



BANK Of ZAMBIA

MONETARY POLICY COMMITTEE STATEMENT

Policy Rate Maintained at 15.5%, access to central bank liquidity by commercial banks eased

The Monetary Policy Committee (MPC), at its meeting on 14 and 15 November 2016, decided to maintain the Policy Rate at 15.5%. However, access to central bank liquidity by commercial banks was eased, with the removal of some quantitative restrictions. The Committee noted that annual overall inflation declined over the second and third quarters of 2016 from 22.2% in March to 18.9% in September. The deceleration in overall inflation was driven by both food and non-food inflation, attributed mainly to the seasonal increase in the supply of some food items and the appreciation of the Kwacha against the US Dollar. As of October, annual inflation fell further to 12.5%, largely reflecting the base effect and continued appreciation of the Kwacha against the US dollar. Although the increase in fuel prices in October is likely to raise monthly inflation in November and December, annual inflation is still projected to decline to single digit by year-end. This outturn is consistent with the MPC's inflation projection in May 2016. However, economic activity remained subdued due to continued electricity shortages, high cost and unavailability of credit, as well as, increased labour costs. Whilst broad money, which had been contracting, increased, private sector credit growth contracted and lending interest rates remained high. However, liquidity conditions eased, the demand for Government securities increased and yield rates declined. The Committee welcomed the introduction of a medium-term inflation target of 6-8% announced by the Hon. Minister of Finance in the 2017 Budget Address as it is in line with the current forward looking monetary policy framework. The 2017 Budget appropriately focuses on addressing the challenges to fiscal sustainability, economic diversification and growth. Effective implementation of the Budget, therefore, presents a good opportunity for rebalancing fiscal and monetary policies going forward.

Inflation declined over the second and third quarters of 2016

Annual overall inflation declined over the second and third quarters from 22.2% in March to 21.0% in June and 18.9% in September. Over the same period, month on month inflation also decelerated from 0.5% to 0.3% and 0.1%, respectively. The deceleration in overall inflation was driven by both food and non-food inflation, attributable to the seasonal increase in the supply of some food items and the appreciation of the Kwacha against the US Dollar. Food inflation fell to 23.4% in September from 26.2% in March while non-food inflation declined to 14.0% from 17.9%.

In its May 2016 communication, the MPC indicated that given the trends in monthly inflation, annual inflation was likely to decline sharply during the fourth quarter of 2016. As

of October, annual inflation fell sharply to 12.5%, largely reflecting the base effect¹ and the appreciation of the Kwacha against the US dollar. Although the increase in fuel prices in October is likely to raise monthly inflation in November and December, annual inflation is projected to decline to single digit by year-end.

The global economy remains weak

Global economic growth is expected to remain subdued. For 2016 as a whole, the latest IMF WEO (October 2016) projection shows that the global economy would grow by 3.1%. While emerging markets and developing economies are forecast to grow at 4.2%, advanced economies are forecast to grow at 1.6%. The subdued outlook for advanced economies largely reflects the uncertainty surrounding the impact of Brexit (vote by the United Kingdom to leave the European Union) and weaker than expected economic growth in the United States of America.

Liquidity conditions eased

Liquidity conditions eased as the Bank of Zambia purchased foreign exchange from the market to build foreign exchange reserves. As a result, the overnight interbank rate moved back into the Policy Rate corridor, and ended at 16.6% in September from 26.9% at end-March 2016 in line with the expectation of the MPC during its May 2016 meeting. In addition, the increased liquidity resulted in interbank trading declining by 35% to K17.2 billion.

However, in the face of lingering macroeconomic uncertainty, the Policy Rate and the Overnight Lending Facility (OLF) rate were maintained at 15.5% and 25.5%, respectively. Access to the OLF remained restricted to once a week and the statutory reserve ratio on bank deposits was maintained at 18% with daily compliance.

Demand for Government securities increased and yield rates declined

The demand for Government securities continued to improve in the third quarter, with strong participation by local institutional investors and renewed interest from non-resident investors in longer dated securities. As a result, the stock of Government securities rose by 3.4% to K25.3 billion. The holdings of Government securities by non-residents increased by 59% to K2.9 billion of which 98% was in Bonds.

Yield rates on Government securities declined reflecting improved demand. The weighted average Treasury bill yield rate fell by 0.8 percentage points to 23.7%, whilst the weighted Government Bond yield rate dropped by 1.7 percentage points to 25.2%.

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

Broad money grew by 0.2% to K44.2 billion driven by the expansion in domestic credit. This follows two quarters of consecutive contraction. Domestic credit expanded by 4.9% to K48.5

¹ The base effect in this case relates to the upward shift in the consumer price index following a significant depreciation in the exchange rate in September 2015

billion on account of increased lending to Government while commercial banks credit to the private sector contracted by 1.3%.

Commercial banks nominal lending rates remained high. This largely reflected increases in the funding costs and the high inflationary environment. Lending rates averaged about 28.7% over the second and third quarters of 2016. Interest rates for negotiated deposits ranged from 20.5% to 40.0%. However, the average savings rate for amounts above K20,000.00 fell to 8.4% from 12.9%.

Economic activity remained constrained

Preliminary data indicate that domestic economic activity remained subdued. The constraints to economic activity arising from continued electricity shortages, cost and availability of credit, as well as increased labour costs, noted in the May 2016 Press Release, remained binding. Growth in 2016 has been projected at 3.0%, a slight increase from the 2.9% recorded in 2015.

Fiscal deficit to remain high in 2016

In the 2017 Budget Address, the Honourable Minister of Finance announced that in 2016 the Government projects a budget deficit of around 10% of GDP, including arrears. The aim for 2017 is to reduce the deficit to 7% of GDP. The 2017 Budget also appropriately focuses on addressing the challenges to fiscal sustainability, economic diversification and growth. Effective implementation of the Budget, therefore, presents a good opportunity for rebalancing fiscal and monetary policies going forward.

The current account deficit persisted

The current account deficit increased by US \$25.6 million during the third quarter of 2016 to US \$107.2 million mainly on account of interest payments on Eurobonds. However, the trade balance slightly improved as export earnings rose to US \$1.61 billion from US \$1.58 billion whilst imports remained steady at US \$1.5 billion. The current account deficit was financed by a surplus on the financial account and a drawdown of reserves (US \$60 million). Gross international reserves stood at US \$2.3 billion at end-September 2016.

The Kwacha appreciated

The foreign exchange market was characterised by relative stability, underpinned by improved net supply, mainly from non-resident investors in the Government securities market. The Kwacha appreciated by 7.4% to K9.9670 per US dollar in September. In October, the Kwacha remained relatively stable and appreciated by 11.1% on a year to date basis.

Macroeconomic outlook remains challenging in the short-term, but is more positive over the medium-term

The external sector is expected to remain challenging with modest global growth. However, commodity prices are expected to recover over the medium-term. The recent significant rise in the price of copper, if sustained, will improve the performance of the current account. This

should support efforts to maintain a stable foreign exchange market and accumulate foreign exchange reserves. A stable foreign exchange market will further support the Bank of Zambia objective of achieving and maintaining single digit inflation.

On the domestic front, survey data on business opinion and expectations indicate that economic agents expect lower inflation and a more stable exchange rate over the fourth quarter and increased investments a year from now. However, survey data on credit conditions indicate that credit conditions are expected to remain tight, representing a possible constraint to growth.

Since November 2015, the Bank of Zambia has maintained a highly tightened monetary policy stance. This has included the use of both price and quantitative instruments. As stated in the May 2016 Press Release, the key purpose of taking quantitative measures, in addition to raising the Policy Rate, was to address high volatility in the foreign exchange market and reign in inflation.

Given that inflation is on a downward trend and is forecast to decelerate further, consistent with the targets of 9% in 2017 and 6-8% over the medium-term, the Bank of Zambia has with immediate effect removed some of the quantitative restrictions currently in place. Specifically, commercial banks can:

1. Access the Overnight Lending Facility (OLF) more than once a week; and
2. Roll over intra-day credit into overnight loan (OLF).

In addition, commercial banks' compliance to statutory reserve requirements will revert to weekly average.

These measures are aimed at strengthening the current forward looking monetary policy framework on prices and enhance the ability of the financial system to play a stronger role in financial intermediation in support of economic growth.

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 continue to monitor domestic and external developments closely and stands ready to take appropriate monetary policy measures to support price and financial system stability. Price and financial system stability are key to macroeconomic stability, which is essential for economic growth and development.

The next MPC Meeting will take place in February 2017.

Issued by



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