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# The Evolving Money–Inflation Nexus in Zambia

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## Abstract

This paper examines Zambia’s inflation dynamics over the past three decades, focusing on the shifting relationship between money growth and inflation. Using a time-varying parameter error correction model, we show that the money–inflation nexus has progressively weakened as reforms deepened and policy credibility improved. While monetary expansion exerted muted influence in the early 1990s, elasticity intensified under monetary targeting before declining sharply with the transition to an interest rate–based regime. The findings highlight that reforms can erode the direct impact of money growth on inflation, but external shocks remain dominant. Durable price stability requires consolidating credibility gains, reinforcing expectation management, and prioritizing exchange rate and foreign price shock mitigation.

## Introduction

Inflation management in Zambia provides a valuable lens into how structural reforms and evolving policy frameworks reshape monetary transmission. The trajectory from weak money–inflation linkages in the early 1990s, through heightened responsiveness under monetary targeting, to near-neutrality in the interest rate–based regime illustrates the interplay between credibility, financial depth, and external vulnerability.

## Evolution of the Money–Inflation Nexus

- **Early 1990s:** Money elasticity hovered just above zero. Monetary expansion had only muted effects on inflation due to structural rigidities, shallow financial markets, and weak central bank credibility.
- **Monetary Targeting (2004–2008):** Elasticity peaked, with money growth translating almost directly into inflationary pressures. Weak anchors and elevated expectations amplified responsiveness, leaving inflation highly vulnerable to monetary shocks.
- **Post-Reform Period (2011 onwards):** As reforms strengthened policy credibility and financial depth, elasticity declined markedly. In the interest rate–based regime, the coefficient stabilized around zero, indicating that money growth ceased to be a dominant driver of inflation.

## Policy Lessons

1. **Credibility Consolidation:** Sustained central bank credibility is essential to weaken the money–inflation nexus and anchor expectations.
2. **Expectation Management:** Transparent communication and disciplined signaling reduce volatility and prevent shocks from becoming entrenched.
3. **Focus on External Shocks:** With money growth no longer a primary driver, exchange rate and foreign price shocks now dominate Zambia’s inflation dynamics. Policy must adapt accordingly.
4. **Resilience through Diversification:** Structural diversification is critical to reduce dependence on imports and commodity exports, thereby limiting exposure to external volatility.

## Conclusion

Zambia’s experience demonstrates that reforms can fundamentally alter inflation transmission mechanisms, diminishing the direct role of money growth. Yet vulnerability to external disturbances persists. Durable price stability requires a coherent blend of credibility, expectation management, and adaptive frameworks that prioritize resilience against exchange rate and foreign price shocks. These lessons extend beyond Zambia, offering insights for other emerging economies navigating similar structural and external constraints.