Bank of Zambia

Monetary Policy Statement

JAN - JUN 2019

VISION

To be a dynamic and credible Central Bank
that contributes to the economic development of Zambia.

MISSION STATEMENT

To achieve and maintain price and financial
system stability to foster sustainable economic development.

This Monetary Policy Statement is made pursuant to Part II, Section 9 of the
Bank of Zambia Act Chapter 360 of the Laws of Zambia

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Economic Outlook

Global economic outlook lower than anticipated

Global economic growth prospects remain positive, though lower than earlier projected due to anticipated escalation of trade tensions, tightening financial conditions in advanced nations, and high levels of both public and private debt across regions. The global economic growth projection for 2019 has been reduced to 3.5%, from the previous projection of 3.7%.

Domestic economic outlook stable, but with challenges

Real Gross Domestic Product (GDP) outlook for Zambia remains positive and growth is projected to be at least 4.0% in 2019. The mining, construction, and wholesale and retail trade sectors are expected to continue to be the major sectors driving growth in the near term, supported by relatively stable power supply. However, delayed effective implementation of fiscal adjustment measures by Government and weak credit growth are expected to constrain economic growth in the near-term.

Upside risks to inflation remain dominant

Annual overall inflation is projected to remain within the 6–8% target range in the first half of 2019, although at an elevated level averaging 7.7%, which is lower than the 7.9% average outturn in the second half of 2018. There are, however, upside risks to the inflation projection which include persistently higher than programmed budget deficits and debt service payments as well as deterioration in the current account balance and the decline in international reserves. These are likely to impact inflation mainly through the exchange rate and expectations channels.

Fiscal deficit likely to remain elevated and slow corrective policy action could worsen liquidity challenges.

The fiscal deficit is likely to remain elevated in the near term in light of the slow progress in the implementation of fiscal consolidation measures announced by Government. In 2019, Government intends to reduce the fiscal deficit to 6.5% of GDP. Given the slow progress in the execution of fiscal consolidation measures and liquidity constraints in the financial sector, it may be more challenging for Government to meet its obligations.

In order to support sustainable macroeconomic stability and achieve higher growth, prompt and effective implementation of fiscal adjustment measures remains critical.

Monetary Policy Objectives: January – June 2019

In the first half of 2019, Monetary policy will continue to aim at maintaining inflation within the target range of 6-8%. In line with this policy stance, the Bank of Zambia will continue to rely mainly on market based instruments to maintain the interbank rate within the corridor of +/- one percentage point around the Policy Rate.

Economic Performance

Global economic growth lower than anticipated

Global economic activity moderated in the second half of 2018 on account of faster than anticipated slowdown in advanced economies and some emerging market and developing economies. The slowdown was mainly on account of volatile oil prices and tapering commodity prices in general, rising interest rates, US dollar appreciation and the on-going trade disputes between the US and its major trading partners, particularly China.

[1] Bank of Zambia Composite Index of Economic Activity (CIEA) and the December 2018 Stanbic Bank Zambia Purchasing Managers Index (PMI).
[2] CIF refers to the valuation of imports of goods that includes the cost, insurance and freight.

Domestic economic growth positive, but sluggish

The country recorded positive economic growth in the second half of 2018, although the pace of economic activity remained modest. Several indicators of real activity showed some improvements in the third quarter of 2018 but performance in the fourth quarter was mixed. Real GDP growth for the first three quarters of 2018 at 3.9%, was slightly higher than the 3.6% recorded during the same period in 2017. The Financial and insurance activities drove growth in economic activity, followed by the information and communications industry. The agriculture sector continued to post negative growth in the second half of 2018.

Trade deficit widened

The trade deficit(cif) widened to US$411.0 million in the second half of 2018 compared to a deficit of US$86.8 million in the first half of 2018, driven by a decline in exports and an increase in imports (cif). Exports declined by 5.6% on the back of reduced export volumes and lower average realised prices of copper and cobalt. Imports, on the other hand, increased by 1.4% to US$4,764.8 million from US$4,696.8 million, mainly due to higher importation of chemicals, vehicles, food items, and paper and paper products.

Inflation edged up

Inflation rose to an average of 7.9% in the second half from the average outturn of 7.4% in the first half of 2018. Pass-through effects of the depreciation of the exchange rate of the Kwacha against the US dollar, the increase in transport costs, following the 21.3% upward adjustment in fuel prices, and reduced supply of selected food items were the major contributing factors. In August and October 2018, inflation rose to 8.1% and 8.3%, respectively, breaching the upper bound of the target range, but reverted into the target range much faster than earlier projected. Inflation closed the year at 7.9%

Interest rates remain elevated

The average commercial bank lending rates slightly declined to 23.6% in December 2018 from 24.1% in June 2018. Despite the accommodative monetary policy stance in 2018, with the Policy Rate maintained at 9.75%, the reduction in lending interest rates has remained sluggish partly attributed to high yield rates on Government securities and high non-performing loans . The banking sector's lending to Government remained high, thereby constraining growth of credit to the private sector, aggregate demand and ultimately, overall economic growth.

Monetary policy stance maintained

In August and November 2018, the Bank of Zambia kept the Policy Rate unchanged at 9.75%. Although projections showed that inflation was likely to exceed the upper bound of the target range in the earlier part of the forecast horizon, it was expected to return to the target range towards the latter part of the forecast horizon. Therefore, the relatively accommodative monetary policy stance was aimed at supporting fragile economic growth and minimising potential vulnerabilities to the financial sector such as high non-performing loans. The Bank continued to conduct monetary operations aimed at maintaining the interbank rate within +/-1 percentage point of the Policy Rate.

Fiscal deficit lower than projected, but arrears remain high

The fiscal deficit (on cash basis) in the second half of 2018 at 2.2% was lower than the programmed 3.5% of GDP. This largely reflected lower than programmed expenditures on use of goods and services, grants and other payments, social benefits, strategic food reserve, personal emoluments, ordinary non-financial assets, water and sanitation and financial assets. The deficit was financed mainly through external loans and Government securities. Domestic arrears, however, have remained elevated and are likely to rise at a faster rate in light of liquidity challenges.

[3] The Non-performing Loans-to-Loan (NPL) ratio stood at 11.1% in December 2018 from 12.4% in June.

1.0 INTRODUCTION

This Statement provides an outlook for global economic growth, domestic economic growth and inflation, and outlines the Bank of Zambia's monetary policy objectives during the first 6-months of 2019. In addition, the Statement reviews monetary policy performance and macroeconomic developments in the second half of 2018.

2.0 GLOBAL ECONOMIC OUTLOOK: 2019 - 2020

2.1 Economic Growth

Global economic growth projections for both 2019 and 2020 were revised downwards to 3.5% and 3.6%, respectively, from the previous projection of 3.7% (IMF World Economic Outlook (WEO) Update, January 2019), on account of the anticipated escalation of trade tensions, tightening financial conditions in advanced nations, particularly the US, and high levels of both public and private debt across regions. Brexit uncertainty and carry over effects of slower growth momentum in several economies, particularly in the euro area and China, in the second half of 2018 are also weighing on global economic growth outlook.

In advanced countries, growth is expected to decline to 2.0% and 1.7% in 2019 and 2020 from 2.3% in 2018, respectively, partly reflecting slow growth in several advanced economies, impact of trade tensions and Brexit uncertainties. The Euro area growth is projected at 1.6% in 2019 and 1.7% in 2020, down from 1.8% in 2018. The subdued growth is mainly attributed to weaker private consumption and industrial production, particularly in Germany, weaker domestic demand and higher borrowing costs in Italy, and domestic violence and industrial action in France. Despite the uncertainties surrounding Brexit, an increase in growth projection is expected for the UK, albeit subdued, attributed to anticipated positive impact of fiscal stimulus announced in the 2019 budget.

The growth prospects for Zambia's major trading partners over the medium term remain positive. Growth in the US is projected at 2.5% in 2019 and 1.8% in 2020 compared to 2.9% in 2018. The subdued growth prospects in the US is mainly attributed to the expected slowdown in fiscal stimulus. China's growth is projected at 6.2% for both 2019 and 2020, a decline from 6.6% in 2018. The projected decline is mainly on account of the on-going trade war with the US and the continued accumulation of corporate debt. However, the slowdown is likely to be moderated by expansionary fiscal and accommodative monetary policies introduced in 2019.

Growth in South Africa is projected at 1.4% in 2019 and 1.7% in 2020, down from 0.8% in 2018. The projected increase is mainly on account of higher real wages and the Government's fiscal stimulus measures which are expected to positively impact on household spending and fixed investment. Growth in the Democratic Republic of Congo (DRC) is also projected to increase to 4.5% in 2019 and 4.6% in 2020 from 4.0% in 2018. The projected growth is expected to be supported mainly by the mining sector, improved political sentiments following the successful December 2018 general elections, progress in the security situation coupled with control over the Ebola virus epidemic.

2.2 Commodity Prices Outlook

Copper prices, although still firm, are projected to decline to an average of US $6,322.9 and US $6,428.0 per tonne in 2019 and 2020, respectively from an average of US $6,565.3 per tonne in 2018 due to weaker global economic growth outlook and slowdown in China's growth. Crude oil prices are also projected to decline, averaging US $67.9/barrel and US $66.5/barrel in 2019 and 2020, respectively from an average of US $68.8 in 2018. Factors that are expected to weigh on crude oil prices include surplus production, much of it from the United States, and slowing global economic growth.

3.0 DOMESTIC ECONOMIC OUTLOOK FOR 2019 - 2020

The economic growth outlook for Zambia remains positive, albeit lower than earlier anticipated. Real GDP growth is expected to be above 4.0% in 2019 and about 4.4% in 2020 against a preliminary outturn of 3.7% in 2018. The mining, construction, and wholesale and retail trade sectors are expected to continue to be the major sectors driving growth in the near term, supported by relatively stable power supply. Growth in mineral production is expected to remain positive, with copper output projected to exceed 900,000 metric tons (mt) in 2019 from 851,087mt in 2018. Improved electricity supply and high copper prices on the global market are expected to support increased copper production, although there is a risk surrounding the uncertainties that the new tax

[4] Major trading partners are as defined in the REER Index: USA, Euro area, UK, China, South Africa and the Democratic Republic of Congo (DRC). Although included in the REER, the USA, notably, is not a major trading partner in terms of goods and services. However, the bulk of Zambia's financial transactions with the rest of the world are denominated in US dollars.

regime adopted in the 2019 budget may have on the mining sector output and profitability.

There are, however, a number of downside risks to the domestic economic growth prospects. On the domestic front, downside risks include delayed implementation of fiscal adjustment measures by Government, weak credit growth and delay to dismantle domestic arrears. On the external side, the downside risks include anticipated lower global growth forecasts on the back of increased trade wars between China and the United States, and the higher than projected crude oil prices.

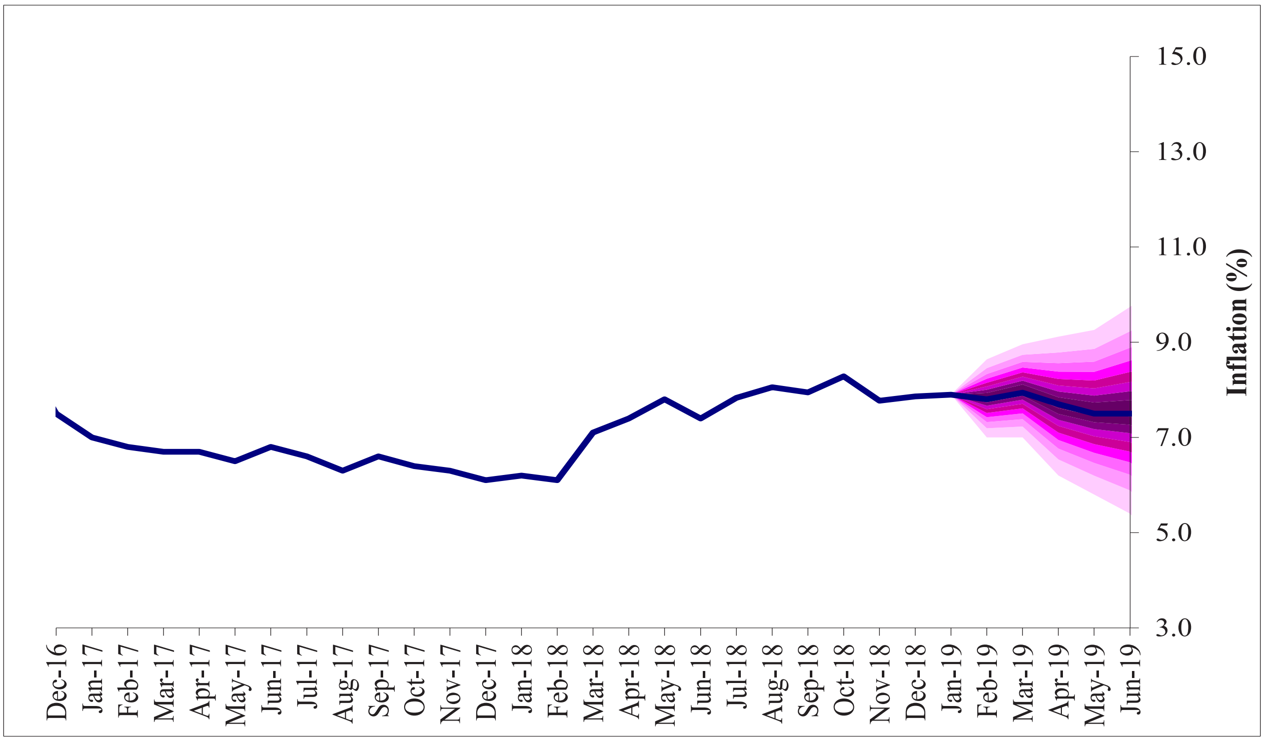
4.0 INFLATION PROJECTIONS FOR THE FIRST HALF OF 2019

Annual overall inflation is projected to remain within the target range of 6–8%, averaging 7.7% in the first half of 2019. The projected inflation is 0.2 percentage points lower than the average outturn of 7.9% in the second half of 2018 (Chart 1 and Table 1 – Appendix).

The inflation outlook over the next six months is premised on lower food prices in the latter half of the forecast period following the onset of the harvest season. In the earlier part of the forecast horizon, inflation is expected to remain at elevated levels on account of relatively high food prices due to reduced supply of selected food items such as maize grain. Relative stability in the Kwacha/US dollar exchange rate, supported by relatively high copper prices which are expected to average around US $6,000 per tonne, will also help in mitigating the adverse inflationary pressures.

However, upside risks to the inflation outlook remain. Reduced agriculture production in the 2018/2019 farming season remains the key upside risk to inflation. Forecasts for the 2018/2019 rainy season indicate that much of the country is likely to receive normal to below normal rainfall. In addition, the invasion of army worms in some parts of the country may impact negatively on the production of maize grain, with adverse consequences on food prices. Further, increased external debt service may impact negatively on the exchange rate of the Kwacha against the US Dollar, and induce upward inflationary pressures through increased cost of imported commodities. A larger than programmed fiscal deficit leading to increased borrowing from the domestic market has the potential to crowd out the private sector from the credit market. This is likely to constrain the private sector's productive capacity, with potential for increase in the prices of goods and services. The implementation of the Goods and Services Tax in the second quarter of 2019 is also likely to induce inflationary pressures during the forecast period. On the whole, if the upside risks materialize, inflation may turn out to be higher than projected over the forecast period.

Chart 1: Actual and Projected Inflation: Dec 2016 - Dec 2018



Source: Central Statistical Office and Bank of Zambia Compilations

[5] 2019-2021 Medium Term Expenditure Framework indicative estimates suggest real GDP growth of 3.7% in 2018, which is 0.2 percentage points above the downward revised GDP growth projection of 3.5% used in the November 2018 MPC round.

5.0 MONETARY POLICY OBJECTIVES AND INSTRUMENTS FOR THE FIRST HALF OF 2019

Monetary policy in the first half of 2019 will continue to aim at maintaining inflation within the target range of 6-8%. In line with this policy stance, the Bank of Zambia will continue to rely mainly on market based instruments to maintain the interbank rate within the corridor of +/- one percentage point around the Policy Rate. In addition, the Bank will continue to strengthen the forward looking monetary policy framework anchored on the Policy Rate as the key signal of the monetary policy stance.

The formulation and implementation of monetary policy will remain supportive of the Government's macroeconomic objectives (Table 2 - Appendix) as outlined in the 2019 Budget Address, as well as the 7th National Development Plan. These include:

i. Achieving real GDP growth rate of at least 4% in 2019;

ii. Sustain single digit inflation within the range of 6 - 8%;

iii. Limit domestic financing to no more than 1.4% of GDP in 2019; and

iv. Raise international reserves to at least 3 months of import cover.

6.0 REVIEW OF GLOBAL DEVELOPMENTS IN THE SECOND HALF OF 2018

6.1 Economic Growth

Global economic activity softened in the second half of 2018 on account of faster than anticipated slowdown in advanced economies and some emerging market and developing economies. Accounting for the slowdown was largely volatile oil prices and tapering commodity prices in general, rising interest rates, US dollar appreciation and materialization of trade disputes between the US and its major trading partners, particularly China. The combined effect of these factors resulted in a deceleration in industrial production, particularly of capital goods and a slowdown to global trade. Preliminary data however indicated that some advanced countries such as the United States (US), and some emerging and developing countries, registered higher growth in the second half of 2018.

At end 2018, growth in the US is estimated to have increased to 2.9% from 2.2% in 2017 on account of expansionary fiscal policy and buoyant consumer and business confidence. On the other hand, growth in the Euro area, United Kingdom, Japan, China and South Africa tapered off on account of softer external demand and private consumption in Germany, sovereign and financial concerns in Italy thus negatively affecting domestic consumption and street protests and industrial action by labour unions in France.

Growth in the UK was affected by the fall in business investment conditions largely due to uncertainty surrounding the outcome of Brexit negotiations while the Japanese economy suffered a setback on account of natural disasters. Slow growth in China largely reflects the effects of the trade dispute with the US, increase corporate debt levels and domestic deleveraging measures implemented by the Chinese authorities. In South Africa, weaker consumer and business confidence as well as delays in implementing the much anticipated structural policy reforms dented economic growth.

6.2 Commodity Prices

Commodity prices generally declined in the second half of 2018. Crude oil prices declined to US$56.5/barrel in December 2018 from US$73.2/barrel in June 2018. Explaining the decline in the oil prices was largely weaker global demand resulting from a slowdown in global economic activities and increased supply. Copper prices declined to US$6,075.0/mt from US$6,966.0/mt over the same period mainly on account of a stronger United States dollar and a slowdown in economic activity in major economies, particularly, China. Performance for agricultural prices was mixed as wheat and maize prices increased while soyabeans and cotton prices declined. Soya bean prices declined to US$381.0/mt in December 2018 from US$413.0/mt in June 2018. The prices of cotton also declined to US $1.90/mt from US $2.15/mt. Maize prices however increased to US $167.4/mt from US$165.1/mt, while wheat prices rose to US$217.8/mt from US $206/mt due falling supply as a result of dry weather conditions.

7.0 REVIEW OF MONETARY POLICY PERFOMANCE IN THE SECOND HALF OF 2018

7.1 Assessment of Monetary Policy Implementation

In the second half of 2018, Bank of Zambia kept its Policy Rate unchanged at 9.75% in line with the assessment of inflation, which broadly remained within the target range of 6-8%. This policy stance helped to cushion some fragilities in the financial system, thereby supporting economic activity. The Bank of Zambia also maintained the statutory reserve ratio at 5.0% and influenced the interbank rate to fluctuate within the +/-1 percentage point of the Policy Rate corridor.

7.2 Challenges to Monetary Policy Implementation

The underdeveloped financial market characterised by low secondary market trading in Government securities, limited financial inclusion, and relatively illiquid and thin capital market continued to be overarching challenges in the implementation of monetary policy. These challenges often distort and limit the transmission of monetary policy impulses on economic activity, as liquidity is usually concentrated among fewer banks.

The higher than programmed fiscal deficits continued in the second half of 2018 and weighed on private sector access to credit. This adversely affected the ability of monetary policy to influence availability of more and affordable credit to help finance the productive sectors of the economy. High external debt service payments also continued to deplete foreign currency reserves, while the huge demand for foreign currency contributed to depreciation and volatility in Kwacha/US dollar exchange rate in the second half of 2018.

However, to support sustainable macroeconomic stability and achieve higher growth, prompt and effective implementation of fiscal adjustment measures remains critical.

8.0 REVIEW OF DOMESTIC MACROECONOMIC DEVELOPMENTS IN THE SECOND HALF OF 2018

8.1 Inflation Outturn

The second half of 2018 was characterised by elevated inflationary pressures arising from high food prices and a depreciated exchange rate of the Kwacha against the US dollar. Consequently, annual overall inflation rose to an average of 7.9% in the second half from the average outturn of 7.4% in the first half of 2018. During the review period, inflation breached the upper bound of the target range of 6-8% in August and October, recording levels of 8.1% and 8.3%, respectively. In terms of end-period developments, inflation rose to 7.9% in December 2018 from 7.4% in June. Annual food inflation rose to an average of 8.3% in the second half of the year from an average of 6.0% in the first half. However, annual non-food inflation declined to an average of 7.6% from the 8.2% outturn recorded during the first six months of 2018 (Chart 2a).

The increase in inflation was mainly driven by high food prices following a reduction in the supply of selected food items, particularly maize grain which exerted upward pressure on the prices of maize grain products such as mealie meal and feedstock. In the latter part of the review period, an upward adjustment in fuel prices as well as the sharp depreciation of the exchange rate of the Kwacha against the US dollar contributed to heightened inflationary pressures. The effects of these factors were reflected in high transport costs which contributed to elevated inflationary pressures, particularly for food inflation.

Chart 2a: Annual Inflation(%)

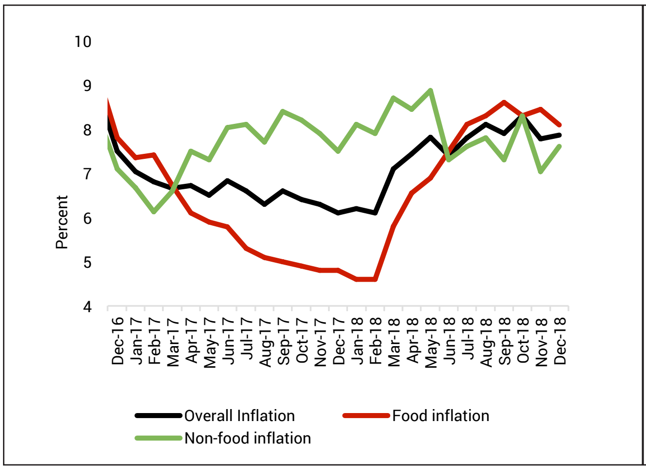
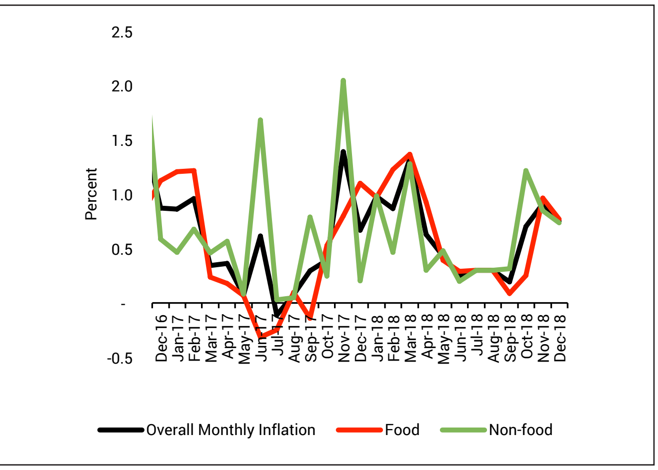


Chart 2b: Monthly Inflation(%)



Source: Central Statistics Office

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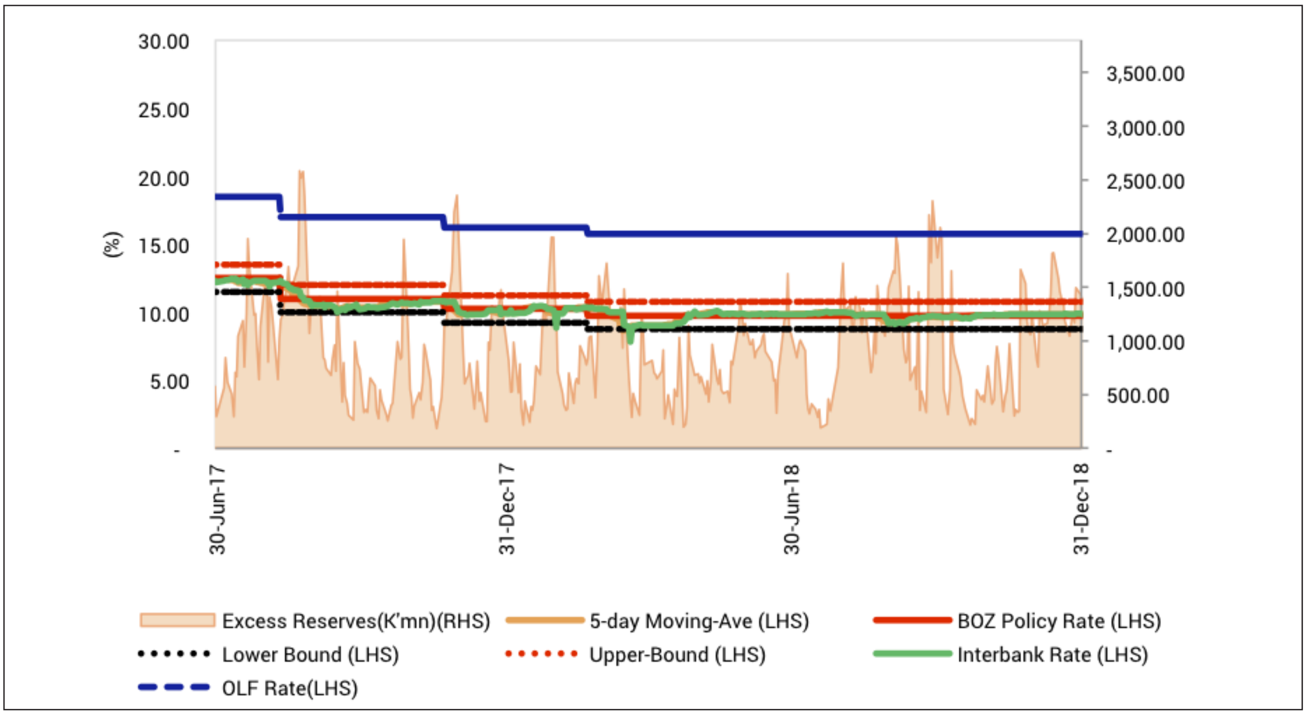
8.2 Interbank Rate and Money Market Liquidity

The overnight interbank rate closed at 9.87% unchanged from end-June 2018 and remained within the BoZ Policy Rate corridor (Chart 3 and Table 3 - Appendix). The bank undertook open market operations (especially at the beginning of the second half of the year 2018) to steer the overnight interbank rate towards the Policy Rate.

Liquidity in the money market (as measured by the commercial banks' aggregate current account balance) rose to K1.4 billion from K1.1 billion as at end-June 2018. The main liquidity influences were net Government securities maturities and BoZ purchases of foreign exchange for international reserves accumulation. However, the rise in liquidity was moderated by statutory reserve transfers, Overnight Lending Facility (OLF) repayments and net Government revenues.

Chart 3: Market Liquidity and Interbank Rate



Source: Bank of Zambia Compilations

8.3 Government Securities Market

The demand for Government securities generally dwindled largely on account of reduced appetite for government bonds, as evidenced by a fall in subscription rates to 33.0% from 134.6% recorded in the first half of 2018. The fall in the Government bonds subscription rate was mainly on account of reduced participation by commercial banks, institutional investors and non-resident investors. However, the subscription rate for Treasury bills picked up to an average of 79% from 69%, previously. The demand for Treasury bills was supported by commercial banks and institutional investors who switched from longer dated instruments in favour of shorter dated instruments on account of higher yields.

Thus, total funds raised (at cost) from Government securities declined to K11.1 billion from K14.0 billion recorded in the last half of 2017, against total maturities of K11.8 billion, resulting in an overall deficit of K0.7 billion. As at end-December 2018, the stock of Government securities at face value rose by 12.5% to K58.4 billion from K51.9 billion. Out of the total stock of Government securities, non- resident investors held K8.1 billion from K8.8 billion, previously (K0.1 billion in Treasury bills).

Interest rates on Government securities generally rose as demand for government securities declined (Table 5 - Appendix). The weighted average Treasury bills yield rate increased to 20.0% from 16.5% while the composite Government bond yield rate rose to 20.0% from 18.3%.

8.4 Foreign Exchange Market

The Kwacha depreciated against a basket of major trading partner currencies. The local unit depreciated against the US dollar by 13.1% to an average of K11.1132 from K9.8241. This was mainly on the back of a stronger US dollar supported by the hike in the Federal Funds Rate and sustained negative market sentiments arising from the downgrade of Zambia's credit ratings by Moody's and S&P in August, 2018. Furthermore, the high foreign exchange demand mainly from the ministry of energy (for oil procurement) weighed on the Kwacha. The depreciation of the Kwacha was amidst net supply of foreign exchange of US $396.6 million compared to a net supply of US$599.1 million recorded in the first half of 2018. The major suppliers of foreign exchange continued to be the mining companies while the public administration sector dominated the demand side.

The Kwacha also depreciated against the Pound sterling and Euro by 6.5% and 7.6% to half year averages of K14.3836 and K12.7927, respectively. The Kwacha's depreciation against the Pound and euro was largely on account of the lesser deprecation of these currencies against the US dollar. This notwithstanding, the local unit appreciated against the South Africa rand by 1.8% to an average of K0.7836 as the South African economy slid into a recession after recording two (2) consecutive quarters of negative growth.

8.5 Capital Markets

The LuSE All-Share index (LASI) and market capitalisation dropped by 3.8% each, closing the last half of 2018 at 5,248.4 and K60.5 billion, respectively. The LASI All-share index was mainly pulled down by manufacturing, energy and the mining sectors. The market developments mainly responsible for market movements included failure of the anticipated purchase of all ordinary shares in CEC by Zambian Transmission LLP, and Zambia Breweries' disposal of company business of manufacturing, distributing, marketing and selling of non-alcoholic drinks. Consequently, the Exchange recorded a higher net outflow by foreign portfolio investors amounting to US$4.1 million by end-December 2018 relative to US$1.3 million recorded in the first half of 2018.

8.6 Interest Rates

The average commercial bank lending rates continued to decline in the second half of 2018, falling to 23.6% in December 2018 from 24.1% in June 2018. On the other hand, savings rates edged up over the same period, with the average 180-day deposit rate for amounts exceeding K20, 000 rising to 9.1% in December 2018 from 8.1% in June (Table 5 - Appendix). Further, the average effective lending rate for the non-bank financial institutions' sector rose to 46.7% during the second half of 2018 from 45.5% recorded during the first half of 2018(Table 6 - Appendix).

8.7 Broad Money

Over the last six months of 2018, broad money (M3) grew by 14.0% to K63.0 billion, compared to a decline of 1.5% recorded in the first half of the year (Table 9 - Appendix). The growth in M3 was on account of increases in both net foreign assets and domestic credit. On an annual basis, M3 growth edged up to 16.5% in December 2018 from 15.6% in June 2018.

8.8 Domestic Credit

Domestic credit grew at a higher pace in the second half of 2018, at 11.4%, compared to a growth of 3.2% in the first half (Table 7 – Appendix). This was on account of expansion of credit to Government, public and private enterprises, as well as households. Year-on-year, domestic credit grew by 15.0% in December 2018, the same as growth registered in June 2018.

The Kwacha denominated commercial banks' credit grew by 8.6% during the second half of 2018 compared to a growth of 3.4% registered in the first half. The growth in kwacha loans was on account of increased lending to households, financial services and the transportation and storage sectors. Foreign currency loans grew by 7.5% in the second half of 2018 against a growth of 0.7% in the first half, reflecting increases in credit to the electricity and gas, manufacturing and financial services sectors.

The household (personal loans) category continued to account for the largest share of total credit from banks, representing 27.9% (29.7% in June 2018), followed by agriculture, forestry and fishing sector at 16.9% (18.8% in June 2018) (Table 8 – Appendix).

8.9 International Trade

The trade deficit widened to US$411.0 million in the second half of 2018 from a deficit of US$86.8 million in the first half of 2018. This outturn was also higher than US$311.3 million recorded during the corresponding period in 2017. The expansion in the deficit was due to decline in exports and a marginal increase in imports (Tables 10 and 11 - Appendix).

Exports declined by 5.6% following a reduction in both export volumes and average realised prices of copper and cobalt. Merchandize exports fell by 5.4% to US$4,285.6 million on account of lower copper export earnings, which declined by 12.4% to US$3,109.6 million. Lower export volumes and average realized prices accounted for the deterioration in copper earnings (Table 12 – Appendix). Copper export volumes declined by 0.3% to 524,455.2 metric tonnes (mt) from 525,880.7 mt whilst average realised prices fell by 12.2% to US$5,930.5 per mt from US$6,753.3 per mt.

Cobalt and Gold export earnings also decreased by 34.4% and 14.4% to US$46.2 million and US$68.3 million, respectively. This was on account of lower volumes and average realised prices. However, non-traditional export earnings rose by 24.0% to US$1,129.8 million (Tables 10 and 12 - Appendix), largely due to higher exports of cement and lime, cotton lint, burley tobacco and cane sugar.

Imports, on the other hand, increased by 1.4% to US$4,764.8 million from US$4,696.8 million., mainly due to higher imports of chemicals, vehicles, food items, and paper and paper products.

8.10 Domestic Economic Activity

The domestic economy is estimated to have expanded by 5.0% year-on-year in the third quarter of 2018 compared to 3.9% in the second quarter of 2017. The drivers of this growth included information and communication, wholesale & retail trade and finance and insurance industries. Over the three quarters of 2018, GDP growth rate was 3.9%, marginally higher than 3.6% recorded during the same period in 2017. The Bank of Zambia composite index of economic activity (CIEA) suggests that economic activity grew by 3.9% in the fourth quarter of 2018, lower than 5.8% estimated for the corresponding period in 2017.

8.11 Fiscal Balance

Preliminary data indicate that the fiscal deficit, on cash basis, at 2.2% of GDP, was 1.3 percentage points lower than the programmed budgeted deficit of 3.5% (Table 13 - Appendix). This largely reflected lower than programmed expenditure on use of goods and services, grants and other payments, social benefits, strategic food reserve, personal emoluments, ordinary non-financial assets, water and sanitation and financial assets. Revenue collections, however, were above target. The deficit was financed from both external sources mainly project support as well as domestic resources mainly Government securities. Domestic arrears, however, have remained elevated and are likely to rise at a faster rate in light of liquidity challenges Government is facing. This has potential adverse effects on non-performing loans and the overall stability of the financial sector.

9.0 CONCLUSION

Although annual overall inflation is projected to remain within the target range of 6-8% during the first half of 2019, there are several upside risks which can cause inflation to rise should they materialize. These include higher than anticipated food prices which may result from reduced agriculture production in the 2018/2019 crop season and higher than programmed fiscal deficits as well as a possible increments in domestic fuel prices. Higher than programmed external debt service payments could also adversely impact on inflation through the exchange rate channel.

Achieving positive and higher domestic economic growth has remained a challenge. Real GDP growth in the second half of 2018 is positive albeit moderate, as indicators of economic activity show that business conditions remained weak. Growth for the first three quarters of 2018 recorded at 3.9%, which is 0.3 percentage points above the same period in 2017. The Kwacha depreciated against a basket of major trading partner currencies on the back of a stronger US dollar supported by the hike in the Federal Funds Rate and sustained negative market sentiments arising from the downgrade of Zambia's credit ratings by Moody's and S&P in August, 2018. The demand for foreign exchange mainly for importation of petroleum remained high and contributed to the weakening of the Kwacha exchange rate.

Despite accommodative monetary policy stance pursued by the Bank of Zambia in 2018, interest rates remained high, declining only marginally due to elevated domestic financing requirements of Government and high non-performing loans. Consequently, credit to the private sector remained subdued.

To support sustainable macroeconomic stability and achieve higher economic growth, prompt and effective implementation of fiscal adjustment measures, remains critical.

The Bank of Zambia will continue to closely monitor domestic and external sector developments and stands ready to implement appropriate measures to maintain price and financial system stability and ultimately support economic growth.

[6] Export volumes refer to gross volumes exported which include, but not restricted to, production from Zambian mines.

Appendix

Table 1: Actual and Projected Inflation: Jan 2017 – Jun 2019

	Projection (a)	Actual (b)	Forecast Error (b-a)
Jan 2017	7.7	7.0	-0.7
February	6.8	6.8	0.0
March	7.0	6.7	-0.3
April	7.1	6.7	-0.4
May	7.3	6.5	-0.8
June	7.4	6.8	-0.6
July	6.6	6.6	0.0
August	6.5	6.3	-0.2
September	6.7	6.6	-0.1
October	6.8	6.4	-0.4
November	6.8	6.3	-0.5
December	7.0	6.1	-0.9
Jan 2018	6.2	6.2	0.0
February	6.2	6.1	-0.1
March	6.4	7.1	-0.3
April	6.5	7.4	-0.9
May	6.6	7.8	-1.2
June	6.4	7.4	-1.0
July	7.8	7.8	0.0
August	8.1	8.1	0.0
September	8.3	7.9	-0.4
October	8.4	8.3	-0.1
November	8.2	7.8	-0.4
Jan 2019	8.0	7.9	-0.3
February	7.9	7.8	-0.1
March	7.6	7.5	-0.1
April	7.5		
May	7.7		
June	7.7		

Source: Central Statistical Office and Bank of Zambia Compilations

Table 2: Macroeconomic Outturn and Targets: 2016 - 2018

	2016 Outturn	2017 Target	2017 Outturn	2018 Target	2018 Outturn*	2019 Target**
Real GDP growth rate (%)	3.6	4.2	3.4	4.0	3.7	4.0
CPI Inflation, end period (%)	7.5	9.0	6.1	6-8	7.9	6-8
Gross Official Reserves (months of imports)	3.3	3.0	2.9	3.0	1.9	3.0
Broad Money growth (%)	-5.7	17.9	21.4	20.7	16.2	10.2
Budget deficit (on cash basis, excluding grants), % of GDP	5.8	7.0	7.8	6.1	7.6	6.5
Domestic financing of Budget (% of GDP)	3.8	4.6	1.6	4.0		1.4

Source: Bank of Zambia Compilations, Central Statistical Office, Ministry of Finance
*Preliminary; ** Projection

Table 3: Liquidity Influences (K' billion): Jul 2016 – Dec 2018

	Jul-Dec 2016	Jan-Jun 2017	Jul-Dec 2017	Jan- Jun 2018	Jul-Dec 2018
Opening balance	0.8	2.7	0.3	1.4	1.1
Net Government spending	4.4	2.5	4.2	2.6	-1.0
BoZ foreign exchange influence	3.5	2.4	2.2	2.5	1.4
Change in currency in circulation	-0.2	0.1	-0.3	-0.2	-0.5
Change in statutory reserve deposits	-2.2	-0.8	-3.1	-6.0	-1.9
Overnight Lending Facility	-0.2	0.02	-1.6	-2.8	-1.3
Net Government securities influence	4.3	-5.3	-1.6	3.1	2.6
Open market operations	0.3	-1.7	1.3	0.1	0.4
Closing balance	2.7	0.3	1.4	1.1	1.4

Source: Source: Bank of Zambia Compilations

Table 4: Exchange Rate: Jan 2016 – Dec 2018

Bilateral Nominal Exchange Rate (period average)						
	Jan-Jun 2016	Jul-Dec 2016	Jan-Jun 2017	Jul-Dec 2017	Jan-Jun 2018	Jul-Dec 2018
ZMW/USD	10.7140	9.9026	9.5393	9.5305	9.8241	11.1132
ZMW/GBP	15.3506	12.6561	11.9949	12.5691	13.5113	14.3836
ZMW/EUR	11.9499	11.7472	10.3230	11.2159	11.8850	12.7927
ZMW/ZAR	0.6943	0.7072	0.7218	0.7108	0.7982	0.7836
Real Trade-weighted Exchange Rate (end-period)	**Jun 2016**	**Dec 2016**	**Jun 2017**	**Dec 2017**	**Jun 2018**	**Dec 2018**
Domestic CPI (2005=100)	271.7	281.9	291.3	299.0	312.6	322.6
Weighted Foreign CPI (2005=100)	138.6	139.6	141.9	143.2	145.7	146.7
NEER	3.07	2.83	2.81	3.03	3.03	3.45
REER Index (2005=100)	120.0	107.3	104.9	111.2	108.4	120.1

Source: Bank of Zambia Compilations

Table 5: Interest Rates (%, period average): 2016 – 2018

	2016		2017		2018	
	First Half	Second Half	First Half	Second Half	First Half	Second Half
BoZ Policy Rate (end-period)	15.5	15.5	12.5	10.25	9.75	9.75
Overnight Lending rate (end-period)	25.5	25.5	18.5	16.25	15.75	15.75
Overnight interbank rate	24.3	17.2	12.2	10.03	9.87	9.87
Average commercial banks' lending rate	27.1	29	28.2	28.2	24.2	23.7
Savings rate						
more than K100	3.3	3.2	2.7	2.7	2.8	3.0
above K20,000 (180 days)	12.4	12.8	11.9	11.9	8.1	8.5
Treasury bills yield rates						
composite yield rate	24.6	23.7	14.9	15.06	16.5	20.04
91days	21.6	20.9	15.7	9.92	9.97	13.27
182 days	24.4	23.8	17.4	10.09	11.49	14.69
273 days	26.3	25.1	17.9	11.98	11.60	18.77
364 days	26.3	25	19.3	15.98	17.29	21.10
Government bond yield rates						
composite yield rate	25.4	25	18.1	18.2	18.3	19.96
2 years	24.5	25	21.4	16.5	17.1	19.50
3 years	24.3	23.9	20.9	17.9	18.1	19.47
5 years	28.3	26.3	21	17.8	18.6	20.40
7 years	28.5	26.6	21.6	18.6	18.9	18.66
10 years	23.4	24.6	21.4	19.7	19.4	21.00
15 years	23.5	23.3	23.3	18.7	18.2	17.33

Source: Bank of Zambia Compilations

Table 6: Average Annual Non-Banks' Effective Interest Rates (%): 2016 – 2018

	2nd Half 2016	1st Half 2017	2nd Half 2017	1st Half 2018	2nd Half 2018
Microfinance Institutions	72.6	73.4	81.3	82.7	83.1
Leasing Finance Institutions	61.7	59.1	52.0	28.0	40.5
Building Societies	46.2	39.5	35.3	28.9	34.9
Development Bank of Zambia	28.9	25.2	25.2	30.6	26.6
National Savings and Credit Bank	31.0	31.0	31.0	67.0	67.0
Financial Businesses	35.5	33.8	33.8	35.5	35.5
Overall for the sector	**40.7**	**43.7**	**43.1**	**45.5**	**46.7**

Source: Bank of Zambia Compilations

Table 7: Domestic Credit (K' billion unless otherwise stated): Jun 2016 – Dec 2018

	Jun - 2016	Dec - 2016	Jun - 2017	Dec - 2017	Jun - 2018	Dec - 2018
Domestic Credit [Gross](DC)	46.1	48.9	55.5	61.8	63.8	71.1
o/w foreign currency denominated	8.9	8.2	8.1	10.0	10.0	12.9
DC (excl. FX denominated credit)	37.2	40.7	47.4	51.8	53.8	58.2
6-month % change in DC	-3.1	6.1	13.4	11.3	3.2	11.4
6-month % change in Forex Credit/	-9.2	-7.9	-1.2	23.71	0.4	28.8
6-Month Change in DC (Excl. Forex Credit)	-1.5	9.4	16.5	9.3	3.8	8.1
Annual Change in Domestic Credit	4.1	2.8	20.4	26.3	15.0	15.0

Source: Bank of Zambia Compilations

Table 8: Broad Money (K' billion unless otherwise stated): Jun 2016 – Dec 2018

	Jun - 2016	Dec - 2016	Jun - 2017	Dec - 2017	Jun - 2018	Dec - 2018
Broad Money (M3)	44.1	44.6	47.8	54.1	53.3	63.0
Foreign Exchange (FX) Deposits	18.4	17.1	16.7	19.4	21.4	25.4
M3 (excl. Foreign Exchange Deposits)	25.8	27.5	31.1	34.6	31.9	37.6
6-month change in M3 (%)	-6.6	1.0	7.1	13.2	-1.5	14.0
6-month % change in Forex deposits	-11.5	-7.2	-1.9	16.5	10.0	18.5
6-Month % change in M3 (excl. Forex deposits)	-2.8	6.8	12.9	11.4	-7.9	18.0
Annual % change in M3 (%)	19.7	-5.7	8.3	21.4	15.6	16.5
Annual % change in Forex deposits	51.2	-17.9	-8.9	13.7	28.1	30.4
Annual % change in M3 (excl. Forex Deposits)	4.2	3.8	20.6	26.0	2.6	8.7

Source: Bank of Zambia Compilations

Table 9: Shares of Total Loans and Advances by Sector (%): Jun 2016 – Dec 2018

	Jun - 2016	Dec - 2016	Jun - 2017	Dec - 2017	Jun - 2018	Dec - 2018
Agric, forestry, fishing & hunting	17.4	17.2	19.6	20.3	18.8	16.9
Mining & Quarrying	5.6	6.3	6.4	6.3	6.7	7.0
Manufacturing	12.4	12.7	10.6	7.8	7.9	9.2
Electricity, Gas, Water & Energy	1.5	2.2	2.2	3.1	2.8	3.0
Construction	3.8	3.9	3.8	4.4	3.9	3.0
Wholesale & Retail Trade	10.7	10.3	10.2	11.4	11.2	11.1
Restaurants & Hotels	1.5	1.6	1.4	1.5	1.3	1.3
Transport, Storage & Communications	5.2	4.6	4.5	4.7	4.7	6.2
Financial Services	2.8	1.8	2.3	2.2	3.0	4.1
Community, Social & Personal	2.1	1.7	4.3	4.1	4.2	4.8
Real Estate	3.0	3.5	3.7	3.5	3.7	3.5
Personal Loans	27.3	27.5	27.2	28.0	29.7	27.9
Others	6.7	6.8	3.9	2.7	2.1	2.1

Source: Bank of Zambia Compilations

Table 10: Trade Data (c.i.f - US$ million): Jan 2016 – Dec 2018

	Jan-Jun 2016	Jul-Dec 2016	Jan - Jun 2017	Jun - Dec 2017	Jan-Jun 2018	Jul-Dec 2018
Trade Balance	**-316.42**	**-504.6**	**-250.5**	**-311.3**	**-86.8**	**-411.0**
Total Exports, c.i.f. (including Gold)	**3,095.3**	**3,348.8**	**3,758.6**	**4,453.9**	**4,610.0**	**4,353.9**
General Exports, f.o.b	**2,991.4**	**3,261.4**	**3,674.2**	**4,382.3**	**4,530.3**	**4,285.6**
Metals	2,155.9	2,356.8	2,908.0	3,382.4	3,619.3	3,155.8
Copper	2,114.3	2,284.9	2,857.8	3,307.8	3,548.8	3,109.6
Cobalt	41.6	72.0	50.2	74.6	70.5	46.2
Non -Traditional Exports	**835.5**	**904.6**	**766.2**	**999.9**	**911.0**	**1,129.8**
Exporter Audit Adjustor	-13.2	-13.2	-13.2	-13.2	-13.2	-13.2
Sub Total	848.6	913.4	779.4	1,013.0	924.1	1,143.0
Gemstones	13.0	15.4	49.1	4.9	5.1	5.6
Sulphuric acid	18.0	21.1	25.0	47.6	84.8	86.5
Industrial Boilers and Equipment	74.5	43.4	36.0	43.9	59.7	66.8
Cane Sugar	58.4	61.6	72.7	64.3	55.5	69.3
Gasoil/Petroleum Oils	3.1	6.2	4.2	3.8	4.5	5.1
Cement & Lime	30.8	40.8	34.5	40.0	43.7	70.0
Electricity	0.0	13.6	35.8	33.6	33.7	49.3
Raw hides, Skins & Leather	7.5	4.1	4.1	5.0	1.1	4.3
Sulphur, sublimed or precipitated; colloidal	2.5	0.2	0.0	0.0	0.0	0.1
Tobacco	43.6	46.0	51.7	36.8	42.3	62.3
Copper Wire	29.9	37.4	43.2	42.1	35.2	43.7
Scrap of precious metals	0.1	0.1	0.2	0.2	1.2	0.3
Maize & Maize Seed	79.7	108.9	25.4	72.2	18.4	26.0
Electrical Cables	7.0	7.3	9.1	10.9	13.6	7.6
Cotton Lint	19.5	45.0	13.7	24.6	12.0	37.2
Soap, Active Agents, Washing Preps.	17.5	27.9	21.4	24.5	25.4	27.7
Fresh Fruits & Vegetables	4.7	9.2	6.0	8.7	7.6	5.4
Manganese Ores/Concentrates	0.4	6.2	22.0	9.3	9.7	17.2
Wheat & Meslin	3.6	3.6	0.4	0.0	0.0	0.0
Fresh Flowers	4.6	6.2	6.3	4.6	6.4	3.7
Other	430.1	409.4	326.4	536.0	464.1	554.8
Gold	103.9	87.4	84.4	71.6	79.7	68.3
Imports c.i.f./1	**-3,411.7**	**-3,853.3**	**-4,009.1**	**-4,765.2**	**-4,696.8**	**-4,764.8**

Source: Bank of Zambia Compilations

Table 11: Imports by Commodity Groups (c.i.f - US$ million): Jan 2016 – Dec 2018

	Jan-Jun 2016	July-Dec 2016	Jan-Jun 2017	Jul-Dec 2017	Jan-Jun 2018	Jul-Dec 2018
Food Items	208.3	**254.6**	**224.7**	**286.4**	**344.6**	**363.3**
Petroleum Products	722.0	664.4	518.1	649.6	115.4	94.4
Fertilizer	104.8	187.2	303.5	237.3	14.7	14.3
Chemicals	426.8	515.3	503.5	961.4	711.4	794.6
Plastic and Rubber Products	138.0	173.7	175.2	208.6	74.5	81.1
Paper and paper products	44.8	58.0	58.7	56.1	12.7	25.7
Iron and Steel and items thereof	148.3	171.0	173.5	244.4	193.4	183.6
Industrial Boilers and Equipment	466.4	532.0	562.4	568.0	346.5	243.0
Electrical Machinery & Equipment	366.2	320.0	222.1	222.3	2.7	1.7
Vehicles	222.7	227.3	222.8	257.9	9.5	35.8
Ores, Slag and Ash	267.0	434.7	437.9	589.4	674.9	664.9
Other Imports	296.4	315.2	606.9	483.9	2,196.6	2,262.6
Total	**3,411.7**	**3,853.3**	**4,009.1**	**4,765.2**	**4,696.8**	**4,764.8**

Source: Source: Bank of Zambia Compilations *Residual item and includes copper ores, sulphuric acid and clothing

Table 12: Metal Export Volumes, Values and Prices: Jul 2015 – Dec 2018

	Copper				Cobalt			
	Export Volumes (mt)	Export US $'000	Price/ Tonne	Price/ Pound	Export Volumes (mt)	Export US $'000	Price/ Tonne	Price/ Pound
Jul-Dec 2015	556,848.2	**2,628,061.2**	**4,719.5**	**2.1**	**1,592.0**	**34,187.8**	**21,474.7**	**9.7**
Quarter 1	237,636.6	1,043,080.2	4,389.4	2.0	1,241.2	22,037.1	17,754.4	8.1
Quarter 2	225,653.5	1,055,918.3	4,679.4	2.1	1,102.8	20,587.8	18,668.9	8.5
Jan–Jun 2016	**463,290.1**	**2,098,998.5**	**4,530.6**	**2.1**	**2,344.0**	**42,624.9**	**18,184.6**	**8.2**
Quarter 3	221,929.8	1,031,762.2	4,649.1	2.1	1,326.0	33,396.8	25.186.1	11.4
Quarter 4	246,147.8	1,253,097.0	5,090.8	2.3	1,392.0	37,891.0	27,220.6	12.3
Jul-Dec 2016	**468,077.6**	**2,284,859.2**	**4,881.4**	**2.2**	**2,718.0**	**71,287.8**	**26,228.0**	**11.9**
Quarter 1	259,675.9	1,429,496.8	5,504.9	2.5	602.8	26,683.6	44,264.9	19.8
Quarter 2	253,428.0	1,428,281.5	5,635.8	2.6	652.2	23,504.8	36,040.6	23.3
Jan-Jun 2017	**513,104.0**	**2,857,778.4**	**5,569.6**	**2.5**	**1,255.0**	**50,188.4**	**39,991.0**	**21.6**
Quarter 3	231,858.4	1,450,945.6	6,257.9	2.8	726.0	41,054.3	56,548.7	25.7
Quarter 4	278,897.3	1,856,875.8	6,657.9	3.0	609.0	39,067.4	64,150.2	29.1
Jul-Dec 2017	**510,755.2**	**3,307,820.9**	**6,476.3**	**2.9**	**1,335.0**	**80,121.8**	**60,016.3**	**27.2**
Quarter 1	272,106.4	1,907,609.7	7,010.5	3.2	397.0	32,256.1	81,244.0	36.9
Quarter 2	253,774.4	1,641,198.3	6,467.2	2.9	462.0	38,222.7	82,733.2	37.5
Jan-Jun 2018	**525880.8**	**3,548,808.0**	**6,738.9**	**3.1**	**859.0**	**70,478.8**	**81,988.6**	**37.2**
Quarter 3	275,352.9	1,628,639.4	5,914.7	2.7	429.0	28,681.8	66,857.5	30.3
Quarter 4	249,102.4	1,480,936.9	5,945.1	2.7	375.3	17,542.1	46,741.5	21.2
Jul-Dec 2018	**524,455.2**	**3,109,576.3**	**5,929.9**	**2.7**	**804.3**	**46,223.9**	**56799.5**	**25.8**

Source: Bank of Zambia Compilations

Table 13: Government Budget (K'bn): 2017 - 2018

	Budget Performance (K'bn)					
	Second Half 2017		First Half 2018		Second Half 2018	
	Prel	% of GDP	Target	Prel	Target	Prel
Total Revenue & Grants	22.5	**22.7**	**25.2**	**25.2**	**26.2**	**28.2**
Tax Revenue	18.0	19.5	19.9	21.3	20.9	23.0
Non-Tax Revenue	3.5	3.1	4.1	3.7	4.1	4.9
Grants	1.1	0.2	1.2	0.2	1.2	0.4
Total Expenditure	**33.2**	**34.1**	**36.0**	**42.0**	**37.5**	**37.2**
Current Expenditure	24.3	23.6	25.8	24.5	28.0	25.7
Personal Emoluments	10.0	9.4	11.4	10.4	11.7	11.4
Use of Goods & Services	2.7	2.3	3.4	2.8	4.3	2.9
Interest	4.1	5.3	5.4	6.4	5.8	7.2
Grants & Other Payments	5.6	5.0	4.3	3.9	4.3	3.5
Social Benefits	1.1	0.8	1.0	0.6	0.9	0.4
Other Expenses	0.8	0.8	0.3	0.2	0.9	0.4
Liabilities	0.9	1.1	0.7	0.1	0.6	0.3
Assets	6.2	7.9	9.5	14.9	7.2	8.2
Non- Financial Assets	6.1	7.7	9.3	14.9	6.9	8.2
Financial Assets	0.1	0.2	0.2	0.0	0.2	0.0
Change in Balances & Statistical discrepancy	-0.0	1.0	2.2	0.1	0.3	0.2
Fiscal Balance	**-9.0**	**-10.0**	**-10.8**	**-14.3**	**-9.6**	**-6.0**
Financing	**9.0**	**8.9**	**8.6**	**15.0**	**9.6**	**6.1**
Net Domestic	2.6	5.4	5.6	4.0	6.5	3.1
Net Foreign (net)	6.4	3.5	3.2	11.0	3.1	3.0

Source: Ministry of Finance

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