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## INTRODUCTION AND BACKGROUND

- 1 Traditionally, the primary mandate of a Central Bank has been that of ensuring price and financial stability, a key prerequisite for financial intermediation, economic growth and sustainable development.
- 2 The singular price stability focus of many Central Banks, particularly in many developed and newly industrialized countries is premised on the submission that low and stable inflation guarantees sustained savings and investment for economic growth.
- 3 The Government of Zimbabwe, by an Act of Statute conferred the following functions on the Reserve Bank of Zimbabwe;
  - i) Monetary policy formulation and implementation;
  - ii) Regulating and supervising the banking industry;
  - iii) Issue of bank notes and coins;
  - iv) Custodian of gold and other foreign assets;
  - v) Banker and advisor to the Government; and
  - vi) Banker's bank and lender of last resort.
- 4 Monetary policy relates to Central Bank's activities in the economy to influence the price and quantity of money in pursuit of the primary goal of price stability. Therefore, monetary policy formulation and implementation is the pinnacle of all functions performed by the Central Bank.

### Monetary Policy Formulation and Implementation

- 5 The overriding objective of monetary policy is to maintain the domestic money supply at levels consistent with the increase in the overall economic productivity under conditions of low and stable inflation.
- 6 High and variable inflation impairs business planning, dislocates financial intermediation and has a catalytic role in fermenting non-productive, speculative activities.
- 7 The Central Bank has at its disposal a number of tools to influence the level of overall

bank lending in the economy. These include interest rate policy, statutory reserve ratios, open market operations and moral suasion.

- 8 The Central Bank also uses monetary policy to control the flow of money and credit in the economy to attain the desired inflation and economic growth levels.

### **Regulating and Supervising the Banking Industry**

- 9 Banking Supervision aims at regulating and supervising the banking system in order to promote a safe, sound, stable and efficient banking system.
- 10 Monetary and financial stability are intertwined and mutually reinforcing and together with an efficient National Payment System (NPS), constitute critical pillars for financial intermediation and growth.

### **National Payment System**

- 11 The Central Bank is also mandated to ensure a smooth and efficient NPS, as part of ensuring financial stability. An efficient NPS is at the heart of settling inter-party indebtedness.

### **Issuer of Bank Notes and Coins**

- 12 The Central Bank is the sole issuer of bank notes and coin. It has the mandate of determining the level of notes and coin in circulation depending on the cash demands of the economy.

### **Custodian of Gold and Other Foreign Assets**

- 13 The Central Bank also acts as a custodian of gold and other foreign assets such as foreign exchange, the objective being to regulate foreign exchange out-flows and preservation of foreign exchange reserves.

### **Banker and Advisor to Government**

- 14 The Central Bank offers banking services such as handling accounts and gives short-term advances to Government. Besides being a banker to Government, the Central Bank also gives advice to Government.
- 15 The Bank also manages the Government debt, acts as registrar of government stock and conducts Treasury bill tenders on behalf of Government.

### **PARADIGM SHIFT IN CENTRAL BANKING**

- 16 Monetary policy, as much as fiscal policy, plays a central role in economic development. The ultimate role of monetary policy in the process of economic recovery and development is to create a stable macroeconomic environment.
- 17 Accordingly, under a stable economic environment, orthodox Central Banking and monetary policy are founded on the doctrine of instrumental monetary policy to achieve price and financial stability.
- 18 Recent global and domestic economic developments have, however, occasioned a shift in the Central Bank's traditional roles. Where an economy, is experiencing persistent real shocks, monetary policy may be required to do more, taking into account the contextual factors affecting a particular country.
- 19 In the case of Zimbabwe, the country is operating under sanctions as well as sectoral challenges that have created frictional rigidities in the economy.
- 20 Against this background, Monetary Authorities took a position that monetary policy must not be neutral to economic growth and development. The Central Bank adopted a deliberate policy to stimulate productive activities by providing concessional financing to key sectors of the economy.

## JUSTIFICATION OF THE RESERVE BANK OF ZIMBABWE'S INTERVENTIONS

- 21 The Zimbabwean economy has been facing multilayered extraordinary challenges since 2000, following the inception of the Land Reform Programme to correct historical land imbalances. These include illegal sanctions imposed on the country, suspension of balance of payments support, withdrawal of life line projects funding, credit and humanitarian assistance, droughts and rising international oil prices.
- 22 The country has increasingly been relying on the resilience of its economy and the people to mitigate against both natural and man-made exogenous shocks to the economy.
- 23 The Reserve Bank had to put in place extra ordinary and innovative measures and interventions to stimulate economic activity, ensure food self sufficiency, stabilize energy supplies, arrest further economic decline and rein in on inflation.

### Impact of Illegal Sanctions

- 24 The imposition of illegal sanctions against Zimbabwe has crippled the operations of industry, resulting in shrinking GDP with far reaching effects on the majority of the populace.
- 25 The sanctions underpinned to the withdrawal of balance of payments support and donor funding resulted in the closure and suspension of on-going projects which were sustained through external sources of finance.
- 26 In addition, restricted access to foreign lines of credit to finance external trade has constrained the country's foreign exchange generating capacity. This has resulted in severe foreign exchange shortages.
- 27 The severe foreign currency shortages faced by the country constrain economic activity. Key sectors of the economy, such as mining and manufacturing rely heavily on imported inputs for their daily operations.
- 28 The protracted foreign currency shortages, therefore, affected the operations of commerce and in some cases operations have been either scaled down or brought to a halt.
- 29 Consequently, productive sectors of the economy are operating at between 30-40% capacity, resulting in rising per unit costs of production, with pass-on effects on inflation.

### **Increasing Oil Prices**

- 30 The sharp increase in international oil prices from US\$54.59 per barrel in January 2007 to around US\$117 per barrel in April 2008, exerted upward pressure on domestic inflation.
- 31 The increases in oil prices worsened the country's terms of trade thus negatively impacting on its foreign currency reserves.

### **Impact of Drought**

- 32 Zimbabwe has been and continues to face recurring droughts. The droughts have had devastating effects on the country in the form of food shortages.
- 33 This necessitated importation of grain by the Bank to improve the country's food security situation.

### **The Land Reform Programme**

- 34 During the allocative years of the Land Reform Exercise, newly resettled farmers, inherited obsolete and less productive farm equipment.
- 35 The dwindling and unreliable stock of equipment had adverse effect on farm productivity and agricultural output.
- 36 Against this background, the Reserve Bank in close collaboration with Government, embarked on a phased farm mechanization program, to consolidate the gains of the Land Reform. The programme necessitated outlays of resources by the Reserve Bank.

### **Arresting Economic Meltdown**

- 37 Since 2000, the economy of Zimbabwe has faced consecutive declines. Against this background, the Central Bank inevitably had to intervene to avoid further economic meltdown.
- 38 Pursuant to this, the Bank had to take extra ordinary and innovative measures to improve the availability of fuel and energy, spare parts and capital components, chemicals and equipment as ways of stimulating economic activity.
- 39 Accordingly, the Reserve Bank instituted a package of comprehensive and mutually

reinforcing measures geared at arresting further economic decline and re-orient the economy on a sustainable growth and development path.

- 40 The Central Bank made various interventions in the key sectors of the economy to evoke a positive supply side response. These interventions were adopted to buttress the effectiveness of traditional monetary policy instruments, which could not single handedly yield the desired outcome.
- 41 In the endeavor to turnaround the economic fortunes of Zimbabwe, the Central Bank was closely guided by the provisions of the Reserve Bank of Zimbabwe Act, and undertook economy-wide interventions to save local authorities, public enterprises and agriculture from imminent collapse.
- 42 Indeed, the fact that these vital arteries of the economy are still functioning is testimony to the efficacy of the Central Bank efforts.

### **ECONOMIC INTERVENTION FACILITIES INTRODUCED BY THE BANK**

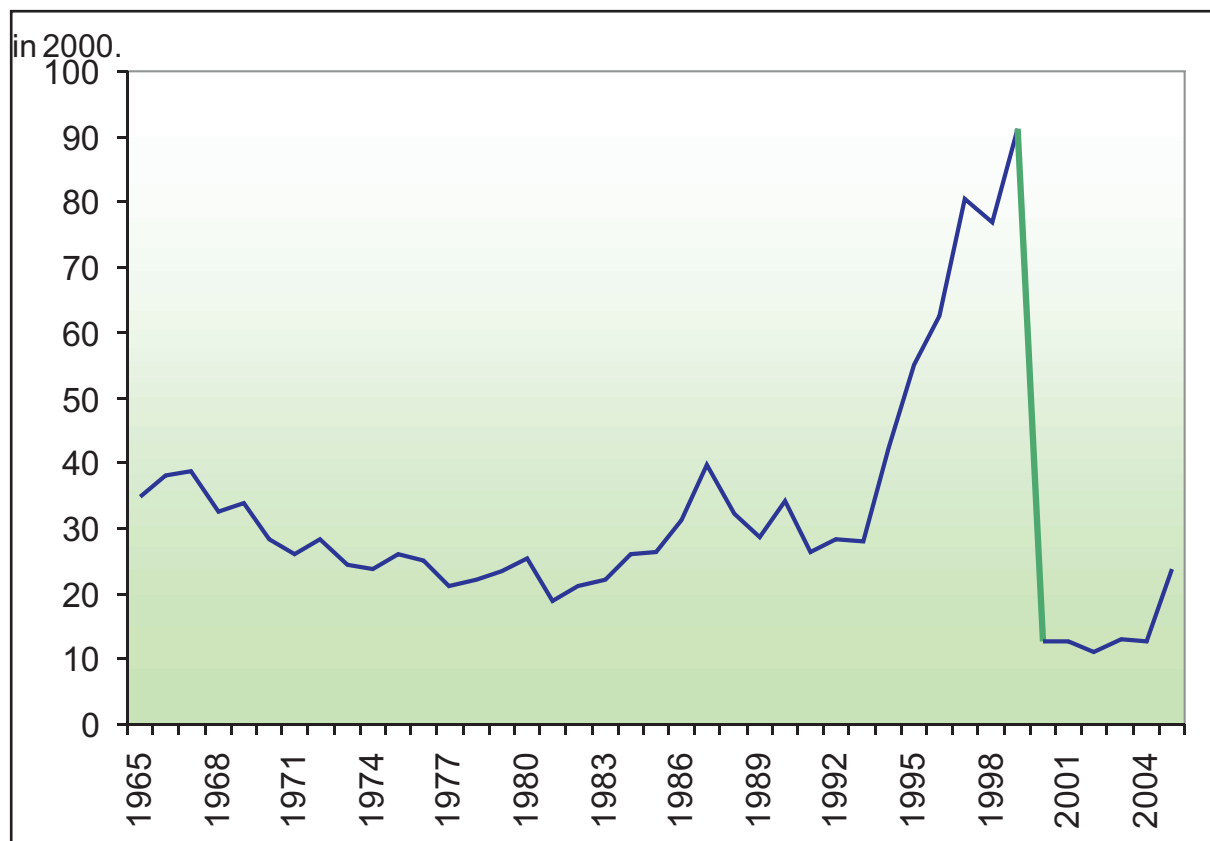
- 43 Pursuant to the economic challenges facing the country, the Reserve Bank had to take extra ordinary and innovative measures since 2004, in order to stimulate economic activity, ensure food self sufficiency, stabilize energy supplies, arrest further economic decline and reign in on inflation.

#### **Productive Sector Facility (PSF)**

- 44 The Productive Sector Finance Facility (PSF) was introduced in December 2003 to assist companies in all sectors of the economy, in a bid to boost production.
- 45 Funding for PSF was the statutory reserves and the level of these reserves provided the threshold of the facility.
- 46 In 2004, PSF, managed to improve productivity in most sectors of the economy, however, the gains were reversed by negative developments such as drought, declared and undeclared sanctions and lack of balance of payments support.

#### **Agriculture Sector Productivity Enhancement Facility (ASPEF)**

- 47 Agriculture Sector Productivity Enhancement Facility (ASPEF) was introduced in June 2005, largely to resuscitate the sector which had been negatively affected by the reluctance of banks to lend to the sector after the implementation of the Agrarian Reform



48 The Graph above shows the immediate collapse of commercial bank financing of agriculture following the Land Reform in 2000.

### Objectives of ASPEF

- 49 The broad objectives of the facility are: -
- i. To provide low cost funding to targeted primary producers in the agricultural sector;
  - ii. To enhance capacity utilization, infrastructure development and output from the agricultural sector;
  - iii. To ensure food security and enable import substitution; and
  - iv. To generate foreign currency.

### Farm Mechanization Programme

50 The desire to cement the gains of the Land Reform Program on the backdrop of declining productivity on farms, due to a dwindling and unreliable stock of equipment forced the Government, through the Reserve Bank, to swiftly and radically transform the agricultural landscape.



- 51 In pursuit of this aspiration, The Bank unveiled a multi-phased Farm Mechanisation Programme on the 11th June to boost the country's agriculture equipment. The thrust of the programme entailed the procurement of all inclusive farming equipment targeted at mechanizing both communal and commercial farmers.

### **Support to Small-Holder Farmers**

- 52 In addition to the power-driven mechanization programmes, greater emphasis under Phase II has been put on capacitating small holder farmers that is A1 and communal farmers, through availing animal drawn implements.
- 53 Under the Animal Drawn Equipment Programme the target is to distribute the following implements:
- 100 000 ox-drawn ploughs;
  - 100 000 ox-drawn planters;
  - 100 000 ox-drawn harrows;
  - 100 000 cultivators;
  - 100 000 scotch carts; and
  - 100 000 portable fumigation tanks.

### **PARASTATALS AND LOCAL AUTHORITIES REORIENTATION PROGRAM (PLARP)**

- 54 PLARP was put in place in January 2005, with the objective of removing structural and supply rigidities which were being experienced by parastatals and other public enterprises.
- 55 The intervention of the Central Bank was meant to assist these institutions in designing and implementing strategies for addressing the operational and financial challenges.
- 56 In this regard the Central Bank sought to ease working capital constraints through measures that include the following:
- i. Paying off expensive overdraft in order to reduce interest costs;
  - ii. Paying off creditors in order to normalize relations with key suppliers; and
  - iii. Financing outstanding maintenance work in order to increase output.
- 57 The facility improved operational capacities of some parastatals and local authorities.

### Ensuring Food Self-Sufficiency

- 58 To buttress Government efforts towards ensuring the attainment of food self sufficiency, the Reserve Bank extended special support to agriculture through Operation Maguta/Inala.

#### Operation Maguta

- 59 Operation Maguta/Inala, which was launched in September 2005, has so far received a total of \$3.038 trillion in support of winter and summer crop programmes.
- 60 The table below gives a breakdown of the amounts disbursed.

#### Summary of Disbursements to Operation Maguta

Facility	Amount Disbursed (\$m)
2005/2006 Summer Programme	559.05
2006 Winter Wheat	3 683.05
2006/2007 Summer Programme	101 200.00
2007/2008 Summer Programme	2 933 326.63
<b>Total</b>	<b>3 038 768.73</b>

#### IMPORT PARITY PRICE FOR FOOD CROPS

- 61 In an effort to curtail food imports, promote food self-sufficiency and ensure viability of local farmers, the Reserve Bank set up a facility to pay import parity prices to farmers.
- 62 The facility gives farmers an option to be paid 100% in local currency, or to receive 50% in local currency and the other 50% in foreign currency of the prevailing international prices.

### **Maize Delivery Bonus Scheme**

- 63 The Maize Delivery Bonus Scheme was introduced in an effort to promote the viability of maize farmers and redirecting maize deliveries from the parallel market to the official system.
- 64 The twin benefits of the scheme are to sufficiently reward farmers, while at the same time encouraging them to deliver their maize to GMB.

### **Troubled Bank Fund**

- 65 Prior to January 2004, a number of banking institutions indulged in non-core banking activities involving speculative investments in non-liquid and non-financial assets.
- 66 Consequently, some banks experienced liquidity distress arising from asset and liability mismatches.
- 67 Commencing January 2004, the Reserve Bank of Zimbabwe embarked on an exercise to return the situation to normalcy in an effort to stabilize the financial sector.
- 68 The liquidity crisis culminated in two (2) institutions being liquidated and eight (8) being placed under curatorship.
- 69 To deal with the liquidity crunch and in exercising its lender of last resort function, the Central Bank introduced the Troubled Bank Fund to assist distressed and solvent banking institutions with temporary liquidity support.

### **Basic Commodities Supply Side Intervention Facility (BACOSSI)**

- 70 During the second quarter of 2007 business wantonly increased the prices of goods and services almost on a daily basis, despite having made a commitment to the Social Contract. In order to protect consumers, Government was forced to introduce price stabilisation measures in July 2007.
- 71 However, the measures had unintended consequences leading to disappearance of goods from the shops which later reappeared on the parallel market. Manufacturers also faced viability challenges making it difficult for them to produce goods.
- 72 This prompted the Reserve Bank to put in place the Basic Commodities Supply-Side Intervention Facility (BACOSSI), under which primary, secondary and tertiary producers

and suppliers in targeted key sectors have access to concessional production-linked financial support for working capital requirements, has been specifically dedicated for evoking positive supply responses.

## **SPECIAL PROJECTS**

- 73 The scarcity of foreign currency in the country led the Central Bank to intervene and play an allocative role to make sure that the critical sectors of the economy are not starved. The critical areas in which the central bank intervened include the fertilizer industry, drugs, fuel, agrochemicals, maize, seed maize and electricity.

### **Strategic Imports**

- 74 The gap between local production and increasing annual demand for fertiliser currently estimated at 500 000 mt for Compound D and 500 000 mt for Urea has increased over the years.
- 75 As a result, substantial measures to close the gap became necessary. In this regard, the Central Bank has facilitated the importation of fertilisers and inputs from reputable and competitive suppliers with proven delivery capacity.

### **Maize Imports**

- 76 Up to December 2007, over 394 566 metric tonnes of maize had been imported through the Grain Marketing Board, from Zambia, Malawi and South Africa.

### **Seed Maize**

- 77 Over the years seed production has been below the national annual seed maize requirement resulting in shortfalls.
- 78 To complement local production, seed houses, PANNAR and SEEDCO have been importing seed maize from the region. This, however, was not sufficient to cover for the total annual seed requirement.
- 79 To further complement efforts of local seed companies, the RBZ intervened to boost the availability of seed on the local market.
- 80 In 2007, the Bank facilitated the importation of over 16 000 mt of maize seed, most of which was received by PANNAR and SEEDCO during the last quarter of 2007.

### **Wheat Imports**

- 81 In 2007, wheat production was estimated at 144 000 metric tones against the national annual requirement of 500 000 metric tones. The deficit in wheat production was met by imports through credit facilities sourced from various suppliers.
- 82 A total of 55 541 metric tonnes had been received by the Grain Marketing Board between January and December 2007.

### **Electricity Imports**

- 83 The Zimbabwe Electricity Supply Authority faced challenges, which were threatening the supply system of imported electricity to the country. The Government, in a bid to avert disaster, intervened by extending support to ZESA.
- 84 The Government, however, spent less on electricity in 2007, compared to 2006. Payments for electricity, through the Central Bank, totaled US\$48.4 million in 2007. This was a 42.6 % decline on the year 2006 payments of US\$84.3 million.

### **Fuel Imports**

- 85 Zimbabwe is a non-oil producing country and over the years, the country has been failing to provide enough fuel for national requirements.
- 86 In order to address this, the Bank secured lines of credit and structured facilities with several friendly suppliers on winwin terms and conditions to ensure a constant flow of fuel supplies to the country.

### **Bio-Diesel Project**

- 87 In order to ensure the full utilization of the distributed engine driven farm implements and reduce the country's dependency on imported fuel, the Central Bank commissioned a Bio-diesel plant in 2007. The plant has a capacity of 100 000 litres of bio-diesel per annum and is the first of its kind in Africa.
- 88 The bio-diesel project is expected to reduce the country's fuel imports by US\$80 million and restrain the inflationary pressures in the economy.

### **Interventions to Capacitate ZINWA**

- 89 In 2007, the country experienced water challenges occasioned mainly by deteriorating infrastructure, coupled with increasing urban population which could not be supported by the existing capacity. Resultantly, some areas went without water for long periods, posing a health hazard.
- 90 The Bank allocated \$8.5trillion and US\$5.25million for various ZINWA projects.
- 91 As at December 12, 2007 total ZINWA disbursements stood at more than \$4.913 trillion.
- 92 According to ZINWA reports there was a marked improvement in the water delivery in the Northern suburbs of Harare, although persistent power cuts slowed down progress.
- 93 Most Water Catchment areas recorded progress especially in terms of infrastructure improvement. These include, though not limited to Harare, Bulawayo, Gwayi, Manyame, Mazowe, Runde, Mzingwane and Sanyati.

### **Transport Sector Resuscitation**

- 94 In view of the need to expand the constrained and shrinking passenger transport sector, the Reserve Bank of Zimbabwe provided a support window to resuscitate the passenger transport system.
- 95 The project is earmarked to procure 110 maxibuses and 140 minibuses by the first quarter of 2008 and add to the current national fleet size of 397 run by the passenger utility company-Zimbabwe United Passenger Company.
- 96 The RBZ also assisted the National Railways of Zimbabwe in order to improve its operational and financial position.
- 97 These initiatives eased the transport problems and reduced the loss of man hours of production time.

### **Drugs**

- 98 The shortages of foreign currency constrained the availability of drugs at public health institutions compromising the health delivery system.
- 99 In order to ameliorate the situation and improve the availability of drugs, the Bank facilitated a revolving credit facility to the tune of US\$1 million in 2007 for the

procurement of critical medical drugs and consumables by the National Pharmaceutical Company (NATPHARM).

- 100 NATPHARM is the Central Governments' procurement organization that receives and distributes drugs to Government health institutions.

### **Critical Skills Retention Programme**

- 101 The country is threatened by a massive loss of critical skills on grounds of remuneration and inability to afford basic needs.
- 102 The Bank launched the Medical Sector Skills Retention Programme on 28th March 2008. Under the programme, the medical sector got motor vehicles for medical practitioners, ambulances, generators and television sets.
- 103 Construction of garden flats and cluster houses for medical practitioners was also launched.

### **INTERNATIONAL MONETARY FUND CRITICISM TO THE BANK'S ECONOMIC INTERVENTIONS**

- 104 While it has become inevitable that Central Banks can play key roles during extraordinary circumstances, the IMF seems to be opposed to any perceived non-core Central Bank activities.
- 105 Evidence has shown that central banks in the USA and UK have embarked on extraordinary economic interventions that are more or less similar to what the Reserve Bank of Zimbabwe has been doing to rescue the economy from the current challenges.
- 106 The Bretton Woods institutions have, however, been very critical of the Reserve Bank for undertaking rescue interventions in the economy.
- 107 During the 2005 Article IV Consultations, the IMF stated that “the Reserve Bank of Zimbabwe (RBZ) needed to focus on its core function of ensuring price stability and rapidly phase out the many quasi-fiscal activities (QFAs) that fuel money growth and inflation. The quasi-fiscal activities (of the RBZ are increasing the web of controls that

hamper the efficient functioning of the economy". The IMF estimated that the Fiscal Budget deficit, including QFAs exceeded 80% of GDP.

- 108 The IMF Executive Board on September 9, 2005 concluded that "the high rates of money growth that fuelled the triple-digit inflation were mainly due to the sharp increase in the RBZ QFAs during 2004 and the first half of 2005 that have resulted in mounting losses on its balance sheet".
- 109 A Statement by IMF Staff at the Conclusion of the 2006 Article IV Consultation Discussions in Zimbabwe recommended that "Going forward, the key will be first to ensure that sharp cuts are made in real terms in fiscal spending, including quasi-fiscal activity previously undertaken by the RBZ. This will mean that the government should aim to stay within the current 2007 budget envelope.
- 110 The statement also advised the Government to liberalize price controls and impose hard budget constraints on public enterprises, whose losses have been largely responsible for quasi-fiscal activities.
- 111 The IMF in a Working Paper released on 25 April 2007 stated that "Zimbabwe's central bank was technically broke and has tarnished its credibility as the regulator of the country's banking system". The IMF said "the RBZ was inadequately placed to manage the levers of Zimbabwe's financial industry and would need to be recapitalised to regain the confidence of the banking sector".
- 112 The IMF indicated that "the quasi-fiscal losses of the central bank have been financed through money creation or issuance of central bank securities".
- 113 The Bretton Wood institution further stated that "these developments have resulted in an unstable macroeconomic environment that risks hyperinflation, reinforcing the argument in favor of far-reaching and simultaneous reforms in the areas of fiscal, monetary, and exchange rate to restore policy credibility and impose macroeconomic discipline".
- 114 Zimbabwe's Central Bank was accused of driving up inflation in the country by pumping out money to fund a range of Government initiatives not accounted for in the budget. The quasi-fiscal losses of the central bank have been financed through money creation or



issuance of central bank securities, pushing inflation to 2 200 percent in March 2007.

- 115 The IMF highlighted that "these developments have resulted in an unstable macroeconomic environment that risks hyperinflation, reinforcing the argument in favor of far-reaching and simultaneous reforms in the areas of fiscal, monetary, and exchange rate to restore policy credibility and impose macroeconomic discipline".
- 116 The IMF Working Paper by Coorey, Clausen, Funke N, Munoz, and Ould-Abdallah, 2007 highlighted that the creation of FISCORP to carry out QFAs, possibly on a transitory basis, would not address the fundamental issue the massive price and exchange rate distortions and poor governance in the public sector (including public enterprises) that place an unsustainable burden on public finances.
- 117 Munoz, 2007 also highlighted that QFAs have been the main driver of inflation in Zimbabwe and also that the failure to address the continuing central bank quasi-fiscal losses has interfered with both monetary management and the independence and credibility of the RBZ. The Realized quasi-fiscal losses were estimated to have amounted to about 75 percent of GDP in 2006.
- 118 Sonia Munoz, 2007 further notes that the escalation of inflation in Zimbabwe has largely been fuelled by rapid money growth arising from RBZ's QFAs.
- 119 The IMF staff's presentation to the Zimbabwean authorities in December 2007 noted that the quasi-fiscal losses were incurred in connection with activities which go much beyond central banking functions and these include subsidies to public enterprises and exporters; realised exchange losses stemming from multiple currency practices; interest payments on RBZ bills sold to mop up liquidity; and unrealized exchange losses.
- 120 The IMF Staff team in their 2007 Staff visit concluded that Quasi-fiscal activities were at the core of the spiraling up inflation in Zimbabwe.

#### **EXPERIENCES OF OTHER COUNTRIES WITH QUASI-FISCAL INTERVENTIONS UNITED STATES OF AMERICA (USA)**

- 121 The USA has on several occasions resorted to the Central Bank window to address 'deemed' national important extraordinary circumstances. Such 'interventions' lie outside the realm of what the Federal Reserve (FED) normally refers to as 'orthodox'

monetary policy and are not explicitly enshrined in Federal Reserve Bank statutes.

122 The following few examples highlight some of the policies that have been instituted by the FED, which seem contradictory to its usual advice.

### **Financial Crisis of August 2007**

123 In August 2007, there was a worldwide "credit crunch" as subprime mortgage backed securities were discovered in portfolios of banks and hedge funds, particularly in the USA but also in many developed economies. Many lenders stopped offering home equity loans and "stated income" loans.

124 In the U.S, the term subprime in mortgage lending refers to loans that do not meet standard mortgage requirements and these include lending to borrowers with compromised credit quality.

125 The crisis began with the high default rates in the U.S mortgage market.

126 During the initial stages of the crisis the FED, resorted to the traditional interest rate tool to solve the financial turmoil. In response the FED successively lowered interest rates as shown below:

- i. **September 18, 2007:** The Fed lowers interest rates by half a point (0.5%) in an attempt to limit damage to the economy from the **housing and credit crises**.
- ii. **October 31, 2007:** Federal Reserve lowers the federal funds rate by 25 basis points to 4.5%.

127 The USA realized that interest rate is a blunt instrument in monetary policy and can only work under normal conditions.

128 While the purchase of securities through open market operations enabled policymakers to inject liquidity into the financial system, they could not ensure that funds went to the institutions that needed most assistance.

129 Upon this realization, the Federal Reserve on 1st November 2007 injected \$41 billion into the circulation for banks to borrow at a low rate.

- 130 In response to intensifying financial sector problems, Fed officials created new lending procedures in the form of the Term Auction Facility (TAF) and the Primary Dealer Credit Facility (PDCF), and changed their securities lending program creating the Term Securities Lending Facility (TSLF).
- 131 The TAF offers commercial banks funds through an anonymous auction facility that seeks to eliminate the stigma attached to normal discount borrowing. The PDCF extends lending rights from commercial banks to investment banks (technically to the 19 so-called primary dealers with whom the Fed does its daily open market operations).
- 132 The TSLF allows investment banks to borrow Treasury bills, notes and bonds using mortgage-backed securities as collateral. All of these programs offered funding for terms of roughly one month at relatively favourable interest rates.
- 133 It is estimated that by the end of March 2008, the Fed had committed more than half of their nearly \$1 trillion balance sheet to initiatives aimed at restoring financial stability through the following :
- i. \$100 billion to the Term Auction Facility;
  - ii. \$100 billion to 28-day repo of mortgage-backed securities;
  - iii. \$200 billion to the Term Securities Lending Facility;
  - iv. \$36 billion to foreign exchange swaps;
  - v. \$29 billion to a loan to support the sale of Bear Stearns; and
  - vi. \$30 billion so far to the Primary Dealer Credit Facility.

### **Involvement in Capital Markets**

- 134 In order, to consolidate financial stability the FED long regarded the guardian of the nation's banks, has redefined its role to also become protector and overseer of Wall Street. This has resulted in the FED involved deeper into capital markets.
- 135 The FED has also turned into becoming an emergency lender to all of the major investment firms. In so doing, the central bank abandoned 75 years of precedent under which it offered direct backing only to traditional banks.
- 136 The investment firms had borrowed an average of \$33 billion under the program in the first week.

### **Hurricane Katrina and Rita -2005**

- 137 In August 2005, Hurricane Katrina battered the Gulf Coast of the United States and within the month, Hurricane Rita followed, both leaving unprecedented damage. The government, private and voluntary organizations have worked in concert to help rebuild the region.
- 138 At President Bush's request, Congress provided a total of \$16.7 billion in Federal funds under the U.S. Department of Housing and Urban Development's Community Development Block Grants program to help rebuild damaged housing and other infrastructure. This was the largest single housing recovery program in the country's history.

### **Post September 11, 2001 Financing**

- 139 The Federal Reserve was also actively involved after the September 11, 2001 attacks in order to prop lending and improve liquidity in the economy.
- 140 The Federal Reserve responded by supplying abundant liquidity to the banking system and reducing the federal funds rate more than would be expected from levels of output and inflation. The US Federal Reserve added \$38.25 billion to the US banking system, some ten times the daily average. Further cuts in interest rates were also initiated.
- 141 The central bankers of the US, Europe and Japan immediately pumped a total of \$120 billion into the financial system.
- 142 Disbursements were made through discount window loans and open market operations. Funds were supplied to the banking system in unprecedented amounts. The destructive force of the attacks themselves caused severe disruptions to the U.S. banking system, particularly in banks' abilities to send payments.
- 143 These disruptions left some banks unable to execute payments to other banks through the Federal Reserve System's large-value payments system, Fedwire, which in turn resulted in an unexpected shortfall for other banks.
- 144 Accordingly, the actions of the Federal Reserve System were intended to counteract the effects of the unusual distribution of liquidity and the difficulties experienced by the

banking system in distributing liquidity directly.

145 This was not the first time, however, that the Federal Reserve responded quickly and forcefully to unusual conditions in financial markets that threatened to spill over to the real economy. Indeed, the September 11 attacks reminded us that problems in financial markets can disrupt the whole economic system.

### **ENGLAND APRIL 2008**

146 Following in the USA footsteps, the Bank of England (BoE) has unveiled a 50 billion pound mortgage plan in response to a global credit crunch that followed a slump in the U.S subprime mortgage market.

147 The Bank of England, aiming to deal with the contagion of the subprime mortgage crisis, announced a 50 billion pound special liquidity scheme to allow banks to swap illiquid mortgage-backed securities for more liquid British Treasury bills (TBs).

148 Government TBs are considered risk free and highly tradable to banks.

149 The Bank's aim is to facilitate interbank trading and restore normal lending practices which had been subverted by the credit crunch.

150 While improving the liquidity position of the banking system, the scheme raises confidence and instills discipline in financial markets and ensures that the risk of losses on the loans remain with the banks.

151 The BoE will require banks to constantly provide security of significantly greater value than the Treasury bills they have received.

152 In the event of the value of the security falling, the banks would be required to provide more security or return some of the Treasury bills.

153 The scheme provides banks with liquidity, to facilitate lending and support the housing market which is the engine of growth for the British economy.

154 The actions of the BoE, may, however, as is always argued lead to moral hazard problems, where financial institutions may be tempted to assume more risk than is necessary.

## WORLD FOOD PRICES

- 155 Food shortages have now assumed a global dimension; some 73 million people in 78 countries depend on the United Nations World Food Programme (UNWFP).
- 156 According to the UNWFP data 1 out of every 80 person relies on somebody else to provide for basic food requirements.
- 157 Most of these hand outs are taking place in Africa, Asia and Central America, but developed countries are feeling the impact for the first time as well. Rice, corn dairy and poultry products are the worst affected commodities around the globe.
- 158 Multiple factors have been attributed to the global food riots among them being the global rise in fuel prices, which is having a chain-reaction effect through the food production system.
- 159 Right from the cost of input such as fertilizer and seed, through the harvesting and the storage and delivery process. The UNWFP noted weather irregularities across the world as another key factors contributing in the global decrease of productivity.
- 160 In light of rising food prices, food riots have occurred in several African countries namely Burkina Faso, Egypt, Ivory Coast Senegal, South Africa and Morocco. Food riots have been triggered by rise in the costs of basic foodstuffs.
- 161 The Reserve Bank of Zimbabwe has already put in place the following measures that will go a long way in averting devastating effects of the looming food crisis:
- i. Agriculture Sector Productive Enhancement Facility (ASPEF);
  - ii. Irrigation rehabilitation programmes; and
  - iii. Farm Mechanization programme
- 162 In light of a pending global food crisis, the Zimbabwean Government has put in place the above measures to ensure food self sufficiency. These measures are focused on boosting agricultural production, with the foresight on cutting back on food imports.

## CONCLUSION

- 163 Stakeholders across the broad sectors of the economy debate the merits or otherwise of the Reserve Bank interventionist approach to economic management. This is enriching and such debate should be encouraged and nurtured adroitly.
- 164 In the context of Zimbabwe's historical and socio-economic developments, the Bank's approach has prevented a complete economic meltdown and has occasioned business continuity particularly for the key sectors of agriculture, manufacturing and mining.
- 165 The worsening global food crisis makes it a national imperative for all stakeholders to re-align their priorities towards agriculture recovery for food self sufficiency. Going forward countries will increasingly rely on own food reserves, reflecting the inevitable reticence of countries to export key grain cereals ahead of their national requirements.
- 166 The economy presently stands on the watershed the gains of visible interventions over the past four years can now be consolidated through specially designed and appropriately implemented economy-wide macroeconomic reforms to achieve growth and stability.

**RESERVE BANK OF ZIMBABWE**

**24 APRIL 2008**

