



Bank of Zambia

MONETARY POLICY COMMITTEE STATEMENT

Monetary Policy Rate held at 10.25%

At its August 19 – 20, 2019 Meeting, the Monetary Policy Committee (MPC) decided to keep the Policy Rate unchanged at 10.25%. Inflation is projected to remain above the upper bound of the 6-8% target range for much of the forecast horizon¹. However, towards the end of the forecast period, inflation is expected to revert to the target range. The Committee also noted, since the last MPC Meeting, the further weakening of near-term growth prospects, liquidity challenges, and risks to financial stability. Addressing large fiscal deficits, elevated debt and debt service levels, high domestic arrears, and liquidity challenges remains critical for overall macroeconomic stability and economic growth.

Inflation rises and remains elevated

During the quarter under review, annual overall inflation averaged 8.1%, up from 7.7% in the previous quarter. In June, annual inflation rose to 8.6% from 7.5% in March. Inflationary pressures increased during this period, driven, mainly, by rising food prices and the pass-through from the depreciation of the Kwacha against the US dollar. In July 2019, these inflationary pressures persisted and pushed inflation further up to 8.8%.

Inflation is projected to remain above the upper bound of the 6-8% target range for much of the forecast horizon. This is on account of the persistent rise in food prices primarily due to low agricultural food output. However, towards the end of the forecast period, inflation is expected to revert to the target range as pressure on food prices should have dissipated.

Key upside risks to the inflation outlook include persistent drought conditions that may result in reduced domestic and regional agricultural production and lower electricity generation²; higher than programmed fiscal deficits; and elevated external debt service payments. These are likely to impact inflation through the exchange rate and expectations channels. In addition, the weaker than projected global growth, partly attributed to the escalation of trade tensions between the US and China, is likely to impact commodity prices, including that for copper, which in turn may negatively affect the exchange rate and ultimately inflation. The foregoing notwithstanding, inflationary pressures may be moderated by subdued domestic aggregate demand and relatively loose global financial conditions.

¹ The forecast horizon or period is eight quarters ahead, that is, the third quarter of 2019 to the second quarter of 2021.

² As electricity generation in Zambia is predominantly hydro, the drought experienced during the 2018/2019 rainy season has led to lower electricity generation, thereby raising production costs.



Interbank rate remains within the Policy Rate Corridor

During the quarter, open market operations conducted by the Bank of Zambia contained the interbank rate within the 9.25% to 11.25% Policy Rate Corridor. The rate averaged 10.05% over the period.

Demand for Government securities remains low

On account of tight liquidity conditions, demand for Government securities remained subdued during the second quarter. The subscription rate for Treasury bills declined to 79% from 91%, while that for Government bonds almost halved to 15% from 29% previously. Nonetheless, the funds raised through auctions were relatively higher than maturities. Consequently, the total outstanding stock of Government securities rose by 3.5% to K60.2 billion at end-June 2019.

Government securities held by non-residents declined by 5.2% to K8.2 billion, representing 13.6% of the total outstanding stock, with all their holdings held in Government bonds.

Interest rates rise further

The commercial banks' average lending rate edged up to 25.4% in June from 24.6% in March, reflecting the upward adjustment in the Policy Rate in May, the increase in the cost of funds, and tight liquidity conditions. Excluding outliers³, the average lending rate rose to 22.8% from 22.3% in March 2019.

Savings rates generally increased, with the 180-day deposit rate for amounts exceeding K20,000 rising further to 10.1% from 9.8%. The range of interest rates on new Kwacha deposits increased slightly to 2.0% - 24.0% from 2.0% - 22.5% in the previous quarter.

The weighted average Treasury bill yield rate increased further to 24.3% from 22.6%, while that for Government bonds rose to 29.6% from 27.4%. The increase in yield rates was mainly attributed to subdued demand and tight liquidity conditions.

Private sector credit and money supply growth slows down⁴

Although year-on-year growth in total domestic credit increased to 20.0% in the second quarter of 2019 from 17.9% in the preceding quarter, growth in credit to the private sector slowed down to 21.4% from 22.5% the preceding quarter, reflecting tight credit conditions. The expansion in domestic credit was largely attributed to the increase in growth of credit to Government, which rose to 17.4% from 12.3%.

Money supply (M3) growth slowed down to 15.4%, year-on-year, from 17.6% the previous quarter. The decline in foreign currency deposits was the major driving factor.

Fiscal Pressures Persist

The fiscal deficit remains a major challenge in 2019. Therefore, implementation of fiscal consolidation measures to address higher than programmed fiscal deficits, elevated debt and debt service levels, high domestic arrears and liquidity challenges remains critical for overall macroeconomic stability and sustainable growth.

Global growth remains subdued and prospects worsen

The global economy slowed down in the second quarter of 2019, with advanced economies registering weaker growth. Prospects for global growth over the medium-term remain sluggish, largely due to weaker

³ These are banks with the highest and lowest lending rates.

⁴ To capture the underlying trend, year-on-year growth figures were used instead of quarterly figures.



momentum in advanced economies and China. The IMF revised global economic growth forecast for 2019 downwards to 3.2% from 3.3%⁵. These developments are likely to weigh on copper prices and consequently export earnings for Zambia.

Current account deficit narrows

Preliminary data⁶ for the second quarter indicate the narrowing of the *current account* deficit to US\$168.0 million from US\$246.4 million, mainly due to the improvements in the *primary income account*, which outweighed the unfavourable performance in the *goods account*. The *primary income account* deficit narrowed on account of the reduction in outflows of profits attributable to non-residents.

The surplus on the *goods account* narrowed by 12.3% to US\$305.6 million as export earnings reduced while imports grew. Goods export earnings fell by 0.5% to US\$1,977.6 million, largely due to lower earnings from copper, which outweighed the rise in non-traditional exports (NTEs). Copper export earnings, at US\$1,335.2 million, were 6.8% lower than the preceding quarter driven by a decline in export volumes. NTEs grew by 18.0% to US\$577.6 million owing to an increase in earnings from gemstones, burley tobacco, cement and lime, and sugar. Imports of goods increased by 2.0% to US\$1,672.0 million, mostly on account of higher importation of copper ores, chemicals, fertilizer, food items, and motor vehicles. The *current account* deficit was financed by a surplus on the *financial account*.

In spite of high debt service, at end-June 2019, gross international reserves remained broadly unchanged at US\$1.4 billion, representing 1.7 months of import cover. Net Bank of Zambia purchases of foreign exchange from the market and mineral royalty tax receipts amounting to US\$140.0 million and US\$93.5 million, respectively, accounted for this outturn. For the first half of the year, net foreign exchange purchases amounted to US\$243.0 million and mineral royalty receipts stood at US\$172.6 million.

The Kwacha depreciates against the US dollar

The Kwacha, which had depreciated by 14.9% between April 1 and May 17, 2019, made some recovery towards the end of the quarter following Bank of Zambia interventions to stem volatility. For the quarter as a whole, it depreciated by 7.7% to K12.88/US dollar owing to increased demand for foreign exchange by the energy sector, a stronger US dollar, and negative market sentiments arising from credit rating downgrades. Net supply of foreign exchange to the market, however, increased to US\$237.1 million from US\$212.4 million.

Domestic economic activity remains subdued and near-term growth prospects weaken

Indicators of economic activity point to reduced growth⁷. In addition, liquidity challenges and constrained aggregate demand continued to weigh on economic activity. Real GDP growth is projected to decline in 2019, largely reflecting the effects of drought on agriculture production and constrained electricity generation as well as lower than anticipated mining output.

The MPC Decision

The MPC, at its August 19- 20, 2019 Meeting, decided to maintain the Policy Rate at 10.25%, taking into consideration all the above factors. In particular, the Committee observed that although inflation is projected to remain above the upper bound of the 6-8% target range for much of the forecast horizon, it

⁵ World Economic Outlook, July 2019

⁶ 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.

⁷ The Bank of Zambia Composite Index of Economic Activity, Bank of Zambia Quarterly Survey of Business Opinions and Expectations and Stanbic PMI.



will revert to the target range towards the end of the forecast period. In addition, note of further weakening of near-term growth prospects since the last MPC Meeting, liquidity challenges, and risks to financial stability was made. The Committee may adjust the Policy Rate upward, if inflation does not revert to the target range.

Decisions on the Policy Rate will continue to be guided by inflation forecasts and outcomes, identified risks, and progress in the execution of fiscal consolidation measures.

The next MPC Meeting is scheduled for November 18 – 19, 2019.

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