PRESS STATEMENT ON MEASURES TO STABILSIE THE CURRENCY AND REDUCE INFLATION WHAT CHANGED?

The Minister of Finance & Economic Development on 11 March 2020 announced a raft of "*measures to stabilise the currency and reduce inflation*". This note summarises the key changes since the last policy pronouncements and outlines experiences from other countries that went through similar transitions.

The first major announcement was the setting up of a Currency Stabilisation Task Force, which will be spearheaded by the Ministry of Finance & Economic Development and the Reserve Bank of Zimbabwe. It will also include members of the MPC and PAC. Ideally, the Taskforce should, through its Terms of Reference, be accorded the necessary authority, power, backing and supportive fiscal, monetary and structural reforms to pursue the mandate of stabilising the macroeconomic environment. Bolivia (1985) adopted a similar stance, but it's "Taskforce" had substantial independence and its was well supported through Supreme Decree 20160, which anchored IMF supported macroeconomic reforms under what was called the New Economic Plan.

Secondly, the Minister announced the move from a crawling peg to a managed floating foreign currency management system, in which Bureau de Change will seemingly have a more liberalised trading framework. It is hoped that more details with regards the operationalisation of the new system will be spelt out by the central bank through the usual exchange control guidelines. Nevertheless, the success of the system still hinges on the extent to which the authorities reduce the premium between the foreign exchange markets as well as ensure consistent availability of foreign currency on the official interbank market.

Thirdly, in terms of interest rates, the Minister's announcement on the introduction of minimum interest rates on all deposits, including trust accounts underpinning mobile banking wallets was enacted through Statutory Instrument 65A of 2020. The move is meant to promote a savings culture and encourage holding of domestic currency. This is in line with the policy measures that were introduced by other countries that pursued similar de-dollarisation programs. However, its success, together with that of the drive to reduce excess liquidity through issuance of corporate bonds, will depend on the authorities' ability to reduce the inflation rate, foster a positive real interest rate environment and reign in money supply growth. Meanwhile, banking institutions are likely to adjust their lending rates upwards as a result of the increase in cost of funds.

Going forward, due to the absence of balance of payments and budgetary support, the authorities will continue to face headwinds in stabilising the macroeconomic environment. Policy conduct, therefore, will remain focused on managing short term pressures and balancing the competing social, economic and political goals.

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WHAT CHANGED?

Table 1: Dollarization & De-dollarization Case Studies

COUNTRY	MACROECONOMIC CONDITIONS PRIOR TO DOLLARIZATION	POLICY POSITION UNDERTAKEN	DE-DOLLARIZATION OUTCOME
Bolivia	✓ Hyperinflation (Average of 11750% in 1985) ✓ Currency Depreciation (13943.2/ USD in 1985)	✓ Initially adopted administrative measures in 1982 by forcing compulsory conversion of foreign deposits into local currency. ✓ Market-driven de-dollarization from 1985, and in the 2000s. i. Higher reserve requirements for foreign currency deposits. ii. Higher provisioning requirement for foreign currency loans. iii. And other incentives for holding financial assets in local currency.	Failed (Macroeconomic instability led to the Government allowing residents to keep foreign currency deposits in 1985). The Government then embarked on an IMF supported program, the New Economic Program, from late 1985, and began a gradual, successful de-dollarization process.
Peru	✓ Hyperinflation (7481% ,1990) ✓ Currency Depreciation: (6947.0, 1990)	✓ Administrative - Compulsory conversion of foreign deposits to local currency. ✓ Comprehensive three-pronged strategy implemented since the early 2000s: i. Strengthened macroeconomic stability through fiscal surpluses, lower debt, inflation targeting, and boosting international reserves, which enabled it to obtain an investment grade rating; ii. Introduced prudential measures to better reflect the risks of currency mismatches; iii. Developed a securities market with longer maturities in domestic currency.	Failed (Capital flight and declining financial integration). Successful.
Angola	✓ Hyperinflation (4145.1%, 1996) ✓ Exchange Depreciation: (4555.2, 1996)	✓ Administrative Measures: i. Oil exporting companies to settle all domestic transactions including Taxes and payments to local suppliers in domestic currency ii. Foreign currency loans to foreign currency earners only. iii. Reduction of reserve requirements on domestic currency deposits relative to foreign currency deposits.	Successful

Other prominent cases of successful de-dollarization include Argentina, Israel, Chile and Egypt. The key take-outs from these episodes are that de-dollarization takes time and that market-based approaches have often yielded better results than administrative based approaches. Inflation rates below 10%, real fiscal surpluses, foreign currency reserves and positive real interest rates are some of the key ingredients for a successful de-dollarisation program.

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