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*Negotiations between the government and copper miners to resolve tensions over the new mining royalties tax begin on 3 February. Barrick Gold's confirmation that it will close its Lumwana mine leads to a 2,000-worker strike and increases the stakes around the royalties tax negotiations. President Edgar Lungu (2015-present) promises that no job losses will occur in the mining sector. The kwacha falls to a new record low against the dollar, as well as other global currencies: low copper prices and the ongoing dispute with copper miners are contributing factors. Lungu announces major cabinet appointments, reappointing all but four ministers of the pre-election transitional cabinet. The president takes a populist stance with the **Zambian Electricity Supply Corporation**, pressuring the parastatal into freezing tariffs for two years.*

Imminent Barrick mine closure raises stakes around tax negotiations...

Negotiations between the new Zambian government and copper mining companies over a new mining royalties tax regime began on 3 February and are expected to last until mid-March. However, the imminent closure of **Canada-based Barrick Gold's Lumwana mine**¹ – and the prospect of 4,000 job losses – has raised the stakes sharply, putting pressure on the government to find a solution.

The **Mines and Mineral Development Act**, which came into force in January 2015, cut corporate income tax rates but also increased the mining royalties tax on mining companies from 6% to 20%. At the same time, companies are struggling with significantly lower copper prices – down from \$6,300 per tonne (t) at the start of the year to a five-year low of \$5,400/t at the end of January 2015. Prices have since recovered to \$5,700/t in February. However, this is still well below the \$7,000-\$8,000/t range during 2012-2014.²

Talks between the government, the mining companies and the **Zambian Chamber of Mines (ZCM)** have been ongoing since 3 February, when President **Edgar Lungu** (2015-present) instructed the **Zambia Revenue Authority (ZRA)** and the finance ministry to negotiate with industry.³ Lungu has personally chaired the talks, which also involved the mining and justice ministers. All sides have kept a positive public face on the talks.⁴ Lungu said on 23 February that the government was working to address the mining sector's concerns over the new royalties tax.⁵

Barrick restated on 13 February that it would close its Lumwana copper at the end of the month.⁶ The company attributed the decision to the poor operating climate. Lumwana produced 135,000 tonnes of copper in 2014 and employs 4,000 people. The company first announced it might close the mine on 17 December 2014.⁷ In response, 2,000 miners at Lumwana went on strike on 23 February. Officials from the ministry of mines and the **Mine Workers Union of Zambia (MUZ)** say they are working with Lumwana management to resolve the dispute.⁸ President Lungu directly addressed the

¹ Canada-based Barrick Gold Corporation has run Lumwana directly rather than through its majority-owned UK-listed subsidiary, African Barrick Gold, itself renamed Acacia Mining Plc in December 2014.

² Investmentmine.com, 2015

³ Times of Zambia, 3 Feb 2015

⁴ Lusaka Times, 23 Feb 2015

⁵ Lusaka Times, 23 Feb 2015

⁶ Market realise, 14 Feb 2015

⁷ Zambia Reports, 20 Feb 2015

⁸ Reuters, 23 Feb 2015

Lumwana closure in a statement later that day, saying that that he would not allow a single mining job to be lost. State-owned **Zambia Consolidated Copper Mines-Investment Holdings (ZCCM-IH)**, which owns a 20% stake in the mine, has said that it will seek a new strategic technical partner to operate Lumwana if Barrick closes it in March.⁹

President Lungu is in a difficult position:

*"(He) is writing cheques he cannot cash. Zambia's finances are not in a state to prop up the mining sector, and finding a partner in this climate will be hard."*¹⁰

*"Lungu has to please the people. He has campaigned on a populist ticket and can't allow job losses... and he needs the revenues from the mining sector to fund the projects (deceased former president) **Michael Sata** (2011-2014) started...that he promised to finish."*¹¹

The president opined on 23 February that the talks should be resolved in the next couple of weeks.¹² However, it is not clear what form any final settlement will take. The government's stated view is that mining output has increased in recent years and, when the price of copper rises, companies will be able to afford the new tax regime. However, the ZCM claims that the new tax would cause 12,000 job losses in the sector and endanger major projects, including London-listed **Glencore Xstrata**-owned **Mopani Copper Mines**.¹³ The new commerce minister **Margaret Mwanakate** told the media on 10 February that the government could defer collection of the royalties for up to two years, as prescribed in the new mining act.¹⁴ Sources in Zambia confirm that deferment is one option the government is considering:

*"Deferring the payments would be one of the options on the table in any negotiation...if the price of copper were higher then the mining companies could [then] be more amenable."*¹⁵

The government made some concessions to the mining companies when the negotiations over the royalties tax were under way. The ZRA announced that it would implement a simplified VAT refund regime on 19 February.¹⁶ Mining companies and the government had been in a dispute over \$500m of VAT refunds since late 2013. The ZRA had announced in September 2014 (see *ARC Zambia September 2014 Briefing*) a revised regulation that the government had delayed implementing. However, progress on the VAT front is no 'silver bullet':

*"If the new legislation goes through, the costs are going to outweigh the VAT receipts issue....it is a step in the right direction but does not solve the problem."*¹⁷

For now, the mining companies (Barrick excepted) seem content to wait for the negotiations to play out before making any major decisions to cut production. However, some have begun to take steps to mitigate the new tax regime's impact. Canada-based **First Quantum Minerals** is restructuring its debt in anticipation of the changing environment in Zambia, renegotiating covenants with its lenders on a \$3 billion senior debt facility, and negotiating a \$100m loan on its **Kansanshi** mine in Zambia. Its creditors have adjusted both debt agreements to reflect the current situation in the copper sector.¹⁸

...shaking market confidence in Zambia's new economic management

The fall in confidence in the mining sector has added to pressure on the kwacha in February. The kwacha fell to a record low of K7.13 to the **United States (US)** dollar on 17 February, beating the

⁹ Lusaka Times, 23 Feb 2015

¹⁰ Source: journalist, Lusaka

¹¹ Source: think-tank director, Lusaka

¹² Lusaka Times, 23 Feb 2015

¹³ Reuters, 10 Feb 2015

¹⁴ Post, 30 Jan 2015

¹⁵ Source: ministry of mines, Lusaka

¹⁶ Reuters, 23 Feb 2015

¹⁷ Source: mining analyst, Cape Town

¹⁸ Reuters, 20 Feb 2015

K7.04 level of May 2014, the previous record low. The kwacha's weakness prompted an emergency meeting of the monetary policy committee of the **Bank of Zambia (BoZ)** the same day.

The currency has fallen 7.5% in February, from K6.5 to the dollar to K6.99 at time of writing (having recovered slightly from its 17 February low). So far in 2015 the currency has fallen 9.7% against the dollar.¹⁹ This depreciation is in part explained by the wider strengthening of the dollar, but the kwacha has fallen against most major currencies in 2015 (e.g. 2.5% against the euro, 3.6% against the Canadian dollar, and 8.7% against the **Chinese** yuan).²⁰

The kwacha's depreciation presents a looming inflationary challenge for the new government. On 16 February the secretary to the treasury, **Fredson Yamba** said that the currency worries were the result of a strong dollar, poor copper prices, and a speculative private sector. However his attempt to talk up the currency, saying it was "*on course to regain its stability and resilience*", has not worked in the short term.²¹ Currency traders say that the breach of the psychological barrier of K6.8 to the dollar and the ongoing, highly public dispute with mining companies over the royalties tax has shaken market confidence over more than the short term.²²

*"Currency trading is easily affected by headline news, and the mining dispute qualifies (for this) ...as long as the copper price remains low and the mining companies aren't happy, the kwacha will trade low."*²³

Lungu dismissed the BoZ's incumbent governor, **Michael Gombwe**, on 13 February and appointed **Denny Kalyalya** to the role. Sources in Zambia attributed the dismissal to Gombwe's poor handling of the currency markets. Kalyalya has spent most of his professional career at the BoZ, where he rose to become a deputy governor. He left in 2014. The president recruited him back from a posting at the **World Bank**.²⁴ The decline in the kwacha has not yet fed through to inflation, which has held around the 8% mark for much of 2014 and 2015. In January, it actually fell slightly to 7.7%, from 8.1% in December 2014. The BoZ said that increased consumer spending on lower-priced foodstuffs and other consumables accounted for the change.²⁵

Lungu's cabinet: continuity confirmed

President Lungu unveiled the rest of his cabinet on 16 February 2015. The make-up closely resembles that of the previous cabinet, with only four former ministers excluded: **Guy Scott** (the interim president during the transition, with whom Lungu had a frosty relationship), **Robert Sichinga** (former commerce minister), **Wilbur Simuusa** (agriculture), and **Emmanuel Chenda** (local government). The new commerce minister is former **Barclays Zambia** and **Barclays Ghana** chief executive Margaret Mwanakate.²⁶ The new agriculture minister is former foreign minister **Given Lubinda**, and the new local government minister is **John Phiri**, a former education minister.²⁷ Another new entrant is **Zambezi West Patriotic Front (PF)** MP **Christabel Ngimbu** as minister of lands. Lungu has appointed two **Movement for Multiparty Democracy (MMD)** MP's to the cabinet. **Mike Kaingu** has taken over the education portfolio and Lungu appointed **Vincent Mwale** minister of sport. The MMD is a minority opposition party that achieved just 0.87% of the vote in the elections. However former MMD leader and Zambian president **Rupiah Banda** (2008-2011) lent his support to Lungu late in the presidential campaign. The MMD cabinet appointments reflect this. Lungu has said

¹⁹ XE.com

²⁰ XE.com

²¹ Lusaka Times, 16 Feb 2015

²² Reuters, 17 Feb 2015

²³ Source: African currency analyst, London

²⁴ Post, 13 Feb 2015

²⁵ Zambia Watchdog, 12 Feb 2015

²⁶ Post, 3 Feb 2015

²⁷ Zambia Reports, 16 Feb 2015

he will remain minister of defence (his role under Sata and during the transition in 2014) until further notice.²⁸

According to sources on the ground, there was a mixed popular reaction to the new cabinet. Some have taken the continuity as a sign that little will change before the 2016 election, but also that the government will have little meaningful impact on major socio-economic problems that built up under Sata. Others believe that a continuation of Sata's policies at least gives a sense of predictability, and that a radical change in government would create public uncertainty.²⁹ Sources are also sceptical about the slowness in announcing the appointments, indicative of Lungu's decision-making style:

*"The cabinet did not warrant President Lungu spending 19 days – inclusive of seven days' retreat – choosing it...it comprises only old faces."*³⁰

Opposition party political groups have been critical of the appointments. The opposition **Forum for Democracy and Development (FDD)** spokesperson **Antonio Mwanza** said: *"Most of those appointments are totally misplaced...cabinet jobs have been given to individuals who lack expert knowledge and experience."*³¹

Government freezes electricity tariffs for two years

President Lungu has ordered the **Zambia Electricity Supply Corporation (Zesco)** to freeze its electricity tariffs for the next two years, having told the state-owned enterprise to be *"pro-poor"*.³² He said on 11 February that the freeze was due to complaints from business and domestic customers that frequent tariff increases – in large increments – were not justified on the back of equally frequent load-shedding and poor supply. He gave the company two years to *"put its house in order"* and demonstrate that it provides a value for money service.³³

Energy minister **Christopher Yaluma** dissolved the Zesco board and replaced Zesco's managing director, **Cyprian Chitundu**, with his chief operations officer, **Victor Mundede** on 16 February. A new board has yet to be appointed at time of writing.³⁴

*"Lungu is acting like Sata, publicly admonishing Zesco for not being 'pro-poor' while cutting its income for a significant period of time."*³⁵

*"Zambia's electricity sector needs investment, not a budget cut. The government needs to fund improvements and upgrades to make sure the problems don't get worse."*³⁶

As well as agreeing to the tariff freezes, Zesco has asked the government for greater powers to reclaim monies it alleges mining companies owe following an electricity tariff dispute. Zesco says that **Vedanta Resources'** local subsidiary, **Konkola Copper Mines (KCM)**, owes Zesco \$110m. However, Zesco currently has no legal recourse to enforce commercial agreements. Chitundu has also requested powers to renegotiate bulk supply agreements with copper miners.³⁷ The government has yet to respond to either of these requests.

²⁸ Zambia Reports, 16 Feb 2015

²⁹ Source: director of a think-tank, Lusaka

³⁰ Source: director of a think-tank, Lusaka

³¹ FDD statement, 7 Feb 2015

³² Lusaka Times, 10 Feb 2015

³³ Zambia Daily Mail 11 Feb 2015

³⁴ Lusaka Times, 16 Feb 2015

³⁵ Source: director of a think-tank, Lusaka

³⁶ Source: energy consultant, Johannesburg

³⁷ Lusaka Times, 10 Feb 2015

Implications

The risk of economic and financial instability in Zambia has heightened in January and February on the back of falling copper prices and has quickly fed through to the currency markets. The kwacha is back to May 2014 levels, market confidence in the government is at rock bottom. The cash-strapped government – committed to Sata’s expensive populist agenda – is tied up in a long and complex negotiation with mining companies over a tax that they cannot, in the current commodities climate, afford to pay. The closure of Lumwana mine seems inevitable, and the government is unlikely to find a replacement investor of the same quality as Barrick. Other mining investors are already putting investment plans on hold given the uncertainty surrounding the royalties tax negotiations. Zambia will remain Africa’s second largest copper producer, so investors are unlikely to exit the market wholesale. However, the new tax – unless significantly watered down – will inevitably lead to job losses and prevent much-needed modernisation, hitting Zambia’s long-term competitive position.

So far, Lungu’s administration has focused on Sata-style big promises and populist politics (albeit delivered with less rhetorical flair). In dismissing the BoZ governor, the attorney general (see *ARC Zambia January 2015 Briefing*), and the head of Zesco, he is playing to the public gallery. He has also castigated Zesco for not being ‘pro-poor’ and has promised no mining job losses, even during a period of low copper prices. The appointment of two MMD ministers shows the fruits of Banda’s support for Lungu in the final stages of election: the minority opposition party (and Banda himself, by extension) gets a seat at the table.

Populism may buy Lungu some short-term breathing space but leaves him little room for manoeuvre on the major issues, such as the minerals royalties tax. He promised repeatedly during and after the recent election that he would implement it. With the 2016 presidential election already firmly in his sights, he cannot afford to alienate the PF’s voting base by conceding too much to the mining companies or (equally) by presiding over mine closures. He has taken away Zesco’s source of income without providing the money needed for infrastructure upgrades and development that would help tackle Zambia’s electricity problems. Even if Zesco receives the go ahead to reclaim the \$110m it alleges the mining companies owe, it needs, significant further investment to solve its poor generation capacity and service delivery.

As with his opposite number, President **John Dramani Mahama** (2011-present), in Ghana, Lungu will be reluctant to seek external help if the kwacha’s slide continues and begins to feed into higher inflation and shortages. President Sata called on the **International Monetary Fund (IMF)** in June 2014 but did not request a formal bail-out. In Ghana, Mahama waited for six months, during which time the Ghanaian cedi was in free-fall, before calling in the IMF. His government’s inability to reverse the economic slump undermined his original goal to preserve popularity. Like Mahama, Lungu may have no option but to call on the IMF if he wants to get a real handle on the economic situation before the 2016 elections. **Alexander Chikwanda** has proven a steady hand as finance minister, and remains a potentially stabilising influence. But it will be on the big (and potentially unpopular) financial decisions where this influence will be truly tested.