



**NATIONAL COMPETITIVENESS COMMISSION**

**Enhancing Zimbabwe's Global Competitiveness**

**ANALYSIS OF ZIMBABWE'S INFLATION AND EXCHANGE RATE  
DEVELOPMENTS ON COMPETITIVENESS**

**JANUARY 2022**

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### **1. Introduction**

- 1.1 Price and exchange rate developments contribute to macroeconomic stability of a country, which is one of the key pillars of competitiveness. A conducive macroeconomic environment allows businesses to plan and enhance productivity, as well as foster certainty and confidence in the economy. It is critical to note that industry can hardly operate efficiently when inflation and exchange rate premiums are relatively unstable.
- 1.2 This paper therefore analyses inflation and exchange rate movements for the month of January 2022 and the respective impact to competitiveness.

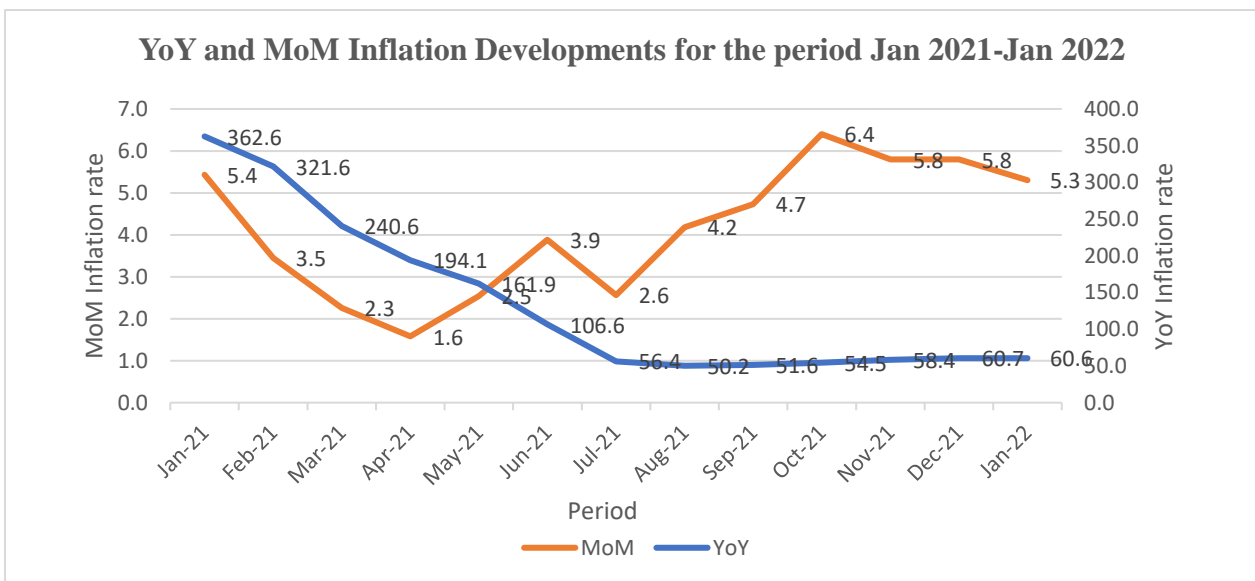
### **2. Inflation Developments**

- 2.1 The month-on-month inflation rate for January 2022 was 5.34 percent compared to the December 2021 rate of 5.76%. This implies that prices rose by an average of 5.34% in January 2022 alone. This also represents a 0.1% decrease in month-on-month inflation rate compared to the corresponding period in 2021.
- 2.2 There was a slight decrease of 0.01% on year-on-year inflation between December 2021 and January 2022. Given that year on year inflation fell from 362.6 in January 2021 to 50.2% in August 2021, January 2022's year-on-year inflation rate of 60.6% signifies an upward trend in inflation.
- 2.3 The continuous increase of prices has a negative bearing on the country's competitiveness. Firms in a high inflation country need to be producing at a lower cost than a competitor in a low inflation country to be competitive.
- 2.4 The developments in inflation can be attributed to several factors, chief among them being the increase in cost drivers, for example electricity was reviewed upwards by 12.3% in January 2022 across all bands, and there has been regular reviews on the price of fuel with the latest being 4.3% and 2.1% for diesel and petrol, respectively.
- 2.5 In as much as the central bank has been tightening money supply, national effective aggregate demand improved due to payments to Government service providers in projects and programmes such as the emergency infrastructure rehabilitation program and the traditional grocery vouchers for civil servants estimated at ZW\$300 million paid out in January.
- 2.6 In addition, inflation pressures are attributed to imports. Sea freight costs reached an all time increase of up to 300%, for example, a ton of urea from Russia to Beira increased from US\$80

to \$240 during the period 2020 to 2022. Indiscipline on the part of beneficiaries to the 2020/21 agricultural season also is highlighted as one other factor that improved liquidity. Farmers embarked on side marketing of maize to avoid loan repayments. Of the ZWL48 billion pumped into the program, only ZWL14 billion was recovered, and the rest found its way into circulation through non-performing loans, thereby increasing liquidity.

2.7 Figure 1 shows inflation movements on a year-on-year and month-on-month basis for the period January 2021 to January 2022.

**Figure 1: Inflation Developments for the period January 2021 - January 2022**



Source: Zimstat

2.8 High inflation rates lead to inefficient pricing, as sellers' price become higher to hedge against perceived price increases. However, two empirical facts may explain why trading partners abroad may avoid buying from high-inflation countries. Firstly, many sales contracts are made for longer terms. Secondly, countries with high inflation usually have volatility. Both these points add significant risks to buyers and sellers in addition to the inefficient pricing.

2.9 In most cases, the reason why buyers may prefer sellers from countries with less inflation may simply be risk aversion.

2.10 However, high inflation can be considered more broadly as symptomatic of poor macroeconomic management. Nevertheless, high inflation rate itself could in many cases not be the cause of aversion to sourcing from the country as it is highly correlated with other factors that influences decision making.

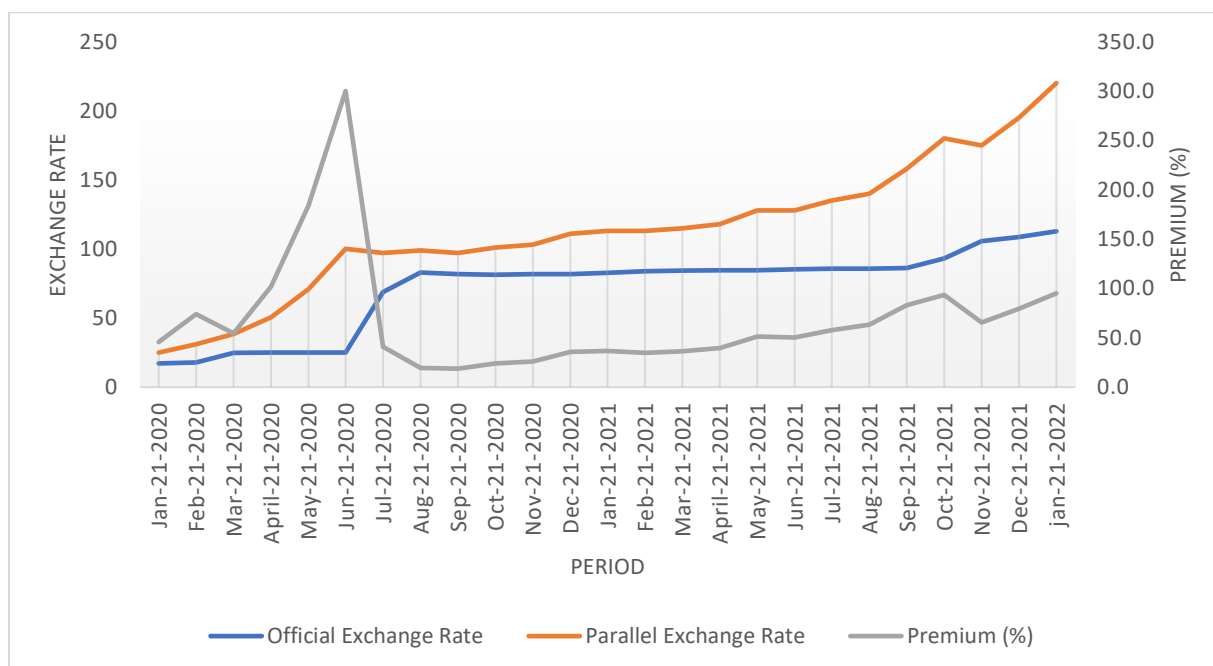
2.11 In conclusion, intuition suggests that in a high inflation country, there would be an overall negative impact, which would reduce competitiveness of products at both domestic and international markets.

### 3. Exchange Rate Developments

3.1 Movements in the exchange rate affects competitiveness. An appreciation of the foreign exchange renders exports more expensive whilst a depreciation gives a temporary boost to competitiveness.

3.2 Zimbabwe’s exchange rate system is characterized by both formal and parallel exchange rates that has a negative impact on industrial viability and productivity, hence competitiveness. The local currency has been continuously depreciating since its re-introduction in June 2019. To address this, a foreign exchange auction system was introduced in June 2020 and has resulted in the stabilisation of the exchange rate.

**Figure 2: Exchange Rate Developments for the Period January 2020 - January 2022**



Source: RBZ and NCC Compilation

3.3 The exchange rate closed the year 2021 on 1:108 on the Central Bank auction and 1:195 on the parallel market. However, in January 2022, the rates increased to 1:112.8 and 1:220 on the auction and parallel markets, respectively. This implies that the ZWL depreciated by 3.8% on the auction and 12.8% on the parallel market in January 2022.

- 3.4 Due to low levels of confidence in the local currency, all payments in the local currency are quickly converted into the US dollar, a more stable currency to hedge against loss of value. This increased demand for the USD on the parallel market against dwindling supplies of forex. This led to the continuous depreciation of the local currency. Also, a delay on the 2022 auction forced some companies to resort to the parallel market for the much-needed foreign currency to meet foreign commitments of raw materials.
- 3.5 Inefficiency on the auction market due to time lags between allotments and actual disbursements is also a cause for concern. Companies resort to the parallel market to compensate the lag, and this has negative bearing on both exchange rate and inflation. If auction and parallel rates continue to diverge, arbitrage tendencies continue prevailing and negatively affecting the exchange rate, resulting in continued indexation of prices of goods and services.
- 3.6 Depreciation tends to increase the rate of economic growth and reduce unemployment as it encourages exports. It therefore encourages consumption of local goods and services, thereby promoting local industrialization. As imports become expensive, and exports promoted, depreciation improves the country's current account balance. However, export intensity is instead systematically affected by other factors such as firms' productivity: as firms become more productive, they tend to export greater volumes.
- 3.7 Depreciation has the major disadvantage of triggering inflation as imports become more expensive, domestic demand is stimulated and firms have less incentive to cut costs.
- 3.8 On the other hand, currency depreciation improves a nation's export competitiveness and hence trade balance over time. However, an abrupt and sizable currency depreciation may scare foreign investors who fear the currency may fall further, making investment in the country unworthy and portfolio investments are pulled out of the country.

**National Competitiveness Commission**

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