MONETARY POLICY STATEMENT

"ESTABLISHMENT OF AN INTER-BANK FOREIGN EXCHANGE MARKET TO RESTORE COMPETITIVENESS"

RESERVE BANK OF ZIMBABWE

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CONTENTS

LIST OF TABLES

LIST OF FIGURES

SECTION ONE

INTRODUCTION

Since the last Monetary Policy Statement on 1st October 2018, Zimbabwe has witnessed significant changes on the economic front. The economy took a different course of direction from a positive economic trajectory to an inflationary environment. This situation needs immediate redress in order to restore value for money. The foreign exchange premiums on the parallel market which ranged from 1.40 to 1.80 to the US dollar in September 2018 increased to the current levels of between 3.00 to 4.00. This movement in forex premiums has had negative pass-through effects on inflation which increased particularly from the September year-on-year level of 5.4% to 20.9% in October and closed the year at 42.09%.

On the positive side, the separation of bank accounts into NOSTRO FCAs and RTGS FCAs has yielded positive results as reflected by the significant increase in the Nostro FCAs to US$451.2 million as at 31st January 2019, compared to US$240.5 million at the beginning of October 2018, a growth of 87.6%.

The significant shift in economic fundamentals during the last quarter of 2018 also increased the practice by retailers of charging goods and services on the basis of a multi-tier pricing system, where a single product has different prices depending on the mode of payment e.g. USD cash, electronic payment, mobile money and bond notes. This situation has continued to put pressure on the country's balance of payments position.

The current pricing structure indicates that the majority of transactions in the economy are now largely being conducted in electronic money and bond notes at an implied parallel market exchange rate of around 3.0 to 3.5 to the USD. In this respect, continuing to use the USD as a unit of account in the economy, when its value has drifted away from the value of the RTGS denominated money supply has brought forth a number of challenges. The challenges include multi-tier pricing by business, speculative pricing, loss of government revenue, valuation and accounting difficulties, asset-liability mismatches and negative investor confidence.

The current monetary arrangements, if maintained, could pose the risk of a costly re-dollarisation of the economy which will move the economy into a recession. This is evidenced by the fact that some businesses are already gradually reducing prices due to low demand in the economy. Moreover, some of those charging in foreign currency have also been experiencing reduced demand for their products and are, thus, reverting to pricing in RTGS and/or bond notes.

Exporters on the other hand, are fast becoming uncompetitive as the export incentive scheme has been eroded by the forex premiums induced inflation. Such a scenario is not conducive for enhancing exports and diaspora remittances. Introduction of a market determined mechanism for trading of US dollars with RTGS balances and bond notes has become imperative. Similarly, without a formal guidance on the relative values of the RTGS, bond notes and the USDs, the transacting public is currently being prejudiced through ad hoc pricing by businesses which factor in different implied parallel market exchange rates in their pricing systems. This needs to be corrected.

This Statement, therefore, presents policies aimed at establishing a trading mechanism of RTGS balances and bond notes with international currencies through establishing an inter-bank foreign exchange market to restore domestic competitiveness and promote growth. The measures are also meant to strengthen demand for the domestic forms of payment and to preserve foreign currency for external payments purposes that include importation of goods and services, foreign dividend payments, business and personal travel and servicing of country's external obligations. The measures in this Statement are necessary to preserve the purchasing power of RTGS money and to restore export competitiveness within the economy.

The rest of the monetary policy statement is organised as follows. Section two discusses the new monetary policy measures. Section three discusses the outlook and conclusion. The statement also contains an Annex which looks at the global and domestic economic and financial developments.

SECTION TWO

NEW MONETARY POLICY MEASURES

1. Establishment of an Inter-bank Foreign Exchange Market

The Bank has taken note of the excellent contributions from the business community, bankers, the academia, the media and members of the public on the need to establish an inter-bank foreign exchange market to formalise the selling and buying of US$s through banks and bureaux de change. This is essential in order to bring sanity in the foreign currency market whilst at the same time promoting exports, diaspora remittances and investments for the good of our national economy.

The Bank considered the implications - accounting, financial, economic, legal and social - that are embedded in the establishment of an inter-bank forex market within the context of the current national payment systems made up of RTGS, mobile payment platforms, point of sale (POS), bond notes and coins.

After taking account of the implications and putting in place safeguards to maintain stability in the forex market, the Bank is, with immediate effect, **establishing an inter-bank foreign exchange market in Zimbabwe to formalise the trading of RTGS balances and bond notes with US$s and other currencies on a willing-buyer willing-seller basis through banks and bureaux de change under the following framework:**

i. Denominating the existing RTGS balances, bond notes and coins in circulation as RTGS dollars in order to establish an exchange rate between the current monetary balances and foreign currency. The RTGS dollars thus become part of the multi-currency system in Zimbabwe. The legal instrument to give effect to this has been prepared.

ii. The RTGS dollars shall be used by all entities (including government) and individuals in Zimbabwe for the purposes of pricing of goods and services, record debts, accounting and settlement of domestic transactions.

iii. The use of RTGS dollars for domestic transactions will eliminate the existence of the multi-pricing system and charging of goods and services in foreign currency within the domestic economy. In this regard, prices should remain at their current levels and or to start to decline in sympathy with the stability in the exchange rate given that the current monetary balances have not been changed. In this respect, the RBZ will commit all its efforts to use the instruments at its disposal to maintain stability of the exchange rate.

iv. The Bank has arranged sufficient lines of credit to enable it to maintain adequate foreign currency to underpin the foreign exchange market. This is essential to restore the purchasing power of RTGS balances through safeguarding price stability emanating from the pass-through effects of exchange rate movements.

v. Foreign currency from the inter-bank market shall be utilised for current bonafide foreign payment invoices except for education fees.

vi. All foreign liabilities or legacy debts due to suppliers and service providers such as the International Air Transport Association (IATA), declared dividends, etc shall be treated separately after registering such transactions with Exchange Control for the purposes of providing the Bank with sufficient information that will allow it to determine the roadmap for orderly expunging the legacy debt.

vii. Foreign currency requirements for Government expenditure and other essential commodities that include, fuel, cooking oil, electricity, medicines and water chemicals shall continue to be made available through the existing letters of credit facilities and/or the Foreign Exchange Allocations Committee.

viii. Banks shall report activities of the inter-bank foreign currency market to the Bank that shall closely monitor the foreign currency trades on a daily basis using the form and format stipulated by the Bank.

ix. Bureaux de change shall be authorised to purchase foreign currency without limits but shall be limited to sell foreign currency for small transactions such as subscriptions, business and personal travel up to a maximum aggregate daily limit of US$10 000 per bureau de change. Like with banks, bureaux de change and their agents shall report their activities of the inter-bank on a daily basis as required by the Bank.

x. In order to allow exporters to benefit from the inter-bank foreign currency market and to promote uninterrupted supply of forex in the economy, the export retention thresholds which are in line with regional practice shall be as follows:

Table 1: Current and Proposed Retention Thresholds

Sector	Level
Manufacturing	80
Gold (Large scale producers)	55
Gold (Small scale producers)	55
All other minerals	50
Tobacco & cotton merchants (for input schemes)	80
Tobacco & cotton growers	30
Horticulture	80
Transport	80
Tourism	80

xi. Similarly, in order to enhance liquidity within the foreign currency market, exporters shall be entitled to utilise their retained export receipts within 30 days, after which the unutilised export receipts will be offloaded into the market at the prevailing market exchange rate.

xii. All international remittances and individual funds received from offshore shall continue to be treated as free funds.

2. Local Settlement of Nostro FCA Transfers

Given the successful completion of the separation of RTGS FCAs and Nostro FCAs, the Bank is, with effect from 25th February 2019, putting in place a local Nostro FCAs settlement platform to allow for domestic inter-bank settlement of Nostro FCA transfers.

3. Liquidity Management

To anchor price stability, the Bank shall aggressively intervene in the market to sterilize liquidity so as to help contain inflationary and exchange rate pressures. The Bank will also implement a monetary targeting framework, with monetary aggregates as operational targets for monetary policy. Under this framework, the

Bank will appropriately target growth in base money with a view to help stabilize and anchor macroeconomic stability. The existing monetary policy instruments, including continued issuance of savings bonds and changes in the statutory reserve requirements, will be instrumental in achieving the reserve money target. The fiscal stance taken by Government to reduce recourse to Central Bank overdraft and to limit the overdraft to statutory levels will provide further impetus on the Bank's ability to contain pressures in the goods and foreign exchange market.

4. IFRS 9 Implementation

Following the initial publication of International Financial Reporting Standard (IFRS) 9 compliant interim financial statements for the period ended 30 June 2018, banks will be publishing 2018 year–end accounts by 31 March 2019. The implementation of IFRS 9 represents a significant milestone in financial stability enhancement due to the forward-looking nature of provisions set under the new standard.

5. Macro-Prudential Policy Framework

As part of ongoing initiatives to strengthen the stability and resilience of the financial system, the Bank is putting in place a macro-prudential policy framework which will be operational by 30 June 2019. The framework provides for effective macro-prudential tools, appropriate governance, transparency, and accountability arrangements that facilitate identification of the build-up of systemic risks, and monitoring thereof, to ensure appropriate measures are taken in a timely manner.

6. Anti-money Laundering Measures

Zimbabwe is party to various international legal instruments that require countries to put in place robust Anti Money Laundering and Counter Financing of Terrorism (AML/CFT) frameworks, to prevent the financial system from being misused by criminals for purposes of money laundering, financing of terrorism or other illicit purposes.

Banks and Designated Non-Financial Businesses and Professions (DNFBPs), including lawyers, accountants, estate agents, casinos and precious stone and precious metal dealers, play a key role in identifying and reporting of suspected cases of money laundering and related criminal activity within the financial system.

Banks have reached acceptable levels in the implementation of AML/CFT requirements. Going forward, the Bank's Financial Intelligence Unit will be placing greater focus towards ensuring compliance by DNFBPs, including through invocation of administrative penalties prescribed under the Money Laundering and Proceeds of Crime Act. The Bank calls upon all stakeholders with various roles in the fight against money laundering, including agencies involved in the identification, investigation and prosecution of money laundering cases, to work diligently to improve the effectiveness of the country's AML/CFT regime.

7. Cyber Risk Management

The Bank is aware that cyber risk will keep changing due to the evolution of cyber threats in the country and indeed across the globe. Financial institutions and individuals are increasingly being exposed to cyber-attacks which have become more sophisticated, frequent, targeted and difficult to identify The Bank urges payment services providers and banks board of directors and senior management to;

i. Intensify their efforts and take responsibility for setting, overseeing the strategy and ensure that cyber risks are accorded due consideration;
ii. Update cyber security policies, strategies and frameworks and submit the same to the Central Bank by 31 March 2019;
iii. Ensure that Information Technology (IT) objectives include maintaining the capacity to effectively anticipate, identify and recover from cyber security attacks for overall IT resilience; and
iv. Immediately make a report whenever an institution becomes aware of cyber security incidences within its system which adversely impact on the customers or the ecosystem.

8. Migration to Euro Mastercard Visa (EMV) Technology

Further to the cyber security guidance, market participants are required to migrate to Euro MasterCard and Visa (EMV) standards to ensure enhanced card security features to curb cyber related activities. Currently, over 80% of the card infrastructure in the country is now EMV compliant. Financial institutions should therefore ensure that all cards issued in the market are EMV compliant by 31 March 2019.

SECTION THREE

ECONOMIC OUTLOOK AND CONCLUSION

The inter-bank foreign exchange system will have significant positive effects on the economy's external and fiscal sectors, domestic production and on the welfare of citizens. The system is envisaged to go a long way in rebalancing the economy and setting it on a sustainable growth trajectory. As such, Zimbabwe's short to medium term macroeconomic outlook following the implementation of the inter-bank market will derive character from sustained positive growth, external sector sustainability and increased capacity utilization in the productive sectors of the economy.

In particular, the new framework is set to bring certainty, predictability and functionality to the economy's foreign exchange market. This, in turn, will address the valuation and unit of account difficulties that has been constraining investment flows into the country. In this regard, investment inflows are projected to improve going forward and this will drive growth on account of opening of new businesses as well as improved availability of foreign exchange for domestic industries.

Furthermore, the fair alignment of the exchange rate is set to trigger an expenditure switching effect across the economy which will benefit local producers, thereby, limiting imports of consumptive goods and services. Similarly the measures are set to encourage export growth as the market determined exchange rate improves external competitiveness of domestic producers that include tobacco and cotton growers.

On the fiscal front, the inter-bank foreign currency system is envisaged to enhance fair valuation of imports at points of entry. This has potential to significantly improve government revenues and enhance sustainability of the country's fiscal balance.

Overall, the measures contained in this Statement are expected to improve the competitiveness of the economy by appropriately rewarding exporters whilst at the same time reducing price distortions and arbitrage within the domestic market. The Bank commits all its efforts to reduce inflation within growth enhancing levels, while minimizing the adverse effects of a tight monetary framework in order to enhance production and productivity in the country.

I THANK YOU.

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GOVERNOR