

AFRICA RISK CONSULTING

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The economy appears to stabilise following several years of poor performance as the price of copper rises to a two-year high and good rainfall increases agricultural output and water levels at hydro power stations. The Bank of Zambia (BoZ) (central bank) loosens monetary policy further at a monetary policy committee (MPC), reducing the interbank rate to 14%. The BoZ cites consumer price inflation falling further to 6.8% in February and two successive oversubscribed bond auctions as reasons for the move. Ratings agency Fitch maintains its B negative rating for Zambia's foreign and domestic denominated debt. The Zambezi River Authority (ZRA) awards a \$294m contract to carry out urgent repairs on the Kariba Dam to France-based Razel-Bec after three years of delays.

Zambia's economy stabilises on copper price rise and rainfall...

The economy of **Zambia** appears to be stabilising following several years of poor performance due to low copper prices and poor rainfall. The government is due to meet the **International Monetary Fund (IMF)** in March to start a fiscal consolidation programme that will reduce public debt but will increase pressures on consumers (see *ARC Briefing Zambia December 2016*). Improvements to the underlying economic conditions will allow businesses and consumers to be more resilient to the coming policy changes.

*"Businesses are beginning to recover from three hard years, goods are cheaper and the lights are staying on. Things definitely feel like they are getting better...but the economy is still vulnerable."*¹

The price of copper, which provides 75% of export receipts for Zambia and has a direct impact on the value of the kwacha, has improved across the last six months. It also accounted for 26% of government revenue in 2015 (the most recent available figures).² Analysts forecast the price of copper will continue to rise across 2017 due to a shortfall in supply.³ The price has increased year-on-year from \$4,600/tonne to \$5,991/tonne at time of writing, a 30% increase in value.⁴ This is due to a projected shortfall in the copper supply due to a strike at the **Escondida Mine** in **Chile**, which produces 5% of the global supply of the commodity (1.43 million tonnes per annum), and at **Grasberg** mine in **Indonesia**, another major producer.⁵ Supplies at bonded warehouses have also begun to decline for the first time in several years.⁶ According to a metal analyst:

*"The price is set in the futures markets, which generally give a commodity a 5-6% fluctuation in output before they start projecting a supply side constriction. The fact that these strikes comes so early in the year plays a part in how high the prices have risen...smaller producers with consistent output will gain in 2017."*⁷

¹ Source, financial journalist, Lusaka

² Lusaka Times, 2 Feb 2017.

³ Bloomberg, 24 Feb 2017.

⁴ Infomine.com

⁵ Bloomberg, 24 Feb 2017.

⁶ Bloomberg, 24 Feb 2017.

⁷ Source, metals analyst, London

Zambia increased its copper production across 2016. Existing producers brought a number of new shafts online in 2016, which meant that production of 226,000 tonnes in the third quarter of 2016 was the highest since 2000.⁸ Annual production for 2016 was 750,000 tonnes and mines minister **Christopher Yaluma** forecasts that this will increase again in 2017.⁹ London-listed **Vedanta Resources** owned **Konkola Copper Mines (KCM)**, one of Zambia's largest producers, announced on 22 February that it would increase its investments in the country in 2017.¹⁰

The end of the **El Niño** weather event of 2016 (which directly followed the **La Niña** event in 2015) has ended the region-wide drought in **Southern Africa**.¹¹ The agriculture ministry projects that the 2017 maize harvest will exceed the fair weather average of 3.22 million tonnes per annum.¹² This is in spite of a plague of army worms that have damaged crops in the south of the country across December 2016 and January 2017.¹³ President **Edgar Lungu** (2015-present) told reporters on 23 January that he wanted Zambia to aim for 10 million tonnes of maize per year by 2020.¹⁴

The heavy rainfall is also increasing reserves in Zambia's reservoirs, alleviating the power crisis which has caused persistent load shedding across the country for the last three years. Zambia remains 95% dependent on hydro generation.¹⁵ The **Kariba Dam** – Zambia's largest power plant – is filling up due to the increased rainfall, increasing its generation potential.¹⁶ However, the lake remains only 25% full in terms of its generation capacity. It will take an estimated three years to return to full generation capacity.¹⁷ However, it started generation seven weeks earlier than in 2016 – in line with a normal rainfall pattern.¹⁸ Zambia also diversified its electricity generation capacity in 2016. The **Maamba Collieries Power Plant**, a 300 megawatt (MW) coal-fired power plant, came online in mid-November.¹⁹

Rain and copper remain the most important drivers of economic prosperity in Zambia. However, this stabilisation could be temporary as both fluctuate according to external factors. The government will be able to use the improved liquidity that both of these factors grant to work on economic stabilisation under the IMF programme. Arguably the increased non-hydro electricity generation and the increased copper output are the most important developments. Structural improvements will outlast fluctuations in the commodities market. How the second Lungu administration handles the current improved circumstances will be a good indicator of economic policy over the next four years.

...leading the BoZ to loosen monetary policy

The improved factors underlying economic stability have persuaded the **Bank of Zambia (BoZ)** (central bank) to loosen monetary policy further at a monetary policy committee (MPC) meeting on 22 February.²⁰ Loosened liquidity will allow commercial banks and lenders to circulate credit products more freely, stimulating economic growth and allowing businesses to borrow to gain further cashflow. The BoZ reduced its interbank lending rate by 150 basis points to 14% from 15.5% and the statutory reserve ratio from 18% to 15.5%.²¹ This is the second consecutive loosening by the MPC, following a reduction at their meeting in November (see *ARC Briefing Zambia November 2016*).²²

⁸ Bloomberg, 23 Oct 2016.

⁹ Bloomberg, 23 Oct 2016.

¹⁰ Xinhua, 22 Feb 2017.

¹¹ Zambia Weekly, 2 Feb 2017.

¹² Zambia Daily Mail, 30 Jan 2017.

¹³ Zambia Daily Mail, 30 Jan 2017.

¹⁴ Lusaka Times, 23 Jan 2017.

¹⁵ Zambia Weekly, 2 Feb 2017.

¹⁶ Zambia Weekly, 17 Feb 2017.

¹⁷ Zambia Weekly, 17 Feb 2017.

¹⁸ Zambia Weekly, 17 Feb 2017.

¹⁹ ZESCO press release 1 Nov 2017.

²⁰ Reuters, 22 Feb 2017.

²¹ Reuters, 22 Feb 2017.

²² Zambia Weekly, 17 Feb 2017.

*"Companies are now able to access affordable credit products again, we are seeing many people going to lenders to restructure losses over the last two years, if the economy holds they will be able to recapitalise their businesses, boosting employment and earnings."*²³

BoZ governor **Denny Kalyala** told the media that the driving factor in the decision was a greatly improved inflation outlook.²⁴ Consumer price index (CPI) inflation slowed year-on-year to 6.8% in February, down from 7% in January.²⁵ This represents a significant improvement from the double-digit inflation across 2015 and 2016. Driving factors include improved costs of imported goods and decreased food costs due to better rainfall.²⁶ Monthly inflation rose marginally to 1% from 0.9%.²⁷ Kalyala told the media that

*"Inflation has declined to single digits and is projected to trend below the 2017 target of 9%."*²⁸

The BoZ's decision is also based on increased market confidence. The kwacha (K) is K9.47 to the dollar at time of writing, up from K10.12 to the dollar at the start of the year and up 17% year on year from K11.47 to the dollar in February 2016.²⁹ The BoZ sold \$163m in kwacha-denominated bonds on 24 February, with 2.5 times more appetite in the auction room.³⁰ This is the second concurrent oversubscribed bond auction. A short notice government kwacha bond auction in November 2016 for \$155m was three times oversubscribed.³¹ According to a currency trader:

*"Low inflation and strong underlying growth factors make the kwacha a decent bet in emerging market currencies. People are getting in to take mid-term positions with the expectation of generating good returns."*³²

However, ratings agencies need convincing that the stabilisation will lead to a recovery. Ratings agency **Fitch** on 20 February maintained its sovereign credit rating for Zambia of 'B' for both foreign and local currency denominated debt with a negative outlook.³³ Fitch cited Zambia's ongoing fiscal deficit as the primary reason to keep both rating and outlook the same; this has driven up the government debt to GDP ratio from 2012-2017.³⁴ Fitch also cited structural constraints, including exposure to the price of copper and annual rainfall, along with a general infrastructure deficit as negative influences on the economy.³⁵ However, Fitch did credit Zambia with improving its monetary policy considerably over the past two years, and noted the improved fiscal outlook.³⁶ It said that the imminent IMF programme was likely to be the primary reason for a ratings change later in 2017.³⁷ Two other ratings' agencies are due to rate Zambia in the next two months: **Standard & Poor's** will review its B negative rating in March, and **Moody's** will review its B3 negative rating in April.³⁸

The BoZ is taking advantage of the positive trend in the economy to give private enterprise free reign to generate growth. This will be important over the coming year as the IMF fiscal consolidation programme will inhibit the government's ability to generate employment or ease the cost of living through subsidies. Zambia has won and lost on the current markets before – the kwacha has

²³ Source, financial journalist, Lusaka

²⁴ Reuters, 22 Feb 2017.

²⁵ Zambia Weekly, 24 Feb 2017.

²⁶ Reuters, 22 Feb 2016.

²⁷ Zambia Weekly, 24 Feb 2017.

²⁸ Reuters, 22 Feb 2017.

²⁹ XE.com

³⁰ Zambia Business Times, 25 Feb 2017.

³¹ Zambia Weekly, 2 Feb 2017.

³² Source, emerging markets currency trader, Johannesburg

³³ Fitch Press release, 20 Feb 2017.

³⁴ Fitch Press release, 20 Feb 2017.

³⁵ Fitch Press release, 20 Feb 2017.

³⁶ Fitch Press release, 20 Feb 2017.

³⁷ Fitch Press release, 20 Feb 2017.

³⁸ Zambia Weekly, 24 Feb 2017.

fluctuated strongly over the last five years against the dollar. Most currency traders are watching the price of copper futures – which remain positive. However, a major shock to confidence in the commodity could hurt the kwacha and the value of Zambia’s debt.

Razel-Bec to rehabilitate Kariba Dam

The governments of Zambia and **Zimbabwe** awarded a contract to rehabilitate the vital **Kariba Dam** to **France**-based **Razel-Bec** on 13 February.³⁹ The Kariba Dam generates 1.626 megawatts (MW) of electricity for Zambia and Zimbabwe, and is the largest producer of electricity for both countries.⁴⁰ The **Zambezi River Authority (ZRA)** – a bilateral organisation that manages the dam – announced at a press conference on the dam site that Razel-Bec had won the tender worth \$294m.⁴¹ Razel-Bec is a civil works subsidiary of France-based infrastructure and engineering firm **Fayat Group**.⁴² It has built dams in **Algeria** and **Cameroon**.⁴³ The costs of the project are primarily covered by donors. The **European Bank for Reconstruction and Development (EBRD)** will provide \$100m, the **World Bank** \$75m, the **African Development Bank (AfDB)** \$36m in grants and \$39m in loans, and the government of **Sweden** \$20m.⁴⁴ The ZRA will cover the balance of \$24m.⁴⁵

“This should have happened years ago, but it is the usual politics – nobody wanted to pay for anything. The government kept it off the balance sheet until after the elections last year.”⁴⁶

The dam, which came online in the 1950s, is in urgent need of repairs, following a report in 2014 from the ZRA that it had detected swelling in the dam wall, meaning that it was in danger of collapse.⁴⁷ An independent report by **AON Global Risk Managers** in 2015 confirmed the ZRA report and projected that a collapse of the dam, which holds back up to 1.8 billion cubic meters of water, would pose a grave risk to 3.5 million people in Zambia, Zimbabwe, **Malawi** and **Mozambique**.⁴⁸ However, disagreements over the cost of the project and a slow bureaucratic process to get the cost ratified in Zambia and Zimbabwe had delayed the project by two years.⁴⁹ A specialist dam engineer told the media that the work was urgent:

“It is a real risk that the dam could fall without that effort being put in place. Some forces are pushing toward the dam wall and digging into it and the water could slip underneath the dam and cause it to collapse.”

Razel-Bec will be on site within a month and will first work on reinforcing the dam wall to reduce the swelling, which will take until 2020.⁵⁰ Other works will include stabilising and reshaping the 80m deep plunge pool and refurbishing the six floodgates.⁵¹ The entire project will take until 2025 to be complete, due to the need to continue generating electricity.⁵²

The Kariba Dam remains one of the most important infrastructure facilities for the entire region. It generates the majority of electricity for Zambia and Zimbabwe. It regulates water flow for Zambia, Zimbabwe, Malawi, Mozambique and **Botswana** allowing for more effective agricultural production. A collapse in the dam would have catastrophic consequences. The two-year delay in fixing the project

³⁹ Bloomberg, 13 Feb 2017.

⁴⁰ Bloomberg, 13 Feb 2017.

⁴¹ Bloomberg, 13 Feb 2017.

⁴² Zambia Weekly, 17 Feb 2017.

⁴³ Zambia Weekly, 17 Feb 2017.

⁴⁴ Zambia Weekly, 17 Feb 2017.

⁴⁵ Zambia Weekly, 17 Feb 2017.

⁴⁶ Source, financial journalist, Lusaka

⁴⁷ Zambia Weekly, 17 Feb 2017.

⁴⁸ Zambia Weekly, 17 Feb 2017.

⁴⁹ Bloomberg, 13 Feb 2017.

⁵⁰ Bloomberg, 13 Feb 2017.

⁵¹ Bloomberg, 13 Feb 2017.

⁵² Bloomberg, 13 Feb 2017.

highlights the impact of political risk on the multitude of ageing infrastructure facilities built in the late 20th century. Now that work has commenced on the dam, the risk of a collapse is significantly less. However, the governments could have reduced the cost of emergency works through regular maintenance of the dam.

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