

Caleb M Fundanga: Financial sector challenges and progress in Zambia

Speech by Dr Caleb M Fundanga, Governor of the Bank of Zambia, at the Information Exchange Forum on Sources of Finance, Lusaka, 10 December 2007.

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- Mr Chairman
- Representatives of International Financial Institutions
- Chief Executives and representatives of Financial Institutions
- Distinguished ladies and gentlemen

I am greatly honoured to be given an opportunity to make some remarks at this forum. I wish to extend a warm welcome to all participants gathered here today, particularly those who have travelled from outside the country. I hope that you will not only have fruitful deliberations but also find time to explore the beautiful scenery and experience the warm hospitality that Zambia has to offer.

Mr Chairman, Ladies and Gentlemen, this forum is more than timely as Zambia is working tirelessly towards financial deepening, wealth creation and reducing the levels of unemployment. In order to achieve this, affordable financial services should be available to the majority of businesses. In fact, the forum has come at an opportune time when the economy has shown signs of macroeconomic stability and growth.

The financial sector in Zambia is considered relatively under developed. In spite of this status, post independence governments have always recognised the importance of the financial sector to national economic development. This is the reason why the activities of the sector had up until 1992 been controlled by the state. Since then, the financial sector has been liberalized while simultaneously strengthening the regulatory framework.

Concerned with the limited contribution of the financial sector to economic development, the Government devised and formulated policy mechanisms for addressing a number of identified obstacles within the framework of the Poverty Reduction Strategy Paper (PRSP) whose implementation started in 2002. In line with the PRSP framework, the World Bank and the International Monetary Fund undertook an assessment of the financial system through the Financial Sector Assessment Programme (FSAP) which was complimented by our own review.

Some of the principle areas of concern identified included:

- Low financial intermediation with limited access to financial services, especially for the rural and peri-urban population and the low-to-middle income earners;
- Poor credit culture in the market;
- Multiple and potentially conflicting roles of the government in the financial sector;
- Weak regulatory framework for non-bank financial institutions, insurance and pension funds;
- Undeveloped money and capital markets; and
- Limited long-term development and housing finance.

In recognition of the strategic importance of the financial sector to the country's development and poverty reduction efforts, the Zambian government launched the Financial Sector Development Plan (FSDP) in 2004 to address weaknesses that had been identified in the financial sector. The FSDP is therefore a comprehensive strategy that is aimed at achieving a financial system that is sound, stable and market-based, that would support efficient resource mobilization necessary for economic diversification and sustainable growth.

The financial sector weaknesses are being addressed through a public and private sector partnership. The implementation structure is chaired by the Secretary to the Treasury at Ministry of Finance and National Planning with the secretariat function responsible for the coordination of activities based at the Bank of Zambia.

Mr Chairman, the goal of the FSDP is to have a financial system that is stable and market-based in order to support efficient resource mobilization necessary for economic diversification and sustainable growth. A number of reforms have already been undertaken under this plan. For instance, a Credit Reference Bureau has been established and we expect it to be operational in the coming year. In addition, studies have also been taken to comprehend the constraints to broader access financial services.

One of the outputs of the FSDP has been a market knowledge study called Finscope Zambia which is a nationally representative survey of the use of, and demand for, financial services. It provides insights into how consumers source their income and manage their financial lives. This is the first time a survey like this has been conducted in Zambia and provides valuable information for players in the financial market.

The survey, which was conducted in 2005, notes that very few Zambians use the formal financial sector. The report reveals that most Zambians prefer to invest in non-financial instruments such as a business, livestock, land or agriculture equipment.

Mr Chairman, the year 2006 marked the eighth consecutive year of positive real growth in output while inflation declined remarkably to single digit level of 8.2%. During this period, investment was strong, particularly in the mining, tourism, construction, transport and agricultural sectors. This set a good basis for further favourable economic growth in the medium to long-term. Increased private sector investment, particularly in the mining sector, contributed to this growth.

Mr Chairman, Ladies and Gentlemen, Zambia's external position has also shown remarkable improvements with the trade surplus rising to US \$1,176.0 million in 2006 from US \$10 million in 2005. Similarly, the current account deficit as a percent of GDP (excluding grants) reduced to 2.3% from 11.8% during the same period. This outturn was mainly attributed to high receipts from increased copper exports. Debt relief and increased budget support from cooperating partners also helped strengthen the external position.

Mr Chairman, the financial system has exhibited continued stability in the last eight years with the banking sector recording an average annual growth of more than 27% in total assets. Similarly, the deposit base has recorded an annual average growth of 28% over the same period. This is evidence of rising economic activities. However, the increase in the deposit base alone can not fully support the enormous need for access to affordable loanable funds in the economy.

I must mention here Ladies and Gentlemen, that financial markets in Zambia are still developing. With respect to money market developments, commercial banks lending rates have been declining but not at the rate as inflation or treasury bill rates. Commercial banks nominal average lending rate declined from 33.9% in December 2005 to 27.6% in December 2006 and stood slightly lower at 27.3% in February 2007. This is still on the high side for most entrepreneurs. However, there are positive indications from commercial banks due to the growing confidence in the economy and lower lending rates are therefore expected given the current environment of low inflation.

Mr. Chairman, in the Non-Bank Financial Institutions (NBFIs) sector, institutional growth has continued to be a challenge. The number of NBFIs supervised by the Bank of Zambia has increased in the last 6 years, by 15% from 52 in 2001 when a specialized NBFIs department was established, to 60 today. The establishment of this specialised department was in response to:

- the expansion of the NBFIs sector;

- the increased innovation in the sector; and
- the increase in the number of NBFIs supervised by BoZ after amendments to the Banking and Financial Services Act (BFSA) in 2000.

The increase in the number of new entrants in the NBFIs sector has been due to the stability in the macro-economic environment in general and the financial sector in particular. To illustrate this further the BOZ receives on average about 7 applications per quarter, mainly from bureaux de change.

This is also being driven by the growing demand for finance by both public and private investors in this sector. In the recent past for instance, a private leasing company received structured finance of US\$10 million (or approximately K38 billion at today's exchange rate) while the Development Bank of Zambia also issued a corporate bond of K68 billion (which is just under US\$18million). Increased participation in both the money and capital markets by non-bank financial institutions with proposals for issuance of other corporate bonds are also under current consideration.

Mr Chairman, some of the key sectors with potential investment include agriculture, mining, manufacturing, tourism and energy.

Mr. Chairman, given all these developments which I have cited, one can tell that there are enormous possibilities for the financial sector in Zambia. In this regard, our expectation, at the Bank of Zambia, is that the financial sector should take a leading role in facilitating further developments in the areas which I have discussed. However, during our interactions, key players in the financial sector have informed us that they have a limited capacity to provide the required services in this regard.

This forum has therefore been organized and arranged by the Bank of Zambia to bring together Zambian financial sector players and international financial players who have an interest to see that Zambia takes its rightful place in the world economy. Our expectation is that after this forum, we shall see the emergence of an interactive and symbiotic alliance between International and Zambia financial institutions whose goal will be to provide financial services that will uplift the well-being of the Zambian populace at large. This sounds like a difficult task to achieve but it is my conviction that it is better to begin a step towards this direction rather than waiting for it happen in future.

On a lighter note, Ladies and Gentlemen, let me remind you that the Soccer World Cup to be hosted by South Africa in 2010, has attracted increased demand in the construction and tourism sectors in the whole Southern African Region. Zambia needs to take advantage of this and invest heavily in the tourism industry to benefit from the event; particularly that it has a vast number of national parks and the Victoria Falls, one of the seven natural wonders of the world. Obviously this can only be done if there is long term partnerships between local financial institutions and International financial institutions like the ones invited here today.

Mr. Chairman,
Ladies and Gentlemen,

I thank you for your attention.