Bank of Zambia

MONETARY POLICY COMMITTEE STATEMENT

Monetary Policy Rate adjusted upwards by 50 basis point to 9.0 percent

The Monetary Policy Committee (MPC), at its November 22-23, 2021 Meeting, ***decided to raise the Monetary Policy Rate by 50 basis points to 9.0 percent****. This is to help steer inflation to single digits in 2022 and to within the 6-8 percent target range by mid-2023 as stated in the 2022 Budget Address. The Committee also took into account the need to continue supporting economic growth and maintaining financial stability. Although inflation is projected to decelerate sharply over the forecast horizon*[1]*, it will still be above the upper bound of the 6-8 percent target range. The upside risks to the inflation outlook include the possible increase in fuel pump prices and electricity tariffs necessary to restore fiscal sustainability, as well as the predicted fourth wave of COVID-19, which could disrupt supply chains and trigger price increases. Further, effective implementation of fiscal reforms will significantly complement the achievement of a low and stable inflation objective.*

Inflation continues to be above the target range

Inflation rose further by 0.2 percentage points to an average of 23.7 percent in the third quarter. This was largely due to the rise in food inflation to 30.8 percent from 29.0 percent in the previous quarter owing to supply constraints, notably for meat and poultry products. On the other hand, non-food inflation declined to 15.6 percent from 17.2 percent, mainly as a result of the appreciation of the Kwacha against the US dollar.

The impact of the appreciation of the Kwacha continued to exert downward pressure on prices leading to inflation declining to 21.1 percent in October from 22.1 percent in September.

Inflation is projected to decelerate sharply over the next eight quarters on account of the dissipation of base effects, lagged impact of the appreciation of the Kwacha, and anticipated stronger fiscal consolidation. Nonetheless, it will remain above the upper bound of the 6-8 percent target range. In 2021, inflation is projected to average 22.6 percent, decline to 15.0 percent in 2022, and to 9.3 percent during the first three quarters of 2023.

The upside risks to the inflation outlook include the possible increase in fuel pump prices and electricity tariffs necessary to restore fiscal sustainability, as well as the predicted fourth wave of COVID-19, which could disrupt supply chains and trigger price increases. The expected further decline in maize prices

[1] The forecast period or horizon is eight quarters ahead, that is, the fourth quarter of 2021 to the third quarter of 2023.

arising from the 2020/2021 bumper harvest and the forecasted normal to above normal rainfall during the 2021/2022 farming season could lower inflation in the short-term.

Demand for Government securities strengthens further

Demand for Government securities, particularly bonds, remained strong. Subscription rates for bonds and Treasury bills rose to 278.3 percent and 138.0 percent from 163.0 percent and 100 percent in the previous quarter, respectively. Explaining the strong demand were the attractive high yields, positive sentiments following Government pronouncement to accelerate discussions for an IMF Programme, and the increase in domestic liquidity. In addition to auctioned securities, Government issued other securities through private placements to pay for arrears to fuel and agricultural inputs suppliers. As a result, the stock of Government securities increased by 5.3 percent to K189.7 billion.

Non-resident investors holdings of Government securities rose by 12.4 percent to K49.2 billion, representing 25.9 percent of outstanding securities, with 97.8 percent of their holdings held in Government bonds.

In October, the subscription rate for Treasury bills remained high, averaging 315.0 percent, while that for bonds fell to 89.0 percent, reflecting reduced participation by non-resident investors in the Government bond auctions.

Interest rates continue to decline

The overnight interbank rate declined to 8.10 percent in September from 8.60 percent in June. The slight decline in the interbank rate was influenced by the improved liquidity flow to the banking system, largely dominated by net Government spending, payments for maturing Government securities, and Bank of Zambia market liquidity support through the Targeted Medium-Term Refinancing Facility (TMTRF). To contain the interbank rate in the Monetary Policy Rate Corridor of 7.5 – 9.5 percent, the Bank undertook contractionary open market operations.

The composite yield rate on Government bonds fell sharply to 24.8 percent in September from 31.6 percent in June. The Treasury bills composite yield rate also declined, though moderately to 18.0 percent from 21.9 percent over the same period. The 180-day deposit rate marginally declined to 9.2 percent from 9.8 percent. However, commercial banks’ nominal average lending rates, at 25.9 percent, remained broadly unchanged in September.

In October, the weighted average yield rate on Treasury bills and Government bonds declined further to 14.2 percent and 23.9 percent, respectively.

Kwacha lending to the private sector strengthens while growth in credit to Government and money supply slow down

Kwacha denominated credit to the private sector continued to expand, growing by 35.9 percent in September, year-on-year, from 33.8 percent in June. This was driven by conversions from foreign currency to Kwacha loans, further disbursements from the TMTRF, and drawdowns on overdraft facilities mainly to meet working capital needs. In contrast, due to conversions to Kwacha loans, foreign currency credit to the private sector contracted further by 30.8 percent over the same period.

Domestic credit to Government continued to slow down, expanding by 26.1 percent in September, year-on-year, compared to 48.3 percent in June as the uptake of Government securities by domestic players reduced.

Over the same period, money supply (M3)[2] growth substantially declined, growing by 11.2 percent from 48.3 percent due to the reduction in foreign currency deposits, valuation effects arising from the appreciation of the Kwacha, and the slowdown in domestic credit.

Domestic economic activity weakens but recovery expected to continue

The emergence of the third wave of COVID-19 and uncertainty regarding the aftermath of the General Elections led to subdued economic activity. Output, volume of sales, domestic sales, profitability, and inventories were adversely impacted according to the *Bank of Zambia Survey of Business Opinions and Expectations*. Similarly, the *Stanbic Purchasing Manager's Index (PMI)* also signalled a weak business environment for the private sector. However, in October the PMI showed a strong improvement in business conditions.

For 2021, the economy is projected to rebound, growing by 3.3 percent on the back of strong performance in the agriculture, information and communication, as well as wholesale and retail trade sectors. In 2022 and 2023, growth is expected to rise to 3.5 percent and 3.7 percent, respectively. This will be underpinned by strong performance in finance and insurance, information and communication, wholesale and retail trade, as well as mining sectors. The new waves of COVID-19, amidst the low vaccination rate, are a key downside risk to the growth outlook.

Fiscal deficit remains elevated, but expected to narrow

The fiscal deficit is expected to narrow to 10.4 percent of gross domestic product (GDP) in 2021 from an outturn of 14.2 percent in 2020[3]. This is mainly due to strong revenue collections from the mining sector and a dividend payment from the Bank of Zambia. A further decline in the deficit to 6.7 percent

[2] M3 comprises currency in circulation, Kwacha deposits, and foreign currency deposits.
[3] 2022 National Budget Speech

of GDP is expected in 2022, largely underpinned by significant reduction in spending on subsidies and capital projects.

Adhering to domestic financing plans will contribute to reducing borrowing costs for the private sector and support economic growth. Securing a funded International Monetary Fund (IMF) Programme is also key to minimising the adverse effects of domestic financing on the credit market and management of external debt to sustainable levels.

However, there are some risks to the fiscal outlook. Key among them failure to fully implement the announced fiscal consolidation measures and possible emergence of new waves of COVID-19, which could stifle economic growth and constrain revenue mobilisation.

Global economic recovery loses momentum

The recovery in global economic activity slowed down in the third quarter of 2021. This largely reflect supply chain disruptions following the re-introduction of lockdown measures to contain the spread of the highly transmittable Delta variant of COVID-19 in some emerging markets and developing economies. For the year as a whole, and on account of expansionary fiscal policies, particularly in advanced economies, and further traction in COVID-19 vaccinations, growth is projected at 5.9 percent. In 2022, growth is projected to ease to 4.9 percent due to dissipation of base effects.

Current account surplus narrows

Preliminary data indicate that the current account surplus narrowed to US$0.4 billion (7.6 percent of GDP) in the third quarter from US$0.5 billion (9.8 percent of GDP) [4] in the previous quarter, as imports expanded faster than exports. Merchandise imports rose by 24.3 percent to US$1.9 billion on the back of the appreciation of the Kwacha and a pick-up in domestic economic activity. Goods exports increased by 3.7 percent to US$2.8 billion, mainly due to higher non-traditional export earnings, particularly gemstones, cement and lime, maize and maize seed, cotton lint, and cane sugar.

Gross international reserves rose to US$2.9 billion (equivalent to 4.9 months of import cover) at end-September 2021 from US$1.4 billion (equivalent to 2.6 months of import cover) at end-June 2021. This followed the receipt of SDR937.5 million allocation (US$1.33 billion) from the IMF.

Kwacha appreciates

The Kwacha, which had been on a depreciating trend, weakening by 7.1% in the year-to-June 2021, appreciated by 25.9% between July 1 and September 30, 2021 to K16.78 per US dollar. This was on the back of improved market sentiments and sustained supply of foreign exchange, particularly from mining

[4] The current account is computed as a percent of quarterly GDP.

companies and foreign investors in Government securities. Demand persisted, reflecting payments relating to fuel arrears and procurement of agricultural inputs under FISP, as supply diminished in the latter part of the quarter. To moderate volatility while maintaining flexibility in the exchange rate, the Bank of Zambia had to sell back receipts from the mining sector amounting to US$510 million compared to US$358.2 million in the second quarter.

However, owing to sustained demand and a significant reduction in supply, the Kwacha weakened, reaching K17.64 by November 19, 2021 as demand for foreign exchange from energy, public, manufacturing as well as wholesale and retail sectors picked-up.

The MPC Decision

The MPC deduced that, although inflation would decelerate sharply over the next eight quarters, it is likely to remain above the upper bound of the 6-8 percent target range. The **Committee, therefore, decided to raise the Monetary Policy Rate by 50 basis points to 9.0 percent** to steer inflation to single digits in 2022 and to within the 6-8 percent target range by mid-2023, as stated in the *2022 Budget Address*. This decision will help to anchor inflation expectations. It is also consistent with the *July – December 2021 Monetary Policy Statement* to continue to normalise the monetary policy stance. Further, effective implementation of the anticipated fiscal reforms will significantly complement the achievement of a low and stable inflation objective. The Committee also took into account the need to continue supporting economic growth and maintaining financial stability.

The possible increase in fuel pump prices and electricity tariffs and the emergence of new waves of COVID-19, which could disrupt supply chains and trigger price increases, are the key upside risks to the inflation outlook.

Decisions on the Policy Rate will continue to be guided by inflation forecasts, outcomes, and identified risks, including those associated with financial stability and the COVID-19 pandemic.

The next MPC Meeting is scheduled for February 17 - 18, 2022.

Issued by

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