Bank Of Zambia

Monetary Policy Statement

JAN - JUN 2018

Bank of Zambia

MISSION STATEMENT

The principal purpose of the Bank of Zambia is 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

REGISTERED OFFICES

Head Office
Bank of Zambia, Bank Square, Cairo Road
P. O. Box 30080 Lusaka, 10101, Zambia
Tel: + 260 211 228888/228903-20
Fax: + 260 211 221764/237070
E-mail:pr@boz.zm
Website: www.boz.zm

Regional Office
Bank of Zambia, Buteko Avenue,
P. O. Box 71511 Ndola, Zambia
Tel: +260 212 611633-52
Fax: + 260 212 614251
E-mail:pr@boz.zm
Website: www.boz.zm

TABLE OF CONTENTS

CONTENTS **Page**

Executive Summary

This statement provides an outlook for global economic growth, domestic economic growth and inflation, and outlines monetary policy objectives for the first half of 2018. The Statement also reviews the performance of monetary policy during the second half of 2017.

Global economic environment supportive of growth

Global economic growth prospects remain positive, with global demand expected to rise, and commodity prices expected to maintain an upward trend. These developments are expected to provide support to Zambia's growth and the current account. However, risks to this outlook remain, which include the impact of economic policy reforms in the United States, and uncertainties surrounding the Brexit negotiations.

Domestic economic growth positive, but remains weak

The economy in the second half of 2017 continued to exhibit signs of improvement. This was reflected in the rise in quarterly GDP to an average of 4.8% in the second half from an average of 3.4% in the first half. The rise in GDP was driven mainly by agriculture, mining, education, and construction sectors.

Nonetheless, in the external sector, the balance on goods and services widened to US$182.0 million during the second half of 2017 from US$113.0 million in the first half, as the growth in imports exceeded that of exports.

Inflation remains well-anchored, but lending interest rates remain elevated

Inflation remained significantly below the annual target of 9% and trended towards the lower bound of the medium-term target range of 6-8%, ending the year at 6.1%. The positive outturn in inflation was largely due to the relative abundance of food items and stability in the exchange rate. Net supply of foreign exchange from the mining sector and non-resident investors in Government Securities accounted for the relative stability in the exchange rate.

Interest rates generally trended downwards following the easing of monetary policy. However, lending rates remained high, in part, due to higher yield rates on Government securities. Demand for Government securities remained robust in the second half of 2017, supported by the easing of liquidity conditions and continued participation by non-resident investors, relatively high yields, and stability in inflation. Domestic credit growth was positive but remained below historical averages. On the other hand, credit to the private sector picked up as economic activity continued to recover and lending rates declined.

In view of the continued decline in inflation and the projected low inflation, the Bank of Zambia eased monetary policy further by lowering the Policy Rate twice to 11.0% in August and to 10.25% in November from 12.5% in May. To provide a firm basis for the Policy Rate as the key signal for the monetary policy stance, the statutory reserve ratio was reduced to 9.5% and to 8.0% from 12.5% over the same period. These measures were intended to reduce the cost of funds and promote credit growth in order to support economic activity. The Bank continued to conduct monetary operations aimed at maintaining the interbank rate within +/-1 percentage points around the Policy Rate.

Fiscal deficit reduced

The fiscal position in the second half of 2017 showed an improvement, reflected in a lower deficit than programmed, due to constrained expenditure and over performance in VAT and mineral royalties, relative to targets. For the year as a whole, the performance of other revenue categories such as income taxes remained below target, partly reflecting the fragility of overall economic growth. The deficit was financed primarily from domestic resources, mainly Government securities, consistent with the Government's new Medium Term Debt Strategy (MTDS).

Economic outlook positive, but challenges to growth in the domestic economy remain

Over the next two years, global growth is projected to pick up to 3.9% in 2018 and 2019, reflecting expectation of favorable financial conditions and positive sentiments that are expected to accelerate growth in global demand. In addition, commodity prices, including copper, are expected to continue rising, on account of the projected pick-up in the global economy and strong demand for copper by China.

In the first half of 2018, inflation in Zambia is projected to average 6.4%, well within the target range of 6-8%. Underlying this low inflation projection is mainly the relative stability in the exchange rate of the Kwacha against the U S dollar, supported by higher copper prices. In addition, the steady supply of food items and the constraint in Government spending, in line with the 2018 Budget, underlie the favourable inflation outlook. However, upside risks to the inflation outlook include projected higher crude oil prices and potentially lower agricultural output due to poor distribution of rainfall in the southern part of the country. Notwithstanding these upside risks, inflation is projected to remain well anchored.

In 2018, GDP is projected to remain positive, mainly on account of the anticipated expansion in mining and manufacturing output. The recovery in electricity generation is also expected to support increased production. However, despite being positive, growth is projected to remain below its potential. Preliminary data indicate that growth in 2018 may be lower than the 5% projected in the 2018 Budget, largely reflecting the impact of adverse weather conditions on the agriculture sector output. Accelerated economic growth will therefore require efforts from both monetary and fiscal policies. On the fiscal side, there is need for concerted efforts to boost growth, particularly in key sectors such as agriculture, tourism and manufacturing. With inflation within the 6-8% target band, the easing of monetary policy is expected to support credit growth and aggregate demand.

With inflation projections indicating low inflation during the first half of 2018, the Bank of Zambia will remain focussed on maintaining inflation within the target range of 6-8%. The Bank will also continue to strengthen implementation of the forward looking monetary policy framework, anchored on the Policy Rate as the key signal for the monetary policy stance. Further, it is expected that measures taken to ease monetary policy in 2017 will continue to support the recovery of the economy and mitigate financial sector risks.

Challenges to the effectiveness of monetary policy remain. Although the Bank of Zambia has eased monetary policy in order to support conditions for lowering the cost of credit, lending interest rates still remain high. At these levels, they continue to constrain credit growth, investment and therefore efforts to grow and diversify the economy. In addition, high fiscal imbalances have continued to crowd out private sector credit growth.

In order to effectively address these challenges there is need for a stronger policy response. On the fiscal side, it is critical that Government expenditures are maintained within planned levels and revenue collection is stepped up in order to narrow fiscal deficits and ultimately contribute to the consolidation of macroeconomic stability. Lower fiscal deficits are also essential in reducing yield rates on Government securities, commercial bank lending rates, and in boosting extension of private sector credit to support the growth and diversification of the economy. Therefore, the ability of the Government to successfully implement the policy reforms outlined in the Economic Stabilization and Growth Programme (ESGP) and in the Medium Term Debt Strategy and meeting the deficit reduction targets remains critical in supporting the growth and diversification of the economy.

1.0 Introduction

This Monetary Policy Statement provides an outlook for global economic growth, domestic economic growth and inflation, and outlines monetary policy objectives for the first half of 2018. The Statement also reviews the performance of monetary policy during the second half of 2017. Selected macroeconomic indicators are presented in the Appendix.

2.0 Global Economic Outlook: 2018 - 2019

2.1 Economic Growth

The global growth projection for 2018 and 2019 was revised upward in January 2018 to 3.9% from 3.7% and 3.8%, respectively projected in October 2017 (IMF World Economic Outlook (WEO) Update, January 2018). The upward revision was mainly attributed to better growth prospects in advanced economies, favourable global financial conditions, and strong sentiments that are expected to support the recent growth in global demand.

The growth projection in Zambia's major trading partners[1], over the 2018-19 period remains positive. Growth in the US is projected to expand to around 2.5% through to 2019 from 2.3% in 2017, mainly reflecting supportive fiscal policy changes, especially corporate tax reforms, that are anticipated to boost corporate financial conditions and investments. In the Euro zone, growth is expected to remain around 2.0% over the 2018-2019 period, underpinned by the current momentum in domestic demand and higher external demand.

However, growth in the euro area faces risks associated with the political uncertainties in Spain[2] and their potentially negative impact on business confidence and demand. For the UK, growth is forecast to remain subdued as private consumption declines due to a weaker currency and uncertainties surrounding the Brexit negotiations which are likely to constrain fixed investments. However, solid global demand may cushion the slowdown.

A slowdown in China's GDP growth to 6.5% and 6.4% in 2018 and 2019, respectively, from a preliminary estimate of 6.8% for 2017 is projected. This is on account of continued economic rebalancing, tighter regulation in the property market, and stricter environmental regulations. Nonetheless, stronger external demand is expected to be a key driver of growth.

GDP growth for South Africa is projected at 1.5% in 2018, increasing to 2.1% in the medium-term. The growth outlook is premised on improved growth prospects in the agriculture sector, recovery in investor sentiments and business confidence, coupled with high global commodity prices expected to support the mining sector.

In the Democratic Republic of Congo (DRC), GDP growth is projected to rise to 3.3% in 2018, up from an estimated outturn of 3.2% in 2017. A further rise in growth to 3.9% is expected in 2019. A recovery in the country's extractive sector on the back of higher commodity prices and improving external demand is expected to drive growth. Nevertheless, the outlook will continue to be closely linked to domestic political developments, which may adversely affect inward investment.

2.2 Commodity Prices

The expansion in the global economy and strong demand for copper by China are expected to strengthen copper prices. Copper prices are projected to average US$6,570.3 and US$6,517.0 per tonne in 2018 and 2019, respectively. Over the same period, higher crude oil prices, averaging US$58.8/barrel and US$62.2/barrel in 2018 and 2019, respectively, are also projected. This is mainly on account of the extension of the OPEC+ Agreement to limit oil production and geopolitical tensions in the Middle East. Further, modest increases in agricultural commodity prices, including non-traditional exports for Zambia (i.e. maize, sugar, wheat and soya beans), are projected. This is mainly on account of less favourable weather conditions (concerns about La Niña) in some countries and rising costs of energy.

[1] 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 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.

[2] Political tension in Spain followed the central government's rejection of the October 1, 2017 Catalonian referendum vote for full self-governance.

3.0 Domestic Economic Outlook for 2018 - 2019

Preliminary data indicates that GDP growth for 2017 was 4.1%, which is slightly below the initial projection of 4.2%. Growth in the medium term is, however, projected to be higher and is expected to be driven mainly by the mining, agriculture, manufacturing, and tourism sectors.

In the mining sector, copper output is projected to rise to over 800,000mt. This is on the back of strong copper prices in line with improving global demand, the easing of power constraints that has enabled the ramping up of production among existing mines and the recovery of production at some mining operations. Investments in Multi Facility Economic Zones, especially in Lusaka East, and the operationalisation of the Single Licensing System[3] are expected to boost activity in the manufacturing and tourism sectors, respectively. More generally, the recovery in electricity generation is also expected to support increased production. Commencement of generation at newly constructed plants and the scaling-up of production at several other existing power stations in the aftermath of the recent electricity shortages will be the drivers for increased supply over the next two years and provide reliable and adequate supply of energy for production.

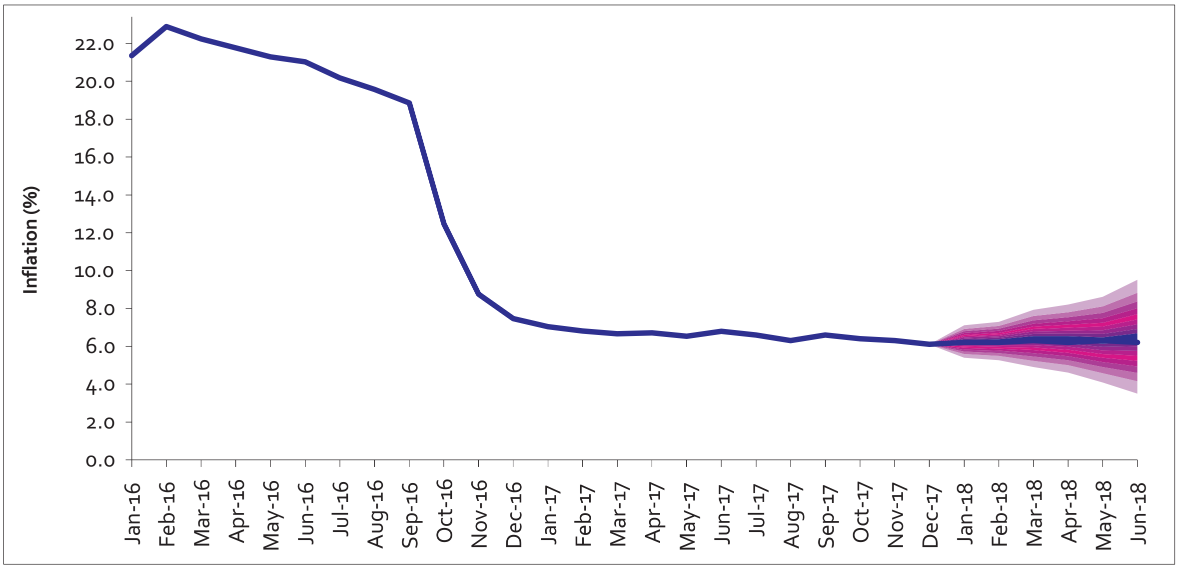
However, the projected growth remains below potential, constrained mainly by the cost of credit, high fiscal deficits, and structural weaknesses in the financial sector[4]. The sluggish response of real economic activity to the loosened monetary policy in 2017 points to the existence of other constraints, which are negating the role of monetary policy in stimulating credit growth and production.

4.0 Inflation Projections for the First Half of 2018

In the first half of 2018, annual overall inflation is projected to remain within the target range of 6–8%. Inflation is projected to average 6.4% over the same period, unchanged from the average outturn in the second half of 2017. The projected inflation of 6.4% for June 2018, is slightly up from the 6.1% outturn in December 2017 (Chart 1 and Table 1 - Appendix).

The low inflation outlook over the next six months is premised on relative stability in the exchange rate of the Kwacha against the US dollar, which will be supported by higher copper prices. In addition, the steady supply of food items and improved fiscal performance, in line with the 2018 Budget, are expected to support the favourable inflation outlook. However, upside risks to the inflation outlook include projected higher crude oil prices and potentially lower agricultural output due to poor distribution of rainfall in the southern part of the country. Nonetheless, should these upside risks materialise, inflation is still projected to remain well anchored within the target range of 6–8%.

Chart 1: Actual and Projected Inflation: Jan 2016 – Jun 2018



Source: Central Statistical Office and Bank of Zambia Compilations

[3] A licensing system designed to facilitate compliance with multiple licensing requirements by multiple regulatory bodies through a single regulatory point.

[4] These structural weaknesses in the financial sector include: market segmentation in the banking sector, high fiscal deficits which crowd out private sector credit, dollarisation and low penetration of financial services that all have an adverse impact on the transmission mechanism of monetary policy.

5.0 Monetary Policy Objectives and Instruments for the 1st Half of 2018

Over the first half of 2018, monetary policy will focus on maintaining inflation within the target range of 6-8%. To achieve this objective, the Bank of Zambia will rely mainly on open market operations directed at maintaining the interbank rate within a corridor of +/- one percentage point around the Policy Rate. The Bank will also continue to strengthen the forward looking monetary policy framework anchored on the Policy Rate as the key signal for the monetary policy stance. This is intended to improve the transmission of monetary policy and reduce reliance on non-price tools.

In addition, monetary policy formulation and implementation will remain supportive of the Government's macroeconomic objectives (Table 2 - Appendix) outlined in the 2018 Budget Address, as well as the broader 7th National Development Plan. These include, among others:

i. Achieve real GDP growth rate of at least 5% in 2018;
ii. Maintain single digit inflation in the range of 6 - 8%;
iii. Limit domestic financing to no more than 4.0% of GDP in 2018; and
iv. Maintain international reserves of at least 3 months of import cover.

6.0 Review of Global Developments in the Second Half of 2017

6.1 Economic Growth

Global growth in the second half of 2017 was mainly driven by trade, manufacturing and services sectors in the euro area and other large advanced economies[5]. In the euro area, manufacturing activity benefitted from the second-largest rise in export sales while the services sector was supported by improved domestic demand. In the US, growth was supported by the pickup in domestic demand while in the UK growth was mainly driven by increased manufacturing activities.

Growth in some of Zambia's major trading partners, particularly China, continued to recover in the second half of 2017. This was mainly supported by the services sector, manufacturing, and construction. In South Africa, the manufacturing sector remained subdued as political uncertainty continued to affect consumer and investor confidence, ultimately weighing down growth prospects and threatening the inflation outlook.

6.2 Commodity Prices

Commodity prices generally increased during the second half of 2017. The price of copper increased to US$6,834/mt in December 2017 from US$5,720/mt in June 2017, mainly due to improvements in global economic activity. Over the same period, crude oil prices rose to US$61.4/barrel from US$46.4/barrel, largely underpinned by the expansion in global economic activity and the extension of the OPEC+ Agreement to limit oil production. However, prices of a number of agricultural commodities were mixed. For instance, the price of maize declined to US$149.0/mt in December 2017 from US$157.0/mt in June 2017, so did the price of wheat which declined to US$184.1/mt from US$189.6/mt due to the rise in supply. In contrast, unfavourable weather conditions drove the prices of sugar and soybeans up to US$0.32/kg and US$398.0/mt in December 2017 from US$0.31/kg and US$380.0/mt in June 2017, respectively.

7.0 Review of Domestic Developments in the Second Half of 2017

7.1 Assessment of Monetary Policy Implementation

During the second half of 2017, monetary policy was focused on consolidating the slowdown in inflation towards the 6-8% target range. Annual inflation has trended downwards since March 2016 following the significant tightening of monetary policy in November 2015. With inflation falling within the target range and projections consistently pointing to low inflation, the Bank eased the monetary policy stance twice in the second half by reducing the Policy Rate to 11.0% in August from 12.5% and to 10.25% in November. Over the same period, to provide a firm basis for the Policy Rate as the key signal for the monetary policy stance, the statutory reserve ratio was lowered to 9.5% from 12.5% and further to 8.0%. These measures were intended to also support growth and promote financial system stability as economic growth remained subdued, while real lending rates were considered too high thereby constraining private sector access to credit.

[5]Performance is based on the Purchasing Managers' Index (PMI), which is an indicator of the economic health of the manufacturing sector, derived from monthly surveys of private sector companies. The PMI is based on five major indicators: new orders, inventory levels, production, supplier deliveries and the employment environment. Markit Group, which conducts PMI for over 30 countries worldwide, and the Institute for Supply Management (ISM), which conducts PMIs for the United States, are the principal producers of PMI.

7.2 Challenges to Monetary Policy Implementation

Notwithstanding the positive outturn in inflation in the second half of 2017, challenges to the effectiveness of monetary policy in containing inflation remained. The fiscal position continued to present a challenge to the ability of monetary policy to achieve its objectives. In addition, Government's borrowing from the domestic market continued to constrain private sector access to credit, thereby inhibiting production.

Other structural challenges that continued to limit the effectiveness of monetary policy include the underdeveloped state of the domestic financial markets, characterized by low secondary trading in Government securities, limited financial inclusion, illiquid and thin capital market, as well as money market segmentation. In particular, liquidity in the interbank market continues to be concentrated in a few banks, which negatively impacts on the efficient functioning of the interbank market and the transmission mechanism of monetary policy. Furthermore, the prevailing high lending rates, low credit growth, and high non-performing loans, continue to limit the effectiveness of monetary policy in containing inflation.

In order for monetary policy to be more effective in containing inflation and in creating conditions for lower lending interest rates, it is critical to have a balance on the fiscal side. In particular, it is critical that Government expenditures are maintained within planned levels while revenue collection is stepped up in order to narrow fiscal deficits and ultimately contribute to the consolidation of macroeconomic stability. Lower fiscal deficits are also essential in reducing Government yield rates, commercial bank lending rates, and in boosting private sector credit.

7.3 Macroeconomic Developments

Inflation Outturn

Annual overall inflation declined to an average of 6.4% in the second half of 2017 from 6.8% in the first half of the year. The decline reflected the fall in food inflation, which compensated for the rise in non-food inflation. Annual food inflation decelerated to an average of 5.0% from 6.5%, while non-food inflation rose to an average of 8.0% from 7.0%. In December 2017, inflation was 6.1%, up from 6.8% in June 2017 (Chart 2a). However, month-on-month overall inflation increased marginally to 0.7% in December 2017 from 0.6% in June 2017 (Chart 2b).

The slowdown in annual inflation was largely due to the abundant supply of some food items, particularly maize and other cereal products, which resulted in downward pressure on food inflation and ultimately overall inflation. In addition, the second half of the year was generally characterised by relative stability in the exchange rate of the Kwacha against the US dollar, which contributed to the moderation in prices of imported food items. That be as it may, non-food inflation rose. This was mainly on account of the administrative upward adjustments in both fuel prices and electricity tariffs.[6]

Chart 2a: Annual Inflation(%)

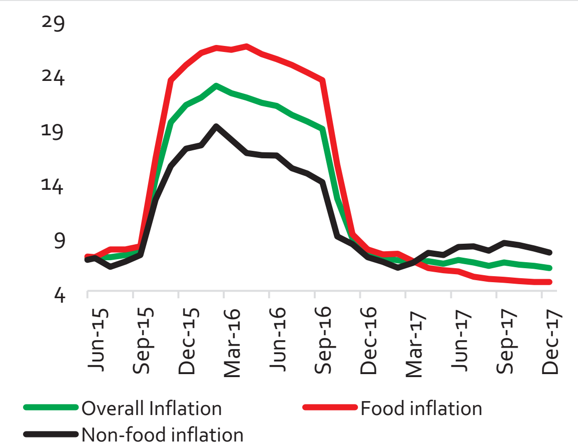
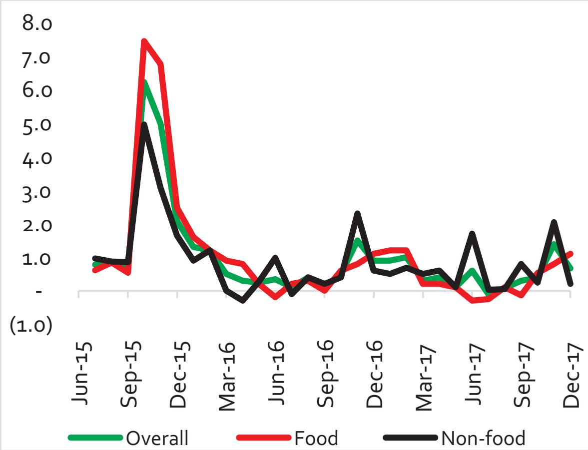


Chart 2b: Monthly Inflation(%)



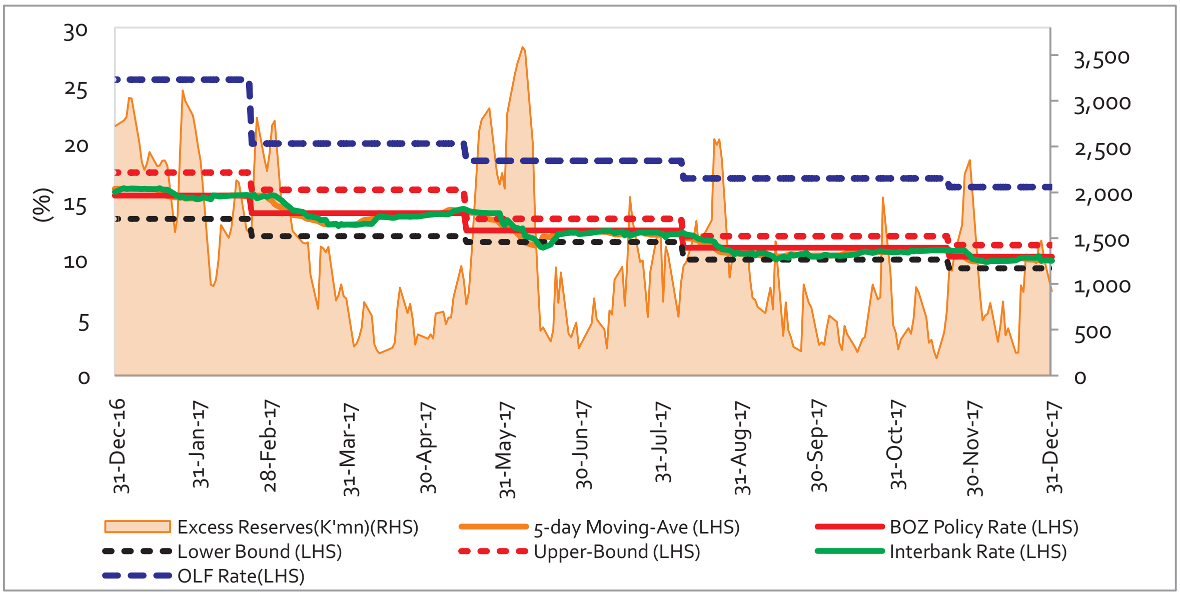
Source: Bank of Zambia Compilations

[6] Electricity tariffs were increased by an additional 25% in September 2017, while fuel prices were adjusted as follows:
a) Petrol prices increased by 11.1% from K11.67/litre to K12.97/litre
b) Diesel prices increased by 12.4% from K9.87/litre to K11.09/litre
c) Kerosenes price increased by 20.3% from K6.50/litre to K7.82/litre

Interbank Rate and Money Market Liquidity

During the second half of 2017, the Bank maintained the overnight interbank rate within the Policy Rate corridor. The overnight interbank rate fell to 10.0% at end-December 2017 from 12.2% at end-June 2017 as liquidity conditions remained loose mainly due to net Government spending and BoZ purchases of foreign exchange for international reserves build-up (Chart 3 and Table 3 - Appendix).

Chart 3: Market Liquidity and Interbank Rate



Source: Bank of Zambia Compilations

Government Securities Market

Demand for Government securities remained robust in the second half of 2017. This was supported by the continued easing of liquidity conditions and higher participation by non-resident investors who were attracted by relatively higher yields, a stable exchange rate, and low inflation. The stock of Government securities increased by 15.1% to K48.4 billion. The stock of Government securities held by non-residents increased by 13.0% to K8.5 billion.

In terms of yield rates, the weighted average Treasury bill yield rate declined to 15.1% in December 2017 from 18.0% in June, while that for Government bonds fell to 18.1% from 19.7%.

Foreign Exchange Market

The Kwacha appreciated against the US dollar and the South African rand by 0.1% and 1.5% to an average of K9.5305/$ and K0.7108/ZAR, respectively during the second half of the year (Table 4 - Appendix). The relatively strong performance of the Kwacha reflected positive market sentiments following the rebound in copper prices and improved foreign exchange supply. Net supply of foreign exchange increased to US$540.6 million from US$528.9 million in the first half. The bulk of the foreign exchange came from the mining sector and non-resident investors who participated in Government securities. On the other hand, the Kwacha weakened against the Euro and Pound Sterling as these currencies surged against the US dollar. The Kwacha lost 8.6% against the euro and 4.8% against the pound to an average rate of K11.2159/EUR and K12.5691/£, respectively. However, towards the end of the year, the Kwacha depreciated against the US dollar to K9.8453/$ in December 2017, following sustained demand for oil imports and adverse market sentiments arising from delays in concluding an IMF programme.

Capital Markets

The Lusaka Securities Exchange (LuSE) All Share Index sustained its gains in the last half of the year supported by the conducive business environment, relative stability in the exchange rate and low inflation. The LuSE All-Share index (LASI) increased by 12.0% to 5,327.58 and market capitalisation grew by 4.0% to K62.3 billion. The increase in the Index was driven by stocks in the manufacturing, energy and banking sectors that benefited from improvements in the economic environment, increased profits and higher interest rate spreads. However, the Exchange recorded a net outflow of foreign portfolio investment of US$4.6 million by end-December 2017 compared to US$2.1 million in first half of 2017.

Interest Rates

Interest rates continued on a downward trend as inflation decelerated and monetary conditions eased further in line with continued monetary policy loosening by the Bank of Zambia.

The average commercial bank lending rate edged down to 24.6% from 26.6%. Over the same period, the average 180-day deposit rate for amounts exceeding K20, 000 fell to 8.6% from 11.0% (Table 5 - Appendix). Further, the average effective lending rate for the non-bank financial institutions' sector marginally decreased to 43.1% from 43.7% (Table 6 - Appendix). It should be noted however, that despite the significant easing in monetary policy, lending rates registered only moderate declines. They therefore remained elevated and continue to act as a constraint to aggregate demand and economic growth.

Domestic Credit

Domestic credit expanded at a slower pace in the second half of 2017 compared to the first half of 2017, mainly on account of relatively lower lending to Government. Total credit grew by 11.3% to K61.3 billion compared to a growth of 13.4% in the first half of 2017 (Table 7 – Appendix). Lending to Government by commercial banks slowed down to 14.7% from 31.4%. Excluding Government, domestic credit expanded by 7.1% against a contraction of 1.6% registered during the first half. Year-on-year domestic credit expanded at a faster pace of 26.3% in December compared to 20.3% in June. Credit to private enterprises gained momentum as economic activity showed some expansion, and growth prospects improved. Annual credit to private enterprises grew by 2.2% in December from a contraction of 9.4% in June.

Further, Kwacha denominated commercial banks' credit continued on a declining trend, contracting by 4.2% as lending to manufacturing and mining sectors decreased. Foreign currency loans, however, expanded by 13.1% after registering a growth of 6.9% in the first half of 2017, reflecting mainly increased lending to the energy, financial services, agriculture, as well as wholesale and retail trade sectors.

In terms of sectoral shares, the household (personal loans) category continued to account for the largest share of total credit from banks, representing 28.0% (27.2% in June 2017) followed by agriculture, forestry and fishing sector at 20.3% (19.6% in June 2017) (Table 8 – Appendix).

Broad Money

Broad money (M3) expanded by 13.2% in the second half of 2017 to K54.1 billion after recording a growth of 7.2% in the first half (Table 9 - Appendix). The expansion in M3 was mainly on account of accumulation of foreign assets abroad by commercial banks and increase in domestic credit. On an annual basis, M3 grew at a faster rate of 21.4% in December 2017 compared to 8.3% in June 2017.

International Trade[7]

The balance on goods[8] registered a surplus of US$182.0 million in the second half of 2017, unchanged from the first half. However, the balance on goods and services recorded a higher deficit of US$182.0 million in the second half of 2017 from US$113.0 million in the first half. This was mainly due to a stronger growth in imports than in exports (Tables 10 and 11 - Appendix).

Merchandize export earnings rose by 16.8% to US$4,391.7 million due to higher earnings from copper, which increased by 14.1% to US$3,260.9 million. In contrast, imports increased by 17.6% to US$4,714.7 million mostly on account of chemicals, iron and steel products, food items and petroleum products.

Higher realised prices accounted for the increase in copper earnings as export volumes declined by 0.5% (Table 12 – Appendix). In addition, cobalt earnings increased by 48.6% to US$74.6 million following an

[7]Export volumes refer to gross volumes exported which include, but not restricted to, production from Zambian mines.
[8]In the computation of Balance on Goods, imports are valued at free on board (f.o.b) i.e., exclude freight and insurance, while imports in the balance on goods and services are valued at cost, insurance and freight (c.i.f)

increase in both export volumes by 13.3% to 1,421.4 mt, and average realised prices by 31.2% to US$52,465.9 per mt. Further, non-traditional export earnings increased by 28.8% to US$986.5 million on account of higher earnings from maize and maize seed, sulphuric acid, cotton lint, industrial boilers and equipment, and raw hides, skins and leather. Gold earnings, however, registered a 17.4% decline to US$69.7 million due to a reduction in export volumes by 11.6% to 63,984.7 ounces and a reduction in average realised prices by 6.1% to US$1,093.1 per ounce.

Domestic Economic Activity

The domestic economy continued to grow, with quarterly GDP growth averaging 4.8% in second half of 2017 from 3.4% in the first half. The growth in GDP was attributed to increases in agriculture, education, and construction activities[9]. Further, the commencement of the agriculture marketing season and improved performance of the service sector led to a pick-up in economic activity[10]. Available indicators of economic activity in the fourth quarter signalled continued improvement in economic activity in most sectors, particularly in mining and electricity.

Fiscal Balance

Preliminary data indicate that the fiscal deficit, on cash basis, at 2.4% of GDP, was significantly lower than the programmed deficit of 3.8% (Table 13 - Appendix). This largely reflected constrained capital spending, as external financing remained low, and over performance in VAT and mineral royalties, relative to targets. For the year as a whole, the performance of other revenue categories such as income taxes remained below target, partly reflecting the fragility of overall economic growth. The deficit was financed primarily from domestic resources, mainly Government securities, consistent with the Government's new Medium Term Debt Strategy (MTDS).

8.0 Conclusion

The economy exhibited signs of improvement in the second half of 2017. This was reflected in the steady rise in GDP up to the third quarter. In addition, inflation remained significantly below the annual target of 9% and trended towards the lower bound of the medium-term target range of 6-8%. The exchange rate was relatively stable, supported by net supply of foreign exchange from the mining sector and non-resident investors in Government Securities. Interest rates also generally trended downwards following further easing of monetary policy by the Bank of Zambia. Credit to the private sector picked up, but remains sluggish.

Challenges to the effectiveness of monetary policy remain. Although the Bank of Zambia has eased monetary policy in line with the fall in inflation and the need to support conditions for lowering the cost of credit, interest rates still remain high and production in the economy continues to be constrained by the high cost of production from increased cost of energy and fuel. High fiscal deficits have continued to limit the effectiveness of monetary policy, especially when financed through borrowing from the domestic financial sector.

With inflation firmly within the target range, it is expected that the measures taken to ease monetary policy in 2017 will continue to support the recovery of the economy and mitigate financial sector risks. However, accelerated economic growth will require concerted efforts from monetary and fiscal policies, as well as strengthened economic management generally.

On the fiscal side, the ability of the Government to implement the ESGP successfully by undertaking the policy reforms and meeting the deficit reduction targets is essential in the consolidation of macroeconomic stability and in supporting growth and diversification of the economy. Lowering the budget deficit is also critical in providing increased credit to the private sector, reducing the yield rates on Government securities and thereby supporting lower lending rates. The reduction of the fiscal deficit and in particular, clearing of arrears to the private sector, is a necessary precondition for supporting the reduction in NPLs in the banking sector. The successful execution of the ESGP and more broadly the Seventh National Development Plan (SNDP) is fundamental to cementing confidence and the medium term growth prospects.

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 support economic diversification and growth.

[9]The Monthly Central Statistical Office, Vol. 179, March 2018.
[10]Bank of Zambia Quarterly Survey of Business Opinions and Expectations, September and December 2017.

Appendix

Table 1: Actual and Projected Inflation: Jul 2015 – Dec 2018

	Projection (a)	Actual (b)	Forecast Error (b-a)
July 2015	7.2	7.1	-0.1
August	7.2	7.3	0.1
September	7.5	7.7	0.2
October	7.9	14.3	6.4
November	19.9	19.5	-0.4
December	20.3	21.1	0.8
Jan 2016	21.9	21.8	-0.1
February	21.7	22.9	1.2
March	21.5	22.2	0.7
April	21.6	21.8	0.2
May	21.2	21.0	0.1
June	21.5	21.3	-0.5
July	20.3	21.0	-0.1
August	19.8	20.2	-0.2
September	19.2	19.6	-0.3
October	13.9	18.9	-1.4
November	9.8	12.5	-1.0
December	9.4	8.8	-1.9
Jan 2017	7.7	7.5	-0.7
February	6.8	7.0	0.0
March	7.0	6.8	-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		
April	6.5		
May	6.6		
June	6.4		

Source: Central Statistical Office and Bank of Zambia Compilations

Table 2: Macroeconomic Outturn and Targets: 2015 -2018

	2015 Outturn	2016 Outturn	2017 Target	2017 Outturn	2018 Target
Real GDP growth rate (%)	2.9	3.6	4.2	4.1%*	5.0
CPI Inflation, end period (%)	21.1	7.5	9.0	6.1	6-8
Gross Official Reserves (months of imports)	3.7	3.3	3.0	2.9	3.0
Broad Money growth (%)	35.2	-5.7	17.9	21.4	20.7**
Budget deficit (on cash basis, excluding grants), % of GDP	8.1	5.8	7.0	6.1*	6.1
Domestic financing of Budget (% of GDP)	1.9	3.8	4.6	1.6*	4.0

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

Table 3: Liquidity Influences (K' billion): Jan 2015 – Jun 2017

	Jul-Dec 2015	Jan-Jun 2016	Jul-Dec 2016	Jan-Jun 2017	Jul-Dec 2017
Opening balance	0.7	1.1	0.8	2.7	0.3
Net Government spending	4.4	-1.3	4.4	2.5	4.2
BoZ foreign exchange influence	-6.3	-0.1	3.5	2.4	2.2
Currency in circulation	-1	0.1	-0.2	0.1	-0.3
Change in statutory reserve deposits	-2	-1.7	-2.2	-0.8	-3.1
Overnight Lending Facility	-7.7	-0.2	-0.2	0.02	-1.6
Net Government securities influence	3.5	1.6	4.3	-5.3	-1.6
Open market operations	0.2	-0.3	0.3	-1.7	1.3
Closing balance	1.1	0.8	2.7	0.3	1.4

Source: Bank of Zambia Compilations

Table 4: Exchange Rate: Jul 2015 – Dec 2017

Bilateral Nominal Exchange Rate (period average)					
	Jul-Dec 2015	**Jan-Jun 2016**	**Jul-Dec 2016**	**Jan-Jun 2017**	**Jul-Dec 2017**
ZMW/USD	10.2021	10.7140	9.9026	9.5393	9.5305
ZMW/GBP	15.6168	15.3506	12.6561	11.9949	12.5691
ZMW/EUR	11.2504	11.9499	11.7472	10.3230	11.2159
ZMW/ZAR	0.7461	0.6943	0.7072	0.7218	0.7108
Real Trade-weighted Exchange Rate (end-period)					
	Dec 2015	**Jun 2016**	**Dec 2016**	**Jun 2017**	**Dec 2017**
Domestic CPI (2005=100)	261.4	271.7	281.9	291.0	299.0
Weighted Foreign CPI (2005=100)	132.6	137.1	138.6	238.4	143.2
NEER	3.09	3.07	2.83	2.81	3.03
REER Index (2005=100)	120.0	118.6	106.6	105.0	111.2

Source: Bank of Zambia Compilations

Table 5: Interest Rates (%, period average): 2015 – 2017

		2015		2016		
	First Half	Second Half	First Half	Second Half	First Half	Second Half
BoZ Policy Rate (end-period)	12.5	15.5	15.5	15.5	12.5	10.25
Overnight Lending rate (end-period)	20.5	20.0	25.5	25.5	18.5	16.25
Overnight interbank rate	13.4	17.7	24.3	17.2	12.2	10.03
Average commercial banks' lending rate	20.4	21.7	27.1	29.0	26.6	24.6
Savings rate						
more than K100	3.4	3.4	3.3	3.2	2.7	2.8
above K20,000 (180 days)	10.5	10.5	12.4	12.8	11.0	8.6
Treasury Bills yield rates						
composite yield rate	18.5	19.5	24.6	23.7	14.9	15.06
91days	13.6	15.0	21.6	20.9	15.7	9.92
182 days	18.8	19.9	24.4	23.8	17.4	10.09
273 days	19.4	20.8	26.3	25.1	17.9	11.98
364 days	22.1	22.5	26.3	25.0	19.3	15.98
Government Bond yield rates						
Composite Yield Rate	20.3	22.6	25.4	25.0	18.1	18.2
2 years	15.4	20.8	24.5	25.0	21.4	16.5
3 years	18.1	23.2	24.3	23.9	20.9	17.9
5 years	23.1	25.5	28.3	26.3	21.0	17.8
7 years	21.4	23.6	28.5	26.6	21.6	18.6
10 years	21.7	20.3	23.4	24.6	21.4	19.7
15 years	22.5	22.5	23.5	23.3	23.3	18.7

Source: Bank of Zambia Compilations

Table 6: Average Annual Non-Banks' Effective Interest Rates (%): 2016 – 2017

	1st Half 2016	2nd Half 2016	1st Half 2017	2nd Half 2017
Microfinance Institutions	63.3	72.6	73.4	81.3
Leasing Finance Institutions	54.9	61.7	59.1	52.0
Building Societies	41.8	46.2	39.5	35.3
Development Bank of Zambia	27.6	28.9	25.2	25.2
National Savings and Credit Bank	36.5	31.0	31.0	31.0
Financial Businesses	35.5	35.5	33.8	33.8
Overall for the sector	43.3	40.7	43.7	43.1

Source: Bank of Zambia Compilations

Table 7: Domestic Credit (K' billion unless otherwise stated): Dec 2015 – Dec 2017

	Dec 2015	Jun 2016	Dec 2016	Jun 2017	Dec 2017
Domestic Credit [Gross](DC)	47.6	46.1	48.9	55.5	61.8
o/w foreign currency denominated	9.8	8.9	8.2	8.1	10.0
DC (excl. FX denominated credit)	37.8	37.2	40.7	47.4	51.8
6-month % change in DC	7.5	-3.1	6.1	13.4	11.3
6-month % change in Forex Credit/	42.0	-9.2	-7.9	-1.2	23.71
6-Month Change in DC (Excl. Forex Credit)	1.1	-1.5	9.4	16.5	9.3
Annual Change in Domestic Credit	21.2	4.1	2.8	20.4	26.3

Source: Bank of Zambia Compilations

Table 8: Shares of Total Loans and Advances by Sector (%): Dec 2015 – Dec 2017

	Dec-15	Jun 2016	Dec 2016	Jun 2017	Dec 2017
Agric, forestry, fishing & hunting	17.3	17.4	17.2	19.6	20.3
Mining & Quarrying	6.4	5.6	6.3	6.4	6.3
Manufacturing	13.5	12.4	12.7	10.6	7.8
Electricity, Gas, Water & Energy	1.7	1.5	2.2	2.2	3.1
Construction	3.4	3.8	3.9	3.8	4.4
Wholesale & Retail Trade	10.8	10.7	10.3	10.2	11.4
Restaurants & Hotels	1.6	1.5	1.6	1.4	1.5
Transport, Storage & Communications	5.1	5.2	4.6	4.5	4.7
Financial Services	2.7	2.8	1.8	2.3	2.2
Community, Social & Personal	1.7	2.1	1.7	4.3	4.1
Real Estate	2.9	3.0	3.5	3.7	3.5
Personal Loans	29.0	27.3	27.5	27.2	28.0
Others	4.0	6.7	6.8	3.9	2.7

Source: Bank of Zambia Compilations

Table 9: Broad Money (K' billion unless otherwise stated): Dec 2015 – Dec 2017

	Dec 2015	Jun 2016	Dec 2016	Jun 2017	Dec 2017
Broad Money (M3)	47.3	44.1	44.6	47.8	54.1
Foreign Exchange (FX) Deposits	20.8	18.4	17.1	16.7	19.4
M3 (excl. Foreign Exchange Deposits)	26.5	25.8	27.5	31.1	34.6
6-month change in M3 (%)	28.2	-6.6	1.0	7.1	13.2
6-month % change in Forex deposits	70.8	-11.5	-7.2	-1.9	16.5
6-Month % change in M3 (excl. Forex deposits)	7.3	-2.8	6.8	12.9	11.4
Annual % change in M3 (%)	28.2	19.7	-5.7	8.3	21.4
Annual % change in Forex deposits	108.2	51.2	-17.9	-8.9	13.7
Annual % change in M3 (excl. Forex Deposits)	3.5	4.2	3.8	20.6	26.0

Source: Bank of Zambia Compilations

Table 10: Trade Data (c.i.f - US$ million): Jan 2015 – Dec 2017

	Jan-Jun 2015	Jul-Dec 2015	Jan-Jun 2016	Jul-Dec 2016	Jan-Jul 2017	Jul-Dec 2017
Trade Balance (Goods and Services)	-231.7	-743.2	-316.42	-504.6	-250.5	-323.5
Total Exports, c.i.f. (including Gold)	3,615.4	3,690.2	3,095.3	3,348.8	3,758.6	4,391.7
General Exports, f.o.b	3,547.7	3,605.2	2,991.4	3,261.4	3,674.2	4,321.5
Metals	2,642.1	2,662.2	2,155.9	2,356.8	2,908.0	3,335.0
Copper	2,605.6	2,628.1	2,114.3	2,284.9	2,857.8	3,260.9
Cobalt	36.5	34.2	41.6	72.0	50.2	74.6
Non -Traditional Exports	905.6	942.9	835.5	904.6	766.2	986.5
Exporter Audit Adjustor	-13.2	-13.2	-13.2	-13.2	-13.2	-13.2
Sub Total	918.8	956.1	848.6	913.4	779.4	999.7
Gemstones	44.6	66.6	13.0	15.4	49.1	52.8
Sulphuric acid	32.1	25.2	18.0	21.1	25.0	47.6
Industrial Boilers and Equipment	48.7	46.9	74.5	43.4	36.0	43.9
Cane Sugar	72.1	74.5	58.4	61.6	72.7	64.3
Gasoil/Petroleum Oils	8.3	3.9	3.1	6.2	4.2	3.8
Cement & Lime	34.9	30.3	30.8	40.8	34.5	40.0
Electricity	39.0	0.0	0.0	13.6	35.8	18.9
Raw hides, Skins & Leather	5.7	6.8	7.5	4.1	4.1	5.0
Sulphur, sublimed or precipitated; colloidal	15.0	4.6	2.5	0.2	0.0	0.0
Tobacco	38.5	67.9	43.6	46.0	51.7	36.8
Copper Wire	34.3	24.3	29.9	37.4	43.2	42.1
Scrap of precious metals	25.0	24.1	0.1	0.1	0.2	0.2
Maize & Maize Seed	72.0	143.9	79.7	108.9	25.4	72.2
Electrical Cables	10.2	10.5	7.0	7.3	9.1	10.9
Cotton Lint	8.2	45.9	19.5	45.0	13.7	24.6
Soap, Active Agents, Washing Preps.	24.6	26.9	17.5	27.9	21.4	24.5
Fresh Fruits & Vegetables	5.6	6.9	4.7	9.2	6.0	8.7
Manganese Ores/Concentrates	1.3	0.1	0.4	6.2	22.0	9.3
Wheat & Meslin	6.7	5.4	3.6	3.6	0.4	0.0
Fresh Flowers	8.6	4.7	4.6	6.2	6.3	4.6
Other	383.4	336.6	430.1	409.4	326.4	489.5
Gold	67.7	85.0	103.9	87.4	84.4	69.7
Imports c.i.f./1	-3,847.1	-4,433.4	-3,411.7	-3,853.3	-4,009.1	-4,714.7
Memo Item:						
Balance on Goods, f.o.b	171.7	-245.9	45.8	-49.5	182.0	182.0

Source: Bank of Zambia Compilations

Table 11: Imports by Commodity Groups (c.i.f - US$ million): Jul 2015 – Dec 2017

	Jul-Dec 2015	Jan-Jun 2016	July-Dec 2016	Jan-Jun 2017	Jul-Dec 2017
Food Items	251.6	210.6	254.6	224.7	286.4
Petroleum Products	975.8	697.8	664.4	518.1	649.6
Fertilizer	205.5	105.5	187.2	303.5	237.3
Chemicals	611.1	440.7	515.3	503.5	961.3
Plastic and Rubber Products	173.3	139.6	173.7	175.2	208.6
Paper and paper products	57.8	47.0	58.0	58.7	56.1
Iron and Steel and items thereof	225.1	146.9	171.0	173.5	224.4
Industrial Boilers and Equipment	588.2	452.3	531.9	562.4	568.1
Electrical Machinery & Equipment	258.4	365.3	320.0	222.1	222.2
Vehicles	272.5	233.4	227.3	222.8	257.7
Other Imports*	814.1	567.3	749.9	1,044.7	1,022.9
Total	4,433.4	3406.4	3853.3	4,009.1	4,714.7

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

Table 12: Metal Export Volumes, Values and Prices: Jan 2015 – Dec 2017

	Copper				Cobalt			
	Export Volumes (mt)	Export US $'000	Price/ Tonne	Price/ Pound	Export Volumes (mt)	Export US $'000	Price/ Tonne	Price/ Pound
Quarter 1	232,587.5	1,277,217.6	5,491.3	2.5	990.0	26,090.6	26,345.1	12.0
Quarter 2	232,660.9	1,328,336.3	5,709.3	2.6	396.8	10,426.7	26,278.6	11.9
Jan-Jun 2015	465,248.3	2,605,553.8	5,600.4	2.5	1,386.8	36,517.3	26,332.5	11.9
Quarter 3	275,944.6	1,374,487.0	4,981.0	2.3	573.0	14,288.4	24,936.1	11.3
Quarter 4	280,905.5	1,253,574.2	4,462.7	2.0	1,019.0	19,899.4	19,528.4	8.9
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	20.1
Quarter 2	253,428.0	1,428,281.5	5,635.8	2.6	652.2	23,504.8	36,040.6	16.3
Jan-Jun 2017	513,104.0	2,857,778.4	5,569.6	2.5	1,255.0	50,188.4	39,991.0	18.1
Quarter 3	231,858.4	1,396,481.9	6,023.0	8.2	747.3	37,497.8	50,178.3	22.8
Quarter 4	278,896.7	1,864,383.8	6,684.9	3.0	674.1	37,078.3	55,001.6	24.9
Jul-Dec 2017	510,755.2	3,260,865.8	6,384.4	2.9	1,421.4	74,576.1	52,465.9	23.8

Source: Bank of Zambia Compilations

Table 13: Government Budget (K'bn): 2016 to Dec 2017

	Budget Performance (K'bn)					
	2016		First Half 2017		Second Half 2017	
	Proj	% of GDP	Target	Prel	Target	Prel
Total Revenue & Grants	42.7	20.0	22.3	20.3	22.5	22.7
Tax Revenue	30.4	14.3	17.4	17.0	18.0	19.5
Non-Tax Revenue	11.7	5.5	3.5	3.0	3.6	3.0
Grants	0.5	0.3	1.1	0.3	1.1	0.2
Total Expenditure	53.1	24.9	31.6	29.5	33.4	29.9
Current Expenditure	40.5	19.0	22.6	23.4	24.4	23.5
Personal Emoluments	19.1	9.0	10.0	10.5	10.0	9.4
Use of Goods & Services	6.2	2.9	2.8	2.5	2.7	2.3
Interest	7.1	3.5	4.2	4.6	4.1	5.1
Grants & Other Payments	6.1	2.9	4.0	4.1	5.6	5.0
Social Benefits	1.1	0.5	1.3	1.1	1.1	0.8
Other Expenses	0.8	0.4	0.3	0.3	0.8	0.8
Liabilities	0.1	0.1	0.3	0.9	0.9	1.1
Assets	9.8	4.6	6.0	4.7	6.4	3.9
Non- Financial Assets	8.8	4.1	5.9	4.6	6.3	3.7
Financial Assets	0.9	0.5	0.1	0.0	0.1	0.2
Change in Balances & Statistical discrepancy	0.0	0.0	0.0	-1.4	-0.0	0.6
Fiscal Balance	-7.8	-3.6	-7.7	-8.4	-9.2	-5.8
Financing	7.8	3.6	7.7	9.8	9.2	5.2
Domestic	2.5	1.2	1.1	6.4	3.2	5.8
Foreign (net)	6.0	2.8	7.2	3.2	6.4	-0.2

Source: Ministry of Finance