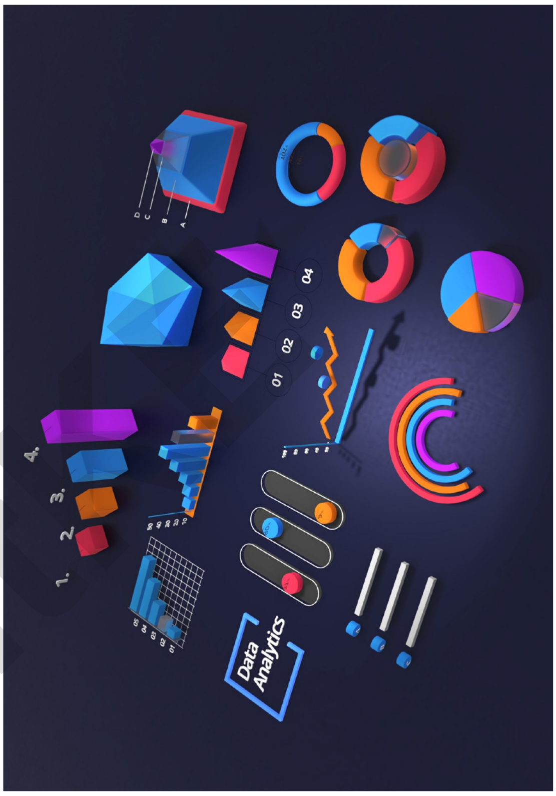
CZI
CONFEDERATION OF
ZIMBABWE INDUSTRIES
Enterprise Leadership Service



JANUARY 2023
INFLATION AND CURRENCY DEVELOPMENTS UPDATE

(MACRO-ECONOMIC)
BRIEFING NOTE TO CZI MEMBERS

10 February 2023

DID YOU KNOW ...

With effect from June 2020 ZIMSTAT has been publishing the new Consumer Price Index (CPI) code-named **Blended Consumer Price Index.** The index measures the combined price changes of goods and services in both the USD and ZWL.

Two separate indices were computed, that is, the USD Consumer Price Index and the already available ZWL Consumer Price Index. The original CPI weights were split into USD and ZWL components using linking factors. These linking factors were proportions of estimated household expenditure in USD and ZWL according to the Classification of individual consumption by purpose (COICOP) classification. The resultant weights were then used to combine the two indices to come up with the blended index.

INFLATION TARGETS FOR 2023

- Average Blended month on month inflation target of below 1.5%
- End period year on year Blended inflation range of 10% to 30%

1.0 INFLATION DYNAMICS

1.1 The downward trajectory of month-on-month inflation continues into 2023

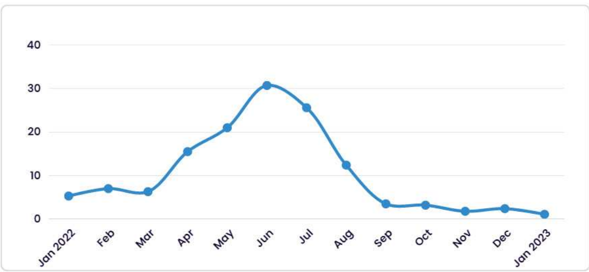
The year 2023 has commenced on a positive note, with the inflation gains made in the second half of the year 2022 continuing into 2023. The continued downward trend of month-on-month inflation, which commenced in July 2022 and had threatened a reverse in December 2023, continued into 2023 (Figure 1). Month on month inflation for January 2023 shed 1.3 percentage points on the December 2022 inflation rate of 2.4 percent.

1.2 Annual inflation continues to decline, although it still remains high

Year on year inflation for January 2023 was 229.8 shedding 13.9 percentage points from the December 2022 rate of 243.8 (Figure 2). The downward trend of year on year inflation, which was experienced on the latter part of 2022 has continued into 2023. However, annual inflation is still relatively high and complementary measures must be put in place to maintain and speed up the downward trajectory.

Figure 1:

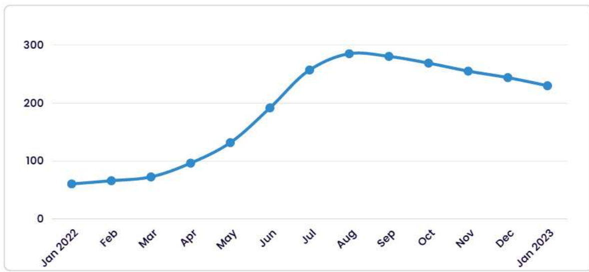
Month on month inflation continues a downward trend



Source: ZIMSTAT

Figure 2:

Zimbabwe's annual inflation continues to trend downwards



Source: ZIMSTAT

1.3 Blended inflation as the official inflation statistics

On the 4th of February 2023 the Reserve Bank Governor announced the 2023 Monetary policy statement. The statement urged the economy to focus more on the blended inflation since the Zimbabwean economy has largely dollarised, with the majority of expenditure in the CPI basket being in USD (Table 1). According to Zimbabwe Statistical Agency (ZIMSTAT) approximately 76% of expenditure is in USD, which reaffirms the notion that Zimbabwe is heading towards full dollarisation. However, while these are sectoral averages, the ratios could actually differ significantly between individual firms and consumers, as there are still a number of firms with higher levels of exposure to the ZWL$ while many consumers earn exclusively in ZWL$. Thus while a blended inflation rate makes sense in accurately defining the nature of inflation, it does not take away the need for publishing inflation rates of ZWL and USD, as these are more useful to business for planning purposes based on their income and cost mixtures of USD and ZWL$. It is, therefore, advisable for ZIMSTAT to publish both the ZWL$ and the USD inflation rates every month.

Table 1:

Proportions of Domestic Expenditure in Foreign Currency and Local Currency (%) by Consumer Price Index (CPI) Division

COICOP DIVISIONS	COICOP Weights	% of Expenditure in		Total
		US$	ZW$	
Food and Non-Alcoholic Beverages	31.3	65.04	34.96	100
Alcoholic Beverages and Tobacco	4.9	87.46	12.54	100
Clothing and Footwear	4.35	97.77	2.23	100
Housing, Water, Electricity, fuels	27.62	76.45	23.55	100
Furniture and Equipment	5.29	99.91	0.09	100
Health	1.42	91.08	8.92	100
Transport	8.39	92.51	7.49	100
Communication	2.65	72.98	27.02	100
Recreation and Culture	2.27	90.78	9.22	100
Education	4.25	95.38	4.62	100
Restaurants and Hotels	1.08	95.57	4.43	100
Miscellaneous Goods and Services	6.46	90.83	9.17	100
Total	100	76.56	23.44	100

Source: ZIMSTAT

1.4 The month on month blended inflation reflects the same pattern

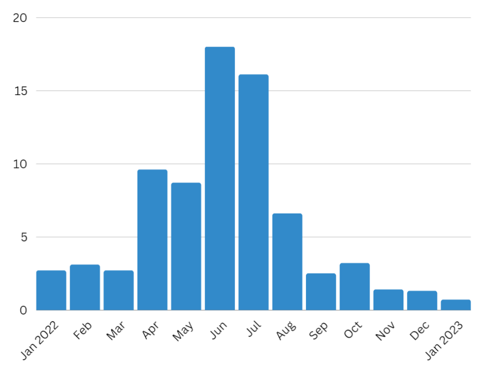
The month-on-month blended inflation rate of January 2023 was 0.7% shedding 0.6 percentage points on the December rate of 1.3%. The Reserve Bank of Zimbabwe expects blended month on month inflation rate to average below 1.5% in 2023. While the RBZ has total control over the ZWL inflation rate, it has very little influence over the USD inflation rate, even if the USD is circulating within the economy. Thus, a blended inflation target WITHOUT a corresponding ZWL$ target might not be appropriate from policy targeting perspectives, as achievement of the target could be solely based on higher levels of dollarisation in the economy (hence higher weights on the USD in the blended inflation calculation) rather than ability to control the ZWL$ inflation. It is, therefore, important for an explicitly stated ZWL$ end of year inflation target as it would be more reflective of the direction that the monetary authorities expect their interventions to be steering the economy towards.

1.5 Annual blended inflation is on the brink of declining into double digit inflation

The annual blended inflation rate for January 2023 was 101%, and has a flatter downward trend than the ZWL$ inflation rate (Figure 4). This shows that on an annual basis, inflation is still very high in Zimbabwe, whether ZWL or blended, although the blended inflation rate is now approaching double digit levels. USD inflation in Zimbabwe was also caused by Statutory Instrument 118A of 2022, which forces the formal sector to sell using the interbank rate, which in turn inflates USD prices. The RBZ set an end of year target of 10-30% annual blended inflation rate. This means that having a market determined exchange rate will be key in achieving this target from two perspectives. First, it will eliminate the inflating of USD prices even when the formal exchange rate is taken into account, hence ensuring that the USD component in blended inflation remains stable. Second, it will curb the ZWL$ inflation, which is basically more reflective of the parallel market exchange rate movements than anything else.

Figure 3:

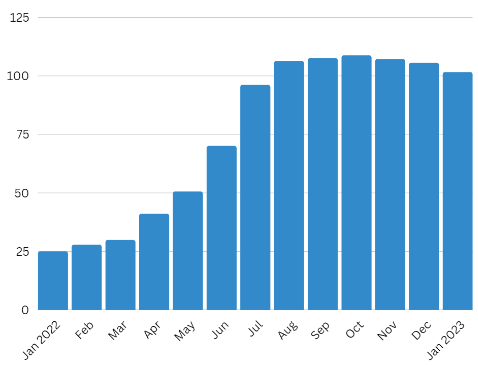
Blended month on month inflation declining



Source: ZIMSTAT

Figure 4:

Downward trend of blended annual inflation (%) spilled over into 2023



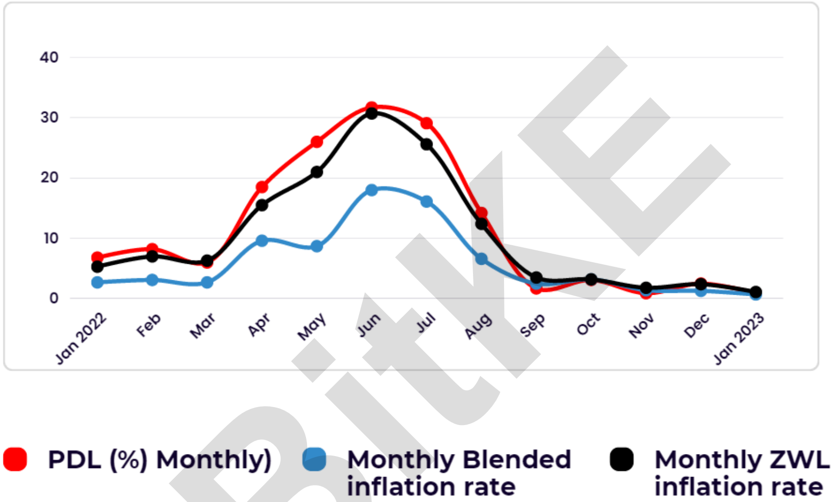
Source: ZIMSTAT

1.6 Blended inflation becoming more prominent in explaining poverty lines.

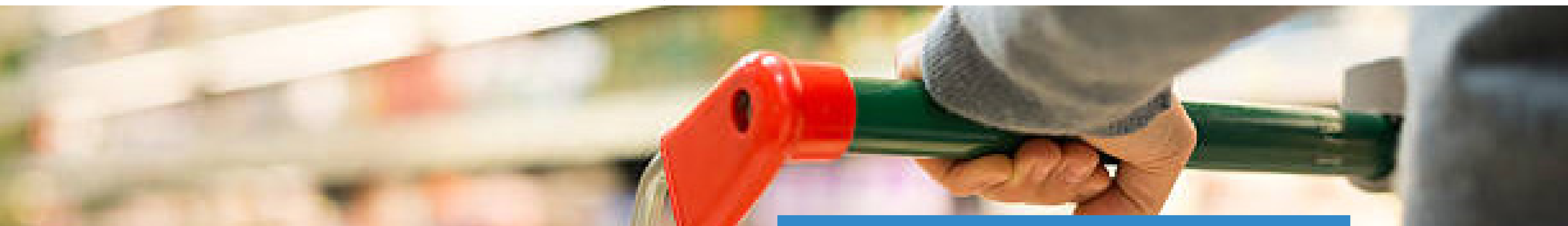
Poverty lines increase in tandem with monthly inflation, thus, inflation remains very relevant in poverty alleviation discourse. However, as the discussion moves to whether blended inflation is a true reflection of the Zimbabwe inflation situation, it is also important to check whether this relationship is also present. Monthly blended inflation rate was disconnected with poverty lines up until September 2022, and since then, just like ZWL$ inflation, blended inflation has been moving in line with poverty lines (except for December 2022) (Figure 6). This also confirms the ZIMSTAT findings that there is increased use of USD in the Zimbabwean economy, as USD inflation explains about three-quarters on the blended inflation rate.

Figure 6:

Percentage changes in poverty lines moving in line with monthly inflation



Source: ZIMSTAT

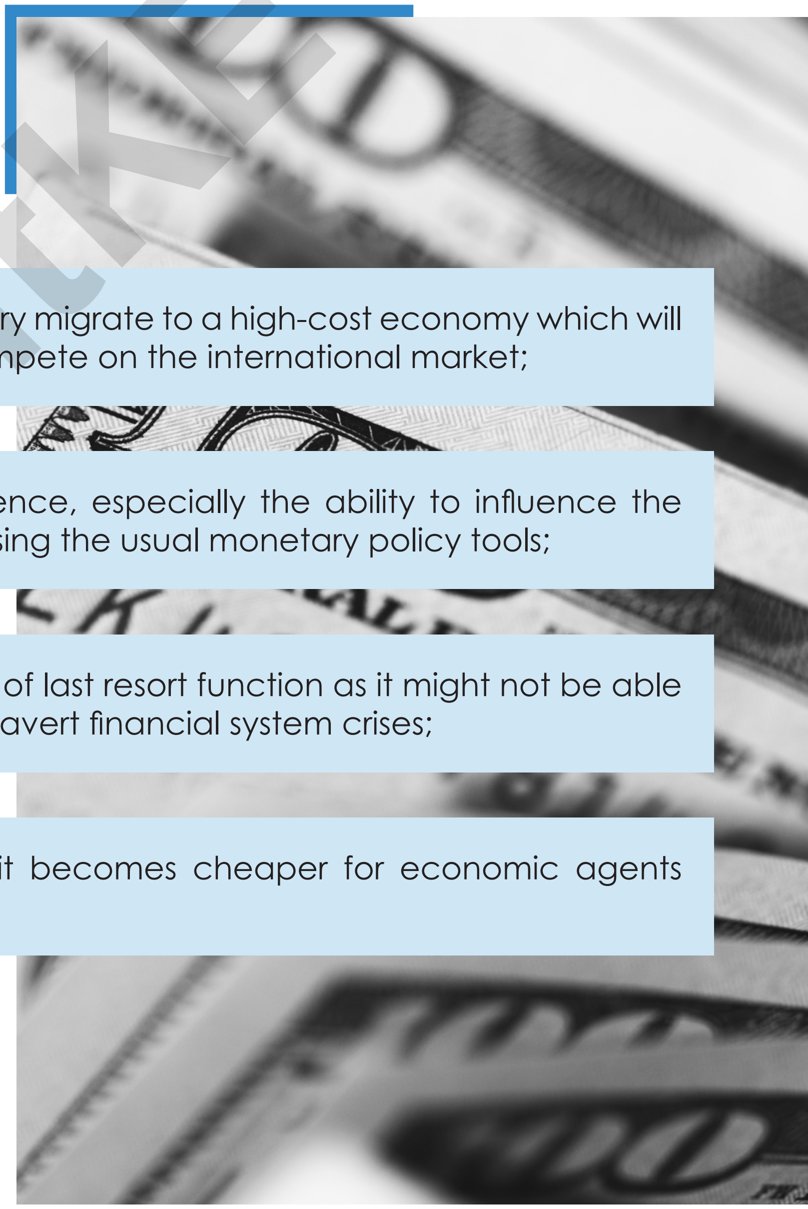


According to ZIMSTAT, the Food Poverty Datum Line for January 2023 was ZWL$22,384.78 having increased from ZWL$22,192.87 in December 2022. This means that a family of five people with an income of ZWL$100,000 per month will not be able to afford the basic food requirements for all family members to stay out of poverty. The Total Consumption Poverty Lines was ZWL$29,499.89 per person in January 2023. This implies that an individual should be able to set aside ZWL$30000 to purchase both non-food and food items so as not to be deemed poor.

2.0 CURRENCY DEVELOPMENTS

2.1 Growing dominance of the US dollar

Zimbabwe is in a multi-currency regime and the policy stated goal is to move to a mono currency regime. However, Zimbabwe is slowly but surely moving towards full dollarisation. While full dollarisation will completely eliminate persistent inflation challenges being faced by Zimbabwe, the cost of full dollarisation tend to outweigh the benefits. Some of the cost of full dollarization include:

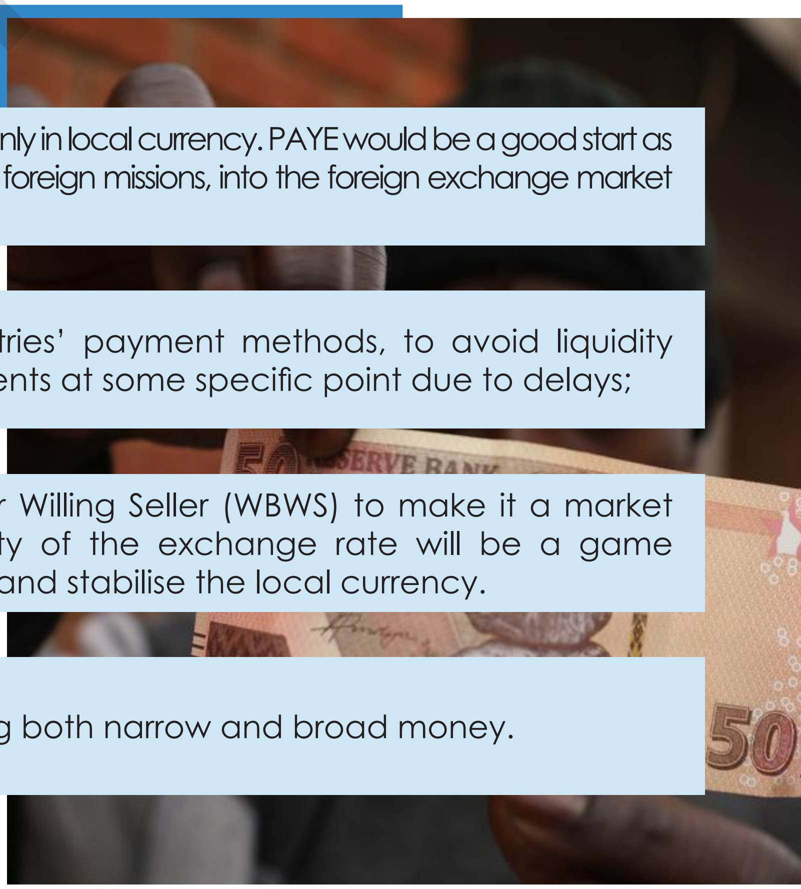


- Economic contraction, as the country migrate to a high-cost economy which will make it difficult for local firms to compete on the international market;
- Loss of Monetary Policy independence, especially the ability to influence the growth trajectory of an economy using the usual monetary policy tools;
- Curtailing the central bank's lender of last resort function as it might not be able to act to assist banks in distress and avert financial system crises;
- Huge current account deficits as it becomes cheaper for economic agents holding US$ balances to import.

2.2 Urgent measures to strengthen the Zimbabwean dollar needed

The Zimbabwean dollar has lost its function as a store of value and economic agents no longer want to hold the Zimbabwean dollar. In some cases, the ZWL$ is being completely rejected in the informal sector. While controlling ZWL$ inflation remains the only way to enhance the store of value function, there is urgent need to at least restore the function of the ZWL$ as a medium of exchange. Currently, there is no demand for the local currency, especially among those that earn foreign currency, as the dual economy nature of Zimbabwe means that they can do all transactions in USD. The main reason why the efforts aimed at ensuring stability have failed is that the efforts are mainly targeted at the supply side, especially controlling money supply growth and managing ZWL$ liquidity. However, these efforts also need demand side management policies to succeed. Currently, there is not much being done on the demand side, which could see any business seeing the need to hold on to the ZWL$.

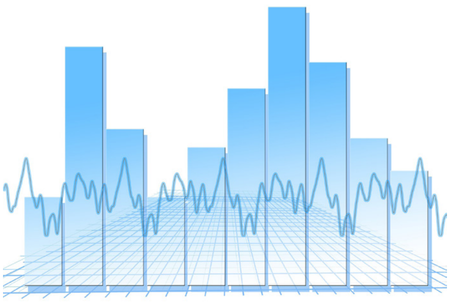
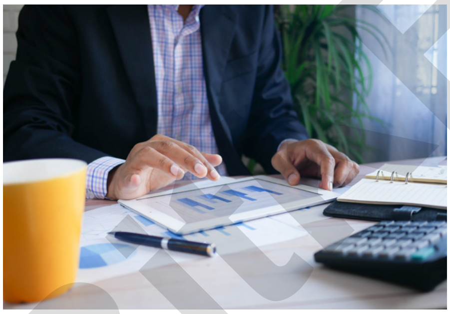
The current Willing Buyer Willing Seller (WBWS) platform is also failing to serve as a market-based platform due to limited interaction of forces of demand and supply; while willing buyers are unlimited, there is a shortage of willing sellers at the platform. There is currently no basis for foreign currency earners to sell the foreign currency, as they can settle almost all of their obligations in USD. The government has als gave a wrong signal to the market, as it also appears to be more determined to get USD at the expense of its own currency. If the policy objective is still to ensure that the ZWL$ does not lose relevance in this environment of accelerated dollarisation, the following, if implemented as a package, could help:



- Migrating certain taxes to being payable only in local currency. PAYE would be a good start as this would bring many institutions including foreign missions, into the foreign exchange market as sellers.
- Smoothening of Government Ministries' payment methods, to avoid liquidity disruptions from simultaneous payments at some specific point due to delays;
- Full liberalisation of the Willing Buyer Willing Seller (WBWS) to make it a market determined exchange rate. Stability of the exchange rate will be a game changer, as it will eliminate inflation and stabilise the local currency.
- Tight money supply control, including both narrow and broad money.

3.0 Inflation Outlook

The 2023 Monetary Policy Statement National has forecasted an average monthly **blended** inflation target of below 1.5% and annual **blended** inflation end period range of 10% to 30% in 2023. While these targets could be achievable, this might largely be due to expanded dollarization and be reflective of the stability of the USD inflation rather than the ZWL$ inflation. The ZWL$ inflation is likely to remain above 200% into the second quarter of the year, given the current level of the CPI. Only if the current month on month inflation rate of 1.1% is maintained will the ZWL$ inflation into double digit levels in June 2023. The widening parallel market premium is thus threatening the attainment of a fast inflation deceleration.



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