Analysis of the 2023 Mid-term Monetary Policy Statement

1.Introduction

The Reserve Bank of Zimbabwe (RBZ) recently announced its 2023 mid-term Monetary Policy Statement (MPS). The Bank outlines policy actions it will take in the second half of the year (2HY23) to its primary mandate of maintaining price, exchange rate, and financial sector stability. The proposed RBZ (the Bank hereafter) actions to achieve these mandates are analysed below.

2. Proposed Policy Actions

2.1 Benchmark Policy Rate

- *The Bank has resolved to maintain its policy rate at 150%*

Generally, central banks increase interest rates (cost of money) during periods of rising prices to discourage speculative borrowing in the economy. According to the Bank, the exchange rate depreciation and inflation pressures experienced in May and June did not emanate from elevated money supply. As such, the instability experienced reflects the impact of adverse behavioral factors. Authorities have since intervened to stabilize the economy. But the sustainability of ongoing ZWL stability experienced since the start of July 2023 remains largely in doubt. In the mainstream media, there are allegations of non-fulfilment of ZWL obligations by the Treasury to government contractors & suppliers. There is also a high prevalence of market pricing distortions that are promoting excessive rent-seeking. More so, the balance of risks[1] to the outlook remains tilted to the downside. So, maintaining a high benchmark policy rate is a commendable move that will continue to deter rent-seeking behaviors such as speculative borrowing by banks which fuels instability.

However, the repeated vicious cycles of economic fluctuations experienced since 2019 are increasingly drifting the economy toward full dollarization. Latest statistics, for instance, show that about 94% of the total banking sector's loan book, 81.51% of the total money supply in circulation, and 88% of total deposits were denominated in foreign currency (USD) as of the end of June 2023.

1. **These include ZWL confidence deficit, lack of public trust in government & its policies, pre-and-post election risks, high global inflation, and worsening global geopolitics.**

The fact that the ZWL as a proportion of the total money supply is declining rapidly will surely undermine the effectiveness of the benchmark policy rate as a monetary policy tool. In other words, Zimbabwe risks losing autonomy as its monetary policy; which is key in economic management; will now be dictated externally. Consequently, the government will be constrained in delivering a goldilocks economy (stable and inclusive growth with low inflation & low unemployment) which is key in uplifting standards of living.

2.2 Deposit Interest Rate

- *The Bank has maintained interest rates on ZWL time and savings deposits at 30% and 50% per annum respectively.*

In its February 2023 MPS, the Bank adjusted the minimum deposit interest rates on both ZWL and USD savings and time deposit accounts upwards. This action was taken to help lure depositors to keep money aside for long-term goals while earning interest. Lucrative interest on deposits ensures that excess money held by the public is kept in the bank rather than being used for speculative purposes. In other words, the higher the deposit interest rate the greater the opportunity cost of holding non-interest-bearing cash.

In its mid-term MPS, the bank has decided to maintain interest rates on ZWL time and savings deposits. However, these interest rates on ZWL deposits are unlikely to lure economic agents to bank their excess ZWL funds. This is because they are largely lagging behind both the current blended inflation level hovering above 100% and the bank's expected inflation of between 60-70% by year-end. The value that will be lost due to price inflation is much higher than the value that will be gained on interest-earning ZWL deposit accounts. As such, there is no incentive for the public and investors to keep their extra money in such accounts in a hyperinflationary environment. They would rather chase value by investing their free funds in riskier assets like stocks or buying USDs in the parallel market.

2.3 Statutory Reserve Requirements (SRR)

- *The Bank has maintained statutory reserve requirements (SRRs) levels on domestic and foreign currency demand and call deposits at 15% and 10% respectively.*

Monetarists believe that SRRs are needed to build adequate liquidity in the banking sector, a lack thereof creates a financial imbalance in case of an untoward incident like fraud which can lead to a risk of financial instability. Considering this, one can conclude that SRRs are crucial in building trust and confidence in the banking sector as investors and the public get assurances that their money is secured through reserves.

More importantly, SRRs are used for liquidity management by the central bank where a high SRR ratio means a large portion of deposits is locked in RBZ's vaults and therefore are not available for on-lending by banks thus constraining credit creation and expansion by commercial banks.

Generally, SRRs are mostly non-interest bearing. As such, a high SRR poses a high opportunity cost to banks, prevents full utilization of savings in the economy, and increases the cost of financial intermediation. But for Zimbabwe, which is already trapped in a high inflationary environment, maintaining a high SRR, particularly on ZWL deposits is a good policy stance that reduces free balances available to commercial banks and thus suppresses excessive speculative lending.

2.4 Foreign Exchange Management

- *The Bank shall continue with the current auction system in place and further liberalize the use of foreign exchange from the wholesale auction system.*

The Bank has decided to maintain the current retail auction system in place and liberalize the use of foreign exchange from the wholesale auction system to allow banks to meet small foreign payment requirements for their customers such as individuals and small businesses. If fully implemented, this proposed liberalization of the use of auction funds will be a highly commendable policy move that will help enhance access to foreign currency by all economic agents. However, it remains our view that authorities must disband the retail auction system so that the interbank emerges as the sole official source of forex for all economic agents. This will help to fast-track exchange rate unification which is key in increasing market pricing transparency, competition, and efficiency.

2.5 Open Market Operations (OMO)

- *The Bank shall strengthen the operation of the Non-negotiable Certificate of Deposits (NNCDs)*

The Bank resolved to strengthen the operation of the NNCDs which it is using to mop excess local currency liquidity in the economy. In monetary economics, an NNCD is a record that contains an acknowledgment that a sum of money has been received by the issuer and a promise by the issuer to repay the sum of money. Typically, NNCDs cannot be transferred, sold, bought, or exchanged. In the past, RBZ has been issuing NNCDs that yield zero interest rates, a move that was unfair to banks who had to give up their excess funds for nothing at a time the local currency has been massively losing value. As such, the decision now taken by the Bank to strengthen these NNCDs as an open market operation (OMO) tool is welcome as it is expected to improve NNCD liquidity and increase gains for holders of these instruments.

2.6 Gold Coins and Gold-backed Digital Tokens (GBDT)

- *The Bank is at an advanced stage in the preparations for the eventual rolling out of GBDT for transactional purposes under the project codenamed ZiG, which stands for Zimbabwe Gold.*

The gold coins were introduced by the bank in July 2022 to serve two (2) primary functions: liquidity management and alternative investment vehicle. As of 14 July 2023, these coins have managed to mop over ZWL35 billion from a total of 36,059 coins. The bank also introduced gold-backed digital tokens (GBDT) in May 2023 to complement the sale of physical gold coins and expand the value-preserving instruments available in the economy, enhance the divisibility of the investment instruments, and widen their access and usage by the public. As of 21 July 2023, the bank had conducted 11 issuances of GBDT valued at ZW$50.50 billion and US$7,794.87 which are backed by 325,024,524 milligrams (325.02 kgs) of gold. In its mid-term MPS, the bank plans to undertake public awareness campaigns ahead of the eventual rolling out of GBDT for transactional purposes.

While these instruments have increased the investment assets pool to rival the USD as a store of value, the opportunity cost posed by these to the economy is huge. For instance, these gold instruments are largely sold in fragile ZWL, a currency that has lost more than 80% of its value against the USD in the first half of 2023. The move is tantamount to selling precious gold at a discount (a loss). This occurs at a time the nation is facing dwindling international reserves which have fallen from 2.7 months of import cover (IC)[2] in 2021 to 1.1 months in 2022. These reserves are crucial in economic management, especially during periods of speculative attacks on local currency, the balance of payment imbalances, and or unforeseen contingencies like climate-change-induced natural disasters which affect the poor and marginalized communities the most. So, Zimbabwe's low IC illuminates her potentially high vulnerability in managing import requirements or external shocks.

Again, access to these instruments by the general public remains too limited thereby risking deepening societal inequalities aided by the State apparatus. With high perceived corruption in public institutions and a lack of mutual trust between the government and other economic agents, rolling out GBDT before setting up adequate infrastructure in place across the nation will expose the general public to predators like fraudsters and scammers. More so, the GBDT dubbed "Zimbabwe's Gold" has its own exchange rate thus creating multiple exchange rates in the economy. There is a consensus among economists that exchange rate multiplicity creates pricing distortions and promotes round-trip transactions – tax evasion.

2. Import Cover measures the number of months of imports that can be covered with foreign exchange reserves available with the central bank.

2.7 Localization of Tobacco Production Financing

- *With immediate effect, there will be no restrictions on the use of locally sourced funds to support the production of tobacco in the country.*

According to Statutory Instrument 64 of 2004, tobacco merchants who fail to secure offshore financing to produce and buy back tobacco are required to apply to the bank for authority to raise funds on the local market. These restrictions have been constraining access to finance by tobacco farmers thereby negatively affecting the production of tobacco. Tobacco is Zimbabwe's top cash crop contributing on average about 10% to forex receipts per annum. In light of this, the bank has decided to remove all restrictions on the use of locally sourced funds with immediate effect. This is a commendable move that will likely positively affect the utilization of land, national output growth, and generation of foreign currency which is key in building reserves and stabilizing the local currency.

Although this move is expected to increase tobacco output, it fails to address the welfare of tobacco farmers who remain impoverished. Tobacco farmers are relegated to the peripheries of the value & supply chain. These farmers are at the mercy of exploitative international markets, exploitative contract farming, limited access to markets, and a lack of competition that is limiting selling options for farmers. At the same time, child labour coupled with high safety & health risks left tobacco farmers more vulnerable. As such, authorities must do more to ensure that the Tobacco Value Chain Transformation Plan (TVCTP) promotes trade justice in Zimbabwe's tobacco industry.

3. Inflation Projections

The bank projects a downward trend of inflation rate in the second half (2HY23), expecting monthly inflation to fall to 3% while yearly inflation will close the year between 60-70%. The bank posits that staying the course of tight monetary policy (as shown by its latest monetary policy measures) to buttress already prevailing strong fundamentals (robust GDP growth, healthy balance of payments, improved foreign currency receipts, and fiscal sustainability) will lead to sustained macroeconomic stability.

However, the ongoing stability touted by the bank seems to be managed and likely temporary. This is because the stability is not backed by the swift implementation of robust economic and political reforms to make it more durable. By starving the market of ZWLs through the one-sided sale of foreign currency and not fulfilling obligations to service providers, authorities are threatening business activity and risking the full dollarization of the economy.

2. Import Cover measures the number of months of imports that can be covered with foreign exchange reserves available with the central bank.

The speculation in the market is also that these unfulfilled ZWL obligations by Treasury will be settled soon after the election. If this is to hold, ZWL liquidity will soon balloon again and cause price & exchange rate destabilization.

Furthermore, there are growing reports in both mainstream and alternative media indicating unbalanced electoral systems and processes such as delimitation report scandals, voters' roll shenanigans, opaque polling stations, voter intimidation particularly in rural areas, banning of opposition rallies, vote buying accusations, and incidences of politically motivated violence among others. All these show that Zimbabwe is likely heading toward a contested electoral result which risks causing deadly post-election violence. This may plunge the nation into pandemonium and exert negative impacts on the economy like increasing investment risk premium, humanitarian crisis, brain drain, and sour international relations.

4. Conclusion

The tight monetary policy being pursued by the Reserve Bank of Zimbabwe is a step in the right direction. To bring durable economic stability, this policy stance must be buttressed by sound fiscal policies that maintain a sustainable budget deficit to suppress borrowing and money printing pressures. All of this is attainable if and only if there is adequate political will to institute robust political and economic reforms. These reforms are key in entrenching democracy, strengthening civic engagement, promoting the rule of law & respect for human rights, enhancing public service delivery, and subduing pricing distortions to improve market competition and innovation.

Address | 49 Pendennis Rd, Mt Pleasant, Harare, Zimbabwe
Telephone| +263 242776830/1
Email |zimcodd@zimcodd.co.zw
Facebook | Zimbabwe Coalition on Debt and Development
Web | www.zimcodd.org
Twitter | @zimcodd1
Instagram | @zimcodd1
YouTube | Zimbabwe Coalition on Debt and Development