ZIMBABWE NATIONAL CHAMBER OF COMMERCE
THE VOICE OF BUSINESS

MONETARY POLICY REVIEW – 2021

(Final Document)

Overview

The Central Bank Governor, Dr John Mangudya, issued the 2021 Monetary Policy Statement (MPS) on 18 February 2021, which provides an evaluation of progress in implementation of monetary policies enunciated in the August 2020 MPS and outlines the monetary policy measures to be pursued by the bank in the next six months to buttress and sustain the obtaining price and exchange rate stability since the introduction of a monetary targeting framework and a functioning foreign exchange auction system.

The Chamber acknowledges efforts by RBZ in resuscitating the economy and improvements in market updates which are important in allowing economic agents to monitor progress and assess whether there is coherence between the Fiscal and Monetary Policy measures. It is also commendable that the central banks continues in attempting to attain a degree of professional independence after the dissolving of its Monetary Policy Committee and appointing a new one. We also commend effort by the central bank to raise retention ratios, though more still needs to be done, including the recent move to allow for 60% of forex retention by tobacco farmers.

Monetary Policy Analysis

In modern economics, the focus of monetary policy is the quantity and price of money in the economy. Central banks have different mandates, most often these days targeting inflation, with subsidiary goals such as employment or growth. Central banks that focus on developmental targets, give greater emphasis to growth and employment than price stability. Increasingly – and reluctantly – central banks are being pushed towards more "social" targets, such as income equality. All wrestle with the reality that more than one target is no target.

Monetary Policy and Macroeconomic Policy

Policy coherence depends on fiscal and monetary policy co-ordination. The macroeconomic framework in the national budget, which differs in some respects, most notably inflation, from the Monetary Policy Statement (Feb 2021), is characterised by incoherence and inconsistency.

- The exchange rate target of Z$80 to the US is incompatible with inflation of 135% (budget) or even 25% estimated (MPS).

- Growth of 7.4% is incompatible with an increasingly overvalued exchange rate, implicit in 135% inflation and a stable exchange rate.
- Employment growth of 18% is sheer fantasy. Historically, formal employment in Zimbabwe has grown at half the rate of real GDP which would mean 3.7%, assuming the 7.54% target is reached, which it won't be.
- The 7.4% growth target is incompatible with gross fixed capital formation of less than 10%.

Macroeconomic Policy

By international standards Zimbabwe's macroeconomic policies are way behind the curve. Across the globe, governments have stepped up spending and eased monetary policy to combat the pandemic and alleviate the harsh economic impact of lockdowns on firms and families, but in Zimbabwe the focus is on mythical budget surpluses and illusory exchange rate stability.

Increased Tax Burden

Adjusted for inflation, government revenue projected for 2021 is up by a third since 2018 and more than doubled since 2016. But real government spending is down 3% since 2018, partly because public sector real incomes have fallen steeply, hence the exodus from the health service.

Paying More for Less

There are major ironies in this. In an economy with mounting unemployment and escalating poverty, the government is collecting 30% more revenue and in return for 3% less in terms of goods and services. If the comparisons are taken back to 2016, revenue is up 112% in real terms, almost three times as much as spending (39%) - more evidence of taxing more and delivering less.

An Inegalitarian Society

The ultimate irony is in the income distribution data. 50% (roughly) of income goes to the richest 20% of the population, 33% of it to the richest 10%. So 80% of the population shares 50% of the income with the elite 20%. It is the top10% to 20% of the income pyramid who can afford solar power, boreholes and private schools and hospitals while the vast majority of the population is deprived.

Targeting

The sole explicit target of monetary policy in Zimbabwe is reserve money (MO), though this is flexibly interpreted by the RBZ. Thus in February 2020 the RM target was 10% to 15% by year-end. The actual year-end growth rate was 86% though the MPS states that this was consistent with its – frequently revised – quarterly growth targets.

The 2020 MPS said that "strict" RM policies would keep money supply growth to 60% in 2020 – actual 425% - which would be consistent with inflation of at year-end of 50% (actual 348%).

Reserve money

Reliance on a highly volatile aggregate – reserve money – to control money supply has been seen to fail. Clearly, the "floating" RM anchor, which fluctuated no less than 11.6% in one week in January-February, is an unreliable yardstick.

At the start of 2021, the RBZ says it will use RM to control money supply, despite the fact that 60% - and rising – of bank deposits are in foreign currency, not susceptible to RM management.

In 2021 there will be a reprise. The exchange rate will slide further and with it the USD element of M3 will rise fuelling inflation and pushing the economy further into re-dollarization and the ZWL further along the road to irrelevance.

Which Exchange Rate?

The MPC believed that "stability" of the exchange rate should be measured against the US dollar. But stability against the USD, especially today, is not the same as stability against Zimbabwe's main trading partners.

Since its recent peak in March 2020, the FRED (St Louis Federal Reserve Bank in the US) trade weighted index of the US dollar has lost 11% of its value which means that exchange rate stability in Zimbabwe is being measured against a sinking anchor.

Indeed, since the auction rate stabilized last August the USD has depreciated 4.5% dragging the ZWL down with it. However, this is only part of the story. Because Zimbabwe's imports are mainly from non-dollar regions – SA, Asia and Europe - the auction rate is not a measure of currency stability.

Since the launch of the auction, the auction rate has devalued some 30%, but on a trade-weighted basis the nominal effective exchange rate is down substantially more - 43%. A major factor has been the double digit (16%) appreciation of the Rand - Zimbabwe's largest trading partner.

More important is the trend of the Real Effective Exchange Rate. It has appreciated some 6% since mid-2020 because the inflation gap between Zimbabwe and its main trading partners is larger than the extent of devaluation. Unless the auction rate is allowed to depreciate substantially in the months ahead, REER overvaluation will worsen. Exports will lose competitiveness and imports become cheaper, which flies in the face of the auction's underpinnings of import controls and intervention in domestic transactions, especially but not only in the mobile space.

Price Discovery

The MPC was resolute in its claim that the auction had delivered price discovery. This was put to bed publicly at the auction of January 26 when accepted bids were approximately 30% above those allotted. In a real auction, the price – the exchange rate – would have adjusted to clear the market (price discovery), but this was not allowed to happen. The market did not clear as some 30% of total bids were accepted but not allocated and became part of an inhouse pipeline to be cleared as and when the funds became available.

As yet more evidence that the auction is not working, banks are reported to have agreed to fund the pipeline so that importers do not have to wait a matter of weeks – in some cases up to 4 to 6 weeks - to secure the forex for which they have paid.

This raises still more questions about the sustainability of the auction. Having added local USD sales to the list of surrender requirements, the RBZ subsequently raised the export surrender ratio to 40% from 30% and now has added yet another fig-leaf in the form of bank bridging finance to try and peg the rate.

The combination of import priorities and controls, and the pipeline – however financed – means that the auction is used to avoid price discovery in the form of further devaluation of the currency.

Instead of the price reflecting the interaction of demand and supply, the RBZ manages demand and supply to peg the price at its arbitrarily determined “policy” level. This is not a Dutch auction. Flower growers in the Netherlands do not try to sell for the lowest price!

Information

The RBZ’s Weekly Economic Review was published regularly on the website until Nov 13. There has been nothing since then. Similarly, the most recent monetary and banking data relate to September 2020. If Reserve Money data can be published with a very short time lag, why is the delay so great for other monetary aggregates?

Banks and businesses need such information for decision-making in an “open-for-business-economy.”

The Inflation-Exchange Rate Nexus

Zimbabweans have been educated to believe that the exchange rate is the prime determinant of inflation. This is not the whole story. It can be argued – as the authorities do – that money supply drives the exchange rate which in turn is the major driver of inflation. It is for this reason that reserve money was selected as an anchor, albeit an impractical one.

Because the system is characterised by multiple and variable time lags, there is no watertight correlation between the exchange rate and inflation. In recent weeks, there has been a rekindling of inflation, partly reflecting the weakness of the ZWL against other currencies (not the USD), especially the rand. The rand has appreciated some 16% against the USD since early September, and as a result the ZWL is down some 13% against the South African unit.

Ministerial and official criticisms of businesses whom they accuse of profiteering ignore the fact that the bulk of Zimbabwe’s imports come from SA, China and the UAE and it is their exchange rates against the ZWL that influence prices in the shops, not the auction rate against the USD. In ZWL terms, rand prices are up some 13%.

Oil

Today the crude oil price at overUS$60 a barrel is 50% higher than its 2020 average of US$40. Amid projections of further price rises in during 2021.This will have two related knock-on implications for Zimbabwe inflation. The exchange rate will weaken, in turn fuelling inflation, while there will also be a direct pass-through of the increased US dollar oil price, leading to a double whammy effect.

Wages

Wage rises will be a major factor in inflation as those fortunate to have jobs will seek to protect real earnings which have fallen sharply. The budget data tell the story of the public sector where in inflation-adjusted prices 2020 the total wage bill, including pensions was almost a quarter lower than in 2018. This number highlights the potential wage pressure in the public sector which is unlikely to be very different from that in the enterprise economy. Accordingly, it is only prudent as well as realistic to expect wage pressures that will vastly exceed productivity growth in 2021. On budget figures the wage bill will rise just 4% this year, but as in every recent year, this budget forecast is likely to fall well short of the reality.

Playing Catch-Up

In similar fashion, businesses are engaged in catchup pricing that is most marked in services – internet charges, bank charges, school, hospital and medical aid fees, security charges, licences and state fees of all kinds etc.,

Some of these are linked to the exchange rate, but mostly the linkages are indirect. Simple macroeconomics tells us that – regardless of the exchange rate impact – when broad money supply (M3) which measures liquidity in the hands of households and firms, rises so too will nominal demand. In the last few years, and especially 2019/20 when real output fell by around a fifth, nominal demand has been growing rapidly while real output has stagnated or declined. Imports have been cut drastically, meaning that there is too much money chasing too few goods, which has a major impact on consumer and producer prices, regardless of exchange rate movements.

Producer Price Inflation

In 2020, producer prices rose faster than consumer prices. There is a time-lag from the factory to the retail outlet, which tells us that some of last year's producer price hikes have still to impact on consumer prices and will do so during 2021.

Thin Ice

In this situation, the auction is skating on thin ice. Just how thin is illustrated in the latest MPS which claims that Zimbabwe has a strong balance of payments with a surplus of US$1.1 billion. It is not said that this "surplus" is achieved by failing to service offshore debts and by import, currency and capital controls and the mortgaging of future export earnings.

But even with this artificial padding, the balance of payments is far from "strong". Of the US$1.1 billion surplus, $845 million (three quarters) was borrowed offshore, while another $648 million was aid. Indeed these two amounts plus Diaspora remittances of $1 billion were the equivalent of two thirds of export earnings.

This puts the "strong" BOP into context. There is no way that a country which is in debt distress with foreign debt in excess of 100% of GDP and which continues to build up arrears year after year can claim to have a "strong" BOP.

Merchandise exports are reported at $4.9 billion while Zimstat which is the source of trade data – not the central bank - reports a much lower number, $4.4 billion. Three pages later, the MPS reports export proceeds – presumably service as well as merchandise exports – of much less, $3.7 billion.

There is no explanation of these discrepancies. The proceeds may be much lower than merchandise exports because payments are delayed, because proceeds are net of transport

RECOMMENDATIONS

a) The central bank needs to put a plan that will ensure the foreign exchange market is a market exchange rate so as to provide incentives to exporters, businesses and households to liquidate their foreign currency earnings in the formal market. The current foreign exchange regulations are subsidizing importation of finished goods, while taxing the local producers who also need to pay for various government levies in foreign currency. Additionally it leads to numerous arbitrage opportunities in the importation and trading of fuel (among other commodities) which will create market shortages

b) The bank also needs to increase mobile money transaction limits to ZW$70 000 per week so as to allow increased flow of transactions to merchants and encourage digital transactions

c) The auction system needs to be enhanced for efficiency and transparency; it seems the rate has been dragging hence draining market confidence in the existing exchange rate. There is need to smoothen the Auction System and ensure that foreign currency buyers receive their allotted foreign currency within a week so that there are no supply gaps (delays in importing raw materials and essential inputs) or renewed pressure on the parallel market

d) Tightening liquidity conditions may suffocate credit expansion and threaten the targeted economic growth. The medium term banking accommodation facility may need to be increased to cater for high working capital and capital expenditure requirements from industry

e) With the economy partially dollarised, there is need for a foreign currency denominated overnight window to enable greater lending in USD. Also consider opening up USD lending to non-exporters

f) Private sector players should retain the bulk of their export proceeds (85%) and surrender only 15% in the move towards total liberalization were they will retain 100% by the 4^{th} quarter of 2022

g) The authorities should continue/improve on current measures to contain money supply. The 22.5% quarterly reserve money targeting framework must be adhered to as money supply remains the biggest headache up to date worsened by a shrinking GDP in the process swamping the market with unproductive liquidity

h) There is need to put in place measures to achieve exchange rate stability; lasting and durable stability

i) We are against the upward revision of interest rates (overnight accommodation) regardless of stubborn inflationary pressures. This will certainly not discourage speculative borrowing given that its catatonic policy uncertainty not negative interest rates which had been driving disruptive speculation. Businesses cannot afford any further interest rate hike worse still given the absence of an affordable relief facility to neutralise negative effects of covid-19 on corporate performance

j) Central bank should defer printing of new notes or higher denominations in order to contain inflationary pressures

k) There is need to build forex reserves

l) There is need to exit from the costly Afreximbank loans

m) There is need for a funding mechanism to buy grain from farmers; liquidity management has to be done in such a way that it caters for funding for the purchase of grain from the farmers – this can be done by reducing statutory reserves so that liquidity goes back to banks, banks can then invest in agro bills which can be used for the purchase of grain

n) Absence of a clear de-dollarisation trajectory is evidence that the Government itself does not have confidence in its currency, this is worsened by statutes which compel businesses to declare tax in currency of trade….if there was confidence in the prevailing exchange rate, the debate on currency to declare taxes was going to be superfluous. The mixed messages on the currency framework will remain an eyesore to investment attraction and confidence building

UPCOMING EVENT

- ZNCC Forex Auction Performance Review Breakfast Meeting with RBZ Governor: *Thursday 29 April 2021*

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