



REPUBLIC OF ZAMBIA

2015 MID-YEAR ECONOMIC AND BUDGET REVIEW STATEMENT

By

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Made to the

National Assembly

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Introduction

- 1. Mr. Speaker, I am pleased to present the Mid-Year Economic and Budget Review for 2015 to this August House.** This review provides an account on the performance of the Economy since the commencement of the year and a review of the implementation of the budget over the first five months of the year. My address will further provide revised macroeconomic and budget targets that take into account both domestic and external challenges faced in the first 5 months of this year. It will also provide proposals aimed at ensuring that we stay on course with our programme of economic growth and job creation in 2015, and beyond.
- 2. Sir,** my address to this August House is therefore divided into 4 Parts. Part 1 will be a review of the performance of the Economy and will provide adjusted projections, while Part 2 will review the performance of the budget against targets, and provide revisions thereof. Part 3 will provide proposed revisions to the budget targets including the deficit. In Part 4, I will conclude and ask the House to consider passing some statutory reviews and approvals.

PART I - 2015 MACROECONOMIC PERFORMANCE

Projected Economic Growth

- 3. Mr Speaker, when I tabled the 2015 budget, we expected the economy to grow by at least 7.0 percent.** This growth was

premised on healthier recovery in the global economy as well as continued favourable performance in the country's growth sectors, namely agriculture, manufacturing, construction, tourism and mining. However, we have observed that the global economic environment has been much weaker, characterised by a slowdown in economic activity in Europe, China and the emerging market economies. Given these developments, global economic growth for 2015 has been revised downwards to 3.5 percent from the earlier projection of 3.8 percent. The slowdown coupled with the strengthening of the United States dollar has triggered a decline in prices of most traded commodities including copper, our main export, and ominously, prices of non-traditional exports such as cement, lime, cotton lint, fresh fruits, vegetables and flowers. These developments exerted pressure on our revenue receipts and external sector position, as I will elaborate later.

4. Domestically, the crop forecast survey for the 2014/2015 farming season indicates a decline in output of a number of crops. For instance, maize output is expected to decline by 21.9 percent to 2.62 million metric tons from 3.35 million metric tons in the 2013/2014 farming season. This was due to the late onset and poor distribution of rainfall. With this expected outturn in maize output, growth in agriculture is expected to be lower than anticipated.

5. **With respect to the mining sector**, we had projected that the sector would grow by above 12.0 percent. This was mainly premised on copper production exceeding 800,000 metric tons in 2015 from 708,265 metric tons in 2014. |Data for the first quarter shows that copper output at 164,386 metric tons was 8.5 percent lower than the 179,584 metric tons produced in the corresponding quarter of 2014. This fall in copper output during the quarter is likely to result in lower than projected total copper output in 2015 with a likely consequence of lower growth in the mining sector than projected. Sir, the drop in copper production is as a result of the persistent fall in the price of the commodity, which in turn is attributed to the weak global demand for the metal as it is for other traded commodities.
6. Taking into account that the slowdown in agriculture and mining has knock-on effects to other sectors such as manufacturing, GDP growth for 2015, while remaining positive is now estimated at 5.8 percent from the initial projection of at least 7 percent.

Inflation

7. **Mr. Speaker, in my 2015 budget address to this House, I announced an end-year inflation target of no more than 7.0 percent.** This was to be anchored on the continued implementation of an effective monetary policy, supported by prudent fiscal operations.

8. In line with this objective, the Bank of Zambia continued managing liquidity through Open Market Operations and maintained the Policy Rate at 12.5 percent. The Bank also raised the Commercial Banks' statutory reserve ratio to 18 percent from 14 percent to counter pressures on the exchange rate mainly in the first quarter of the year. These measures contributed to the decline in annual inflation to 6.9 percent in May, 2015 from 7.9 percent in December, 2014.

9. Sir, despite the recent increase in prices of fuel and the lagged effect of the depreciation of the exchange rate, we are confident that the projected inflation will be attained. This is on account the fine balance between monetary and fiscal policy that is required to maintain stability in the economy and ensure continued economic growth.

Interest rates

10. Mr. Speaker, Commercial Banks nominal interest rates were generally stable during the first five months of 2015. The average lending rate and average savings rate for amounts above K100 were relatively unchanged around 20.5 percent and 3.4 percent respectively.

11. Despite this stability in the Commercial Banks' lending rates, the cost of borrowing continued to be relatively inhibitive

for the larger section of the private investors. In this regard, Government will continue to closely collaborate with the Bank of Zambia and relevant financial institutions on ways of making the cost of borrowing affordable. Government will also continue implementing reforms aimed at lowering the cost of doing business. We remain resolved in stimulating the growth of our economy particularly through the active participation of SMEs.

Exchange rate

12. Sir, Government continues to maintain a market driven foreign exchange regime with Central Bank's interventions, limited to smoothening short-term volatility.

Compared to the tranquillity observed during the fourth quarter of 2014, pressures on the Kwacha were observed during much of the first part of 2015. **The Kwacha depreciated** by 18.6 percent and 12.6 percent against the US dollar and the Rand, respectively, to end the quarter at K7.5867 and K0.6236 from the end-March 2015 levels. The depreciation was largely on account of the persistent weak copper prices and the global strengthening of the US dollar. The weak copper prices adversely affected foreign exchange earnings and supply on the domestic market.

13. Mr. Speaker, recent measures implemented by the Bank of Zambia have seen the Kwacha strengthening mostly

in the second quarter. The local currency appreciated by 4.4 percent and 7.6 percent and against the US dollar and the Rand, respectively as at June 5, 2015. Improved foreign exchange supplies also supported the gains in the Kwacha.

External sector developments

14. The developments in the balance of payments for the first quarter of 2015 were unfavourable as the overall BOP deficit widened to US \$405.2 million from US \$131.9 million in the fourth quarter of 2014. This was largely on account of unfavourable performance in both the current and financial accounts, which in turn were adversely affected by the sluggish performance of the global economy, as alluded to earlier.

15. Mr. Speaker Sir, we remain steadfast to reverse this trend by adopting trade policy measures that promote exports and discourage non-essential imports. Expenditure switching policies and strategies that support raising domestic productive capacities will continue to be implemented to make domestic goods competitive and increase output.

Debt Management and Debt Sustainability

16. Mr. Speaker, I am duty bound to inform this house on the sustainability of our debt.

17. **Zambia's** external debt currently stands at US\$4.8 billion representing about 18.5 percent of GDP while the domestic debt is K20.5 billion (approximately US\$3.7 billion) representing about 14.2 percent of GDP. Total public debt is therefore around 32.7 percent of GDP. As members of this August House will note, our Debt position is far below the internationally accepted threshold of 40 percent. This position was confirmed by the results of the Debt Sustainability Analysis (DSA) undertaken in June 2014.

18. That stated Mr Speaker, let me emphasise that we are not complacent, and take issues of debt sustainability very seriously. It is for this reason that the Government will continue to undertake periodic debt sustainability analysis.

19. **Mr. Speaker, as a further step in ensuring prudent debt management,** I have in accordance with the provisions of the Loans and Guarantees (Authorization) Act Cap 366 of the Laws of Zambia, set up a sinking fund for the purpose of repayment of the two 10 year Sovereign Eurobonds amounting to US\$ 750 million and US\$1 billion issued on the international capital market in 2012 and 2014, respectively.

20. I have further set out the general regulations for the management and operation of the Fund to address issues of

transparency and accountability in its management and to ensure that the resources in the Fund are used for the sole intended purpose of paying back the Eurobonds.

*** PART 2 - 2015 Budget Performance Review**

21. Mr. Speaker, during the review period, Government faced a number of challenges in executing the 2015 budget.

Developments in the domestic and external economies have exerted unforeseen pressure on the implementation of the Budget, resulting in serious adverse consequences for both revenues and expenditures.

22. On the external side, the drop in copper prices has led to a reduction in projected tax collections from the mining sector while foreign exchange earnings have reduced. The depreciation of the Kwacha has largely resulted in higher external debt service payments and the cost of maintaining and running Zambian missions abroad. More Kwacha than was budgeted is now needed to meet these inescapable obligations. Further, the Treasury has seen significant reduction in trade-related taxes on account of a reduction in volumes of imports, a consequence of reduced availability and higher cost of foreign exchange. The Government has also revised the taxation regime for the mining sector to address the concerns that arose from the mineral

royalty based system. Total revenue projections are expected to decline by K2.12 billion below the budget level.

23. On the domestic front, some categories of expenditure have increased beyond budget. The categories that have increased beyond budget relate principally to domestic interest payments that have substantially increased by K2.1 billion in response to the rise in interest rates in the domestic financial market, arrears on road sector projects from 2014 of K1.3 billion, an additional K376 million that was required for the purchase of crops for the 2013/2014 farming season, K148.9 million for the Kafue Bulk Water Supply Project, K3.2 billion for the payment of fuel arrears and K163.0 million for the holding of the Presidential bye-Election. Total expenditures are projected to increase by K13.43 billion beyond Budget.

24. Sir, you may recall that in my 2015 budget address, I proposed to spend K46.7 billion. This was to be financed by domestic revenues of K35.1 billion and grants from cooperating partners of K1.2 billion. Domestic borrowing was projected at 2.0 percent of GDP translating to K3.8 billion, while K4.2 billion was to be a combination of foreign financed programmes and projects from our Cooperating Partners. The balance of K2.4 billion was due to be financed externally. This combination yields a deficit of K8.5 billion that was contained in the 2015 Budget estimates that were approved by this House.

25. Mr. Speaker, the developments I have highlighted have meant that projected revenues will be lower while expenditures will be higher than budgeted. The deficit has increased therefore to K20.0 billion from the budgeted K8.5 billion.

PART 3 - Deficit Financing

26. Mr. speaker, in order to address these pressures and ensure macro-economic stability and positive growth, I propose to put in place the following measures:

1. Raising additional revenues of K500 million by increasing the fee unit from 20 to 30 ngwee;
2. Rationalising expenditure and make a projected saving of K5 billion. This will involve limiting expenditures on recurrent programmes and concentrating on completion of on-going capital projects before embarking on new projects; and
3. Proceeding with the identified financing of K8.5 billion that is in the current budget estimates.

27. The measures above will result in an un-financed deficit of about K10.5 billion that will require new financing.

28. Sir, borrowing on the domestic market is not prudent given the attendant risks associated with the possible crowding out of

the private sector and domestic debt unsustainability in light of the current higher interest rates. As the domestic route will be too grave to embark on, we therefore have one plausible option, which is external financing. Given limited resources that can be availed by cooperating partners, this may entail borrowing at commercial terms.

29. Mr. Speaker, to this end, and as a consultative Government and one that believes in constitutionalism, I will in line with the Loans and Guarantees Authorisation Act, Cap 366 of the Laws of Zambia, be requesting the House to increase the ceiling on external borrowing from the current K35 billion to K60 billion. This will enable us to have greater recourse to external financing which at current international rates is cheaper than domestic borrowing. We intend to use any such resources to complete the various developmental projects that we commenced.

30. Sir, to counter any risks associated with such borrowing, we will use legal provisions such as those which authorise the Ministry of Finance to set up debt repayment facilities. As a responsible Government, we have already put in place concrete legal provisions through the setting up of the sinking fund to deal with any future risks. Further, as I indicated earlier, our debt is still very much within sustainable levels, even with the new intended borrowing.

31. **Mr. Speaker, Governments all over the world face difficult decisions as the gap between what a country needs and what it can afford is usually very wide. In this case, we as a country,** must continue to pursue a fiscal strategy that should spur growth, boost revenue and ensure efficient resource use through innovative fiscal consolidation measures.

PART 4: CONCLUSION

32. **Honourable Members of the House, despite the external and domestic challenges factors that have affected budget execution, we remain steadfast in exercising prudent fiscal management.**

33. Mr. Speaker, I mentioned earlier that growth is now expected to be lower at an estimate of 5.8 percent compared to, at least 7.0 percent at the time I tabled the 2015 budget. Given this reduced growth and the lower revenue from the mining and external grants over the reviewed period, it is vital that we make some adjustments to the 2015 budget provisions. Further, threats from the external environment are still a reality as the global economic outlook remains uncertain and generally fragile. There is thus need for decisive and focused action in order for us, as a nation, to stay on course with economic transformation and the improvement in the lives of our people.

34. Sir, to achieve this, we will as Government continue to undertake reforms aimed at dealing with structural difficulties that we face in managing the economy. These will include:

1. Lengthening the period for capital projects implementation, particularly in the road sector;
2. Reducing spending on goods and services in the public service so as to invest more in capital projects;
3. Improving efficiency in the implementation of FISP and FRA;
4. Ensuring implementation of full cost recovery of domestic fuel pump prices; and
5. Enactment of the Planning and Budget Act that will bring about prudence in spending

35. **In concluding, Honourable Speaker, allow me to acknowledge the guidance and support of the President in these difficult times.** Cabinet collectively owns this mid-year budget policy statement. Its support and understanding for tough measures is highly appreciated.

36. **I must express gratitude to all the Zambian's who have offered words of encouragement as well as criticism and concerns.** This is what keeps us accountable and drives us constantly to deliver to the Zambian people.

37. **Mr. Speaker, I hereby table for consideration by this House, the mid-year economic and budget review.** A supplementary Appropriation Bill and other attendant legislation for the revenue measures I have outlined in the Statement will be presented to this house in due course.

38. **Sir, Members of the House,** I call for your support for the various measures that I have presented to this House.

Mr. Speaker, I thank you.