PRESS STATEMENT

BY

THE MONETARY POLICY COMMITTEE OF THE RESERVE BANK OF ZIMBABWE

DATE: 29 JANUARY 2014

INTRODUCTION

1. The Monetary Policy Committee (MPC) of the Reserve Bank of Zimbabwe met on Thursday 23 January 2014 to deliberate on the structure of interest rates and proposed yield curve for Zimbabwe.

2. Since the adoption of the multicurrency system in early 2009, the Reserve Bank of Zimbabwe's ability to influence interest rates has been limited.

3. This notwithstanding, the structure of interest rates remain a critical ingredient in achieving sustained economic growth. Interest rates determine the deployment of surplus investable funds to key export and productive sectors of the economy. In essence, the extent to which credit is extended to productive sectors is inextricably bound to developments on the interest rate front, which in turn determine the affordability of loans.

4. Interest rates have a direct bearing on inflation levels since the cost of capital is encapsulated in production costs. In turn, the competitiveness of a country's products, both in the domestic and export markets remain closely related to the evolution of that country's interest rates. Developments on the interest rate front also determine capital flows across international frontiers, as

international investors search for favourable returns to their investments.

5. The persistently high interest rate regime, in the Zimbabwean economy has ignited debate among various stakeholders on the pricing model being used by banks to come up with the interest rate structure. The interest rate structure has turned out to be a doubled edged sword, deterring both borrowers and savers from undertaking transactions in the country's formal banking system.

6. The low deposit rates being offered by banks have conspired with high bank charges to militate against efforts geared at broadening the country's deposit base, from which productive sectors ordinarily tap into. These adverse developments have resulted in banks largely attracting short term and highly volatile deposits while an estimated US$2 billion continue circulating outside the banking system.

7. It is against this background that the MPC deliberated on the need for an appropriate interest rate structure that can be used as a **benchmark** in the country's financial markets. The proposed interest rate structure is derived from both theoretical and empirical literature on yield curve determination.

Current Interest Rate Structure

8. The current interest rate structure in Zimbabwe is distorted as evidenced by the wide disparity between deposit and lending rates. These distortions have been sending mixed signals to the market, as reflected by inconsistencies in the pricing of loans and savings deposits.

9. Lending rates quoted by banks range between 6% and 35% per annum, with most banks quoting average lending rates of around 20%. However, deposit rates range from 0.15% for savings accounts, to 20% for time deposits. The wide disparity between rates in the makert underscores the need for a properly discernable yield curve to guide the market.

Proposed Interest Rate Structure

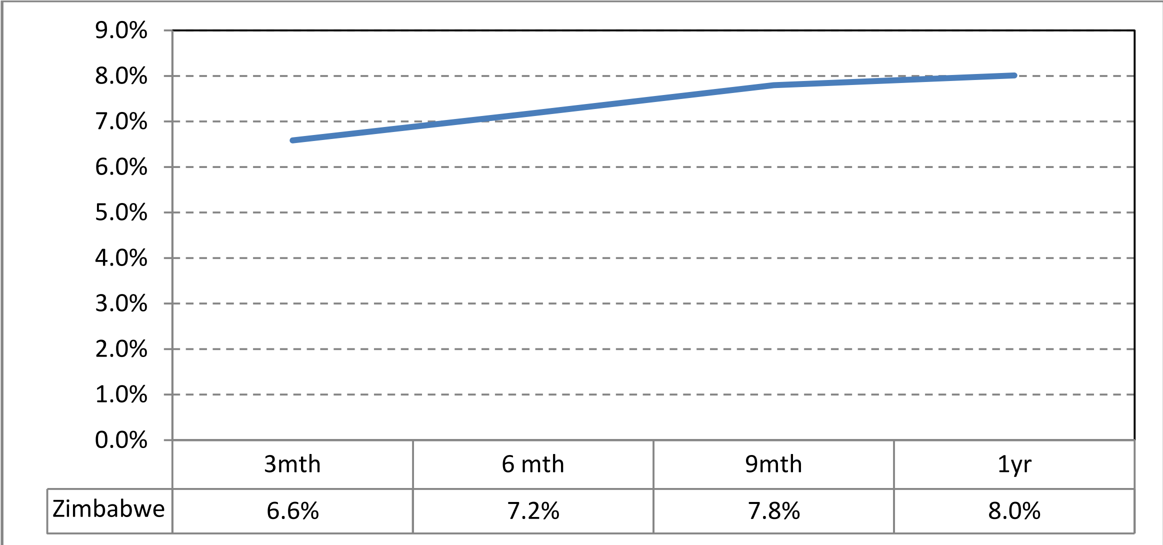
10. Ordinarily, interest rates in an economy should be anchored on a reference policy rate, notably the Central Bank's overnight accommodation rate or the Bank Rate. Under the multicurrency system, however, where the Central Bank has not been performing its Lender of Last Resort (LOLR) function, there has been lack of requisite and potent tools/instruments to influence the levels of interest rates in the market.

11. The recent move by the Government to capacitate the Central Bank to resume its LOLR function is, therefore a welcome development and is envisaged to lower market liquidity risks, by unlocking funds in the inter-bank market.

12. For the inter-bank market to operate smoothly there is need for the availability of acceptable securities to be pledged by the deficit banking institutions. This calls for the issuance of instruments, which qualify as collateral. A yield curve is, therefore, vital in providing guidance on the yield to maturity of such instruments.

13. Accordingly, the proposed yield curve for Zimbabwe shown below combines an appropriate foreign yield curve adjusted for the country's risk premium and inflation developments.

Proposed Yield Curve for Zimbabwe



	3mth	6 mth	9mth	1yr
Zimbabwe	6.6%	7.2%	7.8%	8.0%

14. The proposed indicative yields of 6.6% for 91 day instruments, 7.2% for 180 day instruments and 8% for 365 days (1 year) instruments are envisaged to sanitize the country's interest rate structure which has curtailed deposit and credit growth. This yield curve acts as a guide to the structure of interest rates, especially the Treasury Bill rates.

CONCLUSION

15. At the MPC meeting, the following was agreed upon unanimously:

i. Zimbabwe yield curve is normal, implying that yields are rising as maturity lengthens (i.e., the slope of the yield curve is positive);

ii. The **proposed yield curve can be utilized as a guide** to the direction and structure of interest rates; and

iii. The yield curve **will be adjusted from time to time** in line with macroeconomic developments notably, foreign interest rates, domestic inflation and country risk profile.

DR. C.L. DHLIWAYO

CHAIRPERSON OF THE MONETARY POLICY COMMITTEE AND ACTING GOVERNOR

RESERVE BANK OF ZIMBABWE

END OF STATEMENT