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THE WEEKEND READER

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

ANALYSIS OF THE MONETARY POLICY COMMITTEE RESOLUTIONS TO STABILIZE THE ZIG

On the 27th of September 2024, the Reserve Bank of Zimbabwe (RBZ), through its Monetary Policy Committee (MPC), announced significant monetary policy shifts aimed at stabilizing the local currency, the Zimbabwe Gold (ZiG). A few months after the RBZ (the Bank hereafter) launched it into the market in early April 2024, the ZiG experienced frequent fluctuations, particularly in the alternative (parallel/ black) markets.

Key Highlights from the MPC Statement

On the 27th of September 2024, the MPC instituted the following measures:

- Immediately increased the Bank's benchmark policy rate from 20% to 35%.
- Immediately increased and standardized statutory reserve requirements for demand and call deposits for the ZiG and US$ deposits to 30% from 15% and 20%, respectively.
- Immediately increased statutory reserve requirements for savings and time deposits for ZiG and US$ from 5% to 15%.
- Reduced foreign currency one can take out of Zimbabwe to US$2,000 from US$10,000.
- To allow for greater exchange rate flexibility, in line with increased demand for foreign currency.

Context

On the 5th of April 2024, the ZiG officially replaced the Zimbabwe local dollar (ZWL) after the latter had experienced an accelerated decline of about 72.3% of its initial value against the US dollar (US$) in the official market (year-to-date terms). The excessive deterioration of the ZWL occurred only in three (3) months ending 31 March 2024. To tame this excessive depreciation of the local unit, the monetary authority adopted the ZiG as a structured local currency at an official exchange rate of 13.5685 per US$1. A structured currency is a currency that is pegged to a specific exchange rate or currency basket and backed by a bundle of foreign exchange assets like gold.

At the time of ZiG's introduction, the Bank indicated that this local unit was backed by RBZ reserve asset holdings constituting US$100 million in cash and 2.5 tonnes of gold (worth US$185 million at the time). The Bank viewed the combined US$285 million worth of reserve assets as adequate to provide full cover of reserve money[1] in the system, which totaled about ZWL2.6 trillion (US$90 million equivalence at the time). This would mean that holding other factors constant, the ZiG money supply growth is limited to the growth of RBZ's reserve asset holdings. So, hypothetically, this arrangement could restrict the ability of the monetary authority to print ZiG willy-nilly, thus subduing exchange rate depreciation and price inflationary pressures. With this interpretation in mind, ZIMCODD applauded authorities for the ZiG concept[2] as it would instill monetary discipline and help clamp rapid dollarization of the economy.

1. The base level of money supply made up of currency (notes and coins in circulation) and the deposits held by commercial banks at the central bank.
2. https://zimcodd.org/wp-content/uploads/2024/04/Analysis-of-the-2024-Monetary-Policy-Statement.pdf

However, only a few months after some sense of stability, the ZiG has started to depict the same characteristics as the ZWL, which is unexpected for a structured currency. This development is reminiscent of June 2020, when the Dutch foreign currency auction system was introduced. Hard data shows that for the first few months of the auction market, the ZWL and inflation were subdued before they started to go haywire. The MPC has since devised some monetary policy strategies to address the current anomaly and save the ZiG from suffering the same fate as the ZWL.

Analysis of MPC Measures

A benchmark policy rate is the RBZ's key lending rate which it uses to regulate the economy's availability, cost, and use of money and credit. By increasing the benchmark policy rate, the MPC intends to discourage speculative borrowing in the economy. However, with the massive spike in parallel market rates in recent weeks, 35% seems inadequate to deter rent-seeking. As such, the public expects the MPC to hike the rate further in the coming weeks.

The MPC has also increased the statutory reserve ratio (SRR)[3]. The RBZ uses the statutory reserve requirements for liquidity management. A high SRR ratio means a large portion of commercial banks' deposits is locked in RBZ's vaults and, therefore, is not available for on-lending by banks, thus constraining credit expansion. However, since the SRRs are mostly non-interest bearing, an SRR that is too high poses an increased opportunity cost to banks, prevents full utilization of savings, and increases the cost of financial intermediation.

In addition, the MPC has limited individuals' foreign currency exports to only US$2,000 per trip. The move intends to subdue foreign currency demand pressure in the formal markets. While this policy action will also likely deter forex externalization, it may drive the public away from the formal banking channels and harm informal cross-border trade. All this promotes a cash economy (mattress/pillowcase banking) that encourages corruption and underhand dealings, thus rendering fiscal and monetary policies ineffective.

Furthermore, the MPC has resolved to allow for greater exchange rate flexibility. The Bank devalued the ZiG by at least 40%, from about USD/ZiG 14 to USD/ZiG 25. Although this policy shift raises concerns about whether reserve assets back the ZiG or the exchange rate market-determined, this devaluation was long overdue as the official rate was now overvalued. Before the official devaluation, the parallel market premia – percentage differences between official and parallel market rates – had widened unsustainably. By allowing exchange rate flexibility (operation of market forces of demand and supply), the Bank intends to collapse the exchange rate premium and stabilize the ZiG. However, the sharp official ZiG decline had significantly suppressed real incomes, likely negatively impacting public service delivery (budget constraints), consumer aggregate demand, business investment, hiring, and national output growth.

The above monetary policy measures taken by authorities will go a long way in stabilizing the local currency. For sustainable development and attainment of Vision 2030, Zimbabwe must strive to gravitate toward a mono-currency regime.

3. An SRR is an instrument used to manage liquidity where banking institutions are required to maintain balances in their SRR accounts equivalent to a certain proportion of their eligible liabilities.

This is because near-full dollarization disadvantages the country relative to its regional peers, as domestic firms are rendered uncompetitive. A small nation's use of a strong currency (US$) on global demand reduces it into a supermarket economy, as unsustainable import bills eliminate domestic manufacturing and kill jobs.

Moreover, with a mono-currency regime, a nation can enjoy monetary policy autonomy by printing its currency whenever needed. Mono-currency regimes can seek relief from their money printing rooms (central banks) during severe economic downturns, major bank runs, or natural disasters. This option will be unavailable if foreign currency is used instead. For such scenarios, one of the viable solutions will be public borrowing either locally (increases interest rates, thus crowding out private sector investment) or externally (increases the default risk and being in another country's pocket ruins credit ratings).

Policy Alternatives

Cognizant of the preceding, it remains the public's position that the ZiG is facing a myriad of risks, including, among others, debt unsustainability, political vulnerabilities, societal polarization, rising informality, frequent and severe climatic shocks, rapid dollarization, negative public perceptions, electricity shortages, and elevated global geopolitical tensions. As such, robust policy measures must be swiftly instituted to attain durable stability and achieve de-dollarization targets (mono-currency) by the end of 2030. According to a recent analysis by ZIMCODD[4], these include but are not limited to:

- Political commitment to reforms, particularly implementation of economic, governance, and land tenure system reforms.
- Policy consistency - internal, vertical, and horizontal consistency.
- Policy consultations - increased stakeholder participation, including citizens.
- Adopt a market-determined exchange rate to clamp rent-seeking behaviors.
- Treasury must embrace fiscal discipline.
- Creation of ZiG demand.
- RBZ independence and increased transparency and accountability.
- Adoption of advanced financial technologies.
- Greening vital sectors – agriculture, mining, transport, and manufacturing.
- Economic diversification – strengthening value chains and beneficiation.
- Effective domestic resource mobilization (DRM).

For more currency analysis, please check out ZIMCODD's Public School of Economics on Tuesday, October 8th. You can also check the Economics Section of ZIMCODD's 3rd Edition of the Break Free Newsletter to be published next week.

4. https://zimcodd.org/wp-content/uploads/2024/04/The-Weekend-Reader-Recommendations-to-stabilize-the-ZiG.pdf

Opportunities

- Portfolio officer: https://app.unv.org/opportunities/1768895990892800
- GIS Developer familiar with Data Analytics: https://phe.tbe.taleo.net/phe02/ats/careers/v2/viewRequisition?org=PEDAIDS&cws=41&rid=3070
- CALL FOR APPLICATION: UNLOCKING POTENTIAL ENTREPRENEURSHIP SADC WORKSHOP: https://careers.unesco.org/job/Harare-Call-for-Application-Unlocking-Potential-Entrepreneurship-SADC-Workshop/804060702/
- Head of Experimentation: https://app.unv.org/opportunities/1768893658662144
- Country Director (CARE): https://phg.tbe.taleo.net/phg02/ats/careers/v2/viewRequisition?org=CAREUSA&cws=52&rid=7497
- Vote for your favorite changemaker who is making an impact in their communities: https://thelist.identitiesmedia.com/vote-now/

#Youth4Integrity pledge

Are you a member of the youth (18-35 years) with a passion for fighting social and economic injustice? Do you want to join the action for Integrity? Do You want to become an Integrity Icon? If your answer to any of these questions is yes, take the pledge today: https://rb.gy/90gzgx

Watch Episode 4 of our #Youth4Integrity Podcast: https://youtu.be/LqiyXGftufg?si=PVqghnNppxgoOcE_

Quote of the week: Victor Hugo

A creditor is worse than a slave-owner; for the master owns only your person, but a creditor owns your dignity, and can command it.

Picture of the week: *Rural Young Women Support Network makes a call for Breast Cancer Awareness Month.*