Bank of Zambia

MONETARY POLICY COMMITTEE STATEMENT

Monetary Policy Rate maintained at 9.0 percent

The Monetary Policy Committee (MPC), at its August 15-16, 2022 Meeting, ***decided to maintain the Monetary Policy Rate at 9.0 percent****. The Committee considered the sharp deceleration in inflation in the second quarter of the year and a further projected decline into the 6-8 percent target range during the first quarter of 2024. The Committee was also mindful of the lingering vulnerabilities in the financial sector, relatively tight domestic liquidity conditions, and weak domestic growth. Sustained implementation of fiscal consolidation and structural reform measures, supported by the Extended Credit Facility (ECF) from the International Monetary Fund (IMF), are among the key factors expected to contribute to lower inflation. However, the Committee noted upside risks to the inflation outlook that include persistently elevated energy prices, higher than expected maize prices, adverse weather conditions, tight global financial conditions and weak demand, as well as supply chain disruptions that could stem from COVID-19 containment measures.*

Inflation declines further

Annual average overall inflation fell sharply to 10.5 percent in the second quarter from 14.1 percent in the first quarter. The dissipation of shocks to prices of meat and poultry products as well as solid fuels, the appreciation of the Kwacha against the US dollar, and improved supply of vegetables were key in driving inflation down. Average food and non-food inflation declined to 12.8 percent and 7.5 percent from 16.1 percent and 11.6 percent, respectively.

Following the increase in fuel pump prices on June 30 and the subsequent rise in transportation costs, annual overall inflation rose to 9.9 percent in July from 9.7 percent in June.

Over the forecast horizon[1], inflation is projected to decline to averages of 11.4 percent and 8.4 percent in 2022 and 2023, respectively, from the outturn of 22.1 percent in 2021. In the first half of 2024, inflation is expected to average 7.0 percent. These projections are underpinned mainly by sustained implementation of fiscal consolidation and structural reform measures as well as the benefits associated with securing an IMF Extended Credit Facility.

[1] The forecast horizon is from third quarter of 2022 to the second quarter of 2024.

August 17, 2022

Bank Square, Cairo Road, P.O. Box 30080, Lusaka, Zambia Tel:+260-211-399301,399300. Fax: +260-211-237070. E-mail: govenor@boz.zm. Web: http://www.boz.zm

Working through the exchange and interest rates channels, these factors are also anticipated to boost market confidence and anchor inflation expectations. This will in turn foster a stable macroeconomic environment, essential for sustainable and transformative growth.

Nonetheless, there are upside risks to the inflation outlook. These include persistently elevated energy and food prices due to the prolonged Russia-Ukraine conflict, tighter global financial conditions, weakening global growth amid higher global inflation, spillovers from intensified COVID-19 pandemic containment measures in other countries, and higher domestic maize prices due to the short supply of this staple grain in some neighbouring countries.

Interest rates movements mixed

The average interbank rate remained virtually unchanged at 8.9 percent and was maintained within the Monetary Policy Rate Corridor throughout the quarter. The commercial banks' average nominal lending rate was also broadly unchanged at 25.2 percent. In contrast, the 180-day deposit rate for amounts exceeding K20,000 declined to 6.8 percent from 7.5 percent. The weighted average Treasury bill and Government bond yield rates, however, rose by 0.3 and 0.4 percentage points to 13.0 percent and 22.1 percent, respectively. The rise in yield rates largely reflected reduced demand as liquidity conditions tightened[2].

Credit slows down and money supply contracts further

In June, domestic credit growth slowed to 6.8 percent, year-on-year, compared to 11.5 percent in March. This was largely attributed to the slowdown in lending to Government and contraction in private sector credit. Growth in credit to Government decelerated to 12.0 percent, year-on-year, in June against the 16.8 percent in March. Furthermore, credit to the private sector contracted by 2.1 percent, year-on-year, relative to the 1.3 percent growth over the same period. This was primarily due to valuation effects on foreign currency loans, which offset the moderate growth in Kwacha denominated credit.

Money supply (M3) contracted further by 5.2 percent, year-on-year, during the quarter under review. This was largely due to the slowdown in total domestic credit and valuation effects following the appreciation of the Kwacha against the US dollar.

[2] Foreign exchange sales by the Bank of Zambia and currency demand by the non-bank public significantly reduced the commercial banks' current account balances held at the Bank.

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Domestic economic activity picks up

High frequency indicators point to a pick-up in economic activity in the second quarter. According to the *Bank of Zambia Quarterly Survey of Business Opinions and Expectations*, ***the volume of sales and service, domestic sales, profitability,*** and ***level of investment*** increased. Similarly, the *Stanbic Bank Zambia PMI™* Purchasing Managers' Index (PMI) rose to a quarterly average of 50.1 from 49.9 in the previous period, signalling improved business conditions for the private sector as *output* and *employment* went up.

In July, the PMI rose to 50.5 from 49.9 in June, indicating improvement in private sector business conditions as customer demand rose.

Real GDP growth is projected to gradually pick up in the medium-term. The economy is forecast to expand by 3.1 percent, 4.0 percent, and 4.1 percent in 2022, 2023 and 2024, respectively. Growth over the period is expected to come from the financial and insurance, information and communications, wholesale and retail trade, mining and quarrying, agriculture, as well as education sectors. Nevertheless, the impact of the Russia-Ukraine conflict, resurgence of the COVID-19 pandemic, tighter domestic and global financial conditions, as well as slow recovery in trade partner countries remain key downside risks to the growth outlook.

Lower fiscal deficit sustained

Preliminary data indicate a lower cash fiscal deficit in the second quarter, largely on account of reduced expenditure amid strong revenue performance. A standstill on external debt service, principally to non-multilateral creditors, and lower spending on capital projects underlie this outturn. In contrast, revenue exceeded the target due to relatively higher realised copper prices and improved tax payments by the non-mining sector. However, significant fiscal risks remain, including the Russia-Ukraine conflict and subsequent unprecedented rise in energy and food prices, and unfavourable weather conditions.

Global growth downgraded

In July, the IMF[3] revised global growth downwards by 0.4 and 0.7 percentage points for 2022 and 2023 to 3.2 percent and 2.9 percent, respectively. Tighter global financial conditions following contractionary monetary policies by major central banks, lower consumer spending, higher food and energy prices, stemming from the Russia-Ukraine conflict, as well as stringent containment measures associated with

[3] International Monetary Fund, *World Economic Outlook Update*, July 2022.

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new COVID-19 variants and the real estate crisis in China necessitated the revision. The persistence of these factors presents key downside risks to global growth.

Current account surplus narrows

Preliminary data indicate a narrowing of the *current account* surplus to US$0.2 billion[4] in the second quarter from US$0.5 billion in the preceding quarter. This was attributed to the decline in net exports of goods and widening deficit on the *services account*. Imports grew by 23.3 percent to US$2.1 billion, driven by a pick-up in economic activity and appreciation of the Kwacha against the US dollar. In contrast, exports declined by 2.2 percent to US$2.9 billion, owing to the moderation in copper earnings that reflected the reduction in both volume and average realised prices. The *service account* deficit widened on account of higher transportation expenditures as imports recovered.

Gross international reserves marginally increased to US$3.0 billion (3.7 months of import cover[5]) at end-June 2022 from US$2.9 billion (3.6 months of import cover[6]) at end-March. The primary sources of inflows were mining tax payments and receipt of project funds.

Kwacha appreciates

During the quarter under review, the Kwacha appreciated by 3.4 percent against the US dollar to an average of K17.15/US$. The Kwacha's strength arose mainly from increased supply of foreign exchange. Positive market sentiments arising from stronger prospects of securing an IMF Extended Credit Facility following the meeting of the Official Creditor Committee on external debt restructuring under the G20 Common Framework also contributed to the observed appreciation of the Kwacha.

Total supply of foreign exchange to the market during the quarter was US$2,128.3 million out of which the Bank of Zambia received US$494.0 million (23.2 percent) through mining taxes. In order to manage periodic exchange rate volatility in the face of increased prices of petroleum products and fertilizer following the Russia-Ukraine conflict, the Bank provided US$424.0 million back to commercial banks.

[4] The current account surplus reduced to 2.6 percent of GDP from 7.9 percent in the first quarter.

[5] Projected imports of goods and services were US$9,782.6 million

[6] Projected imports of goods and services were US$9,402.5 million

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Bank *of* Zambia

Monetary Policy Committee Decision

The Monetary Policy Committee (MPC), at its August 15-16, 2022 Meeting, **decided to maintain the Monetary Policy Rate at 9.0 percent**. The Committee considered the sharp deceleration in inflation in the second quarter and a further projected decline into the 6-8 percent target range during the first quarter of 2024.

Sustained implementation of fiscal consolidation measures and structural reforms under the Eighth National Development Plan, supported by the Extended Credit Facility from the IMF and its catalytic benefits, are among the key factors expected to contribute to lower inflation.

The Committee was also mindful of the lingering vulnerabilities in the financial sector, relatively tight domestic liquidity conditions, and weak domestic growth.

Further, the Committee took into account risks to the inflation outlook from both domestic and global factors. These included persistently elevated energy prices, higher than expected maize prices, adverse weather conditions, tight global financial conditions and weak demand, as well as supply chain disruptions that could stem from COVID-19 containment measures.

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

The next MPC Meeting is scheduled for November 21 and 22, 2022.

Issued by

Dr. Denny H. Kalyalya
GOVERNOR

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