Analysis of The 2019 Monetary Policy Statement

"…the thing I feared has overtaken me…" Job 3:25.

This biblical statement from the book of Job aptly sums the implications and impact of the 2019 Monetary Policy, which was announced on the 20th of February 2019. Indeed, for the monetary authorities, it was now a matter of damned if they did it, and damned if they didn't do it. And in the end, they made the difficult, but necessary decision to liberalise the foreign exchange market.

As usual, this analysis uses the POiNT approach to analyse, in general, the positives, opportunities, threats and new thinking from the policy statement. For the purposes of avoiding giving precisely wrong macroeconomic forecasts and projects, given the prevailing high levels of uncertainty, the analysis concludes with a reference to the Argentine experience (1992-2018) – as Argentina is one of the countries that went through similar crisis and reforms to the ones that Zimbabwe is going through.

1. Positives

- The liberalisation of foreign currency "FX" markets was in line with industry recommendations, demonstrating the authorities' willingness to engage and listen to stakeholders as well as take on board their recommendations.
- Liberalisation enhances competitiveness for local industry, especially against imported substitute goods, through the exchange rate effect.
- Liberalisation improves the allocation of foreign currency, i.e. through elimination of the "uneconomic" demand for foreign currency that was emanating from the 1:1 parity between the US Dollar and the then surrogate currency – the bond notes.
- A market based exchange rate ensures viability of the sectors that generate foreign currency – the proverbial goose that lays the eggs.
- Liberalisation also railroaded the much needed internal devaluation, which also enhances local competitiveness.
- The 30-day window for utilisation of foreign currency earnings is a positive administrative measure that is meant to ensure that FX liquidity continues to flow through the interbank market in the formative stages, and thaws pressure on the exchange rate.
- The continued treatment of remittances and individual funds received from offshore as free funds is a confidence-booster critical in widening FX inflows. This is essential given that international remittances accounted for c.17% of total FX receipts of US$6.3bln in 2018.

2. Opportunities

- Formal trading of foreign currency through Bureau De Change.
- Corporate restructurings, especially given that most corporates' balance sheets are likely to be affected during the realignment and revaluations to the new exchange rate framework.
- Currency trading through formal channels, e.g. Remittances recipients can now openly trade through banks and bureau de change. MTAs also have an opportunity to integrate with or upscale operations to include bureau de change.
- Import substitution drive – the exchange rate adjustment somewhat makes imports relatively expensive, and this may force consumers to switch expenditure patterns. Such expenditure switching could present a "good crisis" for local manufacturers that can locally produce substitute products at competitive prices.

3. Threats

- Erosion of household and enterprise balance sheets, and loss of consumer buying power, which may lead to depressed aggregate demand, corporate failures and potential recession/ stagflation. There will be a need to avoid prolonged periods of low economic activity as a result of the austerity measures, as has been the case in the PIGS countries, particularly Greece.
- Increased inflationary pressures, especially if utilities and basic commodities that had not fully adjusted to the parallel market exchange pricing are allowed to adjust to the new official exchange rate. In Argentina, during the 1999/2002 crisis and resolution thereof, the authorities froze utility charges as part of measures to control inflation. However, this also comes at a cost, e.g. through reduced public service delivery. It also puts pressure on government as it may be required to subsidise/bail out parastatals due to high operational costs versus low revenues.
- High utility and public service charges may also result in social dislocations, hence the need for social safety nets.
- Meanwhile, if the high inflation is matched with upward adjustments of wages, this may result in a vicious cycle of high inflation as well as a reversal of the competitiveness gains that have been brought about through the internal devaluation. Thus, to manage the cost pressures, industry would need to expeditiously move towards productivity-based remuneration as well as adoption of efficient production methods. These include automation and digitalisation. Definitely, digital transformations pause further threats to labour and employment, but there is also further room for upskilling, training and redeployment of employees. The Government also faces

significant increase in RTGS$ expenditure, especially if the Government adjusts producer prices for agricultural commodities such as maize to the new exchange rate. The increase in expenditure could, however, be managed through, among other means, virements. It is also conceivable that there will be an inflation-induced increase in revenue collections, which should be used to fund the increased expenditure commitments.

- The requirement to liquidate FX receipts within 30 days may adversely affect players such as NGOs and Donor funded institutions, as most of their projects are of a long term nature. As such, it is hoped that this will be fully addressed in the EXCON Guidelines. Additionally, the tight window may result in distorted utilisation of foreign currency, hence the need for the authorities to ensure that there is progressive relaxation of the surrender requirements as the market improves.
- The interest rate peg, against the high levels of inflation and limited foreign currency liquidity, may result in increased borrowing in RTGS$ for the purposes of buying foreign currency. This will expose the RTGS$ to speculative attacks, thereby threatening the sustainability of the exchange rate liberalisation. Additionally, the low interest rates make it uneconomic to build RTGS$ denominated savings. This may result in early redemptions on instruments such as the savings bond, again leading to excess RTGS$s being redirected towards the FX market.
- Rent seeking behaviours - there are potential threats to the interbank market, including misrepresentation of invoices, holding of FX by supposed importers, diversion of FX proceeds to the unofficial markets and reselling of FX bought on the interbank market at higher exchange rates. These could be mitigated through, among others, driving towards exchange rate and price convergence, tightening declaration requirements, e.t.c.

4. New Thinking

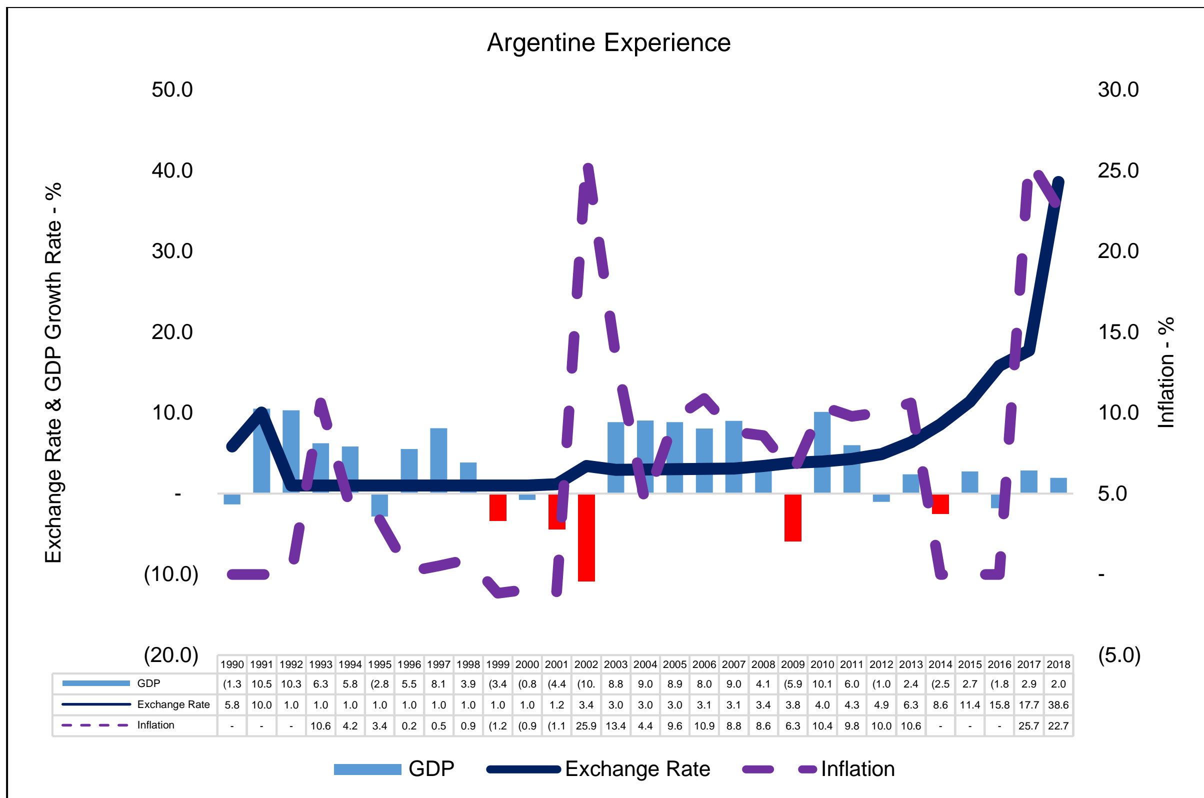
- Continuation of multicurrency, though necessary in order to maintain confidence, and possibly stabilise the FX markets, will likely create transacting challenges, especially for conversion rates from RTGS$ to other currencies. It would be ideal to gradually reduce the basket of currencies, to the major currencies, e.g. ZAR, Euro and USD.
- Households would need to embark on expenditure switching tactics in-order to stabilise their consumption patterns.
- The authorities appeared to be relying more on administrative measures to support the local currency, e.g. by mandating that all accounting, reporting, payments, et.c., should be done in the RTGS$. However, there is need to expedite adoption of market-based instruments to support usage of the

RTGS$ and create value out of it. These include revamping the interest rate framework to allow market-based interest rates, which in turn will help in attracting and building RTGS$ savings. Higher interest rates will also enforce the tight monetary policy stance, and thus, thaw speculative borrowing for the purposes of buying foreign currency. Of cause, there is always the valid argument that industry needs low interest rates in order to invest. However, high interest rates can also be counter-balanced with tax incentives from the fiscal side. Additionally, visible efforts to reduce inflation and foster macroeconomic stability remain imperative for consumers to gain confidence in the RTGS$.

- The authorities need to rebuild public confidence given the earlier mentioned risk of erosion of households and corporate balance sheets. This entails improving the frequency, transparency and timely communication of key macro-economic indicators such as level of government debt, status of RBZ overdraft facility, monthly government finances (net position), money supply growth etc. Such a scenario is important in allowing economic agents to monitor progress and assess whether there is coherence between the Fiscal and Monetary Policy measures.
- Whereas credit line facilities are critical, the call to build reserves cannot be understated. Globally, the level of reserves determines the success or failure of currencies. Thus, the authorities need to put more efforts towards accumulation of reserves, particularly supported by improved utilisation of export proceeds.
- The authorities need to continuously address the production issue. For instance, finalising the 99-year leases will provide a window for banks to boost agricultural support. This will act as a suitable alternative to the concessional facilities issued in the past 3 years. Furthermore, finalisation of an industrial development policy will enhance value-addition, which is essential in promoting import-substitution for most finished goods.

5. Outlook

One of the countries that has gone through a similar economic crisis and reform program as the one being pursued by Zimbabwe is Argentina. As such, we outline below a graph indicating the trends in Argentine exchange, inflation and GDP growth rates from the end of the Argentine hyperinflation in 1992 to 2018.



	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
GDP	(1.3	10.5	10.3	6.3	5.8	(2.8	5.5	8.1	3.9	(3.4	(0.8	(4.4	(10.	8.8	9.0
Exchange Rate	5.8	10.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.2	3.4	3.0	3.0
Inflation	-	-	-	10.6	4.2	3.4	0.2	0.5	0.9	(1.2	(0.9	(1.1	25.9	13.4	4.4

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
GDP	8.9	8.0	9.0	4.1	(5.9	10.1	6.0	(1.0	2.4	(2.5	2.7	(1.8	2.9	2.0
Exchange Rate	3.0	3.1	3.1	3.4	3.8	4.0	4.3	4.9	6.3	8.6	11.4	15.8	17.7	38.6
Inflation	9.6	10.9	8.8	8.6	6.3	10.4	9.8	10.0	10.6	-	-	-	25.7	22.7

As shown in the graph above, Zimbabwe is now at the same state as Argentina was in 2002, i.e. the abolishment of the 1:1 peg and liberalisation of the foreign exchange market. A spike in inflation, low industrial output, corporate insolvency and reduced GDP growth, among other challenges, characterise such periods, as the economy adjusts to the macroeconomic reforms. The authorities' success in reigning money supply growth, pursuing fiscal prudence, building confidence though policy consistency and engagement of stakeholders, and building economic diplomacy ties, among other initiatives, will undoubtedly foster macroeconomic stability and result in rapid economic growth. However, a failure to address these fundamental issues may also result in the country spontaneously dollarising again, as were the cases in Bolivia and Peru.

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