Bank *of* Zambia

MONETARY POLICY STATEMENT

JANUARY - JUNE 2020

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Bank *of* Zambia

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 outlines the monetary policy objectives of the Bank of Zambia (BoZ) for the first half of 2020. It also provides prospects for the global economy and an outlook for domestic economic growth and inflation. In addition, a review of monetary policy performance and macroeconomic developments in the second half of 2019 is presented.

Over the first half of 2020, inflation is projected to remain above the target range on account of the effects of on-going electricity supply challenges and increased external debt service, which affect inflation through the expectations and exchange rate channels. Elevated food prices as well as the second round effects of increases in electricity and fuel prices in January 2020 are also expected to contribute to higher inflation over the first half of the year. However, inflation could decline faster than expected should improvements in agricultural output during the 2019/2020 crop season materialise.

Monetary policy will focus on bringing inflation back to the 6-8% target range in the medium-term using the forward-looking monetary policy framework. The framework is anchored on the Policy Rate as the key signal for the monetary policy stance. This takes into account inflation forecasts and outcomes, identified risks, as well as progress in the execution of fiscal consolidation. The Policy Rate was maintained at 11.5% in February 2020, taking into consideration weak domestic growth and the need to safeguard financial stability.

Monetary policy continued to focus on bringing inflation back to the target range of 6-8% in the second half of 2019. In this regard, the Policy Rate was raised by 125 basis points to 11.5% in November as inflation was projected to remain above the target range of 6-8%. Annual overall inflation remained high and averaged 11.3% in the second half of 2019 from 7.5% in the first half of 2019. This was mainly due to a sharp increase in prices of maize grain and related products and the significant depreciation of the Kwacha against the US dollar. To moderate pressure on the exchange rate, the *statutory reserve ratio* was raised to 9.0% in December from 5.0% and the compliance shifted to daily from weekly. The Overnight Lending Facility rate was also adjusted upwards to 28% in November from 18%.

Market interest rates continued to rise in the second half of 2019 mostly due to sustained Government domestic borrowing that kept yield rates high. In this regard, commercial banks' lending rates continued to rise while credit to the private sector remained subdued as credit conditions tightened further and weak economic activity persisted.

Indicators of economic activity[1] suggest a further slowdown in growth in the second half of 2019 owing to the contraction in mining output, electricity generation, cement production, consumer spending and manufacturing. In 2020 and the medium-term, real GDP growth is projected to pick-up, albeit at a weaker pace, driven largely by the anticipated recovery in the agriculture, electricity, and mining sectors.

A lower merchandize trade surplus was recorded in the second half of 2019 due to a higher contraction in exports relative to imports. Export earnings declined mainly on account of a drop in copper export volumes. However, copper prices rose due to favourable market sentiments associated with the “US-China Phase One Trade Deal” and supply disruptions in Chile. Imports of goods declined as a result of subdued economic activity.

The fiscal performance remained unfavourable, reflecting higher than programmed spending on capital projects and external debt service payments, compounded by the depreciation of the Kwacha. The continued volatility in the Kwacha exchange rate is likely to pose additional risk to the performance of the 2020 budget. Further, the accumulation of domestic arrears remains a risk to the stability of the financial sector. Therefore, there is need for effective and sustained implementation of fiscal adjustment and structural measures to address elevated debt levels and debt service, the accumulation of domestic arrears, and liquidity constraints.

The global economy is estimated to have expanded at a slower pace in 2019 than the preceding year.[2] Growth decelerated mainly on account of trade and geopolitical tensions, weather related disasters, as well as uncertainty surrounding Brexit. Over the medium-term, global growth is projected to pick-up, albeit at a reduced pace, driven by the recovery in manufacturing, business confidence, investment, and global trade.

[1]The Bank of Zambia Composite Index of Economic Activity, Bank of Zambia Quarterly Survey of Business Opinions and Expectations and Stanbic Bank PMI.
[2]IMF World Economic Outlook Update, January 2020.

1.0 Introduction

This Statement outlines the monetary policy objectives of the Bank of Zambia (BoZ) for the first half of 2020. It also provides prospects for the global economy and an outlook for domestic economic growth and inflation. In addition, a review of monetary policy performance and macroeconomic developments in the second half of 2019 is presented.

2.0 Monetary Policy Objectives and Instruments for the First Half of 2020

In the first half of 2020, monetary policy will focus on bringing inflation back to the 6-8% target range in the medium-term. The Bank of Zambia will continue to rely on the forward-looking monetary policy framework anchored on the Policy Rate as the key signal for the monetary policy stance. This takes into account inflation forecasts and outcomes, identified risks, as well as progress in the execution of fiscal consolidation.

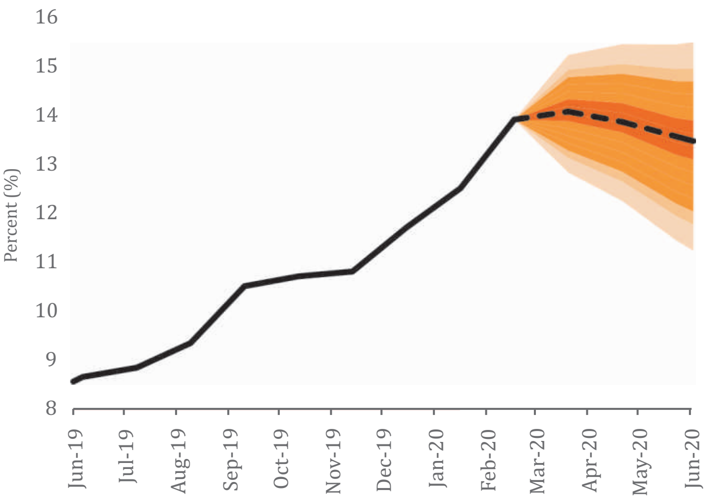
Further, monetary policy remains supportive of the Government's macroeconomic objectives outlined in the 2020 Budget Speech and the Seventh National Development Plan (Table 2 - Appendix). Higher than planned Government domestic financing requirements and tight liquidity conditions in the market may, however, drive interest rates upwards thereby crowding out the private sector and constraining the effectiveness of monetary policy. Therefore, there is need for effective and sustained implementation of fiscal adjustment and structural measures to address elevated debt levels and debt service, the continued accumulation of domestic arrears, and liquidity constraints. This is critical for moderating inflationary pressures, restoring macroeconomic stability and promoting robust and sustained economic growth.

3.0 Inflation Projections for the First Half of 2020

Annual overall inflation is projected to remain above the upper bound of the 6-8% target range in the first half of 2020, averaging 13.5%, up from the outturn of 10.3% in the second half of 2019 (Chart 1 and Table 1 – Appendix). Underlying this projection are the effects of on-going electricity supply challenges and increased external debt service payments, which affect inflation through the expectations and exchange rate channels. The upside risks to the inflation outlook include further increases in the prices of maize grain and related products, the second round effects of the increases in fuel and electricity prices as well as slower progress on fiscal consolidation. However, it is envisaged that inflation could decline faster than currently projected on account of the anticipated improvement in agricultural output due to the favourable rainfall pattern observed so far during the 2019/2020 crop season.

The range of possible inflation outcomes during the first half of 2020 are illustrated in Chart 1. Inflation outcomes are expected to range from a minimum of 13.4% to 14.3% with a 30% probability; 11.9% to 15.0% with a 70% probability; and 11.2% to 15.6% with a 90% probability.

Chart 1: Actual and Projected Inflation: June 2019 – June 2020



Source: Zambia Statistics Agency and Bank of Zambia Compilations

4.0 Domestic Economic Outlook for 2020 - 2021

In 2020 and the medium-term, domestic economic growth is projected to pick-up, albeit at a weaker pace, driven largely by the anticipated recovery in the agriculture, electricity, and mining sectors. The projected recovery in mining is premised on the expected resumption of production by some mining companies and improvement in copper production as investment projects on selected copper ore bodies have reached production stage.

Real GDP growth is projected at 3.2% in 2020 and 3.7% in 2021 from the estimated outturn of 2.0% in 2019. The downside risks to the projected recovery include elevated domestic and external debt and debt service, arrears accumulation, and slower than expected fiscal adjustment. In addition, weaker than anticipated global economic growth associated with the lagged effects of trade disputes and the impact of the recent outbreak of COVID-19 is likely to weigh on domestic economic activity.

5.0 Global Economic Outlook for 2020 - 2021

5.1 Economic Growth

The global economy is projected to pick-up to 3.2% in 2020 and 3.4% in 2021 from 2.9% in 2019.[3] Underlying the pick-up in growth is the recovery in manufacturing, business confidence, investment and global trade, largely reflecting diminishing uncertainty related to trade tensions following the signing of the US-China Phase One Trade Deal[4], and the formal exit of the United Kingdom(UK) from the European Union on January 31, 2020[5]. The accommodative monetary policy stance adopted by some central banks in advanced and emerging market economies is also expected to continue supporting global economic growth in the near-term.

The risks to global growth, however, remain tilted downwards, although they have become less pronounced. They include policy uncertainty related to the possibility of a re-escalation of trade tensions; renewed geopolitical tensions in the Middle East, notably between the US and Iran; rising debt vulnerabilities; weaker external demand; lower commodity prices; anticipated extreme weather events and the impact of the recent outbreak of COVID-19.

Growth in the Sub-Saharan Africa region (SSA) is projected to pick-up to 3.5% in 2020 and 2021 from 3.3% in 2019 on the back of a slight recovery in economic activity in Nigeria and South Africa. Increased household spending and expected rebound in capital investment should provide support to economic growth. Weak external demand, high debt levels, lower commodity prices, and extreme weather conditions are some of the major downside risks to growth prospects.

Despite a positive SSA growth outlook, economic activity in some of Zambia's major trading partners i.e. the Democratic Republic of Congo (DRC) and South Africa is expected to remain subdued over the medium-term. Real GDP growth for the DRC is projected to slowdown to 4.0% in 2020 and 3.9% in 2021 from 4.3% in 2019 mainly on account of reduced mining sector production. Large fiscal deficits and persistent Ebola virus epidemic amidst intensified conflicts could also weigh on growth prospects. However, large-scale infrastructure projects and the recent agreement with the IMF on an economic reform programme to improve the business environment may boost capital inflows and support economic activity.

For South Africa, a modest recovery in GDP growth is projected in 2020 and 2021 to 0.8% and 1.0%, respectively from 0.4% in 2019. Underlying this growth projection is mainly the recovery in household spending and a rebound in capital investment. Further, the moderation in the US-China trade conflicts and positive progress on Brexit could give a boost to manufacturing activity and trade flows. In addition, the implementation of structural reforms is expected to offer support to investment and overall growth. Fiscal challenges, however, remain. The economy is also exposed to low job creation, domestic supply constraints, and electricity shortages.

Economic growth prospects in other trading partner countries for Zambia are also projected to be subdued in the medium-term. Growth in China is expected to moderate further to 5.6%[6] in 2020 and 5.8% in 2021 from the estimated 6.1% in 2019. This is largely due to a slowdown in labour productivity growth as a result of an aging population, effects of the trade war and its impact on manufacturing, global trade and external demand as well as high corporate and sovereign debt levels. The impact of the Coronavirus (COVID-19) could further lower growth in 2020, particularly if it persists and becomes widespread.

In the US, growth is expected to moderate to 2.0% in 2020 and 1.7% in 2021 from 2.3% in 2019. This sluggish growth reflects continued drag from trade tensions despite the signing of the US-China Phase One Trade Deal, high corporate debt, and the fading effects of past fiscal stimulus.

Further, growth in the euro area is projected to increase to 1.3% and 1.4% in 2020 and 2021, respectively from 1.2% in 2019. The upturn in growth reflects strong labour markets and improvements in external demand, manufacturing and business sentiments as the Brexit process unfolds with minimal distractions, coupled with dissipating trade tensions.

In the UK, real GDP growth is projected at 1.4% in 2020 and 1.5% in 2021, an increase from 1.3% in 2019. The upward momentum in growth is largely premised on the orderly exit of the UK from the EU and the anticipated favourable trading agreement with the EU coupled with more supportive

[3] IMF Press Release No. 20/61, February 22, 2020: Remarks by IMF Managing Director to G20 on the Economic Impact of COVID-19; and World Economic Outlook Update, January 2020. In October 2019, global growth was projected at 3.4% and 3.6% for 2020 and 2021, respectively. The downward revision in January 2020 reflected the impact of increased social unrest and the lower growth forecast for some emerging market and developing economies (EMDEs).

[4] On January 15, 2020, the US and China signed a Trade Agreement, which includes tariff reductions on Chinese imports in exchange for China's commitment to protect intellectual property rights, increased transparency about foreign exchange policy, and to purchase US$200 billion of additional US manufactured, energy, and agriculture goods. However, key trade issues remain unresolved. The Agreement came into force on February 14, 2020.

[5] The UK formally exited the European Union on January 31, 2020 and went into a transition period until December 31, 2020. It is anticipated that the Withdrawal Agreement will reduce near-term uncertainties that households, businesses and financial markets have faced since the Brexit process was initiated on March 29, 2017 after the June 23, 2016 Referendum.

[6] IMF Press Release No. 20/61, February 22, 2020: Remarks by IMF Managing Director to G20 on Economic Impact of COVID-19.

monetary and fiscal policy. This is expected to remove some uncertainty facing businesses and households thereby boosting their confidence, demand and investment.

5.2 Commodity Prices

Commodity prices are projected to remain subdued in the first half of 2020, mainly reflecting weak global demand. Copper prices are projected to remain stable in the medium-term, averaging US$6,004.2 and US$6,054.3 per tonne in 2020 and 2021, respectively from US$6,075.3 in December 2019. Subdued growth in China and the recent outbreak of the COVID-19 could weigh on copper prices in the medium-term.

Crude oil prices are expected to be lower in 2020, averaging US$60.9/barrel from US$64.5/barrel in December 2019, but rise moderately to US$62.0/barrel in 2021. Lower prices will be driven by the projected increase in global supply. However, the projected slowdown in China (the world's biggest oil importer) and the impact of the recent outbreak of COVID-19 could weigh on oil prices in 2020. The main upside risks to oil prices relate to the decision by OPEC+ Members to extend oil production cuts until end-March 2020, and heightened Middle East geopolitical tensions, particularly between the US and Iran, that may reduce global supply.

Prices of selected agricultural products are expected to decline in the medium-term on account of increased supply and the slowdown in demand in light of subdued global growth. Climate change and the possibility of escalation of trade tensions between China and the US pose upside risks to agricultural commodity prices.

6.0 Review of Global Developments in the Second Half of 2019

6.1 Economic Growth

The global economy is estimated to have expanded at a reduced rate of 2.9% in 2019 compared to 3.6% in 2018[7]. Growth slowed down mainly on account of trade and geopolitical tensions, weather related disasters, as well as uncertainty surrounding Brexit which continued to weigh on manufacturing activity, trade, investment and business confidence in the second half of 2019. Further, country-specific shocks in key emerging market economies affected domestic demand. Nonetheless, the global economy stabilised towards the end of 2019, supported by accommodative monetary policy and fiscal easing. Further, improvements in commodity prices and financial market sentiments on account of optimism about the Phase One Trade Deal between the US and China and less fears of a hard Brexit contributed to the improvement in the global economy towards the end of the year.

Growth in the Sub-Saharan Africa region (SSA) increased to 3.3% in 2019 from 3.2% in 2018 mainly on account of higher growth in Nigeria and the recovery in Angola. Growth in Nigeria was attributed to a rise in domestic consumption and the recovery in the non-oil sector as bank lending to both households and businesses picked-up. The recovery in Angola was mainly on account of an uptick in global oil prices and the ensuing positive sentiments about the economy. However, growth in Zambia's major trading partners slowed down due to subdued economic activities in the Democratic Republic of Congo (DRC) and South Africa.

Growth in the DRC remained sluggish due to deteriorating mining activity and the decline in metal prices owing to the US–China trade tensions. Further, the Ebola outbreak persisted amid domestic conflicts. Economic growth slowed down to 4.6% in 2019 from 5.8% in 2018. In South Africa, the economy contracted particularly in the fourth quarter of 2019 on account of high fiscal deficits and rising debt levels, declining mining output, and weak manufacturing activity and continued electricity loadshedding. Further, household spending remained subdued and unemployment remained high. Preliminary estimates indicate that on an annual basis, real GDP growth declined to 0.4% in 2019 from 0.8% in 2018.

Economic growth in Zambia’s other major trading partners also slowed down in 2019. In China, growth slowed down in the second half of 2019 amid trade tensions, which weighed on manufacturing activity and investor sentiments. For the year as a whole, growth in China declined to 6.1% in 2019 from 6.6% in 2018. The slowdown largely reflected the authorities' implementation of financial regulatory measures meant to reign in overleveraging by corporates and the effects of the trade disputes with the US.

Growth in the US is estimated to have declined to 2.3% from 2.9% in 2018. The moderation mainly reflects waning effects of the expansionary fiscal policy as the economy returns to a neutral fiscal stance.

Real GDP growth in the Euro Area slowed down to 1.2% from 1.9% in 2018, largely weighed down by faster-than-expected declines in Germany, France, Spain and Italy. In Germany, manufacturing activity and private consumption significantly contracted on account of new automobile emission standards and softer external demand. Street protests and industrial action by labour unions in France hurt economic growth while stronger than expected slowdown in domestic demand and

[7] IMF World Economic Outlook Update, January 2020. The slowdown in the global economy in 2019 was the most synchronised since the global financial crises as most economies recorded subdued growth.

exports in Spain, and sovereign and financial concerns in Italy, negatively affected domestic consumption.

In the UK, GDP growth was estimated at 1.3 % in 2019, the same as in 2018. Growth was supported by private consumption and improved economic activity in the services and manufacturing sectors. However, uncertainty surrounding Brexit and the nature of the new economic relationship with the European Union negatively affected economic activity in the UK. Meanwhile, the approval of the Withdrawal Agreement[8] in December 2019 provided some optimism and supported business confidence.

6.2 Commodity Prices

Commodity prices generally edged up in the second half of 2019, reflecting positive market sentiments about the US-China trade deal. Copper prices increased to US$6,075.3/metric tonne in December 2019 from US$5,882.2/metric tonne in June 2019 following favourable market sentiments associated with the "US-China Phase One Trade Deal. Further, supply disruptions in Chile and tentative signs of an improving global manufacturing activity, especially in China, supported copper prices. Over the same period, crude oil prices rose to US$64.5/barrel from US$61.3/barrel in June 2019 on account of production cuts by OPEC+ Members and geopolitical tensions in the Middle East.

Agricultural prices generally increased in the second half of 2019 on account of optimism about the trade deal that boosted Chinese demand for soybeans and wheat. Prices for soybeans increased to US$376/metric tonne in December 2019 from US$360.3/metric tonne in June 2019, while wheat prices increased to US$237.7/metric tonne from US$206.1/metric tonne. Maize prices, however, fell to US$167.0/metric tonne from US$195.1/metric tonne on account of the rise in maize stocks following an increase in global production.

7.0 Assessment of Monetary Policy Implementation in the Second Half of 2019

Monetary policy continued to focus on bringing inflation within the target range of 6-8% in the second half of 2019.

The projected increase in inflationary pressures during the second half of 2019 influenced the upward adjustment in the Policy Rate by 125 basis points to 11.50% in November 2019 as some of the upside risks previously identified had materialised. In addition, the statutory reserve ratio was increased in December 2019 to 9.0% from 5.0% to address emerging exchange rate pressures that contribute to inflation. For maximum effect, the compliance arrangement for statutory reserve requirement was changed to daily from weekly. These measures were intended to bring inflation back to the target range of 6-8% in the medium-term as it was projected to persist above 8.0% over the period fourth quarter of 2019 to the third quarter of 2021.

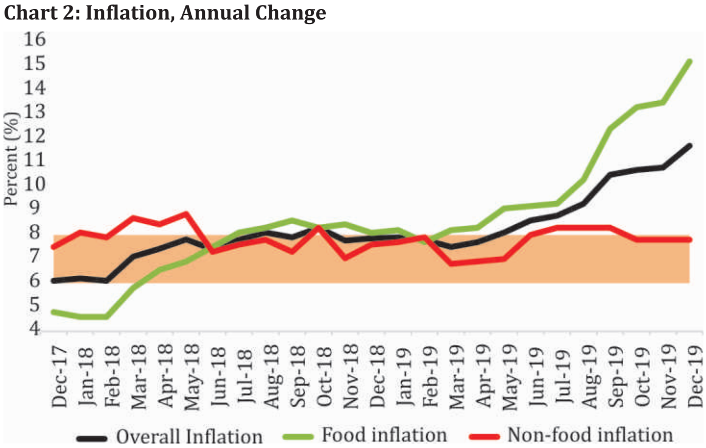
The effectiveness of monetary policy implementation in the second half of 2019 continued to be constrained by persistent fiscal deficits, elevated debt and debt service levels, high domestic arrears, and liquidity challenges. Therefore, monetary policy actions need to be complemented by other corrective measures that set the fiscal deficits, debt levels and debt service payments on a sustainable path.

8.0 Review of Macroeconomic Developments in the Second Half of 2019

8.1 Inflation Outturn

Inflationary pressures continued to mount in the second half of 2019, driven mainly by a sharp increase in prices of maize and related products and the significant depreciation of the Kwacha against the US dollar (refer to section 8.5 below). The increase in maize prices was mainly due to relatively low supply. Average maize prices increased by 50.0% while that for mealie meal went up by about 36.0%. This contributed to the rise in average annual food inflation to 12.4% in the second half of 2019 from 8.5% in the first half of the year. However, non-food inflation rose marginally to 8.0% from 7.4%. Consequently, overall annual inflation rose to an average of 10.3% in the second half of 2019 from 7.9% in the first half, the highest since the second half of 2016 (Chart 2).

Chart 2: Inflation, Annual Change



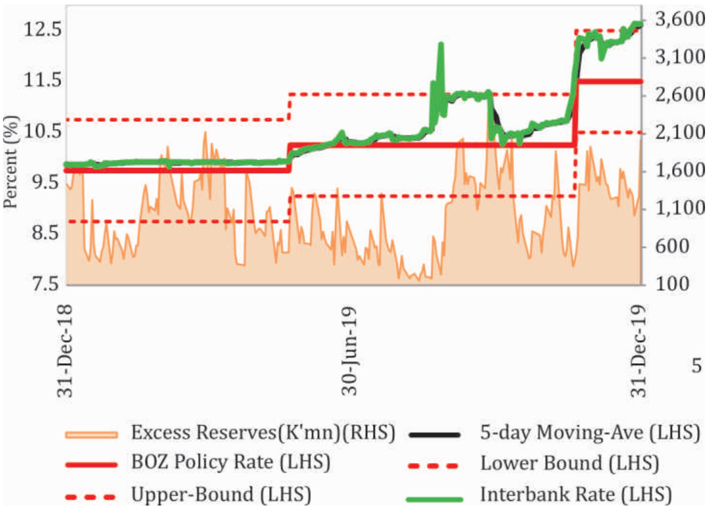
Source: Zambia Statistics Agency

[8]The approval allows the UK to avoid an abrupt exit from the EU. The Withdrawal Agreement and the extension of the UK's EU membership are expected to remove some uncertainty and support confidence in the near-term.

8.2 Interbank Rate and Money Market Liquidity

The overnight interbank rate increased to an average of 11.09% from 9.98%, but broadly remained within the BoZ Policy Rate Corridor (Chart 3).

Chart 3: Market Liquidity and Interbank Rate



Source: Bank of Zambia Compilations

The upward pressure on the overnight interbank rate persisted in the second half of 2019 as liquidity conditions tightened largely on account of the continued withdrawal of Kwacha from the system to meet external debt service obligations. In addition, the upward adjustment in the statutory reserve ratio to 9.0% from 5.0%, effected on December 23, 2019, to address emerging exchange rate pressures, contributed to the tight liquidity conditions. The upward adjustment in the *statutory reserve ratio* resulted in the withdrawal of about K1.4 billion from the system (Table 3 – Appendix). For maximum effect, the compliance arrangement for statutory reserve requirement was also changed to daily from weekly and that had the effect of generating additional demand for liquidity.

With tight liquidity conditions, the interbank rate breached the upper bound of the Policy Rate Corridor in August, September and December. To steer the overnight interbank rate back to the Policy Rate Corridor, expansionary open market operations (OMOs) were conducted. A total of K24.9 billion was injected on an overnight basis, up from K10.6 billion in the first half of 2019.

8.3 Government Securities Market

Demand for Government securities improved in the second quarter of 2019, but remained subdued on account of tight liquidity conditions. The subscription rate for Treasury bills fell to an average of 83.5% from 84.5% but that for Government bonds rose to 41.2% from 24.8%. The pick -up in demand for bonds was mainly supported by commercial banks and institutional investors. Thus, the total funds raised at cost from the auctions rose to K11.2 billion compared to K10.6 billion in the last half of 2019 against total maturities of K11.1 billion resulting in an overall surplus of K0.1 billion. However, additional securities were issued through private placements to meet Government financing needs. Consequently, the outstanding stock of Government securities (at face value) rose by 33.2% to K80.2 billion at end-December 2019. Of the total stock of Government securities, non-resident investors held K8.8 billion (11.0% of the stock) from K8.2 billion (13.8% of the stock) at end-June 2019 and almost all of their holdings were in Government bonds.

8.4 Capital Markets

Market capitalisation declined by 2.2% to K56.6 billion at end-December 2019. This is reflected in the drop in the Lusaka Securities All Share Index (LASI) by 6.6% to 4,264.51 from 4,564.78 in the first half of 2019. The fall in the LASI was largely on account of the decline in share prices of ZAMEFA Plc, ZAMBEEF, Standard Chartered Bank Plc, African Explosives Limited, ZCCM-IH, Real Estate Investment Zambia and Copperbelt Energy Corporation. These companies were adversely affected by, increased operational costs due to sustained power outages, and the depreciation of the Kwacha. Net outflows from the Lusaka Securities Exchange also increased to US$0.9 million from US$0.4 million recorded in the first half of 2019.

8.5 Foreign Exchange Market

The Kwacha depreciated against all currencies of Zambia's major trading partners during the second half of 2019 (Table 4 – Appendix). Against the US dollar, the Kwacha depreciated by 7.9% to an average of K13.4107. The depreciation of the Kwacha was largely on the back of subdued supply of foreign exchange amidst heightened demand for foreign exchange for the importation of petroleum products, electricity, and agricultural inputs. In addition, the Kwacha was weighed down by adverse market sentiments following Zambia's credit rating downgrade[9].

8.6 Interest Rates

Interest rates continued on a rising trend in the second half of 2019, largely reflecting high Government financing requirements, which kept yield rates high (Table 5 – Appendix). In addition, the upward adjustments in both the Policy Rate in November 2019 and the *statutory reserve ratio* in

[9] In August, the S&P downgraded Zambia to CCC+ from B- with stable outlook citing a combination of factors, including rising external debt levels, huge infrastructure spending and rising domestic arrears. The S&P expressed concern over the country's declining reserves amidst increasing external debt service as well as widening fiscal deficits and delays in locking in a much-needed IMF deal for balance of payments support.

December in response to high exchange rate volatility and hence inflationary pressures, contributed to the general rise in interest rates, especially lending rates.

The weighted average Treasury bill and Government bond yield rates increased to 25.18% and 30.8% from 23.55% and 26.63%, respectively (Table 5 – Appendix). Similarly, commercial banks' lending rate averaged 28.0% in December 2019, up from 25.4% in June 2019. The average effective lending rate for the non-bank financial institutions' sector also rose to 48.4% from 46.7% (Table 6 – Appendix). The average 30-day deposit rate for amounts exceeding K20,000 rose to 6.8% from 6.2% over the review period.

8.7 Domestic Credit

Domestic credit growth picked up to 8.4% in the second half of 2019 from 7.8% in the first half (Table 7 – Appendix). This was mainly on account of the increase in lending to Government, mostly in form of securities. Foreign currency loans grew by 8.0%, driven mainly by increased demand for working capital particularly by the mining, wholesale and retail trade, as well as financial services sectors. Kwacha denominated loans also increased by 0.6%, albeit slower than in the first half when they grew by 8.6%. Households (personal loans) continued to account for the largest share of total Kwacha commercial banks' credit, representing 23.8% (27.1% in June 2019), followed by the agriculture, forestry and fishing sector, at 16.4% (17.3% in June 2019) (Table 8 – Appendix).

8.8 Broad Money

Broad money (M3) grew by 11.2% compared to 1.2% recorded in the first half of 2019. This raised M3 to K70.9 billion at end-December 2019 (Table 9 - Appendix). The growth in M3 was largely due to the expansion in lending to Government.

8.9 International Trade

The merchandize trade surplus narrowed in the second half of 2019 to US$69.4 million from US$223.8 million in the first half. This was mainly due to a larger fall in exports than imports (Tables 10 and 11 - Appendix).

Export earnings declined by 7.8% to US$3.6 billion. This followed a drop in copper earnings by 18.5% that outweighed the rise in cobalt and non-traditional exports (Table 10 - Appendix). The drop in copper earnings was due to a reduction in both export volumes[10] and average *realised prices* (Table 11 - Appendix). Copper export volumes fell by 13.8% to 387,184.6 metric tonnes on account of continued operational challenges at some mines. *Realised copper* prices declined to US$5,791.3 per metric tonne from US$6,128.9 per metric tonne. Further, imports of ores fell further and contributed to the decline in copper processed by Zambian mines during the second half.

Imports declined by 4.1% to US$3.5 billion largely due to subdued domestic economic activity. This was on account of the reduction in imports of copper ores, chemicals, motor vehicles, petroleum products, as well as industrial boilers and equipment (Table 12 - Appendix).

8.10 Fiscal Balance

Preliminary data indicate a cash fiscal deficit of 8.2% of GDP in 2019 against a budget target of 6.5%[11] (Table 2 - Appendix). This reflects higher than programmed spending on capital projects and the Farmer Input Support Programme, as well as external debt service payments. The depreciation of the Kwacha against the US dollar, experienced during the period, compounded the expenditure pressures.

8.11 Economic Activity

Indicators of economic activity suggest a further slowdown in growth in the second half of 2019 owing to the contraction in mining output, electricity generation, cement production, consumer spending, and manufacturing[12]. Real GDP growth for the first half of 2019 averaged 2.3% compared to 3.9% over the same period in 2018. The Stanbic Purchasing Manager's Index (PMI),[13] for example, remained below the 50.0 threshold in the second half of 2019, declining to an average of 47.2 from 47.9 in the first half, indicating persistent challenging business conditions for the private sector. Businesses reported liquidity constraints, load shedding, and subdued demand as some of the key factors that weighed on economic activity.

9.0 Conclusion

Inflation is projected to remain above the target range over the first half of 2020 on account of the effects of on-going electricity supply challenges and increased external debt service, which affect inflation through the expectations and exchange rate channels. However, it is envisaged that inflation will decline thereafter on account of the anticipated improvements in agricultural output due to the favourable rainfall pattern observed so far during the 2019/2020 crop season. Taking into account weak domestic growth, liquidity challenges, and the

[10] Export volumes refer to gross volumes exported which include, but not restricted to, production from Zambian mines.
[11] Minister of Finance Statement on the State of the Zambian Economy, February 2020.
[12] The Bank of Zambia Composite Index of Economic Activity, Bank of Zambia Quarterly Survey of Business Opinions and Expectations and Stanbic Bank PMI.
[13] The PMI is a composite indicator produced by Stanbic Bank Zambia to provide an overall view of activity in the economy. It is calculated as a weighted average of five individual sub-components: New Orders, Output, Employment, Suppliers' Delivery Times and Stocks of Purchases.

need to safeguard financial stability, the Policy Rate was held unchanged at the February 2020 MPC Meeting. Monetary policy will continue to focus on bringing inflation back to the target range of 6-8% in the medium-term.

The Bank of Zambia will continue to rely on the forward-looking monetary policy framework anchored on the Policy Rate as the key signal for the monetary policy stance. This takes into account inflation forecasts and outcomes, identified risks, as well as progress in the execution of fiscal consolidation.

In the second half of 2019, the Policy Rate and the *statutory reserve ratio* were adjusted upwards to counter inflationary pressures and exchange rate volatility. Annual overall inflation, however, remained high, largely due to the sharp increase in prices of maize grain and related products and the significant depreciation of the Kwacha against the US dollar. Annual inflation averaged 10.3% up from 7.9% in the first half of 2019. Although monetary policy was relatively tightened it remained insufficient to contain inflationary pressures. Therefore, there is need for effective and sustained implementation of fiscal adjustment and structural measures to address elevated debt levels and debt service, the accumulation of domestic arrears, and liquidity constraints.

Appendix

Table 1: Actual and Projected Inflation: Jan 2018 – Jun 2020

	Projection (a)	Actual (b)	Forecast Error (b-a)
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	7.8	0.0
August	8.1	8.1	0.0
September	8.3	7.9	-0.4
October	8.4	8.3	-0.1
November	8.2	7.8	-0.4
December	8.2	7.9	-0.3
Jan 2019	8.0	7.9	-0.1
February	7.9	7.8	-0.1
March	7.6	7.5	-0.1
April	7.5	7.7	0.2
May	7.7	8.1	0.4
June	7.7	8.6	0.9
July	8.8	8.8	0.0
August	9.0	9.3	0.3
September	9.5	10.5	1.0
October	10.8	10.7	-0.1
November	10.9	10.8	-0.1
December	10.9	11.7	0.8
Jan 2020	12.5	12.5	0.0
February	12.5	13.9	1.4
March	14.1		
April	13.9		
May	13.6		
June	13.3		

Source: Zambia Statistics Agency and Bank of Zambia Compilations

Table 2: Macroeconomic Targets and Outturns: 2018 -2020

	2018 Target	2018 Outturn	2019 Target	2019 Outturn	2020 Target
Real GDP growth rate (%)	4.0	4.0	4.0	2.0*	3.2
CPI Inflation (%), Annual Average	6-8	7.5	6-8	9.1	6-8
Gross International Reserves (months of imports)	3.0	1.8	3.0	2.1	2.5
Broad Money growth (%)	20.7	15.4	10.2	7.9	11.8
Budget deficit (on cash basis, excluding grants), % of GDP	6.1	7.6	6.5	8.2	5.5
Domestic financing of Budget (% of GDP)	4.0	3.2	1.4	3.4*	1.1

Source: Bank of Zambia Compilations, Zambia Statistics Agency, Ministry of Finance
*preliminary estimate

Table 3: Liquidity Influences (K' billion): Jan 2017 – Dec 2019

	Jan-Jun 2017	Jul-Dec 2017	Jan-Jun 2018	Jul-Dec 2018	Jan-Jun 2019	Jul-Dec 2019
Opening balance	2.7	0.3	1.4	1.1	1.4	0.9
Net Government spending	2.5	4.2	2.6	-1.0	-8.1	-3.8
BoZ foreign exchange influence	2.4	2.2	2.5	1.4	3.2	4.2
Change in currency in circulation	0.1	-0.3	-0.2	-0.5	-0.1	-0.3
Change in statutory reserve deposits	-0.8	-3.1	-6.0	-1.9	-0.3	-1.4
Overnight Lending Facility	0.02	-1.6	-2.8	-1.3	0.0	0.7
Net Government securities influence	-5.3	-1.6	3.1	2.6	2.3	3.4
Open market operations	-1.7	1.3	0.1	0.4	1.5	-1.5
Closing balance	0.3	1.4	1.1	1.4	0.9	2.0

Source: Bank of Zambia Compilations

Table 4: Exchange Rate: Jan 2017 – Dec 2019

	Jan-Jun 2017	Jul-Dec 2017	Jan-Jun 2018	Jul-Dec 2018	Jan-Jun 2019	Jul-Dec 2019
ZMW/USD	9.5393	9.5305	9.8241	11.1132	12.4260	13.4107
ZMW/GBP	11.9949	12.5691	13.5113	14.3836	16.0622	16.9035
ZMW/EUR	10.3230	11.2159	11.8850	12.7927	14.0373	14.8728
ZMW/ZAR	0.7218	0.7108	0.7982	0.7836	0.8752	0.9128
Real Trade-weighted Exchange Rate (end-period)						
	Jun 2017	Dec 2017	Jun 2018	Dec 2018	June 2019	Dec 2019
Domestic CPI (2005=100)	291.3	299.0	312.6	322.6	339.6	360.2
Weighted Foreign CPI (2005=100)	141.9	143.2	145.7	146.7	149.3	150.0
NEER	2.81	3.03	3.03	3.45	3.73	4.13
REER Index (2005=100)	104.9	111.2	108.4	120.1	125.8	132.0

Source: Bank of Zambia Compilations

Table 5: Interest Rates (Percent, period average): 2017 – 2019

	2017		2018		2019	
	First Half	Second Half	First Half	Second Half	First Half	Second Half
BoZ Policy Rate (end-period)	12.5	10.25	9.75	9.75	10.25	11.5
Overnight Lending rate (end-period)	18.5	16.25	15.75	15.75	18.0	28.0
Overnight interbank rate	12.2	10.03	9.87	9.87	9.98	11.09
Average commercial banks' lending rate	28.2	28.2	24.2	23.6	25.4	28.0
Savings rate						
more than K100	2.7	2.7	2.8	3.0	3.1	3.0
above K20,000 (180 days)	11.9	11.9	8.1	8.5	10.1	10.1
Treasury bills yield rates						
composite yield rate	14.9	15.06	16.46	20.04	23.55	25.47
91days	15.7	9.92	9.96	13.27	15.59	16.50
182 days	17.4	10.09	11.49	14.69	15.61	18.38
273 days	17.9	11.98	11.60	18.77	23.67	26.38
364 days	19.3	15.98	17.29	21.10	24.60	27.29
Government bond yield rates						
composite yield rate	18.1	18.2	18.56	19.38	28.11	31.08
2 years	21.4	16.5	16.40	19.25	27.66	29.50
3 years	20.9	17.9	17.90	19.22	28.00	29.50
5 years	21	17.8	17.90	20.30	28.83	32.63
7 years	21.6	18.6	18.98	18.74	25.04	25.00
10 years	21.4	19.7	19.50	20.56	26.62	26.38
15 years	23.3	18.7	18.50	17.37	18.33	24.50

Source: Bank of Zambia Compilations

Table 6: Average Annual Non-Banks' Effective Interest Rates (Percent): 2017 – 2019

	1st Half 2017	2nd Half 2017	1st Half 2018	2nd Half 2018	1st Half 2019	2nd Half 2019
Microfinance Institutions	73.4	81.3	82.7	83.1	81.0	81.0
Leasing Finance Institutions	59.1	52.0	28.0	40.5	39.0	39.9
Building Societies	39.5	35.3	28.9	34.91	34.9	34.9
Development Bank of Zambia	25.2	25.2	30.6	26.6	27.1	27.1
National Savings and Credit Bank	31.0	31.0	67.0	67.0	73	73.0
Financial Businesses	33.8	33.8	35.5	35.5	35.5	35.5
Overall for the sector	43.7	43.1	45.5	46.7	48.4	48.6

Source: Bank of Zambia Compilations

Table 7: Domestic Credit (K' billion unless otherwise stated): Jun 2017 – Dec 2019

	Jun 2017	Dec 2017	Jun-2018	Dec-2018	Jun-2019	Dec-2019
Domestic Credit [Gross](DC)	55.5	61.8	63.8	71.1	76.6	83.0
o/w foreign currency denominated	8.1	10.0	10.0	12.9	15.1	22.7
DC (excl. FX denominated credit)	47.4	51.8	53.8	58.2	61.5	60.3
6-month % change in DC	13.4	11.3	3.2	11.4	7.8	8.4
6-month % change in Forex Credit/	-1.2	23.71	0.4	28.8	16.6	16.7
6-Month Change in DC (Excl. Forex Credit)	16.5	9.3	3.8	8.1	5.8	5.5
Annual Change in Domestic Credit	20.4	26.3	15.0	15.0	20.1	16.8

Source: Bank of Zambia Compilations

Table 8: Shares of Total Loans and Advances by Sector (%): Jun 2017 – Dec2019

	Jun 2017	Dec 2017	Jun 2018	Dec 2018	Jun-2019	Dec 2019
Agric, forestry, fishing & hunting	19.6	20.3	18.8	16.9	17.3	16.4
Mining & Quarrying	6.4	6.3	6.7	7.0	6.6	7.4
Manufacturing	10.6	7.8	7.9	9.2	10.7	8.9
Electricity, Gas, Water & Energy	2.2	3.1	2.8	3.0	4.3	4.3
Construction	3.8	4.4	3.9	3.0	2.4	2.2
Wholesale & Retail Trade	10.2	11.4	11.2	11.1	10.7	11.5
Restaurants & Hotels	1.4	1.5	1.3	1.3	1.1	0.9
Transport, Storage & Communications	4.5	4.7	4.7	6.2	7.8	8.8
Financial Services	2.3	2.2	3.0	4.1	2.6	2.1
Community, Social & Personal	4.3	4.1	4.2	4.8	4.7	6.6
Real Estate	3.7	3.5	3.7	3.5	3.3	3.2
Personal Loans	27.2	28.0	29.7	27.9	27.1	23.8
Others	3.9	2.7	2.1	2.1	1.3	3.9

Source: Bank of Zambia Compilations

Table 9: Broad Money (K' billion unless otherwise stated): Jun 2017 – Dec 2019

	Jun 2017	Dec 2017	Jun-2018	Dec-2018	Jun-2019	Dec-2019
Broad Money (M3)	47.8	54.1	53.3	63.0	63.7	70.9
Foreign Exchange (FX) Deposits	16.7	19.4	21.4	25.4	25.9	28.9
M3 (excl. Foreign Exchange Deposits)	31.1	34.6	31.9	37.6	37.8	42.0
6-month change in M3 (%)	7.1	13.2	-1.5	14.0	1.2	11.2
6-month % change in Forex deposits	-1.9	16.5	10.0	18.5	2.3	11.5
6-Month % change in M3 (excl. Forex deposits)	12.9	11.4	-7.9	18.0	0.4	11.1
Annual % change in M3 (%)	8.3	21.4	15.6	16.5	15.4	12.5
Annual % change in Forex deposits	-8.9	13.7	28.1	30.4	21.2	14.0
Annual % change in M3 (excl. Forex Deposits)	20.6	26.0	2.6	8.7	18.5	11.6

Source: Bank of Zambia Compilations

Table 10: Trade Data (c.i.f - US$ million): Jan 2017 – Dec 2019

	Jan-Jun 2017	Jul-Dec 2017	Jan-Jun 2018	Jul-Dec 2018	Jan-Jun 2019	Jul-Dec 2019
Trade Balance	-250.5	-311.3	-86.8	-357.0	223.8	69.4
Total Exports, c.i.f. (including Gold)	3,758.6	4,453.9	4,610.0	4,407.9	3,909.9	3,604.5
General Exports, f.o.b	3,674.2	4,382.3	4,530.3	4,339.6	3820.7	3497.5
Metals	2,908.0	3,382.4	3,619.3	3,179.2	2,755.5	2,281.7
Copper	2,857.8	3,307.8	3,548.8	3,130.7	2,752.2	2,242.3
Cobalt	50.2	74.6	70.5	48.5	3.3	39.4
Non-Traditional Exports	766.2	999.9	911.0	1,160.4	1,065.2	1,215.8
Exporter Audit Adjustor	-13.2	-13.2	-13.2	-13.2	0.0	0.0
Sub Total	779.4	1,013.0	924.1	1,173.6	1,065.2	1,215.8
Gemstones	49.1	4.9	5.1	5.6	63.0	86.4
Sulphuric acid	25.0	47.6	84.8	86.5	95.1	53.7
Industrial Boilers and Equipment	36.0	43.9	59.7	66.8	80.2	59.0
Cane Sugar	72.7	64.3	55.5	69.3	66.8	75.0
Gasoil/Petroleum Oils	4.2	3.8	4.5	5.1	4.1	3.5
Cement & Lime	34.5	40.0	43.7	70.0	71.9	95.3
Electricity	35.8	33.6	33.7	49.3	38.2	30.4
Raw hides, Skins & Leather	4.1	5.0	1.1	4.3	1.8	2.9
Sulphur sublimed or precipitated; colloidal	0.0	0.0	0.0	0.1	0.2	0.0
Burley Tobacco	51.7	36.8	42.3	62.3	28.5	41.7
Copper Wire	43.2	42.1	35.2	43.7	34.6	16.3
Scrap of precious metals	0.2	0.2	1.2	0.3	0.7	1.4
Maize & Maize Seed	25.4	72.2	18.4	26.0	10.7	25.7
Electrical Cables	9.1	10.9	13.6	7.6	11.2	5.3
Cotton Lint	13.7	24.6	12.0	37.2	21.2	32.0
Soap, Active Agents, Washing Preps.	21.4	24.5	25.4	27.7	21.6	33.5
Fresh Fruits & Vegetables	6.0	8.7	7.6	5.4	4.4	5.0
Manganese Ores/Concentrates	22.0	9.3	9.7	17.2	7.6	10.4
Wheat & Meslin	0.4	0.0	0.0	0.0	0.0	0.0
Fresh Flowers	6.3	4.6	6.4	3.7	4.6	4.6
Other	326.4	536.0	464.1	585.4	498.6	633.1
Gold	84.4	71.6	79.7	68.3	89.2	107.2
Imports c.i.f./1	-4,009.1	-4,765.2	-4,696.8	-4,764.8	-3,686.1	-3,535.2

Source: Bank of Zambia Compilations

Table 11: Metal Export Volumes, Values and Prices: Jan 2016 – Dec 2019

	Copper				Cobalt			
	Export Volumes (mt)	Export US $'000	Price/ Tonne	Price/ Pound	Export Volumes (mt)	Export US $'000	Price/ Tonne	Price/ Pound
Jan–Jun 2016	463,290.1	2,098,998.5	4,530.6	2.1	2,344.0	42,624.9	18,184.6	8.2
Quarter 3	221,929.8	1,031,762.2	4,649.1	2.1	1,326.0	33,396.8	25.186.1	11.4
Quarter 4	246,147.8	1,253,097.0	5,090.8	2.3	1,392.0	37,891.0	27,220.6	12.3
Jul-Dec 2016	468,077.6	2,284,859.2	4,881.4	2.2	2,718.0	71,287.8	26,228.0	11.9
Quarter 1	259,675.9	1,429,496.8	5,504.9	2.5	602.8	26,683.6	44,264.9	19.8
Quarter 2	253,428.0	1,428,281.5	5,635.8	2.6	652.2	23,504.8	36,040.6	23.3
Jan-Jun 2017	513,104.0	2,857,778.4	5,569.6	2.5	1,255.0	50,188.4	39,991.0	21.6
Quarter 3	231,858.4	1,450,945.6	6,257.9	2.8	726.0	41,054.3	56,548.7	25.7
Quarter 4	278,897.3	1,856,875.8	6,657.9	3.0	609.0	39,067.4	64,150.2	29.1
Jul-Dec 2017	510,755.2	3,307,820.9	6,476.3	2.9	1,335.0	80,121.8	60,016.3	27.2
Quarter 1	272,106.4	1,907,609.7	7,010.5	3.2	397.0	32,256.1	81,244.0	36.9
Quarter 2	253,774.4	1,641,198.3	6,467.2	2.9	462.0	38,222.7	82,733.2	37.5
Jan-Jun 2018	525,880.7	3,548,808.0	6,748.3	3.1	859.0	70,478.8	82,044.9	37.2
Quarter 3	275,352.9	1,628,639.4	5,914.7	2.7	429.0	28,681.8	66,857.5	30.3
Quarter 4	244,753.5	1,502,029.9	6,136.9	2.8	478.2	19,848.6	41,510.3	18.8
Jul-Dec 2018	520,106.3	3,130,669.3	6,019.3	2.7	907.2	48,530.4	53,497.1	24.3
Quarter 1	236,434.7	1,431,902.6	6,056.2	2.7	66.0	3,314.4	50,217.9	22.8
Quarter 2	212,614.6	1,320,268.4	6,209.7	2.8	0.0	0.0	n.a	n.a
Jan-Jun 2019	449,049.3	2,752,171.1	6,128.9	2.8	66.0	3,314.4	50,217.9	22.8
Quarter 3	174,325.6	1,013,727.7	5,815.1	2.6	0.0	0.0	n.a	n.a
Quarter 4	212,859.0	1,228,572.9	5,771.8	2.6	1,205.3	39,371.3	32,664.5	14.8
Jul-Dec 2019	387,184.6	2,242,300.6	5,791.3	2.6	66.0	3,314.4	50,217.9	22.8

Source: Bank of Zambia Compilations

Table 12: Imports by Commodity Groups (c.i.f - US$ million): Jan 2017 – Dec 2019

	Jan-Jun 2017	Jul-Dec 2017	Jan-Jun 2018	Jul-Dec 2018	Jan-Jun 2019	July-Dec 2019
Food Items	224.7	286.4	255.9	258.9	235.9	300.0
Petroleum Products	518.1	649.6	674.9	664.9	648.5	608.7
Fertilizer	303.5	237.3	186.9	244.5	104.3	231.9
Chemicals	503.5	961.4	504.3	492.6	470.6	381.9
Plastic and Rubber Products	175.2	208.6	224.7	247.4	212.4	228.0
Paper and paper products	58.7	56.1	58.0	74.8	51.5	78.2
Iron and Steel and items thereof	173.5	244.4	276.6	289.0	243.7	247.0
Industrial Boilers and Equipment	562.4	568.0	676.8	713.0	606.9	528.1
Electrical Machinery & Equipment	222.1	222.3	346.5	242.6	222.5	217.8
Vehicles	222.8	257.9	364.1	439.3	304.5	278.6
Ores, Slag and Ash	437.9	589.4	657.5	614.0	138.9	20.7
Other Imports	606.9	483.9	470.6	484.1	446.3	414.2
Total	4,009.1	4,765.2	4,696.8	4,765.1	3,686.1	3,535.2

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

Table 13: Government Budget (K'bn): Jan 2018 - Jun 2019

	Second Half 2018		First Half 2019		Second Half 2019	
	Target	**Prel**	**Target**	**Prel**	**Target**	**Prel**
Total Revenue & Grants	26.2	28.2	30.1	32.6	28.0	28.8
Tax Revenue	20.9	23.0	24.8	25.1	22.8	23.3
Non-Tax Revenue	4.1	4.9	4.6	7.0	4.8	5.2
Grants	1.2	0.4	0.6	0.5	0.4	0.4
Total Expenditure	37.5	37.2	43.1	46.1	44.1	42.0
Current Expenditure	28.0	25.7	27.2	26.1	33.3	31.0
Personal Emoluments	11.7	11.4	12.9	11.2	12.4	11.8
Use of Goods & Services	4.3	2.9	2.3	1.9	1.4	2.2
Interest	5.8	7.2	7.3	9.2	7.9	8.8
Grants & Other Payments	4.3	3.5	3.7	3.4	10.5	7.8
Social Benefits	0.9	0.4	0.7	0.1	0.9	0.1
Other Expenses	0.9	0.4	0.4	0.2	0.4	0.3
Liabilities	0.6	0.3	0.3	0.0	0.2	0.2
Assets	7.2	8.2	11.1	14.3	10.5	10.7
Non- Financial Assets	6.9	8.2	11.0	14.3	10.4	10.7
Financial Assets	0.2	0.0	0.0	0.0	0.1	0.0
Change in Balances & Statistical discrepancy	0.3	0.2	1.5	1.0	-2.4	0.5
Fiscal Balance	-9.6	-6.0	-8.5	-7.9	-16.1	-13.1
Financing	9.6	6.1	10.0	8.8	13.8	13.6
Net Domestic	6.5	3.1	2.9	0.2	7.2	7.4
Net Foreign (net)	3.1	3.0	7.1	8.6	6.6	6.3

Source: Ministry of Finance