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THE WEEKEND READER

"Your Weekly Read on Debt, Development & Socio-Economic Justice"

ANALYSIS: MONETARY POLICY COMMITTEE (MPC) INTRODUCES WHOLESALE AUCTION FOR BANKS AS ZWL PLUNGES

Reserve Bank of Zimbabwe's (RBZ) Monetary Policy Committee (MPC) convened an ad hoc meeting on the 6th of June 2023 amid the deepening currency crisis. The MPC meeting comes after the Treasury had earlier announced a cocktail of policy measures to stabilize the local currency and prices. The Zimbabwe dollar (ZWL) which was re-introduced in 2019 following a decade of full dollarization is again on the verge of collapse and total market rejection.

The local unit of exchange which was trading at an average ZWL/USD 3600 in the alternative exchange markets as at end of May 2023 has lost a staggering 40% of its value to ZWL/USD 6000 in only the first 8 days of the month of June 2023. In year-to-date (YTD) terms, the ZWL is down 85% in parallel markets. It is the ordinary citizens largely earning in ZWLs who are disproportionately affected by this currency conundrum as retail shops change ZWL prices daily yet workers' salaries are stuck.

To clamp the increased ZWL volatility and contain galloping inflation, the MPC resolved to introduce a wholesale forex auction where RBZ will be selling foreign currency (forex) at a market-determined exchange rate through banks and the banks shall in turn sell that forex to their customers.[1] According to the MPC, this move will help support and strengthen the interbank market to ensure that it is the primary source for forex needs in the economy. The policy shift comes after May 29th announcement from Treasury limiting forex auction envelope to a maximum of US$5 million per week. Further, the MPC removed the 90-day liquidation requirement on export proceeds which was instituted earlier by the Treasury when it announced an auction fix.

The inaugural wholesale forex auction for banks was conducted on the 7th of June 2023. About US$11.2 million was allotted as the ZWL plummeted by 24.5% to ZWL/USD 4868.52 from ZWL3673.77 a daily earlier (June 6th) when US$4.99 million was traded at the retail forex auction for importers.[2] In the previous week, the ZWL plummeted significantly against the USD at the Dutch forex auction of 30 May 2023 as it erased about 26.7% of its value to settle at ZWL/USD 2577.06 from ZWL/USD 1888.01 realized on the 23rd of May 2023. All this shows that in only 6 days (30May-7June) the ZWL has lost about 47.1% of its value in the Dutch auction market. In year-to-date (YTD) terms, the local unit is down 85.5% at the auction market.

1. https://www.rbz.co.zw/documents/press/2023/June/RESOLUTIONS_OF_THE_MONETARY_POLICY_COMMITTEE_MEETING_HELD_06_June_2023.pdf
2. The retail forex auction was introduced by RBZ on the 23rd of June 2020.

The foregoing massive decline of the ZWL in the official markets can be viewed as an exchange rate adjustment to recent Treasury policy shifts. When the forex auction was introduced on 23 June 2020, the ZWL lost 56.4% in the first trade. However, as authorities buttressed the new auction system with fiscal discipline and tight monetary targeting, the ZWL gained 20% in the alternative markets between July and September 2020. The average parallel rate sailed stable through November 2020 before it started to burgeon again in response to rising liquidity growth associated with spiking fiscal spending in the fourth quarter.

So, the MPC is highly commended for the recent bold action it took toward increased liberalization of the exchange rate which if aided by other prudent policy actions like discontinuation of quasi-fiscal activities by RBZ, sustainable Treasury spending, and increased fiscal transparency will help arrest the ongoing ZWL instability. To allow the market to freely determine the true ZWL price, the MPC has also removed the 10% interbank trading margin to the auction and increased interbank maximum bids from US$100 000 to US$500 000. Also, the scrapping of the 90-day forex liquidation requirement will reduce forex demand on the interbank market as many businesses will utilize their FCA balances to meet forex needs.

More so, the MPC had resolved to increase RBZ benchmark policy rate from 140% to 150%. This is meant to discourage speculative borrowing in the economy which fuels consumer and business spending, especially on big-ticket items. Rising interest rates tend to weigh on asset prices, reversing the wealth effect for individuals and making banks more cautious in lending decisions. Also, when the RBZ responds to elevated inflation risks by raising its benchmark policy rate, it effectively increases the level of risk-free reserves in the financial system, limiting the money supply available for purchases of riskier assets.

Although the policy rate recently set by MPC is way below the prevailing ZWL inflation independently estimated at above 700% (inadequate to discourage speculation), rising interest rates signal the likelihood that RBZ will continue to tighten monetary policy, further tamping down inflation expectations. In addition, the MPC decided to increase statutory reserve requirement (SRR) ratio on ZWL call and demand deposits to 15% from 10%. The SRR is an instrument used by central banks to manage the significant build-up of liquidity which may result in financial imbalances and create risks to financial stability. As such, increasing the SRR ratio has an effect of reducing money available for lending by banks.

The foregoing actions taken by the MPC this week complement stabilization measures previously announced by Treasury such as promotion of ZWL use and sterilization of excess liquidity. If prudently implemented in full, these actions will go a long way in suppressing ZWL decline, ceteris paribus. Nevertheless, it remains to be seen if there is adequate political will to allow the Treasury to thwart mounting spending pressure emanating from the upcoming harmonized elections. Generally, elections in developing nations like Zimbabwe fuel opportunistic political business cycles – volatile changes in fiscal spending and taxation - which worsen the already fragile macroeconomic environment. In other words, without political will to swiftly reform the economy and institutions, the status quo (massive ZWL decline, rampant price growth, widening inequalities, and rising abject poverty) will remain risking full market dollarization.

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