# Caleb M Fundanga: Monetary policy issues and the process of foreign payments

Presentation by Dr Caleb M Fundanga, Governor of the Bank of Zambia, at the Zambian Heads of Missions Briefing Seminar, Lusaka, 19 July 2005.

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The Hon. Minister of Foreign Affairs, Lt. Gen. Ronnie Shikapwasha, MP
Hon. Deputy Minister of Foreign Affairs
Permanent Secretaries
Your Excellencies, High Commissioners and Ambassadors
Senior Government Officials
Distinguished Invited Guests
Ladies and Gentlemen

It is an honour for me to be here this morning to talk to you on the topic of ***"Monetary Policy Issues and the Process of Foreign Payments"***. This topic provides me with an opportunity to explain the role of the Bank of Zambia in the economy and the process of foreign payments which has been a topical issue.

As you may be aware, the Bank of Zambia's mission is to **formulate and implement monetary and supervisory policies that will ensure price and financial system stability**. However, in line with the topic above, my presentation this morning will focus on the first aspect of the mission of the Bank, namely, price stability.

There are generally three prices of major concern to the Bank of Zambia. These are general prices of goods and services, interest rates and the exchange rate of the kwacha against major foreign currencies. I will now deal with each of these in turn.

The central bank deals with general prices of goods and services in the context of inflation. In simple terms, inflation may be defined as the change in the general price level of goods and services. However, in every day usage, inflation may be defined as "too much money chasing too few goods". Describing inflation this way makes it easier to link it to monetary policy which is the control of money supply in an economy.

The Bank of Zambia is concerned that inflation has remained stubbornly high for quite sometime now. As at end-June 2005, inflation was at 19.2% which we consider too high to foster sustainable economic growth. The poor weather patterns over the last agricultural season resulted in low crop output, particularly that of maize, which induced inflationary pressures. The unyielding rise in world oil prices on account of high demand from China and India, due to high economic activity, disruptions in supply, arising from war in the Middle East, as well as processing capacity constraints in many oil consuming countries have also caused a general rise in the domestic prices of petroleum products thereby increasing the cost of domestic production.

In order to moderate the inflationary pressures arising from low crop output, on a sustainable basis, efforts should be directed at diversifying and improving agricultural output away from rain-fed agricultural practices. Government's commitment to increased investment in the agricultural sector is therefore commendable as this should assist in improving the supply of agricultural output, in particular that of food items. This has an important bearing towards reducing consumer food inflation. Similarly, although it is not possible to completely eliminate inflationary pressures stemming from rising world oil prices, efforts are nonetheless needed to moderate their impact on the economy. To this end, such efforts as conserving the use of petroleum products can go a long way in reducing the attendant inflationary pressures.

Allow me now to turn to the issue of interest rates. As you may be aware, interest rates refer to the price of money. Over the last few years the general trend in commercial banks' weighted average lending rates has been largely downwards. As at end-June 2005, the weighted average base lending rate had reduced to 28.6% from 36.2% in January 2004. The fall in lending rates has in large part been induced by a fall in yield rates on Government securities as banks in Zambia have tended to use yield rates as anchors.

However, at the current levels, lending interest rates are too high to contribute to sustainable productive investment. This calls for concerted efforts among other key stakeholders, namely, the Government, commercial banks and the borrowing private sector to continue playing their respective roles effectively to bring about a further reduction in the lending interest rates. It has also to be appreciated that inflation is another major contributing factor to high interest rates as banks set their lending interest rates above the rate of inflation thus the need to reduce the high inflation that has characterised the economy. On our part, we will do all we can, using all monetary instruments at our disposal, to contribute to reducing inflation and therefore, interest rates.

As regards the exchange rate, this refers to the price of one currency in terms of another. In our case, it refers to the relative price of the kwacha against other currencies. The price of the kwacha against other currencies is directly determined by supply and demand conditions in the foreign exchange market and indirectly through the conduct of monetary policy. To improve the operations of the foreign exchange market, the Bank of Zambia developed the broad-based inter-bank foreign exchange system where suppliers (traditional and non-traditional exporters) and users (importers) of foreign exchange can trade transparently.

Following the introduction of this system, there has been a significant improvement in the supply of foreign exchange on the market owing to the confidence in the system by market participants, efficient flow of information among all players and improved external sector performance brought about by increased copper output and unprecedented high world copper prices in recent times. These developments have contributed to the relative stability of the kwacha against major currencies and thus moderating inflationary pressures. In addition, the containment of growth in money supply has contributed to this outcome. Furthermore, the anti-dollarisation campaign that the Bank of Zambia waged some two and half years ago has had an equally important role to play in the observed relative stability of the kwacha against major currencies.

However, continued relative stability of the exchange rate of the kwacha against major currencies is heavily dependent on longer term initiatives for sustained improvement in the supply of foreign exchange. Among these strategies is a sustained increase in export earnings through the stimulation and maintenance of a strong export sector.

**Ladies and Gentlemen**, let me now turn to the other part of the topic, namely, the process of foreign payments. The Bank of Zambia has issued Directives that put limits on cash transactions in foreign exchange with authorised dealers. For instance, bureaux de change cannot transact in excess of US dollars 1,000 or equivalent foreign currency per transaction per day with any one individual. This arises from their primary purpose of being money changers. The corresponding limit for commercial banks is US dollars 5,000 or equivalent foreign currency per transaction per day for account holders and US dollars 1,000 or equivalent foreign currency for non-account holders. It is important to stress that these limits for commercial banks pertain to cash transactions only. Account holders and non-account holders alike wishing to transact above these limits can do so by choosing other modes of payments, such as, direct transfers, drafts, etc.

Any remittance in excess of US dollars 5,000 has to be channelled through commercial banks and the person remitting the funds is required to support the transaction with appropriate documentation for statistical purposes, as well as guarding against money laundering and financing of terrorism.

The convenience of making foreign payments from Kwacha bank accounts has also been improved by introduction of new products. One such product is the VISA based electronic debit card where holders of such cards can access their kwacha balances from anywhere in the world where the card is accepted. This has not only reduced the need for people to carry huge amounts of foreign currency but also has made the kwacha a truly convertible currency. All these innovations have come about because of the relative stability of the exchange rate of the Kwacha against major currencies.

**Ladies and Gentlemen,** in conclusion, I wish to emphasise that the role of the Bank of Zambia is to formulate and implement monetary and supervisory policies that will ensure price and financial system stability. We are committed to playing our part and will do all that is necessary to make an effective contribution to a stable macroeconomic environment. In this regard, I call upon all other stakeholders including Your Excellencies to promote and support these positive efforts in the countries of your accreditation. I hope you found my short presentation useful in understanding the conduct of monetary policy and the role that the Bank of Zambia plays.

I thank you.