



Promoting the Application of Econometrics

Impact of Liberalization and Monetary Reforms on Exchange Rate Pass-Through in Zambia

Noah Mutoti

April 2026

Abstract

This paper investigates how liberalization and successive monetary reforms reshaped the dynamics of exchange rate pass-through to inflation in Zambia. Using a time-varying parameter error correction model, we find that pass-through was rapid and near-complete in the early 1990s, moderated during the monetary targeting era, and re-emerged as a dominant channel under the interest rate-based regime. While reforms progressively reduced the speed and magnitude of transmission, external shocks continued to exert strong influence through the exchange rate channel. The findings underscore that credibility and reforms can dampen volatility but cannot eliminate vulnerability. Durable price stability requires sustained expectation management, disciplined signalling, and structural diversification.

Introduction

Exchange rate pass-through remains a central challenge for inflation management in emerging economies. Zambia's experience illustrates how liberalization and monetary reforms altered the responsiveness of domestic prices to external shocks. This study traces the

evolution of pass-through across three policy regimes, highlighting the interplay between credibility, expectations, and external dependence.

Phases of Exchange Rate Pass-Through

- **Early Liberalization (1990s):** Pass-through was rapid and forceful, with coefficients close to unity. Exchange rate shocks translated almost immediately into triple-digit inflation, reflecting weak policy credibility, unstable expectations, and structural dependence on imports.
- **Monetary Targeting Era (2000s):** Liberalization initially heightened vulnerability. Around 2006, elasticity rose markedly, amplifying inflation's responsiveness to external volatility. As reforms matured and credibility improved, the coefficient moderated by 2007, showing that exchange rate effects slowed and weakened. Transmission remained present but increasingly contained compared to the turbulence of the early liberalization phase.
- **Interest Rate–Based Regime (2010s–2020s):** Episodes such as the 2015 depreciation and COVID-19 disruptions reignited strong pass-through, momentarily pushing inflation into double digits. This re-emergence underscores that while reforms dampened volatility, external shocks continued to exert dominant influence through the exchange rate channel.

Policy Lessons

1. **Credibility Alone Is Insufficient:** Reforms and improved signalling reduce pass-through intensity but cannot eliminate vulnerability to external shocks.
2. **Expectation Management:** Anchoring expectations through transparent communication and disciplined policy conduct is essential to prevent shocks from destabilizing inflation.
3. **Structural Diversification:** Reducing reliance on imports and commodity exports is critical to limit exposure to exchange rate volatility and foreign price swings.
4. **Adaptive Frameworks:** Policy design must complement credibility gains with flexibility to absorb shocks without allowing them to become entrenched.

Conclusion

Zambia's experience reveals three distinct phases of exchange rate pass-through: pronounced transmission in the early liberalization period, intensified but later moderated vulnerability under monetary targeting, and renewed dominance in the interest rate era. The evidence shows that reforms reshape the dynamics of pass-through by progressively reducing its speed and magnitude, but resilience against external disturbances ultimately depends on credibility, diversification, and adaptive policy frameworks. These lessons hold broader relevance for emerging economies confronting similar external and structural constraints.