



Bank of Zambia

MONETARY POLICY COMMITTEE STATEMENT

Monetary Policy Rate held at 8.0%

The Monetary Policy Committee (MPC), at its November 16 - 17, 2020 Meeting, decided to maintain the Monetary Policy Rate at 8.0% to moderate risks to financial stability and support growth, lives and livelihoods. This decision also allows monetary policy measures taken earlier in the year to take full effect. This is despite projections indicating that inflation will persist above the 6-8% target range throughout the forecast horizon¹. The Committee noted that financial stability remains fragile despite signs of marginal improvement in economic activity in the third quarter following the partial relaxation of COVID-19 restrictions. Although growth is expected to recover in the medium-term, limited fiscal space, as well as uncertainty surrounding the persistence of the COVID-19 pandemic and access to external financing remain key downside risks to growth prospects. In this regard, successfully navigating the debt restructuring process to restore debt sustainability and implementing fiscal and other structural reforms are critical to return to fiscal fitness and macroeconomic stability.

Less severe contraction of the global economy projected in 2020

Global economic activity is showing signs of recovery as economies partially reopen and policy stimulus measures begin to take effect. In this regard, a less severe contraction of 4.4%² is projected in 2020 than the earlier projection of 4.9%.

A strong rebound in global growth is projected in 2021, supported largely by policy stimulus measures. The recovery is still expected to be protracted and highly uncertain over the medium-term due to the impact of income losses on aggregate demand, rising sovereign debt and subdued commodity prices. Further, the risks to global growth remain tilted to the downside due to the high degree of uncertainty surrounding the evolution of the pandemic as well as the speed of delivering a vaccine.

Domestic economic activity showing signs of picking up, but weaker recovery projected in the medium-term

High frequency data and coincident indicators of economic activity point to some improvement in the third quarter, reflecting the partial relaxation of COVID-19 restrictions. Broadly, all the monitored indicators in the [*Third Quarter 2020 Indicative Bank of Zambia Survey of Business Opinions and Expectations*](#) exceeded the second quarter reading. The [*Stanbic Bank Zambia Purchasing Manager's Index*](#) also signalled a softer

¹ The forecast horizon or period is eight quarters ahead, that is, the fourth quarter of 2020 to the third quarter of 2022.

² October 2020 IMF *World Economic Outlook (WEO) Update*



deterioration in the private sector business environment. The rate of decline for new orders, output and employment moderated and business confidence showed signs of improvement.

Nonetheless, for 2020 as a whole, the economy is projected to contract by 4.2%. The observed better performance in mining production in the year to September may moderate the severity of the contraction. Over the medium-term, growth is expected to recover, albeit at a weaker pace than earlier anticipated due to limited fiscal space, as well as uncertainty surrounding the persistence of the COVID-19 pandemic, and access to external financing.

Inflationary pressures remain high

After rising steadily for six successive quarters, annual overall inflation decelerated to an average of 15.7% in the third quarter from 16.1% in the preceding quarter. This was mainly due to improved supply of maize grain and related products. On account of this, food inflation declined to 15.2% from 16.9%. However, non-food inflation rose to 16.2% from 15.1% largely due to the depreciation of the Kwacha.

The recent reading of inflation points to a resurgence in inflationary pressures. In October, inflation rose to 16% from 15.7% in September largely reflecting the weakening of the Kwacha.

Over the next eight quarters, a moderation in inflationary pressures is anticipated although inflation will persist above the 6-8% target range throughout the forecast horizon. Inflation is forecast to average 16.7% in the fourth quarter of 2020. In 2021, it is expected to decline to 13.5% and further to about 10.0% in 2022 on an annual average basis. The factors underlying the decline in inflation include subdued aggregate demand and moderation in food prices as well as money supply growth. However, the risks to the inflation outlook are tilted to the upside and these include higher than anticipated monetary expansion, possible upward adjustment in fuel pump prices, further deterioration of the fiscal position, as well as the depreciation of the Kwacha. Inflation may decelerate faster if the measures being taken by Government to restructure debt and implement key structural reforms materialise.

Overnight interbank rate declines further, as monetary policy remains accommodative

The overnight interbank rate declined to a quarterly average of 8.55% from 10.98% and was maintained within the Policy Rate Corridor of 7.0% to 9.0% throughout the quarter. This followed a further reduction in the Policy Rate in August and the increase in market liquidity. Liquidity conditions eased due to increased Government spending and stimulus measures implemented by the Bank of Zambia through the Secondary Market Bond Purchase Programme, Targeted Medium-Term Refinancing Facility and open market operations undertaken on flexible terms.

Demand for Government securities remains high

Following the increase in liquidity levels, demand for Government securities remained strong. In particular, demand for Treasury bills was much stronger as the auctions attracted bids in excess of the amounts on offer by 54%. In contrast, Government bond auctions were undersubscribed as the bid amounts fell short by 40%. However, this was an improvement over the 60% shortfall recorded during the previous quarter. Demand for Government bonds has been relatively weaker due, in part, to investors' expectations of high levels of short-term interest rates over the next few quarters. With increased demand, funds raised from the auctions significantly increased, resulting in a surplus of K6.4 billion. As a result, the stock of Government securities grew by 15.8% to K118.7 billion.

At end-September 2020, Government securities held by non-residents increased by 5.7% to K14.3 billion, representing 12.0% of the total securities. Nearly all these holdings (97.8%) were in Government bonds.



Interest rates decline further

Generally, market interest rates maintained a downward trend, largely reflecting the accommodative monetary policy stance. The commercial banks' average lending rate declined to 25.7% in September from 26.4% in June and further to 25% in October. The savings rate for 180-day deposits also reduced to 10.3% from 10.7% and is currently at 9.9%. Similarly, the composite yield rate on Treasury bills declined to 22.7% from 26.3%. The composite Government bond yield rate marginally increased to 32.3% from 31.8%.

Credit to the private sector remains subdued, but money supply expands further

Credit growth to the private sector picked up slightly to 13.8%, year-on-year, in September from 10.4% in June. This was largely attributed to the sustained increase in demand for bridge financing and working capital by firms to meet rising operating costs. However, credit to Government continued to expand at a faster pace, growing by 69.2% in September compared to 46.9% in June. In line with the expansion in credit to Government, money supply (M3)³ growth rose to 46.5% in September from 29.4% in June.

Fiscal pressures persist

Fiscal pressures heightened as the financing gap widened. Spending pressures escalated amidst declining domestic revenue due to the persistent adverse effects of the COVID-19 pandemic. Going forward, uncertainties regarding the evolution of the COVID-19 pandemic, debt suspension and restructuring, as well as securing external financing will continue to exert pressures on the fiscal position. In this regard, successfully navigating the debt restructuring process to restore debt sustainability and implementing fiscal and other structural reforms are critical to return to fiscal fitness and macroeconomic stability.

Current account surplus expands

The current account surplus expanded to US\$601.7 million (3.8% of GDP) from US\$350.7 million (2.2% of GDP) in the second quarter, driven by net exports. Merchandise exports grew by 35.2% to US\$2.3 billion due to higher earnings from copper and non-traditional exports (NTEs). Copper earnings increased by 40.6% to US\$1.7 billion as export volumes expanded and realised prices rose. Non-traditional exports, at US\$0.6 billion, were 50.7% higher driven by a seasonal pick up in agricultural exports such as burley tobacco, maize and maize seed, as well as cane sugar. Merchandise imports grew by 19.8% to US\$1.2 billion, supported by the easing of COVID-19 restrictions and a gradual pick-up in domestic economic activity.

Rate of depreciation of the Kwacha slows down

The Kwacha depreciated against other major trading partner country currencies, albeit at a slower pace mainly on account of increased foreign exchange market interventions by the Bank of Zambia. Against the US dollar, the Kwacha weakened by 3.3% to an average of K18.94/US\$ in the third quarter and closed the quarter at K20.02/US\$.

Currently, subdued foreign exchange supply amidst increased demand has continued to underlie the market. The reduction in the supply of foreign exchange to the market is partly due to a slowdown in global economic activity, which has adversely affected capital flows. Heightened demand for foreign exchange is mainly for the importation of agricultural inputs and petroleum products. With limited supply, the Bank has increased its intervention in order to support the market.

With increased net foreign exchange sales for market support coupled with debt service, gross international reserves declined by US\$111.8 million to US\$1,321.2 million (equivalent to 2.3 months of import cover) at end-September from US\$1,433.0 million at end-June (equivalent to 2.3 months). Despite the decline in the

³ M3 comprises currency in circulation and Kwacha as well as foreign currency deposits.



level of reserves, the months of import cover remained unchanged due to the drop in imports of goods and services attributed to the subdued economic activity and the depreciation of the Kwacha.

The MPC Decision

From the foregoing, it is noted that imbalances in the economy remain. In particular, inflationary pressures have persisted, growth is anaemic and fragilities in the financial sector have not abated. Uncertainty surrounding the persistence of the COVID-19 pandemic, and access to external financing remain key downside risks to growth prospects. This requires striking a right balance between price and financial systems stability, and growth.

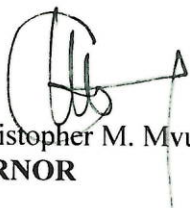
In this regard, the MPC considered three options: raising, reducing or maintaining the Policy Rate. With inflation on the rise, conventionally, raising the Policy Rate in an effort to control inflation would have been expected. However, doing so, in an already depressed economic situation, would result in further contraction in economic activity and threaten the stability of the financial sector. On the other hand, reducing the Policy Rate in an attempt to give further support to the economy may put additional pressure on the exchange rate in a supply-constrained environment. This may worsen the inflation outlook.

Considering all these factors, including the significant reduction in the Policy Rate by 350 basis points in 2020, and to allow monetary policy measures to take full effect, **the MPC decided to maintain the Policy Rate unchanged at 8.0%.**

Decisions on the Policy Rate will 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 February 15 - 16, 2021.

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