Caleb M Fundanga: Third quarter 2010 media briefing

Presented by Dr Caleb M Fundanga, Governor of the Bank of Zambia, Lusaka, 8 November 2010.

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Executive summary

This brief examines monetary policy implementation and its outcomes in the third quarter of 2010. The brief also reviews other economic and financial sector developments. In the conclusion, it provides an inflation outlook for the fourth quarter of 2010.

Monetary policy

The focus of monetary policy during the third quarter of 2010 continued to be the achievement of the end-year annual inflation target of 8.0%. Consistent with this inflation outturn, annual overall inflation was programmed at 7.3% for end-September 2010.

To achieve this, the Bank of Zambia utilised largely Open Market Operations and Government securities auctioning to maintain reserve money within the programmed growth path. This was to be complemented by prudent fiscal management.

Inflation

Quarterly overall inflation increased to 1.6% in September 2010 from the 1.0% recorded in June 2010, but was slightly lower than the 1.7% recorded in the third quarter of 2009. This outturn was mainly attributed to the rise in food inflation to –0.1% from the –1.7% recorded in the previous quarter, as non-food inflation slowed down to 3.2% from 3.7% during the same period.

However, the annual overall inflation rate was largely unchanged at 7.7% in September 2010 compared to the 7.8% recorded in June 2010, but was above the projected 7.3% for the period. This outturn was largely attributed to the decline in annual food inflation to 2.8% from 3.8% recorded in June 2010 as non-food inflation increased to 12.5% from 11.8% during the same period.

The decline in food inflation was on account of price reductions on cereals, various vegetables, various beef products, mutton and dried kapenta, due to improved seasonal supply factors.

Annual non-food inflation increased on account of pass-through effects of the Kwacha exchange rate depreciation, coupled with higher transport fares and the upward adjustment of electricity tariffs by an average of 25.6% during the period under review.

Money supply and domestic credit

Preliminary estimates indicate that growth in broad money (M3), comprehensively defined to include foreign currency deposits, was 7.2% in the third quarter of 2010 down from 13.3% as at end-June 2010, and was above the 4.0% projected quarterly growth rate. In absolute terms, M3 is estimated to have increased to K17,898.9 billion from K16,698.3 billion in June 2010. The outturn in M3 was largely due to the increase in both Net Domestic Assets (NDA) and Net Foreign Assets (NFA).

On an annual basis, M3 growth increased to 32.0% in September 2010 from 27.7% in June 2010. This outturn was due to the rise in NDA by 96.9% (June 2010, rose by 58.2%) primarily on account of increased lending to government. However, the NFA fell by 9.8% compared with a fall of 1.2% recorded in June 2010.

Total domestic credit, comprehensively defined to include foreign currency loans, increased by 3.1% at end-September 2010 compared with 10.1% growth registered in the second quarter of 2010. This was mainly due to a 4.4% rise in net claims on central government. Similarly, lending to the private sector (including public enterprises) grew by 2.2%.

On an annual basis, domestic credit growth at 13.5% in September 2010 was 10.1 percentage points lower than the 23.6% recorded in June 2010. This largely reflected a slowdown in credit to the private sector, including public enterprises to 0.7% compared with the 25.9% growth recorded in June 2010. However, lending to the government increased by 41.7% from 108.9% in June 2010.

On a sectoral basis, households (personal loans category) continued to account for the largest share of outstanding credit, accounting for 26.3% (26.2%)[1] in September 2010. The agricultural sector was second at 17.1% (18.5%), followed by manufacturing 13.4% (13.0%), wholesale and retail trade, 12.0% (11.7%), transport, storage and communications, 5.3% (5.4%) and real estate, 5.4% (5.2%).

Interest rates

Demand for Government securities remained strong although it was relatively lower during the quarter under review. Therefore, yield rates trended higher across all tenors.

In the Treasury bills market, the composite weighted average yield rate increased by 2.5 percentage points to an average of 7.4% from 4.9% recorded in the second quarter. Similarly, the composite weighted average yield rate for Government bonds increased by 109 basis points to 11.5% during the third quarter, up from an average of 10.4% recorded in the previous quarter.

Developments in commercial banks' nominal interest rates were mixed during the quarter under review. The weighted average lending base rate (WALBR) continued its downward trend, falling to 19.8% from 20.9% in June 2010. Similarly, the average lending rate (ALR) fell marginally to 26.8% in September 2010 from 27.9% in June 2010. However, the 30-day deposit rate for amounts exceeding K20 million and the average savings rate (ASR) for amounts above K100,000 remained unchanged at 5.6% and 4.7%, respectively.

Real sector

Developments in the real sector were favourable during the reviewed quarter. This was reflected in increased output of metals (copper & cobalt), beer, soft drinks and cement. Further, international arrivals also increased during the period under review.

The stock of maize grain held by major millers in the country rose by 124.6% to 101,807.0 metric tonnes (mt) as at 29th September 2010 from 45,336.7 mt as at 30th June 2010. In terms of holdings by province, Lusaka contributed 51,117.1 mt (50.2%), Copperbelt 26,644.0 mt (26.2%), Southern 19,861.0 mt (19.5%), Western province 4,050.0 mt (4.0%), and Northern 35.0 mt (0.03%) respectively, while Eastern province accounted for 100.0 mt (0.1%).

During the reviewed quarter, copper output increased by 16.4% to 232,554.87 mt from 199,621.06 mt in the previous quarter. This outturn reflected continued improvement in hydro-geological conditions and uninterrupted mining operations in the country resulting in increased ore extraction at both open pit and deep underground mines. On a year- to-date basis, copper output at 625,844.1 mt was 20.9% higher than the quantity produced in the corresponding period of 2009.

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[1] Previous quarter.

Cobalt output also increased by 16.1% to 2,349.41 mt during the third quarter of 2010 from 2,023.84 mt recorded in the previous quarter. The improvement in output mainly reflects continued benefits arising from the resumption of production at Konkola Copper Mines and Chambishi Metals Plc coupled with improved hydro-geological conditions. Further, cobalt output on a year-to-date basis at 6,362.2 mt was 59.7% higher than the 3,982.9 mt of cobalt produced in the corresponding period of 2009. Cement output[2] increased by 26.1% to 234,240.7 mt in the third quarter of 2010 from 185,702.0 mt during the previous quarter. However, on a year-to-date basis, output of cement at 577,130 mt was 4.0% lower than the 601,432.5 mt produced in the same period of 2009.

During the quarter under review, international arrivals at the country's four international airports[3] were 124,244 passengers compared with 105,163 passengers in the second quarter of 2010. This was 20.7% higher than 102,918 passengers recorded during the same quarter in 2009.

Foreign exchange market

The slow pace of economic recovery in the United States continued to cast a dark shadow on the US dollar, the world's most traded currency. The lingering economic uncertainty and the burgeoning fiscal deficit drove the US dollar weaker across all currencies.

Therefore, benefitting from the broad based dollar weakness and relatively high levels of US dollar liquidity in the market, the Kwacha posted a 5.0% gain against the American currency. A sustained rise in the copper prices at the London Metal Exchange to an average of US$7,281.08 per tonne in the third quarter from US$6,530.00/per tonne gave further support to the domestic currency, with the interbank rate ending the period at an average of K4,869.21 per US dollar.

Balance of payments

Preliminary data show that Zambia's overall balance of payments (BoP) recorded a surplus of US $357.6 million during the third quarter of 2010 compared to a deficit of US $94.3 million in the previous quarter. This was driven by the improvement in the performance of both the current account and the capital and financial account balances.

The current account surplus increased to US $453.6 million from a surplus of US $92.8 million recorded the previous quarter, reflecting an increase in the merchandise trade surplus coupled with the narrowing of the services and income accounts deficits. Supporting the current account was the merchandise trade surplus which rose by 74.8% to US $897.2 million in the quarter under review following an increase in exports as well as a decline in imports.

Merchandise export earnings edged upward by 18.7% to US $1,949.6 million, on account of increases in both metal and non-traditional export earnings. Metal export earnings recorded a 20.0% rise to US $1,611.5 million during the reviewed period, following a rise in copper export earnings although earnings from cobalt fell.

Cobalt export earnings declined by 0.5% to US $75.7 million in the third quarter of 2010 due to a 13.8% drop in the average realised price to US $32,642.20 per mt from US $37,858.20 per mt in the second quarter. Nevertheless, cobalt export volumes increased by 15.4% to 2,318.14 mt in the third quarter of 2010.

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[2] Does not include production by Zambezi Portland Cement as data was not available at finalisation of the report.

[3] Lusaka, Livingstone, Mfuwe and Ndola.

During the reviewed period, non-traditional exports (NTEs) increased by 13.2% to US $338.1 million. This was principally due to an increase in export earnings from cane sugar, cotton lint, electrical cables, fresh flowers, fruits and vegetables, and electricity products.

Merchandise imports declined by 6.1% to US $1,078.9 million during the reviewed quarter. A slide in import bills associated with commodity groups, such as, petroleum products, fertiliser, paper and paper products, and industrial boilers and equipment, explained this outturn.

Developments in the financial sector

The overall financial condition of the banking sector for the quarter ended September 2010 was satisfactory. On aggregate, the banking sector was adequately capitalised and the liquidity levels remained high. The sector's profit after tax also improved, although the asset quality modestly deteriorated.

The overall financial condition and performance of the Non Bank Financial Institutions (NBFI) sector was rated fair during the quarter under review. The sector was adequately capitalised with "fair" asset quality while earnings and liquidity performance were also rated "fair". However, the leasing subsector reported regulatory capital deficiencies.

During the quarter under review, the FinScope 2009 Consumer Survey report was launched to the public in Lusaka and Ndola. The survey findings indicated that agricultural activities still remained a major source of income for most Zambians yet the sector was largely under-served. Overall, there was a marginal increase of 3.6 percentage points in financial access to 37.3% in 2009 from 33.7% in 2005.

Developments in banking, currency and payment systems

During the quarter, there was a continued improvement in the availability of electronic payment options. The number of Point of Sale (POS) terminals increased by 3.8% to 1,033 terminals (Quarter 2 2010: 995). The volume of POS transactions also increased by 15% to 199,817 (Quarter 2 2010: 173,606) while the values increased by 13% to K86 billion (Quarter 2 2010: K76 billion).

The number of Automated Teller Machines (ATMs) increased by 4% to 468 ATMs (Quarter 2 2010: 450). The volume of ATM transactions also increased by 11% to 6,333,073 (Quarter 2 2010: 5,697,122). The Bank would like to continue urging the public to use electronic payment methods as they provide a more convenient, safer, efficient and effective way of making payments.

The volume and value of cheques returned unpaid on account of insufficiently funded accounts continued to decrease following the issuance of the directives on dishonoured cheques and direct debit instructions by the Bank of Zambia in the second quarter of 2010. The volume of unpaid cheques decreased by 15% to 4,202 (Quarter 2: 4,929). The public is advised to ensure that they have sufficient funds on their accounts whenever they issue cheques in order to avoid charges.

Economic reform programme

An IMF Mission was in Zambia from 2nd to 15th September, and 28th October to 3rd November 2010, to conduct the 5th Review under the Extended Credit Facility (ECF) arrangement. Overall, the mission was satisfied with the programme performance and reached agreement with the Zambian authorities on a set of macroeconomic policies and structural measures for the remainder of 2010 and for 2011. The policies and structural measures would pave the way for the completion of the Fifth Review of the ECF arrangement, subject to approval by the IMF's Executive Board.

Total disbursed poverty reduction budget support (PRBS) in the third quarter of 2010 amounted to US $19.5 million from the World Bank. A total of US $150.0 million mining tax revenue was received while the Bank of Zambia foreign exchange purchases from the market amounted to US $70.0 million.

Preliminary data indicate that the quantitative performance criteria under the Extended Credit Facility (ECF) arrangement were observed as at end-September 2010 and that all structural benchmarks were generally on track.

National budget 2011

The Minister of Finance and National Planning announced the 2011 National Budget on October 8, 2010. The Government maintained its focus on diversifying the economy, increasing productive employment and maintaining a stable macro-economic environment.

The key Macroeconomic objectives for 2011 are;

- To exceed 6% GDP growth;
- To reduce end-year inflation to 7.0%; and
- To maintain international reserves of at least 4 months of import cover.

The growth in GDP for 2011 is premised on the continued strong performance of the agriculture, mining, construction, manufacturing, transport and communications and tourism sectors.

Inflation outlook for the third quarter of 2010

In the fourth quarter of 2010, annual overall inflation is projected to remain below the end year target of 8.0%. This favourable outlook is on account of expected stability in maize prices in view of the bumper harvest in 2010, favourable supply of vegetables and fresh fish during the period and relative stability of the exchange rate of the Kwacha against the US dollar for much of the fourth quarter.

However, the Bank of Zambia will continue to monitor developments and undertake appropriate monetary policy actions to ensure that monetary targets are achieved. To contain growth of money supply within the programmed path, Bank of Zambia will continue to employ open market operations and auctioning of Government securities. This is expected to be complemented by prudent fiscal operations.

I thank you for your attention.

Introduction

This brief examines monetary policy implementation and its outcomes in the third quarter of 2010. The brief also reviews other economic and financial sector developments. In the conclusion, it provides an inflation outlook for the fourth quarter of 2010.

Monetary policy

The focus of monetary policy during the third quarter of 2010 continued to be the achievement of the end-year annual inflation target of 8.0%. Consistent with this inflation outturn, annual overall inflation was programmed at 7.3% for end-September 2010.

To achieve this, the Bank of Zambia utilised largely Open Market Operations to maintain reserve money within the programmed growth path. This was to be supported by the auctioning of Government securities and the maintenance of the fiscal deficit within the programme limits.

Inflation

Quarterly overall inflation increased to 1.6% in September 2010 from the 1.0% recorded in June 2010, but was slightly lower than the 1.7% recorded in the third quarter of 2009. This outturn was mainly attributed to the rise in food inflation to –0.1% from the –1.7% recorded in the previous quarter, as non-food inflation slowed down to 3.2% from 3.7% during the same period.

However, on an annual basis, overall inflation was little changed at 7.7% in September 2010 when compared to the 7.8% recorded in June 2010, but was above the projected 7.3% for the period. This annual inflation outturn was largely attributed to the decline in annual food inflation to 2.8% from 3.8% recorded in June 2010, as annual non-food inflation rose to 12.5% from 11.8% during the same period.

Food inflation

Quarterly food inflation rose to –0.1% in September 2010 from the –1.7% recorded in the previous quarter, but was 1.0 percentage point below the 0.9% recorded during the third quarter of 2009. This was due to higher prices of rice, various beef products, pork chops, mutton, fresh kapenta, dried kapenta, carrots, green beans, groundnuts and cassava tubers during the quarter under review. This was attributed to the impact of the upward adjustment of transport charges in July 2010 on the commodity market.

Annual food inflation fell on account of price reductions on cereals, various vegetables, groundnuts, tubers, beef products (fillet steak, rump steak), mutton and dried kapenta, due to improved seasonal supply factors.

Non-food inflation

Quarterly non-food inflation slowed down to 3.2% from the 3.7% observed in June 2010, but was 0.7 percentage points above the 2.5% recorded in the third quarter of 2009. This was mainly attributed to lower quarterly inflation for the following sub-groups: Furniture and household goods of 4.5% [7.5%], Medical care 1.6% [2.7%], Transport and communications 0.9% [5.1%], Recreation and Education –0.1% [1.3%], and other goods and services 1.7% [2.8%].

However, on an annual basis, non-food inflation increased to 12.5% from the 11.8% registered in June 2010. This was due to higher annual inflation rates for the following sub-groups: Clothing and footwear by 11.3%, [9.9%][4]; Furniture and household goods 11.5%, [10.1%]; Transport and communications 15.3%, [11.1%]; and other goods and services 14.1%, [12.8%]. These developments reflected pass-through effects of the Kwacha exchange rate depreciation by 4.8% over the 12 month period, coupled with higher transport fares and the upward adjustment of electricity tariffs by an average of 25.6% during the period under review. Non-food inflation contributed 6.3 percentage points to the annual overall inflation outturn.

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[4] The numbers in square brackets are for June 2010.

Broad money and domestic credit[5]

Preliminary estimates indicate that growth in broad money (M3), comprehensively defined to include foreign currency deposits, was 7.2% in the third quarter of 2010 down from 13.3% as at end-June 2010, and was above the 4.0% projected quarterly growth rate. In absolute terms, M3 is estimated to have increased to K17,898.9 billion from K16,698.3 billion in June 2010. The outturn in M3 was largely due to the increase in both NDA and NFA. NFA edged up by 12.2% mainly on account of a 15.7% increase in gross international reserves to US $1,972.0 million as at end-September 2010. The increase in NDA was mainly due to the expansion in lending to the Government. Excluding foreign currency deposits that increased by 30.2% (June 2010, fell by 5.1%), money supply declined by 2.0% compared to the 22.9% growth recorded during the second quarter of 2010.

On an annual basis, M3 growth increased to 32.0% in September 2010 from 27.7% in June 2010. This outturn was due to the rise in NDA by 96.9% (June 2010, rose by 58.2%) primarily on account of increased lending to government. However, the NFA fell by 9.8% compared with a fall of 1.2% recorded in June 2010. Excluding foreign currency deposits that grew by 29.8% (June 2010, fell by 5.9%), money supply growth was 33.2% from the 49.0% recorded in June 2010.

Total domestic credit, comprehensively defined to include foreign currency loans, increased by 3.1% at end-September 2010 compared with 10.1% growth registered in the second quarter of 2010. This was mainly due to a 4.4% rise in net claims on central government that contributed 1.7 percentage points to the growth in domestic credit. Similarly, lending to the private sector (including public enterprises) grew by 2.2% and contributed 1.4 percentage points to the total domestic credit outturn. Excluding foreign currency denominated credit, which fell by 4.1%, domestic credit increased by 5.2% compared to the 7.5% registered in June 2010.

On an annual basis, domestic credit growth at 13.5% in September 2010 was 10.1 percentage points lower than 23.6% recorded in June 2010. This largely reflected a slowdown in credit to the private sector, including public enterprises, to 0.7% compared with the 25.9% growth recorded in June 2010. This outturn contributed 0.4 percentage points to the total domestic credit growth in the quarter under review. However, lending to the government increased by 41.7% from 108.9% in June 2010 and contributed 13.1 percentage points to the total domestic credit growth.

On a sectoral basis, households (personal loans category) continued to account for the largest share of outstanding credit, accounting for 26.3% (26.2%)[6] in September 2010. The agricultural sector was second at 17.1% (18.5%), followed by manufacturing 13.4% (13.0%), wholesale and retail trade, 12.0% (11.7%), transport, storage and communications, 5.3% (5.4%) and real estate, 5.4% (5.2%).

Interest rates

Demand for Government securities remained strong although it was relatively lower during the quarter under review. The average rate of subscription at the Treasury bill tenders was recorded at 123.7% down from 129.5% in the preceding period. Similarly, the average rate of subscription rate for Government bonds was down at 123.5% compared with 126.6% recorded in the second quarter. Although participation at the auctions was strong, yield rates trended higher across all tenors, as investors sought to sustain recent gains on government paper.

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[5] Estimates used before monetary survey is compiled.

[6] Previous quarter.

In the Treasury bills market, the composite weighted average yield rate increased by 2.5 percentage points to an average of 7.4% from 4.9% recorded in the second quarter. Similarly, the composite weighted average yield rate for Government bonds increased by 109 basis points to 11.5% during the third quarter, up from an average of 10.4% recorded in the previous quarter.

During the quarter ending September 2010, developments in commercial banks' nominal interest rates were mixed. The weighted average lending base rate (WALBR) continued its downward trend, falling to 19.8% from 20.9% in June 2010. Similarly, the average lending rate (ALR) fell marginally to 26.8% in September 2010 from 27.9% in June 2010. However, the 30-day deposit rate for amounts exceeding K20 million and the average savings rate (ASR) for amounts above K100,000 remained unchanged at 5.6% and 4.7%, respectively.

Real sector developments

Developments were favourable in the real sector during the reviewed quarter. This was reflected in increased output of metals (copper & cobalt), beer, soft drinks and cement. Further, international arrivals also increased during the period under review.

Agriculture

The stock of maize grain held by major millers in the country rose by 124.6% to 101,807.0 mt as at 29th September 2010 from 45,336.7 mt as at 30th June 2010. In terms of holdings by province, Lusaka contributed 51,117.1 mt (50.2%), Copperbelt 26,644.0 mt (26.2%), Southern 19861.0 mt (19.5%), Western 4,050.0 mt (4.0%), and Northern 35.0 mt (0.03%) respectively, while Eastern province accounted for 100.0 mt (0.1%). Data on maize stocks from Central province was not available at the reporting date.

Mining

During the reviewed quarter, copper output increased by 16.4% to 232,554.87 mt. This output was also 30.5% higher than the 178,140.1 mt of copper produced in the third quarter of 2009. This outturn reflected continued improvement in hydro-geological conditions and uninterrupted mining operations in the country at both open pit and deep underground mines. On a year to date basis, copper output at 625,844.1 mt was 20.9% higher than the quantity produced in the corresponding period of 2009.

Cobalt output also increased by 16.1% to 2,349.41 mt during the third quarter of 2010 from 2,023.84 mt recorded in the previous quarter. This level of output reflected a 16.6% rise compared to 2,015 mt produced in the third quarter of 2009. The improvement in output mainly reflects continued benefits arising from the resumption of production at Konkola Copper Mines and Chambishi Metals Plc coupled with improved hydro-geological conditions. Further, cobalt output on a year-to-date basis at 6,362.2 mt was 59.7% higher than the 3,982.9 mt of cobalt produced in the corresponding period of 2009.

Manufacturing

Cement output[7] by the monitored company increased by 26.1% to 234,240.7 mt in the third quarter of 2010 from 185,702.0 mt during the previous quarter. Nonetheless, on a year-to-date basis, output of cement at 577,130 mt was 4.0% lower than the 601,432.5 mt produced in the same period of 2009.

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[7] Does not include production by Zambezi Portland Cement as data was not available at finalisation of the report.

During the quarter under review, production of clear beer by the monitored company increased by 26.7% to 223,607 hectolitres from 176,515 hectolitres the previous quarter Further, this output was 45.9% higher than the 153,220 hectolitres produced in the corresponding quarter of 2009.

Output of soft drinks by the monitored company rose by 1.8% to 127,244.0 hectolitres from 124,944.0 hectolitres produced in the previous quarter. Moreover, this output level was 38.3% higher than 91,968.0 hectolitres produced in the corresponding quarter of 2009.

Production of milk by the monitored company during the quarter under review rose by 4.2% to 7,830,878 litres from 7,510,227 litres produced in the second quarter of this year. However, this output was 1.2% lower than 7,924,054.0 litres of milk produced during the corresponding quarter of 2009.

Tourism

During the quarter under review, international arrivals at the country's four international airports[8] were 124,244 passengers compared with 105,163 passengers in the second quarter of 2010. This was 20.7% higher than 102,918 passengers recorded during the same quarter in 2009. Livingstone and Mfuwe international airports, which are the major tourist destinations, accounted for 21,272 passengers and 241 passengers compared with 18,180 passengers and 269 passengers in the previous quarter, respectively.

During the third quarter of 2010, tourist entries into the country's national parks[9] were 25,244 compared with 13,737 in the previous quarter. Nevertheless, this was lower than 26,720 in the corresponding quarter of 2009. Europe accounted for 9,404 followed by Zambia (residents) at 7,308 while North America, Rest of America and Australasia were 4,016, 2,810 and 1,412 respectively. The rise in the entries into the country's national parks was in part attributed to the world cup and improved weather conditions.

External sector developments

Foreign exchange market

The slow pace of economic recovery in the United States continued to cast a dark shadow on the US dollar, the world's most traded currency. The lingering economic uncertainty and the burgeoning fiscal deficit drove the US dollar weaker across all currencies.

Therefore, benefitting from the broad based dollar weakness and relatively high levels of US dollar liquidity in the market, the Kwacha posted a 5.0% gain against the American currency. A sustained rise in the copper prices at the London Metal Exchange to an average of US$7,281.08 per tonne in the third quarter from US$6,530.00/per tonne gave further support to the domestic currency, with the interbank rate ending the period at an average of K4,869.21 per US dollar.

The weakness in the US dollar saw the Euro and the pound sterling rebound, underpinned by austerity measures instituted in Greece and the United Kingdom and favourable bank stress test results in the European Union banking sector. Reflecting this recovery, the South African rand, which tracks the euro, also performed well, posting significant gains in the currency market. These developments saw the Kwacha depreciate against the three currencies during the review period. It shed off 1.3% value against the euro and depreciated by 1.9% vis-à-vis the rand ending the quarter at an average of K6,344.50/€ and

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8 Lusaka, Livingstone, Mfuwe and Ndola.

9 South Luangwa, Mosi-oa-Tunya, Lower Zambezi, Kafue, North Luangwa, Blue Lagoon.

K677.45/ZAR, respectively. The rate of depreciation against the pound sterling was relatively lower at 0.6% with the Kwacha trading at K7,560.15/£.

With regard to the volume of foreign exchange transactions, a total of US$1,230.7 million was exchanged in the domestic interbank market. From the rest of the market, commercial banks purchased a net of US$49.2 million compared to net sales of US$4.7 million the previous quarter. Similarly banks made net purchases of €1.4 million Euros during the review period.

Conversely, banks' net sales of the South African rand amounted to ZAR729.3 million, higher than ZAR645.3 million recorded in the second quarter. Transactions involving the pound sterling followed a similar trend, with commercial banks recording net sales of £2.5 million depicting a reduction over the previous quarter's net sales of £1.7 million.

Balance of payments

Preliminary data show that Zambia's overall balance of payments (BoP) recorded a surplus of US $357.6 million during the third quarter of 2010 compared to a deficit of US $94.3 million in the previous quarter. This was driven by the improvement in the performance of both the current account and the capital and financial account balances.

The current account surplus increased to US $453.6 million from a surplus of US $92.8 million recorded the previous quarter, reflecting an increase in the merchandise trade surplus coupled with the narrowing of the services and income accounts deficits. Supporting the current account was the merchandise trade surplus which rose by 74.8% to US $897.2 million in the quarter under review following an increase in exports as well as a decline in imports.

Merchandise export earnings edged upward by 18.7% to US $1,949.6 million, on account of increases in both metal and non-traditional export earnings. Metal export earnings recorded a 20.0% rise to US $1,611.5 million during the reviewed period, following a rise in copper export earnings although earnings from cobalt fell.

Cobalt export earnings declined by 0.5% to US $75.7 million in the third quarter of 2010 due to a 13.8% drop in the average realised price to US $32,642.20 per mt from US $37,858.20 per mt ton in the second quarter. This was despite the increase in cobalt export volumes by 15.4% to 2,318.14 mt in the third quarter of 2010.

During the reviewed period, non-traditional exports (NTEs) increased by 13.2% to US $338.1 million. This was principally due to an increase in export earnings from cane sugar, cotton lint, electrical cables, fresh flowers, fruits and vegetables, and electricity products.

Merchandise imports declined by 6.1% to US $1,078.9 million during the reviewed quarter. A slide in import bills associated with commodity groups, such as, petroleum products, fertiliser, paper and paper products, and industrial boilers and equipment, explained this outturn.

During the same quarter, the services and income account deficits narrowed by 5.7% and 1.5% to US $168.0 million and US $369.3 million, respectively.

The capital and financial account surplus increased to US $278.5 million in the third quarter 2010 from US $122.3 million the previous quarter. This was largely due to an increase in project grants coupled with a reduction in portfolio and other investment outflows.

Developments in the financial sector

The overall financial condition of the banking sector for the quarter ended September 2010 was satisfactory. On aggregate, the banking sector was adequately capitalised and the liquidity levels remained high. The sector's profit after tax also improved, although the asset quality modestly deteriorated.

The overall financial condition and performance of the Non Bank Financial Institutions sector was rated fair during the quarter under review. The sector was adequately capitalised with "fair" asset quality while earnings performance was rated "satisfactory". However, the leasing subsector reported regulatory capital deficiencies and unsatisfactory earnings performance.

During the quarter under review the Financial Sector Development Plan (FSDP) Implementation and FSDP Steering Committees approved the work plans and budgets of the six FSDP Working Groups for the period 2010 to 2012.

During the quarter under review, the FinScope 2009 Consumer Survey report was launched to the public in Lusaka and Ndola. The survey findings indicated that agricultural activities still remained a major source of income for most Zambians but that this sector was largely under-served by financial service providers. The survey findings also showed that there was an increase in the number and types of banking services and products but that the uptake had remained unchanged as the focus of financial service providers appeared to be serving the same market, as opposed to enhancing financial inclusion. Overall, there was a marginal increase of 3.6 percentage points in financial access to 37.3% in 2009 from 33.7% in 2005.

Developments in banking, currency and payment systems

During the quarter, there was a continued improvement in the availability of electronic payment options. The number of Point of Sale (POS) terminals increased by 3.8% to 1,033 terminals (Quarter 2, 2010: 995). The volume of POS transactions also increased by 15% to 199,817 (Quarter 2, 2010: 173,606) while the values increased by 13% to K86 billion (Quarter 2, 2010: K76 billion).

The number of Automated Teller Machines (ATMs) increased by 4% to 468 ATMs (Quarter 2 2010: 450). The volume of ATM transactions also increased by 11% to 6,333,073 (Quarter 2 2010: 5,697,122) while the value increased by 16% to K2,898 billion (Quarter 2 2010: K2,498 billion). The Bank would like to continue urging the public to use electronic payment methods as they provide a more convenient, safer, efficient and effective way of making payments.

The volume and value of cheques returned unpaid on account of insufficiently funded accounts continued to decrease following the issuance of the directives on dishonoured cheques and direct debit instructions which were issued by the Bank of Zambia in the second quarter of 2010. The volume of unpaid cheques decreased by 15% to 4,202 (Quarter 2: 4,929). Similarly the value of unpaid cheques decreased by 6.6% to K35.3 billion from K37.8 billion reported in the second quarter of 2010. The public is advised to ensure that they have sufficient funds in their accounts whenever they issue cheques in order to avoid charges.

Economic reform programme

An IMF Mission was in Zambia from 2nd to 15th September 2010, to conduct the 5th Review under the Extended Credit Facility (ECF) arrangement. Overall, the mission was satisfied with the programme performance. A follow-up mission visited the country from 28th October to 3rd November 2010 to conclude the discussions.

The mission had fruitful discussions with the Zambian authorities and reached agreement on a set of macroeconomic policies and structural measures for the remainder of 2010 and for 2011. The policies and structural measures would pave the way for the completion of the Fifth Review of the ECF arrangement, subject to approval by the IMF's Executive Board. The Board meeting is expected to be held around mid-December 2010.

The IMF mission commended the Zambian Government for its handling of economic policy so far in 2010. Notably, fiscal performance has been broadly in line with expectations although there was been need to finance the purchase of the maize surplus. The mission also noted that the Bank of Zambia managed monetary policy well with a view to reducing inflation whilst at the same time maintaining conditions to facilitate economic growth. Economic prospects remain favourable, with growth projected to remain strong in 2010. In addition, the 2011 budget is consistent with the maintenance of sound macroeconomic policies. Furthermore, envisaged revenue enhancement which stems from new tax policy measures and administrative improvements, is appropriately ambitious whilst the expenditure mix shifts towards capital and social spending.

Total disbursed poverty reduction budget support (PRBS) in the third quarter of 2010 amounted to US $19.5 million from the World Bank. A total of US $150.0 million mining tax revenue was received from First Quantum Mining Plc while the Bank of Zambia foreign exchange purchases from the market amounted to US $70.0 million. Against these inflows were payments to PTA Bank (US $116.0 million) for oil procurement and debt service payments (US $15.9 million).

Preliminary information showed that the Net Domestic Assets (NDA) of the Bank of Zambia, the Net Domestic Financing (NDF) of Government and the Unencumbered International Reserves (UIR) quantitative performance criteria under the Extended Credit Facility (ECF) arrangement were observed as at end-September 2010. Further, all structural benchmarks were generally on track.

National budget 2011

The Minister of Finance and National Planning announced the 2011 National Budget on October 8, 2010.

In the budget, the Government maintained its focus on diversifying the economy, increasing productive employment and maintaining a stable macro-economic environment.

The key Macroeconomic objectives for 2011 are;

- To exceed 6% GDP growth;
- To reduce end-year inflation to 7.0%; and
- To maintain international reserves of at least 4 months of import cover.

The growth in GDP for 2011 is premised on the continued strong performance of the agriculture, mining, construction, manufacturing, transport and communications and tourism sectors.

Inflation outlook for the fourth quarter of 2010

In the fourth quarter of 2010, annual overall inflation is projected to remain below the end year target of 8.0%. This favourable outlook is on account of expected stability in maize prices in view of the bumper harvest in 2010; expected favourable supply of vegetables and fresh fish during the period and expected relative stability of the exchange rate of the Kwacha against the US dollar for much of the fourth quarter.

At end-September 2010, annual inflation was largely unchanged at 7.7% compared to the 7.8% recorded in June 2010, due to a decline in annual food inflation against a rise in annual non-food inflation during the same period. Consistent with this outturn, inflation projections indicate an annual overall inflation rate of 7.3% for end-December 2010.

The Bank of Zambia will continue to monitor developments and undertake appropriate monetary policy actions to ensure that monetary targets are achieved. To contain growth of money supply within the programmed path, Bank of Zambia will continue to employ open market operations and auctioning of Government securities. This is expected to be complemented by prudent fiscal operations.