



BANK OF ZAMBIA

MONETARY POLICY COMMITTEE STATEMENT

The Bank of Zambia (BoZ) Policy Rate reduced by 150 basis points to 14.0%, the Overnight Lending Facility (OLF) Rate reduced to 600 basis points above the Policy Rate, and the Statutory Reserve Ratio reduced by 250 basis points to 15.5%.

The Monetary Policy Committee (MPC), at its Meeting on 20 and 21 February 2017, decided to reduce the Policy Rate by 150 basis points to 14.0%, the Statutory Reserve Ratio by 250 basis points to 15.5% from 18%, and the Overnight Lending Facility Rate to 600 from 1,000 basis points above the Policy Rate. The Committee noted that annual inflation closed the quarter at 7.5%, down from the end-third quarter outturn of 18.9%. The sharp fall in inflation reflected mainly the dissipation of the base effect, and continued appreciation of the Kwacha against the US Dollar. Inflation in January 2017 fell to 7% and current forecasts indicate that it will remain within the target range of 6-8% over the medium-term. Economic activity in the fourth quarter of 2016 continued to face challenges, with electricity generation, and the production of copper and some selected manufactured products declining. Broad money grew modestly but total domestic credit growth remained subdued. Credit to the private sector contracted further due to tight credit conditions. The demand for Government securities increased and yield rates declined as liquidity conditions eased further. However, lending interest rates remained high. The 2017 National Budget was approved by Parliament in December 2016. The Budget appropriately focuses on addressing the challenges to fiscal sustainability, economic diversification and growth. Effective implementation of the Budget, therefore, presents a good base for rebalancing fiscal and monetary policies going forward. The Bank of Zambia will closely monitor domestic and external developments and stands ready to take appropriate monetary policy measures on price and financial system stability that support the diversification and growth of the economy.

Inflation declined sharply to 7.5% at end-fourth quarter 2016

Annual overall inflation closed the quarter at 7.5%, down from the end-third quarter outturn of 18.9%. The sharp fall in inflation reflected mainly the dissipation of the base effect, and continued appreciation of the Kwacha against the US Dollar. Both food and non-food inflation slowed down to 7.8% and 7.1% in the fourth quarter from 23.4% and 14.0% in the previous quarter, respectively.

Month-on-month inflation, however, rose to 0.9% in December 2016 from 0.1% in September 2016. This was largely a reflection of the increase in the prices of some food items as well as the upward adjustment in the price of petroleum products by an average of 32.1% in October 2016.



In January 2017, annual inflation fell further to 7%, although monthly inflation remained unchanged at 0.9%.

The global economy remained subdued, but projections indicate a gradual recovery over the medium-term.

Global growth remained subdued, declining to 3.1% in 2016 from 3.2% in 2015 (IMF WEO, January 2017). Growth in advanced economies declined to 1.8% from 1.9% while that of emerging markets and developing economies remained unchanged at 4.1%.

In 2017 and 2018, global growth is projected to increase to 3.4% and 3.6%, respectively. Much of this growth is expected to come from emerging markets and developing economies whose growth is projected at 4.5% in 2017 and 4.8% in 2018. In the advanced economies, a marginal recovery in growth to 1.9% in 2017 and 2.0% in 2018 is projected.

Liquidity conditions in the money market continued to ease

During the fourth quarter, the interbank rate was well entrenched within the Policy Rate corridor, moving further towards the Policy Rate as money market liquidity conditions continued to ease. The interbank rate decreased by 84 basis points to 15.8% in December 2016. The easing in liquidity conditions was mostly driven by net Government spending and BoZ accumulation of international reserves.

Given the improved liquidity, the trading of interbank funds reduced further in the fourth quarter with a total of K10.2 billion traded compared to K17.2 billion in the previous quarter of 2016. The volume of funds accessed through OLF also declined significantly to K0.2 billion from K2.1 billion. The easing of some quantitative restrictions at the November 2016 MPC Meeting, which allowed commercial banks improved access to BoZ liquidity and statutory reserves, provided them additional flexibility in managing their liquidity needs.

Demand for Government securities increased and yield rates declined marginally

The demand for Government securities continued to increase in the fourth quarter of 2016, largely on account of easing liquidity conditions, and the continued strong participation by local institutional investors. In addition, there was increased participation by non-resident investors in response to the attractive yield rates, relative stability in the exchange rate and reduced uncertainty following the conclusion of the August 2016 General Elections. The holdings of Government securities by non-residents more than doubled to K6.6 billion in the fourth quarter from K2.9 billion in the previous quarter. Preference by non-residents continued to be in Government bonds, with holdings rising to K6.5 billion from K2.8 billion.

Increased demand, upward adjustment in the tender sizes, and higher frequency of Government bond auctions, resulted in the stock of Government securities rising by 30.4% to K32.9 billion. The weighted average Treasury bill yield rate fell by 0.2 percentage points to 23.6%, whilst the weighted Government bond yield rate dropped by almost 1.0 percentage point to 24.6%.



Broad money increased, private sector credit growth contracted further while lending interest rates remained high

Broad money increased by 0.8% in the fourth quarter to K44.6 billion after registering a 0.2% growth in the third quarter. The rise in broad money was mainly due to Bank of Zambia purchase of US\$228.2 million for international reserves build-up.

Total domestic credit growth remained subdued in the fourth quarter, expanding moderately by 1.1% to K48.9 billion compared to the 4.9% expansion in the third quarter. However, credit to the private sector contracted further by 4.8% due to tight credit conditions. On an annual basis, domestic credit grew by a modest 2.8% in 2016 compared with 21.3% in 2015.

Commercial banks' nominal lending rates maintained an upward trajectory over the fourth quarter of 2016 despite a sharp fall in inflation. The weighted average lending rate edged upwards to 29.2% from 28.9% in the third quarter. Lending rates continued to exhibit a wide range, with the lowest lending rate in December at 10.0% (9.0% in September) and the highest rate at 41.0% (40.0% in September). The rising trend in lending rates reflected the preference by banks to lock-up funds in Government securities thereby reducing the amount of loanable funds available to households and private enterprises. It also reflected commercial banks' response to rising non-performing loans stemming from shocks to the economy.

However, interest rates for negotiated deposits ranged from 18.5% to 36.0% in December 2016, slightly lower than the 20.5% - 40.0% range in September 2016. The average 180-day deposit rate for amounts exceeding K20, 000 also declined, albeit marginally to 12.6% from 13.0% in the third quarter. Improved availability of liquidity reduced banks' motivation to take on expensive deposits.

Domestic Economic activity continued to face challenges

Economic activity in the fourth quarter of 2016 continued to face challenges, with electricity generation and the production of copper and a number of manufactured products declining. Indications are that other sectors of the economy also continued to face challenges and this was compounded by the reduction in private sector credit.

The current account deficit persisted

The current account deficit widened by US\$27.8 million to US\$190.5 million in the fourth quarter, as imports increased reversing a declining trend since September 2015. Imports grew faster than exports, registering a growth of 21.7% to US\$1.9 billion against a 14.9% expansion in exports to US\$1.8 billion. Consequently, a deficit of US\$202.3 million was recorded on the balance on goods against a surplus of US\$13.9 million in the previous quarter. The significant rise in the demand for food items, petroleum products as well as industrial boilers and equipment accounted for the increase in imports. On an annual basis, preliminary data suggest that the current account deficit was US\$981.9 million compared to US\$767.7 million in 2015.

Gross international reserves closed the year at US\$2.4 billion, representing 3.3 months of import cover.



The Kwacha appreciated further

The Kwacha appreciated by 1.2% against the U.S. dollar to K9.8477, supported by higher copper prices, strong non-resident investors' appetite for Government securities and exporter-led foreign currency conversions to meet domestic obligations. This also reflected the continued relatively tight monetary policy stance, despite the easing of some quantitative restrictions in November 2016.

Fiscal deficit is projected to narrow in 2017

In December 2016, the 2017 National Budget was approved by Parliament. As indicated in the November MPC Statement, the aim for 2017 is to reduce the deficit to 7% of GDP. The Budget appropriately focuses on addressing the challenges to fiscal sustainability, economic diversification and growth. Effective implementation of the Budget, therefore, presents a good base for rebalancing fiscal and monetary policies going forward.

Macroeconomic environment improving

Inflation in January 2017 fell to 7% and current forecasts indicate that it will remain within the target range of 6-8% over the medium-term. On balance, risks to inflation are currently assessed to be favouring low and stable inflation. These include predicted normal to above normal rainfall, fiscal consolidation, and the projected pick-up in global growth.

The external sector is expected to improve in 2017 and strengthen further over the medium-term. The recovery in commodity prices should help support export growth, the stability of the foreign exchange market and accumulation of foreign reserves.

Over the medium-term, economic growth prospects are expected to improve with GDP growth for 2017 and 2018 forecasted at 3.9% and 4.6%, respectively. Growth will be underpinned by expected improved performance of the agriculture sector due to better weather conditions, increased energy supply and minerals production. A further rise in productivity in the transport and storage, construction, and accommodation and food services sectors will also support growth. Government's fiscal consolidation measures are critical to the realization of the projected growth outcomes. The improving external sector will provide a conducive environment in supporting industrialisation and diversification efforts under the Economic Recovery Programme – “Zambia Plus”.

The MPC Decision

The MPC at its February 20-21, 2017 Meeting decided to:

1. Reduce the Policy Rate by 150 basis points to 14.0% from 15.5%;
2. Restore the Overnight Lending Facility Rate to 600 basis points from 1,000 basis points above the Policy Rate; and
3. Reduce the Statutory Reserve Ratio by 250 basis points to 15.5% from 18%.



The key factors the Committee took into account in arriving at this decision included:

- The decline in inflation to single digits, with inflation forecast to remain well below the 2017 target of 9.0% and within the medium-term target range of 6-8% by end-2018;
- Low and sluggish economic growth; and
- The prevailing high lending rates, which are constraining access to credit by the productive sector of the economy, as reflected in contraction of credit to the private sector in most of 2016.

In the implementation of monetary policy, BoZ will continue to strengthen the *forward looking monetary policy framework*, anchored on interest as the key signal for monetary policy. Changes in the Policy Rate will be guided by inflation outcomes and forecasts as well as progress in fiscal consolidation. The Bank of Zambia will also closely monitor domestic and external developments and stands ready to take appropriate monetary policy measures to support price and financial system stability that supports the diversification and growth of the economy.

The next MPC Meeting will take place on May 15 – 16, 2017.

Issued by



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