NATIONAL COMPETITIVENESS COMMISSION

Enhancing Zimbabwe's Global Competitiveness

ANALYSIS OF ZIMBABWE'S INFLATION AND EXCHANGE RATE DEVELOPMENTS

FEBRUARY 2022

1.0 Introduction

1.1 Current inflation and exchange rate developments in the month of February 2022 continue to threaten the country's macro-economic stability. The country continues to tread in an upward trajectory from January for inflation and exchange rates developments.

1.2 This paper, therefore, analyses inflation and exchange rate movements for the month of February 2022.

2.0 Inflation Developments

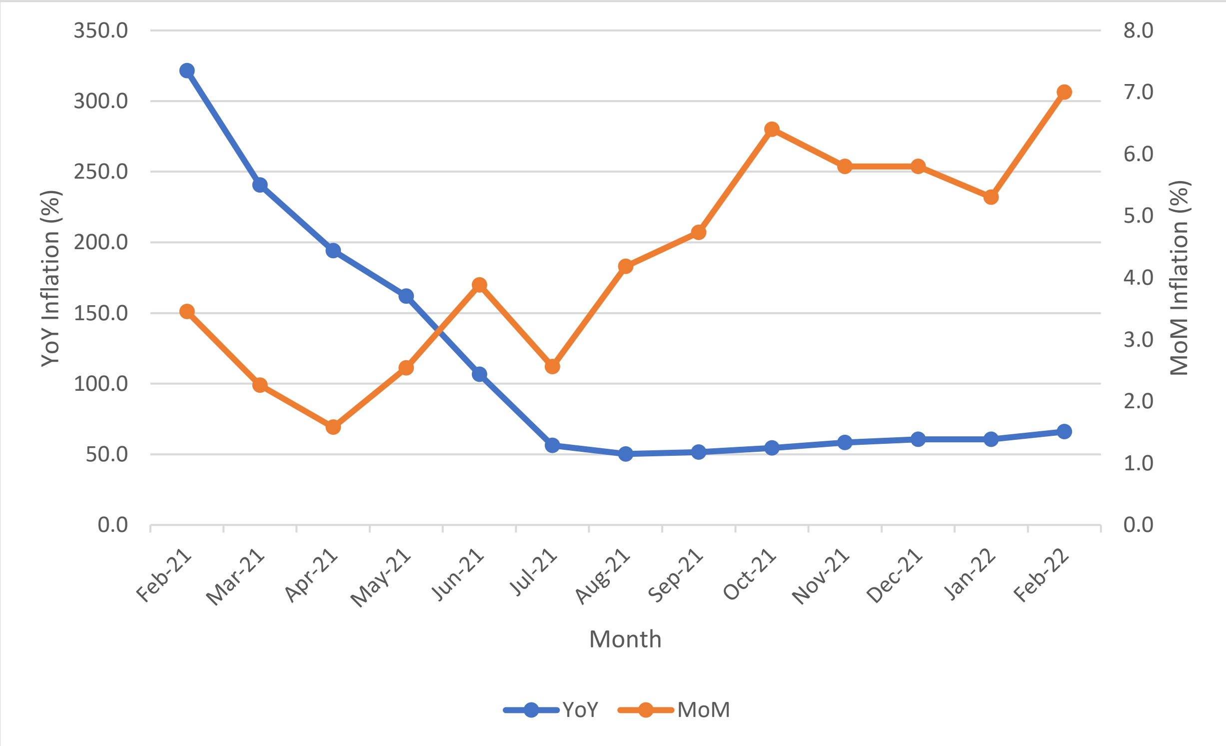
2.1 The month-on-month inflation rate for February 2022 moved by 1.7 percentage points upwards from 5.3% in January 2022 to 7.0%. This implies that prices rose by an average of 7% in February 2022 alone. This also represents a 3.5% increase in the month-on-month inflation rate compared to the corresponding period in 2021.

2.2 The increase is mainly attributed Food and Non-Alcoholic Beverages, which recorded 5.3% in February 2022, gaining 1.2 percentage points on the January 2022 rate of 4.1%.

2.3 Similarly, there was an increase of 5.5% in year-on-year inflation between January 2022 and February 2022, rising from 60.6 % to 66.1%, respectively.

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

Figure 1: Inflation Developments for the period February 2021 - February 2022



Source: ZIMSTAT

2.5 This continuous increase in prices has a negative bearing on the country's competitiveness. This entails that Zimbabwean firms must be producing at a lower cost than competitors in low inflation countries to remain competitive.

2.6 It is also critical to note that as the continued indexation of prices to the parallel market exchange rate, is impacting on inflation developments in the economy.

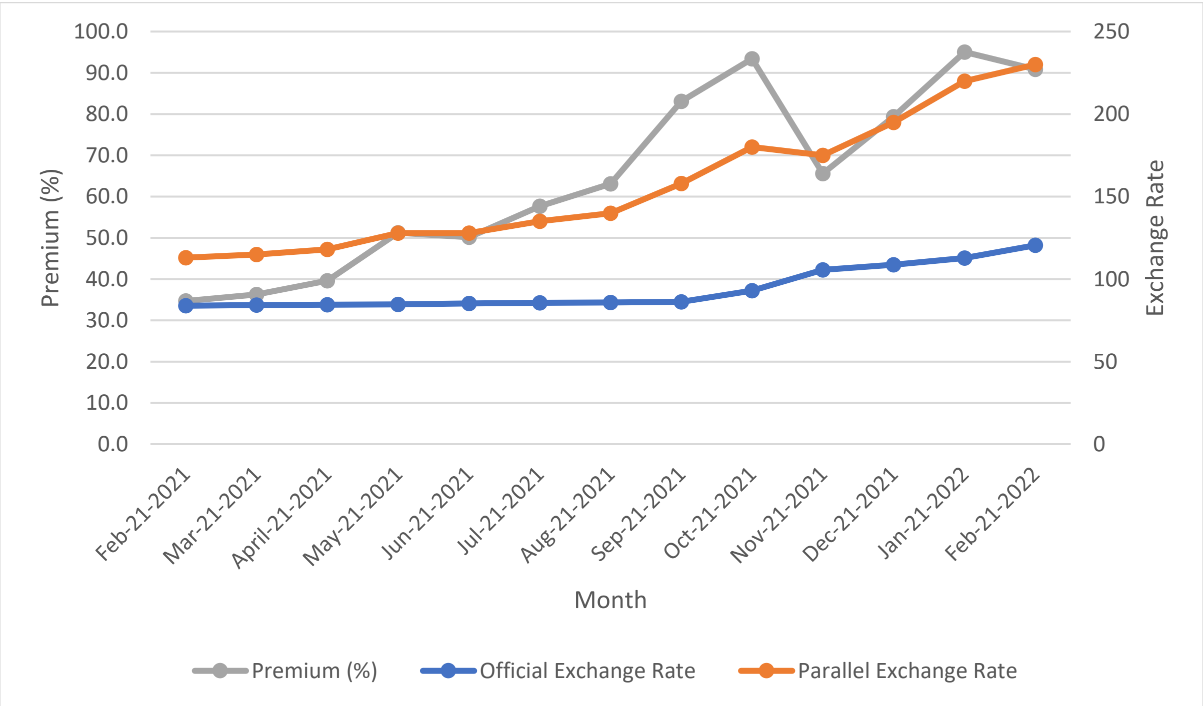
2.7 The latest developments in the geopolitical conflict between Ukraine and Russia are also expected to exert inflationary pressures in the economy, through supply disruptions of imported raw materials as well as fuel price increases. However, the pass-through effect of the conflict did not have a noticeable effect on February 2022 inflation.

3.0 Exchange Rate Developments

3.1 A depreciation of the local currency gives Zimbabwe a boost to competitiveness as exports become cheaper and imports expensive. However, a prolonged depreciation is counter competitiveness as the country is a net importer of raw materials used in the production of goods for export.

3.2 The local currency has been continuously depreciating. Figure 2 shows the exchange rate developments at both official and parallel market rates from February 2021 to February 2022.

Figure 2: Exchange Rate Developments for the Period February 2021 - February 2022



Source: RBZ and NCC Compilation

3.3 The auction and parallel market rates closed February 2022 at 1:120.5 and 1:230, respectively. This implies that the ZWL depreciated by 6.8% on the auction and 4.6% on the parallel market in February 2022.

3.4 Currency depreciation improves a nation's export competitiveness and hence trade balance over time. However, protracted currency depreciation triggers inflation and investment flight. Foreign capital tends to flow into countries that have strong Governments, dynamic economies and stable currencies. A nation, therefore, needs a relatively stable currency to attract capital from foreign investors.

4.0 Conclusion and Recommendations

4.1 Authorities should strive to eliminate the disparity between auction and parallel exchange rates as a starting point towards combating inflation pressures, as industry is indexing their prices to parallel rates making local products uncompetitive due to high-cost drivers.

4.2 In order to ensure industry viability and enhanced competitiveness, the Commission recommends the following, among others:

- Implementation of fiscal and monetary policy strategies that address macroeconomic imbalances through creation of an efficient exchange rate system that is market-oriented, with a view to timeously avail foreign currency for raw materials, retooling and purchase of spares, and mobilisation of savings through rebuilding public confidence in the financial markets to create a pool of resources to fund development of real sectors and infrastructure;
- Allowing productive sectors to access foreign currency at interbank rate across the financial sector with a view to increase volumes, which in turn will drive down unit costs of production;
- Enhanced engagement between Government through Ministry of industry and Commerce with industry players in order to dialogue on issues affecting the industry so that they can take an active role of influencing monetary and fiscal policy regarding operational issues, particularly the auction system; and
- Upgrading efforts in promoting import substitution to boost local production and reduce the import bill.

National Competitiveness Commission

17 March 2022