GOVERNOR'S MEMORANDUM TO FINANCIAL INSTITUTIONS: FINE TUNING OF MONETARY POLICY

SUMMARY OF KEY ISSUES: 9 OCTOBER 2006

Policy Area	Key features	Implications
Financial Sector Stabilization Bond	• The RBZ has introduced a **5-year financial sector stabilization bond, which all licensed institutions will hold as a performing asset, with effect from 16 October 2006.** • Key features of the bond: (a) It is acceptable as collateral for accommodation purposes (b) Its annual coupon rate is variable, as follows: Year 1 500% Year 2 250% Year 3 100% Year 4 25% Year 5 10% (c) Holding thresholds, depend on institutions' balance sheet size as at 30 September 2006, as follows: Commercial Banks 10% Merchant Banks 7.5% Finance Houses 5% Building Societies 5% Discount Houses 5% Asset Management 2.5%	• **LIQUIDITY:** – The bond will immediately withdraw liquidity from the money market, resulting in firming interest rates**.** – With significant amounts of customer deposits being short-dated, the bond is expected to exert adverse pressure on institutions' liquidity mismatch profiles. • **RETURN ON INVESTMENT:** – Depending on the anticipated inflation outlook, investment returns are likely to be negative, at least for the first 12 months. – Notwithstanding, the bond proffers a 5-year policy outlook on interest rates. • **DEBT RESTRUCTURING** – Through the bond, the RBZ effectively restructures financial institutions exposure to the public sector, from short term to long term.
Accommodation and Interest Rate Policy	**With immediate effect. RBZ accommodation rates** increased from: – 300% to 500% for secured accommodation, and – 350% to 600% for unsecured accommodation. ♦ Debts accrued through RBZ accommodation rates are not affected by the "In Duplum rule".	• **BANK LENDING RATES** – Banks' prime lending rates are expected to be reviewed upwards in line with changes in cost of funds. • **SPECULATIVE BORROWING** – The expected up-tick in interest rates is envisaged to discourage speculative borrowing, which unnecessarily feeds into inflation.
Capitalization Requirements	• The RBZ has de-linked minimum capital requirements from the exchange rate.	• **EXPOSURE TO EXCHANGE RISK** – This has effectively reduced bank exposure to open-ended exchange rate risk (especially where exchange rate stability is uncertain).
Statutory Reserves	• No reduction in statutory reserves was announced. • However, the RBZ indicates that they have adopted a policy of successive reduction in statutory reserves. • The RBZ will undertake inspections and audits on financial institutions to detect and punish institutions that were deliberately evading statutory reserve payments.	• **COMPLIANCE** – Compliance to regulations to be tightened as errant behavior attracts punitive action.
Cancellation of Money Transaction Agencies (MTA).	– **With immediate effect** the RBZ has cancelled all MTA licenses. – Existing contractual arrangements between MTA's and Zimbabweans in the Diaspora will be dealt on a case by case basis. – Stakeholders are advised to deal with authorized dealers only i.e. Commercial & Merchant banks and Homelink.	• Minimal impact on foreign exchange flows, as little volumes were transacted through MTAs.

Policy Area	Key features	Implications
<u>Productive Sector Financing Support</u>	– Through moral suasion, the RBZ has indicated the desired levels of banks' lending portfolios by sector *(bracketed figures show position as at 31 July 2006)*: Agriculture 30% *(25%)* Mining. 15% *(3%)* Manufacturing 15% *(11%)* SME's 10% *(0.01%)* Tourism 10% *(5%)* Other Sectors 20% *(55.99%)*	• **CONSUMPTIVE BORROWING** – Overtime, the impact of this policy recommendation is to reduce consumptive borrowing, mainly to the private individual sectors. – The RBZ has threatened to review its moral suasion stance if the industry does not take heed of the recommendations.
<u>Compliance with Cash Withdrawal Limits & Anti-Money Laundering Laws</u>	**Daily Cash Withdrawal limits** ♦ ZWD 100,000 for individuals , ♦ ZWD 750,000 for Corporates. ♦ All high value cash handlers in urban areas (transacting above $ 5 million a day) are required to bank their money on a daily basis. ♦ Banking institutions must report all suspicious transactions to the RBZ. Penalties for any violations will be enforced, including a review of banking licence. **Compliance Certification requirements** ♦ With immediate effect, **<u>Banks' Compliance Record</u>**, discipline and uprightness will be used as a score card for the annual reviews of banking licenses. ♦ With immediate effect all banking institutions will be required to obtain a **<u>Certificate of Compliance</u>** annually before 31 January of each year. This compliance clearance certificate will be included in audit reports to the public. **Zimbabwe Stock Exchange (ZSE) Transactions** • All ZSE transactions above ZWD 50,000 to be done through the ZETSS system (this applies to both individuals and Corporates). • All ZSE transactions, above ZWD 50,000 to be supported by records of the full identity of the investor and relevant ZIMRA tax number. • Limits for which transaction disclosure to the RBZ is required are as follows: – Individuals & Nominees: ZWD 100,000 – Corporates: ZWD 1,000,000	• **CASH WITHDRAWAL LIMITS** – Continued enforcement of cash withdrawal limits is driving the players in the economy to use non-cash payments methods, more frequently. – Banks have recorded increased flows through the ZETTS system. • **COMPLIANCE** – Banks and other stakeholders need to adopt a zero tolerance to money laundering. – This is a global stance against money laundering and financing of terrorism, which requires all to play a part. • **STOCK EXCHANGE** – The ZSE indices are expected to slow down (or retract temporarily), as the new measures take effect.
<u>Other Policy Measures</u>	• Reduced funding to parastatals and local authorities. • Banking institutions urged to play a complementary role in instilling sound financial management systems and corporate governance standards in the parastatal sector as condition for lending. ♦ 10% of all exports to be channeled towards the energy sector. ♦ Export incentives targeted at the top 20% exporters.	• Government commitment paramount. • Holistic approach to macroeconomic problems – complementarity in all policies.