Bank Of Zambia

Bank of Zambia Monetary Policy Statement

Jul - Dec 2013

Bank of Zambia

MISSION STATEMENT

The principal purpose of the Bank of Zambia is to achieve and maintain price and financial system stability for balanced macro-economic development.

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

This Monetary Policy Statement is made pursuant to Part II, Section 9 of the Bank of Zambia Act No. 43 of 1996

Monetary Policy Statement

Table AIII.6: Indicators of Bidding Behaviour in the Government Securities Market[1]

	Amts Offered (K blns)		Bid Amts (K blns)		Excess Demand (K blns)[2]		Subscription Rate (%)[3]	
	Jan – Jun, 12	Jul – Dec, 13	Jan – Jun, 12	Jul – Dec, 13	Jan – Jun, 12	Jul – Dec, 13	Jan – Jun, 12	Jul – Dec, 13
91-day bills	750	450.0	608.8	598.4	-141.2	148.4	81.2	133.0
182-day bills	840	1,140.0	1,709.9	2,244.5	869.9	1104.5	203.6	196.9
273-day bills	960	1,230.0	1,008.4	1,780.4	48.4	550.4	105.0	144.7
364-day bills	1,690.0	2,240.0	2,677.6	2,830.2	987.6	590.2	158.4	126.3
TOTAL	4,240.0	5,060.0	6,004.7	7,453.5	1,764.7	2,393.5	141.6	147.3
2-year bond	100.0	115.0	188.0	258.6	88.0	143.6	188.0	224.9
3-year bond	300.0	330.0	511.9	539.4	211.9	209.4	170.6	163.5
5-year bond	500.0	520.0	765.4	538.2	265.4	18.2	153.1	103.5
7-year bond	70.0	85.0	178.0	136.9	108.0	51.9	254.3	161.1
10-year bond	160.0	180.0	129.2	183.7	-30.8	3.7	80.8	102.1
15-year bond	70.0	70.0	10.7	29.2	-59.3	-40.8	15.3	41.7
TOTAL	1,200.0	1,300.0	1,783.2	1,686.0	583.2	386.0	148.6	129.7

Source: Bank of Zambia
1 Treasury bills are offered weekly while Government bonds are offered monthly
2 Average Excess Demand = Average Amounts Bid less Average Amounts Offered, (-ve = shortfall, +ve = excess)
3 Average Subscription Rate = Average bid amounts as percentage of average amount offered.

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Executive Summary

During the first half of 2013, monetary policy was focused on the achievement of end-year annual inflation target of 6.0%, while the end-June 2013 annual inflation was projected at 7.2%. To this end, monetary policy operations were aimed at maintaining the 5-day weighted average interbank rate within a corridor of +/- 200 basis points of the Bank of Zambia (BoZ) Policy Rate target, which in view of rising inflationary pressures was raised to 9.50% during the second quarter from 9.25%.

During the first four months of the year, the performance of monetary policy was favourable. Annual overall inflation slowed down to 6.5% in April 2013 from 7.3% in December 2012, mainly on account of lower food prices. However, higher food and non-food prices in the months of May and June 2013 led to annual overall inflation rising to 7.3% at the end of the first half of 2013.

The response of commercial banks to adjustments in the BoZ Policy Rate was generally satisfactory. The average interbank rate remained within the corridor for most of the review period, despite momentarily breaching the upper bound in tight liquidity environment in the second quarter of 2013.

Over the first six months of 2013, reserve money declined by 17.4% to K6,931.95 million mainly due to Open Market Operations (OMO) withdrawals and net government securities transactions amounting to K981.3 million and K1,510.7 million, respectively. These influences were partially offset by maturing OMO amounting to K616.0 million. However, broad money rose by 8.2% to K27,807.8 million as at end-June largely due to a 30.8% increase in net domestic assets (NDA) largely attributed to an increase in lending to government.

Total domestic credit rose by 32.6% during the first half of 2013 compared with an increase of 7.2% recorded in the second half of 2012. This was on account of the increase in lending to central government and the private sector by 144.7% and 18.3% contributing 23.8 and 8.6 percentage points, respectively, to domestic credit growth. Increased lending to the government may lead to crowding out of the private sector. Therefore, government should ensure that effective measures are put in place to improve budget execution.

In the Government securities market, the weighted average Treasury bill and weighted average bond yield rates, for the six month period, increased to 13.1% and 15.2% in June 2013 from 11.9% and 13.5% in December 2012, respectively. Similarly, the average lending rate increased to 16.3% from 16.1%.

In the first half of 2013, the performance of Kwacha against major trading currencies was characterised by a depreciating trend. This was largely due to high levels of liquidity and commercial banks demand for foreign exchange to meet statutory reserve requirements. In addition, market participants' position taking ahead of Statutory Instrument No 55 implementation in July contributed to the increased demand. Further, the US dollar strengthened against most currencies following the release of US employment data in May 2013 that signalled an improvement in the US economy.

During the review period, the real effective exchange rate appreciated by 5.1% as reflected in the decline of the index to 95.7 in June 2013 from 100.2 recorded in December 2012.

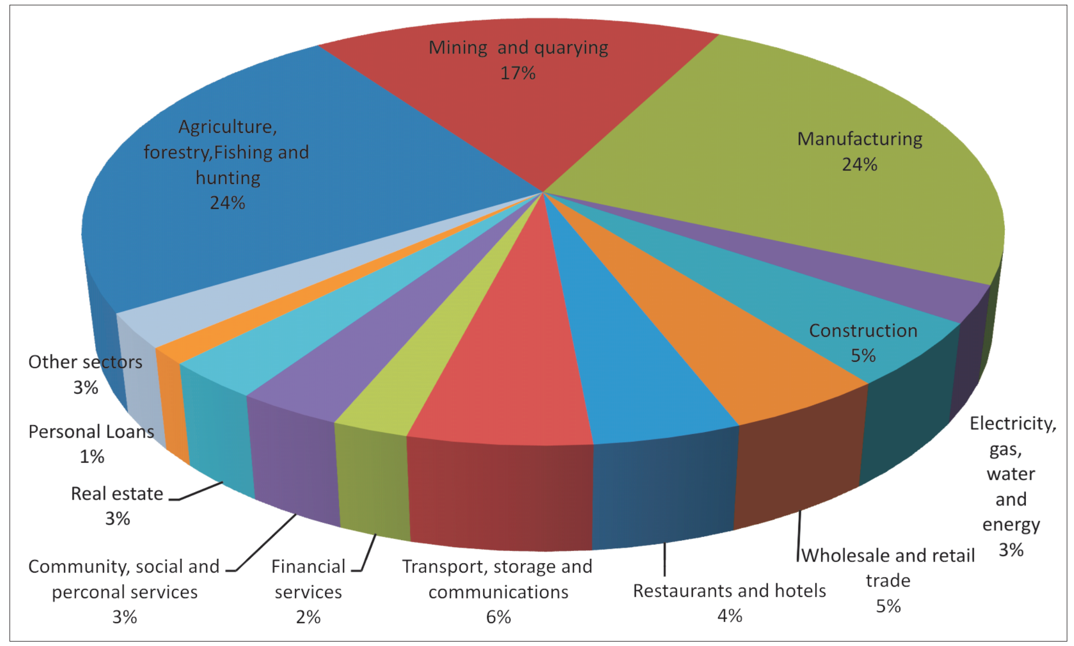
Preliminary data show that in the first half of 2013, Zambia's external sector performance remained positive, although the overall merchandise trade surplus (c.i.f) marginally declined to US $356.0 million from US $364.6 million registered during the second half of 2012. This outturn was explained by a higher increase in the merchandise imports bill relative to the increase in the merchandise exports earnings. However, capital goods constitute a large proportion of the imports, which would increase production and increased contribution to economic growth in the coming years.

The latest update on the World Economic Outlook forecast lower global growth for 2013 amidst prospects of a more protracted recession in Europe and a slowdown in key emerging and developing countries. As result, world economic growth is projected at 3.1% down from an earlier forecast of 3.3%. However, Zambia's economic prospects for the second half of 2013 remain favourable mainly driven by continued strong domestic investment in mining, manufacturing, tourism, communication and social infrastructure. The co-hosting of the United Nations World Tourism Organisation should boost tourist arrivals, and support the growth in tourism.

During the second half of 2013, annual overall consumer price inflation is projected to increase to 7.5% in December from 7.3% in June 2013. The upward risks to inflation are likely to emanate from cost push factors related to the uncertainty in external demand for the country's major export commodity, copper, which may reduce export earnings and put pressure on the exchange rate. In addition, demand side pressures due to the public service wage increase effective in September 2013 and the continued higher regional demand for food items may contribute to inflationary pressures.

In the two year period ending 2015, monetary policy formulation and implementation will be geared towards attaining Government's broad economic objectives, which include maintaining single-digit inflation of at most 5.5% by 2015; achieving real GDP growth rate of at least 7.5% in 2015; limiting overall fiscal deficit to 4.3% of GDP in 2015; limiting domestic borrowing to at most 1.8% of GDP in

Chart AIII.3: Structure of Forex Loans and Advances June 2013



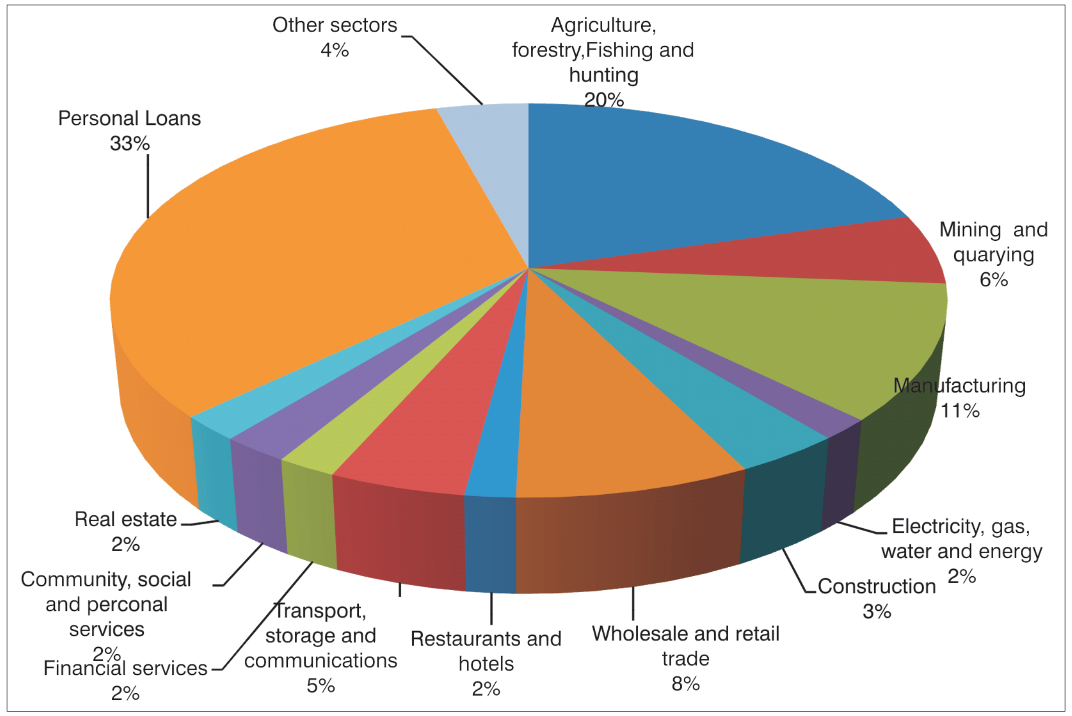
Source: Bank of Zambia

Table AIII.5: Shares of Total Loans and Advances by Sector (Excluding Foreign Currency Loans), Dec 2010 – Jun 2013 (%)

Sector	Dec-10	Jun-11	Dec-11	Jun-12	Dec-12	Jun-13
Agriculture, forestry, fishing & hunting	12.1	12.0	13.1	9.4	21.1	20.5
Mining & Quarrying	1.4	1.5	0.9	1.2	1.4	5.8
Manufacturing	10.9	10.5	6.9	7.0	6.8	11.1
Electricity, Gas, Water & Energy	1.5	1.2	1.7	2.3	1.5	1.7
Construction	6.8	5.8	3.3	3.3	3.1	3.5
Wholesale & Retail Trade	8.0	10.4	9.7	9.2	6.7	7.8
Restaurants & Hotels	1.3	1.7	1.5	1.4	0.9	1.7
Transport, Storage & Comm	4.2	5.8	4.0	4.1	4.4	4.5
Financial Services	2.3	2.0	2.9	2.9	1.9	2.0
Community, Soc & PersServices	4.1	4.2	2.4	2.5	2.3	2.3
Real Estate	5.5	5.6	1.7	1.8	1.9	2.1
Personal Loans	39.6	37.0	47.8	50.7	43.9	32.9
Others	2.3	2.4	4.1	4.2	4.0	4.2

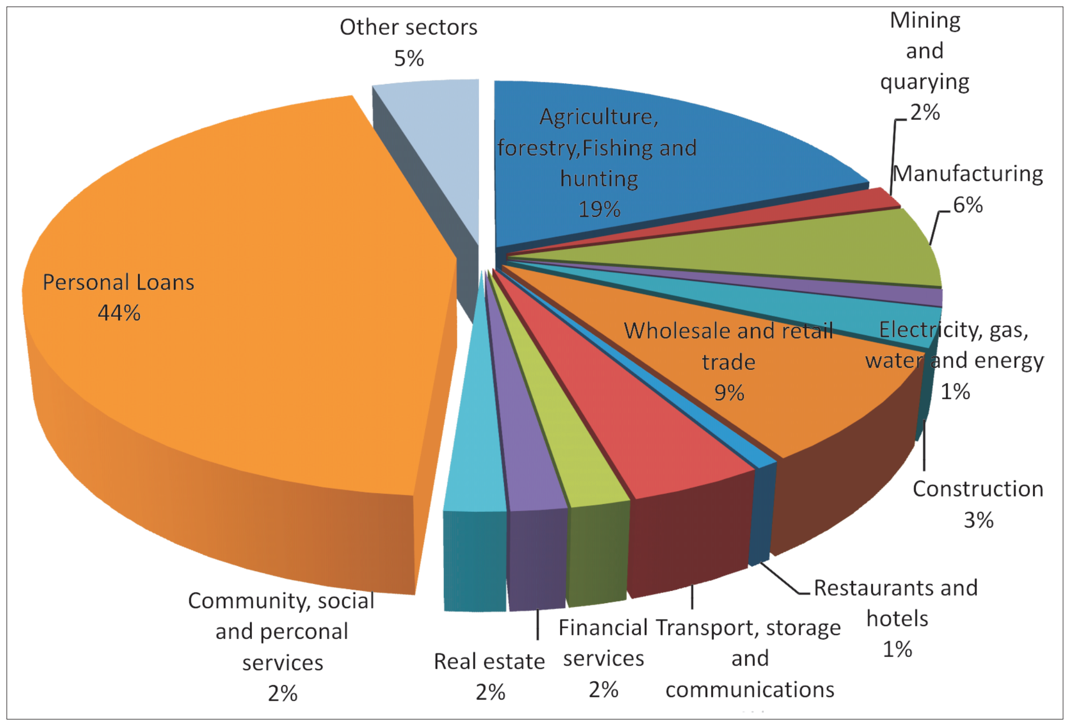
Source: Bank of Zambia

Chart AIII.1: Structure of Loans and Advances, June 2013



Source: Bank of Zambia

Chart AIII.2: Structure of Loans and Advances, (Excluding Foreign Currency Loans) June 2013



Source: Bank of Zambia

2015; and accumulating foreign reserves to at least 4 and 3.9 months of import cover in 2014 and 2015, respectively.

The Bank of Zambia will continue to monitor global and domestic developments and take appropriate measures to maintain price and financial system stability. This will be complemented by prudent fiscal management.

1.0 Introduction

This Monetary Policy Statement reviews the performance of monetary policy during the period January to June 2013 and outlines the objectives of monetary policy for the second half of 2013. The Statement also discusses major challenges, which may influence the conduct of monetary policy during the second half of the year. In this regard, sections 2 to 4 review the performance of monetary policy during the period January to June 2013, while section 5 outlines the objectives of monetary policy, economic outlook and inflation projection for the second half of 2013. A summary of the principles that will guide monetary policy formulation and implementation from January 2013 to December 2015 are outlined in the final part of the Statement.

2.0 Conduct of Monetary Policy

During the first half of 2013, monetary policy remained focused on attaining the end-year inflation target of 6.0%. To this end, monetary policy was aimed at maintaining the 5-day moving average of the overnight interbank rate around Bank of Zambia (BoZ) Policy Rate, but within a corridor of +/- 200 basis points. In order to steer the interbank rate towards the BoZ Policy Rate, the Bank offered repos and term deposits through Open Market Operations (OMO) to align the overnight interbank rate towards the policy rate.

3.0 Challenges to Monetary Policy

During the review period, monetary policy faced a number of challenges including the following:

i. Liquidity overhang from the last half of 2012;

ii. Pass through effects of the depreciation in the Kwacha against major trading currencies;

iii. Removal of fuel subsidies, which led to an increase in the fuel pump prices by 21%; and

iv. Increase in maize prices following the removal of maize subsidies to millers in the second quarter.

Given these challenges, the Bank of Zambia raised the Policy Rate to 9.50% in June 2013 from 9.25% previously. In addition, the Bank continued to mop-up excess liquidity through OMO (see Table 1). It is also noteworthy, that the removal of subsidies is expected to improve fiscal performance and may have a positive impact on inflation and the economy in the medium to long term. Savings from the removal of subsidies are expected to be redirected to projects that support infrastructure development, poverty reduction, increase food security, diversification of crops and service delivery in rural areas.

Table 1: Inflation Outturn, January 2011 – June 2013 (%)

			2012 Proj	2012 (Annual)	Jul –Dec 2012	Jan - Jun 2013
	Proj.	Actual		Actual	Actual	Actual
Annual Overall Inflation	7.0	7.2	7.0	7.3	7.3*	7.3
Non-food Inflation	5.5	10.2	-	6.1	6.1*	7.1
Food Inflation	9.7	-3.9	-	8.4	8.4*	7.6
BoZ Policy Rate (%)	n.a	n.a	9.25**	9.25**	9.25**	9.5**
Overnight Interbank Rate	-	5.2	8.2	9.1	8.2	11.3
Reserve Money	-5.6	6.3	19.5		66.7	17.4
Broad Money	9.3	22.4	14.7	17.9	11.7	8.2
Domestic Credit	-	19.0		17.3	7.2	32.6
Government	-	-6.3		-37.7	-37.1	144.7
Public Enterprises	-	70.8		602.6	506.4	-72.9
Private Sector Credit	-	30.8		31.4	19.1	18.2
Domestic Financing (% of GDP)	1.4	3.0	1.9	1.9	-	-

Source: Central Statistical Office Bulletin, The Monthly and Bank of Zambia
Notes: n.a - not applicable
-Indicates no target under the ECF Programme
* Annual figures
** End-period

Table AIII.3: Imports by Commodity Groups in US $ millions (c.i.f.); Jul 2011– Jun 2013

Description	Jul-Dec2011	Jan-Jun 2012	Jul-Dec 2012	Jan-Jun2013*	% Change
Food Items	209.6	231.7	273.1	229.4	-16.0
Petroleum Products	368.8	373.4	561.9	451.9	-19.6
Fertilizers	176.2	136.7	167.5	154.2	-7.9
Chemicals	413.1	456.1	450.1	437.4	-2.8
Plastic and Rubber Products	205.9	213.8	220.7	250.1	13.3
Paper and Paper Products	66.3	70.0	67.1	67.2	0.1
Iron and Steel	283.0	280.2	289.0	329.8	14.1
Industrial Boilers & Equipment	718.3	733.2	774.7	915.1	18.1
Electrical Machinery & Equipment	269.8	238.9	258.7	317.0	22.5
Vehicles	334.5	369.5	505.8	508.1	0.4
Other Imports	902.9	1,013.4	1,120.4	1,381.1	23.3
Total Imports	3,948.4	4,117.0	4,689.2	5,041.3	7.5

Source: Bank of Zambia
*Figures are preliminary

Table AIII.4: Sources of Reserve Money Growth

	Total (K'mn)	Contributions to Reserve Money Growth %	Total (K'mn)	Contributions to Reserve Money Growth %
	July-Dec 2012		Jan-June 2013	
1/ Net Foreign Assets (a+b+c+d)	**-1,016.90**	**-34.4**	**637,944.10**	**489.6**
a) Net Purchases from Govt	43.6		638,591.80	
b) Net Purchases from non-Government	-979.9		-846.4	
c) Bank of Zambia own use of forex	-89.5		0	
d) Change in stat. reserve deposits forex balances	8.9		198.7	
2/ Net Domestic Assets (a+b)	**3,971.80**	**134.4**	**-639,247.10**	**-490.6**
a) Autonomous influences	**19,607.20**		**-638,240.30**	
Maturing Open Market Operations	15,766.10		616	
Direct Govt Transactions	3,714.00		-637,333.60	
TBs and Bonds Transactions	-41.5		-1,510.70	
Claims on non-banks (Net)	168.6		-12.1	
b) Discretionary influences	**-15,635.40**		**-1,006.80**	
Open Market Operations	**-15,581.60**		**-981.30**	
i. Short term loans	0		2,208.70	
ii. Repos/Outright TB sales	-1,645.00		0	
iii. Term Deposits Taken	-13,936.60		-3,190.00	
Treasury bill Rediscounts	0		0	
Other claims (Floats, Overdrafts)	**-53.8**		**-25.5**	
Change in Reserve Money	**2,954.90**		**-1,303.00**	

Source: Bank of Zambia

Appendix III: Statistical Tables and Charts

Table AIII.1: Trade Data in US $ million (c.i.f), Jul:Dec 2011 – Jan:Jun 2013

	Jul-Dec 2011	Jan-Jun 2012	Jul-Dec 2012	Jan-Jun 2013*	% Change
Trade Balance	430.8	210.7	364.6	356.0	-2.3
Exports, c.i.f	4,379.2	4,327.7	5,053.8	5,397.3	6.8
Metals	3,381.5	3,065.1	3,464.6	3,619.2	4.5
Copper	3,282.8	2,981.0	3,313.5	3,554.3	7.3
Cobalt	98.7	84.1	151.1	64.9	-57.0
Total NTEs	997.7	1,262.6	1,589.1	1,778.1	11.9
Exporter Audit Adjustor	-13.2	-13.2	-13.2	-13.2	0.0
Total	1,010.9	1,275.8	1,602.3	1,791.2	11.8
Copper Wire	92.0	67.8	83.7	69.3	-17.2
Cane Sugar	87.4	49.8	92.0	82.3	-10.6
Burley Tobacco	62.6	76.7	79.9	58.3	-27.0
Cotton Lint	101.3	22.9	106.2	33.0	-68.9
Electrical Cables	20.9	16.9	34.0	32.4	-4.7
Fresh Flowers	10.0	12.3	11.4	27.6	142.1
Cotton Yarn	0.0	0.0	0.0	0.0	0.0
Fresh Fruits & Vegetables	5.0	4.3	11.4	26.3	130.5
Gemstones	5.4	94.9	137.3	173.4	26.3
Gasoil/Petroleum Oils	10.6	65.3	31.8	17.9	-43.6
Electricity	2.1	24.0	18.7	35.8	-100.0
Other	613.6	840.9	995.8	1,234.9	27.6
Of which Maize & Maize Seed	138.4	335.9	106.6	45.7	-57.2
Wheat & Meslin	15.1	15.6	19.7	9.2	-53.5
Cement & Lime	40.7	21.8	4.8	118.9	2,379.3
Gold	42.0	23.1	71.3	71.8	0.7
Imports c.i.f.	-3,948.4	-4,117.0	-4,689.2	-5,041.3	7.5

Source: Bank of Zambia
*Figures are preliminary

Table AIII.2: Metal Production, Export Volumes, Values and Prices; Jul 2011 – Jun 2013

Period	Copper				Cobalt			
	Export Volume	Production	Value	Price	Export Volume	Production	Value	Price
	Tonnes	Tonnes	US $'000	US$/Tonne	Tonnes	Tonnes	US $ '000	US$/Tonne
Q3-2011	239,491	214,461	1,821,759	7,607	1,744	1,726	53,904	30,915
Q4-2011	193,724	201,749	1,461,554	7,545	1,676	1,604	44,793	26,721
Jul -Dec 2011	433,215	416,210	3,283,313	7,579	3,420	3,330	98,697	28,859
Q1-2012	200,834	217,524	1,510,970	7,523	2,035	1,596	43,775	21,514
Q2-2012	206,179	203,756	1,470,038	7,130	1,483	1,439	40,335	27,208
Jan-Jun 2012	407,013	421,280	2,981,007	7,324	3,517	3,035	84,110	23,914
Q3-2012	249,524	192,310	1,779,118	7,130	3,099	1,244	81,000	26,141
Q4-2012	225,558	211,387	1,534,368	6,803	3,414	1,156	70,172	20,557
Jul -Dec 2012	475,082	403,696	3,313,486	6,975	6,512	2,400	151,172	23,214
Q1-2013	233,848	230,784	1,772,266	7,579	1,641	1,630	35,131	21,404
Q2-2013	244,926	246,509	1,782,040	7,276	1,502	1,502	29,750	19,805
Jan-Jun 2013*	478,775	477,293	3,554,306	7,424	3,144	3,132	64,881	20,640

Source: Bank of Zambia Statistics Fortnightly
*Figures are preliminary

4.0 Assessment of Monetary Policy Outcome, January – June 2013

Monetary policy operations during the period under review were aimed at maintaining the 5-day weighted average interbank rate within a corridor of +/- 200 basis points of the BoZ Policy Rate. Due to inflationary pressures, the Bank of Zambia raised the policy rate to 9.50% from 9.25%.

During the first four months of the year, monetary policy performance was favourable as overall inflation was broadly in line with the end-year inflation target of 6.0%. During this period, annual overall inflation slowed down to 6.5% in April 2013 from 7.3% in December 2012, mainly on account of lower food prices. However, annual overall inflation rose to 7.3% at the end of the first half of 2013 following higher food and non-food prices in May and June 2013.

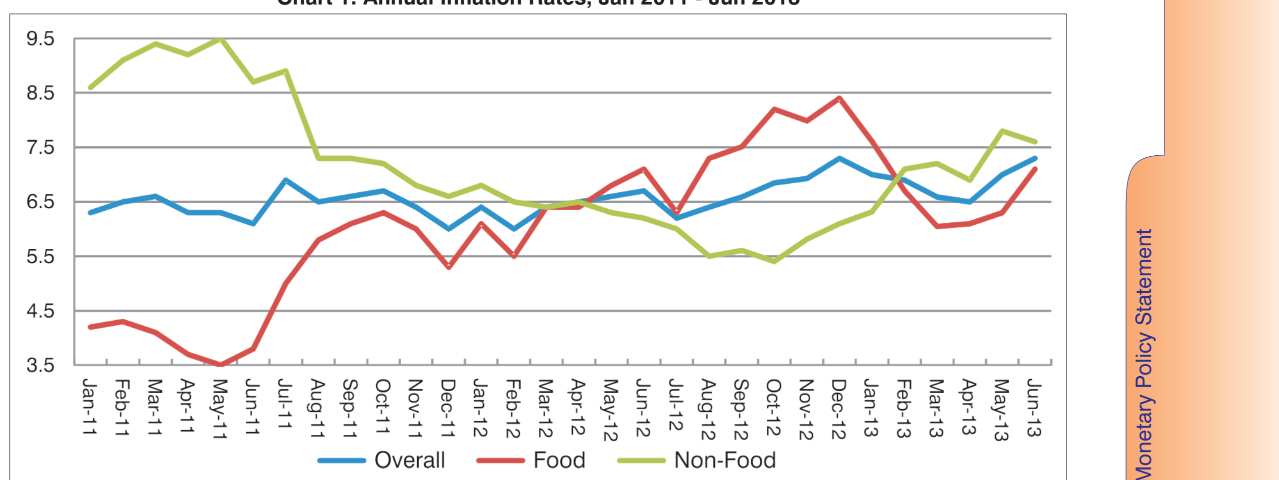
In order to address the loose liquidity conditions earlier in the period, the Bank of Zambia tightened monetary policy mainly through net sales of Government securities, net statutory reserve withdrawals, net foreign exchange sales and OMO. As a result, at end-June 2013, the average interbank rate remained within the corridor.

In the first half of 2013, the foreign exchange market was characterised by depreciation trend of Kwacha against major trading currencies due to a combination of domestic and international factors, which exerted pressure on the Kwacha. Specifically, firm domestic demand, market participants' position-taking ahead of Statutory Instrument No 55 implementation and developments in the Euro-zone, China and USA contributed to the observed weakness in the Kwacha. However, the real effective exchange rate remained stable, implying that the country's exports remained competitive.

4.1 Overall Inflation

Consumer price developments during the first four months of 2013 were favourable, as annual overall inflation slowed down to 6.5% in April 2013 from 7.3% in December 2012. This outturn in inflation during this period was mainly credited to a slowdown in food inflation. Food inflation fell largely on account of the decline in maize and mealie meal prices, in turn explained by a stable supply of cheaper maize by the Food Reserve Agency. However, inflation rose to 7.0% and 7.3% in May and June 2013, respectively. The pick-up in inflation in May and June was largely driven by increases in both food and non-food inflation (see Chart 1 and Table 2).

Chart 1: Annual Inflation Rates, Jan 2011 - Jun 2013



Source: Bank of Zambia

4.1.1 Non-Food Inflation

Annual non-food inflation rose to 7.7% in June 2013 from to 6.1% in December 2012. This was attributed to the higher inflation outturns for the following sub-groups: Education, 13.3% [8.8%] ; Housing, water, electricity, gas and other fuels, 9.0% [7.0%]; Clothing and footwear, 7.9% [6.5%]; Transport, 8.3% [3.3%]; Alcoholic Beverages, 6.6% [5.9%]; Communication, 2.8% [1.4%]; Restaurants and Hotels, 6.4% [5.0%]; and Miscellaneous goods and services, 6.8% [6.6%].

These developments partly reflected the pass-through effects of the relatively weaker exchange rate of the Kwacha against major foreign currencies in the last quarter of 2012, and most part of the first half of 2013. The higher inflation outturn for Housing, water, electricity, gas and other fuels; and Transport sub-groups was on account of the 21% rise in petroleum products (in May 2013) following the removal of the fuel subsidy. However, lower inflation rates were recorded in the Recreation and culture, 3.4% [4.2%]; and Furnishings, household equipment and maintenance, 5.2% [6.5%], sub-groups.

4.1.2 Food Inflation

Annual food inflation moderated during the first quarter of the year, declining to 6.0% in March 2013 from 8.4% in December 2012, before rising to 7.1% in June 2013. The fall in inflation during the first quarter was partly explained by the stable supply of cheaper maize grain by the Food Reserve Agency. Further, supplies of fish and selected vegetables improved during the first quarter due to the lifting of the annual fish ban and seasonal factors, respectively. However, with the removal of the maize subsidy in May 2013 coupled with delays in commencement of the marketing season for 2013, mealie meal prices edged upwards during the second quarter of 2013. Further, the increase in domestic fuel pump prices by 21% occasioned by the removal of the fuel subsidy, pushed up transportation costs for various food commodities.

Table 2: Inflation Outturn, Jan 2012 – Jun 2013 (%)

	Monthly			Year-to-date			Annual		
	Overall	Food	Non-Food	Overall	Food	Non-Food	Overall	Food	Non-Food
Jan-12	1.1	1.9	0.2	1.1	1.9	0.2	6.4	6.1	6.7
Feb-12	0.3	-0.1	0.7	1.4	1.8	0.9	6.0	5.5	6.5
Mar-12	1.4	1.9	1.1	2.8	3.7	2.0	6.4	6.4	6.4
Apr-12	0.7	0.5	0.7	3.5	4.2	2.7	6.5	6.4	6.5
May-12	0.4	0.3	0.6	3.9	4.6	3.3	6.6	6.8	6.3
Jun-12	0.0	-0.4	0.5	4.0	4.1	3.8	6.7	7.1	6.2
Jul-12	0.7	0.8	0.7	4.8	4.9	4.5	6.2	6.3	6.0
Aug-12	0.9	1.1	0.6	5.7	6.1	5.2	6.4	7.3	5.5
Sep-12	0.5	0.5	0.4	6.2	6.6	5.6	6.6	7.5	5.6
Oct-12	0.1	0.4	-0.3	6.3	7.0	5.3	6.8	8.2	5.4
Nov-12	0.2	0.2	0.1	6.4	7.3	5.5	6.9	8.0	5.8
Dec-12	0.8	1.0	0.6	7.3	8.4	6.1	7.3	8.4	6.1
Jan -13	0.8	1.1	0.5	0.8	1.1	0.5	7.0	7.6	6.3
Feb-13	0.2	-0.9	1.4	1.0	0.2	1.9	6.9	6.7	7.1
Mar-13	1.2	1.2	1.1	2.2	1.4	3.0	6.6	6.0	7.2
Apr-13	0.6	0.7	0.5	2.8	2.1	3.6	6.5	6.1	6.9
May-13	0.9	0.4	1.3	3.7	2.5	5.0	7.0	6.3	7.8
Jun-13	0.4	0.4	0.3	4.1	2.9	5.3	7.3	7.1	7.6

Source: Central Statistical Office Bulletin, The Monthly and Bank of Zambia

4.2 Interbank Rate, Monetary and Credit Developments

4.2.1 Overnight Interbank Rate

Monetary policy operations during the period under review were aimed at maintaining the 5-day weighted average interbank rate within a corridor of +/- 200 basis points of the BoZ Policy Rate. Due to inflationary pressures, which threatened the attainment of end year inflation target of 6%, the Bank of Zambia raised the policy rate during the second quarter of 2013 to 9.50% from 9.25%.

The average interbank rate remained within the corridor for most of the review period despite momentarily breaching the upper bound in a tight liquidity environment in the second quarter of 2013. At end-June, the 5-day moving average interbank rate closed at 11.3% from 8.2% at end-December 2012 (see Chart 2). This was achieved mainly through net sales of Government securities, net statutory reserve withdrawals, net foreign exchange sales and OMO.

Appendix II: Zambia's Economic Programme

An International Monetary Fund (IMF) mission visited the country from 3rd to 12th April 2013 to review recent economic developments and discuss key economic challenges facing the country. The mission discussed with the authorities, issues concerning maize marketing, oil subsidies, pension issues, Government wage bill and financing gaps in 2013 and 2014, exchange rate and gross international reserves, interest rate ceilings and Bank of Zambia Act Amendments, among other issues.

Regarding foreign exchange inflows in the first half of 2013, the Poverty Reduction Budget Support (PRBS) received amounted to US $35.6 million compared to US $93.0 million disbursed in the second half of 2012. The funds received came from the United Kingdom (US $12.1 million), European Investment Bank (US $5.8 million), Finland (US $7.9 million) and Norway (US $9.8 million). Further, a total of US $71.4 million mining tax revenue was received during this period for the benefit of Government compared to US $322.2 million received in the second half of 2012. Meanwhile, Bank of Zambia foreign exchange purchases from the market amounted to US $8.0 million during the period under review.

The above receipts were against major foreign exchange outflows including, Bank of Zambia sales to the market (US $575.5 million) and debt service payments to various creditors, excluding the IMF (US $68.4 million).

With regards to performance of the economic programme, preliminary data indicate that the Net Domestic Assets (NDA) of the Bank of Zambia, the Net Domestic Financing (NDF) of Government and the Unencumbered International Reserves (UIR) quantitative performance criteria were all off track as at end June 2013, the average NDA was K1,629.9 million above the end-June 2013 programme ceiling of K2,133.1 million whilst the NDF stood at K13,134.4 million and was K2,063.8 million above the end-June adjusted ceiling of K11,070.6 million. The UIR at US $2,212.6 million, were US $96.7 million below the end-June 2013 adjusted floor of US $2,309.3 million. The NDA and UIR were largely affected by Bank of Zambia foreign exchange sales to the market whilst the NDF was affected by net government spending.

Table A II.1: Macroeconomic Outturn in 2012, and Targets for 2013 and 2014

	End –Dec 2012 Outturn	End-Dec 2013 Targets	End-Dec 2014 Targets
Description	7.3	7.0	7.3
Real GDP growth rate (%)	7.3	6.0	6.5
CPI Inflation, end period (%)	6.6	6.3	7.0
CPI Inflation, annual average (%)	4.2	2.8	4.0
Gross Official Reserves (in months of imports)	17.9	17.4	17.3
Broad Money growth (%)	4.9	5.9	6.6
Budget deficit, excluding grants (% of GDP)	1.1	1.8	2.3

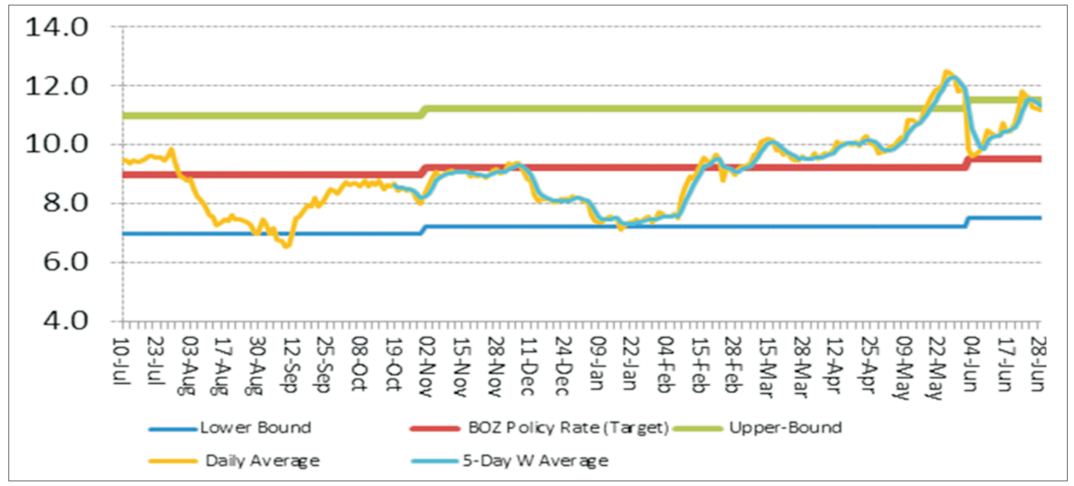
Source: Bank of Zambia, Budget Speech, 2013, IMF Aide Memoire 2013

Appendix I: Selected Macroeconomic Indicators

Description/Years	Dec-11	Dec-12	Jan-13	Feb-13	Mar-13	Apr-13	May-13	Jun-13
Monetary Aggregates (K'million)								
Reserve money (end-period in K'million)*	5,385.40	6,740.70	8,246.50	6,501.60	7,104.40	6,721.20	6,888.90	7,380.50
Growth Rate	11.6	10.6	22.3	-21.2	9.3	-5.4	2.5	7.1
Broad money (in K'million)	24,830.40	25,699.00	25,237.00	27,565.00	25,809.60	26,507.10	26,659.40	27,807.80
Growth Rate	1.9	3.5	-1.8	9.2	-6.4	2.7	0.6	4.3
Net Claims on Government (in K'million)	5,200.10	3,242.10	4,952.90	6,121.70	5,474.30	6,571.00	7,432.60	7,934.70
GDP Growth	6.8	7.3						
Nominal GDP (in K' million)	93,344.40	111,049.40						
Nominal GDP (in US $'million)	19,204.60	21,618.20						
Population (million)	13.4	13.8						
GDP per capta (in K)	6,953,102.00	8,046,618.90						
GDP per capta (in US $)	1,430.50	1,566.50						
Prices (%)								
Inflation	7.2	7.3	7	6.9	6.6	6.5	7	7.3
Food	5.3	8.4	7.6	6.7	6	6.1	6.3	7.1
Non-Food	6.6	6.1	6.3	7.1	7.2	6.9	7.8	7.7
Nominal Interest and yield rates (aver. %)								
Commercial Banks ' rates								
Commercial banks' weighted lending base rate	16.6	8.8	9.3	9.3	9.3	9.3	9.3	9.5
Average Savings rate (>K100)	4.3	4.3	4.3	4.3	2.8	3	3.3	3.4
Deposit rate (30 days, over K20,000.00)	5.3	5.3	5.3	5.3	4.5	4.4	4.7	4.9
Treasury bill yield rates								
Weighted TB rate	11.7	11.8	9.3	10.9	12	12.5	12.8	13.1
91-day	7.1	9.4	7.5	6.2	5.5	5.5	6.3	6.5
182-day	9.8	12.4	10.1	9.6	12.2	12.6	12.6	12.7
273-day	11.4	11.4	9.4	9.9	12.2	12.8	12.7	12.9
364-day	13.4	12.1	10.4	11.6	12.5	12.5	12.9	13.3
Government bonds Yield Rates								
24 months	14.7	11	11	11.2	12	12	12.3	12.7
3 year	15.1	12.8	12.8	12.9	13.5	13.5	13.9	14.5
5 year	15.4	13.5	13.5	13.8	14.8	14.8	15.1	15.5
7 year	15	14.5	14.5	14.5	14.5	14.5	14.8	15.2
10 year	15.9	16.5	16.5	16.6	17	17	17	17
15 year	16.2	16.6	16.6	16.6	16.6	16.6	16.8	17
Real Interest and Yield Rates (%)								
Commercial Banks' rates								
Commercial banks' weighted lending base rate	9.4	1.5	2.3	2.4	2.7	2.8	2.3	2.2
Average Savings rate (>K100)	-2.9	-3	-2.7	-2.6	-3.8	-3.5	-3.7	-3.9
Deposit rate (30 days, over K20,000.00)	-1.9	-2	-1.7	-1.6	-2.1	-2.1	-2.3	-2.4
Treasury bill yield rates								
Weighted TB rate	4.5	4.5	2.3	4	5.4	6	5.8	5.8
91-day	-0.1	2.1	0.5	-0.7	-1.1	-1	-0.7	-0.8
182-day	2.6	5.1	3.1	2.7	5.6	6.1	5.6	5.4
273-day	4.2	4.1	2.4	3	5.6	6.3	5.7	5.6
364-day	6.2	4.8	3.4	4.7	5.9	6	5.9	6
Government bonds Yield Rates								
Weighted Bond rate								
24 months	7.5	3.7	4	4.3	5.4	5.5	5.3	5.4
3 year	7.9	5.5	5.8	6	6.9	7	6.9	7.2
5 year	8.2	6.2	6.5	6.9	8.2	8.3	8.1	8.2
7 year	7.8	7.2	7.5	7.6	7.9	8	7.8	7.9
10 year	8.7	9.2	9.5	9.7	10.4	10.5	10	9.7
15 year	9	9.3	9.6	9.7	10	10.1	9.8	9.7
Exchange rates (average K/US $)								
Commercial banks' interbank mid-rate	5,118.50	5,217.30	5.3	5.3	5.4	5.4	5.3	n/a
Bank of Zambia mid rate**	5,117.00	5,146.60	5.4	5.3	5.4	5.3	5.3	5.5
Real sector								
Mining output (tonnes)								
Copper	66,443.30	69,617.20	74,900.40	66,187.10	74,417.70	89,219.23	79,512.29	77,777.59
Cobalt	534.6	385.3	495.3	468.6	665.6	533.9	492	476.2
Metal Earnings (US $'000)								
Copper	463,386.20	496,361.00	592,951.20	569,501.10	609,813.40	673,327.60	541,955.20	566,757.00
Cobalt	15,048.80	13,166.20	12,172.30	11,671.90	11,286.80	10,799.80	9,937.10	9,012.80
Total	478.4	568, 000.00	602,400.00	512,500.00	601,000.00	599,000.00	551,892.30	575,769.80
External sector (US $ mn)								
Trade Balance	15.5	103.3	80.4	91.9	50.5	68	62	3.2
Exports, c.i.f.	614	847.3	868.4	898.8	888.5	932.8	929.5	879.3
Imports, c.i.f.	-598.5	-743.9	-788	-806.9	-838.1	-864.7	-867.5	-876
Gross Official Reserves (US $'mn)	2,347.00	3,277.90	3,090.10	2,735.10	2,633.00	2,496.70	2,499.10	2,468.30

Source: Bank of Zambia Statistics Fortnightly
* Reserve money is narrowly defined.
**Based on BoZ end of period mid-exchange rate

Chart 2: 5-Day Average Interbank Rate and Policy Rate, Jul 2012 – Jun 2013

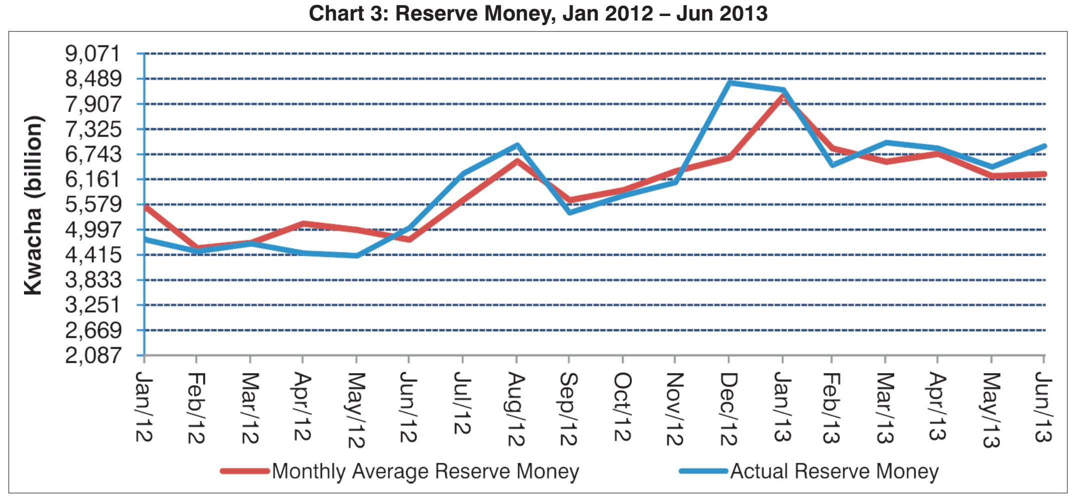


Source: Bank of Zambia

4.2.2 Reserve Money

Over the first six months of 2013, reserve money declined by 17.4% to K6,931.95 million from K8,396.04 million in the preceding half of 2012. This outturn was mainly influenced by OMO withdrawals, net foreign exchange sales and net government securities transactions amounting to K981.3 million, K650.1 million and K1,510.7 million (see Appendix III, Table AIII.4), respectively. These influences were however partially offset by maturing OMO amounting to K616.0 million (see Chart 3).

Chart 3: Reserve Money, Jan 2012 – Jun 2013



Source: Bank of Zambia

4.2.3 Broad Money

Broad money (M3) comprehensively defined to include foreign currency deposits, rose by 8.2% to K27,807.8 million as at end-June 2013 from K25,699.0 million at end-December 2012 (see Table 3). This outturn was largely due to a 30.8% increase in net domestic assets (NDA) which contributed 16.5 percentage points to M3 growth. The rise in NDA was largely attributed to a 144.7% increase in lending to government. On the other hand, net foreign assets (NFA) fell by 18.0%, contributing negative 8.3 percentage points to M3 growth. Excluding foreign currency deposits that rose by 4.2%, money supply rose by 9.7% in the period under review compared with 22.9% growth recorded in the second half of 2012.

Table 3: Broad Money Developments (in K' million unless otherwise stated), Dec 2010 – Jun 2013

Description	Dec 2010	Jun 2011	Dec 2011	Jun 2012	Dec 2012	Jun 2013
Broad Money (M3)	17,916.6	20,340.3	21,804.8	23,004.6	25,699.0	27,807.8
Foreign Exchange Deposits	6,639.0	8,680.9	7,695.2	7,822.5	7,036.1	7,329.2
M3 (excl. Foreign Exchange Deposits)	11,277.6	11,659.3	14,109.6	15,182.1	18,662.9	20,478.6
6-Month Change in M3 (%)	11.5	13.5	7.2	5.5	11.7	8.2
6-Month Change in Foreign Exchange Deposits (%)	39.2	30.8	-11.4	1.7	-10.1	4.2
6-Month Change in M3 (excl. Foreign Exchange Deposits) [%]	-0.2	3.4	21.0	7.6	22.9	9.7
Annual Change in M3 (%)	26.8	26.6	21.7	13.1	17.9	20.9
Annual Change in Foreign Exchange Deposits (%)	30.3	82.0	15.9	-9.9	-8.6	-6.3
Annual Change in M3 (excl. Foreign Exchange Deposits) [%]	24.9	3.2	25.1	30.2	32.3	34.9

Source: Bank of Zambia

4.2.4 Domestic Credit

Domestic credit, comprehensively defined to include foreign currency loans, rose by 32.6% during the first half of 2013 compared with an increase of 7.2% recorded in the second half of 2012. In absolute terms, domestic credit rose to K26,164.7 million in June 2013 from K19,726.8 million as at end-December 2012 (see Table 4). This was on account of the increase in lending to central government and the private sector by 144.7% and 18.3% contributing 23.8 and 8.6 percentage points, respectively, to domestic credit growth. It is noteworthy that fiscal performance should not only be supportive of end-year inflation objective, but should also the spur a private sector led economy.

However, lending to public enterprises fell by 72.9% and contributed negative 2.6 percentage points to domestic credit growth, while credit to households rose by 9.7%, contributing 2.8 percentage points to the domestic credit outturn. Excluding foreign currency denominated loans that rose by 3.7%, domestic credit rose by 42.0% compared with 12.1% growth recorded in December 2012.

Table 4: Domestic Credit Developments (in K' million unless otherwise stated), Dec 2010 – June 2013

Description	Dec 10	Jun 11	Dec 11	Jun 12	Dec 12	Jun 13
Domestic Credit (DC)	14,682.9	14,538.7	16,822.6	18,396.3	19,726.8	26,164.7
O/w Foreign Exchange Credit	4,538.4	4,051.8	4,538.4	5,090.0	4,808.2	4,984.6
DC (Excl. FX Credit)	10,144.5	10,486.9	12,284.2	13,306.3	14,918.6	21,180.1
6-Month Change in Domestic Credit	7.6	-1.0	15.7	9.4	7.2	32.6
6-Month Change in Foreign Exchange Credit	42.6	-10.7	12.0	12.2	-5.5	3.7
6-Month Change in DC (Excl. Foreign Exchange Credit)	-3.0	3.4	17.1	8.3	12.1	42.0
Annual Change in Domestic Credit	21.0	6.6	14.6	26.5	17.3	42.2
Annual Change in Foreign Exchange Credit	23.0	27.3	44.8	25.6	5.9	-2.1
Annual Change in DC (Excl. Foreign Exchange Credit)	5.8	0.3	21.0	26.9	21.4	59.2

Source: Bank of Zambia

In terms of credit by sector, households (personal loans category) continued to hold the largest share of outstanding credit, accounting for 32.9% in June 2013 compared with 32.4% in December 2012. The Agricultural sector was second at 20.5% (22.6%), followed by Manufacturing 11.1% (11.3%), Wholesale and Retail Trade 7.8% (6.7%), Mining and Quarrying 5.8% (5.7%), and Transport, Storage and Communications 4.5% (4.6%) (see Appendix III, Table AIII.5).

4.3 Foreign Exchange Market

In the first half of 2013, the foreign exchange market was characterised by depreciation trend of Kwacha against major trading currencies attributed to a combination of domestic and international factors. On the domestic front, firm demand for foreign exchange in the first quarter was largely attributed to high levels of liquidity and commercial banks demand for foreign exchange to meet statutory reserve requirements. In the second quarter, the depreciation trend was attributed to a combination of demand and supply mismatches and market participants' position- taking ahead of Statutory Instrument No 55 implementation in

Table 7: Actual Inflation and Projections, July 2011 – June 2013

Description		Projection (a)	Actual (b)	Forecast Error (b-a)
Second Half of 2011	July	8.6	9.0	0.4
	August	7.4	8.3	0.9
	September	8.1	8.8	0.7
	October	7.9	8.7	0.8
	November	8.1	8.1	0.0
	December	8.3	7.2	-1.1
	Average	8.1	8.4	0.3
First Half of 2012	January	6.5	6.4	-0.1
	February	6.5	6.0	-0.5
	March	5.6	6.4	0.8
	April	6.1	6.5	0.4
	May	5.9	6.6	0.7
	June	6.5	6.7	0.2
	Average	6.2	6.4	0.3
Second Half of 2012	July	5.8	6.2	0.4
	August	6.4	6.4	0.0
	September	6.7	6.6	-0.1
	October	6.7	6.8	0.1
	November	6.8	6.9	0.1
	December	7.2	7.3	0.1
	Average	6.6	6.7	0.1
First Half of 2013	January	7.1	7.0	-0.1
	February	7.2	6.9	-0.3
	March	7.1	6.6	-0.5
	April	6.9	6.5	-0.4
	May	6.7	7.0	0.3
	June	6.4	7.3	0.9
	Average	6.9	6.9	(0.0)
Second Half of 2013	July	6.8		
	August	6.9		
	September	7.4		
	October	7.7		
	November	7.8		
	December	7.5		
	Average	7.4		

Source: Bank of Zambia
Note: A positive number implies that actual inflation outturn was above the projection and the opposite is true

5.3 Monetary Policy Principles for the Period July 2013 – December 2015

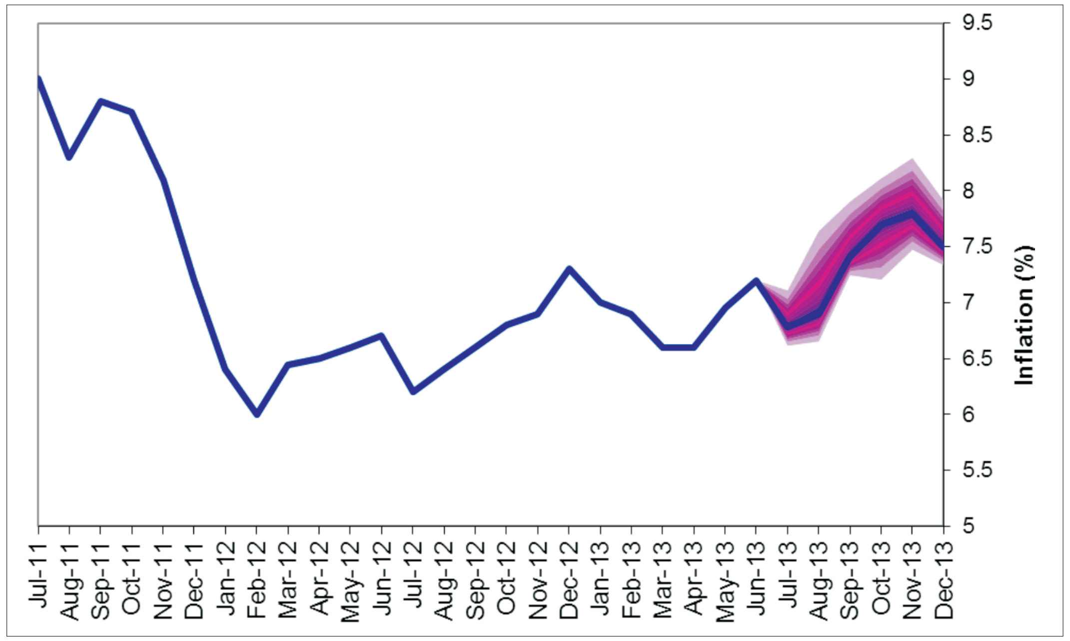
In the two-year period ending 2015, monetary policy formulation and implementation will continue to focus on attaining Government's broad economic objectives, which include:

i. Maintaining single-digit inflation of at most 6.5% in 2014 and 5.5% in 2015;
ii. Achieving real GDP growth rate of at least 7.3% in 2014 and 7.5% in 2015;
iii. Limiting overall fiscal deficit to 5.0% of GDP in 2014 and 4.3% in 2015;
iv. Limiting domestic borrowing to at most 2.3% of GDP in 2014 and 1.8% in 2015; and
v. Accumulating foreign reserves to at least 4 months of import cover in 2014 and 3.9 months in 2015.

The Bank of Zambia will continue to use market-based instruments of monetary policy to steer the average interbank rate towards the policy rate. This will be complemented by prudent fiscal management.

deficit in the medium to long term and thereby mitigate the impact of subsidy removal on inflation.

Chart 12: Actual and Projected Inflation, July 2011 – December 2013



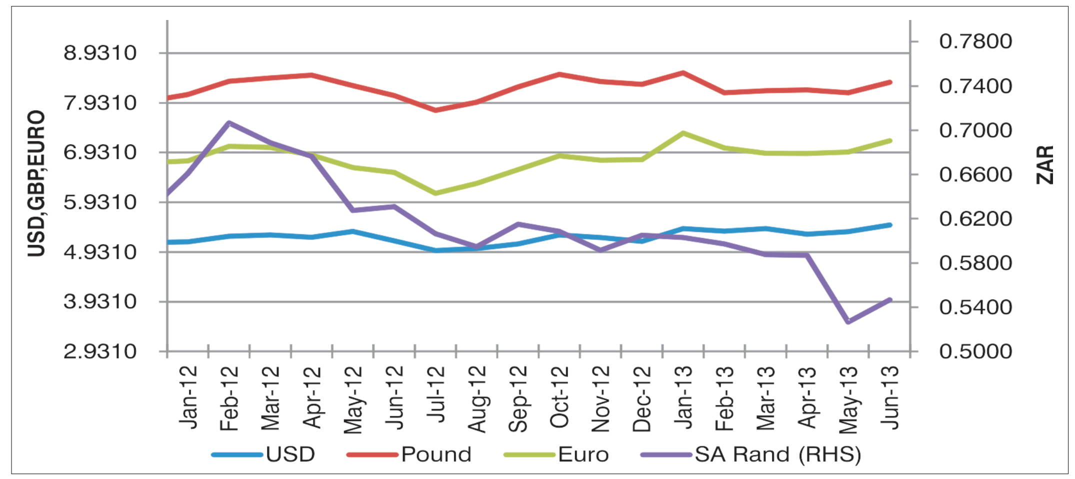
Source: Bank of Zambia

July 2013. The depreciation trend was moderated by steady supply of foreign exchange by corporates, in particular the mining companies and foreign financial firms. The Bank of Zambia also made net sales of foreign exchange (US$101.0 million) to the market to level out volatility and improve liquidity conditions during the first half of 2013.

Exchange rate developments also took cue from the global economic developments, specifically developments in the Euro-zone, China and USA. The dollar got some support from robust US jobs data in May that was higher than forecasts, signalling that the US economy was recovering steadily. The Eurozone did not generate significant economic growth, attributed largely to austerity measures amid record unemployment levels. Japan led Asia's economic push with aggressive monetary easing, while China experienced economic slowdown with authorities attempting to manage a gradual economic slowdown through a transition from an export-driven to a domestic consumption-oriented economy. In addition, increased risk aversion by foreign investors towards emerging market assets emanating from continued uncertainty in global markets restrained portfolio flows.

Against this background, the Kwacha depreciated against the US dollar, Pound and Euro but was resilient against the depreciated South African Rand at close of June 2013. The Kwacha depreciated by 6.3%, 5.6% and 0.5% against the US dollar, Euro and Pound to close at K5.4721/US$, K7.1671/€ and K8.3439/£, respectively. The Kwacha however, appreciated against the South African rand by 9.6% to close the period at K0.5467/ZAR from K0.6050/ZAR, previously (see Chart 4).

Chart 4: Exchange rates (Kwacha per foreign currency), Jan 2012 – Jun 2013



Source: Bank of Zambia

During the review period, the real effective exchange rate appreciated by 5.1% as reflected in the decline of the index to 95.7 in June 2013 from 100.2 recorded in December 2012 (see Table 5). This was largely driven by a 2.8% appreciation of the nominal effective exchange rate (of which the South African rand accounted for 4.4 percentage points), coupled with a 2.4% decline in relative prices (foreign prices relative to domestic prices)

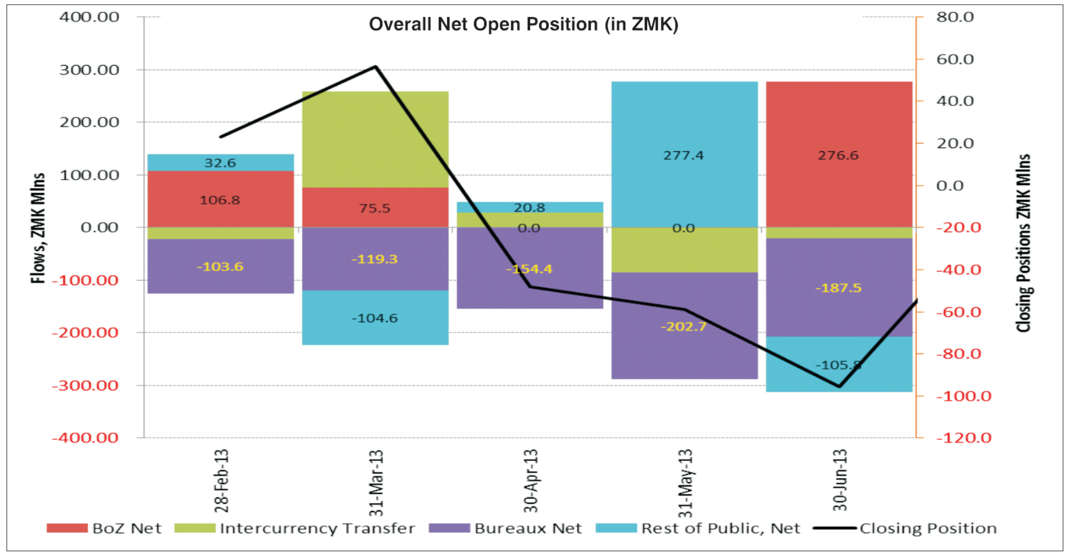
Table 5: Annual Average Real Effective Exchange Rate, Jan 2012 - Jun 2013

	Jan 2012	Jun 2012	Dec 2012	Jan 2013	Jun 2013	% Change (Dec. 12/Jun. 13)
Domestic CPI(2005=100)	176.1	181.1	186.9	188.4	194.3	4.0
Weighted Foreign	121.5	123.1	124.2	124.0	126.1	1.5
CPI(2005=100) NEER Index	1.99	1.98	1.98	1.99	1.92	-2.8
REER Index (2005=100)	105.3	103.2	100.8	100.7	95.7	-5.1

Source: Bank of Zambia

In the review period, there was net foreign exchange supply into the market as volumes supplied to commercial banks increased. Banks recorded net purchases of US$681.2 million from the public compared with US$671.1 million in the second half of 2012. Sales to the bureaux-de-change sector declined to US$173.3 million from US$258.8 million in the latter half of 2012. Commercial banks increasingly sold US dollars in exchange for other non-Kwacha currencies (inter-currency transactions). In this regard, banks gave up an increased amount of US$638.9 million in inter-currency transactions compared with US$632.7 million in the second half of 2012 (see Chart 5). This was attributed to the increased demand mainly for the South African rand amounting to ZAR4,752.4 million in the review period and other non-US$ denominated imports.

Chart 5: Commercial Banks' Sources of Foreign Exchange (US$ Million)



Source: Bank of Zambia

In the first half of 2013, volatility in the domestic exchange rate moderated compared to the second half of 2012, with the six-month moving standard deviation at K60.13 compared to K153.15. The BoZ intervened in the market to minimise volatility in the exchange rate. On a net basis, the BoZ sold US$101.0 million compared with net sales of US$194.5 million recorded during the second half of 2012. Due to tight liquidity in the foreign exchange market, commercial banks' US dollar net position declined to a short position of US$8.6 million at end-June 2013 from a short position of US$1.2 million at end-Dec 2012.

4.4 International Trade Developments

Preliminary data show that in the first half of 2013, Zambia's external sector performance remained positive, although the overall merchandise trade surplus (c.i.f) marginally declined to US $356.0 million from US $364.6 million registered during the second half of 2012 (see Appendix III, Table A III.1). This outturn was explained by a higher increase in the merchandise imports bill relative to the increase in the merchandise export earnings.

Merchandise imports grew by 7.5% to US $5,041.3 million compared with US $4,689.2 million recorded during the last six months of 2012, driven by increased import bills of commodity groups such as, electrical machinery & equipment (22.5%), industrial boilers & equipment (18.1%), iron and steel (14.1%), plastic and rubber products (13.3%), vehicles (0.4%), paper and paper products (0.1%) and other imports (23.3%). However, capital goods constitute a large proportion of the imports, which would increase production and higher contribution to economic growth in the coming years.

Over the same period, merchandise export earnings rose by 6.8% to US $5,397.3 million from US $5,053.8 million registered during the second half of the previous year. This was largely driven by increased metal and non-traditional export earnings. Metal export earnings rose by 4.5% to US $3,619.2 million during the first half of 2013 from US $3,464.6 million registered during the last six months of 2012, on account of increased copper export earnings.

Copper export earnings increased by 7.3% to US $3,554.3 million from US $3,313.5 million registered during the second half of the previous year, on account of a rise in both the realised average prices and export volumes. The realised average price of copper increased by 6.4% to US $7,423.75 per ton (US $3.37 per pound) from US $6,974.56 per ton (US $3.16 per pound) realised during the last six months of 2012. Similarly, copper export volumes, increased to 478,774.7 metric tons (mt) from 475,081.9 mt recorded in the second half of 2012.

However, during the review period, cobalt export earnings reduced by 57.1% to US $64.9 million from US $151.1 million recorded during the last half of 2012. This outturn was attributed to declines in both export volumes and the average realised price. Cobalt export volumes reduced by 51.7% to 3,143.5 mt from 6,512.1 mt recorded in the second half of 2012 (see Appendix III, Table 2). The average realised price of cobalt declined by 11.1% to US

Table 6: Average Annual Effective Interest Rates (%)

Description	First Half 2013	Second Half 2012
Microfinance Institutions	38.3	115.5
Leasing Finance Institutions	24.7	63.0
Building Societies	21.7	25.3
Development Bank of Zambia	20.6	20.6
National Savings and Credit Bank	27.0	27.0
Overall for the sector	**26.5**	**50.3**

Source: Bank of Zambia

5.0 Monetary Policy Objectives and Instruments for July – December 2013

Monetary policy during the second half of 2013 will continue to be focussed on achieving the end-year inflation target of 6%. Consistent with this objective, the Bank of Zambia will rely mainly on Open Market Operations (OMO) to maintain the interbank rate within the BoZ policy rate corridor.

5.1 Economic Outlook for the Second Half of 2013

Zambia's economic prospect for the second half of 2013 remains favourable, to be driven by both influences from domestic and external demand. The country's positive prospects are mainly premised on continued strong domestic investment in mining, manufacturing, tourism, communication and social infrastructure. In particular, the tourism sector should be boosted by higher international arrivals on account of Zambia's co-hosting of the United Nations World Tourism Organisation General Assembly. In this regard, GDP is expected to be broadly in line with the projected annual GDP growth rate of at least 7%. This is despite a weaker economic outlook for many commodity exporters (including those among the BRICS), on account of lower commodity prices.

According to the World Economic Outlook (WEO) growth in sub-Saharan Africa (SSA) is forecast at 5.1% in 2013 from a growth of 4.9% in 2012. Like in most SSA countries, with the exception of some of its largest economies (Nigeria and South Africa) strong domestic demand is expected to drive much of the expected growth. Nevertheless, consistent with the falling commodity prices following a less than positive global economic outlook, the price of petroleum products is expected to decline, a development which should support growth and, moderate inflation in oil-importing countries, including Zambia.

However, growth in the second half of 2013 is likely to be moderated by overall lower global growth prospects, which should adversely affect most commodity exporting countries. The WEO forecasts lower global growth for 2013 amidst prospects of a more protracted recession in Europe and a slowdown in key developing countries such as China and Brazil. As a result, world economic growth is now projected at 3.1% this year down from a forecast of 3.3% three months ago. This is despite recent signs of economic recovery in the USA and Japan.

Zambia's copper export earnings should decline if the slowdown persists particularly in China and India, as copper prices weaken. This may exert pressure on the exchange rate and consequently, inflation, if not compensated by a substantial increase in export volumes. Further, the continued higher regional and domestic demand for food items is likely to put pressure on food prices in the second half of 2013. This may pose a challenge to the achievement of the inflation objective.

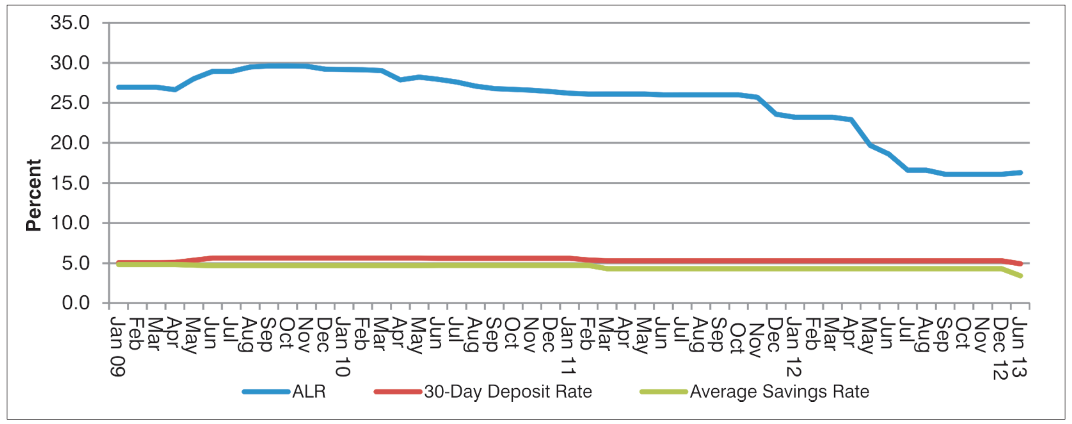
The Bank of Zambia will continue to monitor global and domestic developments and take appropriate measures to maintain price and financial system stability in order to support growth.

5.2 Inflation Projection for July - December 2013

During the second half of 2013, annual overall inflation is expected to increase to 7.5% in December from 7.3% in June 2013 (see Chart 12 and Table 7) . The upward risks to inflation are likely to emanate from the lagged effects of the depreciation of the Kwacha and the expected higher prices of some food items, particularly maize as a result of removal of subsidies and high regional demand. Furthermore, the expected demand-pull pressures arising from the rise in the public sector wages, effective September 2013, may impact negatively on inflation performance.

However, the removal of consumer subsidies is expected to reduce the Government fiscal

Chart 10: Lending and Saving Rates, Jan 2009- Jun 2013

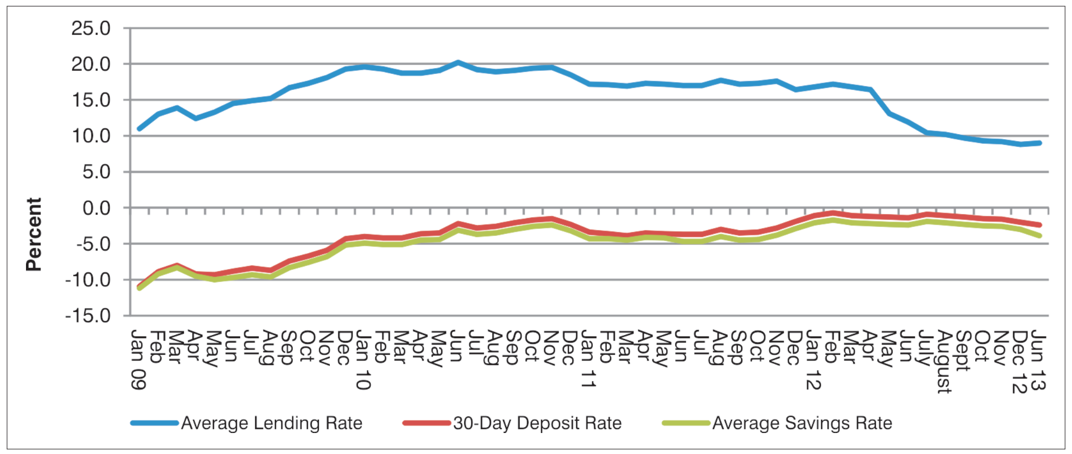


Source: Bank of Zambia

In real terms, interest rates recorded a mixed performance during the review period due to changes in the nominal interest rates. The real ALR rose to 9.0% in June 2013 from 8.8% in December 2012. However, the real ASR for amounts above K100.00 and the real 30-day deposit rate for amounts above K20,000.00 declined to -3.9% [-3.0%] and -2.4% [-2.0%], respectively (see Chart 11).

The negative real savings rates continue to be a major source of concern. In order to address this challenge, the Bank will continue with efforts to increase competition in the sector. In addition, the recent Government initiative aimed at implementing a Treasury Single Account may help, once implemented, as banks will be motivated to find ways of enhancing deposit mobilisation.

Chart 11: Real Interest Rates, Jan 2009- Jun 2013



Source: Bank of Zambia

4.6.3 Non-Bank Financial Institutions Lending Rates

In the first half of 2013, the total cost of credit in the non-bank financial institutions (NBFIs) sector (measured as the average effective annual interest rate) decreased by 23.8 percentage points to 26.5% per annum from 50.3% per annum in the second half of 2012 (see Table 6). The significant decrease in the cost of credit was attributed to the introduction of interest rate caps, effective January 2013. The decrease in the cost of credit resulted in a 25.0% rise in the volume of loans extended by NBFIs to K2,224.8 million in the first half of 2013 from K1,780.0 million in the preceding period.

$20,639.92 per ton (US $9.36 per pound) from US $23,213.91 per ton (US $10.53 per pound) recorded during the last half of 2012.

Non-traditional export earnings surged by 11.9% to US $1,778.1 million during the first six months of 2013 from US $1,589.1 million registered during the second half of the previous year. This was explained by increased earnings from the export of fresh flowers, fresh fruits and vegetables, gemstones, wheat and meslin, cement and limes, gold and other exports. However, export earnings for commodities such as copper wire, electrical cables, sugar, cane sugar, burley tobacco, cotton lint, maize, wheat and meslin declined, an outcome that could in part be attributed to the appreciation in the REER.

4.5 Money and Capital Markets Developments

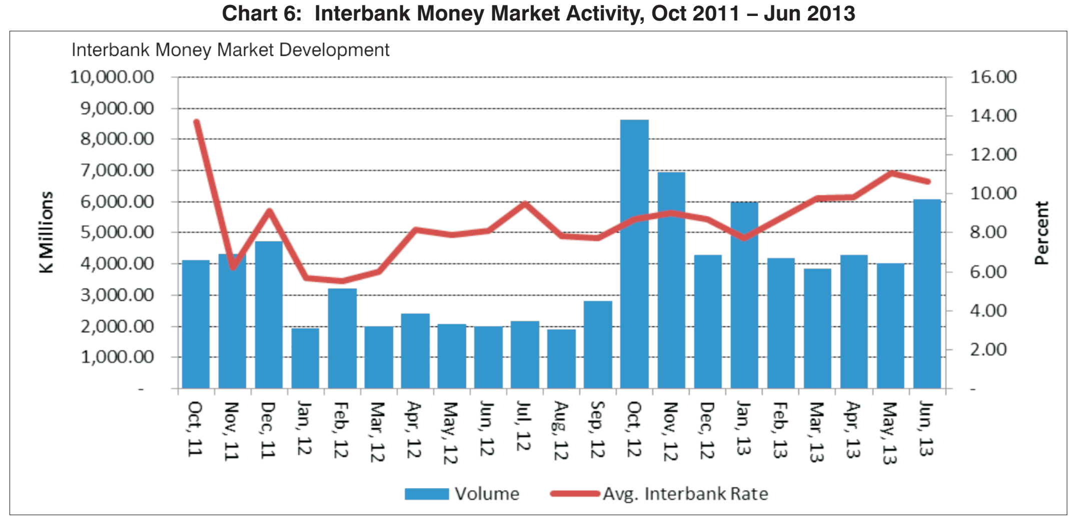
4.5.1 Money Markets

Interbank market

The volume of funds traded in the interbank money market declined to K25,919.1 million from K26,337.7 million in the second half of 2012. The decline in interbank funds traded was reflective of the tight liquidity conditions attributed in part to high concentration of funds in a few banks. During the review period, the market remained most active at the shortest maturity with K24,136.1 million of the total funds traded being exchanged on an overnight basis.

The concentration of liquidity in a few big banks continued to place an upward pressure on the cost of interbank loans. At the close of June 2013, the overnight interbank rate increased further to close at 11.2% compared to 8.2% at close of December 2012. This is attributed to relatively tight liquidity conditions, coupled with high concentration of the funds in few banks. In order to resolve the apparent structural liquidity conditions in the market, the Bank ensured that the money market was adequately liquid through timely interventions, including engagement with affected commercial banks.

Chart 6: Interbank Money Market Activity, Oct 2011 – Jun 2013



Source: Bank of Zambia

Overnight Lending Facility

In the review period, banks increased their borrowings at the overnight lending facility window, due to the uneven distribution of liquidity in the money market. A total of K3,967.2 million in short-term relief funds was borrowed from the Bank of Zambia, compared with K796.2 million borrowed in the second half of 2012. These funds were advanced at rates in the range of 11.75% to 12.50%.

Government Securities Market

The total value of Treasury bills placed on offer was K5,060.0 million compared with K4,240.0 million during the second half of 2012. In response to the tender invitations, investors submitted bids amounting to K7,453.5 million, higher than K6,004.7 million submitted in the preceding period. This translated into an over-subscription of 47.3% compared with an over-subscription of 41.6% in the second half of 2012. Total sales to the market were recorded at K4,539.8 million against maturities of K3,450.3 million.

With regard to Government bonds, securities worth K1,300.0 million were placed on offer, compared to the K1,200.0 million offered previously. Investors placed bids worth K1,686.0 million, which translated into a subscription rate of 129.7%, which was lower than 148.6% subscription rate in the second half of 2012 (see Table AIII.6). Out of the bids received, K1,284.6 million was accepted against a maturity of K560.2 million.

Stock of Government Securities

As a result of the net sales of Government securities in the primary market, the total stock of Government securities in circulation rose by 20.0% to K17,226.7 million from K14,357.7 million recorded at end-December 2012. The stock of Treasury bills in circulation increased by 20.6% to K8,251.1 million compared with a decline of 1.6% in the second half of 2012. The stock of marketable Government bonds outstanding rose by 19.4% to K8,975.6 million from K7,516.9 million.

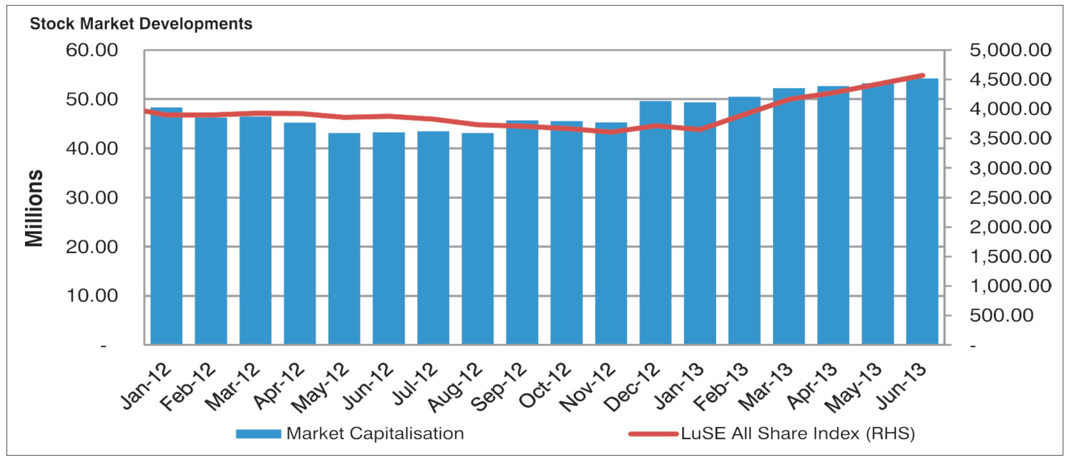
Of the total K17,226.7 million worth of outstanding Government securities, commercial banks accounted for the largest proportion, with a holding of K8,598.2 million (49.9%). The non-bank public accounted for K6,100.1 million (35.4%) while the Bank of Zambia accounted for K2,528.3 million or 14.7% of the total outstanding securities.

4.5.2 Capital Market

The stock market posted gains over the first six months of 2013. Market capitalisation increased by 9.2% to K54,179.0 million from the end-December 2012 position of K49,624.7 million, while the Lusaka Stock Exchange (LuSE) All Share Index increased by 23.0% to 4,568.0 from 3,714.6. The largest share price increases were registered by Zanaco, Zambia Sugar, Celtel and Zamefa (see Chart 7).

Preliminary data show that net foreign portfolio inflows totalled US$3.3 million for the period, compared to net outflows amounting to US$1.3 million in the second half of 2012.

Chart 7: LUSE Indicators, Jan 2012 – Jun 2013



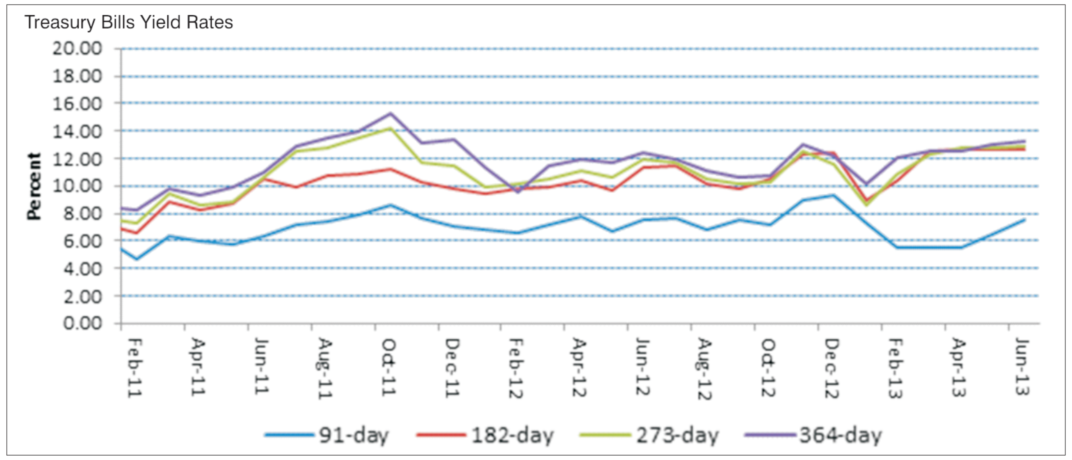
Source: Bank of Zambia

4.6 Interest Rates

4.6.1 Government Securities Interest rates

During the review period, yield rates on Treasury bills were mixed. The yield rate for the 91-day bill closed lower at 7.5% at end-June 2013 compared to 9.5% at close of December 2012. However, yield rates for the 182-, 273- and 364-day bills closed higher at 12.7% ,12.8% and 13.2% compared to 12.6%, 11.0% and 11.7%, respectively, suggesting a stronger appetite for shorter dated treasury bills maturities. The weighted average Treasury bill yield rate for the six month period increased to 13.1% from 11.9% attributed to the rise in yield rates for the 182, 273 and 364 day Treasury bills (see Chart 8).

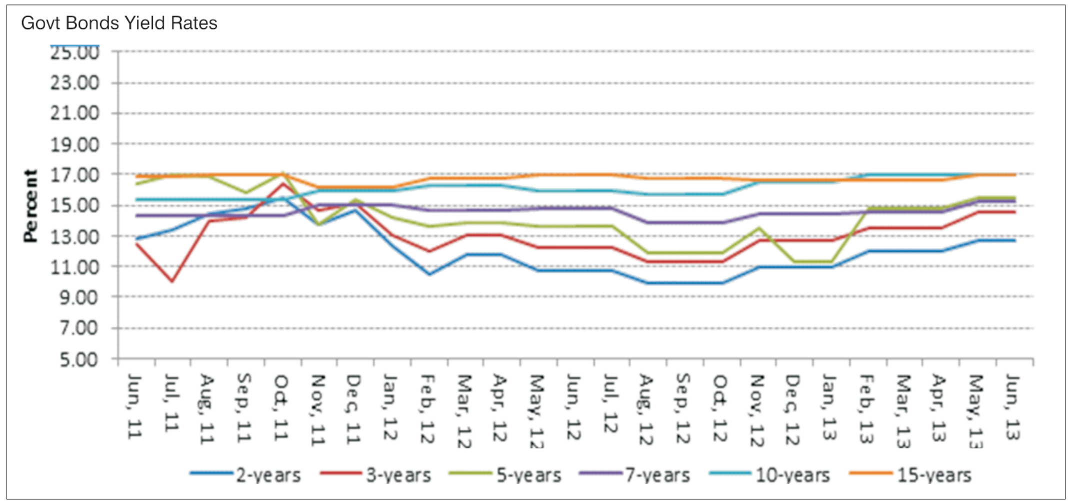
Chart 8: Treasury bill yield rates, Feb 2011 – Jun 2013 (% p.a)



Source: Bank of Zambia

Yield rates on Government bonds increased during the first half of 2013 due to tight liquidity in the market and increases in tender sizes, which signalled huge appetite for funds. Yield rates on the 2- and 3-year papers increased to 12.7% and 14.5% from 11.0% and 12.8%, respectively. Similarly, yield rates on the 5 and 7- year tenors increased to 15.5% and 15.2% from 13.5% and 15.0% previously. Further, yield rates on the 10- and 15- year bonds both rose to 17.0% from 16.5% and 16.6%, respectively. The weighted average bond yield rate similarly closed higher at 15.2% from 13.5% (see Chart 9).

Chart 9: Government bond yield rates, Jun 2012 – Jun 2013 (% p.a)



Source: Bank of Zambia

While the higher yield rates have potential to spur increased foreign investment in the Government securities market, a sustained increase in yield rates may have a negative impact on the Treasury due to increased cost of interest payments. On the other hand, the increased participation of investors could also lower yields due to competition by investors.

4.6.2 Commercial Banks' Interest Rates

The Average Lending Rate (ALR) increased to 16.3% in June 2013 from 16.1% in December 2012 due to the adjustment in the BoZ policy rate. However, both the Average Savings Rate (ASR) for amounts above K100 and the 30-day deposit rate for amounts exceeding K20,000.00 declined to 3.4% and 4.9% from 4.3% and 5.3%, respectively (see Chart 10).