Bank *of* Zambia

MONETARY POLICY COMMITTEE STATEMENT

Monetary Policy Rate maintained at 9.0 percent

At its February 14-15, 2022, Meeting, the Monetary Policy Committee (MPC) ***decided to maintain the Monetary Policy Rate at 9.0 percent.*** *Key factors the Committee took into account in arriving at this decision include the sharp deceleration in inflation and its projected continued downward trend towards the 6-8 percent target range over the forecast period.[1] However, there are upside risks to the inflation outlook that include increase in crude oil prices, initial effects of implementing the transition to cost reflective electricity tariffs, possible lower crop production due to adverse weather conditions, lingering supply chain bottlenecks induced by the COVID-19 pandemic, and tightening of monetary policies in major economies. The Committee also noted and welcomed the Government's Medium-Term Budget Plan (White Paper). Successful execution of this Plan is deemed critical to the achievement of macroeconomic stability, including low inflation and a stable financial system.*

Inflation continues to trend downwards

Annual overall inflation declined sharply to an average of 18.9 percent in the fourth quarter of 2021 from 23.7 percent in the third quarter. This was largely driven by the appreciation of the Kwacha against the US dollar and the dissipation of base effects, particularly for meat and poultry products. As a result, both food and non-food inflation declined to 24.5 percent and 12.5 percent from 30.8 percent and 15.6 percent, respectively.

In January 2022, inflation fell further to 15.1 percent from 16.4 percent in December 2021, largely as a result of improved supply of fruits and vegetables.

Inflation is projected to continue trending downwards towards the 6-8 percent target range over the forecast period, averaging 13.2 percent in 2022 and 7.3 percent in 2023. Underlying this projection are mainly the catalytic benefits of securing an IMF programme, such as, access to budget support, reduction of the external debt burden through restructuring, and unlocking investments, as well as the positive impact of higher copper prices, mainly through the exchange rate. Further, the dissipation of base effects will contribute to the projected fall in inflation.

However, there are upside risks to the inflation outlook. These include the increase in crude oil prices, possible lower crop production due to adverse weather conditions, lingering supply chain bottlenecks induced by the COVID-19 pandemic, and tightening of monetary policies in major economies in

[1] The forecast period or horizon is eight quarters ahead, that is, the first quarter of 2022 to the fourth quarter of 2023.

response to rising inflation in their jurisdictions. The transition to cost reflective electricity tariffs may also have short-term effects on inflation although over the medium to long-term, this is expected to have positive economic benefits through, for example, increased investment, supply, access to electricity, and exports.

Interest rates performance mixed

The movement in interest rates was mixed. The overnight interbank rate increased while yield rates on Government securities and commercial banks' savings rates declined. On the other hand, commercial banks' average lending rate remained unchanged.

Consistent with the increase in the Policy Rate from 8.5 percent to 9.0 percent in November 2021, the overnight interbank rate rose, closing the quarter at 8.93 percent in December from 8.10 percent in September. However, it was contained within the bounds of the Monetary Policy Rate Corridor throughout the quarter.

Yield rates on Government securities trended downwards for the fourth successive quarter, falling to 13.0 percent and 21.9 percent in December from 15.6 percent and 23.9 percent in September for Treasury bills and Government bonds, respectively. The fall in yield rates is largely explained by sustained demand for Government securities. This is evidenced by the high subscription rates of Government bonds and Treasury bills at 185.1 percent and 120.0 percent, respectively. A major driver of strong demand for Government securities was improved liquidity conditions.

The 180-day deposit rate, for amounts exceeding K20,000, reduced to 7.5 percent from 9.2 percent. However, commercial banks' average lending rate ended the quarter unchanged at 25.9 percent.

Credit and money supply growth slow down further

In December, growth in Kwacha lending to the private sector moderated to 19.4 percent, year-on-year, from 35.9 percent in September. This was mainly on account of reduced disbursements under the Targeted Medium-Term Refinancing Facility as available funds were nearly exhausted. Over the same period, some corporates continued to convert foreign currency credit into Kwacha. This contributed to a further contraction of foreign currency credit by 31.3 percent compared to 30.8 percent in September. Lending to Government increased by 19.4 percent, year-on-year, in December compared to 26.1 percent in September. The slowdown is largely explained by reduced loans and advances to Government.

Similarly, the growth in money supply (M3)[2] declined further to 4.3 percent in December, year-on-year, from 11.2 percent in September as domestic credit decelerated and international reserves declined, driven by debt service and net Bank of Zambia foreign exchange sales to the market.

Domestic economic activity shows signs of recovery

High frequency indicators suggest some recovery in economic activity in the fourth quarter, driven by increased consumer demand during the festive season and enhanced investor confidence. According to the *Bank of Zambia Survey of Business Opinions and Expectations*, the level of investment, capacity utilisation, new orders, volume of sales, domestic sales, and profitability improved. The *Stanbic Purchasing Manager's Index (PMI)* at an average of 51.5[3] also signalled a healthier business environment for the private sector.

In January 2022, however, the PMI declined to 49.9, reflecting a deterioration in the business environment, occasioned by the fourth wave of the COVID-19 pandemic.

Real GDP is projected to grow moderately over the medium-term. Strong performance in finance and insurance, information and communication, wholesale and retail trade, education as well as mining sectors will underpin this growth. The economy is projected to grow by 3.5 percent, 3.6 percent, and 3.9 percent in 2022, 2023 and 2024, respectively from the preliminary outturn of 3.3 percent in 2021. Key downside risks to the growth outlook include uncertainty surrounding the resurgence of new COVID-19 variants, amid low vaccination rates, and lower than anticipated recovery in the economies of major trading partner countries.

Fiscal deficit narrows amid emerging upside risks

Preliminary estimates indicate that the fiscal deficit in 2021 was broadly in line with the target due to strong revenue performance despite expenditure (excluding amortisation) exceeding the target. Total revenue and grants exceeded the target mainly on account of higher tax collections from the mining sector.

The fiscal deficit is projected to narrow to 6.7 percent in 2022, 6.3 percent in 2023, and 5.2 percent in 2024[4] as revenue performance is enhanced, expenditure controls are strengthened, and an IMF Programme, that catalyses the mobilisation of external budget support, is secured. Key risks to the fiscal outlook include emergence of stronger variants of COVID-19 and the effects of adverse weather

[2] M3 comprises currency in circulation, Kwacha deposits, and foreign currency deposits.
[3] PMI readings above 50.0 signal an improvement in business conditions while readings below 50.0 indicate a deterioration.
[4] Refer to the 2022-2024 Medium-Term Budget Plan (White Paper) published by the Ministry of Finance and National Planning in February 2022.

conditions on crop production, infrastructure, and people's lives and livelihoods. These are likely to put pressure on the budget through reduced revenues and higher than planned spending.

Global growth prospects weaken

Global economic recovery gathered pace in the fourth quarter on the back of accelerated growth in advanced and emerging market economies as COVID-19 vaccinations gained further traction. However, global growth is projected to slow down to 4.4 percent in 2022 and soften further to 3.8 percent in 2023 from a resilient recovery of 5.9 percent in 2021. Expansion in major economies, particularly those of the United States and China, is expected to weaken, reflecting tightening of monetary policy and lingering supply disruptions. Another key downside risk to global growth outlook over the medium-term is the possible emergence of new and highly transmissible COVID-19 strains.

Current account surplus expands

Preliminary data indicate an expansion in the current account surplus to US$0.7 billion (14.5 percent of Gross Domestic Product (GDP) in the last quarter of 2021 from US$0.3 billion (5.0 percent of GDP)[5] in the previous quarter as exports of goods increased amid the contraction in imports. At US$3.1 billion, goods exports were 9.1 percent higher due to increased copper and non-traditional export earnings. Imports fell by 9.1 percent to US$1.8 billion, largely reflecting COVID-19 pandemic induced supply disruptions.

Gross international reserves declined slightly to US$2.8 billion (equivalent to 4.4 months of import cover) at end-December 2021 from US$2.9 billion (4.9 months of import cover) at end-September 2021.This was mainly on account of net foreign exchange sales amounting to US$146.0 million against net purchases of US$156.0 million in the preceding quarter.

Kwacha appreciates

The Kwacha, which appreciated strongly during the third quarter, came under pressure for most part of the quarter, except in December when it was supported by positive sentiments after a Staff-Level Agreement was reached with the IMF. The rate of appreciation reduced to 7.4 percent in the fourth quarter compared with 17.5 percent in the previous quarter. Most of the pressure emanated from higher demand for the importation of petroleum products while supply declined. To help meet demand and dampen volatility in the exchange rate, the Bank of Zambia continued to support the market and sold a net of US$146.0 million.

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

In January 2022, increasing demand pressures continued and the Kwacha depreciated by 2.9 percent against the US dollar to a monthly average of K17.27.

The MPC Decision

The Monetary Policy Committee (MPC), at its February 14-15, 2022 Meeting **decided to maintain the Monetary Policy Rate at 9.0 percent**. In arriving at this decision, the Committee took into account the sharp decline in inflation since the November 2021 MPC Meeting and the forecast that shows a continued deceleration in inflation towards the 6-8 percent target range. However, there are upside risks to the inflation outlook that include increase in crude oil prices, initial effects of implementing the transition to cost reflective electricity tariffs, possible lower crop production due to adverse weather conditions, lingering supply chain bottlenecks, induced by the COVID-19 pandemic, and tightening of monetary policies in major economies in response to rising inflation in their jurisdictions.

The Committee also noted and welcomed the Government's Medium-Term Budget Plan (White Paper). The importance of successful execution of this Plan to the achievement of macroeconomic stability, including low inflation and a stable financial system, can hardly be overemphasised.

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 May 16 and 17, 2022.

Issued by

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