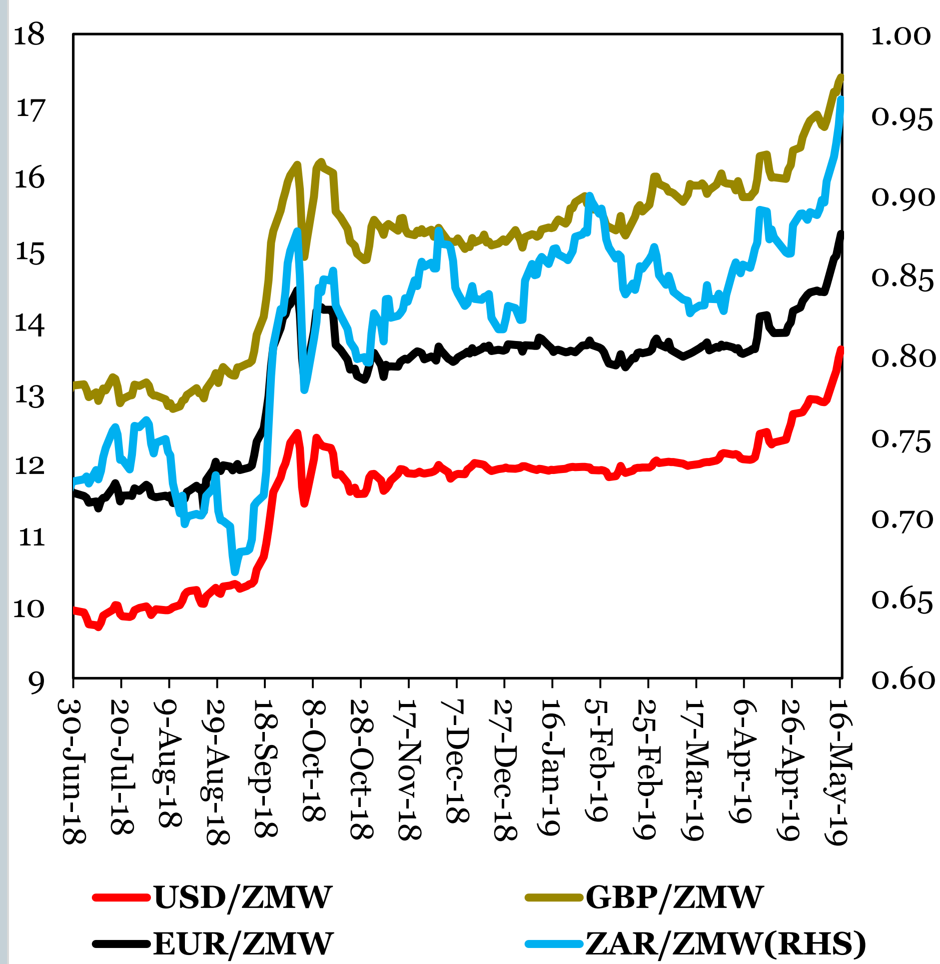
In Q1 2019, the Kwacha was relatively stable, weakening marginally by 0.6% to an average of K11.95/US dollar.

The Kwacha also depreciated against the Euro, British pound and South African rand by 0.2%, 1.8% and 2.5%, respectively.

Since the beginning of the second quarter, the Kwacha has come under severe pressure, depreciating by 14.9% against the US dollar by 17th May 2019.

The depreciation is attributed to elevated demand for petroleum imports, reduced supply of foreign exchange and negative market sentiments.

Figure 11: Exchange rate developments

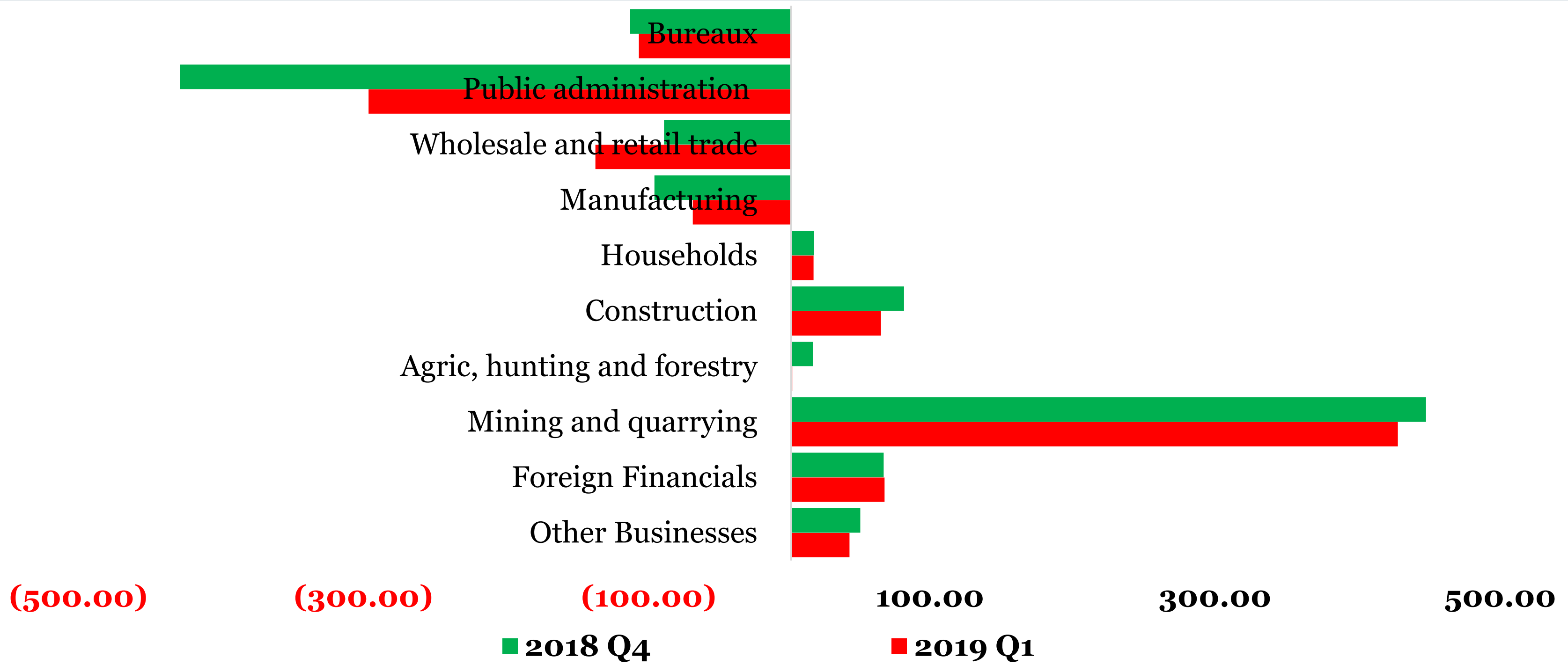


Source: Bank of Zambia

DOMESTIC ECONOMIC DEVELOPMENTS
Foreign Exchange Market

- **Net supply of foreign exchange rose to US $212.4 million in the first quarter from US $92.1 million in the preceding quarter.**
- **The mines continued to be the major suppliers of foreign exchange while the public sector continued to dominate the demand-side.**

Figure 12: Supply and Demand (US$'mln)

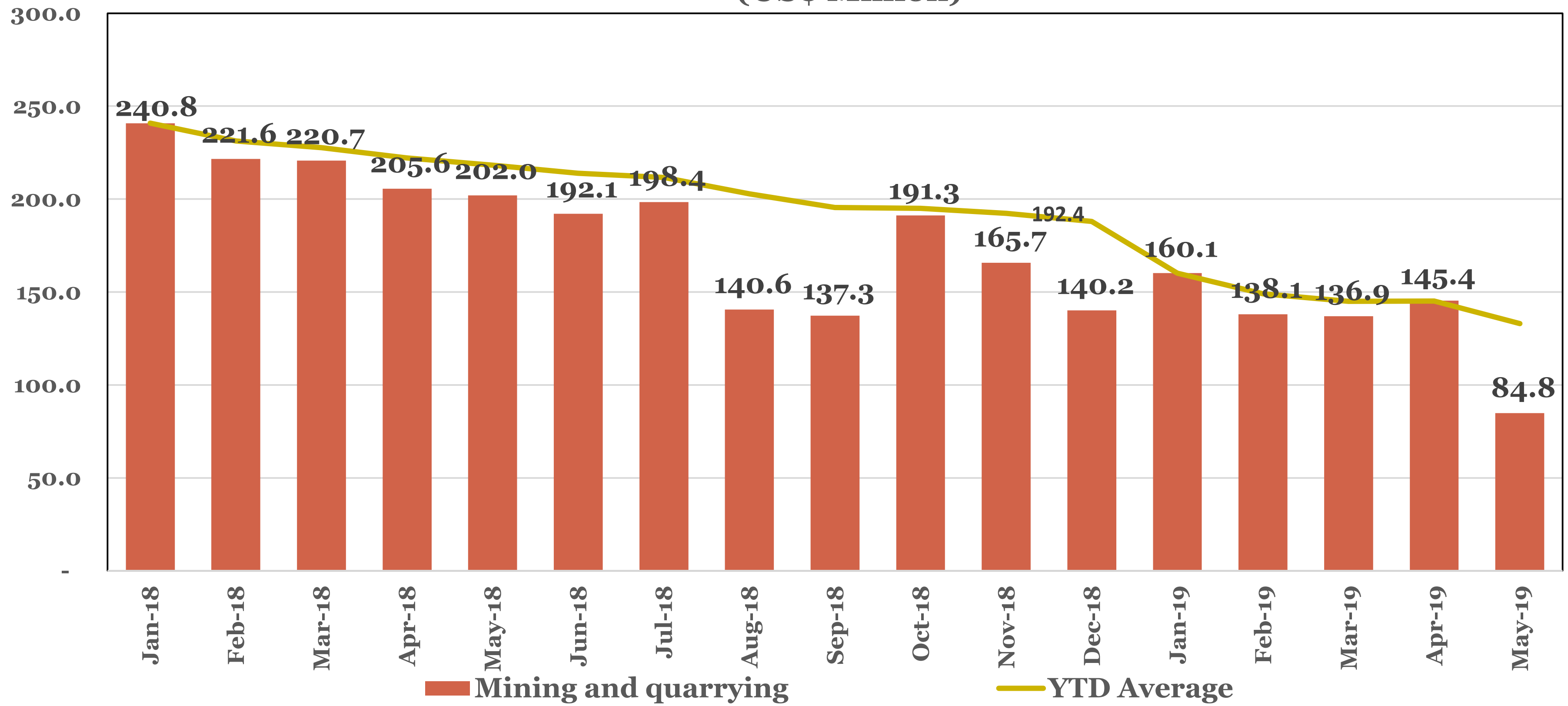


Source: Bank of Zambia

DOMESTIC ECONOMIC DEVELOPMENTS
Foreign Exchange Market

- **Supply from the mines has been declining, falling to US $435,1 million in Q1 2019 compared to US $683.1 million in Q1 2018**

Figure 13: Monthly Supply by the mining sector (US$ Million)

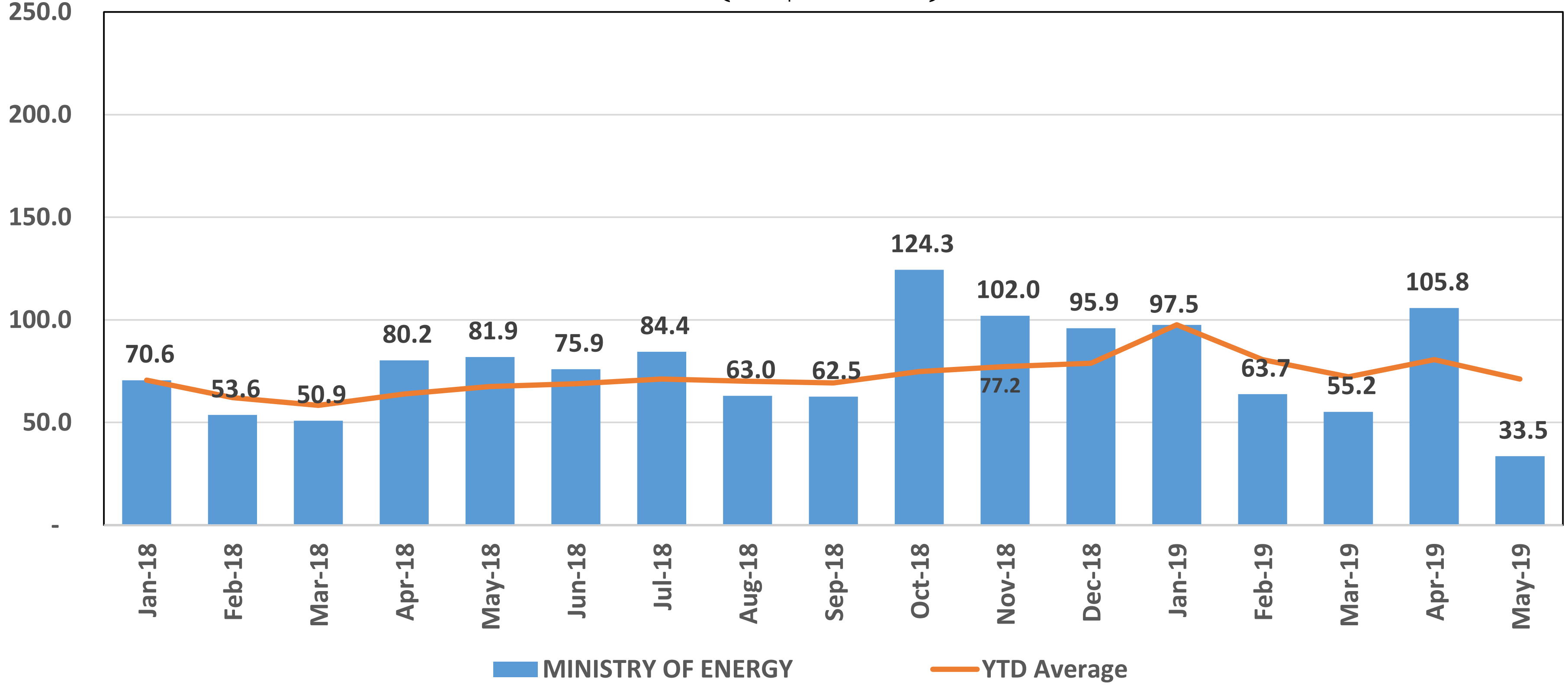


Source: Bank of Zambia

DOMESTIC ECONOMIC DEVELOPMENTS
Foreign Exchange Market

- **Demand for foreign exchange for petroleum imports has risen to US $216.4 million compared to US $178.1 million over the same period.**

Figure 14: Monthly Demand by Ministry of Energy (US$ Million)

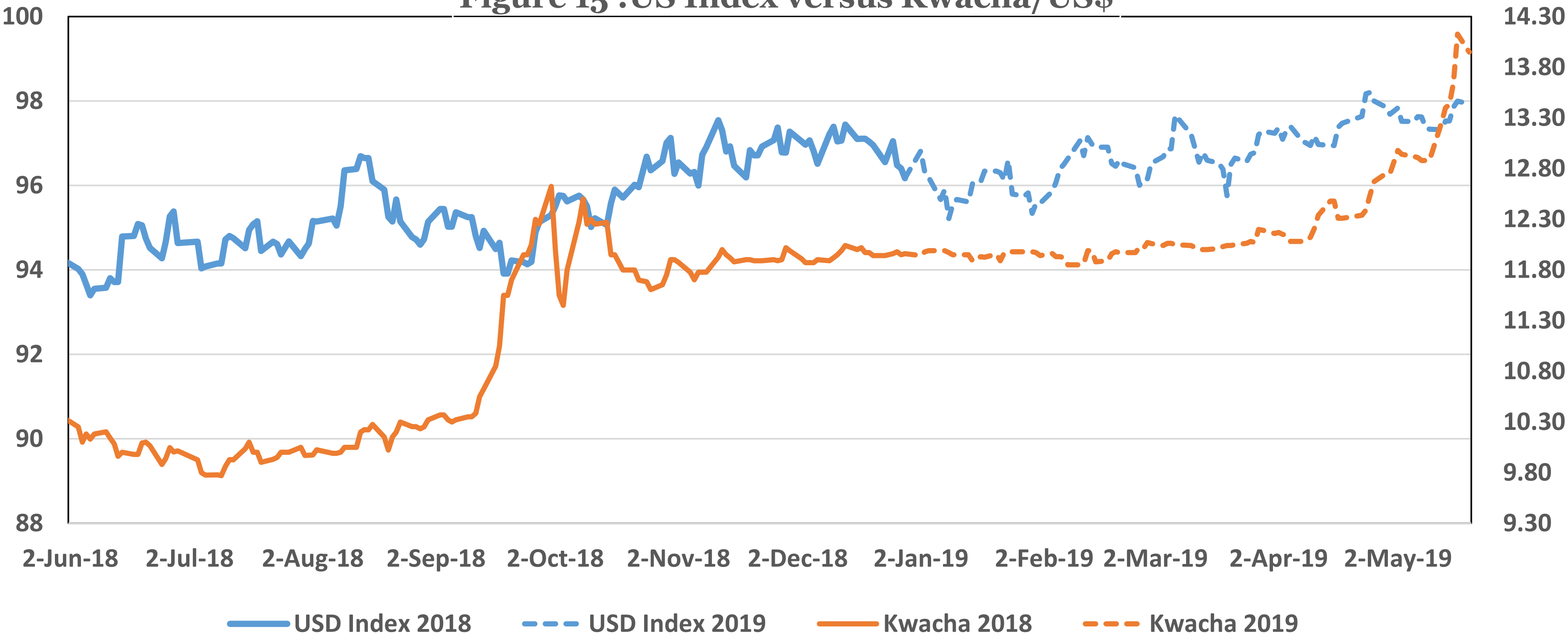


Source: Bank of Zambia

DOMESTIC ECONOMIC DEVELOPMENTS
Foreign Exchange Market

Apart from domestic factors, the US dollar has been strengthening against major trading partner currencies in 2019.

Figure 15 :US Index versus Kwacha/US$



Note: USD Index is the index of Dollar against 6 major currencies, namely Euro (EUR), Japanese yen (JPY), Pound sterling (GBP), Canadian dollar (CAD), Swedish krona (SEK) and Swiss franc. A rise in the index denotes strength of the US dollar and fall in t

Source: Bank of Zambia

DOMESTIC ECONOMIC DEVELOPMENTS
Real Sector Activity

Preliminary estimates from CSO indicate that the economy grew by 3.7% in 2018, up from 3.5% in 2017.

In Q 1 2019, economic activity was generally subdued as most economic indicators point to contraction.

Copper production contracted by 11.3% to 195,244 metric tons from 220,039 in Q4 2018.

Production of cement declined by 24.1% in the quarter under review compared to a decline of 9.5% in the preceding quarter.

Real consumer spending declined by 11.7% in the quarter under review, reflecting post-festive seasonal reduction in spending.

Electricity generation also declined by 5.7% in Q1 2019.

DOMESTIC ECONOMIC DEVELOPMENTS
External Sector

The current account surplus narrowed to US $19.4 million from US $112.2 million in Q4 2018, driven by unfavorable performance in the primary income which outweighed improvements in the goods account.

Table 5: Balance of Payments (US' million)

	Q2 2018	Q3 2018	Q4 2018	Q1 2019
Current Account Balance	**-295.5**	**131.6**	**112.2**	**19.4**
Balance on Goods	88.0	194.6	-98.7	348.5
Total Exports	**2,230.8**	**2,289.7**	**2,094.6**	**1,986.7**
Copper	1,641.2	1,628.6	1,480.9	1,431.9
Cobalt	38.2	28.7	17.5	3.3
Gold	37.5	31.3	36.9	43.2
NTEs	496.3	583.5	541.7	489.5
Total Imports	**2,142.9**	**2,095.1**	**2,193.3**	**1,638.1**
Primary Income	-294.7	30.9	309.3	-253.7
Secondary Income	67.9	68.9	70.2	71.9
Services Account	-156.8	-162.8	-168.7	-147.3
Capital Account	17.2	16.3	16.3	17.9
Financial Account	-359.0	355.0	147.0	151.1
Net Errors/Omissions	24.0	37.7	-25.0	-33.9
Overall Balance	**-104.6**	**169.4**	**43.5**	**147.7**
Change in Reserve Assets	78.3	-172.0	-72.0	-163.1

Source: Bank of Zambia

DOMESTIC ECONOMIC DEVELOPMENTS
Fiscal performance

The fiscal deficit (cash basis) in 2018 at 7.6% of GDP was above the 6.1% target, largely reflecting higher than programmed spending on capital projects and debt service on external as well as domestic loans.

However, the 2018 fiscal deficit outturn was slightly lower than 7.8% of GDP recorded in 2017.

Urgent and effective implementation of fiscal adjustment measures, therefore, remains critical to put fiscal deficits, debt levels and debt service payments on a sustainable path.

DOMESTIC ECONOMIC DEVELOPMENTS
Inflation

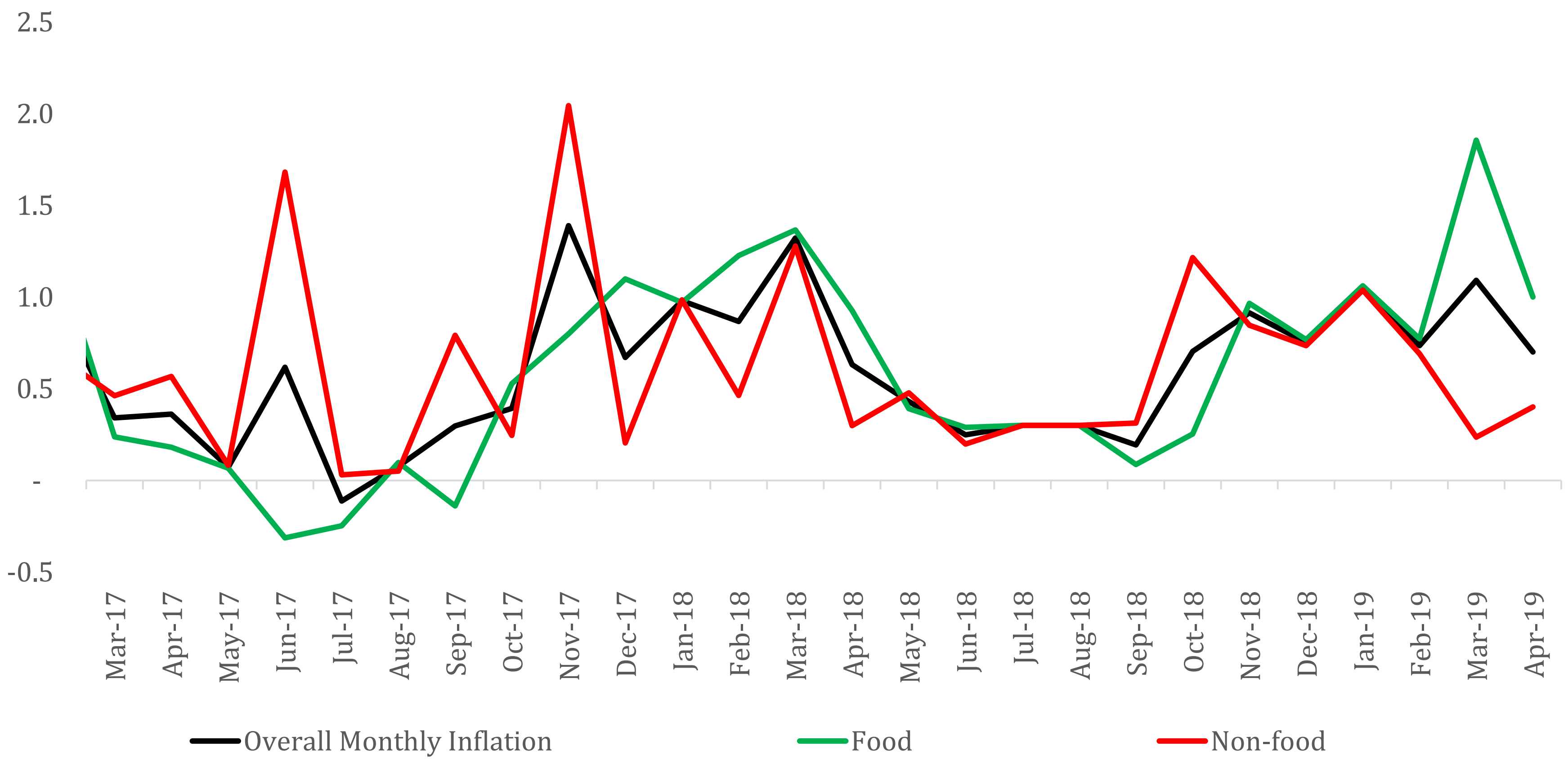
Annual overall inflation declined to an average of 7.7% in Q1 2019 from 8.0% in Q4 2018.

The fall in inflation was driven by increased supply of selected food items and the reduction in fuel pump prices.

- **At end-March 2019, inflation was 7.5%, lower than the 7.9% outturn in Q4 2018.**
- **Food inflation marginally rose to 8.2% in March 2019 from 8.1% in December 2018.**
- **Non-food inflation at 6.8% in March 2019 was lower than the 7.6% recorded in December 2019, driven by decline in fuel pump prices.**
- **In April 2019, inflation rose to 7.7% from 7.5% recorded in March, reflecting increases in both food and non-food inflation to 8.3% and 6.9% from 8.2% and 6.8%, respectively.**
- **Month-on-month inflation rose to 1.9% in March 2019 from 0.8% in December, driven largely by food inflation that rose to 1.3% from 0.3% in the preceding quarter. In April, monthly inflation slowed down to 1.1% as food inflation declined to 1.0% from 1.9% in March 2019.**

DOMESTIC ECONOMIC DEVELOPMENTS
Inflation

Figure 16: Inflation Developments, m-o-m (%)



Source: Central Statistical Office

MACROECONOMIC OUTLOOK
Real GDP growth

In 2019, economic growth is projected to slow down, mainly on account of lower agricultural production and mining output as well as constrained electricity generation.

There are downside risks to growth, which include delayed implementation of fiscal adjustment measures, rising domestic arrears and subdued credit growth to the private sector.

Overall, growth remain a concern to the Government as it is not high enough for employment creation and sustainable poverty reduction.

Source: Ministry of Finance, Central Statistical Office

MACROECONOMIC OUTLOOK
Inflation

Inflation is projected to remain outside the upper bound of the 6-8% target range over the forecast horizon.

Key upside risks to inflation outlook include:

- **Lower maize output;**
- **Continued elevated fiscal deficits;**
- **High debt service payments; and,**
- **Decline in international reserves.**

These risks are likely to impact inflation through the supply-side as well as exchange rate and expectations channels.

CONCLUSION

The MPC noted elevated inflationary pressures, with inflation projected to remain above the upper bound of the 6-8% target range.

Upside risks are judged to dominate the inflation outlook, and may lead to higher inflation outcomes than projected, if the continue to materialise.

In arriving at the decision to raise the Policy Rate, the MPC took cognizance of the anticipated slow down in growth, slow progress on the implementation of fiscal adjustment measures, weak growth in credit to the private sector and the tight financial conditions induced by external debt service.

The decision to raise the Policy Rate is therefore, aimed at countering inflationary pressure and support macroeconomic stability, which is essential for sustained and higher economic growth.

THANK YOU AND GOD BLESS…