NATIONAL COMPETITIVENESS COMMISSION

Enhancing Zimbabwe's Global Competitiveness

ANALYSIS ON THE PROMOTION OF THE USE OF LOCAL CURRENCY: LOCAL CURRENCY USE AND COMPETITIVENESS

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1.0 Introduction

1.1 The National Competitiveness Commission (NCC) is mandated to enable the creation of a competitive environment for Zimbabwean businesses through the development, coordination, and implementation of key policy improvements. Further, the Commission is expected to analyse and closely monitor the macro-economic policies that have an impact on national competitiveness and propose areas of intervention thereof. This paper elucidates on the nexus between the use of the local currency and national competitiveness, in line with Treasury's Press Statement on the measures to promote market adoption and acceptance of the local currency (Zimbabwe Gold).

1.2 Zimbabwe adopted the use of the multiple currency system dominated by the American dollar since 2009 when the local currency depreciated in value due to hyperinflation. However, there is a growing recognition of the benefits associated with conducting domestic transactions using the local currency as it promotes national competitiveness.

2.0 Merits of Settling Transactions in Local Currency

Stability and Control

2.1 Using local currency gives the Government, through the Central Bank, more control over monetary policy, which promotes effective management of economic aggregates and allowing for greater stability in the economy. This stability creates a conducive environment for business growth and investment. Furthermore, the enhanced autonomy enables Government to respond effectively to economic challenges and tailor policies to specific domestic needs, thereby minimising the effect of economic ills such as liquidity crisis and thus promote competitiveness.

Reduced Relative Transaction Costs in Local Currency Terms

2.2 Conducting transactions in local currency reduces the need for currency conversion, which results in lower transaction costs for businesses. Use of a relatively weaker local currency to settle transactions help to lower costs of production which promotes competitiveness of locally produced goods especially on the export market. Reliance on the use of stronger currencies such as the American dollar to settle local transactions would diminish the country`s export competitiveness.

Reduced Exchange Rate Risk

2.3 When conducting business transactions in local currency, companies avoid exchange rate risks associated with fluctuating foreign exchange rates and liquidity challenges. This stability provides certainty in pricing and budgeting for businesses. Changes in foreign currency cross-rates under the multiple currency can induce price distortions and pricing challenges, which negatively impact on production and national competitiveness.

Promotion of Domestic Industry

2.4 Using local currency promotes domestic industries by making locally produced goods and services more competitive compared to imports. This leads to increased demand for local products, thereby supporting domestic businesses and creating employment. In addition, embracing the use of local currency enables firms to cut operational costs bypassing the risk and need for intermediaries involved in sourcing foreign currency to settle transactions. This reduction in costs results in increased production, which contributes much to business competitiveness.

Minimised Eexposure to External Shocks

2.5 Using local currency in trade reduces the country`s exposure to external shocks such as imported inflation and global financial recession. This ability to insulate the economy from such shocks grants the country a competitive edge.

Enhanced Business and Economic growth

2.6 The use of local currency allow growth in consumer demand which mean business growth for firms. The increase in demand for products will result in the creation of employment which is key towards poverty reduction and economic growth.

Favourable Interest Rates

2.7 The Central Bank has recalibrated the bank policy rate from 130% per annum to 20% per annum consistent with the new monetary policy framework. The overnight accommodation interest rate has been set at 5% above the Bank policy rate and the Bank deposit facility interest rate at 7.5% below the Bank policy rate, thus giving the starting interest rate corridor of between 11% to 25% per annum. Such interest rates are low compared to interest rates on foreign currency and will help in ensuring the availability of financing at favourable costs which promote competitiveness.

Freeing Up Funds to Forster Competitiveness

2.8 The use of the local currency to settle local transactions assists in freeing up foreign currency reserves for use in improving infrastructure and other development projects that promote national competitiveness.

3.0 Demerits of Using Local Currency

Limited Global Reach

3.1 While the use of local currency can provide certain advantages such as greater monetary autonomy and reduced dependency on foreign currencies, it can also lead to limited global reach for businesses due to factors such as currency risk, higher transaction costs, regulatory barriers, and market perception. Using local currency may limit a country's global reach, as international trade often requires transactions in widely accepted currencies like the US dollar or Euro. Resultantly, export-oriented businesses hindered from accessing international markets, thereby reducing the net value from exports. For example, businesses in countries with less recognized currencies may face difficulties in securing foreign investment or participating in global supply chains.

Exchange Rate Volatility

While using local currency can mitigate exchange rate risks, it exposes businesses to domestic currency fluctuations. Sudden depreciation or appreciation of the local currency can impact the competitiveness of businesses reliant on imports or exports. The use of local currency can lead to exchange rate volatility due to a combination of domestic and external factors, including economic conditions, market sentiment, speculative trading, central bank interventions, liquidity constraints, policy uncertainty, and global financial conditions.

Higher Financing Costs

3.2 Businesses operating in countries with high inflation or unstable currencies may face higher financing costs, as lenders may demand higher interest rates to compensate for currency risk. This can particularly affect businesses that rely on external financing or loans denominated in foreign currencies. For instance, despite the 5% inflation target, businesses in Zimbabwe have historically faced high inflation, leading to soaring borrowing costs and financial instability.

Lack of Currency Convertibility

3.3 In some cases, local currencies may have limited convertibility or may be subject to strict exchange controls by the Government. This can hinder businesses' ability to access foreign currency for importing essential goods or services.

4.0 Conclusion and Proposed Areas of Intervention

4.1 The general use of the local currency to settle all domestic transactions benefits the economy as it reduces relative costs of production which translates to enhanced competitiveness. To hedge against the aforementioned demerits and leverage on the advantages, Government and Private Sector should work together to ensure the wider use of local currency, which can contribute to enhanced business competitiveness and sustainable economic development. To this end, the Commission proposes the following areas for intervention:

4.2 **Macroeconomic Stability:** Continued prioritization of maintaining macroeconomic stability through sound fiscal and monetary policies to ensure currency stability and investor confidence. Merits from the use of local currency depends on its general acceptance as a medium of exchange based on the confidence of economic agents. Government and relevant stakeholders should work to improve confidence in the use of the local currency by widening its useability in the payment for all Government services, including fuel and tax obligations.

4.3 **Currency Hedging Instruments:** Government to promote the development of currency hedging instruments to help businesses manage exchange rate risks effectively. This includes the establishment of currency futures markets or providing incentives for businesses to use hedging tools.

4.4 **Promotion of Export Diversification:** Government in collaboration with ZimTrade to support initiatives aimed at diversifying export markets and products to reduce dependency on specific currencies and markets. This involves strengthened trade agreements, export promotion programs, and market diversification strategies.

4.5 **Enhanced ZiG Awareness:** Government to increase awareness campaigns of the ZiG currency to boost confidence.

4.6 **Collaborative Efforts:** Government and Private Sector collaboration is essential to address currency-related challenges effectively. This involves strengthened dialogues, partnerships, and policy coordination to create an enabling environment for business growth and competitiveness.

4.7 **Infrastructure Investment:** Both Government and Private Sector in collaboration with ZIDA to invest in infrastructure development to reduce transaction costs and enhance competitiveness. This includes improving transportation networks, communication systems, and trade facilitation measures.