NATIONAL COMPETITIVENESS COMMISSION

"Enabling Zimbabwe's Global Competitiveness"

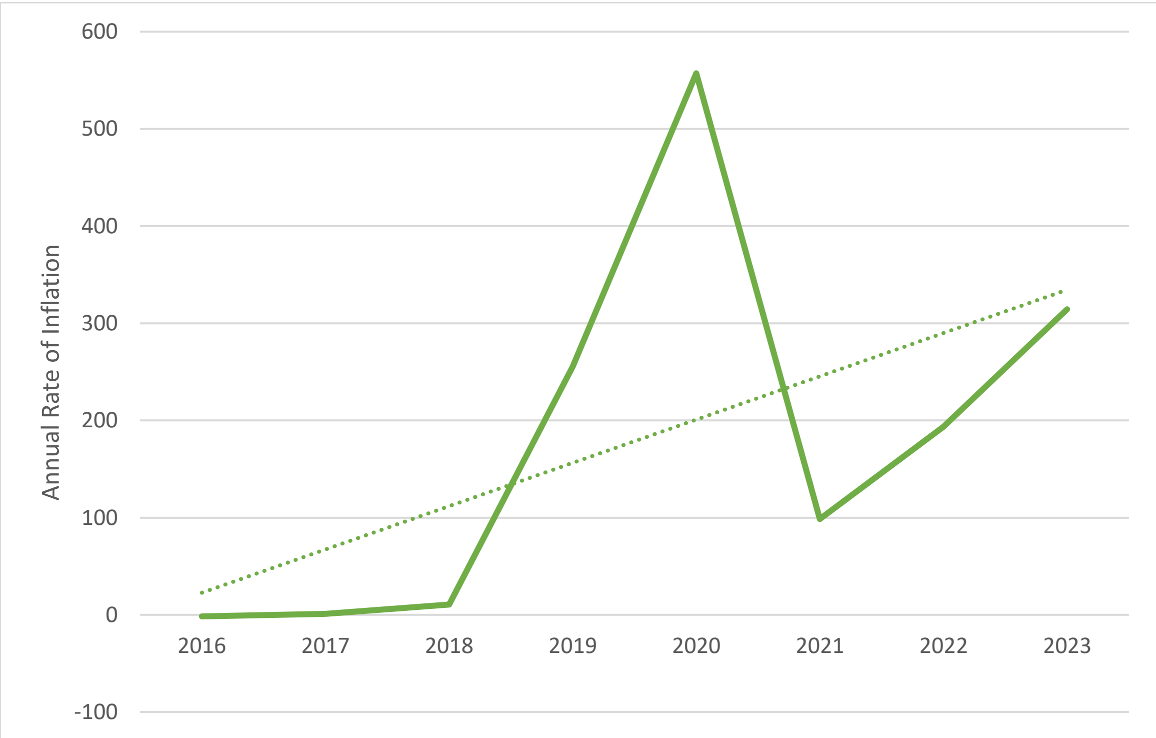
IMPACT OF RISING DOMESTIC INFLATION ON BUSINESS COMPETITIVENESS

2023

Introduction

The stability of the macroeconomic environment in an economy is one of the basic requirements that determine the ability of businesses to thrive and hence the overall competitiveness of a country (World Economic Forum). High inflationary environment in Zimbabwe has been one of the downside risk to macroeconomic stability, which is one of the critical factor for competitiveness. Consequently, high inflation of 557,2% in 2020 and 314,5% in 2023 have acted against business operations and growth across all sectors of the economy. Figure 1 depicts trends in the annual rate of inflation for Zimbabwe over the period 2016 to 2023

Figure 1: Zimbabwean Annual Rate of Inflation; 2016 –2023

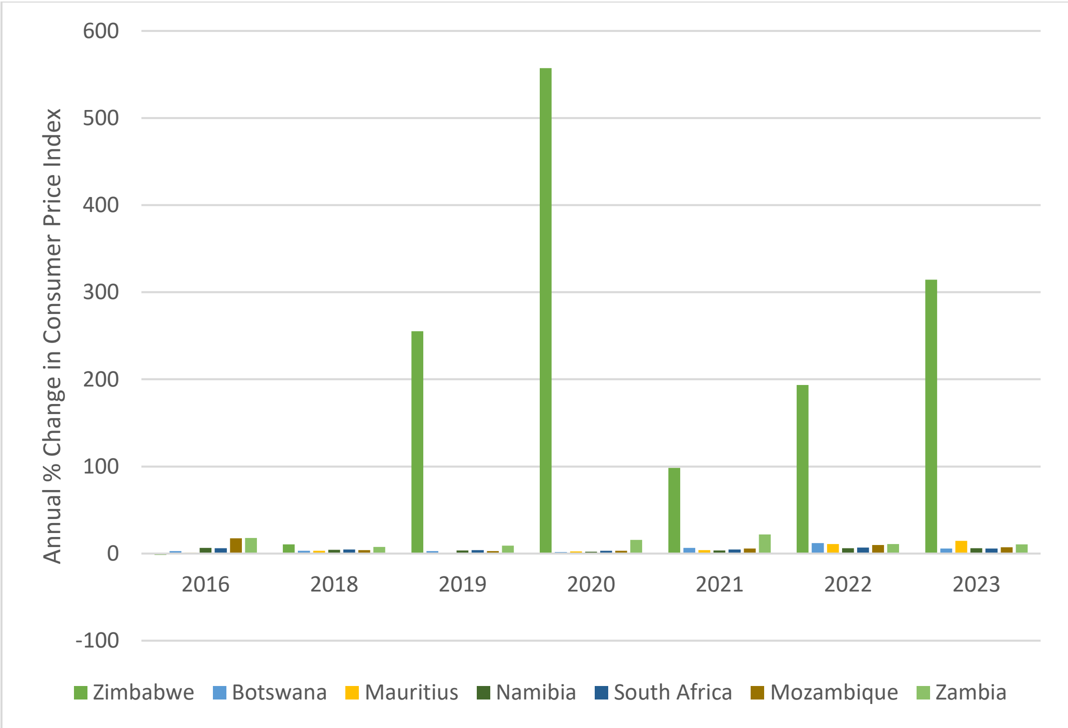


Source: ZimStat

The annual rate of inflation rose from a minimum of -1.6% in 2016 to a maximum of 557.2% in 2020 before declining to 314,5% in 2023. High monetary expansion and exchange rate misalignment has been the major causes of inflation in Zimbabwe. Persistent depreciation of the local currency has been a major cause of inflationary pressures in the country. The widening gap between the ZWL$ and the US$ values on the official and the parallel exchange market induced price distortions, which increased the appetite for the American dollar resulting in persistent depreciation of the local currency. Price distortions and hyperinflation resulted in operational costs and pricing instability which made business planning and investments difficult, thereby negatively impacting on business competitiveness.

Zimbabwe has a record of high rates of inflation, which surpasses its regional partners in SADC as shown by figure 2 below:

Figure 2: Zimbabwe Annual Inflation Rate against Comparator Countries, 2016 – 2023



Source: IMF

The annual rate of inflation for Zimbabwe was competitively low in the region between 2016 and 2018 before registering an abrupt increase to be the highest inflationary economy between 2019 and 2023 (estimates). Zambia (22% in 2021) and Mozambique (18 % in 2016) also had rising annual rates of inflation although at manageable levels than Zimbabwe. The three-digit inflation for Zimbabwe compared to single and two-digit inflation of the comparator countries in the region negatively impacts on the country's business competitiveness.

Recommendation:

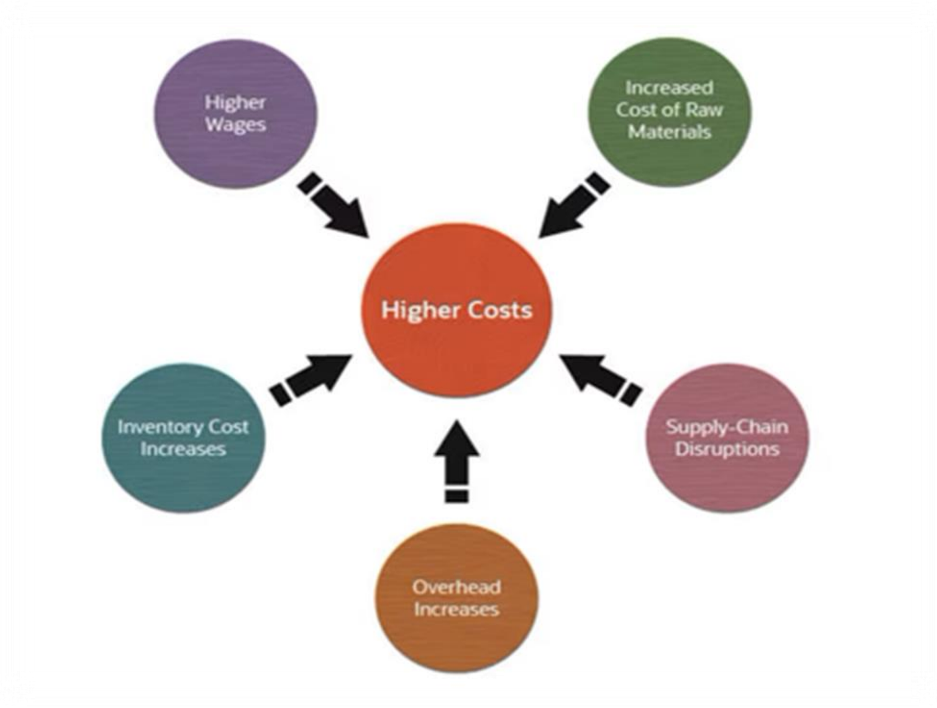
Continued implementation of tight fiscal and monetary policies to contain exchange rate arbitrage and stay on the course to price and overall macroeconomic stability that promote business operations and industrial competitiveness

Nexus between Inflation and business competitiveness

The major impact of inflation on business competitiveness is that it raises operational costs, which has debilitating effects on production and competitiveness. Rising raw material costs, demands for higher wages, rising inventory costs and increasing interest rates together with inflation induced disruptions in supply chains drive up an organization's overhead costs. These dynamics will culminate into rising business operational costs, which make businesses to be uncompetitive.

Figure 3 summarises the impact of inflation on business operational costs and competitiveness.

Figure 3: Summary of the Impact of Inflation on Business Operational Costs

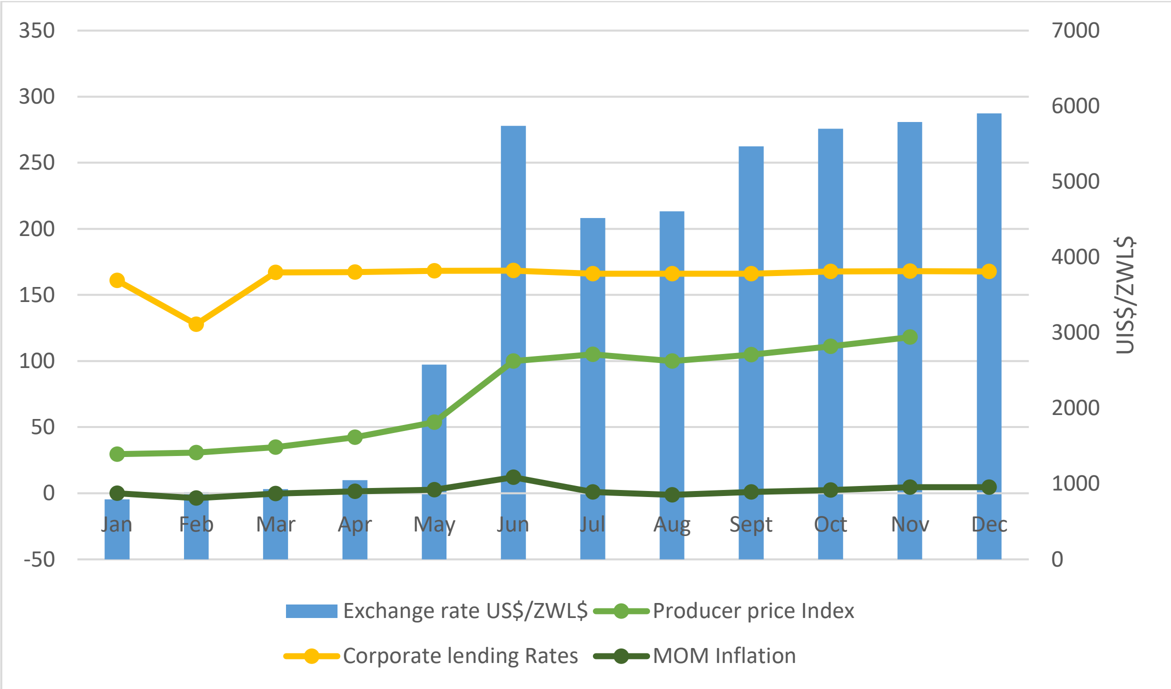


Source: The Oracle

In general, inflation negatively impacts on the microeconomics of business operations through undesirable ripple effects on cost of raw materials, labour, interest rates and other cost drivers that impinge on business competitiveness. It is critical to note that exchange rate misalignment and persistent currency depreciation resulted in rising interest rates and costs of production during the second quarter of 2023.

Figure 4 depicts how the exchange rate trended with inflation resulting in high interest rates and rising costs of production for the period January to December 2023.

Figure 4: Trends in Exchange rate, Inflation, Corporate lending rates and Costs of production; January to December 2023



Source: Zimstat and RBZ

The month-on-month inflation rate rose from a minimum of -0,37% in February to a maximum of 12,1% in June before fluctuating to 4,7% in December 2023, as the exchange rate depreciated by 641,2% from US$1:$ZWL 796,5 in January to US$1:$ZWL 5903,39 in December 2023. The rate of increase in monthly corporate lending rates mirrored the month-on-month rate of inflation over the period. The producer price index rose with rising corporate lending rates due to the exchange rate induced inflation.

In tandem, the producer price index rose by 298,9% from 29,6% in January to 118,07% in November 2023, in response to the continuous increase in the rate of inflation and depreciating exchange rate indicating the significance and negative impact of inflation on cost of finance resulting in high cost of production and on business competitiveness.

Consequently, Zimbabwe products are expensive compared to regional countries such as Zambia, South Africa and Tanzania as depicted on table 1.

Table 1: Regional Prices Comparison of Basic Commodities under the Retail Rate, December 2023

Product	Zimbabwe Retail rate (ZWL$6 316)	South Africa (US$)	Zambia (US$) -	Tanzania (US$)
Rice/2Kg	2,50	2,66	2,16	2,40
Flour/ 2Kg	2,30	2,40	2,28	1,60
Cooking Oil/2L	3,70	4,46	3,80	7,04
Salt/1Kg	0,55	1,82	1,04	1,20
Sugar/1kg	1,55	1,96	1,25	1,20
Milk/1L	1,75	1,03	4,00	2,00
Eggs	4,30	6,35	1,51	6,38
Beef/Kg	4,80	10,34	4,32	6,19

Source: NCC compilations

The local currency was traded at USD$/ $ZWL 5903,39 at the official market, while the alternative rate was at USD$/ $ZWL 10000. The retail rate at one of the major supermarkets was USD$/ZWL$6 316, resulting in higher prices products in the formal sector.

Recommendation:

Liberalise the exchange rate to eliminate distortions and currency depreciation.

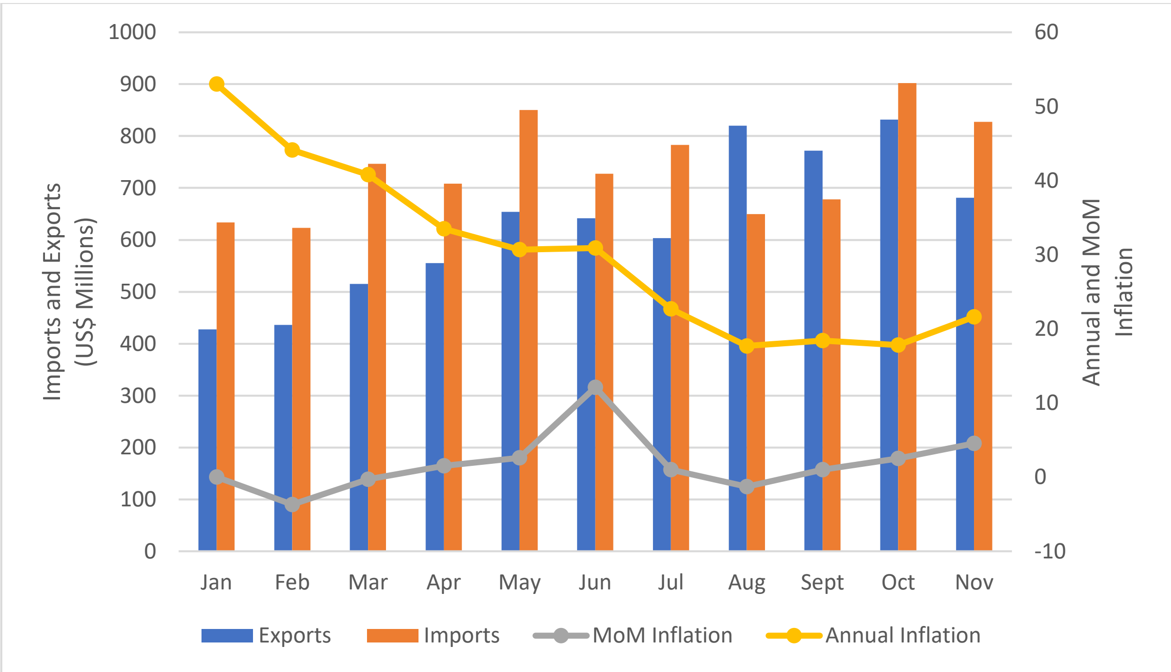
Inflation and External Trade

Inflation also has a negative impact on the country`s external trade through debilitating effects on production and exports. In addition, inflation differentials with trading partners induce diverging cost developments or structural inefficiencies such as nominal and real rigidities in product as well as labour markets.

Locally manufactured goods become more expensive compared to other countries leading to loss of competitiveness, and demand on the global market. Furthermore, the trade imbalance is exacerbated by the fact that most of the country's exports are primary products, raw material, while most of our imports are finished products, which attract high value.

Figure 5 depicts trends in exports, imports, and inflation performance for the period January – November 2023.

Figure 5: Impact of inflation on imports, and exports performance January - November 2023



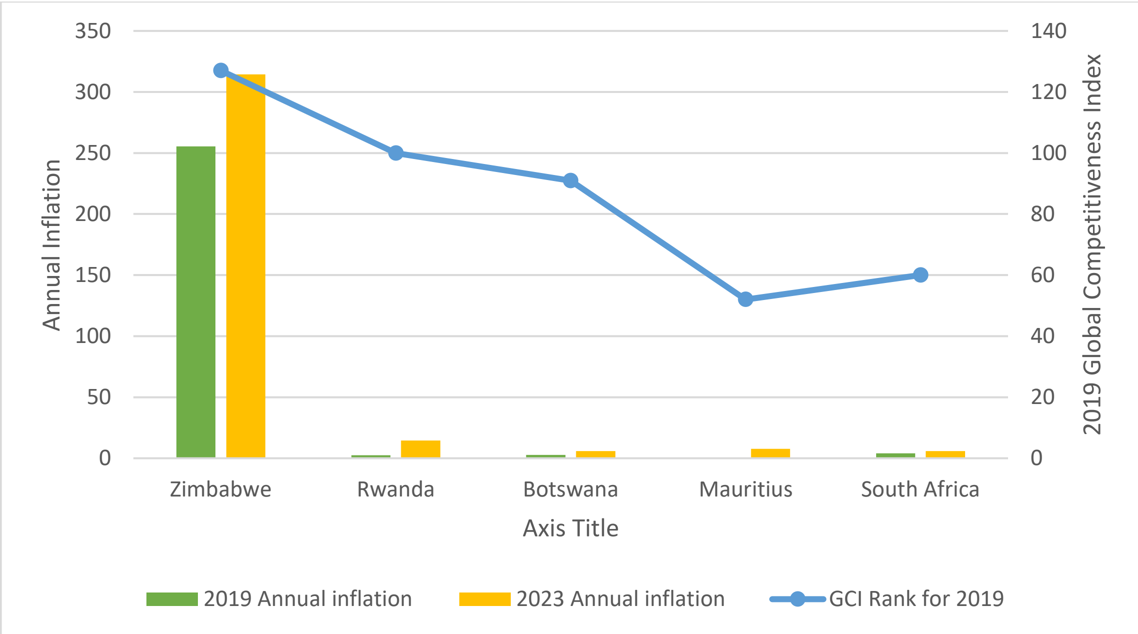
Source: ZimStat

The rate of inflation varied inversely with exports over the period, as inflation decelerated from 53% in January to 21.63% in November 2023, resulting in exports rising at a rate greater than imports and registering a positive trade balance. Exports rose persistently from US$427,7 million in January to a maximum of US$831,9 million in October 2023. However, the rise in annual inflation rate to 21,63% in November resulted in imports increasing at a faster rate than exports to US$827,3 million, and exports declining to US$681,4 million causing a trade deficit of US$146 million. Thus, high rates of inflation promote imports while declining inflation promote exports competitiveness.

Regional Comparison

Zimbabwe `s trade has persistently suffered due to a record of high rates of inflation, which surpasses its regional partners. The high inflationary environment in Zimbabwe impacted negatively on the country`s business competitiveness in comparison to SADC trade partners as shown by figure 6 below:

Figure 6: Impact of High Inflation on Global Competitiveness (CGI) Rank for Zimbabwe and Comparator Countries 2019-2023



Source: IMF

Macroeconomic instability characterised by high rates of inflation was part of the major causes of Zimbabwe`s poor GCI Ranking of 127 in 2019. The persistence of high inflation dynamics could mean worsening performance on the GCI rank for Zimbabwe in 2023 and beyond.

Recommendation:

Explore a permanent solution to domestic inflation and restore global competitiveness through increased productivity, enhance beneficiation and value addition of minerals and raw materials

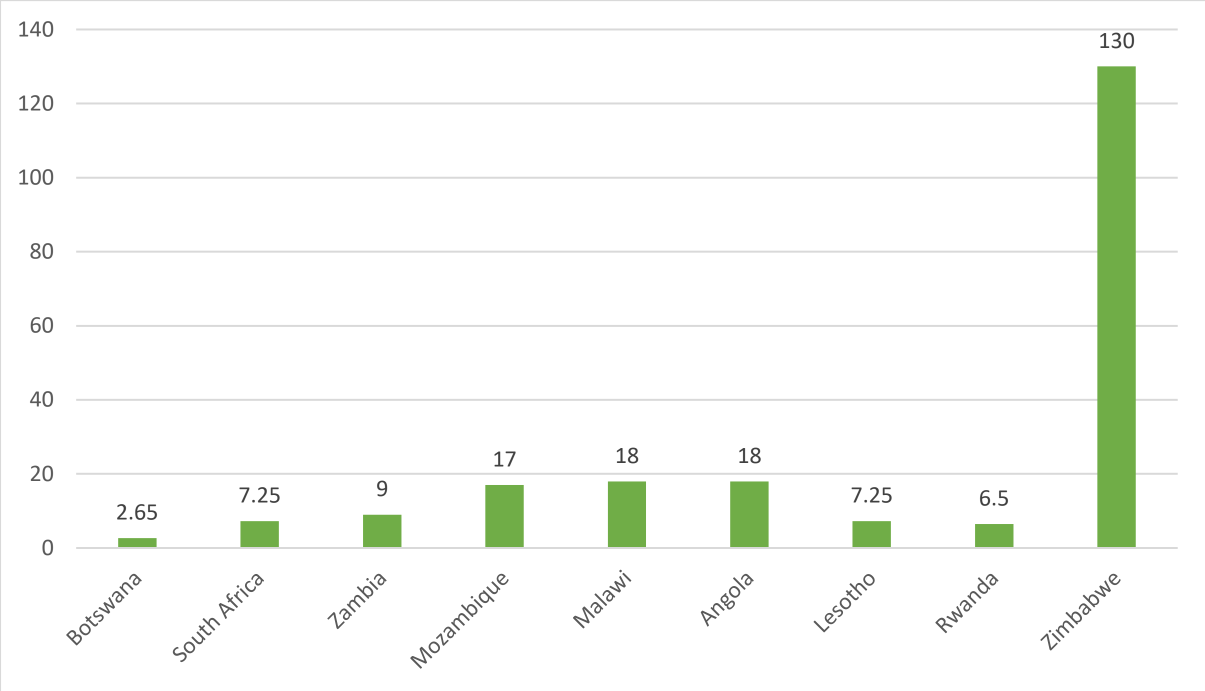
Current policies to curb inflation and their impact on competitiveness.

Government implemented several policy initiatives to curb inflation and exchange rate instability. The measures implemented were centred around promoting the use of local currency in domestic transactions and reduction of money supply in the economy. The measures include a 100 percent retention of domestic foreign currency earnings, lifting of all restrictions on importation of basic goods, introducing a 1% tax on all foreign payments, enhanced foreign exchange auction system, all excise duty on fuel will now be paid for in US$, promotion of the use of the domestic currency by Government agencies, promotion of the use of local currency on customs duty, ZESA payment by non-exporters and fees by Government agencies and issuance of gold coin and gold backed digital tokens, among others.

The measures have positively impacted in correcting exchange rate and in curbing inflation although they contributed to business costs through high interest rates and reduced aggregate demand, which negatively impact on business competitiveness.

Notwithstanding building business confidence in the local currency, the reduction in money supply and increase in RBZ policy rate to the current 130% is aggressive and remains high in the region, which affect business competitiveness. Figure 6 depicts a summary of policy rate for Zimbabwe against comparator countries.

Figure 6: Zimbabwe's Central Bank Policy Rates against Comparator Countries; 2022 – 2023



Source: International Central Banks

Figure 6 indicates that Zimbabwe has the highest monetary policy rate, which increase business borrowing costs and make industries uncompetitive. Recent monetary policy measures have remained restrictive and are inducing deflationary effects on the economy. The high cost of borrowing deters investments, business activity and national competitiveness.

Recommendation:

1. *Contain money supply growth, which adversely impacting on exchange rate movements.*
2. *Continue to explore other ways of building business confidence in the local currency*

Effect of Changes in Inflation Computation Methodologies

The Statutory instrument (S.I) 27 of 2023 gazetted by the Ministry of Finance and Economic Development in March 2023 directed the national statistical agency to use a weighted average of goods and services priced in Zimbabwean dollars and United States dollars when calculating the rate of inflation. The Inflation Computation Methodology uses a scale of 79,32 USD and 20,68 ZWL as reflected by the mode of currency used in national transactions. The new methodology has an impact of suppressing inflation figures and makes business planning and accounting harder. Hence, it becomes difficult to compare inflation figures with our regional counterparts.

Recommendations:

Adopt standard, international Inflation Computation Methodologies that allow for genuine international comparisons.