

## AFRICA RISK CONSULTING

### Zambia Monthly Briefing June 2015

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#### Zambia Summary 30 June 2015

*Parliament votes to nearly double Zambia's borrowing limit to \$8.5 billion to cover an increased budget deficit. Finance minister Alexander Chikwanda decreases the 2015 growth forecast from 7% to 5.8% in line with recommendations from the International Monetary Fund (IMF). Mines minister Christopher Yaluma announces a further decrease in the new mining royalties' tax from 9% to 6% for deep mining operations. Mining companies also report that the Zambian Revenue Authority (ZRA) has started repaying \$600m in valued added tax (VAT) refunds it has owed the mining industry since late 2013. A court in Lusaka acquits former president Rupiah Banda (2008-2011) of corruption charges relating to an oil deal with Nigeria during his administration.*

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#### Zambia doubles borrowing limit to fund budget deficit

Parliament voted to almost double the country's borrowing limit to \$8.5 billion from \$4.5 billion to finance the growing budget deficit. Finance minister **Alexander Chikwanda** put the proposals to a vote after a downturn in the kwacha and lower mining revenues reduced 2015 gross domestic product (GDP) growth forecasts from 7% to 5.8%.<sup>1</sup> Chikwanda and the **Bank of Zambia (BoZ)** central bank estimate that the 2015 budget deficit will increase 8% to \$1.69 billion, higher than the \$1.56 billion the government predicted in January. This is an increase from 4.6% to 6% of GDP.<sup>2</sup>

The increased borrowing limit will be used to fund capital spending projects to address the infrastructure deficit. The funds will also finance institutions that support small and medium enterprises.<sup>3</sup> The plan to borrow externally, rather than locally, is due to the cheaper price of debt in external markets. This will help to keep interest rates low for consumers through not crowding out the local lending market.<sup>4</sup> Zambia's external debt obligations are currently \$4.8 billion, 18.5% of GDP, and domestic obligations are \$3.7 billion, 14.2% of GDP.<sup>5</sup> Consumer price index (CPI) inflation increased year-on-year to 7.1% in June from 6.9% in May. The increase was largely due to increases in the price of fuel. Monthly inflation increases remained static at 0.6%.<sup>6</sup>

The kwacha has continued to fall against the dollar throughout June. It fell from K7.24 to the dollar on 1 June, to K7.58 at time of writing, a 4.6% increase across the month.<sup>7</sup> The kwacha has depreciated 18% over the first two quarters of 2015, from K6.39 in January. However, it is still lower than its two-year, all-time low (Zambia rebased its currency in 2013) of K7.76 it reached in March 2015.<sup>8</sup>

*"The kwacha's depreciation is partly due to external factors such as the increased strength of the dollar and falling copper prices, but internal factors like the ongoing mining dispute and increased deficit and decreasing fiscal deposits have also affected its value."<sup>9</sup>*

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<sup>1</sup> ZNBC, 16 Jun 2015.

<sup>2</sup> Reuters, 16 Jun 2015.

<sup>3</sup> ZNBC, 25 Jun 2015.

<sup>4</sup> Lusaka Times, 25 Jun 2015.

<sup>5</sup> Lusaka Times, 25 Jun 2015.

<sup>6</sup> Reuters, 25 Jun 2015.

<sup>7</sup> XE.com.

<sup>8</sup> XE.com.

<sup>9</sup> Source, international organisation, Washington DC

The revised growth estimates are in line with those of the **International Monetary Fund (IMF)** mission that visited the country from 11 to 22 May. The IMF put 2015 growth at 5.6%. The IMF described the economy as having strong potential but said that “*large fiscal imbalances, lower copper prices and policy uncertainties*”<sup>10</sup> have kept GDP growth down.<sup>11</sup> The primary factor in the lower growth estimate, according to the IMF, is the decreasing price of copper. It predicts that growth will remain between 5.5% and 5.8% of GDP over the coming three years and cites investments in the mining and electricity sectors as key factors pushing growth up.<sup>12</sup> Business sources with ties to the presidency say that President **Edgar Lungu** (2015-present) takes the IMF report very seriously, and is moving his finance minister more towards a free market model:

*“Lungu is taking good advice from the IMF and his advisers (many of whom are former IMF)... Chikwanda is a first republic man, still looks up to [first president of Zambia, **Kenneth**] Kaunda [1973-1991]... Lungu has put lots of pressure on him to liberalise his outlook.”<sup>13</sup>*

The IMF welcomed the government’s implementation of total cost recovery for petroleum products, its resolution of a dispute with mining companies over a royalties tax, and public financial management reforms. The IMF commended the BoZ for its support of tight monetary policy during a time of currency fluctuation.<sup>14</sup> However, it also highlighted the need for “*significant fiscal consolidation*”<sup>15</sup> across 2015 to reduce the deficit and stabilise debt.<sup>16</sup> Curbing increases of the public sector wage bill, increasing the tax base and scaling back the pension scheme to a sustainable size are suggested measures to achieve this. The IMF also noted the government should exercise prudence in borrowing from commercial entities and prioritise capital spending projects in order to bridge the infrastructure gap.<sup>17</sup>

### Government lowers mining rates further and begins VAT repayments

The government has decreased the new royalties’ rate on mining from 9% to 6% for deep mines<sup>18</sup> and has started repaying \$600m in value-added tax refunds that it has withheld from mining companies since late 2013.<sup>19</sup> These two developments are a notable change in relations between the mining ministry and mining companies and are part of efforts to increase growth and stabilise the kwacha (see above).

Mining minister **Christopher Yaluma** announced on 5 June that the government would reduce the royalties’ tax rate on mining profits from 9% to 6%. The reduction will apply only to deep mines and not to royalties on open pit mines, which remain at 9%. The rate change reflects the higher costs of operating deep mines, which include electricity and water pumping costs.<sup>20</sup> Lungu intervened in March when negotiations over the royalty rate, which the ministry originally set at 20%, led to companies threatening to halt operations (see *ARC Zambia March 2015 Briefing*). Lungu set up closed door meetings between the finance and mines ministries, the presidency, and mining companies to resolve the situation. The presidency released a statement after Yaluma’s announcement saying that it hoped that the lower rates would lead to greater production and profits, netting the state more overall value from the mining sector.<sup>21</sup>

<sup>10</sup> IMF section IV report, 22 May 2015

<sup>11</sup> IMF section IV report, 22 May 2015

<sup>12</sup> IMF section IV report, 22 May 2015

<sup>13</sup> Source, CEO, Zambia

<sup>14</sup> IMF section IV report, 22 May 2015

<sup>15</sup> IMF section IV report, 22 May 2015

<sup>16</sup> IMF section IV report, 22 May 2015

<sup>17</sup> IMF section IV report, 22 May 2015

<sup>18</sup> Lusaka Times, 5 Jun 2015.

<sup>19</sup> Zambia Reports, 29 Jun 2015.

<sup>20</sup> Lusaka Times, 5 Jun 2015.

<sup>21</sup> Reuters, 5 Jun 2015.

Local media reported that the government had started making repayments of the VAT refunds to mining companies on 29 June. Sources in the mining industry reported that the **Zambia Revenue Authority (ZRA)** had begun to make small repayments to mining companies.<sup>22</sup> Mines minister Yaluma told reporters that the government was “*very committed to repaying...to clear the debacle*”.<sup>23</sup> However, the mining industry reports that the current level of repayments is very low.<sup>24</sup> The ZRA originally held back the repayments due to a regulation that required miners to declare the ultimate destination of the exported copper. Mining companies argued that since they sold the copper to traders they were unable to identify who that might be. The government relaxed the regulations in February 2015 (see *ARC Zambia February 2015 Briefing*) but these are the first reports of any repayments.<sup>25</sup>

The government is making a concerted effort to put the tensions of the past two years behind it. The new policy appears based on the idea that decreasing taxation will allow the mining sector to grow and help drive an economic recovery. BoZ governor **Denny Kalyalya** said that he had advised the government that greater exports from lower taxation could improve the value of the kwacha.<sup>26</sup>

*“Lungu is very insistent that mining continues to be the engine for Zambia’s growth...he was bound by promises he made on the campaign trail but now that he’s in office he is overruling more populist voices.”<sup>27</sup>*

Mining companies have responded positively to the developments. **Canada-based First Quantum Minerals** director of operations **Matt Pascal** said that despite a frequently changing tax regime over the last five years:

*“We are heartened by the fact that the current government has expressed the willingness to talk to the industry and come up with a rational tax going forward that will be conducive to further investments and the sustainability of the mines.”<sup>28</sup>*

However, the company is still holding back \$1 billion of investments in exploration in Zambia as it waits for the situation to develop.<sup>29</sup> **United Kingdom (UK)-based Vedanta Resources** also publicly commended the government on the developments.<sup>30</sup> **Switzerland-based Glencore Xstrata** and **Canada-based Barrick Gold**, the other two copper miners in the country, have not publicly commented at time of writing.

### Court clears Banda of corruption charges

A court in capital city **Lusaka** has cleared former president **Rupiah Banda** (2008-2011) of corruption charges relating to an oil contract with **Nigeria** while he was president. This brings to an end a trial which former president **Michael Sata** (2011-2014) began against his predecessor in 2013.<sup>31</sup>

The prosecution alleged that the oil deal was a private ‘government-to-government’ deal that involved transfers of \$2.5m to Banda and members of his family. However, magistrate **Joshua Banda** ruled that the prosecution was unable to provide any evidence that such a transfer took place or that Banda and his family benefitted.<sup>32</sup> He also criticised the prosecution for not interviewing any officials from **Nigeria** during the course of its investigation.<sup>33</sup> **Kenneth Konga**, who was energy minister under

<sup>22</sup> Zambia Reports, 29 Jun 2015.

<sup>23</sup> Reuters, 29 Jun 2015.

<sup>24</sup> Zambia Reports, 29 Jun 2015.

<sup>25</sup> Zambia Reports, 29 Jun 2015.

<sup>26</sup> Lusaka Times, 10 Jun 2015.

<sup>27</sup> Source, CEO, Zambia

<sup>28</sup> Reuters, 18 Jun 2015.

<sup>29</sup> Reuters, 18 Jun 2015.

<sup>30</sup> Reuters, 5 Jun 2015.

<sup>31</sup> Zambia Watchdog, 29 Jun 2015.

<sup>32</sup> News24, 29 Jun 2015.

<sup>33</sup> News24, 29 Jun 2015.

Banda, testified that he had travelled to Nigeria to secure the oil deal when Zambia was in desperate need of fuel and that Banda had not profited personally.<sup>34</sup> The acquittal is a positive development for the former **Movement for Multiparty Democracy (MMD)** leader who faced up to five years in prison if found guilty.<sup>35</sup>

Banda's supporters have long claimed that he was the victim of an opposition crackdown under Sata. The fact that former director of public prosecutions (DPP) **Mutembo Nchito** first brought the case supports this view. Nchito is a member of the so-called '*cartel*' that wielded considerable influence under Sata's presidency.<sup>36</sup> Lungu suspended Nchito from his post in February and has launched a number of attacks on cartel members, including **Post Newspapers** owner **Fred M'membe** and **Zambia Finance Bank (ZFB)** chairman **Rajan Mahtani** (see *ARC Zambia May 2015 Briefing*). However, Banda's opponents believe that the acquittal was politically motivated as part of an attempt to discredit Nchito and as a reward for Banda's support of Lungu's presidential campaign:

*"Nchito and the cartel are very corrupt but so was Banda and he is being let off the hook because of political circumstances."*<sup>37</sup>

## Implications

Lungu's economic policy is slowly starting to take shape. After a difficult few months at the beginning of his presidency Lungu now appears more inclined to move the government towards a more economically liberal stance. The increased budget deficit is partly the short-term costs of reducing the mining royalties' tax. The treasury had forecasted a 4.6% deficit for 2015 on the basis of 20% taxation and no reduction in output. Lungu's strategy of more realistic taxation relies on copper producers to retain and then increase output in order for the government to recoup those revenues. This is a risky plan; the kwacha is highly volatile, as is the price of copper. Increased borrowing in the short term coupled with a further currency decline could destabilise Zambia's debt position and drive up inflation.

Chikwanda's backing of Lungu as a candidate when he was still relatively unknown in October 2014 lent him considerable influence on the campaign trail. However, now that Lungu is in charge, Chikwanda's policies, such as the 20% mining tax, are gradually being reversed. Chikwanda is a very powerful figure within the ruling **Patriotic Front (PF)** and Lungu needs that influence on his side. However, if Lungu wins the 2016 elections, and the Zambian media currently believes he will, then Chikwanda's future in the finance ministry is less than certain.

It is unclear whether the Lusaka court's acquittal of Banda shows that the charges were politically motivated and groundless, or whether the acquittal itself is politically motivated. What is clear is that Lungu's suspension of Nchito and his moves against the rest of the cartel are politically motivated. They fought hard to keep him out of office and pose a threat to his authority. However, this does not necessarily mean that Lungu would let Banda off the hook if there were clear evidence that he benefitted from the Nigeria deal. Investors should watch the series of upcoming cases against Mahtani carefully to determine to what extent the judiciary is allowed to remain independent and hold senior business people and politicians to account.

<sup>34</sup> News24, 29 Jun 2015.

<sup>35</sup> Zambia Watchdog, 29 Jun 2015.

<sup>36</sup> Reuters, 29 Jun 2015.

<sup>37</sup> Source, think-tank director, Lusaka

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