



# ZAMBIA

June 2015

## 2015 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 2015 Article IV consultation with Zambia, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its May 20, 2015 consideration of the staff report that concluded the Article IV consultation with Zambia.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on May 20, 2015, following discussions that ended on March 31, 2015, 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 May 5, 2015.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the World Bank.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Zambia.

The document listed below will be separately released.

### Selected Issues Paper

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### **IMF Executive Board Concludes 2015 Article IV Consultation with Zambia**

On May, 20, 2015, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation<sup>1</sup> with Zambia.

Zambia has strong growth potential, but lingering vulnerabilities pose risks to the outlook. In the last two years, the Zambian economy has been weighed down by large fiscal imbalances, lower copper prices and policy uncertainties. Real GDP growth has slowed, the current account has deteriorated, international reserves have fallen and the exchange rate has been under downward pressure. Fund staff estimate that real GDP growth slowed from 6.7 percent in 2013 to 5.6 percent in 2014, driven by a contraction in copper production. Year-on-year inflation fell from a peak of 8.1 percent in November 2014 to 7.2 percent in March 2015, largely driven by lower fuel prices. The fiscal deficit on a cash basis rose sharply to 6.5 percent of GDP in 2013 and remained elevated at 6 percent in 2014.

The Zambian kwacha has fluctuated widely since the beginning of 2014. After depreciating by about 20 percent in the first half of the year, it recovered in the second half of the year reflecting tightened monetary policy and the issuance of Zambia's second Eurobond in the amount of US\$1 billion. Downward pressures on the Kwacha re-emerged in the first quarter of 2015 reflecting external developments (U.S. dollar strength, and lower copper prices) as well as domestic factors (growing fiscal deficit, depleting government deposits and a change in the fiscal

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<sup>1</sup> 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.

regime that adversely affected the outlook for the mining sector). Monetary policy has carried the burden of containing inflation and countering the depreciation pressures on the Kwacha.

Growth is projected to average 5.5–7 percent a year over the medium term, reflecting the impact of investments in mining and electricity in recent years. Inflation is projected to stay in single digits and decline gradually to 5 percent. Key risks to the outlook are delayed fiscal adjustment in the lead-up to general elections in 2016, persistent low copper prices, and policy uncertainties that could undermine investment in the economy. On the upside, steps taken by the government to resolve mining taxation problems by easing documentation for VAT refund claims by exporters and the decision to rescind the new fiscal regime for mining introduced in January 2015 could lead to higher copper production and growth.

### **Executive Board Assessment<sup>2</sup>**

Executive Directors noted that, after a period of strong macroeconomic performance, the Zambian economy is facing significant challenges arising from large fiscal deficits, lower copper prices, and policy uncertainties. Directors emphasized that steadfast and strong efforts are needed to ensure macroeconomic stability and foster inclusive growth.

Directors underscored the need for significant fiscal consolidation in 2015 and over the medium term, to reduce the deficit, stabilize debt, and create conditions for lower interest rates.

They welcomed the authorities' decision to implement the policy of full cost recovery in the pricing of petroleum products. Directors called for sustained expenditure and revenue efforts, including efforts to contain the wage bill, target social spending through cash transfers, broaden the tax base, and put the pension system on a sustainable footing. They also welcomed the authorities' decision to rescind the royalty-based mining fiscal regime, and called for swift action to resolve the issue of outstanding VAT refund claims to exporters.

Directors welcomed recent progress in the implementation of public financial management reforms, including the Integrated Financial Management Information System and the pilot phase of Treasury Single Account. They encouraged the authorities to utilize these tools to strengthen

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<sup>2</sup> At the conclusion of the discussion, the 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>.

budget controls to avoid the accumulation of arrears, and to enhance the transparency of the budget process by improving fiscal reporting.

Directors noted that Zambia's moderate risk of external debt distress calls for prudence in borrowing on commercial terms. Recognizing the need to address infrastructure gaps, they advised the authorities to strengthen the project selection process and prioritize capital spending. They also called for the development of a comprehensive debt management strategy to help address public debt vulnerabilities.

Directors supported the commitment of the Bank of Zambia to maintain a tight monetary policy stance to contain inflationary pressures. They stressed the importance of continued exchange rate flexibility and rebuilding reserves to provide adequate buffers for the economy.

Directors noted that the financial sector remains well capitalized and stable, and commended the strengthened banking supervision. They recommended continued efforts to enhance financial inclusion, including improving access to financial services in rural areas. Directors also called for the elimination of interest rate ceilings as they restrict access to credit.

Directors noted that poverty remains high, particularly in rural areas. To foster job creation, inclusive growth, and economic diversification, Directors encouraged the authorities to improve the business climate by restraining labor costs and ensuring a stable regulatory environment. They also recommended action to address infrastructure and electricity supply constraints; develop skills; and rationalize farm subsidies with a reallocation of resources to the social cash transfer program.

## Zambia: Selected Economic Indicators, 2012–15

	2012	2013	2014 Prel.	2015 Proj.
	(Percentage change, unless otherwise indicated)			
National account and prices				
GDP growth at constant prices	6.8	6.7	5.6	5.6
Mining	-2.7	5.9	-7.2	7.7
Non mining	8.0	6.8	7.1	5.4
GDP deflator	4.2	5.7	7.1	7.5
GDP at market prices (millions of kwacha)	128,370	144,775	163,736	186,015
Consumer prices				
Consumer prices (average)	6.6	7.0	7.8	8.0
Consumer prices (end of period)	7.3	7.1	7.9	8.0
External sector				
Terms of trade (deterioration -)	-14.2	-6.6	-2.9	-6.0
Average exchange rate (kwacha per U.S. dollar)	5.1	5.4	6.2	...
(percent change; depreciation +)	5.9	4.8	14.0	...
Real effective exchange rate (depreciation -) <sup>1</sup>	4.0	4.2	-4.0	...
Money and credit				
Domestic credit to the private sector	37.0	12.6	26.4	12.2
Reserve money (end of period)	51.4	-0.4	59.5	18.2
Broad Money (M3)	17.9	20.8	12.6	15.7
	(Percent of GDP, unless otherwise indicated)			
National accounts				
Gross investment	34.2	33.6	31.1	31.7
Government	6.2	6.3	5.4	5.9
Private	28.0	27.3	25.7	25.7
National savings	39.7	33.0	29.4	31.1
External current account balance	5.5	-0.6	-1.7	-0.6
Central government budget				
Revenue	19.1	18.4	19.3	18.0
Taxes	15.0	14.7	15.8	12.9
Grants	1.7	1.5	0.8	0.8
Other revenue	2.4	2.2	2.7	4.4
Expenditure	22.3	25.1	24.8	25.8
Expense	16.2	18.8	19.4	19.9
Net acquisition of nonfinancial assets	6.2	6.3	5.4	5.9
Net lending/borrowing <sup>2</sup>	-2.9	-6.5	-6.0	-7.7
Excluding grants	-4.6	-8.0	-6.8	-8.5
Net acquisition of financial assets	1.7	-1.0	0.3	-0.7
Domestic	1.7	-1.0	0.3	-0.7
Foreign	0.0	0.0	0.0	0.0
Net incurrence of liabilities	4.6	5.4	6.2	7.0
Domestic	0.9	5.0	1.0	1.2
Foreign	3.7	0.4	5.3	5.9
Government deposits	5.5	3.3	2.8	1.8
External sector				
Current account balance	5.5	-0.6	-1.7	-0.6
(excluding grants)	4.7	-1.1	-2.0	-0.7
Gross International Reserves (months of prospective imports) <sup>3</sup>	3.3	3.1	3.8	3.7
Excluding FDI-financed imports	3.8	3.5	4.4	4.4
Public debt				
	(Percent of GDP)			
Total central government debt, gross (end-period)	25.5	28.5	35.1	39.6
External	13.5	13.1	18.4	25.3
Domestic	12.0	15.4	16.7	14.3

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

<sup>1</sup> Excludes Zimbabwe.

<sup>2</sup> Measured from total financing below the line.

<sup>3</sup> Total reserves including encumbered and unencumbered reserves.



# ZAMBIA

## STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION

May 5, 2015

### KEY ISSUES

**Context.** Zambia achieved strong growth and macroeconomic stability over most of the last decade. However, in the last two years, the Zambian economy has been facing strong headwinds from large fiscal imbalances, lower copper prices, and policy uncertainties. The current account has deteriorated, international reserves have fallen, and the exchange rate has been under downward pressure.

**Outlook and risks.** Provided the authorities implement strong adjustment measures, growth is projected to remain at annual rates of 5½–7 percent over the medium term, as investments in mining and electricity bear fruit. Annual inflation is projected to stay in single digits and decline gradually to 5 percent. Key risks to the outlook are persistent low copper prices, delayed fiscal adjustment in the lead-up to general elections in 2016, and policy uncertainties that could undermine mining operations and overall investment in the economy.

**Resolving mining sector tax issues.** A large build up of VAT refund claims of exporters and a change in the mining fiscal regime that came into effect at the beginning of 2015 adversely impacted the outlook for the mining sector which accounts for three quarters of Zambia's export earnings. The authorities have partially addressed the VAT refund problem and have announced that the mining fiscal regime will revert to a system similar to what was in effect in 2014.

**Ensuring macroeconomic stability and reducing external vulnerability.** Growing fiscal deficits and depleting government deposits are threatening macroeconomic stability. Fiscal adjustment and continued tight monetary policy will help stabilize the exchange rate and contain inflation pressures. Given Zambia's susceptibility to external shocks, the Bank of Zambia should aim to rebuild reserves over the medium term. Also, the export base needs to be diversified to reduce the high dependence on copper.

**Enhancing competitiveness and inclusive growth.** The government needs to address impediments to doing business and labor market policies in order to enhance competitiveness and promote job creation. To maintain Zambia as an attractive investment destination, frequent regulatory changes and uncertainty about policy direction should be avoided.

Approved By  
**David Owen and  
 Bob Traa**

Discussions took place in Lusaka during December 4–18, 2014 and March 19–30, 2015. The team comprised Messrs. Tsikata (head), Cui, Jang, Rosales (all AFR), Tchaidze (SPR), and Rasmussen (resident representative). Ms. Kapwepwe (Executive Director) and Mr. Saidy (OED) participated in the discussions. The mission met with the Minister of Finance, the Governor of the Bank of Zambia (BoZ), other senior government and BoZ officials, and representatives of the private sector, trade unions, civil society, and the donor community.

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## BACKGROUND

- 1. Zambia achieved high growth and macroeconomic stability over most of the past decade (Figure 1).** This performance was the result of market-liberalizing reforms that started in the 1990s, strong copper prices (from 2004) which helped attract foreign direct investment (FDI), and prudent macroeconomic policies. However, poverty remains high (at over 60 percent of the population) with a large population of underemployed youth, and Zambia is likely to miss many of the Millennium Development Goals (Table 9).
- 2. The economy is facing strong headwinds.** Over the last two years, large fiscal deficits, lower copper prices and policy uncertainties have exerted significant pressures on the exchange rate and slowed growth. The new royalty-based mining fiscal regime that came into effect in January 2015 dampened the outlook for production and investment in the mining sector, with ripple effects to other sectors. On April 20, the cabinet of ministers approved a return to a mining fiscal regime similar to what was in place in 2014, comprising a corporate income tax and uniform royalty. This reversal, which is expected to become effective from July 1, requires parliamentary approval.
- 3. There has been a large build-up of VAT refund claims of exporters and expenditure arrears.** In September 2013, the government tightened enforcement of documentation requirements on VAT refunds, which led to a significant backlog of refunds (Appendix II). Outstanding VAT refund claims grew from 1 percent of GDP at end-2013 to 3 percent of GDP at end-2014. The documentation requirements for exporters were eased in February 2015 but there has been no progress yet on resolving the outstanding claims.<sup>1</sup> On the expenditure side, the government accumulated domestic arrears equal to 2.5 percent of GDP in 2014, including to the public pension system, contractors for road projects, and obligations associated with agricultural subsidies.
- 4. Progress in implementing past Fund policy advice has been mixed (Box 1).** The fiscal situation has worsened, and a new royalty-only mining fiscal regime was introduced against the advice of Fund staff. Domestic fuel prices and electricity tariffs were adjusted to reduce subsidies, but fuel subsidies re-emerged in early-2015 because of depreciation of the kwacha and a large reduction in domestic retail prices in January (SI, Chapter IV). The Bank of Zambia (BoZ) tightened monetary policy to contain inflation and allowed more exchange rate flexibility. The authorities have also made progress in improving access to financial services.
- 5. Zambia's data provision has some shortcomings but is broadly adequate for surveillance purposes.** The authorities improved national accounts data with technical assistance from the Fund, including rebasing their benchmark year to 2010 from 1994 and expanding coverage. According to the rebased GDP data, 2013 nominal GDP was about 20 percent higher than previously estimated.

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<sup>1</sup> The authorities have not formally recognized all these claims as obligations. Some of the claims were the subject of court cases.

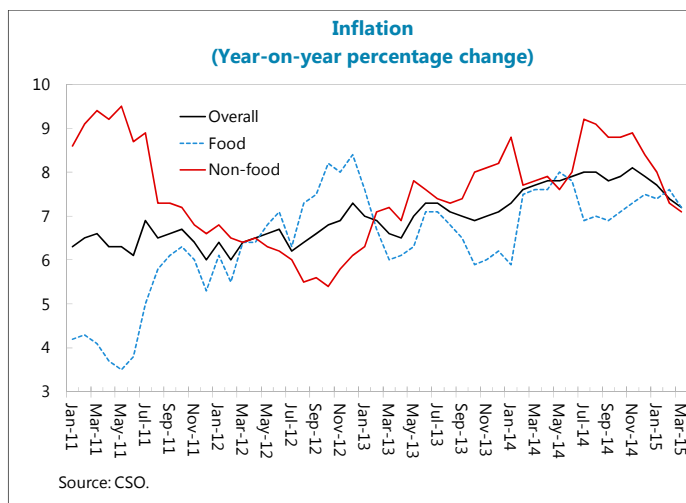
6. **A new president took office in January 2015.** Following his narrow victory in a by-election, Mr. Edgar Lungu was sworn in as the sixth president of Zambia on January 25. He will serve out the remainder of the term of President Michael Sata who died in October 2014. General elections are scheduled for September 2016.

### Box 1. Main Recommendations of the 2013 Article IV Consultation

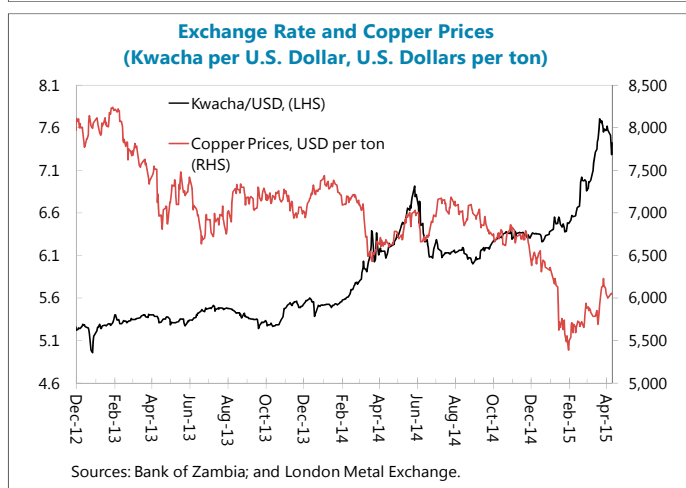
Recommendations	Status
<p><b>Fiscal policy:</b> Reduce the fiscal deficit to 5 percent of GDP in 2014 and to 3 percent over the medium term by containing recurrent expenditures while boosting domestic revenue.</p>	<p>Following a 45 percent average increase in wages and salaries in late 2013, a two-year wage freeze was introduced in 2014 and has been maintained in 2015. While the cash deficit narrowed slightly in 2014, the underlying deficit increased as a result of overspending, and accumulation of VAT refund claims and expenditure arrears.</p>
<p><b>Public financial management:</b> Stepped up efforts are needed. In particular, investment planning needs to be strengthened to support the scaling up of capital spending.</p>	<p>Progress has been made in implementing the Treasury Single Account and rolling out the Integrated Financial Management Information System (IFMIS), but investment planning needs to be improved.</p>
<p><b>Monetary policy:</b> BoZ needs to continue to tighten monetary policy to contain inflation. BoZ should allow more exchange rate flexibility and continue to build up reserves.</p>	<p>BoZ tightened monetary policy. The exchange rate moved flexibly and BoZ built up international reserves, although still below its medium-term target. BoZ removed the exchange restrictions in the regulation on foreign exchange transactions.</p>
<p><b>Financial sector policy:</b> Remove lending rate ceilings as part of the effort to improve access to financial services.</p>	<p>Access to financial services has improved but lending rate ceilings remain.</p>
<p><b>Competitiveness.</b> Staff advised maintaining a good business environment for strong growth and economic diversification.</p>	<p>Frequent changes in regulations and uncertainty about policy direction are clouding the business climate.</p>

## RECENT DEVELOPMENTS

7. **Growth and inflation.** Real GDP growth slowed from 6.7 percent in 2013 to an estimated 5.6 percent in 2014. The slowdown was driven by a significant contraction in copper production arising from technical problems at some mines; this was partially offset by a bumper harvest in agriculture. The annual rate of inflation rose from 7.1 percent in 2013 to 7.9 percent in 2014, reflecting the impact of a large increase in civil service salaries in late 2013, exchange rate depreciation in the first half of 2014, and increases in fuel prices and electricity tariffs. Inflation fell from a peak of 8.1 percent in November 2014 to 7.2 percent in March 2015, largely driven by lower fuel prices.



8. **The Zambian kwacha was under pressure during the first half of 2014 and again in the first quarter of 2015.** The kwacha depreciated by about 20 percent against the U.S. dollar during both periods, reflecting both external factors (lower copper price for both periods and dollar strength in the first quarter of 2015), and domestic factors (loose fiscal policy for both periods and uncertainty about mining taxation in early 2015).



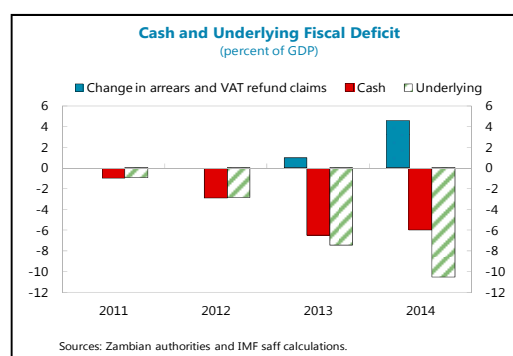
9. **Monetary policy has carried the burden of fighting depreciation and containing inflation.** BoZ tightened monetary policy, including increasing the policy rate and reserve requirements (Text Table).<sup>2</sup> While the BoZ allowed the currency to depreciate, it also sold substantial amounts of U.S. dollars in the foreign exchange market, particularly in the first half of 2014. After tightening monetary policy substantially in response to the

Kwacha Depreciation and Policy Response		
	Feb–May 2014	Jan–Mar 2015
Exchange rate depreciation	22%	20%
BoZ policy rate	from 9.75 to 12%	no change at 12.5%
Reserve requirements	from 8 to 14%	from 14 to 18%
FX intervention	\$500 million	\$150 million

<sup>2</sup> In March 2014, the authorities revoked two statutory instruments (SIs)—one that restricted the use of foreign currencies in domestic transactions (SI33 of 2012) and another that tightened reporting requirements on foreign transactions (SI55 of 2013).

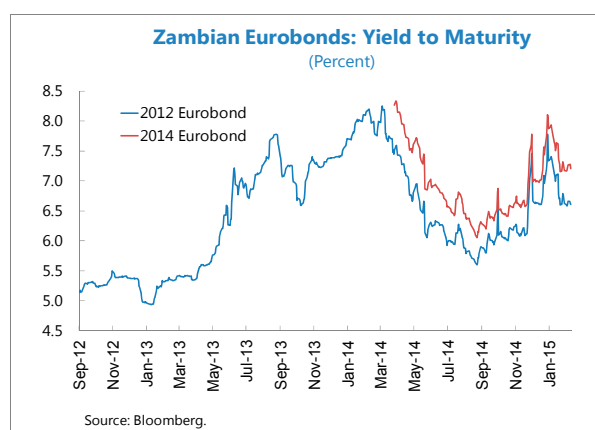
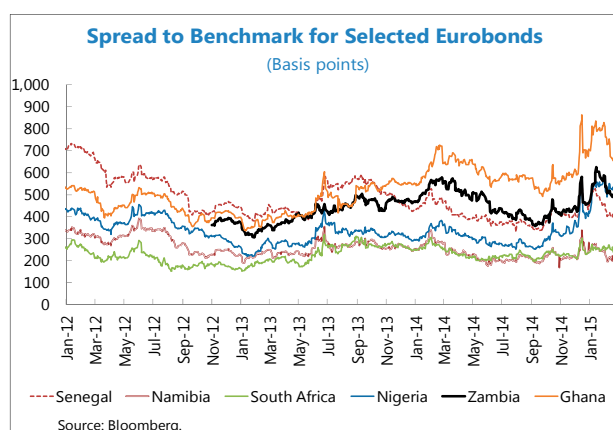
exchange rate pressure in the first half of 2014, the BoZ has maintained a tight policy stance; at its November 2014 monetary policy committee (MPC) meeting, the BoZ increased the policy rate by 50 basis points to 12.5 percent, citing deterioration in the external sector and the objective of lowering inflation to 7 percent by end-2015, and kept the rate at 12.5 percent at the February 2015 MPC meeting. In light of the renewed pressure on the exchange rate in recent months, the BoZ increased reserve requirements from 14 to 18 percent from early April 2015.

10. **Fiscal policy has been loose (Figure 2).** The fiscal deficit rose sharply in 2013 and remained elevated in 2014. On a cash basis, the deficit declined from 6.5 percent of GDP in 2013 to 6 percent in 2014. However, the underlying deficit—adjusting for the accumulation of outstanding VAT refund claims and expenditure arrears—grew from 7.5 percent of GDP in 2013 to 10.6 percent in 2014 (Text Chart). The large government financing needs have raised domestic interest rates substantially, with the 1-year Treasury bill rate increasing from about 12 percent in 2012 to over 20 percent in recent months.



11. **The external position has been under pressure (Figure 3).** The current account deficit is estimated to have widened to 1¾ percent of GDP in 2014 as a decline in imports (mostly driven by lower investment activity in the mining sector and kwacha depreciation) was more than offset by a reduction in non-copper exports. Financing inflows increased, but mainly due to proceeds from the \$1 billion Eurobond issued in April 2014, which allowed international reserves to rise to \$3 billion (3.8 months of imports) in 2014 from \$2.7 billion (3.1 months of imports) in 2013. Since then, reserves have again fallen back to the end-2013 level, partly reflecting intervention in the foreign exchange market.

12. **Sovereign bond spreads.** The yield for the Eurobond issued in 2014 was 8.625 percent, 3 percentage points higher than on the 2012 Eurobond at issuance. Zambia's Eurobond yields have tended to move broadly in line with those of other sub-Saharan African countries.



## OUTLOOK AND RISKS

13. **Zambia has strong growth potential.** Growth in 2015 is expected to be maintained at the 2014 level (estimated at 5.6 percent) as the projected impact of increased output from the mining sector (reflecting the coming on stream of a major new mine) is offset by a decline in agricultural output due to unfavorable weather conditions. Over the medium term, growth is projected to remain strong at 6–7 percent a year on the back of an expected further increase in mining production due to large FDI in the sector in recent years. Given the depreciation of the kwacha and expected increases in fuel prices, inflation is projected to reach 8 percent in 2015. Assuming the authorities implement fiscal adjustment measures discussed with the mission and that monetary policy remains tight, staff projects inflation to decline gradually to 5 percent in the medium term. Increased copper production and non-copper exports together with the proposed fiscal adjustment are expected to improve the current account to a small surplus over the medium term (Text Table 1).

**Text Table 1. Zambia: Selected Economic Indicators**

	2013	2014	2015	2016	2017	2018	2019	2020
Real GDP growth (%)	6.7	5.6	5.6	6.2	6.9	7.0	6.8	6.8
Inflation (y-o-y, %, end-period)	7.1	7.9	8.0	7.0	6.0	5.0	5.0	5.0
Overall fiscal deficit (cash basis, % of GDP)	-6.5	-6.0	-7.7	-6.0	-5.0	-4.0	-3.4	-2.9
Underlying fiscal deficit (% of GDP) <sup>1</sup>	-7.5	-10.6	-5.7	-5.0	-3.8	-3.7	-3.4	-2.9
External current account balance (% of GDP)	-0.6	-1.7	-0.6	1.4	2.5	3.0	3.3	3.4
Gross international reserves								
US\$ billions	2.7	3.1	3.2	3.5	3.9	4.3	4.8	5.2
Months of prospective imports	3.1	3.8	3.7	3.8	3.8	3.8	3.9	4.0
Copper price (US\$/tonne)	7,331	6,863	5,825	5,810	5,785	5,763	5,744	5,734
Oil price (US\$/barrel)	104	96	58	66	70	72	73	74

Sources: Zambian authorities and IMF staff estimates.

<sup>1</sup> Adjusted for the accumulation/clearance of VAT refund claims and arrears relating to FRA and FISP programs, road projects, and pensions.

14. **Lingering vulnerabilities pose downside risks to the outlook (Box 2).** The pressures on the exchange rate in the first half of 2014 and earlier this year demonstrated the economy's vulnerability to shocks. Key external risks include a surge in global financial market volatility (possibly linked to normalization of monetary policy in the U.S.), which could result in capital outflows and higher financing costs, and persistent low copper prices, which would have significant adverse effects on export earnings, investments, growth and government revenue.<sup>3</sup> Domestic risks include delayed fiscal adjustment and continued uncertainty about policy direction that could lead

<sup>3</sup> The mining sector accounts for over 70 percent of export earnings and about 10 percent of GDP, and contributes directly (through royalties and corporate income tax) about 12 percent of government domestic revenues.

to lower production in the mining sector and threaten investment more generally. On the upside, the reversal of the royalty-only mining fiscal regime could lead to higher copper production and growth than assumed in the baseline macro framework.

15. **Authorities' views.** The authorities were more optimistic about near-term growth prospects but otherwise broadly agreed with staff's assessment of the economy and outlook. They noted that measures would be taken to contain the fiscal deficit in 2015 and over the medium term. They also emphasized their commitment to improving the business environment, noting the recent changes to VAT refund documentation and their ongoing dialogue with mining companies to address their concerns.

<b>Box 2. Zambia: Risk Assessment Matrix</b>			
<b>Sources of Risks</b>	<b>Likelihood</b>	<b>Expected Impact on Economy</b>	<b>Recommendations</b>
<b>Domestic Risks</b>			
<b>Delayed fiscal adjustment</b>	<b>Medium</b>	<b>High.</b> Given the government's high funding needs, the failure to contain the wage bill and other recurrent expenditure could reduce needed capital and social spending, or crowd out private sector credit, and prompt currency depreciation.	Contain the 2015 budget deficit and continue fiscal adjustment over the medium term.
<b>Loss of investor confidence</b>	<b>Medium</b>	<b>Medium to High.</b> Frequent regulatory changes and uncertainty about the policy direction (e.g., changing the mining fiscal regime without consultations) could lead to a sharp drop in FDI and a substantial rise in financing costs.	Improve dialogue with stakeholders before introducing policy and regulatory changes.
<b>External Risks</b>			
<b>A surge in global financial market volatility</b>	<b>High</b>	<b>Medium.</b> Higher financing costs and capital flow reversals could trigger disorderly adjustment. Large kwacha depreciation could put pressure on inflation.	Maintain exchange rate flexibility and increase policy rate. Undertake fiscal consolidation to reduce the government's funding needs.
<b>Protracted period of slower growth in advanced and emerging economies</b>	<b>High</b>	<b>High.</b> A substantial fall in copper prices could result in a sharp drop in export earnings and FDI in the mining sector; part of the impact would be offset by lower profit and dividend payments to foreign owners.	Maintain exchange rate flexibility and build resilience against external shocks by strengthening the government's efforts to diversify the economy.
<b>Geopolitical risks</b>	<b>Medium</b> in the Middle East  <b>Medium</b> in Russia/Ukraine	<b>Medium.</b> A sharp rise in oil prices could have negative spillovers to the Zambian economy.	Adjust fuel prices to reflect full cost recovery while strengthening social benefits programs to mitigate the impact on the poor. Allow the first-round effects of higher oil prices.

## ENSURING MACROECONOMIC STABILITY

16. **Strong and credible fiscal adjustment and policy coherence are needed to ensure macroeconomic stability.** Fiscal adjustment and maintaining tight monetary policy will help stabilize the exchange rate and contain inflation pressures. Over the medium term, fiscal consolidation would help achieve the authorities' target of 5 percent annual inflation, improve the current account balance, and facilitate the accumulation of international reserves. Shifting to a more balanced macroeconomic policy mix with a tighter fiscal stance would allow room for lowering interest rates to support investment and growth.

### A. Fiscal Policy

#### Mining taxation

17. **The government underestimated the adverse consequences of a change in the mining fiscal regime (SI, Chapter I).** The change was from a dual (royalties and corporate income tax (CIT)) regime to a royalty-only regime—8 percent for underground mines and 20 percent for open cast mining operations as final taxes. In response, several companies announced postponement of planned investments and one company served notice to government that it was going to put its operations in care and maintenance mode. Staff noted that at 6 percent, Zambia's royalty rate in 2014 was already high by international standards, and that much higher rates would have a significant negative impact on future production. In January–February 2015, mining revenue was about 40 percent lower than projected. Staff urged the government to resolve the impasse over the mining fiscal regime as quickly as possible but advised against mine-by-mine agreements that would be difficult to manage and could lead to the government foregoing substantial revenues to keep individual mines in operation. International best practice suggests that a sound regime ought to be stable over time while also being flexible to fluctuating economic and financial conditions. In staff's view, this is best achieved with a regime that combines royalty and CIT. Staff recommended that the government consider reinstating the 2014 regime while it undertakes a fresh review of mineral taxation, in consultation with all relevant stakeholders. Staff also urged the authorities to settle the issue of the outstanding stock of VAT refund claims.

18. **On April 20, 2015, the government announced that the mining fiscal regime will revert to a system similar to what was in place in 2014.** The main changes to the regime that came into effect in January 2015 include: (i) a single royalty rate of 9 percent for all mines; (ii) 30 percent CIT on mining operations; and (iii) variable profit tax. The changes require parliamentary approval. The government plans to submit a bill on the new regime to the next session of parliament (scheduled for June) and expects it to take effect from July 1.

#### Fiscal adjustment

19. **Absent strong adjustment measures, the fiscal deficit will rise sharply in 2015.** The 2015 budget targets a deficit of 4.6 percent of GDP on a cash basis, but staff estimates that changes in assumptions about the external and domestic environment as well as unbudgeted expenditures

would likely add about 4.0 percent of GDP to the deficit.<sup>4</sup> Furthermore, the clearance of expenditure arrears—which was not provided for in the budget—would add another 1.5 percent of GDP to the cash deficit, taking it to 10.1 percent of GDP. The authorities proposed revenue and expenditure measures (Text Table 2) to reduce the prospective cash deficit to 7.7 percent. The government has authorized the sale of some of the extra maize purchased by the Food Reserve Agency (FRA) in 2014 (beyond the level justified by food security needs). On the expenditure side, the authorities plan to maintain the current wage freeze throughout 2015 and to cut spending on travel allowances, goods and services, and agricultural subsidies (through increased efficiency in the operations of FRA and in the implementation of the Farmer Input Support Program (FISP)). Moreover, capital spending would be prioritized to strategic projects to create room to clear arrears on road projects, and fuel prices would be adjusted to fully cover costs. Finally, 2 percent of GDP in this adjusted cash deficit refers to paying off arrears and VAT refunds from previous years. Taking these out yields the underlying deficit of 5.7 percent of GDP.

**Text Table 2. Zambia: Fiscal Adjustments**  
(Millions of kwacha and percent of GDP)

	Millions of kwacha	Percent of GDP
Total effect on fiscal balance	4,407	2.4
Revenue	1,050	0.6
Extra sales of maize	700	0.4
Administrative reforms	350	0.2
Expenditure	3,357	1.8
Goods and services	1,007	0.5
Compensation of public employees	250	0.1
Efficiency gains on agriculture subsidies	400	0.2
Farmer Input Support Program (FISP)	200	0.1
Food Reserve Agency (FRA)	200	0.1
Capital spending	1,700	0.9

Sources: Zambian authorities and IMF staff estimates.

20. **In summary, the implementation of the proposed measures would reduce the underlying fiscal deficit substantially in 2015 (Text Table 3).** The underlying deficit would decline from 10.6 percent of GDP in 2014 (see paragraph 10 above) to 5.7 percent of GDP in 2015, mainly by avoiding a repeat of the expenditure overruns that occurred in 2014 (FRA extra maize purchases, FISP) while also avoiding accumulation of new expenditure arrears and VAT refund claims. Staff urged the authorities to better manage the government's cash flow and deposits to avoid the accumulation of new arrears.

<sup>4</sup> Downward revision to revenue to reflect the impact of lower copper prices, reduction in projected volume of copper output and lower imports (1.3 percent of GDP); higher interest payments reflecting higher rates and government's additional financing needs (1 percent of GDP); re-emergence of fuel subsidies (1.2 percent of GDP); unbudgeted capital spending (0.2 percent of GDP); higher intergovernmental transfers (0.2 percent of GDP); and cost of presidential and parliamentary elections (0.1 percent of GDP).



**Text Table 3. Summary Fiscal Operations, FY2014 and FY2015**  
(Percent of GDP)

	2014 Prel.	2015 Budget	
		Approved	Projection
<b>Revenue and grants</b>	<b>19.3</b>	<b>18.8</b>	<b>18.0</b>
Revenue excluding grants (A)	18.5	18.1	17.3
<i>Of which:</i> Accumulation of VAT refunds <sup>1</sup> (B)	2.1	-0.5	-0.5
Revenue net of backlog of VAT refunds (A - B)	16.4	18.7	17.8
<i>Of which:</i> Value Added Tax net of backlog refunds	3.7	4.0	4.0
Income tax	7.0	6.2	6.4
Non-tax revenue (includes royalties)	2.7	4.7	4.4
<b>Expenditure</b>	<b>24.8</b>	<b>23.4</b>	<b>25.8</b>
<i>Of which:</i> Compensation of employees	9.6	8.8	8.7
Goods and services	3.1	3.5	3.0
Subsidies (fuel, FRA, FSIP)	2.0	1.2	2.6
Capital spending	5.4	5.6	5.9
<b>Overall balance (cash basis)</b>	<b>-6.0</b>	<b>-4.6</b>	<b>-7.7</b>
Accumulation of VAT refunds claims (+)	2.1	0.0	0.0
Accumulation of arrears (+)	2.5	0.0	0.0
Clearance of VAT refunds claims (-)	0.0	-0.5	-0.5
Clearance of arrears (-)	0.0	0.0	-1.5
<b>Underlying balance<sup>2</sup></b>	<b>-10.6</b>	<b>-4.0</b>	<b>-5.7</b>
<i>Memo item</i>			
Outstanding VAT refunds	3.0	1.7	2.1

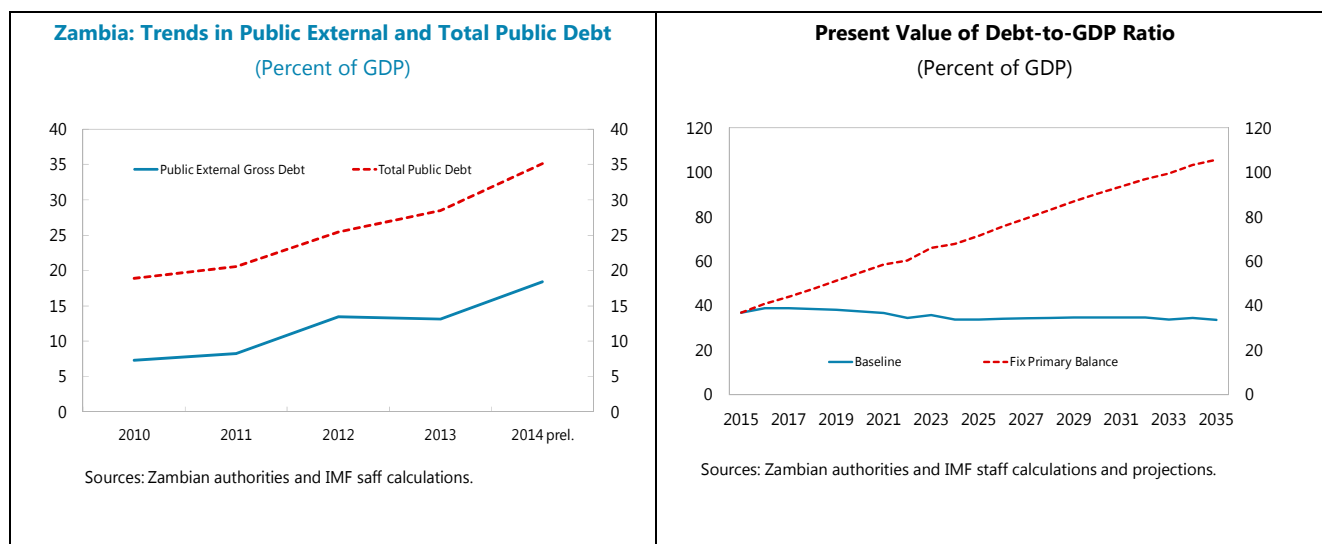
Sources: Zambian authorities and IMF staff estimates.

<sup>1</sup> Negative numbers indicate repayment of outstanding VAT refunds.

<sup>2</sup> Adjusted for the accumulation of VAT refunds claims and arrears and for the clearance of VAT refunds claims and arrears.

21. **Given the small size of the domestic financial market, staff recommended that the government limit recourse to domestic financing** to less than 2 percent of GDP to avoid crowding out private sector credit. Even after taking the measures discussed above, this would still leave a need for almost 6 percent of GDP of external financing in 2015. Staff expressed concerns about the increasing reliance on external borrowing and urged the authorities to consider additional measures (including on the revenue side) to avoid excessive external borrowing. The authorities are considering various options for external financing, including non-concessional bilateral and multilateral loans.

22. **Staff recommended that the authorities reduce the overall fiscal deficit to 3 percent of GDP over the medium term** to limit the rapid increase in government debt (Text Chart). In the view of staff, this strikes an appropriate balance between the need to reduce the large fiscal deficit and meeting infrastructure investment needs, and would stabilize the debt-to-GDP ratio at around 40 percent. This level of debt is moderate, but considering limited absorptive and debt management capacities, it would be prudent to limit debt-financed spending to critical public infrastructure projects. If the deficit is not reduced, the fiscal position will become unsustainable (Text Chart).



23. **Possible measures to achieve projected medium-term fiscal consolidation include:**

- Raise the VAT rate.<sup>5</sup>
- Harmonize corporate income tax rates (by raising rates on low-tax sectors).
- Reduce tax expenditures.
- Restrain growth in the wage bill (including through a comprehensive civil service reform).
- Eliminate fuel subsidies by enforcing the policy of full cost recovery in the pricing of petroleum products.
- Enhance efficiency of FISP (including by moving to an e-voucher system).
- Move to cost-reflective electricity pricing to ease pressure on the budget and attract much needed investments into the energy sector.

24. **Subsidies and social benefits.** Current government subsidies are costly (2 percent of GDP in 2014) and are not well targeted towards the poor. Recent assessments by the World Bank and other development partners indicate that there is significant scope for reducing poverty by shifting resources from subsidizing FRA operations and FISP to the better targeted social cash transfer program. Staff urged the government to scale up the social cash transfer program by re-allocating resources. Staff also recommended that the government limit the operations of FRA to its mandate of maintaining a strategic reserve (understood as requiring no more than 500,000 metric tons of maize) and leave the bulk of the distribution of maize to the private sector.

<sup>5</sup> Zambia's rate of 16 percent is below the median for sub-Saharan Africa (17 percent).

25. **Pension reforms.** Putting the pension system on a sustainable footing remains an important challenge facing the government. The Public Service Pension Fund (PSPF) had arrears of 1.6 percent of GDP at end-2014, which the government intends to clear by 2018, including about 0.4 percent of GDP in 2015 (Tables 2 and 3). The government announced that it intends to modify the decision taken last December to increase the retirement age for civil servants from 55 to 65, by lowering to 60 and introducing the option for early retirement at age 55. Staff highlighted the need to continue with pension reforms to ensure the financial sustainability of the system, including by revising the formula for calculating benefits and reviewing commutation factors.

26. **Managing risks.** Zambia does not have scope to respond, especially on the fiscal side, to a significant downside scenario. In the event of disruptions to proposed external financing for the budget or delayed fiscal adjustment, there is limited space for additional domestic financing. Any revenue over-performance, including from higher-than-projected copper prices, should be used to reduce the fiscal deficit further rather than being used for higher spending.

27. **Authorities' views.** The authorities emphasized their determination to implement all the adjustment measures discussed with staff, which would be reflected in a mid-year budget to be presented to Parliament in June. They agreed that fiscal deficit reduction would help rebuild fiscal space, which will help the country cope with future shocks, and would rebalance the macroeconomic policy mix, which will facilitate the lowering of interest rates. They noted that although government debt is still modest by international standards, its rate of increase has been rapid and needs to be arrested. The authorities indicated that no decision has been made on the nature of external financing and that, to reduce external borrowing costs, they are considering borrowing from the non-concessional window of the African Development Bank for a number of investment projects. They stressed that the government is strongly against mine-by-mine agreements to resolve the current impasse over mining tax issues.

### **Fiscal structural reforms**

28. **Revenue administration reforms.** Staff supported ongoing efforts to strengthen the capacity of Zambia Revenue Authority (ZRA) to effectively monitor the tax returns of mining companies. Staff welcomed the progress made in cross checking taxpayers' information between customs and the domestic revenue services and the introduction of electronic filing and payment, which will help improve efficiency and enhance transparency. Staff encouraged early implementation of the Mineral Value Chain Monitoring framework.

29. **Public Financial Management (PFM) reforms.** Staff urged the authorities to step up PFM reforms in order to improve budget planning and implementation and fiscal reporting. Staff welcomed the progress made in rolling out the Integrated Financial Management Information System (IFMIS)—bringing coverage to 44 out of 51 institutions—and encouraged the authorities to resolve remaining implementation issues, including generation of in-year cash based financial reports reconciled with banking data. Staff emphasized the importance of maintaining appropriate levels of government deposits to prevent arrears accumulation and highlighted the need to strengthen the government cash flow forecasting framework. In this regard, the launch of a pilot

phase of the Treasury Single Account (TSA) at the Ministry of Finance (MoF) in January 2015 is welcome, but the TSA needs to be extended to other line ministries to help improve cash management and strengthen transparency and accountability. Internal information sharing remains weak, with inconsistent figures between the BoZ and the MoF (Budget Office, and Investment and Debt Management Unit).

30. **Investment planning.** While there is a need to boost infrastructure, investment planning is weak and procurement practices are frequently poor. Staff underlined the need to strengthen the public investment cycle by properly vetting projects, aligning them to the country's development strategy, and improving government's project appraisal capacity. In light of projected rises in commercial borrowing, debt management also needs to be improved further.

31. **Authorities' views.** The authorities agreed with the need to strengthen PFM and investment planning, and noted that, with TA from IMF and other donors, they are stepping up PFM reforms. Given growing pressures on the government budget, the authorities intend to speed up the implementation of the TSA, which will improve liquidity management and reduce borrowing by utilizing line ministries' idle balances at banks. The authorities plan to improve collaboration across ministry units and with the BoZ to produce more reliable data.

## B. Monetary and Exchange Rate Policies

32. **Exchange rate regime.** Zambia has a floating exchange rate regime with the authorities committed to intervening in the foreign exchange market mainly to smooth excessive volatility. Exchange rate flexibility provides an important buffer for the economy. In view of the susceptibility of the economy to external shocks, the authorities are also committed to rebuilding international reserves to provide at least four months of import cover.

33. **Monetary policy stance.** The BoZ intends to maintain a tight monetary policy stance in line with the inflation target of 7 percent for end-2015 and 5 percent over the medium term. Risks to inflation are on the upside over the near term, because of the recent large depreciation of the kwacha and the need to increase retail fuel prices. The large fiscal imbalances are complicating the BoZ's task of containing inflation. Staff supported the recent tightening of monetary policy, which reduced the banking system's liquidity and helped stabilize the kwacha. Should further tightening be needed, the BoZ should consider raising the policy rate on a temporary basis to signal its determination to restore stability.

34. **Monetary policy framework.** The BoZ introduced the policy rate in 2012. Given the still weak interest rate transmission mechanism, staff supported the BoZ's plan to keep reserve money and bank liquidity in check during the transition period from conducting monetary policy through reserve money targeting to conducting policy through the policy rate. Further progress will be needed to develop high frequency indicators of economic activity to aid policy formulation. Successful implementation of a TSA starting in early 2015 will help improve liquidity forecasting.

35. **Interest rate caps** aimed at reducing the cost of credit are impeding access to finance, particularly by small- and medium-scale enterprises. Staff noted that caps on commercial bank lending rates have become increasingly binding as treasury bill rates have risen. Moreover, the current level of the lending rate cap for microfinance institutions appears lower than the minimum level required to compensate for the credit risk and high administration costs relating to micro-enterprise loans, limiting access to credit by micro-enterprise borrowers. Staff urged the authorities to remove the caps.

36. **Authorities' views.** The authorities reiterated their commitment to a flexible exchange rate regime. They stated that BoZ will maintain a tight monetary policy stance to contain inflation. Utilizing the ongoing Norway/MCM TA, BoZ will continue to develop all the structures necessary for the effective functioning of the policy rate as the main policy tool. BoZ plans to implement a credit market monitoring program with support from a foreign NGO to collect data needed to conduct an in-depth study of the impact of the lending rate ceilings.

### C. Financial Sector Stability

37. **Background.** The banking sector (which dominates the financial sector) has grown steadily and remains well-capitalized. Credit growth has moderated since mid-2013 (see private sector credit panel in Figure 4), and the average lending rate has increased substantially. Nonperforming loans (NPL) have declined from 15 percent of total loans in 2010 to 6 percent in December 2014. One medium-sized bank was successfully restructured, contributing to the decline in NPL, and the BoZ continues to make efforts to strengthen two small banks' balance sheets. Banks' total credit to the private sector remains low at 14 percent of GDP in 2014, below the sub-Saharan regional average (21 percent), but their exposure to foreign currency denominated loans is relatively high at 25 percent of total loans. Banks face limited funding risks since loan-to-deposit ratios remain low at 60-65 percent and their dependence on wholesale funding is limited. Moreover, the banking system is profitable and well-capitalized with Tier 1 and total capital adequacy ratios of 25 and 27 percent, respectively. The Basel II capital framework is expected to be implemented later in 2015. Most banks have met the new minimum capital requirements, and the minimum capital requirements for nonbank financial institutions were increased in 2014.

38. **Banking supervision.** Staff supported the BoZ's intensive banking supervision to assess potential build-up in vulnerability and risks to financial stability. The BoZ is closely monitoring banks' net open foreign currency positions given the large exchange depreciation and volatility since early 2014. Staff also welcomed the BoZ's efforts to conduct stress testing of bank balance sheets and produce a financial stability report. Given the importance of stress testing to assess banks' potential vulnerability and its implications for adequate bank capital requirements, future stress tests should be more stringent than ones based on historical events.

39. **Financial inclusion.** Staff welcomed the authorities' continued efforts to enhance financial services delivery by strengthening the Credit Reference Bureau, expanding bank branches and agent banking in rural areas, and improving credit culture. The planned introduction of a unified collateral registry system, agency banking guidelines, and an Insolvency Bill will further facilitate credit

provision and improve access to financial services. Staff analysis indicates that relaxing constraints on collateral appear to offer the greatest benefits in terms of economic growth while inclusion of firms is better tackled through measures that lower financial participation cost (SI, Chapter II).

40. **Authorities' views.** The authorities noted that the BOZ is carefully monitoring developments in bank and nonbank lending and collecting weekly returns on banks' net open foreign currency positions, which show that banks largely comply with the applicable prudential limits. On foreign currency loans, the BoZ stated that they assess the adequacy of banks' foreign exchange risk management frameworks during onsite inspections and found no major problems; a large part of the foreign currency loans have been provided to borrowers which generate foreign currency incomes, such as export-oriented commercial farmers and mining companies. The authorities noted enhancing financial inclusion as a government priority.

## REDUCING EXTERNAL VULNERABILITY

41. **The external position has been under pressure in the last few years.** Reflecting sharp declines in government saving, the current account balance has deteriorated by about 7 percent of GDP between 2012 and 2014, despite an increase in copper exports by about 3½ percent of GDP. Reducing the pressure on the exchange rate and improving the current account balance in a lasting way will require large reductions in fiscal deficits over the medium term. Increased copper exports and the planned fiscal adjustment are projected to improve the current account balance. Resolution of uncertainties around mining taxation and fiscal adjustment is likely to attract FDI and portfolio inflows resulting in an overall balance of payments surplus, which, in turn, would allow the BoZ to accumulate reserves in line with its medium-term target of 4 months of imports.

42. **Given weaknesses in metrics for assessing the adequacy of reserves in Zambia (Appendix I), staff advice was based mainly on recent developments in the country.** In view of the fast pace of reserve depletion in the last two years, the economy's vulnerability to external shocks and the need to boost confidence in the kwacha, staff advised BoZ to seize opportunities to rebuild reserves to its medium-term target of 4 months of import cover.

43. **Exchange rate assessment.** Two model-based approaches, EBA-lite and ERER, provided divergent assessments (Appendix I). EBA-lite indicated that Zambia's current account deficit was larger than the level consistent with the medium term fundamentals by almost 5 percent of GDP in 2014, partly reflecting loose fiscal policy. ERER suggested that the real exchange rate was slightly undervalued. Taking into account uncertainties about data quality, the recent deterioration in the external terms of trade, the relatively flat real effective exchange rate over the last the last few years, and the loose fiscal policy over the last two years, staff concludes that the kwacha was moderately over-valued in 2014. The planned fiscal deficit reduction and improved policy stability and consistency (particularly regarding the mining sector) should ease pressure on the exchange rate.

44. **Coping with terms of trade shocks.** The historically high terms of trade and increases in FDI and copper production have been key drivers of economic growth over the past decade.

With copper exports representing three quarters of total exports in 2014, Zambia is vulnerable to terms of trade shocks. The country needs to diversify its export base. The floating exchange rate will help by depreciating when the terms of trade fall, making other tradable goods and services more competitive.

45. **Debt sustainability analysis (DSA).** Zambia's external debt remains relatively low, but vulnerabilities have increased. With higher fiscal deficits and borrowing than assumed in the previous DSA, the current DSA indicates moderate risk of external debt distress and heightened public debt vulnerabilities (see DSA). Under the baseline and alternative scenarios, all the external debt sustainability indicators remain below their thresholds, but the debt service-to revenue ratio breaches the threshold under a number of shocks. With Zambia's increased access to international capital markets, it will be important to develop a comprehensive debt management strategy. Contingent liabilities of the public sector, particularly the operations of SOEs, need to be monitored closely.

46. **Authorities' views.** The authorities broadly agreed with staff's assessment of the external balance and the exchange rate. They indicated that BoZ will start building up reserves once the foreign exchange market stabilizes. With respect to the DSA, the authorities noted that, to strengthen debt management, the MoF prepared its own DSA in 2014 with donor assistance, and that the results were similar to those obtained by staff. However, they emphasized that they do not intend to rely on the international capital markets to the extent assumed under staff's baseline scenario. They referred to ongoing work by the MoF on a debt management strategy aimed at lowering refinancing risks among other objectives. Specific actions under consideration to facilitate repayment of the Eurobonds include establishment of a sinking fund.

## ENHANCING COMPETITIVENESS AND INCLUSIVE GROWTH

47. **Background.** Despite strong growth over the past decade, poverty remains high at over 60 percent of the population, well above the sub-Saharan Africa average of 48 percent. Urban poverty has fallen to about 30 percent, but rural poverty remains high at over 70 percent, and high youth underemployment persists. Assessments of constraints to inclusive growth in Zambia suggest that reforms are needed to address bottlenecks in infrastructure services, low quality of human capital, low agricultural productivity, and weak business environment (SI, Chapter III). Zambia's ranking in the latest Doing Business indicators shows a slight decline as compared to the previous year. In particular, Zambia needs to make improvements in getting electricity, trading across borders, and registering property. Zambia's revised Sixth National Development Plan (2013–16) proposes to address constraints to inclusive growth by focusing on developing infrastructure and human capacities, promoting employment and developing rural areas. Better prioritization of various development projects is needed given the difficult fiscal situation.

48. **Agriculture.** Rationalizing farm subsidies and other distortive government interventions in agriculture can support greater diversification, trade competitiveness, and rural income growth.



Periodic trade bans (e.g., on maize exports and wheat imports), market distortions caused by FRA pricing and procurement policies, and inefficiencies in the FISP discourage private investment in agricultural production and food processing. Savings from eliminating the inefficiencies can also support the scaling up of the more targeted cash transfer program to reduce poverty more effectively.

49. **Fuel supply.** Although ensuring cost-recovery fuel pricing will reduce pressures on the budget, cutting the underlying cost of supplying fuels is needed to enhance the competitiveness of Zambia's economy. Staff discussed the need to increase transparency in national fuel procurement. In light of the worldwide transition towards larger-scale and more efficient oil refineries, it will also be important to reevaluate the benefits of continuing to operate a national refinery.

50. **Minimum wage policies are hindering job creation.** The public sector minimum wage is about three times the private sector minimum wage, which is already higher than in many neighboring and peer countries. Pressuring private companies to adopt the public sector minimum wage will hamper the country's competitiveness and job creation. To encourage job creation, the government needs to strike an appropriate balance between protecting the welfare of workers and adding to the costs of doing business. Staff recommended promoting labor-intensive employment through improving skills development and the business climate.

51. **Authorities' views.** The authorities underlined that the government's priority is to maintain high capital spending on roads and electricity to address key bottlenecks to inclusive growth and competitiveness, but agreed that better prioritization can deliver results more efficiently. They stated that against the backdrop of recent fuel shortages in the country, the government is reviewing fuel procurement policies to reduce pressures on the budget and facilitate reliable supply. The authorities noted that extending the government minimum wage to the private sector is not official policy.

## STAFF APPRAISAL

52. **Outlook and risks.** The Zambian economy is facing strong headwinds. Large fiscal imbalances, lower copper prices, and policy uncertainty are dampening economic activity and putting pressures on the exchange rate. Key risks to the outlook are persistent low copper prices, delayed fiscal adjustment, and domestic policy uncertainties that threaten to lower investment and current production in the mining sector. Zambia's risk of external debt distress is moderate but the overall risk of debt distress is heightened by public debt vulnerabilities.

53. **Macro policy mix.** The current policy mix combines tight monetary policy and a loose fiscal stance. Monetary policy has carried the burden of fighting depreciation; the Zambian kwacha depreciated by about 20 percent in the first quarter of 2015. There is an urgent need to ensure macroeconomic stability by implementing a credible fiscal deficit reduction plan. Fiscal adjustment and maintaining the current tight monetary policy stance will help stabilize the exchange rate and contain inflation.



54. **Fiscal deficit reduction.** Staff estimates that the 2015 deficit is likely to reach 10 percent of GDP, on a cash basis, in the absence of further measures. Revenue is projected to be lower than budgeted by about 1 percent of GDP, and unbudgeted spending to amount to about 4 percent of GDP, including on fuel and agricultural subsidies and clearance of arrears on road projects. To maintain macro stability, it will be important to reduce the 2015 deficit by about 2½ percent of GDP and to continue to reduce the deficit to 3 percent of GDP over the medium term through revenue and expenditure measures. Eliminating fuel subsidies and containing the wage bill would create fiscal space for the needed capital and social spending. In the event of revenue over-performance, the authorities should reduce the deficit rather than increase spending. Deficit reduction will help the country cope with shocks and alleviate domestic financing pressures that are keeping interest rates high. Staff urges the government to resolve the outstanding issues regarding VAT refunds to exporters and to foster policy consistency and stability to boost investor confidence.

55. **PFM reforms.** Staff welcomes recent progress in implementing the TSA and IFMIS, and encourages the authorities to attach high priority to PFM reforms, including on fiscal reporting and budgetary controls. Investment planning and implementation also need to be improved.

56. **External vulnerability.** Reducing the pressure on the exchange rate and improving the current account balance in a lasting way will require addressing the large fiscal deficit. Exchange rate flexibility provides an important buffer for the economy. Given Zambia's susceptibility to external shocks, staff supports the BoZ's plan to start rebuilding reserves once the foreign exchange market has stabilized. The export base needs to be diversified to reduce the dependence on copper. Strong debt management capacity is needed to maintain debt sustainability in light of increasing reliance on non-concessional borrowing.

57. **Financial sector issues.** The banking sector remains well-capitalized and profitable. The BoZ's intensive banking supervision to assess potential build-up in vulnerability and risks to financial stability is welcome, given the large exchange rate depreciation and volatility. The planned introduction of various measures, including agency banking guidelines, will improve access to financial services particularly in rural areas. Staff recommends the elimination of the lending rate ceilings introduced in early 2013, which restrict access to credit, particularly by SMEs, and have become binding as treasury bill rates have increased.

58. **Inclusive growth and competitiveness.** Despite strong growth over the past decade, poverty remains high, particularly in rural areas. Rationalizing farm subsidies and other government interventions in agriculture and reallocating resources to social cash transfers can contribute to rural income growth and greater diversification. Staff recommends that the current fuel supply policy be revisited to reduce the cost of supplying fuels and to ensure a proper supply of fuels. Staff strongly advises against pressuring private companies to adopt the government's minimum wage, which would hamper competitiveness and job creation. To maintain Zambia as an attractive investment destination, frequent regulatory changes and uncertainty about policy direction should be avoided. Improving the business environment would also help promote inclusive jobs-creating growth.

59. **Statistics.** 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.

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

Table 1. Zambia: Selected Economic Indicators, 2012–20

	2012	2013	2014	2015	2016	2017	2018	2019	2020
			Prel.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
(Percentage change, unless otherwise indicated)									
<b>National account and prices</b>									
GDP growth at constant prices	6.8	6.7	5.6	5.6	6.2	6.9	7.0	6.8	6.8
Mining	-2.7	5.9	-7.2	7.7	12.0	15.0	13.1	11.0	10.0
Non mining	8.0	6.8	7.1	5.4	5.6	6.1	6.3	6.3	6.4
GDP deflator	4.2	5.7	7.1	7.5	7.3	6.3	5.2	4.8	4.8
GDP at market prices (millions of kwacha)	128,370	144,775	163,736	186,015	211,983	241,017	271,536	303,996	340,357
<b>Consumer prices</b>									
Consumer prices (average)	6.6	7.0	7.8	8.0	7.5	6.5	5.5	5.0	5.0
Consumer prices (end of period)	7.3	7.1	7.9	8.0	7.0	6.0	5.0	5.0	5.0
<b>External sector</b>									
Terms of trade (deterioration -)	-14.2	-6.6	-2.9	-6.0	-1.1	-1.0	-1.2	-1.5	-2.6
Average exchange rate (kwacha per U.S. dollar)	5.1	5.4	6.2	...	...	...	...	...	...
(percentage change; depreciation +)	5.9	4.8	14.0	...	...	...	...	...	...
Real effective exchange rate (depreciation -) <sup>1</sup>	4.0	4.2	-4.0	...	...	...	...	...	...
<b>Money and credit</b>									
Domestic credit to the private sector	37.0	12.6	26.4	12.2	15.2	17.1	18.0	19.7	22.3
Reserve money (end of period)	51.4	-0.4	59.5	18.2	16.4	15.5	16.1	18.7	17.7
Broad Money (M3)	17.9	20.8	12.6	15.7	17.2	16.5	17.2	19.3	18.4
(Percent of GDP, unless otherwise indicated)									
<b>National accounts</b>									
Gross investment	34.2	33.6	31.1	31.7	31.5	32.6	34.5	34.6	34.6
Government	6.2	6.3	5.4	5.9	4.8	4.8	4.8	4.8	4.8
Private	28.0	27.3	25.7	25.7	26.7	27.7	29.7	29.8	29.8
National savings	39.7	33.0	29.4	31.1	32.9	35.1	37.5	37.9	38.0
External current account balance	5.5	-0.6	-1.7	-0.6	1.4	2.5	3.0	3.3	3.4
<b>Central government budget</b>									
Revenue	19.1	18.4	19.3	18.0	17.4	18.2	18.8	19.3	19.8
Taxes	15.0	14.7	15.8	12.9	12.5	13.3	13.3	13.8	14.3
Grants	1.7	1.5	0.8	0.8	0.8	0.8	0.8	0.8	0.8
Other revenue	2.4	2.2	2.7	4.4	4.1	4.2	4.7	4.7	4.7
Expenditure	22.3	25.1	24.8	25.8	23.4	23.2	22.8	22.7	22.7
Expense	16.2	18.8	19.4	19.9	18.6	18.4	18.0	17.9	17.9
Net acquisition of nonfinancial assets	6.2	6.3	5.4	5.9	4.8	4.8	4.8	4.8	4.8
Net lending/borrowing <sup>2</sup>	-2.9	-6.5	-6.0	-7.7	-6.0	-5.0	-4.0	-3.4	-2.9
Excluding grants	-4.6	-8.0	-6.8	-8.5	-6.8	-5.7	-4.8	-4.2	-3.7
Net acquisition of financial assets	1.7	-1.0	0.3	-0.7	0.0	0.2	0.2	0.2	0.2
Domestic	1.7	-1.0	0.3	-0.7	0.0	0.1	0.1	0.1	0.1
Foreign	0.0	0.0	0.0	0.0	0.0	0.2	0.1	0.1	0.1
Net incurrence of liabilities	4.6	5.4	6.2	7.0	6.1	5.2	4.2	3.6	3.1
Domestic	0.9	5.0	1.0	1.2	1.6	1.7	1.5	1.5	1.4
Foreign	3.7	0.4	5.3	5.9	4.5	3.5	2.8	2.1	1.7
Government deposits	5.5	3.3	2.8	1.8	1.5	1.5	1.5	1.5	1.4
<b>External sector</b>									
Current account balance	5.5	-0.6	-1.7	-0.6	1.4	2.5	3.0	3.3	3.4
(excluding grants)	4.7	-1.1	-2.0	-0.7	1.2	2.4	2.8	3.1	3.3
Gross International Reserves (months of prospective imports) <sup>3</sup>	3.3	3.1	3.8	3.7	3.8	3.8	3.8	3.9	4.0
Excluding FDI-financed imports	3.8	3.5	4.4	4.4	4.4	4.4	4.4	4.5	4.7
<b>Public debt</b>									
(Percent of GDP)									
Total central government debt, gross (end-period)	25.5	28.5	35.1	39.6	41.1	41.0	40.6	40.2	39.4
External	13.5	13.1	18.4	25.3	27.4	27.7	27.6	27.1	26.3
Domestic	12.0	15.4	16.7	14.3	13.8	13.3	13.0	13.1	13.1

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

<sup>1</sup> Excludes Zimbabwe.<sup>2</sup> Measured from total financing below the line.<sup>3</sup> Total reserves including encumbered and unencumbered reserves.

**Table 2. Zambia Fiscal Operations of the Central Government, 2012–20**  
(Millions of kwacha)

	2012	2013	2014		2015		2016	2017	2018	2019	2020
			Budget	Prel.	Budget	Proj.	Proj.	Proj.	Proj.	Proj.	
Revenue	24,541	26,678	31,614	31,564	35,495	33,559	36,809	43,869	51,061	58,656	67,338
Revenue excluding grants	22,303	24,482	29,539	30,297	34,282	32,132	35,183	42,019	48,977	56,323	64,727
Tax	19,260	21,307	24,457	25,837	25,344	24,005	26,585	31,945	36,246	42,027	48,746
Income taxes	10,275	9,814	10,781	11,499	11,793	11,985	13,192	14,999	16,898	18,918	21,181
Value-added tax	4,743	7,348	8,099	9,512	6,577	6,470	7,129	9,710	11,133	13,852	17,135
Excise taxes	2,201	2,337	3,247	2,854	3,633	3,308	3,808	4,430	5,069	5,754	6,532
Customs duties	2,041	1,808	2,331	1,972	3,341	2,242	2,455	2,807	3,147	3,503	3,898
Other revenue, including mineral royalties	3,042	3,175	5,081	4,460	8,937	8,127	8,598	10,074	12,731	14,296	15,981
Of which: Mineral royalties	1,459	1,761	2,186	1,617	5,937	4,197	4,819	5,778	7,891	8,878	9,914
Of which: Sales of maize	...	...	627	532	625	1,325	707	...	...	...	...
Grants	2,238	2,196	2,076	1,267	1,214	1,427	1,627	1,849	2,083	2,333	2,612
Budget support	755	301	533	235	0	0	0	0	0	0	0
Project grants	1,482	1,895	1,543	1,032	1,214	1,427	1,627	1,849	2,083	2,333	2,612
Expenditure	28,685	36,356	40,206	40,640	44,202	47,975	49,599	55,871	61,942	69,012	77,341
Expense	20,753	27,216	30,466	31,770	33,650	36,937	39,446	44,239	48,979	54,495	60,992
Compensation of employees	9,393	11,897	15,497	15,750	16,549	16,233	18,585	20,289	22,075	24,437	27,342
Use of goods and services	4,640	4,799	5,777	5,062	6,666	5,594	6,781	7,663	8,500	9,500	10,565
Interest	1,737	2,231	3,277	3,711	3,436	5,187	6,512	7,786	9,066	10,442	11,748
Domestic	1,636	1,870	2,250	2,954	2,196	3,380	3,904	4,303	4,724	5,328	5,954
Foreign	101	361	1,026	757	1,240	1,806	2,608	3,483	4,342	5,114	5,794
Subsidies	1,894	5,044	1,513	3,308	2,331	4,922	2,273	2,724	2,766	2,813	3,160
Fertilizer support program	840	1,122	500	1,456	1,338	1,228	1,512	1,535	1,561	1,888	1,888
Strategic Food Reserve (FRA)	300	2,311	1,013	1,545	993	1,193	1,045	1,212	1,231	1,252	1,273
Fuel	754	1,610	0	307	0	2,191	0	0	0	0	0
Intergovernmental transfers	1,729	2,576	3,386	3,196	3,615	3,948	3,594	3,769	4,261	4,771	5,341
Social benefits	874	669	1,016	742	1,053	1,053	1,701	2,008	2,262	2,532	2,835
Other	486	0	0	0	0	0	0	0	0	0	0
Net acquisition of nonfinancial assets	7,932	9,141	9,740	8,870	10,552	11,038	10,153	11,632	12,963	14,517	16,349
Of which: non-donor financed	4,957	6,365	7,695	6,210	7,576	7,648	6,415	8,959	9,952	11,145	12,574
Statistical Discrepancy (-overfinancing) <sup>1</sup>	427	284	0	-711	0	0	0	0	0	0	0
Net lending/borrowing	-3,717	-9,394	-8,591	-9,787	-8,706	-14,415	-12,790	-12,002	-10,881	-10,356	-10,003
Excluding grants	-5,955	-11,590	-10,668	-11,053	-9,920	-15,843	-14,416	-13,852	-12,965	-12,688	-12,614
Excl. Government takeover of FRA loans in 2013	...	-8,194	...	...	...	...	...	...	...	...	...
Financing	3,717	9,394	8,591	9,787	8,706	14,415	12,790	12,002	10,881	10,356	10,003
Financing (Identified)	3,717	9,394	-8,592	9,787	8,574	14,415	12,790	12,002	10,881	10,356	10,003
Net acquisition of financial assets	2,143	-1,515	1,079	423	-2,494	-1,354	70	575	604	635	669
Domestic	2,143	-1,515	1,079	423	-2,494	-1,354	70	180	203	227	254
Currency and deposits <sup>2</sup>	2,040	-2,278	0	-140	-2,418	-1,200	-130	0	0	0	0
Loans	0	0	0	0	0	0	0	0	0	0	0
Equity and investment fund shares	102	763	1,079	563	-76	-154	200	180	203	227	254
Foreign	0	0	0	0	0	0	395	401	408	415	415
Net incurrence of liabilities	5,860	7,879	9,671	10,209	6,079	13,061	12,860	12,578	11,485	10,991	10,672
Domestic	1,115	7,284	2,902	1,592	3,072	2,155	3,402	4,131	4,003	4,581	4,749
Debt securities	1,262	4,390	3,502	2,315	3,772	2,789	3,532	4,131	4,003	4,581	4,749
BOZ recapitalization	0	390	0	-130	0	-130	-130	0	0	0	0
Loans	-147	2,504	-600	-593	-700	-533	0	0	0	0	0
Foreign	4,745	595	6,769	8,617	3,007	10,906	9,458	8,447	7,482	6,410	5,923
Loans	885	595	1,269	1,937	3,007	2,690	2,962	1,763	1,824	1,737	1,802
Budget support, gross	1,821	2,140	0	4,015	0	1,030	563	327	327	321	311
Project loans, gross	0	0	1,515	0	2,676	2,513	2,916	1,868	2,086	2,326	2,595
Other, gross	0	0	0	0	1,483	0	0	0	0	0	0
Amortization	-1,212	-642	-246	-352	-1,152	-1,330	-922	-830	-879	-1,119	-1,276
Debt securities	3,860	0	5,500	6,680	0	8,216	6,496	6,683	5,659	4,673	4,120
Financing gap	0	0	17,183	0	0	0	0	0	0	0	0
<i>Memorandum items:</i>											
Net Domestic Financing <sup>2</sup>	-925	9,562	2,902	1,732	5,490	3,355	3,532	4,131	4,003	4,581	4,749
Of which: saved proceeds from 2014 Eurobond (-)	...	...	...	-1,200	2,418	1,200	0	0	0	0	0
Overall balance, including arrears accumulation/clearance	-3,717	-10,794	...	-17,276	-7,706	-10,638	-10,590	-9,167	-10,081	-10,356	-10,003
Roads, pensions, and other arrears (flow)	...	...	...	4,053	...	-2,777	-400	-800	-800	0	0
Backlog of VAT refunds (flow)	0	1,400	...	3,436	-1,000	-1,000	-1,800	-2,036	0	0	0
Backlog of VAT refunds (stock)	...	1,400	...	4,836	3,300	3,836	2,036	0	0	0	0
Revenues excluding grants, net of backlog of VAT refunds	22,303	23,082	26,861	26,861	35,282	33,132	36,983	44,055	48,977	56,323	64,727
Primary balance	-1,980	-7,163	-5,315	-6,075	-5,270	-9,229	-6,278	-4,217	-1,816	86	1,746
Mining revenue	4,069	2,844	4,419	3,125	5,937	4,297	4,819	5,778	7,891	8,878	9,914
Stock of domestic debt, gross	15,409	22,272	23,146	27,334	...	26,540	29,187	32,164	35,311	39,829	44,507
Stock of external debt, gross	17,292	19,014	25,957	30,132	...	47,084	57,993	66,744	74,920	82,274	89,504

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

<sup>1</sup> The discrepancy largely reflects changes in the carryover of budgetary releases.

<sup>2</sup> Includes spending of saved proceeds from 2012 and 2014 Eurobonds.

**Table 3. Zambia Fiscal Operations of the Central Government, 2012–20**  
(Percent of GDP)

	2012	2013	2014		2015		2016	2017	2018	2019	2020
			Budget	Prel.	Budget	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Revenue	19.1	18.4	19.0	19.3	18.8	18.0	17.4	18.2	18.8	19.3	19.8
Revenue excluding grants	17.4	16.9	17.7	18.5	18.1	17.3	16.6	17.4	18.0	18.5	19.0
Tax	15.0	14.7	14.7	15.8	13.4	12.9	12.5	13.3	13.3	13.8	14.3
Income taxes	8.0	6.8	6.5	7.0	6.2	6.4	6.2	6.2	6.2	6.2	6.2
Value-added tax	3.7	5.1	4.9	5.8	3.5	3.5	3.4	4.0	4.1	4.6	5.0
Excise taxes	1.7	1.6	2.0	1.7	1.9	1.8	1.8	1.8	1.9	1.9	1.9
Customs duties	1.6	1.2	1.4	1.2	1.8	1.2	1.2	1.2	1.2	1.2	1.1
Other revenue, including mineral royalties	2.4	2.2	3.1	2.7	4.7	4.4	4.1	4.2	4.7	4.7	4.7
Of which: Mineral royalties	1.1	1.2	1.3	1.0	3.1	2.3	2.3	2.4	2.9	2.9	2.9
Of which: Sales of maize	...	...	0.4	0.3	0.3	0.7	0.3	...	...	...	...
Grants	1.7	1.5	1.2	0.8	0.6	0.8	0.8	0.8	0.8	0.8	0.8
Budget support	0.6	0.2	0.3	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Project grants	1.2	1.3	0.9	0.6	0.6	0.8	0.8	0.8	0.8	0.8	0.8
Expenditure	22.3	25.1	24.2	24.8	23.4	25.8	23.4	23.2	22.8	22.7	22.7
Expense	16.2	18.8	18.3	19.4	17.8	19.9	18.6	18.4	18.0	17.9	17.9
Compensation of employees	7.3	8.2	9.3	9.62	8.76	8.73	8.8	8.4	8.1	8.0	8.0
Use of goods and services	3.6	3.3	3.5	3.1	3.5	3.0	3.2	3.2	3.1	3.1	3.1
Interest	1.4	1.5	2.0	2.3	1.8	2.8	3.1	3.2	3.3	3.4	3.5
Domestic	1.3	1.3	1.4	1.8	1.2	1.8	1.8	1.8	1.7	1.8	1.7
Foreign	0.1	0.2	0.6	0.5	0.7	1.0	1.2	1.4	1.6	1.7	1.7
Subsidies	1.5	3.5	0.9	2.0	1.2	2.6	1.1	1.1	1.0	0.9	0.9
Fertilizer support program	0.7	0.8	0.3	0.9	0.7	0.8	0.6	0.6	0.6	0.5	0.6
Strategic Food Reserve (FRA)	0.2	1.6	0.6	0.9	0.5	0.6	0.5	0.5	0.5	0.4	0.4
Fuel	0.6	1.1	0.0	0.2	0.0	1.2	0.0	0.0	0.0	0.0	0.0
Intergovernmental transfers	1.3	1.8	2.0	2.0	1.9	2.1	1.7	1.6	1.6	1.6	1.6
Social benefits	0.7	0.5	0.6	0.5	0.6	0.6	0.8	0.8	0.8	0.8	0.8
Other	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net acquisition of nonfinancial assets	6.2	6.3	5.9	5.4	5.6	5.9	4.8	4.8	4.8	4.8	4.8
Of which: non-donor financed	3.9	4.4	4.6	3.8	4.0	4.1	3.0	3.7	3.7	3.7	3.7
Statistical Discrepancy (-overfinancing) <sup>1</sup>	0.3	0.2	...	-0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net lending/borrowing	-2.9	-6.5	-5.2	-6.0	-4.6	-7.7	-6.0	-5.0	-4.0	-3.4	-2.9
Excluding grants	-4.6	-8.0	-6.4	-6.8	-5.2	-8.5	-6.8	-5.7	-4.8	-4.2	-3.7
Excl. Government takeover of FRA loans in 2013	...	-5.7	...	...	...	...	...	...	...	...	...
Financing	2.9	6.5	5.2	6.0	4.6	7.7	6.0	5.0	4.0	3.4	2.9
Financing (Identified)	2.9	6.5	5.2	6.0	4.5	7.7	6.0	5.0	4.0	3.4	2.9
Net acquisition of financial assets	1.7	-1.0	0.6	0.3	-1.3	-0.7	0.0	0.2	0.2	0.2	0.2
Domestic	1.7	-1.0	0.6	0.3	-1.3	-0.7	0.0	0.1	0.1	0.1	0.1
Currency and deposits <sup>2</sup>	1.6	-1.6	0.0	-0.1	-1.3	-0.6	-0.1	0.0	0.0	0.0	0.0
Loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Equity and investment fund shares	0.1	0.5	0.6	0.3	0.0	-0.1	0.1	0.1	0.1	0.1	0.1
Foreign	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.2	0.1	0.1	0.1
Net incurrence of liabilities	4.6	5.4	5.8	6.2	3.2	7.0	6.1	5.2	4.2	3.6	3.1
Domestic	0.9	5.0	1.7	1.0	1.6	1.2	1.6	1.7	1.5	1.5	1.4
Debt securities	1.0	3.0	2.1	1.4	2.0	1.5	1.7	1.7	1.5	1.5	1.4
BOZ recapitalization	0.0	0.3	0.0	-0.1	0.0	-0.1	-0.1	0.0	0.0	0.0	0.0
Loans	-0.1	1.7	-0.4	-0.4	-0.4	-0.3	0.0	0.0	0.0	0.0	0.0
Foreign	3.7	0.4	4.1	5.3	1.6	5.9	4.5	3.5	2.8	2.1	1.7
Loans	0.7	0.4	0.8	1.2	1.6	1.4	1.4	0.7	0.7	0.6	0.5
Budget support, gross	1.4	1.5	0.0	2.5	0.0	0.6	0.3	0.1	0.1	0.1	0.1
Project loans, gross	0.0	0.0	0.9	0.0	1.4	1.4	1.4	0.8	0.8	0.8	0.8
Other, gross	0.0	0.0	0.0	0.0	0.8	0.0	0.0	0.0	0.0	0.0	0.0
Amortization	-0.9	-0.4	-0.1	-0.2	-0.6	-0.7	-0.4	-0.3	-0.3	-0.4	-0.4
Debt securities	3.0	0.0	3.3	4.1	0.0	4.4	3.1	2.8	2.1	1.5	1.2
Financing gap	0.0	0.0	...	0.0	0	0.0	0.0	0.0	0.0	0.0	0.0
<i>Memorandum items:</i>											
Net Domestic Financing <sup>2</sup>	-0.7	6.6	1.7	1.1	2.9	1.8	1.7	1.7	1.5	1.5	1.4
Of which: saved proceeds from 2014 Eurobond (-)	...	...	...	-0.7	1.3	0.6	0.0	0.0	0.0	0.0	0.0
Overall balance, including arrears accumulation/clearance	-2.9	-7.5	...	-10.6	-4.1	-5.7	-5.0	-3.8	-3.7	-3.4	-2.9
Roads, pensions, and other arrears (flow) <sup>3</sup>	...	0.0	...	2.5	0.0	-1.5	-0.2	-0.3	-0.3	0.0	0.0
Backlog of VAT refunds (flow)	...	1.0	...	2.1	-0.5	-0.5	-0.8	-0.8	0.0	0.0	0.0
Backlog of VAT refunds (stock)	...	1.0	...	3.0	1.7	2.1	1.0	0.0	0.0	0.0	0.0
Revenues excluding grants, net of backlog of VAT refunds	...	15.9	...	16.4	18.7	17.8	17.4	18.3	18.0	18.5	19.0
Primary balance	-1.5	-4.9	-3.2	-3.7	-2.8	-5.0	-3.0	-1.7	-0.7	0.0	0.5
Mining revenue	3.2	2.0	2.7	1.9	3.1	2.3	2.3	2.4	2.9	2.9	2.9
Stock of domestic debt, gross	12.0	15.4	13.9	16.7	...	14.3	13.8	13.3	13.0	13.1	13.1
Stock of external debt, gross	13.5	13.1	15.6	18.4	...	25.3	27.4	27.7	27.6	27.1	26.3
Nominal GDP (millions of kwacha)	128,370	144,775	166,474	163,736	188,954	186,015	211,983	241,017	271,536	303,996	340,357

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

<sup>1</sup> Includes arrears payments for goods and services and other liability payments.

<sup>2</sup> Includes spending of saved proceeds from 2012 and 2014 Eurobonds.

<sup>3</sup> In 2014, arrears on road contracts amounted to 1 percent of GDP, 0.8 percent on pension liabilities, 0.5 percent on obligations to FRA and FISP programs, and 0.1 percent on fuel subsidies.

**Table 4. Zambia: Government Cash Flow Schedule, 2013–20**  
(Millions of kwacha, unless otherwise indicated)

	2013	2014	2015	2016	2017	2018	2019	2020
		Prel.						
			Projection					
<b>Deposits, beginning of period</b>	<b>7,032</b>	<b>4,754</b>	<b>4,615</b>	<b>3,385</b>	<b>3,255</b>	<b>3,650</b>	<b>4,051</b>	<b>4,459</b>
<b>Gross inflows</b>	<b>17,866</b>	<b>23,696</b>	<b>30,157</b>	<b>29,350</b>	<b>33,027</b>	<b>35,856</b>	<b>39,510</b>	<b>45,396</b>
Primary surplus	0	0	0	0	0	0	86	1,746
Domestic debt placement	13,734	14,727	16,967	18,970	23,751	27,495	31,895	36,452
T-bills <sup>1</sup>	11,129	12,023	14,064	17,281	20,920	24,485	28,591	32,874
T-bonds	2,605	2,704	2,903	1,689	2,831	3,010	3,304	3,578
External borrowing <sup>2</sup>	1,237	8,969	12,236	10,380	9,277	8,361	7,530	7,198
Other <sup>3</sup>	2,894	0	954	0	0	0	0	0
<b>Gross outflows</b>	<b>20,143</b>	<b>23,835</b>	<b>31,387</b>	<b>29,480</b>	<b>32,632</b>	<b>35,455</b>	<b>39,102</b>	<b>44,981</b>
Primary deficit	7,163	6,075	9,229	6,278	4,217	1,816	0	0
Interest	2,231	3,711	5,187	6,512	7,786	9,066	10,442	11,748
Domestic debt securities	9,344	12,411	14,178	15,438	19,619	23,492	27,314	31,703
T-bills <sup>1</sup>	7,883	11,273	11,752	14,064	17,281	20,920	24,485	28,591
T-bonds	1,462	1,138	2,426	1,374	2,338	2,572	2,829	3,112
Domestic amortization (other loans)	0	723	663	130	0	0	0	0
External amortization	642	352	1,330	922	830	879	1,119	1,276
Acquisition of financial assets	763	563	800	200	180	203	227	254
<b>Net inflows (+)</b>	<b>-2,278</b>	<b>-140</b>	<b>-1,230</b>	<b>-130</b>	<b>395</b>	<b>401</b>	<b>408</b>	<b>415</b>
<b>Deposits, end of period</b>	<b>4,754</b>	<b>4,615</b>	<b>3,385</b>	<b>3,255</b>	<b>3,650</b>	<b>4,051</b>	<b>4,459</b>	<b>4,874</b>
<i>Memorandum items</i>								
Nominal GDP	144,775	163,736	186,015	211,983	241,017	271,536	303,996	340,357
Debt	41,286	57,465	73,624	87,180	98,909	110,232	122,103	134,012
Domestic	22,272	27,334	26,540	29,187	32,164	35,311	39,829	44,507
Of which: Arrears	1,164	4,777	2,000	1,600	800	0	0	0
External	19,014	30,132	47,084	57,993	66,744	74,920	82,274	89,504
Deposits, end of period (percent of GDP)	3.3	2.8	1.8	1.5	1.5	1.5	1.5	1.4
Of which: Sinking fund (cumulative, percent of GDP)	0.0	0.0	0.0	0.0	0.2	0.3	0.4	0.5

Sources: IMF staff projections and Zambian authorities' data.

<sup>1</sup> Includes rollover of T-bills within the year.

<sup>2</sup> Includes loan disbursements and Eurobond placements.

<sup>3</sup> In 2013 includes bridge financing from Bank of Zambia and banks' loans to FRA. In 2015 includes the sale of government's stake at a holding mining company.

**Table 5. Zambia: Monetary Accounts, 2012–20<sup>1</sup>**  
(Millions of kwacha, unless otherwise indicated)

	2012	2013	2014	2015	2016	2017	2018	2019	2020
			Prel.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
<b>Monetary survey</b>									
Net foreign assets	12,014	11,663	15,306	16,750	19,119	21,848	24,558	28,549	31,348
Net domestic assets	13,685	19,379	19,653	23,713	28,315	33,434	40,207	48,728	60,157
Domestic claims	19,727	28,404	31,987	37,142	43,204	50,082	58,204	68,374	81,252
Net claims on central government	3,242	10,335	9,182	11,621	13,881	15,825	17,873	20,174	22,390
Claims on other sectors	16,485	18,069	22,805	25,521	29,323	34,257	40,331	48,201	58,862
Claims on other financial corporations	78	135	202	202	202	202	202	202	202
Claims on state and local government	19	23	37	37	37	37	37	37	37
Claims on public non-financial corporations	694	236	232	232	232	232	232	232	232
Claims on private sector	15,695	17,675	22,335	25,051	28,853	33,786	39,861	47,730	58,391
Other items net	-6,041	-9,025	-12,334	-13,430	-14,889	-16,648	-17,997	-19,646	-21,095
Broad money (M3)	25,699	31,042	34,959	40,462	47,434	55,281	64,765	77,278	91,504
Quasi money	25,699	31,042	...	...	...	...	...	...	...
Foreign exchange deposits	6,185	7,627	...	...	...	...	...	...	...
<b>Monetary authorities</b>									
Net foreign assets	10,789	8,631	12,722	14,166	16,535	19,264	21,974	25,965	28,764
Asset	16,623	14,810	19,210	20,376	22,427	24,851	27,279	30,577	33,139
Liabilities	-5,834	-6,179	-6,488	-6,210	-5,892	-5,588	-5,305	-4,612	-4,376
Net domestic assets	-2,414	-292	578	1,557	1,768	1,872	2,559	3,150	5,500
Net domestic claims	-2,097	818	2,535	3,514	3,724	3,828	4,516	5,107	7,457
Net claims on other depository corporations	24	-1,774	32	-89	-56	-158	329	691	2,803
Net claims on central government	-2,151	2,534	2,438	3,538	3,714	3,921	4,121	4,350	4,588
Claims on other sectors	29	58	66	66	66	66	66	66	66
Other items (net)	-317	-1,110	-1,957	-1,957	-1,957	-1,957	-1,957	-1,957	-1,957
Reserve money	8,375	8,339	13,301	15,723	18,302	21,135	24,533	29,115	34,263
Currency outside banks and cash in vaults	3,840	4,597	5,724	6,625	7,648	8,816	10,214	12,159	14,330
Other depository corporation reserves <sup>2</sup>	4,515	3,718	7,556	9,066	10,617	12,276	14,267	16,895	19,862
Liabilities to other sectors	21	24	20	32	37	43	51	61	72
<i>Memorandum items:</i>									
Reserve money (end-of-period, annual percent change)	51.4	-0.4	59.5	18.2	16.4	15.5	16.1	18.7	17.7
Broad money (M3) (annual percent change)	17.9	20.8	12.6	15.7	17.2	16.5	17.2	19.3	18.4
Credit to the private sector (annual percent change) <sup>3</sup>	37.0	12.6	26.4	12.2	15.2	17.1	18.0	19.7	22.3
Velocity (nominal GDP/M3)	5.0	4.7	4.7	4.6	4.5	4.4	4.2	3.9	3.7
Money multiplier (M3/reserve money)	3.1	3.7	2.6	2.6	2.6	2.6	2.6	2.7	2.7
Credit to the private sector (percent of GDP)	12.2	12.2	13.6	13.5	13.6	14.0	14.7	15.7	17.2
Gross foreign exchange reserves of the									
Bank of Zambia (millions of U.S. dollars)	3,044 <sup>p</sup>	2,684	3,078	3,182	3,503	3,883	4,262	4,778	5,179
Exchange rate (kwacha per U.S. dollar, end period)	5.147	5.513	6.393	...	...	...	...	...	...

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

<sup>1</sup> End of period.

<sup>2</sup> The required reserve ratio increased from 8 to 14 percent from mid-March 2014, and to 18 percent from early April 2015.

<sup>3</sup> For 2014, private sector credit increased by 17.1 percent (rather than 26.4 percent) if valuation adjustments to FX-denominated loans and K800 million due to an expanded coverage of the monetary data from January 2014 are excluded.

**Table 6. Zambia: Balance of Payments, 2012–20**  
(Millions of U.S. dollars, unless otherwise indicated)

	2012	2013	2014	2015	2016	2017	2018	2019	2020
			Prel.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Current account	1,372	-161	-463	-148	373	760	1,000	1,217	1,393
Trade balance	1,595	1,648	1,523	1,551	2,275	2,950	3,489	3,991	4,471
Exports, f.o.b.	9,521	10,843	10,220	9,679	10,801	12,290	13,802	15,284	16,831
Of which: copper	6,295	6,911	7,619	6,967	7,786	8,915	10,046	11,114	12,205
Imports, f.o.b.	-7,926	-9,195	-8,697	-8,129	-8,526	-9,340	-10,313	-11,293	-12,361
Of which: oil	-931	-1,083	-1,421	-1,068	-1,052	-1,081	-1,110	-1,138	-1,167
Services (net)	-344	-1,058	-794	-606	-617	-688	-765	-844	-946
Income (net)	-333	-1,153	-1,517	-1,365	-1,582	-1,830	-2,088	-2,332	-2,574
Of which: interest on public debt	-44	-60	-124	-230	-338	-441	-541	-627	-698
Current transfers (net)	454	402	324	272	296	328	364	401	442
Budget support grants	124	57	23	0	0	0	0	0	0
Sector-wide approach grants	65	66	48	32	34	38	42	47	51
Private transfers	265	279	253	240	262	290	322	355	390
Capital and financial account	-613	-154	950	314	19	-313	-558	-655	-976
Capital account	223	278	202	162	177	196	217	239	263
Project grants	223	278	202	162	177	196	217	239	263
External debt cancellation	0	0	0	0	0	0	0	0	0
Financial account	-836	-432	748	152	-158	-509	-775	-894	-1,239
Foreign direct investment (net)	2,433	1,691	2,484	1,653	1,803	1,998	2,217	2,441	2,687
Portfolio investment (net)	899	96	1,206	1,114	843	845	705	572	496
Financial derivatives (net)	-11	3	-1	-1	-1	-1	-1	-1	-1
Other investments (net)	-4,158	-2,222	-2,940	-2,614	-2,803	-3,351	-3,696	-3,906	-4,422
Public sector (net)	172	105	294	462	384	223	227	213	217
Disbursements	407	224	372	545	504	328	337	350	371
Of which: budget support	52	0	0	155	95	74	55	40	29
Amortization due	-235	-119	-78	-83	-120	-105	-109	-137	-154
Commercial banks (net)	423	-352	146	0	0	0	0	0	0
Other sectors	-4,753	-1,974	-3,380	-3,076	-3,187	-3,574	-3,923	-4,119	-4,639
Errors and omissions	-33	-30	-17	0	0	0	0	0	0
Overall balance	727	-345	470	166	391	447	442	562	417
Financing	-727	345	-470	-166	-391	-447	-442	-562	-417
Central bank net reserves (- increase)	-727	345	-470	-166	-391	-447	-442	-562	-417
Of which: Gross reserve change	-722	360	-441	-104	-321	-379	-380	-516	-401
Of which: Use of Fund resources	-5	-15	-30	-61	-71	-67	-62	-46	-16
Financing gap	0	0	0	0	0	0	0	0	0
<i>Memorandum items:</i>									
Current account (percent of GDP)	5.5	-0.6	-1.7	-0.6	1.4	2.5	3.0	3.3	3.4
Total official grants (percent of GDP)	1.7	1.5	1.0	0.8	0.8	0.8	0.8	0.8	0.8
Change in copper export volume (percent)	4.8	19.2	17.7	7.7	12.0	15.0	13.1	11.0	10.0
Copper export price (U.S. dollars per tonne)	7,959	7,331	6,863	5,825	5,810	5,785	5,763	5,744	5,734
Crude oil price	105	104	96	58	66	70	72	73	74
Gross international reserves (total)	3,044	2,684	3,078	3,182	3,503	3,883	4,262	4,778	5,179
In months of prospective imports	3.3	3.1	3.8	3.7	3.8	3.8	3.8	3.9	4.0
In months of imports excluding FDI financed items	3.8	3.5	4.4	4.4	4.4	4.4	4.4	4.5	4.7
GDP (millions of U.S. dollars)	24,940	26,831	26,612	25,218	27,509	30,487	33,830	37,243	41,003

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



**Table 7. Zambia: Balance of Payments, 2012–20**  
(Percent of GDP, unless otherwise indicated)

	2012	2013	2014	2015	2016	2017	2018	2019	2020
			Prel.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Current account	5.5	-0.6	-1.7	-0.6	1.4	2.5	3.0	3.3	3.4
Trade balance	6.4	6.1	5.7	6.1	8.3	9.7	10.3	10.7	10.9
Exports, f.o.b.	38.2	40.4	38.4	38.4	39.3	40.3	40.8	41.0	41.0
Of which: copper	25.2	25.8	28.6	27.6	28.3	29.2	29.7	29.8	29.8
Imports, f.o.b.	-31.8	-34.3	-32.7	-32.2	-31.0	-30.6	-30.5	-30.3	-30.1
Of which: oil	-3.7	-4.0	-5.3	-4.2	-3.8	-3.5	-3.3	-3.1	-2.8
Services (net)	-1.4	-3.9	-3.0	-2.4	-2.2	-2.3	-2.3	-2.3	-2.3
Income (net)	-1.3	-4.3	-5.7	-5.4	-5.8	-6.0	-6.2	-6.3	-6.3
Of which: interest on public debt	-0.2	-0.2	-0.5	-0.9	-1.2	-1.4	-1.6	-1.7	-1.7
Current transfers (net)	1.8	1.5	1.2	1.1	1.1	1.1	1.1	1.1	1.1
Budget support grants	0.5	0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Sector-wide approach grants	0.3	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1
Private transfers	1.1	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Capital and financial account	-2.5	-0.6	3.6	1.2	0.1	-1.0	-1.6	-1.8	-2.4
Capital account	0.9	1.0	0.8	0.6	0.6	0.6	0.6	0.6	0.6
Project grants	0.9	1.0	0.8	0.6	0.6	0.6	0.6	0.6	0.6
External debt cancellation	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	-3.4	-1.6	2.8	0.6	-0.6	-1.7	-2.3	-2.4	-3.0
Foreign direct investment (net)	9.8	6.3	9.3	6.6	6.6	6.6	6.6	6.6	6.6
Portfolio investment (net)	3.6	0.4	4.5	4.4	3.1	2.8	2.1	1.5	1.2
Financial derivatives (net)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other investments (net)	-16.7	-8.3	-11.0	-10.4	-10.2	-11.0	-10.9	-10.5	-10.8
Public sector (net)	0.7	0.4	1.1	1.8	1.4	0.7	0.7	0.6	0.5
Disbursements	1.6	0.8	1.4	2.2	1.8	1.1	1.0	0.9	0.9
Of which: budget support	0.2	0.0	0.0	0.6	0.3	0.2	0.2	0.1	0.1
Amortization due	-0.9	-0.4	-0.3	-0.3	-0.4	-0.3	-0.3	-0.4	-0.4
Commercial banks (net)	1.7	-1.3	0.5	0.0	0.0	0.0	0.0	0.0	0.0
Other sectors	-19.1	-7.4	-12.7	-12.2	-11.6	-11.7	-11.6	-11.1	-11.3
Errors and omissions	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	2.9	-1.3	1.8	0.7	1.4	1.5	1.3	1.5	1.0
Financing									
Central bank net reserves (- increase)	-2.9	1.3	-1.8	-0.7	-1.4	-1.5	-1.3	-1.5	-1.0
Of which: Gross reserve change	-2.9	1.3	-1.7	-0.4	-1.2	-1.2	-1.1	-1.4	-1.0
Of which: Use of Fund resources	0.0	-0.1	-0.1	-0.2	-0.3	-0.2	-0.2	-0.1	0.0
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<i>Memorandum items:</i>									
Current account (percent of GDP)	5.5	-0.6	-1.7	-0.6	1.4	2.5	3.0	3.3	3.4
Total official grants (percent of GDP)	1.7	1.5	1.0	0.8	0.8	0.8	0.8	0.8	0.8
Change in copper export volume (percent)	4.8	19.2	17.7	7.7	12.0	15.0	13.1	11.0	10.0
Copper export price (U.S. dollars per tonne)	7,959	7,331	6,863	5,825	5,810	5,785	5,763	5,744	5,734
Crude oil price	105	104	96	58	66	70	72	73	74
Gross international reserves (total)	3,044	2,684	3,078	3,182	3,503	3,883	4,262	4,778	5,179
In months of prospective imports	3.3	3.1	3.8	3.7	3.8	3.8	3.8	3.9	4.0
In months of imports excluding FDI financed items	3.8	3.5	4.4	4.4	4.4	4.4	4.4	4.5	4.7
GDP (millions of U.S. dollars)	24,940	26,831	26,612	25,218	27,509	30,487	33,830	37,243	41,003

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

**Table 8. Zambia: Financial Soundness Indicators, 2008–14**  
(Percent, unless otherwise indicated)

	2008	2009	2010	2011	2012	2013	2014
<b>Capital adequacy</b>							
Regulatory capital to risk-weighted assets	18.6	22.3	22.1	19.2	21.3	26.8	27.0
Tier 1 regulatory capital to risk-weighted assets	15.7	18.9	19.1	16.8	19.4	24.5	24.6
Capital to total assets	9.9	11.2	10.4	10.2	12.0	14.1	15.1
<b>Asset quality</b>							
Past due advances (NPL) to total advances	7.2	12.6	14.8	10.4	8.1	7.0	6.1
Loan loss provisions to nonperforming loans	104.6	86.6	80.3	76.7	73.5	83.2	76.5
Bad debt provisions to advances	6.1	10.9	11.9	8.0	6.0	5.8	3.9
<b>Loan concentration</b>							
Households	30.1	30.9	32.2	30.8	34.3	34.5	36.0
Government and parastatals	1.9	3.1	4.6	4.7	3.9	2.1	4.3
Agriculture	16.0	19.0	17.6	17.7	22.6	20.2	16.6
Mining	5.0	4.0	3.2	4.2	5.7	6.6	5.0
Manufacturing	11.0	12.0	12.7	12.2	11.3	9.5	11.5
Construction	4.0	3.0	5.8	4.2	3.7	3.5	3.4
Services	9.0	8.0	7.0	7.1	3.9	4.1	2.5
Others	23.0	20.0	16.9	19.1	14.6	19.5	20.7
<b>Earnings and profitability</b>							
Return on average assets	3.6	2.1	2.9	3.7	3.9	3.4	3.7
Return on equity	20.8	9.4	12.1	25.5	20.8	18.2	17.3
Gross interest income to total gross income	66.6	65.1	58.6	59.3	61.3	64.5	66.4
Gross noninterest income to total gross income	33.4	34.9	41.4	40.7	38.7	35.5	33.7
Net interest margin	10.4	10.7	9.0	8.1	8.4	8.3	8.5
<b>Liquidity</b>							
Liquid assets to total assets	35.5	38.0	43.8	40.3	36.0	38.9	35.8
Liquid assets to total deposits	49.9	52.6	58.5	53.3	49.0	52.6	49.8
Advances to deposits ratio	66.3	60.1	53.1	57.1	66.0	61.4	62.0
<b>Exposure to foreign currency</b>							
Foreign currency loans to total gross loans	42.1	36.4	32.8	39.1	28.7	25.6	29.0
Foreign currency liabilities to total liabilities	35.8	38.0	39.6	39.0	22.9	30.4	32.1
Net open position in foreign exchange to capital	6.9	2.5	4.1	5.5	2.8	3.6	1.6

Source: Bank of Zambia.

Table 9. Zambia: Millennium Development Goals, 1990–2013

	1990	1996	2002	2004	2006	2007	2010	2013	2015 Target
<b>Goal 1: Eradicate extreme poverty and hunger<sup>1</sup></b>									
Proportion of population living in extreme poverty (%)	58	53	46	53	51	...	42	...	29
Poverty gap ratio (incidence X depth of poverty) (%)	62	51	...	53	34	...	28	...	31
Prevalence of underweight under 5 children (%)	...	25	28	20	...	15	13	15	11
<b>Goal 2: Achieve universal primary education<sup>2</sup></b>									
Primary net enrollment ratio (%)	80	...	78	85	97	...	94	...	100
Pupils reaching grade 7 (%)	64	...	...	82	83	...	91	...	...
Literacy rate for 15–24 year olds (%)	75	...	...	70	...	...	89	81	100
<b>Goal 3: Promote gender equality<sup>3</sup></b>									
Ratio of girls to boys in primary education (%)	90	...	...	95	97	96	99	100	100
Ratio of girls to boys in secondary education (%)	90	...	...	...	86	89	86	110	100
Ratio of literate women to men (15–24 olds) (%)	75	...	...	...	80	80	89	...	100
Proportion of seats held by women in national parliament (%)	7	...	...	...	14	14	11	...	30
<b>Goal 4: Reduce child mortality<sup>4</sup></b>									
Under 5 mortality rate (per 1,000)	...	197	168	...	...	119	138	75	63.6
Infant mortality rate (per 1,000 live births)	...	109	95	...	...	70	76	45	35.7
One - year - olds immunized against measles (%)	...	87	84	...	...	85	94	85	100
<b>Goal 5: Improve maternal health<sup>5</sup></b>									
Maternal mortality ratio (deaths per 100,000 live births)	...	649	729	...	...	591	483	398	162.3
Births attended by skilled personnel (%)	...	...	43	...	...	47	44	64	...
Contraceptive Prevalence rate (%)	...	11	19	...	...	25	...	45	...
<b>Goal 6: Combat HIV/AIDS, malaria, and other diseases<sup>6</sup></b>									
HIV prevalence rate (%)	...	...	16	...	...	14	...	13	16 or less
Proportion of 15 - 24 - year - olds with comprehensive, correct knowledge of HIV & AIDS (%)	...	...	31	...	...	48	...	45	...
Ratio of school attendance of orphans to non-orphans (10–14 years, %)	...	...	79	...	...	93	...	...	...
Proportion of population with advanced HIV infection on ART (%)	...	...	...	...	...	...	78	...	80
New malaria cases per 1,000 population	255	...	388	383	412	358	330	382	255 or less
Malaria fatality rate per 1,000 population	11	...	48	33	40	40	34	21	11
Proportion of households with ITNs (pre - or - post treated, %)	...	...	14	...	38	53	64	73	...
<b>Goal 7: Ensure environmental sustainability<sup>7</sup></b>									
Land covered by forest (%)	60	59	...	...	...	60	50	...	...
Land protected to maintain biological diversity (%)	39	39	...	40	...	...	41	...	...
CO2 emissions (metric tons per capita)	0	0	...	0	0	0	...	...	...
Consumption of ozone depleting CFCs (ODP MT)	35	30	...	10	7	4	...	...	...
Proportion of population using solid fuels (%)	89	85	...	84	84	...	83	88	...
<b>Goal 8: Develop a Global Partnership for Development<sup>8</sup></b>									
Official Development as a percentage of GDP	...	...	...	...	5	5	3	...	...

Source: *Millennium Development Goals Progress Report — Zambia — 2013*, UNDP; *Zambia Demographic and Health Survey 2013/2014*, CSO; and *Annual Health Statistical Bulletin (various years)*, Ministry of Health.

<sup>1</sup>Goal 1 targets: Halve, between 1990 and 2015, the proportion of people whose income is less than one dollar a day. Halve, between 1990 and 2015, the proportion of people who suffer from hunger.

<sup>2</sup>Goal 2 target: Ensure that, by 2015, children everywhere, boys and girls alike, will be able to complete a full course of primary schooling.

<sup>3</sup>Goal 3 target: Eliminate gender disparity in primary and secondary education preferably by 2005 and to all levels of education no later than 2015.

<sup>4</sup>Goal 4 target: Reduce by two-thirds, between 1990 and 2015, the under-5 mortality rate.

<sup>5</sup>Goal 5 target: Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio.

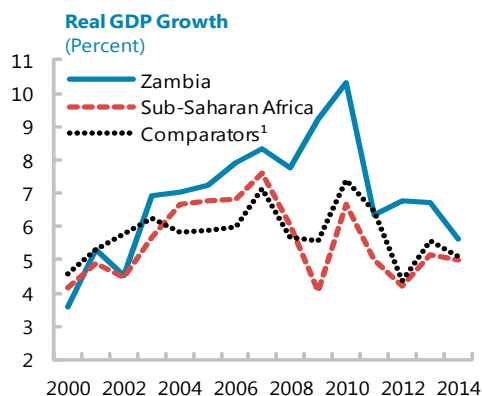
<sup>6</sup>Goal 6 targets: Have halted by 2015, and begun to reverse, the spread of HIV/AIDS. Have halted by 2015, and begun to reverse, the incidence of malaria and other major diseases.

<sup>7</sup>Goal 7 targets: Integrate the principles of sustainable development into country policies and programs and reverse the loss of environmental resources. Halve, by 2015, the proportion of people without sustainable access to safe drinking water.

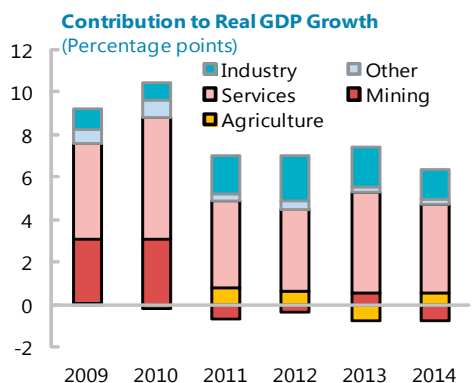
<sup>8</sup>Goal 8 targets: Develop further an open, rule-based, predictable, nondiscriminatory trading and financial system. Address the special needs of the least developed countries. Address the special needs of landlocked countries and small island developing countries.

**Figure 1. Zambia: Real Sector Developments**

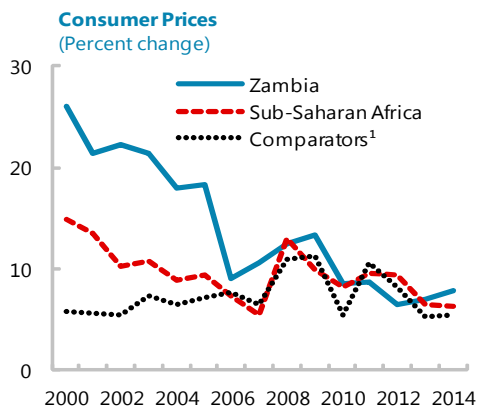
Growth remains strong but is down from 2010 high.



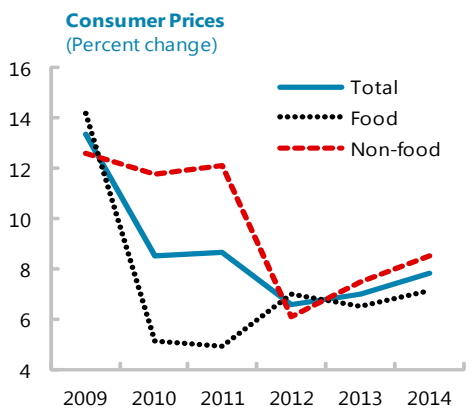
In 2014, real GDP growth slowed down due to lower mining activity.



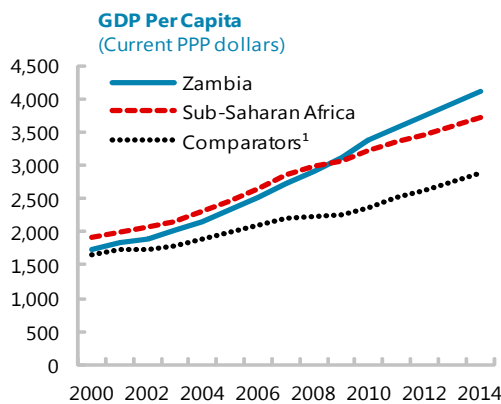
Inflation has been reduced to single digits...



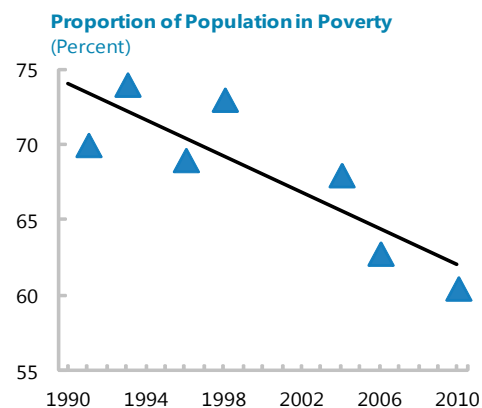
... but has risen from its low in 2012.



Average income level has risen rapidly...



... and poverty has declined, although it is still high.

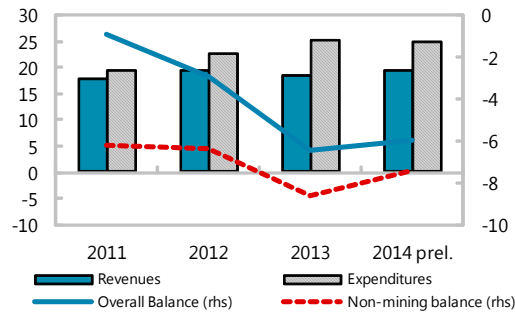


Sources: Zambia, Central Statistics Office; IMF, World Economic Outlook database.

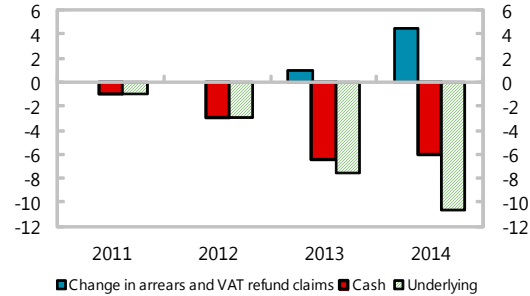
<sup>1</sup> Median of Ghana, Kenya, Mauritius, Mozambique, Nigeria, Senegal, Tanzania, and Uganda.

**Figure 2. Zambia: Fiscal Developments**  
(Percent of GDP, unless otherwise specified)

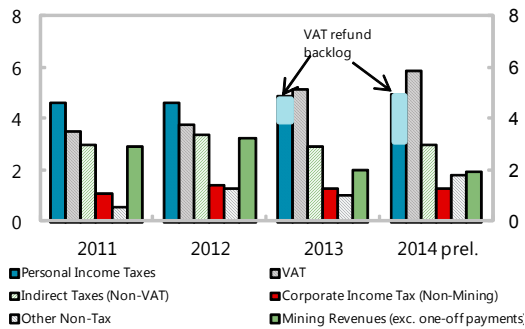
The cash deficit in 2014 narrowed slightly...



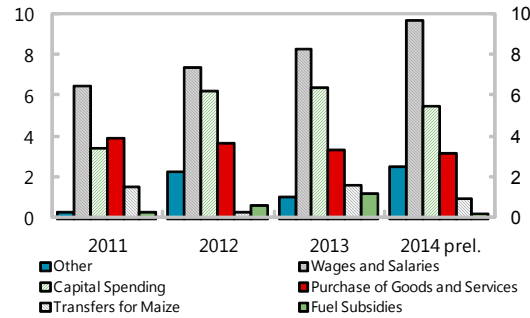
...but substantial arrears accumulation and the backlog in VAT refunds mask the fiscal performance.



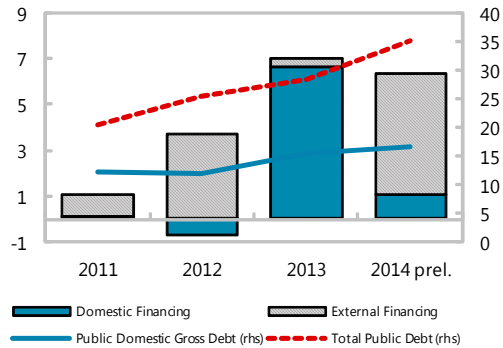
Revenue, excluding the backlog of VAT refunds, increased in 2014 due to rising income tax and non-tax revenue collection



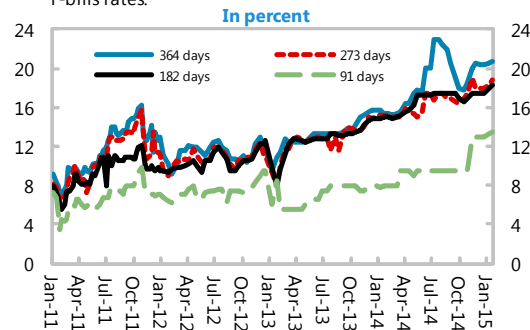
The wage bill and public investment have dominated government spending.



The 2014 budget was financed using proceeds from the Eurobond placement.



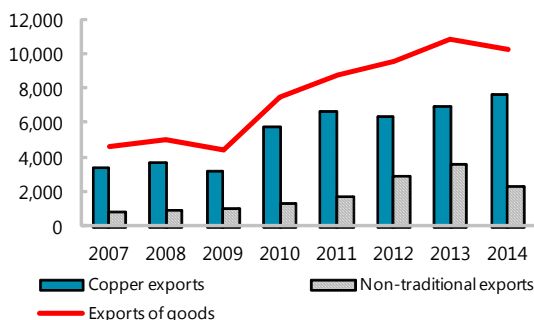
High overall financing needs led to large increases in T-bills rates.



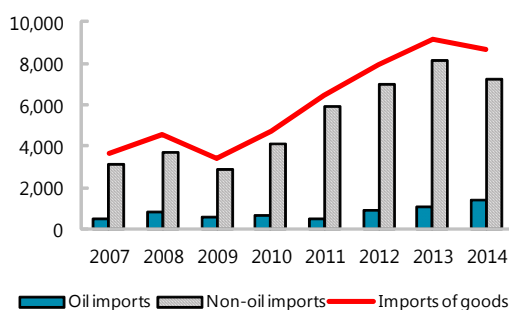
Sources: Zambian authorities, Bloomberg, and IMF estimates and calculations.

**Figure 3. Zambia: External Sector Developments**  
(Millions of U.S. dollars, unless otherwise indicated)

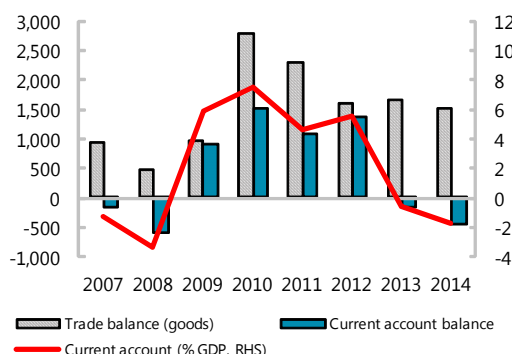
Total exports fell due to lower non-traditional exports in 2014.



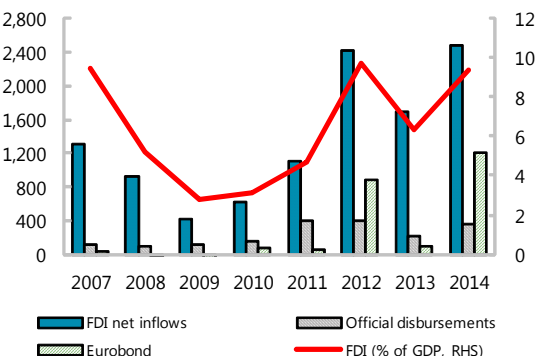
Non-oil imports decreased in 2014 in part because of the currency depreciation.



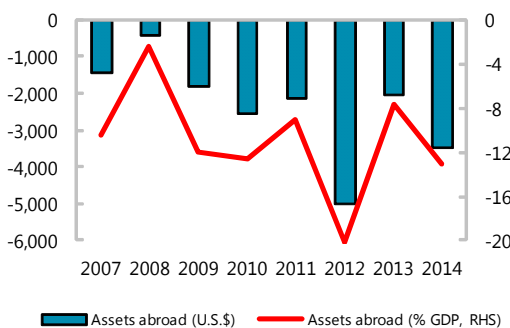
As a result, the current account balance continued to deteriorate.



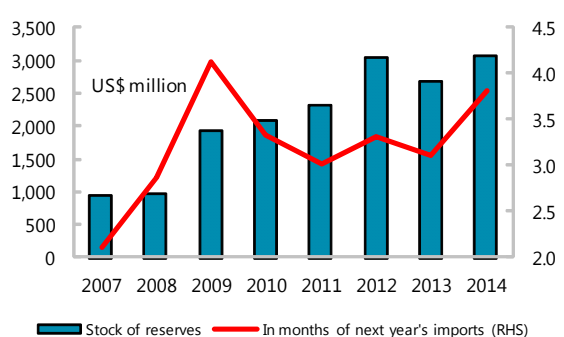
Net FDI inflows recovered in 2014 and official borrowing was boosted by Eurobond proceeds.



Other outflows remain sizeable.



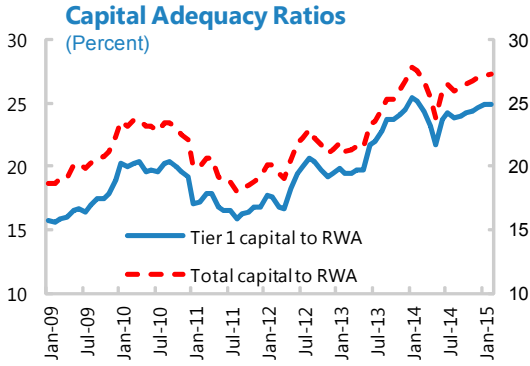
Reserve import coverage improved thanks to Eurobond proceeds.



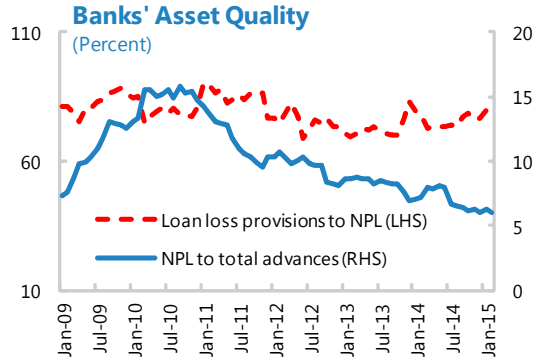
Sources: Bank of Zambia and IMF staff forecasts (for 2014).

**Figure 4. Zambia: Banking Sector Developments**

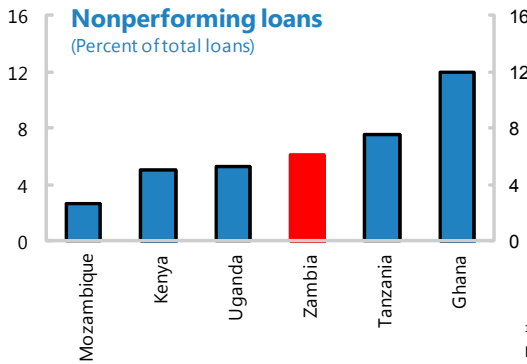
The banking system is well capitalized...



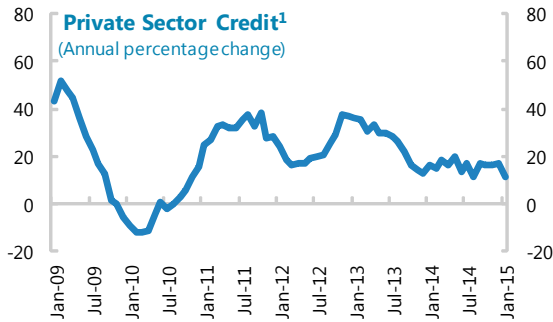
...and asset quality has improved.



The size of nonperforming loans in Zambia is in the middle among its peers<sup>1</sup>.

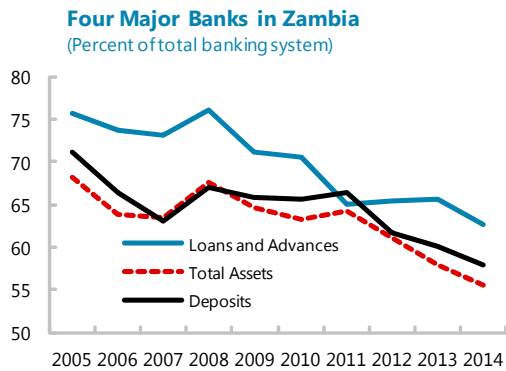


Credit growth remains modest.

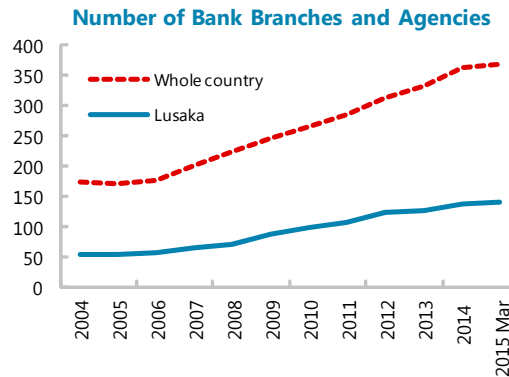


<sup>1</sup> For 2014, excluding valuation adjustments to FX-denominated loans and K800 million due to an expanded coverage of the monetary data from

Bank concentration has declined.



Enhancing access to financial services in rural areas is a government priority.

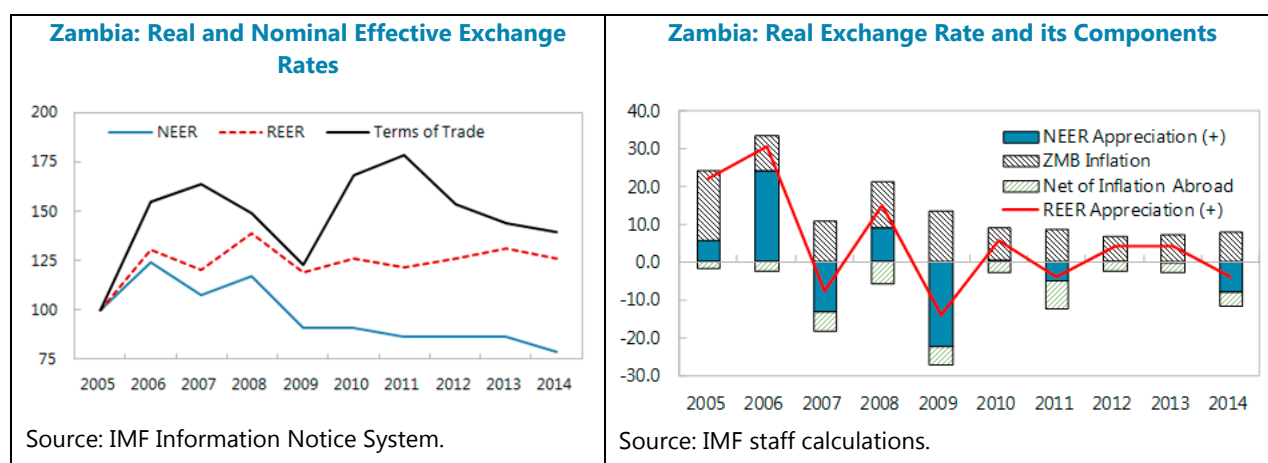


Sources: Zambian authorities; and IMF staff calculations.

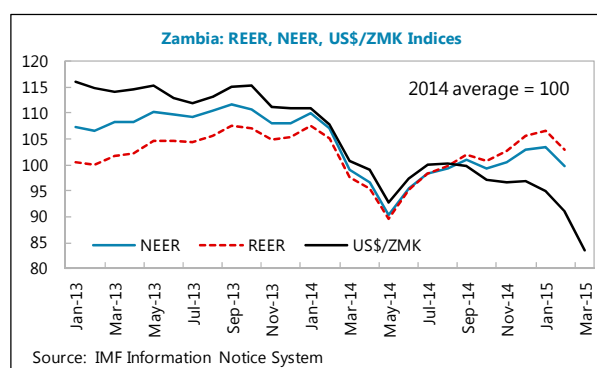
## Appendix I. External Stability Assessment<sup>1</sup>

### REER and NEER Dynamics in 2014

1. **Zambia's real effective exchange rate depreciated by 4 percent in 2014, reversing a similar size appreciation in 2013.** This depreciation reflects a continued deterioration in terms of trade (reflecting an ongoing decline in copper prices of almost 40 percent between the peak in early 2011 and late 2014–early 2015) and is accounted for by an 8 percent depreciation of the nominal effective exchange rate (mainly reflecting stress in the local foreign exchange market in the first half of 2014) partly offset by inflation differential against Zambia's trade partners. While the deterioration in terms of trade has been ongoing since 2011, the REER has remained broadly flat over this period, suggesting a build-up of a REER gap.



2. **2014 annual averages mask substantial variability within the year.** Between January and May 2014, NEER and REER depreciated by some 17 percent before appreciating in the second half of the year by 14 percent in nominal and 19 percent in real terms. While the kwacha has been depreciating against the U.S. dollar since August 2014, this depreciation did not manifest itself in terms of effective exchange rates until February 2015 reflecting that many of Zambia's trading partners also saw their currencies depreciate against the U.S. dollar.



<sup>1</sup> Prepared by Robert Tchaidze.



**External Position Assessment**

3. **In order to assess Zambia’s external position in 2014, tools developed by the IMF staff have been used.** These are empirical methods that link either the real exchange rate (the so-called ERER approach of the CGER methodology<sup>2</sup>) or the current account balance (the so-called EBA methodology<sup>3</sup>) to their respective fundamentals.

4. **In the past decade a prominent feature of Zambia’s BOP statistics has been current account surpluses (or small deficits) combined with sizeable outflows, recorded as part of the financial account.**<sup>4</sup> Based on the reported data, Zambia recorded current account surpluses of some 6 percent of GDP on average during 2009–12. Notable developments included a 25 percent import contraction in 2009 and an 80 percent increase in copper export proceeds in 2010. Subsequently, the current account balance deteriorated to -0.6 percent in 2013 and further to -1.7 percent in 2014. However, throughout this period, Zambia also saw outflows of 8–20 percent of GDP.

5. **The headline current account balance, if taken at face value, would imply undervaluation of the kwacha in 2014.** While the preliminary estimates indicate a current account deficit of 1.7 percent of GDP, the EBA-lite methodology suggests that a low-income country with macroeconomic fundamentals similar to those of Zambia (such as per capita income, budget deficit, demographics, etc) could run a current account deficit. But this methodology is not adjusted for copper exports, which would suggest that Zambia should run a strong current account balance. Indeed, the reality is one of downward pressures on the kwacha and BoZ has been encountering difficulties in keeping its stock of international reserves from declining. To obtain a more accurate picture, an adjustment is made, where a part of the aforementioned outflows (paragraph 4) is reclassified to the current account to better reflect their impact on the domestic foreign exchange market, the exchange rate, and international reserves. These outflows are driven by mining companies’ preference to keep a share of export proceeds abroad and are estimated by the BoZ staff based on declared mining-related flows as well as BIS data on international banking transactions. For the purposes of this current exercise, the part to be reclassified is estimated as a linear function of exporting industries’ FX cash flow—approximated by adding up export proceeds, new (i.e. excluding reinvested earnings) FDI inflows, net borrowing and subtracting imports of

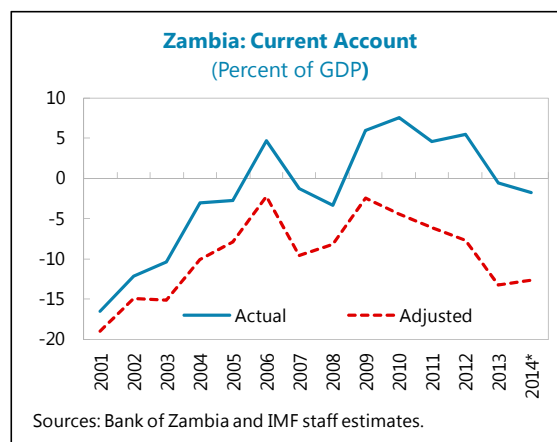
<sup>2</sup> See <http://www.imf.org/external/np/pp/eng/2006/110806.pdf>

<sup>3</sup> See <http://www.imf.org/external/pubs/cat/longres.aspx?sk=41200.0>

<sup>4</sup> See “Assets abroad” in Tables 6 and 7.

equipment, dividend outflows, and private sector interest payments—with which it is highly (0.88) correlated.<sup>5</sup>

6. **The adjusted current account balance reflects a persistent deficit, in contrast to headline surpluses.** In particular, reclassification of the outflows results in a current account deficit of almost 13 percent of GDP in 2014. Application of the EBA-lite methodology to this adjusted current account suggests a sizeable deviation from the value consistent with the fundamentals, indicating an overvaluation of the kwacha. Deviation of about 1.5 percentage points reflects fiscal policy, which is looser than in trading partners, and the rest is an unexplained residual. This estimate, however, is subject to uncertainty, given the imprecise nature of the adjustment described above and some of the components of the 2014 current account being preliminary estimates.

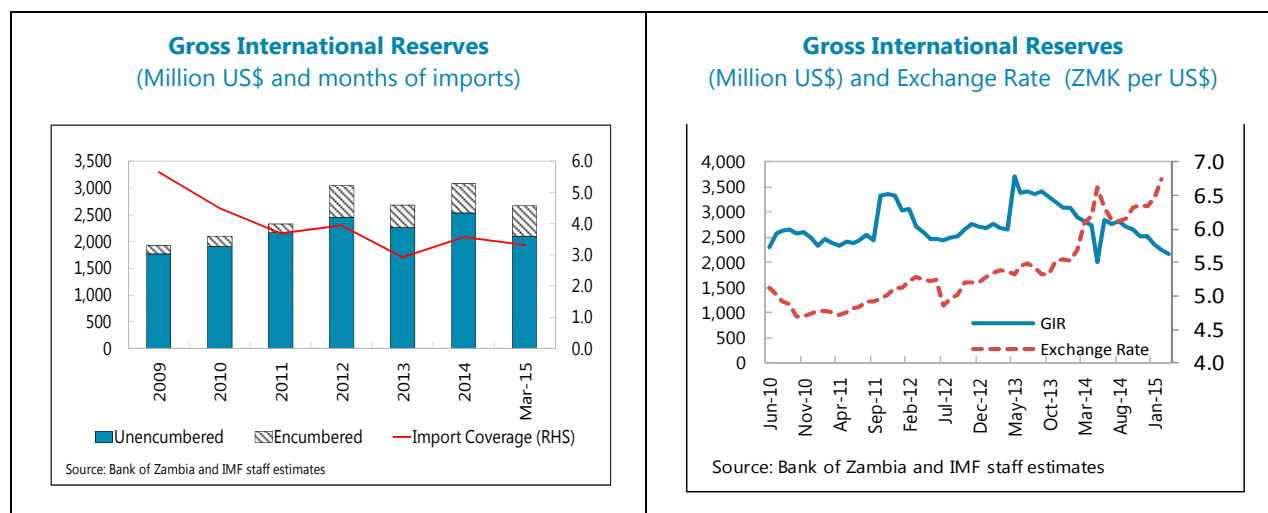


7. **The two methods of evaluating the real exchange rate provide diverging assessments.** While the estimate of the adjusted current account gap implies a sizeable overvaluation in 2014, the ERER approach of CGER suggests the REER to be undervalued by few percent. Given this divergence and uncertainties described earlier, staff sees the kwacha as moderately overvalued.

### **Reserve Adequacy**

8. **It has proved difficult for the BoZ to keep its stock of international reserves from declining.** After peaking in 2009 at 5.7 months of current imports, reserve coverage fell to 2.9 in 2013, bounced back to 3.6 at end-2014, and as of March fell again to 3.3, below the authorities' target of 4.0. The reserves were boosted in 2014 as the Bank of Zambia purchased the Eurobond proceeds from the government, but it also had to spend a significant part of it in order to stabilize the kwacha. The loss of reserves, however, would have been higher, had it not been for the currency depreciation.

<sup>5</sup> A similar adjustment was made for the 2012 and 2013 Article IV consultations as well, but with a fixed share of the outflows reclassified into the current account.



9. **To assess adequacy of the stock of reserves, a cost-benefit approach developed by Fund staff is used.**<sup>6</sup> This approach weighs the benefits of holding reserves with the view to smooth domestic absorption/consumption in case of large exogenous shocks against the opportunity cost of holding reserves. The opportunity cost is measured in three ways: marginal product of capital (MPK), sterilization costs, and external financing costs. However, only the metric associated with external financing costs (for LICs that have had access to international capital markets) seems appropriate to Zambia's circumstances. Even this metric has shortcomings for Zambia, since the country's two Eurobonds were issued in very different environments; the first (September 2012) during highly favorable market conditions that produced a yield of 5.625 percent, and the second (April 2014) in highly unfavorable market conditions that produced a yield of 8.625 percent. The analysis suggests benchmarks in the range between 2.0 and 3.6 months of imports.

10. **While the current costs of attracting foreign exchange are somewhat high, BoZ should aim at accumulating reserves over the medium term.** Given a rather fast depletion in the last two years and the need to boost confidence, staff recommends an additional buffer and aim at a 4-month import coverage. In this context, BoZ's recent interventions would be in line with the purposes for which reserves have been accumulated in the first place, provided their stock does not fall much further.

<sup>6</sup> See the IMF Policy Paper "Assessing Reserve Adequacy—Specific Proposals" (<http://www.imf.org/external/npp/pp/eng/2014/121914.pdf>). Empirical analysis, applied to a sample of 49 low-income countries in 1980–2008, is used to estimate the likelihood and severity of a crisis.

## Appendix II. Value Added Tax Refunds to Exporters<sup>1</sup>

1. **The VAT is a tax on domestic consumption.** Its objective is to allow a government to capture part of the value added on goods and services at each stage of their production and distribution without adding to production costs. Like other countries, Zambia uses an invoice-credit method. Under this system, taxpayers credit the VAT paid on their purchases against the VAT charged on their sales, transferring the net balance to the tax authority. If the balance is negative—usually the case for net exporters—the tax authority is required to refund taxpayers. Timely compliance with such refunds is important to preserving the VAT as a tax on domestic consumption and maintaining the competitiveness of exports.
2. **Zambia’s VAT refund system is regulated, among others, by VAT Rule 18 for proof of export.** Before 2013, exporters were required to provide: (a) copies of export documents bearing a certificate of shipment provided by Zambia Revenue Authority (ZRA); (b) copies of import documents bearing a certificate of importation into the country of destination provided by the customs authority in that country; (c) proof of payment by the customer; and (d) tax invoices for the goods exported. ZRA, however, made VAT refunds without enforcing requirement (b).
3. **In 2013, ZRA amended Rule 18.** Starting in January 2013, exporters were required to provide: (e) documentary evidence, proving that payment for the goods has been made by the customer into the exporter’s bank account in Zambia. Beginning in September 2013, the ZRA also started enforcing requirement (b), rejecting those requests that did not meet all five requirements. The stated aim was to prevent abuses where refunds were sought for goods that had not been exported. Exporters, mainly mining companies, complained that getting proof from other countries’ tax authorities was impractical in the commodities business, where goods such as copper are often sold to traders and where ownership may change several times before the goods reach their final destination. As a result of the ensuing impasse, the government accumulated, as of end-February 2015, about K5.7 billion or 3.1 percent of GDP in outstanding VAT refund requests.
4. **Requiring proof of export is normal international practice.** Table 1 shows the requirements in a range of other countries, including commodity exporters in the region and elsewhere. Requirements vary across countries, but are generally less stringent than in Zambia. In particular, no country in the sample requires documentation from the importing country’s

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<sup>1</sup> Prepared by Manuel Rosales.

customs authority, although South Africa in some cases requires proof that the goods were received by the purchaser in the importing country. Moreover, no country in the sample requires proof of payment into the domestic bank account of the exporter.

5. **Following dialogue with mining companies, the government again amended Rule 18 in late February 2015.** Requirement (b) was eased by allowing exporters to provide documentation from the country of transit instead of final destination. The amendment was not retroactive, however, leaving the backlog of claims unresolved. While the Chamber of Mines has indicated that the amended rule is manageable, there is also an issue for non-mining exporters who may face difficulties obtaining documents from the importing country's customs authority.

**Table 1. Proof of Exports Requirements in Selected Countries' VAT Laws**

Country	Requirement
Australia	To qualify for a refund: (a) Export must occur within 60 days; and (b) must be accompanied by documents that would "enable a person who is independent of the transaction to reasonable conclude that a supply of goods was made and exported within the specified time limits."
Chile	Invoices for exports issued by the National Customs Services and stamped by the Internal Revenue Authority.
European Union	(a) Customs clearance forms; and (b) invoices for VAT amounts claimed.
Ghana	(a) Valid export entries certified by the Customs Divisions of the Ghana Revenue Authority; (b) as additional validation, selected checks by the Domestic Tax Revenue Division on among others: customers orders, sales contracts, inter-company correspondence, copy of exports invoices, insurance and freight charges, etc.
Namibia	Stamped documents by Customs and Excise official (a) the original customs export documents, including Form SAD500, Form 178, any export certificate or certificate of origin; and (b) Commercial and tax invoices for the supply.
New Zealand	(a) Bill of lading or air waybill; (b) packing list or delivery note showing overseas delivery address; (c) insurance documents; and (d) purchase order showing overseas delivery address.
Peru	Customs documents must prove that the exported goods have left the country.
South Africa	Direct export: (i) By local vendor: (a) either the purchaser order or the contract between the purchaser and the South African vendor; (b) a copy of the export documentation prescribed under the Customs and Excise Act bearing an original South African Customs and Excise stamp; (c) proof that the goods have been received by the purchaser in the export country; and (d) proof of payment. (ii) By cartage contractor; (a), (c), and (d) as above as well as proof that the South African vendor paid the transportation costs and proof of physical movement (transportation documentation). Indirect export (i.e., by the purchaser), the South African vendor charges the standard VAT rate and the purchaser must request the refund and provide: (a) export goods through a designated commercial port; (b) present personally to a VRA or Custom official together with the goods and the tax invoice; (c) endorsed tax invoice the VRA or Custom official; and (d) VAT 255 form. If purchaser uses a cartage contractor, the purchaser must submit a written request for the refund only after the purchaser has physically received the goods in country of destination: (a) original tax invoice (from vendor); (b) copy of purchaser passport or trading license; (c) purchaser order or the contract between cartage contractor and purchaser; and (d) proof of payment for the goods by the purchaser.
Uganda	(a) Copy of the bill of entry or export certified by the customs authority; (b) copy of the invoice issued to the foreign purchaser with tax shown at the zero rate; and (c) evidence sufficient to satisfy the Commissioner General that the goods have been exported in the form of an order from, or signed contract with, a foreign purchaser, or transport documentation (i.e., bill of lading, airway bill, transit order, or road manifest).
United Kingdom	Covered under Section 6, the taxpayer must produce for VAT zero-rating, either (a) official evidence produced by the Customs system; or (b) commercial evidence, which describes the physical movement of the goods (e.g., authenticated sea-way bill, authenticated air-way bill). Photocopies are not accepted.
Zambia (amended Rule 18)	(a) Copies of export documents for the goods bearing a certificate of shipment provided by the Authority; (b) copies of import documents for the goods, bearing certificate of importation into the country of destination provided by the customs authority in the country of destination or copies of transit documents for goods bearing a certificate of transit provided by the customs authority of the country of transit; (c) tax invoices for the goods exported; (d) documentary evidence, proving that payment for the goods has been made by the customer into the exporter's bank account in Zambia; (e) such other documentary evidence as the authorized officer may reasonably require.



# ZAMBIA

## STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION—DEBT SUSTAINABILITY ANALYSIS

May 5, 2015

Approved By  
**David Owen and  
Bob Traa (IMF)  
and John Panzer (IDA)**

Prepared by the staffs of the International Monetary Fund (IMF) and the International Development Association (IDA)

*Based on the Joint Fund-Bank Debt Sustainability Framework for Low-income Countries (LIC DSA), Zambia's risk of external debt distress is moderate and the overall risk of debt distress is heightened, given total public debt vulnerabilities. The risk of external debt distress has been changed from low given deterioration in debt dynamics since the previous DSA, issued in November 2013.*

*Under the baseline and alternative scenarios, all external debt sustainability indicators remain below their applicable thresholds, but the debt service-to-revenue ratio breaches the threshold under a number of shocks.*

*Zambia's overall public sector debt dynamics is sustainable under the baseline. However, the fixed primary balance scenario underscores the need for an improved fiscal position, as advocated by staff.*

*Besides sound macroeconomic policies, strong debt management, greater diversification of the export base, and improved project appraisal are needed to maintain debt sustainability in the face of a projected rise in non-concessional borrowing and potential external shocks.*

## BACKGROUND

1. **Zambia's stock of external public and private debt has been rising since 2011 (Text Table 1).** At the end of 2014 it stood at 24 percent of GDP compared to 15 percent in 2011. An increase in the stock of external public and publicly guaranteed debt (PPG) of the central government (10 percentage points between 2011 and 2014) to a large extent reflects issuance of Eurobonds in 2012 and 2014 (3.0 and 3.8 percent of GDP respectively). The share of central government's debt from multilaterals has fallen sharply (from 60 percent to 27 percent), while the share owed to private banks/investors has increased from zero to 46 percent. Meanwhile, the stock of private and parastatal external debt has decreased from 7 percent of GDP in 2011 to 6 percent in 2014.
2. **Zambia's total public debt has also increased rapidly, mainly reflecting the evolution of the PPG external debt of the central government.** Domestic public debt increased from 12 percent of GDP in 2011 to 17 percent of GDP in 2014. In 2011, treasury bills (T-bills) and treasury bonds (T-bonds) accounted for about 93 percent of the total domestic debt, with the remainder coming from accumulation of arrears (e.g., to the pension system) and financing from the banking system. In 2014, the share of government securities (T-bills and T-bonds) dropped to 72 percent of total domestic debt while arrears increased to about 15 percent of the total and the remaining 14 percent reflected debt to the Bank of Zambia and domestic commercial banks.

## UNDERLYING DSA ASSUMPTIONS

3. **The medium-term scenario underlying the debt sustainability calculations assumes implementation of strong fiscal adjustment measures and monetary policy aiming at decreasing inflation to 5 percent.** Zambia's economic growth in 2015 is projected to be maintained at the 2014 level (estimated at 5.6 percent) and to remain strong at 6–7 percent over the medium term on the back of an expected further increase in mining production due to large foreign direct investment (FDI) in the sector in recent years and a scale-up of government investments. The fiscal deficit is projected to temporarily increase in 2015 as the authorities plan to clear a substantial portion of arrears accumulated in recent years; the deficit decreases to 3 percent of GDP by 2020. Expenditure policy is assumed to give priority to social (i.e., education, health, and social safety net) and capital investment spending as a means of promoting broad-based economic growth. Increased copper production and non-copper exports together with the proposed fiscal adjustment are expected to improve the current account to surpluses over the medium term (see Box 1 for details).



**Text Table 1. Zambia: Evolution of Debt Indicators**

	2011	2012	2013	2014
Percent of GDP				
Total External debt	15.3	17.2	20.1	23.9
Central Government	6.4	11.8	11.8	16.9
BoZ	1.9	1.6	1.5	1.3
Private and Parastatal	7.1	3.7	6.9	5.7
Total Public debt	20.6	25.5	28.5	35.1
Domestic debt	12.3	12.0	15.4	16.7
Securities	11.4	11.2	12.2	11.9
T-bills	6.0	5.9	6.1	6.0
T-bonds	5.4	5.3	6.0	5.9
Other 1/	0.9	0.8	3.2	4.8
External debt	8.3	13.5	13.1	18.4
Composition of Central Government's External Debt (percent)				
Multilaterals	59.7	33.6	35.5	26.8
Bilaterals	9.4	3.2	2.1	1.5
Private banks/investors	0.0	34.7	32.5	45.9
Suppliers' Credit	31.0	28.5	30.0	25.9
Composition of Domestic Debt (percent)				
Securities	92.6	93.2	79.0	71.5
T-bills	48.5	48.8	40.0	36.1
T-bonds	44.1	44.4	39.1	35.3
Other 1/	7.5	6.8	21.1	28.6

Sources : Zambia authorities and IMF staff calculations.

1/ Includes accumulation of domestic arrears and financing from BoZ and commercial banks.

### Box 1. Baseline Macroeconomic Assumptions

**Economic growth:** Real GDP growth in 2015 is projected to remain at the 2014 level (estimated at 5.6 percent), with higher mining production offset by an anticipated decline in agriculture. Growth is projected to remain strong, averaging about 6½ percent over the medium term (down from 7¾ percent in the previous DSA). Based on investments that have to a large extent already been completed, copper production is expected to reach over 1.4 million tons by 2020, almost twice the 2014 level. Medium-term growth will be further underpinned by ongoing large public investment, mainly in transportation and energy infrastructure. In the long run, the mining sector will remain important, but economic diversification—including in areas such as electricity generation, agriculture and food processing, and tourism—is expected to support economic growth at around 5 percent annually.

**Inflation:** In the context of the current depreciation of the kwacha and expected adjustments in fuel prices, inflation is projected to reach 8 percent in 2015 and then gradually decrease to 5 percent in the medium term (similar to the previous DSA). This projection is underpinned by continued tight monetary policy and the implementation of a credible fiscal consolidation plan.

**External sector:** Mining export volumes are expected to show an average annual increase of 11.5 percent over 2015–20; and the copper price is assumed to remain around US\$2.6 per pound. Copper remains Zambia's most important export product (around 75 percent of total exports of goods). Nontraditional exports, after growing by 40 percent on average in 2010–13 and registering a sharp decline in 2014, are projected to grow over the medium term at 12 percent a year. After peaking at 9.8 percent of GDP in 2010 and somewhat abruptly coming down in 2011, FDI is expected to stabilize at 6.6 percent of GDP (compared to 7¾ percent of GDP in the previous DSA), concentrated in the mining, manufacturing, and transport sectors. The current account balance is projected to increase to above 3 percent of GDP by 2020.

**Fiscal sector:** The fiscal deficit, on a cash basis, is projected to temporarily increase in 2015 as the authorities clear a substantial portion of arrears accumulated in recent years. The deficit is then reduced to 4 percent of GDP by 2018 and to 3 percent of GDP by 2020. This is supported by government plans to strengthen and modernize tax and customs administrations, broaden the tax base by reducing exemptions, and other reforms to mobilize higher revenue. As a result, domestic revenues would rise gradually from 16.4 percent of GDP in 2014 (net of outstanding VAT refunds) to 19.0 percent by 2020 (lower ratios relative to the previous DSA are due to GDP rebasing). Primary expenditures are projected to decline from 22.5 percent of GDP in 2014 to 19.2 percent of GDP in 2020 on the back of a lower wage bill due to the 2015 wage freeze and recruiting limited to the education, health, and security sectors. This is expected to be followed by civil service reforms, including of the pay structure and recruiting and promotion policies. Additionally, the government would work towards increasing the efficiency of the farmer input support program, including through the rollout of an e-voucher mechanism, and reallocate resources to the social cash transfer program for better targeting of the most needy. Capital spending would be maintained at about 5 percent of GDP during 2015–20, prioritized to strategic sectors of the economy, including energy, transport, health, and education, with a view to promoting broad-based economic growth.

**Government financing:** Net external financing is expected to decline from near 6 percent of GDP in 2015 to 2 percent of GDP by 2020 and stabilize at 1.5 percent of GDP over the long term. External financing, obtained by issuance of sovereign debt, would be used to finance social and capital spending. Net domestic financing would be maintained at 1.5 percent of GDP.

**Text Table 2. Zambia: Evolution of Selected Macroeconomic Indicators 1/**

	2013	2014	2015	2016	2017	2018
	(Percentage Change)					
Real Growth						
Previous DSA	6.0	7.3	7.5	7.6	7.6	7.7
Current DSA	6.7	5.6	5.6	6.2	6.9	7.0
Inflation (deflator, av.)						
Previous DSA	7.6	7.2	5.9	5.1	5.0	5.0
Current DSA	5.7	7.1	7.5	7.3	6.3	5.2
	(Percent of GDP)					
Budget Deficit						
Previous DSA	8.6	6.3	5.7	5.2	4.2	3.0
Current DSA	6.5	6.0	7.7	6.0	5.0	4.0
Net FDI						
Previous DSA	8.0	7.8	7.9	7.8	7.8	7.7
Current DSA	6.3	9.3	6.6	6.6	6.6	6.6
Current Account Balance						
Previous DSA	-1.3	-0.6	-0.4	-0.2	0.0	0.1
Current DSA	-0.6	-1.7	-0.6	1.4	2.5	3.0

Source: IMF staff calculations and projections.

1/ The current DSA uses rebased GDP. According to the rebased GDP data, 2013 nominal GDP was about 20 percent higher than previously estimated.

4. **Compared to the previous DSA (Text Table 2)**, the growth path has been lowered, largely reflecting lower copper prices, while the inflation path has been revised up, reflecting the projected higher inflation in 2015 due to the recent large depreciation of the kwacha and the need to increase retail fuel prices. Staff forecasts higher budget deficits in the medium term, given looser fiscal policy in 2014–15 than assumed at the time of the 2013 DSA. The current account balance has been revised up for a number of reasons, including lower imports (in line with recent developments) and upward revisions to exports of services (reflecting revisions to historical data based on recent survey results). FDI inflows are projected at a lower rate given worsening of the business environment.

## EXTERNAL DEBT SUSTAINABILITY

5. **External debt burden indicators rise in the medium term, but are expected to remain below the indicative policy thresholds (Table 1 and Figure 1).**<sup>1</sup> The stock of external debt is expected to peak at 35 percent of GDP in 2017 and decrease to 24 percent by 2035.

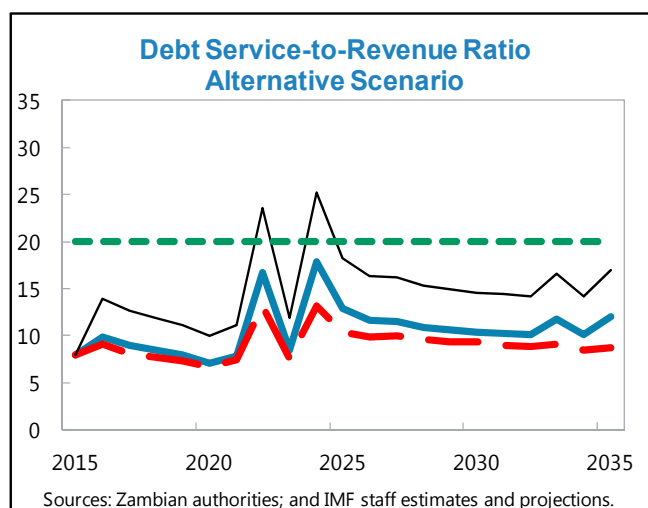
<sup>1</sup> The World Bank's Country Policy and Institutions Assessment (CPIA) ranks Zambia as a medium performer (the average 2010–12 CPIA score is 3.45). Thus, the external debt burden thresholds for Zambia are (i) a PV of debt-to-GDP at 40 percent; (ii) a PV of debt-to-exports at 150 percent; (iii) a PV of debt-to-revenue at 250 percent; (iv) a debt service-to-exports at 20 percent; and (v) a debt service-to-revenue at 20 percent.

The present value (PV) of PPG debt relative to GDP increases from about 16 percent in 2014 to 26 in 2017 and declines afterwards.<sup>2</sup> The PV of PPG debt relative to exports peaks at 58 percent in 2016, well below the threshold of 150 percent. The PV of PPG debt relative to revenue increases from 84 percent in 2014 to 151 percent in 2016; again, remaining below the threshold of 250 percent.<sup>3</sup>

**6. While external debt sustainability is maintained under alternative scenarios, one of the indicators breaches the threshold under the stress tests.**

The debt service-to-revenue ratio breaches the threshold in 2024–28 under a number of shocks (to exports,<sup>4</sup> U.S. dollar GDP deflator, non-debt creating flows, one-time depreciation in 2016, Table 3 and Figure 1f). The breach occurs under the assumption that external funding is secured under commercial terms (similar to the 2012 and 2014 Eurobonds). If part of the external funding

were to be secured from multilateral and bilateral partners instead under more favorable terms, the stress test would show breaches in 2022 and 2024 when the Eurobonds mature (see text chart, which assumes an equal split between external funding from official bilateral and multilateral sources and from the issuance of sovereign debt<sup>5</sup>).



**7. These scenarios illustrate Zambia's vulnerability to swings in the copper price and underline the need for the country to diversify its export base and strengthen its external debt management.** Several of the stress tests under which breaches occur are related to Zambia's ability to generate export earnings. As developments in 2014–15 illustrate, a sizeable decline in copper prices can exert significant pressures on the exchange rate while government's ability to step in and substitute the FX flows with external borrowing is limited.

<sup>2</sup> Present Values (PV) are calculated based on a 5 percent annual discount.

<sup>3</sup> The large residuals in Table 1 are caused by the fact that the official balance of payments statistics for Zambia show the (mostly foreign-owned) mining companies as keeping a large share of their mining export proceeds as rapidly increasing deposits abroad (see also Appendix II of the 2015 Article IV Staff Report).

<sup>4</sup> The calculations of the export shock are modified. The standard assumption is that losses in export proceeds are compensated one-to-one by public external borrowing. In the case of Zambia, however, the exporting sector is dominated by foreign-owned mining companies. A shortfall in export proceeds will be partly offset by a decline in mining income outflows, giving rise to a BOP gap that is less than the assumed shortfall in export proceeds, and thus requiring less additional government borrowing than the stress test assumes.

<sup>5</sup> Under these circumstances, the most extreme shock is not an export shock, but a one-time depreciation shock.

8. **The authorities stressed that they do not intend to tap international bond markets to the extent assumed in the baseline.** They indicated that the government is exploring other sources of external financing, including from multilateral and bilateral sources, on more favorable terms. They also emphasized ongoing work to strengthen public debt management, including the development of a debt management strategy (with support from the World Bank, the IMF and the Macroeconomic and Financial Management Institute of Eastern and Southern Africa (MEFMI)), aimed at lowering refinancing risks among other objectives. Specific actions under consideration include the establishment of a sinking fund for the Eurobonds. The authorities suggested that the pace of fiscal adjustment would be faster than projected under the baseline scenario.

## PUBLIC DEBT SUSTAINABILITY

9. **Zambia's total public debt is projected to rise gradually over the medium term, but remain at manageable levels over the long term (Table 2 and Figure 2).** Staff estimates that, under the baseline scenario, the PV of total public debt would peak at 39 percent of GDP in 2017, declining to 34 percent of GDP by 2035.

10. **Under the standard shock scenarios, risks to public debt dynamics would come mainly from a deterioration of the fiscal stance and negative shocks to GDP growth.**

- The results under the fixed (at the 2014 level) primary balance scenario underscore the need to strengthen fiscal consolidation over the medium term to maintain public debt sustainability (Figure 3 and Table 2). Under this scenario, the PV of debt-to-GDP ratio and the PV of debt-to-revenue keep rising over time.
- The bound tests show that the main risk would mainly come from lower GDP growth, which highlights the need for Zambia to diversify its production structure to mitigate vulnerabilities related to declines in mining production over the long term and to strengthen public investment management to ensure productivity-enhancing investment and thus addressing the country's constraints to broad-based growth.

## CONCLUSIONS

11. **Zambia faces a moderate risk of debt distress, based on an assessment of public external debt, but a heightened overall risk of debt distress given total public debt vulnerabilities.**<sup>6</sup> The public debt DSA suggests that Zambia's overall public sector debt dynamics would be sustainable under the baseline scenario, but the fixed primary balance scenario

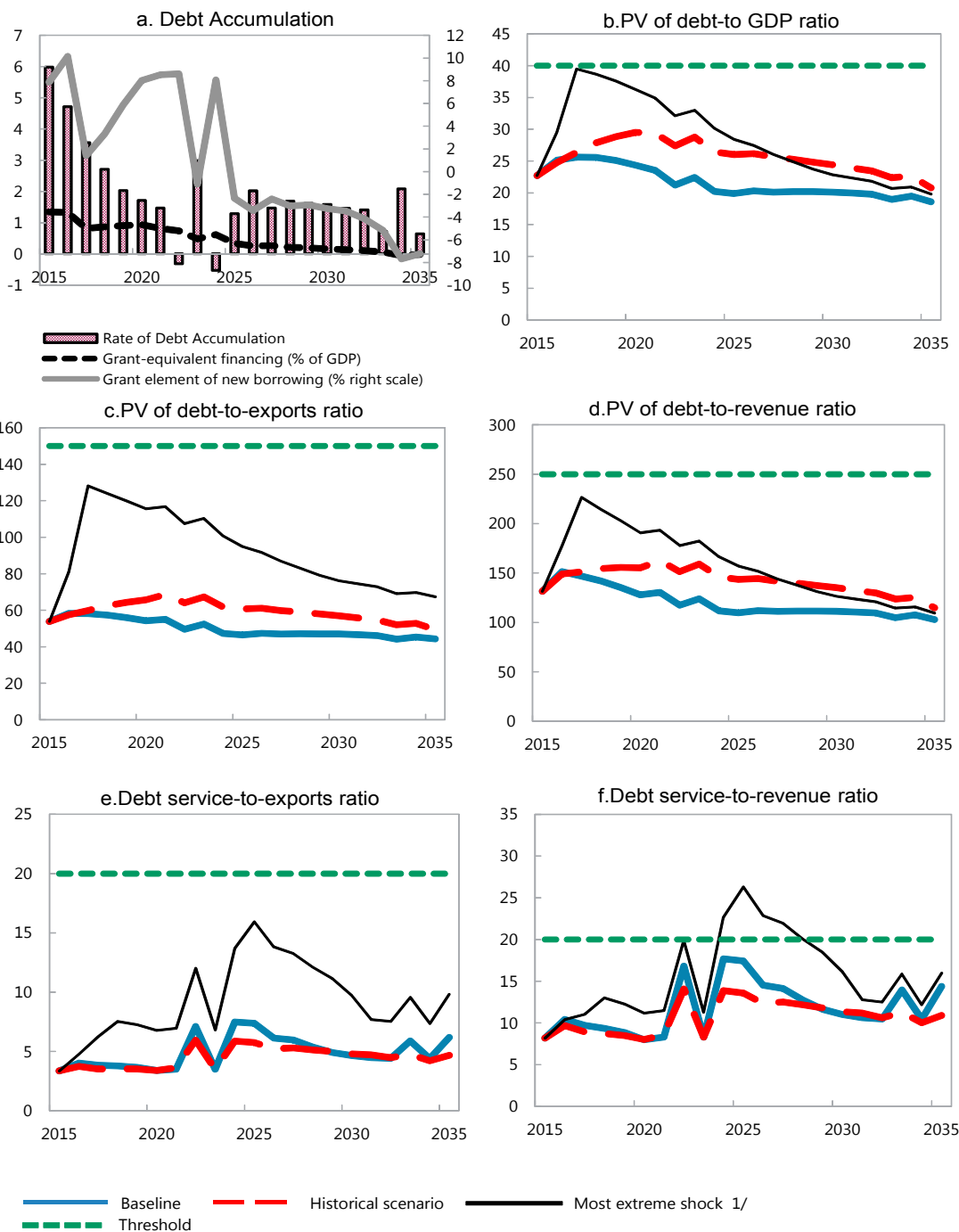
<sup>6</sup> Per page 35 of the DSA guidance note (<http://www.imf.org/external/np/pp/eng/2013/110513.pdf>): "Moderate risk: although the baseline scenario does not lead to breaches of thresholds, stress tests result in one or more breaches."

underscores the need for an improved fiscal position. The external debt indicators remain below their thresholds in the baseline scenario but the indicative threshold is breached for one of the indicators under a number of stress tests. In addition to sound macroeconomic policies and debt management strengthening, developing project appraisal capacity and diversification of the export base are needed in order to maintain productivity-enhancing investments and debt sustainability in the face of access to international markets and a gradual increase in non-concessional borrowing.

12. **The authorities' assessment of debt sustainability is somewhat more favorable.**

In 2014 the Ministry of Finance of Zambia prepared its own DSA with donor assistance, the results of which are similar to the ones obtained under the alternative scenario described earlier in the text, where the debt service-to-revenue ratio briefly breaches the threshold under a one-time depreciation shock in years when the Eurobonds mature. The authorities indicated that they are looking into ways to facilitate repayments of the Eurobonds and while specific plans are still to be laid out, the considered options include establishment of a sinking fund.

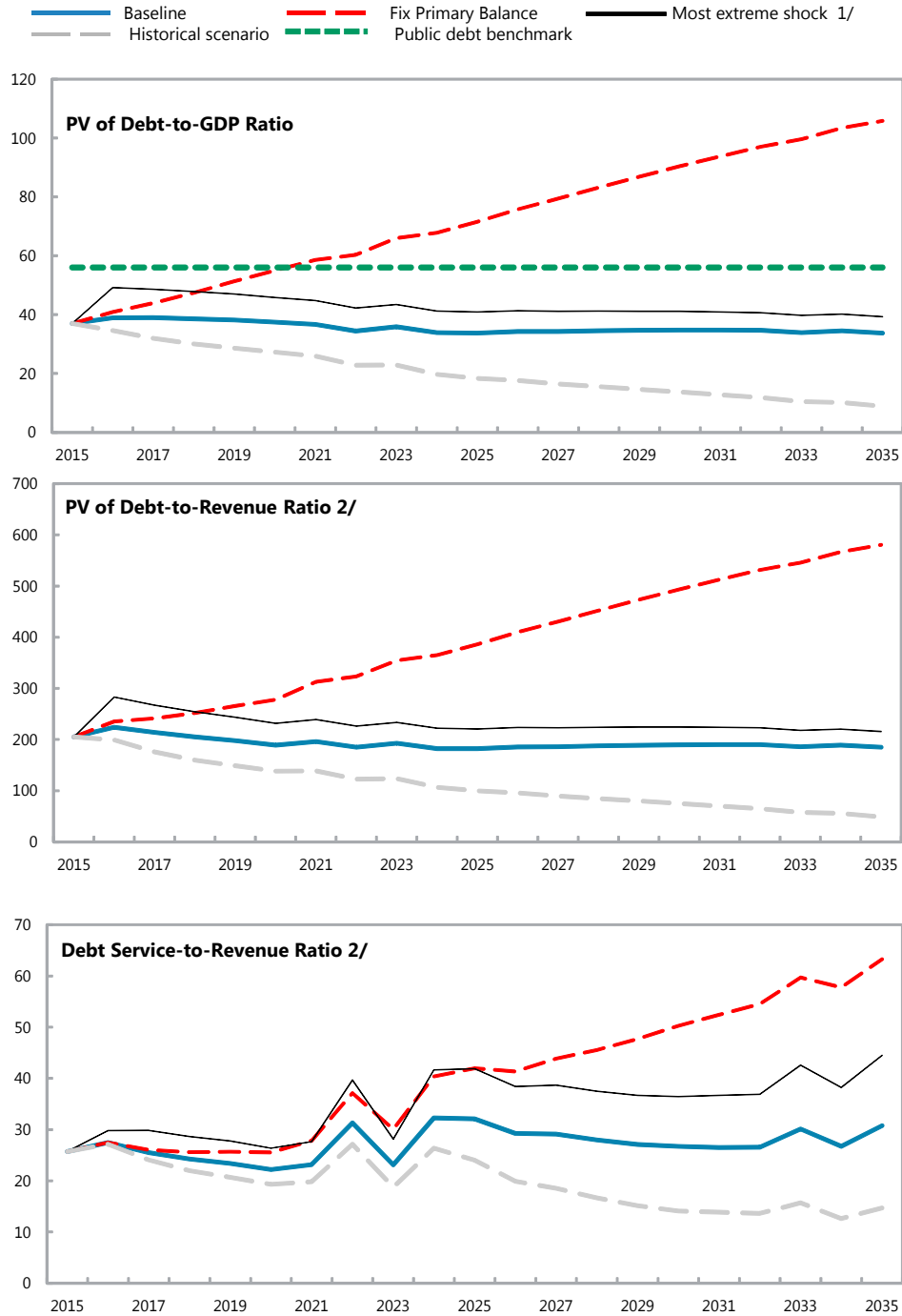
**Figure 1. Zambia: Indicators of Public and Publicly Guaranteed External Debt under Alternative Scenarios, 2015–2035 1/**



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

1/ The most extreme stress test is the test that yields the highest ratio on or before 2025. In Figure b. it corresponds to an Exports shock; in c to an Exports shock; in d. to an Exports shock; in e. to an Exports shock and in Figure f to an Exports shock.

**Figure 2. Zambia: Indicators of Public Debt Under Alternative Scenarios, 2015–2035 1/**



Sources: Country authorities; and staff estimates and projections.  
 1/ The most extreme stress test is the test that yields the highest ratio on or before 2025.  
 2/ Revenues are defined inclusive of grants.



**Table 1. Zambia: External Debt Sustainability Framework, Baseline Scenario, 2012–2035 1/**  
(Percent of GDP, unless otherwise indicated)

	Actual			Historical <sup>6/</sup> Standard <sup>6/</sup>		Projections							2015-2020			2021-2035
	2012	2013	2014	Average	Deviation	2015	2016	2017	2018	2019	2020	Average	2025	2035	Average	
<b>External debt (nominal) 1/</b>	<b>17.2</b>	<b>20.1</b>	<b>23.9</b>			<b>32.4</b>	<b>35.1</b>	<b>35.2</b>	<b>34.8</b>	<b>34.1</b>	<b>33.1</b>		<b>27.2</b>	<b>24.2</b>		
<i>of which: public and publicly guaranteed (PPG)</i>	13.5	13.2	18.2			26.0	29.0	29.3	29.2	28.7	27.9		22.4	19.8		
Change in external debt	1.8	2.9	3.8			8.5	2.7	0.1	-0.3	-0.7	-1.0		-0.6	-1.0		
Identified net debt-creating flows	-16.0	-6.9	-7.4			-7.3	-9.7	-11.2	-11.7	-12.0	-12.0		-10.6	-9.5		
<b>Non-interest current account deficit</b>	<b>-5.8</b>	<b>0.2</b>	<b>1.1</b>	<b>-2.4</b>	<b>4.0</b>	<b>-0.7</b>	<b>-2.8</b>	<b>-4.0</b>	<b>-4.5</b>	<b>-4.8</b>	<b>-4.8</b>		<b>-4.2</b>	<b>-3.4</b>	<b>-4.2</b>	
Deficit in balance of goods and services	-5.0	-2.2	-2.7			-3.7	-6.0	-7.4	-8.1	-8.5	-8.6		-8.2	-7.5		
Exports	42.1	43.2	41.6			42.1	43.1	44.1	44.6	44.8	44.8		42.8	42.1		
Imports	37.1	41.0	38.9			38.4	37.0	36.7	36.5	36.4	36.3		34.5	34.5		
Net current transfers (negative = inflow)	-1.8	-1.5	-1.2	-2.3	0.9	-1.1	-1.1	-1.1	-1.1	-1.1	-1.1		-1.0	-0.9	-1.0	
<i>of which: official</i>	-0.8	-0.5	-0.3			-0.1	-0.1	-0.1	-0.1	-0.1	-0.1		-0.1	0.0		
Other current account flows (negative = net inflow)	1.0	3.9	5.1			4.1	4.3	4.4	4.6	4.7	4.9		5.0	5.0		
<b>Net FDI (negative = inflow)</b>	<b>-9.8</b>	<b>-6.3</b>	<b>-9.3</b>	<b>-6.0</b>	<b>2.6</b>	<b>-6.6</b>	<b>-6.6</b>	<b>-6.6</b>	<b>-6.6</b>	<b>-6.6</b>	<b>-6.6</b>		<b>-6.2</b>	<b>-6.2</b>	<b>-6.2</b>	
<b>Endogenous debt dynamics 2/</b>	<b>-0.4</b>	<b>-0.8</b>	<b>0.8</b>			<b>-0.1</b>	<b>-0.3</b>	<b>-0.6</b>	<b>-0.7</b>	<b>-0.6</b>	<b>-0.7</b>		<b>-0.1</b>	<b>0.1</b>		
Contribution from nominal interest rate	0.3	0.4	0.7			1.3	1.5	1.6	1.6	1.5	1.4		1.2	1.3		
Contribution from real GDP growth	-1.0	-1.1	-1.1			-1.4	-1.8	-2.2	-2.2	-2.2	-2.1		-1.3	-1.2		
Contribution from price and exchange rate changes	0.2	-0.1	1.3			...	...	...	...	...	...		...	...		
<b>Residual (3-4) 3/</b>	<b>17.8</b>	<b>9.8</b>	<b>11.2</b>			<b>15.9</b>	<b>12.4</b>	<b>11.3</b>	<b>11.4</b>	<b>11.3</b>	<b>11.0</b>		<b>9.9</b>	<b>8.6</b>		
<i>of which: exceptional financing</i>	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0		
PV of external debt 4/	...	...	21.3			29.1	31.3	31.5	31.2	30.5	29.6		24.7	23.0		
In percent of exports	...	...	51.3			69.0	72.6	71.4	70.0	68.1	66.0		57.6	54.7		
<b>PV of PPG external debt</b>	<b>...</b>	<b>...</b>	<b>15.6</b>			<b>22.7</b>	<b>25.1</b>	<b>25.6</b>	<b>25.6</b>	<b>25.1</b>	<b>24.4</b>		<b>19.9</b>	<b>18.6</b>		
In percent of exports	...	...	37.5			53.9	58.3	58.1	57.4	56.0	54.3		46.5	44.2		
In percent of government revenues	...	...	84.4			131.6	151.3	147.0	141.8	135.4	128.1		109.9	102.9		
<b>Debt service-to-exports ratio (in percent)</b>	<b>5.3</b>	<b>2.6</b>	<b>3.0</b>			<b>4.6</b>	<b>5.2</b>	<b>5.0</b>	<b>4.9</b>	<b>4.8</b>	<b>4.6</b>		<b>8.5</b>	<b>7.3</b>		
<b>PPG debt service-to-exports ratio (in percent)</b>	<b>2.7</b>	<b>1.5</b>	<b>1.8</b>			<b>3.4</b>	<b>4.0</b>	<b>3.8</b>	<b>3.8</b>	<b>3.7</b>	<b>3.4</b>		<b>7.4</b>	<b>6.2</b>		
<b>PPG debt service-to-revenue ratio (in percent)</b>	<b>6.4</b>	<b>3.9</b>	<b>4.1</b>			<b>8.2</b>	<b>10.4</b>	<b>9.7</b>	<b>9.3</b>	<b>8.9</b>	<b>8.0</b>		<b>17.4</b>	<b>14.4</b>		
Total gross financing need (Billions of U.S. dollars)	-3.2	-1.2	-1.7			-1.2	-1.8	-2.4	-2.8	-3.3	-3.7		-4.1	-8.8		
Non-interest current account deficit that stabilizes debt ratio	-7.6	-2.7	-2.7			-9.2	-5.5	-4.1	-4.2	-4.1	-3.8		-3.6	-2.4		
<b>Key macroeconomic assumptions</b>																
Real GDP growth (in percent)	6.8	6.7	5.6	7.6	1.4	5.6	6.2	6.9	7.0	6.8	6.8	6.6	5.0	5.0	5.2	
GDP deflator in US dollar terms (change in percent)	-1.6	0.8	-6.1	8.8	18.1	-10.3	2.7	3.6	3.7	3.0	3.0	1.0	3.0	3.0	3.0	
Effective interest rate (percent) 5/	2.1	2.6	3.2	2.6	1.7	5.2	5.1	5.0	5.0	4.9	4.6	5.0	4.5	5.4	4.8	
Growth of exports of G&S (US dollar terms, in percent)	11.6	10.4	-4.6	19.1	25.1	-4.0	11.4	13.4	12.2	10.7	10.2	9.0	8.2	6.0	7.9	
Growth of imports of G&S (US dollar terms, in percent)	22.7	18.9	-6.1	18.7	20.0	-6.4	5.2	9.7	10.6	9.7	9.8	6.4	8.2	8.2	8.0	
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	7.9	10.2	1.4	3.3	5.9	8.0	6.1	-2.3	-7.2	-1.4	
Government revenues (excluding grants, in percent of GDP)	17.4	16.9	18.5			17.3	16.6	17.4	18.0	18.5	19.0		18.1	18.1	18.1	
Aid flows (in Billions of US dollars) 7/	0.8	0.6	0.6			0.9	0.9	0.6	0.6	0.6	0.7		0.7	0.6		
<i>of which: Grants</i>	0.4	0.4	0.2			0.2	0.2	0.2	0.3	0.3	0.3		0.3	0.2		
<i>of which: Concessional loans</i>	0.4	0.2	0.4			0.7	0.7	0.3	0.3	0.3	0.4		0.5	0.4		
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			1.3	1.3	0.8	0.9	0.9	0.9		0.3	0.0	0.3	
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			16.6	21.0	17.8	22.6	28.1	32.5		9.1	-0.6	10.5	
<b>Memorandum items:</b>																
Nominal GDP (Billions of US dollars)	24.9	26.8	26.6			25.2	27.5	30.5	33.8	37.2	41.0		62.4	136.8		
Nominal dollar GDP growth	5.1	7.6	-0.8			-5.2	9.1	10.8	11.0	10.1	10.1	7.6	8.2	8.2	8.4	
PV of PPG external debt (in Billions of US dollars)	...	...	4.0			5.6	6.8	7.8	8.6	9.3	9.9		12.3	25.2		
(Pvt-Pvt-1)/GDPt-1 (in percent)	...	...	...			6.0	4.7	3.6	2.7	2.0	1.7	3.4	1.3	0.6	1.3	
Gross workers' remittances (Billions of US dollars)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0		
PV of PPG external debt (in percent of GDP + remittances)	...	...	15.6			22.7	25.1	25.6	25.6	25.1	24.4		19.9	18.6		
PV of PPG external debt (in percent of exports + remittances)	...	...	37.5			53.9	58.3	58.1	57.4	56.0	54.3		46.5	44.2		
Debt service of PPG external debt (in percent of exports + remittances)	...	...	1.8			3.3	4.0	3.8	3.8	3.7	3.4		7.4	6.2		

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as  $[r - g - \rho(1+g)] / (1+g+\rho+gp)$  times previous period debt ratio, with  $r$  = nominal interest rate;  $g$  = real GDP growth rate, and  $\rho$  = growth rate of GDP deflator in U.S. dollar terms.

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

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

6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

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

8/ 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).

**Table 2. Zambia: Public Sector Debt Sustainability Framework, Baseline Scenario, 2012–2035**  
(Percent of GDP, unless otherwise indicated)

	Actual			Average <sup>5/</sup>	Standard Deviation <sup>5/</sup>	Estimate					Projections				
	2012	2013	2014			2015	2016	2017	2018	2019	2020	2015-20		2021-35	
											Average	2025	2035	Average	
<b>Public sector debt 1/</b>	25.5	28.6	34.8			40.3	42.7	42.7	42.2	41.8	41.0		36.3	35.0	
<i>of which: foreign-currency denominated</i>	13.5	13.2	18.2			26.0	29.0	29.3	29.2	28.7	27.9		22.4	19.8	
Change in public sector debt	4.9	3.2	6.2			5.5	2.4	-0.1	-0.4	-0.4	-0.8		-0.4	-0.9	
Identified debt-creating flows	1.2	4.7	4.1			7.0	2.0	0.2	-0.3	-0.7	-1.1		-0.2	-0.1	
Primary deficit	1.8	5.2	3.3	-0.8	6.5	4.9	2.9	1.9	0.9	0.4	0.0	1.8	0.3	0.1	0.2
Revenue and grants	19.1	18.4	19.3			18.0	17.4	18.2	18.8	19.3	19.8		18.5	18.2	
<i>of which: grants</i>	1.7	1.5	0.8			0.8	0.8	0.8	0.8	0.8	0.8		0.4	0.1	
Primary (noninterest) expenditure	20.9	23.6	22.6			22.9	20.3	20.1	19.7	19.6	19.8		18.8	18.3	
Automatic debt dynamics	-0.6	-0.5	0.8			1.6	-0.9	-1.7	-1.3	-1.0	-1.1		-0.4	-0.2	
Contribution from interest rate/growth differential	-0.6	-1.1	-0.6			-0.5	-0.6	-0.9	-0.8	-0.7	-0.8		-0.2	0.0	
<i>of which: contribution from average real interest rate</i>	0.7	0.5	1.0			1.4	1.8	1.9	2.0	2.0	1.9		1.5	1.7	
<i>of which: contribution from real GDP growth</i>	-1.3	-1.6	-1.5			-1.9	-2.4	-2.8	-2.8	-2.7	-2.7		-1.7	-1.9	
Contribution from real exchange rate depreciation	0.0	0.6	1.4			2.1	-0.3	-0.8	-0.4	-0.3	-0.3		...	...	
Other identified debt-creating flows	0.0	0.0	0.0			0.5	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0			0.5	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	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 (specify, 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	
Residual, including asset changes	3.7	-1.5	2.1			-1.6	0.4	-0.2	-0.1	0.2	0.2		-0.2	-0.7	
<b>Other Sustainability Indicators</b>															
<b>PV of public sector debt</b>	...	...	32.3			37.0	38.9	39.0	38.6	38.2	37.4		33.8	33.7	
<i>of which: foreign-currency denominated</i>	...	...	15.6			22.7	25.1	25.6	25.6	25.1	24.4		19.9	18.6	
<i>of which: external</i>	...	...	15.6			22.7	25.1	25.6	25.6	25.1	24.4		19.9	18.6	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	9.6	12.3	12.7			14.3	11.8	10.5	9.4	8.7	8.2		10.3	10.1	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	167.6			205.1	223.9	214.1	205.2	198.0	189.2		182.2	185.1	
PV of public sector debt-to-revenue ratio (in percent)	...	...	174.6			214.2	234.3	223.5	213.9	206.2	196.9		186.4	186.5	
<i>of which: external 3/</i>	...	...	84.4			131.6	151.3	147.0	141.8	135.4	128.1		109.9	102.9	
Debt service-to-revenue and grants ratio (in percent) 4/	17.4	15.5	19.1			25.7	27.5	25.5	24.3	23.4	22.2		32.1	30.8	
Debt service-to-revenue ratio (in percent) 4/	19.1	16.9	19.9			26.9	28.8	26.6	25.3	24.4	23.1		32.8	31.0	
Primary deficit that stabilizes the debt-to-GDP ratio	-3.1	2.0	-2.9			-0.6	0.5	1.9	1.4	0.8	0.8		0.6	0.9	
<b>Key macroeconomic and fiscal assumptions</b>															
Real GDP growth (in percent)	6.8	6.7	5.6	7.6	1.4	5.6	6.2	6.9	7.0	6.8	6.8	6.6	5.0	5.0	5.2
Average nominal interest rate on forex debt (in percent)	2.3	1.8	3.6	1.5	0.9	5.7	5.4	5.2	5.1	4.9	4.6	5.2	4.5	5.6	4.9
Average real interest rate on domestic debt (in percent)	7.0	6.1	5.8	2.3	4.0	4.5	6.9	7.9	9.0	9.8	9.7	8.0	7.5	7.1	7.5
Real exchange rate depreciation (in percent, + indicates depreciation)	-0.4	4.5	11.1	-3.1	16.0	11.7	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	4.2	5.7	7.1	10.3	4.4	7.5	7.3	6.3	5.2	4.8	4.8	6.0	5.0	5.0	5.0
Growth of real primary spending (deflated by GDP deflator, in percent)	21.5	20.5	0.9	4.3	8.8	7.4	-5.9	5.7	5.2	6.4	7.5	4.4	4.4	4.9	4.7
Grant element of new external borrowing (in percent)	...	...	...	...	...	7.9	10.2	1.4	3.3	5.9	8.0	6.1	-2.3	-7.2	...

Sources: Country authorities; and staff estimates and projections.

1/ Central government and publicly guaranteed, gross basis.

2/ 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.

3/ Revenues excluding grants.

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

5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

**Table 3. Zambia: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2015–2035**  
(Percent)

	Projections							
	2015	2016	2017	2018	2019	2020	2025	2035
<b>PV of debt-to GDP ratio</b>								
<b>Baseline</b>	23	25	26	26	25	24	<b>20</b>	19
<b>A. Alternative Scenarios</b>								
A1. Key variables at their historical averages in 2015-2035 1/	23	25	26	28	29	30	<b>26</b>	21
A2. New public sector loans on less favorable terms in 2015-2035 2	23	26	27	28	28	27	<b>24</b>	26
<b>B. Bound Tests</b>								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	23	25	26	25	25	24	<b>20</b>	18
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	23	29	39	39	38	36	<b>28</b>	20
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	23	28	33	33	32	31	<b>25</b>	24
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	23	28	31	31	30	29	<b>23</b>	19
B5. Combination of B1-B4 using one-half standard deviation shocks	23	29	37	36	35	34	<b>27</b>	20
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	23	35	36	36	35	34	<b>28</b>	26
<b>PV of debt-to-exports ratio</b>								
<b>Baseline</b>	54	58	58	57	56	54	<b>47</b>	44
<b>A. Alternative Scenarios</b>								
A1. Key variables at their historical averages in 2015-2035 1/	54	57	60	63	64	66	<b>61</b>	49
A2. New public sector loans on less favorable terms in 2015-2035 2	54	60	62	62	61	60	<b>56</b>	62
<b>B. Bound Tests</b>								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	54	57	58	57	55	54	<b>46</b>	44
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	54	81	128	124	120	116	<b>95</b>	67
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	54	57	58	57	55	54	<b>46</b>	44
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	54	64	71	69	67	65	<b>54</b>	45
B5. Combination of B1-B4 using one-half standard deviation shocks	54	68	88	85	83	80	<b>66</b>	51
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	54	57	58	57	55	54	<b>46</b>	44
<b>PV of debt-to-revenue ratio</b>								
<b>Baseline</b>	132	151	147	142	135	128	<b>110</b>	103
<b>A. Alternative Scenarios</b>								
A1. Key variables at their historical averages in 2015-2035 1/	132	149	151	154	156	155	<b>144</b>	115
A2. New public sector loans on less favorable terms in 2015-2035 2	132	156	156	153	149	142	<b>133</b>	144
<b>B. Bound Tests</b>								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	132	148	147	141	135	127	<b>109</b>	102
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	132	178	226	214	203	191	<b>157</b>	110
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	132	168	188	181	173	164	<b>140</b>	131
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	132	167	180	171	163	154	<b>128</b>	105
B5. Combination of B1-B4 using one-half standard deviation shocks	132	172	212	201	191	179	<b>149</b>	113
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	132	210	206	198	189	179	<b>153</b>	143

**Table 3. Zambia: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2015–2035 (continued)**  
(Percent)

	Projections							
	2015	2016	2017	2018	2019	2020	2025	2035
<b>Debt service-to-exports ratio</b>								
<b>Baseline</b>	3	4	4	4	4	3	<b>7</b>	6
<b>A. Alternative Scenarios</b>								
A1. Key variables at their historical averages in 2015-2035 1/	3	4	4	4	4	3	<b>6</b>	5
A2. New public sector loans on less favorable terms in 2015-2035 2	3	4	3	3	3	3	<b>5</b>	6
<b>B. Bound Tests</b>								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	3	4	4	4	4	3	<b>7</b>	6
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	3	5	6	8	7	7	<b>16</b>	10
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	3	4	4	4	4	3	<b>7</b>	6
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	3	4	4	4	4	4	<b>9</b>	6
B5. Combination of B1-B4 using one-half standard deviation shocks	3	4	5	5	5	5	<b>11</b>	7
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	3	4	4	4	4	3	<b>7</b>	6
<b>Debt service-to-revenue ratio</b>								
<b>Baseline</b>	8	10	10	9	9	8	<b>17</b>	14
<b>A. Alternative Scenarios</b>								
A1. Key variables at their historical averages in 2015-2035 1/	8	10	9	9	9	8	<b>14</b>	11
A2. New public sector loans on less favorable terms in 2015-2035 2	8	10	8	8	8	8	<b>11</b>	15
<b>B. Bound Tests</b>								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	8	10	10	9	9	8	<b>18</b>	14
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	8	10	11	13	12	11	<b>26</b>	16
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	8	12	13	12	11	10	<b>22</b>	19
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	8	10	11	11	10	9	<b>21</b>	15
B5. Combination of B1-B4 using one-half standard deviation shocks	8	11	11	12	12	11	<b>25</b>	16
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	8	15	14	13	13	11	<b>25</b>	20
<i>Memorandum item:</i>								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	-3	-3	-3	-3	-3	-3	<b>-3</b>	-3

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

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

2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline, while grace and maturity periods are the same as in the baseline.

3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).

4/ Includes official and private transfers and FDI.

5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.

6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

**Table 4. Zambia: Sensitivity Analysis for Key Indicators of Public Debt 2015–2035**

	Projections							
	2015	2016	2017	2018	2019	2020	2025	2035
<b>PV of Debt-to-GDP Ratio</b>								
<b>Baseline</b>	37	39	39	39	38	37	34	34
<b>A. Alternative scenarios</b>								
A1. Real GDP growth and primary balance are at historical averages	37	35	32	30	29	27	18	9
A2. Primary balance is unchanged from 2015	37	41	44	47	51	55	72	106
A3. Permanently lower GDP growth 1/	37	39	39	39	39	39	37	46
<b>B. Bound tests</b>								
B1. Real GDP growth is at historical average minus one standard deviations in 2016-2017	37	39	39	39	39	38	35	36
B2. Primary balance is at historical average minus one standard deviations in 2016-2017	37	42	46	45	44	43	39	38
B3. Combination of B1-B2 using one half standard deviation shocks	37	38	39	38	38	37	33	32
B4. One-time 30 percent real depreciation in 2016	37	49	48	48	47	46	43	47
B5. 10 percent of GDP increase in other debt-creating flows in 2016	37	49	49	48	47	46	41	39
<b>PV of Debt-to-Revenue Ratio 2/</b>								
<b>Baseline</b>	205	224	214	205	198	189	182	185
<b>A. Alternative scenarios</b>								
A1. Real GDP growth and primary balance are at historical averages	205	199	176	160	149	138	100	49
A2. Primary balance is unchanged from 2015	205	235	241	252	266	278	386	580
A3. Permanently lower GDP growth 1/	205	225	216	209	203	196	202	251
<b>B. Bound tests</b>								
B1. Real GDP growth is at historical average minus one standard deviations in 2016-2017	205	224	216	208	201	193	189	196
B2. Primary balance is at historical average minus one standard deviations in 2016-2017	205	241	251	239	230	219	209	206
B3. Combination of B1-B2 using one half standard deviation shocks	205	220	214	205	197	187	177	175
B4. One-time 30 percent real depreciation in 2016	205	282	266	254	245	234	233	259
B5. 10 percent of GDP increase in other debt-creating flows in 2016	205	283	267	254	244	232	221	216
<b>Debt Service-to-Revenue Ratio 2/</b>								
<b>Baseline</b>	26	27	26	24	23	22	32	31
<b>A. Alternative scenarios</b>								
A1. Real GDP growth and primary balance are at historical averages	26	27	24	22	21	19	24	15
A2. Primary balance is unchanged from 2015	26	27	26	26	26	26	42	63
A3. Permanently lower GDP growth 1/	26	28	26	25	24	23	34	36
<b>B. Bound tests</b>								
B1. Real GDP growth is at historical average minus one standard deviations in 2016-2017	26	27	26	24	24	22	33	32
B2. Primary balance is at historical average minus one standard deviations in 2016-2017	26	27	26	26	25	24	35	33
B3. Combination of B1-B2 using one half standard deviation shocks	26	27	25	24	23	22	32	30
B4. One-time 30 percent real depreciation in 2016	26	30	30	29	28	26	42	45
B5. 10 percent of GDP increase in other debt-creating flows in 2016	26	27	28	27	26	24	38	34

Sources: Country authorities; and staff estimates and projections.

1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of the length of the projection period.

2/ Revenues are defined inclusive of grants.



# ZAMBIA

## STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

May 5, 2015

Prepared By

African Department  
(In Consultation with Other Departments)

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## RELATIONS WITH THE FUND

As of March 31, 2015

**Membership Status: Joined: September 23, 1965; Article VIII**

### General Resources Account:

	SDR Million	Percent Quota
Quota	489.10	100.0
Fund holdings of currency	489.10	100.0
Reserve position in Fund	0.02	0.0

### SDR Department

	SDR Million	Percent Allocation
Net cumulative allocation	469.14	100.0
Holdings	357.44	76.19

### Outstanding Purchases and Loans

	SDR Million	Percent Quota
ECF arrangements	226.57	46.32

### Latest Financial Arrangements

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

### Projected Payments to the Fund<sup>2</sup>

(SDR million; based on existing use of resources and present holdings of SDRs)

	Forthcoming				
	2015	2016	2017	2018	2019
Principal	41.24	49.88	47.32	43.32	31.93
Charges/interest	<u>0.047</u>	<u>0.066</u>	<u>0.064</u>	<u>0.062</u>	<u>0.14</u>
Total	<u>41.28</u>	<u>49.94</u>	<u>47.38</u>	<u>43.38</u>	<u>32.07</u>

<sup>1</sup> Formerly PRGF.

<sup>2</sup> When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

**Implementation of HIPC Initiative**

	<b>Enhanced Framework</b>
Commitment of HIPC assistance	
Decision point date	Dec. 2000
Assistance committed (1999 NPV terms) <sup>3</sup>	
By all creditors (US\$ million)	2,499.20
<i>Of which:</i> 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 <sup>4</sup>	39.47
Total Disbursement	508.27

**Implementation of MDRI Assistance**

I. Total debt relief (SDR million) <sup>5</sup>	402.59			
Of which: MDRI	398.47			
HIPC	4.12			
II. Debt relief by facility (SDR million)				
	<b>Delivery date</b>	<b>GRA</b>	<b>PRGT</b>	<b>Total</b>
	January 2006	n/a	402.59	402.59

<sup>3</sup> Net present value (NPV) terms at the decision point under the enhanced framework.

<sup>4</sup> 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.

<sup>5</sup> 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.



## **Safeguard Assessments**

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.

On January 31, 2014, the Zambian authorities amended the regulation on foreign exchange transactions (Statutory Instrument 55 of 2013) to remove the two exchange restrictions identified in the 2013 Article IV staff report. On March 21, 2014, the authorities repealed Statutory Instrument 55 of 2013 in full. However, 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 December 11, 2013.

## **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 April 30–May 15, 2002, and July 15–26, 2002. A mission from the Fund and the World Bank conducted a follow up FSAP in November 2008.

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 2009)****Resident advisors**

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

**Technical assistance missions**

<b>Department</b>	<b>Dates</b>	<b>Purpose</b>
MCM	March 2009	Contingency planning and lender of last resort
	July 2009	Debt management strategy
	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
	June 2013	Markets for government securities
	August 2013	Financial stability analysis

<b>Department</b>	<b>Dates</b>	<b>Purpose</b>
	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
	March 2015	Organizational structure and operational set up
STA	January 2009	Consumer price index
	April 2010	Government finance statistics
	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	National accounts
	March 2015	Price statistics

FAD	January 2009	Tax administration
	April 2009	Public financial management
	November 2009	Tax administration
	February 2010	Tax administration
	June 2010	Public financial management
	August 2010	Tax policy
	September 2010	Public financial management
	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

### **Resident Representative**

A Fund Resident Representative first took up the position in Lusaka in June 1990. Mr. Tobias Rasmussen has been the Resident Representative since January 2013.

## JOINT WORLD BANK-FUND WORK PROGRAM, 2015–16

Title	Products	Expected Delivery Date
World Bank work program in next 12 months	1. Analytical work – <i>Economic Briefs</i> focused on mining	June 2015
	2. Analytical work – Managing copper resources for poverty reduction and lasting prosperity (3 policy notes)	June 2015
	3. Lending – DPO focused on PFM reforms (\$50 million)	June 2015
	4. TA – PFM reform program and dialogue	Continuous
	5. TA – Setting up a project appraisal system in MoF	Continuous
	6. TA – E-procurement support	Continuous
	7. TA – Pay Policy Reform	June 2015
	8. TA – Zambia Mining Sector Governance Reform including EITI	June 2015
	9. Analytical work – Zambia investment climate assessment	June 2015
	10. TA – Follow-up project with BoZ on risk-based supervision	Start August 2015
	11. TA – Financial Inclusion Support Framework (2-3 year program)	Start June 2015
	12. TA – Financial Consumer Protection/Financial Literacy	June 2016
	13. TA – Development Bank of Zambia on shadow credit rating	June 2016
	14. Analytical work – Education Public Expenditure Review	Start Oct. 2015
	15. Analytical work – Economic analysis for the benefit of girls	June 2015
IMF work program in next 12 months	1. Technical assistance: tax administration peripatetic advisor to the Zambia Revenue Authority	Ongoing
	2. Technical assistance: Central bank capacity building resident advisor to the Bank of Zambia	Ongoing
	3. Staff visit to discuss mid-term 2015 budget and 2016 budget	July 2015
	4. 2016 Article IV mission	March 2016

Fund request to Bank	1. Analytical work on mining taxation issues	July 2015
	2. Analytical work on poverty maps	June 2015
	3. Pay Policy Reform Report	July 2015
Bank request to Fund	1. Medium-term macroeconomic framework	Continuous
Joint products in next 12 months	1. DSA for Article IV and for WB DPO	April 2015
	2. Regular meetings with the Bank of Zambia	Continuous

## STATISTICAL ISSUES

As of March 31, 2015

### 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:** Rebased GDP, 2010 from the previous benchmark year of 1994, was published in 2014. Broadened coverage of the informal sector has significantly improved the quality of the national accounts. As of yet, however, the rebased national accounts have only been extended beyond 2010 using the old industry growth rates. Figures for 2011–13 may be subject to considerable revisions once ongoing establishment surveys are completed and methodological enhancements are applied. The Central Statistics Office is also planning to release quarterly GDP estimates, which will help to fill a gap in high frequency indicators of economic activity. Beyond that, it will be important to continue improving the source data and compilation procedures for regular GDP estimates including for household consumption and capital formation.

**Price statistics:** The CPI broadly adheres to international methodological standards. The classification system used for compilation closely follows the Classification of Individual Consumption by Purpose. A new CPI series with updated weights based on the latest household budget survey was started in February 2012. An STA (AFS) ongoing project on introduction of producer price index (PPI) is expected to enhance the procedures for measuring volume changes of GDP and its components.

**Government finance statistics:** The coverage of these 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 AFR 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. Zambia last reported data to STA in GFSM 2001 format for fiscal year 2011, including data on transactions in financial assets and liabilities.

**Monetary statistics:** There has in recent years been a noticeable improvement in the quality of monetary accounts compiled and reported in accordance with the standardized report forms (SRFs) for the Bank of Zambia (BoZ), other depository corporations (ODCs) and other financial corporations (OFC).

**Balance of payments statistics:** The data adequacy has 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 data are compiled quarterly and IIP data annually. 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. In addition, the capture of quarterly data through the investment survey (relating to financial account and primary income) has contributed to the improvement of the BOP data recently.

**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. A Data ROSC Assessment was published in February 2005.



**Zambia: Table of Common Indicators Required for Surveillance**  
As of April 27, 2015

	Date of Latest Observation	Date Received	Frequency of Data <sup>7</sup>	Frequency of Reporting <sup>7</sup>	Frequency of Publication <sup>7</sup>	Memo Items:	
						Data Quality – Methodological soundness <sup>8</sup>	Data Quality – Accuracy and Reliability <sup>9</sup>
Exchange rates	April 24, 2015	April 24, 2015	D	D	D		
International reserve assets and reserve liabilities of the monetary authorities <sup>1</sup>	April 22, 2015	April 22, 2015	D	W	M		
Reserve/base money	April 24, 2015	April 27, 2015	D	W	I	LO, LO, LO, LO	LO, O, O, O, O
Broad money	Feb. 2015	March 25, 2015	M	M	M		
Central bank balance sheet	Feb. 2015	March 25, 2015	M	M	M		
Consolidated balance sheet of the banking system	Feb. 2015	March 25, 2015	M	M	M		
Interest rates <sup>2</sup>	April 17, 2015	April 20, 2015	W	W	I		
Consumer Price Index	March 2015	March 25, 2015	M	M	M	O, LO, O, LO	LNO, LO, LO, LNO, LO
Revenue, expenditure, balance and composition of financing <sup>3</sup> —general government <sup>4</sup>	NA	NA				LO, LNO, LNO, LO	LNO, LO, O, O, LNO
Revenue, expenditure, balance and composition of financing <sup>3</sup> —central government	March, 2015	April 24, 2015	M	M	M		
Stocks of central government and central government-guaranteed debt <sup>5</sup>	January, 2015	March, 2015	M	M	A		
External current account balance	Q4 2014	March, 2015	Q	Q	A	LO, LNO, LNO, O	LNO, O, LNO, LO, LNO
Exports and imports of goods and services	Feb. 2015	March 26, 2015	M	M	M		
GDP/GNP	2013	April 2014	A	A	A	LO, LO, LO, LO	LNO, LO, LNO, LNO, LNO
Gross external debt	Dec. 2014	March 2015	I	I	I		
International investment position <sup>6</sup>	2013	April 2015	A				

<sup>1</sup>Any reserve assets that are pledged or 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.

<sup>2</sup>Both market-based and officially determined, including discounts rates, money market rates, rates on treasury bills, notes and bonds.

<sup>3</sup>Foreign, domestic bank, and domestic nonbank financing.

<sup>4</sup>The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

<sup>5</sup>Including currency and maturity composition.

<sup>6</sup>Includes external gross financial asset and liability positions vis-à-vis nonresidents.

<sup>7</sup>Daily (D), weekly (W), monthly (M), quarterly (Q), annually (A); irregular (I); or not available (NA).

<sup>8</sup>Reflects the assessment provided in the data ROSC, published February 1, 2005, and based on the findings of the mission that took place during May 18–June 3, 2004 for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning (respectively) concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).

**Statement by Ms. Chileshe Mpundu Kapwepwe, Executive Director for Zambia;  
and Ms. Gillian Nkhata, Senior Advisor to Executive Director**

**May 20, 2015**

1. On behalf of the Zambian authorities, we thank staff for frank and productive consultations and a thorough and incisive set of papers. The authorities had wide-ranging discussions with staff, which helped pinpoint the main challenges and inform the policy agenda going forward, and they appreciate the continuing engagement with the Fund. The authorities broadly agree with staff's assessment of the Zambian economy, although they have a more optimistic view on growth prospects, as well as some important qualifications to convey to the Board regarding the policy mix and creating buffers to external shocks. The following elaborates on some of these qualifications and provides further information on some recent developments.

**Recent developments, risks and outlook**

2. After almost a decade of robust growth and macroeconomic stability, the Zambian economy is facing increased challenges. The authorities and staff agree that the positive outcome over the past decade was a result of both domestic and external factors. In particular, the authorities' prudent macroeconomic management and strong reforms were supported by exogenous factors, such as the sustained period of favorable copper prices and improved investor sentiments, which helped increase FDI. Over the past year, the weight of exogenous factors on fiscal efforts was evident when international commodity prices and the strengthening dollar exerted increasing pressure not only on external sector performance, but also on debt sustainability, inflation, mining production levels, and the pace of fiscal consolidation.

3. While the Zambian authorities consider the staff report balanced overall, they believe that it underplays the role of global economic developments in 2014, and their impact on fiscal performance in 2015. In this regard, the authorities underscore the potential for a more favorable scenario for 2015, given the signs of a more favorable external environment and the new mining taxation regime, which together with steadfast implementation of reforms to improve the business environment will reinvigorate investor confidence, raise copper production in the near future and boost growth more generally.

**The fiscal stance and the overall policy mix**

4. The authorities remain committed to fiscal sustainability and have taken measures to contain the fiscal deficit in 2015. Specifically, the authorities are undertaking measures to close the K18.0 billion deficit, which include the sale of maize stocks by FRA, a reduction of spending on goods and services, which has already been approved by Cabinet and the deferral of capital spending, and full cost recovery in fuel pump prices, which should be achieved by July 2015, following a first increase on May 13, 2015.

5. On taxation, while cognizant of the need to strengthen revenue mobilization, the Zambian authorities emphasize the need to be mindful of the political economy and the often cited issue of policy consistency. The authorities are of the view that there is limited scope to raise taxes in the near-term, and it would be difficult to do so midway through the year. Regarding VAT refunds, the authorities are actively working to eliminate the backlogs caused by the tightening of documentation requirements, including through a streamlining of administrative procedures.

6. Regarding the overall policy mix, the Zambian authorities are faced with the challenge of tightening fiscal policy, while promoting growth and creating space for priority infrastructure and social spending, in an unfavorable global climate. In recent months, the policy response has relied more on monetary policy, given the need to avoid excessive volatility in the kwacha, after the rapid depreciation in the first quarter of 2015. However, the authorities remain committed to implementing the fiscal adjustment measures discussed with staff, and to continue rebalancing the policy mix and rebuilding fiscal buffers. They consider these measures critical to build resilience against heightened vulnerabilities.

7. As regards financing, staff has expressed some concern about external borrowing. However, given the limited size of the domestic capital market, the higher cost of domestic borrowing, and the need to crowd-in the private sector, the Zambian authorities consider that external financing will need to remain among the financing options.

### **Mining tax regime**

8. The direct contribution of the mining sector to government revenues (royalties, corporate income tax) has increased with higher copper production and prices, although it remains low, at just over 2 percent of GDP to government revenue, while the sector accounts for 30 percent of GDP. With increasing copper production, higher sector value-added and prices, the expectations for a higher contribution have risen, which prompted the government to introduce changes to the mining fiscal regime in the 2015 budget. From a system comprising a uniform royalty rate (6 percent), corporate income tax and a variable income tax, the regime was switched to a royalty only system, with differentiated rates for underground mines (8 percent) and open cast mines (20 percent).

9. The change to a royalty only regime would have provided a more predictable source of income, and raised total revenue by an estimated 1 percent of GDP. However, the introduction of the regime coincided with falling commodity prices, resulting in a greater burden on the mining sector and risks to growth that could not have been anticipated. The announcement of the regime led to suspension of investment plans in some mines, while others were placed in “care and maintenance” status.

10. The authorities recognize that the new regime, which will take effect in July, will have negative implications for this year’s budget, but they also note that, over the medium-term, the regime should attract greater investment in the sector and boost copper production. The decision in April to readjust the regime was largely motivated by concerns about growth in the face of these adverse external developments. Cabinet has approved the revision of the tax structure and the Income Tax Act will be duly amended.

### **Monetary policy and the removal of interest rate caps**

11. As regards monetary and exchange rate policies, the Zambian authorities remain committed to maintaining exchange rate flexibility. They also intend to continue rebuilding international reserves to reach at least four months of import coverage in the medium term. In addition, the Bank of Zambia recently tightened monetary policy to reduce the liquidity constraints in the banking system and stabilize the currency. The Bank of Zambia stands ready to tighten monetary policy further, should circumstances warrant. Following the introduction of a policy rate in 2012, the authorities are continuing to build the structures necessary for a successful transition from reserve money targeting to using the policy rate for monetary purposes.

12. The Zambian authorities agree with staff that interest rate caps on commercial bank lending may have become a binding constraint on credit to SMEs, given rising treasury bill rates. The authorities are actively working with the World Bank to complete analytical work to inform the policy direction.

### **Reducing external vulnerabilities**

13. It is clear that Zambia is facing significant external challenges following the recent period of declining copper prices and production, which underscores the need to strengthen buffers to cushion the economy against external shocks. The authorities agree with staff on the assessment of the challenges. They also agree that the planned fiscal adjustment will play an important role in relieving pressure on the current account balance, as will exchange rate flexibility. As mentioned above, clarity on mining tax regime will help attract FDI and portfolio inflows and support reserve build-up. There will be a need to diversify the export base, including by alleviating supply side constraints related to infrastructure, quality of goods and other factors. This is an area where there is scope for further collaboration with the Fund and Bank.

14. Regarding the exchange rate, the staff report concludes that the kwacha is over-valued, which suggests that further depreciation would be needed. While the authorities welcome staff's attention to using a broader set of indicators for the exchange assessment, they consider that given the divergence with the ERER assessment and the uncertainties about data quality and methodology, the interpretation of the EBA-Lite results may warrant greater caution.

### **Conclusion**

15. I could not conclude without reiterating the strong commitment of the Zambian authorities to prudent fiscal and monetary policies, sustained debt management practices and deeper structural reforms to boost competitiveness, promote inclusive growth and accelerate poverty reduction.