THE ECONOMICS ASSOCIATION OF ZAMBIA

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ECONOMICS ASSOCIATION OF ZAMBIA LAUDS BOZ MONETARY POLICY STANCE, RISKS TO ECONOMY ARE REAL, NEED TO BE AGGRESSIVLEY MANAGED

The Economics Association of Zambia - EAZ would like to laud the Bank of Zambia Monetary Policy Committee (MPC) for the policy stance in 22 February announcement. The Association appreciates the forward looking view of the central bank taking into account the macro backdrop and global uncertainty in light of the US- China trade relations and Brexit effects impacting the base metal and emerging markets currency markets. The Association acknowledges that most central banks globally have adopted accommodative, flexible and non – predetermined monetary policy through holding benchmark interest rates at current levels. The Association appreciates the BOZ's stance on the Zambia's balance sheet vulnerabilities and downside risks to growth hence its stance today.

The Need for BOZ to correct the Kwacha Demand Curve.

The Association acknowledges the fiscal dislocations from monetary policy which reflect in elevated yields of Government security curve especially where the treasury bill yields are at spreads above the primary bond curve yields. This have resulted in investor behavioural tendency to prefer shorter dated higher yielding assets than longer dated fixed income assets. ***The Association has observed a skewed pattern in kwacha asset appetite towards treasury bills especially in the 9-month and 1-year yielding 23% and 23.5% respectively and that treasury bills auctions are heavily concentrated in the longer end of the T-bill curve.*** The Association has monitored the treasury bill performance in 2019 and does acknowledge that subscriptions are just adequate to meet maturity profiles however the market has kept a close eye on Government funding needs versus the outcome of treasury auctions to the extent that undersubscriptions are causing worry as to how deficits will be plugged. ***The Association aligns with the Governors speech citing an 88% rise in treasury bills demand from 68% quarter on quarter versus 33% suppressed bond appetite***. The last bond auction of the 2018, was poorly subscribed at 15% due to liquidity and unattractiveness in yields. The Association would in this vein urge the BOZ to correct this anomaly in the term structure of kwacha interest rate as it risks suppressing the bond market.

The Vicious Spiral effects of Elevated Treasury yields

The Association acknowledges that the risks of elevated treasury yields as a vicious cycle especially that most corporate lenders reference credit risk spreads above treasury bills yields. Price discovery in the secondary markets has also revealed that offshore players have demonstrated appetite for Kwacha assets at spreads above treasury bills rates in the primary market with non-deliverable forward and swap markets pricing risk at 350-450 basis points which could potentially impact corporate debt issues in kwacha terms. The Association is alive to these offshore market behavioural tendencies which it urges the BOZ to be alive to and work towards aligning to so as to mitigate the risk of asset mispricing (over/under-pricing).

Balance Sheet Vulnerabilities Persist – FX Reserves Still Weak

The Association appreciates the frantic efforts to levitate the level of foreign exchange reserves to above 3- months import cover. Much as the Association recognises efforts to boost reserves through strategies like remission of mineral royalty taxes in dollars to the tune of USD$109.6million directly to the central bank by the mines. ***The Association would like to encourage more avenues to boost reserves taking into account that foreign currency purchases (in excess of USD$346million) continue to exceed the velocity of reserve build up. The Association recognises the Governors stance on including gold stocks to the international reserves to help address mismatch between dollar supply versus absorption highlighted.*** The Association recognises that declining reserves (*at USD$1.57billion as at Dec18*) increases the country's vulnerabilities to stress shocks.

With debt service payments denominated in foreign currency, the Association foresees high Open Market Operations (OMO) activity to manage availability of the local currency. If not well managed this could lead to a potential liquidity crunch impacting the domestic credit market. ***The Association wishes to advise the fiscal authorities to expedite its sinking fund strategy in addition to a debt redemption strategy that will absorb the forested pressures that could potentially cause further dislocation in the macros.***

The Need for Stimulus to attain Gross Domestic Product

The Association echoes the central banks view on credit growth contraction in the fourth quarter of last year to 1.3% from 9.9% in the third quarter. The Association acknowledges the role credit extension, especially to the private sector, plays in oiling the wheels of economic growth. The Association is cognisant that private sector activity continues to be in the red zone as revealed by headline Stanbic Bank/Markit Purchasing Managers Index (PMI) readings that have been below 50 for 6 – straight months. This is as a result of elevated manufacturing cost curves as a consequence of higher fuel prices and minimum wage levels that has fuelled input inflation which is at 21-month high and as such selling prices have been on the rise. ***The Association would advise the Energy Regulation Board to rethink its pricing and fuel procurement strategy to allow for benefits of crude price bears to trickle to the markets to allow for reduction in international crude price to be reflected in fuel pump prices.*** These methodologies have been effected in jurisdictions such as South Africa and Botswana where on a monthly basis pump prices are reviewed in line with oil price developments. Risks to growth threaten the nation's attainment of its GDP target for 2019.

Credit Risk Management in Currency Denomination Debt Contraction Mix

The Association notes the re- calibration in debt currency denomination mix as a strategy to manage credit risk. The Governors note reveals a 2.4% decline in FCY denominated debt contraction in Q4:18 compared to a 10.2% rise in Q3. However, the Association observes a 4.7% uptick in LCY debt contraction from 3.7% in the third quarter of last year. ***The Association wishes to laud the fiscal authorities for a more local currency skewed approach in debt mix and would like to encourage more kwacha denominated debt as local debt has lesser stress of management due to zero currency or exchange rate risk.*** There is a real need to encouraged issuance of kwacha bonds to fund projects locally that skew towards foreign currency denominated obligations which exert pressure on the feeble foreign exchange reserve stock.

Persistent Technical Vulnerabilities – Twin deficit Scenarios C/A and Fiscal

Other key technical vulnerabilities of urgency the Association has identified include the volatilities in current account and fiscal deficits which even the rating agencies have expressed concerns weighing in the overall sovereign risk rating of Zambia. The Association urges the authorities to reign in the fiscal deficit which the BOZ suggests reflects a higher preliminary figure than anticipated. ***The Association also wishes to use the current account deficit as stressing point for the need for increased manufacturing capabilities to help boost export base to cushion the effects.*** The Association notes that twin deficit scenarios cause imbalances in currency markets whose plague easily extends to the money markets. The Association bemoans the 8.5% decline in exports to USD$2,094million on account of weaker copper and non-traditional exports (NTEs). The Association advises the need for diversification efforts to double in the wake of the deficit scenario's.

The EAZ is confident that with the right policy stances both monetary and fiscal Zambia will successfully address the balance sheet vulnerabilities it is exposed to.

The Association would also wish to call on all involved in the commerce, banking, export, import, manufacturing sectors to rally behind the law makers to address the vulnerabilities the economy faces. ***The Association will continue to play an advisory and policy advocacy role and would like to invite Zambians to the first ever National Economic Summit in Livingstone at which captains of industry, business analysts, economists and thought leaders will meet to discuss solutions to African problems which the Association believes reside in Africans***.

ECONOMICS ASSOCIATION OF ZAMBIA

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National Secretary