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President Edgar Lungu (2015-present) performs relatively well during his first year in office, despite the ongoing economic and operational problems. Lungu demonstrates his willingness to adapt policy in the face of criticism, and positive political leadership but intervenes in fiscal policy. The World Bank reports that Zambia faces its greatest economic challenge for a decade as growth falls below 5%, inflation increases to 20% and the budget deficit is at 6.9%. External observers predict that Zambia will have to increase borrowing from external sources to balance its budget after the state overspends by $1.35 billion in 2015. The Zambia Electricity Supply Corp (Zesco) increases its tariffs 80% to $0.1 per kilowatt but the changes do not impact copper producers who consume 55% of Zambia's electricity capacity. Copper miners are resisting the government's efforts to get them to sign up to further tariff increases.

A year of Lungu: the presidential scorecard

President **Edgar Lungu** (2015-present) has come to the end of his first calendar year as **Zambia's** head of state, running the country during a challenging year. The country has weathered major problems in the relationship between its copper mining sector and the government, a collapsing currency, rising debt/gross domestic product (GDP) ratio and an ongoing power crisis. However, Lungu has also advanced the revisions to Zambia's constitution – something his predecessor, the late **Michael Sata** (2011-2015), failed to start, has gone after the 'cartel' of powerful business figures who tried to run Zambia behind the scenes, and has shown a degree of policy flexibility and resilience.

Politically, Lungu has managed to reunite the ruling **Patriotic Front (PF)** party behind him, following an acrimonious internal battle for succession following Sata's death in October 2014. The president has retained figures from the Sata administration such as finance minister **Alexander Chikwanda** and mining minister **Christopher Yaluma.** However, he has put his own supporters into prominent positions, notably vice-president **Inone Winga.** Winga has continued to play the active role that her predecessor (and opponent of Lungu) **Guy Scott** played under Sata. Lungu also brought in figures from outside of politics, such as commerce minister **Margaret Mwanakate**, the former chief of **Barclays Zambia**.

> *"Lungu excluded the few figures who opposed him quickly and has rebuilt a consensus within the party. He is now focused on taking on [opposition leader]* ***Hakainde Hichilema****, winning several key by-elections...most people I know in the PF are satisfied."*[1]

Lungu has taken on the cartel, removing **Mutembo Nchito** from his position as director of public prosecutions (DPP), investigating **Post Newspapers** owner **Fred M'membe**, and supporting investigations into how **Zambia Finance Bank** chairman **Rajan Mahtani** acquired key investments.[2] The cartel had unprecedented influence under the Sata regime and put forward its own candidate, **Miles Sampa**, to run against Lungu (see *ARC Briefing Zambia December 2014*). However some sources are unconvinced that Lungu's motivation for taking on the cartel is to improve governance.

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[1] Source, PF party official, Lusaka

[2] Zambia reports, 20 Nov 2014

"Lungu is removing opponents, he has his allies within the PF whom he promotes…he has not taken wider measures to tackle corruption in Zambia."[3]

The economy has overshadowed Lungu's first year. Zambia is facing its toughest economic challenge for a decade (see below). The kwacha has fallen 70% against the dollar, the government has overspent by $1.35 billion to meet the needs of the power crisis[4] and the copper sector is in turmoil, laying off 8,500 employees. The collapse of the copper price is the primary driver of the economic downturn. Decades of poor investment in the power sector have exacerbated the power shortages, caused by low rainfall. The president appears to have handled the economic challenges relatively sensibly. He worked with both mining companies and unions to ensure that the lay-offs are low as possible (see *ARC Briefing Zambia November 2015*). Lungu also took charge of negotiations between copper miners and the finance ministry over proposed changes to the tax regime between February and June. Lungu personally chaired meetings and negotiated a policy compromise (see *ARC Briefing Zambia* February-June 2015). He has impressed sources in both the mining industry and the unions:

"I don't envy Lungu's position, he has an election in less than a year [2016], a legacy of poor economic management and the copper price to contend with…I was impressed by the process of the meetings this year…they were candid, the government didn't leak the contents, and Lungu and Sampa's desire to work with us, not against us, was welcome…the fact that the situation is still dire is not for lack of communication."[5]

"Usually we [a mining union] work with companies to try and reduce losses while the government makes noise and threatens…this year they have been more realistic in their approach."[6]

However, some of Lungu's decisions are more questionable. Economic observers highlight fiscal policy as an area where the Lungu administration could improve its performance. Public sector wages still account for 75% of domestic revenue. The government's record of efficient spending on infrastructure projects remains poor.[7] The **Bank of Zambia (BoZ)** (central bank) opted not to spend foreign currency reserves on the foreign exchange markets to prop up the kwacha as it argued it would rise and fall with the price of copper. However, Lungu ordered the BoZ to spend to stabilise the price in September and November. He argued that the state could not sit by while companies had to close due to the poor exchange rate. An economic source criticised the decision as:

"…a political gesture, tokenism at best which did little to help the currency which fell back to where it had been two days later."[8]

The president has also attracted scepticism over his job creation strategy of pushing former miners out into agricultural work in order to rebalance the economy.[9] He hopes that new agri-business ventures alongside a new airport in **Copperbelt Province** will create 10,000 new jobs in 2016.[10] However, the government will need to fund the airport out of state funds, the jobs will largely be temporary (i.e. in construction) and Copperbelt is not Zambia's most fertile ground – making it an unattractive investment for mid-large sized agri-business.

"It is another policy that has not been though through properly, if Lungu wants to attract private investment he needs to make it actually attractive, not just assume that if it is there, someone will come along with the money…this shows his inexperience as a premier, hopefully it will improve over time."[11]

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[3] Source, director of a think-tank, Lusaka
[4] Lusaka Times, 9 Dec 2015
[5] Source, senior mining executive, Lusaka.
[6] Source, union official, Copperbelt
[7] Zambia Weekly, 18 Dec 2015.
[8] Source, developmental economist, Durban
[9] Zambia Weekly, 18 Dec 2015.
[10] Zambia Weekly, 18 Dec 2015.
[11] Source, investor with assets in Zambia, Johannesburg

Lungu additionally caused alarm when he flew to **South Africa** for medical treatment in March after collapsing at a celebration of **International Women's Day** (see *ARC Briefing Zambia March 2015*). According to sources who know Lungu, the president is HIV positive and suffered a minor illness in March which required him to receive specialist treatment.[12] However, he remains in good health and there is little risk to the country as he reportedly manages the condition well.[13] Other sources from within the government rate Lungu's leadership style saying he is decisive but inclusive:

> *"More than our past president, Lungu is willing to listen….once he's decided that is that, but he will always listen when decision making."*[14]

Zambia facing 'toughest economic challenge in a decade'

Zambia's economy is facing the *"toughest economic challenge in a decade"*[15] according to **World Bank** analysis released on 9 December.[16] Economic figures support this analysis. The treasury estimates that GDP growth for 2015 will end up being 3.9%, well below the 7% it forecast this time last year and considerably below the 10% target the treasury estimates the country needs in order to improve the lives of all Zambians.[17] The budget deficit has increased to 6.7% of GDP, and the value of the kwacha is down 70% against the dollar since January.[18] The currency, trading at K10.98/$ at time of writing, has remained stable across December and has appreciated 20% since its low of K13.89/$ in November.[19] All of this has translated into a sharp spike in consumer price index inflation to 20% in October, up from 8% in August, as the price of consumer goods rose. The electricity crisis (see below) has also increased inflation as households and businesses have to buy expensive diesel to run generators during periods of load shedding.[20] Unemployment is up due to mining sector lay-offs and the low value of the kwacha affecting import-dependent businesses.

The bank noted the depressing factors on the economy: poor copper prices and the power crisis were likely to continue, and possibly get worse, in 2016.[21] The government could improve fiscal policy, which has struggled to keep up with the highly volatile kwacha, to inspire greater market confidence.[22] This is particularly important after Zambia's issue of a $1.25 billion Eurobond in July 2015 which leaves it further exposed to the capital markets.[23] According to senior World Bank officials:

> *"Tough action is required in 2016 to curb runaway expenditure, double-digit inflation and growing twin deficits."*[24]

Ratings agency **Fitch** also focused on capital market debt in its year-end review of the economy. The agency rated the sovereign debt at grade B (two levels below investment grade) with a stable outlook in August. However it believes that Zambia's exposure to the debt markets – it has $3 billion in bonds out currently – leaves the country undesirably exposed to fluctuations in confidence. Fitch also predicts that the government will need to return to the markets and issue a further bond in 2016 to balance its books.[25] It argues that Zambia *"is in for a torrid time"* in 2016.[26]

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[12] Source, personally acquainted with the president, London
[13] Source, personally acquainted with the president, London
[14] Source, senior government figure, Lusaka
[15] World Bank, 9 Dec 2015.
[16] World Bank, 9 Dec 2015.
[17] Zambia Weekly, 18 Dec 2015.
[18] XE.com
[19] XE.com
[20] Zambia Weekly, 18 Dec 2015.
[21] World Bank, 9 Dec 2015.
[22] World Bank, 9 Dec 2015.
[23] Reuters, 11 Dec 2015.
[24] World Bank officials in Reuters, 9 Dec 2015.
[25] Fitch, 10 Dec 2015.
[26] Fitch, 10 Dec 2015.

The government will need to raise further capital in order to be able to meet spending commitments. Chikwanda told the national assembly on 9 December that the country had overspent its budget by $1.36 billion, with a total spend of $5.86 billion. This is 58% more than the original spending target of $3.7 billion and a 30% increase on October's revised spending target of $4.5 billion.[27] The increased spending was due to the need to buy emergency power and fuel for diesel generation, and low valuation of the kwacha impacting the price of all imports.[28] Zambia's external debt burden currently stands at $6.3 billion. It has increased 78% since the PF came to power in 2011 and is at its highest levels since 2001.[29] In his October budget speech Chikwanda outlined plans to reduce the budget deficit to 3.8% of GDP down from a projected 6.9% this year.[30] If predictions of a further currency slump and the need to take on more debt are true, the finance ministry will end up radically altering its predictions across 2016.

Electricity tariff increases to fund new generation projects

The government granted the **Zambia Electricity Supply Corp (Zesco)** permission to increase electricity tariffs in 2016. This is to finance its development programme and to attract independent power producers (IPPs) to invest in Zambia. The price of electricity increased on 2 December to $0.1035/kilowatt (kW) from $0.06.[31] Zambia is still suffering from an acute shortage of electricity generation capacity. The electricity deficit peaked in September at 985 megawatts (MW), up from 560MW in March, due to low water levels across the country caused by a region-wide drought.[32] Current estimates of the shortfall range from 700-850MW.[33] This leads to regular blackouts and load-shedding, especially in urban areas, which further depresses economic activity and productivity.[34] The energy ministry announced that Zambia will import a further 200MW of electricity from neighbouring **Mozambique** in 2016. It currently imports 148MW from the country.[35]

The proceeds of the higher tariffs will fund $3.7 billion in power development projects which will add 1,500MW to the national grid – a 70% increase in capacity from the current 2,200W.[36] The **International Monetary Fund (IMF)** approved the new rates saying that they would lay the foundation for a new generation of IPPs to enter the market.[37] The IMF's resident representative **Tobias Rasmussen** said:

> *"The move, on its own, does not ensure full cost recovery in electricity provision, but this is an important step towards putting the power sector on a sustainable footing and overcoming the electricity shortages that have plagued the economy."*[38]

The tariff increases will not affect mining companies who purchase their electricity through the **Copperbelt Energy Co (CEC)**. They have already shouldered a 20% increase in electricity this year from the CEC (see *ARC Briefing Zambia September 2015*). However, external economic observers agree that the mining companies will need to pay more in order to make electricity provision sustainable. The World Bank argued that copper miners, which consume roughly 55% of Zambia's electricity capacity, should pay higher prices.[39] The director of energy within the energy ministry, **Oscar**

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[27] Lusaka Times, 9 Dec 2015.
[28] Lusaka Times, 9 Dec 2015.
[29] Zambia Weekly, 18 Dec 2015.
[30] Lusaka Times, 9 Dec 2015.
[31] ZESCO press release, 2 Dec 2015.
[32] Lusaka Times, 11 Dec 2015.
[33] Zambia Weekly, 18 Dec 2015.
[34] Zambia Weekly, 18 Dec 2015.
[35] Zambia Weekly, 18 Dec 2015.
[36] ZESCO press release, 2 Dec 2015.
[37] Reuters, 3 Dec 2015.
[38] Rasmussen quoted in Reuters, 3 Dec 2015.
[39] World Bank, 9 Dec 2015.

Kalumiana, said that the government is talking to mines about increasing their tariffs in order to keep power generation sustainable.[40]

However, mining companies argue that they are unable to shoulder any further costs as the low price of copper has already necessitated job cuts and mine closures. The **Zambian Chamber of Mines (ZCM)** warned the government that Zambia needs to allow mines the freedom to extract minerals profitably or else *"our future as a copper producing nation is in peril"*.[41] Sources in the mining sector echo this sentiment:

> *"While the government has been good at talking to us [mining companies] we cannot generate jobs or revenue if we face further costs…we can't compete and more mines will close."*[42]

Implications

The final vote on Lungu appears to be that he is a competent president, but has not taken the radical steps needed to alleviate Zambia's current economic crisis. Many of the problems are not within his ability to solve. However, he did push the taxation reform, which hurt the copper sector in the first half of the year – when the copper price was higher. He has not addressed inefficiency in public sector spending and was slow to push out tenders for IPPs when the signs of a drought first appeared in March. In 2016 Lungu and his team, especially Chikwanda, will need to push through unpopular austerity measures in order to rebalance the books. This will be particularly difficult in an election year. The test of character of Lungu will be whether he manages to put Zambia ahead of the PF's desire to win the next election. As a compromise broker he will probably try to do both, but this could end up with a weakened PF majority in even worse economic circumstances.

The responsible measures that Lungu needs to take are to reign in public sector spending, and carefully attribute borrowed funds to get ahead of the power crisis and reliance on copper mining. It is vital that the administration gets the kwacha under control, while the currency will theoretically rise when the copper price increases the damage low exchange rates do in the meantime is significant. Lungu cannot just spend foreign exchange reserves, especially as Zambia is largely dependent on the copper miners for their foreign exchange capital. The government has to reassure the markets through diversification and fiscal responsibility. Lungu's new policy initiative to diversify into agri-business could pay off in the long run. Zambia has some very successful agri-businesses already. Unless it is well packaged, the investment will be low and the chance of success of the projects decreases.

The government and the miners will enter the New Year with further difficult negotiations over the price of power. Sentiment, for the moment, appears to be on the side of the government which will add pressure on mining companies to accept higher power prices. However, if the price of copper slips further all the mines will cease to be profitable. This will lead to job cuts and mine closures on an unprecedented scale. The government will need to show it is able to leave the miners space to operate by easing regulatory burdens, funding this with efficiency savings from elsewhere.

Next year has the potential to be more challenging than 2015 – the power crisis, currency slide, fiscal deficit and inflation could all worsen before they improve. Combined with the expense (and lost time for governance) of an election campaign and a constitutional referendum both in November Lungu's government will be stretched to keep on top of Zambia's problems. The short-term economic, but not political, risk is high.

[40] Reuters, 9 Dec 2015.
[41] Reuters, 18 Dec 2015.
[42] Source, senior mining executive, Lusaka

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