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FOR IMMEDIATE RELEASE

Date: 26/07/21

CTPD'S REACTION TO THE KWACHA APPRECIATION

On 2nd January 2019, each United States Dollar (USD) sold for an average of K11.96. A year later, on 2nd January 2020, the average selling price for one USD was K14.19, representing a depreciation of the Kwacha of 18.6 percent. However, in 2020 alone, sparked and driven by the complexes and contradictions associated with the Covid-19 pandemic, the Kwacha came tumbling further down, ending the year at K21.19 per USD, a depreciation of about 50 percent. The USD value of the Kwacha peaked at K22.69 on 12 July 2021. Yet, for the past two weeks, the Kwacha has been gaining gradually against the USD, reaching an average selling price of K21.41 on 23 July 2021, representing an appreciation of 5.6 percent.

The Kwacha appreciation has sent scores of economic commentators into a frenzy of excitement, speculating about the potential causes of the appreciation amid the third wave of the Covid-19 pandemic and two weeks before the presidential elections. Fortunately, both the Ministry of Finance (MoF) and the Bank of Zambia (BoZ) have provided some measure of guidance in terms of explanatory factors associated with the Kwacha appreciation. On 23rd July 2021, MoF explained that the appreciation of the Kwacha over the past two weeks "largely reflects changes in the supply of foreign exchange and broad improvements in market expectations." Three key points are raised to support this conclusion:

Firstly, rising copper prices and production expansion are considered to have led to improved foreign exchange flows, with the trade balance rising to an estimated at USD1.9 billion between January to May, compared with about USD0.58 billion in the corresponding period the previous year.

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Secondly, the oversubscription in bond issuance standing at 116 percent was powered by inflows from non-resident investors making purchases of government securities, subsequently leading to an improvement in foreign exchange availability.

Finally, another key explanatory factor is BoZ's intervention in the foreign exchange market. Ancillary factors cited by MoF include restoration of confidence in the market due to a probable SDR allocation to Zambia, with potential to bolster foreign exchange reserves by about USD1.3 billion in August, as well as BoZ purchase of gold to prop up gross international reserves.

Meanwhile, BoZ, in a statement issued on 24 July 2021, argues that "the appreciation of the Kwacha largely reflects changes in the actual supply of foreign exchange and expectations of further improvements in supply associated with the forthcoming IMF Special Drawing Rights (SDR) allocation, improved prospects of a formal Extended Credit Facility (ECF) programme with the IMF, as well as buoyant copper prices." The rising copper prices "has resulted in improved foreign exchange flows from the mining sector through tax receipts remitted directly to the Bank of Zambia in US dollars." BoZ has injected more USDs back into the foreign exchange market due to this measure. Consider this contrast: by 23 July 2020, BoZ only sold USD86.0 million to the foreign exchange market, compared with USD687.5 million injected into the foreign exchange market by 23 July 2021. International reserves have increased by USD200 million in under two months, to USD1.4 billion at the end of May 2021.

Drawing upon these insights provided by the authorities – MoF and BoZ – We wish to add a voice to the ongoing conversation by making a commentary on the sustainability of identified factors driving the present volatility of the Kwacha. Zambia's chronic dependence on copper exports for foreign exchange earnings is as worrying today as it was more than half a century ago. The structural dynamics of Zambia's economy reflecting in the undue reliance upon copper exports leave the Zambian economy largely susceptible to the vagaries of the external sector. While, fortuitously, copper has been trading around decadal peaks well over USD9,000 per metric tonne, history teaches us that copper prices fluctuate, booms and busts are part and parcel of the dynamics of the commodity market.

Nevertheless, it appears that tinkering the supply side of the foreign exchange market by BoZ's injection of USD into the market may explain the bulk of the gains enjoyed by the Kwacha over the past few days. Indeed, the measure put in place by BoZ to receive tax

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receipts in USD from the mining companies is novel, but this means that BoZ will now shift its portfolio around, by offloading USD into the foreign exchange market and crediting the ZRA account at BoZ with Kwacha. Because arrangements in place between BoZ and ZRA in this regard are not in the public domain, one can only speculate as to how BoZ will settle this transaction without undue liabilities and transactional costs.

Further, bond issuance to non-residents, though it has bolstered foreign exchange inflows for the time being, cannot be relied upon for long-term stability of the exchange rate. Bond sells today to nonresidents mean that there will be outflows of foreign exchange at some point future, adding to demand pressures in the foreign exchange market.

Moreover, debt suspension initiatives rolled out and goodwill from international lenders have meant that Zambia’s public debt repayments have not been as scheduled. In 2019, debt repayment costs were about USD944.4 million, dropping to USD639.68 million in 2020 on account of Covid-19 debt repayment relief support. Central Government external debt stands at USD12.74 billion; hence, resumption of normal debt repayment is likely to ramp up demand for USD.

As we have argued elsewhere, structural transformation of the Zambian economy is the answer the country seeks for its developmental pursuits more broadly and stability of its currency and rate of inflation in particular. Structural transformation calls upon building an integrated structure of production, bound together by coordinated investments across sectors and economic activities. Initially, this will imply creating productive capacity in linkage and employment maximizing agricultural and industrial sectors, with a view to reducing import dependence. For example, commercialization of agriculture feeding into agro-processing plants to serve both domestic and foreign markets.

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Editor’s Note

The Centre for Trade Policy and Development (CTPD) is a not- for –profit, membership based trade policy and development think tank. The organization was established in 1999 and existed as the civil society trade network (CSTNZ), until 2009 when it was rebranded as the Centre for Trade Policy and Development (CTPD).

The mandate of CTPD is to influence pro-poor trade and investment reforms at national, regional and multilateral levels as well as facilitate the participation of various stakeholders including member organizations in ensuring that trade is used as a tool for poverty eradication.

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