

Caleb M Fundanga: Investment opportunities in the Zambian real estate business - the role of the Bank of Zambia

Paper presented by Dr Caleb M Fundanga, Governor of the Bank of Zambia, to the International Conference on Investment Opportunities in Zambia - Integrating African Property Markets, Lusaka, 15 June 2005.

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- The Chairperson
- Distinguished Guests
- Ladies and Gentlemen

I feel greatly honoured to have been invited to talk to you on the theme, *“Investment Opportunities in the Zambian Real Estate Business: The role of the Bank of Zambia.”*

From the outset I wish to express my sincere gratitude to Business Week for organising such an important Conference. You will agree with me that this Conference is, perhaps, the first of its kind to have been solely organised by the private sector to look specifically at the issue of investment in the Zambian real estate sector. As you may be aware, investment in the real estate sector is critical to the economic well being of any country, since economic growth alone is insufficient if it does not translate into development, as reflected through better living standards that includes provision of quality and adequate infrastructure, such as, real estate.

Real estate can be defined to include physical property and bare land owned by an individual or organisation under freehold or non-freehold tenure. However, for purposes of my discussion this afternoon, I will use the term real estate to mean physical property.

My discussion therefore, is structured as follows:

- i. First, I will look at the contribution of the Zambian real estate sector to gross domestic product (GDP) in Zambia. During the discussion of this issue, I will also look at the characteristics of the Zambian real estate finance sector; and
- ii. Secondly, I will explain the role of the Bank of Zambia in the real estate sector.

Ladies and Gentlemen

In Zambia, the share of the real estate sector has increased from an average of 6.8% between 1995 and 1999 to 9.4% between 2000 and 2004. This is a welcome development, as it shows that real estate business has been contributing positively to real GDP growth over the last six years.

However, I strongly believe that the sector can perform even better than this, especially that most of our people have no good and affordable accommodation, as evidenced by emergence of large unplanned residential areas. This is a challenge for you experts in the real estate business to facilitate the building of more houses and office accommodation to reduce rentals for these facilities to affordable levels and stem the expansion of unplanned residential areas.

In spite of the growth in the share of real estate to GDP, the Zambian real estate finance sector is still characterized by inadequate long-term finance. Prior to 1990, the sector was dominated by the Zambia National Building Society (ZNBS), which following the liberalisation of the economy in the 1990s, is unable to meet the demand for real estate finance. Much as there are other building societies now, their impact on real estate finance is still minimal. Consequently, most of the people who are constructing nowadays are doing so out of their own funds. Since they are building using their own meagre resources, the quality of their structures leaves much to be desired and the projects take long to complete. This, in part, explains the mushrooming of shanty compounds I have alluded to earlier. What I have said clearly shows that there is need for new players in the real estate financing sector. To this effect, I wish to challenge the private sector to invest in the real estate financing business.

Having said that, what is the role of the Bank of Zambia in enhancing investment opportunities in the real estate business? As you may be aware, the primary mission of the Bank of Zambia is to formulate and implement monetary and supervisory policies that will ensure price and financial system stability.

How does this tie in with real estate business? The relationship between real estate business and monetary policy and financial system stability is a much debated issue among academics and policy-makers, alike. The relationship brings to the fore important challenges involving policy design, financial regulation and risk management. In Zambia, however, like most other developing countries, we have had difficulties in quantifying the relationship due to paucity of reliable information on property markets, thereby limiting the scope for meaningful analysis as an input into policy formulation. It is therefore, critical that improvements are made in the quality of real estate sector data to enhance analysis and policy response to developments in this sector.

There is no doubt that the rate of inflation is still too high in Zambia compared to some of our neighbours, like Tanzania, Botswana, and Mozambique. However, I wish to assure you that lower rates of inflation are within reach given Government commitment to fiscal discipline and macroeconomic stability.

It is a well established that high inflation (that is, above ten percent) is a cost to economic activities. This happens through:

1. Increased investment costs. High and persistent inflation adversely affects savings mobilization in the economy because savers would opt to hedge against inflation. Ultimately, this leads to a reduction in the availability of loanable funds and investments. In addition, high inflation is normally associated with high interest rates and high interest rates inhibit borrowing for investment purposes, thereby slowing down economic growth and the development process;
2. Rising prices erode the public and investors' confidence in the economy and contribute to rapid exchange rate depreciation. This leads to currency substitution or dollarisation, which in turn, reduces the effectiveness of monetary policy;
3. Rising prices also undermine the country's external competitiveness, which may lead to a decline in export earnings, thus, worsening the balance of payments position of the country; and
4. Rising prices entrench poverty through the erosion of peoples' incomes, particularly those on fixed incomes.

Therefore, high inflation is a major source of concern to the Central Bank as it poses a threat to general economic development. With regard to the real estate sector, high inflation will affect the cost of property. In the case of the low income group, high inflation will make real estate prices unaffordable.

Apart from inflation, there are other financial prices which are of great concern to the Bank of Zambia, especially in our efforts to stabilise the macro-economy. One such financial price is the level of interest rates. Interest rates, being the cost of funds, can inhibit borrowing for investment in real estate if they are too high. Inflation also affects the level of interest rates.

To this effect, lowering of interest rates requires that all key stakeholders play their respective roles effectively and consistently. The Government, by reducing domestic borrowing, contributes to the lowering of yield rates on Government securities, which are often used as anchors by commercial banks in setting their interest rates. Commercial banks are, on their part, also expected to respond favourably to improving macroeconomic conditions consistent with low interest rates, while borrowers need to improve their credit culture. As for the Bank of Zambia, the greatest contribution we can make to the lowering of interest rates is reduction of inflation to single digit levels. In this regard, the Bank will continue monitoring financial conditions and take appropriate actions to contribute to the lowering of lending interest rates.

Exchange rates are yet another financial price that should be stabilised to effectively contribute to the promotion of the growth of the real estate industry, particularly that a substantial amount of building materials, such as, steel are imported. An unpredictable behaviour of the exchange rate can make investment in real estate unattractive.

However, following the introduction of the Broad-based Interbank Foreign Exchange System (IFES) in July 2003, the exchange rate of the Kwacha against major foreign currencies, particularly the US dollar, has been relatively stable. The Kwacha appreciated by 2.6% against the US dollar in 2004, after depreciating by 7.2% in 2003. Other factors contributing to the relative stability of the Kwacha include strong performance of the external sector, prudent fiscal management, and the broad weakness of the US dollar in the international market. From the behaviour of the exchange rate of the

Kwacha against major currencies, it is clear that, supported by effective supervision, foreign exchange market participants are able to police themselves and instil discipline in the market.

Ladies and Gentlemen

Allow me, at this juncture, to turn to the other function of the Bank of Zambia – that of ensuring financial system stability. As you may be aware, financial system stability is very critical to the maintenance of macroeconomic stability. As a matter of fact, monetary policy would not be effective in pursuing the inflation objective if the financial system were not stable, for monetary policy actions are transmitted through financial institutions.

In this regard, a stable financial system plays a catalytic role for financial institutions to provide the financial products that will contribute to the development of the real estate business.

Therefore, to enhance the capacity of the financial institutions to meet the challenges of financing, among others, the real estate sector, the Bank has undertaken a lot of reforms. For instance, the Bank's legislative and supervisory powers have been strengthened to conform to a liberalised financial sector.

However, the development of a more active secondary financial market to enhance efficiency in the financial system remains a key challenge to us. To address these and other challenges, the Government approved the Financial Sector Development Plan (FSDP) in 2004. In coming up with the FSDP, the Government recognised, among other weaknesses, that public financial institutions that were established to facilitate the provision of various financial services to the majority of the people in the country were insolvent, and therefore ineffective, or have closed down. e.g., mortgages (ZNBS); agriculture lending (LIMA Bank, Co-operative Bank and EXIM Bank in the past) and; banking services for the rural populace (NSCB). In addition, long-term project finance has remained difficult to access for many years. In this vein, the FSDP is aimed at enhancing financial intermediation and efficiency of the financial sector, and it is anticipated that problems related to real estate finance would be resolved once the FSDP is fully functional.

Ladies and Gentlemen

In conclusion, I wish to reiterate the importance of the real estate sector in economic and social development in the country. With your contribution, and that of other stakeholders Zambia could easily achieve the national socio-economic goals in the medium term. Every economic unit needs the services of a booming real estate and construction sectors for them to contribute more to economic growth and development. In this regard, I trust that the various institutions represented here will continue to facilitate and promote investments in the real estate sector in Zambia. On our part as the Bank of Zambia, we will continue to facilitate real sector economic activity by continuing to improve the macroeconomic conditions in the country that are critical to the mobilisation and expansion of business. In turn, it is expected that other sectors of the economy will benefit and contribute to accelerated economic growth and development.

I THANK YOU.