NATIONAL COMPETITIVENESS COMMISSION

Enhancing Zimbabwe's Global Competitiveness

ANALYSIS OF THE RESERVE BANK OF ZIMBABWE MONETARY POLICY COMMITTEE RESOLUTION OF 1ST APRIL 2022

27 APRIL 2022

1.0 Introduction.

1.1 Zimbabwe has managed to tame inflation from 837.5% in July 2020 to 50.6 by July 2021 through the adoption of the Dutch foreign currency auction system introduced in June 2020. However, the country has not been spared by the foreign exchange challenges both pre- and post-dollarization. The main topical issue since the beginning of 2022 by fiscal and monetary authorities, as in the previous years has been foreign currency management and exchange rate stability.

1.2 The current resurgence in inflation reflects the growth of the parallel market premium, compounded by widespread indexation of prices to the parallel market.

In order to stabilise inflation and exchange rate, the Reserve Bank of Zimbabwe (RBZ) through the Monetary Policy Committee (MPC) resolution of 1 April 2022 announced the following measures.

2.0 Inflation Measures

2.1 In an endeavour to contain inflation, theMPC resolved that:

i. Bank Policy Rate be reviewed upwards from 60% to 80%;

ii. Medium-Term Bank Accommodation Facility Interest Rate be reviewed upwards from 40% to 50% per annum;

iii. Minimum deposit rates for ZW$ savings and time deposits be reviewed upwards from 10% and 20% per annum to 12.5% and 25%, respectively; and

iv. Reduced the quarterly reserve money growth target from 7.5% to 5% for the quarter ending June 2022.

2.2 The above resolutions are welcome as they aim to contain inflation by tightening the broad money supply and are consistent with the monetary policy statement. However, due to the pass-through effect of the exchange rate by indexation of commodity prices to the US dollar, the measures will not suffice alone. Exchange rate stabilization is key to the full containment of inflation.

2.3 In addition, these measures fall short in mobilising savings in the banking sector, due to negative real interest rate attributed to high inflation.

Exchange Rate Measures

2.4 The foreign exchange auction failed to unlock free funds from individuals and corporates and the RBZ remains the sole supplier of foreign currency mobilised from export retention funds.

This is exacerbated by delays in disbursements of allotments of up to 8 – 10 weeks. In this regard, in a bid to unlock free funds from corporates and individuals, the MPC further resolved:

i. Liberalization of the foreign exchange market by allowing banks to conduct foreign exchange transactions of up to US$1000 under an arrangement agreed upon between banks and the Bank and in terms of which individuals with free funds and entities/corporates holding foreign exchange in their foreign currency accounts (after meeting the statutory surrender requirements) shall be free to sell foreign currency to banks on a willing buyer willing seller basis; and

ii. Ensuring commercial imports are processed through normal banking channels in line with international best practices.

2.5 The new exchange trading system complement the current auction system, which is mostly a distribution platform and not a forex trading system.

2.6 The RBZ measure on willing-buyer-willing-seller is envisaged to address the weaknesses of the former system and allow banks to trade in foreign currency at an agreed exchange rate.

2.7 Given that the low unrealistic exchange rate on the auction trading system attracts huge traffic of forex buyers but dispels sellers, trading under the willing-buyer-willing-seller concept, is expected to unlock forex inflows in the formal system. However, this requires confidence from stakeholders.

2.8 It is critical to note that the new system is not automatic and magical. The system is flawed with both design and operational shortcomings.

Design Weaknesses

2.9 The RBZ press statement categorically states that under the new trading system, banks would be allowed to conduct foreign exchange transactions of up to US$ 1000, the maximum amount that individuals and/or entities/ corporates can transact. The threshold is only significant to individuals, but from a business point of view, this amount is just a drop in the ocean to corporates' forex requirements per day. Even if similar transactions are allowed with equal participating banks in the market, other than funds likely to be insufficient, the process itself is likely to be prohibitive and discouraging unless the system is digitalized. To be short and precise, the RBZ suggested cap is unrealistic, impractical, and defeats the intended purpose of the system if not revised in line with industry requirements to enhance competitiveness.

2.10 Furthermore, anticipation that the willing-buyer-willing-seller concept would unlock forex inflows from individuals with free funds and entities/corporates holding foreign exchange in their foreign currency accounts (after meeting the statutory surrender requirements) has short comings, given that the black-market premium is higher than the official.

2.11 On the other hand, some entities may consider risks associated with black market activities and decide to conduct clean business via the new trading system. However, the corporates have already established relationships with forex dealers dotted around the country, assessed the risk level involved, and have accepted it into their business such that breaking the intimacy demands great commitment from authorities.

Operational Weaknesses

2.12 The introduction of the interbank exchange rate brought some confusion in the foreign exchange market, where the country now operates a dual exchange rate system. At introduction, the interbank rate was 1: 250, whilst the already existing auction rate was at 1:143. This is evident that the auction rate is highly manipulated and fails to be a price discovery mechanism, but rather a foreign currency allocative platform.

2.13 Furthermore, policy inconsistency is a cancer that has destroyed public confidence in both Zimbabwean policy and policy makers. As alluded earlier in the introduction, the Government has no permanent position on the best exchange trading regime for the country. It seems like authorities are making "try and error" experiment with the public. It is now not known whether it is lack of policy trust/ policy distrust, which is causing policy failures or inefficiency or its policy failures/ inconsistences that is eroding policy trust or causing policy distrust.

3.0 Conclusion and Recommendations

3.1 The analysis indicated that the newly adopted willing-buyer-willing-seller exchange trading system has great potential to stabilise the inflationary and exchange rate pressures, which will improve investment and production capacities, hence Zimbabwe's national and global competitiveness.

3.2 However, the continued use of the auction rate to liquidate exporters' surrender value continues to rob exporters of their value and discourages exportation. In that regard, the Commission recommends that:

- RBZ reviews upwards (in line with business requirements) the forex trading cap on the new exchange trading regime,
- The interbank rate be applied to liquidate the exporters' 40% surrender value to encourage exports.

- The central bank only uses the auction rate for the allocation of foreign currency and the interbank be the transaction rate to unlock free funds from businesses and individuals.

National Competitiveness Commission
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