Caleb M Fundanga: Recent economic developments in Zambia

Speech by Dr Caleb M Fundanga, Governor of the Bank of Zambia, on the occasion of the monthly meeting with chief executive officers of commercial banks, Bank of Zambia, Lusaka, 2 April 2004.

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1. Recent economic developments

Introduction

This brief reviews monetary, economic and financial sector developments during February 2004.

Monetary developments

- During February 2004 monetary policy was focused on reducing monthly overall inflation rate to 1.6%. Net strong revenue inflows complemented with primary auctions of Government securities helped to maintain an appropriate level of liquidity.

Inflation

- Monthly overall inflation slowed down by 1.5 percentage points to 1.1% in February 2004 from 2.6% in January. This was 0.5 percentage points lower than the projection of 1.6% for February 2004. The decrease in the monthly overall inflation rate was attributed to the slow down in food and non-food inflation rates to 0.9% and 1.4% in the month under review from 2.3% and 2.9% in January 2004, respectively.
- The slow down in food inflation was attributed to continued ample supply of food items in the market while the drop in non-food inflation was largely due to price declines in rental and fuel prices as well as in prices of transport and communications, recreational and educational services.
- The annual overall inflation rate fell to 16.8% in February 2004 from 17.4% in January 2004. This was 0.2 percentage points below the end-February 2004 inflation projection of 17.0%. The annual overall inflation at 16.8% was also 6.1 percentage points below the end-February 2003 inflation outturn of 22.9%.

Broad money

- Preliminary data indicate that broad money (M3)[1] growth slowed down to 1.4% (8.4% in December 2003) to K4,530.7 billion in January 2004 from K4,467.9 billion in December 2003. This growth was 1.0 percentage points lower than the 2.4% recorded during the corresponding period in 2003, but was 0.4 percentage points above the programmed money supply growth of 1.0% for the month.
- The growth in broad money during the period under review was largely on account of the increase in net foreign assets of the banking system, which increased by 2.9% to K2,364.9 billion.
- Year-on-year broad money growth on the other hand declined by 1.2 percentage points to 22.2% in January 2004 from 23.4% in December 2003.

Domestic credit

- Preliminary data show that growth in domestic credit slowed down to 2.3% (3.1% in December 2003) to K4,310.9 billion in January 2004 from K4,215.1 billion in December

[1] Broad money is here defined to include currency outside banks, demand deposits at Bank of Zambia and commercial banks, local currency savings and time deposits, and foreign currency deposits.

2003. This was mainly attributed to the decline in borrowing by the public sector to negative 4.0% from 22.5%. In addition, there was a slow down in the growth of Government, private and non-bank financial institutions sectors borrowings to 2.3%, 3.1% and 10.3% in January 2004 from 3.1%, 3.4% and 14.5%, respectively. On a year-on-year basis, domestic credit slowed down by 7.5 percentage points to 40.0%.

- Following the reduction in the statutory reserve ratios on commercial banks' Kwacha and foreign currency deposits to 14.0% from 17.5% on 31st October 2003, commercial banks' total loans and advances increased by 6.6% between October 2003 and January 2004 in nominal terms. Sectors to which most of this lending went with respective percentage increases were: agriculture (12.2%), mining (36.3%) and electricity, gas, water and energy (316.9%). However, credit to the manufacturing sector fell by 18.8% while lending to the transport, storage and communications sector declined by 9.6%.

Interest rates

Yield rates on Treasury bills and Government bonds

- High liquidity levels, coupled with Government's restraint on further borrowings from the market, continued to exert downward pressure on yield rates. The weighted average yield rate for all Treasury bills fell by 3.7 percentage points to 15.5 percent in February. This was driven by declines in the individual yield rates of all Treasury bills.
- Similarly, yield rates on Government bonds further declined, supported by reduced Government borrowing and abundance of liquidity in the market. Thus, the weighted average yield rate for all Government bonds fell to 17.5 percent in February from 22.7 percent in January.

Commercial banks' nominal interest rates

- Consistent with the trend in yield rates on Government securities, all commercial banks' nominal interest rates declined. The weighted average lending base rate (WALBR) and the average lending rate (ALR) declined to 33.7% and 41.3% in February 2004 from 36.2% and 43.9% in January 2003, respectively. The average savings rate for amounts above K100,000 and the 30-day deposit rate for amounts of over K20 million dropped to 7.0% and 11.5% from 7.2% and 15.1% in January 2004, respectively.

Real interest rates

- All real interest rates declined due to the decrease in the rate of inflation and the fall in nominal interest rates. The real WATBR fell by 3.9 percentage points to negative 2.2% in February from 1.7% in January 2004. The real Weighted Average Treasury bill Rate (WALBR) declined by 1.9 percentage points to 16.9% from 18.8%. Similarly, the real 30-day deposit rate for amounts above K20 million fell by 3.0 percentage points to negative 5.3%. However, the real ASR for amounts exceeding K100,000 increased by 0.4 percentage points to negative 9.8%.

Foreign exchange market

- During the review period, the Kwacha remained relatively stable. It gained 0.2 percent against the US dollar to an average of K4,763.99 per US dollar in February. However, the Kwacha weakened against other major traded currencies, depreciating by 2.7 percent against the pound sterling to an average of K8,879.12 per British pound and 1.7 percent against the South African rand to an average of K706.87 per rand. Further, the Kwacha lost 0.5 percent against the euro, moving to an average of K6,025.64 per euro.
- The continued relative stability in the Kwacha vis-à-vis other currencies was partly explained by the well-functioning broad based interbank foreign exchange system, which has thus far led to an efficient flow of information in the foreign exchange market since its inception in July 2003. In addition, the fall in the value of merchandise imports, coupled with the rise in the value of exports during the month of January 2004, contributed to the observed relative stability in the foreign exchange market in February 2004.

Real sector developments

Agriculture

- As at 29th February 2004, the Food Reserve Agency (FRA) had purchased a cumulative total of 54,773.15 metric tonnes (mt) of maize compared with 54,598.57 metric tonnes (mt) of maize purchases at the end of January 2004. The highest amount purchased was from Eastern Province, 16,052.55 mt followed by 11,935.0 mt from Southern Province. The rest of the purchases were from Central (9,026.15 mt), Northern (8,824.75 mt), North-western (3,100.15 mt), Luapula (2,561.85 mt), Lusaka (2,381.50 mt), Western (498.80 mt) and Copperbelt (392.40 mt) provinces.
- As at 29th February 2004, major milling companies in the country had an estimated maize stock of 58,620.0 mt compared with 74,224.0 mt recorded at end-January 2004. Of this, Lusaka Province was holding 28,670.0 mt, Copperbelt (16,200.0 mt), Southern Province (6,650.0 mt), Central Province (6,000.0 mt), Northern Province (1,000.0 mt), and Eastern Province (1,000.0 mt).
- Millers' average purchase price for maize rose by about 7% to K35,967.0 per 50kg bag in February 2004 from K33,599.50 per 50kg bag in January 2004, mainly due to seasonal movements, as the 2003/2004 consumption period is about to come to an end.

Mining[2]

- Total copper production declined by 4.8% to 31,764.00 mt in January 2004 from 33,369 mt in December 2003. Copper output fell as a result of reduced production at all major mines arising from seasonal factors in the rainy season.
- Similarly, cobalt output declined by 6.8% to 171.50 mt from 184.00 mt in the previous month. There was no cobalt production at one of the major mines during the period under review on account of higher processing charges, given low quantities of cobalt that were available for processing. The downward movement in production was a result of seasonal considerations as the mines become waterlogged during the rainy season.

Tourism[3][4]

International passenger movement

- During February 2004, the country's four international airports[5] recorded reduced international passenger movements. International arrivals at these airports declined by 3.0% to17,733 from 18,279 in January 2004. At 18,637, departures were 2.9% above the 18,104 recorded in the previous month.
- Of the total international arrivals, Livingstone and Mfuwe Airports, which are the major tourist destinations, accounted for 3,530 and 102, respectively. This was an improvement from the 3,110 and 36 recorded the previous month, respectively. The increase in international arrivals at these two airports was mainly on account of continued marketing in the tourism sector. Livingstone posted 3,782 departures during the reviewed month compared to 3,424, while Mfuwe recorded 106 departures against 31 in January 2004.

External sector developments

- Preliminary data indicate that the country's trade deficit narrowed to minus US $19.8 million in January 2004 from minus US $45.3 million in December 2003, mainly due to a decrease in the value of imports.

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[2] Mining production figures reported with a one-month lag.

[3] International arrivals are being used as a proxy for tourism.

[4] Tourist peak period is March to July.

[5] Lusaka, Ndola, Livingstone and Mfuwe.

- Total merchandise imports declined by 15.1% to $121.0 million in January 2004 from US $142.5 million in December 2003. The fall in imports was mainly attributed to the decline in the imports of food items (40%), fertilisers (19%), chemicals (21%), plastic and rubber products (40%), iron and steel items (48.6%), nuclear reactors and equipment (31%), and electrical machinery and equipment (52%).
- On the other hand, merchandise exports increased by 4.1% to US $101.2 million in January 2004 from US $97.2 million in December 2003. The increase in copper export receipts was on account of the rise in both the volume of copper exports by 2.1% to 30,076 metric tons in January 2004 from 29,449 metric tons in December 2003, and an increase in realised prices by 5.5% to 96 cents per pound in January 2004 from 91 cents per pound in December 2003.
- However, cobalt export receipts decreased following the decline in the sales volume by 42.9% to 131.8 metric tons in January from 230.9 metric tons in December 2003. Cobalt realised prices, on the other hand, increased by 46.6% to US $22.08 per pound in January 2004 from US $15.06 in December 2003.
- Non-metal export earnings increased by 1.6% to US $31.0 million in January 2004 compared with US $30.4 million realised in December 2003. The major non-traditional export items that contributed to the rise in export receipts in January 2004 were burley tobacco, cement, cotton lint and sugar.

2. Developments in the financial sector

Banking sector

Overview of financial performance of the banking sector

- On the basis of capital adequacy, asset quality, earnings performance and liquidity, the overall financial condition and performance of the banking industry during the month of February was satisfactory.
- The industry's net worth position increased by 3.2% to K639,660 million from K619,955 million in January. The sector also continued to be adequately capitalised. All banks met their minimum regulatory capital requirements in the month under review.
- The asset quality in the month under review was satisfactory, with the level of interest earning assets accounting for 77% of total assets compared to 76% for the preceding month.
- The sector's income before tax amounted to K48,206 million compared to K23,897 million recorded in January. The 100% increase in profit before tax was mainly on account of the following: interest income, which increased by K58,497 million or 93% compared to K11,813 million or 82% increase in interest expenses. Additionally, foreign exchange income in gains and commissions increased by 100% from K30,291 million to K60,857 million. Non-interest expenses increased to K 104,869 million compared to K52,916 million in January 2004. However, the ratio of non-interest expenses to total net income remained at 69%.
- The banking sector's liquidity position was satisfactory with the liquidity ratio (liquid assets to total deposits and short-term liabilities) remaining constant at 75%. All banks met the prudential minimum ratio of 50%. The deposit concentration at 28% from 31% in January was also well spread. Total deposits to total assets dropped to 71% from 73% in January.

Money laundering draft directives

- On 18 March 2004, the BoZ held a consultative workshop with financial institutions, to discuss the draft Money Laundering Directives. Valuable contributions to clarify or strengthen the draft Directives at this well attended workshop were received. The BoZ is now in the process of finalising the said directives.

ESAF/SADC Bank Supervision Application project

- The implementation of the BSA project has reached an advanced stage. It is expected that the implementation will be completed by end of April. The consultants are finalising the returns that will be used for submission of data. The finalised returns, in the form of a workbook will be circulated to all the banks. In the meantime, the BoZ would like to thank the five banks (Barclays Bank, Stanbic Bank, Cavmont Capital Bank, Investrust Bank and African Banking Corporation) that submitted test data for finalising the returns. The BoZ will be calling on the banks to take part in the testing of the electronic submission of data.

Non-bank financial institutions sector

- The performance of the non-bank financial institutions sector was generally satisfactory although some institutions were still faced with financial distress. The Bank of Zambia is addressing the problems of distressed financial institutions within the framework of the Financial Sector Development Plan.

3. Announcements and areas of concern

Update on the Financial Sector Development Plan (FSDP)

- The BoZ is seeking comments from the public and other stakeholders on the FSDP which was placed on the BoZ website on 6 February 2004. The last day for submission of comments is 31 March 2004. A National Forum to discuss the FSDP is scheduled for April 2004. Further details on the Forum will be advised in due course.

Update on the microfinance regulations

- The draft microfinance regulations, which are aimed at providing a legal framework for regulation and supervision of microfinance institutions, are currently being reviewed by the BoZ and are scheduled to be submitted to the Minister of Finance and National Planning during the second quarter of 2004.

Polymer notes

- As most of you must have heard, through the media, there are public concerns about some features fading on the polymer banknotes of K500 and K1,000. While we have also noticed a number of them, we wish to inform you that fading is a definite and expected feature of these notes as they approach the end of their useful life. However, we also feel that being a new concept, the notes could still be subjected to undue stress testing due to public curiosity. However, we are also not ruling out premature wearing of the notes. We are therefore doing everything possible to ensure that subsequent consignments do not suffer similar setbacks. In the meantime, we wish to make an earnest appeal to all the banks to assist the Bank of Zambia in ensuring that faded notes are quickly taken out of circulation, in the same way as soiled banknotes have been handled in the past. The Bank of Zambia is also going to set up mechanisms for enhancing the process and pace of siphoning faded notes from circulation.

International Fund for Agricultural Development Mission

- An International Fund for Agricultural Development (IFAD) Mission was in the country to solicit comments on the Rural Finance Programme Inception Report of November 2003 on the development of rural finance. The major findings were that the Inception Report provided the basis for the provision of rural finance, however, it was noted that the report was limited in scope and was too focused on creating an enabling environment for the provision of rural finance. In addition, the report lacked concrete initiatives for rural finance. In view of this, the Mission proposed the following interventions:
    - Support of community based financial institutions;
    - Rural banking;

    - Credit facility for contract farming operations;
    - Innovation and outreach facility; and
    - Policy, legislative and management support.
- As a way forward, the Mission agreed to complete a draft formulation report by end-April 2004, hold a stakeholders' workshop by end-May 2004 and finalise the formulation report by end-June 2004. The programme appraisal would be conducted by end-September 2004.

AFRACA Workshop

- A workshop was held in South Africa under the auspices of AFRACA. A number of issues came up but a particular one we would like to encourage in our market is the linked banking. This involves commercial banks entering into arrangements with other institutions, such as, microfinance institutions to extend some form of banking services even to outlying areas. We feel that linked banking provides an opportunity to improve the intermediation role that banks play in an economy. Our Non-Bank Financial Institutions Department will be happy to provide more information on this and other innovative approaches to provision of rural financial services discussed at the said workshop.

Update on ZIPSS-RTGS implementation

- The Project ZIPSS-RTGS implementation team has successfully undertaken the following activities within the project time frame:
    - Development of RTGS policy/position papers;
    - Delivery, installation of BOZ RTGS hardware and software;
    - Conducting of training for BOZ business and IT staff;
    - Conducting of both Business and Technical Functional Tests of BOZ RTGS; and
    - Inspection of Commercial Banks readiness in terms of hardware and SWIFT connectivity.
- It is important to note that these activities are critical for the successful delivery of the systems within the agreed time and budget. Commercial Banks are therefore urged to ensure that their banks are ready for the next phase which directly affects them. The Implementation Team has put in extra efforts to assist commercial banks to ensure that they are ready within the agreed time frames. Given the importance of the RTGS system, commercial banks must ensure that whatever solution they go for does not compromise reliability, availability, speed and security of the system.

On-site examination of commercial bank's readiness

- The Bank of Zambia on-site examination for commercial banks' readiness commenced as planned on 22 March 2004. Preliminary indications are that the majority of the banks were ready for the installation of the RTGS application software on 29 March 2004. The installation of the software is being done in a phased manner, i.e. on first-ready-first installed basis. This is to ensure that the project schedule is not held back unnecessarily.
- It is also important to remind all banks that every bank is required to comply with the minimum technical infrastructure specifications for both the Perago RTGS client configuration and SWIFT connectivity prior to the installation of the application software. This will enable timely installation of the Perago RTGS application software, bilateral key exchange (BKE) for SWIFT connectivity and commencement of the pilot project.

RTGS training for commercial bank staff

- The RTGS training facilities have been installed, tested and are currently running in the Bank of Zambia In-Service Training Centre. Training for the Bank of Zambia staff has been finalised. Training for commercial bank staff is scheduled to commence on 16 April 2004. This training will involve Perago RTGS Server Applications Technical Operations Training for the IT area staff and Perago RTGS Entry training for the business area staff. This programme covers training for transaction capturers, authorisers, and systems administrators and operators.

- As earlier communicated to commercial banks, a number of training sessions have been devised because the training facilities can only accommodate 12 participants at a time. In this regard, a month has been provided for commercial banks' training ending 5 May 2004. All banks are reminded to ensure that they submit names of nominated officers to the Assistant Director - Payment Systems as soon as possible to enable the training to start according to schedule.

Piloting of the RTGS system

- The piloting of the system is scheduled to commence on 27 April 2004. It is therefore cardinal that the entire industry moves in unison on this project. As indicated to commercial banks at the last meeting, the training of both Bank of Zambia and commercial banks staff and the execution of the pilot project have been arranged close to each other to enable the quick and effective transfer of acquired skills to staff's "desks" or operational areas. Therefore, the need for all banks to move at the same pace cannot be over emphasised.

Counterfeits

- We would like to alert you all that there are people trying to encash counterfeit notes and as banks you are the most vulnerable. It is therefore incumbent upon all of your members of staff to be vigilant when handling incoming cash. The incidence of the counterfeits is suspected to affect other locations beyond Lusaka as such even your outlying areas must be alerted. You should urgently report such cases to the Zambia Police Service.

Bank of Zambia and government participation in foreign exchange market

- As discussed during the meeting in Ndola and consistent with the code of conduct for the broad based interbank system, we would like to reiterate the fact that Bank of Zambia is a participant in the market like all other players. As such the Bank's participation should not be seen as extraordinary but as part of the process. Equally, Government participation should be treated in a similar manner.
- In addition, a number of issues were raised in the workshop regarding the operations of the foreign exchange market and a report has been circulated to that effect. In this regard, the Bank of Zambia will soon write to the Bankers Association of Zambia (BAZ) outlining those issues that require action by all concerned parties.

Use of EDP funds

- It has come to our attention that some intermediaries of the EDP funds are not utilizing the funds according to the agreed rules. In some instances, the intermediaries are not on-lending the funds to their clients. Such practices if allowed to continue will defeat the purpose of the efforts aimed at creating a sustainable source of wholesale medium- to long-term funds in our market. We wish to urge all of you to adhere to the established rules, failure to which those institutions engaged in unacceptable practices may not be able to secure such funding in the future thereby denying their clients critical project funding.

ZIBAC meeting

- A second meeting for the Zambia International Business Advisory Council (ZIBAC), was held in Livingstone from 5 to 7 March 2004. During the meeting, ZIBAC members and the private sector, represented by the Zambia Business Forum (ZBF), applauded the Bank of Zambia and the Government for achieving relative stability in the macroeconomic environment. This is reflected in the relative stability in the exchange rate and the downward movement in interest rates for which the weighted Treasury bill yield rate entered the single-digit region by early March 2004. This trend is due to, among other factors, the reduced Government borrowing from the financial system and indeed your cooperation as banks, especially those that have responded by appreciable adjustments in their base rates. The other aspect was that of inflation, which slowed down to 17.2% in December 2003 from 26.7% in December 2002 and the further fall to 16.8% by February 2004. Accordingly, calls were made for the Bank and the Government to continue with the efforts to stabilise the macroeconomic environment, since stability is one major consideration in investors' decisions for investment destinations.

While ZIBAC and ZBF members commended commercial banks for positively responding to the Bank of Zambia and Government actions by reducing lending rates, they pointed out that the cost of borrowing for the productive private sector was still high and that there was need to further lower lending rates so as to make loans affordable. In addition, low lending rates would improve the investment climate in the country.

4. Outlook

The March 2004, inflation pressures were anticipated to slow down. Factors for this anticipation include the following:

- Given that the supply of fresh foodstuffs from the 2003/2004 agricultural season had started, inflationary pressures were likely to ease. Coupled with the lifting of the fishing ban in March 2004 and expected increase in the supply of fish on the market, these factors were expected to dampen food inflationary pressures;
- The slow growth in broad money in January 2004 and the decline in average reserve money at end-February 2004 were expected to have a dampening effect on non-food inflation in March 2004;
- The exchange rate of the Kwacha against other currencies was expected to remain relatively stable on account of improved foreign exchange supply on the market arising from favourable export receipts due to higher metal prices and increased non-traditional earnings especially of sugar, cotton lint, burley tobacco and cement; and
- Government expenditure was expected to be within the targeted levels and this was expected to contribute to ensuring that net domestic financing of Government from the banking system would remain within the projected ceiling and thereby contribute to the anticipated drop in inflation.

In view of these expectations, the Bank of Zambia will continue to implement appropriate monetary policy aimed at containing the growth in reserve money and broad money within the projections.

As part of the outlook, there are two important events that will be forthcoming. These are:

The upcoming IMF mission

- We wish to inform you that the IMF mission will be in the country during mid-April to assess progress made against the Staff Monitored Programme (SMP) with a view to consider Zambia's return to a PRGF. It is therefore, our hope that nothing will be done in the market to reverse the many successes that we have achieved thus far because we all need the programme which will not only lead to the country reaching the much anticipated completion point under the enhanced HIPC initiative, but also bring along other benefits, such as, increased supply of foreign exchange in the economy.

The Country Assistance Strategy (CAS)

- In addition, a Country Assistance Strategy (CAS) for Zambia was recently approved by the World Bank Board. Here too a lot of praise was given to our achievements but with caution as more work needs to be done in our economic programme. The approval of CAS for Zambia means that some substantial funding will be released beginning soon and will spread over a relatively stretched period. This will help ease the situation given the resource constraints that the country is facing, especially to fund capital and related projects.