CZI
CONFEDERATION OF ZIMBABWE INDUSTRIES
Enterprise Leadership Service

INDUSTRY POLICY RESPONSE
TO SI 127

31 MAY 2021

STATUTORY INSTRUMENT 127 OF 2021

EXECUTIVE SUMMARY

CZI believes that SI 127 should be immediately suspended.

CZI agrees with the issues that the MOF is trying to resolve:

- Control inflation.
- Eradicate the use of the black and informal markets.
- Bring stability/ sanity to the foreign currency markets.
- Prevent abuse of the foreign currency obtained on the auction for profiteering and other opaque activity.

It is our submission that the SI127 does the exact opposite of the above and indeed will:

- Reduce the amount of foreign currency in the official and formal channels.
- Create USD inflation to achieve a perceived required return by business.
- Bring businesses that previously were able to generate forex into the auctions. These organizations were able to collect foreign currency from sales previously.
- The market believes that the auction is a controlled rate and therefore from the past we have seen that it looks for another reference point to determine a price. That will mean we are back to the dark days when the black-market rate anchors pricing. This market has thin volumes and is driven by rumors and speculation.
- Reduce foreign currency revenues by government as currency will be driven underground.
- Farmers will be negatively impacted as we expect the parallel rate to take over and crash the market. GMB for example has fixed a price for purchase of grain. This price will not reward farmers for their efforts.

Business is mostly interested in long term survival and therefore will take positions that may lead to a defensive posture. Trading takes a back seat to balance sheet integrity should the black-market rate start to devalue the ZWL. This leads to further inflation as fewer goods come to the market.

PROBLEM STATEMENT

We believe that the problem is the fact that our journey on currency reforms has not been completed and is at the center of this conversation. Price discovery was in the black-markets and should come in the formal sector. We believe that the Dutch Auction principles should be implemented and that the auction resolves price discovery matters as it was intended.

We do not believe the rate will run as we saw last year budget surpluses and money supply restrictions work. We proffer that M3 is more important in the long run than M0 which is tactical.

CURRENT POLICY SCENARIO AND ITS IMPACT

Over the past nearly12 months since the launch of the Foreign Currency Auction, the economy has witnessed much progress, notably due to the stability engendered and occasioned by the Dutch Foreign Exchange Auction system. As a result of the Auction system, exchange rate predictability, and growing access of foreign currency through the formal system, the formal positive outcomes were realised:

- Collapse in adverse expectations.
- Narrowing of the Alternative exchange rate premium.
- Falling month on month inflation (from 35.5% in July to 3.2% in November 2020).
- Increase in local industry capacity utilization.
- Increase in locally manufactured goods.
- Increase in USD deposits in the banks.
- Fiscal revenues growth.
- Steady Recovery in domestic demand.
- Business Volumes growth.
- Exports growth.

The above is a summary of the multiple benefits for the economy arising from a stable and predictable exchange rate and Foreign currency management system. A stable and predictable macroeconomic environment inherently promotes business growth, capacity utilization, employment, exports and facilitates formalization of the economy. This has mutually beneficial gains for both State (fiscal revenues, youth and gender mainstreaming, financial inclusion, among others) and industry (capacity and business growth). We see the increase in the dollar deposits is a success attributable to government efforts. We do not view this as a problem as we have heard it positioned. We recommend applying ourselves to intermediation instruments so we can take advantage of our victories.

FOREIGN EXCHANGE AUCTION POLICY IMPACT ON INFLATION

The initial impact on headline inflation has been most pronounced, with month-on-month inflation decelerating from above 30% in June/July to an average of 2.2% for the months March through to June 2021.

On current trends, headline inflation was on course to decline further to 55% by July and 30% by December 2021. Such significant progress would have laid a strong foundation for further inflation deceleration to levels well below 20% by December 2022 under the Policy scenario and further towards single digit levels by 2023.

THE TABLE BELOW SHOWS POLICY INFLATION SCENARIO:

	CPI	MOM	YOY%
Nov-20	3766.78	0.032	399.61%
Dec-20	3941.78	0.046	348.58%
Jan-21	4155.90	0.054	362.30%
Feb-21	4299.41	0.035	321.67%
Mar-21	4396.60	0.023	240.63%
Apr-21	4481.49	0.019	196.25%
May-21	4593.71	0.025	163.76%
Jun-21	4704.13	0.024	105.15%
Jul-21	4817.20	0.024	55.02%
Aug-21	4932.99	0.024	46.39%
Sep-21	5033.49	0.020	43.86%
Oct-21	5136.04	0.020	40.65%
Nov-21	5240.68	0.020	39.13%
Dec-21	5347.45	0.020	33.66%
Mar-22	5680.98	0.020	29.21%
Apr-22	5767.35	0.015	28.69%
May-22	5855.04	0.015	27.46%
Jun-22	5944.06	0.015	26.36%
Jul-22	6034.43	0.015	25.27%
Aug-22	6126.18	0.015	24.19%
Sep-22	6200.01	0.012	23.18%
Dec-22	6426.89	0.012	20.19%
Dec-23	6911.28		9.52%

Under the Policy scenario and subject to policy refinements to improve the FX Auction system, widen access and narrow down the premium, the Policy scenario of sustained inflation decline is achievable. This would be buttressed by strong fiscal policy stance and tighter monetary policy.

As already highlighted, the economy has recorded a significant rebound in the current year, characterised by:

- RBZ has been keeping a tight leash on money supply growth.
- Treasury has been running a budget surplus.
- Consequently, annual headline inflation has been on a downward trend from 834.1% in July 2020 to 161% in May 2021. This is significant and material progress. Month on month inflation has decelerated sharply.
- Industry has been ramping up production since the relaxation of lockdowns, with very real prospects of growth being achieved by year end.
- Agriculture has had significant growth across key subsectors, following the good rains.
- Employment figures have been rising on the back of a stable environment since June 2020.
- The use of multicurrency in the economy allowed for spending of diaspora remittances and company retentions on local products thereby boosting demand and reducing imports ultimately impacting positively on the country's balance of payment position.

RISKS TO THE CURRENT POLICY SCENARIO

The FX Auction system was put in place as a price discovery mechanism and to avail foreign currency on the formal market. In its active price discovery, the Auction system quickly started to close the gap between the auction rate and the parallel market rate without driving up the parallel rate. However, when supply and demand became somewhat distorted at the auction when all demand was allocated but settlements significantly delayed, this signaled that the auction had now lagged behind in price discovery and was now operating at an almost fixed rate that it could not clear, the parallel market rate picked up. It is important for the auction to stay the course of price discovery and eliminate the margins that are an effective tax on exporters who surrender part of their earnings to the auction as this would also encourage forex generators to come to the auction and improve its liquidity.

As CZI, we feel strongly that we are very close to achieving overall macroeconomic stability, necessary to power sustained recovery and growth. Both market and policy deficiencies can be addressed without jeopardising that trajectory with a heavy-handed SI which will likely reverse the gains of the past year.

We understand and appreciate Government concerns for stability and the frustration with some aberrations by a few corporate entities which access FX at the Auction rate and yet price at the alternative market rates. This is not representative of the entire industry, and we believe engagement between industry and Authorities can resolve such aberrations. The industry body does not support such behaviour in any way, but we also believe, it does not warranty the blanket SI which has far reaching adverse implications for the economy.

Pursuant to the foregoing, CZI therefore calls for urgent dialogue with MoF and Monetary Authorities to map a way forward.

Whilst the overall trajectory has been upward, the period has not been without its challenges, among them:

- Delays in settlement on the Auction Allotments for extended periods, have been affecting companies' working capital. Companies have been struggling due to the delays and this has slowed their recovery.
- The increasing premium between the official exchange rate and the parallel market rate is a cause for concern. The risk is that the economy can readily slide back into hyperinflation as a result of the widening parallel market premium, which has re-ignited a build-up in inflation expectations.
- The dislocative effects of a widening premium could favor imports while discouraging local production for exports.

1. IMPACT ASSESSMENT FOR SI 127 OF 2021

1.1 GOVERNMENT PERSPECTIVE

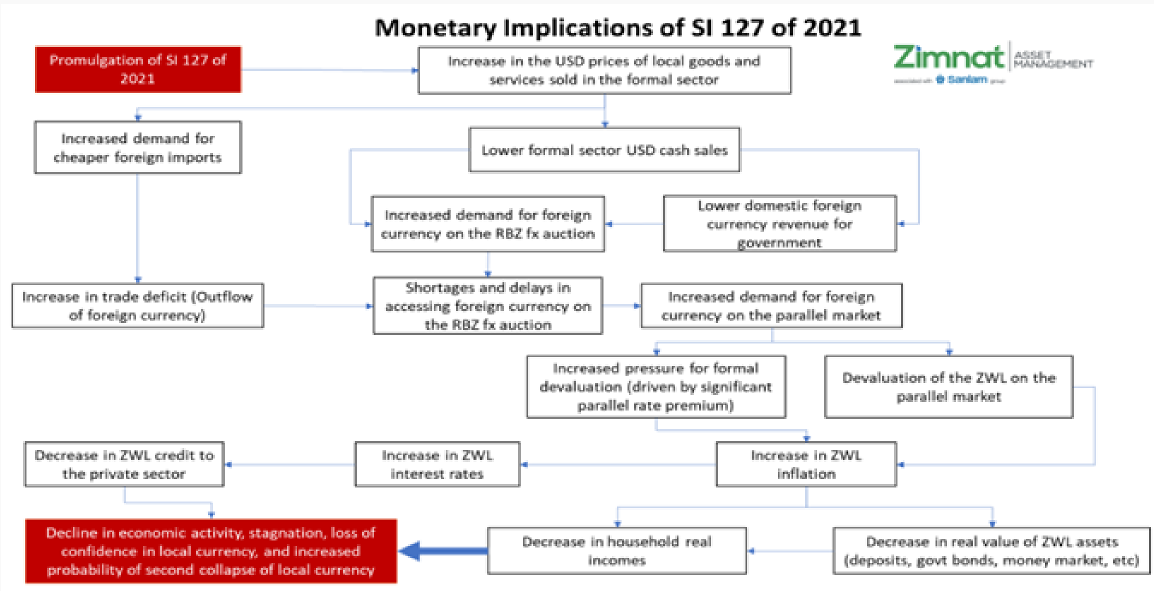
Industry has been supportive of efforts by Government and the RBZ to reign in the problems that have bedeviled the economy since the introduction of the ZWL. We are also aware of the concerns of Government, which include inter alia:

- Abuse of funds accessed on the Auction.
- Pricing of goods and services at parallel market rates, including by companies benefiting from the Auction.
- Increasing dollarization against a policy thrust towards de-dollarisation.
- Mis-invoicing practices perpetrated by some businesses.
- Prevalent use of rates other than the ruling exchange rate, including predatory rates meant to completely discourage use of the local currency by customers. In a few instances some suppliers outright refuse payment in local currency.

2. UNINTENDED CONSEQUENCES BUSINESS FORESEE ARISING FROM SI 127 OF 2021

While the intentions of government in promulgating the SI are noble and appreciated, there are some unintended consequences that we see resulting from the application of the SI. These include the following:

- The immediate impact of applying the SI would be that US dollar prices will be hiked so as to result in the same ZWL price prevailing prior to the SI. This means an immediate spike in USD inflation, a component of our blended inflation rate.
- Companies have been relying on local US dollar sales to generate the bulk of foreign currency used to sustain operations. Use of the Auction rate would result in consumers converting their US dollars to ZWL on the parallel market prior to purchasing, a practice already rampant outside the major retail chains such as Pick n Pay, OK and Bon Marche. This will deprive companies of what has become their main source of foreign currency.
- Demand for foreign currency on the Auction is going to increase significantly as this becomes the only source of foreign currency in the absence of domestic sales in US dollars. There is not likely to be a corresponding supply side increase in the amount of US dollars coming onto the Auction, which will either result in an increase in the delays on disbursements, or a sharp increase in the rate.
- To date, our members still have their allocations on the Auction pro-rated, thus a surge in demand on the Auction is likely to exacerbate this problem and cause a slowdown in the economic recovery and job creation witnessed to date.
- Goods such as fuel are priced in USD and companies cannot bid for local payments at the auction. Inability to sell in US dollars locally will thus cause supply chain issues unless service stations are also compelled to sell fuel in ZWL at the prevailing Auction rate. Such a pronouncement however has led to fuel shortages in the past and thus is undesirable.



RECOMMENDATIONS & WAY FORWARD

CZI recommends that implementation of the SI be suspended, and urgent stakeholder consultations be held between government and business to come up with a way forward that will not jeopardise the rebound witnessed in the economy to date. Some of the issues we believe government needs to take into consideration are:

- Confidence is at the centre of all fiat currencies, and it is important to avoid policy misperceptions that may result from well-intentioned Statutory Instruments.
- The path to de-dollarisation must be more clearly defined and will need stakeholder buy in along the way for confidence.
- It is important to address deficiencies observed on the Auction, which include delayed settlements arising from more currency being sold than is available. There needs to be confidence in the auction or a formal foreign currency market before driving towards a mono currency. We have already witnessed the unintended consequences of a premature push towards a mono currency in the past two years.
- It is important that we move to a single exchange rate at which the entire economy operates, as the presence of multiple exchange rates in the economy encourages arbitrage between the different markets/platforms. Further engagements are necessary to make this a reality, whether through greater efficiency on the Auction or through the interbank/bureau markets or some other appropriate mechanism.
- A policy position has to be taken for the efficiency of the auction market where all foreign currency accruing to government through export surrender, local Forex earnings surrender, Taxes, Duties and any other fees received in foreign currency should be put in one pot as a correct supply position for Price Discovery/determination at the auction. This would improve the efficiency of the market in Price determination.