Bank Of Zambia

Monetary Policy Statement

JUL - DEC 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

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EXECUTIVE SUMMARY

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

ECONOMIC PERFORMANCE

Global growth momentum to continue supporting Zambia's growth

The projected positive global growth prospects and the associated pick-up in copper prices are expected to support Zambia's growth, particularly in mining through increased export performance. There are, however, downside risks associated with uncertainties surrounding Brexit[1] and trade wars between the US and its major trading partners.

Domestic economic growth positive, but sluggish

The domestic economy in the first half of 2018 registered positive but subdued growth. This was reflected in the fall in real GDP growth to 2.6% in the first quarter of 2018 from 3.2% recorded during the same period in 2017. The fall was mainly on account of a decline in growth in the agriculture and manufacturing sectors. During the second quarter, however, some real sector indicators[2] pointed to some improvements in economic activity attributed to increased output in mining and selected manufactured products.

Trade deficit widens

In the external sector, the trade deficit widened further to US$742.8 million during the first half of 2018 from US$309.9 million in the second half of 2017. This was mainly due to a significant growth in imports relative to the rise in exports. Imports grew by 9.8% mostly due to higher copper ores, industrial equipment, iron and steel and paper products. Nonetheless, merchandise exports rose by 0.8% to US$4,490.7 million due to higher earnings from copper, which increased by 4.5% to US$3,455.7 million.

Inflation edges up

Inflation edged up during the first half of 2018, to 7.4% in June, from 6.1% in December 2017, but remained within the target range of 6-8%. The upward adjustment in fuel prices and the subsequent increase in transportation costs were the key drivers of inflation. The seasonal reduction in the supply of some food items, particularly fresh vegetables and maize grain, also contributed to the rise in inflation.

Interest rates remain high

Despite the significant easing of monetary policy by the Bank of Zambia between February 2017 and February 2018, interest rates remained elevated. Lending rates remained elevated partly attributed to high yield rates on Government securities and high non-performing loans. Consequently, the banking sector continued to prefer lending to Government, thereby constraining private sector credit provision, aggregate demand and ultimately, overall economic growth.

Monetary policy eased further

With inflation falling within the target range and projections consistently pointing to low inflation, the Bank of Zambia in February eased monetary policy further by lowering the Policy Rate to 9.75% from 10.25% and maintaining it over the rest of the first half of the year. The

[1]Brexit (vote by the United Kingdom to leave the European Union)
[2]Bank of Zambia Composite Index of Economic Activity (CIEA) and the June 2018 Stanbic Bank Zambia Purchasing Managers Index (PMI).

statutory reserve ratio was reduced to 5.0% from 8.0% over the same period. This policy stance was intended to support growth and promote financial system stability. The Bank continued to conduct monetary operations aimed at maintaining the interbank rate within +/-1 percentage point of the Policy Rate.

Fiscal deficit higher than programmed

The fiscal deficit (on cash basis) in the first half of 2018 was higher than programmed, largely reflecting higher than programmed expenditures on capital projects, and interest payments. The deficit was financed mainly through external loans and Government securities. Arrears to domestic suppliers of goods and services were also projected to have risen from K12.7 billion in December 2017 to K13.9 billion in March 2018.

ECONOMIC OUTLOOK

Global economic outlook positive

Global economic growth prospects remain positive despite uncertainties surrounding Brexit and trade wars between the US and its major trading partners. The global economy is projected to grow by 3.9% in both 2018 and 2019. Growth projections are anchored on favourable global financial conditions, accommodative monetary policies, particularly in advanced economies, continued recovery in commodity prices, and improved growth prospects in Emerging Markets and Developing Economies (EMDEs).

Domestic economic outlook stable, but with challenges

Real Gross Domestic Product (GDP) is projected to grow by 4.0% in 2018, mainly on account of the anticipated continued expansion in mining and manufacturing output. However, growth is expected to remain sluggish. Higher than programmed fiscal deficits, rising Government debt, weak credit growth, and elevated non-performing loans continue to pose downside risks to broader and robust economic growth.

Upside risks to inflation heighten

In the second half of 2018, annual overall inflation is projected to trend around the upper bound of the 6–8% target range, averaging 8.1%, 1.1 percentage points higher than the average out-turn of 7.0% in the first half of 2018. This is premised on elevated food prices as well as a weaker Kwacha exchange rate, which may exert pressure on prices of both food and non-food items. Upside risks to the inflation outlook include higher than anticipated food prices and fiscal deficits, as well as a possible rise in domestic fuel prices, owing to the upward movement in international crude oil prices. In addition, higher than programmed external debt service payments could adversely impact on inflation through the exchange rate channel.

Fiscal adjustment key

Given the high interest rate environment and elevated non-performing loans, continued over reliance on monetary policy only would tend to exacerbate macroeconomic challenges. Urgent and full implementation of the fiscal consolidation measures recently announced by Government is, therefore, critical to containing inflationary pressures and avoiding further undermining the already fragile economic growth. Containing fiscal deficits within programmed levels is also key to maintaining overall macroeconomic stability.

The Bank will, therefore, 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.

1.0 Introduction

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

2.0 Global Economic Outlook: 2018 - 2019

2.1 Economic Growth

2. The projections for global economic growth for both 2018 and 2019 remain unchanged at 3.9% (IMF World Economic Outlook (WEO) Update, July 2018), in line with the April 2018 WEO. The growth projections were anchored on favourable global financial conditions, accommodative monetary policies, particularly in advanced economies, continued recovery in commodity prices, improving growth prospects in Emerging Markets and Developing Economies (EMDEs), and strong market sentiments that are expected to support growth in global demand. The growth forecasts for EMDEs remain unchanged at 4.9% and 5.1% in 2018 and 2019, respectively, with financial conditions remaining supportive of growth.

3. Growth in advanced countries is expected to remain at 2.4% in 2018 (same level as in 2017) before declining to 2.2% in 2019. The forecast for 2018 largely reflects subdued growth outlook for the euro area, Japan and the United Kingdom (UK). The growth projection for the UK was revised downwards to 1.4% from 1.6% in 2018 mainly due to continued uncertainties surrounding the Brexit negotiations whilst that for the euro area was revised downwards to 2.2% and 1.9% from 2.4% and 2.0% in 2018 and 2019, respectively. The downward revision was mainly attributed to recent political uncertainty that could weigh on domestic demand, tariff wars and issues surrounding Brexit. The 2018 growth forecast for Japan was also revised downwards to 1.0% from 1.2% mainly due to weaker private consumption and investment, a continuation of the contraction observed in the first quarter of 2018. However, growth in Japan is expected to pick up over the remainder of the year into 2019, supported by stronger private consumption, external demand, and investment.

4. The growth prospects for Zambia's major trading partners[3], over the 2018-19 period remain positive. Growth in the US is projected to expand to 2.9% and 2.7% in 2018 and 2019, respectively, while growth in China is projected at 6.6% and 6.4% over the same period. The downside risks to growth in China include a potential full-blown trade war between China and the United States, a cooling domestic property market and financial deleveraging.

5. Growth for South Africa is projected at 1.5% in 2018, and is expected to rise to 2.1% in the medium-term. The projections are premised on improved growth prospects in the agriculture sector, recovery in investor sentiments and business confidence reflected in strengthening private investment, coupled with high global commodity prices. In the Democratic Republic of Congo (DRC), GDP growth is projected at 3.3% in 2018 and 3.7% in 2019. A continued 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 Outlook

6. Copper prices are expected to remain high, premised on improving global growth and sustained demand by China. Copper prices are projected to average US$6,593.7 and US$6,605.3 per tonne in 2018 and 2019, respectively. Crude oil prices are projected to be higher, averaging US$70.6/barrel and US$69.2/barrel in 2018 and 2019, respectively. This is mainly on account of the extension of the OPEC+ Agreement to limit oil production and geopolitical tensions in the

[3]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.

Middle East. A modest rise in agricultural commodity prices is also projected in 2018 mainly on account of reduced agricultural output due to unfavourable weather conditions across the globe.

3.0 Domestic Economic Outlook for 2018 - 2019

7. Real GDP growth in Zambia is projected to be above 4.0% in 2018 and 2019, against the preliminary growth rate of 3.4% for 2017. The mining, manufacturing and construction sectors are expected to be the major drivers of GDP growth in the medium term. Mineral output is expected to continue rising with copper production expected to exceed 800, 000 metric tonnes at the close of 2018 from 786,731.5 metric tonnes produced in 2017. The rise in copper production is premised on the ramp up of production by mines such as Kalumbila and Lumwana in the medium-term. In addition, high copper prices on the international market are expected to support increased mining output in the medium term.

8. However, economic recovery remains weak. Higher than programmed fiscal deficits, rising Government debt, weak credit growth, and elevated non-performing loans continue to pose downside risks to broader and robust economic growth.

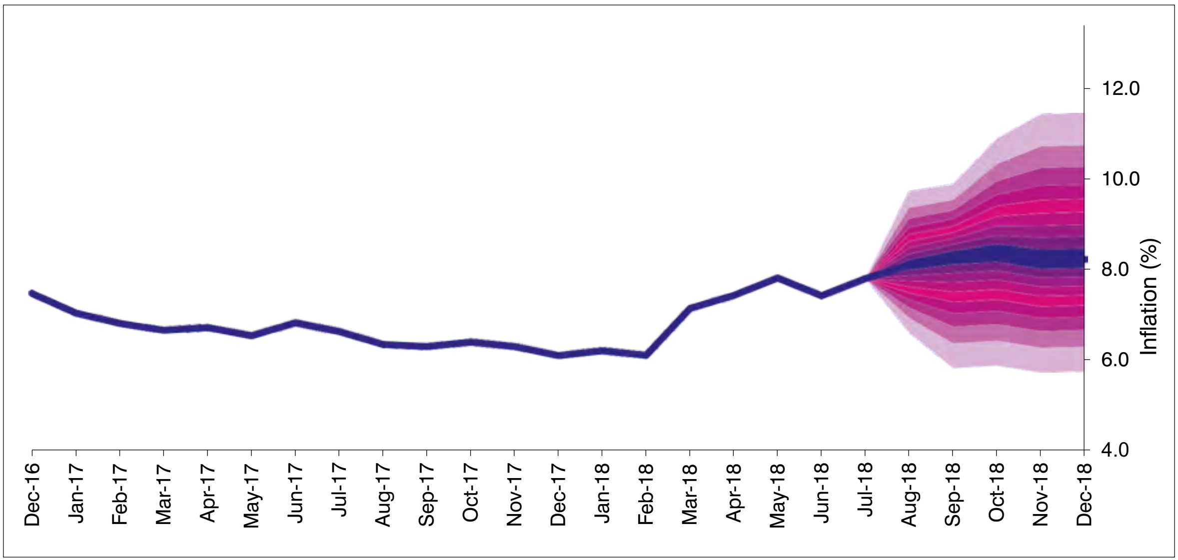
4.0 Inflation Projections for the Second Half of 2018

9. Annual overall inflation is projected to trend around the upper bound of the 6–8% target range, averaging 8.1% in the second half of 2018. The projected inflation is 1.1 percentage points higher than the average outturn of 7.0% in the first half of 2018 (Chart 1 and Table 1 – Appendix).

10. The inflation outlook over the next six months is premised on elevated food prices as well as a weaker Kwacha exchange rate, which will have an adverse effect on both food and non-food inflation.

11. However, upside risks to the outlook remain. These include a possible rise in domestic fuel prices, owing to the upward movement in international crude oil prices. This may exert inflationary pressures on both food and non-food items. In addition, the reduction in the output of maize grain during the 2017/2018 farming season at the domestic and regional levels may result in an increase in the price of maize grain in the last three months of the year. Higher than anticipated food prices and a larger than programmed fiscal deficit are likely to lead to higher inflation. Further, higher than programmed external debt service payments could adversely impact on inflation through the exchange rate channel.

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



Source: Central Statistical Office and Bank of Zambia Compilations

5.0 Monetary Policy Objectives and Instruments for the Second Half of 2018

12. Monetary policy in the second half of 2018 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 open market operations 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.

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

i. Achieving real GDP growth rate of at least 5% in 2018;
ii. Maintain single digit inflation within 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 First Half of 2018

6.1 Economic Growth

14. Global growth was largely driven by strong performance in emerging market and developing economies (EMDEs). Preliminary data indicate that economic growth in EMDEs remained robust, benefiting from accommodative financial conditions, higher commodity prices and resilient global trade. In addition, supportive policies in Brazil continued to underpin a recovery of domestic demand, while in Russia, growth remained stable, but below the pre-sanction levels, as the impact of oil production cuts and policy uncertainty continued to be offset by more accommodative monetary policy and higher oil prices[4]. Further, global growth was supported by strong business performance in the US arising from tax cuts and a continued tightening labour market[5]. These factors boosted consumer spending as the employment rate picked up further, with rising wages and retail sales and consumer confidence. Although the growth performance in the EMDEs remained resilient, the region experienced rising oil prices, higher yields in the US, dollar appreciation, trade tensions and political uncertainties that weighed on the growth performance during the review period.

15. China, continued to record positive growth albeit at a slower pace. This was mainly supported by solid domestic demand reflected by robust growth in consumption and a resurgence in fixed asset investments. In South Africa, political transition and economic reform initiatives supported investor confidence and contributed to stronger economic activity.

6.2 Commodity Prices

16. Commodity prices generally increased in the first half of 2018. Crude oil prices rose to US$72.6/barrel in June 2018 from US$61.4/barrel in December 2017, largely underpinned by the continued expansion in global economic activity and curtailed production in the aftermath of the extension of the OPEC+ Agreement to limit oil production. The price of soya beans increased to US$425.4/mt in June 2018 from US$399.00/mt in December 2017 while the price of maize rose to US$169.1/mt from US$149.0/mt. The price of wheat went up to US$195.3/mt from US$172.53/mt over the same period due to a decline in supply while the price of cotton marginally increased to US$2.02/kg from US$1.88/kg. The price of copper, however, declined to US$6,825.0/mt from US$6,834.0/mt over the same period mainly on account of a stronger US dollar, while the price of sugar declined to US$0.29/kg from US$0.32/kg.

[4]Brazil, like many other commodity exporting countries eased monetary policy as inflation eased in the first half of 2018.
[5]In periods of relatively high demand, there is a lot of employment opportunities such that the unemployment will be low and there will be many unfilled job vacancies.

7.0 Review of Domestic Developments in the First Half of 2018

7.1 Assessment of Monetary Policy Implementation

17. The conduct of monetary policy by the Bank was aimed at keeping inflation within the target range of 6-8%. With inflation falling within the target range and projections consistently pointing to low inflation. Monetary Policy was eased further in February by lowering the Policy Rate to 9.75% from 10.25% and maintaining it over the rest of the first half of 2018. The statutory reserve ratio was also reduced to 5.0% from 8.0% over the same period. This policy stance was also intended to support growth and promote financial system stability. The Bank continued to conduct monetary operations aimed at maintaining the interbank rate within +/-1 percentage point of the Policy Rate.

7.2 Challenges to Monetary Policy Implementation

18. In the implementation of monetary policy, the Bank of Zambia continued to face challenges. Structural challenges to monetary policy implementation included the underdeveloped financial market characterised by low secondary market trading in Government securities, limited financial inclusion, and a relatively illiquid and thin capital market. In addition, money market segmentation characterised by concentration of liquidity in a few banks negatively impacted the efficient functioning of the interbank market and the transmission mechanism of monetary policy. All of these factors continued to limit the effectiveness of monetary policy.

19. Other challenges that affected monetary policy implementation included higher than anticipated fiscal deficits. The Government increased domestic borrowing to finance the fiscal deficit. This kept Government securities yield rates elevated, thereby constraining access to and expansion of private sector credit, which is critical to stimulating economic growth. In addition, higher than programmed external debt service payments continued to hamper efforts to accumulate gross international reserves. The reduction in reserves limits the economy's capacity to manage adverse external shocks without severe and adverse disruption in macroeconomic stability and economic growth, and could also adversely affect the inflation rate through the exchange rate channel. Therefore, urgent and immediate implementation of fiscal consolidation measures recently announced by Government is critical in order to maintain macroeconomic stability.

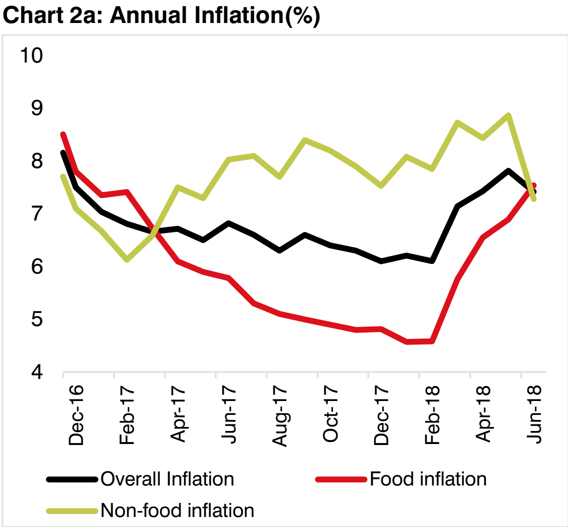
7.3 Macroeconomic Developments

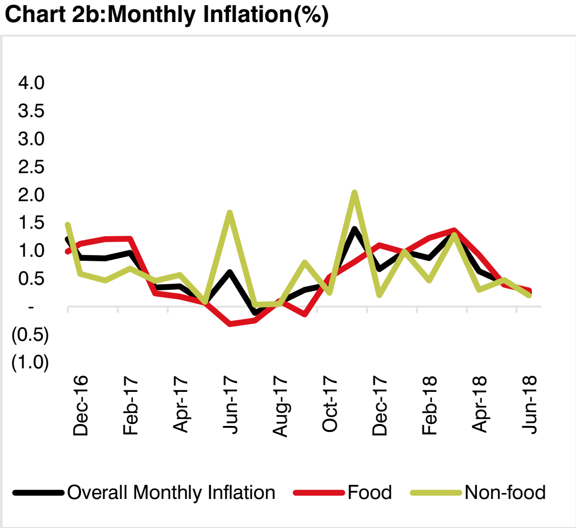
7.3.1 Inflation Outturn

20. Annual overall inflation increased to an average of 7.0% in the first half of 2018 from 6.5% in the second half of 2017. The increase reflects the rise in both food and non-food inflation. Annual food inflation rose to an average of 6.0% from 5.1% while non-food inflation increased to an average of 8.2% from 8.0%. As at end-June 2018, annual overall inflation was recorded at 7.4%, up from 6.1% in December 2017 (Chart 2a).

21. The rise in inflation was mainly due to reduced supply of selected food items such as maize grain and vegetables due to seasonal factors and the closure of some major fresh food supply markets to contain cholera outbreak[6] at the beginning of the year. In addition, tax measures introduced in the 2018 Budget such as the increase in presumptive tax for public service vehicles and the introduction of a K2 levy on a 50 kilogram bag of cement contributed to inflationary pressures. The upward adjustment of petroleum prices which pushed up transportation costs added further inflationary pressures during the review period.

[6]The 2017/2018 cholera outbreak was declared on 6th October 2017



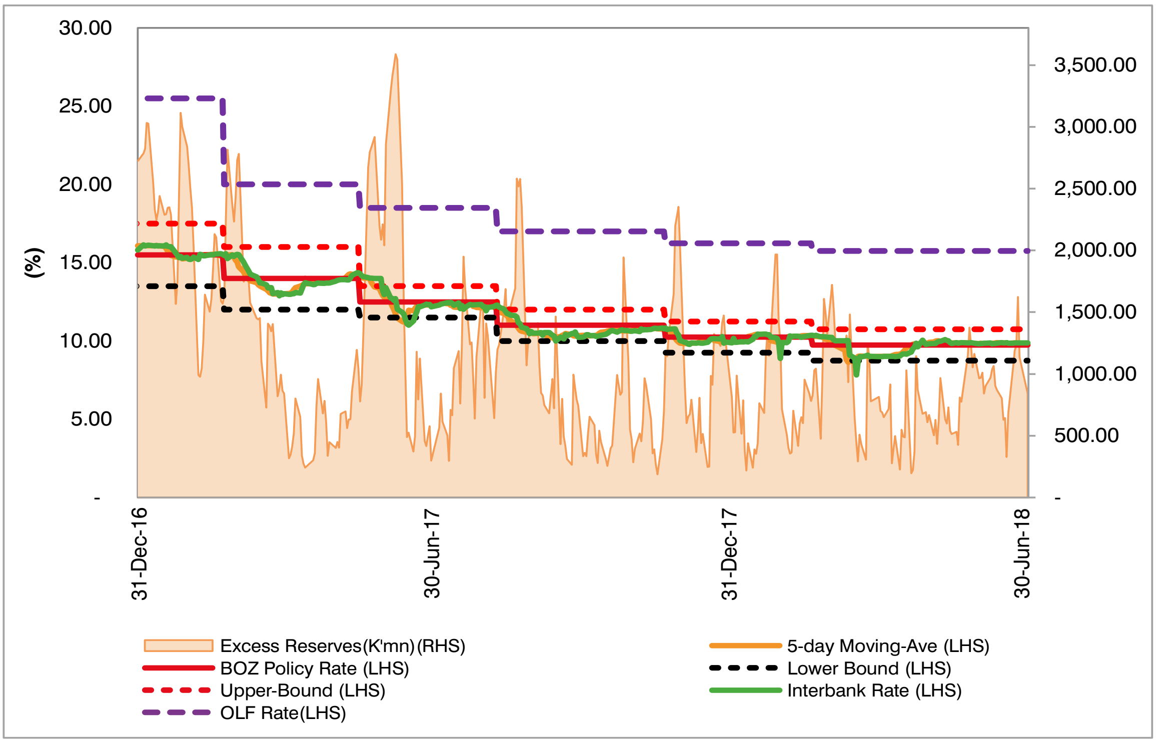


7.3.2 Interbank Rate and Money Market Liquidity

22. The overnight interbank rate closed the first half of 2018 at 9.87%, down from 10.03% as at end-December 2017 and remained within the BoZ Policy Rate corridor[7] (Chart 3 and Table 3 - Appendix). The Bank continued to conduct open market operations to steer the overnight interbank rate towards the Policy Rate.

23. Market liquidity (as measured by the commercial banks' aggregate current account balance) declined to K1.1 billion from K1.4 billion. The major liquidity influences were statutory reserve transfers, Overnight Lending Facility (OLF) repayments and currency withdrawals. This notwithstanding, market liquidity was moderated by net Government securities maturities, net Government spending and BoZ purchases of foreign exchange for the accumulation of international reserves.

Chart 3: Market Liquidity and Interbank Rate



Source: Bank of Zambia Compilations

[7]Policy rate corridor is +/- 1% around the policy rate

7.3.3 Government Securities Market

24. Demand for Government securities declined during the first half of 2018, as reflected by the fall in the Treasury bills subscription rates[8] to 65% from 85% during the last half of 2017. The subscription rates for Government bonds, however, increased marginally to 97% from 95%. The fall in the subscription rates for Treasury bills is largely attributed to the decline in the demand for Treasury bills by non-residents, who preferred long dated Government paper on account of relatively higher yields.

25. Consistent with the overall decline in demand for Government securities, total funds raised (at cost) from Government securities fell to K12.8 billion from K13.4 billion recorded in the last half of 2017. However, total maturities during the period amounted to K11.4 billion, which resulted in an overall surplus of K0.9 billion.

26. Despite the fall in funds raised, the stock of Government securities (at face value) increased by 7.2% to K51.9 billion from K48.4 billion. Out of the total securities holdings, K8.8 billion was held by non-residents, mostly in Government bonds (with less than K0.1 billion holdings in treasury bills), representing an increase of 3.5% from end-December, 2017.

27. The weighted average Treasury bills yield rate increased to 16.5% in June 2018 from 15.1% in December 2017 whilst the composite Government bond yield rate rose to 18.3% from 18.2%. The yield rates edged upward mainly driven by relatively low demand for government securities (Table 4 - Appendix).

7.3.4 Foreign Exchange Market

28. The Kwacha depreciated against a basket of major trading partner currencies. Against the US dollar, the Kwacha lost by 3.1% to an average of K9.8241 per US$, largely on account of a stronger US dollar following the hike in the Federal Funds Rate and adverse market sentiments related to Zambia's external debt position. The Kwacha depreciated against the Pound sterling and Euro by 7.5% and 6.0% to averages of K13.5113 and K11.8850 per US$, respectively. Against the South Africa rand, the Kwacha depreciated by 12.3% to an average of K0.7982 (Table 5 - Appendix). The Kwacha's depreciation against the Pound, Euro, and rand was largely on account of the lesser depreciation of these currencies against the US dollar. The US dollar index (which tracks a basket of six currencies) rose by 2.7% to 94.6 from 92.1 as at end-December, 2017. Despite the Kwacha's depreciation, the market recorded an increase in net supply of foreign exchange by 10.7% to US$598.7 million from US$540.6 million recorded in the last half of 2017. The major suppliers of foreign exchange were mining companies while the public administration sector dominated the demand side.

7.3.5 Capital Markets

29. Overall, stocks generally benefited from continued improvements in the economic environment, profitability, and increased construction activity. However, the Stock Exchange recorded a net outflow of foreign portfolio investment of US$13 million by end-June 2018 compared to US$2.1 million recorded in the second half of 2017. The Lusaka Securities Exchange (LuSE) All Share Index posted gains in the first half of 2018, mainly backed by the continued conducive business environment and relative stability of the exchange rate and inflation. The LuSE All-Share Index (LASI) rose by 2.4% to close the first half of the year at 5,455.8 while market capitalisation grew by 0.9% to K62.9 billion. The main sectors driving the All-Share Index were the energy, manufacturing and real estate. The biggest individual contributor to gains in the All-share index was CEC, whose price was driven by the anticipated purchase of all its ordinary shares by Zambian Transmission LLP.

[8]The subscription rate is computed as a ratio of funds received at cost over the amount on offer

7.3.6 Interest Rates

30. Despite the significant easing of monetary policy by the Bank of Zambia, interest rates remained elevated. The average commercial bank lending rate marginally declined to 24.3% in June 2018 from 24.6% in December 2017. Over the same period, the average 180-day deposit rate for amounts exceeding K20, 000 fell to 8.2% from 8.6% (Table 4 - Appendix). In addition, the average effective lending rate for the non-bank financial institutions' sector marginally rose to 45.5% during the first half of 2018 from 43.1% recorded during the second half of 2017 (Table 6 - Appendix). Lending rates remained elevated partly due to the high yield rates on Government securities and high non-performing loans. Consequently, the banking sector preferred to lend to Government, thereby constraining private sector credit growth, aggregate demand and economic growth.

7.3.7 Broad Money

31. Broad money (M3) grew at a reduced pace of 2.2% in the first half of 2018 to K55.3 billion compared to an expansion of 13.2% in second half of 2017 (Table 7 - Appendix). The growth in M3 was mainly attributed to the expansion in domestic credit. On an annual basis, M3 growth slowed down to 15.6% in June 2018 from 21.4% in December 2017 as annual growth in domestic credit slowed down.

7.3.8 Domestic Credit

32. Domestic credit continued to grow, albeit at a reduced pace in the first half of 2018 compared to the second half of 2017. This was attributed to the slowdown in expansion of credit to Government, as credit to private enterprises remained subdued. Total credit grew by 3.3% to K63.8 billion against an expansion of 11.3% in the second half of 2017 (Table 8 – Appendix). Growth in credit to Government by commercial banks slowed down to 2.9% from 14.7%, while growth in credit to private enterprises fell to 1.1% from 5.9%. Year-on-year, domestic credit growth at 15.0% in June, was lower than 26.3% recorded in December 2017.

33. The Kwacha denominated commercial banks' credit during the first half of 2018 grew by 3.4% against a contraction of 4.2%, as lending to households, financial services and the wholesale and retail trade sectors picked up. Foreign currency loans, however, grew at a reduced pace of 0.7% against an expansion of 13.1% in the second half of 2017, reflecting mainly a slowdown in growth of credit to the construction, and electricity and gas sectors.

34. The household (personal loans) category continued to account for the largest share of total credit from banks, representing 29.7% (28.0% in December 2017), followed by agriculture, forestry and fishing sector at 18.8% (20.3% in December 2017) (Table 9 – Appendix).

7.3.9 International Trade[9]

35. The trade deficit widened to US$742.8 million in the first half of 2018 compared to US$309.9 million in the second half of 2017. This was mainly due to significant growth in imports relative to the rise in exports (Tables 10 and 11 - Appendix). Imports increased by 9.8% to US$5,233.5 million mostly due to higher copper ores, industrial equipment, iron, steel and paper products imports.

36. Merchandize exports rose by 0.8% to US$4,490.7 million due to higher earnings from copper, which increased by 4.5% to US$3,455.7 million. Higher export volumes and average realized prices accounted for the improvement in copper earnings (Table 12 – Appendix). Copper export volumes grew by 1.9% to 520,326.5 metric tonnes (mt) from 510,755.8 mt whilst average realised prices increased by 2.5% to US$6,641.4 per mt from US$6,476.3 per mt.

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

37. Gold export earnings also increased by 11.3% to US$79.7 million. However, cobalt and non-traditional export earnings fell by 13.1% and 10.5% to US$64.8 million and US$895.0 million, respectively (Tables 10 and 12 - Appendix). The decline in non-traditional exports was mainly driven by lower exports of copper wire, maize and maize seed.

38. The first half of 2018 trade deficit was also higher than US$316.4 million recorded during the corresponding period in 2017.

7.3.10 Domestic Economic Activity

39. The Zambian economy is estimated to have grown by 2.6% year-on-year in the first quarter of 2018 compared to 3.2% in the first quarter of 2017. The mining and quarrying industry contributed the highest to the registered growth with 1.4 percentage points, followed by the financial and insurance, information and communication and wholesale and retail trade industries with 0.9, 0.6 and 0.4 percentage points, respectively.

7.3.11 Fiscal Balance

40. Preliminary data indicate that the fiscal deficit, on cash basis, at 4.3% of GDP during the first half of 2018, was significantly higher than the programmed budgeted deficit of 3.1% (Table 13 - Appendix). This largely reflected higher than programmed capital expenditure, interest payments and ordinary grants. Revenue collections, however, were largely on target. The deficit was financed from both domestic resources, mainly Government securities, as well as external financing primarily project support.

8.0 Conclusion

41. Annual overall inflation is likely to remain around the upper bound of the policy target range of 6-8% during the second half of 2018, as upside risks have heightened. These include higher than anticipated food prices and fiscal deficits as well as a possible rise in domestic fuel prices, owing to an upward movement in international crude oil prices. In addition, higher than programmed external debt service payments could adversely impact on inflation through the exchange rate channel.

42. The domestic economy in the first half of 2018 registered moderate growth. However, economic recovery remained weak, evidenced by a fall in real GDP growth to 2.6% in the first quarter of 2018 from 3.3% recorded during the fourth quarter of 2017. Inflation edged up during the first half of 2018, to 7.4% in June, from 6.1% in December 2017 but remained within the medium-term target range of 6-8%. The Kwacha weakened against the US dollar and a basket of other major trading partner currencies on account of the strengthening of the US dollar following the hike in the Federal Funds rate, the unfolding trade war between USA and China and negative investor sentiments related to Zambia's external debt position. Despite the significant easing of monetary policy by the Bank of Zambia in 2017 and during the first quarter of 2018, interest rates remained high, on account of elevated domestic financing requirements of Government and high non-performing loans. Consequently, credit to the private sector remained subdued.

43. Given the high interest rate environment, and elevated non-performing loans, delayed fiscal adjustment could exacerbate macroeconomic challenges. In this regard, urgent and full implementation of the fiscal consolidation measures recently announced by Government is critical to contain inflationary pressures and avoid further undermining the already fragile economic growth. Thus, keeping fiscal deficits within programmed levels is critical to maintaining macroeconomic stability.

44. The Bank of Zambia will, therefore, 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.

Appendix

Table 1: Actual and Projected Inflation: Jan 2016 – Dec 2018

	Projection (a)	Actual (b)	Forecast Error (b-a)
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	21.3	0.1
June	21.5	21.0	-0.5
July	20.3	20.2	-0.1
August	19.8	19.6	-0.2
September	19.2	18.9	-0.3
October	13.9	12.5	-1.4
November	9.8	8.8	-1.0
December	9.4	7.5	-1.9
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	0.7
April	6.5	7.4	0.9
May	6.6	7.8	1.2
June	6.4	7.4	1.0
July	7.8		
August	8.1		
September	8.3		
October	8.4		
November	8.2		
December	8.2		

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	3.4*	4.0
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 2016 – Jun 2018

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

Source: Bank of Zambia

Table 4: Interest Rates (%, period average): 2015 – 2018

	2015		2016		2017		2018
	First Half	Second Half	First Half	Second Half	First Half	Second Half	First Half
BoZ Policy Rate (end-period)	12.5	15.5	15.5	15.5	12.5	10.25	9.75
Overnight Lending rate (end-period)	20.5	20	25.5	25.5	18.5	16.25	15.75
Overnight interbank rate	13.4	17.7	24.3	17.2	12.2	10.03	9.87
Average commercial banks' lending rate	20.4	21.7	27.1	29	28.2	28.2	24.2
Savings rate							
more than K100	3.4	3.4	3.3	3.2	2.7	2.7	2.8
above K20,000 (180 days)	10.5	10.5	12.4	12.8	11.9	11.9	8.1
Treasury bills yield rates							
composite yield rate	18.5	19.5	24.6	23.7	14.9	15.06	16.5
91days	13.6	15	21.6	20.9	15.7	9.92	9.97
182 days	18.8	19.9	24.4	23.8	17.4	10.09	11.49
273 days	19.4	20.8	26.3	25.1	17.9	11.98	11.60
364 days	22.1	22.5	26.3	25	19.3	15.98	17.29
Government bond yield rates							
composite yield rate	20.3	22.6	25.4	25	18.1	18.2	18.3
2 years	15.4	20.8	24.5	25	21.4	16.5	17.1
3 years	18.1	23.2	24.3	23.9	20.9	17.9	18.1
5 years	23.1	25.5	28.3	26.3	21	17.8	18.6
7 years	21.4	23.6	28.5	26.6	21.6	18.6	18.9
10 years	21.7	20.3	23.4	24.6	21.4	19.7	19.4
15 years	22.5	22.5	23.5	23.3	23.3	18.7	18.2

Source: Bank of Zambia

Table 5: Exchange Rate: Jul 2015 – Jun 2018

Bilateral Nominal Exchange Rate (period average)						
	Jul-Dec 2015	Jan-Jun 2016	Jul-Dec 2016	Jan-Jun 2017	Jul-Dec 2017	Jan-Jun 2018
ZMW/USD	10.2021	10.7140	9.9026	9.5393	9.5305	9.8241
ZMW/GBP	15.6168	15.3506	12.6561	11.9949	12.5691	13.5113
ZMW/EUR	11.2504	11.9499	11.7472	10.3230	11.2159	11.8850
ZMW/ZAR	0.7461	0.6943	0.7072	0.7218	0.7108	0.7982
Real Trade-weighted Exchange Rate (end-period)						
	Dec 2015	Jun 2016	Dec 2016	Jun 2017	Dec 2017	Jun 2018
Domestic CPI (2005=100)	261.4	271.7	281.9	291.0	299.0	312.6
Weighted Foreign CPI (2005=100)	132.6	137.1	139.6	141.7	143.2	145.7
NEER	3.09	3.07	2.83	2.81	3.03	3.03
REER Index (2005=100)	120.0	118.6	106.6	104.9	111.2	108.4

Source: Bank of Zambia

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

	1st Half 2016	2nd Half 2016	1st Half 2017	2nd Half 2017	1st Half 2018
Microfinance Institutions	63.3	72.6	73.4	81.3	82.7
Leasing Finance Institutions	54.9	61.7	59.1	52.0	28.0
Building Societies	41.8	46.2	39.5	35.3	28.9
Development Bank of Zambia	27.6	28.9	25.2	25.2	30.6
National Savings and Credit Bank	36.5	31.0	31.0	31.0	67.0
Financial Businesses	35.5	35.5	33.8	33.8	35.5
Overall for the sector	**43.3**	**40.7**	**43.7**	**43.1**	**45.5**

Source: Bank of Zambia

Table 7: Broad Money (K' billion unless otherwise stated): Dec 2015 – Jun 2018

	Dec 2015	Jun 2016	Dec 2016	Jun 2017	Dec 2017	Jun 2018
Broad Money (M3)	47.3	44.1	44.6	47.8	54.1	53.3
Foreign Exchange (FX) Deposits	20.8	18.4	17.1	16.7	19.4	21.4
M3 (excl. Foreign Exchange Deposits)	26.5	25.8	27.5	31.1	34.6	31.9
6-month change in M3 (%)	28.2	-6.6	1.0	7.1	13.2	-1.5
6-month % change in Forex deposits	70.8	-11.5	-7.2	-1.9	16.5	10.0
6-Month % change in M3 (excl. Forex deposits)	7.3	-2.8	6.8	12.9	11.4	-7.9
Annual % change in M3 (%)	28.2	19.7	-5.7	8.3	21.4	11.5
Annual % change in Forex deposits	108.2	51.2	-17.9	-8.9	13.7	28.1
Annual % change in M3 (excl. Forex Deposits)	3.5	4.2	3.8	20.6	26.0	2.6

Source: Bank of Zambia

Table 8: Domestic Credit (K' billion unless otherwise stated): Dec 2015 – Jun 2018

	Dec 2015	Jun 2016	Dec 2016	Jun 2017	Dec 2017	Jun-2018
Domestic Credit [Gross](DC)	47.6	46.1	48.9	55.5	61.8	63.8
o/w foreign currency denominated	9.8	8.9	8.2	8.1	10.0	10.0
DC (excl. FX denominated credit)	37.8	37.2	40.7	47.4	51.8	53.8
6-month % change in DC	7.5	-3.1	6.1	13.4	11.3	3.2
6-month % change in Forex Credit/	42.0	-9.2	-7.9	-1.2	23.71	0.4
6-Month Change in DC (Excl. Forex Credit)	1.1	-1.5	9.4	16.5	9.3	3.8
Annual Change in Domestic Credit	21.2	4.1	2.8	20.4	26.3	15.0

Source: Bank of Zambia

Table 9: Shares of Total Loans and Advances by Sector (%): Dec 2015 – Jun 2018

	Dec 2015	Jun 2016	Dec 2016	Jun 2017	Dec 2017	Jun 2018
Agric, forestry, fishing & hunting	17.3	17.4	17.2	19.6	20.3	18.8
Mining & Quarrying	6.4	5.6	6.3	6.4	6.3	6.7
Manufacturing	13.5	12.4	12.7	10.6	7.8	7.9
Electricity, Gas, Water & Energy	1.7	1.5	2.2	2.2	3.1	2.8
Construction	3.4	3.8	3.9	3.8	4.4	3.9
Wholesale & Retail Trade	10.8	10.7	10.3	10.2	11.4	11.2
Restaurants & Hotels	1.6	1.5	1.6	1.4	1.5	1.3
Transport, Storage & Communications	5.1	5.2	4.6	4.5	4.7	4.7
Financial Services	2.7	2.8	1.8	2.3	2.2	3.0
Community, Social & Personal	1.7	2.1	1.7	4.3	4.1	4.2
Real Estate	2.9	3.0	3.5	3.7	3.5	3.7
Personal Loans	29.0	27.3	27.5	27.2	28.0	29.7
Others	4.0	6.7	6.8	3.9	2.7	2.1

Source: Bank of Zambia

Table 10: Trade Data (c.i.f - US$ million): Jul 2015 – June 2018

	Jul-Dec 2015	Jan-Jun 2016	Jul-Dec 2016	Jan-Jun 2017	Jul-Dec 2017	Jan-Jun 2018
Trade Balance	**-743.2**	**-316.42**	**-504.6**	**-250.5**	**-309.9**	**-742.8**
Total Exports, c.i.f. (including Gold)	**3,690.2**	**3,095.3**	**3,348.8**	**3,758.6**	**4,455.2**	**4,490.7**
General Exports, f.o.b	**3,605.2**	**2,991.4**	**3,261.4**	**3,674.2**	**4,383.6**	**4,410.9**
Metals	2,662.2	2,155.9	2,356.8	2,908.0	3,383.7	3,511.6
Copper	2,628.1	2,114.3	2,284.9	2,857.8	3,307.8	3,455.7
Cobalt	34.2	41.6	72.0	50.2	80.3	55.8
Non -Traditional Exports	**942.9**	**835.5**	**904.6**	**766.2**	**999.9**	**899.4**
Exporter Audit Adjustor	-13.2	-13.2	-13.2	-13.2	-13.2	-13.2
Sub Total	956.1	848.6	913.4	779.4	1,013.0	912.5
Gemstones	66.6	13.0	15.4	49.1	4.9	5.3
Sulphuric acid	25.2	18.0	21.1	25.0	47.6	82.4
Industrial Boilers and Equipment	46.9	74.5	43.4	36.0	43.9	57.8
Cane Sugar	74.5	58.4	61.6	72.7	64.3	57.2
Gasoil/Petroleum Oils	3.9	3.1	6.2	4.2	3.8	4.5
Cement & Lime	30.3	30.8	40.8	34.5	40.0	42.0
Electricity	0.0	0.0	13.6	35.8	33.6	34.3
Raw hides, Skins & Leather	6.8	7.5	4.1	4.1	5.0	1.2
Sulphur, sublimed or precipitated; colloidal	4.6	2.5	0.2	0.0	0.0	0.0
Tobacco	67.9	43.6	46.0	51.7	36.8	43.5
Copper Wire	24.3	29.9	37.4	43.2	42.1	34.1
Scrap of precious metals	24.1	0.1	0.1	0.2	0.2	1.2
Maize & Maize Seed	143.9	79.7	108.9	25.4	72.2	17.4
Electrical Cables	10.5	7.0	7.3	9.1	10.9	14.5
Cotton Lint	45.9	19.5	45.0	13.7	24.6	6.5
Soap, Active Agents, Washing Preps.	26.9	17.5	27.9	21.4	24.5	25.3
Fresh Fruits & Vegetables	6.9	4.7	9.2	6.0	8.7	7.7
Manganese Ores/Concentrates	0.1	0.4	6.2	22.0	9.3	9.7
Wheat & Meslin	5.4	3.6	3.6	0.4	0.0	0.0
Fresh Flowers	4.7	4.6	6.2	6.3	4.6	6.3
Other	336.6	430.1	409.4	326.4	536.0	461.6
Gold	85.0	103.9	87.4	84.4	71.6	79.7
Imports c.i.f./1	**-4,433.4**	**-3,411.7**	**-3,853.3**	**-4,009.1**	**-4,765.2**	**-5,233.5**

Source: Central Statistical Office and Bank of Zambia Compilations

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

	Jan-Jun 2016	July-Dec 2016	Jan-Jun 2017	Jul-Dec 2017	Jan-Jun 2018
Food Items	208.3	254.6	224.7	286.4	257.1
Petroleum Products	722.0	664.4	518.1	649.6	614.1
Fertilizer	104.8	187.2	303.5	237.3	194.7
Chemicals	426.8	515.3	503.5	961.3	1,050.5
Plastic and Rubber Products	138.0	173.7	175.2	208.6	229.3
Paper and paper products	44.8	58.0	58.7	56.1	59.9
Iron and Steel and items thereof	148.3	171.0	173.5	224.4	292.7
Industrial Boilers and Equipment	446.4	531.9	562.4	568.0	670.9
Electrical Machinery & Equipment	366.2	320.0	222.1	222.2	299.1
Vehicles	222.7	227.3	222.8	257.7	334.5
Ores, Slag and Ash	267.0	434.7	437.8	589.4	683.3
Other Imports	296.4	315.2	606.9	483.9	547.3
Total	**3,406.4**	**3,853.3**	**4,009.1**	**4,765.2**	**5,233.5**

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

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

	Copper				Cobalt			
	Export Volumes (mt)	Export US $'000	Price/ Tonne	Price/ Pound	Export Volumes (mt)	Export US $'000	Price/ Tonne	Price/ Pound
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	1,450,945.6	6,257.9	2.8	726.0	41,054.3	56,548.7	25.7
Quarter 4	278,896.7	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	276,619.1	1,907,609.7	6,896.2	3.1	397.0	27,707.2	69,786.7	31.7
Quarter 2	243,707.4	1,548,099.0	6,352.3	2.9	341.3	28,138.7	82,435.7	37.4
Jan-Jun 2018	**520,326.5**	**3,455,708.8**	**6,641.4**	**3.0**	**738.4**	**55,845.9**	**75,634.2**	**34.3**

Source: Bank of Zambia Compilations

Table 13: Government Budget (K'bn): 2016 - 2018

	Budget Performance (K'bn)					
	2016		Second Half 2017		First Half 2018	
	Prel	% of GDP	Target	Prel	Target	Prel
Total Revenue & Grants	**40.0**	**17.6**	**22.5**	**22.7**	**25.2**	**25.1**
Tax Revenue	31.8	14.9	18.0	19.5	19.9	21.2
Non-Tax Revenue	6.1	2.5	3.5	3.1	4.1	3.7
Grants	0.5	0.2	1.1	0.2	1.2	0.2
Total Expenditure	**64.0**	**26.1**	**33.2**	**34.1**	**36.0**	**36.4**
Current Expenditure	46.8	19.1	24.3	23.6	25.8	24.5
Personal Emoluments	20.0	8.2	10.0	9.4	11.4	10.4
Use of Goods & Services	4.8	2.0	2.7	2.3	3.4	2.8
Interest	9.8	4.0	4.1	5.3	5.4	6.5
Grants & Other Payments	9.1	3.7	5.6	5.0	4.3	3.9
Social Benefits	1.9	0.8	1.1	0.8	1.0	0.6
Other Expenses	1.1	0.4	0.8	0.8	0.3	0.2
Liabilities	2.0	0.8	0.9	1.1	0.7	0.1
Assets	12.9	5.3	6.2	7.9	9.5	11.8
Non- Financial Assets	12.7	5.2	6.1	7.7	9.3	11.7
Financial Assets	0.3	0.1	0.1	0.2	0.2	0.0
Change in Balances & Statistical discrepancy	-0.3	-0.1	-0.0	1.0	2.2	0.6
Fiscal Balance	**-18.7**	**-7.6**	**-9.0**	**-10.0**	**10.8**	**11.3**
Financing	**19.3**	**7.8**	**9.0**	**8.9**	**8.6**	**11.9**
Domestic	11.9	4.9	2.6	5.4	5.6	5.0
Foreign (net)	7.1	2.9	6.4	3.5	3.2	7.8

Source: Ministry of Finance