

Caleb M Fundanga: Narrowing Zambia's investment gap for sustainable development

Keynote address by Dr Caleb M Fundanga, Governor of the Bank of Zambia, at the Euro-Money Zambia Investment Conference "Narrowing Zambia's investment gap for sustainable development", Lusaka, 10 June 2008.

* * *

1.0 Introduction

Over the recent past, the Zambian economy has performed relatively well. This is reflected in the positive growth rates in real Gross Domestic Product (GDP), low inflation, relative stability in the exchange rate of the Kwacha against major currencies, stable financial sector and improved banking services.

The recent impressive economic trends suggest that the reform programmes that have been pursued are working and bearing fruit. These reforms have focused on the restructuring of the economy, to let markets determine prices, shift production decisions from the Government to the private sector and provide an enabling environment for increased investment. This has led to a stable macroeconomic environment and has provided a basis for growth. However, the challenge that still remains is that of meeting the basic needs of Zambians in order to uplift their living standards. Equally, the economy still has low savings needed to finance development activities and therefore needs more foreign capital to expand its productive capacity and create more jobs that contribute to the uplifting of people's living standards.

Zambia is a country with abundant natural resources and human capital. It is a centrally located country with eight neighbouring countries and close proximity to the large market of South Africa, a surface area of over 750,000 sq km, and an approximate population of over 11 million people. It also boasts of a suitable climate, peace and a multi-party competitive democratic political system. The country possesses all the necessary attributes for sustainable economic growth and development. Competitive production costs, incentives, and reforms have also enhanced the attractive investment climate for both local and foreign investors. Numerous investment opportunities exist amongst the agriculture, manufacturing, tourism and mining sectors across various regions of the country. Almost all provinces in Zambia remain potential areas of investment whose resources remain largely untapped. Its active participation in the SADC Trade protocol and the COMESA/FTA offers preferential tariff access to market potential of nearly 380 million people.

The Zambian Development Agency (ZDA) Act ensures that property rights are fully respected with full compensation on market value made in case of expropriation. The country is also a signatory to the Multilateral Investment Guarantee Agency of the World Bank which guarantees foreign investment protection in cases of disasters and other disturbances. Bilateral investment treaties with a number of countries also encourage, promote and protect foreign investment. Foreign investors seeking joint venture partners can approach ZDA which registers investors together with project profiles of domestic investors seeking collaboration.

2.0 Recent economic developments

2.1 Real Gross Domestic Product (GDP)

During the period 2001-2007, growth in real Gross Domestic Product (GDP) averaged about 5.1% per annum, largely due to investment in the mining, tourism, construction and transport

and agriculture sectors. This has set a strong basis for further favourable economic growth in the medium to long-term. Thus GDP growth is projected to rise by no less than 7.0% in 2008 and beyond. Consistent with the developments in the economy, GDP per capita rose to US \$934.5 in 2007 from US \$360.5 in 2001.

2.2 Interest rates

Commercial banks' lending rates have also been declining, though not as fast as the reduction in inflation and Treasury bills rates. For instance, the commercial banks average lending rate fell from 54.6% in December 2001 to 24.4% in December 2007. Lower lending rates are expected in the current environment of low inflation and will contribute to reducing the cost of doing business in Zambia.

2.3 Inflation

Inflation has declined from 18.7% recorded in 2001 to single digit level of 8.2% in 2006 and 8.9% in 2007. It is projected to slow down further to 7.0% by December 2008. This inflation outturn was largely credited to the conduct of appropriate monetary policy coupled with prudent fiscal policy and relative stability of the Kwacha, assisted by lower food prices following the favourable 2005/06 and 2006/07 farming seasons.

2.4 External sector

Zambia's external position continues to show remarkable improvements as reflected in the build up of gross international reserves to 3.6 months of import cover in 2007 from 0.9 months of import cover in 2001. Preliminary assessment is that Zambia's surplus trade balance rose to US \$983.1 million compared to the deficit of US \$342.2 million in 2001. Similarly, the current account deficit as a percentage of GDP reduced to 4.4% in 2007 from 19.1% in 2001.

This outturn was mainly attributed to high receipts from increased copper exports following increased production and record high prices on the international market due to strong demand mainly from China. Coupled with this, between 2000 and 2007, nontraditional export earnings rose by 260% from US\$ 255.7 million in 2000 to US\$ 920.7 million in 2007 with commodities such as sugar, copper wire and tobacco, coupled with receipts from tourism making notable contributions.

In addition, the attainment of the enhanced HIPC completion point in April 2005 and Multilateral Debt Relief Initiative (MDRI) in 2006 provided for cancellation of (IMF, IDA and ADB) debt resulting in a reduction in debt stock to about US \$2.1 billion in 2007 from the end-2001 debt stock of US \$7.3 billion. The debt relief and increased budget support from cooperating partners also helped strengthen the external position.

The foreign exchange market is liberalised, therefore the Kwacha is determined by demand and supply conditions in the market. In 2007, the Kwacha appreciated against the major international currencies with the exception of the euro. Against the US dollar, the Kwacha appreciated by 7.2% compared with a depreciation of 20.7% in 2006. This was attributed largely to higher inflows of foreign exchange on the market due to increased export receipts, which largely reflected high copper prices and the continued participation of foreign portfolio investors in the domestic Government securities market. The depreciation of the Kwacha against the euro can be attributed to significant gains of the euro against the US dollar and other major currencies, supported mainly by relatively buoyant growth prospects in the euro area.

2.5 Banking sector environment

The overall financial condition and performance of the banking sector has been satisfactory, as reflected in adequate capitalisation and most banks meeting their minimum regulatory capital requirements. With 13 commercial banks in operation comprised of both local and foreign, investment opportunities are immense. The Government through the Bank of Zambia continues to modernise the overall commercial banking environment, by endorsing various legislation to promote safe, sound and efficient operations and development of not only the banking sector but the financial system as a whole. This is evidenced by enhanced financial stability and the emergence of a number of financial institutions offering an array of financial services. For example, the National Payments Systems Act was enacted in June 2007, while Access Bank, the fourth largest bank in Nigeria is expected to open a branch in the country by July 2008, raising the number of commercial banks to 14.

2.6 Capital market developments

The Lusaka stock exchange performed remarkably well, market capitalisation increased by 45.0% to K18,872.9 billion compared to the increase of 13.9% in 2006. The Lusaka All Shares index almost doubled, rising by 92.9% to close the year at 3,533.52 points compared to an increase of 47.7% in the previous year. This robust performance was a reflection of strong macroeconomic fundamentals in the economy and positive investor expectations in the growth and earnings prospects for both listed and quoted companies.

Government introduced 7, 10 and 15-year bonds to help deepen the financial markets in 2007. Foreign investments in Government securities rose to K830.5 billion as at December 2007 from K539.8 billion recorded end-December 2005, an indication of the rising confidence in the economy.

2.7 Fiscal developments

On the fiscal front the Government is expected to limit domestic borrowing to 1.2 percent of GDP in 2008. By reducing levels of government borrowing and enforcing prudent budget execution, this should result in greater mobilisation of domestic resources and effective coordination with the monetary authorities.

Zambia has articulated its long-term development objectives in the National Long Term Vision 2030, which is aimed at raising Zambia to a middle income status by 2030. Part of this vision is enshrined in the Fifth National Development Plan (FNDP); 2006-2010 whose theme is: "Broad Based Wealth and Job Creation through Citizenry Participation and Technological Advancement". The growth of the economy will be driven by increased activities by the private sector in agriculture, mining, export-led manufacturing and tourism. Government will support this growth by accelerating the implementation of structural reforms and promote investing in key infrastructure such as roads, energy and telecommunication in conjunction with the private sector as well as improve legal, institutional and regulatory frameworks.

3.0 Infrastructure development

In order to consolidate the recent economic successes and to realize full potential, Zambia needs to address the large infrastructure gap that is inhibiting further growth. Weak infrastructure such as: roads, rail system, airports/airstrips and other communication barriers reduce the ability to take advantage of the good location that the country has. Furthermore investment, particularly in rural infrastructure needs to be scale-up significantly. Poor infrastructure and inadequate access is resulting in significantly increased cost of doing business, making it difficult to integrate the rural population with the rest of economy. Opportunities for investment in infrastructure development exist in the following sectors:

3.1 Transport and communication

The generally good land route communication networks of Zambia's neighbouring countries have encouraged the southern connections. The government of Zambia has embarked on the process of rehabilitating the road network, which covers 35,168 km. Therefore investment opportunities are available in the areas of road rehabilitation, routine maintenance and consultancy. Although the country has international highway links with Tanzania, Democratic Republic of Congo, Botswana, Zimbabwe, Namibia, Malawi, Mozambique and South Africa, the roads can not accommodate the growing traffic due to increased trade with other countries. There is a large investment potential for multiple lane highways to cater for the smooth running of traffic for increased efficiency in trade.

Further, the railway system remains the dominant mode of transport for heavy goods to local and international routes. It also links Zambia to six African seaports such as Dar es Salaam, Beira, East London, Port Elizabeth, Durban and Cape Town. The railway system however, requires substantial investment to upgrade it into an ultra modern facility that would allow speedy transportation of goods and products to the ports for delivery to other markets.

In air transport, Zambia has 4 international airports at Lusaka, Livingstone, Mfuwe and Ndola. In order to support the increased transportation demand for goods and services, there is need to increase the capacity of the existing airports to provide direct links with most countries in the sub-region and other places. Connections to all countries in the subregion will also encourage large commercial airlines to set up in the country and take advantage of Zambia's central location.

Over 97 percent of the telephone exchanges are automatic, and the country enjoys direct dialling facilities, fax, e-mail and television links with the rest of the world. In the main urban centres, public telephones and independently operated cellular telephone networks are in place. Zambia also hosts ZamNet and other internet service providers.

In order to continue diversifying our export base and further increase our export earnings, it is imperative that we intensify use of marketing strategies that take advantage of the fact that globalisation requires each country to develop more efficient modes of communication. Therefore, inadequate infrastructure, institutional capacity and investment in skilled human resources should continue to be aggressively addressed by targeting identified weak areas, and implement policies to tackle the weaknesses speedily so as to enhance economic growth and developments prospects. In addressing these issues, it is crucial to build strong partnerships, particularly with the private sector, for effective Information and Communication Technology (ICT) development in Zambia.

The agriculture sector however, remains one of the key areas where advancements in ICTs have not yet been fully taken advantage of in order to benefit rural communities and the economy in general. In fact, communications infrastructure has been either lacking or inadequate in most rural areas of Zambia to give an opportunity to rural communities to access and distribute information at low cost, as well as facilitate interactive participation in the creation and use of agricultural information. The potential benefits of a well integrated ICT in agriculture are diverse and include:

- transparent dissemination of information such as weather patterns, seed and fertilizer use, availability and distribution;
- easy accessibility to suppliers of inputs;
- common distribution of information on market prices of crops; and
- generally bringing together of suppliers and buyers of crops.

Government has put agriculture at the core of rural development and poverty reduction as well as employment creation. It is therefore important to note that the expansion of ICTs in rural communities is more required now than ever before, as most information is now

disseminated through internet and cellular phones. These facilities will help uplift the living standards of rural communities.

3.2 *Agriculture*

Zambia's agriculture sector has enormous potential to become a major grower and exporter of agricultural and horticultural produce. The country has an abundance of quality land, water (over 40% of fresh water resources in Southern Africa) and ideal climate all suited to a wide range of agricultural products. Only 15% of Zambia's 60 million hectares of arable land is under cultivation.

The recent surge in food prices in the world presents an enormous opportunity for Zambia to become the food basket of the sub region. This can be achieved by re-doubling efforts to boost agricultural productivity coupled with substantial increase in infrastructure investment to ease supply bottlenecks that are pushing up prices. Zambia's irrigation potential is estimated at more than 500,000 hectares while only about 40,000 hectares are irrigated despite the country having abundant water resources. Increased yields in agricultural products like maize, rice and wheat, requires inputs such as fertilizers, irrigation water and proper roads to enable the harvested crops to be transported to the main markets and to prevent crop losses.

3.3 *Energy (electricity)*

Abundant investment opportunities exist in the energy sector in view of the huge power deficits in Southern Africa and Zambia's potential for more hydro-power generation plants. Due to vast water resources and coal reserves, Zambia is ideal for the provision of hydroelectric power. Although most of the electricity is supplied from major hydro stations, there are also small diesel power stations in rural areas. There are plans to develop a 600-megawatt hydroelectric generation plant on the Kafue River. Currently, the development of Itezhi-Tezhi Hydro Electric Project; Kafue Gorge Lower Hydro-Electric Project; Zambia-Tanzania Interconnector; and Zambia-Namibia Interconnector are underway.

However, there is still potential for more power generation capacity for the private sector to invest in. Apart from the mining sector that provides a huge demand for power in the country, there is a huge demand for power in the SADC region as well as the Eastern African bloc. The expected rise of the manufacturing sector will also increase demand for power in the country.

Opportunities also exist in alternative sources of power such as solar energy and gas energy for domestic cookers. With a temperatures ranging between 15 and 27 degrees for most parts of the year, the solar energy potential is high. The oil refineries in the country also emit gasses that can be tapped and turned into gas for domestic cookers.

3.4 *Mining*

Zambia's mineral wealth remains substantial. Quite apart from the traditional mining activities in copper and cobalt the list of investment opportunities in this sector include:

- Precious metal-gold; silver; selenium;
- The platinoid group – iron, tin, nickel and manganese;
- Agro-minerals-rock phosphate and igneous phosphate suitable for conversion to fertilizer, peat, limestone;
- Reclaiming of copper from slug tailing dumps;
- Gemstones-emerald, amethyst, aquamarine, tourmaline;
- Nickel;

- Uranium; and
- Other deposits-talc, fluorspar, graphite, barites and clays, etc.

The 1995 Mines and Minerals Act provide exemption from import duty and VAT on all machinery and equipment, including specialised motor vehicles required for prospecting or mining activities.

In its 2008 Budget, the Government introduced the new fiscal and regulatory framework for the mining sector. Under this framework, the mining sector will begin to adequately contribute to the advancement of and the social economic welfare of the people of Zambia.

3.5 Tourism

Untapped tourism opportunities exist in all the 19 National Parks and 34 game management areas as well as the 23 million hectares devoted to the conservation of an amazing variety of animals. Major attractions include the Victoria Falls (one of the seven natural wonders of the world) and the Kariba Lake (one of the largest man-made lake). Specific areas of investment in this sector include:

- Game ranching;
- Provision of accommodation (i.e. high quality five and four star hotels, Lodges and Camp sites near the popular tourist areas);
- Transport service – Investment potential exists in air charters in form of helicopters and/or small planes to service game areas;
- Adventure holiday packages;
- Organised tours;
- Out door sports facilities (golf courses and stadia); and
- Zambia's cultural heritage.

3.6 Construction and real estate

The construction sector is yet another area of investment as the economy expands. A lot has been done in the recent past in construction with housing schemes coming up in various parts of the country. However, there is still a large deficit in terms of housing in Zambia. This deficit in housing provides an opportunity for further investment in the construction of more houses.

4.0 Conclusion

Looking ahead, the achievement and maintenance of a low and stable inflation rate, remains key to enhancement of investment, business planning, confidence in the economy, maintaining external competitiveness and stabilising people's incomes. In the medium-term, Government continues to pursue market and structural reforms in partnership with the private sector with the view of consolidating the gains so far attained for sustained economic growth and development. Currently, there are enormous business opportunities which still lie unexploited in Zambia in virtually all sectors of the economy.

The overall economic growth in the economy would be enhanced underpinned on low and single digit inflation and relative stable exchange rate. With an enabling environment, the private sector would exploit their full potential. Hence, employment would increase and poverty reduction would be achieved. This would contribute to the achievement of MDGs and towards the attainment of the Vision 2030.