Bank *of* Zambia

PRESS STATEMENT

UPGRADE OF ZAMBIA'S SOVEREIGN CREDIT RATING

The Bank of Zambia wishes to add its voice to the very positive development in our country, notably, the recent upgrading of Zambia's sovereign credit rating by Standard and Poor's (S&P) Global Ratings and Fitch Ratings to **CCC+** and **B-** from *Selective Default* and *Restricted Default*, respectively. This is a very significant milestone that validates the progress the country has made in restructuring its external debt and strengthening economic management, thereby placing the country's debt back on a sustainable path. This achievement is particularly noteworthy having occurred against a background of significant global shocks, including geopolitics and uncertainty, arising from the realignment of global trade policy. These global developments were compounded by the 2023/2024 devastating drought, which led to very poor harvest of particularly the staple crop, maize, and a severe reduction in electricity supply, given the country's high dependency on hydro-electricity. The debt overhang and these external and domestic factors have had adverse impact on economic growth, employment generation, the exchange rate, and inflation. The debt overhang also had an adverse impact on liquidity conditions (i.e. availability of money) in the economy, which posed a threat to the ability of the financial institutions to perform their intermediation role (financial stability).

From the financial sector standpoint, the credit rating upgrade has a number of important implications, including the following: First, when Zambia defaulted on its payment of interest on Eurobonds in November 2020, the country's external debt rating was immediately downgraded to *Selective Default* status. Financial institutions, including our own banks, were as a result, forced to reduce the limits of credit they could extend to the Government and to Zambian businesses generally. Second, for these institutions to lend money to any local entity, they had to put aside more capital (i.e. to save as a buffer in the event of a default), making it more expensive for borrowers as banks factored this in their lending interest rates. This made it relatively more difficult for banks to support both short-term and long-term investments. Third, following the default, Government had become so dependent on issuance of Government securities (Bonds and Treasury Bills) to augment revenues to finance its operations. This pushed the cost of these instruments up, which in turn pushed up lending interest rates. Fourth, the ensuing challenges in raising adequate financial resources by the Government to meet its obligations tightened liquidity conditions in the economy, thereby pausing a risk to financial stability. Fifth, foreign financial institutions were increasingly less willing to invest in financial assets in Zambia, such as, Government bonds, reducing the supply of foreign exchange in the market. This had an adverse impact on the exchange rate and in turn, inflation.

The removal of Zambia from selective default status, now makes it possible for financial institutions, both domestic and international, to increase their credit exposure to Zambia and to do so at a relatively lower cost. Thus, making Zambia a more viable investment proposition.

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In other words, financial institutions would now be more willing and able to finance investment and growth in the economy at lower cost, whether this be through participation in public-private financing projects, or increasing direct lending to both the private sector and Government. Some investors who had anticipated that Zambia's credit rating was likely to be upgraded had, however, begun increasing their exposure to Zambia. The ratings upgrade by both S&P and Fitch are therefore supportive of these initiatives and the recent trends of declining Government security yield rates (the cost of lending to Government), which should in turn contribute to overall reduction in banks' lending rates. In addition, the improvement in the investment profile that these upgrades entail consolidates the stabilisation of the exchange rate and the declining trend in inflation. This is ultimately expected to support a reduction in the cost of living for the average Zambian.

The upgrade also has positive implications for Government's fiscal operations. Under the selective default status, the Government had to deeply rely on the domestic financial markets to finance its operations and investments for development. The extensive reliance on domestic markets meant that the cost of credit in the economy was increasingly difficult to reduce, as indicated earlier. Where possible, the Government also got some concessional borrowing from multilateral financial institutions and limited grants from development partners.

In a nutshell, it is important to note that the ratings upgrade represents more than just a recognition that Zambia's debt is more sustainable going forward, but also a clear recognition that the broader economic reforms implemented by the Government put Zambia on the right trajectory of higher growth, single digit inflation, a more stable exchange rate, and more robust long-term investment in the economy, primarily by the private sector.

In view of the significance of this development for our economy, the Bank will henceforth undertake outreach exercises to unpack the above issues and other related matters of public interest.

Issued by,

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