Caleb M Fundanga: Recent economic developments in Zambia

Talking notes by Dr Caleb M Fundanga, Governor of the Bank of Zambia, with the business community in Kitwe, Kitwe, 25 July 2011.

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RECENT ECONOMIC DEVELOPMENTS

Introduction

- The Zambian economy has recorded significant positive developments following the implementation of various reforms. This is reflected in positive real GDP since the early 2000s, low and falling inflation, a downward trend in lending interest rates, favourable external sector performance as well as relative stability in the exchange rate of the Kwacha.
- These developments can be attributed to improved monetary and fiscal policy management and improved economic management, which in turn has enhanced investor confidence.

Real gross domestic product (GDP)

- Zambia's national output, as measured by Gross Domestic Product (GDP), has grown by an average of 6.4 percent annually in the last five years. The Zambian economy grew by 7.6 percent in 2010, compared to 6.4 percent in 2009, and exceeded the target of 5 percent.
- The key contributors to the sustained increase in economic activity have been increased production in the mining, agricultural and construction sectors.
- The agricultural sector recorded a historical bumper maize harvest of over 2.8 million metric tonnes during the 2009/10 season and another 3.0 metric tonnes during the 2010/11 harvest season. This was supported by favourable weather conditions and the Farmer Input Support programme.
- Performance of the mining sector increased following higher output arising from increased capacity utilisation at various mines and investments into operations at various mines. Metal mining was the main driver of this growth, with copper and cobalt output growing by 17.4% and 49.4% to 819,159.19 mt and 8,781 mt, respectively.
- Construction output was driven by increased public and commercial infrastructure projects around the country, as well as continued high demand for housing. This was supported by expansion in domestic production of cement.

Inflation

- Consistent with the favourable performance in economic growth, the country has succeeded in lowering inflation. Inflation has declined from 17.2 percent in 2003, 9.9 percent in 2009 and stood at 7.9 percent at end-2010. Inflation continued to be moderate, and stood at 9.0 percent as at June 2011.
- The decrease in inflation over the years can be attributed to prudent monetary policy and a relatively stable exchange rate. The increase in food supply, arising from the favourable crop harvest, has also been a key factor in moderating inflationary pressures in light of high and increasing prices of petroleum products due to high international oil prices.

Interest rates

- Interest rates have generally been on a declining trend in line with the fall in inflation and yield rates on Government securities. This trend was broken as a result of the financial crisis in 2008.
- Commercial banks' average lending rates decreased to 27.9 percent in 2010 from 28.4 percent in 2009. In June 2011, average lending rates stood at 26.0 percent.
- In the Government securities market, the weighted average Treasury bill yield rate was 7.7 percent in 2010, from 9.5 percent in 2009. Similarly, Government bonds composite yield rate fell to 12.3% from 15.9 percent in 2009. As at June 2011, the weighted average Treasury bill rate was 10.0 percent, while the composite bond yield rate was 15.7 percent.

External sector performance

- The external sector recorded favourable performance, as evidenced by an increase in the balance of payments surplus and a rise in the country's gross international reserves.
- The country's gross international reserves rose to US$2,093.7 million from US$1,924.2 million in 2009. This followed increased receipt of donor funds as well as recovery in the global economy that saw increased demand and international prices for most commodities, including copper.
- The Balance of Payments (BoP) recorded a surplus of US$138.1 million in 2010. The surplus was attributed to the positive outturn of the current account to US$982 million in 2010 from a deficit of US$378 million in 2009. This was mainly on account of an improvement in Zambia's trade balance, which increased by 312.8 percent to US$2,076.5 million from a surplus of US$503 million in 2009.
- Total merchandise export earnings rose by 71.2 percent to US$7,261.7 million in 2010 from US$4,242.8 million recorded in 2009, following increases in both metal and non-traditional export earnings.
- Metal export earnings rose by 81.6 percent to US$6,071.7 million in 2010 from US$3,343.1 million in 2009, of which copper export earnings were US $5,767.9 million and cobalt export earnings were US $303.8 million. This was explained by the rise in copper and cobalt production following increased capacity utilisation at various mines and higher global market prices.
- Exports of non-traditional products registered a growth of 34.3 percent to US$1,279.3 million in 2010 from US$952.5 million the previous year. This was driven by higher exports of copper wire, cane sugar, burley tobacco, cotton lint, electrical cables, gemstones, maize and maize seed, and wheat and meslin.
- Total merchandise imports grew by 40.3 to US$4,788.8 million in 2010 from US $3,413.4 million in 2009.

Exchange rate

- Following strong macroeconomic fundamentals and increased supply in foreign exchange, the Kwacha performed favourably against all the major traded currencies in 2010, except for the South African Rand. The Kwacha appreciated by 4.7 percent against US dollar to trade at K4,798.36/US$ from K5,033.95/US$ in 2009.
- Similarly, the Kwacha appreciated by 6.0 percent against the British Pound and by 8.0 percent against the Euro to trade at K7,392.04/£ and K6,362.14/€, respectively.

However, the Kwacha registered a depreciation of 8.8 percent against the South African Rand.

Fiscal sector developments

- Fiscal prudence has improved over the past years, with domestic revenues performing well following higher collections of value added taxes, as well as income taxes from mining companies.
- This in effect has also been seen in increased government expenditure on growth-supporting activities such as infrastructure and social sector spending. Over the last few years, Government has also reduced its borrowing from the banking sector, thereby avoiding the crowding out of the private sector and contributing to downward movements in interest rates.

Financial sector developments

- The overall financial condition and performance of the financial sector in 2010 was satisfactory, as reflected in adequate capitalisation and most financial institutions meeting their minimum regulatory requirements.
- The banking sector was adequately capitalized and asset quality, liquidity and earnings performance remained satisfactory. The Bank granted a licence to International Commercial Bank (Z) Limited, bringing the number of commercial banks operating in the country to 18.
- Similarly, the overall financial performance and condition of the Non-Bank Financial Institutions (NBFIs) in 2010 was fair. On average, the leasing finance institutions and bureaux de change sub-sectors reported adequate capital, fair asset quality, liquidity position and earnings performance.

Prospects for 2011

- Several indicators point to continued strong economic performance in 2011.
- Real GDP is projected to grow by at least 6.8 percent and will continue to be driven by strong performance in the agricultural, mining, construction and tourism sectors. This will be aided by anticipated strong performance in the external sector, already reflected by favourable performance in the first half of the year.
- Inflation is expected to slow down to 7.0 percent by end of 2011. The bumper harvest recorded during the 2010/11 harvest season is expected to dampen effects on overall inflation through the food component.
- In the mining sector, copper production is expected to increase due to continued investments in the mining sector.
- In addition, the major infrastructure projects currently taking place are expected to support growth in the construction sector.
- As the global economy continues to recover from effects of the global economic crisis, growth in tourism is also expected in 2011.
- The positive developments recorded in the Zambian economy thus far will go a long way is shaping tomorrow's future. This should trickle down to all sectors of the economy and raise employment and income opportunities for Zambians, and therefore be lifted the majority of people out of poverty.

IMPLICATIONS OF RECLASSIFICATION OF ZAMBIA TO MIDDLE INCOME STATUS

- Effective July 1, 2011, Zambia has been reclassified by the World Bank as a lower middle income nation. Lower middle-income countries are those with per capita gross national incomes (GNIs) of between US $1,006 and US $3,975 per year; while upper middle-income countries are those with GNIs between US $3,976 and US $12,275. This status reflects the continued economic growth that has been registered in the recent years.
- Zambia's reclassification as a middle income country would enhance investor confidence and further boost the investment climate thereby creating jobs and wealth for the people. In terms of financing, it should be noted that with the new arrangement, the government would be able to access more non concessional financing which remain key for infrastructure development necessary for economic development. This is in contrast with the previous status whereby Zambia could only access limited concessional financing which attracted very low interest rates and payable after a long time.
- Despite the positive reclassification, it should be noted that the disparity between the poor and the rich would always be there and do exist even in developed countries. The challenge for the Government is to implement policies that will redistribute wealth so that inequality is reduced.
- Nevertheless, with reclassification, it shows that the Government has been working very hard to accelerate economic growth, which is a necessary for economic development.
- On average, people have been pulled out from poverty as per capita income has risen from US $300 in 2000 to over US $1000 in 2010.
- Countries in Africa that are in this class, lower middle income, include the following Angola, Cameroon, Cape Verde, Republic of Congo, Côte d'Ivoire, Djibouti, Arab Republic of Egypt, The Gambia, Ghana, Lesotho, Mauritania, Morocco, Nigeria and São Tomé and Principe.

IMPLICATIONS OF SOVEREIGN CREDIT RATING

- The rating that has been assigned to Zambia reflects strong economic performance as shown by the GDP growth rate. This has also been supported by low rate of inflation and fiscal deficits, external sector performance supported by the mining sector, and activities in key economic sectors, including agriculture and tourism, as well as strong external balance position after huge debt relief from international creditors obtained in 2005.
- The rating puts the Zambian business community and government in a strong position to access finance globally at risk adjusted interest rates for investment that is essential for sustained economic growth and improved living conditions of the citizens.
- Furthermore, the rating entails transparency in the economic management of the country's resources and provides an opportunity for the country to work on the weaknesses identified by the rating agencies. For instance, from the rating report it was noted that Zambia still faces challenges in the energy sector and infrastructure development. It therefore, follows that once the country addresses the identified weaknesses, the rating could improve.
- In summary, the rating assigned to Zambia shows stability and predictability of government policies and signals improvements in the business environment. This is also comparable to our peers in Africa. With increased globalisation of the world

economy, there is no doubt that Zambia stands to benefit from the rating assigned on condition that the country adopts appropriate policies that are supportive to sustainable economic growth environment.

RECENT DEVELOPMENTS IN MINING AND MANUFACTURING (MFEZ)

A. Mining

- Growth in the Zambian mining and quarrying sector has continued to be strong since privatisation. In 2010, the growth in the sector was 15.2% (20.2% in 2009), thus contributing strongly to the 7.6% real GDP growth in 2010.
- Growth in metal mining was 16.0% with copper and cobalt output increasing by 17.4% and 49.4% to 819,159.19 mt and 8,781 mt, respectively.
- During the first half of 2011, total copper output at 414,984.5 mt, was 4.0% higher than 399,062.0 mt produced during the corresponding period of 2010. Similarly, cobalt output was 4,352.7 mt, 8.5% higher than 4,012.8 mt produced in the first half of 2010.
- This outturn was largely explained by the increase in the scale of production by the mines coupled with the rebound in copper prices, following the relative recovery in the global economy.

B. Manufacturing

- Performance of the manufacturing sector in 2010 and the first half of 2011 have been favourable with a 4.1% growth in 2010 (2.2% in 2009). Growth has largely been driven by agro-processing (food & beverages), including production of non-metallic mineral and fabricated metal goods, chemicals, explosives and construction materials (such as cement).
- Growth in Agro-processing has been supported in part by the last two maize bumper harvests, 2010 (2.8 million mt of maize) and (3.0 million mt of maize 2011).
- Strong construction activities have stimulated strong demand for manufacture of construction materials particularly cement and cement-related products.
- Total cement output by the country’s three manufacturing plants (Lafarge Zambia Plc, Oriental Quarries and Zambezi Portland Plc) rose by 37.9% to 1,126,728 mt in 2010 from 817,223.0 mt in 2009. Further, during the first half of 2011 cement output at 617,115.2 mt was 36.0% higher than the 453,791.0 mt produced in the corresponding half of 2010.

C. Multi-facility economic zones

- Zambia’s goal catalyzing industrial and economic development through increased activity in the manufacturing sector has led the country to embark on the development of Multi-Facility Economic Zones (MFEZs) in selected parts of the country. Among the MFEZs are:
  - The Chambishi MFEZ (construction is advanced) being developed in partnership with the Chinese government with a commitment of over US $1 billion;
  - Two Lusaka MFEZs (preparatory phases) and one industrial park. One of the Lusaka MFEZs, the Lusaka South, will be developed in cooperation with a Malaysian firm at an estimated cost of US $1 billion;

- Solwezi (Lumwana) (preparatory phase).

- The MFEZs are expected to significantly contribute to employment creation in the country.

HOW LOCAL BUSINESSES CAN POSITION THEMSELVES TO TAKE ADVANTAGE OF THE OPPORTUNITIES ARISING FROM THE ABOVE

- Local businesses should take advantage of the improved confidence in the Zambian economy to access cheaper credit from the international capital markets;
- Higher domestic incomes imply higher domestic demand; thus local producers can take advantage economies of scale from increased production for the domestic market;
- Local businesses should also take advantage of the opening up of new mines and the establishment of MFEZ in adding local content to the products. This will entail making local products and services more competitive.