

AFRICA RISK CONSULTING

Zambia Monthly Briefing May 2018

Zambia Summary 31 May 2018

Finance minister Margaret Mwanakatwe recalls and cancels a controversial sovereign guarantee that President Edgar Lungu (2015-present) signed off in September 2016 without finance ministry approval. The finance ministry refutes predictions by United States-based risk consultancy Eurasia Group that Zambia will default on its debt by 2019, saying Zambia has no intention to default on any Eurobond interest payments. The Zambia Revenue Authority (ZRA) completes an audit of all major mining companies operating in Zambia. United Kingdom-based Vedanta Resources and Canada-based First Quantum Minerals challenge high tax assessments but are unlikely to go to court.

Allegations of graft surround President Lungu

Finance minister **Margaret Mwanakatwe** recalled and cancelled on 30 May a controversial sovereign guarantee that President **Edgar Lungu** (2015-present) had signed off in September 2016 without finance ministry approval.¹ The sovereign guarantee was for a \$500m loan from **South Africa**-based **STAG African Investments** of behalf of **Zambian** state-owned power company **Zesco**.² Mwanakatwe recalled and cancelled the controversial sovereign guarantee as STAG Investments Africa had not raised any funds, despite the Zambian government meeting the criteria to receive the loan.³ Signing sovereign guarantees without finance ministry approval is considered irregular.⁴ In this case, it may demonstrate the desperation with which Zambian politicians are trying to access money, and the true extent of Zambia's national debt.⁵ Others allege Lungu facilitated the sovereign guarantee to facilitate corruption. **Chishimba Kambwili**, a member of parliament and member of Lungu's **Patriotic Front (PF)** party, accused Lungu of making the sovereign guarantee to commercially benefit his daughter, **Tasila Lungu**.⁶

*"It is believed that it was the reason President Lungu singly and hastily signed the sovereign guarantee ZESCO STAG loan deal involving \$500m in order for Zesco Limited to obtain a loan which would consequently enable ZESCO to pay Tasila Lungu's company, Midways Express Limited."*⁷

Tasila Lungu, along with her father, has faced several allegations of corruption. In a press release on 29 May, the opposition **National Democratic Congress (NDC)** challenged both Edgar and Tasila Lungu to justify their ownership of 300 fuel tankers through Zambia-registered company Midways Express Limited. The cost of such tankers greatly exceeds Lungu's salary as president and Tasila Lungu's councillor salary of approximately \$342 per month, her only registered income.⁸

¹ Lusaka Times, 30 May 2018.

² Lusaka Times, 30 May 2018.

³ Lusaka Times, 30 May 2018.

⁴ Source, analyst, Lusaka

⁵ Africa Confidential, 18 May 2018.

⁶ Zambia Online, 25 May 2018.

⁷ Source, journalist, Lusaka.

⁸ Zambian Observer, 29 May 2018.

Lungu is further dogged by allegations of corruption regarding his plans to build a mansion in **eSwatini** (formerly **Swaziland**). Information minister **Dora Siliya** stated on 15 May that President Lungu is planning to build a \$4m mansion in eSwatini on land “gifted” to him by eSwatini ruler **King Mswati III**, assuring the public that there is “*nothing sinister about the development*”.⁹ However, an ARC source said King Mswati III and the eSwatini government deny giving President Lungu such a gift, and that eSwatini-based **Inyatsi Properties Ltd (Inyatsi)** had gifted Lungu the land.¹⁰ Lungu has a close relationship with Inyatsi and has used his position as head of the **Road Development Agency (RDA)** to offer Inyatsi many road-building contracts.¹¹ One road-building project cost Zambian taxpayers 47m kwacha (\$4.6m) despite Inyatsi reportedly merely filling potholes with sand.¹² Lungu’s reportedly favourable treatment of Inyatsi despite its poor standard of work, coupled with the company’s large gift to the president, hints strongly at corruption.

Whilst not appearing to directly affect Lungu’s leadership, mounting allegations of corruption against the president instill a deepening lack of confidence in the government’s ability to turn its economic situation around. Zambia is in a debt trap, from which it will be difficult to emerge.¹³ If the corruption allegations surrounding Lungu are true, Zambia’s economic woes may be graver than previously thought.

Zambia’s debt increases as government denies report on its debt issue

Finance ministry spokesperson **Chileshe Kandeta** stated on 8 May that Zambia has not defaulted on any Eurobond interest payments and does not intend to do so.¹⁴ Kandeta said the finance ministry’s medium-term expenditure framework covers all economic and fiscal numbers over a three-year period, including debt service.¹⁵ The statement came in reaction to a **United States**-based risk consultancy, **Eurasia Group**, report that forecast Zambia would default on its debt by 2019.¹⁶ The Eurasia Group reported that Zambia’s external debt is likely higher than the official \$8.7 billion figure:

*“The risk of default is low in 2018, but will increase substantially in 2019 and 2020 absent an [International Monetary Fund] IMF programme. President **Edgar Lungu** (2015-present) ... will probably continue to borrow and spend in the lead up to the [2021] election.”*¹⁷

The report echoes investor concerns regarding Zambia’s debt situation. **United Kingdom (UK)** ambassador to Zambia **Fergus Cochrane-Dyett** said the debt situation is UK investors’ foremost concern about Zambia.¹⁸ **African Development Bank** president **Akinwumi Adesina** has expressed concern that other **African** countries are following Zambia’s lead and offering very high interest rates to make their bonds attractive to investors, even though Zambia may not be able to meet its future debt obligations.¹⁹ Zambia’s 2027 Eurobond yield climbed to 9.43%, the highest point since December 2016, due to fears of Zambia’s rising debt and the unlikelihood of an IMF bailout.²⁰ A **Lusaka**-based analyst said the IMF bailout appears to be on hold:

⁹ News24, 16 May 2018.

¹⁰ Source, journalist, Lusaka.

¹¹ Source, journalist, Lusaka.

¹² **Zambian Watchdog**, 17 May 2018.

¹³ Source, journalist, Lusaka.

¹⁴ **Lusaka Times**, 8 May 2018.

¹⁵ **Lusaka Times**, 8 May 2018.

¹⁶ **Lusaka Times**, 8 May 2018.

¹⁷ **Bloomberg**, 4 May 2018.

¹⁸ **Twitter**, 22 May 2018.

¹⁹ **Bloomberg**, 8 May 2018.

²⁰ **Bloomberg**, 8 May 2018.

“The IMF bailout is not forthcoming, which is unfortunate as Zambia is already in a ‘debt trap’ and it will be hard to escape without outside assistance.”²¹

In perhaps an effort to restore investor confidence, Lungu renewed the contract of **Bank of Zambia** (central bank) governor **Denny Kalyalya** on 17 May, extending his appointment to 2023.²² While investors have praised his monetary policies since taking office in 2015, Kalyalya will struggle to maintain low inflation rates, increase foreign reserves to service debt, and prevent the kwacha from severely devaluing, while the government continues to borrow and spend at unreasonable rates.²³ Inflation dropped from 22.9% in 2015 to 6.1% in December 2017, while the treasury spent \$504m in 2017 to service debt, a 4.1% increase from 2016.²⁴ Zambia’s currency, the kwacha (K), has weakened to approximately K10.034 per dollar due to fears of debt issues.²⁵ The lower value of the kwacha will increase the debt service repayments of the euro-denominated bonds.²⁶

Zambian organisations have also refuted the Eurasia Group’s findings. Zambia-based public policy think-tank, **The Policy Monitoring and Research Centre**, stated on 5 May that the government’s account of its debt stock is accurate and that the opposition is politicising numbers for its own gains.²⁷ However, the finance ministry reported on 28 May that external debt was larger than \$8.7 billion, rising to \$9.1 billion in just two months from December 2017 to February 2018.²⁸ This would appear to support the Eurasia Group’s report that Zambia does not have a ‘hidden debt’ situation, as is the case in **Mozambique**, but rather a breakdown of the debt-tracking process.²⁹ The announcement of a further \$400m in debt accumulated in two months raises fears that further debt could be ‘found’, taking Zambia’s debt to even more unsustainable levels. The debt debate “*will be a major issue on the agenda*” when the national assembly resumes around 10 June.³⁰

The increasing price of copper will provide some relief in the short term, but the government will remain vulnerable to external shocks if it relies on a single commodity. A drop in the copper price or a drought that affects hydropower production would both hurt the mining sector.³¹ An IMF bailout is not likely in the short term as long as the government continues its borrowing and spending patterns. Lungu may, however, be forced to adopt the IMF’s policies if the country does start defaulting on its loans, particularly if this is close to election season.

Mining companies battle colossal tax bills issued by Zambian government

The **Zambia Revenue Authority (ZRA)** finished an audit on 7 May of all major mining companies operating in Zambia and informed companies what they owe.³² Since issuing an \$8 billion tax bill to **Canada-based First Quantum Minerals** in March, Zambia has pursued a policy of “*resource nationalism*” akin to that of its neighbours, **Tanzania** and the **Democratic Republic of the Congo**, scrapping favourable tax rates for extractive industries.³³ The government issued **United Kingdom-based Vedanta Resources** a tax bill of \$18m in its latest audit.³⁴

²¹ Source, analyst, Lusaka.

²² Bloomberg, 23 May 2018.

²³ Bloomberg, 17 May 2018.

²⁴ Daily Mail, 10 May 2018.

²⁵ Bloomberg, 8 May 2018.

²⁶ Bloomberg, 8 May 2018.

²⁷ Daily Mail, 5 May 2018.

²⁸ Lusaka Times, 28 May 2018.

²⁹ Bloomberg, 4 May 2018.

³⁰ Source, analyst, Lusaka.

³¹ Bloomberg, 4 May 2018.

³² Reuters, 7 May 2018.

³³ Mining Journal, 16 May 2018.

³⁴ Reuters, 7 May 2018.

Vedanta Resources plans to dispute its \$18m bill and other mining companies will do the same.³⁵ **RBC Capital Markets** global mining research head **Stephen Walker** described the First Quantum Minerals tax assessment as “*unrealistic*” and said the company unequivocally refutes it:

*“[It] does not appear to have any discernible basis of calculation and [First Quantum Minerals] will continue working with the ZRA, as it normally does, to resolve the issue.”*³⁶

In a bid to downplay the situation, First Quantum Minerals CEO **Phillip Pascal** assured shareholders that First Quantum Minerals had never gone to court in Zambia, and would negotiate a settlement with the Zambian government.³⁷

With Zambia’s debt and global mineral prices rising, the Zambian government may have seized on an opportunity to squeeze mining companies with massive fines, backdated tax bills and an all-round raise in taxes to bolster its ailing public finances. **Deutsche Bank** analyst **Patrick Jones** said there could be a larger political motive behind the ZRA announcement:

*“With the fiscal deficit and debt position still worrisome, this could push the government to find alternative methods to raise revenue and repair the government’s fiscal position.”*³⁸

The revised tax bills appear to be more about gaining revenue than following a particular tax policy. It is likely that the ZRA and mining companies will come to negotiated settlements. Regardless, the actions of the Zambian state to impose such large bills on mining companies will certainly dent investor confidence in the country, and could have a negative impact on attracting foreign direct investment.

³⁵ Reuters, 9 May 2018.

³⁶ G. Clive Newall, quoted in MiningMX, 21 Mar 2018.

³⁷ MiningMX, 21 Mar 2018.

³⁸ Patrick Jones, quoted in MiningMX, 21 Mar 2018.

Planner

4 Jun 2018: **Chishimba Kambwili** due to stand trial for corruption

June 2018: 2nd National Assembly session begins

20-21 Aug 2018: Monetary Policy Committee meeting

19-20 Nov 2018: Monetary Policy Committee meeting

2021 Scheduled presidential elections;

Chronology

30 May 2018 (**Zambia**) *Lusaka Times*. Finance minister **Margaret Mwanakatwe** recalls and cancels controversial \$500m sovereign guarantee made by President **Edgar Lungu** on behalf of state-owned energy company **Zesco** to **South Africa**-based **STAG African Investments**;

28 May 2018 (**Zambia**) *Daily Mail*. Treasury announces that debt rose from \$8.7 billion to \$9.1 billion since the start of 2018;

17 May 2018 (**Zambia**) *Daily Mail*. President **Edgar Lungu** reappoints **Bank of Zambia** (central bank) governor **Denny Kalyalya** until 2023;

9 May 2018 (**Zambia**) *Reuters*. **United Kingdom**-registered mining company **Vedanta Resources** disputes the almost \$18m tax bill issued by the **Zambian** government;

8 May 2018 (**Zambia**) *Bloomberg*. **Zambia**'s government states it has not defaulted on any debt repayments and will not do so in 2019;

7 May 2018 (**Zambia**) *Reuters*. The **Zambia Revenue Authority (ZRA)** completes its audit of major mining companies;

4 May 2018 **Lusaka (Zambia)** *The East African*. **Zambia**'s President **Edgar Lungu** and **Angola**'s President **João Lourenço** waive visas for their citizens travelling between the two countries;

3 May 2018 (**Zambia**) *Bloomberg*. **United States**-based risk consultancy, **Eurasia Group**, forecasts that **Zambia**'s debt is larger than it states and likely to default in 2019;

26 Apr 2018 (**Zambia**) *Reuters*. **Zambia**'s annual inflation rate increases to 7.4% in April, up from 7.1% in March;