BANK *Of* ZAMBIA

QUARTERLY SURVEY OF BUSINESS OPINIONS AND EXPECTATIONS REPORT

Fourth Quarter 2018, Vol 2.4

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

FEBRUARY 2019

PREFACE

The Quarterly Survey of Business Opinions and Expectations (QSBOEs) provides useful indications about current and future economic activity and assists in the formulation of decisions today that impact on future economic performance. Given the dominant role expectations play in shaping economic behaviour, the survey provides a guide to likely future developments.

Accordingly, the Survey undertaken by the Bank of Zambia is designed as a supplementary tool to providing information on the business community's opinions and expectations about the current and future direction of the economy.

This Report is based on the results of the QSBOEs conducted from December 2018 – January 2019. A total of 283 questionnaires were distributed. Of these, 244 firms responded, thus representing a response rate of 86.2%. Of the 244 firms that responded, 36.5% were tourist operators, 23.4% were merchants, 18.4% manufacturers, 11.1% farmers while 1.2% were from the construction sector (see Figures 1 and 2).

Figure 1: Response Rates by Sector (%)

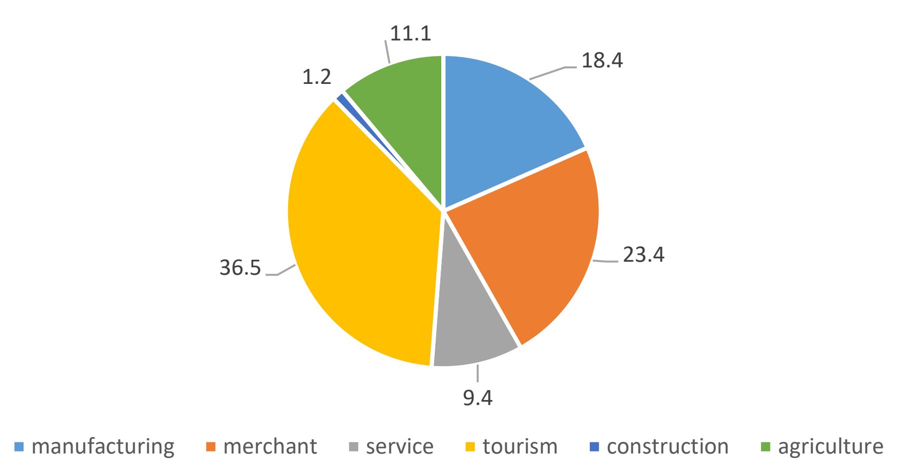
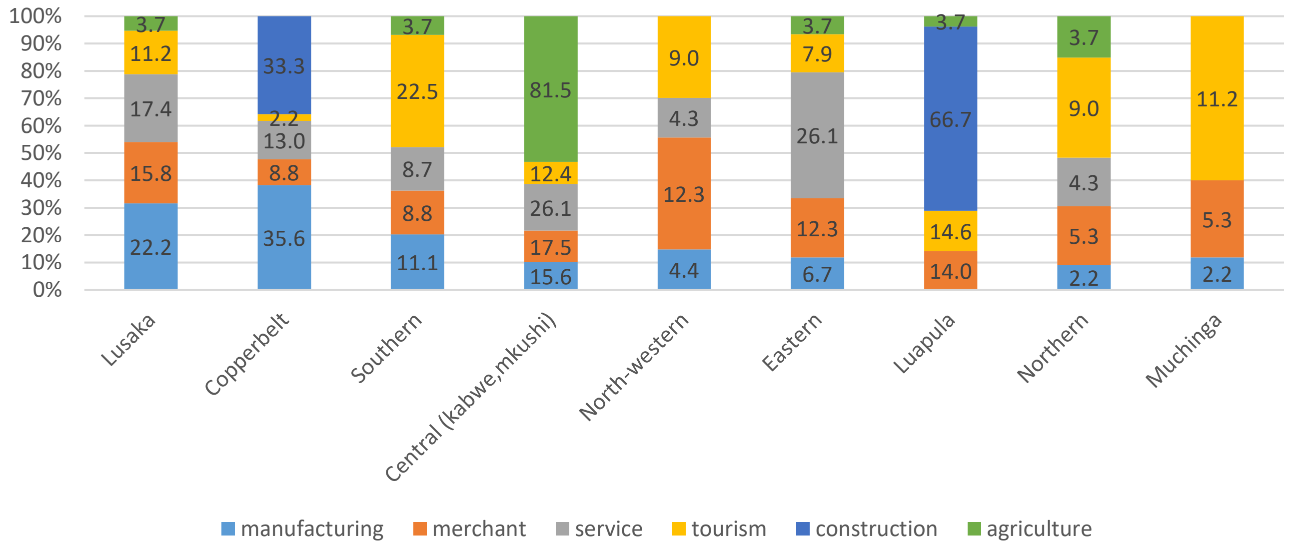


Figure 2: Sectoral Distribution by Region (%)



Executive Summary[1]

The Survey of Business Opinions and Expectations showed that generally economic performance was weak and remained below the historical average during the fourth quarter of 2018. This was despite an improvement in capacity utilisation, new orders, inventories and domestic sales, largely driven by the rise in demand associated with the festive season. Profitability remained relatively unchanged, while labour demand and the level of investment declined when compared to the third quarter of 2018 (see Figure 3). This followed the rise in costs of doing business, upward revision of the minimum wage, weaker Kwacha exchange rate against trade partner currencies, as well as high input costs. Reduced business activities in the tourism sector during the rainy season also contributed to the fall in labour demand.

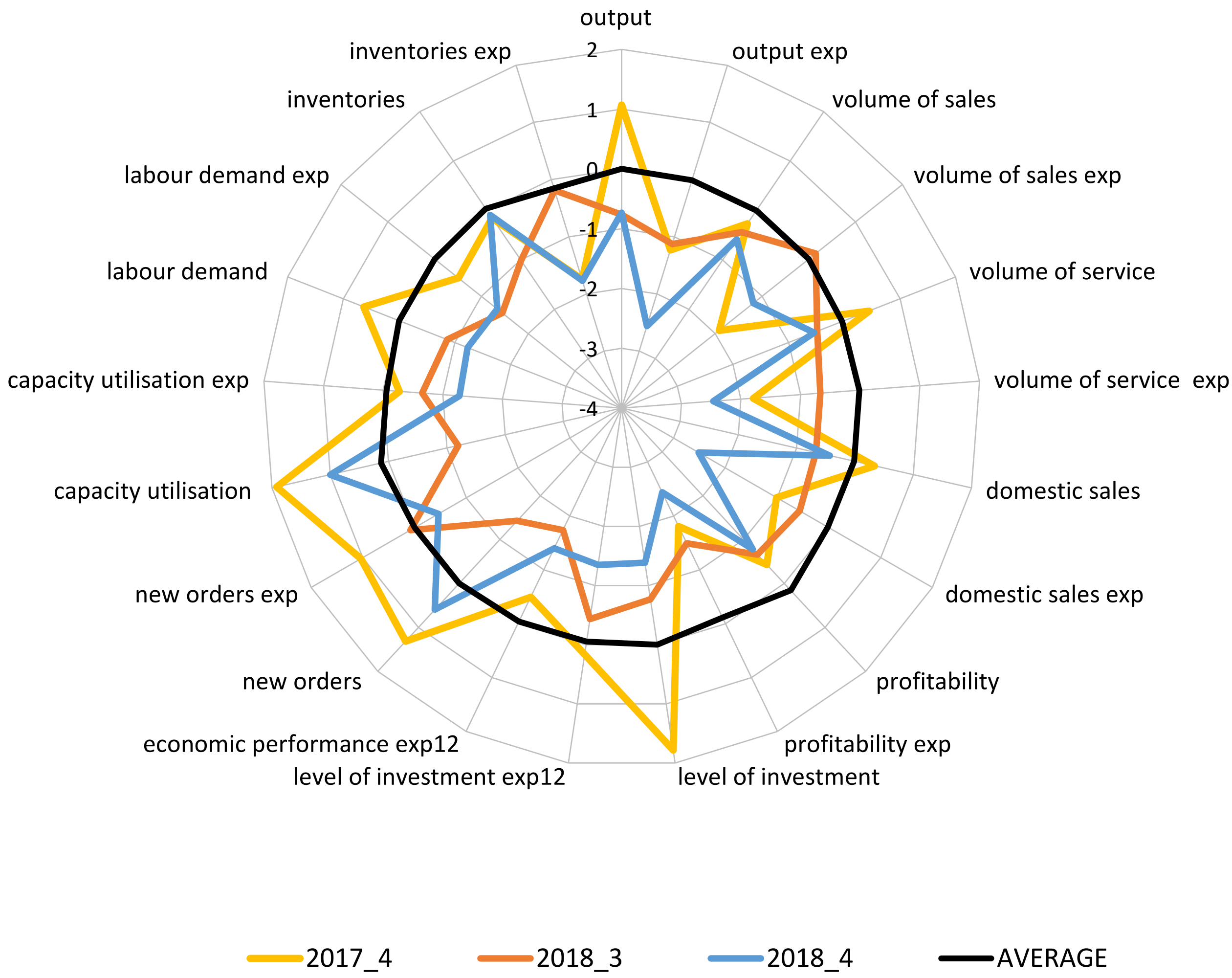
The outlook for the first quarter of 2019 indicated a slowdown in economic performance, as all the monitored indicators were expected to decline when compared to the previous quarter. This pattern of activity is typical during the first quarter of the year on account of lower demand after the festive period, less activity in the tourism and construction sectors due to the rainy season, liquidity constraints as well as the high cost of doing business affecting the manufacturing sector.

The above, notwithstanding, there was a change in perceptions of economic performance to improve over the next twelve, unlike the previous three quarters. Most respondents, apart from those in the manufacturing sector, anticipate an improvement in economic activity. This was largely premised on continued investment in infrastructure (i.e. roads and airports), diversification efforts towards the agriculture sector announced in the 2019 budget speech as well as fiscal consolidation measures, if implemented. The expected improvement is, however, not strong enough to pull the economy back to the long-term historical average performance.

Inflationary pressures are expected to remain elevated and above the historical price levels over the next twelve months. This perception was mainly attributed to expected weaker Kwacha exchange rate against the US dollar, rising production costs and the higher tax burden which is likely to be passed on to consumers. Commercial banks' lending rates are also expected to remain high due to rising government domestic borrowing coupled with high credit risk and the commercial banks' desire for profit margins. As a result, about 70.2% of respondents continued to rely on retained earnings as the main source of investment finance and working capital while only 15.9% of the respondents were able to access bank borrowing.

[1] This Report presents findings of the Quarterly Survey of Business Opinions and Expectations conducted during the fourth quarter of 2018. The results are based on responses from 244 firms of the 283 questionnaires distributed, covering manufacturing, merchants, tourism and services, agriculture and construction sectors. This outturn represented a response rate of 86.2%.

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.*

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 fourth quarter of 2018 as well as expectations for the first quarter of 2019, while section II presents opinions and expectations for the same period on input costs, wages and selling prices, among other variables. Section III provides first quarter 2019 perceptions on variables that influence monetary policy, while section IV provides the general conclusion.

I. Opinions and expectations of economic activity

Economic activity remained weak in Q4 2018 but expected to improve over the next 12 months

In the previous quarter, respondents expected the economy to remain weak during the fourth quarter 2018, with most monitored indicators declining except for new orders, and domestic sales which would be supported by the rise in demand associated with the festive period. Business conditions were perceived to be challenging following the rise in costs of production, and lower activity in the tourism and agriculture sectors due to seasonal factors. Consistent with these perceptions, there was an improvement in new orders, domestic sales, as well as inventories and capacity utilisation to satisfy high consumer demand during the festive period. However, generally economic performance remained subdued as most of the other indicators remained lower than the historical average and fourth quarter 2017 performance (see Chart 1).

With regard to expectations for the first quarter of 2019, most respondents anticipated a deterioration in economic activity. This was reflected in a decline in most of the monitored indicators largely due to seasonal factors affecting the tourism, construction and agriculture sectors, coupled with subdued demand (see Chart 2).

Over the next 12 months, however, economic performance is expected to improve slightly, mainly driven by continued infrastructure development by Government, diversification efforts towards agriculture, as well as fiscal consolidation as indicated in the 2019 Budget speech if implemented.

Chart 1: Business Opinions Response Patterns

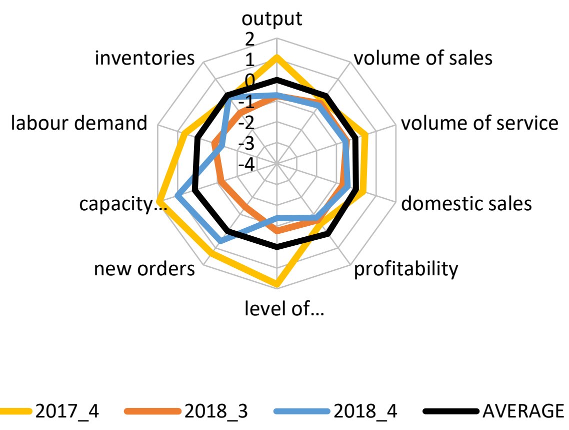
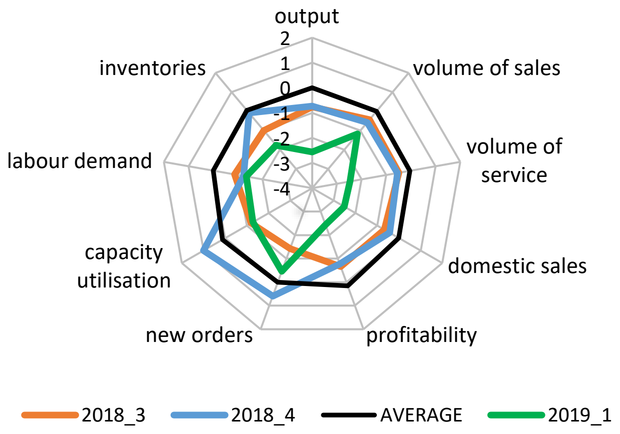


Chart 2: Business Expectations Response Patterns



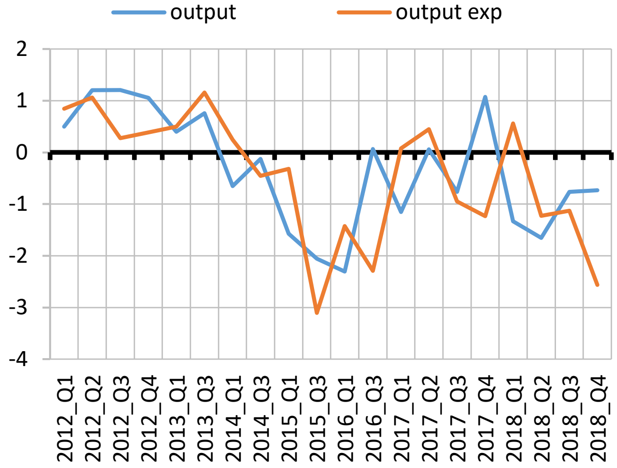
Q: What has been your firm's experience with respect to output?

(Net balance, -14.1%; Q3 2018, -14.5%)

During the fourth quarter of 2018, output was relatively unchanged and remained below the historical average. Although there was an increase in new orders and demand for manufactured products during the festive period, lower activity in the agricultural sector moderated the impact on output (see Chart 3).

During the first quarter 2019, most respondents anticipate a decline in output largely on account of the expected lower demand following the festive period.

Chart 3: Opinion on Output

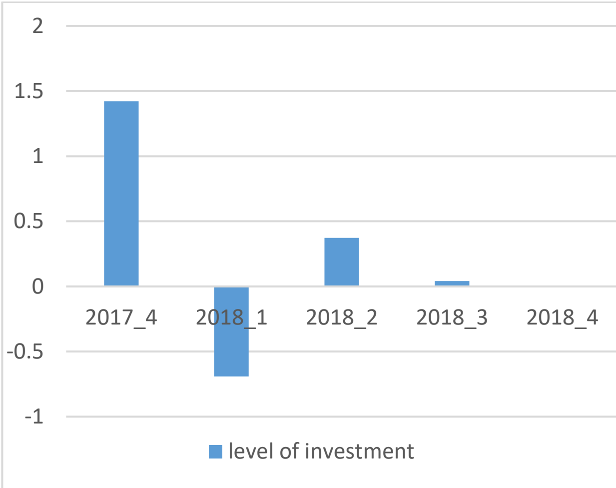


Q: How was your firm's level of investment?

(Net balance, 0.00 %; Q3 2018, 4.1%)

Total investment declined during the fourth quarter of 2018 in comparison with the third quarter, as reported by most respondents. This was largely due to reduced demand for tourism services, liquidity constraints, inadequate demand and high costs of doing business (see Chart 4).

Chart 4: Level of investment



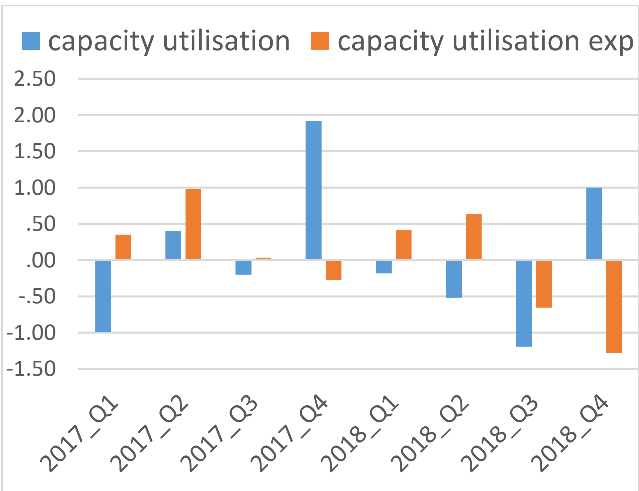
Q: What has been your firm's experience with respect to capacity utilisation?

(Net balance, 0.00%; Q3 2018, -26.5%)

The manufacturing sector reported an improvement in capacity utilisation during the fourth quarter of 2018, above the historical average performance (see Chart 5). This was mainly attributed to increased demand and new orders recorded by the manufacturing and merchant sectors during the festive period.

In the first quarter of 2019, capacity utilisation is expected to fall below the historical average performance, mainly on account of reduced demand following the festive season as well as plant maintenance for some manufacturers.

Chart 5: Capacity Utilisation



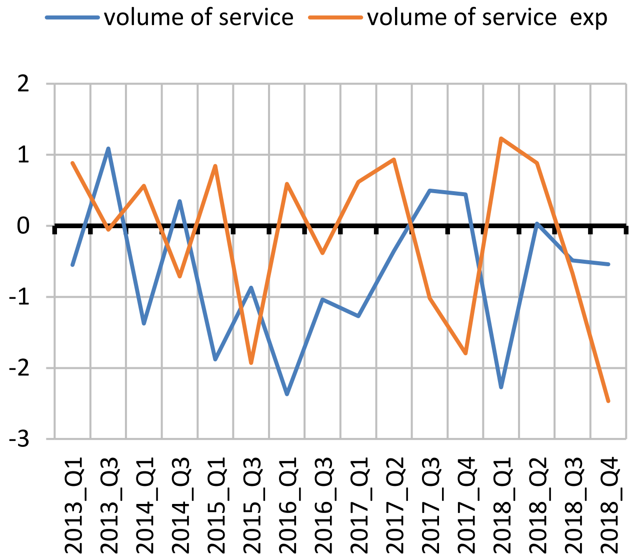
Q: What has been your firm's experience with respect to volume of service?

(Net balance, -15.5%; Q3 2018, -14.5%)

During the fourth quarter of 2018, the volume of service slightly decreased in comparison to the previous quarter (see Chart 6). This was attributed to the low tourism season which was moderated by an increase in domestic activities during the festive period.

Respondents anticipate a decline in the volume of service during the first quarter of 2019, mainly on account of seasonal closures of some tourism facilities in national parks and game management areas as well as subdued domestic demand for services.

Chart 6: Volume of Service



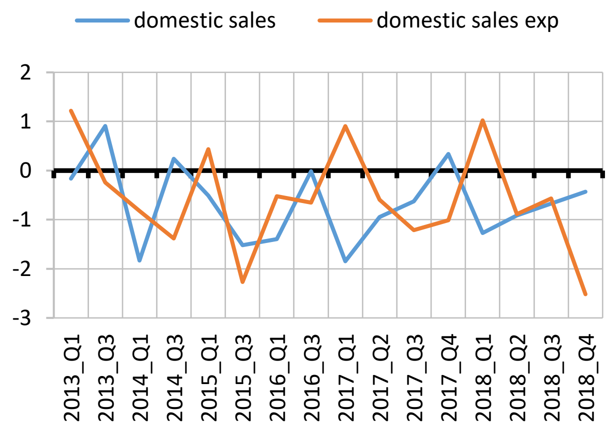
Q: What has been your firm's experience with respect to domestic sales?

(Net balance, -12.5%; Q3 2018, -16.4%)

Domestic sales improved during the fourth quarter, although they were below the historical average (see Chart 7). This was mainly due to higher demand for orders in the manufacturing sector as well as Merchant sales to satisfy high consumers demand during the festive season.

In the first quarter of 2019, domestic sales are expected to fall, following reduced consumer demand, lack of money in circulation and low productivity in the manufacturing and agriculture sectors.

Chart 7: Domestic Sales

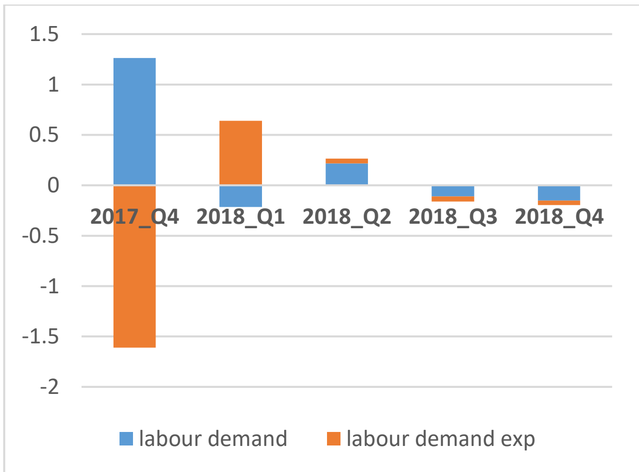


Q: How do you rate your firm's labour demand?

(Net balance, -15.2%; Q3 2018 -10.9%)

Labour demand continued on a downward trend in the fourth quarter of 2018 (see Chart 8). This was mainly attributed to the increased cost of doing business, i.e. upward revision of the minimum wage as well as high input costs. The reduction in business activities in the tourism sector during the rainy season also contributed to the fall in labour demand.

Chart 8: Labour Demand



The demand for labour is expected to remain weak and below the historical average during the first quarter of 2019. This is largely due to the anticipated weaker economic activity in the manufacturing, tourism and agriculture sectors.

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

Main source of financing remained retained earnings

Most respondents indicated that retained earnings were the main source of investment finance and working capital, with 70.4% (72.1%) and 70.2% (71.7%) response rates, respectively. This was followed by bank borrowing at 15.9% (13.3%) and 15.3% (15.5%), respectively (see Charts 9A and 9B).

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

(Net balance, 60.9%; Q3 2018, 58.3%)

During the fourth quarter of 2018, most respondents reported tighter credit conditions compared to the previous quarter. This was mainly on account of stringent collateral requirements by lending institutions, increased Government domestic borrowing, high stock of non-performing loans (NPLs), continued high lending rates and tight liquidity (see Chart 10).

Chart 9A: Sources of Investment Finance

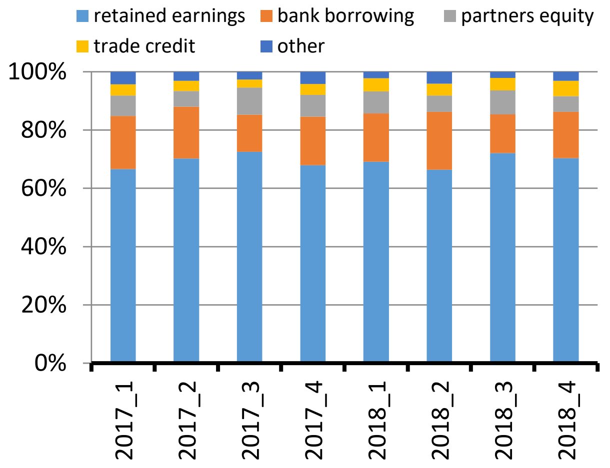


Chart 9B: Sources of Working Capital

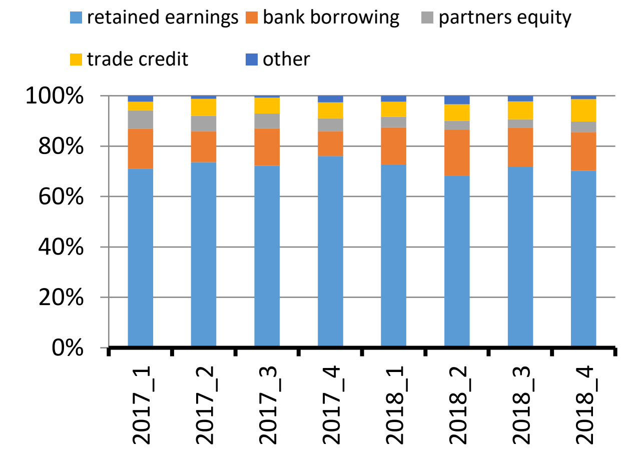
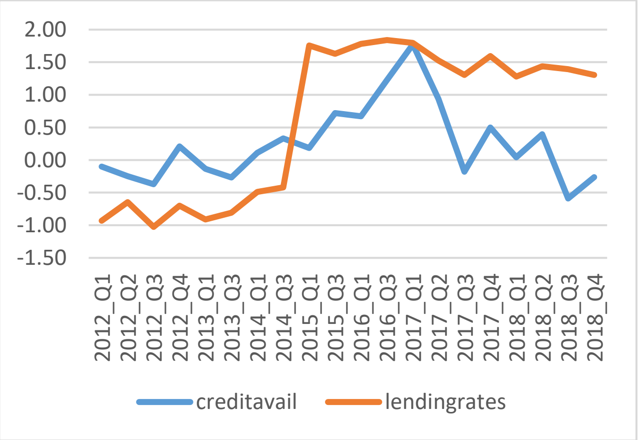


Chart 10: Credit Availability and lending Rates



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, 25.5%; Q3 2018, 20.1%)

Most respondents reported an increase in input costs during the fourth quarter of 2018 compared with the previous quarter (see Chart 11). The increase was largely on account of the pass through of a weaker Kwacha exchange rate against trade partner currencies, upward adjustments in fuel prices and the minimum wage as well as high cost of raw materials.

Input costs are, however expected to decline in the first quarter of 2019, but remain above the historical average, mainly due to lower production and labour costs.

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

(Net balance, 17.2%; Q3 2018, 6.8%)

Most respondents reported an increase in the wage bill during the fourth quarter of 2018, above the historical average level (see Chart 12). This was mainly attributed to the implementation of the new minimum wage and payment of bonuses.

During the first quarter of 2019, the wage bill is expected to decrease compared to the fourth quarter 2018 level. This is mainly premised on the expected reduction in the demand for labour in the agriculture and manufacturing sectors during the first quarter. In addition, wages for the first quarter will not include end year bonuses as was the case in the fourth quarter.

Chart 11: Average input costs

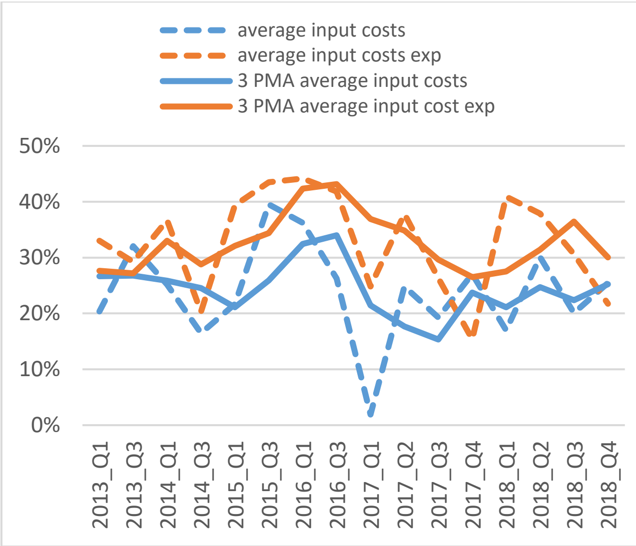
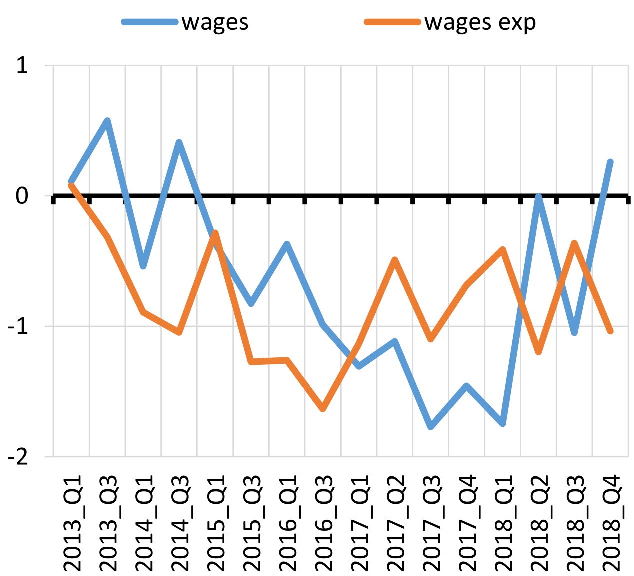


Chart 12: Evolution of wages



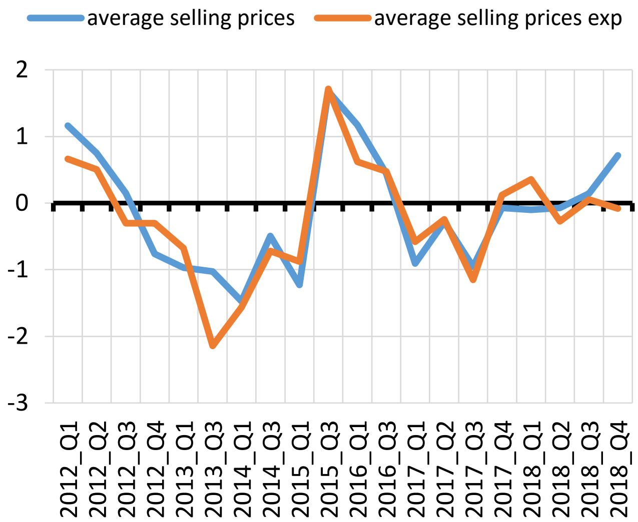
Q: What has been your firm's experience during the quarter under review with respect to average selling prices?

(Net balance, 13.4%; Q3 2018, 3.4%)

Average selling prices increased in the fourth quarter of 2018, as reported by most respondents and remained above the historical average (see Chart 13). The increase in the average selling prices was largely due to higher costs of production following the upward adjustment in fuel prices, depreciation of the Kwacha against the US Dollar as well as high cost of raw materials and imported commodities.

During the first quarter of 2019, average selling prices are expected to fall slightly below the historical average largely on account of low demand following the festive season and clearance sales to clear inventories.

Chart 13: Evolution of average selling prices



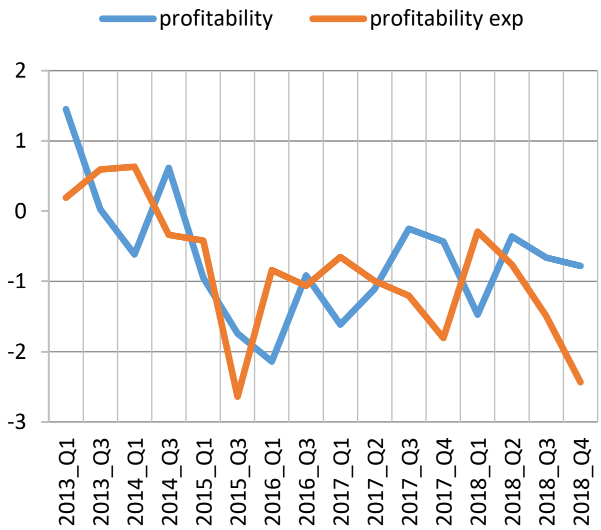
Q: What has been your firm's experience with respect to profitability?

(Net balance, -29.9%; Q3 2018, -27.5%)

Most respondents reported a slight decrease in profitability during the fourth quarter of 2018 compared to the previous quarter (see Chart 14). This was largely attributed to higher costs of production, increased import costs due to the exchange rate depreciation faced by manufacturers and merchants, lower sales in the tourism sector as well as an increase in the IFRS 9 provisioning in the Banking sector.

In the first quarter of 2019, profitability is expected to decline further, largely on account of an expected slowdown in economic activity and subdued demand.

Chart 14: Profitability



III EXPECTATIONS ON MONETARY POLICY FOR FIRST QUARTER 2019

The first quarter 2019 expectations indicated a rise in inflation, a weaker exchange rate and higher lending rates (see Chart 15).

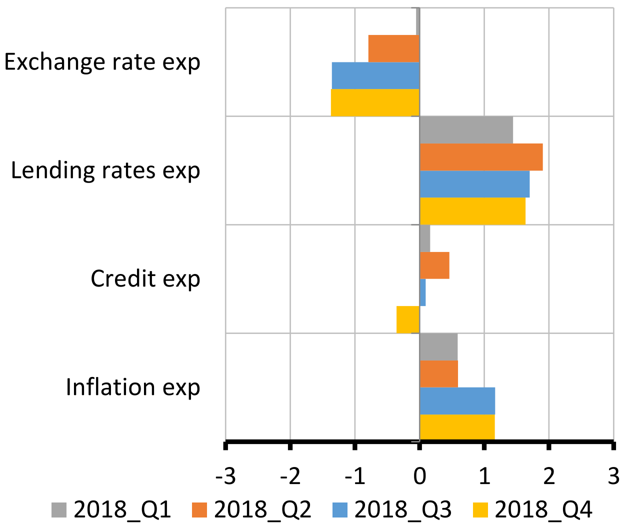
Q: Over the next quarter what do you expect the price level to be?

(Net balance, 60.5%; Q3 2018, 60.6%)

Inflationary pressures are expected to remain elevated and above the historical price levels during the first quarter of 2019. This is mainly attributed to an anticipated weaker exchange rate and higher production costs (see Chart 16).

Over the next 12 months, inflation is expected to remain stable but above the historical average level, mainly on account of the anticipated weaker Kwacha exchange rate of the Kwacha against the US Dollar, higher cost of production and introduction of sales tax to replace VAT.

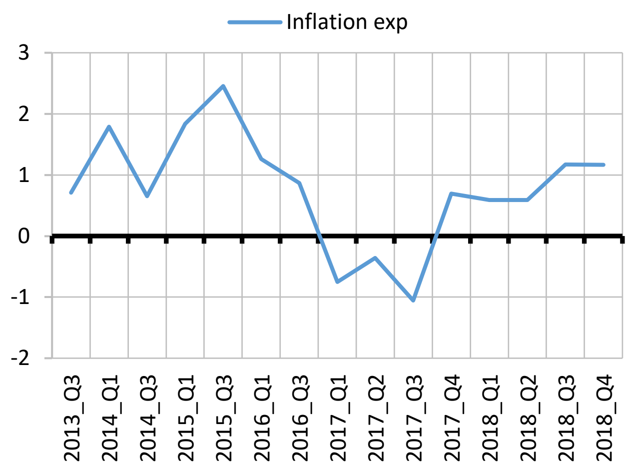
Chart 15: Expectations for rising inflation, weaker Kwacha and high lending rates



Notes:

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

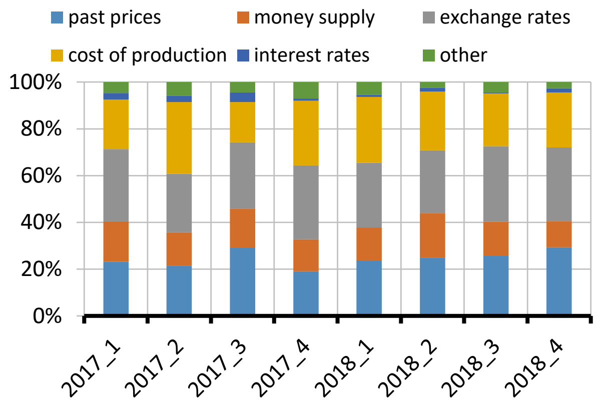
Chart 16: Inflationary pressures expected to remain above historical average in Q1 2019



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

Inflationary pressures in the first quarter of 2019 are expected to emanate largely from the exchange rate depreciation, as indicated by 31.5% of the respondents compared to 32.3% in the previous quarter. This would be followed by past prices at indicated by 29.3% (25.7%) and higher cost of production at 23.4% (22.6%) (see Chart 17).

Chart 17: Inflationary expectations mainly driven by the exchange rate and cost of production

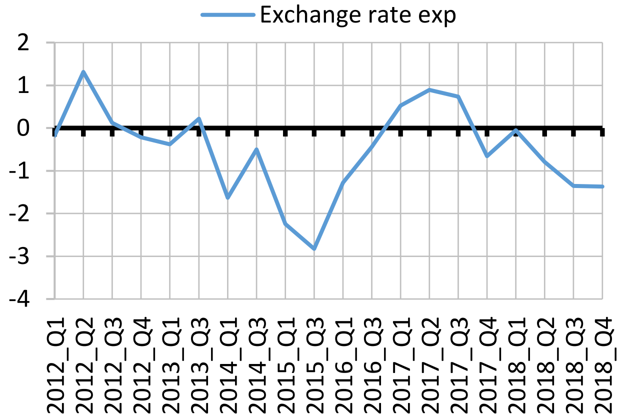


Q: How do you expect the performance of the Zambian Kwacha against the US Dollar to be at the end of the next quarter?

(Net balance, -51.3%; Q3 2018, -50.9%)

The exchange rate of the Kwacha against the US Dollar is expected to remain stable but slightly weaker than the previous quarter (see Chart 18). This is largely premised on the deteriorating external perceptions of the economy due to high debt levels.

Chart 18: Exchange rate expectations next quarter

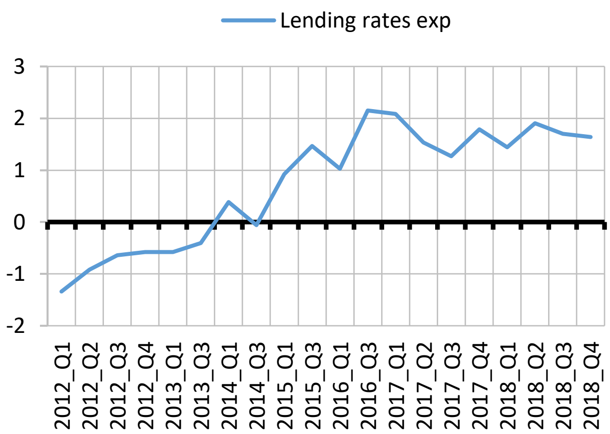


Q: Over the next quarter, what do you expect to happen to commercial banks' lending interest rates?

(Net balance, 67.9%; Q3 2018, 69.8%)

The majority of the respondents expect commercial banks' lending rates to remain high (see Chart 19). This is mainly on account of high government domestic borrowing coupled with high credit risk and the commercial banks' desire for high profit margins.

Chart 19: Interest rate expectations next quarter



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

(Net balance, -8.7%; Q3 2018, -16.1%)

Over the next 12 months, respondents expect economic performance to improve, although it will remain below the historical average performance (see Chart 20). The improvement is premised on higher levels of infrastructure development, continued diversification of the economy, progressive economic policies as announced in the budget speech.

IV CONCLUSION

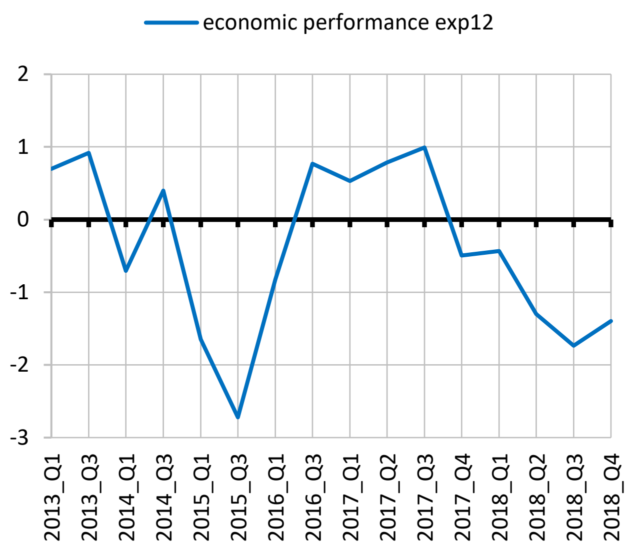
The fourth quarter 2018 Survey of Business Opinion and Expectations conducted during December 2018 - January 2019, revealed that economic activity was relatively subdued despite an improvement in capacity utilisation, new orders and domestic sales during the fourth quarter of 2014. This was mainly driven by the rise in consumer demand associated with the festive season.

The outlook for the first quarter 2019 showed a slowdown in economic activity, as reflected in the decline in all the monitored indicators. This perception was attributed to reduced economic activity and lower demand that follows the festive period.

Over the next 12 months, economic performance is expected to recover slightly, although it will remain below the historical average. The anticipated improvement is premised on continued infrastructure development, diversification efforts into agriculture from mining and sound economic policies as announced in the budget speech, if implemented.

Inflationary pressures are expected to remain elevated and above the historical price levels over the next twelve months. This perception was mainly attributed to an expected weaker exchange rate, rising production costs and the higher tax burden which is likely to be passed on to consumers. Commercial banks' lending rates are also expected to remain high mainly on account of rising government domestic borrowing coupled with high credit risk and the commercial banks' desire for profit margins. As a result, about 70.4% of respondents continued to rely on retained earnings as the main source of investment finance and working capital while only 15.9% were able to access bank borrowing.

Chart 20: Economic performance in next 12 months



Appendix I: Background on the QSBOEs

This Report is based on the results of the QSBOEs conducted from December 2018 – January 2019. Out of the 283 questionnaires distributed, 244 firms responded, representing a response rate of 86.2%.

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.