Bank *of* Zambia

Quarterly Survey of Business Opinions and Expectations

June 2020
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Summary

Economic activity worsened in the second quarter of 2020 as all the monitored indicators remained below their historical average. This was largely attributed to the negative impact of the COVID-19 pandemic that led to reduced demand, disruptions in the supply of certain products, temporay closure of businesses and in some cases exit, particularly in the restaurant and hospitality as well as travel sectors. This was in addition to the depreciation of the Kwacha against the US dollar amidst high Government external debt service, tight liquidity and credit conditions, high energy prices as well as electricity load shedding. Subdued economic activity is expected to persist in the third quarter of 2020. This notwithstanding, some improvements in capacity utilisation and new orders are expected in the third quarter due to expansion works in the manufacturing sector and the pick-up in demand following the partial relaxation of some COVID-19 pandemic related restrcitions in the tourism and aviation industries. Over the next 12 months, firms expect economic activity to remain weak largely due to the high cost of doing business as result of electricity load shedding, high energy prices and the depreciation of the Kwacha against the US dollar. The uncertainties surrounding the prolonged negative impact of the COVID-19 pandemic is also likely to affect economic activity.

1.0 Introduction

The Quarterly Survey of Business Opinions and Expectations (QSBOEs) provides useful signals about current and future economic activity and assists in the formulation of decisions that may impact on future economic performance. The Survey provides an indication of likely future developments given the dominant role that expectations play in shaping economic behaviour. Further, the Survey acts 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 presents Survey findings on business opinions and expectations for the second quarter of 2020 conducted between June and July 2020. A total of 247 firms were surveyed, of which 75 responded from the provinces as follows: 15 (Central), 14 (Lusaka), 13 (Copperbelt), 9 (Northern), 9 (Luapula), 6 (Southern), 4 (Muchinga), 3 (Eastern), and 2 (North-Western). This represented a response rate of 30.4%. The sectoral distribution of the responses was: 37.3% (tourism), 22.7% (manufacturing), 16.0% (merchants), 12.0% (services), 9.3% (agriculture) and 2.6% (construction).

The poor response rate was largely due to the negative effects of COVID-19 pandemic that disrupted normal business operations. This was mainly characterised by remote working and the resultant closure and, in some cases, exit of some companies mainly in the transport, services, tourism and hospitality sectors. Further, the COVID-19 induced travel restrictions resulted in the Survey being conducted through electronic mail and telephone calls. This was the first time since inception in 1993 that the Survey was conducted without physical contact with respondents.

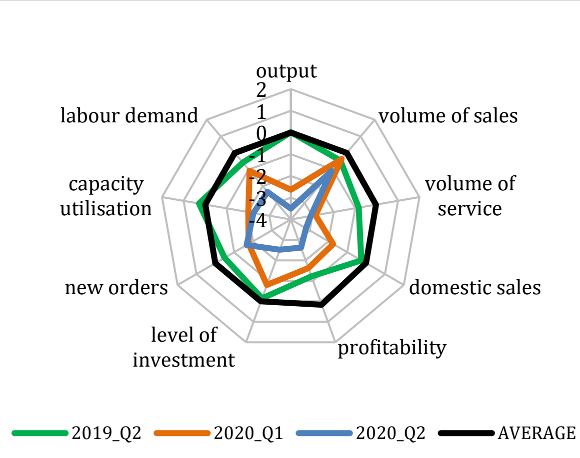
This Report is divided into four sections. Section 2 presents responses on economic performance during the second quarter 2020 and expectations for the third quarter of 2020 as well as 12 months ahead. Section 3 presents opinions and expectations on input costs, wages and selling prices, among other variables, over the same period as in section 2. Section 4 provides perceptions on monetary policy influences in the third quarter of 2020. Section 5 concludes. The Survey methodology is described in the appendix.

2.0 Economic Performance in the Second Quarter of 2020 and Expectations of Economic Activity in the Third Quarter of 2020 and 12 Months Ahead

Economic activity declined in Q2 2020; expected to remain subdued over the next 12 months

In line with the expectations formed in the first quarter of 2020, economic activity worsened in the second quarter of 2020 (Chart 1).

Chart 1: Business Opinions Response Patterns*

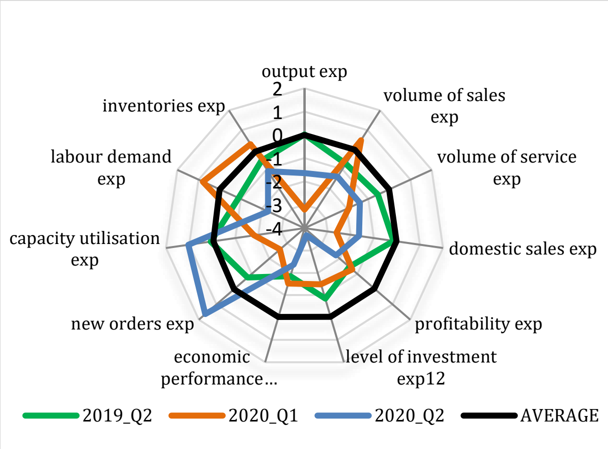


*Note: The survey indicators are standardised net balances with mean=0 and standard deviation=1. A value within the black circle entails weaker economic conditions than historical average and a value outside the black line is better than historical average.

The surveyed firms continued to record low business activity with all monitored indicators declining except for new orders. This was mainly on account of the negative impact of the COVID-19 pandemic that resulted in subdued consumer demand amidst tight liquidity conditions, high energy prices and electricity load shedding. New orders were largely for pharmaceutical products needed in the fight against the COVID-19 pandemic.

In the third quarter of 2020, economic performance is expected to remain subdued as reflected in the volume of sales, labour demand and profitability (Chart 2).

Chart 2: Business Expectations Response Patterns



This is mainly on account of the expected depreciation of the Kwacha, low demand, prolonged negative effects of COVID-19 pandemic, high cost of doing business as well as reduced productivity in the agriculture sector.

This, notwithstanding, capacity utilisation, new orders, output, domestic sales, volume of service and output are expected to improve mainly due to some expansion works being undertaken in the manufacturing sector. The expected increase in demand for goods and services following the partial relaxation of the COVID-19 restrictions in the tourism and aviation industries is also expected to contribute positively to economic performance.

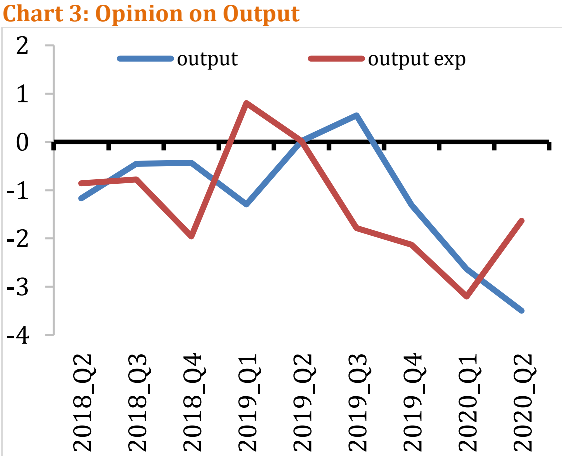
Over the next 12 months, economic performance is expected to decline further, premised on increased cost of production, electricity load shedding and low consumer demand due to COVID-19 pandemic.

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

(Net balance, -0.68; Q1 2020, -0.53)

Output declined further during the quarter under review and remained below the long-term average (Chart 3). This was mainly on account of high cost of production, electricity load shedding, low demand for locally manufactured goods due to stiff competition from cheap imports as well as subdued demand for cold beverages following the cold season and the closure of some bars due to COVID-19 pandemic.

Chart 3: Opinion on Output



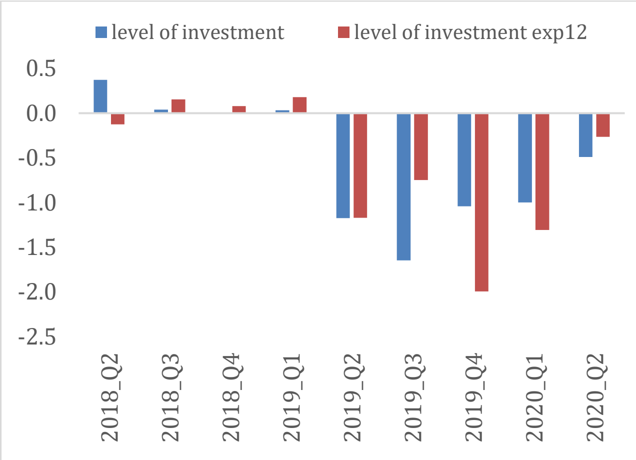
In the third quarter, output is expected to remain subdued owing to on-going electricity load shedding, sustained high cost of production as well as seasonality in the agriculture sector.

2.2 How was your firm's level of investment?

(Net balance, -0.30; Q1 2020, -0.09)

Business investment remained subdued in the second quarter (Chart 4). This was largely attributed to the high cost of doing business mainly driven by high energy prices, depreciation of the Kwacha and persistent electricity load shedding. Further, subdued demand induced by tight liquidity conditions following the deterioration of business activity due to COVID-19 pandemic as well as high inflation contributed to low investment activities.

Chart 4: Level of Investment



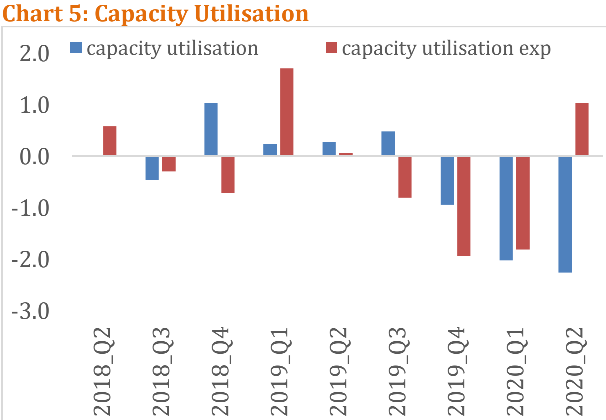
Over the next 12 months, investment was projected to remain below the historical average mainly on account of anticipated tight credit conditions associated with the rise in credit risk following the deterioration of the business environment due to COVID-19 pandemic. Further, the level of investment was expected to be adversely affected by the high cost of doing business mainly on account of persistent depreciation of the Kwacha, high inflation and electricity load shedding.

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

(Net balance, -0.59; Q1 2020, -0.55)

Capacity utilisation remained constrained during the second quarter of 2020 (Chart 5).

Chart 5: Capacity Utilisation



This was mainly on account of low demand largely induced by the COVID-19 pandemic, stiff competition and high cost of production arising from high fuel and electricity prices amidst persistent electricity load shedding.

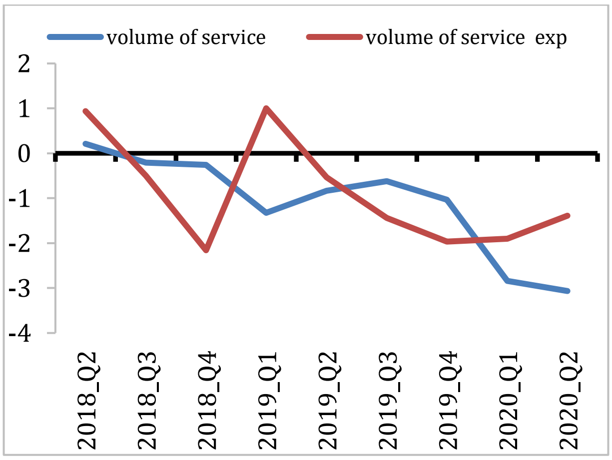
Capacity utilisation is, however, expected to rebound during the third quarter on the back of expansion plans and possible deployment of new machinery by some manufacturing and construction firms. This ismainly on account of the resumption in construction activities to support road construction projects as well as the unchanged consumer demand for some manufactured commodities despite the COVID-19 outbreak.

2.4 What has been your firm's experience with respect to the volume of service?

(Net balance, -0.76; Q1 2020, -0.71)

The volume of service declined further in the second quarter and remained below the historical average (Chart 6). This was largely on account of the decline in the demand for services following the COVID-19 pandemic, rising inflation, depreciation of the Kwacha and the decline in incomes. Moreover, COVID-19 pandemic induced travel restrictions and business shutdowns negatively impacted the services and tourism sector.

Chart 6: Volume of Service



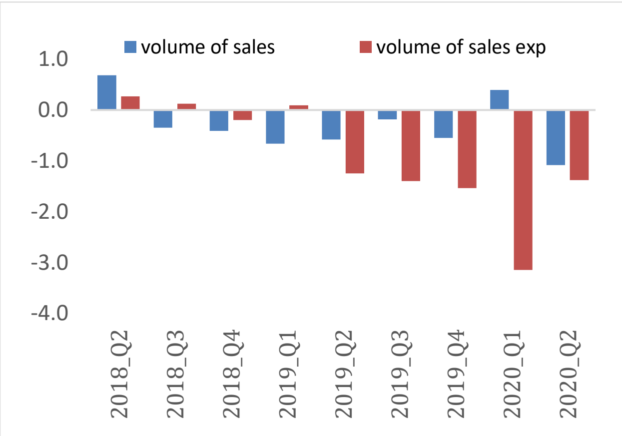
The volume of service was expected to remain subdued in the third quarter largely due to the prolonged effects of the COVID-19 pandemic amidst tight liquidity conditions.

2.5 What has been your firm's experience with respect to the volume of sales?

(Net balance, -0.75; Q1 2020, -0.45)

The volume of sales declined during the second quarter mainly on account of subdued consumer demand following the COVID-19 pandemic-induced economic disruptions. Morever, the depreciation of the Kwacha and the subsequent rise in inflation also affected sales volumes (Chart 7).

Chart 7: Volume of Sales



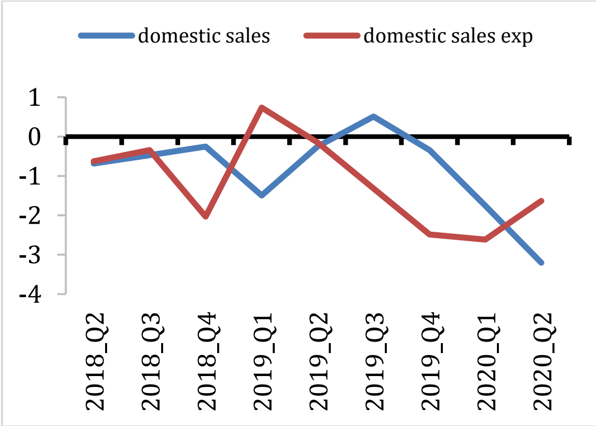
During the third quarter, the volume of sales was expected to remain subdued largely on account of an anticipated exchange rate depreciation, elevated inflation, tight liquidity conditions and low demand attributed to expenditure rationing due to uncertainties surrounding the COVID-19 pandemic.

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

(Net balance, -0.67; Q1 2020, -0.40)

Domestic sales declined further in the second quarter of 2020 (Chart 8). This was largely on account of falling consumer demand due to tight liquidity conditions, deterioration in economic activity following the COVID-19 pandemic as well as stiff competition from imported products.

Chart 8: Domestic Sales



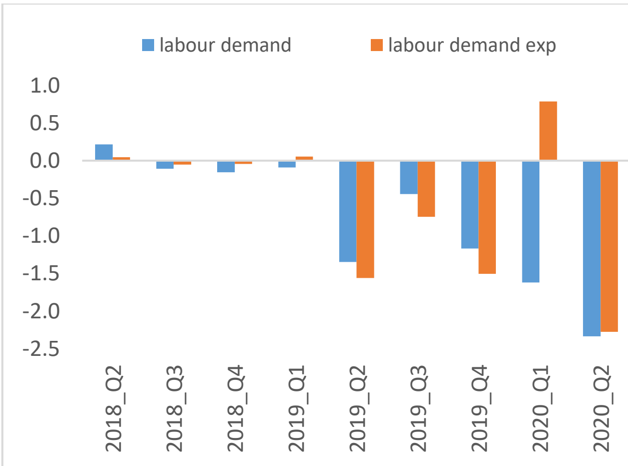
Over the next quarter, domestic sales were expected to remain below the historical average. This was mainly premised on persistently lower consumer demand induced by the COVID-19 pandemic as well as sustained liquidity constraints.

2.7 How do you rate your firm's labour demand?

(Net balance, -0.49; Q1 2020, -0.28)

Labour demand significantly fell during the second quarter (Chart 9). This was largely attributed to low profitability induced by a reduction in the demand for goods and services amidst tight liquidity conditions. In addition, the implementation of the new labour law alongside the COVID-19 related company closures resulted in employee redundancies as businesses sought to minimise their labour costs.

Chart 9: Labour Demand



Labour demand was anticipated to remain below the historical average during the third quarter of 2020 mainly on account of reduced productivity activities in the agriculture sector, depreciation of the Kwacha and high inflation. Furthermore, the reduction in manufacturing output due to persistent electricity load shedding as well as the uncertainties surrounding the possible prolonged negative impact of COVID-19 were cited as key determinants of subdued labour demand.

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

Retained earnings remained the main source of investment finance and working capital during the second quarter, with 66.7% and 72.2% response rates from 66.7% and 72.2% in the first quarter, respectively (Charts 10A and 10B). This was followed by bank borrowing.

Chart 10A: Sources of Investment Finance

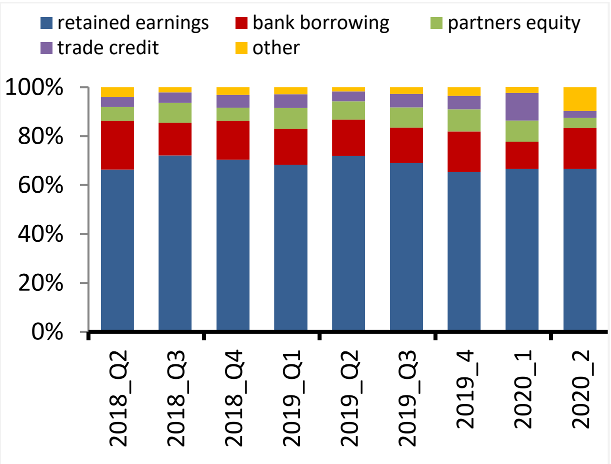
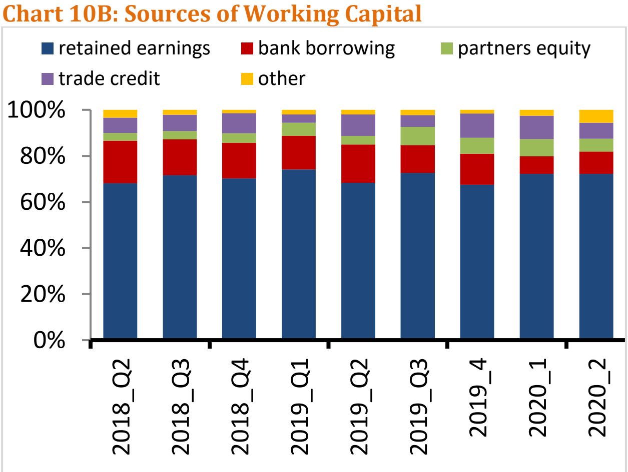


Chart 10B: Sources of Working Capital

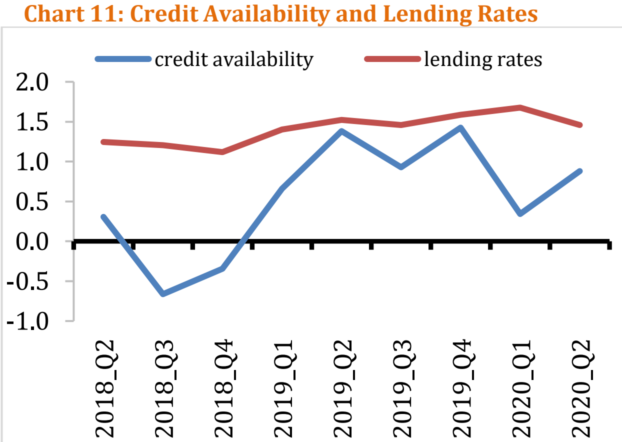


2.9 What is your perception of the current availability of credit?

(Net balance, 0.71; Q1 2020, 0.67)

Persistent tight credit conditions were observed by respondents during the quarter under review despite the Bank of Zambia launching the Targeted Medium-Term Refinancing Facility (Chart 11). This was reflected in high lending rates attributed to sustained Government domestic borrowing, rise in credit risk following poor business performance largely attributed to the COVID-19 pandemic and subsequent strict lending requirements.

Chart 11: Credit Availability and Lending Rates



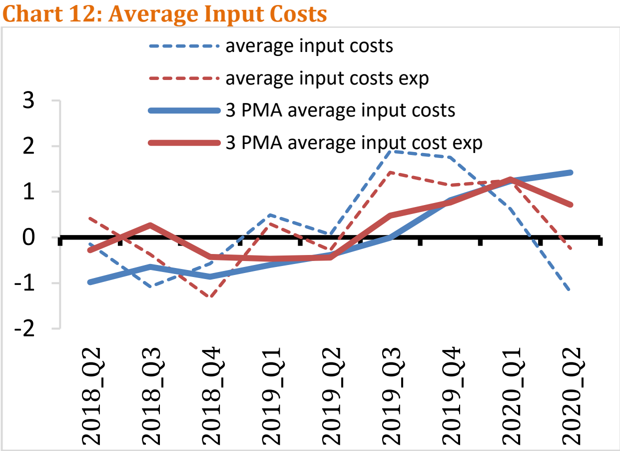
3.0 Evolution of Costs, Wages and Prices

3.1 What has been your firm's experience with average input costs?

(Net balance, 0.19; Q1 2020, 0.38)

Average input costs declined during the second quarter of 2020 mainly due to reduced business activity coupled with some business closures, particularly in the tourism and services sector as result of the COVID-19 pandemic (Chart 12).

Chart 12: Average Input Costs



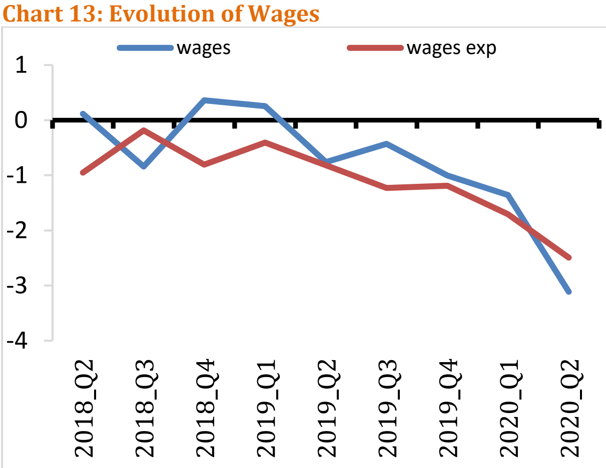
In the third quarter, average input costs are expected to continue to fall mainly on account of low demand as well as anticipated reducedactivity largely attributed to the COVID-19 pandemic.

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

(Net balance, 0.13; Q1 2020, 0.02)

Due to the reduction in working hours, less bonus payments and employee redundancies resulting from constrained business activity and company closures induced by COVID-19 pandemic, the wage bill declined during the second quarter of 2020 (Chart 13).

Chart 13: Evolution of Wages



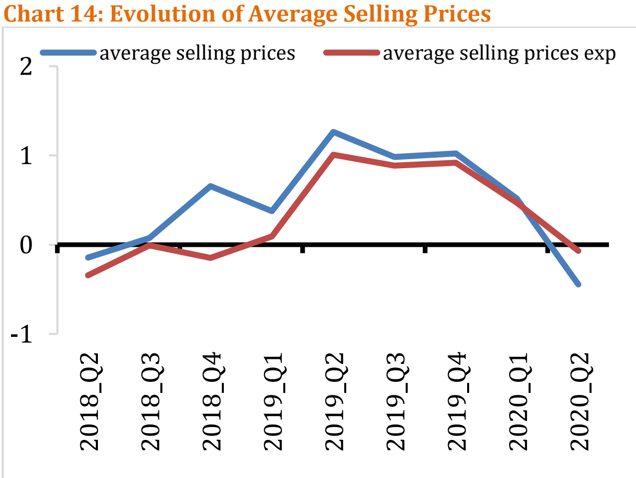
The wage bill was expected to continue falling in the third quarter on account of anticipated low profit margins arising from business disruptions due to the COVID-19 pandemic.

3.3 What has been your firm's experience with respect to average selling prices?

(Net balance, -0.06; Q1 2020, 0.11)

Average selling prices declined in the second quarter of 2020 mainly due to subdued demand, which forced firms to offer discounts to maintain their customer base. In addition, seasonal factors contributed to lower average selling prices following the post-harvest increase in the supply of agricultural products such as maize and sweet potatoes (Chart 14).

Chart 14: Evolution of Average Selling Prices



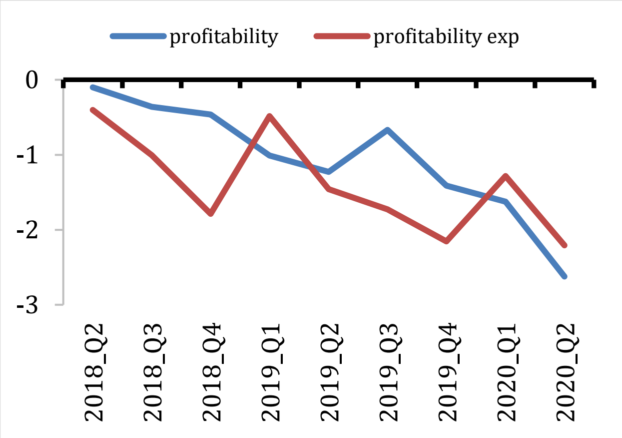
Average selling prices were largely expected to continue declining in the third quarter on account of subdued demand due to COVID-19 pandemic, stiff competition as well as promotions in order to maintain the customer base

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

(Net balance, -0.81; Q1 2020, -0.57)

Profitability declined further during the quarter under review mainly on account of high production costs associated with high energy prices coupled with low demand induced by the COVID-19 pandemic. In addition, tight liquidity conditions and the depreciation of the Kwacha negatively impacted profits (Chart 15).

Chart 15: Profitability

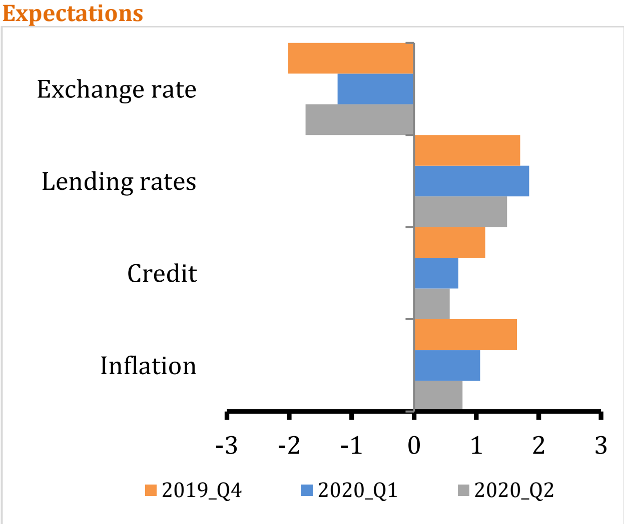


Profitability was expected to continue declining in the third quarter mainly due to an anticipated reduction in demand coupled with the depreciation of the Kwacha and high operationing costs.

4.0 Expectations of Monetary Policy for Third Quarter 2020

Persistently high inflationary pressures, tight credit conditions, elevated commercial banks' lending rates and continued depreciation of the Kwacha were anticipated in the third quarter of 2020 (Chart 16).

Chart 16: Inflation, Exchange Rates and Lending Rates Expectations



Notes:

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

4.1 What do you expect the price level to be over the next quarter?

(Net balance, 0.56; Q1 2020, 0.62)

Inflationary pressures were expected to remain high in the third quarter of 2020 (Chart 17). This was mainly on account of persistent high cost of production, electricity load management and depreciation of the Kwacha as well as uncertainty about economic activity due to the COVID-19 pandemic.

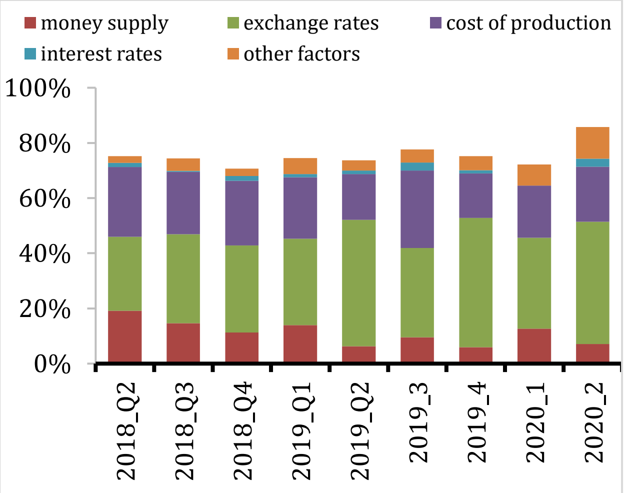
Chart 17: Inflationary Expectations Next Quarter

Over the next 12 months, inflationary pressures were anticipated to persist mainly on account of high Government debt service, high cost of production, lagged effects of the COVID-19 pandemic and an increase in money supply due to high Government spending attributed to the impending 2021 General Elections.

4.2 What is the main factor explaining your expectations of inflation?

The key drivers of expected inflationary pressure was the depreciation of the Kwacha, followed by the cost of production (Chart 18).

Chart 18: Key Drivers of Inflationary Expectations

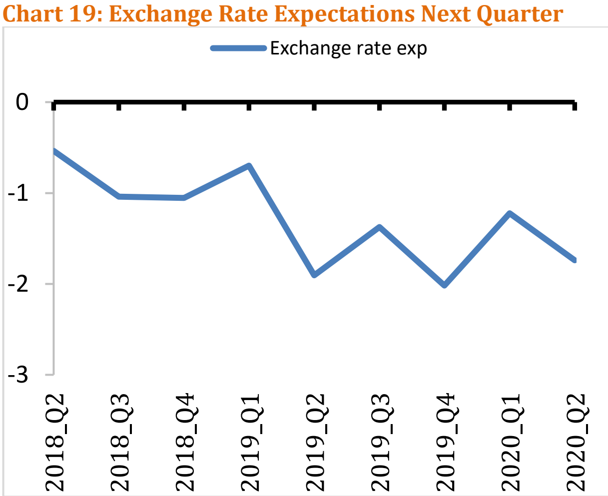


4.3 How do you expect the performance of the Kwacha against the US dollar to be at the end of the next quarter?

(Net balance, -0.72; Q1 2020, -0.56)

The depreciation of the Kwacha against the US dollar was expected to persist during the third quarter of 2020 (Chart 19). This was largely due to the fall in investor confidence and foreign exchange earnings following the negative impact of COVID-19 pandemic on copper exports amidst high demand for the US dollar to support Government debt service as well as imports of goods and services.

Chart 19: Exchange Rate Expectations Next Quarter



4.4 Over the next quarter, what do you expect credit availability to be?

(Net balance, 0 .64; Q1 2020, 0.65)

Credit conditions were expected to remain tight during the third quarter of 2020 (Chart 20). This was mainly on account of tight liquidity conditions, high interest rates, the crowding-out effects of high Government borrowing as well as stringent lending conditions to curb credit risk exacerbated by the COVID-19 pandemic.

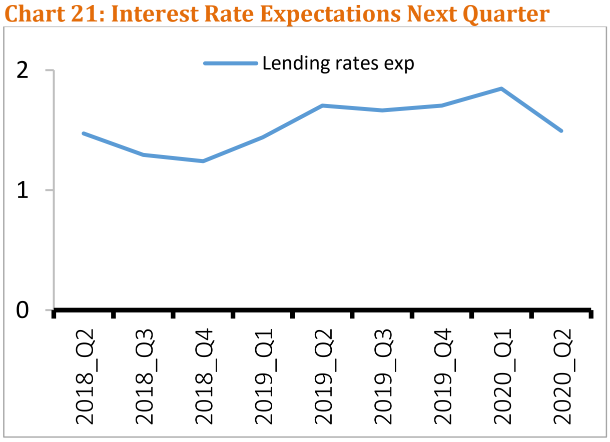
Chart 20: Credit availability expectations next quarter

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

(Net balance, 0.77; Q1 2020, 0.89)

Commercial banks' lending rates were expected to continue on an upward trend during the third quarter of 2020 (Chart 21). This was mainly due to the rise in credit risk following low economic activity induced by the COVID-19 pandemic, rising inflation and depreciation of the Kwacha.

Chart 21: Interest Rate Expectations Next Quarter

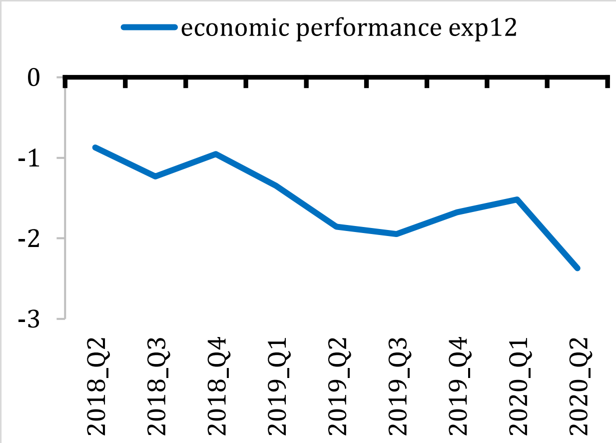


4.6 What is your expectation of the performance of the economy in the next 12 months?

(Net balance, -0.46; Q1 2020, -0.24)

Respondents remained pessimistic about the performance of the economy over the next 12 months (Chart 22).

Chart 22: Economic Performance in the Next 12 Months



This was mainly premised on persistent increases in the cost of production largely induced by high fuel and electricity prices, electricity load shedding, depreciation of the Kwacha, high cost of living driven by rising inflation as well as the long-term negative effects of COVID-19 pandemic. Inconsistent Government policies and high tax burdens were perceived as additional determinants of the poor economic performance.

5.0 Conclusion

The Business Opinions and Expectations Survey for the second quarter of 2020 was conducted between June and July 2020. The Survey revealed further deterioration in economic activity inthe second quarter as aall the monitored real sector indicators declined except for new orders. The negative impact of the COVID-19 pandemic, tight liquidity conditions in the market as well as high cost of production (energy prices, exchange rate depreciation and electricity load shedding) largely accounted for the negative outturn in the second quarter.

In the third quarter of 2020, economic performance is expected to remain subdued largely due to the anticipated further depreciation of the Kwacha and the high cost of doing business mainly reflected in high lending rates, tight liquidity conditions, rising inflation, electricity loadshedding and high energy prices. This, notwithstanding, improvements in capacity utilisation, new orders, output, domestic sales and volume of services were expected largely on account of some expansion works to be undertaken in the construction and manufacturing sectors. Further, the partial relaxation of the COVID-19 restrictions in the tourism and aviation industries is likely to positively influence economic activity.

Economic performance sentiments for the next 12 months are gloomy mainly on account of elevated cost of doing business influenced by the exchange rate depreciation, high energy prices and the sustained impact of COVID-19 pandemic. In addition, tight credit and liquidity conditions, high commercial banks' interest rates, low export earnings coupled with sustained demand for foreign exchange to meet Government external debt service are perceived as other key drivers of weak economic performance in the next 12 months. High inflationary pressures are expected to persist due to the depreciation of the Kwacha, high energy prices, Government debt service, and past inflation.

Appendix - Survey Methodology

Data collection for the Quarterly Survey of Business Opinions and Expectations is done through a questionnaire 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 12 months ahead. The questionnaire is administered to a sample of respondents in manufacturing, trading, tourism and services, construction, and agriculture sectors selected on the basis of their contribution to GDP.

The Survey covers the Copperbelt (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) Provinces.

Data analysis is undertaken based on Net Balance Statistic (*N*) methodology where qualitative responses are converted into quantitative measures as follows:

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

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

The Net Balance Statistic method is widely used in the analysis of survey data and has the advantage of detecting the directional changes in performance/expectations of respondents in surveys. It 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. On the other hand, a negative net percentage means a decrease/deterioration/loosening, depending on the variable under consideration.