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AN ANALYSIS OF THE 2023 MONETARY POLICY STATEMENT

Definition of Key Terms

Balance of Payment (BoP): A method by which countries measure all of the international monetary transactions within a certain period. It consists of three main accounts: the current account, the capital account, and the financial account.

Exchange Control: It refers to actions directly regulating or affecting the influx and outflow of capital across national borders.

Exchange Rate: An exchange rate is a rate at which one currency will be exchanged for another currency and affects trade and the movement of money between countries.

Letter of Credit (LCs): A letter issued by a bank to another bank (especially one in a different country) to serve as a guarantee for payments made to a specified person under specified conditions.

Fiscal Policy: These are measures employed by governments to stabilize the economy, specifically by manipulating the levels and allocations of taxes and government expenditures.

Monetary Policy: It refers to the financial policies adopted by the monetary authority of a country to achieve the country's economic goals. These goals are often a combination of economic growth, price stability, and credit availability.

Non-Negotiable Certificates of Deposit (NNCDs): A bank 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 other than a deposit account or negotiable instrument.

Non-Performing Loans (NPLs): A loan is considered non-performing when more than 90 days pass without the borrower paying the agreed installments or interest.

Broad Money (M3): This is the definition of the money supply which includes a wide scope for the definition of money including both notes and coins, but also more illiquid forms of money-- such as bank deposits, treasury bills, and gilts.

Savings Deposit Account: A bank account on which interest is usually paid and from which withdrawals can be made usually done by written authorization on a prescribed form.

Seigniorage: A profit made by a government by issuing currency, especially the difference between the face value of coins and their production costs. It can also relate to interest central bank charges from lending commercial banks money.

Statutory Reserve Requirement (SRR): This is an instrument to manage liquidity where banking institutions are required to maintain balances in their SRR accounts equivalent to a certain proportion of their eligible liabilities (EL), this proportion being the SRR rate.

Round-tripping: This is an illegal way to inflate revenues by swapping assets or shell transactions, usually on a no-profit basis through a mutual settlement or an agreement.

Time Deposits Account: It is also known as term deposit which refers to a deposit account with a fixed maturity and interest rate. It usually prevents the premature withdrawal of the deposit.

1. Introduction

The Reserve Bank of Zimbabwe (RBZ) usually announces its Monetary Policy Statement (MPS) in February of every year. A monetary policy is a list of actions to be taken by a country's central bank to influence how much money is in the economy and how much it costs to borrow. It is implemented through various tools including inter alia the adjustment of interest rates, trading of government securities, and altering the amount of money circulating in the economy. This policy's primary objectives are to manage inflation or unemployment and maintain currency exchange rates and financial market stability. As such, the success of a central bank is generally measured by the prevailing level of price inflation and currency performance. For 2023, the Governor presented the MPS on the 2nd of February. This piece, seeks to analyze the measures proposed to form part of Zimbabwe's 2023 monetary policy.

2. Key Highlights: 2023 Monetary Policy Measures

The following are the key highlights from the 2023 Monetary Policy Statement (MPS):

- RBZ Policy Rate reduced to 150% per annum (p.a) from 200% p.a. Adjusted minimum deposit interest rates on savings and time deposits to 30% and 50% p.a respectively.
- Adjusted minimum deposit interest rates on savings and time deposits to 30% and 50% p.a respectively.
- To maintain minimum deposit interest rate on saving and time foreign currency (forex) deposits at 1% and 2.5% p.a respectively.
- Both statutory foreign currency and ZWL demand and call deposits standardized at 10%.
- Forex auction system to continue along with the WBWS. The WBWS to continue as the official reference exchange rate.
- No plans to withdraw the coins in the short and medium term.
- Export retention increased and standardized at 75% across all sectors. The incremental export incentive (IEI) scheme was suspended.
- Forex retention on domestic sales increased to 85% from 80% with exemptions for fuel sales, NGO funds, free funds, and government-funded projects & programs.
- Export of forex cash and gold coins was reviewed upwards from US$5 000 to US$10 000 and export of local banknotes from ZWL20 000 to an equivalent of US$1 000.
- Export of demonetized and old banknotes now limited to not more than 100 pieces of each denomination.
- The deadline for banking sector compliance with minimum capital requirements was extended to end-December 2023.

3. Analysis of 2023 Monetary Policy Measures

3.1 Inflation Projections

The Bank projects a downward trend of inflation rate in 2023 and expects it to average 1.5% per month.

A continued tight monetary policy stance, strong fiscal stance, strong coordination between fiscal and monetary authorities on liquidity management, continued use of a dual currency system, and normal-to-above-normal rainfall patterns to dampen food prices are the underpinning assumptions. A granular analysis, however, shows that in making its inflation projections the Bank through 2023 MPS has failed to price the impacts of the upcoming general elections and its associated risks. These risks, for instance, include the pending Private Voluntary Organization (PVO) Bill which is awaiting presidential assent after sailing through both chambers of the National Assembly. The Bill has a high potential to constrain the civic space which could affect NGO remittances to Zimbabwe. In 2022 alone, forex inflows from NGOs were up 16.6% to constitute about 10% of US$11.6 billion received abroad for the entire year. The foreign exchange markets risk losing a significant amount of these remittances if the Bill gets signed and this could exert severe ZWL exchange rate, social, and humanitarian implications.

Also, the Bank is projecting inflation to keep plunging through 2023. However, a glance at statistics shows that government borrowing is mounting unsustainably. The latest RBZ report shows that in 2022, Treasury Bills issuance expanded by 394% from ZWL40.24 billion in Jan 2022 to ZWL198.81 billion in Dec 2022. This is clear evidence of mounting spending pressures which could get worse in an election year (2023). As such, it is difficult to expect a decline in ZWL inflation when the ZWL had already lost about 20% of its value year-to-date in the parallel markets. While we admit that US$ transactions are now dominating the economy, a shift to blended inflation figures (combined ZWL and USD inflation) for policy guidance in 2023 will likely misrepresent the cost of living being borne by Zimbabweans, especially those largely earning in local currency. It is highly conceivable that the Bank has more control over ZWL inflation than the US$ component. US$ prices are largely dictated by variables largely outside the Bank's control. Cognizant of this, the Bank's policies should remain guided by what it has control over – the ZWL inflation figures. It is therefore our view that inflation will remain elevated in the outlook.

3.2 Interest Rates

3.2.1 Benchmark Policy Rate

The Bank has proposed to reduce its benchmark policy rate by 50 percentage points to 150% in line with moderating inflation pressures experienced since Q4:22. From their perspective, this stance will bring positive real interest rates in the economy which are good as they encourage borrowing for both investment and consumption. Also, the previous exorbitant 200% interest rate had fuelled dollarization as shown by the increase in foreign currency loans in 2HY22 thus relegating ZWL to only a transactional currency. However, it is our view that the decision to decrease the benchmark policy rate at a time the exchange rate is plummeting particularly in the parallel market is counterproductive as it will encourage speculative borrowing which fuels inflation.

Statistics show that the moderation of inflation experienced in 2HY22 only came after the implementation of vast policy measures by authorities which managed to clamp massive ZWL depreciation experienced in the first half of the year (1HY22).

Now, with the ZWL already down by 18.2% on average in the parallel market since the start of 2023, ZWL prices will likely escalate in the months ahead. The decline of the local unit will also likely be worsened by the excessive fiscal spending ahead of the upcoming harmonized elections. Election seasons are highly distortionary as political pressures increase the possibility of fiscal policy slippages and reversals. Studies have shown that incumbent governments facing re-election tend to display dovish spending tendencies as political goals are prioritized at the expense of the long-term health of the general economy and the welfare of citizens. Cognizant of this, RBZ should have tightened its monetary stance to keep exchange and inflation pressures suppressed.

3.2.2 Deposit Interest Rates

By adjusting the minimum deposit interest rates on both ZWL and US$ savings and time deposit accounts upwards, the Bank seeks to lure depositors to keep money aside for long-term goals while earning interest. This ensures that excess money with the public does not end up being used for speculative purposes as it is kept in the bank account for a long time. In other words, the higher the deposit interest rate the greater the opportunity cost of holding non-interest-bearing cash. However, for Zimbabwe's scenario, ZWL deposit interest of between 30-50% is insignificant as it is lagging behind the inflation level. The value lost due to inflation (measured at 229.8% as of end-January 2023) is higher than the value gained on interest-earning deposit accounts. As such, there is no incentive for the public and investors to maintain such accounts in a hyperinflationary environment. They would rather chase value by investing their free funds, for instance, in stocks or buying hard currency in the parallel market.

3.3 Statutory Reserves Requirements (SRRs)

The statutory reserve requirements are meant to build up adequate liquidity in the banking sector. Generally, a lack of SRRs may create a financial imbalance in case of an untoward incident like fraud or scam which can lead to a risk of financial instability. These SRRs are key 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. 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 banks. However, since SRRs are mostly non-interest bearing, a high SRR poses a high opportunity cost to banks, prevents full utilization of savings, and increases the cost of financial intermediation. Also, RBZ's SRR ratio of 10% on ZWL call and demand deposits in a highly inflationary environment may be inadequate in reducing money supply.

3.4 Export Retention

As highlighted in section 2, the Bank has increased export retention on both export proceeds and domestic foreign currency sales. For instance, before this policy shift if one has export receipts of about US$1 000, they were forced to surrender 40% (US$400) to RBZ in exchange for ZWLs at the foregoing WBWS interbank rate. Now, they are required to cede only 25% of their export proceeds. Thus, increasing retention ratios will bring great relief to individuals, exporting businesses, and domestic firms as it will help reduce exchange rate losses. In 2022 alone, the ZWL lost about 84% of its value against the US$.

With 40% and 20% of export and domestic forex sales revenues respectively required to be ceded to RBZ at the interbank rate, it means these businesses incurred huge exchange rate losses in 2022.

This negatively affected their investment and production plans as well as their pricing when coupled with acute electricity shortages and high fuel prices experienced in 2022. In the end, it is the consumer that was disproportionately affected as inflation averaged 184% per month. Now by increasing forex retention thresholds the Bank will help reduce US$ demand in the formal market. Also, the policy stance will expand free funds which then allows companies to increase the importation of industrial raw materials which are key in sustaining high domestic production, employment, and output.

3.5 Exchange Rate Liberalization

The Bank promised to continue supporting the auction and the WBWS by availing forex from the surrender portion of forex receipts. While this foreign exchange market support is commendable, it is our view that the piecemeal approach to ZWL exchange rate liberalization being taken by authorities is hurting the price discovery process. The auction market should be disbanded as it is facilitating the creation of multiple exchange rates in the economy thus promoting round-tripping and rent-seeking behaviors. As such, to get a single unified official rate the Bank should only maintain the WBWS interbank market purely based on market forces of demand and supply. For smooth functioning, the currently existing WBWS circuit breakers in terms of the volumes traded should be scrapped. This will help boost forex volumes and increase the participation of many buyers and sellers. A market-driven exchange rate is essential in stabilizing ZWL and eliminating distortions caused by rent-seeking.

3.6 Gold coins

The gold coins were introduced by the Bank in July 2022. As of 13 January 2023, about 25 188 gold coins were purchased thus enabling RBZ to mop excess ZWL20 billion in the market. Of the total coins, 84% were acquired by corporates while the balance of 16% was bought by individuals. The gold coins are serving two primary functions -liquidity management (Open Market Operation) and alternative investment vehicle. Concerning the former, the fact that the gold coins are being largely sold in ZWLs at an overvalued WBWS interbank rate the Bank is selling at a loss. For instance, on 31 January 2023 an ounce of gold coin sold for US$1 923.05[1] which was equivalent to ZWL1.53 million at the prevailing official rate of ZWL/USD 796.52 (versus parallel market value of ZWL1.92 million at ZWL/USD 1000). All else constant, this variance gives an indicative loss of about ZWL0.39 million per ounce sold that day.

Since the turn of 2023, the ZWL is on a deterioration path against the US$ in both markets. It has already erased nearly 20% of its value in alternative markets pushing parallel market exchange premia[2] above 35%. As such, the selling of precious gold in fragile ZWL is tantamount to a waste of gold reserves at a time the nation has become too susceptible to unforeseen contingencies like disease outbreaks, droughts, and cyclones.

1. https://www.rbz.co.zw/documents/Mosi-Rates/2022/August/MOSI-OA-TUNYA-PRICES-01-August--2022.pdf
2. This is percentage difference between official and parallel market exchange rates.

Despite the presence of these coins, RBZ statistics also show broad money supply mounting by 99.12% from ZWL1.12 trillion in June 2022 to about ZWL2.34 trillion in December 2022. This shows that the ZWL20 billion mopped by gold coins in more than 6 months is too little to influence the exchange rate and inflation dynamics. It is therefore the public's view that gold coins are inefficient in managing liquidity hence the program of selling the coins in ZWL should be discontinued unless the Bank allows for full liberalization of the WBWS system.

3.7 Export of Forex Cash and Gold Coins

The Bank has reviewed the upwards export of forex cash and gold coins from US$5 000 to US$10 000. Since the economy has now largely dollarized as confirmed by estimates by ZimStat at the Classification of Individual Consumption by Purpose (COICOP) division and statistics from RBZ forex accounts balances, increasing forex export limit was inevitable to bring travel convenience. In our view, the Bank's major aim in maintaining exchange controls is to manage or prevent an adverse balance of payments (BoP) position. As such, these controls will help reduce capital flight that may emanate from speculative pressures on ZWL, protect local industry, restrict non-essential imports, build forex reserves, encourage the importation of priority goods, and manages the exchange rate. However, exchange controls may strengthen already flourishing currency black markets as foreign currency demand may end up exceeding supply in the official market.

3.8 Conclusion

The measures offered by the Bank are inadequate to clamp the prevailing perpetual ZWL decline. The public expected measures that could further tighten market liquidity, improve the appeal (use) of the ZWL as both a transactional and investment currency, and boost public confidence and trust. In our view, the proposed measures largely promote the use of US$ which is against the authorities' position that the economy is on a de-dollarization path. Also, the 2023 MPS unmasked various policy inconsistencies by authorities, for instance, the reversal of an Incremental Export Incentive (IEI) scheme barely 2 years after it was installed. This is appalling since it is vividly clear from official statistics that the IEI scheme had immensely contributed to record forex generation, for example, via gold deliveries to official points of sale. More so, the MPS shows that RBZ is lagging in terms of gender mainstreaming its monetary policies to cover marginalized groups such as women and youths.

3.9 Recommendations

These are some of the recommendations to the Bank and the Treasury:

RBZ independence: There is a need for political will to increase the independence of the RBZ. This improves its credibility which is crucial in reducing inflationary expectations.

De-dollarization Policies: To achieve durable de-dollarization, authorities must build credible macroeconomic stabilization, fully liberalize the exchange rate, and shift from excessive external borrowing.

Exchange Rate Management: The ZWL must be fully floated to help quickly discover its true price. This entails disbanding the auction system and 100% liberalization of WBWS interbank market.

Large ZWL Banknotes: The Bank must introduce larger banknotes like ZWL500 and ZWL1000 to bring transacting convenience.

Limit Quasi-Fiscal Operations (QFOs): The Treasury must minimize its recourse to the central bank and exercise fiscal discipline.

Policy Consistency: There is a need for the monetary authority to maintain policy consistency as this brings business predictability.

Policy Consultations: The policymakers must get a firm understanding of stakeholders outside government as this help in building trust and social cohesion. The Bank must also publish and widely disseminate simplified citizens versions of policy documents.

Complementarity of Policies: Monetary and fiscal authorities must work hand in glove ahead of the election season to reduce chances of policy slippages.

Structural and Economic Reforms: The authorities must swiftly implement structural reforms to improve market competition and market price discovery.

Gender Mainstreaming: The Bank must gender mainstream its monetary policies to ensure that it responds more effectively to the needs of all citizens.

International Remittances: The president must not sign the pending Private Voluntary Organization (PVO) Bill as it stifle civic space and poses a greater humanitarian crisis if signed into law.

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