Bank *of* Zambia

Quarterly Survey of Business Opinions and Expectations Report

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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 that may impact on future economic performance. Given the dominant role expectations play in shaping economic behaviour, the Survey provides a guide to likely future developments. Further, the Survey acts as a supplementary tool to provide information on the business community's opinions and expectations about the current and future direction of the economy.

This Report for the third quarter of 2019 is based on the results of the QSBOEs conducted in August and September 2019. A total of 239 firms from a sample of 276 responded, representing a response rate of 86.5%. About 36% of the firms were from the tourism sector, 22% were merchants, 17% were manufacturers, 12% were from the agriculture sector, 11% from services sector and 3% from the construction sector.
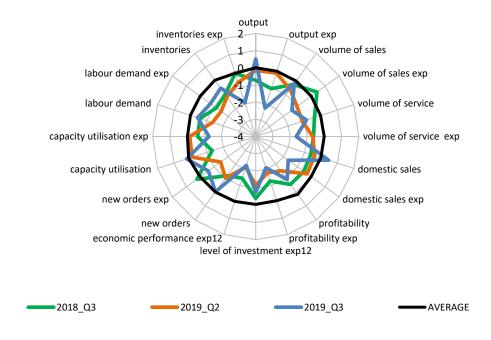
Executive Summary

Despite some improvements, economic performance remained subdued in the third quarter of 2019. All the monitored indicators of economic activity remained below the long term average with the exception of output, capacity utilisation, and domestic sales (Chart 1). Electricity load shedding, high fuel prices, exchange rate volatility, high lending rates and tight liquidity conditions continued to weigh-in on economic activity .

Economic performance is expected to further deteriorate in the fourth quarter of 2019 largely on account of an increase in the cost of doing business attributed to electricity load shedding, high fuel prices, exchange rate volatility, high cost of credit and liquidity constraints. Further, inflationary pressures are expected to heighten due to high food prices, depreciation of the Kwacha, persistent electricity load shedding, high fuel prices, and high cost of raw materials.

Over the next 12 months, economic performance is expected to continue to be constrained mainly on account of persistent load shedding, rising inflation, continued exchange rate volatility, tight liquidity and high interest rates. Further, high government borrowing, high tax burdens, low investor confidence, and subdued commodity prices are expected to negatively impact economic activity.

Chart 1: 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.

1.0 Introduction

This Business Opinions and Expectations Survey Report is divided into six sections. Section 2 presents the response patterns for economic performance during the third quarter of 2019 and expectations for the fourth quarter 2019 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 variables influencing monetary policy in the fourth quarter. Section 5 provides a conclusion while section 6 outlines the Survey methodology.

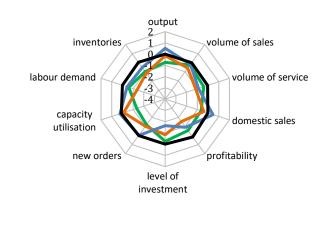## 2.0 Opinions and Expectations of Economic Activity

Economic activity remained weak in Q3 2019 with signs of improvement, but expected to deteriorate over Q4 2019 and 12 months ahead

Economic activity remained subdued in the third quarter of 2019. With the exception of level of output, capacity utilisation and domestic sales, all monitored indicators remained below the long term average (Chart 2). This notwithstanding, an improvement was observed in most indicators, consistent with the expectations made in the second quarter of 2019.

Economic activity is expected to deteriorate in the fourth quarter of 2019 mainly due to the increase in the cost of doing business, largely driven by electricity load shedding, high fuel prices, exchange rate volatility, high cost of credit, and liquidity constraints (Chart 3).

Over the next 12 months, economic activity is expected to further deteriorate, owing to persistent load shedding, rising inflation, continued exchange rate volatility, tight liquidity conditions, and high interest rates.
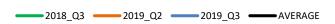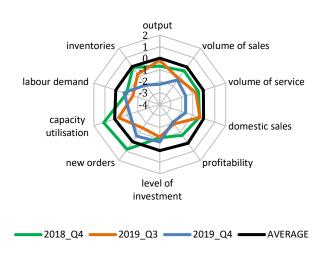
Chart 2: Business Opinions Response Patterns

2018_Q3 — 2019_Q2 — 2019_Q3 — AVERAGE

Chart 3: Business Expectations Response Patterns
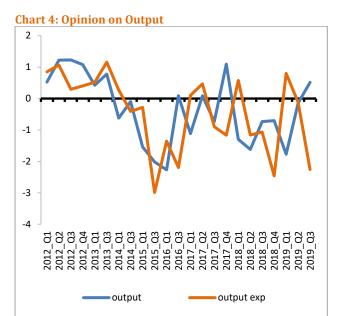

2018_Q4 — 2019_Q3 — 2019_Q4 — AVERAGE

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

(Net balance 0.03; Q2 2019, -0.06)

Output is reported to have increased in the third quarter compared to the second quarter. This was largely attributed to crop harvesting (bananas and macadamia), completion and subsequent commencement of operations at the National Milling Company flour plant in Lilayi that has led to an increase in flour production (Chart 4).

Output is, however, expected to decline in the fourth quarter of 2019 mainly on account of

extended hours of electricity load shedding and off-harvest season in agriculture.
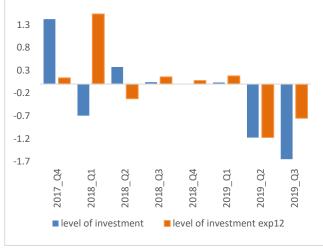
2.2   How was your firm's level of investment?

(Net balance -0.07; Q2 2019, 0.00)

Total investment declined in the third quarter mainly due to tight liquidity, high cost of credit and low retained earnings. Further, the high cost of raw materials, electricity load shedding as well as subdued demand in the manufacturing sector compounded the situation.

Furthermore, exchange rate volatility, high input costs and uncertainty in weather patterns have affected investment in the agriculture sector (Chart 5).
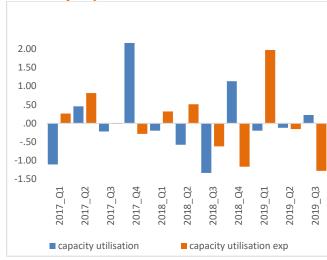
2.3   What has been your firm's experience with respect to capacity utilisation?

(Net balance -0.10; Q2 2019, -0.13)

Capacity utilisation improved in the third quarter compared to the second quarter mainly due to increased milling activities as raw material supply improved (Chart 6).

Capacity utilisation is, however, expected to decline in the fourth quarter mainly due to continued electricity load shedding.
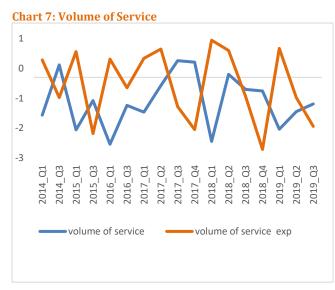
2.4   What has been your firm's experience with respect to the volume of service?

(Net balance -0.23; Q2 2019, -0.28)

Although the volume of service improved in comparison with the second quarter, it remained below the long term average (Chart 7). This was largely due to stiff competition in the tourism sector. Moreover, tight liquidity and increased electricity load shedding have negatively affected the volume of service in the banking industry and hydro-electricity power generation entities, respectively.

The volume of service is expected to further decline in the fourth quarter owing to reduced tourism activities during the rainy season, persistent electricity load shedding and continued tight liquidity expectations in the banking sector.

Chart 7: Volume of Service

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

(Net balance -0.31; Q2 2019, -0.49)

The volume of sales declined in the third quarter of 2019 and remained below the long term average (Chart 8). This was due to increased prices of merchandise from local suppliers arising from the rising cost of production, Kwacha depreciation as well as tight liquidity in the economy.

In the fourth quarter, most respondents expect the volume of sales to decline further due to anticipated tight liquidity and a rise in the cost of imports resulting from the expected Kwacha depreciation during the festive season.
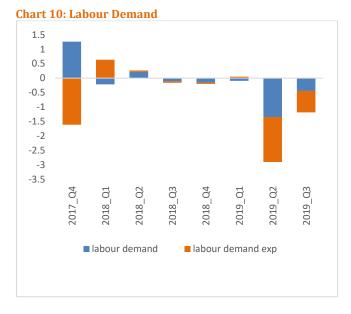
Chart 8: Volume of Sales

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

(Net balance 0.02; Q2 2019, -0.13)

Most respondents reported an increase in domestic sales during the third quarter compared to the second quarter of 2019 (Chart 9). This was mainly explained by an increase in output in the manufacturing and agriculture sectors.

Domestic sales are, however, expected to decline in the fourth quarter of 2019 on account of liquidity constraints as well as anticipated low output due to continued load shedding. In addition, a decline in the supply of maize is expected to negatively affect manufacturing activities and consequently domestic sales.

Chart 9: Domestic Sales

Chart 10: Labour Demand

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

(Net balance -0.09; Q2 2019, -0.20)

Labour demand declined in the third quarter despite recording an improvement relative to the second quarter (Chart 10). The decline was largely on account of subdued economic activity electricity load shedding and tight liquidity. This impacted mainly the merchant as well as the services and tourism sectors where some staff redundancies were recorded.

In the fourth quarter, it is anticipated that labour demand will decline further largely due to expected deterioration in economic activity coupled with electricity load shedding for the manufacturing and merchant sectors. In the service and tourism sector, labour demand is expected to decline due to a reduction in tourism activities as a result of the onset of the rainy season.

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

Retained earnings continued to be the main source of financing

Retained earnings remained the main source of investment finance and working capital followed by bank borrowing (Charts 11A and 11B).
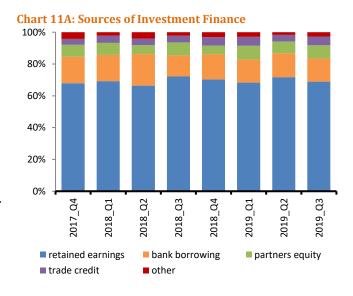
Chart 11A: Sources of Investment Finance

Chart 11B: Sources of Working Capital

Legend:
- retained earnings
- bank borrowing
- partners equity
- trade credit
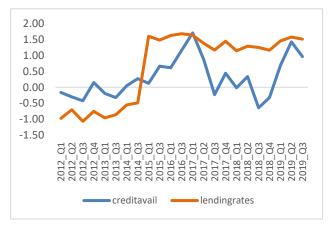- other

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

(Net balance 0.72; Q2 2019, 0.75)

Credit conditions remained tight in the third quarter (Chart 12). This was mainly reflected in strict lending conditions by commercial banks, high levels of non-performing loans (NPLs), high lending interest rates, and tight liquidity.
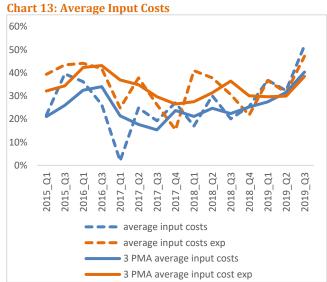
Chart 12: Credit Availability and Lending Rates

Legend:
- creditavail
- lendingrates

3.0 Evolution of Costs, Wages and Prices

3.1 What has been your firm's experience during the quarter under review with respect to average input costs?

(Net balance 0.52; Q2 2019, 0.32)

Average input costs increased during the third quarter (Chart 13), largely driven by the upward adjustment in the price of fuel, impact of electricity load shedding, and the depreciation of the Kwacha.

In the fourth quarter, average input costs are expected to increase further due to anticipated extended hours of load shedding and the depreciation of the Kwacha during the festive season.
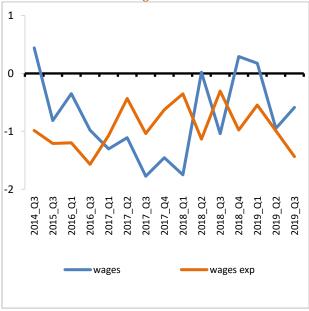
Chart 13: Average Input Costs

Legend:
- average input costs
- average input costs exp
- 3 PMA average input costs
- 3 PMA average input cost exp

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

(Net balance 0.10; Q2 2019, 0.08)

Most respondents reported a decline in the wage bill (Chart 14). This was mainly attributed to a fall in labour demand arising largely from electricity load shedding and a subsequent decline in sales volume.

The wage bill is expected to decline further in the fourth quarter due to anticipated low volume of sales, low tourism activities during the rainy season, persistent load shedding and continued mechanisation in the agriculture sector.

Chart 14: Evolution of Wages

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

(Net balance 0.19; Q2 2019, 0.24)

Most respondents reported a moderate rise in average selling prices in the third quarter (Chart 15). The increase was underpinned by the rise in fuel prices, high cost of raw materials, Kwacha depreciation, and electricity load shedding.

In the fourth quarter, average selling prices are expected to increase further. This is largely on account of anticipated persistent load shedding, and unfavourable exchange rate associated with the rise in imports during the festive season.

Chart 15: Evolution of Average Selling Prices

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

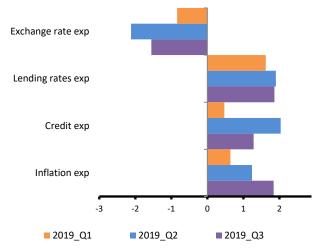*(Net balance -34.7; Q2 2019, -47.9)*

Profitability is reported to have declined in the third quarter (Chart 16). This was mainly due to low sales attributed to tight liquidity, high fuel prices, competition from cheaper imports, unfavourable exchange rate and electricity load shedding.

In the fourth quarter, profitability is expected to decline further largely on account of low demand due to continued tight liquidity conditions, high fuel prices, persistent load shedding and unfavourable exchange rate. Moreover, high agricultural input costs and the reductions in hectorage are expected to worsen the profitability situation in the agriculture sector.

Chart 16: Profitability

4.0 Expectations of Monetary Policy for Fourth Quarter 2019

Heightened inflationary pressures, tight credit conditions, high lending rates and the depreciation of the Kwacha are anticipated in the fourth quarter (Chart 17).

Chart 17: Expectations for Rising Inflation, Weak 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 (-)*
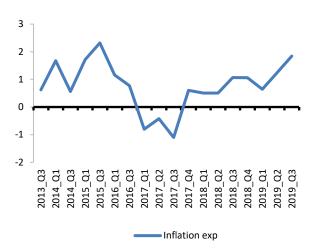
4.1 What do you expect the price level to be over the next quarter?

(Net balance 0.78; Q2 2019, 0.65)

Most respondents expect a build-up in inflationary pressures in the fourth quarter of 2019 (Chart 18). This is mainly premised on high food prices, depreciation of the Kwacha, persistent electricity load shedding, high fuel prices and high cost of raw materials.

Inflationary pressures are expected to continue over the next 12 months due to high energy costs and persistent exchange rate volatility.
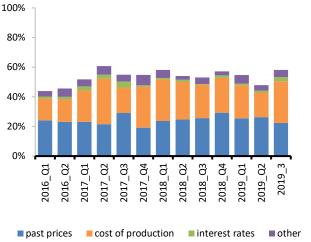
Chart 18: Inflation Rate Expectations Next Quarter

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

Inflationary pressures are expected to be largely driven by the depreciation of the Kwacha, followed by cost of production and past prices (Chart 19).

Chart 19: Key Drivers of Inflationary Expectations

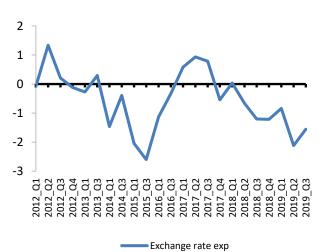Legend: past prices · cost of production · interest rates · other

4.3 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, -0.61; Q2 2019, -0.76)

The Kwacha is expected to remain weak against the US dollar in the fourth quarter 2019 (Chart 20). This is mainly on account of anticipated high demand for imports during the festive season, low export earnings, low foreign exchange reserves, and high external debt service. In addition, fuel and planned electricity imports are likely to contribute to the increase in the demand for foreign exchange during the fourth quarter.

Chart 20: Exchange Rate Expectations Next Quarter
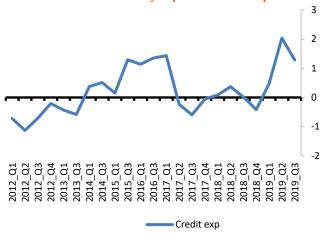

Legend: Exchange rate exp

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

(Net balance, 0.70; Q2 2019, 0.77)

Credit conditions are expected to remain tight during the fourth quarter of 2019 (Chart 21). This is mainly premised on low liquidity in the market, high interest rates associated with high Government borrowing, and strict lending conditions by commercial banks.

Chart 21: Credit availability expectations next quarter
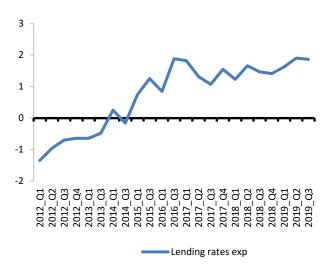

Legend: Credit exp

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

(Net balance, 0.83; Q2 2019, 0.84)

Lending rates are expected to remain high in the fourth quarter of 2019 largely on account of high Government domestic borrowing, tight liquidity, depreciation of the Kwacha and rising inflation (Chart 22).
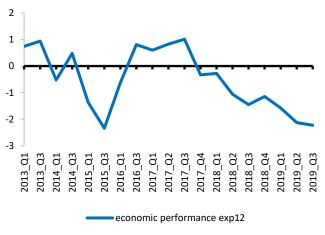
Lending rates exp

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

(Net balance, -0.35; Q2 2019, -0.33)

Most respondents remained pessimistic about the performance of the economy over the next 12 months (Chart 23). This is largely on account of persistent load shedding, rising inflation, continued exchange rate volatility, tight liquidity and high interest rates. Further, high Government borrowing, high tax burdens, low investor confidence, low agriculture output and subdued commodity prices are expected to negatively impact economic activity.

Chart 23: Economic Performance in the Next 12 Months

economic performance exp12

5.0   Conclusion

The Survey of Business Opinions and Expectations conducted between August and September 2019 revealed sustained subdued economic performance in the third quarter, although a slight improvement was observed compared to the second quarter.

Inflationary pressures are expected to be driven by high food and fuel prices, high cost of raw materials, depreciation of the Kwacha and persistent electricity load shedding. The expected depreciation of the Kwacha is premised on the declining foreign exchange reserves largely attributed to high external debt service coupled with high demand for imports during the festive season. High food prices will be driven by low maize stocks held by the Food Reserve Agency.

Over the next 12 months, economic performance is expected to continue declining mainly due to continued electricity load shedding, rising inflation, exchange rate volatility, tight liquidity, and high interest rates. In addition, high Government borrowing, high tax burdens, low investor confidence and subdued commodity prices are expected to negatively impact economic activity.

6.0   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:

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

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.