



CENTER FOR TRADE POLICY AND DEVELOPMENT

STATE OF THE ECONOMY BRIEF:

FIRST QUARTER HIGHLIGHTS AND
PROSPECTS FOR SECOND QUARTER

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1.0 INTRODUCTION

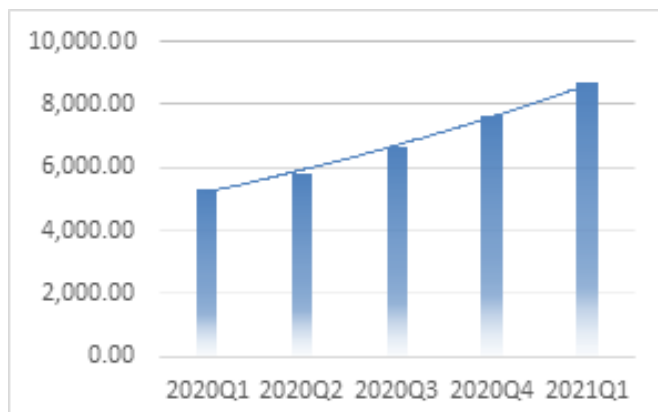
The Zambian economy, as is the case with many economies, is facing the negative impacts of the Covid-19 global health pandemic. Coupled with an already deteriorating macro-economic outlook at the onset of the pandemic, the economy slid into a recession in 2020 as economic growth shrunk by 3.0 percent (ZSA, 2021). Nonetheless, the economy is now set for a recovery, as evidenced by the less severe contraction in economic growth of -2.7 percent in the fourth quarter of 2020 relative to the -3.1 percent estimated for the third quarter. In this brief, we highlight Zambia's economic performance in the first quarter of 2021 and present our expectations for the second quarter of 2021.

1.1 COPPER PRICES

Upswing in Copper Prices....

Since the first quarter of 2020, international copper prices have maintained an increasing trajectory, rising to an average of USD 8,714.91 per tonne in the first quarter of 2021 from a quarterly average of USD 7,610.34 previously. Specifically, international copper prices hit USD 9,286.00 per tonne in February, 2021- the highest in a decade (BoZ, 2021). The upswing in copper prices was mainly driven by supply constraints and increasing demand for copper as most economies, particularly China, were opening up and resuming industrial activities after the first wave of the Covid-19 pandemic. The volume of refined Copper exported for the period January to February 2021 was 154.6 thousand metric tonnes while that of 2020 for the same period was 134.9 thousand metric tonnes representing a 14.6 percent increase (ZSA, 2021).

Figure 1: International Copper Prices



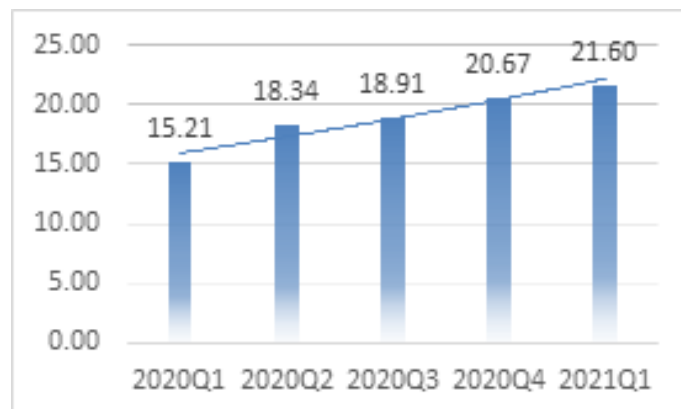
Source: Bank of Zambia, Statistics Fortnightly, March 2021

1.2 EXCHANGE RATE

The steep depreciation of the Kwacha...

The Zambian Kwacha has continued to lose value against major currencies such as the United States Dollar (USD), depreciating by about 4 percent to an average of K21.60 per USD in the first quarter of 2021 from an average of K20.67 per USD in the last quarter of 2020. The rate of depreciation slowed down from the 9.4 percent recorded from the third to fourth quarter of 2020, largely reflecting the Bank of Zambia's scaled up interventions in the foreign exchange market as indicated in the 2021 first quarter Monetary Policy Statement, and a slow-down in the demand for foreign currency, premised on reduced demand for imports (BoZ, 2021).

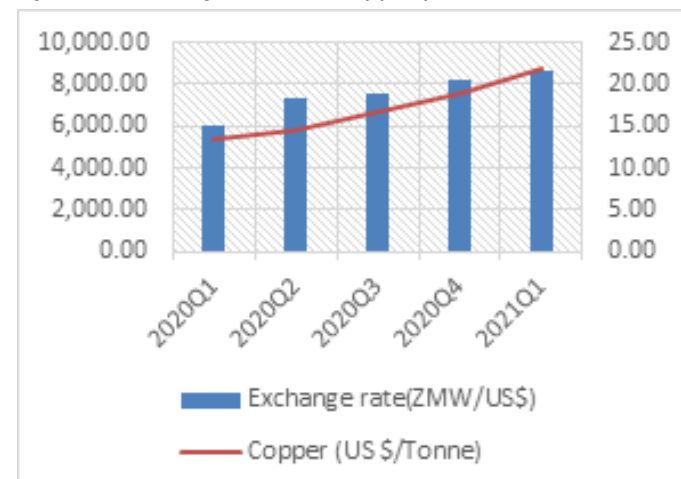
Figure 2: Zambian Kwacha/ USD Exchange rate



Source: Bank of Zambia, Statistics Fortnightly, March 2021

The relationship between copper prices and exchange rate stability since first quarter of 2020 is counter-intuitive. The exchange rate continued to depreciate, even though, copper prices maintained an increasing trajectory, partly signalling structural misalignments in the economy.

Figure 3: Exchange rate and copper prices



Source: Bank of Zambia, Statistics Fortnightly, March 2021

1.3 TRADE PERFORMANCE

Trade Surplus contracts...

The country recorded a trade surplus in the first quarter of 2021, as was the case in the last quarter of 2020. However, the value of the trade surplus edged down to K17.4 billion in the first quarter of 2021 from K20.1 billion in the last quarter of 2020, driven by a contraction in the value of both exports and imports over the review period.

The value of exports fell to K34.2 billion from K48.4 billion while that of imports fell to K16.7 billion from K28.2 billion in the preceding quarter (ZSA, 2021)¹. This was driven by a contraction in exports of domestically produced goods, intermediate goods and raw materials, supplemented by a diminution in imports of consumer goods, capital goods and raw materials over the quarter under review.

For the first two months of the first quarter, earnings from Traditional Exports increased to K26.8 billion from K23.9 billion recorded in the first two months of the previous quarter. Over the same period, earnings from Non-Traditional Exports (NTEs) declined to K 7.3 billion from the previous K7.6 billion.

Figure 4: Value of Exports and Imports



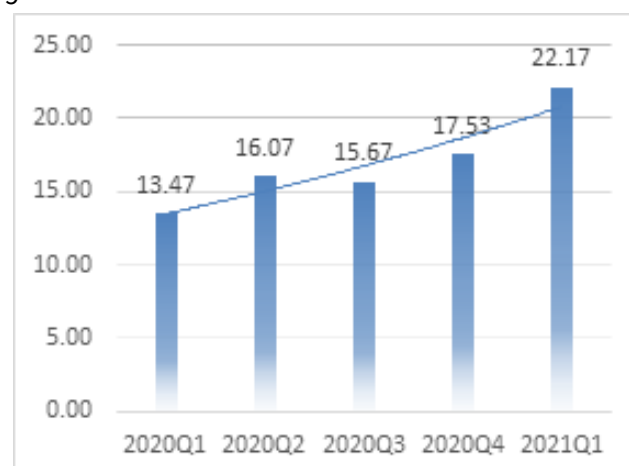
Source: Zambia Statistical Agency, the monthly bulletin, March 2021

1.4 INFLATION

Overall Inflation rises further, driven mainly by food inflation...

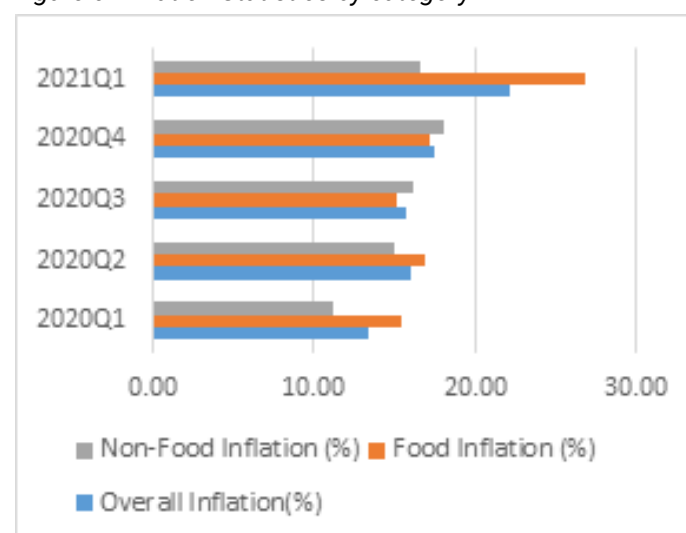
Overall Inflation rose to a quarterly average of 22.17 percent from the previous outturn of 17.53 percent. This was driven mainly by an increase in food inflation as non-food inflation slowed down. Food Inflation rose substantially, to a quarterly average of 26.90 percent from the previous 17.20 percent while non-food inflation declined to a quarterly average of 16.63 percent from the previous 18.03 percent (ZSA, 2021).

Figure 5: Trend in overall inflation



Source: Bank of Zambia, Statistics Fortnightly, March 2021

Figure 6: Inflation Statistics by category



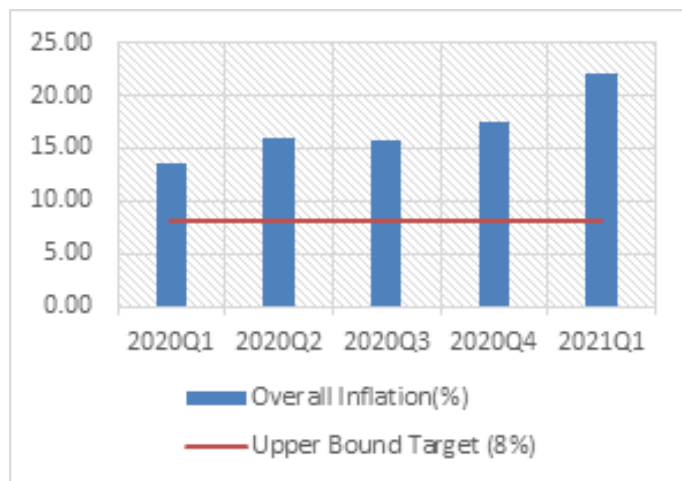
Source: Bank of Zambia, Statistics Fortnightly, March 2021

Headline Inflation deviates further from the target range...

Ideally, the objective of the Bank of Zambia is to maintain inflation within the 6-8 percent target range, and this has been one of the macroeconomic objectives in the annual National Budgets since 2018. However, the Ministry of Finance (MoF) and the Bank of Zambia (BoZ), for the first time since 2018, revised this objective in 2021 as it now seeks to reduce inflation 'towards' the upper bound of the target range. Nevertheless, the inflation outturn for the first quarter reveals a wider gap between overall inflation and the 8 percent upper bound target.

¹ The figures for the first quarter of 2021 are preliminary, based on January and February figures.

Figure 7: Headline Inflation/upper bound



Source: Bank of Zambia, Statistics Fortnightly, March 2021

1.5 PUBLIC DEBT

Public external debt increased to US\$ 12.74 Billion...

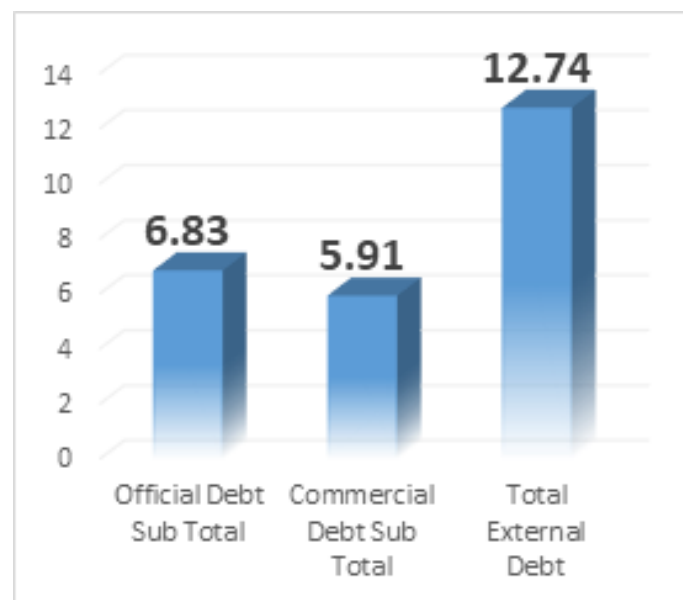
In the 2021 National Budget, Government committed to lighten the debt burden by stopping the contraction of new commercial external debt, supplemented by the cancellation, postponement and re-scoping of projects.

Latest official statistics from the Ministry of Finance indicate that Zambia's total public debt stands at USD 18.88 billion broken down into USD 12.74 billion Central Government external debt including existing principal arrears and USD equivalent of 6.14 billion or K 130.2 billion domestic debt as at end-December 2020.

The 2021 national budget estimated debt repayments to eat up over 70 percent of total domestic revenues. This position has since worsened, in light of the Kwacha depreciation. Moreover, Zambia has accrued some arrears after skipping its \$42.5 million and \$56.1 million coupon payments in November, 2020 and January, 2021, respectively (MoF, 2021).

The Government of the Republic of Zambia (GRZ) held formal talks with the International Monetary Fund (IMF) from 11th February to 3rd March, 2021, to request a formal IMF program under the Extended Credit Facility (ECF) window and exchanges have continued towards the finalization of a formal program.

Figure 8: Latest public external debt statistics



Source: Ministry of Finance, 2021

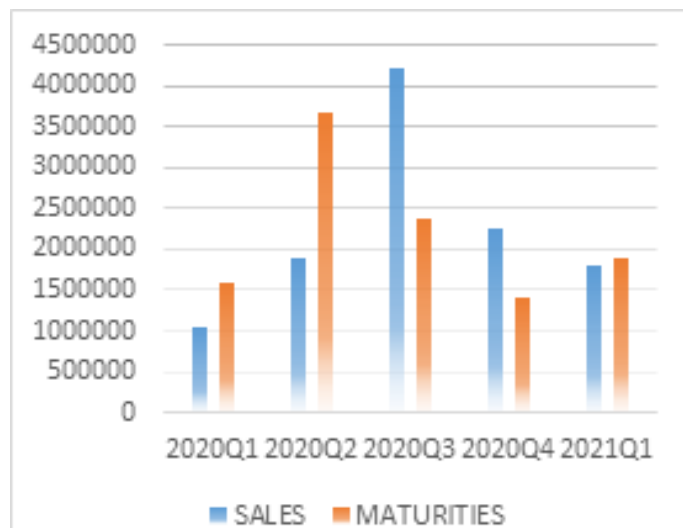
Public external debt has increased by 6 percent from the USD 11.97 billion reported at end-June, 2020. Likewise, domestic debt increased by 14 percent from the previous K114 billion. Of the USD 12.74 billion external debt, USD 6.83 billion is Official Debt from Bilateral, Plurilateral and Multilateral lenders while the remaining USD 5.91 billion is commercial debt disaggregated into Eurobonds and Non-bonded Debt (MoF, 2021).

1.6 FINANCIAL MARKETS

Demand for Government bonds weakens as demand for Treasury Bills improves...

Demand for Government bonds has continued to weaken since third quarter of 2020 as total sales declined to K 1,794,863,000 as at 21st March, 2021 from K2, 250, 529, 000 in the last quarter of 2020, partly reflecting a sustained contraction in investor appetite for long-term securities. Maturities increased to K1, 905,139, 083 from K1, 414, 710, 095, translating into a marginal deficit of K110, 276,083 when compared to the total sales for the first quarter.

Figure 9: Government Bonds Sales and Maturities



Source: Bank of Zambia, Statistics Fortnightly, March 2021

Conversely, the demand for short-term instruments marginally improved as treasury bills total sales edged up, rising to K9, 269,423, 093 as at 21st March, 2021 from K8, 825,905, 000 in the last quarter of 2020. This is in contrast to the decline in maturities which fell to K4, 967,037, 000 from K5, 543,591, 058, thereby yielding a surplus of K4, 302,386, 093 when compared to the total sales.

Figure 10: Treasury Bills Sales and Maturities



Source: Bank of Zambia, Statistics Fortnightly, March 2021

1.7 PROSPECTS FOR SECOND QUARTER

Looking forward, as the measures taken by BoZ, which include raising the policy rate by 50 basis points to 8.50% from the previous 8.0% and scaling-up interventions in the foreign exchange market, take full effect, the second quarter is expected to register a better macro-economic outlook.

Inflationary pressures are expected to be moderate as the depreciation of the Kwacha will expectedly slow down. Copper prices are expected to remain high. Thus, putting in place short-term and long-term measures to stimulate copper production will enable the economy benefit fully from the high copper prices and 'brighten' the macro-economic outturn for the second quarter. In the financial markets, uncertainties surrounding the political economy may continue to dwindle investor appetite for long-term securities. Any improvements will thus likely be driven by investments in short-term securities.

Preliminary Gross Domestic Product (GDP) estimates from the Zambia Statistical Agency (ZSA) indicate a less severe contraction in economic growth of -2.7 percent in the fourth quarter of 2020 relative to the -3.1 percent estimated for the third quarter. This trend is expected to continue in the first and second quarter of 2021 with economic activity 'picking up pace' by the second quarter, underpinned by reduced uncertainties surrounding the resurgence of Covid-19, especially with the news of the vaccines coming into the country on the horizon.

As copper prices continue to soar and Zambia enhances its copper production capacity, it is likely that inflows of foreign exchange will both support stabilisation of the exchange rate and improvement of the gross international reserve position. If the government adheres to the prescription of the Economic Recovery Plan which proposes a tight fiscal approach the fiscal deficit, is likely to shrink as public expenditure obeys the prescribed austerity measures.

There are some downside risks to a better economic outturn going forward: Fiscal pressures are expected to persist as the country continues its pursuit for a successful debt restructuring process. There are also concerns that with elections approaching in August 2021, it will become increasingly difficult for the government to abandon ongoing public investments in capital projects which gobble up huge chunks of the fiscus.

The protracted discussions with the International Monetary Fund (IMF) following the virtual talks that took place within the first quarter remain a handicap to this process. A resumption of debt service obligations before the debt restructuring process is completed will exert upside pressures on the exchange rate. This, coupled with supply-side constraints may continue to drive the rise in inflation.

1.8 CONCLUSION

The macroeconomic outlook for the first quarter of 2021 seems to be abysmal, partly suggestive that the long journey to economic recovery is perhaps still at the take-off stage. In the first quarter of 2021, preliminary trade statistics indicate a contraction in the trade surplus. Inflationary pressures persisted and the Kwacha continued to depreciate. The debt position has worsened, as both domestic and external debt have increased. Copper prices surged, albeit the country not having been in a position to fully benefit from rising copper prices. The financial markets posted a surplus, driven by increased demand for short-term securities as demand for long-term securities edged down.

Economic activity is expected to improve in the second quarter as various economic agents resume full-time work. Inflationary pressures are expected to be moderate as the depreciation of the Kwacha will expectedly slow down. Some downside risks to this expectation largely revolve around continued pressures from the fiscal side.

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