

AFRICA RISK CONSULTING

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Finance minister Alexander Chikwanda presents the 2016 budget to parliament and proposes raising expenditure by 14% and cutting the budget deficit by 50%. Domestic and international analysts are sceptical of how achievable the targets are. The economic situation continues to worsen: the kwacha depreciates 5.5% across October and is now 97% lower against the dollar from January. The power crisis threatens to close small businesses. Consumer price index inflation nearly doubles from 7.7% to 14.3% from September to October. A court convicts health ministry official Henry Kapoko for his role in graft from 2006-2009 which cost the government and international donors an estimated \$5.1m.

Chikwanda's 2016 budget: 14% more spending but 50% less deficit...

Finance minister **Alexander Chikwanda** on 10 October presented the 2016 budget to parliament which outlines plans to halve Zambia's budget deficit to 3.8% of gross domestic product (GDP) from 6.9% in the next year.¹ However, total government spending in 2016 will be \$4.5 billion, a 14% increase from the 2015 total of \$3.7 billion.² Chikwanda lowered growth estimates for 2015 to 4.6%, below the 5% target the finance ministry set earlier this year.³ However, the government estimates that growth will increase in 2016 to 5%.⁴

Curbing debt and the cost of debt are central to Chikwanda's plan to get the economy back on track. Chikwanda said that the government plans to raise \$3.35 billion in revenue to fund the budget. This is 20% more than the government received in 2015. The government intends to borrow the remaining \$1.15 billion on domestic and international markets.⁵ It plans to limit domestic borrowing to 1.2% of GDP and international borrowing to 2.9% of GDP.⁶ Domestic borrowing is set to decrease to \$199m, or 4.7% of the budget. Foreign borrowing will almost double to \$620m, or 15% of the budget.⁷ The government plans to spend \$400m on external and \$340m on domestic debt repayments across 2016.⁸ This takes into account the new debt as well as the costly \$1.2 billion Eurobond the government marketed in June at a 9.7% yield. However, observers are sceptical of Chikwanda's ability to keep borrowing under control:

"Government borrowing is responsible for the position that Zambia is in today... but with revenues coming up short the government will have to borrow if the copper price falls again or output drops and if the power crisis continues."⁹

"We do not see the target of halving the budget as reasonable, our models predict that the budget deficit will increase to around 8.7% in 2016."¹⁰

¹ Lusaka Times, 10 Oct 2015.

² Lusaka Times, 10 Oct 2015.

³ Zambia Reports, 10 Oct 2015.

⁴ Zambia Reports, 10 Oct 2015.

⁵ Zambia Weekly, 11 Oct 2015.

⁶ Lusaka Times, 10 Oct 2015.

⁷ Bloomberg, 10 Oct 2015.

⁸ Zambia Weekly, 11 Oct 2015.

⁹ Source, economist, Lusaka

¹⁰ Source, econometrician, Cape Town

Significantly, ratings agency **Fitch** was sceptical of the plan:

*"The ambitious fiscal consolidation plan in Zambia's 2016 budget will prove challenging due to its reliance on raising revenue rather than cutting expenditure."*¹¹

Others believe that the budget reflects the ruling **Patriotic Front (PF)** party's political agenda more than an economic one.

*"Chikwanda cannot have it both ways, he cannot increase expenditure and halve the deficit... this is a populist move to win the election."*¹²

However, Chikwanda said that the target to halve the budget deficit was *"sacrosanct... it is a reasonable target"*.¹³

Chikwanda allocated \$1.92 billion to general public service expenditure, the single largest expense accounting for 36% of the total budget.¹⁴ Healthcare will receive \$350m, 8.7% of the budget, and education will receive \$788m or 17% of the budget.¹⁵ The government will spend \$525m on road infrastructure. Poor roads are a major infrastructure problem in Zambia and prevent the efficient transport of goods to rural areas of the country. The government will fund the **Pave Zambia**, the **Link Zambia 8000 Road Project** and the **C400** road projects from this section of the budget. Chikwanda allocated a further \$525m to other infrastructure projects.¹⁶ The government will spend \$39m upgrading **Kenneth Kaunda International Airport**, outside **Lusaka**.¹⁷ The government has allocated \$80m to the **Farmer Input Support** programme and a further \$4.5m to irrigation programmes to support the agricultural sector.¹⁸ Chikwanda allocated \$57m for the general election and constitutional referendum that the government will hold in November 2016 (see *ARC Briefing Zambia March 2015*).¹⁹

... as kwacha's slump and power crisis fuel massive inflation rise

Zambia's economic crisis has continued across October, driven by the continued devaluation of the kwacha and the ongoing power crisis, which led consumer price index (CPI) inflation to nearly double to 14.3% in October.²⁰ The kwacha devalued 5.5% across October from K11.9 to the **United States (US)** dollar on 1 October to K12.56 to the dollar at time of writing.²¹ This included a 3% slump on 27 October as the markets reacted to predictions of a further slowdown in **China**, the main consumer of copper, Zambia's primary export.²² The 5.5% decline makes October the steadiest month for the currency since June.²³ The kwacha has fallen 97% against the dollar across 2015 from K6.39 in January.²⁴

The **Bank of Zambia (BoZ)** traded in foreign exchange reserves to keep the price stable across October after President **Edgar Lungu** (2015-present) ordered the central bank to intervene.²⁵ Lungu gave the order after the currency fell 17% against the dollar on 2 October. The BoZ spent dollar reserves buying the kwacha on the foreign exchange (forex) markets from 3 to 7 October, and again

¹¹ Fitch press release, 12 Oct 2015.

¹² Source, director of a thinktank, Lusaka

¹³ Chikwanda, quoted in Bloomberg, 13 Oct 2015.

¹⁴ Zambia Weekly, 11 Oct 2015.

¹⁵ Zambia Weekly, 11 Oct 2015.

¹⁶ Zambia Weekly, 11 Oct 2015.

¹⁷ Lusaka Times, 10 Oct 2015.

¹⁸ Zambia Weekly, 11 Oct 2015.

¹⁹ Zambia Weekly, 11 Oct 2015.

²⁰ Zambia Weekly, 30 Oct 2015.

²¹ XE.com, 30 Oct 2015.

²² Reuters, 28 Oct 2015.

²³ Xe.com, 30 Oct 2015.

²⁴ XE.com, 30 Oct 2015.

²⁵ Lusaka Times, 1 Oct 2015.

on 7 October.²⁶ The BoZ altered its internal rules to allow it to trade more than \$1m per transaction in order to keep the currency stable. However, there are fears that continued forex trading could deplete Zambia's foreign currency reserves, especially at a time when foreign currency revenue is low due to reduced copper output:

"The reason the BoZ did not want to trade on the forex markets was that the monetary policy committee (MPC) felt there was no point if the kwacha rises and falls with the copper price... if the central bank runs out of foreign currency it badly affects the spending power of the public purse."²⁷

The copper price has fallen 25% across the last year from \$6,865 per tonne in October 2014 to \$5,179 per tonne at time of writing.²⁸ Mining accounts for 70% of export revenues and is the second largest employer in the country, directly employing 60,000 workers and indirectly supporting an industry of over 200,000.²⁹ Copper mining is the largest sub-sector and Zambia is Africa's second largest producer of copper.³⁰ The sector has had a difficult year: a disagreement over taxation with the government curtailed production from January to April (see *ARC Briefing Zambia January-April 2015*) and reduced power supply reduced production again from August onwards (see *ARC Briefing Zambia August and September*).

Electricity shortages have continued across October. State electricity utility **Zambia Electricity Supply Corp (Zesco)**, which cut power to copper mines by 25% in September, has had to pass costs on to consumers to remain solvent. It announced plans to introduce a 50% fee increase for all consumers other than mining companies seeking investment on 5 October.³¹ Electricity will increase in cost for commercial users from \$0.02/kilowatt hour (Kwh) to \$0.07/Kwh. Residential consumers that use about 500Kwh per month will have to pay \$0.12/Kwh up from \$0.04/Kwh.³² Zesco is seeking permission from the power ministry to introduce the new tariffs from 1 November.³³ Zesco argues that the new tariffs will help to attract investment in Zambia's power sector necessary to make up the energy shortfall.³⁴ The government announced that \$4.3 billion in investments in the power sector would come online by August 2016 adding 1,673 megawatts to generation capacity once completed.³⁵

Zambians are increasingly angry at the continuing power outages, as water levels at the crucial **Kariba Dam** remain low, and domestic and consumer consumption increases. Most households have a rolling eight hours on, eight hours off power outage schedule – locally referred to as load shedding.³⁶ The continuing power cuts mean that most households have to rely on burning charcoal for cooking fuel, which is sharply rising in price. Diesel generators have also become a valuable commodity costing up to \$14,000 to power a medium-sized office for a year.³⁷

"I have had to lay off half my staff, our revenue has dipped by 40% and costs have increased by 25% despite the lay-offs... if this continues for much longer I will have to close shop."³⁸

The falling price of the kwacha, the low copper price and output, and the electricity crisis have all contributed to the sharp rise in CPI inflation, which nearly doubled to 14.3% in October from 7.7% in

²⁶ Zambia Weekly, 30 Oct 2015.

²⁷ Source, economist, Lusaka

²⁸ Infomine, 2015

²⁹ Reuters, 9 Oct 2015.

³⁰ Reuters, 9 Oct 2015.

³¹ Reuters, 5 Oct 2015.

³² Reuters, 5 Oct 2015.

³³ Reuters, 5 Oct 2015.

³⁴ Zambia Reports, 5 Oct 2015.

³⁵ Zambia Reports, 5 Oct 2015.

³⁶ Lusaka Times, 27 Oct 2015.

³⁷ Lusaka Times, 27 Oct 2015.

³⁸ Source, business owner, Lusaka

September.³⁹ The rate is the highest since August 2009 and is close to the all-time high of 19.2% that Zambia reached in April 2005.⁴⁰ The finance ministry released a statement on 27 October saying that an increase in both food and non-food items drove the rise. The increase in inflation is partially the poor macro-economic situation catching up with consumers as existing stocks of goods imported at lower costs run out.⁴¹ Economic analysts believe that the situation is likely to get worse before the end of the year:

"This is the perfect economic storm: the primary commodity price is low, driving down the currency and driving up import costs. The power crisis hits copper output, decreasing government revenue and market confidence, driving the kwacha down further. It also makes previously simple actions such as cooking a meal more complicated and expensive... this will get worse through November and will only begin to get better in January when the rainy season will hopefully restore power."⁴²

Former health ministry official jailed for corruption

A court sentenced **Henry Kapoko**, a former human resource officer in the health ministry, to two years' imprisonment on 27 October for his role in organising a graft scandal that severely affected the healthcare system in Zambia.⁴³ Magistrate **Lameck Ng'ambi** convicted Kapoko of abuse of authority of office and corruption, and ordered him to repay \$2,000 he received from the **Esu School of Nursing**.⁴⁴ Kapoko's co-accused, Esu director **Edwin Ushibantu**, was ordered to pay back \$10,000. Both have appealed.⁴⁵

The conviction and sentence are small compared to the scope of the scandal, but represent the government's eventual success in prosecuting Kapoko for his role. In 2009, the **Anti-Corruption Commission (ACC)** uncovered that health ministry staff had misappropriated \$2.1m in 2008-2009 – and estimated that they had misappropriated more than \$5.1m since 2006. The department suspended and seized the assets of 32 employees, including permanent secretary **Simon Miti** (who later turned state witness).⁴⁶ The ACC alleged that Kapoko, his uncle **Robert Kalimi** (currently Zambia's deputy high commissioner to **Kenya**) and Miti organised the scam. As a result, both **The Netherlands** and **Sweden** froze their funds to the health sector.⁴⁷ International aid to Zambia only resumed in 2012 after Zambia repaid \$13m into the **Global Fund to Fight AIDS, Tuberculosis and Malaria** to replace the money allegedly embezzled from donations.⁴⁸

Kapoko has avoided multiple convictions:

- In September 2014, magistrate **Sharon Nawa** acquitted Kapoko and seven other health ministry officials of various combinations of 21 counts of theft by a public servant, theft and money laundering involving \$300,000.⁴⁹ Nawa convicted **Royal Secretarial College** director **Valenta Nkata** and her daughter for receiving money for ministry workshops that never took place, but ruled that the state had failed to prove that Kapoko and the other seven had taken the money fraudulently.⁵⁰

³⁹ Zambia Weekly, 30 Oct 2015.

⁴⁰ Zambia Weekly, 30 Oct 2015.

⁴¹ Source, economist, Lusaka

⁴² Source, economist, Lusaka

⁴³ Lusaka Times, 27 Oct 2015.

⁴⁴ Lusaka Times, 27 Oct 2015.

⁴⁵ Lusaka Times, 27 Oct 2015.

⁴⁶ Zambia Weekly, 30 Oct 2015.

⁴⁷ Zambia Weekly, 30 Oct 2015.

⁴⁸ Zambia Weekly, 30 Oct 2015.

⁴⁹ Zambia Weekly, 30 Oct 2015.

⁵⁰ Zambia Weekly, 30 Oct 2015.

- In December 2012 magistrate **Rodgers Kaoma** acquitted Kapoko and Kalimi of seven charges of theft by public servant and money laundering involving \$29,000.⁵¹ Kaoma ruled the prosecution had failed to establish a case, arguing that there was no evidence that the two had forged Miti's signature to siphon money into Kalimi's company, **Rojo Trading**.⁵²
- In November 2012 magistrate **Kenneth Mulife** acquitted Kapoko and eight others of money laundering and theft of \$150,000.⁵³ They were accused of having pretended to supply 50,000 mother-baby-kits to the ministry.⁵⁴ Mulife argued that the state had failed to prove its case beyond reasonable doubt.⁵⁵

Kapoko's conviction is a victory for the prosecution service, but analysts in Zambia say the affair has revealed serious flaws in their operations:

"The prosecutors that tried these cases made repeated basic mistakes in handling and presenting of evidence... the expensive defence lawyers for Kapoko and others clearly outmatched them in the courtroom... if we are to take on corruption in this country then there needs to be clear reform of the prosecution service to ensure that prosecutors perform to the highest standard... this [Kapoko's conviction] is not a victory for the justice department, he should have gone away for a lot longer on more charges."⁵⁶

Implications

Chikwanda's budget does not present a clear way out of Zambia's precarious financial situation. The finance minister appears to be banking on a stabilisation of the copper price in 2016 as well as the government's own ability to rapidly increase power supply during the rainy season in time for the dry season mid-2016. This places the key factors in turning the economy around beyond Chikwanda's control – he is unable to influence the global copper price and is relying on the new power generation projects to meet a tight timetable. For the moment, the short and medium economic outlook for Zambia remains very poor.

The budget is a gamble, and the 2016 elections are clearly a factor. If everything falls into place, Chikwanda and the PF are highly likely to walk into a second term. If not, the government will be forced to significantly revise spending just months before the election. Populist politics won both former president **Michael Sata** (2011-2014) the 2011 elections and Lungu the 2015 presidential by-election. However, the sharp increase in the cost of living and the negative impact of load shedding make the electorate far less receptive to promises that are not easily delivered.

Zambia's judicial and legal system is often the target of criticism from civil society groups, especially the public prosecutor's office. However, Kapoko's conviction is the latest in a number of government attempts to reign in corrupt officials. Corruption continues to be a risk for investors, but the risk is likely to improve in the medium term.

⁵¹ Zambia Weekly, 30 Oct 2015.

⁵² Zambia Weekly, 30 Oct 2015.

⁵³ Zambia Weekly, 30 Oct 2015.

⁵⁴ Zambia Weekly, 30 Oct 2015.

⁵⁵ Zambia Weekly, 30 Oct 2015.

⁵⁶ Source, think tank director and lawyer, Lusaka

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