



BANK *Of* ZAMBIA

**QUARTERLY SURVEY OF BUSINESS
OPINIONS AND EXPECTATIONS
REPORT**

Second Quarter 2018, Vol 2.2

Disclaimer:

The opinions and expectations presented herein are of the respondents and not of the Bank of Zambia.

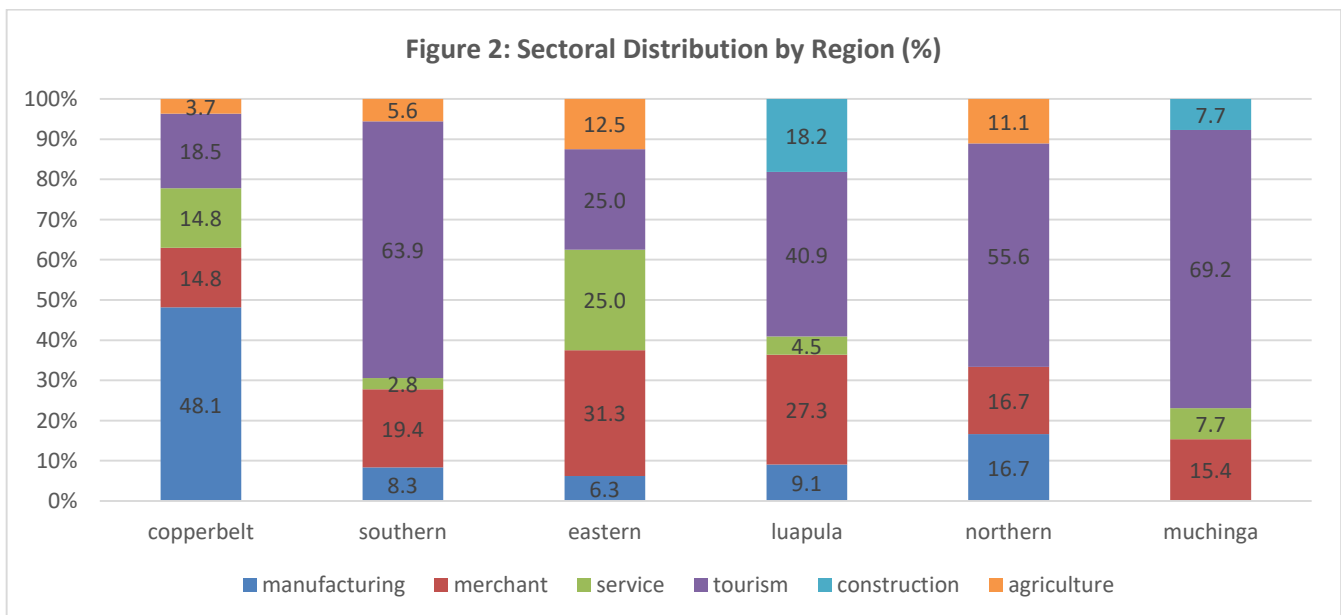
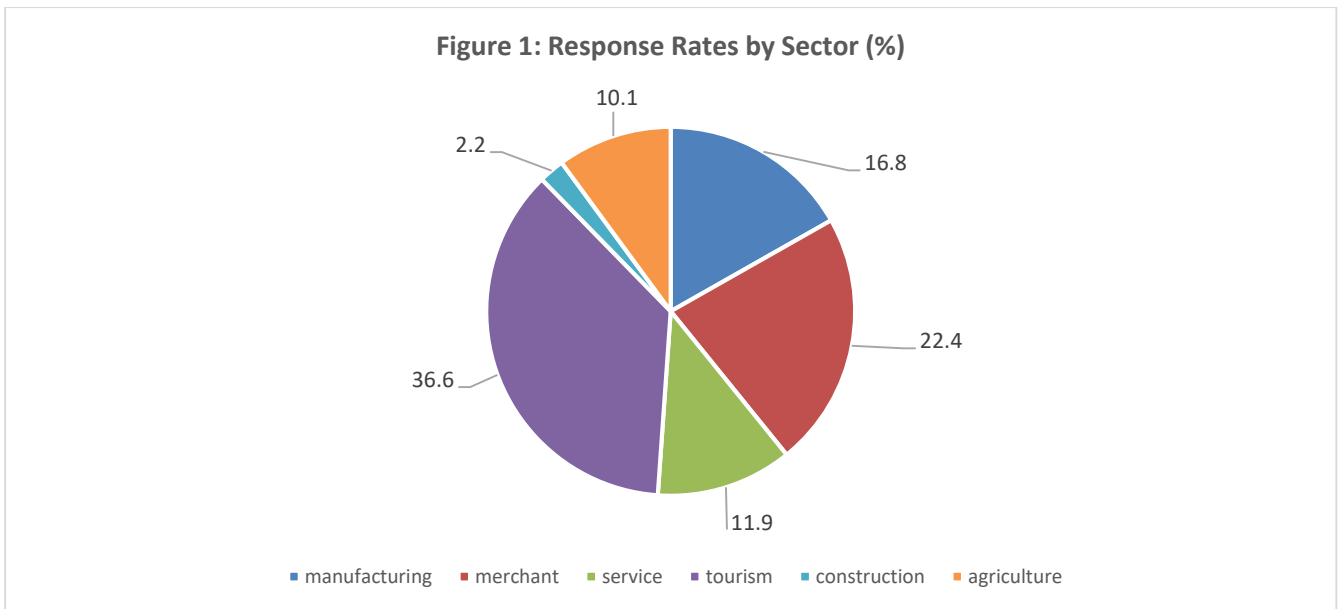
JULY 2018

PREFACE

The Quarterly Survey of Business Opinions and Expectations (QSBOEs) undertaken by the Bank of Zambia is designed as a supplementary tool to provide information on the business community’s opinions and expectations about the current and future direction of the economy.

The business opinions and expectations survey provides useful indications about current and future economic activity and assists in the formulation of decisions today that impact on future economic performance. The survey provides a guide to likely future developments because of the dominant role expectations play in shaping economic behaviour.

This Report is based on the results of the QSBOEs conducted from May - June 2018. A total of 297 questionnaires were distributed. Of these, 268 firms responded, thus representing a response rate of 90.2%. Of the 268 firms that responded, 26.6% were from tourism and 22.4% were merchants (see Figures 1 and 2).



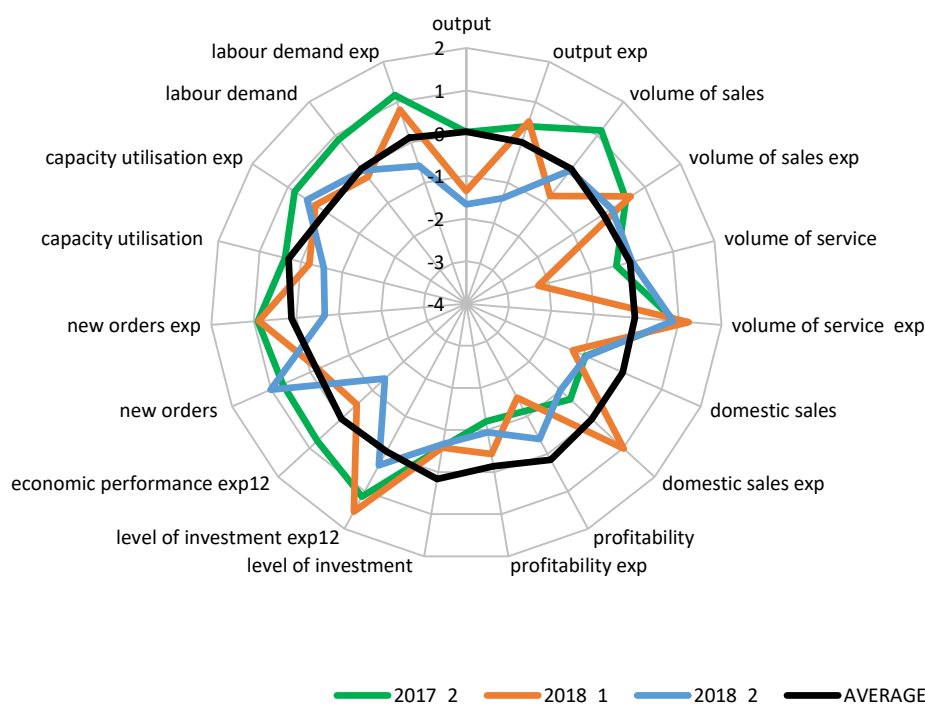
Executive Summary¹

The Survey of Business Opinions and Expectations for the second quarter of 2018 showed an improvement in economic activity compared to the first quarter. With the exception of output and capacity utilisation, all the monitored variables were above their first quarter levels, although below their long term average performance. Profitability, new orders, volume of sales, volume of service, domestic sales, level of investment and labour demand were all above their first quarter 2018 levels.

The outlook for the third quarter, however, indicates a decline in economic performance, as reflected in labour demand, output, domestic sales, new orders and profitability which are all expected to be lower than the previous quarter. The anticipated deterioration is mainly on account of low demand due to competition from cheap imports, high cost of raw materials as well as the partial drought, which negatively affected the agricultural sector output. Nonetheless, capacity utilisation and new orders are expected to perform better than the previous quarter, thereby providing positive sentiments towards the economy.

Respondents' expectations indicate that economic performance would remain subdued over the next 12 months. This is premised on poor agricultural performance in the 2017/2018 agricultural season, high unemployment, high levels of government debt, high cost of investment finance, competition from cheap imports, high taxes and policy inconsistencies by Government (see Figure 3).

Figure 3: Overall Survey Response Patterns*



*Note: The survey indicators are standardised net balances with mean=0 and standard deviation=1. A value within the black circle entails weaker economic conditions than historical average and a value outside the black line is better than historical average.

¹ This Report presents findings of the Quarterly Survey of Business Opinions and Expectations conducted during the second quarter of 2018. The results are based on responses from 268 firms of the 297 questionnaires distributed, covering manufacturing, merchants, tourism and services, agriculture and construction sectors. This outturn represented a response rate of 90.2%.

Introduction

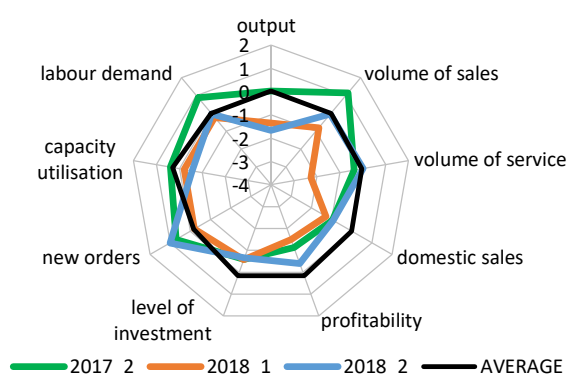
This Business Opinions and Expectations Survey Report is divided into four sections. The first section presents the response patterns related to economic performance during the second quarter of 2018 and expectations for the third quarter, while section II presents opinions and expectations on input costs, wages and selling prices, among other variables. Section III provides third quarter 2018 perceptions on variables that influence monetary policy, while section IV provides the general conclusion.

I. Opinions and expectations of economic activity

Economic Activity declined in Q1 2018

In the last report, respondents expected economic performance in the second quarter of 2018 to improve. Consistent with this, the overall response pattern from this survey for the second quarter indicated that economic activity improved. This was reflected in an increase in profitability, new orders, volume of sales, volume of service, domestic sales, level of investment and labour demand which were all above the first quarter 2018 level, although below the long term average performance. This notwithstanding, capacity utilisation and output remained subdued during the quarter under review (see Chart 1).

Chart 1: Business Opinions Response Patterns

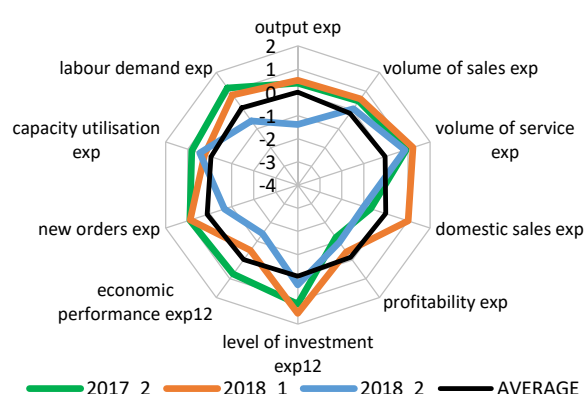


Expectations for the third quarter of 2018, however, showed weaker economic performance, as reflected in labour demand, output, domestic

sales, new orders and profitability, compared to expectations for the second quarter.

Further, economic performance is expected to remain subdued over the next 12 months. This is mainly attributed to poor agriculture performance in the 2017/2018 farming season, high unemployment, high levels of government debt, high cost of investment finance, competition from cheap imports, high taxes and policy inconsistencies by Government (see Chart 2).

Chart 2: Business Expectations Response Patterns



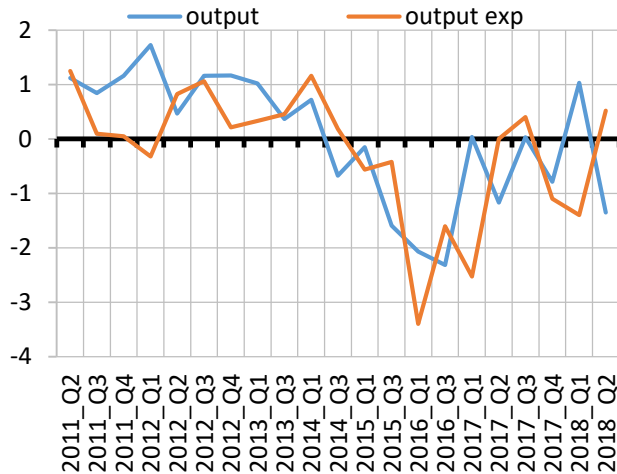
Q: What has been your firm's experience with respect to output?

(Net balance, -27.1 %; Q1 2018, -22.6%)

Output declined during the quarter under review and was below the historical average. This was mainly on account of low demand due to competition from cheap imports, high cost of raw materials as well as the partial drought, which negatively affected the agriculture sector output.

Expectations for the third quarter, however, showed an increase in output, mainly attributed to increased availability of raw materials, foreign investment in the manufacturing sector and an anticipated rise in demand stimulated by sales of agricultural produce during the 2018/2019 agricultural marketing season (see Chart 3).

Chart 3: Opinion on Output

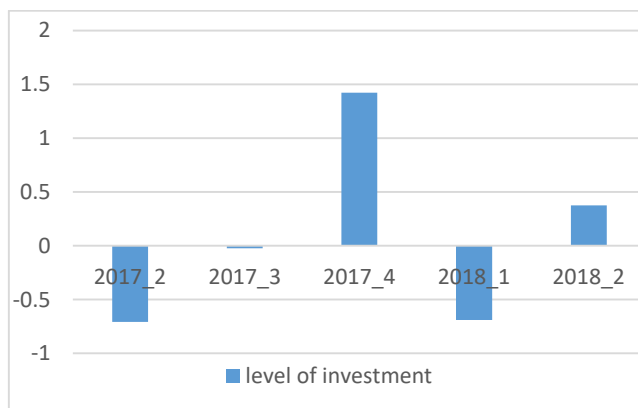


Q: How was your firm's level of investment?

(Net balance, 8.6%; Q1 2018 -9.0%)

Respondents indicated that total investment increased during the second quarter of 2018 in comparison with the first quarter. This was mainly attributed to business expansions in the manufacturing sector as well as replacement of farm equipment and an increase in area planted in the agriculture sector (see Chart 4).

Chart 4: Level of investment



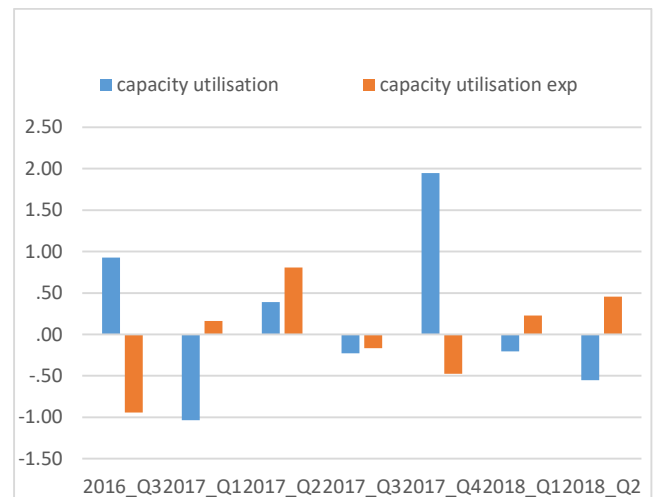
Q: What has been your firm's experience with respect to capacity utilisation?

(Net balance, -18.4%; Q1 2018, -14.3%)

Capacity utilisation, however, decreased during the second quarter of 2018 compared to the first quarter, as indicated by most respondents. This was mainly on account of low demand, stiff competition and high cost of raw materials in the manufacturing sector.

Capacity utilisation is expected to improve in the third quarter of 2018 due to an anticipated increase in consumer demand, largely attributed to an increase in income in the agriculture sector during the crop marketing season (see Chart 5).

Chart 5: Capacity Utilisation



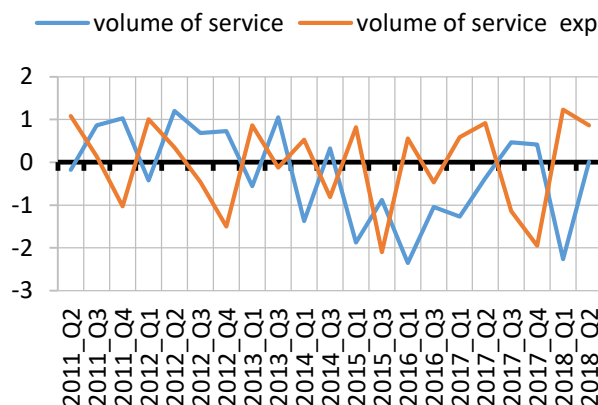
Q: What has been your firm's experience with respect to volume of service?

(Net balance, -33.1%; Q1 2018, -45.7%)

Volume of service improved during the second quarter of 2018, although it remained below the long term average. This was mainly due to the peak tourism season as well as increased demand for transportation and banking services during the harvest period.

In the third quarter, the volume of service is expected to decline, as the demand for tourism services slows down. Nonetheless, volume of service is expected to remain above the long term average during this period (see Chart 6).

Chart 6: Volume of Service



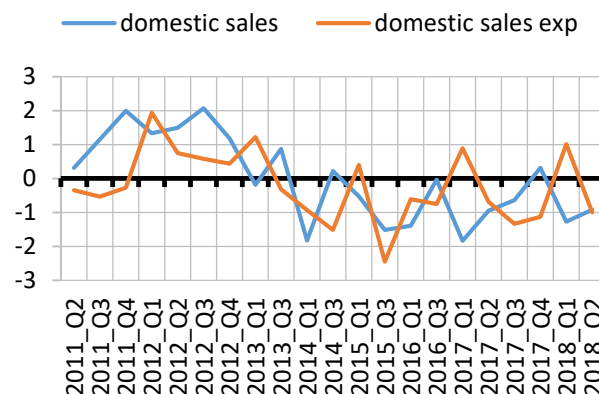
Q: What has been your firm's experience with respect to domestic sales?

(Net balance, -20.3%; Q1 2018, -26.2%)

Domestic sales improved during the second quarter of 2018, but remained below the historical average. This was largely due to increased output of cooking oil and mealie-meal following the commencement of the agricultural marketing season as well as increased output of vegetables i.e. tomatoes (see Chart 7).

During the third quarter, however, domestic sales are expected to decline, largely due to an expected fall in maize stocks held by millers following the low agricultural output.

Chart 7: Domestic Sales



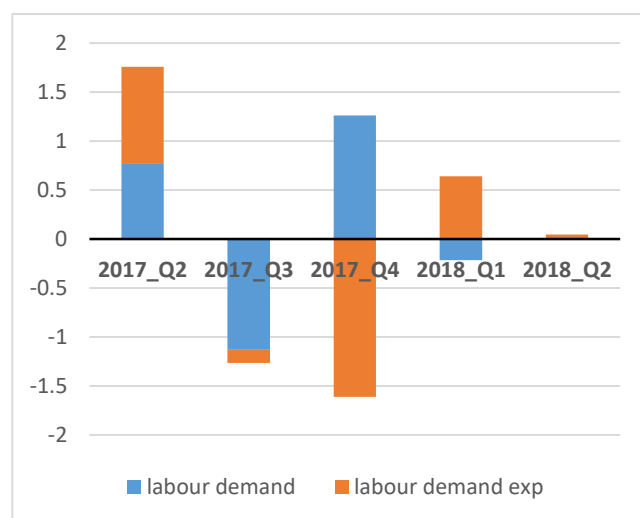
Q: How do you rate your firm's labour demand?

(Net balance, -1.0%; Q1 2018 -1.8%)

Labour demand increased during the second quarter of 2018. This was mainly attributed to the agricultural harvest, rise in tourism activities during the peak tourism period, new projects in the construction sector as well as increased sales by merchants.

During the third quarter, demand for labour is expected to decline, largely due to increased mechanisation, close of the harvest period and completion of some projects in the construction sector and (see Chart 8).

Chart 8: Labour Demand



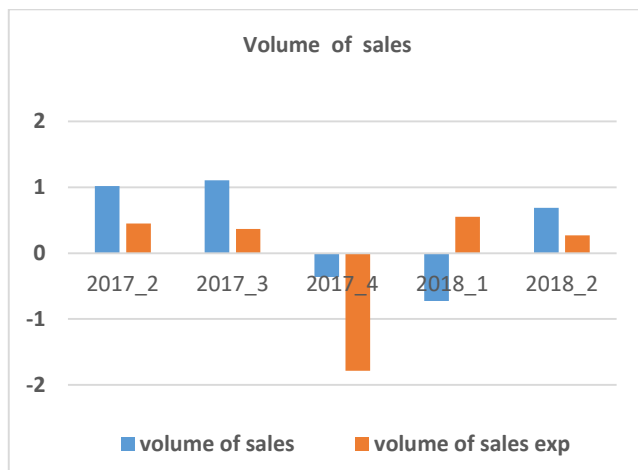
Q: What has been your firm's experience with respect to volume of sales?

(Net balance, -7.9%; Q1 2018, -48.3%)

Volume of sales improved during the quarter under review compared to the first quarter. This was mainly attributed to opening of new outlets by some chain stores, increased demand for winter clothes as well as increased demand for goods emanating from a rise in incomes stimulated by sales of agricultural produce.

Volume of sales is, however, expected to decline in the third quarter, largely on account of low demand resulting from an anticipated depreciation of the Kwacha (see Chart 9).

Chart 9: Volume of Sales



Q: What is your current main source of investment finance and working capital?

Main source of financing remained retained earnings

During the quarter under review, retained earnings remained the main source of investment finance and working capital, with 66.4% (69.2%)² and 68.2% (72.7%) of respondents indicating so, respectively. This was followed by bank borrowing at 19.8% (16.5%) and 18.4% (14.8%), respectively (see Charts 10A and 10B).

² Figures in brackets are for Q1 2018

Chart 10A: Sources of Investment Finance

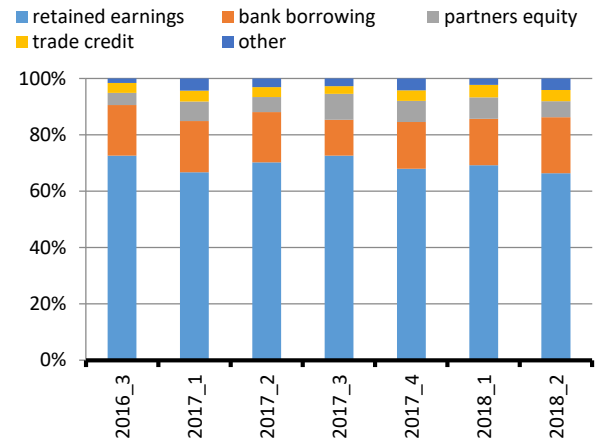
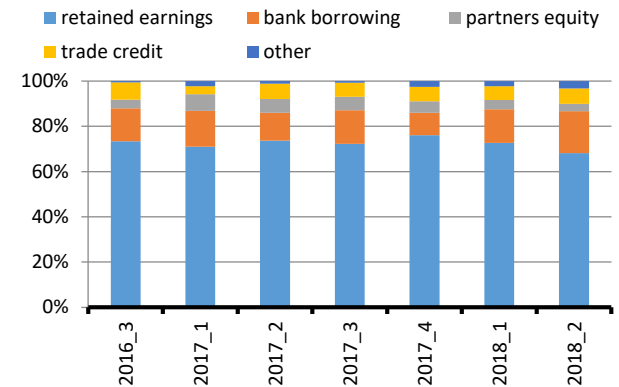


Chart 10B: Sources of Working Capital



Q: What is your perception of the current availability of credit?

(Net balance, 66.4%; Q1 2018, 63.4%)

Respondents indicated that they continued to observe tight credit conditions during the second quarter of 2018. This was mainly premised on increased Government appetite to borrow domestically, stringent collateral requirements and high stock of non-performing loans (NPLs) (see Chart 11).

Chart 11: Credit conditions and lending rates

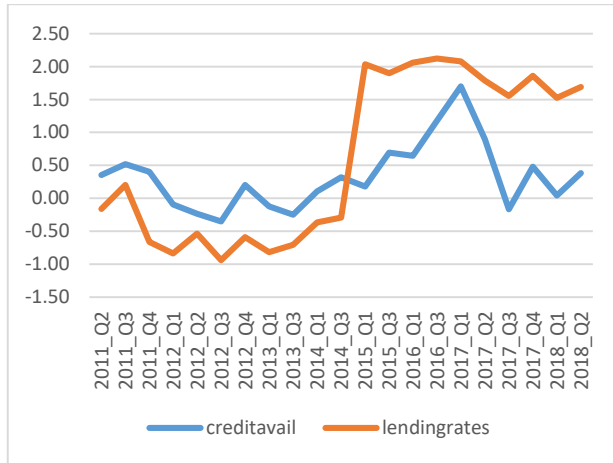
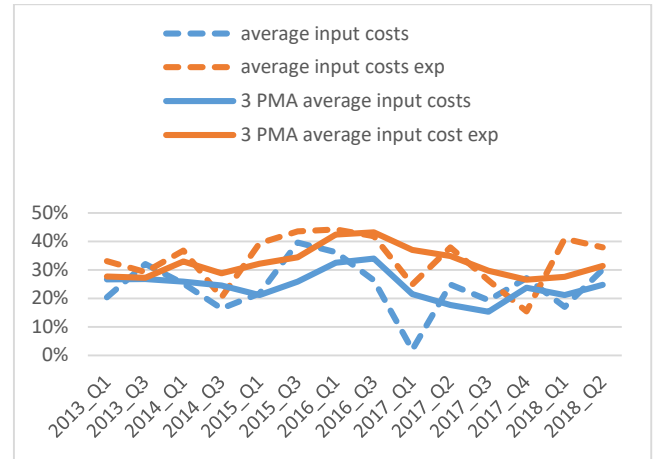


Chart 12: Average input costs



II EVOLUTION OF COSTS, WAGES AND PRICES

Q: What has been your firm’s experience during the quarter under review with respect to average input costs?

(Net balance, 30.1%; Q1 2018, 17.0%)

During the quarter under review, respondents recorded an increase in average input costs. This was largely on account of the exchange rate depreciation observed in the second quarter, annual salary increments, toll fees and the newly introduced borehole fees. In addition, a rise in maize prices due to low supply contributed to high average input costs (see Chart 12).

Although input costs are expected to decline in the third quarter of 2018, they are expected to remain above the historical average. The anticipated depreciation in the exchange rate of the Kwacha against the US dollar, high tax rates, annual salary upward adjustments, increased cost of maintenance in tourism infrastructure as well as high electricity and water tariffs largely explained the expected high average input costs.

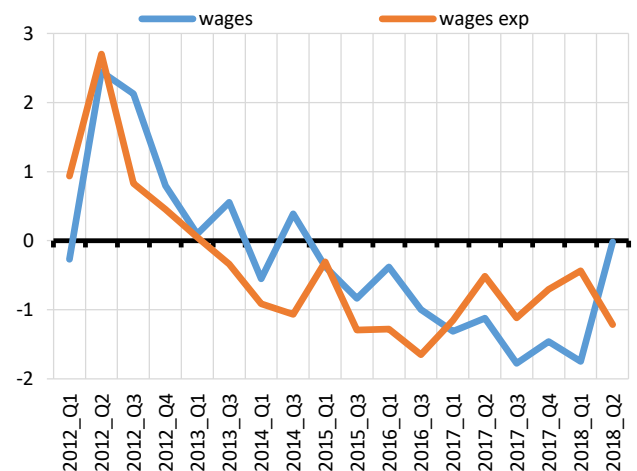
Q: What has been your firm’s experience with respect to the wage bill?

(Net balance, 15.1%; Q1 2018, 1.3%)

The wage bill increased during the second quarter of 2018 compared to the first quarter. This was mainly attributed to annual salary upward adjustments, opening of new outlets by some chain stores, agricultural harvest period, tourism peak period and diversification activities.

In the third quarter, however, the wage bill is expected to decline as the agricultural harvest period closes (see Chart 13).

Chart 13: Evolution of wages



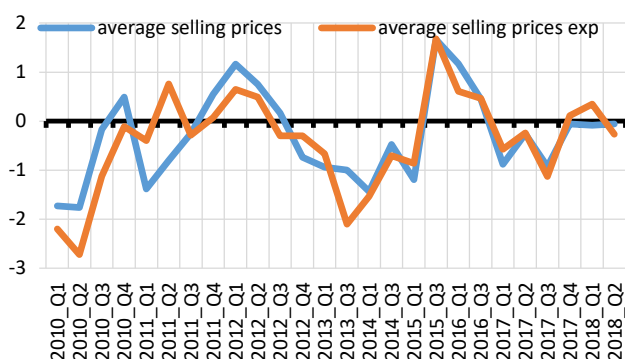
Q: What has been your firm's experience during the quarter under review with respect to average selling prices?

(Net balance, 0.0%; Q1 2018, -0.88%)

Average selling prices increased slightly during the second quarter of 2018 in comparison to the first quarter. This was largely due to the depreciation of the Kwacha against the US Dollar, the reduction in maize supply on the market, the rise in input costs and an upward revision of bank charges by some commercial banks (see Chart 14).

In the third quarter, however, average selling prices are expected to decline on account of stiff competition from informal traders and cheaper tourist accommodation in neighbouring Zimbabwe. In addition, continued importation of cheaper Chinese goods is expected to further stiffen the competition for local manufacturing companies.

Chart 14: Evolution of average selling prices



Q: What has been your firm's experience with respect to profitability?

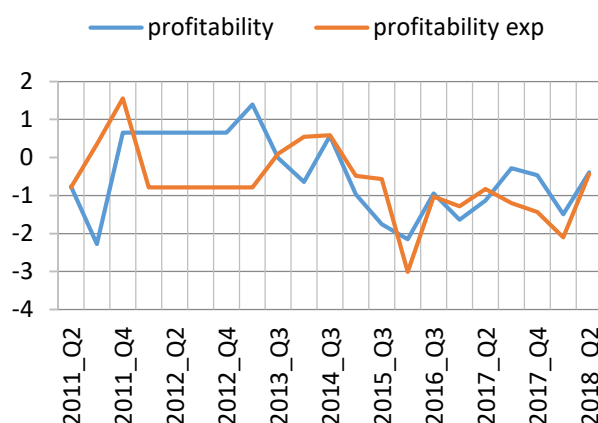
(Net balance, -21.4%; Q1 2018, -43.9%)

Most respondents reported an increase in profitability during the second quarter of 2018. This was mainly due to increased tourism activities during the peak period and sales volume in the merchant sector. The increase in pay TV subscriptions during the football world cup and interest receipts in the banking sector also,

contributed to the registered increase in profitability.

Similarly, profitability is expected to rise in the third quarter, mainly resulting from a continued increase in tourism activities, improvement in marketing strategies for some business entities and an anticipated rise in agricultural inputs into the manufacturing sector during the 2017/2018 marketing season (see Chart 15).

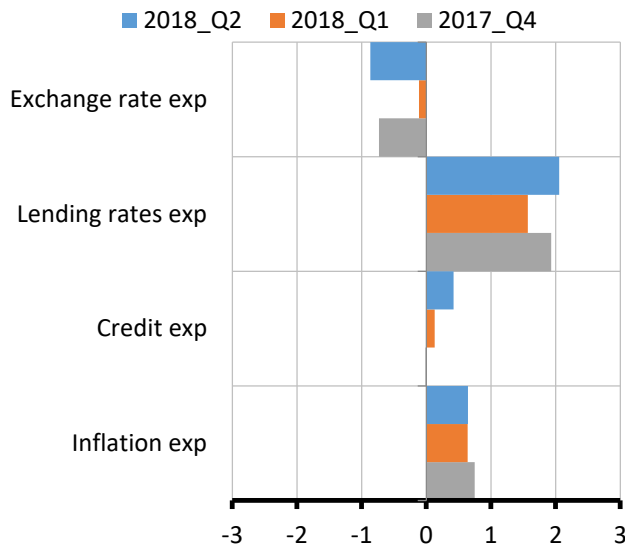
Chart 15: Profitability



III EXPECTATIONS ON MONETARY POLICY FOR THIRD QUARTER 2018

Expectations for the third quarter of 2018 showed stable inflation, higher lending rates, a depreciation in the exchange rate and tighter credit conditions (see Chart 16).

Chart 16: Expectations of stable inflation, weaker Kwacha, tighter credit conditions and higher lending rates



Notes:

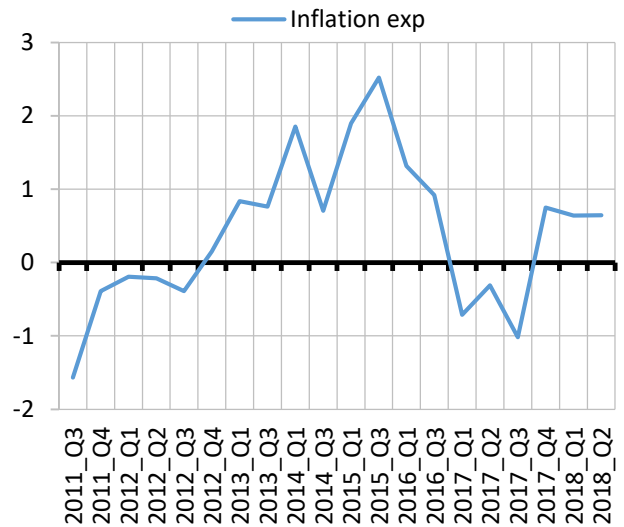
- Exchange rate = appreciation, strong (+)/depreciate, weak (-)
- Lending rates = increase, high (+)/decrease, low (-)
- Credit conditions = tight (+)/loose (-)
- Inflation expectations = increase, high (+)/decrease, low (-)

Q: Over the next quarter what do you expect the price level to be?

(Net balance, 47.8%; Q1 2018, 48.1%)

Inflationary pressures are expected to remain stable during the third quarter of 2018, mainly on account of increased supply of agricultural produce on the market, expected implementation of austerity measures aimed at reducing Government domestic borrowing and a general improvement in the business environment in the economy (see Chart 17).

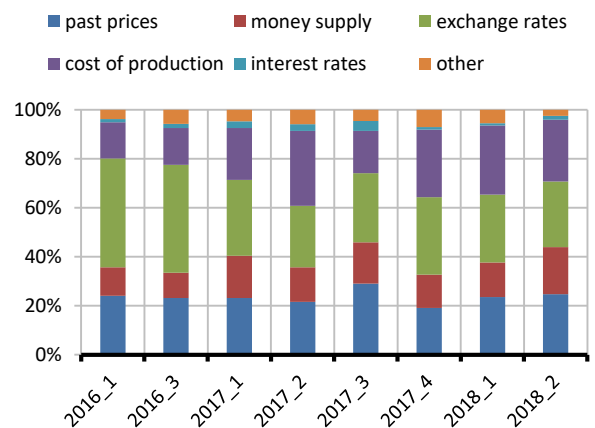
Chart 17: Inflationary expectations above historical average in Q2 2018



Q: Which is the main factor explaining your expectations of inflation?

The majority of the respondents indicated that the main driver of inflationary expectations was the exchange rate, as indicated by 26.8% of the firms compared to 27.7% in the first quarter. This was followed by cost of production at 25.2% (28.2%), past prices at 24.8% (23.6%) and money supply at 19.2% (14.1%) (see Chart 18).

Chart 18: Inflationary expectations mainly driven by the exchange rate and cost of production

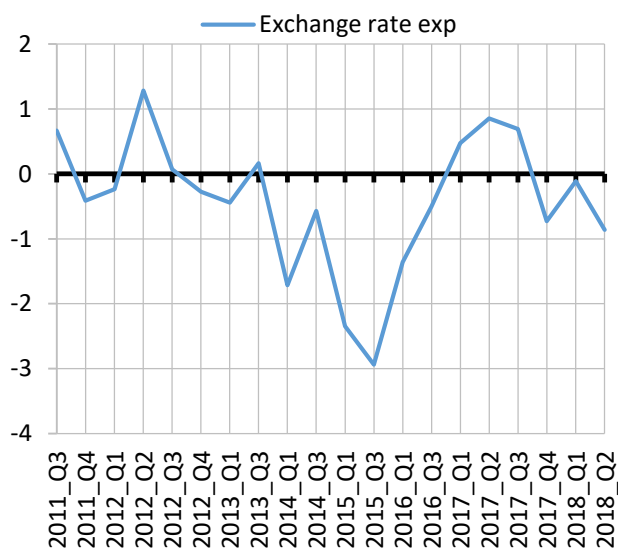


**Q: What do you expect the value of the
Zambian Kwacha against the US
Dollar to be at the end of the next
quarter?**

(Net balance, -36.0%; Q1 2018, -16.5%)

The respondents expected the Zambian Kwacha to depreciate against the US Dollar in the third quarter of 2018. This is mainly premised on perceived deterioration in foreign reserves against high foreign debt payments, huge imports of raw materials and rising oil prices on the international market. In addition, low export earnings coupled with increased trade barriers on agricultural exports and low FDI inflows due to reduced investor confidence are expected to impact negatively on the exchange rate (see Chart 19).

Chart 19: Exchange rate expectations next quarter



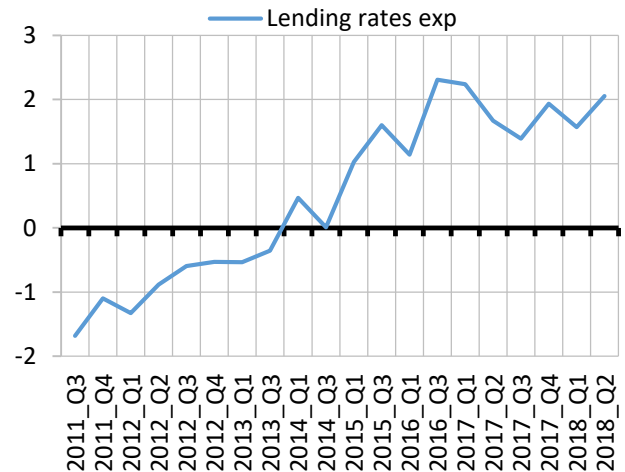
**Q: Over the next quarter, what do you
expect to happen to commercial banks' lending
interest rates?**

(Net balance, 76.2%; Q1 2018, 61.8%)

Commercial banks' lending rates are expected to rise during the third quarter. This is largely due to high Government domestic borrowing, rising stock of Non-

Performing Loans (NPLs), anticipated exchange rate depreciation and low levels of liquidity in the economy (see Chart 20).

Chart 20: Interest rate expectations next quarter

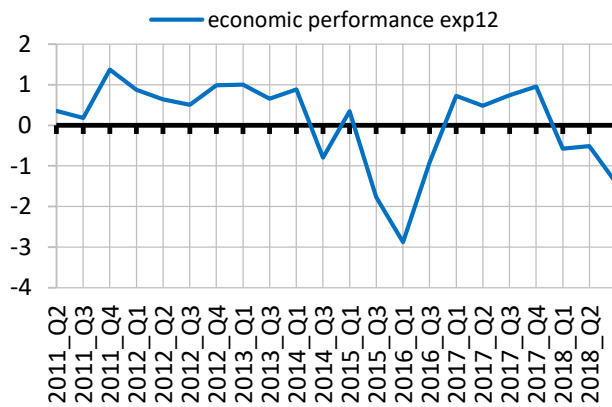


**Q: What is your expectation of the
performance of the Zambian economy in the
next 12 months?**

(Net balance, -6.6%; Q1 2018, 12.5%)

Over the next 12 months, general economic performance is expected to deteriorate, largely due to the widening fiscal deficit, high Government debt, poor agricultural performance and low commodity prices as well as a slowdown in manufacturing activities. This will be exacerbated by the anticipated rise in oil prices on the international market, exchange rate depreciation, high taxes and energy costs, high unemployment, low export earnings and increased political interference in economic management (see Chart 22).

Chart 22: Economic performance in next 12 months



international market, exchange rate depreciation, high taxes and energy costs, high unemployment, low export earnings and increased political interference in economic management.

IV CONCLUSION

The Survey of Business Opinions and Expectations conducted in the second quarter of 2018 showed an improvement in economic activity. All the variables, with the exception of capacity utilisation and output, improved in comparison to the first quarter of 2018. Profitability, new orders, volume of sales, volume of service, domestic sales, level of investment and labour demand were above the previous quarter's levels.

The outlook for the third quarter indicated weaker economic performance compared to the second quarter. This was reflected in labour demand, output, domestic sales, new orders and profitability, which were projected below the second quarter and their historical average levels.

Inflation is, however, expected to remain stable during the third quarter, mainly on account of increased supply of agricultural produce on the market, expected implementation of austerity measures aimed at reducing Government domestic borrowing and a general improvement in the business environment in the economy.

Over the next 12 months, economic activity is expected to remain subdued largely due to the widening fiscal deficit, high Government debt, poor agricultural performance and low commodity prices as well as a slowdown in manufacturing activities. This will be exacerbated by the anticipated rise in oil prices on the

Appendix I: Background on the QSBOEs

This Report is based on the results of the QSBOEs conducted from May - June 2018. Out of the 297 questionnaires distributed, 268 firms responded, representing a response rate of 90.2%.

Survey Methodology

Data collection for the Quarterly Survey of Business Opinions and Expectations is done by means of a questionnaire which is designed to capture information on economic performance, sources of finance and operational constraints for the current quarter as well as expectations for the following quarter and the following 12 months. The questionnaire is administered to a sample of respondents in manufacturing, trading, tourism and services, construction and agriculture sectors. The sectors covered were selected on the basis of their contribution to GDP.

The Survey covers the Copperbelt towns of Luanshya, Ndola, Kitwe and Chingola, Southern (Mazabuka, Choma, Kalomo and Livingstone), Central (Chisamba, Kabwe and Mkushi Farming Block), Eastern (Petauke, Chipata and Mfuwe), North-Western (Kasempa and Solwezi), Northern (Kasama, Mbala and Mpulungu), Muchinga (Mpika, Chinsali, Isoka and Nakonde), Luapula (Samfya and Mansa) and Lusaka (Lusaka and Kafue). Data analysis is done using the Net Balance Statistic (N) where qualitative responses are converted into quantitative measures using the following equation:

$$N = \frac{U - D}{U + D + S} * 100$$

Where U , D and S represent the number of respondents indicating Up, Down and Same, respectively.

The Net Balance Statistic method has the advantage of detecting the directional changes in performance/expectations of respondents in such surveys. The method indicates the predominance of either an improvement or deterioration in a

variable. A positive net percentage indicates that more respondents reported/ expected an increase/ improvement/ tightening and a negative net percentage means a decrease/ deterioration/ loosening, depending on the variable under consideration. This method has been used widely in the analysis of survey data.