Bank *Of* Zambia

## MONETARY POLICY COMMITTEE STATEMENT

***Bank of Zambia (BoZ) Policy Rate lowered to 10.25% and Statutory Reserve Ratio reduced to 8.0%***

*The Monetary Policy Committee (MPC), at its Meeting on November 20–21, 2017, lowered the Policy Rate by 75 basis points to 10.25% from 11.0% and reduced the Statutory Reserve Ratio by 150 basis points to 8.0% from 9.5%. In arriving at this decision, the Committee took into account that annual overall inflation declined to 6.6% at the end of the third quarter and is trending towards the lower bound of the 6–8% medium-term target range. Economic activity has continued to improve. Interest rates have, broadly, continued to decline. However, commercial banks' lending rates have remained high and credit to the private sector has continued to be subdued. Preliminary data for the year to September indicate that the Government's fiscal deficit (on a cash basis) was in line with the 2017 Budget target of 7.0%. Containing the budget deficit and the overall debt, including domestic arrears, to sustainable levels remain critical to consolidating macroeconomic stability. The Bank of Zambia will 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 diversification and growth.*

***Inflation declined and is trending towards the lower bound of the 6–8% medium-term target range***

Annual overall inflation ended the third quarter at 6.6%, down from 6.8% at the end of the second quarter, well within the medium-term target range of 6–8%. The marginal decrease in inflation was largely due to the pass-through from the appreciation of the Kwacha against the U.S. dollar and the seasonal increase in the supply of some food items. Food inflation declined to 5.0% from 5.8%, outweighing the increase in non-food inflation, which rose to 8.4% from 8.0%. This increase was mainly due to the 25.0% upward adjustment in electricity tariffs in September 2017.

Year to October 2017, annual overall inflation stood at 3.9%. Over the next eight quarters, it is projected to trend towards the lower bound of the target range. The risks to inflation are, on balance, currently assessed to favour low and stable inflation. The excess supply of maize from the 2016/17 farming season, and relative stability in the exchange rate of the Kwacha on the back of the recovery in commodity prices, especially for copper, are expected to support low inflation.

***Interbank rate remained within the Policy Rate corridor***

Following the reduction in the Policy Rate in August 2017 to 11.0% from 12.5% and the ensuing open market operations conducted by the Bank, the overnight interbank rate declined to 10.4% at end-September 2017 from 12.2% at end-June. At this level, it was within the Policy Rate corridor of 10-12%.

***Demand for Government securities remained high***

Demand for Government securities remained high in the third quarter, as subscription rates for Treasury bills and Government bonds averaged 106.0% and 122.0%, respectively. The sustained high demand was largely driven by eased liquidity conditions and higher participation by non-resident investors. The stock of Government securities rose to K45.3 billion from K42.0 billion in the second quarter. Holdings of Government securities by non-residents increased by 1.3% to K7.6 billion, representing 16.9% of the total stock. Government bonds continued to be their preferred securities.

***Interest rates continued to fall, while lending rates remain high***

Yield rates on both Treasury bills and Government bonds continued to decline, reflecting increased demand. The weighted average yield rates for Treasury bills and Government bonds dropped to 10.6% and 17.2% in September 2017 from 14.1% and 19.9% in June 2017, respectively.

Average nominal lending rates for commercial banks remained high, declining only marginally to 25.4% in September 2017 from 26.6% in June 2017. In addition, the highest lending rate increased to 39.5% in September from 37.0% in June 2017 in spite of the easing of monetary policy. While recognizing the current high non-performing loans and yield rates on Government securities as some of the underlying factors for the elevated cost of credit, there is still room for commercial banks to adjust lending rates downwards.

Deposit rates (cost of funds) have come down, with the highest interest rates on wholesale deposits declining to 27.0% in September from 29.5% in June. The savings rate for 180-day deposits for amounts exceeding K20, 000 also declined to 9.4% from 11.0%, whilst the average savings rate for amounts below K100 was virtually unchanged at 1.9%.

***Money supply increased, but private sector credit remains subdued***

Money supply growth more than doubled in the third quarter to 4.8% as domestic credit continued to expand. At end-September 2017, money supply was K50.8 billion, up from K47.8 billion at end-June 2017.

Total domestic credit grew by 6.1% in the third quarter to K58.9 billion, slightly slower than the 6.5% growth in the previous quarter. This was mainly driven by continued lending to Government. However, commercial bank lending to the private sector remains subdued.

*Domestic economic activity improving and outlook remains positive, but challenges remain*

Available real sector and business survey data indicate that economic activity continued to improve in the third quarter and the economic outlook remains positive. Output in selected sectors, such as mining, and energy continued to expand. Overall, business conditions improved further, evidenced by the sharp increases in output, new orders, outstanding business and higher sales and increased demand for labour[1].

Businesses expect the level of investment and economic performance to improve over the next 12 months[2]. Over the medium-term, economic growth prospects are expected to improve, with GDP growth for 2017 and 2018 projected at 4.2% and 5.0%, respectively from an outturn of 3.8% in 2016. Underlying this projection is anticipated expansion in the mining and manufacturing output, complimented by higher production in the agriculture sector. The recovery in electricity generation is also expected to support increased production. However, challenges to growth remain. These continue to include high lending rates, low private sector credit growth, high non-performing loans, structural weaknesses in the financial sector, high fiscal deficits and debt levels.

*Measures to address high fiscal deficits and debt underway*

The current relatively high fiscal deficit and debt levels continue to pose risks to macroeconomic stability. For the year to September 2017, the preliminary budget deficit (on a cash basis), was broadly in line with the 2017 Budget. The measures taken by Government to reform subsidies in the energy and agriculture sectors and to pay down arrears are important steps towards reducing the fiscal deficit. Further steps to contain high debt levels are required. In this regard, under the medium-term debt strategy, the Government is realigning its financing away from external to domestic sources to avoid external debt distress and achieve debt sustainability. Other measures underway include legal reforms in public financial management and the contraction of debt.

*Global economic recovery continues*

The global economy has continued to show signs of recovery as commodity prices and global trade pick-up, demand in China strengthens, business investments expand, manufacturing rebounds, and consumer confidence rises. In 2017 and 2018, global growth is projected to increase to 3.6% and 3.7%, respectively from a preliminary outturn of 3.2% in 2016[3]. Much of this growth is expected to come from emerging markets and developing economies whose growth is projected at 4.6% and 4.9% in 2017 and 2018, respectively.

*Current account deficit narrows*

Preliminary data[4] indicate that the current account deficit narrowed to US$237.5 million in the third quarter from US$274.4 million in the previous quarter as export earnings rose more than imports. Total exports grew by 11.6% to US$2,108.5 million while imports increased by 9.5% to US$2,044.4 million. Higher realised copper prices have continued to support export

[1] Stanbic Zambia Purchasing Managers Index (PMI), October 4, 2017.
[2] Bank of Zambia Quarterly Survey of Business Opinions and Expectations, September, 2017.
[3] IMF World Economic Outlook (WEO) Update, October, 2017.
[4] Central Statistical Office and Zambia Revenue Authority.

earnings. The deficit was financed by a surplus on the financial account and a drawdown of international reserves. Gross international reserves declined to US$2.2 billion (representing 3.0 months of prospective import cover from US$2.4 billion in the previous quarter.

***Exchange rate remained relatively stable***

During the quarter under review, the exchange rate of the Kwacha against the U.S. dollar remained relatively stable, with an appreciation bias. The Kwacha appreciated by 3.5% against the U.S. dollar to K8.99, supported largely by improved supply of foreign exchange from the mining sector and non-resident investors in Government securities. The foreign exchange market was also characterised by positive sentiments arising from relatively low and stable inflation and higher copper prices, among other factors.

***The MPC Decision***

The MPC, at its November 20 – 21, 2017 Meeting, taking into account the above factors, decided to:

1. Lower the Policy Rate by 75 basis points to 10.25% from 11.0%; and
2. Reduce the Statutory Reserve Ratio by 150 basis points to 8.0% from 9.5%.

In particular, guided by the continued decline in inflation and projections that it will remain well anchored within the medium-term target range of 6–8% over the forecast horizon (next eight quarters), the MPC also considered the following:

- The prevailing high lending rates, which continue to constrain access to credit, especially by the productive sectors of the economy;
- Subdued economic growth; and
- Risks to the stability of the financial sector.

In the implementation of monetary policy, the Bank will continue to strengthen the forward looking monetary policy framework, anchored on the Policy Rate as the key signal. Changes in the Policy Rate will continue to be guided by inflation outcomes and forecasts as well as progress in fiscal consolidation. The Bank will 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 diversification and growth.

The next MPC Meeting will take place on February 20 – 21, 2018.

Issued by

Denny H Kalyalya (Dr)
**GOVERNOR**

November 22, 2017