Bank *of* Zambia

MONETARY POLICY COMMITTEE STATEMENT

Monetary Policy Rate raised to 9.50 percent

The Monetary Policy Committee, at its May 15-16, 2023 Meeting, ***decided to raise the Monetary Policy Rate by 25 basis points to 9.50 percent****. The decision was informed by the projection that inflation will continue to be above the target band of 6 – 8 percent over the forecast horizon[1]. The Committee also took into account fragile growth, and vulnerabilities and risks in the financial sector. Continued delays in external debt restructuring negotiations, tighter global financial conditions, higher maize prices due to the anticipated lower production amid strong regional demand, as well as the impact of the prolonged Russia-Ukraine war on food and energy prices remain key upside risks to the inflation outlook. Observed budgetary discipline and continued implementation of fiscal consolidation measures and broader economic reforms outlined in the Eighth National Development Plan (8NDP) will remain important anchors in achieving lower inflation and macroeconomic stability.*

Inflation declines in first quarter of 2023, but pressures to persist

Inflation declined further[2] in the first quarter of 2023, albeit marginally. However, it remained elevated and is projected to stay above the target band of 6 – 8 percent over the next eight quarters (the forecast horizon).

In the first quarter of 2023, inflation averaged 9.6 percent compared to 9.8 percent in the fourth quarter of 2022. Dissipation of base effects in a broad range of items in the consumer basket[3] and sustained reduction in the prices of oils and fats, due to lower costs of imported inputs, were the key drivers. Notable items in the consumer basket in which base effects dissipated were road passenger transport, fish, fuel, bread and cereals, as well as rent. Accounting for the reduction in prices of oils and fats was the decline in the international soybean prices.

In April 2023, inflation rose to 10.2 percent from 9.9 percent in March. This was mostly driven by strong regional demand for maize grain and maize meal and the lagged pass-through from the depreciation of the Kwacha against the US dollar.

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[1] The forecast horizon is from the second quarter of 2023 to the first quarter of 2025.

[2] Inflation averaged 10.5 percent and 9.9 percent in the second and third quarters of 2022, respectively.

[3] Prices of these commodities went up significantly a year ago, but subsequent changes have reduced and/or stabilised and are no longer part of the annual comparison.

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In the first quarter of 2023, the Kwacha depreciated by 16.8 percent to an average of K19.52 against the US dollar. The key drivers were excess demand, adverse market sentiments associated with protracted external debt restructuring negotiations, and tighter global financial markets conditions. To support the market in meeting some critical imports, such as, oil and agricultural inputs, the Bank provided US$377.0 million, of which US$186.0 million was from mining tax receipts.

The aforementioned support to the market, multilateral debt service, and Government uses contributed to the decline in gross international reserves to US$2.9 billion (equivalent to 3.3 months of imports cover[4]) at end-March 2023 from US$3.1 billion (equivalent to 3.8 months of import cover) at end-December 2022.

In April, the Kwacha appreciated against the US dollar by 16.8 percent to K17.73, mostly driven by improved supply of foreign exchange mainly from quarterly corporate tax obligations. The reaching of the Staff-Level Agreement on the first review of the International Monetary Fund Extended Credit Facility (IMF ECF) arrangement created expectations that external debt restructuring would soon be concluded. This positively changed market sentiments and also contributed to the appreciation of the Kwacha. Pressures in the foreign exchange market have, however, re-emerged, mostly due to excess demand for foreign exchange from a broad range of sectors, chief among them the wholesale and retail, financial, as well as electricity, gas and water supply. As at May 16, 2023, the Kwacha was trading at K18.53 per US dollar.

The inflationary pressures observed in April are expected to persist over the forecast horizon and keep inflation above the target band despite declining slightly relative to the February 2023 forecast. Underpinning the current forecast are largely the impact of the recently approved electricity tariffs and elevated maize prices, particularly in 2023, as anticipated in the February forecast. In this regard, inflation in 2023 and 2024 is projected to average 10.5 percent and 8.4 percent compared to 11.1 percent and 10.5 percent in the February 2023 forecast, respectively. In the first quarter of 2025, inflation is forecast to remain at 8.4 percent. Further delays in external debt restructuring negotiations, tighter global financial conditions, higher maize prices, due to the anticipated lower production amid strong regional demand, as well as the impact of the prolonged Russia-Ukraine war on food and energy prices remain key upside risks to the inflation outlook.

Current account balance to rebound as the global economy recovers

The *current account* deficit narrowed in the first quarter of 2023 as deficits on both *primary* and *services accounts* reduced. The *primary income* deficit reduced on account of lower investment

[4] The decline in the months of import cover also reflects higher projected prospective imports for 2023.

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income following a decline in dividend payments on foreign direct investment. Similarly, the *services account* deficit narrowed, reflecting lower expenditure on transportation attributed to passenger travel. In the medium term, the *current account* balance is poised to post a surplus due to a faster rise in exports relative to imports on the back of the recovery in global growth. The recovery is underpinned by a rebound in growth in China, unwinding supply-chain constraints, and subsiding disruption to food and energy markets.

Credit growth slows down, money supply expands, and economic growth to rebound in the medium-term

In March 2023, growth in domestic credit slowed down to 12.1 percent, year-on-year, from 18.7 percent in December 2022 following reduced lending to Government. However, over the same period, credit to the private sector continued to grow—35.9 percent compared to 34.2 percent. Money supply grew further by 30.0 percent in March 2023 compared to 24.5 percent in December 2022 due to increased credit to the private sector and valuation effects relating to US dollar denominated credit.

The economy is projected to slowdown in 2023, and rebound in 2024. This is underpinned by the recovery in agriculture and mining sectors as well as sustained growth in information and communications, manufacturing, transport, and financial and insurance sectors. However, a slowdown in global growth, tight global financial conditions, adverse weather conditions, due to climate change, and elevated energy and food prices related to the ongoing Russia-Ukraine war continue to be key downside risks to the growth outlook.

Preliminary data from the *May 2023 Bank of Zambia Quarterly Survey of Business Opinions and Expectations* and *the Stanbic Bank Zambia PMI*™ point to a moderation in economic activity in the first quarter of 2023. This was largely attributed to the depreciation of the exchange rate and increase in fuel pump prices.

Monetary Policy Committee Decision

The Monetary Policy Committee, at its May 15-16, 2023 Meeting, **decided to raise the Monetary Policy Rate by 25 basis points to 9.50 percent**. The decision was informed by the projection that inflation will continue to be above the target over the forecast horizon. The Committee also took into account fragile growth, and lingering vulnerabilities and risks in the financial sector. Observed budgetary discipline and continued implementation of fiscal consolidation measures overall, including broader economic reforms outlined in the Eighth National Development Plan (8NDP), will remain important anchors to achieving lower inflation and macroeconomic stability.

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

The next MPC Meeting will take place on August 21 and 22, 2023.

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