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UNPACKING THE 2022 MONETARY POLICY

What is Monetary Policy?

On the 7th of February 2021, the Reserve Bank of Zimbabwe (RBZ) announced its 2022 Monetary Policy. Monetary policy details policies by the monetary authority to control either interest rate or money supply to influence macroeconomic variables like inflation, consumption, liquidity, and economic growth, among others. Economists mainly measure the performance of a central bank using the level of inflation. In this regard the RBZ continues to perform way below the expected standard. Unattended inflationary pressures have triggered a severe cost of living crisis in Zimbabwe and locked millions of Zimbabweans in severe hunger and poverty.

The Monetary policy was expected to address or at least reverse the massive ZWL$ instability particularly in the parallel market and increased inflation pressures persisting in the economy since the advent of austerity and failed currency reforms of 2019. In this regard the RBZ was expected to adopt a contractionary monetary policy stance aimed at moderating inflation growth by reducing the quantum of money circulating in the economy (at least on paper). A contractionary monetary policy is driven by increases in the various base interest rates controlled by central banks or other means producing growth in the money supply.[1]

Typically, the level of general prices should not exceed 10% which is also a global benchmark for price stability. The RBZ expects that the measures it announced will pull monthly price increases to hover below 4% in the first quarter of the year (Q1:22) and an average below 3% in the first half of 2022. In January 2021, monthly inflation outturn came in at 5.34% after increasing by 5.76% in both November and December 2021. The Bank projects 2022 annual inflation to hover between 25-35% by December from 60.7% recorded as of December 2021.

2022 Monetary Policy Highlights

Below are some of the key measures in the 2022 Monetary Policy that according to the Bank will help to attain low inflation goal:

a) 7.5% Reserve Money Target

A quarterly reserve money target of 7.5% down from 10% is commendable considering that it is the most price-sensitive level of the money supply. If the 2022 reserve money growth target is religiously followed coupled with an efficient exchange rate management mechanism and fiscal discipline, inflation growth will subside. Generally, money supply growth should move in tandem with the growth of economic activity (GDP) to dampen inflationary pressure and anchor the exchange rate.

[1] https://www.investopedia.com/terms/c/contractionarypolicy.asp#:~:text=Contractionary%20Policy%20as%20a%20Monetary,money%20circulating%20in%20the%20economy

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b) RBZ Policy Rate

The maintenance of the RBZ policy rate at 60% is a step in the right direction in the fight against ravaging inflation. By maintaining a 60% rate RBZ has admitted that the Zimbabwe dollar is under pressure and in need of full support. While a high policy rate is the right prescription to the current rampant ZWL$ deterioration and price spiral, it has negative spill-over effects on the entire economy which can subdue national output (GDP) growth. It increases the cost of borrowing hence increasing the cost of doing business. The corporates always find a way to shift their cost to the consumers (citizens). To give the desired impact, this policy stance should be aided by sustainable money supply growth.

c) Statutory Reserve Requirement Ratio

RBZ also maintained a statutory (required) reserves requirement ratio at 10% for demand (call) deposits and 2.5% for saving and time deposits. Statutory reserve requirements are money balances, banking institutions are required to maintain in their Statutory Reserve Accounts (SRA) equivalent to a certain proportion of their eligible liabilities (EL), this proportion being the SRR rate.[2] Keeping a high reserve ratio of 10% on-demand/call deposits reduces free funds available to banks for speculative lending which can destabilize the local currency. However, if these reserves are not earning interest, they become a cost to banks thus crippling money creation in the economy. Just as a high central bank policy rate, high statutory reserves may trigger a liquidity crunch.

d) More forex to fuel dealers

Increasing forex to designated fuel dealers to import more fuel to sell in local currency is another commendable policy move given that the fuel market has largely dollarized. Fuel prices increase have also had a domino effect triggering price increases in for basic goods and services. Therefore, increasing fuel sold in local currency will provide relief to average citizens who are earning in fragile Zim dollar. The revival of the local currency fuel market will also create demand for local currency, hence supporting its value. However, this policy stance may have insignificant impact on currency stability as it will likely create an avenue for corruption and arbitrage in the fuel market. The top fuel importers who also play a bigger role in the fuel retail market will find incentives to hoard fuel and channel it into the parallel market to earn riskless profits since the Zimbabwe dollar is overvalued on the auction market.

e) Withdrawal Limits

The increase of cash withdrawal limits from ZWL$2,000 per week to ZWL$5,000 will bring transaction convenience to the public as price levels have increased from the last time the limit was set last year. A ZWL$2,000 withdrawal limit was one of the contributing factors to widening black market physical cash premiums. In as much the Bank is targeting a cashless society to deepen financial inclusion, there are transactions that still require cash. Although ZWL$5,000 per week is still insufficient to address the problem, the increment will save the public some amount of time that was being wasted in bank queues as well as travel costs to and from banking halls.

f) Refinement of the auction market

The Bank also announced that it will continue to refine the auction market to discover the true price of the local currency. However, this has been the government talk since the introduction of

[2] https://www.bnm.gov.my/statutory-reserve-requirement-srr-

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the auction system on 23 June 2020. The maintenance of the auction system in its current form is contributing largely to the massive depreciation of the local currency. Although the parallel market rates have a speculative component, parallel premiums of over 100% alone highlight the inefficiencies of the official exchange rate management system. It is profitable for one to buy forex on the auction (low market) and sell it in the parallel market (high market) at a lucrative rate thus defying the purpose of the auction. As a sole seller, the Bank is constantly overwhelmed by demand. Lack of access to the auction market is forcing the public to rely on the expensive parallel market. Therefore, there is a need for bold actions to ensure transparency and inclusivity in the auction market.

The risks to 2022 Outlook

The measures put forward by the Bank are informed by existing economic trends, and on paper can deliver currency and price stability. However, the market has been moving away from the ZWL$ and re-dollarizing fast. Most supermarkets are now offering huge discounts for forex transactions while maintaining ZWL$ prices benchmarked at the parallel market rate. The government is also dumping its currency as shown by increased taxes on forex. RBZ statistics show that nearly 60% of banking sector deposits are local currency hence disputing the fact that the economy is near dollarization. The bank however ignores the fact that the general public, informal traders, as well as other formal companies, are banking their forex earnings under their pillows.

Conclusion

If RBZ religiously follows the tight monetary targeting framework as per the 2022 policy, it will be able to reduce excessive liquidity (money supply) in the economy. The exchange rate system should be revamped to discover the true value of the local currency thus dampening depreciation pressures. Also, larger banknotes are now long overdue to increase public transaction convenience. The fiscal side should also support the monetary front by ensuring that they spend within budgets and promote the use of the local currency by collecting most domestic taxes in the domestic currency.

While a monetary policy leg is crucial in economic management, the nation should return to the Zimbabwe dollar if and only if all prerequisites such as industrial production and prudent market-driven policies are fully instituted.

Access ZIMCODD's Analysis of the 2022 Monetary Policy here: https://zimcodd.org/sdm_downloads/analysis-of-the-2022-monetary-policy/

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