IMF Country Report No. 19/263

ZAMBIA

August 2019

2019 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR ZAMBIA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2019 Article IV consultation with Zambia, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on July 24, 2019, following discussions that ended on April 30, 2019, with the officials of Zambia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on July 11, 2019.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the World Bank.
- A **Statement by the Executive Director** for Zambia.
- A **Statement by the Staff Representative** for Zambia.

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August 2, 2019

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IMF Executive Board Concludes 2019 Article IV Consultation with Zambia

On July 24, 2019, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Zambia.

Zambia's development strategy has focused on a rapid-scaling up of public investment to address the country's infrastructure needs. While public investment has increased sharply, economic growth remains well below levels seen earlier this decade and is estimated at 3.7 percent in 2018. Inflation averaged 7 percent in 2018, but a depreciation of the currency late in 2018 and again this spring coupled with food price rises has pushed inflation above 8 percent. Fiscal revenues exceeded budget targets in 2018, but the deficit widened above 10½ percent on a commitment basis (over 8 percent of GDP on a cash basis) due to a rising interest bill and a surge in public investment reflecting faster than expected execution of public investment projects. Total public and publicly-guaranteed (PPG) debt including arrears at end-2018 was 78 percent of GDP. The current account deficit widened to 2.6 percent of GDP in 2018 due to higher imports and debt service, while reserves declined from 2.4 months of import cover in 2017 to 1.9 months at end-2018.

The outlook is clouded by the ongoing drought and heightened debt vulnerabilities. Growth is projected to slow to 2 percent in 2019, reflecting a decline in mining sector activity in an uncertain environment for mining companies and the drought's impact on hydro power production. Absent significant policy adjustments, growth is likely to remain subdued over the medium term as expenditure arrears and an ongoing forced adjustment in response to increasing debt-related pressures weigh on the private sector. Inflation is projected to remain above the top of the Bank of Zambia's (BoZ) target band in 2019 and 2020. The BoZ increased the policy rate by 50 bps to 10.25 percent in May. While the central bank has moved to shore up reserves as market conditions have permitted, reserves are projected to decline to 1.6 months of import cover by end-2019. Key risks include the uncertain impact of the drought, a potential tightening of

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

(continued…)

global financial conditions, a further escalation in trade tensions, and the uncertain growth dividend from recent infrastructure investments.

Executive Board Assessment[2]

Executive Directors agreed with the thrust of the staff appraisal. They noted the deterioration in macroeconomic outcomes in Zambia and heightened vulnerabilities due to the ongoing drought and recent policy slippages. They expressed concern that public debt and debt service have increased rapidly due to heavy reliance on non-concessional debt to finance large infrastructure investment, while growth has lagged, thus putting Zambia at high risk of external and public debt distress. Against this background, Directors emphasized the urgency of reforms and of a firm commitment to implement them.

Directors noted that under current policies public debt is on an unsustainable path, and ongoing financing constraints have started to force the inevitable fiscal adjustment to occur in a disorderly way, with mounting expenditure arrears. They cautioned that there is a narrow window for tackling fiscal challenges in an orderly and planned manner. This would require a large front-loaded and sustained fiscal adjustment centered on stronger control and prioritization of public investment projects and postponing the contracting of new non-concessional debt, accompanied by enhanced revenue mobilization and the scaling back of exemptions and tax expenditures, while reducing domestic expenditure arrears. Directors stressed that the adjustment strategy should aim to minimize drag on growth and contain the impact on priority social spending. Some Directors also urged the authorities to carefully consider the benefits and disadvantages of shifting from a value-added tax to a sales tax.

Directors welcomed the Cabinet decision in late May to indefinitely postpone the contracting of all new non-concessional loans, cancel some committed but undisbursed loans and enhance the control and management of disbursements of foreign-financed loans, and to strictly adhere to public financial management rules under the 2018 PFM Act. Directors emphasized that strong actions would be needed to reduce debt-related vulnerabilities and called for continued efforts to enhance debt management and transparency. They urged the authorities to address weaknesses in procurement and in project selection and management to ensure prioritization and greater investment efficiency. They also stressed that stronger procedures are needed to ensure that budget execution reflects the authorities’ fiscal goals. Directors noted the importance of ongoing and future technical assistance in enhancing the authorities’ capacity in these areas.

Directors welcomed the recent monetary tightening by the Bank of Zambia (BoZ). They underscored the important role for forward-looking monetary policy in securing macroeconomic

[2] At the conclusion of the discussion, the Acting Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

stability and supporting reserves, in conjunction with a reorientation of the fiscal stance. They commended BoZ's actions to implement the recommendations of the 2017 FSAP, including strengthening its supervisory capacity and enhancing the crisis preparedness framework. Directors urged the authorities to closely monitor pressures from the macrofinancial linkages between the financial system and the sovereign. They also recommended continuing to address nonperforming loans.

Directors saw potential for growth to accelerate over the medium term with the appropriate fiscal adjustment. They emphasized that achieving inclusive growth and reducing poverty will require a steady focus on improving the investment climate, promoting productivity and human capital, and addressing the risk of corruption. They advised the authorities to develop proactive strategies to respond to the drought and climate-related risks and to promote well-functioning support programs in the agricultural sector to enhance resilience.

Zambia: Selected Economic Indicators, 2017–24

	2017	2018	2019	2020	2021	2022	2023	2024
			Proj.					
	(Percentage change, unless otherwise indicated)							
National account and prices								
GDP growth at constant prices	3.5	3.7	2.0	1.7	1.7	1.6	1.5	1.5
Mining	3.0	6.3	-2.0	2.0	2.0	3.0	3.0	3.0
Non mining	3.6	3.4	2.5	1.7	1.7	1.4	1.3	1.3
GDP deflator	10.1	9.5	10.0	9.7	8.2	8.3	8.0	7.7
GDP at market prices (millions of kwacha)	246,252	279,441	313,496	349,831	385,196	423,750	464,432	507,929
Consumer prices								
Consumer prices (average)	6.6	7.0	9.9	10.0	8.0	8.0	8.0	8.0
Consumer prices (end of period)	6.1	7.9	12.0	8.0	8.0	8.0	8.0	8.0
External sector								
Terms of trade (deterioration -)	16.0	-3.8	-6.4	-1.5	0.3	0.1	-0.2	-1.1
Average exchange rate (kwacha per U.S. dollar)	9.5	10.5	…	…	…	…	…	…
(percentage change; depreciation +)	-7.7	9.9	…	…	…	…	…	…
Money and credit								
Domestic credit to the private sector	5.2	16.7	7.5	7.9	7.9	6.2	6.9	7.1
Reserve money (end of period)	-25.6	-0.6	10.3	13.4	11.0	11.9	11.6	10.5
Broad Money (M3)	21.4	16.5	11.9	11.0	10.1	11.0	10.7	10.5
	(Percent of GDP, unless otherwise indicated)							
National accounts								
Gross investment	41.0	43.3	41.1	40.2	37.3	36.6	36.0	35.7
Government	5.5	8.6	7.3	8.4	6.9	6.5	6.1	6.1
Private	35.5	34.8	33.8	31.9	30.5	30.2	29.9	29.6
National savings	39.3	40.7	37.5	36.8	34.4	34.0	33.7	33.7
External current account balance	-1.7	-2.6	-3.6	-3.4	-2.9	-2.6	-2.3	-2.0
Central government budget								
Revenue	17.5	19.1	19.4	19.7	19.8	19.8	19.7	19.7
Taxes	14.8	15.8	15.7	15.9	16.0	16.0	15.9	15.9
Grants	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1
Other revenue	2.5	3.1	3.5	3.7	3.7	3.7	3.8	3.8
Expenditure	25.0	27.4	24.2	24.8	23.3	22.9	22.6	22.4
Expense	19.4	18.8	16.8	16.4	16.4	16.4	16.5	16.3
Net acquisition of nonfinancial assets	5.5	8.6	7.3	8.4	6.9	6.5	6.1	6.1
Fiscal balance (cash basis)[2]	-7.5	-8.3	-4.8	-5.1	-3.4	-3.1	-2.9	-2.6
Excluding grants	-7.7	-8.5	-5.0	-5.2	-3.6	-3.2	-3.0	-2.7

Fiscal balance (commitment basis)[3]	-6.8	-10.7	-9.0	-5.6	-4.0	-3.1	0.0	-5.6
Net acquisition of financial assets	0.3	-0.7	0.0	0.0	0.0	0.0	0.0	0.0
Domestic	0.3	-0.7	0.0	0.0	0.0	0.0	0.0	0.0
Foreign	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrance of liabilities	8.1	7.6	4.8	5.1	3.4	3.1	2.9	2.6
Domestic	5.2	2.7	1.0	0.8	0.8	0.8	0.8	0.7
Foreign	2.9	4.9	3.9	4.3	2.7	2.3	2.1	1.9
External sector								
Current account balance	-1.7	-2.6	-3.6	-3.4	-2.9	-2.6	-2.3	-2.0
Gross International Reserves (months of prospective imports)	2.4	1.9	1.6	1.3	0.9	0.6	0.6	0.5
Excluding FDI-financed imports	2.5	2.0	1.7	1.3	1.0	0.6	0.6	0.6
Public debt				(Percent of GDP)				
Total central government debt, gross (end-period)	65.5	78.1	91.6	95.5	98.0	97.6	96.7	95.1
External	38.2	48.1	59.9	65.6	69.5	70.8	71.5	71.3
Domestic	27.3	30.0	31.7	29.8	28.5	26.8	25.2	23.8

Sources: Zambian authorities; and IMF staff estimates and projections.

[1] Excludes Zimbabwe.

[2] Measured from total financing below the line.

[3] Adjusted for the accumulation/clearance of VAT refund claims and arrears relating to FRA, FISP, subsidies, public investment projects, and pensions.

INTERNATIONAL MONETARY FUND

ZAMBIA

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION

July 11, 2019

KEY ISSUES

Context. Zambia's development strategy has targeted a rapid scale-up of public investment to address infrastructure needs. This has resulted in large fiscal deficits, financed by nonconcessional debt and the accumulation of domestic arrears, adversely impacting the private sector. Recent efforts to adjust the fiscal stance have delivered some improvement in revenues, but deficits have continued to rise following faster-than-budgeted execution of foreign-financed capital spending. With the anticipated growth dividend yet to materialize, the debt burden has risen sharply, resulting in currency weakness and rising local borrowing costs that have further pushed up the interest bill. Reserve coverage has fallen to 1.7 months of imports.

Outlook and Risks. The path forward is very narrow. With the outlook already subdued, the drought in the south and west is further weighing on growth, via agriculture and the heavy dependence on hydro power, placing vulnerable groups at risk. While tightening cash constraints are forcing some fiscal adjustment, Zambia's public debt under current policies is on an unsustainable path. Zambia has remained current on debt service obligations, but a significant reorientation of the fiscal policy stance is needed to preserve macroeconomic stability and begin reducing debt-related vulnerabilities. With an end of the drought and progress addressing arrears, growth would accelerate in the medium term. However, risks would remain elevated.

Key Policies. A large, frontloaded, and sustained fiscal effort is needed to bring debt down to safer levels. This should include a moratorium on contracting new external non-concessional borrowing, steps to raise revenues, halt the buildup of domestic expenditure arrears, and to better prioritize public investment projects. Avoiding too harsh a drag on growth or priority social spending is key, and effective responses are needed to the drought. The authorities agreed on the need for action to restore stability and reduce debt accumulation. Decisive steps forward to build confidence and deliver meaningful fiscal adjustment will be essential. Appropriately tight monetary policy also has a role to play in securing stability. Reserves should be replenished over the medium term. Steady attention to the business environment is also needed to support private investment going forward.

Approved By
David Robinson (AFR) and Martin Sommer (SPR)

Discussions were held in Lusaka from April 16–30. The staff team comprised Ms. Goodman (head and SPR), Messrs. Kalonji, Gupta, Pondi Endengle (all AFR), and Li (SPR). Mr. Robinson (Deputy Director, AFR) joined the mission's concluding policy discussions. Mr. Mwansa (Economist, Office of the Resident Representative) assisted the mission. Ms. Mannathoko (Alternative Executive Director) and Mr. Sitima-wina (both OED) participated in policy discussions. Staff met Minister of Finance Margaret Mwanakatwe, Bank of Zambia (BoZ) Governor Denny Kalyalya, other senior government and BoZ officials, members of parliament, senior officials of selected parastatals, as well as representatives of the private sector, labor unions, civil society organizations, and Zambia's development partners. Bakar Ould Abdallah, Krisztina Fabo, Cleary Haines and Sandrine Ourigou (all AFR) assisted from headquarters.

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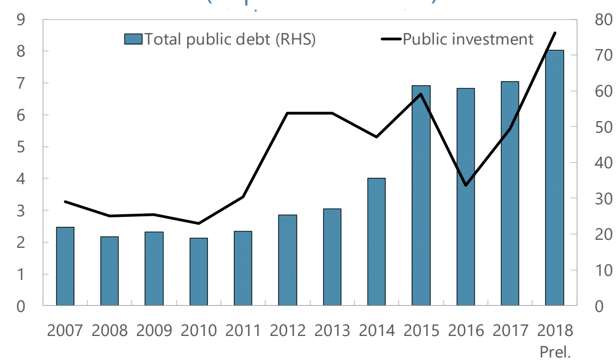
CONTEXT

1. **Zambia is facing slowing growth and acute vulnerabilities**. The growth slowdown seen since 2011 reflects a protracted fall in copper prices and severe droughts in 2015/2016 and 2018/2019 that constrained hydropower electricity generation and lowered agriculture output. An expansionary fiscal stance financed by nonconcessional borrowing and domestic expenditure arrears has resulted in a rapid increase in debt and negative spillovers to the private sector. Reflecting these vulnerabilities, Eurobond spreads rose to 1,575 in early June.

Public Investment and Debt

(in percent of GDP)



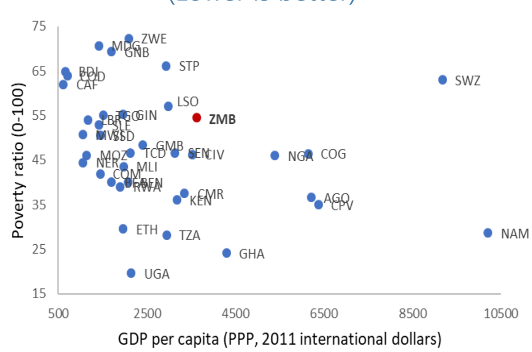
Sources: Zambia authorities and IMF estimates and calculations.

2. **Presidential elections are due in 2021**. The Patriotic Front Party came into office in 2011, retaining office in the 2016 elections, and has pursued the development strategy elaborated in Zambia's Vision 2030 long-term development plan and the Seventh National Development Plan (7NDP). This is centered on a significant ramping up of infrastructure spending, notably to extend the road network on which Zambia—a landlocked country—significantly relies.

3. **Poverty and inequality are among the highest in SSA**. The poverty rate has risen since the early 2000s, though it declined somewhat during 2010–15, while the GINI coefficient also has risen. Unemployment stood at 12.5 percent at the end of 2018. In addition, Zambia currently hosts over 70,000 refugees from neighboring countries, adding pressure on government resources.

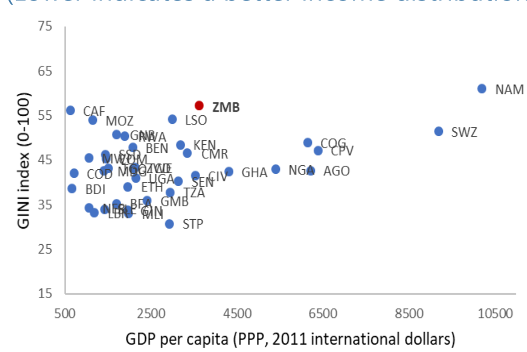
Sub-Saharan Africa: Poverty Headcount

(Lower is better)



Sub-Saharan Africa: GINI Index

(Lower indicates a better income distribution)



Source: WEO, World Bank's WDI, and IMF staff estimates.

4. **Implementation of past IMF policy advice has been limited (Annex I).**[1] Staff recommendations to rein in the fiscal deficit and reduce debt vulnerabilities were not implemented. Structural reforms in public financial management and public investment were delayed. Approval of the Public Finance Management Act in 2018 should help strengthen budget execution. However, accompanying legislation needed to support implementation, promote transparency, and introduce fiscal risk management remains pending (e.g. the Planning & Budgeting Act and the Loans and Guarantees Act). Fuel subsidies were eliminated in 2017, and price adjustments continue to be made, while electricity tariffs were adjusted to start the process of cost recovery. In addition, the Bank of Zambia (BoZ) has made good progress in strengthening the monetary policy framework and reforming the regulatory, supervision, and crisis frameworks, though enforcement has lagged.

RECENT ECONOMIC DEVELOPMENTS

5. **Economic activity has remained subdued even as public investment increased**. In 2018, growth ticked up to 3.7 percent from 3.5 percent in 2017, driven by a modest expansion in telecommunications, financial and insurance activities, wholesale and retail trade, and mining. With a drought in the southern and western parts of the country, agriculture's contribution was negative. (Box 1). The growth impact from the significant ramping up of public investment has been muted by the low efficiency and high import content of public investment and a continuing build-up of public sector expenditure arrears that has hampered private sector activity.

6. **Inflation rose in 2018, reflecting price increases in food and fuel and the large exchange rate depreciation**. The kwacha depreciated by 20 percent last year, mostly in September, reflecting a weakening of Zambia's economic fundamentals and downgrades by all major international rating agencies amid broader EM pressures. Year-on-year inflation hovered around the upper end of the BOZ's target band (6–8 percent) in late 2018, rising to 8.1 percent in May 2019 due to increasing food prices and renewed exchange rate pressures. In light of rising inflationary pressures, the Monetary Policy Committee (MPC) increased the policy rate by 50 basis points to 10.25 percent at its May meeting.

7. **Revenues performed strongly in 2018, but the deficit rose to above 10½ percent of GDP reflecting a further increase in public investment and a rising interest bill**. Despite the rationalization of public investment announced in June 2018 through a moratorium on projects less than 80 percent completed, foreign-financed capital expenditure for the year exceeded budget targets by 3½ percentage points of GDP. Interest payments reached almost 20 percent of total spending. A combination of tighter domestic debt markets and structural weaknesses in expenditure controls led to an accumulation of about 1½ percent of GDP in domestic arrears. In addition, almost a percent of GDP in audited but unpaid VAT refund claims accumulated. The cash deficit widened slightly to 8.3 percent of GDP from 7.7 percent in 2017.

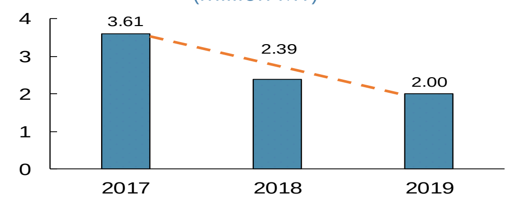
[1] The Executive Board completed the last Article IV consultation in October 2017.

Box 1. Impact of Drought and Other Climate-Related Shocks

Climate-related shocks are impacting the current growing season (October 2018-April 2019) and hydroelectricity generation. The drought hitting southern Africa is impacting southern and western Zambia, while flash floods have occurred in the north. Agricultural activity contracted by 21 percent in 2018, and the most recent Crop Forecast Survey projects a 16 percent drop in agricultural production for this growing season. With drought affecting Lusaka and Central provinces, which account for about one-third of the national maize output, production of the country's principal food staple in 2019 is estimated to be roughly 55 percent of 2017 levels. The power deficit is projected to average roughly 13 percent of Q2-Q4 average load, and ZESCO, the national utility, began implementing four hours of daily load-shedding in early June. A limited regional supply of electricity for import and ZESCO's financial weakness may complicate the response to this shock.

Estimated Maize Production

(million MT)



Source: CSO.

The rural population is particularly at risk. The vast majority of the rural population depends on agriculture, which directly or indirectly represents more than 50 percent of total employment while contributing under 10 percent of GDP. It is dominated by small and medium scale farms that heavily rely on rainfall as irrigation systems are still lacking. Zambia's high levels of rural poverty (77 percent) amplify the impact of such shocks. The World Food Program estimates as many as 1.3 million people may require humanitarian assistance between July 2019 and February 2020 due to reduced incomes and higher food prices, with food security hotspots already emerging in drought-affected districts.

The government's short-term response is centered on the Food Reserve Agency (FRA), while maize exports have been banned. The FRA manages a national food reserve, buying and selling maize to ensure food security in times of shortages, reduce the volatility of grain prices, and provide liquidity in the market. The authorities expect current maize stocks to be adequate to ensure food security in 2019. Past experience indicates inefficiencies associated with FRA's involvement in the market and that its price stabilizing policies disproportionately benefit the relatively better-off in procurement and sales operations.[1] Looking forward, the authorities see increasing larger scale agricultural production in the northern part of the country as a way to improve food security.

Steps are underway to improve Zambia's resilience to weather-related shocks and food security, supported by development partners. Zambia experienced 3 droughts and 12 floods since 2000. Average annual temperatures have also increased by 1.3 degrees since 1960. The government response has focused on subsidy programs, with the result that Zambia has become an overall surplus producer for maize. Increasing agricultural productivity will require increased investment in irrigation systems (supported by the World Bank), the adoption of new technologies, and enhancing farmers' education and market information. In 2017, the AfDB launched a climate-resilient livestock management project to improve smallholder livestock production and productivity, create market linkages, and increase household income.

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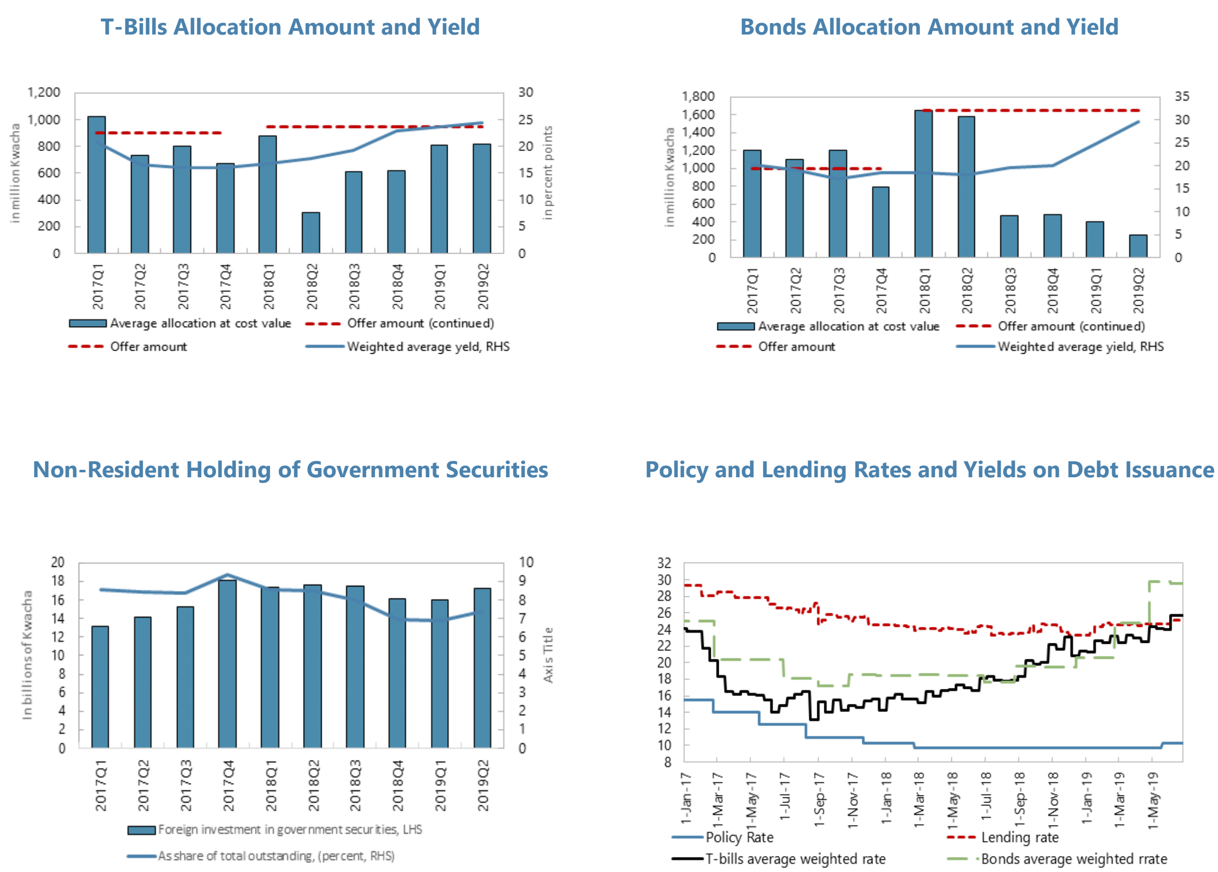
[1] See World Bank, Zambia Economic Brief, Volume 9, June 2017.

Contributors: World Bank Poverty and Equity Global Practice and IMF staff.

8. **Domestic markets have tightened, but non-resident investors have maintained their exposure**. Starting in mid-2018, treasury securities auctions were regularly undersubscribed. With yields rising sharply and reaching around 20 percent on T-bills and government bonds in September, the government did not roll over the full amount of maturing treasury bills in 2018, repaying 1.9 billion Kwacha (0.6 percent of GDP) on a net basis. Government bonds auctions were also undersubscribed but were complemented with private placements of around 4.2 billion Kwacha.[2] While foreign investors have not been active participants in primary auctions since mid-2018, they have broadly maintained their exposure and recently increased their activity in the secondary market.

Domestic Debt Market

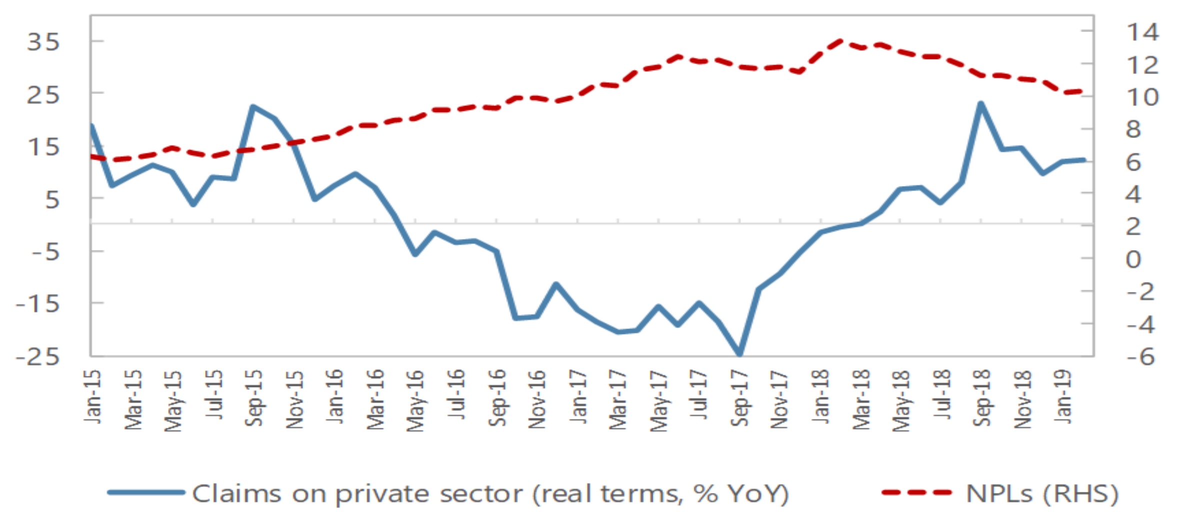


Sources: Bank of Zambia and IMF staff calculations.

[2] Around 2 billion Kwacha was raised from NAPSA and the remaining amount from commercial banks.

9. **Lending rates have remained elevated**. From early 2017 to March 2018, the monetary policy rate and the statutory reserve ratio (SRR) were progressively lowered by a cumulative 450 bps and 1000 bps respectively prior to the recent policy rate increase. Despite this significant easing, lending rates remained high as commercial banks benchmarked their lending rates on rising government yields. As during the 2015-16 crisis, many commercial banks have sought to maintain high liquidity, enhancing their resilience to growing macroeconomic vulnerabilities (Table 7).

Credit Growth and Non-Performing Loans



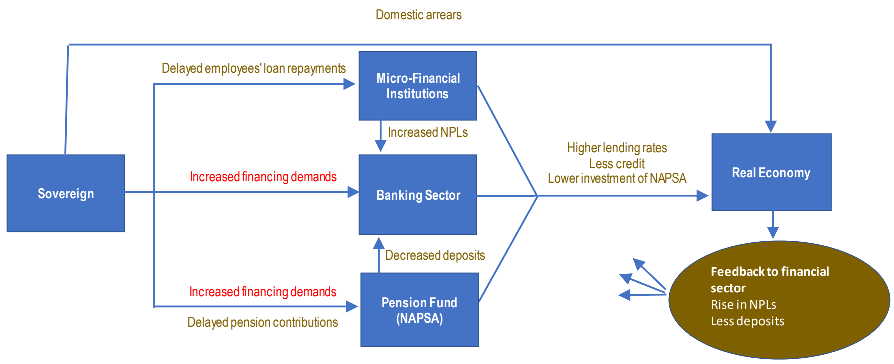
Source: Bank of Zambia and IMF Staff Calculations.

10. **Stresses from the sovereign-financial nexus have increased (Annex IV).** High levels of domestic arrears[3] are exerting pressure on private sector creditworthiness, slowing the decline in NPLs and holding back credit growth[4] and private sector-led economic activity. Recent delays in remitting pension contributions and payroll-based deductions for civil servants' loan repayments could increase liquidity pressures in the financial system and boost NPLs at micro-financial institutions (MFIs), which provide large share of loans to individuals and play a vital role in financial inclusion.

[3] The stock of domestic expenditure arrears was K15.6 billion (5½ percent of GDP) at end-2018.

[4] The September 2018 increase in credit to the private sector reflects exchange rate depreciation and the high share of foreign currency denominated loans in total loans (around 40 percent at end-2018). Credit in domestic currency increased by 3 percent in real terms.

Sovereign – Financial Nexus: Intensifying Links



Source: IMF staff.

11. **Public sector indebtedness has continued to increase, with the stock of public and publicly guaranteed (PPG) debt reaching 78 percent of GDP at end 2018 from 65.5 percent in 2017, two-thirds of which is held by foreign creditors.**[5] External debt increased from $9.5 billion (38 percent of GDP) in 2017 to $11.3 billion (48 percent of GDP) in 2018, reflecting project disbursements and the depreciation in late 2018. External PPG debt service increased from $0.5 billion in 2017 to $0.9 billion in 2018 (21¾ percent of government revenues) as grace periods on several project loans ended.

Text Table 1. Zambia: Stock of Public and Publicly Guaranteed Debt (2013-18) (billions of U.S. dollars)

	2013	2014	2015	2016	2017	2018
Total public debt	**7.4**	**9.4**	**10.4**	**13.2**	**16.3**	**18.3**
External public debt	**3.8**	**5.4**	**7.3**	**8.0**	**9.5**	**11.3**
Multi/pluri-laterals	1.5	1.5	1.5	1.6	1.7	1.9
o.w. IMF	0.4	0.3	0.3	0.2	0.1	0.1
Bilaterals	1.2	1.5	2.0	2.4	2.7	3.0
Paris Club	0.1	0.2	0.2	0.2	0.1	0.1
Non-Paris Club	1.1	1.4	1.8	2.2	2.6	2.9
Commercial	0.8	1.8	3.2	3.2	4.3	5.1
Guarantees	0.3	0.6	0.7	0.8	0.7	1.2
Domestic public debt	**3.6**	**4.0**	**3.1**	**5.3**	**6.8**	**7.0**
Treasury bills	1.6	1.5	0.9	1.0	2.0	1.5
Treasury bonds	1.6	1.6	0.9	1.4	2.8	3.3
Others (incl. supplier arrears)	0.4	1.0	1.2	2.8	1.9	2.1
Memo: foreign-held LC debt 1/	0.3	0.4	0.2	0.6	0.9	0.7
Memo: total public debt to GDP (%)	27.1	36.1	62.3	60.7	65.5	78.1

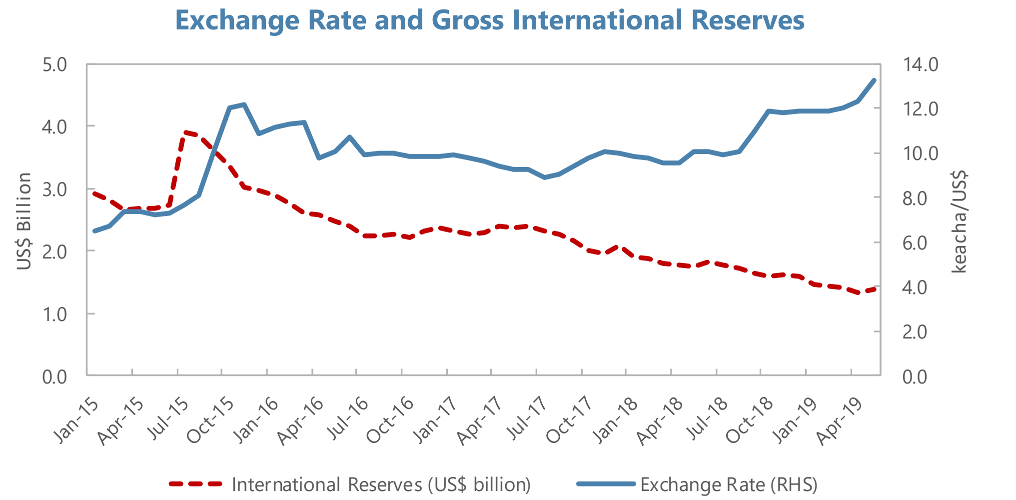
1/ Included under domestic debt in this text table but considered external debt in the DSA, which is conducted on a residency basis.

Source: Zambian authoritites and IMF staff estimates.

12. **Zambia's external position weakened in 2018**. The current account deficit widened modestly to 2.6 percent of GDP owing to higher imports and interest payments, despite a recovery in copper exports on higher prices. FDI contracted as foreign firms repatriated earnings and new investment remained subdued against the uncertain outlook. Foreign portfolio investors, who earlier had been increasing their participation in domestic primary debt markets, broadly maintained their exposures while local commercial banks continued to maintain dollar liquidity overseas. These imbalances in trade and financial flows led to a sharp decline in FX reserves—from 2.4 months of import cover in 2017 to 1.9 months in 2018. Rapidly rising public sector external indebtedness has

[5] The PPG debt stock includes outstanding central government direct and guaranteed debt (including budget expenditure arrears), consistent with the authorities' official debt coverage. The Debt Sustainability Analysis (DSA) uses a broader debt coverage which includes nonguaranteed external debt of ZESCO (see accompanying DSA for more details) and totaled 80¾ percent of GDP at end-2018.

led to a deteriorating international investment position, putting pressure on the exchange rate. Considering the challenges to external sector sustainability, staff assesses the external position to be moderately weaker than fundamentals and desirable policies, although the CA and REER EBA models do not provide clear evidence of misalignment (Annex II).



Source: Zambian authorities.

OUTLOOK AND RISKS

The medium-term outlook is clouded by substantial debt vulnerabilities. The drought and subdued mining sector activity are negatively impacting growth in 2019. With financing constrained and debt service increasing, a forced fiscal adjustment is under way.

13. **Growth is expected to slow markedly in 2019 and remain subdued going forward absent a large up-front fiscal adjustment**. Growth in 2019 is expected to drop to 2.0 percent as agriculture and electricity production continues to suffer from weather-related shocks, domestic demand remains weak, and mining activity declines somewhat due to lower international copper prices and in response to changes in the mining tax regime and a planned shift from VAT to a nonrefundable sales tax (see discussion of mining sector issues, Annex V). While a rebound in agriculture and a moderate recovery in mining activity is projected for 2020, growth is projected to decline next year and over the medium term as financing constraints force continued disorderly cuts in public expenditures. Liquidity constraints and depreciation pressures would lead to a contraction of both manufacturing and import-dependent services, notably wholesale and retail trade (which account for 20 percent of GDP), pushing growth down to 1.5 percent by 2023. Absent an effective policy adjustment strategy, inflation would remain above the BoZ's upper band in 2019 and 2020 due to the pass-through of exchange rate depreciation in addition to the impacts of the drought.

14. **External imbalances are projected to widen, adding to pressure on reserves**. The current account deficit is expected to widen in 2019 on lower copper exports (with lower prices and production) and the higher imports and interest payments associated with public investment. FDI

and other financial account inflows are expected to remain subdued. International reserves under the baseline are projected to decline to 1.6 months of imports by end-2019 and to around 1 month of imports by 2021, leaving little buffer to cushion external shocks or for redemption of the 2022 Eurobond. Additional risks are posed by foreign holdings of local-currency debt (currently at about $0.7 billion, or half of FX reserves).

15. **Risks to the outlook are tilted to the downside (Annex 3).** The impact on rural households in regions impacted by the drought could be more severe than anticipated, presenting challenges for an effective policy response. Low water levels could further restrict electricity generation and negatively impact growth prospects, while drought-related price shocks could further pressure inflation. Delayed policy adjustment could exacerbate the erosion of consumer and investor confidence and result in large capital outflows, exchange rate depreciation and further tightening of domestic financial conditions. A weaker kwacha would increase the debt service burden, further crowding out priority social spending. Tightened global financing conditions would further complicate rollover of the 2022 Eurobond. Escalating trade tensions and a slowdown in growth in China could adversely impact copper prices, while the modest recovery anticipated in mining activity in 2020 after a decline in 2019 is subject to uncertainty.

Authorities' Views

The authorities broadly agreed with staff's near-term growth and inflation outlook, notably the impact of the drought on 2019 outcomes. Over the longer term they expected a larger growth pay-off from recent public investments that they consider have significantly increased the country's growth potential. They also emphasized the large investment needs to close the infrastructure gap, especially in the rural areas where fast population growth has led to increasing demand for social, health, education, and transportation infrastructure. They noted that the government will put in place measures to offset the impact of the drought by tapping the strategic maize reserve stocks and providing support to farmers. The decision to begin load shedding was a proactive response to the drought.

POLICY DISCUSSIONS

Discussions focused on reducing debt-related vulnerabilities and preserving macroeconomic stability while implementing structural reforms to achieve higher and more inclusive growth.

A. Reducing Debt-Related Vulnerabilities

16. **Under current policies, public debt is on an unsustainable path (see accompanying DSA).** Total public debt is projected to increase from 78 percent of GDP in 2018 to 91½ percent of GDP in 2019 as the large stock of undisbursed project loans (roughly 40 percent of GDP) continues to disburse. The debt service burden is also expected to rise above 30 percent of government revenues in 2019. While the DSA baseline is characterized by large and protracted breaches of both solvency and liquidity indicators, the authorities have committed to remain current on their debt

obligations and there are no arrears on either external or domestic debt.[6] The risk of debt distress has increased substantially since the last DSA (October 2017) and is currently assessed to be at a very high level.

17. **Under an alternate scenario, a large upfront and sustained fiscal adjustment can begin reducing debt-related vulnerabilities and build credibility (Text Table 2).** Orderly adjustment anchored on frontloaded revenue mobilization, a moratorium on new external nonconcessional borrowing and guarantees, and scaled-back capital spending would put debt on a downward trajectory to about 60 percent of GDP by end-2029, enabling the government to meet its obligations in a timely manner while also allowing adequate resources to be allocated to priority social spending and arrears repayment. While the adjustment would have a drag on growth in the near-term, fiscal multipliers are estimated to be low based on the limited impact on growth of the recent sharp increases in government spending. Halting accumulation of expenditure arrears should improve domestic liquidity, and with a buildup of credibility financing conditions should ease. Growth would pick up starting in 2020. Strong and sustained implementation of fiscal adjustment would also boost market confidence and capital inflows, leading to a buildup of reserves to about 2½ months of imports by 2023.[7] Even in this adjustment scenario, downside risks would remain very high and additional efforts could be needed.

Text Table 2. Zambia: Selected Economic Indicators, 2016–23

	2016	2017	2018	Baseline					Adjustment				
			Prel. est.	2019	2020	2021	2022	2023	2019	2020	2021	2022	2023
Real GDP growth (%)	3.8	3.5	3.7	2.0	1.7	1.7	1.6	1.5	1.6	1.9	2.1	2.4	2.8
Inflation (y-o-y, %, end-period)	7.5	6.1	7.9	12.0	8.0	8.0	8.0	8.0	9.5	7.5	7.0	7.0	7.0
Overall balance (cash basis, % of GDP)	-6.1	-7.7	-8.3	-4.8	-5.1	-3.4	-3.1	-2.9	-4.3	-4.0	-3.4	-3.0	-2.7
Overall balance (committment)[1]	-9.0	-7.0	-10.7	-9.0	-5.6	-4.0	-3.1	-2.9	-6.3	-3.4	-2.9	-2.5	-2.3
External current account balance (% of GDP)	-3.3	-1.7	-2.6	-3.6	-3.4	-2.9	-2.6	-2.3	-3.7	-3.2	-2.4	-2.0	-1.8
Gross international reserves													
US$ billions	2.4	2.1	1.6	1.3	1.0	0.8	0.5	0.5	1.6	1.8	2.0	2.1	2.3
Months of prospective imports	3.3	2.4	1.9	1.6	1.3	0.9	0.6	0.6	2.0	2.1	2.4	2.4	2.5
Public debt[2]	60.7	65.5	78.1	91.6	95.5	98.0	97.6	96.7	84.6	85.0	84.4	81.6	78.4
External[2]	36.6	38.2	48.1	59.9	65.6	69.5	70.8	71.5	52.2	52.7	52.3	50.5	49.1
Copper price (US$/tonne)	4,868	6,170	6,530	6,058	5,991	6,045	6,090	6,123	6,058	5,991	6,045	6,090	6,123
Oil price (US$/barrel)	43	53	68	66	64	61	59	58	66	64	61	59	58

Sources: Zambian authorities, IMF staff estimates and projections.

[1]Adjusted for the accumulation/clearance of VAT refund claims and arrears relating to FRA, FISP, subsidies, public investment projects, and pensions.

[2] Includes public and publicly guaranteed external debt.

18. **The 2019 budget envisions the first step in such an adjustment, but binding financing constraints are forcing a sharper disorderly adjustment (Text Table 3).** The 2019 budget aimed to reduce the deficit to 6½ percent of GDP (commitment basis) by increasing revenues and cutting current and capital expenditures. While revenue overperformance continued during the first quarter,

[6] The Zambian authorities are in the process of clearing some *de minimis* arrears recently reported to the Paris Club by Belgium. The authorities' were confirming *de minimis* sovereign arrears reported by France. There is an ongoing internal reconciliation exercise to prevent such arrears from reoccurring. In addition, some pre-HIPC arrears to Iraq still exist but an agreement in principle has been reached and is currently pending finalization.

[7] This assumes no additional IFI support, which could be potentially triggered by a credible consolidation plan and help replenish reserves to a more adequate level.

higher interest costs coupled with negative net domestic financing more than offset it. To bring cash spending closer in line with available financing, expenditure is being scaled back, including on social programs and transfers to local governments. Arrears to suppliers are rising, with delays also seen in remitting some public employees' loan payment and pension contributions.[8] Financing constraints are expected to hold the cash deficit to 4¾ percent of GDP, but with weak expenditure controls, arrears will continue accumulating, and the deficit on a commitment basis would reach close to 9 percent of GDP.

Text Table 3. Zambia: Summary of Budgetary Central Government Operations, 2018–19

(in percent of GDP)

	2018	2019	
	Est.	Budget	IMF
Revenue	19.1	19.3	19.4
Tax	15.8	15.5	15.7
Other revenue, including mineral royalties	3.1	3.1	3.5
Grants	0.2	0.6	0.2
Expenditure	27.4	25.7	24.2
Compensation of employees	7.8	8.4	7.7
Use of goods and services	2.8	2.2	1.6
Interest	4.6	4.7	4.9
Other current spending	3.5	3.6	2.6
Net acquisition of nonfinancial assets	8.6	6.8	7.3
Of which: externally financed	6.6	5.6	6.8
Net lending/borrowing (overall balance, cash basis)	-8.3	-6.5	-4.8
Arrears and VAT refund backlog (- payments)	2.5	0.0	4.3
Net lending/borrowing (overall balance, commitment basis)	-10.7	-6.5	-9.0
Financing (Identified)	8.3	3.9	4.8
Domestic	3.3	1.2	0.9
Foreign	4.9	2.7	3.9
Financing gap	0.0	2.6	0.0

Sources: Zambia authorities and staff estimates.

19. **The 2019 budget announced the replacement of the VAT with a sales tax in line with the authorities' goal of increasing revenues**. While VAT receipts have been strong in recent years, the authorities feel the level of refunds has held back its performance and have had difficulty staying current on VAT refunds.[9] A dual-rate sales tax has been proposed (9 percent on domestic goods and 16 percent on imports in line with the current VAT rate). It is envisaged as a hybrid between a VAT and sales tax, levied at every stage of production, with exemptions for production inputs (e.g. capital goods) and no scope to claim refunds. The authorities estimate significant windfalls of up to 2 percent of GDP annually from introducing the sales tax. While initially proposed to come into effect

[8] In April, the outstanding amount due to NAPSA totaled 1.1 billion Kwacha (450 million in delayed contributions and 650 million in penalties).

[9] The stock of verified VAT claims to be refunded has grown recently and stood at 4 billion Kwachas (1½ percent of GDP) at end-2018. In addition, there is a large stock of unverified claims which the authorities are in the process of auditing with the help of an international consulting firm. Once the stock of outstanding VAT refund claims is verified, the Zambian Revenue Authority expects they would be at least partially offset by overdue tax obligations and the remainder cleared within a year.

on April 1, the introduction has been delayed to allow for consultations with taxpayer groups on key provisions. Staff noted that VAT has performed increasingly well in recent years and urged the authorities to carefully consider the pros and cons of moving away from VAT to a sales tax, including creation of distortions due to cascading, complexity, and the scope for discretion in application of the tax through granting of exemptions and preferences. Staff also urged that, in the event the transition was made, the granting of exemptions and preferences be contained or estimated yields could be substantially reduced.

20. **Staff proposed a more determined upfront fiscal consolidation that would be large enough to create the necessary space to continue to service debt and cover wages and priority social expenditure**. This would mean a fiscal deficit on a commitment basis of about 6.3 percent of GDP in 2019 from 10.7 percent of GDP in 2018. Fiscal consolidation should continue in 2020 to bring the deficit to 3.4 percent of GDP. Achieving such a reduction in the deficit would hinge critically on the authorities' ability to rein back capital spending to recent levels of below 5 percent of GDP while improving the efficiency of spending to limit the negative impact on growth. Key elements would include:

- Ending uncertainty about the tax regime and raising tax revenues to 16 percent of GDP in 2020 by broadening the tax base, reducing tax expenditures and exemptions, strengthening compliance, simplifying the tax system, and enhancing tax audit capacity.
- Introducing a moratorium on new non-concessional external borrowing and guarantees.
- Significantly lowering public investment spending, carefully prioritizing ongoing projects, and ensuring only high-return projects are implemented.
- Ensuring adequate space for priority social spending, including on goods and services.
- Halting the accumulation of domestic arrears and gradually clearing the existing stock.
- Restricting new recruitments to essential personnel (health, education and police) and continuing efforts to identify ghost workers.
- Updating the Medium-Term Expenditure Framework (MTEF) to clearly align with a strategy to reduce fiscal imbalances.

Text Table 4. Zambia: Composition of Recommended Fiscal Adjustment

(Percent of GDP)

	2018	2019 Adjustment Scenario	Savings
Contribution of revenue			
Total domestic revenue	18.9	19.5	0.6
Grants	0.2	0.2	0.0
Contribution of expenditures			
Current spending	18.8	19.0	-0.2
Capital spending	8.6	5.1	3.5
o/w domestically financed	2.0	1.0	1.0
externally financed	6.6	4.1	2.5
Clearance of arrears			
Domestic payment arrears	1.7	1.7	0.0
VAT refunds backlog	0.8	0.3	0.5
Total			**4.4**

Sources: Zambian authorities and IMF staff estimates.

21. **Following a Cabinet meeting in May, the authorities announced a series of measures to contain and better control spending**. These included indefinitely postponing contraction of new non-concessional loans; cancelling some committed but undisbursed loans; and increasing control and management of disbursements on foreign-financed loans.

Authorities' Views

The authorities agreed on the importance of a large front-loaded fiscal adjustment to bring debt back to a more sustainable path. They acknowledged the need for timely action to control debt accumulation and stop arrears buildup, emphasizing the importance of Cabinet-level decisions in this regard. The authorities recently announced the halting of disbursement of newly-signed (2018) loan agreements. Separately, they noted there could be challenges including on the legal front to pausing ongoing project execution and related disbursements, which would be done in accordance with contract provisions. They highlighted the importance of effective coordination, noting the close communication across ministries and with key external lenders. They emphasized the challenges posed by the large VAT refunds to the mining sector and anticipated that revenue generation will be helped by the introduction of the sales tax. The authorities viewed the new tax as simpler to administer while avoiding the issue of refunds, and noted that similar systems were in place in several other countries.

Text Table 5. Zambia: Fiscal Operations of the Budgetary Central Government 2016–24)

(Percent of GDP)

	2016	2017	2018		2019	Baseline						Adjustment					
			Budget	Prel. est.	Budget	2019	2020	2021	2022	2023	2024	2019	2020	2021	2022	2023	2024
Revenue	18.2	17.5	18.6	19.1	19.3	19.4	19.7	19.8	19.8	19.7	19.7	19.7	20.0	20.2	20.6	20.7	20.7
Of which: One-off receipts	0.0	0.1	0.0	1.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.0
VAT refunds (+ accumulation)	-0.5	-0.6	0.0	0.8	0.0	0.4	0.0	0.0	0.0	0.0	0.0	0.3	0.0	0.0	0.0	0.0	0.0
Adjusted revenues	18.7	18.1	18.6	18.3	19.3	19.0	19.7	19.8	19.8	19.7	19.7	19.4	20.0	20.2	20.6	20.7	20.7
Expenditure	26.1	27.7	17.9	30.2	24.4	22.7	24.2	22.9	22.1	22.4	22.2	22.6	22.9	23.1	22.9	23.5	23.3
Current	22.3	20.8	18.9	20.7	17.6	15.7	16.2	16.3	16.3	16.2	16.1	17.8	18.3	18.6	18.9	18.8	18.5
Of which: Arrears (+ accumulation)	1.8	0.9	0.0	1.8	-1.3	-1.2	-0.2	-0.1	-0.2	-0.2	-0.2	-1.2	-0.7	-0.3	0.0	0.0	0.0
Capital	3.8	6.8	5.1	9.6	6.8	7.0	8.0	6.6	5.8	6.1	6.1	4.7	4.6	4.5	4.1	4.7	4.9
Of which: Arrears (+ accumulation)	0.0	1.3	0.0	1.0	0.0	-0.3	-0.3	-0.3	-0.7	0.0	0.0	-0.3	-0.3	-0.3	-0.7	0.0	0.0
Overall balance, (committment)[1]	-7.3	-9.6	-5.6	-11.9	-6.5	-9.0	-5.6	-4.0	-3.1	-2.9	-2.6	-6.3	-3.4	-2.9	-2.5	-2.3	-2.2
Primary balance (committment)[1]	-5.5	-3.0	-1.7	-6.1	-1.7	-4.1	-0.4	1.3	2.4	2.9	3.2	-2.0	1.3	1.7	1.9	2.1	1.8
Deficit (cash basis)	-6.1	-7.7	-6.1	-8.3	-6.5	-4.8	-5.1	-3.4	-3.1	-2.9	-2.6	-4.3	-4.0	-3.4	-3.0	-2.7	-2.6
Primary balance (cash basis)	-2.7	-3.7	-2.2	-3.6	-1.7	0.2	0.1	1.9	2.4	2.9	3.2	0.0	0.7	1.2	1.4	1.6	1.4

staff estimates and projections.

[1] Adjusted for the accumulation/clearance of VAT refund claims and arrears relating to FRA, FISP, subsidies, public investment projects, and pensions.

[2] Includes public and publicly guaranteed external debt.

B. Strengthening PFM to Anchor Fiscal Sustainability

22. **The enactment of the Public Finance Management Act in April 2018 is an important step toward strengthening management of public resources**. If effectively implemented, this

would enhance commitment control and improve predictability of budget allocations, reducing the incidence of domestic arrears.[10] Staff recommended:

- moving to early quarterly budget releases so ministries and departments do not issue purchase orders outside of the Integrated Financial Management Information System (IFMIS) and introducing complementary IFMIS functionality to restrict line ministries' total monthly payments to a cash limit; and
- for expenses not subject to commitment controls in IFMIS, such as wages and utilities, effective reconciliation of payroll and HR system data and introducing pre-paid meters and vouchers for utility and rent payments.

23. **The efficiency of public investment also needs to be improved**. The 2017 PIMA estimated an efficiency loss of 45 percent for Zambia's public investment relative to an average of 36 percent for SSA countries. Key areas for improvement included vetting of projects and more systematically conducting appraisals of domestically-financed projects before inclusion in the budget, and procurement processes that undermine efficiency and create opportunities for corruption. In 2018 the Government embarked on development of the Public Investment Management System to establish an institutional framework for coordinating and undertaking ex ante appraisal of new public investment projects. It is expected to begin operating in 2020. Staff stressed that enacting the Planning and Budgeting Bill will be important to enhance the project selection and appraisal process, while revising the Loans and Guarantees Act will provide the necessary framework for medium-term debt management. Staff also recommended that a small unit be established in the Ministry of Finance to monitor and mitigate risks related to implementation of the 5-10 largest capital expenditure projects.

Authorities' Views

The authorities acknowledged the need to rationalize public investment expenditure. They noted that some of the accompanying legislation to the PFM Act requires constitutional changes and thus will take time to enact. They highlighted the role that the Public Investment Management System will play in ex ante appraisal of public investment projects once it is operational. They also pointed to the recent establishment of the Public Investment Board (PIB) as the overall review and decision-making body on public investment management for new capital projects. The authorities committed to enforcing strict adherence to PFM rules established under the PFM Act of 2018 and announced steps to this effect following the Cabinet meeting in late May. They will aim to release cash warrants in a timely manner to limit the risk of arrears.

C. Strengthened Debt Management and Market Development

24. **Further improvements in debt management would help contain debt vulnerabilities**. Building on an initial mission in May, a pipeline of debt management technical assistance, informed

[10] Past Fund TA identified predictability and control in budget execution as areas of weakness (2017 PEFA report), while Zambia fared well on policy-based fiscal strategy and budgeting.

by a reform plan currently in development, will be delivered jointly by IMF, World Bank, and Macroeconomic and Financial Management Institute of Eastern and Southern Africa in the coming years. The recently-initiated quarterly debt stock update is a welcome step and can be further enhanced by the launch of a quarterly Debt Statistics Bulletin (planned for 2019). Beyond this, key priorities include:

- Strengthening management over the large stock of contracted but undisbursed debt, to ensure clear prioritization of projects and agreement on the pace of project execution.
- Close monitoring and management of portfolio risks against rapidly rising external debt payments (most in foreign currency) and the nearing Eurobond maturities.
- Improving monthly cash flow forecasts to facilitate more flexibility in domestic debt auctions to better adapt to market financing conditions.
- Better inter-agency coordination to ensure timely budget allocation and payment processing to avoid late payments.
- SOE debt (guaranteed and nonguaranteed) should be managed more systematically to allow timely monitoring of fiscal risks.

25. **The BoZ is also taking steps to develop domestic securities markets, including through the planned launch later this year of a Primary Dealership System (PDS)**. Under the PDS, primary dealers would be obliged to take up, market, and distribute benchmark bonds to ensure reliable demand for securities and provide market liquidity. The BoZ has been buying government bonds in the secondary market to build a backstop facility. However, the current environment, particularly recent continuous undersubscription of government bonds, presents complications for launching a well-functioning PDS. To encourage market transactions, the handling fee charged on government securities has been lowered to 1 percent from 2 percent.

Authorities' Views

The authorities concurred on the value of public debt transparency and the importance of a prudent management of the contracted debt portfolio. Regarding existing debt, they had engaged in discussions with a bilateral creditor on a voluntary debt reprofiling and the possibility of servicing debt in the lenders' national currency. They also agreed with staff on the necessity of closely monitoring debt payment schedules and associated portfolio risks to ensure timely payments through effective coordination among different government functions.

D. Enhancing Monetary Policy and Operations

26. **The BoZ has continued to strengthen its monetary policy framework (MPF)**. The overnight interbank rate has been maintained within the narrowed policy rate corridor, and the BoZ increased the use of open market operations (OMOs) and announced clear inflation targets that were largely observed. However, the increase in yields on government securities has weakened monetary transmission as elevated bank lending rates reflected yields on government securities. In the

Interbank Foreign Exchange market, while volume has remained modest, there is no evidence of FX shortages or existence of a parallel FX market. The BoZ is also developing, with Fund TA, a forecasting and policy analysis system (FPAS) to be used as a key input in monetary policy decision making.

27. **Consistent with the BoZ's forward-looking MPF, some further tightening of the monetary policy stance would address rising inflationary pressures and support reserve accumulation**. In raising the policy rate by 50 bps to 10.25 percent in May, the MPC emphasized its intention of countering inflationary pressures and supporting macroeconomic stability. With inflationary pressures expected to persist, and inflation marginally above the upper bound of the target range, the policy stance should continue to be adjusted to keep forward looking real rates positive and support reserve accumulation. At 1.7 months of imports, the level of reserves is modest compared to public debt service needs, and the BoZ has entered the market in recent months to purchase reserves as market conditions permit. Reserves should be opportunistically replenished over the medium term, with market intervention otherwise limited to smoothing excessive volatility. Staff advised that monetary policy effectiveness would be higher if accompanied by a large and upfront fiscal consolidation.

Authorities' Views

The authorities agreed that the current situation was giving rise to inflationary pressures. The BoZ expressed its intention to use monetary policy instruments at its disposal to ensure that inflation is kept within the its target band but stressed that the efficacy of the monetary policy response would depend on fiscal consolidation. The authorities also indicated their commitment to a flexible exchange rate policy and the importance of bolstering reserves and believe that reserves will be higher than projected by staff. The BoZ also expressed appreciation for Fund support on FPAS.

E. Securing Financial Stability

28. **The BoZ has made good progress in upgrading the institutional, regulatory, supervision and crisis management framework in line with the 2017 FSAP recommendations** (**Annex I)**. The revised 2017 Banking and Financial Service Act (BFSA) and the amended draft BoZ Act, currently with the Ministry of Finance, appropriately address the BoZ's operational independence, Basel II/III standards and licensing. In completing work on upgrading the BoZ Act to grant the central bank operational independence, staff advised to avoid increasing the BoZ's financing ceiling to the government. In June 2017, the BoZ revised and strengthened the legal framework for Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) and terrorist financing offense. The BoZ is also examining options to implement a deposit insurance scheme, with Fund TA.

29. **The strong nexus between Zambia's financial sector and the sovereign creates potential channels of stress**. While bank capitalization levels are strong, deepening macrofinancial linkages likely will contribute to keeping NPLs above Zambia's 10 percent prudential benchmark and

are impacting banks' liquidity preferences (Annex IV). High levels of dollarization[11] may limit the effectiveness of BoZ liquidity support in case of a crisis.

30. **Significant progress has been achieved in improving BoZ supervision, and additional steps would support a robust, rules-based progressive enforcement program, including early intervention**. Staff advised to:

- complete the staffing and training of the supervision department and enhance the crisis preparedness and management framework; and
- limit on-site activities to high priority risks and functions, and prioritize onsite inspections of individual banks based on risk assessment.

Authorities' Views

The authorities agreed with staff's assessment of the financial sector and welcomed the intersectoral perspective provided by the discussion of macrofinancial linkages and vulnerabilities. The BoZ also agreed with staff's recommendation on upgrading the BoZ Act, noting the ongoing work to put in place implementing regulations for the new BFSA. The authorities also agreed on the need to improve supervisory capacity by filling vacant positions and prioritizing capacity building, and they noted the importance of prioritizing inspection activities.

F. Achieving Higher and More Inclusive Growth

31. **Zambia is endowed with abundant natural resources, but the poverty rates remain high particularly in rural areas that remain dependent on rain-fed agriculture and with large infrastructure gaps**. Zambia's water resources, at 6,000 cubic meters per inhabitant, are second to Angola in southern Africa. Just 14 percent of arable land is under cultivation despite the high incidence of agriculture as an economic activity.[12] Agriculture remains labor-intensive and highly vulnerable to climatic shocks. The electricity access rate is 31 percent.[13] Transport logistics and communication services are particular constraints in rural areas, where 77 percent of the population live in poverty. The informal sector dominates employment.

32. **Building resiliency in the agriculture sector would support inclusive growth while also promoting productivity**. Proactive strategies to anticipate and respond to adverse climate shocks and promote well-targeted support programs would bolster resilience in the agricultural sector. Implementation of the Farmer Input Support Programme (FISP) should be improved by targeting primarily poor and small-scale farms. Establishing a more stable and predictible regulation of the maize market would also benefit the poorest.

[11] Commercial banks' foreign currency liabilities were roughly 47 percent of total liabilities at end-2018.

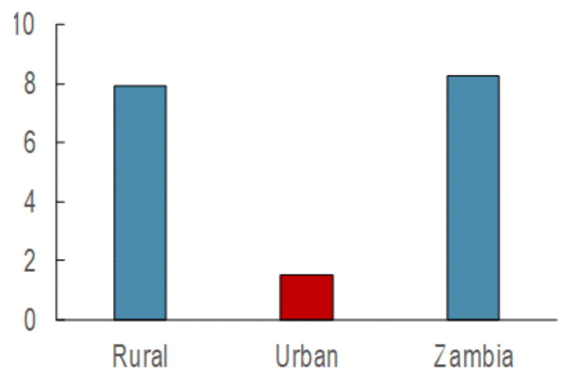
[12] FAO, 2014

[13] Power Africa, 2018

33. **Addressing constraints in the electricity sector—both generation and distribution—would boost the business environment and lower contingent fiscal liabilities at ZESCO**. Staff advised completing the cost of service study and advancing tariff reforms. Staff encouraged appropriate protection for vulnerable groups given the high cost and poor targeting of existing electricity subsidies (richest decile of households receive 64 percent of electricity subsidies while those in the poorest half receive only 1.5 percent).[14] Looking forward, the significant increase in electricity generation capacity expected by end-2020 (roughly 25 percent of current capacity) as the Kafue Gorge Lower hydroelectric plant is expected to come on stream could help improve the ability to respond to shocks to generation capacity.

The Poor in Zambia

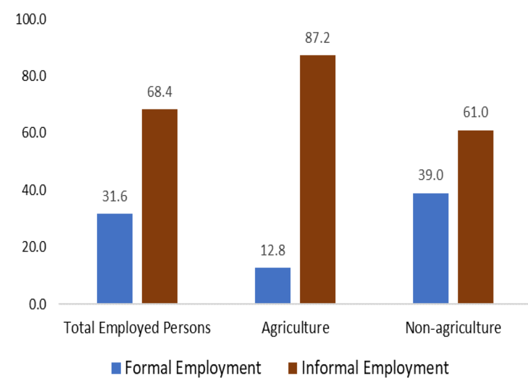
(millions)



Source: World Bank 2018.

Employment Population by Types

(Percentages)

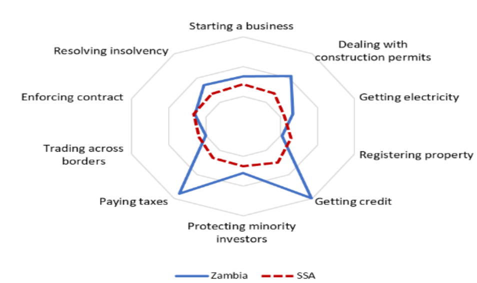


Source: CSO 2018.

34. **Steady focus on the business climate is also needed**. While Zambia compares favorably with SSA average on several dimensions of the 2019 Doing Business Indicators, economic growth has slowed and private investment has remained subdued in the current challenging environment (Annex II). Active engagement with mining companies should aim to resolve differences that have undermined confidence.

Components of Ease of Doing Business

(Distance to the Frontier: 0-100; 100 is best)



Source: Doing Business Indicators, 2019.

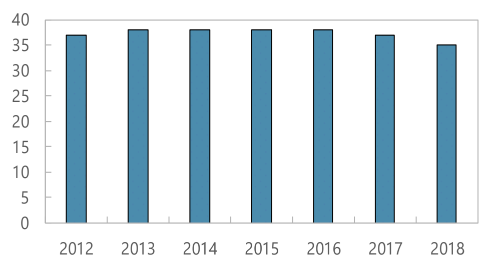
35. **Governance and institutional quality, as measured by Worldwide Governance Indicators (WGI),[15] are close to the average of the SSA**

[14] See Zambia, 2017 Article IV.

[15] WGIs are third-party indicators which summarize views of many enterprises, citizens and expert survey respondents on the quality of governance in a country. The data are gathered from survey institutes, think tanks, non-governmental organizations, international organizations, and private sector firms. The index ranges between -2.5

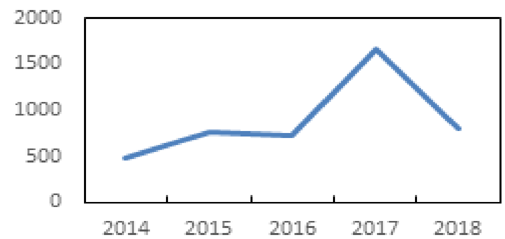
region but have deteriorated recently (Annex V). Zambia's Financial Intelligence Center (FIC), the government agency that collects reports on suspicious activities, publishes annual reports of cases related to tax evasion, corruption and public procurement. These have increased in 2017–2018. In 2018, several donors froze aid funds for the government social cash transfer program after audit reports revealed grant misappropriation. The authorities acknowledge the rise in tax evasion and procurement-related cases and have launched reforms aimed at raising accountability and transparency in the allocation and use of public finances. The recently-approved Public Financial Management Act should provide a strong basis to improve fiscal transparency by setting clear guidelines for procurement procedures.

Corruption Perception Index[1]



Source: Transparency International.

Number of Suspicious Reports Received by FIC



Source: Various FIC Trend reports

[1]Corruption Perception Index is a third-party indicator published annually by Transparency International. It ranges between 0 (highest level of perceived corruption) to 100 (lowest level). It is a combination of opinion surveys and expert assessments of corruption, collected by twelve institutions. Confidence interval for the 2018 score was between 32 and 38, with standard error of 1.93.

Authorities' Views

The authorities agreed on the necessity to boost electricity generation capacity, increase agricultural productivity and enhance the preparedness to climate-related shocks. They highlighted solar energy projects initiated as part of efforts to diversify from hydroelectric power. They planned to complete the cost of service study but saw risks to increasing electricity tariffs in the current economic environment. In agriculture, they noted that the Zambia Integrated Agriculture Management Information System (ZIAMIS) was developed to support agri-businesses, farmer expansions and extension services for agriculture-related public programs.

G. Capacity Building and Statistics

36. **The IMF's CD strategy for Zambia is targeted at supporting the key policy priority of fiscal consolidation while reducing vulnerabilities and preserving macroeconomic stability (Annex VII).** The Fund has provided CD on strengthening budget preparation and execution as well as enhancing the medium-term macro-fiscal framework. A joint IMF/WB debt management reform

to 2.5, with higher values representing more favorable governance. Note that given the confidence interval, uncertainties exist around Zambia's point estimate. The WGI scores are normalized each year to mean zero and hence measure relative performance.

plan TA mission took place in May and will be followed by a Medium-term Debt Management Strategy TA mission tentatively scheduled for July. Fund CD also targets building BoZ capacity in bank supervision, systemic risk analysis and financial crisis management, drawing on the 2017 FSAP, as well as capacity building on national accounts and price statistics.

37. **Data provision is broadly adequate for surveillance, despite some shortcomings**. Supported by an active CD program, work has begun on rebasing the current 2010-based GDP numbers, although the process is likely to be delayed beyond its original end-2019 timeframe. Staff encourages further progress on strengthening data collection and estimation of key national account statistics and improving the reconciliation of data on the fiscal outturn between fiscal reports and government accounts in monetary statistics.

STAFF APPRAISAL

38. **Zambia is facing a difficult macroeconomic environment**. The drought in the southern and western parts of the country—impacting both the agricultural sector and electricity production—has added to the growth slowdown. While the government's development strategy has targeted a significant scaling-up in infrastructure investment, the growth benefits have yet to materialize, resulting in large fiscal deficits financed through non-concessional borrowing. With depreciation of the kwacha and the end of grace periods on several loans, increasing debt service payments are compromising the government's ability to deliver on its priorities and support the most vulnerable.

39. **Fiscal consolidations announced in the 2017 and 2018 budgets did not materialize, in large part as foreign-financed projects were executed more rapidly than anticipated**. The very large stock of contracted but undisbursed debt (equivalent to a further 40 percent of 2018 GDP), highlights the need for strengthened control and prioritization of public investment projects, while weak control of budget execution has also undermined the authorities' efforts to contain spending, contributing to the buildup of domestic arrears.

40. **On current policies, public debt is on an unsustainable path and financing constraints are forcing the inevitable fiscal adjustment to occur in a disorderly manner**. The risk of debt distress has increased substantially, but the authorities remain current on their debt service obligations and reiterated their commitment to remain so. The BOZ has also sought to build up reserves as market conditions have permitted. But with the availability of domestic financing tightening, the government is being forced into cash budgeting seriously impacting the ability to deliver public services.

41. **There is a narrow window for tackling fiscal challenges in an orderly and planned manner**. A large front-loaded and sustained fiscal adjustment is urgently needed to reduce debt-related vulnerabilities. With adjustment already occurring as financing constraints bite, the drag on growth and impact on provision of priority social spending can be contained through a carefully planned and executed adjustment. Revenue mobilization, including scaling back unnecessary exemptions and tax expenditures, is essential to create fiscal space. The Cabinet decision in late May to indefinitely postpone contraction of all new non-concessional loans, cancel some committed but

undisbursed loans and increase control and management of disbursements on foreign-financed loans, and to strictly adhere to PFM rules under the 2018 PFM Act are steps in the right direction. Strong and sustained actions are critical. Even with a bold adjustment, risks would remain very high.

42. **Building on approval of the Public Finance Management (PFM) Act in April 2018, stronger procedures are needed to ensure budget execution reflects the authorities' fiscal goals**. Weaknesses in procurement processes and in project selection, appraisal and implementation that undermine efficiency and create opportunities for corruption need to be addressed. Improving public investment efficiency can also help moderate the initial reduction in growth from the fiscal adjustment. The Planning & Budgeting Act and the Loans and Guarantees Act should be advanced to promote transparency and fiscal risk management.

43. **Monetary policy has an important role to play in securing stability**. The BoZ has strengthened its forward-looking monetary policy framework and the increase in the policy rate in May as inflation crept above the BoZ's inflation band is a welcome step. Given persistent pressure on the kwacha and a rise in inflationary pressures, some further monetary policy tightening is warranted to keep real rates positive and support accumulation of reserves which are low compared to public debt service needs. To be effective, monetary policy actions must be accompanied by a reorientation of the fiscal stance.

44. **Financial sector supervisory capacity has improved**. While financial sector indicators have remained broadly resilient, macrofinancial pressures from the strong linkages between the financial system and the sovereign warrant close monitoring. Limiting the buildup of arrears, and avoiding payments delays on pension and loan contributions, would help to avoid further increases in NPLs and liquidity pressures in the financial system. Banking supervision and the BOZ's crisis preparedness and management frameworks should continue to be strengthened, as recommended by the 2017 FSAP, and resolution of non-performing loans should remain a priority.

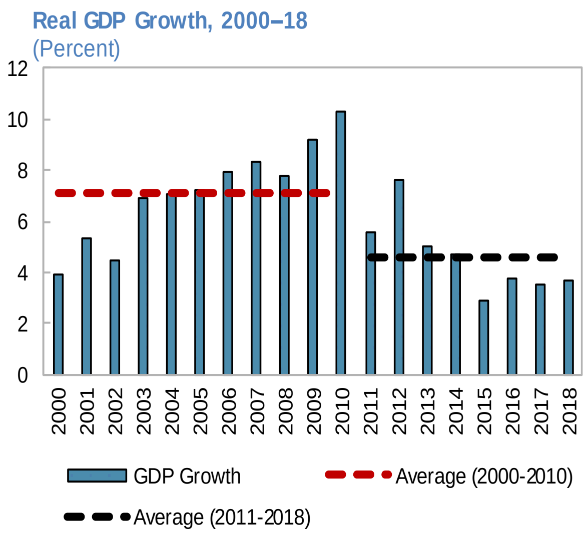
45. **There is potential for growth to accelerate over the medium term**. Achieving inclusive growth also will require steady focus on improving the investment climate, promoting productivity and human capital, and addressing the risks of corruption. Beyond the response to the current drought, proactive strategies to anticipate climate-related risks and promote well-functioning support programs in the agricultural sector would support resilience.

46. **Zambia maintains one exchange restriction subject to Fund approval under Article VIII, Section 2(a) (see Informational Annex)**. Staff does not recommend approval, as there is no timetable for its removal.

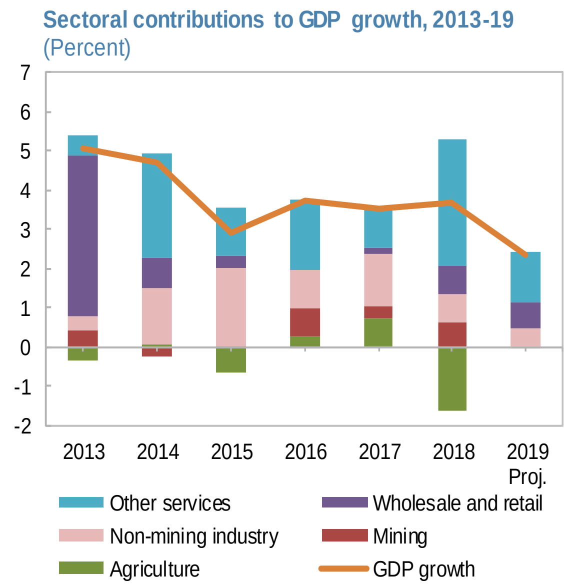
47. **Staff recommends that the next Article IV consultation be held on the standard 12-month cycle**.

Figure 1. Zambia: Recent Developments

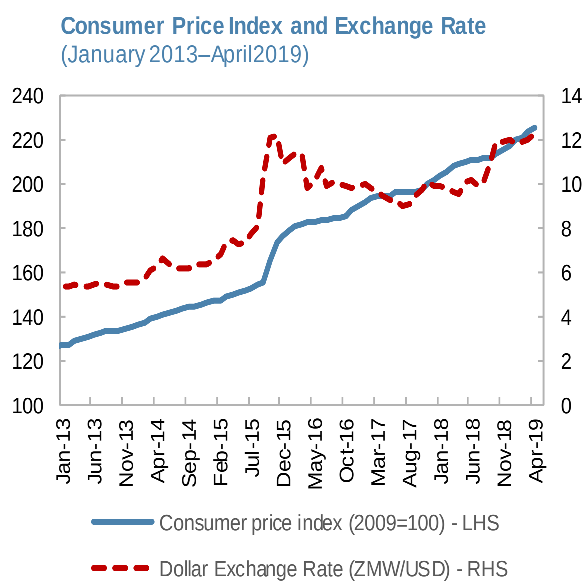
Growth has slowed in recent years.



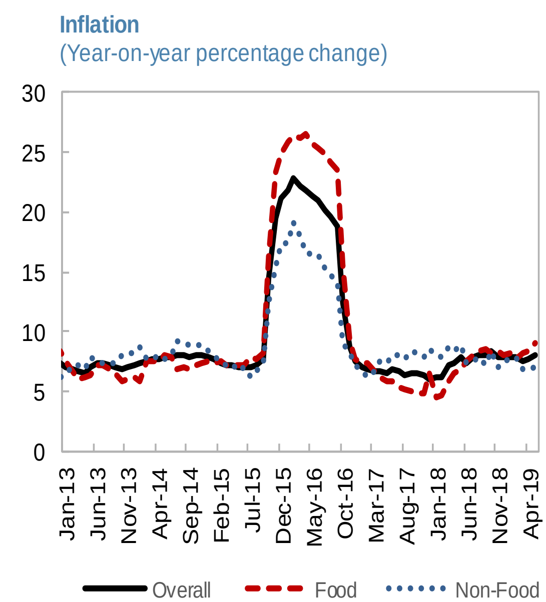
Services and industry are the main sources of growth.



The 2015/2016 commodity price shock drove a spike in inflation and a sharp depreciation of the kwacha.



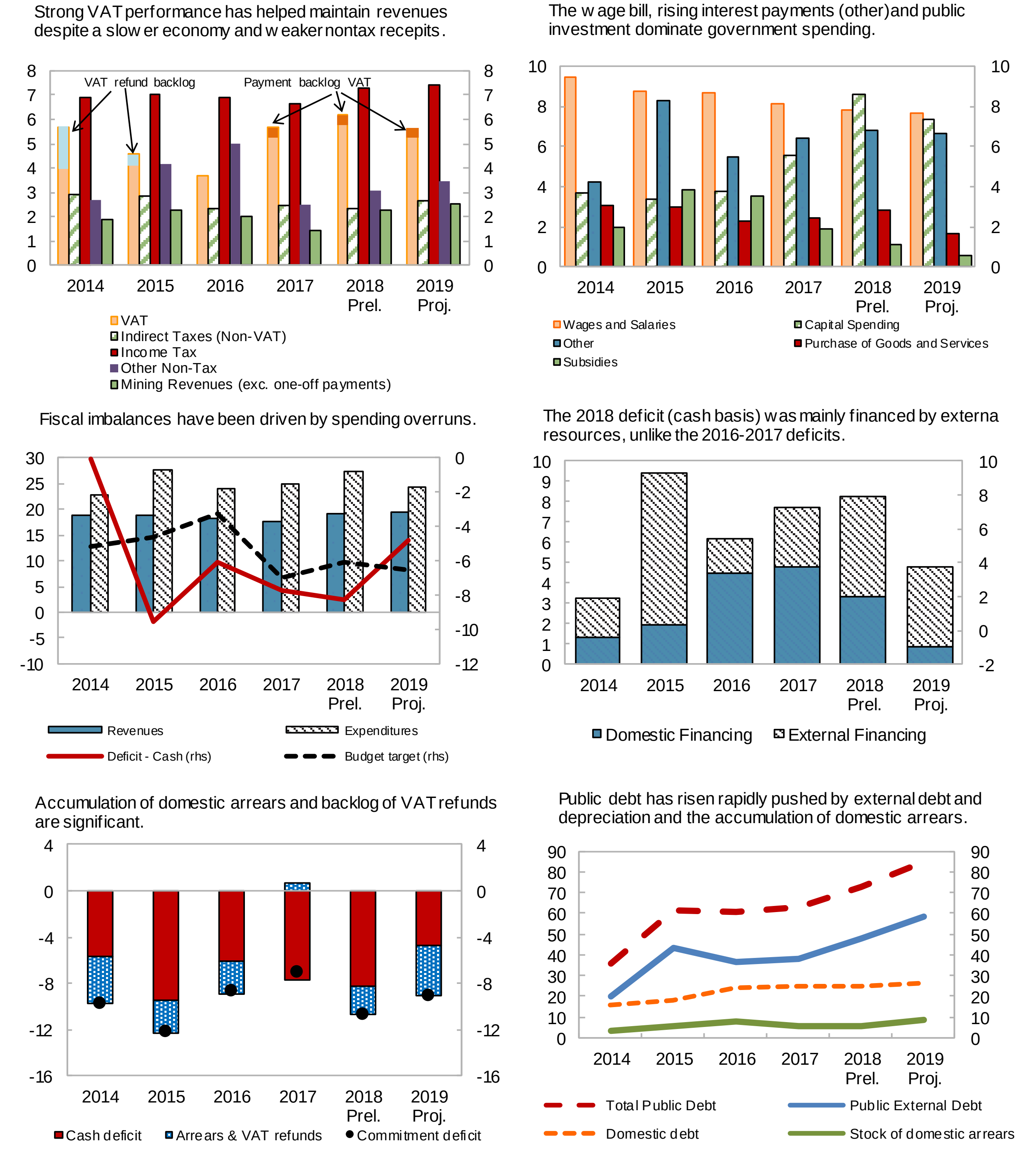
Inflation has crept up in recent months due to kwacha depreciation and increases in food and fuel prices.



Sources: Zambia Central Statistics Office; LME; IMF, World Economic Outlook database; and IMF staff estimates and projections.

Figure 2. Zambia: Fiscal Developments

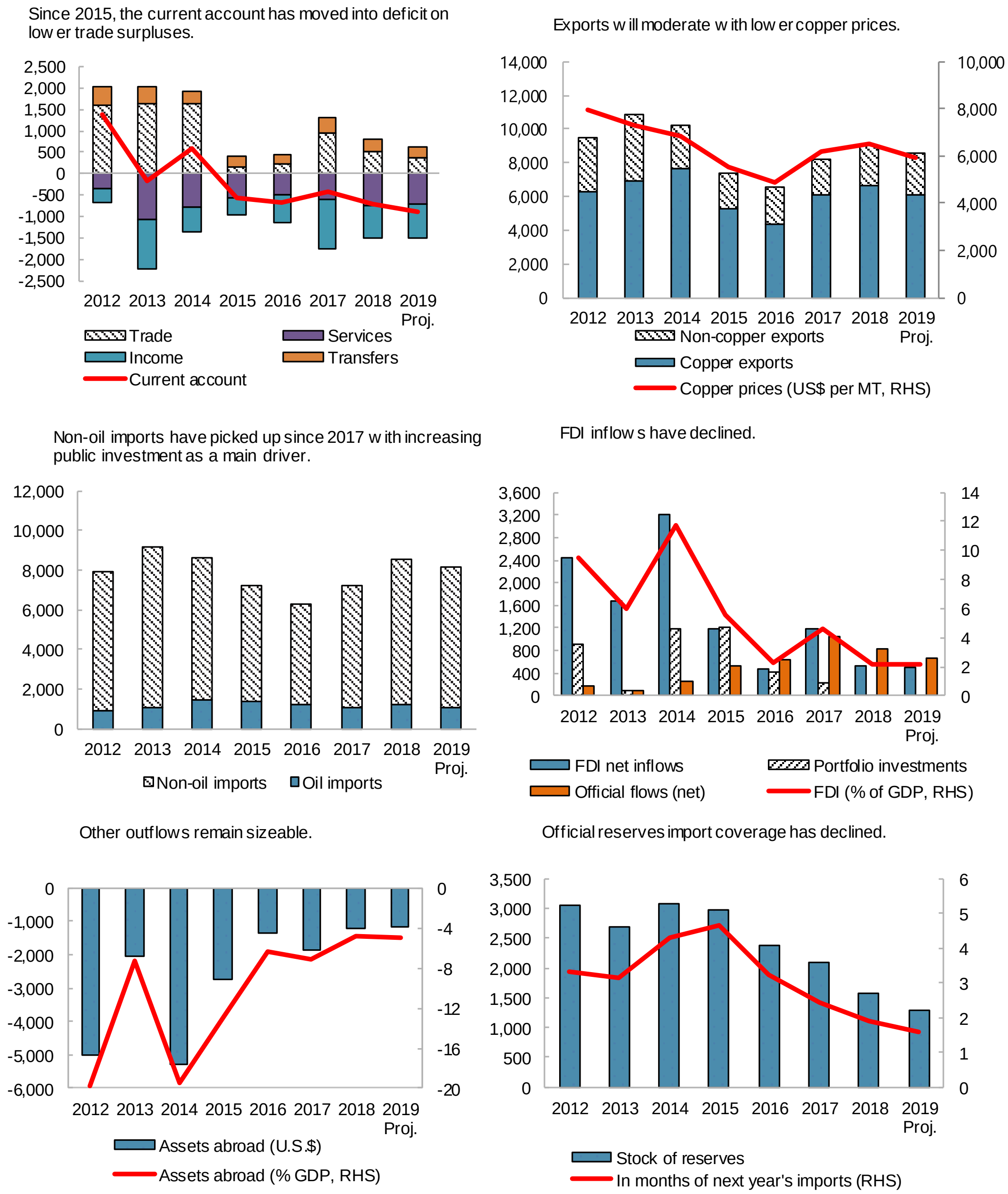
(Percent of GDP, unless otherwise specified)



Sources: Zambian authorities and IMF estimates and calculations.

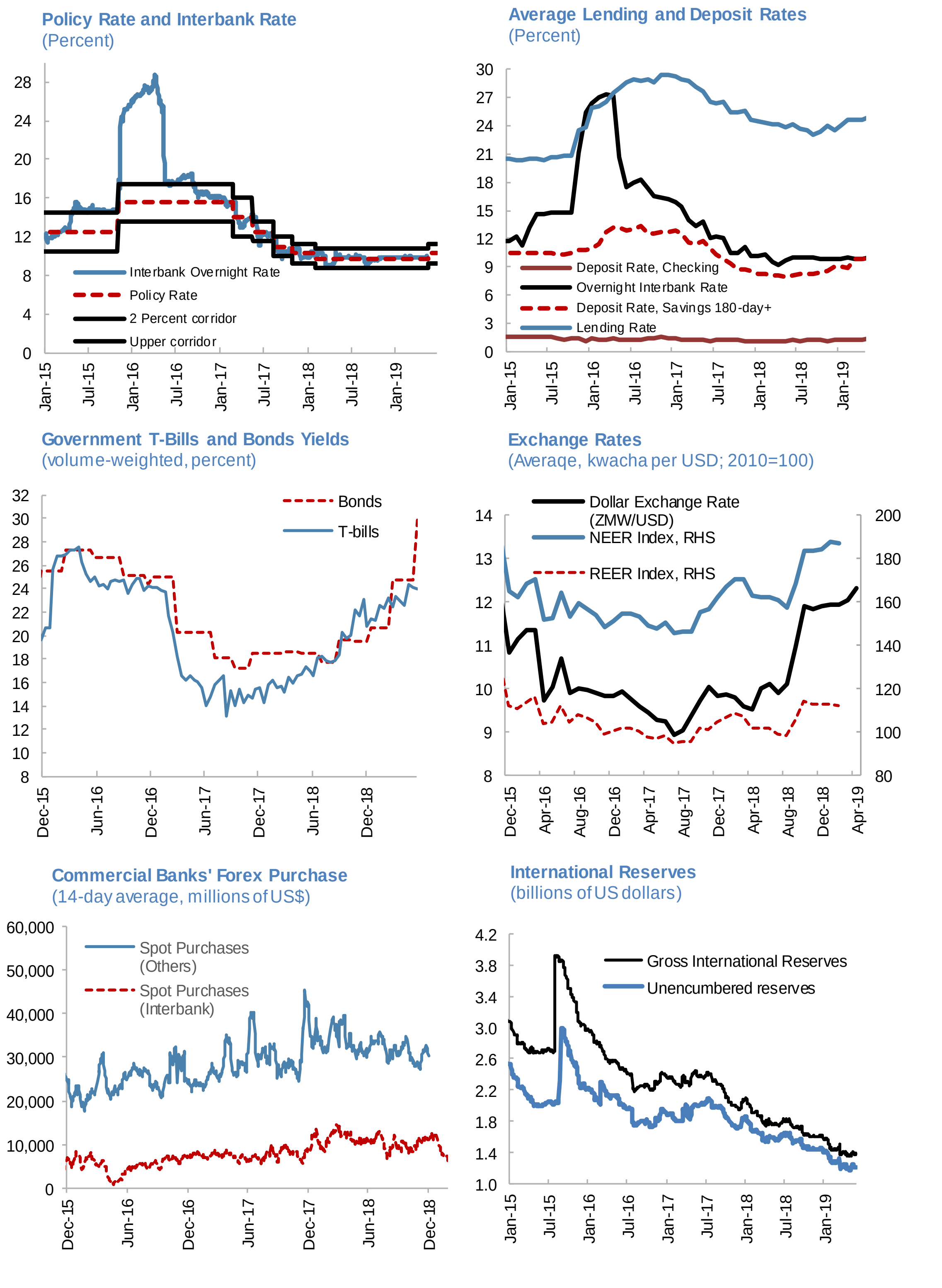
Figure 3. Zambia: External Sector

(Millions of U.S. dollars, unless otherwise specified)



Sources: Bank of Zambia and IMF staff forecasts.

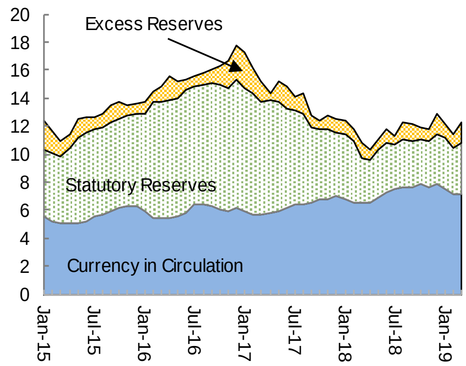
Figure 4. Zambia: Monetary & Financial Developments



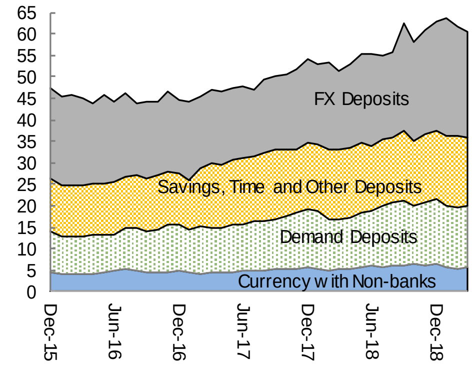
Source: Bank of Zambia.

Figure 4. Zambia: Monetary & Financial Developments (concluded)

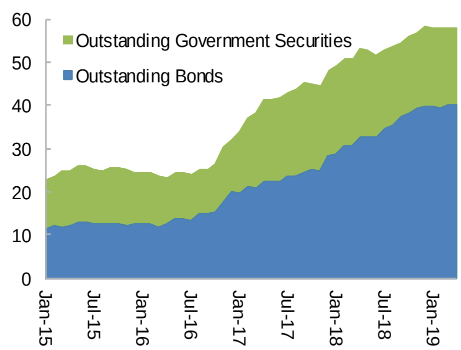
Reserve Money
(monthly average, billions of kwacha)



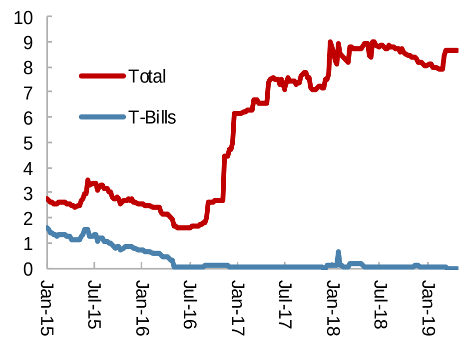
Broad Money
(billions of kwacha)



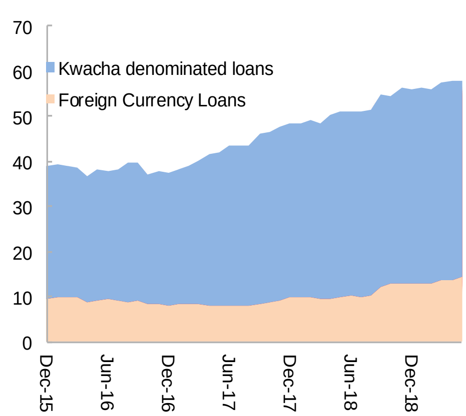
Outstanding Government Securities
(T-bills and bonds, billions of kwacha, face value)



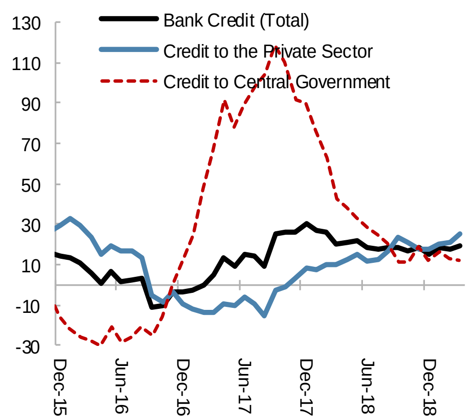
Foreign Holdings of Government Securities
(Face Value, kwacha billions)



Bank Credit to Domestic Economy
(billions of kwacha)



Bank Credit Growth
(year-on-year percent change)



Source: Bank of Zambia

Table 1. Zambia: Selected Economic Indicators, 2016–24

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2019	2020	2021	2022	2023	2024
			Prel.	Projections						Adjustment					
National account and prices															
GDP growth at constant prices	3.8	3.5	3.7	2.0	1.7	1.7	1.6	1.5	1.5	1.6	1.9	2.1	2.4	2.8	3.3
Mining	7.3	3.0	6.3	-2.0	2.0	2.0	3.0	3.0	3.0	-2.0	2.0	3.0	4.0	5.0	5.0
Non mining	3.4	3.6	3.4	2.5	1.7	1.7	1.4	1.3	1.3	2.0	1.9	2.0	2.2	2.6	3.1
GDP deflator	13.6	10.1	9.5	10.0	9.7	8.2	8.3	8.0	7.7	7.9	7.2	6.7	6.5	6.6	6.4
GDP at market prices (billions of kwacha)	216.1	246.3	279.4	313.5	349.8	385.2	423.7	464.4	507.9	306.4	334.6	364.5	397.8	435.9	479.3
GDP at market prices (millions of kwacha)	216,098	246,252	279,441	313,496	349,831	385,196	423,750	464,432	507,929	306,384	334,593	364,466	397,756	435,924	479,266
GDP at market prices (millions of USD)	20,941	25,868	26,720	23,946	23,342	23,415	23,636	23,951	24,401	24,914	25,874	27,137	28,587	30,251	32,119
Consumer prices															
Consumer prices (average)	17.9	6.6	7.0	9.9	10.0	8.0	8.0	8.0	8.0	8.7	8.5	7.3	7.0	7.0	7.0
Consumer prices (end of period)	7.5	6.1	7.9	12.0	8.0	8.0	8.0	8.0	8.0	9.5	7.5	7.0	7.0	7.0	7.0
External sector															
Terms of trade (deterioration -)	-3.0	16.0	-3.8	-6.4	-1.5	0.3	0.1	-0.2	-1.1	-6.5	-2.0	0.5	0.2	-0.1	-0.8
Average exchange rate (kwacha per U.S. dollar)	10.3	9.5	10.5	...	...	...	...	...	...	...	...	...	...	...	...
(percentage change; depreciation +)	19.5	-7.7	9.9	...	...	...	...	...	...	...	...	...	...	...	...
End-of-period exchange rate (kwacha per U.S. dollar)	9.9	9.9	11.9	...	...	...	...	...	...	...	...	...	...	...	...
Real exchange rate (depreciation +)	4.3	-10.8	5.4	...	...	...	...	...	...	...	...	...	...	...	...
Money and credit															
Domestic credit to the private sector	-9.4	5.2	16.7	7.5	7.9	7.9	6.2	6.9	7.1	10.1	13.1	13.0	14.4	14.4	12.5
Reserve money (end of period)	12.8	-25.6	-0.6	10.3	13.4	11.0	11.9	11.6	10.5	11.5	14.1	12.6	12.9	13.4	11.2
Broad Money (M3)	-5.7	21.4	16.5	11.9	11.0	10.1	11.0	10.7	10.5	11.7	10.3	10.2	10.6	11.0	11.2
Credit to the private sector (percent of GDP)	12.1	11.2	11.5	11.0	10.6	10.4	10.1	9.8	9.6	11.5	12.0	12.4	13.0	13.6	13.9
National accounts															
Gross investment	38.2	41.0	43.3	41.1	40.2	37.3	36.6	36.0	35.7	39.8	40.2	40.3	40.5	40.7	41.2
Government	3.8	5.5	8.6	7.3	8.4	6.9	6.5	6.1	6.1	5.1	4.9	4.8	4.8	4.7	4.9
Private	34.4	35.5	34.8	33.8	31.9	30.5	30.2	29.9	29.6	34.8	35.3	35.5	35.8	36.1	36.4
National savings	34.9	39.3	40.7	37.5	36.8	34.4	34.0	33.7	33.7	36.2	37.0	37.8	38.5	39.0	39.7
External current account balance	-3.3	-1.7	-2.6	-3.6	-3.4	-2.9	-2.6	-2.3	-2.0	-3.7	-3.2	-2.4	-2.0	-1.8	-1.5
Central government budget															
Revenue	18.2	17.5	19.1	19.4	19.7	19.8	19.8	19.7	19.7	19.7	20.0	20.2	20.6	20.7	20.7
Taxes	13.0	14.8	15.8	15.7	15.9	16.0	16.0	15.9	15.9	16.1	16.0	16.3	16.5	16.6	16.6
Grants	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.2	0.1	0.1	0.1	0.1	0.1
Other revenue	5.0	2.5	3.1	3.5	3.7	3.7	3.7	3.8	3.8	3.5	3.8	3.9	4.0	4.0	4.1
Expenditure	23.9	25.0	27.4	24.2	24.8	23.3	22.9	22.6	22.4	24.1	24.0	23.6	23.6	23.5	23.3
Expense	20.2	19.4	18.8	16.8	16.4	16.4	16.4	16.5	16.3	19.0	19.1	18.8	18.9	18.8	18.5
Net acquisition of nonfinancial assets	3.8	5.5	8.6	7.3	8.4	6.9	6.5	6.1	6.1	5.1	4.9	4.8	4.8	4.7	4.9
Net lending/borrowing (cash basis)	-5.7	-7.7	-8.3	-4.8	-5.1	-3.4	-3.1	-2.9	-2.6	-4.3	-4.0	-3.4	-3.0	-2.7	-2.6
Net lending/borrowing (commitment basis)	-9.0	-7.0	-10.7	-9.0	-5.6	-4.0	-3.1	-2.9	-2.6	-6.3	-3.4	-2.9	-2.5	-2.3	-2.2
Net acquisition of financial assets	-0.6	0.3	-0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic	-0.6	0.3	-0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrance of liabilities	5.5	8.1	7.6	4.8	5.1	3.4	3.1	2.9	2.6	4.4	4.0	3.4	3.0	2.7	2.6
Domestic	3.8	5.2	2.7	1.0	0.8	0.8	0.8	0.8	0.7	2.8	2.9	2.5	2.0	1.1	1.0
Foreign	1.7	2.9	4.9	3.9	4.3	2.7	2.3	2.1	1.9	1.6	1.1	0.9	1.1	1.6	1.6
Financing gap	-0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
External sector															
Current account balance	-3.3	-1.7	-2.6	-3.6	-3.4	-2.9	-2.6	-2.3	-2.0	-3.7	-3.2	-2.4	-2.0	-1.8	-1.5
(including current and capital grants)	-3.0	-1.5	-2.4	-3.3	-3.1	-2.7	-2.4	-2.1	-1.8	-3.4	-2.9	-2.2	-1.8	-1.6	-1.4
(excluding grants)	-3.3	-1.8	-2.6	-3.6	-3.4	-2.9	-2.6	-2.3	-2.0	-3.7	-3.2	-2.4	-2.0	-1.8	-1.5
Gross International Reserves (months of prospective imports)	3.3	2.4	1.9	1.6	1.3	0.9	0.6	0.6	0.5	2.0	2.1	2.4	2.4	2.5	2.5
Public debt															
Total public debt, gross (end-period)	60.7	65.5	78.1	91.6	95.5	98.0	97.6	96.7	95.1	84.6	85.0	84.4	81.6	78.4	74.8
External [1]	36.6	38.2	48.1	59.9	65.6	69.5	70.8	71.5	71.3	52.2	52.7	52.3	50.5	49.1	47.4
Domestic [2]	24.1	27.3	30.0	31.7	29.8	28.5	26.8	25.2	23.8	32.3	32.4	32.1	31.1	29.3	27.4

Sources: Zambian authorities; and IMF staff estimates and projections.

[1] Public and publicly guaranteed external debt.

[2] Including arrears.

Table 2a. Zambia: Fiscal Operations of the Budgetary Central Government, 2016–24

(Millions of kwacha)

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2019	2020	2021	2022	2023	2024
			Prel.	Projections						Adjustment					
Revenue	39,410	43,032	53,449	60,806	68,949	76,284	83,836	91,616	100,259	60,458	66,823	73,758	81,822	90,286	99,415
Revenue excluding grants	38,885	42,566	52,802	60,112	68,493	75,833	83,389	91,175	99,825	59,801	66,390	73,334	81,405	89,875	99,008
Tax	28,028	36,490	44,240	49,228	55,636	61,653	67,592	73,699	80,623	49,222	53,588	59,260	65,636	72,234	79,473
Tax revenues adjusted by the backlog of VAT refunds	29,114	37,911	42,030	48,004	55,636	61,653	67,592	73,699	80,623	48,222	53,588	59,260	65,636	72,234	79,473
Other revenue, including mineral royalties	10,856	6,076	8,563	10,884	12,857	14,179	15,797	17,475	19,202	10,579	12,802	14,073	15,769	17,641	19,535
Of which: Mineral royalties	3,053	2,435	3,937	4,800	5,568	6,154	6,968	7,799	8,519	4,566	5,436	6,049	7,012	8,043	8,883
Grants	525	467	647	694	456	452	447	441	434	657	433	425	417	412	407
Expenditure	51,713	61,500	76,505	75,762	86,763	89,567	97,124	104,907	113,623	73,728	80,236	86,159	93,914	102,243	111,857
Expense	43,555	47,842	52,569	52,756	57,501	63,169	69,677	76,423	82,560	58,215	63,849	68,665	74,986	81,812	88,469
Compensation of employees	18,807	19,995	21,856	23,992	26,691	29,259	31,818	34,207	36,998	24,126	26,177	28,495	30,639	33,612	37,004
Use of goods and services	4,897	5,930	7,944	5,120	5,186	5,489	5,916	6,667	7,236	7,130	7,836	8,335	9,897	11,043	12,150
Interest	7,448	9,826	12,988	15,477	18,200	20,544	23,338	26,792	29,381	13,338	15,919	16,720	17,589	19,020	19,292
Domestic	4,025	5,045	7,414	8,575	9,796	11,213	13,188	15,126	17,514	8,150	8,874	9,583	10,356	11,112	11,581
Foreign	3,423	4,781	5,574	6,902	8,404	9,332	10,150	11,666	11,868	5,188	7,045	7,137	7,233	7,908	7,711
Subsidies	7,672	4,666	3,136	1,876	1,848	2,128	2,119	2,492	2,176	5,511	5,062	5,357	5,750	5,416	5,582
Intergovernmental transfers	4,195	5,506	5,631	4,910	4,535	4,633	5,258	4,918	5,296	6,048	6,593	7,318	8,398	9,749	11,174
Social benefits	537	1,919	1,015	1,381	1,041	1,117	1,228	1,346	1,472	2,062	2,262	2,439	2,712	2,972	3,267
Net acquisition of nonfinancial assets	8,157	13,658	23,936	23,006	29,261	26,397	27,447	28,484	31,063	15,512	16,388	17,494	18,928	20,431	23,388
Of which: domestically-financed	3,357	5,928	5,582	1,773	3,379	3,467	4,862	6,995	7,946	2,956	3,269	3,910	4,864	5,152	6,782
Of which: foreign-financed	4,810	7,730	18,354	21,232	25,882	22,931	22,586	21,488	23,117	12,556	13,119	13,584	14,064	15,279	16,605
Statistical Discrepancy (-overfinancing)	-874	-525	0	0	0	0	0	0	0	0	0	0	0	0	0
Net lending/borrowing (overall balance, cash basis)	-13,177	-18,993	-23,056	-14,956	-17,814	-13,283	-13,288	-13,291	-13,364	-13,269	-13,413	-12,400	-12,092	-11,957	-12,442
Primary balance (cash basis)	-5,728	-9,166	-10,068	521	386	7,262	10,049	13,500	16,017	69	2,506	4,320	5,497	7,063	6,850
Domestic arrears (- payments)	7,287	-243	4,684	12,165	1,725	2,300	0	0	0	5,128	-1,950	-1,950	-1,950	-1,950	-1,950
Backlog of VAT refunds (flow)	-1,086	-1,421	2,210	1,225	0	0	0	0	0	1,000	0	0	0	0	0
Overall balance, (commitment basis)[1]	-19,378	-17,328	-29,949	-28,345	-19,539	-15,583	-13,288	-13,291	-13,364	-19,397	-11,463	-10,451	-10,142	-10,007	-10,492
Primary balance (commitment basis)[1]	-11,929	-7,502	-16,962	-12,868	-1,339	4,962	10,049	13,500	16,017	-6,059	4,455	6,269	7,447	9,013	8,800
Financing	13,177	18,993	23,056	14,956	17,814	13,283	13,288	13,291	13,364	13,269	13,413	12,400	12,092	11,957	12,442
Net acquisition of financial assets	-1,314	839	-1,861	153	0	0	0	0	0	153	0	0	0	0	0
Domestic	-1,314	839	-1,861	153	0	0	0	0	0	153	0	0	0	0	0
Currency and deposits	-1,437	839	-1,861	153	0	0	0	0	0	153	0	0	0	0	0
Loans	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Foreign	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Net incurrence of liabilities	11,862	19,832	21,194	15,108	17,814	13,283	13,288	13,291	13,364	13,422	13,413	12,400	12,092	11,957	12,442
Domestic	8,216	12,691	7,429	2,998	2,944	2,978	3,424	3,491	3,481	8,669	9,810	9,134	7,890	4,993	4,569
Foreign	3,646	7,141	13,765	12,110	14,870	10,305	9,865	9,800	9,884	4,753	3,603	3,267	4,203	6,964	7,873
Loans	3,646	7,141	13,765	12,110	14,870	10,305	-3,581	9,800	-10,932	4,753	3,603	3,267	-6,233	6,964	-7,048
Budget support, gross	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Project loans, gross	4,966	7,678	17,872	20,983	25,718	22,768	22,425	21,330	22,961	13,007	12,963	13,431	13,914	15,131	16,459
Other, gross	0	1,274	0	0	0	0	0	0	0	0	0	0	0	0	0
Amortization	-1,320	-1,811	-4,107	-8,872	-10,848	-12,463	-26,006	-11,529	-33,893	-8,255	-9,360	-10,164	-20,147	-8,166	-23,507
Debt securities	0	0	0	0	0	0	13,446	0	20,816	0	0	0	10,435	0	14,922
Financing gap	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Memorandum items:															
Net Domestic Financing	9,653	11,852	9,290	2,845	2,944	2,978	3,424	3,491	3,481	8,517	9,810	9,134	7,890	4,993	4,569
Backlog of VAT refunds (stock)	3,224	1,803	4,013	5,238	9,722	9,722	9,722	9,722	9,722	5,013	5,013	5,013	5,013	5,013	5,013
Basic balance (cash basis)[2]	-8,377	-11,406	-5,349	5,583	7,613	9,196	8,850	7,756	9,753	-713	-294	1,183	1,972	3,322	4,164
Basic primary balance (cash basis)[3]	-2,371	-3,381	-5,133	1,601	3,309	10,277	14,464	20,055	23,963	3,025	5,775	8,230	10,362	12,215	13,632
Primary balance, excluding mining revenue (cash basis)	-10,061	-12,669	-16,456	-7,311	-8,688	-2,850	-1,391	693	1,960	-7,350	-5,958	-4,996	-5,059	-4,855	-6,247
Primary balance, excluding mining revenue (commitment basis)[1]	-16,262	-11,005	-23,350	-20,700	-10,413	-5,150	-1,391	693	1,960	-13,478	-4,008	-3,046	-3,110	-2,906	-4,297
Mining revenue	4,332	3,503	6,388	7,832	9,074	10,111	11,441	12,807	14,057	7,419	8,463	9,315	10,557	11,919	13,097
Stock of domestic debt, gross	51,979	67,300	83,913	99,428	104,304	109,811	113,486	117,253	121,035	99,046	108,259	116,917	123,664	127,593	131,185
Of which: Stock of domestic arrears	17,317	10,901	15,585	27,936	29,869	32,397	32,649	32,924	33,226	22,049	21,452	20,976	19,834	18,770	17,793
Stock of external debt, gross	79,122	94,051	134,358	187,887	229,655	267,794	299,926	331,982	361,938	160,053	176,179	190,544	200,709	213,974	227,109
Total public debt	131,101	161,352	218,271	287,315	333,959	377,605	413,412	449,234	482,973	259,099	284,438	307,460	324,373	341,567	358,294

Sources: Zambian authorities; and IMF staff estimates and projections.

[1] Adjusted for accumulation/clearance of VAT refund claims and arrears relating to FRA, FISP, subsidies, public investment, and pensions.

[2] Defined as total revenue minus total expenditure, excluding foreign-financed investment expenditure.

[3] Defined as total revenue minus total expenditure, excluding all interest and foreign-financed investment expenditure.

Table 2b. Zambia Fiscal Operations of the Budgetary Central Government, 2016-24
(Percent of GDP)

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2019	2020	2021	2022	2023	2024
			Prel.	Projections						Adjustment					
Revenue	18.2	17.5	19.1	19.4	19.7	19.8	19.8	19.7	19.7	19.7	20.0	20.2	20.6	20.7	20.7
Revenue excluding grants	18.0	17.3	18.9	19.2	19.6	19.7	19.7	19.6	19.7	19.5	19.8	20.1	20.5	20.6	20.7
Tax	13.0	14.8	15.8	15.7	15.9	16.0	16.0	15.9	15.9	16.1	16.0	16.3	16.5	16.6	16.6
Tax revenues adjusted by the backlog of VAT refunds	13.5	15.4	15.0	15.3	15.9	16.0	16.0	15.9	15.9	15.7	16.0	16.3	16.5	16.6	16.6
Other revenue, including mineral royalties	5.0	2.5	3.1	3.5	3.7	3.7	3.7	3.8	3.8	3.5	3.8	3.9	4.0	4.0	4.1
Of which: Mineral royalties	1.4	1.0	1.4	1.5	1.6	1.6	1.6	1.7	1.7	1.5	1.6	1.7	1.8	1.8	1.9
Grants	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.2	0.1	0.1	0.1	0.1	0.1
Expenditure	23.9	25.0	27.4	24.2	24.8	23.3	22.9	22.6	22.4	24.1	24.0	23.6	23.6	23.5	23.3
Expense	20.2	19.4	18.8	16.8	16.4	16.4	16.4	16.5	16.3	19.0	19.1	18.8	18.9	18.8	18.5
Compensation of employees	8.7	8.1	7.8	7.7	7.6	7.6	7.5	7.4	7.3	7.9	7.8	7.8	7.7	7.7	7.7
Use of goods and services	2.3	2.4	2.8	1.6	1.5	1.4	1.4	1.4	1.4	2.3	2.3	2.3	2.5	2.5	2.5
Interest	3.4	4.0	4.6	4.9	5.2	5.3	5.5	5.8	5.8	4.4	4.8	4.6	4.4	4.4	4.0
Domestic	1.9	2.0	2.7	2.7	2.8	2.9	3.1	3.3	3.4	2.7	2.7	2.6	2.6	2.5	2.4
Foreign	1.6	1.9	2.0	2.2	2.4	2.4	2.4	2.5	2.3	1.7	2.1	2.0	1.8	1.8	1.6
Subsidies	3.6	1.9	1.1	0.6	0.5	0.6	0.5	0.5	0.4	1.8	1.5	1.5	1.4	1.2	1.2
Intergovernmental transfers	1.9	2.2	2.0	1.6	1.3	1.2	1.2	1.1	1.0	2.0	2.0	2.0	2.1	2.2	2.3
Social benefits	0.2	0.8	0.4	0.4	0.3	0.3	0.3	0.3	0.3	0.7	0.7	0.7	0.7	0.7	0.7
Net acquisition of nonfinancial assets	3.8	5.5	8.6	7.3	8.4	6.9	6.5	6.1	6.1	5.1	4.9	4.8	4.8	4.7	4.9
Of which: domestically-financed	1.6	2.4	2.0	0.6	1.0	0.9	1.1	1.5	1.6	1.0	1.0	1.1	1.2	1.2	1.4
Of which: foreign-financed	2.2	3.1	6.6	6.8	7.4	6.0	5.3	4.6	4.6	4.1	3.9	3.7	3.5	3.5	3.5
Statistical Discrepancy (-overfinancing)	-0.4	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net lending/borrowing (overall balance, cash basis)	-6.1	-7.7	-8.3	-4.8	-5.1	-3.4	-3.1	-2.9	-2.6	-4.3	-4.0	-3.4	-3.0	-2.7	-2.6
Primary balance (cash basis)	-2.7	-3.7	-3.6	0.2	0.1	1.9	2.4	2.9	3.2	0.0	0.7	1.2	1.4	1.6	1.4
Domestic arrears (- payments)	3.4	-0.1	1.7	3.9	0.5	0.6	0.0	0.0	0.0	1.7	-0.6	-0.5	-0.5	-0.4	-0.4
Backlog of VAT refunds (flow)	-0.5	-0.6	0.8	0.4	0.0	0.0	0.0	0.0	0.0	0.3	0.0	0.0	0.0	0.0	0.0
Overall balance, (commitment basis)[1]	-9.0	-7.0	-10.7	-9.0	-5.6	-4.0	-3.1	-2.9	-2.6	-6.3	-3.4	-2.9	-2.5	-2.3	-2.2
Primary balance (commitment basis)[1]	-5.5	-3.0	-6.1	-4.1	-0.4	1.3	2.4	2.9	3.2	-2.0	1.3	1.7	1.9	2.1	1.8
Financing	6.1	7.7	8.3	4.8	5.1	3.4	3.1	2.9	2.6	4.3	4.0	3.4	3.0	2.7	2.6
Net acquisition of financial assets	-0.6	0.3	-0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic	-0.6	0.3	-0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	5.5	8.1	7.6	4.8	5.1	3.4	3.1	2.9	2.6	4.4	4.0	3.4	3.0	2.7	2.6
Domestic	3.8	5.2	2.7	1.0	0.8	0.8	0.8	0.8	0.7	2.8	2.9	2.5	2.0	1.1	1.0
Debt securities	2.2	5.1	3.0	1.2	0.8	0.8	0.8	0.8	0.7	3.0	2.9	2.5	2.0	1.1	1.0
Loans	1.6	0.0	-0.4	-0.2	0.0	0.0	0.0	0.0	0.0	-0.2	0.0	0.0	0.0	0.0	0.0
Foreign	1.7	2.9	4.9	3.9	4.3	2.7	2.3	2.1	1.9	1.6	1.1	0.9	1.1	1.6	1.6
Loans	1.7	2.9	4.9	3.9	4.3	2.7	-0.8	2.1	-2.2	1.6	1.1	0.9	-1.6	1.6	-1.5
Budget support, gross	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Project loans, gross	2.3	3.1	6.4	6.7	7.4	5.9	5.3	4.6	4.5	4.2	3.9	3.7	3.5	3.5	3.4
Other, gross	0.0	0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Amortization	-0.6	-0.7	-1.5	-2.8	-3.1	-3.2	-6.1	-2.5	-6.7	-2.7	-2.8	-2.8	-5.1	-1.9	-4.9
Debt securities	0.0	0.0	0.0	0.0	0.0	0.0	3.2	0.0	4.1	0.0	0.0	0.0	2.6	0.0	3.1
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:															
Net Domestic Financing	4.5	4.8	3.3	0.9	0.8	0.8	0.8	0.8	0.7	2.8	2.9	2.5	2.0	1.1	1.0
Backlog of VAT refunds (stock)	1.5	0.7	1.4	1.7	2.8	2.5	2.3	2.1	1.9	1.6	1.5	1.4	1.3	1.1	1.0
Basic balance (cash basis)[2]	-3.9	-4.6	-1.9	1.8	2.2	2.4	2.1	1.7	1.9	-0.2	-0.1	0.3	0.5	0.8	0.9
Basic primary balance (cash basis)[3]	-1.1	-1.4	-1.8	0.5	0.9	2.7	3.4	4.3	4.7	1.0	1.7	2.3	2.6	2.8	2.8
Mining revenue	2.0	1.4	2.3	2.5	2.6	2.6	2.7	2.8	2.8	2.4	2.5	2.6	2.7	2.7	2.7
Stock of domestic debt, gross	24.1	27.3	30.0	31.7	29.8	28.5	26.8	25.2	23.8	32.3	32.4	32.1	31.1	29.3	27.4
Stock of external debt, gross[4]	36.6	38.2	48.1	59.9	65.6	69.5	70.8	71.5	71.3	52.2	52.7	52.3	50.5	49.1	47.4
Total public debt	60.7	65.5	78.1	91.6	95.5	98.0	97.6	96.7	95.1	84.6	85.0	84.4	81.6	78.4	74.8
Nominal GDP (millions of kwacha)	216,098	246,252	279,441	313,496	349,831	385,196	423,750	464,432	507,929	306,384	334,593	364,466	397,756	435,924	479,266

Sources: Zambian authorities; and IMF staff estimates and projections.

[1] Adjusted for accumulation/clearance of VAT refund claims and arrears relating to FRA, FISP, subsidies, public investment, and pensions.

[2] Defined as total revenue minus total expenditure, excluding foreign-financed investment expenditure.

[3] Defined as total revenue minus total expenditure, excluding all interest and foreign-financed investment expenditure.

[4] Public and publicly guranteed external debt.

Table 3. Zambia: Monetary Accounts, 2016–24

(Millions of kwacha, unless otherwise indicated)

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2019	2020	2021	2022	2023	2024
			Prel.			Projections						Adjustment			
Monetary survey															
Net foreign assets	21,881	21,985	24,810	28,689	29,775	30,897	34,900	40,259	42,168	29,006	29,669	31,124	30,566	33,418	33,803
Net domestic assets	22,686	32,100	38,187	41,834	48,503	55,263	60,775	65,666	74,845	41,342	47,932	54,420	64,012	71,559	82,962
Domestic claims	41,339	53,577	62,219	65,456	69,360	73,458	77,240	82,375	88,290	70,143	80,571	91,483	103,060	113,468	124,157
Net claims on central government	14,606	25,315	28,998	29,638	30,444	31,333	32,347	34,179	36,268	33,469	39,077	44,587	49,380	52,001	54,743
Claims on other sectors	26,733	28,262	33,222	35,818	38,916	42,125	44,894	48,195	52,022	36,674	41,494	46,896	53,679	61,466	69,414
Claims on other financial corporations	284	289	549	658	790	948	1,138	1,365	1,817	658	790	948	1,138	1,365	1,817
Claims on state and local government	74	36	67	79	115	176	258	378	513	79	94	144	211	309	419
Claims on public non-financial corporations	223	412	489	570	759	797	797	797	797	570	607	607	607	607	607
Claims on private sector	26,152	27,524	32,117	34,511	37,252	40,204	42,701	45,656	48,896	35,367	40,003	45,196	51,724	59,185	66,570
Other items net	-18,653	-21,477	-24,032	-23,622	-20,857	-18,195	-16,465	-16,708	-16,708	-28,801	-32,639	-37,063	-39,048	-41,908	-44,807
Broad money (M3)	44,567	54,085	62,997	70,523	78,278	86,160	95,675	105,926	117,012	70,348	77,601	85,544	94,577	104,977	116,764
Of which: foreign exchange deposits	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
Monetary authorities															
Net foreign assets	15,216	12,707	10,256	9,180	6,311	2,657	-1,842	-2,342	-2,875	11,987	14,919	19,257	21,389	25,235	28,366
Asset	23,315	20,726	18,827	18,465	16,210	13,331	9,668	10,059	10,393	20,238	23,229	27,747	30,119	34,274	37,726
Liabilities	-8,099	-8,019	-8,571	-9,285	-9,899	-10,675	-11,510	-12,401	-13,268	-8,251	-8,310	-8,490	-8,729	-9,040	-9,360
Net domestic assets	3,107	929	3,299	5,778	10,647	16,168	22,915	25,866	28,861	3,126	2,320	146	512	-407	-751
Net domestic claims	10,197	9,841	13,327	14,804	18,770	23,479	30,225	33,177	36,172	13,154	13,351	12,832	13,198	12,279	11,935
Net claims on other depository corporations	165	-368	30	1,401	5,091	9,419	15,710	18,388	20,763	-390	-955	-2,504	-3,113	-4,344	-5,417
Net claims on central government	9,940	10,122	13,204	13,275	13,492	13,786	14,114	14,202	14,550	13,417	14,119	15,062	15,911	16,036	16,493
Claims on other sectors	92	87	94	128	187	274	401	587	859	128	187	274	401	587	859
Other items (net)	-7,090	-8,912	-10,028	-9,026	-8,123	-7,311	-7,311	-7,311	-7,311	-10,028	-11,031	-12,686	-12,686	-12,686	-12,686
Reserve money	18,323	13,636	13,555	14,958	16,958	18,825	21,073	23,524	25,986	15,113	17,239	19,403	21,901	24,828	27,615
Currency outside banks and cash in vaults	6,551	7,415	8,292	8,661	9,223	9,714	11,892	14,438	18,376	8,640	9,143	9,644	11,756	14,309	18,337
Other depository corporation reserves	11,740	6,181	5,207	6,999	8,522	9,985	10,169	10,202	12,117	7,173	8,875	10,626	11,123	11,624	14,132
Liabilities to other sectors	32	40	56	-702	-786	-874	-988	-1,115	-1,244	-700	-780	-867	-977	-1,105	-1,241
Memorandum items:															
Reserve money (end-of-period, annual percent change)	12.8	-25.6	-0.6	10.3	13.4	11.0	11.9	11.6	10.5	11.5	14.1	12.6	12.9	13.4	11.2
Broad money (M3) (annual percent change)	-5.7	21.4	16.5	11.9	11.0	10.1	11.0	10.7	10.5	11.7	10.3	10.2	10.6	11.0	11.2
Credit to the private sector (annual percent change)	-9.4	5.2	16.7	7.5	7.9	7.9	6.2	6.9	7.1	10.1	13.1	13.0	14.4	14.4	12.5
Velocity (nominal GDP/M3)	4.8	4.6	4.4	4.4	4.5	4.5	4.4	4.4	4.3	4.4	4.3	4.3	4.2	4.2	4.1
Money multiplier (M3/reserve money)	2.4	4.0	4.6	4.7	4.6	4.6	4.5	4.5	4.5	4.7	4.5	4.4	4.3	4.2	4.2
Credit to the private sector (percent of GDP)	12.1	11.2	11.5	11.0	10.6	10.4	10.1	9.8	9.6	11.5	12.0	12.4	13.0	13.6	13.9
Gross foreign exchange reserves of the Bank of Zambia (millions of U.S. dollars)	2,366	2,081	1,569	1,285	1,022	766	508	490	473	1,587	1,751	2,020	2,117	2,328	2,475
Exchange rate (kwacha per U.S. dollar, end period)	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
Nominal GDP (million Kwacha)	216,098	246,252	279,441	313,496	349,831	385,196	423,750	464,432	507,929	306,384	334,593	364,466	397,756	435,924	479,266

Sources: Zambian authorities; and IMF staff estimates and projections.

Table 4a. Zambia: Balance of Payments, 2016–24

(Millions of U.S. dollars, unless otherwise indicated)

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2019	2020	2021	2022	2023	2024
			Prel.			Projections						Adjustment			
Current account	-685	-435	-708	-851	-792	-686	-616	-560	-489	-910	-822	-665	-574	-534	-489
Trade balance	238	960	514	417	715	889	1,025	1,156	1,230	428	811	1,002	1,140	1,256	1,344
Exports, f.o.b.	6,535	8,216	9,029	8,539	8,703	9,029	9,369	9,717	10,067	8,524	8,824	9,191	9,603	10,118	10,715
Of which: copper	4,399	6,119	6,658	6,053	6,107	6,284	6,521	6,754	6,881	6,053	6,107	6,346	6,649	7,020	7,454
Imports, f.o.b	-6,296	-7,255	-8,515	-8,122	-7,987	-8,140	-8,344	-8,561	-8,837	-8,096	-8,013	-8,189	-8,463	-8,861	-9,371
Of which: oil	-1,220	-1,028	-1,228	-1,092	-1,048	-1,028	-1,018	-1,027	-1,046	-1,146	-1,167	-1,189	-1,220	-1,272	-1,350
Services (net)	-488	-609	-731	-733	-757	-773	-793	-810	-825	-713	-717	-718	-728	-749	-795
Income (net)	-647	-1,145	-766	-783	-991	-1,044	-1,092	-1,153	-1,146	-883	-1,182	-1,229	-1,282	-1,354	-1,370
Of which: interest on public debt	-337	-374	-567	-625	-724	-754	-768	-796	-757	-625	-708	-719	-722	-743	-704
Current transfers (net)	212	359	276	247	241	242	244	247	252	257	267	280	295	312	332
Of which: Private transfers	212	325	276	247	241	242	244	247	252	257	267	280	295	312	332
Capital and financial account	118	188	306	611	544	433	358	542	472	973	1,001	936	671	745	636
Capital account	55	58	66	69	61	55	50	45	42	72	67	63	60	57	55
Project grants	55	58	66	69	61	55	50	45	42	72	67	63	60	57	55
Financial account	63	130	240	542	483	378	308	496	430	901	934	873	612	688	581
Foreign direct investment (net)	486	1,180	537	481	669	871	1,029	1,043	1,062	600	974	1,221	1,436	1,520	1,614
Portfolio investment (net)	417	235	-238	-16	-7	23	748	-5	996	33	92	221	946	193	1,193
Financial derivatives (net)	15	68	10	9	9	9	9	9	9	9	10	10	11	11	12
Other investments (net)	-855	-1,353	-69	68	-188	-524	-1,478	-551	-1,638	258	-141	-579	-1,782	-1,036	-2,238
Public sector (net)	711	1,012	1,740	1,833	1,376	907	-315	390	-717	1,288	662	524	-563	368	-664
Disbursements	864	1,144	2,189	2,773	2,224	1,740	1,251	1,100	1,103	2,228	1,510	1,356	1,000	1,050	1,103
Of which: budget support	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Amortization due	-154	-132	-449	-940	-848	-833	-1,566	-710	-1,820	-940	-848	-832	-1,563	-682	-1,767
Commercial banks (net)	-64	-154	-276	-276	0	0	0	0	0	-276	0	0	0	0	0
Other sectors	-1,501	-2,211	-1,533	-1,489	-1,564	-1,431	-1,163	-941	-920	-754	-803	-1,103	-1,219	-1,404	-1,573
Errors and omissions	25	31	-43	0	0	0	0	0	0	0	0	0	0	0	0
Overall balance	-541	-216	-445	-240	-248	-253	-258	-18	-17	62	179	272	97	210	147
Financing	542	217	444	240	248	253	258	18	17	-62	-179	-272	-97	-210	-147
Central bank net reserves (- increase)	542	217	444	240	248	253	258	18	17	-62	-179	-272	-97	-210	-147
Of which: Gross reserve change	611	290	506	284	263	256	258	18	17	-18	-164	-269	-97	-210	-147
Of which: Use of Fund resources	-69	-74	-61	-44	-15	-3	0	0	0	-44	-15	-3	0	0	0
Exceptional financing	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Financing gap	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Memorandum items:															
Current account (percent of GDP)	-3.3	-1.7	-2.6	-3.6	-3.4	-2.9	-2.6	-2.3	-2.0	-3.7	-3.2	-2.4	-2.0	-1.8	-1.5
Total official grants (percent of GDP)	0.3	0.4	0.2	0.3	0.3	0.2	0.2	0.2	0.2	0.3	0.3	0.2	0.2	0.2	0.2
Change in copper export volume (percent)	-4.8	9.7	2.8	-2.0	2.0	2.0	6.7	6.6	6.5	-2.0	2.0	3.0	6.7	6.6	6.5
Copper export price (U.S. dollars per tonne)	4,868	6,170	6,530	6,058	5,991	6,045	6,090	6,123	6,123	6,058	5,991	6,045	6,090	6,123	6,123
Crude oil price	43	53	68	66	64	61	59	58	59	66	64	61	59	58	59
Gross international reserves (millions of U.S. dollars)	2,366	2,081	1,569	1,285	1,022	766	508	490	473	1,587	1,751	2,020	2,117	2,328	2,475
In months of prospective imports	3.3	2.4	1.9	1.6	1.3	0.9	0.6	0.6	0.5	2.0	2.1	2.4	2.4	2.5	2.5
GDP (millions of U.S. dollars)	20,941	25,868	26,720	23,946	23,342	23,415	23,636	23,951	24,401	24,914	25,874	27,137	28,587	30,251	32,119

Sources: Zambian authorities; and IMF staff estimates and projections.

Table 4b. Zambia: Balance of Payments, 2016–24

(Percent of GDP, unless otherwise indicated)

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2019	2020	2021	2022	2023	2024
			Prel.	Projections						Adjustment					
Current account	-3.3	-1.7	-2.6	-3.6	-3.4	-2.9	-2.6	-2.3	-2.0	-3.7	-3.2	-2.4	-2.0	-1.8	-1.5
Trade balance	1.1	3.7	1.9	1.7	3.1	3.8	4.3	4.8	5.0	1.7	3.1	3.7	4.0	4.2	4.2
Exports, f.o.b.	31.2	31.8	33.8	35.7	37.3	38.6	39.6	40.6	41.3	34.2	34.1	33.9	33.6	33.4	33.4
Of which: copper	21.0	23.7	24.9	25.3	26.2	26.8	27.6	28.2	28.2	24.3	23.6	23.4	23.3	23.2	23.2
Imports, f.o.b	-30.1	-28.0	-31.9	-33.9	-34.2	-34.8	-35.3	-35.7	-36.2	-32.5	-31.0	-30.2	-29.6	-29.3	-29.2
Of which: oil	-5.8	-4.0	-4.6	-4.6	-4.5	-4.4	-4.3	-4.3	-4.3	-4.6	-4.5	-4.4	-4.3	-4.2	-4.2
Services (net)	-2.3	-2.4	-2.7	-3.1	-3.2	-3.3	-3.4	-3.4	-3.4	-2.9	-2.8	-2.6	-2.5	-2.5	-2.5
Income (net)	-3.1	-4.4	-2.9	-3.3	-4.2	-4.5	-4.6	-4.8	-4.7	-3.5	-4.6	-4.5	-4.5	-4.5	-4.3
Of which: interest on public debt	-1.6	-1.4	-2.1	-2.6	-3.1	-3.2	-3.3	-3.3	-3.1	-2.5	-2.7	-2.6	-2.5	-2.5	-2.2
Current transfers (net)	1.0	1.4	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Budget support grants	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Sector-wide approach grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Private transfers	1.0	1.3	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Capital and financial account	0.6	0.7	1.1	2.6	2.3	1.8	1.5	2.3	1.9	3.9	3.9	3.5	2.3	2.5	2.0
Capital account	0.3	0.2	0.2	0.3	0.3	0.2	0.2	0.2	0.2	0.3	0.3	0.2	0.2	0.2	0.2
Project grants	0.3	0.2	0.2	0.3	0.3	0.2	0.2	0.2	0.2	0.3	0.3	0.2	0.2	0.2	0.2
External debt cancellation	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	0.3	0.5	0.9	2.3	2.1	1.6	1.3	2.1	1.8	3.6	3.6	3.2	2.1	2.3	1.8
Foreign direct investment (net)	2.3	4.6	2.0	2.0	2.9	3.7	4.4	4.4	4.4	2.4	3.8	4.5	5.0	5.0	5.0
Portfolio investment (net)	2.0	0.9	-0.9	-0.1	0.0	0.1	3.2	0.0	4.1	0.1	0.4	0.8	3.3	0.6	3.7
Financial derivatives (net)	0.1	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other investments (net)	-4.1	-5.2	-0.3	0.3	-0.8	-2.2	-6.3	-2.3	-6.7	1.0	-0.5	-2.1	-6.2	-3.4	-7.0
Public sector (net)	3.4	3.9	6.5	7.7	5.9	3.9	-1.3	1.6	-2.9	5.2	2.6	1.9	-2.0	1.2	-2.1
Disbursements	4.1	4.4	8.2	11.6	9.5	7.4	5.3	4.6	4.5	8.9	5.8	5.0	3.5	3.5	3.4
Of which: budget support	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Amortization due	-0.7	-0.5	-1.7	-3.9	-3.6	-3.6	-6.6	-3.0	-7.5	-3.8	-3.3	-3.1	-5.5	-2.3	-5.5
Commercial banks (net)	-0.3	-0.6	-1.0	-1.2	0.0	0.0	0.0	0.0	0.0	-1.1	0.0	0.0	0.0	0.0	0.0
Other sectors	-7.2	-8.5	-5.7	-6.2	-6.7	-6.1	-4.9	-3.9	-3.8	-3.0	-3.1	-4.1	-4.3	-4.6	-4.9
Errors and omissions	0.1	0.1	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-2.6	-0.8	-1.7	-1.0	-1.1	-1.1	-1.1	-0.1	-0.1	0.3	0.7	1.0	0.3	0.7	0.5
Financing															
Central bank net reserves (- increase)	2.6	0.8	1.7	1.0	1.1	1.1	1.1	0.1	0.1	-0.3	-0.7	-1.0	-0.3	-0.7	-0.5
Of which: Gross reserve change	2.9	1.1	1.9	1.2	1.1	1.1	1.1	0.1	0.1	-0.1	-0.6	-1.0	-0.3	-0.7	-0.5
Of which: Use of Fund resources	-0.3	-0.3	-0.2	-0.2	-0.1	0.0	0.0	0.0	0.0	-0.2	-0.1	0.0	0.0	0.0	0.0
Exceptional financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:															
Current account (percent of GDP)	-3.3	-1.7	-2.6	-3.6	-3.4	-2.9	-2.6	-2.3	-2.0	-3.7	-3.2	-2.4	-2.0	-1.8	-1.5
Total official grants (percent of GDP)	0.3	0.4	0.2	0.3	0.3	0.2	0.2	0.2	0.2	0.3	0.3	0.2	0.2	0.2	0.2
Change in copper export volume (percent)	-4.8	9.7	2.8	-2.0	2.0	2.0	6.7	6.6	6.5	-2.0	2.0	3.0	6.7	6.6	6.5
Copper export price (U.S. dollars per tonne)	4,868	6,170	6,530	6,058	5,991	6,045	6,090	6,123	6,123	6,058	5,991	6,045	6,090	6,123	6,123
Crude oil price	43	53	68	66	64	61	59	58	59	66	64	61	59	58	59
Gross international reserves (millions of U.S. dollars)	2,366	2,081	1,569	1,285	1,022	766	508	490	473	1,587	1,751	2,020	2,117	2,328	2,475
In months of prospective imports	3.3	2.4	1.9	1.6	1.3	0.9	0.6	0.6	0.5	2.0	2.1	2.4	2.4	2.5	2.5
GDP (millions of U.S. dollars)	20,941	25,868	26,720	23,946	23,342	23,415	23,636	23,951	24,401	24,914	25,874	27,137	28,587	30,251	32,119

Sources: Zambian authorities; and IMF staff estimates and projections.

Table 5. Zambia: Financial Soundness Indicators, 2008–18

(Percent, unless otherwise indicated)

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018 Dec
Capital adequacy											
Regulatory capital to risk-weighted assets	18.6	22.3	22.1	19.2	21.3	26.8	27.0	21.2	26.2	26.5	22.1
Tier 1 regulatory capital to risk-weighted assets	15.7	18.9	19.1	16.8	19.4	24.5	24.6	19.2	23.4	24.5	20.1
Capital to total assets	9.9	11.2	10.4	10.2	12.0	14.1	15.1	12.2	13.5	12.6	12.3
Asset quality											
Past due advances (NPL) to total advances	7.2	12.6	14.8	10.4	8.1	7.0	6.1	7.3	9.7	11.5	11.0
Loan loss provisions to nonperforming loans	104.6	86.6	80.3	76.7	73.5	83.2	76.5	70.5	71.5	69.2	86.4
Bad debt provisions to advances	6.1	10.9	11.9	8.0	6.0	5.8	3.9	4.6	5.6	8.0	9.5
Loan concentration											
Of Which											
Households	30.1	30.9	32.2	30.8	34.3	34.5	36.0	30.2	28.7	28.8	29.0
Government and parastatals	1.9	3.1	4.6	4.7	3.9	2.1	4.3	3.0	4.8	5.4	7.5
Sectoral Breakdown											
Agriculture	16.0	19.0	17.6	17.7	22.6	20.2	16.6	17.3	17.0	20.3	16.8
Mining	5.0	4.0	3.2	4.2	5.7	6.6	5.0	6.4	6.3	7.5	7.1
Manufacturing	11.0	12.0	12.7	12.2	11.3	9.5	11.5	13.5	12.8	8.2	9.2
Construction	4.0	3.0	5.8	4.2	3.7	3.5	3.4	3.4	3.9	3.7	3.0
Services	9.0	8.0	7.0	7.1	3.9	4.1	2.5	2.7	1.8	2.4	4.2
Others	55.0	54.0	53.7	54.6	52.8	56.1	61.0	56.7	58.2	58.1	59.8
Earnings and profitability											
Return on average assets	3.6	2.1	2.9	3.7	3.9	3.4	3.7	2.8	2.5	3.1	3.0
Return on equity	20.8	9.4	12.1	25.5	20.8	18.2	17.3	13.1	12.3	15.4	14.7
Gross interest income to total gross income	66.6	65.1	58.6	59.3	61.3	64.5	66.4	67.1	68.6	69.0	67.9
Gross noninterest income to total gross income	33.4	34.9	41.4	40.7	38.7	35.5	33.7	32.9	31.4	31.0	32.1
Net interest margin	10.4	10.7	9.0	8.1	8.4	8.3	8.5	8.2	8.7	9.1	9.1
Liquidity											
Liquid assets to total assets	35.5	38.0	43.8	40.3	36.0	38.9	35.8	34.8	39.1	45.5	47.0
Liquid assets to total deposits	49.9	52.6	58.5	53.3	49.0	52.6	49.8	47.9	54.2	56.5	57.0
Advances to deposits ratio	66.3	60.1	53.1	57.1	66.0	61.4	62.0	56.4	50.0	45.2	47.3
Exposure to foreign currency											
Foreign currency loans to total gross loans	42.1	36.4	32.8	39.1	28.7	25.6	29.0	36.9	35.7	41.6	44.5
Foreign currency liabilities to total liabilities	35.8	38.0	39.6	39.0	22.9	30.4	32.1	48.9	45.0	44.0	46.6
Net open position in foreign exchange to capital	6.9	2.5	4.1	5.5	2.8	3.6	1.6	4.7	0.8	1.4	1.7

Source: Bank of Zambia.

Annex I. Main Recommendations of the 2017 Article IV Consultation and FSAP

Main Recommendations of the 2017 Article IV Consultation	
Fiscal Policy	
Recommendations	**Status**
Debt sustainability. Lower the debt level, including by restraining external non-concessional borrowing, in order to move from high to moderate risk of debt distress rating.	Not implemented. The debt stock increased by about 10 percent of GDP in 2018 and DSA continues to show a high risk of debt distress.
Fiscal consolidation. Reduce the overall fiscal deficit.	Not implemented. The fiscal deficit widened significantly as there were large spending overruns on capital outlays, compounded by continued arrears on VAT refunds and suppliers' credits.
Revenue mobilization. Increase domestic revenues by broadening VAT and CIT tax base, introduce land titling, reducing widespread exemptions/incentives.	Not implemented.
Fuel prices. Recover importation and procurement costs in the supply value chain and reflect changes in international prices and the exchange rate.	Implemented. The Energy Regulatory Board has been reviewing fuel prices every sixty days and has changed the fuel prices when needed to recover procurement costs.
Public investment management. Prioritize infrastructure projects in line with absorptive capacity by setting up an institutional framework for approval of public investment projects, including for large projects.	Not implemented. The government has continued to approve public investment projects without implementing a proper framework for coordinating and managing the identification, preparation, appraisal and implementation of public investment projects to ensure efficiency and value for money.
Public Financial Management. Roll out IFMIS, enhance commitment controls, and implement the Treasury Single Account (TSA) to strengthen transparency and accountability and reduce the risk of accumulating arrears.	Partially implemented. IFMIS was rolled out. However, purchase orders on goods and services are issued outside IFMIS, and expenditure overshooting and arrears accumulation point to weak expenditure controls. There remain a large number of accounts and significant balances outside the TSA (1-2 percent of GDP) held at commercial banks by government entities.

Main Recommendations of the 2017 Article IV Consultation (Concluded)	
Public Financial Management legislation. Improve transparency and credibility of fiscal policy.	Ongoing. The approval in April 2018 of the new Public Finance Management Act needs to be complemented by approving other critical legislation such as the Planning and Budgeting Bill, the revisions to Loan and Guarantees Act, and the Public Procurement Act.
Monetary and Financial Sector Policies	
Recommendations	**Status**
Monetary policy stance. Maintain a relatively tight monetary policy stance and rebuild reserves buffers.	Partially implemented. BoZ kept its tight monetary stance in 2017, but started unwinding its stance in 2018, in line with reduced inflationary pressures. Reserves have continued to decline, largely reflecting higher external debt payments and a widening current account balance. In May 2019, the BoZ increased its policy rate to 10.25 percent.
Monetary Policy Framework. Grant BoZ formal operational independence to pursue price stability as its primary mandate by amending the BoZ Act.	Ongoing. The amended draft BoZ Act addresses issues related to operational independence of the BoZ and is currently with the Ministry of Finance.
Bank supervision. Strengthen banking supervision capacity and enhance its crisis preparedness.	(See discussion of FSAP.)
Energy Sector	
Recommendation	**Status**
Finalize the energy sector Cost of Service Study.	Not implemented. Having enacted an interim electric tariff increase of 75 percent for 2017, the Government initiated a Cost of Service Study (COSS) in May 2017, to inform the next adjustment to attain full cost recovery in electricity pricing and pave the way for a reform of the power sector. The COSS has not been yet completed. A ZESCO-proposed a tariff increase was declined in May.

Main Recommendations of the 2017 FSAP	
Recommendations	**Implementation Status**
Upgrade the BoZ and Banking (BFSA) Acts to grant BoZ operational independence, provide for Basel II–III standards, sole BoZ licensing powers, setting down broad supervisory principles and leaving the details for regulations.	In progress. The new BFSA and the amended draft BoZ Act addresses issues related to operational independence, Basel II/III standards, and licensing. The BFSA has been streamlined and the BoZ is currently working on a number of regulations to operationalize the Act.
Complete onsite inspections of all banks and nonbanks and conduct an asset quality review that focuses on the loan classification process.	Largely completed. All banks except three (accounting for 4.7 percent of total banking sector assets) and 60 percent of NBFIs have been examined and asset quality review completed.
Introduce a regular cycle of onsite inspections on a risk basis, informed by offsite analysis.	In Progress.
Implement a centralized, structured, relational database for banking supervision and stress testing.	Completed. The Bank supervision system is currently in use as a centralized data base system for the Banking and Supervision Department.
Urgently increase staff resources, in number and expertise, in an orderly and manageable fashion.	Largely completed. Several new staff have already been added and recruitment is underway for a few vacant positions. Priority is being given to capacity building.
Introduce a consolidated supervision regime and BoZ implement the new risk-based approach to onsite supervision.	In Progress.
Introduce proactive information sharing by BoZ with home supervisors of Zambian banks and ensure that BoZ is involved in resolution plans of parents of Zambian banks.	In Progress. The BoZ has started to engage the home regulators on resolution plans for parent banks by ensuring that it is part of the agenda items for Supervisory Colleges.
Issue risk management directives incorporating concentration and cross-border exposure limits.	In progress. Draft to be issued soon.
Strengthen the Anti-Money Laundering/Combatting the Financing of Terrorism (AML/CFT) legal framework and terrorist financing offense, in line with the Financial Action Task Force (FATF) standards.	In 2017, the BoZ revised and strengthened the AML/CFT legal framework and subsequently issued directives which apply to all reporting entities licensed or designated by the BoZ.
Stipulate exceptional nature of ELA in regulatory texts and establish adequate statutory safeguards to prevent the BoZ from providing solvency support.	In progress. The BoZ Act is undergoing review.
Include purchase and assumption, bridge bank, and bail-in resolution provisions in new BFSA.	Largely implemented. Other than bail-in, the proposed resolution recommendations have been addressed in the 2017 BFSA. However, a request has been made to amend the 2017 BFSA to enable the above measures to be affected without BoZ taking possession of the bank.

Main Recommendations of the 2017 FSAP (Concluded)	
Refine Draft Deposit Protection Scheme (DIS) Bill in line with IADI norms.	In progress.
Introduce DIS law only once the preconditions for deposit protection are fully in place, as per IADI norms.	In progress. The BoZ is working on a problem bank resolution regime to deal with banks with supervisory weaknesses and strengthen their performance, as precondition for deposit protection. A Draft problem bank management and resolution framework has been developed and is expected to be finalized before end-2019.

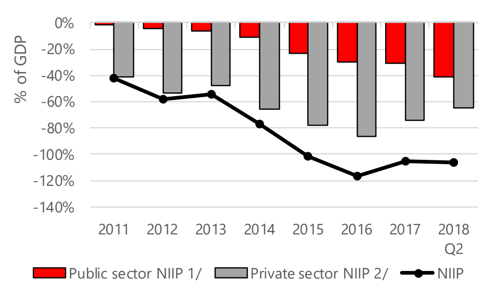
Annex II. External Sector Assessment

Zambia's external position weakened in 2018 along with deteriorating fundamentals as the current account deficit widened and the foreign exchange (FX) reserves declined to less than two months of import cover. A large exchange rate depreciation in September reflected both weaker fundamentals (wider fiscal imbalances and deteriorated terms of trade) and negative market sentiment following Zambia's sovereign rating downgrades amid the broader pressures on emerging markets in late 2018. The currency stabilized toward the end of the year but weakened further this spring. The rapidly increasing public sector external indebtedness and declining FX reserves suggest that pressures on the real exchange rate may persist from a balance sheet perspective. However, the real exchange rate based on the REER model is estimated to be broadly in line with its norm at end-2018,[1] and the regression-based EBA-lite current account model finds no evidence of a clear external sector misalignment. With conflicting signals between different approaches, the external position is assessed by staff to be moderately weaker than fundamentals and desirable policies on the basis of the deteriorated external balance sheet driven by the buildup of public debt. A steadfast fiscal adjustment, accompanied by ongoing reforms to improve structural competitiveness, is needed to strengthen external positions going forward and address the underlying causes of the external imbalances.

External Balance Sheet

1. **Zambia's net international investment position (NIIP) has started to stabilize after having deteriorated rapidly since the early 2010s**. Zambia has been a net debtor since 2011 and its NIIP registered –106 percent of GDP at end-June 2018 (latest available official statistics).[2] It consisted of 27 percent of GDP in foreign assets (largely reserve assets and currency and deposits held overseas by resident mining companies) and 134 percent of GDP in foreign liabilities – largely FDI liabilities (76 percent of GDP) and foreign borrowing of the public sector. However, the sectoral composition has shifted with rapidly increasing public sector external indebtedness replacing private sector foreign liabilities.

Zambia: External Balance Sheet



Sources: IMF staff estimates and Bank of Zambia.
1/ Approximated by reserves minus external PPG debt.
2/ Difference between total NIIP and estimated public sector NIIP.

2. **Zambia's large negative NIIP poses a significant risk to external sustainability and points to a need for current account adjustment**. The deterministic balance-sheet approach of the EBA-lite methodology indicates that a real effective exchange rate adjustment over the medium-term is needed to improve the trade balance to stabilize the NIIP at its end-June 2018 level (–106 percent of GDP) assuming no policy adjustment. Stabilizing the NIIP at a lower and more sustainable level (e.g. at its 2011-14 average level of –58 percent of GDP) would, ceteris paribus, imply a larger real exchange rate adjustment. This assessment is, however, very sensitive to the assumptions on the

[1] There is also no evidence of a parallel exchange rate market in Zambia

[2] Comparable IIP statistics are not available for the pre-2011 period.

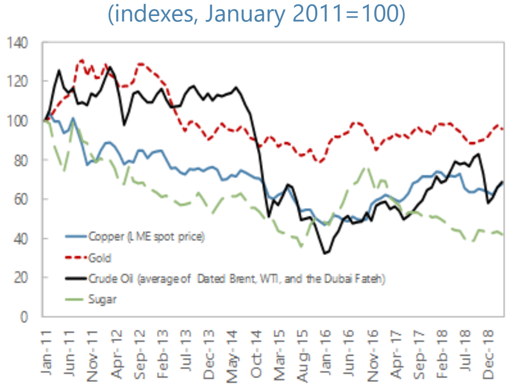
rates of return on foreign assets and liabilities (for which supporting data are scarce and of poor quality) especially when the gross assets/liabilities positions are large.[3] Nevertheless, with large fiscal imbalances expected to continue pressing down the NIIP going forward, a decisive adjustment to reduce the public sector's external indebtedness is needed to directly tackle the balance sheet mismatch which cannot be easily resolved by an exchange rate adjustment.

Current Account

3. **Zambia's external current account deficit widened modestly in 2018 as foreign-financed public investment project-related imports and interest payments increased**. The current account has moved into deficit since 2015 and registered a 2.6 percent of GDP deficit in 2018. Copper prices declined in the course of 2018 while oil prices were broadly unchanged on average, leading to deteriorated terms of trade. Rising interest payments on public debt as well as elevated non-oil imports (including those related to large foreign-financed public investment projects) have exerted pressure on the non-copper current account. The current account deficit is expected to widen again in 2019 absent policy change before gradually declining as large project-related imports unwind and the negative repercussions of government arrears accumulation contribute to import compression.

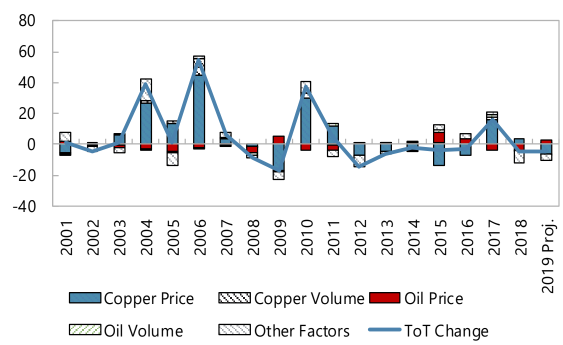
Commodity Prices

(indexes, January 2011=100)



Source: WEO

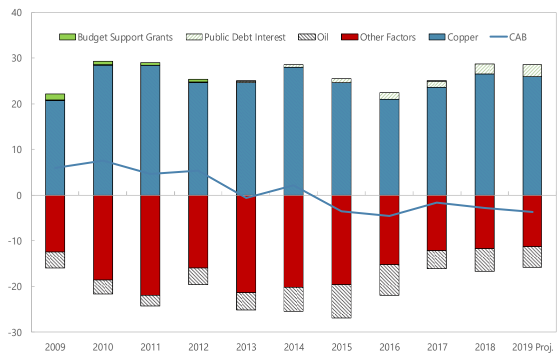
Decomposition of Changes in Terms of Trade



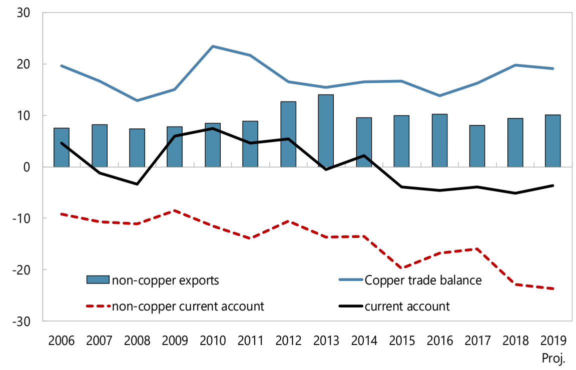
Source: IMF staff calculations

[3] Given the large exchange rate adjustment need implied by the deterministic approach, a complementary probabilistic assessment to construct the distribution of needed REER adjustments to deliver external sustainability seems warranted but is practically difficult to implement given the data limitations.

Current Account and Its Components
(In percent of GDP)



Zambia: Current Account Balance and its Components (Percent of GDP)



Sources: Bank of Zambia and IMF staff estimates.

4. **The current account deficit at end-2018 was broadly in line with its EBA-lite norm**. The current account approach of the EBA-lite methodology considers external balance determinants including (i) policy variables; (ii) non-policy fundamentals; and (iii) cyclical factors. The desirable fiscal policy stance is assumed to be -2.2 percent of GDP over the medium-term. On this basis, the CA approach estimates a multilaterally consistent cyclically adjusted CA norm of -2.9 percent of GDP and an insignificant CA gap of -0.2 percent of GDP in 2018. While large fiscal imbalances (evidenced by a negative fiscal policy gap) contributed to external imbalances, there are positive but undesirable policy gaps in other areas including subdued private credit growth and impaired social safety net (proxied by public health expenditure). These offsetting factors (between the public sector and private sector's savings and investment balances) explain the current account's broad alignment with fundamentals and desirable policies. However, to gradually rebuild FX reserves (currently well below adequate) against subdued capital inflows absent major change in sentiment, the external position needs to be strengthened going forward. Under current policies, the external imbalances are projected to further widen in the near-term, putting pressure on the real effective exchange rate.

Zambia: Real Effective Exchange Rate (REER) Gap

	(percent of GDP)				
	Norm	Actual/Proj.	Gap	Elasticity	REER gap[1]
1. Current account model (cyclically-adjusted)	-2.9	-3.0	-0.2	-0.28	0.6%
2. Real effective exchange rate model (index)	93.6	89.1	n.a.	n.a.	-4.9%
3. External sustainability approach					
Stabilizing IIP at current level (2018Q2, -106% of GDP)	7.0	-2.4	-9.4	-0.28	34.0%

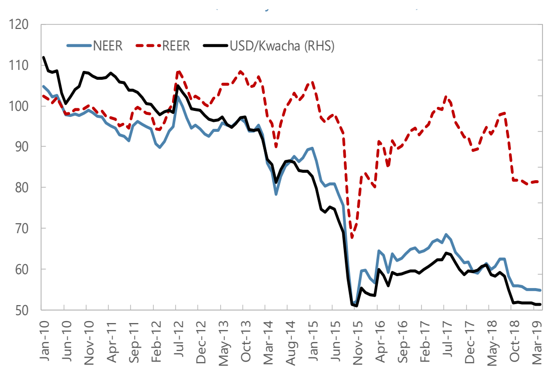
[1] A positive number indicates overvaluation.

Real Exchange Rate

5. **After a relatively calm era following the sharp depreciation in 2014/15, the currency came under renewed pressure in late 2018**. The exchange rate depreciated by 20 percent against the U.S. dollar in September 2018, reflecting both weakened fundamentals (widened fiscal imbalances and deteriorated terms of trade) and weakened confidence following the sovereign

rating downgrades by all the three major rating agencies. Unlike during the 2014/15 episode, the Bank of Zambia did not intervene in the market or respond to the sharp depreciation by tightening the monetary stance. The REER recent depreciation is expected to contribute only gradually and marginally to improving the current account (with a limited impact on mostly dollar-denominated exports and larger impact on imports through both price and income channels), assuming a large but not full pass-through of depreciation to inflation with a lag.

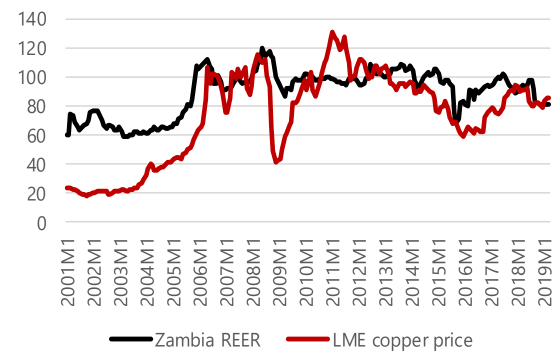
Zambia: NEER, REER, and Exchange Rate
(January 2010-March 2019)



Source: Bank of Zambia and IMF staff estimates.

Note: A decline represents depreciation.

Zambia: REER and Copper
(indices, 2010=100)



Source: Bank of Zambia and Haver Analytics.

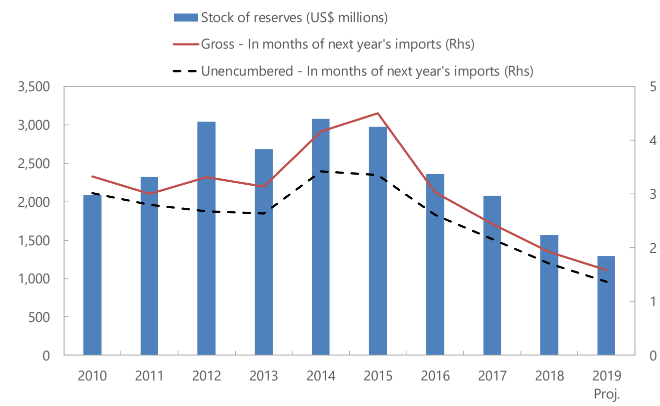
6. **The EBA-lite REER approach suggests that the real effective exchange rate was broadly in line with its equilibrium level at end-2018**. The REER model assumes that actual real interest rate will converge to a value that is consistent with inflation and output stabilization needs in the near-term. Staff estimates this to be 3½ percent for Zambia (the current difference between the policy rate and the inflation rate is about 2¾ percent). Under these assumptions, the REER is estimated to be roughly 5 percent lower than its equilibrium value (within the 95 percent confidence interval). The REER is also found to be broadly in line with the price developments of copper, Zambia's major exporting commodity.

Reserves

7. **Zambia's reserves buffer has further deteriorated as external imbalances widened**. Export earnings recovered somewhat compared to 2017 benefiting from higher average copper prices while FDI declined due to uncertainties around the macro outlook. Foreign exchange outflows were largely driven by external debt payments which have increased significantly. The Bank of Zambia has continued opportunistic purchases of foreign exchange in the FX market to support reserves and instructed mines to pay mineral royalty directly to the central bank in foreign currency. However, the opportunistic FX purchases were deterred by pressures on the kwacha during the episodes of large depreciation in September 2018 and May 2019, and international reserves declined by more than $500 million in 2018 and a further $200 million between January and May 2019.

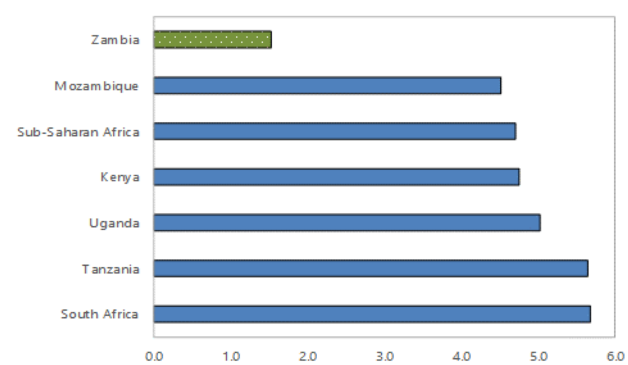
8. **The current reserves level is below what can be considered adequate**. At US$1.4 billion it provides 1¾ month import cover, significantly lower than in several of its peers, including those with relatively more diversified exports products and markets. Zambia's reserves holdings are mainly for precautionary purpose (consumption smoothing in the event of shocks), preventing disorderly market reactions, and cover against capital flight. Zambia's heavy reliance on copper exports and the need to protect against current account shocks driven by volatility in copper prices suggest a higher reserves buffer than the three-month rule may be needed. Indeed, a cost-benefit analysis developed by Fund staff for low-income countries suggests an optimal level range of 3½-4 months of current year's imports.[4] On a different metric, the current reserves level provides just about a full year coverage of external debt payments (which have been rapidly rising; discussed in detail in the DSA). In relation to broad money, another common measure for reserve adequacy against capital flight (of residents), the current reserves level provides an 80 percent coverage. Non-resident holdings of domestic currency debt had increased rapidly during 2016-17 (currently at about $670 million) in response to attractive yields and relative stability in exchange rate but now could be susceptible to reversal, posing a risk to the balance of payments given the relatively low level of reserves.

Zambia: Gross Reserves



Source: Bank of Zambia.

Zambia: Gross Reserves in Months of Imports
Relative to Peers: 2018

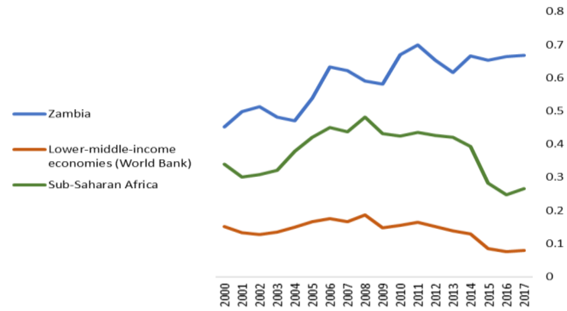


Source: IMF World Economic Outlook.

[4] The assessment attempts to balance the absorption smoothing benefits of reserves in the event of adverse shocks against the opportunity cost of holding reserves, taking into account country specificities including the exchange rate regime, fiscal balance, institutional quality, the nature of external drains and degree of access to international capital markets. For details, refer to IMF Working Paper 11/249 "Optimal Precautionary Reserves for Low-Income Countries: A Cost-Benefit Analysis".

Assessment of Structural Competitiveness

Concentration Index, Exports
(Closer to 1 when exports are highly concentrated on a few products)



Source: United Nations Conference on Trade and Development.

9. **Zambia's exports are heavily concentrated in a few products**. The exports concentration index, prepared by the United Nations Conference on Trade and Development,[5] indicates that Zambia's exports are much less diversified than the average Sub-Saharan Africa level. Copper exports represent around 70 percent of the total exports, which makes exports highly vulnerable to fluctuations in copper price. Exports of agricultural products account for most of the remainder (over 20 percent of all exports).

10. **Reforms already undertaken have improved the underlying framework for business in several areas and set a sound basis for improving structural competitiveness with resolution of current pressures**. Notable improvements were registered in Zambia's Doing Business Indicators in recent years. For 2019, Zambia ranks higher on Overall Ease of Doing Buisiness than the Sub-Saharan Africa (SSA) average and the SSA Low-Income Developing Countries Frontier Markets[6] (SSA-LIDC FM) average. Earlier reforms have helped improve frameworks for credit access and tax payment. Weaker areas on business environment include trading across borders, registering property, and enforcing contracts.[7] According to the World Economic Forum Global Competitiveness, for 2017–2018, the main constraints to doing business as perceived by investors were access to financing, corruption and tax rates.[8]

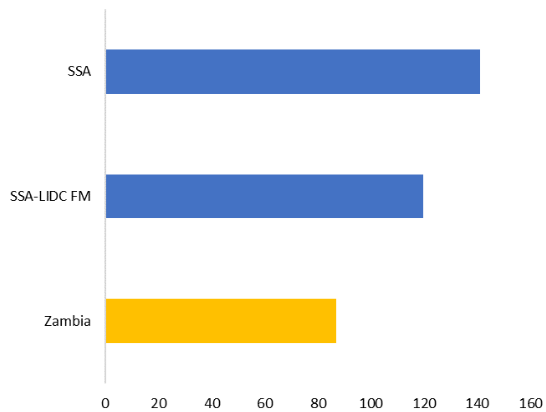
[5] The UNCTAD export concentration index is a normalized Herfindahl-Hirschmann index which takes values between 0 and 1. The Herfindahl-Hirschmann index is estimated as the sum of the squares of the export shares of the products. 1 corresponds to a high concentration of exports on a few products, and 0 corresponds to a perfect diversification among a series of products.

[6] The Doing Business Indicators for a calendar year are published the year before. These indicators should be interpreted with caution due to a limited number of respondents, a limited geographical coverage and some standardized assumptions on business constraints and information availability. SSA Low-Income Developing Countries Frontier Markets include Cote d'Ivoire, Ghana, Kenya, Mozambique, Nigeria, Senegal, Tanzania, Uganda, and Zambia.

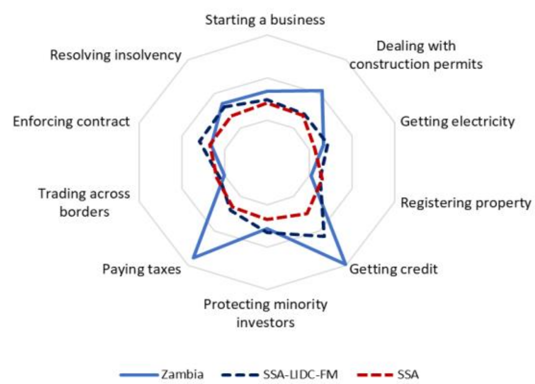
[7] For more details, see the 2019 Doing Business Report.

[8] Results from the World Economic Forum's Executive Opinion Survey. Caution is required when interpreting these results, as they may be affected by recording errors, information availability, and sample size.

Zambia: Overall Ease of Doing Business, 2019
(Rank, lower is better)



Zambia: Components of the Ease of Doing Business
(Distance to the Frontier: 0-100; 100 is best)



Source: Doing Business 2019

11. **With a resolution of current uncertainties, improvement in the business climate will boost competitiveness and attract investment.** The reforms initiated by the Zambian government to adress weaknesses in competitiveness and improve governance include reforms on: access to credit (use of moveable collateral to access finance); tax payments (introduction of an online platform for filling and paying taxes); trading (implementation of a web-based data management system); and contract enforcement (online availability of commercial matters judgements at the appellate and supreme court levels). Improving efficiency in the petroleum product procurement system would cut fuel cost and enhance competitiveness. In the mining sector, establishing a mining tax regime in line with international best practices would provide a better business environment for mining investors.

12. **Structural reforms to enhance the diversification of export products would improve resilience to external shocks.** With a potential market from surrounding countries facing maize deficits, developing and modernizing agriculture in Zambia would enhance exports and benefit to the maize sector. Establishing a more stable and predictible regulation on maize exports by improving the regulation of maize exports and limiting the role of the Food Reserve Agency in the marketing of maize could attract more private investors. The savings from better management of farm subsidy programs could be used to invest in measures to enhance crop yields and long-term competitiveness.

Annex III. Risk Assessment Matrix

Source of Risk	Relative Likelihood	Impact if realized	Policy Response
Domestic Risks			
Delayed/insufficient fiscal adjustment particularly ahead of elections.	**H**	H. Continued accumulation of domestic arrears would increase stress on the financial sector through higher NPLs and hamper private sector activity. Domestic refinancing risks for government securities would increase. Uncertainty over VAT status as well as refunds could hurt revenue collection and exacerbate the fiscal deficit, while weakening incentives for new investment slowing down FDI inflows. Non-resident exit from government domestic securities market would adversely impact reserves and further pressure the exchange rate. Debt sustainability would be placed in even greater jeopardy. Significant downward pressures on growth.	Implement credible fiscal adjustment measures, remove unnecessary exemptions to widen the tax base and increase domestic revenue; consolidate capital expenditures by prioritizing infrastructure projects and postponing those with less growth impact and those not aligned with development priorities; reduce public sector wage bill by restricting new hires to priority sectors.
Continued drought.	**M**	H. Adverse impact on agriculture sector and on the poor; higher food price inflation; reduced agricultural exports (maize); higher spending on social safety nets and on subsidies (Farmer Input Support Program); negative impact on hydropower generation; and downward pressures on growth.	Provide effective support to vulnerable impacted populations; diversify food crops away from maize to crop varieties that better aligned to the shortened rainy seasons; consider medium-term strategies such as reservoir dam to help regulate water flow to main dams during high or low rain periods. Tighten monetary policy if second-round inflationary effects are significant.

Rising social tensions.	**M**	M. Public sector salary arrears to employees result in strikes; Negative impact on investor confidence.	Implement orderly fiscal adjustment notably by increasing domestic revenue, reducing capital expenditures and containing the wage bill to avoid arrears; set up arrears clearance plan.

External Risks[1]			
Sharp tightening of global financial conditions.	**H**	H. Higher debt service on external debt and higher refinancing costs and risks. Loss of reserves, pressure on the kwacha. Worsening debt position.	Implement fiscal consolidation measures notably increasing domestic revenue, cutting unproductive spending and prioritizing capital spending. Rebuild fiscal and external buffers.
Weaker-than-expected global growth: **China**: Intensification of trade tensions and/or housing market downturn leading to slowdown not fully offset by policy easing; Delayed deleveraging in the near term causing capital outflows and exchange rate pressures; insufficient progress in rebalancing growth and in deleveraging in the medium term. **EU**: Disorderly Brexit causing market disruption and negative spillovers; Weak foreign demand causing delayed investment coupled with low confidence and	**M/H** **M** **H**	H. Reduced demand for Zambia's exports notably copper leading to widening trade deficit, loss of foreign reserves and increased pressure on the kwacha; Negative impact on debt sustainability.	Accelerate reforms enhancing export competitiveness and diversify the economy to build resilience against external shocks; enhance regional integration including through existing SADC and future AfCFTA protocols; Maintain exchange rate flexibility. Implement fiscal adjustment to rebuild fiscal and external buffers.

[1] Based on the February 2019 update of the Global Risk Assessment Matrix.

consumption; Lack of discipline regarding common fiscal rules and high sovereign yields for high debt countries leading to bleaker medium-term prospects.			
Rising protectionism and retreat from multilateralism; escalating trade tensions.	**H**	H. Reduced demand for Zambia's exports notably copper leading to widening trade deficit, loss of foreign reserves and increased pressure on the kwacha; negative impact on debt sustainability.	Accelerate reforms enhancing export competitiveness and diversify the economy to build resilience against external shocks; maintain exchange rate flexibility. Implement fiscal consolidation to rebuild buffers.
Volatility in global copper prices.	**M**	H. Lower export earnings and increased pressure on the exchange rate.	Accelerate reforms to diversify the economy to build resilience against external shocks; maintain exchange rate flexibility.
Spillovers of the regional security situation.	**H**	H. A deterioration of the security situation in neighboring countries would result in inflow of displaced population/refugees and higher security and humanitarian costs.	Prepare contingency plans for refugee influx in coordination with UNHCR and other humanitarian agencies.

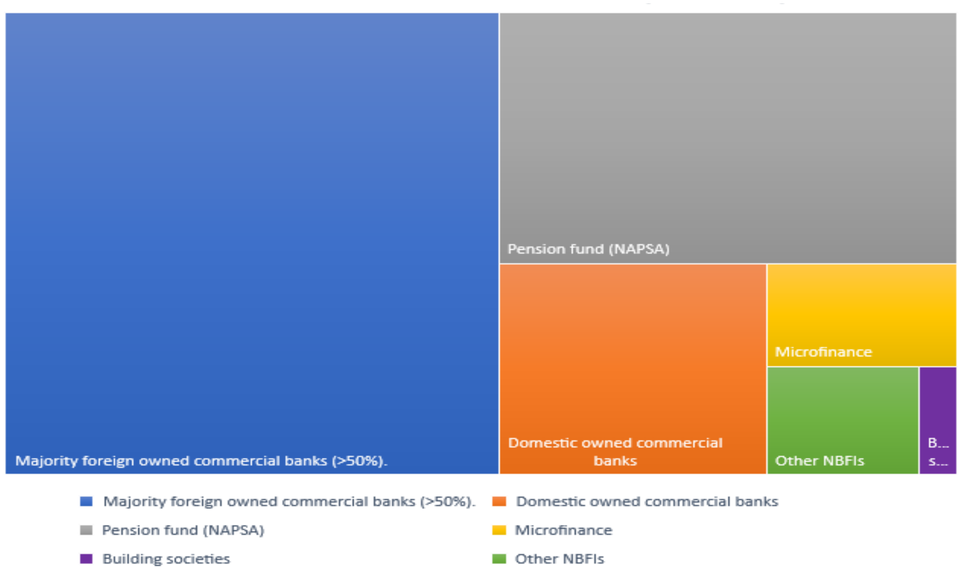
Annex IV. Macro-Financial Linkages

High levels of domestic arrears and government financing needs are crowding out credit to the private sector and contributing to an elevated level of NPLs. Direct and indirect exposure from the sovereign to the financial sector is high. While the financial sector so far remains resilient, a significant deterioration in macroeconomic outlook or continuous increase in sovereign stress could negatively impact financial stability and trigger a shock to the economy.

Financial Sector Overview

1. **Zambia's financial sector is relatively underdeveloped and mainly dominated by commercial banks and the state-run pension fund (NAPSA)**. The 18 registered commercial banks account for about 70 percent of total financial sector assets; the majority are foreign-owned. The non-bank financial institutions (NBFIs) sector is dominated by government-run National Pension Scheme Authority (NAPSA) which accounts for around 75 percent of NBFI assets. NAPSA was established in 2000 and has a growing pool of assets (around 30 billion Kwacha at end-2018), playing an important role in the domestic government securities market and investment activities. Other NBFIs are the 35 MFIs, 80 bureaux de change and some building societies, leasing companies and development finance institutions.

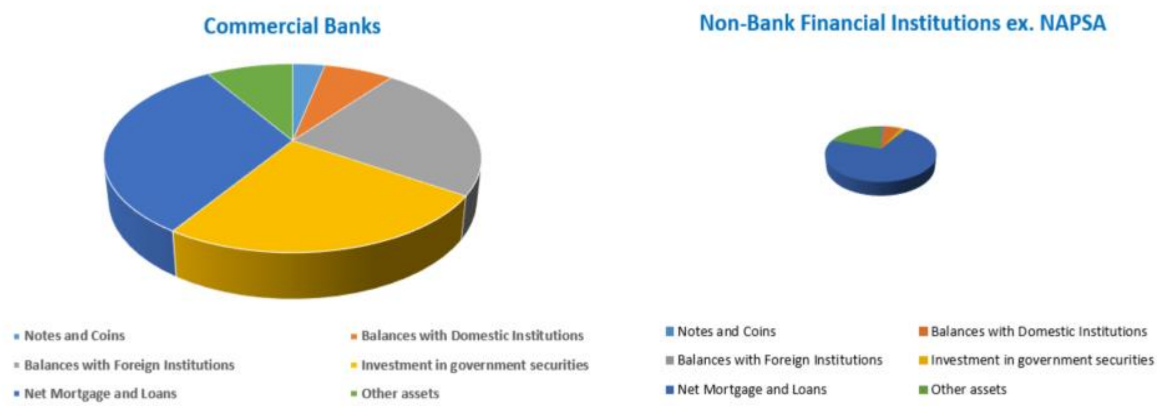
Zambia: Financial Sector Structure (end-2018)



Source: Bank of Zambia and IMF staff estimations.

2. **MFIs play a vital role in financial inclusion**. In contrast to commercial banks, which invest in government securities or foreign assets, MFIs are mainly focused on domestic payroll-based lending activity. Although small by value, they provide a large number of credit arrangements.

Asset Decomposition of Commercial Banks and NBFIs



Source: Bank of Zambia and IMF staff estimates.

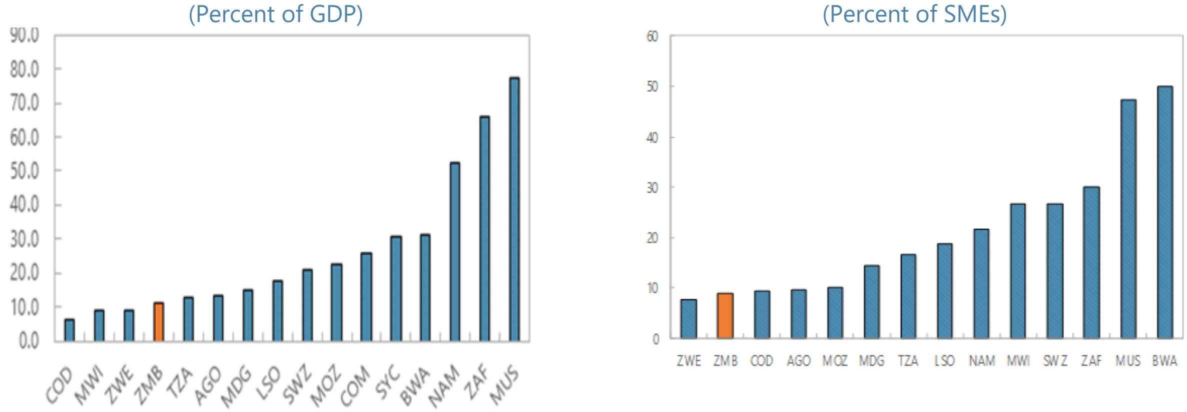
3. **Credit to the private sector remains low compared to the South African Development Community (SADC) countries and mainly concentrated in personal loans and the agricultural sector**. Zambia witnessed intensified pressures on private sector credit growth during the 2015–16 crisis owing to slower GDP growth, sharply lower copper prices, electricity shortages, tight monetary policy and mounting fiscal arrears. Private sector credit declined from 15¾ percent of GDP in 2015 to around 11½ percent in 2018 and remains considerably lower than the average of SADC countries. High and growing domestic arrears to suppliers, elevated levels of NPLs, and rising lending rates are contributing to subdued private sector lending activity.

4. **Although individual financial inclusion has expanded in recent years, access to finance for SMEs has worsened**. Zambia has made significant progress in improving both access and usage of formal and informal financial services since 2010, but still lags its peers: 59 percent of adults make use of financial services (formal or informal), while around 38 percent of adults have a formal transaction account[1]. There are significant disparities in financial inclusion between rural and urban areas, men and women, youth and adults, and between SMEs and large firms. Financing for SMEs remains extremely challenging: a high share of SMEs face loan rejections, and where credit is available, nominal lending rates are significantly higher than for the larger firms. Given these constrains, access to loans by firms in Zambia remains one of the lowest amongst SADC countries.

[1] Source: Zambia's National Financial Inclusion Strategy 2017-22. These levels are below peer SSA countries such as Botswana, Kenya, Namibia, South Africa, Tanzania, Uganda, Zimbabwe,

Access to Credit in Zambia versus SADC Countries

Credit to Private Sector, SADC (Percent of GDP) | **Access to Loans by Firms** (Percent of SMEs)



Source: IFS, World Bank Enterprise Survey and IMF staff calculation

Financial Sector Stability

5. **Financial conditions and performance of the banking sector remains broadly resilient, but stress is emerging**. Although capital adequacy ratios have decreased since last year, they remain well above the minimum prudential requirement of 5 percent and 10 percent for the primary and total regulatory capital respectively and remain adequate to absorb unexpected losses. Earning performance has been improving and level of non-performing loans (NPLs) has been gradually declining since early-2018, although NPLs remain sticky around the 10% prudential benchmark. Liquidity in the banking sector remains satisfactory, but the high share of placements abroad poses risks. On average, placements abroad constitute about half of the total liquid assets of commercial banks. The significant placements abroad are partly due to the substantial amount of foreign currency denominated deposit liabilities which are not entirely invested in foreign-currency loans in the Zambian economy due to limited capacity of the market. The 2017 FSAP report highlighted that, particularly in an event of a liquidity crisis, these balances may not be readily available. Excluding these assets from the calculation of liquid assets, liquidity ratios would be an adjusted 28.2 percent and an adjusted 23.2 percent for assets and deposits respectively, remaining close to the prudential benchmark of 25 percent.

6. **Commercial banks' exposure to foreign exchange risks arising from adverse foreign exchange movements remains moderate**. The share of foreign currency denominated loans in banks' total domestic loans stood at around 45 percent at end-2018. To reduce risks, most banks only extend FX loans to borrowers with FX cash flows, and a large share of these foreign currency denominated loans is to the agricultural and mining sectors. In case of a large exchange rate shock, defaults for these FX denominated loans could increase and capital ratios may decline.

7. **Non-bank financial institutions remain most vulnerable, with low asset quality**. Although regulatory capital and earning performance remains adequate and well above the minimum threshold, both ratios decreased in 2018. Notwithstanding the loss absorption buffer

provided by their capital, vulnerabilities remain high due to high level of NPLs (17 percent of total loans at end-Feb 2019). Furthermore, 14 institutions, accounting for about 25 percent of NBFIs assets (excluding NAPSA), have NPL ratio above 20 percent.

Zambia: Financial Soundness Indicators

(Percent, unless otherwise indicated)

	Banks		NBFIs (ex. NAPSA)	
	Jan-18	Mar-19	Jan-18	Feb-19
Capital adequacy				
Regulatory capital to risk-weighted assets	26.2	21.6	39.3	30.3
Tier 1 regulatory capital to risk-weighted assets	24.3	19.6	28.3	21.8
Capital to total assets	12.5	12.4	24.4	21.5
Asset quality				
Past due advances (NPL) to total advances	12.7	9.9	19.5	16.8
Loan loss provisions to nonperforming loans	76.1	83.8	78.0	80.9
Earnings and profitability				
Return on average assets	0.9	2.9	13.2	9.9
Return on equity	4.8	14.8	53.9	45.7
Liquidity[1]				
Liquid assets to total assets	45.0	42.4	14.4	13.7
Liquid assets to total deposits	61.1	52.6	24.5	23.1
Advances to deposits ratio	45.1	50.2		
Exposure to foreign currency				
Foreign currency loans to total gross loans	40.6	47.0		
Foreign currency liabilities to total liabilities	43.4	48.0		
Net open position in foreign exchange to capital	1.9	1.6		

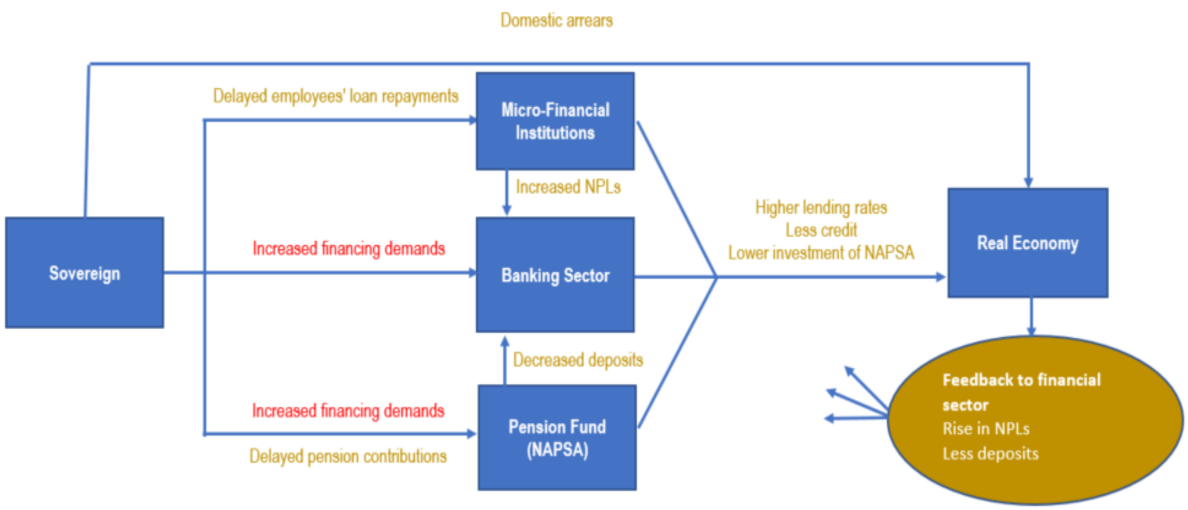
Source: Bank of Zambia.

[1] Part of the decline in liquidity ratio was due to Kwacha depreciation.

Macro-Financial Linkages and Sovereign-Financial Nexus

8. **The sovereign-financial nexus remains prominent and could be a source of fragility**. The figure presents key macro-financial linkages in Zambia. Direct exposure of commercial banks and NAPSA to the sovereign is mainly via their investment in government securities which helps to meet the government's domestic financing needs (colored in red below). Indirect exposures of the banks, MFIs and NAPSA are through their role as lenders to suppliers and households, as the pension fund manager, and through their relationships with one another. Civil servants' pension contributions and salary-backed loan repayments are deducted by the government from wages and remitted to the respective institutions.

Sovereign-Financial Nexus: Intensifying Links



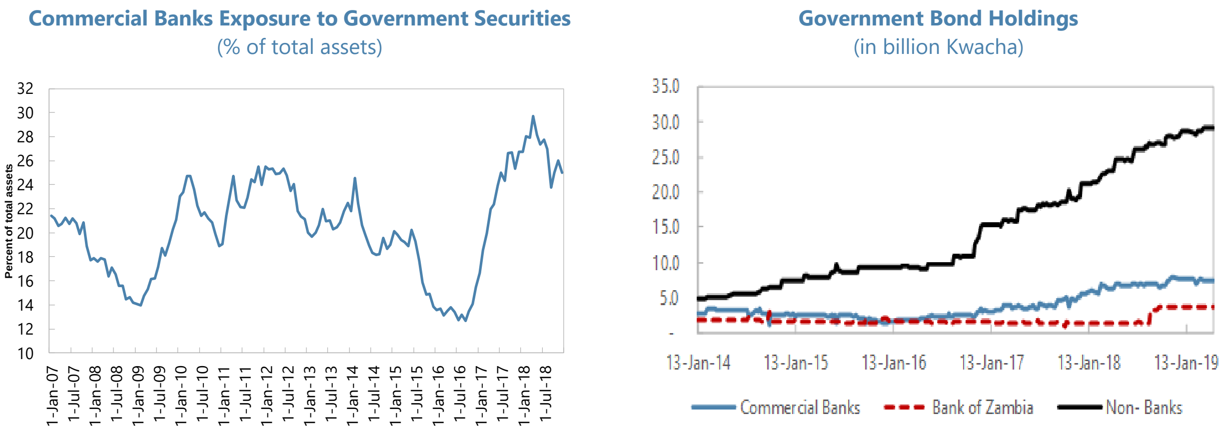
Source: IMF staff.
Note: Red indicates direct exposure and brown indicates indirect exposure.

9. **Direct sovereign exposures of the financial sector to the sovereign increased significantly in 2017–18**. With the easing of the monetary policy stance starting in late 2016, already-high NPLs, and lack of attractive risk opportunities, commercial banks invested heavily in high-yielding government securities. Commercial banks' total holdings of government securities increased to around 25 percent of assets in 2018 but have been declining more recently.[2] Most of these holdings by the commercial banks are of shorter maturity instruments (T-bill) yielding an annual real yield of around 10-15 percent and improving commercial banks' profitability. The NBFIs, particularly NAPSA, hold longer maturity government bonds (Figure 4b). While static

[2] There are not established guidelines on the level of sovereign exposure appropriate in low-income countries, which will be a function of investment opportunities and the balance of risk and reward. In emerging markets, the average range of direct exposure is around 15-21 percent. See Dell'Ariccia (2018), "Managing the Sovereign-Bank Nexus", IMF Departmental Paper No. 18/16

analysis indicates financial institutions have scope to further increase holdings of government debt, this would leave the financial sector vulnerable to episodes of sovereign stress.

Commercial Banks Exposure and Trend in Government Bond Holdings



Source: Bank of Zambia and IMF staff estimate

10. **Pressures from indirect exposure have increased significantly in recent months**. As domestic financing conditions have tightened, government domestic arrears to suppliers have risen, reaching around 6 percent of GDP at end-2018. This is contributing to keeping NPLs elevated. Recently the government was also delayed in remitting some civil servants' pension contributions and repayment of salary-backed loans to various financial institutions.[3] If payment of salary-backed loans is delayed significantly, they could be classified as non-performing loans, with a negative impact on micro-financial institutions, which are already under pressure. This might also negatively impact the borrowers' ability to secure future credit arrangements.

11. **Both direct and indirect sovereign-financial linkages are holding back real sector activity**. High government borrowing needs are driving higher yields on government securities, which are often used by commercial banks to benchmark their private sector lending rates. Private sector credit is also being held back by concerns about the outlook as banks prefer to maintain liquidity given macroeconomic vulnerabilities. NAPSA's investments and its deposits in the banking sector have also been impacted by the governments' financing needs and delays in remitting pension contributions. Finally, difficulties at several micro-financial institutions pose challenges to the authorities' objective of increasing financial inclusion.

12. **These exposures increase the potential of a spillover of sovereign stress to the financial sector**. Banks' core function of supporting credit to the private sector is being constrained. In a shallow financial market, deepening sovereign-financial linkages can also amplify risks when liquidity conditions tighten.

[3] Data on exact amount and nature of delays is under review by the MoF.

Addressing Vulnerabilities

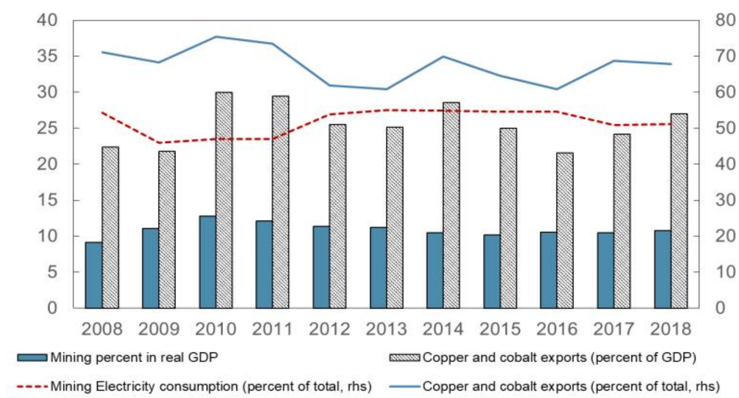
13. **The 2017 FSAP highlighted the need to update and strengthen the crisis management framework**. The BoZ has proposed the creation of the Interagency Financial Stability Committee (IAFSC), which would be a platform for coordination between the BoZ, MoF, PIA, and SEC on crisis preparedness and management. The IAFSC would address both macroprudential policy and crisis management.

14. **Fiscal and external imbalances constrain the capacity to manage a systemic crisis**. This puts a premium on crisis prevention, and readiness, to ensure any emerging problems are tackled early and minimize the impact on financial stability. In this regard, fragilities related to the deepening sovereign-financial nexus bear close monitoring.

Annex V. Mining Sector

1. **Mining is a key sector of the economy**. It is the most important source of foreign exchange, generating almost 70 percent of total export receipts; it contributes an average of 11 percent of GDP—making it the third largest sector after wholesale and retail trade and public services; and (considering direct and indirect effects) it accounts for almost 10 percent of total formal employment and about 25 percent of total private sector employment.

Mining: Share in GDP and Electricity Consumption



Sources: Energy Regulation Board, Zambian authorities, and IMF staff estimates.

2. **The sector can be a source—or amplifier—of supply shocks**. Mining production relies heavily on the availability of electricity—mining activities account for about half of electricity consumption—and thus is exposed to weather-related shocks since hydropower accounts for more than 80 percent of Zambia's electricity generation. Mining production's vulnerability vis-à-vis climate shocks was highlighted in 2015 when a severe drought caused a 7 percent drop in power generation, contributing to a 17 percent decline in copper and cobalt production. While power generation has been bolstered in recent years, the current drought represents a risk to mining operations. A further fall in international copper prices due in part to trade wars and the relative slowdown in China (one of the world's largest consumers of copper), would be another source of risk to the outlook.

3. **Over time, the sector's direct contribution to budget revenues has increased with changes in the fiscal regime**. Mining's contribution to domestic revenue has historically been low as the sector has benefited from various exemptions since being privatized in the 1990s and mining companies reported low or no profits, partly owing to significant capital investments. In the early 2000s the sector contributed less than 0.1 percent of GDP to domestic revenue, although that

Mining Sector Contribution to Government Revenue

(Percent of GDP)

Sources: Zambian authorities and IMF staff estimates.

contribution increased to about 2 percent of GDP in recent years with changes in the fiscal regime.[1]

Norm Price Range	Royalty rates (percent)	
	Previous	New
Less than US$4,500	4.0	5.5
US$4,500 but less than US$6,000	5.0	6.5
US$6,000 but less than US$7,500	6.0	7.5
US$7,500 and above	N/A	10

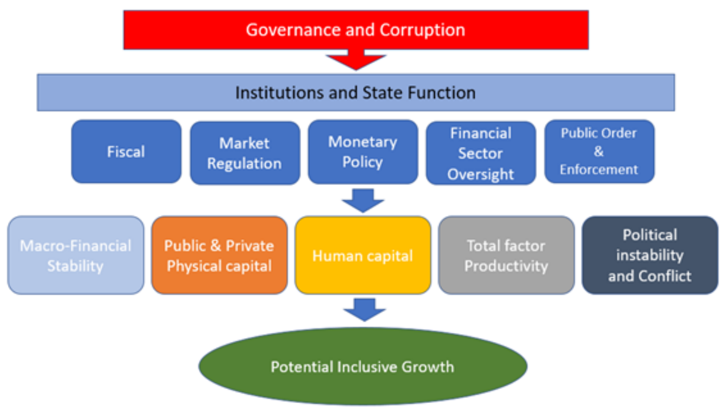
4. **The 2019 budget introduced policy changes aiming at further increasing the mining sector's contribution to budget revenues**. Mineral royalty rates on copper were increased by 1.5 percentage points and the royalty rate on cobalt to 8 percent from 5 percent. Mineral royalties were also made non-deductible for income tax purposes. An import duty of 5 percent on copper and cobalt concentrates imports was levied to discourage processing of imported concentrates in favor of domestic ones. A 15 percent export duty on precious metals was also introduced. The budget also announced the intention to introduce a nonrefundable sales tax in lieu of the VAT. Focus has also been stepped up on enhancing compliance, and audits of mining sector operations were initiated in December 2018. Legal action was initiated against one firm in May.

[1] See International Monetary Fund (2015). Analysis of Change in Zambia's Mining Fiscal Regime. *Zambia Selected Issues*

Annex VI. Institutions and Governance

1. **Strong institutions that promote good governance and low corruption are key drivers of potential and inclusive growth**. These factors affect growth dynamics by enhancing macro-financial stability, helping in improving public investment efficiency and human capital accumulation, and increasing total factor productivity. The main channel through which governance and corruption impact the economy reflects key state functions such as the execution of budgetary policy, public financial management, tax collection, market regulation, financial sector oversight, and public order and enforcement.

Corruption-Growth Nexus



Source: IMF, 2017

2. **Potential growth and inclusiveness are hindered in Zambia by tax evasion, weak governance and corruption**. Current Worldwide Governance Indicators (WGI)[1] and Transparency International indicators for Zambia are close to the SSA average, but this represents a notable deterioration in governance and institutional quality in recent years. Zambia had seen a significant improvement in Worldwide Governance Indicators (WGIs) in the 2000s but has faced challenges in recent years, with indicators especially of governance effectiveness, control of corruption declining significantly since 2012. Similarly, Transparency International's Corruption Perception Index (CPI)[2]

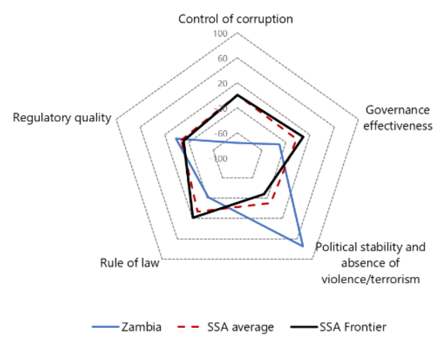
[1] WGIs are third-party indicators which summarize views of many enterprises, citizens and expert survey respondents on the quality of governance in a country. The data are gathered from survey institutes, think tanks, non-governmental organizations, international organizations, and private sector firms. The index ranges between -2.5 to 2.5, with higher values representing more favorable governance. Note that given the confidence interval, uncertainties exist around Zambia's point estimate. The WGI scores are normalized each year to mean zero and hence measure relative performance.

[2] CPI is a third-party indicator published annually by the Transparency International ranging between 0 (highest level of perceived corruption) to 100 (lowest level). It is a combination of opinion surveys and expert assessments of corruption, collected by twelve institutions. The CPI does not tell the full story of corruption in a country, only the level of corruption in the public sector within the past two years. Confidence interval for the 2018 score was between 32 and 38, with standard error of 1.93.

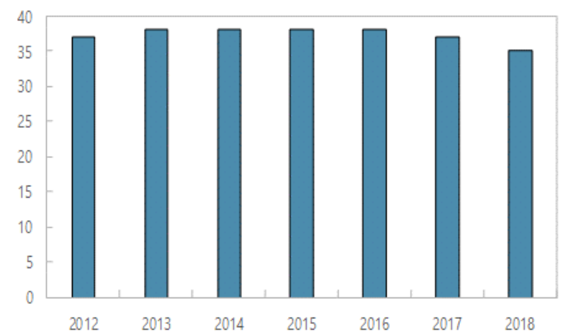
shows a deterioration since 2014-15. This is against a trend of improving averages for Sub-Saharan African economies, albeit from relatively lower levels.

Governance Indicators and Corruption Perception Index

Governance Indicators
(Percentage change between 2013 and 2017[1])



Corruption Perception Index



Sources: Worldwide Governance Indicators, Transparency International and Doing Business Database.
[1]An increase means an improvement of the indicator a decrease a deterioration.

3. **Zambia has established a national agency, the Financial Intelligence Center (FIC), whose mandate includes informing the public of complaints related to corruption and tax evasion and disseminating financial intelligence to law enforcement agencies**. The FIC was established in 2010 following enactment of the Financial Intelligence Centre Act, No. 46 of 2010 and became operational in November 2013. The FIC is the sole designated government agency responsible for the receipt, analysis and dissemination of suspicious transaction reports to various Law Enforcement Agencies (LEAs) (e.g., Anti-Corruption Commission, Zambia Revenue Authority). The FIC has reported a significant increase in the total number of suspicious transaction and spontaneous disclosure reports from 719 in 2016 to 1,664 in 2017 and to 799 in 2018.[3] (Table 1)

Table 1. Trend in Suspicious Transaction and Spontaneous Disclosures

Year	Number of suspected reports	Number of reports disseminated to LEAs
2014	487	-
2015	767	357
2016	719	114
2017	1664	425
2018	799	80

Source: Various FIC Trend reports.

[3] Assessment period for 2018 was from 1st January 2018 to 30th September 2018.

4.

4. **Most of the reports received by the FIC in 2017 and 2018 were related to suspected corruption, tax evasion and procurement violations**. In 2017, 425 reports were validated and disseminated to various law enforcement agencies (LEAs) for further investigation and prosecution. In 2018, 80 reports were transmitted to LEAs. Most of these reports are related to procurement corruption occurring in government and quasi-government institutions when the private sector is contracted for projects. The main method found for procurement corruption were direct bidding and subsequent variation of contracted amount.

5. **The Zambian authorities have placed the fight against corruption on the country's political agenda**. Institutional, regulatory and legal measures have been taken to prevent and fight corruption (including updating the Anti-Corruption Act). However, weak mechanisms of financial control combined with ineffectiveness in public financial management mechanisms, and the limited capacity of to regulatory bodies to provide effective oversight, have hampered the ability to investigate and bring cases to trial.

6. **The authorities are digitalizing customs processes and undertaking initiatives to advance border coordination and trade facilitation**. In tax administration, progress includes increased uptake of electronic filing and payments methods, strengthened practices to manage tax arrears owed by corporations and individuals, and improvements to the dispute resolution process. However, more effort is required to: address the accuracy of the taxpayer registration database, ledgers and customs data; boost on-time filing across all core tax types; develop a strategy to address low rate of compliance across all taxes and obligations; and improve monitoring and reporting of performance against desired outcomes. Recent approval of the Public Financial Management Act provides a basis for further actions to strengthen the procurement process.

Annex VII. Capacity Development Strategy Note

CD Strategy

1. **Fiscal consolidation to reduce debt-related vulnerabilities and preserve macroeconomic stability is the key policy priority**. The IMF's CD strategy for Zambia is therefore anchored on assisting the authorities to achieve orderly and adequate fiscal adjustment through providing detailed technical policy advice and enhancing institutional capacity to implement needed reforms. CD on budget preparation and execution and debt management supports these goals. In addition, the last FSAP (2017) highlighted risks to financial stability due to insufficient capacity for bank supervision, systemic risk analysis and financial crisis management, and Fund CD has also focused on strengthening the Bank of Zambia (BOZ)'s capacity in those areas. Finally, capacity building continues to be provided in the areas of compilation and timely dissemination of economic statistics.

Key Overall CD Priorities Going Forward

Priorities	Objectives
Tax policy and revenue administration.	Enhance domestic revenue mobilization as part of fiscal consolidation. Focus on widening tax base notably for income and consumption taxes and strengthening compliance.
Public finance management. (PFM)	Enhance the budget preparation process; strengthen budget execution and control with the aim to avoid accumulation of payment arrears; strengthen identification and management of fiscal risks; improve public investment system to ensure better alignment of public investment projects with national priorities; strengthen public debt management.
Monetary policy implementation and operations.	Strengthen monetary policy implementation to facilitate transition towards a modern inflation targeting framework. Promote a well-functioning foreign exchange market. Upgrade BOZ's legal framework.
Strengthen macroeconomic and financial statistics compilation and dissemination for decision making.	Improve the quality and coverage of national accounts, external sector statistics, and government finance statistics. Support the compilation of producer and import price indices.

Main Risks and Mitigation

2. **Poor coordination between government agencies and inadequate staffing continue to constitute important risks to the implementation of TA recommendations**. These risks could be mitigated by ensuring broader engagement and interaction with TA missions at the level of implementing agencies, proper sequencing of TA and training delivery, and longer term TA engagement notably through longer term/resident experts. Communication with various groups/stakeholders is also key to secure the proper buy-in.

Authorities' views

3. The authorities are in broad agreement with the overall assessment, strategy and priorities.

INTERNATIONAL MONETARY FUND

ZAMBIA

July 11, 2019

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

African Department
(In consultation with other departments)

CONTENTS

FUND RELATIONS

(As of May 31, 2019)

Membership Status: Joined: September 23, 1965; Article VIII
General Resources Account:

	SDR Million	Percent Quota
Quota	978.20	100.0
Fund holdings of currency	978.20	100.0
Reserve position in Fund	0.02	0.0

SDR Department

	SDR Million	Percent Allocation
Net cumulative allocation	469.14	100.0
Holdings	158.09	33.70

Outstanding Purchases and Loans

	SDR Million	Percent Quota
ECF arrangements	32.28	3.30

Latest Financial Arrangements

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
ECF [1]	06/04/2008	06/29/2011	220.10	220.10
ECF [1]	06/16/2004	09/30/2007	220.10	220.10
ECF [1]	03/25/1999	03/28/2003	278.90	237.52

Projected Payments to the Fund[2]
(SDR million; based on existing use of resources and present holdings of SDRs)

	Forthcoming				
	2019	2020	2021	2022	2023
Principal	19.40	11.04	1.84		
Charges/interest	1.74	3.46	3.46	3.46	3.46
Total	21.14	14.50	5.30	3.46	3.46

[1] Formerly PRGF.

[2] When a member has overdue financial obligations outstanding form more than three months, the amount of such arrears will be shown in this section.

Implementation of HIPC Initiative

	Enhanced Framework
Commitment of HIPC assistance	
Decision point date	Dec. 2000
Assistance committed (1999 NPV terms)[3]	
By all creditors (US$ million)	2,499.20
Of which: Fund assistance (US$ million)	602.00
(SDR equivalent in millions)	468.80
Completion point date	April 2005
Disbursement of IMF assistance (SDR million)	
Assistance disbursed to Zambia	468.80
Interim assistance	351.60
Completion point balance	117.20
Additional disbursements of interest income[4]	39.47
Total Disbursement	508.27

Implementation of MDRI Assistance

I. Total debt relief (SDR million)[5]		402.59
Of which:	MDRI	398.47
	HIPC	4.12

II. Debt relief by facility (SDR million)

Delivery date	GRA	PRGT	Total
January 2006	n/a	402.59	402.59

Safeguard Assessments

[3] Net present value (NPV) terms at the decision point under the enhanced framework.

[4] Under the enhanced framework, an additional disbursement is made at the completion point corresponding to interest income earned on the amount committed at the decision point but not disbursed during the interim period.

[5] The Multilateral Debt Relief Initiative (MDRI) provides 100 percent debt relief to eligible member countries that are qualified for assistance. The debt relief covers all debt owed to the Fund as of end-2004 that is outstanding at the time the member qualifies for the relief.

Safeguards assessments of the Bank of Zambia (BoZ) were completed in June 2004, January 2009, and October 2010. The 2009 assessment concluded that the bank had adequate safeguards in several areas, but confirmed the existence of certain vulnerabilities in the BoZ's legal framework and financial reporting. The 2010 update report concluded that the BoZ had made progress in implementing safeguards recommendations. Staff noted improvements in the internal audit and internal control mechanisms. Weak statutory independence remains a substantive safeguards concern.

Exchange Rate Arrangement

The currency of Zambia is the kwacha. The exchange rate arrangement is a "float," with the kwacha exchange rate determined in the interbank market. The buying rate of the BoZ is a simple average of the primary dealers' low bid rates, and the BoZ's selling rate is the simple average of the primary dealers' high offer rates. On April 19, 2002, Zambia accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement.

Zambia continues to maintain an exchange restriction, which is subject to Fund approval under Article VIII, arising from limitations imposed by the government on access to foreign exchange for the making of payments and transfers for current international transactions, which is evidenced by the existence of external payments arrears accumulated prior to October 4, 1985.

Article IV Consultations

Zambia is on the standard 12-month Article IV consultation cycle, subject to Decision No. 14747– (10/96), as amended. The Executive Board concluded the last Article IV consultation on October 6, 2017.

FSAP Participation and ROSC

Zambia has participated in the financial sector assessment program (FSAP); an FSAP mission from the Fund and the World Bank conducted a comprehensive external assessment of the financial system on April 30–May 15, 2002, and July 15–26, 2002. A follow-up FSAP mission was conducted by the Fund and the World Bank in November 2008. More recently, another joint World Bank-Fund FSAP mission was conducted on July 11-August 3, 2016 to assess the stability of the financial system. On June 8-16, 2017, a mission from the Fund was conducted to update the stress tests of the 2016 FSAP.

The fiscal transparency module of a Report on Observance of Standards and Codes (ROSC) assessing compliance with the IMF's Code of Good Practices on Fiscal Transparency—Declaration of Principles was issued to the Executive Board on October 31, 2001. A ROSC data module was issued to the Executive Board on January 18, 2005.

Technical Assistance (since 2011)

Resident advisors

Department	Dates	Position
FAD	2012–15	Peripatetic advisor on tax administration
MCM	2011–15	Advisor on capacity building at the Bank of Zambia

Technical assistance missions

Department	Dates	Purpose
FAD	February 2012	Mining tax administration
	April 2012	Public financial management
	October 2012	Tax administration
	July 2012	Tax policy
	April 2013	Pension reform
	November 2013	Tax administration
	November 2013	Public financial management
	January 2014	Cash management
	February 2014	Program based budgeting
	May 2014	Mining and large taxpayer administration reforms
	July–August 2014	Cash basis financial reporting
	October–November 2014	Treasury single account
	March 2015	Mining Tax administration
	April–May 2015	PFM legislation
	January–February 2016	Macro-fiscal management and budget formulation
	April 2016	Customs administration
	May 2016	Assessment of Tax administration (TADAT)
	May–July 2016	Review of the Performance Budget System
	June 2016	Macro-fiscal planning and fiscal risks management
	July 2016	Tax administration
	July–August 2016	Audit effectiveness for Telecoms

Department	Dates	Purpose
	Nov.–Dec. 2016	Customs administration
	February 2017	Public Investment Management assessment
	April 2017	Tax administration
	January 2018	Tax and Customs Administration
	January 2018	Fiscal risk assessment, cash management and expenditure controls, and fiscal reporting
	June 2018	Tax system assessment and revenue mobilization
	September 2018	Strengthening cash and debt management
	Oct.–Nov. 2018	Managing cash and strengthening budget process
	April 2019	Wage bill management
MCM	November 2011	Monetary policy framework
	January 2012	Inflation targeting framework
	January 2012	Payments system reforms
	January 2012	Central Bank organizational restructuring
	February 2012	Currency management
	March 2012	Macro modeling of transmission mechanism
	May 2012	Stress testing and risk profile of banks
	May 2012	Currency management
	July 2012	Payments system
	September 2012	Currency management
	October 2012	Inflation targeting
	November 2012	Organization review
	November 2012	Financial stability
	December 2012	Bank supervision and regulations
	February 2013	Information handling
	March 2013	Organization of economic analysis
	March 2013	Macro modeling of transmission mechanism
	May 2013	Payments system

Department	Dates	Purpose
	June 2013	Markets for government securities
	August 2013	Financial stability analysis
	September 2013	Liquidity forecasting and interbank market
	November 2013	Monetary policy reports and recommendations
	November 2013	Tasks and performance of the executives
	February 2014	Internal planning functions of BOZ
	February 2014	Automation of book-keeping and accounting in currency operations
	March–April 2014	Stress testing
	April–May 2014	Econometric modeling
	May 2014	Improving efficiency of payment system
	July 2014	Assessing the functioning of the FX market
	August 2014	Project Management
	September 2014	Monetary policy formulation and implementation
	September–October 2014	Improving efficiency of payment systems- National Switch project
	November 2014	Enhancement of the stress testing framework
	January 2015	Improving liquidity of the secondary market for Government securities and deepening interbank money markets
	February 2015	Bank supervision
	March 2015	Organizational structure and operational set up
	June 2015	Payment systems development and oversight
	August 2015	Bank supervision
	September 2015	Macroeconomic modelling
	September–October 2015	Establishment of a centralized database management system
	October 2015	Bank of Zambia organizational structure
	November 2015	Secondary market for Government securities
	February–March 2016	Secondary market for Government securities

Department	Dates	Purpose
	April 2016	Business opinion and expectations survey
	April 2016	Stress testing
	July 2016	Forecasting and policy analysis system
	December 2016	Forecasting and policy analysis system
	April 2017	Forecasting and policy analysis system
	May 2017	TA needs assessment
	June 2017	Risk based supervision
	July 2017	Deposit insurance system
	July 2017	Monetary policy communications
	Aug.-Sept. 2017	Foreign exchange market developments
	October 2017	Central Bank communication
	October 2017	Risk based supervision
	December 2017	FPAS modeling
	April 2018	Systemic risk monitoring
	May 2018	Contingency planning for crisis preparedness and management
	June 2018	FPAS modeling
	June 2018	Diagnostic and PFMI training
	October 2018	FPAS modeling
	Oct-Nov 2018	Cyber security
	Jan 2019	Communications
	April 2019	Stress testing
STA	February 2013	SRF data development
	April 2013	Price statistics
	April 2013	National accounts
	December 2013	Price statistics
	January 2014	National accounts
	January 2014	Open data platform
	April-May 2014	Monetary and financial statistics
	August 2014	National accounts
	March 2015	Quarterly National accounts

Department	Dates	Purpose
	March 2015	Price statistics
	February–March 2016	External sector statistics
	March 2016	National accounts statistics
	March–April 2016	Government finance statistics
	April 2016	Enhanced general data dissemination system
	April–May 2016	National accounts statistics
	May 2016	Natural resources revenue pilot study
	October 2016	National accounts statistics
	December 2016	External sector statistics
	February 2017	National accounts statistics
	March 2017	International investment position and External debt and statistics compilation training
	March 2017	Producer price index
	June 2017	National accounts statistics
	June 2017	External sector statistics
	August 2017	National accounts statistics
	November-December 2017	Government finance statistics
	December 2017	Producer price index
	March 2018	National accounts statistics
	April 2018	Producer price index
	April-May 2018	External sector statistics and International investment position
	June 2018	National accounts statistics
	November 2018	National accounts statistics
	November-December 2018	Government finance statistics
	February 2019	Public sector debt statistics
	March 2019	External sector statistics
	March 2019	National accounts statistics
	April 2019	National accounts statistics

JOINT WORLD BANK-FUND WORK PROGRAM, 2019–20

Title	Products	Expected Delivery Date
World Bank work program in next 12 months	1. Analytical work – Renewable energy; Fostering long-term savings;	2019-20
	2. Lending – Country Partnership Framework	TBD
	3. Analytical work – Insolvency and secured transactions reforms to promote MSME access to credit and financial inclusion	September 2019
	4. Analytical work – Water supply and sanitation sector diagnostic	November 2019
	5. Analytical work – Digital economy diagnostic	November 2019
	6. TA – Financial inclusion support program	December 2019
	7. TA – Capacity building for the Ministry of National Development Planning	May 2020
	8. Analytical work – Debt management reform plan	Continuous
	9. Analytical work – Poverty monitoring and analysis	May 2020
	10. TA – Transport sector PPP	June 2020
IMF work program in next 12 months	1. Technical assistance: Foreign operations and foreign exchange policy implementation	2019/20
	2. Technical assistance: Public financial management	2019/20
	3. Technical assistance: Revenue administration	2019/20
	4. Technical assistance: Contingency planning for crisis preparedness and management	2019/20
	5. Technical assistance: Financial supervision and regulation	2019/20
	6. Technical assistance: Monetary policy implementation and operations	2019/20

	7.	Technical assistance: National accounts statistics	2019/20
	8.	Technical assistance: External sector statistics	2019/20
	9.	Technical assistance: Producer price index	2019/20
	10.	Technical assistance: Government finance statistics	2019/20
Fund request to Bank	1.	Analytical work on impact of drought and other climatic shocks	June 2019
	2.	Analytical work on electricity tariffs review	September 2019
	3.	Analytical work on debt management reform	July 2019
	4.	Assessment of progress in strengthening project appraisal, selection and management as well as public procurement processes.	End-2019
Bank request to Fund	1.	Medium-term macroeconomic framework	Continuous
Joint products in next 12 months	2.	DSA for Article IV	July 2019

STATISTICAL ISSUES

As of June 20, 2019

I. Assessment of Data Adequacy for Surveillance
General: Data provision has some shortcomings but is broadly adequate for surveillance. Issues with source data and compilation affect most datasets but are particularly problematic in fiscal reporting.
National accounts: The Central Statistics Office (CSO) estimates GDP for the current year from benchmark year 2010 and a combination of survey and administrative data. The authorities now compile GDP estimates using value added (VAT) and business income tax data from the Zambian Revenue Authority (ZRA). In October 2016, the CSO started publishing quarterly GDP estimates using quarterly source data, including fiscal records from the ZRA. The two priority areas for attention are: (a) developing a Memorandum of Understanding between the CSO and the ZRA to ensure administrative data has appropriate coverage and quality assurance; and (b) developing a new GDP benchmark within the next three years. AFRITAC South is providing a technical assistance over the ongoing GDP rebasing process.
Price statistics: The classification system used for compilation of the CPI closely follows the Classification of Individual Consumption by Purpose. The current weights are based on expenditure data reported by households in 2002. There is urgent need for a household expenditure survey to update the CPI weights. An ongoing AFRITAC South project on the compilation of the producer price index (PPI) is expected to enhance the measurement of volume changes of GDP and its components.
Government finance statistics (GFS): The coverage of GFS data is limited to budgetary central government. These data include intergovernmental transfers of about 2 percent of GDP to extra-budgetary, social security, and local government units—the economic nature of these expenses are not known and all sources of own revenue of these entities are excluded from the fiscal data. The authorities report monthly budget releases data to the IMF's African Department for operational use in a timely manner, but the data are often subject to substantial revisions. The reconciliation of data on fiscal outturn in fiscal reports and government's accounts in monetary statistics requires significant improvement. There is a GFS TA mission planned for November 2019.
Monetary statistics: The Bank of Zambia (BOZ) reports monetary data to STA for the central bank and other depository corporations on a timely basis. Data for Other Financial Corporations are reported with long delays. Monetary statistics are reported using the standardized report forms, which accord with the concepts and definitions of the IMF's *Monetary and Financial Statistics Manual (MFSM)*. BOZ also reports data on some basic series and indicators of IMF's Financial Access Survey including mobile money and the two indicators adopted by the UN to monitor Target 8.10 of the Sustainable Development Goals (commercial bank branches 100,000 adults and ATMs per 100,000 adults).

Financial sector surveillance: BoZ submits the FSIs for deposit takers on a regular and timely basis which are disseminated on the IMF's FSI website.
Balance of payments statistics: The data adequacy has gradually improved in recent years. The BoZ compiles balance of payments (BOP) and international investment position (IIP) statistics according to the Sixth edition of Balance of Payments and International Investment Position Manual (BPM6). BOP and IIP data are compiled quarterly although the publication time lag is higher than 120 days of the reference quarter. The BoZ has started conducting new services surveys in compliance with BPM6 which have contributed to the significant revision in the services series as well as the fob valuation of exports and imports of goods. The coverage of the quarterly investment survey (relating to financial account and primary income) should be improved as well is its incorporation in the BOP statistics.
External and domestic debt statistics: Data provision is broadly adequate for surveillance purposes. Recent efforts, facilitated by technical assistance, have led to an improvement in the consolidation of the debt databases, both in terms of external and domestic debt. Further work is underway in these areas.
II. Data Standards and Quality
Zambia has participated in the General Data Dissemination System (GDDS) since November 2002, and in June 2016 it implemented the e-GDDS recommendations and disseminated a National Summary Data Page (NSDP; http://nso.zambia.opendataforafrica.org/ddaiaof/national-summary-data-page-nsdp), publishing 14 of the 15 e-GDDS data categories and remaining in Baseline 2 of the e-GDDS. Since June 2016, updating of the NSDP has not been consistent. A Data ROSC Assessment was published in February 2005.

Zambia: Table of Common Indicators Required for Surveillance

As of June 20, 2019

	Date of Latest Observation	Date Received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]
Exchange rates	June 20 2019	June 20, 2019	D	D	D
International reserve assets and reserve liabilities of the monetary authorities[1]	June 6 2019	June 14, 2019	D	W	M
Reserve/base money	June 7 2019	June 14 2019	D	W	M
Broad money	June 7, 2019	June 14, 2019	M	M	M
Central bank balance sheet	April 2019	June 2019	M	M	M
Consolidated balance sheet of the banking system	April 2019	June 2019	M	M	M
Interest rates[2]	June 15, 2019	June 20, 2019	W	W	M
Consumer Price Index	May 2019	May 31, 2019	M	M	M
Revenue, expenditure, balance and composition of financing[3]—general government[4]	N/A	N/A			
Revenue, expenditure, balance and composition of financing[3]— central government	March 2019	June 14, 2019	M	M	M
Stocks of central government and central government–guaranteed debt[5]	December 2018	April 10, 2019	M	M	Q
External current account balance	Q1 2019	May 23, 2019	Q	Q	Q
Exports and imports of goods and services	April 2019	May 31, 2019	M	M	M
GDP/GNP	Q4 2018	April 16, 2019	Q	Q	M
Gross external debt	Q4 2018	April 10 2019	A	A	A
International investment position [6]	Q3 2018	June 12, 2019	Q	Q	Q

[1]Any reserve assets that are pledged of otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

[2] Both market-based and officially determined, including discounts rates, money market rates, rates on treasury bills, notes and bonds.

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[5] Including currency and maturity composition.

[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents. The publication of the new IIP series started in April 2019. According to the Bank of Zambia, the series will be updated on a quarterly basis.

[7] Daily (D), weekly (W), monthly (M), quarterly (Q), annually (A); irregular (I); or not available (NA).

ZAMBIA

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION—DEBT SUSTAINABILITY ANALYSIS[1]

July 11, 2019

Approved By
David Robinson (AFR) and Martin Sommer (IMF) and Marcello Estevão (IDA)

The Debt Sustainability Analysis (DSA) was prepared jointly by the staffs of the International Monetary Fund and the International Development Association, in consultation with the authorities.

Zambia: Joint Bank-Fund Debt Sustainability Analysis	
Risk of external debt distress	*High*
Overall risk of debt distress	*High*
Granularity in the risk rating	*Public debt under current policies is on an unsustainable path*
Application of judgment	*No*

An updated DSA is prepared using the revised Low-income Countries Debt Sustainability Framework (LIC DSF) to assess Zambia's current debt situation. Debt burden indicators have deteriorated considerably since the October 2017 DSA mainly on account of large fiscal deficits as the authorities made use of available financing to boost infrastructure spending, weaker growth and exchange rate, and a worsened external environment (terms of trade and financial conditions). Rising debt service costs (both externally and domestically) and a large pipeline of contracted and to-be-disbursed loans place Zambia's public debt on an unsustainable path under current policies while budget expenditure arrears have risen. Zambia's debt-carrying capacity has also weakened with its FX reserves' import coverage declining from 4.7 months in 2015 to 1.7 months in May 2019. All four external debt burden indicators breach their indicative thresholds, three of them by large margins and throughout the medium-term under the baseline scenario.

[1] This debt sustainability analysis was conducted using the Joint Bank-Fund Debt Sustainability Framework for Low-Income Countries (LIC-DSF) that was approved in 2017.

Total public debt is projected to increase somewhatin the near-term as, under unchanged policies, fiscal deficits remain large, before gradually declining as large debt-financed public projects are completed and forced fiscal adjustment occurs given financing constraints. As a frontier market, Zambia's high gross financing needs (peaking at 19 percent of GDP over the next three years), combined with wide EMBI spreads (1,575 basis points on June 11, 2019) and high domestic borrowing costs, expose it to significant market-financing risks. Despite the challenging fiscal situation, Zambia has remained current on all its debt obligations—domestic and external—and has not experienced a debt distress event. The authorities remain committed to prioritizing debt service payments and have identified resources to continue meeting debt obligations in the near-term. However, staff assess the risk of external and overall public debt distress for Zambia as very high at this juncture, and that a large upfront and sustained fiscal adjustment is essential to begin reducing debt vulnerabilities.

Debt coverage

1. **The public debt definition used in this DSA covers the central government direct and guaranteed debt (including budget expenditure arrears) as well as the nonguaranteed external debt of a fiscally important state-owned enterprise (SOE) (Text Table 1)**. This is a broader debt metric than the authorities' official debt definition which, as in many other developing economies, covers the central government direct and guaranteed debt including budget expenditure arrears, and stood at $18.3 billion (78.1 percent of GDP) at end-2018. The nonguaranteed debt (including borrowings and arrears to foreign IPPs) of the financially challenged state-owned utility company—ZESCO—is for the first time included in the debt perimeter for DSA purposes, justified by the significant fiscal risks posed by the company and in accordance with the LIC DSF Guidance.[2] These contingent liabilities to the central government added about US$0.7 billion (or 2⅔ percent of GDP) at end-2018. To ensure stock-flow consistency, ZESCO's net profit (calculated as revenue minus cost of sales and operating expense, which was estimated by staff at roughly 1 percent of GDP in 2018 and is assumed to remain constant in GDP terms going forward) is included as public sector revenue for the computation of liquidity indicators.[3] The authorities reported no outstanding nonguaranteed external debt of other nonfinancial SOEs as they generally lack the capacity to borrow externally without guarantees. Central bank external debt (including outstanding Fund credit) is included in the debt coverage. Local governments in Zambia currently do not have

[2] ZESCO and other SOEs' guaranteed debt has always been included in DSAs and is now also part of the authorities' officially published debt metric. ZESCO's contingent risks to the sovereign relate to its persistent and large cash deficits. Several reform options are under consideration for improving ZESCO's financial viability (tariff increases, a cost of service study, and renegotiation of PPAs), and its inclusion in the debt perimeter will be reassessed in future DSA updates.

[3] As historical series of ZESCO's liabilities and cash flows are not available, their inclusion (starting in 2018) in the DSA result in a timeseries break between 2017 and 2018.

the capacity to borrow without the central government's backstop, and their outstanding debt (expenditure arrears) is currently captured under the central government. The debt of social security funds is guaranteed by the central government and therefore included. The authorities confirmed that no extrabudgetary funds currently exist with outstanding debt. Limitied data on domestic debt of SOEs suggest the stock is insignificant and is adequately captured through the default SOE shock (2 percent of GDP) in the contingent liability stress test. The authorities have recently started regular collections of SOEs' financial data in an effort to gradually broaden the debt coverage going forward.

Text Table 1. Zambia: Stock of Public and Publicly Guaranteed (PPG) Debt

(End-2018, billions of U.S. dollars)

	Official debt coverage	DSA debt coverage
Total PPG debt	**18.3**	**18.9**
External PPG debt	**11.3**	**12.6**
1. Central government direct external debt	**10.0**	**10.0**
Multi/pluri-laterals	1.9	1.9
o.w. IMF	0.1	0.1
o.w. WB/AfDB	1.6	1.6
Bilaterals	3.0	3.0
Paris Club	0.1	0.1
Non-Paris Club	2.9	2.9
Commercial	5.1	5.1
o.w. Eurobonds	3.0	3.0
2. Central government guaranteed external debt	**1.2**	**1.2**
3. SOE external debt (nonguaranteed)	*Not included*	**0.6**
4. Nonresident holdings of local currency debt	*Treated as domestic*	**0.7**
Domestic PPG debt	**7.0**	**6.3**
1. Central government direct domestic debt	**7.0**	**6.3**
Treasury bills	1.548	1.544
Treasury bonds	3.3	2.7
Others	2.1	2.1
o.w. budget expenditure arrears	1.6	1.6
Memo: nonresident holdings of treasury bills	0.004	0.004
Memo: nonresident holdings of treasury bonds	0.7	0.7
Memo: total PPG debt to GDP (%)	78.1	80.8

Note: the main differences between the official and DSA debt coverages can be attributed to the treatment of nonresident holdings of local currency government debt and nonguaranteed SOE external debt. These items are highlighted in the table.

Sources: Zambian authorities and IMF staff estimates.

Public Debt Coverage and the Magnitude of the Contingent Liability Tailored Stress Test

Public debt coverage and the magnitude of the contingent liability tailored stress test

B. Please customize elements of the contingent liability tailored test, as applicable.

1 The country's coverage of public debt	The central government plus social security, central bank, government-guaranteed debt, non-guaranteed SOE debt			
	Default	Used for the analysis	Reasons for deviations from the default settings
2 Other elements of the general government not captured in 1.	0 percent of GDP	0	
3 SoE's debt (guaranteed and not guaranteed by the government) 1/	2 percent of GDP	2	
4 PPP	35 percent of PPP stock	1.39	
5 Financial market (the default value of 5 percent of GDP is the minimum value)	5 percent of GDP	5	
Total (2+3+4+5) (in percent of GDP)		8.4	

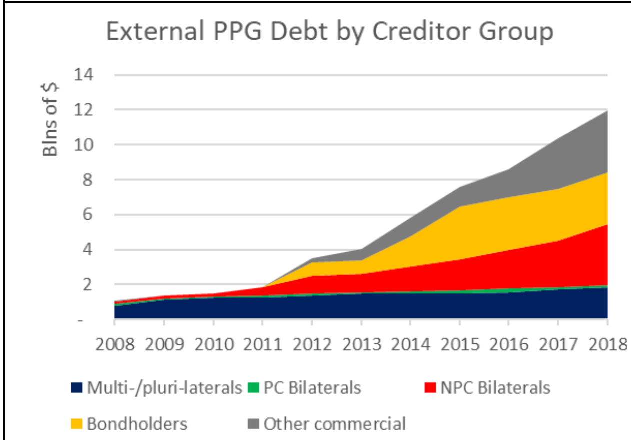
1/ The default shock of 2% of GDP will be triggered for countries whose government-guaranteed debt is not fully captured under the country's public debt definition (1.). If it is already included in the government debt (1.) and risks associated with SoE's debt not guaranteed by the government is assessed to be negligible, a country team may reduce this to 0%.

2. **The DSA is conducted on a residency basis**. Pursuant to the LIC DSF Guidance Note, foreign holdings of local currency debt issued domestically are now treated as external debt. The stock of such holdings as of end-2018 was about US$670 million or 14 percent of total outstanding domestic government securities.

Background

3. **Increased borrowing to finance large capital expenditure has led to a sharp increase in external debt and a shift in the creditor composition (Text Figure 1)**. External central government and government guaranteed debt has tripled (relative to GDP) during the past five years and is estimated to have reached US$12 billion or 51 percent of GDP by end-2018. There has also been a noticeable shift toward more non-concessional borrowing.[4] Non-Paris Club official creditors hold about 29 percent of total outstanding external PPG debt, followed by Eurobond holders (25 percent), foreign banks (19 percent), and foreign investors holding local currency debt (6 percent). The rest is largely held by traditional multilaterals (15 percent), while plurilateral creditors and the Paris Club together account for another 1.3 percent.[5] Domestically, the debt stock largely consists of treasury securities (21 percent of GDP) and budget expenditure arrears on non-debt obligations (7 percent of GDP, including VAT backlogs).

Text Figure 1. Creditor Landscape of Zambia's External Central Government and Government Guaranteed Debt



Sources: Zambian authorities and IMF staff estimates.

4. **Market-financing risks have heightened during the past 12 months**. Zambia's Eurobonds have performed worse than most frontier markets since early-2018, with spreads around 1,575 basis points on June 11, 2019. The widening of Eurobond spreads and pressures on domestic interest rates have come at a time of rising gross financing needs (GFNs). Project-

[4] Nonguaranteed SOE external debt is not included in Text Figure 1 due to a lack of historical data.

[5] The Zambian authorities are in the process of clearing some *de minimis* arrears recently reported to the Paris Club by Belgium. The authorities' were confirming *de minimis* sovereign arrears reported to the Paris Club by France. There is an ongoing internal reconciliation exercise to prevent such arrears from reoccurring. In addition, some pre-HIPC arrears to Iraq still exist but an agreement in principle has been reached and is currently pending finalization.

related inflows meanwhile surged to 6.4 percent of GDP in 2018. The new DSF market-financing module flags a high liquidity risk (Figure 5).

5. **Refinancing risks have started to materialize in domestic debt markets**. Tightening financing conditions in the domestic debt market with frequent undersubscriptions in auctions and structural weaknesses in PFM led to a reemergence of budget financing gaps in 2018 and contributed to further accumulation of budget expenditure arrears.[6] Private placements with domestic institutions totalled 4.2 billlion Kwacha in 2018, of which roughly half was to the state-run pension, NAPSA.

6. **Liquidity pressures also stem from large external debt payments**. External debt service (on public and publicly guaranteed debt plus foreign-held LC debt) is projected to reach $1.6 billion in 2019 (increased from about $1 billion in 2018), larger than the current FX reserves level (as of May 2019). A total of $4.9 billion (principal + interest) are due to external creditors over 2019-21, of which US$4.6 billion on already disbursed debt (Text Table 2). To compensate anticipated external debt payments, the central bank has recently stepped up its efforts in opportunistically purchasing FX from the market.

Text Table 2: External Debt Service by Creditor Class

(on already disbursed debt as of end 2018)

Millions of U.S. dollars	2019	2020	2021	2022	2023
Total debt service on external PPG debt	**1592**	**1489**	**1525**	**2104**	**1082**
Central government	**1226**	**1170**	**1116**	**1822**	**822**
Multi/pluri-laterals	80	66	66	72	76
Paris Club bilaterals	10	12	16	17	16
Non-Paris Club bilaterals	276	299	338	357	370
Eurobonds	237	237	237	987	197
Other commercial creditors	623	555	459	389	163
SOEs	**261**	**215**	**208**	**190**	**182**
o.w. guaranteed	164	152	148	133	128
Foreign holdings of LC debt	**105**	**105**	**201**	**92**	**77**

Sources: Zambian authorities and IMF staff calculations.

Macroeconomic and debt assumptions

7. **The economic outlook on current policies has deteriorated, compared to the October 2017 DSA (Text Table 2)**. Growth is lower and projected to remain subdued over the medium-term as financing contraints force a disorderly fiscal adjustment and increasingly

[6] Per Zambia's Constitution, public debt claims constitute a charge on the government's consolidated fund and are therefore given explicit priority over most other government spending mandates.

weigh on economic activity, and the kwacha has depreciated by 30 percent since end-2017. Fiscal deficits have been larger than previously anticipated. However, financing constraints are becoming increasingly binding, forcing a larger adjustment than envisaged in the 2019 budget. The current account deficit is expected to further widen due to lower copper exports and higher imports and interest payments associated with foreign-financed public investment before narrowing as large government projects are completed and domestic demand weakens with slowing growth and a large forced fiscal consolidation. FDI is ebbing due to an uncertain outlook, leaving public sector project flows and FX reserves as the predominant sources for external financing.

8. **Large external loan disbursements are envisaged by the 2019–21 MTEF (Text Table 3)**. The total amount of contracted but undisbursed debt was estimated at around US$9.7 billion (including guarantees) or 40 percent of 2018 GDP as of April 2019, which is projected to be fully disbursed within the next 5 years (6.7 percent of GDP anticipated in 2019) under the baseline scenario. Of that total, roughly 45 percent is understood to be for projects that had not begun disbursing as of April 2019. New external borrowing is expected to restart in 2022 to rollover the maturing Eurobonds and to support public sector investment. Prospective projects under the World Bank's recently approved Country Partnership Framework (2019–21) for Zambia will be added to the projections as they are incorporated into the authorities' borrowing plans.

9. **Domestic financing is expected from net issuance of government securities and further arrears accumulation**. Banks are expected to be the main buyers for bills while pension/insurance funds are the key players in bond markets (Text Figure 2). Foreign exposure is expected to remain flat in nominal terms absent an improvement in the outlook.[7] Any residual financing needs would be met by further accumulation of supplier arrears. No direct central bank financing is assumed.

10. **Risks to the baseline scenario (current policies) are tilted to the downside**. Government arrears on domestic payments are adding to economy-wide liquidity strains and risk undermining financial stability through rising NPLs and deepening sovereign-financial linkages. The realism tools (Figure 3, 4) suggest the forced adjustment envisaged under the baseline is of a large scale. If the government instead resorted to additional accumulation of supplier arrears, the further delay in fiscal adjustment and sharp rise in debt could drag down investor sentiment, trigger large scale capital outflows, and further disrupt private sector activity. There is also a risk that financing conditions could further deteriorate due to both external and domestic factors, which could intensify already elevated liquidity pressures. However, staff assess that the macro assumptions underpinning the baseline scenario are

[7] While foreign investors have not participated in the primary market since the third quarter of 2018, secondary market purchases have kept the total stock of LC debt held by foreign investors broadly unchanged in kwacha terms since end-2017.

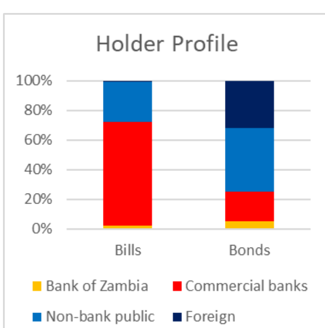
already very conservative. Upside risks stem mainly from the positive impact of a large up-front and sustained fiscal adjustment as recommended by staff, a successful debt operation and higher copper production and prices.

Text Table 3. Macro and Debt Assumptions

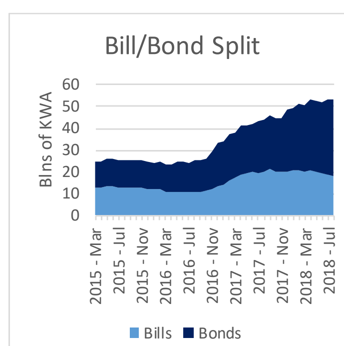
	2017	2018	2019	2020	2021	2022	2023	2024-28
				(Annual percentage change)				
Real growth								
2017 DSA	4.0	4.5	4.5	4.5	4.5	4.5	5.0	5.0
Current policies	3.5	3.7	2.0	1.7	1.7	1.6	1.5	1.5
GDP deflator								
2017 DSA	7.9	8.1	8.1	7.8	8.0	7.9	7.5	5.9
Current policies	10.1	9.5	10.0	9.7	8.2	8.3	8.0	7.4
				(Percent of GDP)				
Primary deficit (on commitment basis)								
2017 DSA	2.0	2.8	2.5	1.6	1.3	0.5	-0.1	-0.1
Current policies (excl. SOE revenues)	3.0	6.1	4.1	0.4	-1.3	-2.4	-2.9	-3.7
Non-interest current account deficit								
2017 DSA	1.7	1.1	-0.4	-1.7	-1.6	-1.3	1.2	1.4
Current policies	0.8	0.9	0.3	0.1	-0.6	-1.2	-1.9	-2.7
Net FDI inflows								
2017 DSA	6.3	6.1	6.0	5.8	5.8	5.8	5.8	5.8
Current policies	4.6	2.0	2.0	2.9	3.7	4.4	4.4	4.4
				(percent)				
Avg. nominal interest rate on external debt								
2017 DSA	4.6	4.5	4.4	3.8	3.5	3.7	3.9	3.8
Current policies	5.4	6.4	4.8	4.9	4.7	4.7	5.1	5.6
Avg. real interest rate on domestic debt								
2017 DSA	2.1	3.3	3.1	3.1	3.7	3.7	4.0	5.4
Current policies	-0.9	1.2	0.6	2.0	4.2	4.5	5.0	6.6
				(Millions of dollars)				
Project loan disbursements (incl. guarantees)								
2017 DSA	1269	1675	1732	1494	1240	980	903	5567
Current policies, o.w.	873	2189	2773	2224	1740	1251	1100	6095
Central government	739	1709	1603	1716	1384	1251	1100	6095
Guarantees	134	480	1171	508	356	0	0	0

Source: IMF staff projections.

Text Figure 2. Central Government LC Debt Profile



Sources: Zambia authorities and IMF staff estimates



Sources: Zambia authorities and IMF staff estimates

Debt-Carrying Capacity

11. **Zambia's debt-carrying capacity under the Composite Indicator (CI) rating is assessed as weak.**[8] In the 2017 DSA, which used the World Bank's CPIA score to determine policy-dependent thresholds for the DSA, Zambia was assessed as a "medium" performer. The weaker debt-carrying capacity is predominantly attributed to the low level of FX reserves on current policies. This lowers the debt burden thresholds for Zambia.

Components	Coefficients (A)	10-year average values (B)	CI Score components (A*B) = (C)	Contribution of components
CPIA	0.385	3.317	1.28	56%
Real growth rate (in percent)	2.719	3.234	0.09	4%
Import coverage of reserves (in percent)	4.052	12.337	0.50	22%
Import coverage of reserves^2 (in percent)	-3.990	1.522	-0.06	-3%
Remittances (in percent)	2.022	0.027	0.00	0%
World economic growth (in percent)	13.520	3.559	0.48	21%
CI Score			2.29	100%
CI rating			Weak	

External DSA Assessment

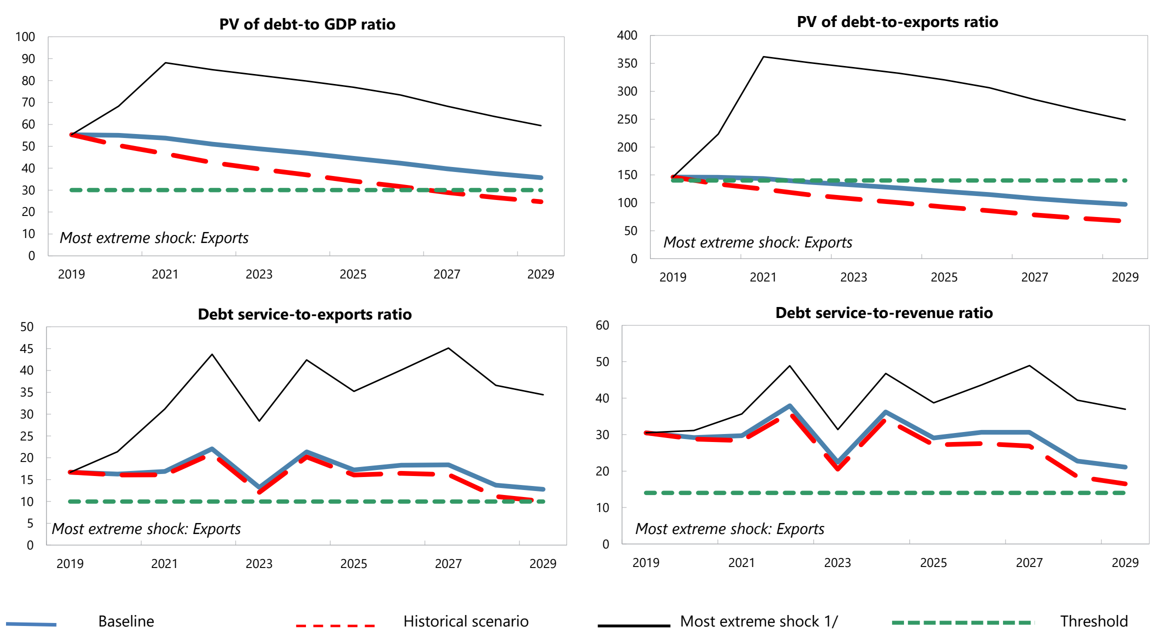
12. **Baseline breaches are persistent and significant for both solvency and liquidity indicators (Figure 1)**. All four external debt burden indicators breach their indicative thresholds and three of them by large margins and throughout the medium-term. This marks an important deterioration compared to the October 2017 DSA, reflecting a worsened macroeconomic/debt situation (namely, lower growth, weaker currency, larger deficits and external loan disbursements). Even if compared to the indicative thresholds for a *medium* performer, the baseline breaches of PV of PPG debt to GDP (peaking at 67 percent) and PPG debt service to revenue (peaking above 30 percent, net of Eurobond amortization) are significant and would endure for the next 10 years, though breaches of the debt service to exports ratio become less pronounced.

13. **Containing Zambia's external debt vulnerabilities requires large adjustment efforts and a coherent policy framework to strengthen debt-carrying capacity**. The staff-proposed adjustment scenario envisages a cumulative 8½ percent of GDP fiscal adjustment (on a commitment basis) over the next five years (with 4½ percent of GDP front-loaded for 2019 centered on substantial scaling back of the recent surge in foreign-financed capital expenditure). Under this scenario, the government is expected to regain investor confidence which would lead to improved growth prospects and support the authorities' efforts in rebuilding FX reserves and strengthening debt-carrying capacity. While some improvements are observed for the solvency indicators, the threshold breach of the PPG debt service to revenue indicator would remain significant and persistent (Text Figure 3), as a large part of the

[8] The composite indicator is calculated using data from the April 2019 WEO.

external debt payments is associated with already disbursed debt (¶6). Enhanced domestic revenue mobilization would be essential to improve the liquidity indicators but could take time to bear fruit. As a cross-check, the historical scenario suggests the adjustment is within reach and the external debt burden indicators would significantly improve if (with adjustment) the economy reverts to its historical trends (e.g. contribution from growth, exchange rate movements, and foreign borrowing).

Text Figure 3. Zambia: External PPG DSA under Staff-Proposed Adjustment Scenario



Source: IMF staff projections.

Public DSA Assessment

14. **Public debt is projected to steadily increase in the near-term before declining over the medium-term as financing constraints force a fiscal adjustment**. The PV of debt to GDP ratio is projected to increase from 81 percent in 2018 to 95 percent by 2021, more than twice the prudent benchmark (35 percent of GDP) for a weak performer. The rising debt stock and increasing roll-over needs (in part due to a larger portion of short-term bills) would keep the debt service-to-revenue ratio at elevated levels over the projection horizon. A regularization/clearance plan is needed for the sizeable budget expenditure arrears, which should be accommodated to the extent possible within the budget envelope. With the baseline scenario already identifying significant and sustained macroeconomic pressures, the debt situation remains vulnerable to various macro-fiscal shocks as found by the stress tests. The standardized exports shock is the most extreme shock for all the external and overall public debt burden indicators in this DSA.

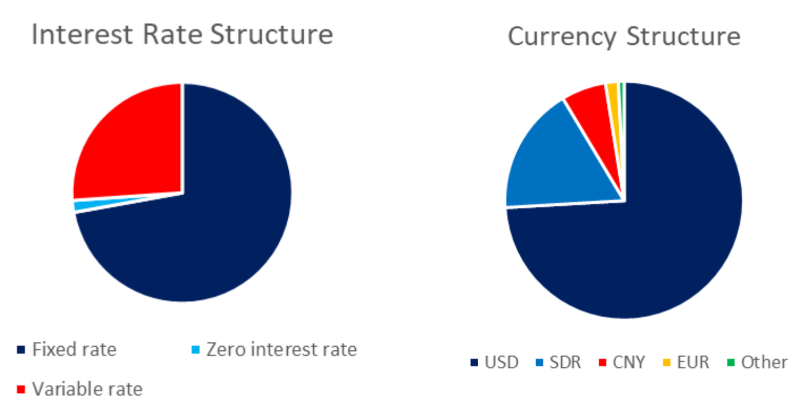
Sustainability Assessment

15. **Zambia's public debt under current policies is on an unsustainable path and large upfront and sustained fiscal adjustment is essential to contain debt vulnerabilities**. There are significant and persistent breaches in multiple debt burden indicators under the baseline scenario, which place Zambia's public debt on an unsustainable path. Tight financing constraints (both externally and domestically) are forcing the government to adjust while budget expenditure arrears continue to accumulate. While the government has been current on its debt payments, a large upfront and sustainable fiscal adjustment is essential to contain debt vulnerabilities and allow the government to meet its future financial obligations. The staff-proposed adjustment scenario (centered on substantial scaling back of the recent surge in foreign-financed capital expenditure) is anchored on putting the debt trajectory on a firmly downward path, which is expected to restore investor confidence, improve financing conditions, and revive FX inflows (including to roll over the 2022 Eurobonds). The risk of debt distress is however expected to remain extremely elevated (with heightened liquidity risks) even under the adjustment scenario.

Final Risk Rating and Application of Judgment

16. **Significant near-term breaches of the liquidity indicators suggest an elevated probability of a future distress event**. The sharp increase in external debt payments weighs heavily on government revenue (averaging 34 percent of revenue over 2019-21) and FX reserves, and is susceptible to interest rate and exchange rate risks which have already started to materialize (Text Figure 4). A standard exports shock (to which Zambia is susceptible as a commodity producer) would push the ratio up to 40 percent.[9]

Text Figure 4. Central Government External Debt Structure



Sources: Zambian authorities and IMF staff estimates.

[9] During 2015-16, a period of a large decline in copper prices and a depreciating exchange rate, the external PPG debt service to revenue ratio averaged 16 percent with the government accumulating a large amount of arrears to domestic suppliers while fully meeting priority spending mandates (including debt payments).

17. **Zambia's ability to borrow has been increasingly hampered by the loosening fiscal stance against rising debt vulnerabilities**. The government continues to issue in the domestic debt market. While auctions have been frequently undersubscribed, private placements have provided some support, and the secondary market remains active. The majority of foreign investment exposure in the LC debt market has so far been maintained, although interest in additional exposure has receded. Zambia also continues to receive very large positive net inflows from commercial banks on contracted project loans.

18. **In staff's judgment, the risk of external and overall public debt distress for Zambia is currently very high**. While the threshold-based analysis points to elevated liquidity risks and a relatively high probability of a distress event over the projection horizon, the government has remained current on its external and domestic debt obligations, with no default or arrears on any debt obligation.[10] The stock of outstanding budget expenditure arrears in part reflects chronic structural weaknesses in PFM and budget execution which in staff's judgment are not forced borrowing undertaken to circumvent liquidity constraints and thus are not by themselves a signal of debt distress. In addition, several mitigating factors in staff's judgment could help avert a distress event in the near term. First, the authorities are determined to prioritize debt payments over other obligations and in line with the constitutional priority of debt service payments are proactively identifying resources (including through central bank FX purchases to replenish reserves) to achieve this. Second, the authorities are discussing relief measures on a voluntary basis with a bilateral creditor, which could be a protracted process but would ease somewhat near-term liquidity pressures.[11] Third, FX reserves appear still sufficient to cover the next 12 months' external debt payments, provided there is no sharp reversal in capital flows. Lastly, in the domestic markets, some "nonmarket" players (e.g. pension funds) still possess resources to continue participating in government debt auctions and have space to augment their portfolio allocations in the near-term. With these, staff assess that the risk of debt distress is elevated in Zambia, with strong actions needed to begin reducing debt-related vulnerabilities.

Authorities' Views

The authorities agreed with staff's assessment of the current debt situation and the sustainability of the debt position under current policies. They also concurred with staff on the need for large upfront adjustment targeted directly at reducing external debt accumulation to contain debt vulnerabilities. While they expected the large investment in infrastructure to pay off over the long-term so that growth over the medium-term could be significantly higher than projected by staff, they recognized that near-term debt service pressures need to be

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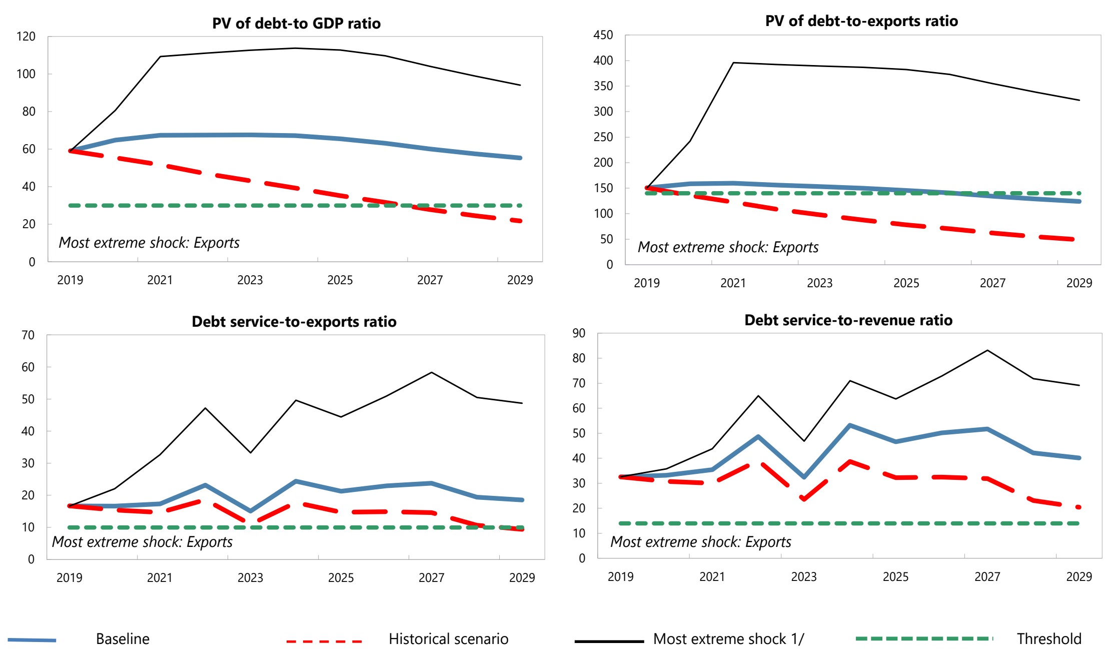
[10] With the exception of the *de minimis* arrears reported in footnote 5, which are in the process of being cleared.

[11] Per LIC DSF guidance, voluntary reprofiling discussions (i.e. not expected to result in a distressed debt exchange) are not to be considered a distress event.

carefully managed. In this context, following a Cabinet meeting in May 2019 they announced plans to prepare a list of projects to be slowed down, postponed, or cancelled in accordance with contract provisions. They also stressed the importance of dismantling budget expenditure arrears to release liquidity and of revenue mobilization in strengthening debt repayment capacity and highlighted that several revenue enhancing initiatives are already underway including notably the planned introduction of the new sales tax.

Figure 1. Zambia: Indicators of Public and Publicly Guaranteed External Debt Under Alternatives Scenarios, 2019–29



Customization of Default Settings	Size	Interactions
Tailored Stress		
Combined CL	No	
Natural disaster	n.a.	n.a.
Commodity price 2/	No	No
Market financing	No	No

Note: "Yes" indicates any change to the size or interactions of the default settings for the stress tests. "n.a." indicates that the stress test does not apply.

Borrowing assumptions on additional financing needs resulting from the stress tests*	Default	User defined
Shares of marginal debt		
External PPG MLT debt	100%	
Terms of marginal debt		
Avg. nominal interest rate on new borrowing in USD	6.0%	6.0%
USD Discount rate	5.0%	5.0%
Avg. maturity (incl. grace period)	15	15
Avg. grace period	5	5

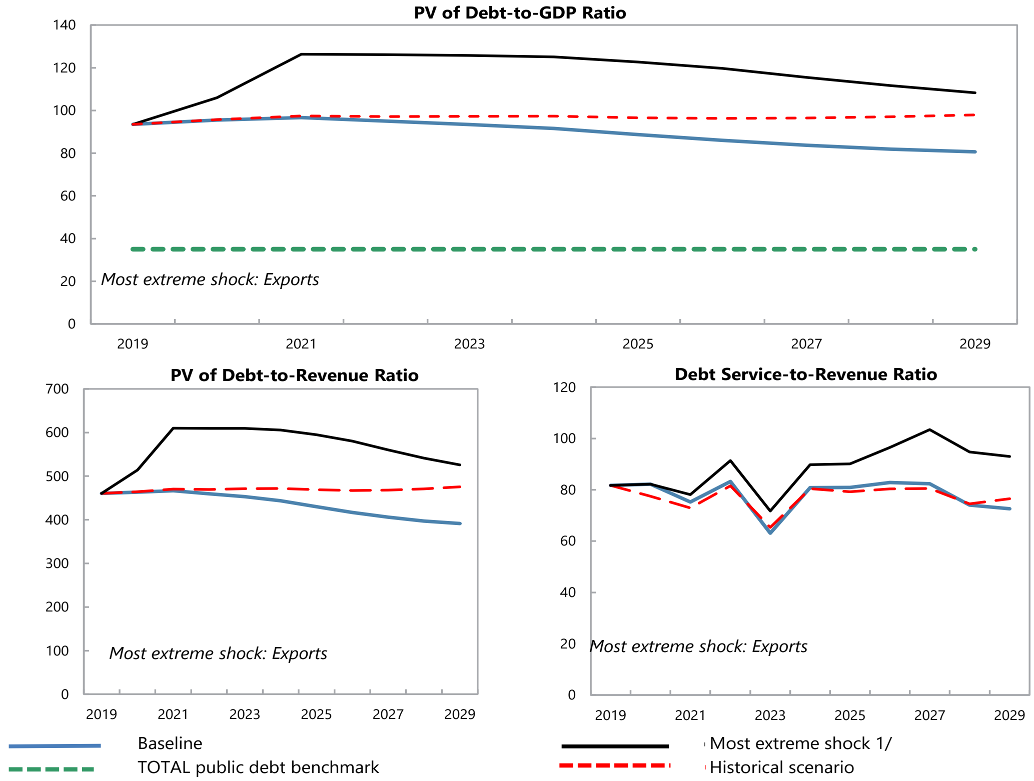
* Note: All the additional financing needs generated by the shocks under the stress tests are assumed to be covered by PPG external MLT debt in the external DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2029. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

2/ The magnitude of shocks used for the commodity price shock stress test are based on the commodity prices outlook prepared by the IMF research department.

Figure 2. Zambia: Indicators of Public Debt Under Alternative Scenarios, 2019–29



Borrowing assumptions on additional financing needs resulting from the stress tests*	Default	User defined
Shares of marginal debt		
External PPG medium and long-term	54%	54%
Domestic medium and long-term	23%	23%
Domestic short-term	23%	23%
Terms of marginal debt		
External MLT debt		
Avg. nominal interest rate on new borrowing in USD	6.0%	6.0%
Avg. maturity (incl. grace period)	15	15
Avg. grace period	5	5
Domestic MLT debt		
Avg. real interest rate on new borrowing	10.0%	10.0%
Avg. maturity (incl. grace period)	9	9
Avg. grace period	8	8
Domestic short-term debt		
Avg. real interest rate	8.3%	8.3%

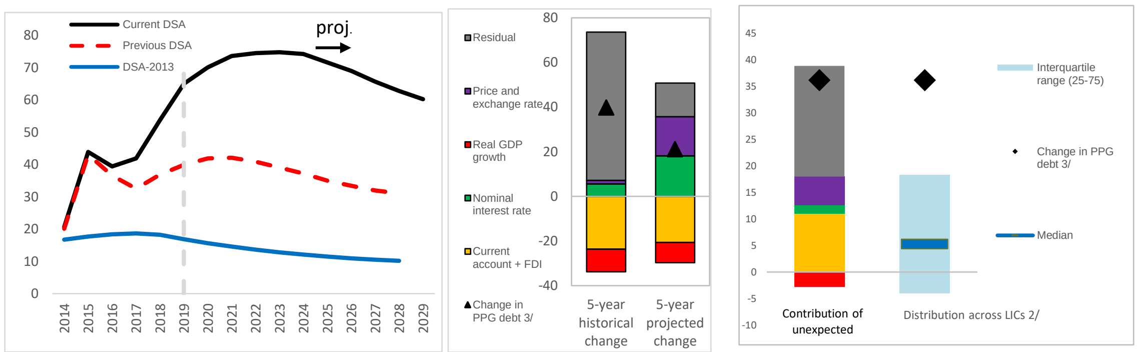
* Note: The public DSA allows for domestic financing to cover the additional financing needs generated by the shocks under the stress tests in the public DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2029. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

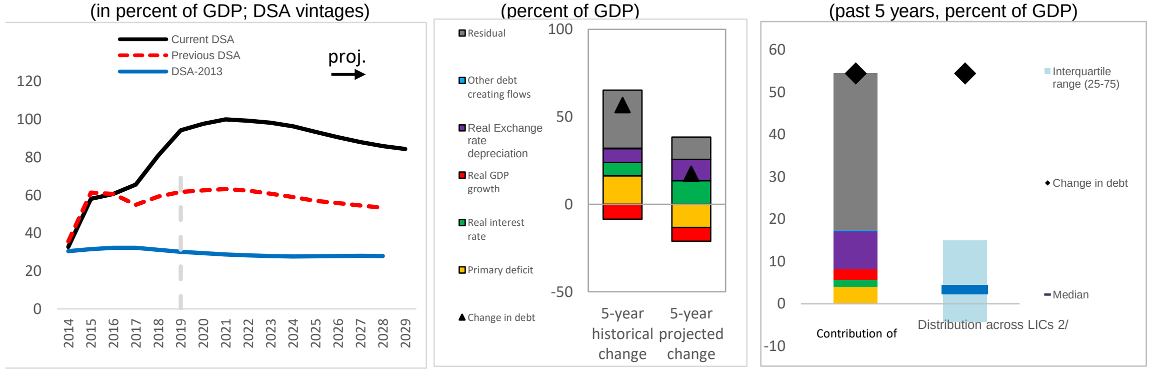
Figure 3. Zambia: Drivers of Debt Dynamics – Baseline Scenario

Gross Nominal PPG External Debt (in percent of GDP; DSA vintages) | Debt-creating flows (percent of GDP) | Unexpected Changes in Debt 1/ (past 5 years, percent of GDP)



Public debt

Gross Nominal Public Debt (in percent of GDP; DSA vintages) | Debt-creating flows (percent of GDP) | Unexpected Changes in Debt 1/ (past 5 years, percent of GDP)



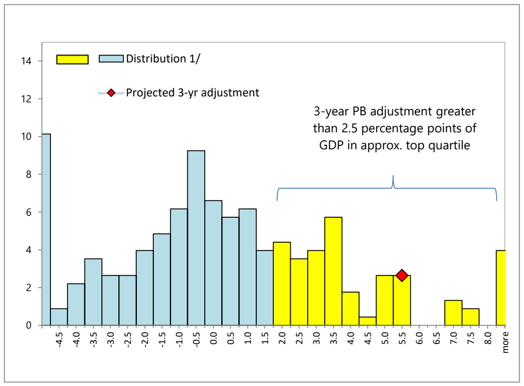
1/ Difference between anticipated and actual contributions on debt ratios.

2/ Distribution across LICs for which LIC DSAs were produced.

3/ Given the relatively low private external debt for average low-income countries, a ppt change in PPG external debt should be largely explained by the drivers of the external debt dynamics equation.

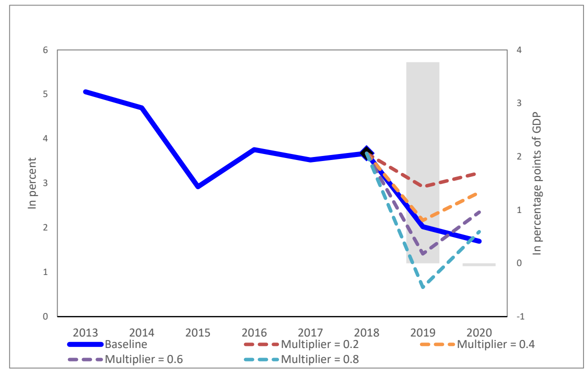
Figure 4. Zambia: Realism Tools

3-Year Adjustment in Primary Balance
(Percentage points of GDP)



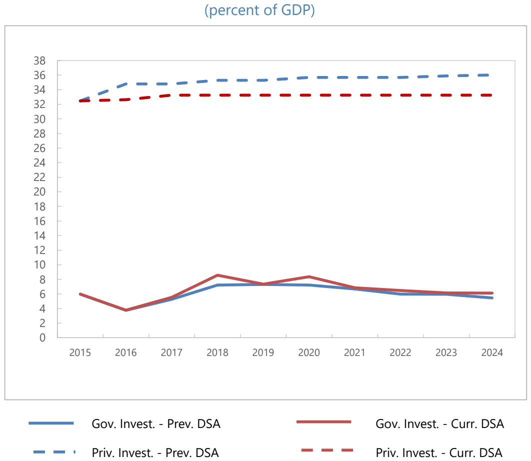
1/ Data cover Fund-supported programs for LICs (excluding emergency financing) approved since 1990. The size of 3-year adjustment from program inception is found on the horizontal axis; the percent of sample is found on the vertical axis.

Fiscal Adjustment and Possible Growth Paths 1/



1/ Bars refer to annual projected fiscal adjustment (right-hand side scale) and lines show possible real GDP growth paths under different fiscal multipliers (left-hand side scale).

Public and Private Investment Rates
(percent of GDP)



Contribution to Real GDP growth
(percent, 5-year average)

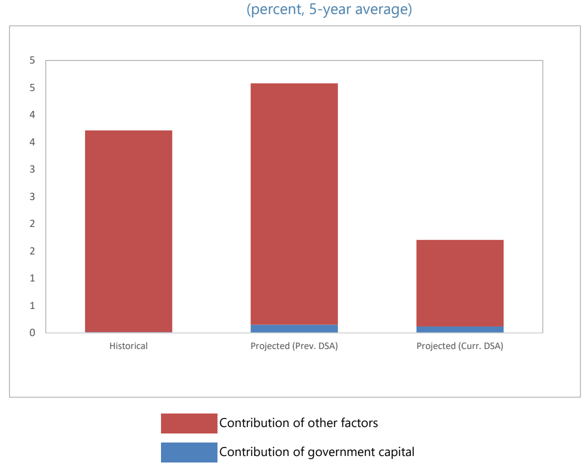
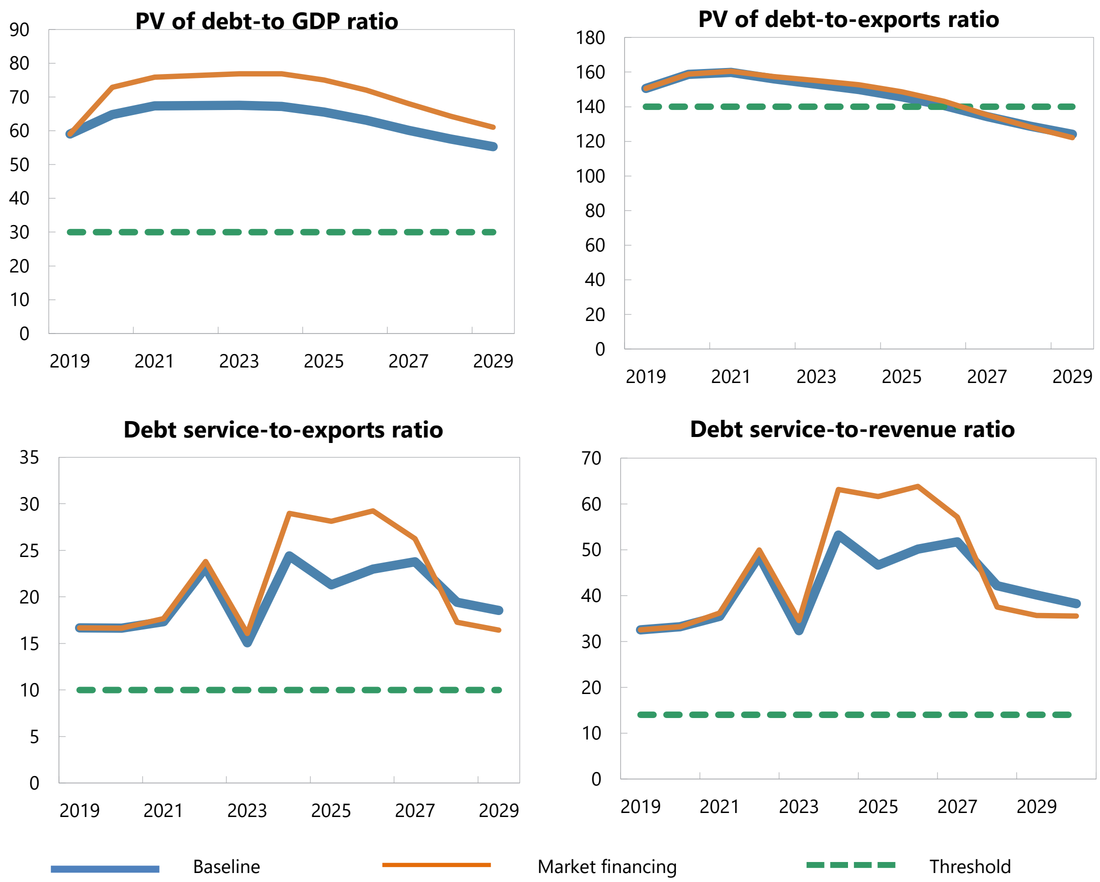


Figure 5. Zambia: Market-Financing Risk Indicators

	GFN 1/	EMBI 2/
Benchmarks	14	570
Values	19	1575
Breach of benchmark	Yes	Yes
Potential heightened liquidity needs	High	

1/ Maximum gross financing needs (GFN) over 3-year baseline projection horizon.
2/ EMBI spreads correspond to the latest available data.



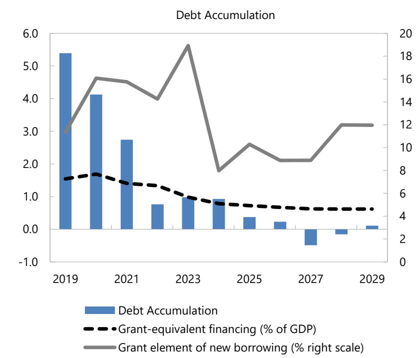
Sources: Country authorities; and staff estimates and projections.

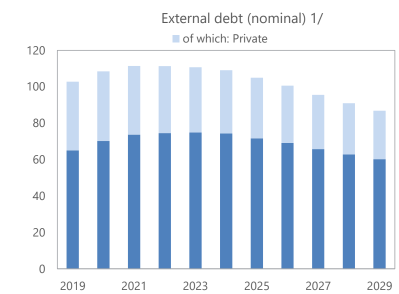
Table 1. Zambia: External Debt Sustainability Framework, Baseline Scenario, 2016–39

(In Percent of GDP, unless otherwise indicated)

	Actual			Projections								Average 8/	
	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029	2039	Historical	Projections
External debt (nominal) 1/	**83.4**	**74.5**	**87.9**	**102.8**	**108.5**	**111.4**	**111.4**	**110.7**	**109.1**	**86.8**	**61.5**	**44.9**	**103.0**
of which: public and publicly guaranteed (PPG)	**39.5**	**41.9**	**53.7**	**65.0**	**70.2**	**73.7**	**74.5**	**74.8**	**74.3**	**60.3**	**47.9**	**25.1**	**69.3**
Change in external debt	1.5	-9.0	13.5	14.9	5.7	3.0	0.0	-0.6	-1.6	-4.1	-1.5		
Identified net debt-creating flows	**2.1**	**-18.6**	**-2.1**	**-0.4**	**-1.3**	**-2.7**	**-3.5**	**-3.6**	**-4.0**	**-4.1**	**-4.4**	**-8.4**	**-3.2**
Non-interest current account deficit	**2.1**	**0.8**	**0.9**	**0.3**	**0.1**	**-0.6**	**-1.2**	**-1.9**	**-2.1**	**-2.9**	**-2.6**	**-2.2**	**-1.8**
Deficit in balance of goods and services	1.2	-1.4	0.8	1.3	0.2	-0.5	-1.0	-1.4	-1.7	-1.9	-1.9	**-3.3**	**-1.1**
Exports	35.4	35.1	37.4	39.2	40.9	42.1	43.2	44.2	44.8	44.5	43.5		
Imports	36.6	33.7	38.2	40.6	41.0	41.6	42.2	42.7	43.2	42.6	41.5		
Net current transfers (negative = inflow)	-1.0	-1.4	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0	**-1.6**	**-1.0**
of which: official	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Other current account flows (negative = net inflow)	1.9	3.5	1.1	0.1	0.9	0.9	0.8	0.6	0.6	0.0	0.3	**2.7**	**0.4**
Net FDI (negative = inflow)	**-2.3**	**-4.6**	**-2.0**	**-2.0**	**-2.9**	**-3.7**	**-4.4**	**-4.4**	**-4.4**	**-4.4**	**-4.4**	**-5.2**	**-3.9**
Endogenous debt dynamics 2/	**2.3**	**-14.8**	**-0.9**	**1.2**	**1.6**	**1.7**	**2.0**	**2.6**	**2.5**	**3.2**	**2.6**		
Contribution from nominal interest rate	1.1	0.9	1.8	3.2	3.3	3.6	3.8	4.3	4.1	4.6	3.7		
Contribution from real GDP growth	-3.1	-2.4	-2.6	-2.0	-1.8	-1.9	-1.8	-1.6	-1.6	-1.4	-1.1		
Contribution from price and exchange rate changes	4.3	-13.3	0.0	...	...	...	...	...	...	...	...		
Residual 3/	**-0.7**	**9.6**	**15.5**	**15.3**	**6.9**	**5.6**	**3.5**	**3.0**	**2.4**	**0.0**	**2.9**	**15.9**	**3.1**
of which: exceptional financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Sustainability indicators													
PV of PPG external debt-to-GDP ratio	**...**	**...**	**47.5**	**59.1**	**64.8**	**67.4**	**67.5**	**67.6**	**67.2**	**55.3**	**43.9**		
PV of PPG external debt-to-exports ratio	**...**	**...**	**127.2**	**150.5**	**158.7**	**159.9**	**156.2**	**153.0**	**150.0**	**124.2**	**101.0**		
PPG debt service-to-exports ratio	**10.1**	**8.8**	**11.7**	**16.7**	**16.6**	**17.3**	**23.2**	**15.1**	**24.4**	**18.5**	**14.5**		
PPG debt service-to-revenue ratio	**19.9**	**17.8**	**22.1**	**32.6**	**33.2**	**35.5**	**48.7**	**32.4**	**53.2**	**40.2**	**30.5**		
Gross external financing need (Million of U.S. dollars)	904.2	-503.0	729.7	1402.5	1070.1	848.8	1240.8	303.7	1327.3	635.8	188.1		
Key macroeconomic assumptions													
Real GDP growth (in percent)	3.8	3.5	3.7	2.0	1.7	1.7	1.6	1.5	1.5	1.6	1.8	**5.6**	**1.6**
GDP deflator in US dollar terms (change in percent)	-5.0	19.3	-0.4	-12.2	-4.1	-1.4	-0.6	-0.1	0.4	2.6	2.6	**-0.4**	**-0.6**
Effective interest rate (percent) 4/	1.4	1.3	2.5	3.3	3.2	3.3	3.4	3.9	3.8	5.3	6.2	**2.4**	**4.1**
Growth of exports of G&S (US dollar terms, in percent)	-9.8	22.4	10.0	-5.9	1.5	3.5	3.5	3.5	3.5	4.0	4.3	**8.3**	**2.6**
Growth of imports of G&S (US dollar terms, in percent)	-10.9	13.8	16.9	-4.8	-1.4	1.8	2.4	2.5	3.0	4.0	4.3	**8.6**	**2.0**
Grant element of new public sector borrowing (in percent)	...	...	...	11.3	16.1	15.8	14.3	18.9	8.0	12.0	11.2	**...**	**12.4**
Government revenues (excluding grants, in percent of GDP)	18.0	17.3	19.8	20.1	20.5	20.6	20.6	20.5	20.6	20.5	20.6	**17.0**	**20.5**
Aid flows (in Million of US dollars) 5/	497.0	431.8	407.0	308.2	314.4	242.8	269.7	226.9	187.6	136.6	206.2		
Grant-equivalent financing (in percent of GDP) 6/	...	...	...	1.5	1.7	1.4	1.3	1.0	0.8	0.6	0.6	**...**	**1.0**
Grant-equivalent financing (in percent of external financing) 6/	...	...	...	13.0	17.2	17.0	15.3	20.5	8.9	12.9	11.5	**...**	**13.5**
Nominal GDP (Million of US dollars)	20,941	25,868	26,720	23,946	23,342	23,415	23,636	23,951	24,401	29,691	45,642		
Nominal dollar GDP growth	-1.4	23.5	3.3	-10.4	-2.5	0.3	0.9	1.3	1.9	4.2	4.5	**5.3**	**1.1**
Memorandum items:													
PV of external debt 7/	...	...	81.8	96.8	103.1	105.1	104.3	103.5	102.0	81.8	57.5		
In percent of exports	...	...	218.8	246.7	252.3	249.3	241.4	234.4	227.6	183.8	132.3		
Total external debt service-to-exports ratio	12.7	5.2	10.2	19.1	18.1	18.9	25.0	17.1	26.6	21.2	17.0		
PV of PPG external debt (in Million of US dollars)			12704.2	14145.7	15134.1	15774.5	15953.0	16184.5	16406.7	16415.7	20035.1		
(PVt-PVt-1)/GDPt-1 (in percent)				5.4	4.1	2.7	0.8	1.0	0.9	0.1	1.6		
Non-interest current account deficit that stabilizes debt ratio	0.7	9.8	-12.6	-14.5	-5.6	-3.6	-1.2	-1.3	-0.5	1.2	-1.1		

Definition of external/domestic debt	**Residency-based**
Is there a material difference between the two criteria?	**Yes**





Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as [r - g - ρ(1+g) + Ɛα (1+r)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, ρ = growth rate of GDP deflator in U.S. dollar terms, Ɛ=nominal appreciation of the local currency, and α= share of local currency-denominated external debt in total external debt.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

4/ Current-year interest payments divided by previous period debt stock.

5/ Defined as grants, concessional loans, and debt relief.

6/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

7/ Assumes that PV of private sector debt is equivalent to its face value.

8/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

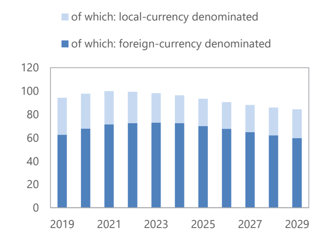
Table 2. Zambia: Public Sector Debt Sustainability Framework, Baseline Scenario, 2016–39

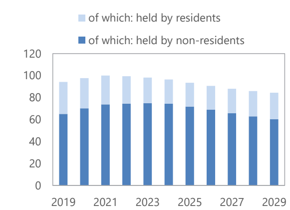
(In Percent of GDP, unless otherwise indicated)

	Actual			Projections								Average 6/	
	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029	2039	Historical	Projections
Public sector debt 1/	**60.7**	**65.6**	**80.8**	**94.2**	**97.7**	**100.0**	**99.3**	**98.2**	**96.4**	**84.4**	**76.3**	**40.0**	**93.5**
of which: external debt	**39.5**	**41.9**	**53.7**	**65.0**	**70.2**	**73.7**	**74.5**	**74.8**	**74.3**	**60.3**	**47.9**	**25.1**	**69.3**
Change in public sector debt	2.6	4.9	15.3	13.4	3.5	2.3	-0.6	-1.1	-1.8	-1.5	-0.1		
Identified debt-creating flows	**-6.8**	**-0.2**	**6.9**	**4.4**	**1.3**	**0.7**	**-0.1**	**-0.5**	**-1.2**	**-2.3**	**-1.4**	**2.8**	**-0.7**
Primary deficit	**2.2**	**3.5**	**2.7**	**-1.1**	**-1.0**	**-2.8**	**-3.3**	**-3.8**	**-4.1**	**-4.8**	**-4.0**	**2.7**	**-3.6**
Revenue and grants	18.2	17.5	20.0	20.3	20.6	20.7	20.7	20.6	20.7	20.6	20.7	**17.9**	**20.6**
of which: grants	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.0		
Primary (noninterest) expenditure	20.5	21.0	22.7	19.2	19.6	17.9	17.4	16.8	16.6	15.8	16.6	**20.6**	**17.0**
Automatic debt dynamics	**-9.1**	**-3.7**	**4.2**	**5.5**	**2.4**	**3.5**	**3.2**	**3.3**	**2.8**	**2.5**	**2.6**		
Contribution from interest rate/growth differential	-0.3	-1.1	-0.5	0.0	0.8	1.3	1.5	2.0	1.8	2.8	2.9		
of which: contribution from average real interest rate	1.8	1.0	1.8	1.6	2.3	3.0	3.1	3.5	3.3	4.2	4.2		
of which: contribution from real GDP growth	-2.1	-2.1	-2.3	-1.6	-1.6	-1.7	-1.6	-1.4	-1.5	-1.4	-1.4		
Contribution from real exchange rate depreciation	-8.7	-2.7	4.7	...	...	...	...	...	...	...	...		
Other identified debt-creating flows	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Recognition of contingent liabilities (e.g., bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Debt relief (HIPC and other)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Other debt creating or reducing flow (please specify)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Residual	**9.5**	**5.1**	**8.3**	**14.5**	**3.7**	**3.8**	**1.2**	**0.7**	**0.4**	**0.5**	**1.1**	**3.4**	**2.1**
Sustainability indicators													
PV of public debt-to-GDP ratio 2/	**...**	**...**	**81.3**	**93.5**	**95.5**	**96.7**	**95.1**	**93.4**	**91.6**	**80.6**	**73.3**		
PV of public debt-to-revenue and grants ratio	**...**	**...**	**405.9**	**460.6**	**463.1**	**466.6**	**459.4**	**452.8**	**443.5**	**391.4**	**354.8**		
Debt service-to-revenue and grants ratio 3/	**58.6**	**57.8**	**71.2**	**81.7**	**82.2**	**75.2**	**83.2**	**63.1**	**80.8**	**72.6**	**77.0**		
Gross financing need 4/	12.9	13.6	17.0	19.5	16.0	13.0	13.6	8.8	12.3	11.1	13.3		
Key macroeconomic and fiscal assumptions													
Real GDP growth (in percent)	3.8	3.5	3.7	2.0	1.7	1.7	1.6	1.5	1.5	1.6	1.8	**5.6**	**1.6**
Average nominal interest rate on external debt (in percent)	5.5	5.4	6.4	4.8	4.9	4.7	4.7	5.1	4.8	6.0	5.7	**3.1**	**5.3**
Average real interest rate on domestic debt (in percent)	-0.6	-0.9	1.2	0.6	2.0	4.2	4.5	5.0	5.5	7.8	9.2	**4.1**	**5.2**
Real exchange rate depreciation (in percent, + indicates depreciation)	-19.8	-7.3	12.3	...	...	...	...	...	...	...	...	**3.7**	**...**
Inflation rate (GDP deflator, in percent)	13.6	10.1	9.5	10.0	9.7	8.2	8.3	8.0	7.7	7.2	7.3	**9.3**	**8.0**
Growth of real primary spending (deflated by GDP deflator, in percent)	-14.3	6.1	12.3	-13.7	3.6	-7.0	-1.3	-2.0	0.1	2.1	2.7	**8.5**	**-1.6**
Primary deficit that stabilizes the debt-to-GDP ratio 5/	-0.4	-1.4	-12.6	-14.5	-4.5	-5.1	-2.7	-2.7	-2.3	-3.3	-4.0	**-4.8**	**-4.0**
PV of contingent liabilities (not included in public sector debt)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		

Definition of external/domestic debt	**Residency-based**
Is there a material difference between the two criteria?	**Yes**

Public sector debt 1/





Sources: Country authorities; and staff estimates and projections.

1/ Coverage of debt: The central government plus social security, central bank, government-guaranteed debt, non-guaranteed SOE debt . Definition of external debt is Residency-based.

2/ The underlying PV of external debt-to-GDP ratio under the public DSA differs from the external DSA with the size of differences depending on exchange rates projections.

3/ Debt service is defined as the sum of interest and amortization of medium and long-term, and short-term debt.

4/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period and other debt creating/reducing flows.

5/ Defined as a primary deficit minus a change in the public debt-to-GDP ratio ((-): a primary surplus), which would stabilizes the debt ratio only in the year in question.

6/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

Table 3. Zambia: Sensitivity Analysis for Key Indicators and Publicly Guaranteed External Debt, 2019–29

(In Percent)

	Projections 1/										
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
PV of debt-to GDP ratio											
Baseline	**59**	**65**	**67**	**67**	**68**	**67**	**66**	**63**	**60**	**58**	**55**
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2029 2/	**59**	**55**	**52**	**47**	**43**	**39**	**35**	**32**	28	25	22
B. Bound Tests											
B1. Real GDP growth	**59**	**68**	**73**	**73**	**73**	**73**	**71**	**69**	**65**	**62**	**60**
B2. Primary balance	**59**	**65**	**75**	**76**	**78**	**78**	**77**	**75**	**72**	**69**	**67**
B3. Exports	**59**	**81**	**109**	**111**	**113**	**114**	**113**	**110**	**104**	**99**	**94**
B4. Other flows 3/	**59**	**69**	**75**	**76**	**76**	**76**	**75**	**72**	**69**	**66**	**63**
B5. Depreciation	**59**	**82**	**84**	**84**	**84**	**84**	**81**	**78**	**75**	**71**	**69**
B6. Combination of B1-B5	**59**	**75**	**81**	**82**	**83**	**83**	**82**	**79**	**76**	**73**	**70**
C. Tailored Tests											
C1. Combined contingent liabilities	**59**	**67**	**71**	**71**	**72**	**72**	**71**	**69**	**66**	**63**	**61**
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	**59**	**67**	**71**	**71**	**72**	**72**	**70**	**68**	**64**	**62**	**59**
C4. Market Financing	**59**	**73**	**76**	**76**	**77**	**77**	**75**	**72**	**68**	**64**	**61**
Threshold	30	30	30	30	30	30	30	30	30	30	30
PV of debt-to-exports ratio											
Baseline	**151**	**159**	**160**	**156**	**153**	**150**	**146**	**141**	134	129	124
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2029 2/	**151**	136	123	109	98	88	78	70	62	55	49
B. Bound Tests											
B1. Real GDP growth	**151**	**159**	**160**	**156**	**153**	**150**	**146**	**141**	134	129	124
B2. Primary balance	**151**	**160**	**177**	**177**	**176**	**174**	**171**	**167**	**161**	**155**	**150**
B3. Exports	**151**	**242**	**396**	**392**	**389**	**387**	**382**	**373**	**355**	**338**	**322**
B4. Other flows 3/	**151**	**168**	**179**	**176**	**173**	**170**	**167**	**161**	**154**	**147**	**141**
B5. Depreciation	**151**	**158**	**156**	**152**	**149**	**146**	**141**	136	130	125	120
B6. Combination of B1-B5	**151**	**200**	**181**	**231**	**229**	**226**	**222**	**215**	**206**	**197**	**190**
C. Tailored Tests											
C1. Combined contingent liabilities	**151**	**164**	**167**	**165**	**163**	**161**	**157**	**153**	**147**	**141**	137
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	**151**	**169**	**173**	**169**	**165**	**162**	**157**	**152**	**145**	139	134
C4. Market Financing	**151**	**159**	**160**	**157**	**155**	**153**	**149**	**143**	135	128	122
Threshold	140	140	140	140	140	140	140	140	140	140	140
Debt service-to-exports ratio											
Baseline	**17**	**17**	**17**	**23**	**15**	**24**	**21**	**23**	**24**	**19**	**19**
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2029 2/	**17**	**15**	**15**	**19**	**11**	**18**	**15**	**15**	**15**	**11**	9
B. Bound Tests											
B1. Real GDP growth	**17**	**17**	**17**	**23**	**15**	**24**	**21**	**23**	**24**	**19**	**19**
B2. Primary balance	**17**	**16**	**18**	**25**	**17**	**26**	**23**	**25**	**27**	**22**	**22**
B3. Exports	**17**	**22**	**33**	**47**	**33**	**50**	**44**	**51**	**58**	**50**	**49**
B4. Other flows 3/	**17**	**17**	**18**	**24**	**16**	**26**	**22**	**25**	**27**	**22**	**21**
B5. Depreciation	**17**	**17**	**17**	**23**	**15**	**24**	**21**	**23**	**23**	**19**	**18**
B6. Combination of B1-B5	**17**	**19**	**24**	**32**	**22**	**34**	**30**	**34**	**35**	**30**	**29**
C. Tailored Tests											
C1. Combined contingent liabilities	**17**	**16**	**18**	**24**	**16**	**25**	**22**	**24**	**25**	**20**	**19**
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	**17**	**17**	**18**	**24**	**16**	**25**	**22**	**24**	**25**	**21**	**20**
C4. Market Financing	**17**	**17**	**18**	**24**	**16**	**29**	**28**	**29**	**26**	**17**	**16**
Threshold	10	10	10	10	10	10	10	10	10	10	10
Debt service-to-revenue ratio											
Baseline	**33**	**33**	**35**	**49**	**32**	**53**	**47**	**50**	**52**	**42**	**40**
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2029 2/	**33**	**31**	**30**	**39**	**24**	**39**	**32**	**32**	**32**	**23**	**20**
B. Bound Tests											
B1. Real GDP growth	**33**	**35**	**39**	**53**	**35**	**58**	**51**	**54**	**56**	**46**	**44**
B2. Primary balance	**33**	**33**	**36**	**52**	**36**	**57**	**49**	**54**	**58**	**49**	**47**
B3. Exports	**33**	**36**	**44**	**65**	**47**	**71**	**64**	**73**	**83**	**72**	**69**
B4. Other flows 3/	**33**	**33**	**37**	**51**	**35**	**56**	**49**	**54**	**58**	**48**	**46**
B5. Depreciation	**33**	**43**	**45**	**62**	**41**	**67**	**59**	**63**	**65**	**52**	**50**
B6. Combination of B1-B5	**33**	**35**	**41**	**56**	**39**	**61**	**54**	**61**	**64**	**53**	**51**
C. Tailored Tests											
C1. Combined contingent liabilities	**33**	**33**	**36**	**50**	**33**	**54**	**48**	**52**	**53**	**44**	**42**
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	**33**	**34**	**37**	**52**	**35**	**56**	**49**	**53**	**55**	**45**	**43**
C4. Market Financing	**33**	**33**	**36**	**50**	**35**	**63**	**62**	**64**	**57**	**37**	**36**
Threshold	14	14	14	14	14	14	14	14	14	14	14

Sources: Country authorities; and staff estimates and projections.

1/ A bold value indicates a breach of the threshold.

2/ Variables include real GDP growth, GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.

3/ Includes official and private transfers and FDI.

Table 4. Zambia: Sensitivity Analysis for Key Indicators of Public Debt, 2019–29

	Projections 1/										
	2019	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**	**2029**
PV of Debt-to-GDP Ratio											
Baseline	**94**	**96**	**97**	**95**	**93**	**92**	**89**	**86**	**84**	**82**	**81**
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2029 2/	**94**	**96**	**97**	**97**	**97**	**97**	**97**	**96**	**96**	**97**	**98**
B. Bound Tests											
B1. Real GDP growth	**94**	**100**	**106**	**106**	**106**	**105**	**104**	**103**	**102**	**102**	**103**
B2. Primary balance	**94**	**101**	**111**	**110**	**109**	**108**	**105**	**103**	**101**	**100**	**99**
B3. Exports	**94**	**106**	**126**	**126**	**126**	**125**	**123**	**120**	**116**	**112**	**108**
B4. Other flows 3/	**94**	**100**	**105**	**104**	**103**	**101**	**98**	**95**	**93**	**90**	**88**
B5. Depreciation	**94**	**105**	**104**	**101**	**99**	**96**	**93**	**90**	**87**	**85**	**84**
B6. Combination of B1-B5	**94**	**97**	**106**	**105**	**103**	**102**	**99**	**97**	**95**	**93**	**92**
C. Tailored Tests											
C1. Combined contingent liabilities	**94**	**104**	**105**	**103**	**102**	**100**	**97**	**95**	**92**	**91**	**90**
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	**94**	**97**	**100**	**99**	**99**	**99**	**97**	**96**	**95**	**95**	**95**
C4. Market Financing	**94**	**96**	**97**	**96**	**94**	**93**	**90**	**87**	**84**	**82**	**80**
TOTAL public debt benchmark	35	35	35	35	35	35	35	35	35	35	35
PV of Debt-to-Revenue Ratio											
Baseline	461	463	467	459	453	443	430	417	406	397	391
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2029 2/	461	464	470	470	471	472	469	467	468	471	476
B. Bound Tests											
B1. Real GDP growth	461	484	513	512	512	510	503	498	495	495	499
B2. Primary balance	461	488	538	533	529	522	510	499	490	484	480
B3. Exports	461	514	610	610	610	606	595	580	560	541	526
B4. Other flows 3/	461	483	507	502	497	489	477	463	449	437	429
B5. Depreciation	461	508	503	490	479	466	450	435	423	414	408
B6. Combination of B1-B5	461	471	511	506	501	493	481	469	459	451	447
C. Tailored Tests											
C1. Combined contingent liabilities	461	502	506	499	493	484	471	458	448	440	435
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	461	486	496	495	492	486	476	466	462	461	463
C4. Market Financing	461	463	468	462	457	450	437	422	408	396	387
Debt Service-to-Revenue Ratio											
Baseline	82	82	75	83	63	81	81	83	82	74	73
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2029 2/	82	77	73	82	65	80	79	80	81	75	77
B. Bound Tests											
B1. Real GDP growth	82	83	81	91	71	92	92	95	95	85	87
B2. Primary balance	82	80	82	98	73	90	89	92	94	85	88
B3. Exports	82	82	78	91	72	90	90	96	103	95	93
B4. Other flows 3/	82	82	76	86	66	83	83	87	88	80	78
B5. Depreciation	82	79	77	88	67	89	88	90	91	80	79
B6. Combination of B1-B5	82	78	75	94	70	87	87	88	87	76	77
C. Tailored Tests											
C1. Combined contingent liabilities	82	80	86	88	67	85	85	87	87	76	80
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	82	83	77	86	68	86	86	88	89	79	81
C4. Market Financing	82	82	76	84	65	91	96	96	88	69	68

Sources: Country authorities; and staff estimates and projections.

1/ A bold value indicates a breach of the benchmark.

2/ Variables include real GDP growth, GDP deflator and primary deficit in percent of GDP.

3/ Includes official and private transfers and FDI.

**Statement by Mr. Dumisani Mahlinza, Executive Director for Zambia,
Ms. Mmatshepo Maidi and Mr. Ted Sitima-wina, Senior Advisors
to the Executive Director**.

July 24, 2019

Introduction

1. Our authorities appreciate the candid and constructive policy dialogue during the recent Article IV consultation. They broadly concur with the staff assessment and key policy recommendations.

2. The Zambian authorities have continued to pursue their long-term development aspirations through the implementation of the Seventh National Development Plan (7NDP) and Economic Stabilization and Growth Programme. The 7NDP seeks to create a diversified and resilient economy for sustained growth and socioeconomic transformation driven by agriculture, tourism, manufacturing and mining, among others. Consistent with this objective, the authorities have prioritized public infrastructure investment financed largely by foreign borrowing.

3. In the course of implementing the 7NDP, significant fiscal pressures have arisen leading to large fiscal deficits, the accumulation of domestic arrears and a growing debt service obligation. Recognizing these challenges, in May 2019, the authorities announced a series of measures to contain spending including, the indefinite postponement of the contraction of new non-concessional loans; cancellation of some committed but undisbursed loans; and increased control and management of disbursements on foreign-financed loans. In this context, our authorities recognize the need for an urgent policy adjustment to entrench macroeconomic stability and bring debt to sustainable levels.

Recent Economic Developments and Outlook

4. Real GDP grew marginally by 3.7 percent in 2018 from 3.5 percent in 2017, reflecting modest expansion in telecommunications, financial and insurance activities, wholesale and retail trade, and mining. However, in 2019 growth is expected to be weighed down by the drought in the southern and western parts of the country, which has affected agricultural output and electricity production as well as weak domestic demand. Over the medium term, growth is expected to recover following the completion of large public infrastructure projects.

5. Inflation has remained within the Bank of Zambia's (BOZ) target band (6-8 percent), rising from 6.6 percent in 2017 to 7.0 percent in 2018. Going forward, inflation is expected to trend upwards due to an increase in food and fuel prices as well as exchange rate depreciation.

6. The current account deficit declined to 1.3 percent of GDP in 2018 from 1.7 percent of GDP in 2017, reflecting a recovery in copper exports at higher prices. At the same time, foreign reserves declined from 2.4 months of import cover in 2017 to 1.9 months in 2018.

Fiscal Policy and Debt Sustainability

7. The authorities are committed to pursue a front-loaded fiscal adjustment with a view to reduce the budget deficit to 6.5 percent of GDP in 2019 and reaching 3 to 4 percent of GDP in the medium term. In this regard, they are taking measures to enhance domestic revenue mobilization by broadening the tax base, reducing tax expenditures and exemptions, simplifying the tax system, strengthening compliance, and enhancing tax audit capacity. The auditing of large tax payers, particularly in the mining sector, is presently being carried out. The switch from VAT to Sales Tax, announced as part of the 2019 budget, is expected to result in large windfall gains. To ensure smooth transition, the authorities are addressing some implementation issues that were identified during the recently concluded country-wide consultation.

8. On the expenditure side, efforts to contain spending include aligning cash spending with available financing. Specific measures currently being undertaken include: prioritizing the funding of projects that are at least 80 percent complete; delaying the implementation of non-growth supportive projects; controlling foreign financed disbursements; curtailing personal emoluments (PEs) related expenditures, including the restriction of leave commutation while obliging all Government officials to take leave; and suspending both foreign and domestic travel for top Government officials. At the same time, strict adherence to the provisions of the Public Finance Management Act (PFMA) will be enforced. The authorities are also taking steps to tighten the commitment control system with a view to curb accumulation of domestic arrears. They plan to steadily clear the existing stock of arrears to ease liquidity in the market and improve financial sector performance.

9. The authorities recognize that strengthening public finance management will anchor fiscal sustainability and ensure efficient utilization of public resources. In this context, they are taking steps to improve the efficiency of public investments, including procurement, selection and implementation of projects. Accordingly, the authorities are working to review the Zambia Public Procurement Act (ZPPA) to ensure value for money. They have also established a Public Investment Board (PIB) to review and take decisions relating to public investment management for new capital projects. In parallel, the authorities are working on the Planning and Budgeting Bill and revising the Loans and Guarantees Act, which will provide the necessary framework for medium-term debt management.

10. Our authorities note the outcome of the debt sustainability analysis (DSA) and reiterate their commitment to bring debt onto a sustainable path. In this regard, they have taken a decision to indefinitely postpone contraction of all new non-concessional debt. They plan to re-scope, cancel or postpone some projects with a view to free up $500 million annually over the medium

term. In addition, they are discussing some debt reprofiling. On debt obligations, they are determined to remain current on debt service, with no default or arrears on either external or domestic debt. Further, measures are being taken to enhance debt management capacity and contain debt vulnerabilities. These include improving monthly cash flow forecasts to facilitate more flexibility in domestic debt auctions and enhancing oversight of state-owned enterprise (SOE) debt to allow timely monitoring of fiscal risks. In this context, the authorities look forward to the debt management TA to be jointly delivered by IMF, World Bank, and the Macroeconomic and Financial Management Institute of Eastern and Southern Africa (MEFMI).

Monetary and Exchange Rate Policies

11. In response to rising inflationary pressures, the Monetary Policy Committee (MPC) increased the policy rate by 50 basis points to 10.25 percent in May 2019, further demonstrating the authorities' resolve to stabilize monetary conditions. Going forward, the BoZ will continue to use monetary policy instruments at its disposal to keep inflation within the target band. Supported by the fiscal reorientation, the authorities believe that the current policy framework is adequate to anchor inflation expectations. They look forward to the completion of the forecasting and policy analysis system (FPAS) being developed with Fund TA, which will be useful in monetary policy decision making. The authorities reiterate their commitment to a flexible exchange rate. In this context, interventions in the foreign exchange market will be limited to smoothing excessive volatility as well as opportunistically building reserves, consistent with staff's recommendation.

Financial Sector

12. Safeguarding financial sector stability and resilience remains a key priority for the authorities. To this end, they have made good progress in upgrading the institutional, regulatory, supervision and crisis management frameworks in line with the 2017 FSAP recommendations. The amended BoZ Act is expected to enhance the bank's operational independence complemented by the new Banking and Financial Services Act (BFSA), whose implementing regulations are being finalized. While the banking system is well capitalized, the authorities are aware that deepening macro financial linkages could contribute to keeping non-performing loans (NPLs) above prudential norms. In this regard, they will continue to enhance supervision to mitigate risks. The legal framework for Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) which was revised and strengthened in 2017, in line with FATF, is also useful in supporting the authorities' anti-corruption efforts. Zambia recently underwent an evaluation which was largely positive, and recommendations thereof are being undertaken.

Structural Reforms

13. The authorities realize that far reaching structural reforms will be necessary to complement macroeconomic policies, promote inclusive growth and reduce poverty in the

context of the 7NDP which emphasizes agriculture, tourism, energy, and mining as the drivers of diversification. In agriculture, one of the labor-intensive sectors, the authorities developed the Zambia Integrated Agriculture Management Information System (ZIAMIS) to support agri-businesses, farmer expansion and extension services for agriculture-related public programs. In addition, they are implementing measures aimed at raising productivity and building resilience as well as improving the delivery of the Farmer Input Support Programme (FISP).

14. The 7NDP highlights access to markets, ICT, and infrastructure development as key growth enablers. In this respect, energy supply and transportation infrastructure are identified as development priorities to address infrastructure bottlenecks. To boost the energy generation capacity, a few projects are under construction while others are in the pipeline including solar energy projects that would reduce heavy reliance on hydroelectric power. On pricing, the ongoing cost of service study would inform electricity tariffs adjustments based on utilization with appropriate protection for the vulnerable groups. The authorities are also addressing human capital development through investments in quality education and healthcare systems given their significance in promoting inclusive growth. Notwithstanding the fact that Zambia compares favorably with the SSA average on several dimensions of the 2019 Doing Business Indicators, our authorities continue to take measures to further improve the business environment.

Conclusion

15. The authorities reiterate their commitment to preserving macroeconomic stability including bringing public debt on a sustainable path. They will continue with efforts to create a diversified and resilient economy for sustained growth and socioeconomic transformation. To this end, they look forward to continued collaboration with the Fund, requisite advice and technical assistance.

Statement by the Staff Representative on Zambia

July 24, 2019

The information below has become available following the issuance of the staff report SM/19/188. It does not alter the thrust of the staff appraisal.

1. **The Honorable Dr. Bwalya Ng'andu was sworn in as Minister of Finance on July 15th, replacing the Honorable Margaret Mwanakatwe**.

2. **On July 17th, Minister Ng'andu released an Update on Economic Developments**. Preliminary data indicated the economy grew by 2.6 percent in Q1 2019 compared to the prior year, and inflation rose to 8.6 percent (year on year) in June. The external debt stock at end-June was reported at $11.5 billion (inclusive of guarantees), and domestic government securities and bonds stood at 60.3 billion Kwacha. Gross international reserves stood at $1.41 billion at end-June, the same level as at end-March. The preliminary balance of payments estimates for 2018 had also been revised in May, and the revised estimated current account deficit in 2018 stood at $341.4 million (1.3 percent of GDP) compared to the previously-estimated deficit of $708 million (2.6 percent of GDP). A more favorable performance on primary income explains the bulk of the change from the earlier estimate.

3. **Spreads on Zambia's Eurobonds narrowed somewhat in comparison to levels seen in late May to early July and stood at 1,442 on July 18th**. The authorities also reported having cleared the *de minimus* arrears earlier reported by France to the Paris Club, and had begun clearing *de minimus* arrears to Belgium.