

Caleb M Fundanga: Fourth quarter 2010 media briefing

Presented by Dr Caleb M Fundanga, Governor of the Bank of Zambia, Lusaka, 18 February 2011.

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Executive summary

1. This brief examines monetary policy implementation and its outcomes in the fourth quarter of 2010. The brief also reviews other economic and financial sector developments, and concludes with an inflation outlook for the first quarter of 2011.

Monetary policy

2. The focus of monetary policy during the fourth quarter of 2010 continued to be the achievement of the end-year annual inflation target of 8.0%. In this regard, the Bank of Zambia utilised largely Open Market Operations to maintain reserve money within the programmed growth path. This was supported by the auctioning of Government securities.

Inflation

3. Quarterly overall inflation increased to 2.5% in December 2010 from 1.6% in the third quarter, and was above the 2.3% recorded in December 2009. This outturn was mainly attributed to the rise in food inflation to 3.6% from -0.1% in the previous quarter, as non-food inflation slowed down to 1.5% from 3.2% during the same period.

4. Similarly, the annual overall inflation rate rose to 7.9% in December 2010 from 7.7% in September 2010, but was in line with the end-year target of 8.0%. This outturn was largely on account of the rise in annual food inflation to 4.4% from 2.8% in September 2010, as annual non-food Inflation decreased to 11.3% from 12.5% during the same period.

5. Food inflation increased mainly on account of price increases on cereals, selected vegetable, beef products, and fish due to seasonal supply factors. However, non-food inflation slowed down on account of the Kwacha exchange rate appreciation against the US dollar during the period under review.

Money supply and domestic credit

6. Preliminary estimates indicate that broad money (M3), comprehensively defined to include foreign currency deposits, increased by 2.5% (September 2010, rose by 7.9%) to K18,477.0 billion in December 2010 from K18,018.4 billion in September 2010. This growth in M3 was below the quarterly projection of 3.2%.

7. The outturn in M3 was largely due to an increase in Net Domestic Assets (NDA) by 10.3% reflecting increased lending to Government. However, Net Foreign Assets (NFA) declined by 7.9% mainly on account of a 1.3% decrease in gross international reserves to US \$2,093.7 million as at end-December 2010, coupled with 1.2% appreciation of the Kwacha against the United States dollar.

8. On an annual basis, M3 growth increased to 30.8% in December 2010 from 32.8% in September 2010. This outturn was due to the rise in NFA by 40.1% (September 2010, fell by 6.9%) primarily on account of an increase in gross international reserves. The NDA rose by a lower margin of 25.6% compared with the rise of 94.6% recorded in September 2010.

9. Domestic credit, comprehensively defined to include foreign currency loans, increased by 5.4% to K14,915.1 billion as at end-December 2010 (September 2010, growth of 3.1%) from K14,153.8 billion in September 2010. This outturn was mainly due to increased lending to the private sector (including public enterprises) and Central Government by 5.7% and 4.6%, respectively. On an annual basis, domestic credit growth at 22.9% was 9.4 percentage points higher than the 13.5% recorded in September 2010.

10. On a sectoral basis, households (personal loans category) continued to account for the largest share of outstanding credit, accounting for 26.8% [26.3%]¹ in December 2010. The agricultural sector was second at 17.6% [17.1%], followed by manufacturing 12.7% [13.4%], wholesale and retail trade 10.8% [12.0%], real estate 6.2% [5.4%], construction 5.8% [6.0%], transport, storage and communications 4.7% [5.3%], community, social and personal services 3.7% [2.5%] and mining and quarrying 3.2% [3.1%].

Interest rates

11. Yield rates for Government securities trended upwards, extending gains from the previous quarter as investors sought to consolidate positive returns over the inflation rate. Thus, the composite weighted average Treasury bill yield rate increased by 58 basis points to 8.2% while that for Government bonds rose marginally by 10 basis points to 11.3%.

12. The stock of Government securities outstanding increased by 5.6% to K9,940.9 billion at the end of the fourth quarter from K9,411.2 billion in the third quarter. This was mainly accounted for by an increase of 13% in the amount of Treasury bills outstanding against a modest growth of 0.2% recorded for Government bonds. Despite this, Government bonds accounted for the largest proportion of the outstanding total stock of marketable securities, contributing K5,439.4 billion (54.7%) to the entire portfolio. Total Treasury bills in circulation amounted to K4,501.5 billion, representing 45.3% of the total marketable securities outstanding.

13. Investment in Treasury bills held by non-residents increased to K497.0 billion from K8.8 billion in the third quarter. The increase reflected renewed confidence in short-term Government paper. Conversely, foreign Investment in Government bonds decreased to K127.9 billion from K150.5 billion recorded in the third quarter, due to net maturities. Collectively, total holdings of Government securities by non-resident was K625.4 billion, representing 7% of total securities outstanding.

14. Developments in commercial banks' nominal interest rates continued to be mixed during the reviewed quarter, with the weighted average lending base rate (WALBR) trending downwards to 19.4% from 19.8% in September 2010. Similarly, the average lending rate (ALR) fell to 26.4% in December 2010 from 26.8% in September 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

15. Developments in the real sector were satisfactory during the reviewed quarter. This was reflected by higher output of most monitored commodities, and an increase in investment pledges.

¹ Figures in square brackets are for September 2010.

Food reserve agency stocks

16. The Food Reserve Agency (FRA) had 982,784 metric tonnes (mt) of maize in stock at end-December 2010, up from 162,956 mt at end-September 2010, out of which, total purchases from the marketing season amounted to 883,036 mt. The Agency also had in stock 4,508 mt of rice (1,794 mt; 30th September 2010), out of which, 3,647 mt was purchased during the 2010/11 agricultural marketing season.

Major Millers maize stocks

17. The stock of maize grain held by major millers in the country fell by 10% to 91,655.9 mt at end-December 2010 from 101,807 mt at end-September 2010. In terms of holdings by province, Lusaka contributed 52,250 mt (57%), Southern 18,007.5 mt (19.6%), Copperbelt 12,200 mt (13.3%), Central 7,128 mt (7.8%), Western 2,000 mt (2.2%), and Northern 40 mt (0.04%), respectively, while Eastern province accounted for 30 mt (0.03%).

Mining

18. During the fourth quarter of 2010, copper output fell by 13.5% to 197,500.2 mt from 228,369.7 mt produced in the previous quarter. Nonetheless, this output was 9.6% higher than the 180,188.2 mt of copper produced in the fourth quarter of 2009. On an annual basis, copper output at 819,159.2 mt was 17.4% higher than the 697,700.7 mt of copper produced in 2009.

19. Cobalt output rose by 1.5% to 2,401.79 mt during the fourth quarter of 2010 from 2,367.26 mt recorded in the previous quarter. This level of output reflected an increase of 26.7% when compared with the 1,896.24 mt produced in the fourth quarter of 2009. On an annual basis, cobalt output at 8,781.85 mt was 49.4% higher than the 5,879.14 mt of cobalt produced in 2009. The improvement in output was due to the resumption of production at Konkola Copper Mines and Chambishi Metals Plc.

Manufacturing

20. During the quarter under review, production of clear beer by *Zambian Breweries Plc* increased by 6.2% to 237,458 hectolitres from 223,607 hectolitres the previous quarter. Further, this output was 46.7% higher than the 160,820 hectolitres produced in the corresponding quarter of 2009. On an annual basis, output of clear beer at 727,191.0 hectolitres was 27.6% higher than the 569,771.0 hectolitres of clear beer produced in 2009.

21. Similarly output of soft drinks by *Zambian Breweries Plc* rose by 28.8% to 163,848.0 hectolitres from 127,244.0 hectolitres in the previous quarter. Moreover, this output level was 45.3% higher than 112,722.0 hectolitres produced in the fourth quarter of 2009. On an annual basis, output of soft drinks at 561,910.0 hectolitres was 49.1% higher than the 376,747.0 hectolitres of soft drinks produced in 2009.

22. Production of milk by *Parmalat Zambia Ltd* during the quarter under review rose by 10% to 8,613,737.0 litres from 7,830,878.0 litres in the third quarter of 2010. Further, this output was 5.3% higher than 8,178,335.0 litres of milk produced during the fourth quarter of 2009. On an annual basis, output of milk at 32,456,505.0 litres was 8.2% higher than the 29,984,030.0 litres of milk produced in 2009.

23. Cement output increased by 26.1% to 359,966.0 mt in the fourth quarter of 2010 from 312,791.0 mt during the previous quarter. This outturn was attributed to a rise in cement production at *Lafarge Cement* and *Oriental Quarries* by 14.9% and 2.3% to 251,505.0 mt and 16,295 mt, respectively. *Zambezi Portland Plc* also increased its output of cement by 18.1%

to 92,166.0 mt. Total output of cement for the year at 1,126,728 mt was 37.9% higher than the 817,223.0 mt produced in 2009.

Tourism

24. During the quarter under review, international arrivals at the country's four international airports² declined to 116,140 passengers from 124,244 passengers in the third quarter of 2010. However, this was 24.0% higher than 93,688 passengers recorded during the fourth quarter of 2009. Livingstone and Mfuwe international airports, which are the major tourist destinations, accounted for 20,590 passengers and 257 passengers compared with 21,272 passengers and 241 passengers in the previous quarter, respectively.

25. On an annual basis, international arrivals at the country's four international airports increased to 679,172 passengers from 438,788 passengers recorded in 2009, representing an increase of 20.27%.

Investment

26. Total investment pledges were estimated at US \$1.0 billion in the fourth quarter of 2010 compared with US \$110.4 million in the third quarter. On a sectoral basis, pledges in manufacturing were US \$377.3 million, real estate (US \$264.0 million), agro-processing (US \$252.4 million), services (US \$31.3 million), agriculture (US \$25.3 million), tourism (US \$16.7 million), construction (US \$11.8 million), ICT (US \$8.8 million), and mining (US \$93.0 million).

27. The pledges when fully executed are expected to generate 22,532 jobs (1,726 jobs: third quarter 2010) with the highest contribution from services at 12,763 jobs followed by agro-processing at 5,860 jobs. The rest were manufacturing (1,882 jobs), construction (847 jobs), agriculture (397 jobs), tourism (343 jobs), real estate (247 jobs), ICT (157 jobs) and mining (14 jobs).

28. Investment pledges for the year 2010 increased by 138.6% to US \$4,791.6 million from US \$2,008.4 million recorded in 2009.

Real Gross Domestic Product (GDP)³

29. Preliminary estimates indicate that Gross Domestic Product (GDP) rose by 7.1% in 2010 from 6.4% in 2009. This outturn was well above the target of 5% announced by the Minister of Finance and National Planning in his 2010 Budget Speech.

30. The GDP outturn was largely attributed to the growth in the agricultural, construction and mining sectors.

- The 2010 agricultural harvest was the highest recorded in history, having produced over 2.8 million mt of maize; while the mining sector also benefitted from higher copper prices and production levels.
- The growth in the construction sector emanated from increased residential, commercial and public infrastructure construction projects across the country by both Government and the private sector.

² Lusaka, Livingstone, Mfuwe and Ndola.

³ Preliminary estimates.

Foreign exchange market

31. The Kwacha was firm against major traded currencies, backed by consolidation of macroeconomic gains and improved liquidity in the foreign exchange market. A sustained increase in the international price of copper to an average of US \$9,127.4 per ton provided further support to the local currency. Thus, the Kwacha appreciated by 2.1% against the US dollar to an average of K4,731.52/US\$ at the end of the fourth quarter.

32. The Kwacha also appreciated by 2.4% against the pound sterling to an average of K7,375.98/£ and by 1.1% against the euro to an average of K6,277.82/€. These gains were partially attributed to the lingering European debt crisis despite the bailouts extended to Ireland and Greece. In contrast, the Kwacha depreciated by 2.0% against the rand to an average of K691.22/ZAR. The South African currency was broadly stronger on account of higher price of gold and lower policy uncertainty after the Government clarified speculation on privatisation of public enterprises.

33. In terms of volume of transactions, commercial banks made spot purchases of US \$1,417.2 million from the non-bank public against sales of US \$1,213.3 million. This translated into net purchases of US \$203.8 million in the fourth quarter. Commercial banks also made net euro and pound sterling purchases €9.2 million £0.3 million, respectively. However, banks recorded net sales of ZAR853.1 million in the fourth quarter, underpinning the continued demand for the South African rand.

34. The general improvement in the availability of foreign exchange necessitated the Bank of Zambia's participation in the market. In this regard, the Bank recorded a net purchase of US \$58.5 million compared with net purchase or sale of US \$67.5 million in the third quarter.

Balance of payments

35. Preliminary data show that Zambia recorded an overall balance of payments (BoP) deficit of US \$71.1 million during the fourth quarter of 2010, compared to the surplus of US \$330.2 million recorded in the third quarter of the year. This was largely due to the unfavourable performance in both the current account balance and the capital and financial account.

36. During the period under review, the current account surplus declined to US \$390.6 million from US \$399.1 million recorded the previous quarter, largely on account of a decline in the merchandise trade surplus and widening of the net income deficit.

37. The merchandise trade surplus declined by 9.2% to US \$771.4 million in the fourth quarter of 2010, from US \$849.6 million recorded in the third quarter, following an increase in imports, which outweighed the rise in exports. Merchandise export earnings, rose by 5.2% to US \$2,040.9 million from US \$1,939.2 million recorded in the previous quarter. This was due to an increase in metal exports earnings by 7.3% to US \$1,728.5 million from US \$1,610.2 million in the previous quarter.

38. Copper export earnings, at US \$1,654.3 million, were 7.8% higher than US \$1,534.9 million recorded during the third quarter of the year, reflecting an increase in the average realised price by 6.8% to US \$7,380.92 per tonne from US \$6,912.96 per tonne recorded in the third quarter. In addition, copper export volumes increased by 0.9% to 224,128.6 tonnes from 222,034.6 tonnes.

39. However, cobalt export earnings declined by 1.4 % to US \$74.2 million in the fourth quarter of 2010 from US \$75.3 million in the previous quarter. This followed a slide in the average realised price by 3.9% to US \$32,165.02 per tonne from US \$ 33,467.08 per tonne in the preceding quarter despite a rise in export volumes by 2.6% to 2,308.0 mt from 2,249.9 mt recorded in the third quarter.

40. Similarly, non-traditional exports (NTEs) f.o.b. fell by 5.1% to US \$312.4 million from the US \$329.0 million realised the previous quarter. This was largely due to declines in export earnings from copper wire, cotton lint, electrical cables, fresh fruits and vegetables, petroleum products and electricity.

41. In the period under review, merchandise imports, at US \$1,308.4 million were 15.4% higher than US \$1,134.3 million recorded the previous quarter. A surge in import bills associated with commodity groups, such as, food items, chemicals, iron and steel and item thereof and industrial boilers and equipment explained this outturn.

42. During the same period, the net income account deficit widened by 3.2% to US \$381.3 million from US \$369.3 million in the third quarter. This was largely on account of an increase in income on equity payments and interest payments. The current account transfers, increased to US \$128.1 million from US \$93.6 million recorded the previous quarter, explained by the disbursement of budget grants amounting to US \$53.8 million.

43. The capital and financial account deficit widened to US \$354.5 million from US \$238.9 million recorded in the third quarter. This was largely due to the unfavourable performance of the financial account arising from a surge in short-term deposits abroad by the private sector, despite the increase in foreign direct investment.

Developments in the financial sector

44. The overall financial condition of the banking sector for the quarter ended December 2010 was satisfactory. On aggregate, the banking sector's capital position, asset quality and liquidity were satisfactory. However, the earnings performance of the sector declined largely on account of an increase in the non-interest expenses (due to increases in staff emoluments, reorganization costs and additional tax provisions).

45. 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".

46. As part of the overall objective to enhance financial inclusion, the BoZ undertook provincial sensitisation tours on savings and credit covering all the nine provinces of Zambia. The tours focused on the following topical areas:

- The role and functions of the BoZ;
- The need to deal with licensed financial institutions;
- Getting credit; and
- The operations of a credit reference bureau.

47. The BoZ is planning to conduct the tours on a regular basis to address public misconceptions about the role of the BoZ in the financial sector. Future tours will also educate the public on how to detect genuine currency and how to invest in Government securities. The BoZ was requested to publish the names of licensed financial service providers in the print media on a more regular basis.

Developments in banking, currency and payment systems

48. During the quarter under review, there was a continued improvement in the availability of electronic payment options. The number of Point of Sale (POS) terminals increased by 8.3% to 1,119 (third quarter 2010: 1,033). The volume of POS transactions also increased by 42.2% to 284,145 (third quarter 2010: 199,817). Similarly, the values of POS transactions increased by 32.6% to K113.9 billion (third quarter 2010: K85.9 billion). The

Bank would like to urge members of the public to use Point of Sale terminals as they provide a more convenient, safer, efficient and cost effective way of making payments.

49. Further, the number of Automated Teller Machines (ATMs) increased by 4.5% to 489 ATMs (third quarter 2010: 468). The volume of ATM transactions also increased by 5.1% to 6,654,992 (third quarter 2010: 6,333,073). Similarly, the value increased by 17.1% to K3,397.3 billion (third quarter 2010: K2,897.6 billion).

50. The total volume of cheques returned unpaid on account of insufficiently funded accounts increased by 5.4% to 4,428 (third quarter 2010: 4,202) cheques while the value decreased by 8% to K36.2 billion (third quarter 2010: K35.3 billion). The Bank would like to urge members of the public to always ensure that they fund their accounts sufficiently whenever they issue cheques. This will ensure that they do not face criminal charges under the National Payment Systems Act for bouncing cheques dishonestly or with intent to defraud.

Economic programme

51. A follow-up International Monetary Fund (IMF) Mission visited the country from 28th October to 3rd November 2010 to conclude discussions for the 5th Review under the Extended Credit Facility (ECF) arrangement. 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 2011.

52. The IMF Executive Board meeting was held on 10th December 2010 and completed the fifth review of Zambia's economic programme. This resulted in the immediate disbursement of an amount equivalent to SDR 18.395 million (about US \$28.3 million), bringing total disbursements under the ECF arrangement to SDR 201.7 million (about US \$310.3 million).

53. The IMF mission commended the authorities for Zambia's economic prospects that have continued to improve as well as for having sound macroeconomic policies. It also commended the authorities for the progress made in implementing structural reforms. However, the Fund noted that the main medium-term challenge remained that of creation of fiscal space for priority spending, enhancement of economic diversification and poverty reduction.

54. Total disbursed poverty reduction budget support (PRBS) in the fourth quarter of 2010 amounted to US \$123.4 million from; the African Development Bank (US \$49.8 million), European Union (US \$43.8 million), Sweden (US \$9.9 million) and Germany (US \$9.9 million). This brought the total disbursed PRBS to US \$227.4 million for the year against the projection of US \$222.9 million. The variance of about US \$4.5 million is largely attributed to exchange rate variations.

55. In addition, a total of US \$35.0 million mining tax revenue was received from First Quantum Mining Plc, for the benefit of Government, while Bank of Zambia foreign exchange purchases from the market amounted to US \$61.0 million during the period under review. The above receipts were against payments to PTA Bank (US \$139.0 million) for oil procurement and debt service payments (US \$44.5 million).

Inflation outlook for the first quarter of 2011

56. Annual overall inflation is projected to remain above 8.0% during the first quarter of 2011, mainly due to the following factors:

- **Seasonal increase in some food prices:** During the first quarter of the year, there is seasonal low supply of selected food items including fish, fresh vegetables and

- ***Lagged effects of money supply growth in 2010:*** During the second half of 2010 there was a rapid increase in broad money by over 15.0%, largely due to lending to government for the purpose of purchasing maize following the bumper harvest.

57. 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.