



Enterprise Leadership Service

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URGENT ENGAGEMENT PAPER ON THE DETERIORATING CURRENCY SITUATION

INTRODUCTION

CZI is committed to working with the Government to resolve the economic ills afflicting the nation such as inflation and economic instability. In the past 12 months, the government has made significant progress towards managing inflation and bring price stability from the peak period of July 2020 when annual inflation reached 838%. The government has also made commendable progress in infrastructure investment in the last 12 months with notable funding on dam construction and road infrastructure standing out. However, inflationary pressures and currency instability has persisted to the detriment of economic progress.

Over the years CZI's advice has been premised on the economic principle that there is **no known example** in economic history that has been able to simultaneously control

1. Money Supply
2. Interest Rates
3. Exchange Rates

Getting the price of foreign currency right is a fundamental matter of Zimbabwe's economic development interest.

- An overvalued ZWL broadly undermines the scope for maximizing structural efficiency and the growth of both the export industry and import substitution.
- The policy of maintaining an overvalued ZWL imposes a big tax on the export industry undermining its growth and transparency.
- The policy also unwittingly subsidises imported industrial goods that then start competing unfairly for supermarket space with locally manufactured goods and accelerates deindustrialization.

WHERE WE ARE NOW

CZI believes what we are witnessing on the Zimbabwe Dollar (Z\$) is tantamount to a bank run on the Reserve Bank of Zimbabwe (RBZ). Mervyn King, Governor of the Bank of England famously said that it may not be rational to start a bank run, but it is

rational to participate in one once it has started. The material and all the case studies on bank runs point to **aggressive actions to restore trust** in the institutions affected. Aggressive, transparent and visible actions are the only way to save the Z\$ and stop the bank run.

We are a point where what to do is just as important as what should not be done. Mono currency ZWL without international reserves should not be done as the economy is not ready for mono currency. Foreign currency accounts should not be raided as has happened before with serious consequences of loss of value at all levels of business and society.

HERE IS WHAT WE BELIEVE HAS GONE WRONG

- The Dutch auction was initially implemented according to the rules of the auction which rules were flouted and this is evidenced by the failure of the auction to settle bids and accumulating backlogs stretching over ten-week periods. This means the auction was auctioning money that was not there. Reports of companies having bids being prorated yet they would have submitted high-rate bids are also an indication the Dutch auction rules which state that the highest bidders get all their allotments was flouted. We published and shared a paper highlighting potential pitfalls which was a comparative analysis of auctions that have succeeded or failed, and we have gone on to do what is in the auctions that have failed.
- The result of the above is that we lost the near convergence position that the auction had achieved in the beginning and trust was also lost especially after several promises of clearing the backlog and this is to companies that still trying to find solutions to legacy debt of yesteryear.
- The failure of the auction to stay on track prevented the expansion of the supply side where holders of foreign currency did not

It is important that a balanced approach is taken to bring back the local currency from the brink of rejection that it faces now in the face of exchange rate instability and increasing inflation. We must also by all means avoid the rushed decision to prematurely introduce a mono currency as the consequences of such are known from the recent past. This approach should take the local currency to the point where it is absolutely trusted by both Government and Citizens as the preferred medium of exchange ahead of any other currency and as the most credible store of value of any savings deposited in any commercial or savings bank under RBZ supervision.

We highlight the three main pillars of policy focus that are needed urgently (these are not in the form of SIs, punishments and blame allocation)

1. Restoring trust and credibility of the ZWL by ensuring it is the preferred medium of exchange and a credible store of value.

2. Liberalising the forex market either through immediate reform of the auction to become a true Dutch Auction System in both principle and practice or creating a separate interbank market that has the latitude to discover price or launching a ZSE forex trading counter
3. Immediately embark on the mobilisation of foreign reserves to back to back the local currency before retiring the multi-currency regime.

CHRONOLOGY OF CZI SUBMISSIONS ON CURRENCY STABILISATION

The chronology of our engagements on currency in the most recent past includes the proposals to establish the auction but to run it as a true Dutch Auction alongside papers on the precautions needed. We attach here the paper we submitted when SI127 was promulgated and the comparative analysis of auction systems both of which highlight what has gone wrong with what was supposed to be a transitional but efficient price discovery mechanism to take us to the desired destination of a liberalised foreign exchange market .

- A Comparative Analysis of Auction Systems
- Industry Response to SI127
- Ideas on SDRs

CZI key recommendations to rescue the current situation

1. The auction should be suspended until the backlog is cleared and published as such
2. The Auction requires independent supervision along with the RBZ. This can include a Chartered Accountancy Firm and a professional registered auctioneer. This serves to address the rapid trust injection required to stabilize the Z\$
3. Allow the currency auction to perform a price discovery role for the efficient allocation of foreign currency. This implies true **Dutch Auction Principles** as originally envisaged are implemented. The highest bids get full allocation within the regulated limits. This will curb abuse of the auction by unscrupulous players in the market, as well as eliminate the premiums and discounts being applied on the official rate. It would further increase flows of foreign currency into the formal system through the participation of willing sellers.
4. Auction what is adjudged independently to be available.
5. Foreign currency retentions must be financed through the budget.
6. Banks must encourage exporters to freely set reserve prices and sell their foreign currency on the auction system.
7. Policy must do away with the priority list and liberalise the market.
8. **High level multi-sectoral meeting that must find a solution for agricultural financing. Banks CEO's, RBZ, Ministry of Agriculture and Ministry of Finance must be closed in a room in Vic Falls until they find a solution that removes the burden of funding agriculture on printing money.**

9. Tight control of money supply through holding constant the stock of money circulating in the economy and implementing reserve and broad money targeting.
10. Suspension of all quasi-fiscal activities which have an effect of increasing money supply growth and creating market distortions or arbitrage opportunities

A lasting solution to a stable exchange rate is now long overdue for a stable inflationary environment. A gradual approach is needed to achieve an effective and efficient exchange rate market, as it is not a one size fit all. CZI proposes a true liberalisation of the foreign exchange market where banks act as match makers linking buyers and sellers of foreign currency. The central bank role will only be limited to using monetary policy instruments (adjustment of interest rates, reserve requirements, bank lending levels, open market operations such as treasury bills and selling or buying foreign currency on the market

Benefits of a liberal foreign exchange on economic stability

- It allows for free market price discovery of the exchange rate. This establishes trust in the market and resolves resentment on foreign earnings retention levels.
- It crowds in various holders of foreign currency such as exporters, NGOs, households, and informal sector into the formal economy. There are billions of US Dollars circulating in the informal sector.
- The central bank will concentrate on managing inflation, bring banking sector stability and building reserves from retained foreign currency earnings. This is largely the role of the central bank in most developed or developing nations.
- It curbs the need for the central bank to borrow externally to support the auction system. Zimbabwe's foreign debt levels are already too high and unsustainable.
- It allows commercial banks to earn significant commissions, thus encourage foreign exchange savings and banking of foreign exchange proceeds.
- It guarantees price stability on the local market, provided the central bank reigns in on money supply growth and quasi fiscal operations.

CZI would like to underline their commitment to continuous, progressive, and constructive engagement with government on all economic policy fronts in pursuit of the country's economic growth targets. CZI position on the local currency is that we must **DEFEND OUR CURRENCY** in a multi-currency environment and strengthen the economic fundamentals that support any currency in use. Such fundamentals include prudence in money supply, a market determined or liberal foreign exchange market, foreign exchange reserves and central bank transparency especially on debt and liabilities.

