Bank *of* Zambia

Statement on Developments in the Foreign Exchange Market July 2021

Lusaka, Saturday, July 24, 2021 – The Bank of Zambia has received enquiries from the public to clarify the factors behind the recent sharp appreciation of the Kwacha against the United States dollar.

In the ***May 2021 Monetary Policy Committee (MPC) Statement***, the Monetary Policy Rate was maintained at 8.5 percent despite the notable increase in inflation. In doing so, the MPC had stated the following:

"…While inflation is projected to remain above the upper bound of the 6-8 percent target range over the forecast horizon, inflationary pressures are expected to ease in view of the improved supply of food, particularly maize and wheat following a good crop harvest. ***In addition, the significant improvement in copper prices and renewed interest in domestic Government securities by non-resident investors are supportive of the foreign exchange market and in turn lower inflation going forward.*** *The decision also recognises existing vulnerabilities in the financial sector and fragile growth. To restore and anchor macroeconomic stability, the implementation of fiscal adjustment measures in line with the Economic Recovery Programme and understandings reached in discussions with the IMF remain critical."*

The expectations of the MPC with respect to the exchange rate have begun to materialise. Having come under immense pressure in 2020, owing to the weakening macroeconomic environment, which was significantly exacerbated by the COVID 19 pandemic, the Kwacha has broadly stabilised in 2021. As at July 23, 2021, the year-to-date rate of depreciation of the Kwacha against the US dollar slowed down significantly to about 5.0 percent compared with almost 30.0 percent over the corresponding period in 2020. More recently, the Kwacha was trading at K21.39 on July 23, 2021 compared to K22.64 on July 1, 2021, representing an appreciation of 5.5 percent. The appreciation of the Kwacha largely reflects changes in the actual supply of foreign exchange and expectations of further improvements in supply associated with the forthcoming IMF Special Drawing Rights (SDR) allocation, improved prospects of a formal Extended Credit Facility (ECF) programme with the IMF, as well as buoyant copper prices.

Bank Square, Cairo Road P.O. Box 30080, Lusaka, Zambia Tel: +260 211 399 300 Fax: +260 211 221 764 Email: info@boz.zm Web: www.boz.zm

The strong recovery in copper prices to the current level of US$9,521 per metric tonne from a low of US$4,745 in March 2020 has contributed to sustained strong export earnings. This has resulted in improved foreign exchange flows from the mining sector through tax receipts remitted directly to the Bank of Zambia in US dollars. In view of this, the Bank of Zambia has been able to provide more foreign exchange liquidity back into the market to reduce excess demand experienced since mid-2020. As at July 23, 2021, the Bank of Zambia sold US$687.5 million to the market compared to US$86.0 million over the same period in 2020. In addition, foreign exchange inflows from non-resident investors purchasing Government securities have significantly increased, further providing liquidity to the foreign exchange market. These inflows have contributed to the substantial reduction in outstanding demand to below US $5.0 million currently from an estimated peak of US $418 million in May 2021.

Besides supporting the market, the Bank has been able to build up international reserves, which stood at US$1.4 billion at the end of May 2021 compared to US$1.2 billion at end-March 2021. The Bank of Zambia has also continued with the local gold purchase programme, accumulating about US$22.0 million in monetary gold as at July 23, 2021. The improvement in the reserve position increases the country's ability to respond to unexpected external events and the ability to address volatility in the exchange rate.

The Bank of Zambia will continue to use all available monetary and foreign exchange intervention options, as appropriate, to address developments in the foreign exchange market. This is consistent with the policy goal of maintaining a flexible but relatively stable exchange rate that reflects underlying market conditions over time.

It is important to note that monetary policy remains focused on containing escalating inflation back to the target range of 6-8 percent over the medium term. In this regard, managing risks to the inflation forecast, which include those associated with financial stability and the COVID-19 pandemic, remains critical. In addition, the full implementation of the Economic Recovery Programme (ERP), including the securing of an IMF programme, is a central element in addressing macroeconomic challenges and supporting sustainable and job-creating growth.

Issued by

Besnat Mwanza
Communications Division
Bank of Zambia
Box 30080
LUSAKA
Email: info@boz.zm

July 24, 2021