



CZI
CONFEDERATION OF
ZIMBABWE INDUSTRIES
Enterprise Leadership Service

JUNE 2020

INFLATION AND CURRENCY DEVELOPMENTS UPDATE

**MACRO-ECONOMIC
BRIEFING NOTE
TO CZI MEMBERS**

20 JULY 2020

The month on month inflation rate for June stood at **31.7%**, gaining **16.5** percentage points on the May 2020 rate of **15.2%**

Zimbabwe's annual inflation rate decelerated from **785.6%** in May 2020 to **737.3%** in June 2020, shedding **48.3** percentage points.

This signifies a slowdown in the rate of price increases in the economy. In this note you will get the following,

- *Inflation developments for June 2020*
- *CZI Price Tracker*
- *Causes of Inflation*
- *Threats to inflation stabilisation*
- *Currency Developments*

CZI PRICE TRACKER

CZI Economics Department tracks prices of a small basket of basic goods and services since mid-November 2019. The CZI Price Tracker measures monthly price changes of selected basic commodities and services only. The consumer basket is not as comprehensive as the CPI Basket for ZIMSTAT. The monthly price change from mid-June to mid-July 2020 was 44.61%. Major changes were recorded as follows:

Percentage Price Changes from Mid-June to Mid-July 2020

Commodity / Service	Percentage Change
Fuel	149%
Pork	88%
Flour	82%
Sugar	69%
Bread	31%

The Caveat

Despite the decrease in annual inflation 785.6% in May 2020 to 737.3% in June 2020, month on month inflation rose from 15% in May 2020 to 31.7% in June the same year. The divergence in the two trends is a result of a technical factor as opposed to actual inflation deceleration. In June 2019, the Monetary Authorities announced that the Zimbabwe dollar will be the sole currency for legal tender purposes. Thus, the ban of multi currencies as legal tender in June 2019, were accompanied by a sharp rise in the Consumer Price Index for June 2019 to 172.6 compared to 124 for May 2019. The effect of this development was to raise the base on which the annual inflation rate for June 2020 is calculated, illustrating that this is a purely superficial decline as opposed to a slow down in price increases.

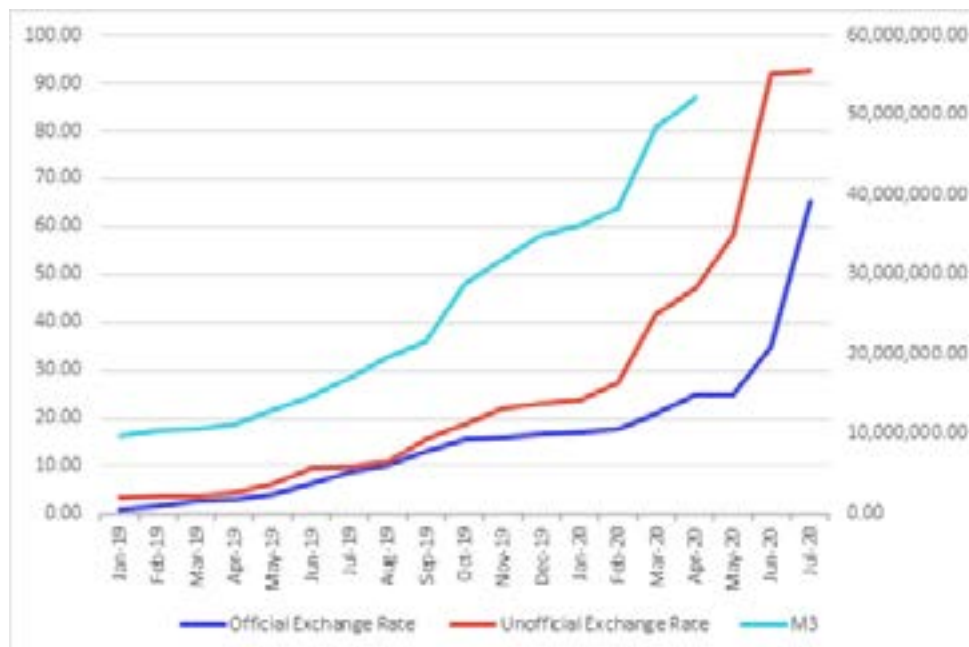
Causes of Inflation and Threats to Inflation Stabilisation

Price stabilisation in the economy is threatened by the following factors:

i. Increase in money supply

A surge in the novel corona virus cases is being experienced in the country, with a total of 1034 cases recorded so far. The need to increase health expenditure to fight the pandemic and injecting a productive sector stimulus package in the economy in view of lack of external financing is likely to lead in creation of money. This will further result in the persistent depreciation of the local currency on the parallel market thereby fueling inflation as depicted by the figure below.

Money Supply and Exchange Rate Developments



ii. Exchange Rate Developments

The fixed exchange rate regime was replaced by a foreign exchange auction trading market on 23 June 2020. Before the fixed exchange rate regime was dumped, the premium between the official rate and the non-official rate was surging, on 19 June the interbank fixed rate was at USD1:25ZWL while parallel market rate was approximately USD1:112ZWL. Since the introduction of the foreign exchange auction market the parallel rate has shown signs of relenting and the auction rate is depreciating - a good indication that convergence is possible. The auction rate stood at USD1:69ZWL on 14 July 2020 compared to the non-official rate at USD1:90ZWL.

Summary Foreign Exchange Auction Results

	23 June 2020	30 June 2020	7 July 2020	14 July 2020
Amount Allotted	10,345,250	16,321,028	13,602,408	15,988,219
Highest Rate	100	92	90	85
Lowest Rate	35	48	55	64.2
Weighted Average	57.35	63.74	65.88	68.87
Total Bids	11,407,240	18,957,677	15,872,482	18,719.664

Prices are adjusting to the auction market, albeit slowly as prices are usually sticky downwards. Nevertheless, there are mixed reactions from industry as some may still be hedging but the feedback from market players is that they are beginning to blend out the old rates with the emerging auction rates and reducing prices.

There are indications in the 2020 Mid Term Fiscal Policy that Authorities will allow the Currency Auction to operate efficiently by zero recourse to Bank financing of budget deficit and avoiding fiscal slippages at all costs. To achieve this feat requires strict discipline as well as monetary and fiscal policy alignment because expenditure overruns are likely to emanate from the following:

Threats to Fiscal Discipline

- High inflation levels eroding the value of collected revenues and expenditure increases.
- Depreciating exchange rate means more domestic resources are required for foreign currency denominated government transactions.
- The impact of covid-19 pandemic and the provision of a ZWL\$18 Billion Stimulus Package.
- Public sector employment costs take up 39% of total expenditures and the current agitation for higher salaries by public sector employees may derail expenditure containment efforts.
- The need to equip health institutions for efficient service delivery to human capital.
- Revenue generation capacity is curtailed by covid19. GDP is expected to decline by 4.5% which limits capacity to generate revenue.
- The USD Public Sector covid19 allowances should be treated as real Nostro accounts to avoid destabilizing the money market through superficial USD accounts.

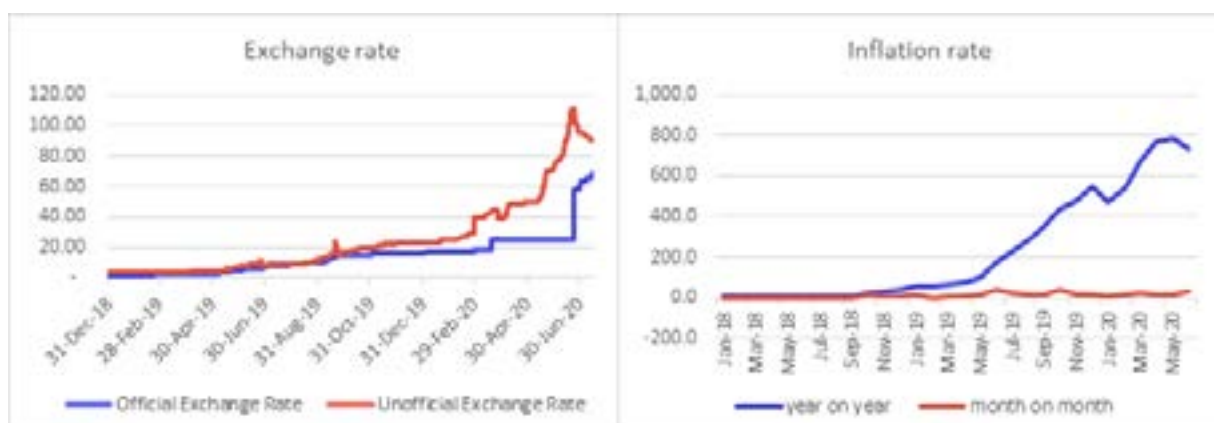
Both the Central and Local Government should give the Currency Auction the opportunity to operate efficiently by levying taxes and fees in local currency in order to create demand for the RTGS dollar. Tax revenue constitutes 97% of total revenue and levying VAT, PAYE and Income taxes in local currency should go a long way in creating demand for the local currency as taxes contribute significantly to revenue as indicated below

- Tax on income and profits contributes (32%)
- Value Added Tax (VAT) (23%)
- Taxes on financial and capital transactions (13%)

Levying taxes in local currency should increase demand for the local currency and this should have positive effects on exchange rate and inflation.

The graph below shows exchange rate and inflation dynamics in the economy.

Exchange Rate and Inflation Dynamics



iii. Uncertainty

The business community is still a little skeptical about the sustainability of the foreign exchange auction market, given the currency ambiguity obtaining in the economy. Uncertainty is heightened by persistent policy reversals. As Authorities announce dedollarisation, the redollarisation tidal wave is gaining steam in the economy as economic agents can now transact in multi currencies since March 2020. Government is also fueling the dollarization process by demanding certain taxes and fees in foreign currency.

As a result of COVID19, some businesses are not sure if they will be able to resume operations after the lockdown due to cash flow difficulties and subdued demand. Those that have resumed operations are functioning in a high cost environment. COVID19 which is novel, has increased uncertainty levels in an economy which was already existing in low confidence levels as a result of policy inconsistencies.

Other inflation drivers are indicated below:

- *Cost Push Inflation*
- *Inflation expectations.*
- *Persistent increase in price of key economic enablers.*
- *Low Capacity Utilisation*

Inflation Outlook

In the short term, the build up in incipient inflation pressures is mainly predicated on the developments in the foreign exchange market. Thus, the relative stability of the exchange rate brought about by the Currency Auction, if sustained will enhance price stability and anchor inflation.

Currency Market Developments and USD Usage in the Economy

USD Usage Areas in the Market

Below is a list of sectors of the economy where the USD is widely used.

- *Government Allowances, levies, taxes and fees*
- *Informal sector*
- *Fuel sector*
- *Wages and Salaries*
- *Large Supermarkets*
- *Medical Services*
- *Educational Services*

Please click the following link for more detailed information
[MAY INFLATION AND CURRENCY DEVELOPMENTS UPDATE](#)



For more information please contact

Tafadzwa Bandama

Chief Economist
tbandama@czi.co.zw