



BANK *Of* ZAMBIA

QUARTERLY MEDIA BRIEFING

BY

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EXECUTIVE SUMMARY

- This brief provides a preliminary assessment of monetary policy implementation and its outcomes in the first quarter of 2008. The brief also reviews other economic and financial sector developments. In the conclusion, it provides an inflation outlook for the second quarter of 2008.

Monetary Policy

- In the first quarter of 2008, monetary policy was aimed at consolidating macroeconomic stability by maintaining single digit inflation, which was recorded at 8.9% in December 2007. Achieving this goal entailed containing the growth of liquidity in the banking system within the projected path.

Inflation

- During the first quarter of 2008, developments in inflation were unfavourable. The annual overall inflation rate remained in single digit, although it rose to 9.8% at end-March 2008 from 8.9% recorded in December 2007. On a quarterly basis, inflation increased to 5.4% from 3.0% recorded in the last quarter of 2007 and was also higher than the 4.6% registered during the corresponding quarter in 2007. This unfavourable overall inflation outturn reflected an increase in both food and non-food inflation.
- Annual food inflation increased to 9.1% in March 2008 from 5.9% recorded in December 2007. On a quarterly basis, it rose to 7.2% from 3.7% in the fourth quarter of 2007, and was well above the 4.1% registered during the first quarter of 2007. Contributing most to higher food inflation were prices of mealie-meal, maize grain, other cereals, cereal products, groundnuts, fresh fruits, chicken, fish (bream), beef, milk, eggs, oils and fats. This was attributed to higher production costs due to electricity load shedding, rising transportation costs, lower seasonal supply, the fishing ban as well as the continued ban on movement of cattle from Southern Province.
- Annual non-food inflation slowed down to 10.4% in March 2008 from 11.9% in December 2007. However, on a quarterly basis, it rose to 3.7% from 2.5% registered in the last quarter of 2007, although it was well below the 5.1% recorded during the corresponding period in 2007. Lower quarterly inflation relative to last year was mainly attributed to the relative stability in the exchange rate of the Kwacha against major trading currencies. The increase in the quarterly non-food inflation was on account of price changes on clothing and footwear, furniture and household goods, transport fares, education charges, medical care and other goods and services category.

Money Supply and Domestic Credit

- Preliminary estimates indicate that broad money (M3), comprehensively defined to include foreign currency deposits, declined by 7.2% in March 2008 (4th quarter 2007:

12.2%) to K9,933.7 billion from K10,707.0 billion in December 2007, due to the contraction in both *net foreign assets* and *net domestic assets* by 12.9% and 0.9%, respectively. Excluding foreign currency deposits, quarterly growth in M3 was 13.3%.

- On an annual basis, M3 growth marginally increased to 27.7% from 26.3% in December 2007. Excluding foreign currency deposits, annual M3 growth was recorded at 21.6% (23.8% in December 2007).
- Preliminary estimates indicate that total domestic credit, comprehensively defined to include foreign currency loans, declined by 9.4% to K6,930.0 billion in the first quarter of 2008 (4th quarter: 12.2%) due to a reduction in both net claims on central Government and credit to the private sector (including public enterprises). Net claims on central Government declined by 30.1% while private sector (including public enterprises) credit declined by 2.6%.
- On an annual basis, domestic credit growth slowed down to 7.1% from 19.7% at end-December 2007. Excluding foreign currency denominated loans, which decreased by 3.6%, domestic credit growth rose to 22.3% from 15.8% during the same period.
 - A sectoral analysis reveals that, personal loans category was the largest recipient of credit, accounting for 21.3% in February 2008 compared to 15.7% in December 2007. This was followed by the agriculture sector at 18.5%. Financial services and manufacturing sectors' shares were 13.7% and 10.7%, respectively.

Interest Rates

- Following increased demand for Government securities in the first quarter of 2008, yield rates on Treasury bills declined by 0.2% to a weighted average composite yield rate of 12.7% at end-March 2008 from 12.9% at end-December 2007. However, the weighted average composite bond yield rate increased by 0.3 percent to 15.9% from 15.6% in the previous quarter. The increase in bond yield rates was attributed to continued foreign investor interest, especially in longer dated securities.
- Commercial banks interest rates developments were mixed. The weighted average lending base rate and the average lending rate declined to 18.2% and 24.3% in March 2008 from 18.3% and 24.4% in December 2007, respectively. However, the 30 day deposit rate for amounts over K20 million increased marginally to 5.0% from 4.8%, while the average savings rate for amounts above K100,000 remained unchanged at 4.8%.
- Owing largely to higher inflation, all real rates declined during the first quarter of 2008. The weighted average lending base rate and the average lending rate declined to 8.4% and 14.5% in March 2008 from 9.4% and 15.5% in December 2007, respectively. Similarly, average savings rate for amounts above K100,000 and the 30 day deposit rate fell to negative 5.0% and negative 4.8% from negative 4.1% each, respectively.

Real Sector

- At the end of the first quarter of 2008, the Food Reserve Agency (FRA) maize stocks stood at 321,195.00mt, 44.5% lower than 578,266.00 mt at end-December 2007 and 2.5% lower than 329,480.2 mt at the end of the first quarter in 2007. The Central, Southern, Eastern, Copperbelt and Northern Provinces contributed 119,420 mt (30.7%), 88,531.0 mt (22.8%), 79,773.0 mt (20.5%), 37,243.0 mt (9.6%) and 32,849.0 mt (8.5%), respectively, while Lusaka Province had 21,284.0 mt (5.5%) of maize. Luapula, North-Western and Western Provinces held 6,436.0 mt (1.7%), 1,872.0 mt (0.5%) and 1,223.0 mt (0.3%), respectively.
- As at end-March 2008, the stock of maize grain held by major millers in the country was estimated to have declined by 74.2% to 23,472.6 mt from 91,121.7 mt as at end-December 2007, a reflection of the seasonal pressure on the maize grain stocks. On a provincial basis, millers in Southern, Lusaka, Central and Copperbelt provinces accounted for 7,012.8 mt (29.9%), 6,646.9 mt (28.3%), 6,276.4 mt (26.7%) and 3,340.0 mt (14.2%), respectively.
- Preliminary data show that copper output declined by 8.9% to 128,592.7 mt from 141,076.9 mt the last quarter 2007. This was largely due to flooding of mines, typical during the rain season. However, this output level was higher than 114,912.7 mt recorded in the corresponding quarter of 2007.
- Similarly, cobalt output declined by 8.2% to 1,150.2 mt in the quarter under review from 1,252.9 mt in the previous quarter. However, cobalt output at 1,150.2 mt was 26.9% higher than 906.5 mt produced in the same period last year.

Foreign Exchange Market

- In the domestic foreign exchange market, the Kwacha maintained its resilience and appreciated against the major foreign currencies, with the exception of the Euro. The Kwacha extended its gains against the US Dollar and appreciated by 4.2% from 3.3% in the previous quarter to an average of K3,675.36/US\$ at end-March 2008 from K3,835.75/US\$ at end-December 2007. Similarly, the Kwacha increased its appreciation margin against the Pound Sterling to 4.6% from 3.5% to close the quarter at an average rate of K7,395.09/£ from K7,748.28/£, previously. With regard to the South African Rand, the local currency strengthened significantly by 14.9% to an average of K475.56/ZAR from K558.82/ZAR. The Kwacha's advance against the Rand in the first quarter of 2008 is the best quarterly performance in the pair since records began. However, the local currency continued to weaken against an internationally strong Euro to record a 1.8% loss in value, up from 1.0% in the previous review period. At the close of the quarter, the Kwacha traded to the Euro at an average rate of K5,629.90 from K5,532.27 at the close of the previous quarter.
- The general appreciation in the Kwacha was due to stronger supplies of foreign exchange into the market relative to demand and the sharp weakening of the US

Dollar in global markets triggered by the ongoing credit crisis in the USA. The high copper prices in international markets and increased foreign investor participation in the Government securities market following the reduction of interest rates in the US accounted for strong foreign exchange inflows.

Balance of Payments

- The trade surplus widened to US \$288.3 million from US \$115.7 million registered during the previous quarter, following an increase in metal earnings. Copper export earnings were 3.2% higher than the US \$858.4 million recorded during the previous quarter, reflecting higher realised LME prices, which increased to US \$7,746.94 from US \$6,949.22 per ton. Cobalt export earnings rose to US \$108.3 million in first quarter of 2008 from US \$79.1 million in the previous quarter, due to an increase in the realised price to US \$42.37 per pound from US \$28.76 per pound.
- At US \$183.6 million during the first quarter of 2008, non-traditional exports (NTEs) were 16.1% below the US \$218.8 million realised in the previous quarter. This was as a result of lower export earnings associated with copper wire, white spoon sugar, burley tobacco, cotton lint, electric cables, fresh flowers and gemstones. However, NTEs were 5.6% higher than the US \$173.9 million registered during the corresponding quarter in 2007.
- In the first quarter of 2008, merchandise imports declined to US \$901.1 million from US \$988.0 million in the previous quarter. The decline was associated with lower import bills of iron and steel products, petroleum products, fertiliser, industrial boilers and equipment and electrical machinery and equipment.

Implementation of the Economic Programme

- During the first quarter, an IMF Mission visited Zambia from 13 to 27 February 2008 to conduct 2008 Article IV consultations and to continue discussions with the Zambian Authorities on an economic programme that could be supported by the IMF following the end of the PRGF arrangement in September 2007. The Zambian Authorities and the IMF Mission reached understanding on an economic programme that could be supported by a new three-year arrangement under the IMF's Poverty Reduction and Growth Facility.

Developments in the Financial Sector

- The overall financial condition and performance of the banking sector during the quarter ended March 2008 was satisfactory. The sector maintained adequate capital reserves while asset quality, earnings and liquidity remained satisfactory.
- In the non-bank financial sector, the overall financial performance and condition of the non-bank financial institutions was satisfactory. On average, the leasing companies, MFIs and bureaux de change sub-sectors reported adequate regulatory

capital. However, one leasing company and one building society had regulatory capital deficiencies. Measures have been put in place to address these deficiencies.

Developments in Banking, Currency and Payment Systems

Currency in Circulation

- In the quarter under review, currency in circulation (CIC) decreased by 7.0% to K1,408.4 billion from K1,514.9 billion at end-December 2007. This decline is similar to the decrease of 6.7% recorded over the same quarter in 2007. The decline is on account of lower demand for cash in the review quarter as compared to the fourth quarter when demand for cash is usually higher on account of the festive season.

Removal of Unfit Banknotes from the Economy

- During the quarter ending March 2008 the number of unfit banknotes removed from the economy totalled 20.3 million pieces. This was slightly lower than the 21.5 million pieces of banknotes removed from the economy during the fourth quarter of 2007.
- In addition, the public exchanged a total of 11,984 pieces of mutilated banknotes for clean banknotes at the Bank of Zambia's mutilated currency window. This represented an increase of 22.5% when compared with 9,779 pieces of mutilated banknotes exchanged for clean banknotes during the fourth quarter of 2007. The main reasons given by the members of the public for exchanging mutilated banknotes at the Bank of Zambia include banknotes being burnt by fire and being eaten by rats from places where the money was kept at home or the business premises.
- In this regard, we urge members of the public to deposit extra cash in commercial banks. Money kept at commercial banks is safe and may even earn the owners some interest.

Bouncing of Cheques

- In view of the operationalisation of the National Payment System Act (NPSA) in June 2007, the Bank of Zambia issued guidelines on how to handle unpaid cheques. The guidelines require members of the public to report persons bouncing cheques to the police for investigations and possible prosecution.
- The general public is advised to take this matter seriously and report all suspect bounced cheques to the Zambia Police Service to stump out the practice and secure the payment systems.
- The consequences of breaching the above provision of the NPSA can result in a person being fined an amount not exceeding one hundred thousand penalty units (currently K18 million) or imprisonment for a period not exceeding two years or both.

COMESA Regional Payment and Settlement System (REPSS)

- The implementation of the COMESA Regional Payment and Settlement System (REPSS) which will facilitate the settlement of trade obligations between member states has reached the pilot testing phase. All COMESA trade payments will be made through the REPSS utilising local Real Time Settlement Systems in member countries. This will result in the reduction of transaction costs to both the importer and the exporter and further enhance trade within the regional grouping.
- The Bank of Zambia is participating in initial tests. It is expected that the REPSS system will be implemented by all member countries by mid-May 2008.

Performance of Item Value Limits

- The introduction of Item Value Limits (IVL) on transactions processed through Physical Inter-bank Clearing (PIC) and the Direct Debit and Credit Clearing (DDACC) payment streams during mid-2007 has yielded positive results. The initiative is aimed at reducing dependency by the public on the usage of cheques and Direct Debits and Credits Clearing (DDACC) in effecting transfer of funds and payments for **large value and urgent** transactions.
- However, it has come to the Bank's attention that customers making large value payments have in some cases split the amount and drawn more than one cheque to the same beneficiary. The Bank wishes to advise the public that this is not an efficient nor secure way of making large value payments. The Real Time Gross Settlement System (RTGS) is specifically designed for the transmission of large value (i.e. amounts above K100 million) and urgent payments such as tax payments. Using the RTGS ensures that the payment is made in real time in a secure manner.

Performance of the Tax Payment Stream

- With the implementation of the Tax payment stream during 2007, tax payers are able to make their tax payments at their convenience through their commercial banks on any day before the deadline. This has greatly reduced queues at the offices of the Zambia Revenue Authority. Further, some corporate tax payers who have appropriate infrastructure are able to issue tax payment instructions from their offices.
- The public is encouraged to embrace this payment stream for all their tax payment obligations as it provides benefits to both the payer and the Government by making and receiving final and irrevocable payments.

National Payment Systems Strategic Agenda for the Year 2008

- During March 2008, the Bank of Zambia, in conjunction with commercial banks heads of operations and technology developed a 13-point strategic Agenda and agreed reform priorities for the national payment system. This is in partial fulfilment of the

National Payment Systems Vision and Strategy 2007-2011. The main items in the Agenda are as follows:

- (a) All banks to complete their central processing projects (banking systems) by end-December 2008;
 - (b) Bankers Association of Zambia (BAZ) through the member commercial banks to design and launch appropriate campaigns to encourage reduced usage of cash by end-June 2008;
 - (c) BAZ to immediately set up a project team to thoroughly study establishment of a single clearing house and report on an appropriate model and requirements for Zambia by end-June 2008;
 - (d) BAZ to thoroughly assess the feasibility of either transforming the existing switch into a national switch or developing a national switch at the Zambia Electronic Clearing House by end-June 2008;
 - (e) All banks to implement Straight Through Processing for Cheques and DDACC by end-June 2008; and
 - (f) BAZ to initiate review of the Code of Banking Practice with a view of bringing it up to date and resolve issues of ownership and lack of enforceability by end-September 2008.
- These are important developments that the media and the public must be aware of and raise their expectations in order to get better service from their bankers. A stable and secure financial system is a prerequisite for any economic development.

Inflation Outlook for the Second Quarter of 2008

- During the second quarter of 2008, overall annual inflation is anticipated to slow down. This is premised on the easing of both food and non-food inflationary pressures.
- Lower food prices are expected due to improved seasonal supply of fresh food items, including maize grain with the start of 2007/2008 crop marketing season in May. This is despite the floods experienced in some regions, as the surplus carryover stocks from the 2006/2007 agricultural season, should help stabilise maize prices. In addition removal of the fishing ban effective 31st March is likely to improve the supply of fish on the market.
- A slow down in non-food inflation is anticipated on account of the pass-through effects of appreciation of the Kwacha against major currencies following strong external sector performance during the first quarter of the year. Further the reduction in Value Added Tax from 17.5% to 16.0% announced in the national budget effective 1st April 2008 will result in a fall in prices of non-zero rated commodities.

- However, there are a number of challenges to sustaining lower inflation during the second quarter. Notably, high production costs due to electricity load shedding and increased transportation charges which are likely to affect all commodity prices. The effects of the recent increase in prices of petroleum products. The high cost of beef in light of the ban on cattle movement from Southern province to curb the spread of the livestock diseases such as CBPP; and persistently high crude oil prices on the world market which may have a negative impact on domestic prices.

The Bank of Zambia will continue to monitor these developments and undertake appropriate monetary policy actions.

I THANK YOU FOR YOUR ATTENTION

INTRODUCTION

- This brief provides a preliminary assessment of monetary policy implementation and its outcomes during the first quarter of 2008. The brief also reviews other economic and financial sector developments. In the conclusion, an inflation outlook for the second quarter of 2008 is provided.

MONETARY POLICY

- In the first quarter of 2008 monetary policy was aimed at consolidating macroeconomic stability by maintaining single digit inflation, which was recorded at 8.2% in December 2007. Achieving the set goal entailed containing the growth of liquidity in the banking system within the projected path. In this regard, the Bank of Zambia (BoZ) relied mainly on Open Market Operations (OMO) and the auctioning of Government securities, complemented by prudent fiscal management.

INFLATION

Overall Inflation

- Overall annual inflation remained in single digit although it increased to 9.8% in March 2008 from 8.9% recorded in December 2007. On a quarterly basis, inflation increased to 5.4% from 3.0% recorded in the last quarter of 2007 and was higher compared to the 4.6% registered during the corresponding quarter in 2007. This overall inflation outturn reflected an increase in both food and non-food inflation.

Food Inflation

- Annual food inflation increased to 9.1% in March 2008 from 5.9% in December 2007. On a quarterly basis, it rose to 7.2% from 3.7% in the fourth quarter of 2007, and was well above the 4.1% registered during the first quarter of 2007. Contributing most to higher food inflation were prices of mealie meal, maize grain, other cereals, cereal products, groundnuts, fresh fruits, chicken, fish (bream), beef, milk, eggs, oils and fats. This was attributed to higher production costs due to electricity load shedding, rising transportation costs, lower seasonal supply, the fishing ban and the continued ban on movement of cattle from Southern Province, a remedy measure to curb the spread of the cattle disease, Contagious Bovine Pleural Pneumonia (CBPP).

Non-Food Inflation

- Annual non-food inflation slowed down to 10.4% in March 2008 from 11.9% in December 2007. On a quarterly basis, it rose to 3.7% from 2.5% in the fourth quarter of 2007, and was well below the 5.1% registered during the first quarter of 2007. This lower outturn relative to 2007 was mainly attributed to the relative stability in the exchange rate of the Kwacha against major trading currencies. The increase in non-food inflation was on account of price changes on clothing and footwear, furniture

and household goods, transport fares, education charges, medical care and other goods and services category.

BROAD MONEY AND DOMESTIC CREDIT

- Preliminary estimates indicate that broad money (M3), comprehensively defined to include foreign currency deposits, declined by 7.2% in March 2008 to K9,933.7 billion from K10,707.0 billion in December 2007, due to the contraction in both net foreign assets and net domestic assets by 12.9% and 0.9%, respectively. Excluding foreign currency deposits, the growth in M3 was 13.3 %.
- On an annual basis, M3 growth increased to 27.7% from 26.3% in December 2007. Excluding foreign currency deposits, annual M3 growth was recorded at 21.6% (23.8% in December 2007).
- Preliminary estimates indicate that total domestic credit, comprehensively defined to include foreign currency loans, declined by 9.4% to K6, 930.0 billion in the first quarter of 2008 due to a reduction in both net claims on central Government and credit to the private sector (including public enterprises). Net claims on central Government declined by 30.1% while private sector (including public enterprises) credit growth declined by 2.6%.
- On an annual basis, domestic credit growth slowed down to 7.1% from 19.7% at end-December 2007. Excluding foreign currency denominated loans, which decreased by 3.6%, domestic credit growth rose to 22.3% from 15.8% during the same period.
- A sectoral analysis reveals that, personal loans category was the largest recipient of credit, accounting for 21.3% in February 2008 compared to 15.7% in December 2007. This was followed by the agriculture sector at 18.5%. Financial services and manufacturing sectors' shares were 13.7% and 10.7%, respectively.

INTEREST RATES

Government Securities

- Demand for Government securities in the first quarter of 2008 exceeded supply as reflected by oversubscriptions on both Treasury bills and Government bonds. In this regard, the average subscription rate on Treasury Bills increased to 117.6% from 84.1%, previously. With regard to bonds, these continued to be over-subscribed although the average subscription rate fell to 113.4% from 151.2%. The robust demand for Government securities was mostly driven by increased foreign investor participation following aggressive interest rate cuts in the US which improved the yield advantage on local securities.
- Yield rates on Treasury bills declined, although by a marginal 0.2% to a weighted average composite yield rate of 12.7% at end March-2008 from 12.9% at end December-2007. However, the weighted average composite bond yield rate

increased by 0.3 percent to 15.9% from 15.6% in the previous quarter. The increase in bond yield rates was attributed to continued foreign investor interest especially in longer dated securities.

Commercial Banks Interest Rates

- Commercial banks interest rates developments were mixed. The average lending base rate and average lending rate declined marginally to 18.2% and 24.3% in March 2008 from 18.3% and 24.4% in December 2007, respectively. However, the 30 day deposit rate for amounts over K20 million increased marginally to 5.0% from 4.8% in December 2007, while the average savings rate for amounts above K100,000 remained unchanged at 4.8%.

REAL SECTOR DEVELOPMENTS

Agriculture

FRA Maize Purchases and Major Millers Maize Stocks

- At the end of the first quarter of 2008, the Food Reserve Agency (FRA) maize stocks stood at 321,195.00 mt, 44.5% lower than 578,266.00 mt at end-December 2007 and 2.5% lower than 329,480.2 mt at the end of the first quarter in 2007. The Central, Southern, Eastern, Copperbelt and Northern Provinces contributed 119,420 mt (30.7%), 88,531.0 mt (22.8%), 79,773.0 mt (20.5%), 37,243.0 mt (9.6%) and 32,849.0 mt (8.5%), respectively, while Lusaka Province had in stock 21,284.0 mt (5.5%) of maize. Luapula, North-Western and Western Provinces held 6,436.0 mt (1.7%), 1,872.0 mt (0.5%) and 1,223.0 mt (0.3%), respectively.
- As at end-March 2008, the stock of maize grain held by major millers in the country was estimated to have declined by 74.2% to 23,472.6 mt from 91,121.7 mt as at end-December 2007, a reflection of the seasonal pressure on the maize grain stocks. On a provincial basis, millers in Southern, Lusaka, Central and Copperbelt provinces accounted for 7,012.8 mt (29.9%), 6,646.9 mt (28.3%), 6,276.4 mt (26.7%) and 3,340.0 mt (14.2%), respectively.

Mining

- Preliminary data show that copper output declined by 8.9% to 128,592.7 mt from 141,076.9 mt the last quarter 2007. This was largely due to flooding of mines, typical during the rain season. However, this output level was higher than 114,912.7 mt recorded in the corresponding quarter of 2007.
- Similarly, cobalt output declined by 8.2% to 1,150.2 mt in the quarter under review from 1,252.9 mt in the previous quarter. However, cobalt output at 1,150.2 mt was 26.9% higher than 906.5 mt produced in the same period last year.

EXTERNAL SECTOR DEVELOPMENTS**Foreign Exchange Market**

- In the domestic foreign exchange market, the Kwacha maintained its resilience and appreciated against the major foreign currencies with the exception of the Euro. The Kwacha extended its gains against the US Dollar and appreciated by 4.2% from 3.3% in the previous quarter. Hence, the exchange rate of the Kwacha against the Dollar averaged K3,675.36/US\$ at end-March 2008 from K3,835.75/US\$ at end-December 2007. Similarly, the Kwacha increased its appreciation margin against the Pound Sterling to 4.6% from 3.5% to close the quarter at an average rate of K7,395.09/£ from K7,748.28/£, previously. With regard to the South African Rand, the local currency strengthened significantly by 14.9% relative to the previous review period when it was relatively unchanged. As a result, the Kwacha/Rand exchange rate averaged K475.56/ZAR from K558.82/ZAR. The Kwacha's advance against the Rand in the first quarter of 2008 is the best quarterly performance in the pair since records began. However, the local currency continued to weaken against an internationally strong Euro to record a 1.8% loss in value, up from 1.0% in the previous review period. Therefore, at the close of the quarter, the Kwacha traded to the Euro at an average rate of K5,629.90 from K5,532.27 at the close of the previous quarter.
- The general appreciation in the Kwacha was due to stronger supplies of foreign exchange into the market relative to demand and the sharp weakening of the US Dollar in global markets triggered by the ongoing credit crisis. The factors accounting for strong foreign exchange inflows are high copper prices in international markets and increased foreign investor participation in the Government securities market following the reduction of interest rates in the US. These rate cuts and growing concerns that the sub-prime triggered credit crisis may result in a recession of the US economy, have subjected the Dollar to severe downward pressure on global markets.
- The strong foreign exchange supplies to the market were reflected by increased commercial banks' purchases of foreign exchange from the non-interbank players (major suppliers). In this regard, commercial banks purchased US\$1,205.0 million in the first quarter of 2008, up from US\$ 1,148.4 million in the fourth quarter of 2007. On the other hand, commercial banks' sales of foreign exchange to the non-interbank sector declined to US \$1,010.7 million from US \$1,032.4 million, reflecting relatively subdued demand for foreign exchange during the period. Hence, on a net basis, commercial banks' net purchases of foreign exchange from the non-interbank players increased to US \$202.7 million from US \$116.0 million. In the forward market however, turnover was low with banks' forward purchases from the non-interbank group declining to US\$8.4 million from US \$42.9 million whilst sales to the same fell to US \$23.1 million from US \$73.6 million. With regard to the interbank market, the value of transactions declined to US \$660.3 million after increasing to US \$740.9 million in the previous quarter.

- The Bank of Zambia continued to reduce its interventions in the foreign exchange market owing to the relative stability in the exchange rate. Over the period, the Bank purchased US \$13.0 million from the market against sales of the same magnitude. This compares with purchases and sales of US \$14.0 million and US \$15.5 million in the last quarter, respectively.

Balance of Payments

- Preliminary data show that Zambia's overall balance of payments (BoP) position recorded a surplus of US \$164.8 million in the first quarter of 2008 from US \$60.6 million in the previous quarter. This performance stemmed from improvements in the capital and financial accounts.
- During the first quarter of 2008, the current account deficit improved to US \$68.9 million from US \$247.1 million recorded during the last quarter of 2007. This was mainly explained by an increase in the trade surplus and improvement in the services account as well as the current transfers.
- The trade surplus expanded to US \$288.3 million from US \$115.7 million registered during the previous quarter, following an increase in merchandise exports earnings.
- During the reviewed quarter, merchandise export earnings at US \$1,177.7 million were 1.8% higher than the US \$1,156.3 million realised in the previous quarter, following an increase in metal earnings.
- Metal export earnings increased to US \$994.3 million from US \$937.5 million in the preceding quarter, reflecting both increased copper and cobalt exports earnings.
- Copper export earnings at US \$886.0 million were 3.2% higher than the US \$858.4 million recorded during the previous quarter, reflecting higher realised LME prices which increased to US \$7,746.94 from US \$6,949.22 per ton. However, copper export volumes declined to 114,367.8 metric tons (mt) from 123,523.8 mt. Compared to the corresponding quarter in 2007, export receipts were also favourable as they were 34.7% higher than the US \$657.5 million realised in that quarter.
- Cobalt export earnings rose to US \$108.3 million in first quarter of 2008 from US \$79.1 million in the previous quarter, due to an increase in the realised price of cobalt to US \$42.37 per pound from US \$28.76 per pound despite lower export volumes. Cobalt export volumes fell to 1,159.14 mt from 1,248.0 mt recorded during the last quarter of 2007. On year to date basis, cobalt receipts were 153.6% above the US \$42.7 million recorded during the corresponding period in 2007.
- At US \$183.6 million during the first quarter of 2008, non-traditional exports (NTEs) were 16.1 below the US \$218.8 million realised in the previous quarter. This was as a result of lower export earnings associated with copper wire, white

spoon sugar, burley tobacco, cotton lint, electric cables, fresh flowers and gemstones. However, on a year to date basis, NTEs were 5.6% higher than the US \$173.9 million registered during the corresponding quarter in 2007.

- In the first quarter of 2008, merchandise imports declined to US \$901.1 million from US \$988.0 million in the previous quarter. The decline was associated with lower import bills of iron and steel products, petroleum products, fertiliser, industrial boilers and equipment and electrical machinery and equipment.
- During the quarter under review, the capital and financial account surplus increased to US \$314.0 million from US \$230.6 million in the preceding quarter. This improvement was mainly attributed to an increase in financial inflows in the form of capital transfers and other investments.

IMPLEMENTATION OF THE ECONOMIC PROGRAMME

- During the first quarter, an IMF Mission visited Zambia from 13 February to 27th February 2008 to conduct 2008 Article IV consultations and to continue discussions with the Zambian Authorities on an economic programme that could be supported by the IMF following the end of the PRGF arrangement in September 2007.
- The Zambian Authorities and the IMF Mission reached understanding on an economic programme that could be supported by a new three-year arrangement under the IMF's Poverty Reduction and Growth Facility. The main goal of the economic programme would be to assist the Zambian authorities in achieving the Fifth National Development Plan's (FNDP) objectives of boosting economic growth and reducing poverty by creating an environment conducive to private sector growth through sustained macroeconomic stability, public sector efficiency and accountability, and creating fiscal space for increased investments in infrastructure and the social sectors while maintaining debt sustainability.

DEVELOPMENTS IN THE BANKING SECTOR

The overall financial condition and performance of the banking sector during the quarter ended March 2008 was satisfactory. The sector maintained adequate capital reserves while asset quality, earnings and liquidity remained satisfactory.

- The banking sector remained adequately capitalised and all the banks except one met the minimum capital adequacy requirement of 10% for total regulatory capital. The Bank of Zambia increased the minimum capital requirement for all banks operating in Zambia effective, 1 January 2007 from K2 million to K12 million. Banks have a grace period of up to 30 June 2008 to meet this requirement.
- The asset quality of the banking sector was generally satisfactory during the quarter under review, with an acceptable level of non-performing loans. Gross non-performing loans declined from 8.8% in December 2007 to 8.3% in March 2008.

Overall, the banking sector experienced an increase of 0.9% in total assets to K13,907.7 billion as at end-March 2008 from December 2007.

- The banking sector's earnings performance during the period under review was satisfactory with the average cumulative return on assets (ROA) and return on equity (ROE) at 4.6% and 34.96%, respectively as at end-March 2008.
- The sector's liquidity condition was also satisfactory, with liquidity ratio of 42.1% as at end-March 2008.

DEVELOPMENTS IN THE NON-BANK FINANCIAL SECTOR

Leasing Sector

- The overall performance of the leasing sub-sector was considered satisfactory¹ during the period under review. Except for one leasing company with a regulatory capital deficiency, the other leasing companies maintained adequate capital relative to their risk profiles. As at 31 March 2008, the aggregate sub-sector regulatory capital position was K44,971 million. This was above the minimum sub-sector regulatory capital of K17,910 million by K27,062 million as at 31 March 2008.

Building Societies-Sub-Sector

- The building societies sub-sector continued to register positive performance in the quarter ended 31 March 2008. The sub-sector recorded a profit before tax of K2,467 million, which represented an increase of 19% from the previous quarter's profit before tax of K2,078 million. As a result of the recorded profits and the capital injection of K15,942 million made by one building society in the quarter under review, the sub-sector's net worth improved to K33,022 million as at 31 March 2008 from a negative net worth of K13,988 million as at 31 December 2007.

Micro-Finance Sub-Sector

- The financial condition and performance of the micro-finance institutions sub-sector (MFIs) was satisfactory. The aggregate capital of the MFIs at the end of 31 March 2008 was K91,017 million and was in excess of the minimum regulatory capital of K41,861 million by K49,156 million. The 31 March 2008 capital position represented an increase of K11,754 million or 15% over the 31 December 2007 figure of K79,263

¹ The Bank of Zambia ranks NBFIs on the basis of their performance in the parameters of Capital Adequacy, Asset Quality, Earnings and Liquidity (CAEL). Composite rating averages the effects of the individual rating in each of the above parameters. A five tier rating system is utilised as shown below:-

Strong-Excellent performance in all parameters, **Satisfactory**-Satisfactory performance and meets minimum statutory requirements, **Fair**-Average performance and meets minimum statutory requirements, **Marginal**-below average performance in some of the parameters, **Unsatisfactory**- Poor performance in most parameters and violates minimum statutory requirements

million. The increase in the capital position of the sector arose from the profit after tax of K12,606 million recorded in the quarter under review.

Bureaux de Change

- The volume of purchases and sales of foreign currency by the bureaux de change sub-sector in the quarter under review amounted to US \$141.4 million (equivalent to K526,017 million) and US \$144.5 million (equivalent to K525,782 million) compared to US \$148.8 million (equivalent to K565,831 million) and US \$150.1 million (equivalent to K563,936 million), respectively for the previous quarter. This represented a decrease of 5% and 4% in the volumes of purchases and sales transactions respectively over the previous quarter.
- The United States Dollar remained the most traded currency in the quarter under review accounting for 94.1% followed by the South African (SA) Rand with 3.8%. Total purchases and sales of the US dollar amounted to US \$133 million (equivalent to K495,505 million) and US \$136 million (equivalent to K494,244 million) while those of the SA Rand amounted to ZAR40.1 million (equivalent to K19,778 million) and ZAR41 million (equivalent to K20,721 million), respectively.

FINANCIAL SECTOR DEVELOPMENT PLAN IMPLEMENTATION

Sovereign Rating for Zambia

- The FSDP Steering Committee held a special meeting on 23 January, 2008 at the Ministry of Finance and National Planning (MoFNP) at which the committee approved the draft terms of references and the expression of interest for hiring a Financial Advisor to conduct the sovereign rating exercise for Zambia. The committee further granted authority to the sub-committee spearheading the work on sovereign rating to go ahead with the hiring of the services of the Financial Advisor.

Deadline of 1 February 2008 for Microfinance Institutions to comply with the Microfinance Regulations of 2006

- The Banking and Financial Services (Microfinance) Regulations (MFRs) provide for a tiered structure where microfinance institutions MFIs falling under Tiers 1 and II will be supervised by the BoZ. MFIs falling outside these regulations will be regulated by their primary regulators. However, those MFIs falling under Tier III still need to demonstrate to the BoZ that they do indeed fall under categories I and II by submitting their latest audited financial statements or management accounts.
- The deadline for MFIs to comply with the MFRs elapsed on 1 February 2008. In this regard, letters have already been sent to those MFIs which have been identified as not being compliant with regulations to immediately suspend operations until they regularise their licensing arrangements.

Update on the Activities of Credit Reference Bureau Africa Limited

- During the month of February 2008, Credit Reference Bureau Africa Limited (CRBAL) installed software at 11 commercial banks and one leasing company and trained staff at the banks in the operation of the system.
- However, the BoZ is concerned at the delay in having the credit reference bureau (CRB) fully functional on account of the following;
 - To date, 10 banks and one leasing company have been connected and the remaining 3 banks are expected to be connected soon. Out of the 10 banks which have been connected, only 4 can actually use the system as they are the only banks that have paid as the system operates on a prepaid basis.
 - Out of the 13 commercial banks in operation, nine have provided CRBAL with data and at least one bank is expected to provide data shortly. Five of the banks where installation has been done have not made any prepayment despite installation and training completed in early February 2008. In the case of the six that have made payments, usage to-date has been low.
 - The usage of the CRB is low primarily because some banks have not provided data to the CRB.
- The whole concept of a CRB is diminished if banks are not prepared to provide or are selective in providing data. To this effect, the BoZ has requested all the commercial banks to submit both positive and negative data to the CRB without subjecting the data to any screening or selection.

DEVELOPMENTS IN BANKING, CURRENCY AND PAYMENT SYSTEMS**Currency in Circulation**

- In the quarter under review, currency in circulation (CIC) decreased by 7.0% to K1,408.4 billion from K1,514.9 billion at end-December 2007. This decline is similar to the decrease of 6.7% recorded over the same quarter in 2007. The decline is on account of lower demand for cash in the review quarter as compared to the fourth quarter when demand for cash is usually higher on account of the festive season.

Removal of Unfit Banknotes from the Economy

- During the quarter ending March 2008 the number of unfit banknotes removed from the economy totalled 20.3 million pieces. This was slightly lower than the 21.5 million pieces of banknotes removed from the economy during the fourth quarter of 2007.

- In addition, the public exchanged a total of 11,984 pieces of mutilated banknotes for clean banknotes at the Bank of Zambia's mutilated currency window. This represented an increase of 22.5% when compared with 9,779 pieces of mutilated banknotes exchanged for clean banknotes during the fourth quarter of 2007. The main reasons given by the members of the public for exchanging mutilated banknotes at the Bank of Zambia include banknotes being burnt by fire and being eaten by rats from places where the money was kept at home or the business premises.
- In this regard, we urge members of the public to deposit extra cash in commercial banks. Money kept at commercial banks is safe and may even earn the owners some interest.

Bouncing of Cheques

- In view of the operationalisation of the National Payment System Act (NPSA) in June 2007, the Bank of Zambia issued guidelines on how to handle unpaid cheques. The guidelines require members of the public to report persons bouncing cheques to the police for investigations and possible prosecution.
- The general public is advised to take this matter seriously and report all suspect bounced cheques to the Zambia Police Service to stump out the practice and secure the payment systems.
- The consequences of breaching the above provision of the NPSA can result in a person being fined an amount not exceeding one hundred thousand penalty units (currently K18 million) or imprisonment for a period not exceeding two years or both.

COMESA Regional Payment and Settlement System (REPSS)

- The implementation of the COMESA Regional Payment and Settlement System (REPSS) which will facilitate the settlement of trade obligations between member states has reached the pilot testing phase. All COMESA trade payments will be made through the REPSS utilising local Real Time Settlement Systems in member countries. This will result in the reduction of transaction costs to both the importer and the exporter and further enhance trade within the regional grouping.
- The Bank of Zambia is participating in initial tests. It is expected that the REPSS system will be implemented by all member countries by mid-May 2008.

Performance of Item Value Limits

- The introduction of Item Value Limits (IVL) on transactions processed through Physical Inter-bank Clearing (PIC) and the Direct Debit and Credit Clearing (DDACC) payment streams during mid-2007 has yielded positive results. The initiative is aimed at reducing dependency by the public on the usage of cheques and Direct Debits and Credits Clearing (DDACC) in effecting transfer of funds and payments for *large value and urgent* transactions.

- However, it has come to the Bank's attention that customers making large value payments have in some cases split the amount and drawn more than one cheque to the same beneficiary. The Bank wishes to advise the public that this is not an efficient nor secure way of making large value payments. The Real Time Gross Settlement System (RTGS) is specifically designed for the transmission of large value (i.e. amounts above K100 million) and urgent payments such as tax payments. Using the RTGS ensures that the payment is made in real time in a secure manner.

Performance of the Tax Payment Stream

- With the implementation of the Tax payment stream during 2007, tax payers are able to make their tax payments at their convenience through their commercial banks on any day before the deadline. This has greatly reduced queues at the offices of the Zambia Revenue Authority. Further, some corporate tax payers who have appropriate infrastructure are able to issue tax payment instructions from their offices.
- The public is encouraged to embrace this payment stream for all their tax payment obligations as it provides benefits to both the payer and the Government by making and receiving final and irrevocable payments.

National Payment Systems Strategic Agenda for the Year 2008

- During March 2008, the Bank of Zambia, working together with commercial banks heads of operations and technology developed a 13-point strategic Agenda and agreed reform priorities for the national payment system. This is in partial fulfilment of the National Payment Systems Vision and Strategy 2007-2011. The main items in the Agenda are as follows:
 - (a) All banks to complete their central processing projects (banking systems) by end-December 2008;
 - (b) Bankers Association of Zambia (BAZ) through the member commercial banks to design and launch appropriate campaigns to encourage reduced usage of cash by end-June 2008;
 - (c) BAZ to immediately set up a project team to thoroughly study establishment of a single clearing house and report on an appropriate model and requirements for Zambia by end-June 2008;
 - (d) BAZ to thoroughly assess the feasibility of either transforming the existing switch into a national switch or developing a national switch at the Zambia Electronic Clearing House by end-June 2008;
 - (e) All banks to implement Straight Through Processing for Cheques and DDACC by end-June 2008;

- (f) BAZ to initiate review of the Code of Banking Practice with a view of bringing it up to-date and resolve issues of ownership and lack of enforceability by end-September 2008; and
- These are important developments that the media and the public must be aware of and raise their expectations in order to get better service from their bankers. A stable and secure financial system is a prerequisite for any economic development.

INFLATION OUTLOOK FOR THE SECOND QUARTER OF 2008

- During the second quarter of 2008, overall annual inflation is anticipated to slow down. This is premised on the easing of both food and non-food inflationary pressures.
- Lower food prices are expected due to improved seasonal supply of fresh food items, including maize grain with the start of 2007/2008 crop marketing season in May. This is despite the floods experienced in some parts of the country, as the surplus carryover stocks from the 2006/2007 agricultural season, should help stabilise maize prices. In addition removal of the fishing ban effective 31st March is likely to improve the supply of fish on the market.
- A slow down in non-food inflation is anticipated on account of the pass through effects of the appreciation of the Kwacha against major currencies following strong external sector performance during the first quarter of the year. Further the reduction in Value Added Tax from 17.5% to 16.0% announced in the national budget effective 1st April 2008 will result in a fall in prices of non-zero rated commodities.
- However, there are a number of challenges to sustaining lower inflation during the second quarter. Notably, high production costs due to electricity load shedding and increased transportation charges which are likely to affect all commodity prices. The high cost of beef in light of the ban on cattle movement from Southern province to curb the spread of the livestock disease, CBPP; the effects of higher prices of petroleum products and persistently high crude oil prices on the world market which may have a negative impact on domestic prices.

The Bank of Zambia will continue to monitor these developments and undertake appropriate monetary policy actions.