BANK Of ZAMBIA

MONETARY POLICY COMMITTEE STATEMENT

Monetary Policy Rate maintained at 9.0 percent

The Monetary Policy Committee (MPC), at its May 16-17, 2022 Meeting, ***decided to maintain the Monetary Policy Rate at 9.0 percent****. The continued deceleration in inflation and its projected further decline towards the target range of 6-8 percent by end-2023 were the two main factors that informed the MPC decision. The underlying factors the Committee considered included the positive efforts in implementing fiscal consolidation measures, relatively weaker growth prospects over the medium-term, as well as lingering vulnerabilities and risks to the financial sector. However, upside risks to the inflation outlook include increases in global energy and food prices, exacerbated by the on-going Russia-Ukraine conflict; outbreaks of more infectious strains of COVID-19; tighter global financial conditions; and the projected grain deficit in some of our neighbouring countries.*

Inflation continues on a downward trend

Annual overall inflation continued to trend downward in the first quarter of 2022, declining to 14.1 percent from 18.9 percent in the last quarter of 2021. The fall in inflation was driven by the dissipation of shocks to prices of meat products and fish, lagged pass-through from the appreciation of the Kwacha against the US dollar, as well as improved supply of fish and fresh maize. Food inflation declined sharply to 16.1 percent from 24.5 percent, while non-food inflation edged down to 11.6 percent from 12.5 percent.

In April, annual overall inflation decelerated, for the ninth consecutive month, reducing to 11.5 percent from 13.1 percent in March. Increased supply of mostly vegetables and solid fuels was key to the decline in inflation.

Over the next eight quarters[1], inflation is projected to continue trending downwards towards single digits. In 2022, inflation is projected to average 12.5 percent and then drop to 8.9 percent in 2023. Underlying these projections are mostly the effects of enhanced fiscal consolidation, anchored on the resolution of the external debt overhang, supported by an International Monetary Fund Extended Credit Facility. These combined are expected to boost market confidence, anchor inflation expectations, positively impact macroeconomic stability, and ultimately contribute to growth that has remained subdued for some time.

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

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However, there are upside risks to this inflation outlook. These include increases in global energy and food prices, exacerbated by the on-going Russia-Ukraine conflict; outbreaks of more infectious strains of COVID-19; and tighter global financial conditions arising from contractionary monetary policies in advanced economies. The projected grain deficit in some of our neighbouring countries, coupled with reduced domestic surplus, is likely to push up food prices.

Interest rates broadly unchanged

Interest rates were broadly unchanged in the first quarter of 2022. The overnight interbank rate was kept within the bounds of the Monetary Policy Rate Corridor throughout the quarter around 8.9 percent. Yield rates on Government securities marginally declined. The weighted average Treasury bill and Government bond yield rates declined by 0.3 and 0.2 percentage points to 12.7 percent and 21.7 percent in March, respectively. The commercial banks' average nominal lending rate, at 26.0 percent, and the 180-day deposit rate for amounts exceeding K20,000, at 7.5 percent, remained unchanged.

Credit rises further, while money supply contracts

In March 2022, total domestic credit grew by 11.5 percent, year-on-year, compared to 8.6 percent in December 2021, largely on account of recovery of credit to the private sector. Although the uptake of domestic credit continued to be dominated by the public sector, it is worth noting that private sector credit growth recovered to 1.4 percent, year-on-year, from a contraction of 7.8 percent in the previous quarter. This growth, which arose from increased need for working capital by businesses to meet rising operating costs[2], was partly supported by further drawdowns on the Bank of Zambia Targeted Medium-Term Refinancing Facility.

In contrast, year-on-year growth in credit to Government slowed down to 16.8 percent in March 2022 from 17.9 percent in December 2021. The continued reduction in credit to Government, in part reflected Government limiting the issuances of securities according to plan.

In March, money supply (M3) contracted by 0.2 percent, year-on-year, against a growth of 3.7 percent in December 2021. However, adjusted for exchange rate movements, money supply grew, although it still slowed down further to 17.5 percent from 32.4 percent. The slowdown in credit growth to Government largely accounted for this outturn.

[2] *Bank of Zambia Credit Conditions Survey*

Domestic economic activity moderated

High frequency indicators of economic activity suggest a slowdown in the first quarter of 2022. According to the *Bank of Zambia Survey of Business Opinions and Expectations*, the *volumes of sales and service, domestic sales, profitability, level of investment*, as well as *new orders* declined. Similarly, the *Stanbic Bank Zambia PMI™* fell below the 50.0 mark signalling weakening business conditions for the private sector as *new orders, output*, and *employment* decreased. The slowdown in economic activity is attributed to higher input prices and rising fuel pump prices.

However, there were signs of recovery in April, as the PMI rose to 50.5, with *output, new orders,* and *employment* positing some growth.

In the medium-term, real GDP is projected to grow moderately. In 2022, the economy is expected to expand by 3.5 percent and by further 3.6 percent and 3.9 percent in 2023 and 2024, respectively. The financial and insurance, information and communications, wholesale and retail trade, education, as well as mining sectors are expected to drive growth over this period. However, the impact of the Russia-Ukraine conflict, slow recovery in trading partner countries, and uncertainty surrounding the resurgence of new and more contagious COVID-19 variants, amid a low vaccination rate, remain key downside risks to the growth outlook.

Fiscal deficit broadly in line with target

Preliminary data indicate an improved fiscal performance in the first quarter of 2022, largely on account of high revenue collections—particularly from the mining sector. However, expenditure slightly exceeded the target following a deliberate increase in spending on social programmes. For 2022 as a whole, the fiscal deficit, as a percent of GDP, is projected to narrow to 6.7 percent from a preliminary outturn of 9.0 percent in 2021. Further reduction in the deficit is projected in 2023 and 2024 to 6.3 percent and 5.2 percent, respectively. Enhanced revenue mobilisation measures and rationalisation of expenditure, reinforced by the debt restructuring under the G20 Common Framework, underpin this projection.

Global growth revised downwards

The Russia-Ukraine conflict has dimmed the prospects for robust global growth. Commodity prices have risen, and there are disruptions, particularly to cross-border production networks and trade flows. In view of this, in April, the IMF revised downwards global growth forecasts for both 2022 and 2023 to 3.6 percent from an earlier forecast of 4.4 percent and 3.8 percent, respectively. These are marked declines from the growth of 6.1 percent recorded in 2021. In 2024, growth is projected to moderate further to 3.4 percent. The key downside risks to the growth outlook, in addition to the effects of the

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Russian - Ukraine conflict include emergence of more infectious variants of COVID-19 and aggressive monetary policy tightening in advanced economies.

Current account surplus expands

Preliminary data indicate an expansion in the current account surplus to US$1.3 billion[3] in the first quarter of 2022 from US$1.1 billion[4] in the previous quarter. The sustained expansion in the surplus is mostly attributed to increased net exports. Export proceeds rose by 5.3 percent to US$3.3 billion owing, mainly, to higher copper export volumes and prices. In contrast, imports declined by 1.8 percent to US$1.7 billion, largely attributed to the reduced imports of consumer goods.

Gross international reserves increased to US$2.9 billion at end-March 2022 from US$2.8 billion at end-December 2021. Mining tax payments and receipt of project funds were the two main sources of inflows, whilst debt service and support to the foreign exchange market were the key uses of these inflows. However, the months of import cover[5] reduced to 3.6 from 4.4 due to the upward revision of projected imports for 2022.

Kwacha depreciates

During the quarter under review, the Kwacha depreciated by 3.7 percent against the US dollar to an average of K17.76 per US dollar. This was on account of excess demand for foreign exchange, chiefly for importation of petroleum products.

To moderate volatility in the exchange rate, the Bank of Zambia continued to support the market. In this regard, US$372.0 million was provided to the market. This was mainly facilitated by foreign exchange purchases from the mining sector amounting to US$422.0 million.

The MPC Decision

The Monetary Policy Committee (MPC), at its May 16-17, 2022 Meeting, **decided to maintain the Monetary Policy Rate at 9.0 percent**. In arriving at this decision, the Committee took into account the continued deceleration in inflation and its projected further decline towards the target range of 6-8 percent by end-2023. The Committee also took note of the positive efforts of implementing fiscal consolidation measures, relatively weaker growth prospects over the medium-term, as well as lingering vulnerabilities and risks to the financial sector.

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[3] 20.3 percent of GDP

[4] 21.2 percent of GDP

[5] Data used to compute months of cover is revised quarterly.

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However, the Committee was cognisant of the upside risks to the inflation outlook. These include increases in global energy and food prices, exacerbated by the on-going Russia-Ukraine conflict; outbreaks of more infectious strains of COVID-19; tighter global financial conditions; and the projected grain deficit in some of our neighbouring countries, coupled with reduced domestic surplus.

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 August 15 and 16, 2022.

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