



Bank of Zambia

MONETARY POLICY COMMITTEE STATEMENT

Monetary Policy Committee raises the Policy Rate by 50 basis points to 10.25%

The Monetary Policy Committee (MPC), at its May 20-21, 2019 Meeting, decided to raise the Policy Rate by 50 basis points to 10.25%. Inflation is projected to breach the upper bound of the 6-8% target range over the forecast horizon¹ due to heightened upside risks, some of which have materialised. Raising the Policy Rate is therefore, intended to counter inflationary pressures and support macroeconomic stability. This is essential for sustained and higher economic growth. In the medium to long-term, growth prospects remain positive. However, to actualise these prospects, there is need for urgent implementation of other corrective policy measures that set the fiscal deficits, debt levels and debt service payments on a sustainable path. Addressing rising domestic arrears will also reduce non-performing loans and strengthen the ability of financial institutions to provide credit to the private sector.

Inflation declined, but upside risks persist

Annual overall inflation declined to an average of 7.7% in the first quarter of 2019 from 8.0% in the fourth quarter of 2018 mainly on account of improved supply of some food items and a reduction in domestic fuel pump prices. At the end of the first quarter, inflation slowed down to 7.5% from 7.9% in December 2018. However, in April 2019, inflation edged up slightly to 7.7%, mostly due to high prices of maize grain and its products and the pass-through from the depreciation of the Kwacha against the US dollar.

Over the next eight quarters, inflation is projected to rise above the upper bound of the 6-8% target range as some of the risks to inflation outlined in previous MPC Statements have begun to materialise. If not addressed, inflation is expected to remain above the target range over the reference period. Lower maize output, continued elevated fiscal deficits, high debt service payments, and the decline in gross international reserves are among the key upside risks to inflation. These risks have also contributed to heightened adverse market sentiments and are exerting pressure on the exchange rate.

Interbank rate maintained within the Policy Rate Corridor

Liquidity conditions were tight during the first quarter of 2019. The Bank of Zambia conducted open market operations to keep the interbank rate close to the Policy Rate. Accordingly, the average interbank rate remained well within the Policy Rate Corridor, although it rose slightly to 9.90% from 9.79% in the previous quarter.

¹ The forecast horizon or period is the second quarter of 2019 to the first quarter of 2021.



Demand for Government securities muted

Demand for Government securities at auctions remained weak during the first quarter of 2019. The subscription rate for Government bonds fell to 29% from 33% previously. However, the subscription rate for Treasury bills rose to 91% from 88%. Overall, the funds raised through auctions were lower than maturities. As a result, the total outstanding stock of Government securities marginally decreased by 0.2% to K58.2 billion at end-March 2019.

Government securities held by non-residents increased by 8.1% to K8.7 billion, representing 14.9% of the total stock. The rise in these holdings was mainly attributed to relatively high yield rates. As at end-March 2019, the non-resident holdings of Government securities were entirely in Government bonds.

Interest rates edge up

Commercial banks' lending rates increased largely on account of the rise in the cost of funds and higher yield rates on Government securities. Commercial banks' nominal average lending rates edged up to 24.6% in March from 23.6% in December 2018. Excluding outliers², the average lending rate rose to 22.8% from 21.8% in December 2018.

The savings rate for 180-day deposits for amounts exceeding K20,000 rose to 9.8% from 9.1%. Similarly, the range of interest rates on Kwacha deposits widened slightly to 2.0% - 22.5% from 3.0% - 22.1% in the previous quarter.

The weighted average Treasury bills yield rate rose to 22.6% from 21.4% while that for Government bonds increased to 24.9% from 20.1%. The increase in yield rates was largely attributed to relatively tight liquidity conditions and negative market sentiments associated with Zambia's sovereign credit rating downgrade in February 2019.

Credit growth picks up as money supply contracts

Total domestic credit growth picked up to 2.9% in the first quarter of 2019 from the 1.3% recorded in the fourth quarter. The increase in domestic credit was driven mainly by lending to private enterprises. Credit to private enterprises grew by 5.0% against a contraction of 4.6% in the previous quarter. Growth in credit to Government, however, slowed down further to 1.1% from 3.3%.

Foreign currency denominated loans grew by 11.0% against a contraction of 2.4% in the previous quarter. This was on the back of increased lending to the transport, mining, agriculture and electricity sectors.

On the other hand, Kwacha loans grew by 2.0%, albeit lower than the 4.7% growth in the previous quarter. The increase in Kwacha denominated loans was mainly on account of higher lending to households, wholesale and retail trade, as well as electricity sectors.

Money supply, however, contracted by 3.9% in the first quarter of 2019 against a growth of 0.9% in the previous quarter. The contraction in money supply was driven by the decline in gross international reserves and a drawdown in commercial banks' offshore accounts. However, on an annual basis, money supply growth picked up to 17.6% in the first quarter from 16.4% in the preceding quarter.

Fiscal deficit remains elevated

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

² These are for banks with the highest and lowest lending rates.



However, it was slightly lower than the 2017 outturn of 7.8% of GDP. 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.

Global growth prospects remain subdued

In the first quarter of 2019, preliminary data indicate that global economic activity was generally stronger than expected on account of favourable growth in some advanced economies. However, in April 2019 the IMF³ revised downwards global economic growth forecast for the year to 3.3% from 3.6%. The downgrade in growth forecasts was mainly due to uncertainties associated with the trade war between the US and its key trading partners as well as delays in concluding Brexit. These developments are expected to continue to weigh on copper prices and consequently export earnings for Zambia.

Current account surplus narrows

Preliminary data⁴ for the first quarter of 2019 indicate that the current account surplus narrowed to US \$19.4 million from the revised figure of US \$112.2 million in the fourth quarter of 2018. This outturn was mainly driven by unfavourable performance in the primary income account following a reduction in losses attributable to foreign owned enterprises and higher interest payments on external debt.

The balance on goods improved, registering a surplus of US \$348.5 million in the first quarter of 2019, due to the contraction in imports, which outweighed the reduction in export earnings. Goods imports declined by 25.3% to US \$1,638.1 million, mostly on account of lower importation of copper ores, industrial boilers and equipment, fertilizer as well as petroleum products. As for the goods export earnings, they fell by 5.2% to US \$1,986.7 million, largely due to lower earnings from copper and non-traditional exports (NTEs). Copper exports, at US \$1,431.9 million, were 3.3% lower than the amount recorded the preceding quarter following a decline in export volumes. NTEs declined by 9.6% to US \$489.5 million owing to a reduction in earnings from burley tobacco and maize exports.

The realised current account surplus was insufficient to cover financial account outflows, resulting in the drawdown of international reserves. Gross international reserves declined to US \$1.40 billion (representing 1.7 months of import cover) from US \$1.57 billion (1.8 months of import cover) recorded at end-December 2018. Payments for principal and interest on external debt were the major factors accounting for the decline in reserves.

Moderating the decline in gross international reserves were the US \$112.0 million net purchases from the market by the Bank of Zambia and mineral royalty tax receipts of US \$78.3 million.

The Kwacha weakens against the US dollar

In the first quarter of 2019, the Kwacha remained relatively stable, marginally depreciating by 0.6% to an average of K11.96 from K11.89 per US dollar in the fourth quarter.

Subsequent to the quarter, the Kwacha has come under severe pressure. Between April 1, and May 17, 2019, the Kwacha depreciated by 14.9% to around K14.00 per US dollar. Accounting for this was elevated demand related to petroleum imports, reduced supply of foreign exchange, and negative market sentiments⁵.

³ IMF: World Economic Outlook, April 2019

⁴ Following the first quarter 2019 Private Capital Flows Survey, the primary income and financial account data was revised in line with the Bank of Zambia balance of payments revision guidelines.

⁵ In addition, the US dollar strengthened against major currencies.



Domestic economic growth remains subdued and downside risks heighten

Indicators of economic activity⁶ point to subdued economic growth during the first quarter of 2019. Mining output, cement production, consumer spending, and tourist arrivals registered negative year-on-year growth. For the year as a whole, real GDP growth is expected to slowdown, reflecting lower agriculture production and mining output as well as constrained electricity generation.

The MPC Decision

The MPC, at its May 20 – 21, 2019 Meeting, decided to raise the Policy Rate by 50 basis points to 10.25%, taking into consideration all the above factors.

Inflation is projected to breach the upper bound of the 6-8% target range over the forecast horizon. This is due to heightened upside risks to the inflation outlook, some of which have materialised.

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 persist and keep inflation above the target range, the Committee may adjust the Policy Rate further upward.

The next MPC Meeting is scheduled for August 19 – 20, 2019.

Issued by



Denny H Kalyalya (Dr)

GOVERNOR

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⁶ The Bank of Zambia Composite Index of Economic Activity, Bank of Zambia Quarterly Survey of Business Opinions and Expectations and Stanbic PMI.

