



## Bank of Zambia

### MONETARY POLICY COMMITTEE STATEMENT

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#### ***Bank of Zambia (BoZ) Policy Rate held at 9.75%***

*At its August 20 – 21, 2018 Meeting, the Monetary Policy Committee (MPC), decided to keep the Policy Rate unchanged at 9.75%. Despite edging up further in the second quarter, inflation remained within the target range of 6–8%. Annual overall inflation, at 7.4% in June 2018, was higher than the 7.1% recorded in March 2018, on account of the reduction in supply of selected food items, general increase in transportation costs, and the depreciation of the Kwacha against the United States (US) dollar. With some of the upside risks indicated in the May 2018 MPC Statement having materialised, inflation is currently projected to remain above 7.5% in the second half of 2018. It is, however, projected to slowdown and remain anchored around the mid-point of the 6-8% target range over the remainder of the forecast horizon<sup>1</sup>. During the quarter under review, there were some improvements in economic activity<sup>2</sup> and a pick-up in credit to the private sector, although growth remains subdued and fragile. Higher than programmed fiscal deficits, rising public debt, sluggish credit growth, and elevated non-performing loans (NPLs) pose downside risks to broader and robust economic growth. The decision to maintain the Policy Rate at 9.75% was therefore finely balanced against that of raising it. In this regard, the Bank of Zambia will continue to closely monitor domestic and external sector developments and stands ready to take appropriate measures to maintain price and financial system stability, and ultimately support economic growth.*

#### ***Inflation rises further and upside risks intensify over the remainder of 2018***

Annual overall inflation rose for the second consecutive quarter to 7.4% in June from the 7.1% recorded in March 2018, but remained within the 6–8% target range. The rise in inflation was mainly attributed to the reduction in the supply of selected food items, general increase in transportation costs, and the depreciation of the Kwacha against the US dollar. In July, annual overall inflation rose to 7.8%, but still remained within the target range, driven largely by seasonal increases in food prices.

Inflation is projected to remain above 7.5% in the second half of 2018, and to be anchored around 7%, the mid-point of the 6-8% target range, for the remainder of the forecast horizon. There are, however, elevated upside risks to the projected inflation over the near-term. These include higher than anticipated food prices and fiscal deficits as well as a possible rise in domestic fuel prices, owing to the upward movement in international crude oil prices. In addition, higher than programmed external debt service payments could have an adverse impact on inflation through the exchange rate channel.

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<sup>1</sup> The forecast horizon is the third quarter of 2018 to the second quarter of 2020.

<sup>2</sup> Bank of Zambia Composite Index of Economic Activity (CIEA) and the June 2018 Stanbic Bank Zambia Purchasing Managers Index (PMI).



### ***Interbank rate maintained within the Policy Rate corridor***

In line with the monetary policy stance, the overnight interbank rate was contained within the Policy Rate corridor. The rate averaged 9.67% in the second quarter, just below the Policy Rate of 9.75%. This was achieved through the conduct of appropriate open market operations.

### ***Demand for Government securities moderates***

There was a reduction in demand for Government securities in the second quarter, mainly due to low liquidity levels in the money market and adverse sentiments relating to the protracted fiscal challenges. The subscription rates for Treasury bills and Government bonds fell to 43.3% and 94.9% from 92.5% and 154.5% in the first quarter, respectively.

Despite the fall in demand for Government securities, the stock of outstanding Government securities, at K51.8 billion at end-June 2018, was 2.0% higher than the K50.9 billion recorded at end-March 2018. Holdings by non-residents increased by 3.5% to K8.8 billion at end-June, representing 17.0% of outstanding Government securities. Virtually all non-resident holdings are in bonds.

### ***Downward trend in most interest rates stalls***

Commercial banks' nominal average lending rates, which had been declining, inched up to 24.3% in June 2018 from 24.1% in March. Excluding outliers<sup>3</sup>, the average lending rate rose to 21.7% in June 2018 from 21.4%. The upward movement in nominal lending rates was partly attributed to the rise in yield rates for Treasury bills.

The yield rates for Treasury bills rose to an average of 16.96% from 15.87% in the first quarter, largely attributed to a general decline in the demand for Treasury bills by commercial banks due to low liquidity levels in the money market. Yields on Government bonds declined marginally to 18.07% from 18.64%.

A further rise in interest rates will undermine the observed growth in credit to the private sector. It is therefore important that the recently announced fiscal consolidation measures are implemented fully and effectively to avoid further undermining the already fragile economic growth.

Savings rates on outstanding deposits of wholesale funds declined significantly. The highest rates on outstanding negotiated deposits fell to 18.0% in June 2018 from 25.0% in March 2018, made possible by a general decline in funding costs for commercial banks. The savings rate for 180-day deposits for amounts exceeding K20,000, however, remained broadly unchanged at 8.2%.

### ***Credit to private enterprises and households rises and money supply expands***

Total domestic credit grew by 2.9% in the second quarter of 2018 compared to a growth of 0.3% in the first quarter. Growth in credit was on the back of a rise in lending to private enterprises and households. Credit to private enterprises grew by 4.7% against a contraction of 3.5% in the first quarter, while credit to households expanded by 5.3% from 3.1%. This was partly attributed to a reduction in the cost of wholesale funds and by banks being more willing to lend. Growth in lending to Government slowed down to 1.3% from 1.7% in the preceding quarter. The rise in Kwacha denominated loans and advances drove credit growth, as foreign currency loans remained broadly unchanged. On an annual basis, however, growth in Kwacha denominated loans remained subdued and contracted further by 1.1% in June after contracting by 0.5% in March.

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<sup>3</sup> These are banks with the highest and lowest lending rates.





Money supply expanded by 7.3% against a contraction of 4.8% in the first quarter of 2018. The increase was largely attributed to a build-up in commercial banks' foreign assets and the purchases of foreign currency by the Bank of Zambia.

### ***Fiscal deficits revised upwards***

The fiscal deficit, on a cash basis, for 2017 was revised upwards to 7.8% of the Gross Domestic Product (GDP) from the preliminary deficit of 6.1% of GDP, against the budget target of 7.0%. The 2018 budget deficit is also likely to remain above 7.0% of GDP. Worth noting and as indicated in the Ministry of Finance July 2018 Statement, domestic arrears have increased to K13.9 billion in March 2018 from K12.7 billion in December 2017. All these developments have adverse effects on the domestic economy. Therefore, urgent and full implementation of the recently announced austerity measures by the Government is critical to maintaining macroeconomic stability in both the short- and medium-term.

### ***Global growth momentum continues, but with heightened downside risks***

Global economic growth momentum was sustained, anchored on continued strong performance of the US and Chinese economies. The global economy is projected to grow by 3.9% in both 2018 and 2019. The projected positive global growth and the associated increase in copper prices are expected to support Zambia's growth prospects and export performance. Whilst global growth prospects remain positive, there are downside risks arising from the escalating trade wars and continued uncertainties surrounding the Brexit<sup>4</sup>, which could depress commodity prices and trigger capital outflows from emerging and frontier markets.

### ***Current account deficit widens***

In the second quarter of 2018, preliminary data<sup>5</sup> indicate that the current account deficit widened to US \$453.8 million from US \$302.7 million in the previous quarter, owing to unfavourable performance of the *balance on goods*.

The *balance on goods* recorded a deficit of US \$135.7 million against a surplus of US \$121.0 million. This was driven mainly by the 9.7% decline in export earnings to US \$2,169.9 million as copper earnings fell. Copper export earnings, at US \$1,602.9 million, were 16.0% lower on account of the 11.6% fall in copper export volumes and a 4.6% decline in realised prices. Imports, however, grew by 1.0% to US \$2,305.6 million. The current account deficit was financed by a surplus on the *financial account*.

In spite of the higher than programmed debt service payments of US \$230.9 million, at end-June 2018, gross international reserves remained virtually unchanged at US \$1.82 billion, representing 2.1 months of import cover. This was mainly on account of foreign currency purchases by Bank of Zambia amounting to US \$181 million.

### ***The Kwacha depreciates against the US dollar***

The Kwacha depreciated by 1.4% against the US dollar to an average of K9.8917 in the second quarter. The stronger US dollar, following the hike in the Federal Funds Rate, and adverse sentiments relating to the protracted domestic fiscal challenges, were the major drivers. Incidentally, the depreciation was despite the increase in net supply of foreign exchange, mainly from the mining industry.

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<sup>4</sup> Brexit (vote by the United Kingdom to leave the European Union)

<sup>5</sup> Central Statistical Office, Zambia Revenue Authority, Ministry of Finance, Bank of Zambia.



### ***Domestic economic activity picks up, growth prospects remain positive, but risks to growth rise***

Real sector indicators point to a rise in domestic economic activity<sup>6</sup> in the second quarter of 2018, attributed to increased output in mining and selected manufactured products. In addition, electricity generation, tourist arrivals, and consumer spending went up. Real GDP is projected to grow by 4.0% in 2018, with mining, agriculture, manufacturing, tourism and construction sectors expected to be the major drivers. However, economic recovery remains weak. Higher than programmed fiscal deficits, rising Government debt, weak credit growth, and elevated non-performing loans continue to pose downside risks to broader and robust economic growth. Business sentiments, regarding expected economic performance over the next twelve months, have also been negative for the past two quarters.

### ***The MPC Decision***

The MPC, at its August 20 – 21, 2018 Meeting, decided to maintain the Policy Rate at 9.75% taking into account the above factors.

Most importantly, inflation over the forecast horizon is currently projected to remain above 7.5% in the second half of 2018, but to be anchored around 7% over the remainder of the forecast horizon.

The MPC also took into consideration:

- Subdued and fragile economic growth; and
- The need to enhance the stability of the financial sector.

The MPC revised upwards its baseline inflation forecast on account of higher than anticipated crude oil and food prices as well as larger than projected fiscal deficits, reflected in increased public debt and debt service payments. The decision not to change the Policy Rate was therefore finely balanced against that of raising it.

**Future 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.**

**The Bank will continue to 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 growth.**

The next MPC Meeting is scheduled for November 19 – 20, 2018.

Issued by



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<sup>6</sup> Measured on a year-on-year basis.

