

zambia



Demographics

Population	14 638 505 (July 2014 est.)
Population: world ranking	71 out of 240 countries (CIA)
Life expectancy (years)	Total population: 51.83; male: 50.24; female: 53.48 (2014 est.)
Main ethnic groups	African 99% (includes Bemba, Tonga, Chewa, Lozi, Nsenga, Tumbuka, Ngoni, Lala, Kaonde, Lunda, and other African groups), other 1% (includes Europeans, Asians, and Americans) (2010 Census)
Business language	Bemba, Nyanja, Tonga, Lozi, Lunda, Kaonde, Luvale, English
Urban population	39.6%
Population below national poverty line	60.5% (2010 est.)

Sources: CIA, World Bank

Geography

Area in sq km	752 618
Area: World ranking	39 out of 252 countries (CIA)
Climate	Tropical; modified by altitude; rainy season (October to April)
Natural resources	Copper, cobalt, zinc, lead, coal, emeralds, gold, silver, uranium, hydropower

Sources: CIA, World Bank

Sovereign ratings

S&P	B+/Negative
Fitch	B/Stable
Moody's	B1/Stable

Source: NKC Research

Economy in 2013

Nominal GDP (US\$bn)	26.80	Total government debt as % of GDP	26.68
Nominal GDP: World ranking	104 out of 188 countries (IMF)	Total external debt as % of GDP	25.57
Real GDP (% change y-o-y)	6.71	Consumer price inflation (average, %)	6.98
GDP growth: World ranking	31 out of 189 countries (IMF)	Current account balance as % of GDP	0.81
GDP per capita (US\$)	1,843.40	Equity market: Size in US\$	US\$8.79bn
Agriculture as % of GDP	10.17	Equity market: Listed companies	21 primary listings (LuSE)
Industry as % of GDP	27.06	Bond market size	N/A
Services as % of GDP	62.77		

Sources: IMF, NKC Research, LuSE, Bloomberg

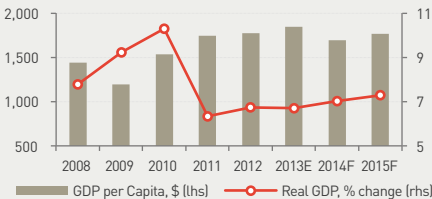
Political environment

Government type	Republic
Head of state	President Michael Sata
Head of government	President Michael Sata
Ruling political party	Patriotic Front (PF)
Main opposition parties	Movement for Multiparty Democracy (MMD), United Party for National Development (UPND)
Elections	Last held on 20 September 2011 (next to be held in 2016)

Source: NKC Research

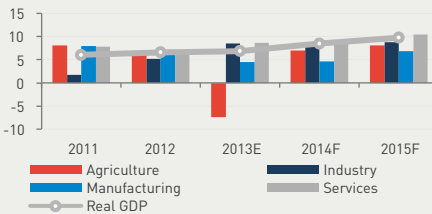
Economic outlook

GDP per capita vs real GDP



Source: NKC Research

Real GDP by sector (% change pa at factor costs)



Source: NKC Research

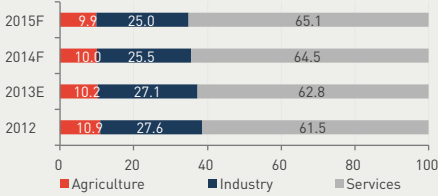
The Central Statistics Office (CSO) updated the base year for GDP calculation from 1994 to 2010 during the first quarter of 2014.

The statistical revision reflects dramatic changes in the structure of the economy, with significant growth in the mining industry over the last decade, as well as the inclusion of new industries (information technology) and a fragmentation of certain industries (e.g. electricity and water supply). According to the revised GDP methodology, Zambia posted real GDP growth of 6.7% in 2013, 0.2 percentage points higher than previously estimated. In terms of economic output, the services sector contributed an estimated 62.8% to GDP in 2013 (prior to the rebasing, the services sector accounted for an estimated 43.7% of GDP).

The contribution of the industrial sector was revised to an estimated 27% of rebased GDP in 2013 (against an earlier estimate of 36.8%), while the agricultural sector saw its contribution to GDP decline to 10.2% (against a previous estimate of 19.5%). We project that real GDP growth will reach 7% in 2014, before quickening to 7.3% in 2015 and 7.7% in 2016. Underpinning our forecast trajectory is the continued development of the extractive sector, the timeous addressing of the power capacity and road infrastructure shortfalls, and continued focus on the diversification of economic income streams.

Note: In the graphs above, E and F are the abbreviations for estimate and forecast respectively.

GDP by sector (% of GDP)



Source: NKC Research

However, downside risk stems from a soft copper market, weak agricultural output, substantial power and infrastructure shortages, and political risk, which may adversely influence foreign direct investment (FDI) flows and private sector capital formation.

International trade

The merchandise trade account continues to be shaped by developments in the extractive sector and the government’s infrastructure programme. Merchandise trade performance deteriorated markedly since the first half of last year, brought about by rising import pressure stemming from infrastructural development projects. Albeit still in positive digit territory, the merchandise trade balance continued to deteriorate during the second quarter of the year due to rising capital goods imports. Building on the sluggish merchandise trade performance during the first four months of the year, the short-term outlook for the trade balance remains bleak. However, we forecast that the merchandise trade account will return to

health over the medium term, driven by increased copper and cobalt output as various projects come on-stream. The outlook for Zambia’s terms of trade is, however, constrained by the invisibles account, which is forecast to remain in negative territory throughout the medium term. Underpinning the forecast is a projected increase on equity and interest payments, and a slowdown in both services receipts and current transfer inflows. In relative terms, the current account is expected to move into deficit territory, reaching 3.16% of GDP in 2014, and widen further to 3.85% of GDP in 2015, from an estimated surplus of 0.8% of GDP in 2013. The revision encompasses rebased GDP figures, as well as data revisions on the invisibles account.

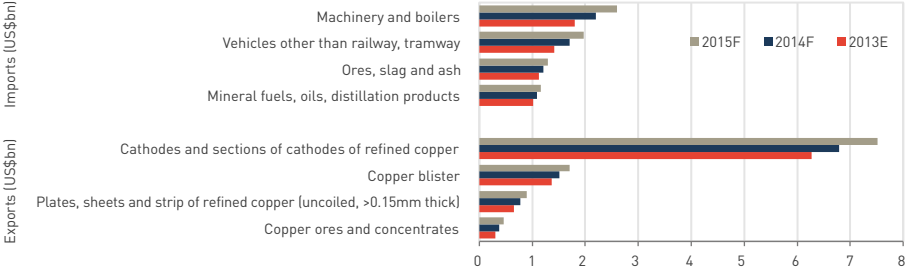
Foreign trade flows, 2013

Main exports	(US\$ billion)	Main imports	(US\$ billion)
Cathodes and sections of cathodes of refined copper	6.27	Machinery and boilers	1.80
Copper blister	1.37	Vehicles other than railway, tramway	1.42
Plates, sheets and strip of refined copper (uncoiled, >0.15mm thick)	0.65	Ores, slag and ash	1.13
Copper ores and concentrates	0.30	Mineral fuels, oils, distillation products	1.02

Source: NKC Research

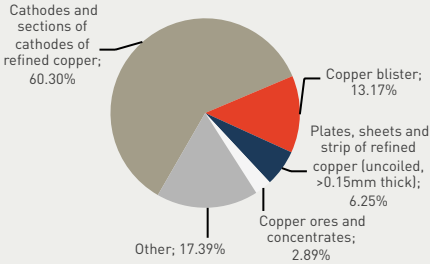
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Zambia top four exports and imports (US\$ billion)



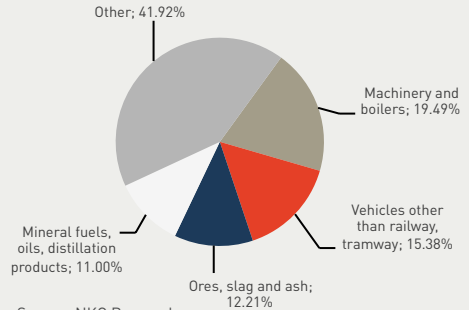
Source: NKC Research

2013 exports (% of total)



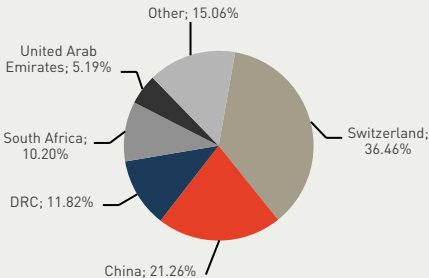
Source: NKC Research

2013 imports (% of total)



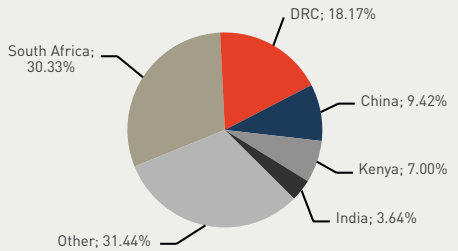
Source: NKC Research

2013 top destinations of exports (% of total)



Source: Trade Map

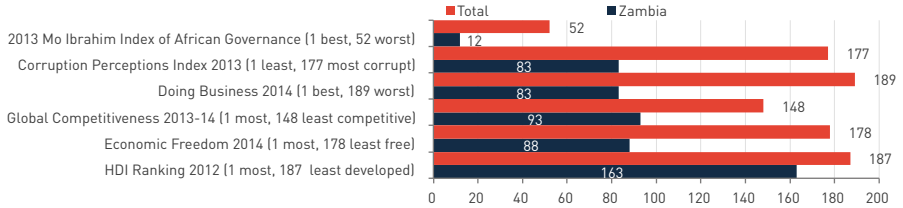
2013 top origins of imports (% of total)



Source: Trade Map

Note: In the graphs above, E and F are the abbreviations for estimate and forecast respectively.

Business development indicators



Source: NKC Research

Policy environment

Monetary policy:

The Bank of Zambia (BoZ, the central bank) tightened monetary policy considerably during the first five months of 2014. In addition to raising the benchmark policy rate by a cumulative 225 basis points during the first four months of the year, the statutory reserve ratio was raised by 600 basis points to 14%, while the overnight lending rate spread above the policy rate was raised by four percentage points to 10%. Notwithstanding a high interest rate environment, consumer price inflation rose to the highest level in three-and-a-half years in April, a level which was maintained in May. The overall inflation rate was registered at 7.8% y-o-y in May, identical to the reading in April, and only 0.1 percentage points higher than March's inflation figure. The second-round effects of kwacha volatility, regional food supply concerns and high fiscal expenditure may impede a notable decline in consumer price inflation in the near term.

Exchange rate policy:

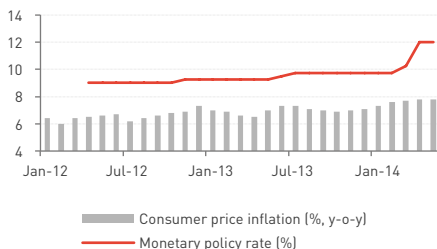
Zambia employs a de facto managed float exchange rate policy, with the monetary regulator intervening in the foreign exchange market to provide dollar liquidity via direct sales to the banking sector, as well as aligning policy in support of the kwacha. Zambia lifted two laws on foreign currency with immediate effect on 21 March 2014. The Zambian government has revoked SI 33 that enforced the use of local currency in all local transactions, as well as SI 55, which allowed the central bank to monitor foreign currency

flows. The revocation of the SIs in recent months may have resulted in a structural break that allows for an increase in baseline portfolio outflows over the medium term. Subsequently, we expect the downside bias to the kwacha to persist due to substantial capital flight risk, as well as strong import pressure, a lower copper price environment and resultant reduced foreign receipts.

Fiscal policy:

Zambia's state budget for the 2014 (Jan to Dec) fiscal year (FY), titled, *Moving Forward to Consolidate Growth and Social Justice in Peace and Unity*, encompasses the government's vision to accelerate broad-based growth and diversify the economy's income streams. The Zambian government announced an expansionary fiscal policy for the 2014 FY in order to meet capital expenditure targets, especially in terms of addressing the large infrastructure shortfall. The 2014 budget is focussed on achieving real GDP growth of above 7%, whilst limiting the overall fiscal deficit to 5.2% of rebased GDP. However, in light of infrastructural expenditure and a deterioration in fiscal discipline, we are circumspect of the government's ability to adhere to the fiscal target and project an overshooting in 2014. In extension of the previous budget's pro-poor stance, the state reiterated its goal to create a minimum of 200 000 jobs in 2014 in 'an ambitious and transparent manner'. Stemming from the expansionary stance, we project that the fiscal budget will remain firmly in deficit territory throughout the medium term.

Consumer price inflation and monetary policy rate

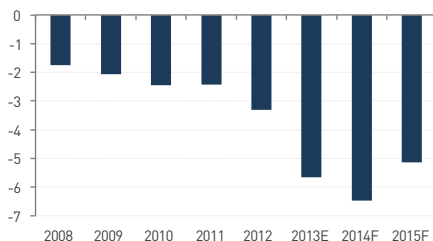


Sources: Central Bank of Zambia

Regulatory and tax environment:

The Zambian tax year commences on 1 April. Zambia introduced a number of changes to the tax environment during 2012 in order to broaden the tax base and encourage the diversification of economic income streams. Changes included an increase in the mineral royalties tax rate by three percentage points to 6%, whilst the tax rate for businesses in the agricultural sector was reduced by five percentage points to 10%. In 2013, a tax rate of 10% was introduced on the transfer or sale of mining rights, whilst capital allowances was reduced from 100% to 25%. In terms of the mining tax structure, a 10% export duty on semi-processed metals and base metals was introduced in 2014. Furthermore, profit distributions by foreign companies' branches are liable for a 15% withholding tax, while the property transfer tax rate has been increased from 5% to 10%. On the foreign exchange front, Zambia lifted two laws on foreign currency with immediate effect in March 2014. The Zambian government has revoked SI 33 (implemented in 2012), which enforced the use of local currency in all local transactions, as well as SI 55 (introduced in 2013), which allowed the central bank to monitor foreign currency flows.

Budget balance (% of GDP)



Source: NKC Research

Political environment

There are concerns over signs that the human rights environment is deteriorating, and over increasingly irrational behaviour by senior members of the ruling Patriotic Front (PF), such as an attempt by the Director of Public Prosecutions to prosecute former president, Rupiah Banda. Both the German and American embassies have issued statements expressing concern over deteriorating human rights in the country. Local media in Zambia are still able to operate relatively freely, but there are suspicions that the situation may not prevail for much longer. Donor issues may arise as a consequence if the situation is not addressed.

There are also worries about the health of President Michael Sata, and in June 2014, senior Cabinet and party members were talking about a succession plan as Vice President Guy Scott was not widely seen as an acceptable replacement. If the president were to die in office without an acceptable replacement ready to take over, some sort of constitutional crisis is a possibility.

Note: In the graphs above, E and F are the abbreviations for estimate and forecast respectively.

Economic environment

Ratings:

Standard & Poor's (S&P) affirmed Zambia's sovereign credit rating at 'B+' with a negative outlook on 4 April, after downgrading the outlook on the rating in October 2013. According to S&P, the rising public debt burden is linked to lacklustre fiscal consolidation efforts, while a limited stock of foreign exchange reserves to support the currency have rendered Zambia increasingly vulnerable to a further deterioration in its terms of trade. Furthermore, S&P notes that downside risks to Zambia's creditworthiness persist, particularly stemming from potential external developments. Similarly, Moody's Investors Services awarded Zambia's local and foreign credit ratings a 'B1' with a stable outlook on 6 November 2012. Underpinning the credit ratings was the assumption of continued resilience

in economic growth, a stable political environment and the continuance of a prudent macroeconomic framework. However, the rating agency views the significant infrastructure shortfall as credit-negative. In turn, Fitch Ratings affirmed Zambia's sovereign credit risk rating at 'B' with a stable outlook on 21 March, after lowering it by one notch in October 2013. The affirmation reflects the rating agency's belief that a robust economic growth trajectory stands in juxtaposition to vulnerability as a result of single-commodity dependence and uncertainty arising from an expansionary fiscal policy. Fitch downgraded Zambia's sovereign credit risk rating in October 2013 amid concerns of a rapidly widening fiscal deficit. On a positive note, Fitch expects that strong infrastructural spending and growth in copper production will culminate in strong GDP growth in the medium term.

Key indicators to watch

Copper prices	Copper exports account for three-quarters of total goods export receipts annually, rendering the balance of payments position and strength of the kwacha exchange rate vulnerable to copper price dynamics.
Forex reserves and exchange rate	The Zambian kwacha displayed large volatility around a downward trajectory in recent months, in apparent disregard of aggressive monetary policy actions to curb excess liquidity.
Monetary policy and inflation	CPI inflation remains elevated in reflection of the expansionary fiscal stance, kwacha weakness and vulnerability to the agrarian sector. Strong fiscal spending may impede the attainment of the year-end target of 6.5% y-o-y for a third consecutive year in 2014.

Source: NKC Research

Key vulnerabilities

Copper sector accounts for majority of export earnings, rendering the economy vulnerable to fluctuating global demand and price dynamics.

What is the government doing to address this?

The government offers tax incentives for investment in priority sectors (e.g. manufacturing and agriculture). In addition, a robust infrastructural development programme is underway to address bottlenecks and diversify the economy away from copper.

Key vulnerabilities	What is the government doing to address this?
Financial integration remains low.	The BoZ raised the cap on commercial lending rates to 28% on 17 June in response to a higher interest rate environment. The commercial interest rate cap of 18.25% was introduced in December 2012 in a bid to curb high borrowing costs.
Infrastructural challenges remains, particularly road and rail transport infrastructure.	The government allocated a substantial portion of the 2014 state budget to road and rail upgrading and maintenance under the umbrella programme of Link Zambia 8 000.

Source: NKC Research

Market participation

Foreign investors	Foreign investors are restricted from obtaining kwacha funding with a maturity of less than one year. Foreign exchange flows have been liberalised with the revocation of statutory instruments (SI) 33 and 55 in March 2014.
Local investors	No specific restrictions imposed on local investors in the domestic debt or equity markets. The domestic banking sector and pension funds account for the vast majority of government security holders, while retail investors tend to participate indirectly via the fund management sector.

Source: NKC Research

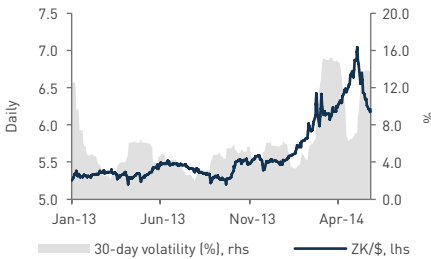
Financial market

Foreign exchange

Security	Average size of a single transaction	Average daily turnover range	Bid/offer spread	Tenor/maturity	Quotation/settlement	Reuters page	Additional information
Spot	US\$0.5m to US\$1m	US\$10m – US\$30m	40 bps for US\$0.5m to US\$1m	-	Two-way quote T+2	ZMW=	Main cross is US\$/ZMW
Forwards (deliverable)	US\$1m to US\$5m	US\$2m – US\$10m	200 bps to 350 bps on US\$1m	Up to 1 year	Two-way quote T+2	-	-

Sources: Reuters

Exchange rate
Zambian kwacha



Source: Reuters

The kwacha has had a tumultuous ride of late, shedding 18.6% of its value over a 12-month period and slumping by 15% y-t-d by June 2014. The local

unit attained a y-t-d low of ZMK7.04/US\$ by the end of May 2014 amid investors' concerns regarding the fiscal debt path and weak merchandise trade performance. The currency, however, has clawed back some losses since June on the back of reduced interbank liquidity. Notwithstanding a higher interest rate environment, the outlook for the kwacha exchange rate remains contingent on copper sector performance due to Zambia's single-commodity dependence and the red metal's position as primary earner of foreign receipts. Furthermore, policy amendments and the revocation of statutory instruments in recent months may have resulted in a structural break that allows for an increase in baseline portfolio outflows over the medium term. Subsequently, the downside bias to the kwacha may persist over the medium term due to capital flight risk, strong import pressure, a lower copper price environment and resultant reduced foreign receipts.

Equities

Stock market	Listed companies	Liquidity	Total market capitalisation	Settlement	Most liquid sector	Daily trading volume
Lusaka Stock Exchange (LuSE)	21	Limited	ZMK62bn	T+3	Financial, Industrial and Consumer staple	N/A

Source: LuSE

The All Share Index (LASI) of the Lusaka Stock Exchange (LuSE) was introduced with a base of 100 points (pts) on 2 January 1997. By 5 June, the LASI closed at 6,038.38 pts according to Reuters data, which translates into an increase of 13% y-t-d and 37% y-o-y. Market capitalisation stood at nearly ZMK62 billion by 5 June, according to LuSE data. There are currently 21 listed companies trading on the LuSE and listed financial instruments include

equity, unit trusts, corporate and government bonds. While performance has generally been robust, several impediments to growth remain. In a speech delivered earlier this year, LuSE Chairman, Friday Ndhlovu, cited a narrow capital base, lack of diversity in listed products, weak liquidity conditions and a low free float ratio as key challenges which needed to be addressed in order to promote Zambia as an attractive investment platform.

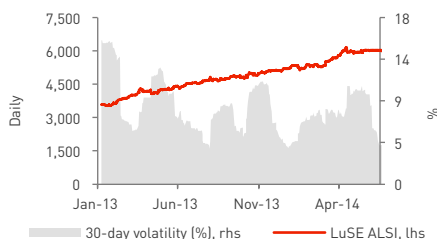
Top-five listed companies

Market capitalisation

Lafarge Cement	US\$857m
China Nonferrous Metal Mining	US\$855m
Standard Chartered	US\$552m
Zambian Brewer	US\$517m
ZANACO	US\$428m

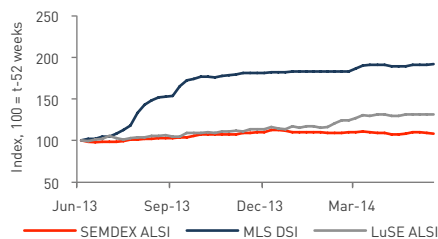
Source: Bloomberg

Lusaka Stock Exchange - LuSE ALSI



Source: Reuters

Mauritius, Malawi and Zambia SEs performance indices



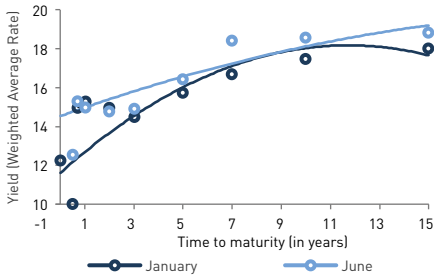
Source: NKC Research, Reuters

Fixed income

Security	Tenor/ maturity	Auction frequency	Liquidity	Quotation/ settlement	Auction participation	Bid/offer spread
Treasury bill	91, 182, and 273	Fortnightly	Moderate to Low	T+2	Licensed primary dealer and market makers (PDMMs)	50 bps – 300 bps (secondary market)
Treasury bonds	364 day	Quarterly	Moderate to Low	T+2	Licensed primary dealer and market makers (PDMMs)	-

Sources: BoZ, Bloomberg, Reuters

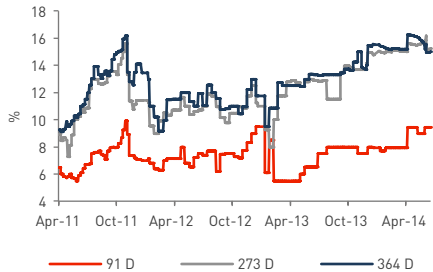
Zambia yield curve (secondary market)



Sources: NKC Research, Reuters

Zambia's ability to source domestic funding from the primary market remains weak, as illustrated by the dismal subscription rates recorded during the second quarter of the year. Furthermore, significant currency risk deterred foreign investment in the domestic primary debt capital market. A narrow capital base, in conjunction with aggressive monetary action to curb excess liquidity on the interbank market and successive increases in the policy rate, has resulted in a marked upward shift in the yield curve y-t-d. Considerable downside risk to the currency exists in the event of a substantial and prolonged copper price shock, especially with consideration of the mounting public external

Zambia treasury bills (secondary market)



Sources: NKC Research, Reuters

debt burden. Looking forward, weak aggregate treasury bill appetite may leave little alternative to accepting higher bid rates in the short term. The conservative monetary policy stance encompassing positive real interest rates may support an upward movement in short-term borrowing costs. Furthermore, Zambia's fiscal deficits may be structural in nature. Borrowing needs that stem from a structural fiscal deficit will lead to a higher interest rate environment and higher yields on the domestic primary market. In addition, the tail-end of the debt curve is furthermore exposed to uncertainty pertaining to perceived political risk and the direction of economic policy.

Macroeconomic data and forecasts

Key annual economic data	2009	2010	2011	2012E	2013E	2014F	2015F
Real GDP (% change)	9.22	10.30	6.34	6.73	6.71	7.03	7.27
Nominal GDP (US\$bn)	15.33	20.31	23.73	24.94	26.80	25.43	27.37
Consumer price inflation (average, %)	13.40	8.50	6.43	6.58	6.98	7.45	7.39
Budget balance, incl grants (% of GDP)	-2.06	-2.45	-2.43	-3.31	-5.67	-6.47	-5.13
- Revenue (% of GDP)	18.85	19.57	22.47	20.83	19.18	17.97	19.08
- Expenditure (% of GDP)	21.31	22.64	25.46	24.84	24.84	24.44	24.20
Government debt (% of GDP)	22.87	22.30	22.57	24.09	26.68	32.24	30.91
Current account balance (% of GDP)	3.80	5.94	2.97	3.22	0.81	-3.16	-3.85
Trade balance (% of GDP)	7.07	16.70	9.29	5.82	5.23	2.46	4.93
ZMW/US\$	5.05	4.79	4.86	5.15	5.40	6.38	6.57
Short-term interest rate (%)	22.06	20.92	18.84	17.10	16.28	20.40	20.70
Foreign reserves (US\$bn)	1.89	2.09	2.32	3.04	2.68	3.57	3.30
Months of import cover	5.57	4.50	3.69	3.99	3.03	3.53	2.97

Source: NKC Research

Key monthly indicators	End-10	End-11	End-12	End-13	Mar-14	Apr-14	May-14
Consumer price inflation (% y-o-y)	7.90	6.00	7.30	7.10	7.70	7.80	7.80
Monetary policy rate (%)	N/A	N/A	9.25	9.75	10.25	12.00	12.00
Foreign reserves (US\$bn)	2.09	2.32	3.04	2.68	N/A	N/A	N/A
91-day treasury bill rate (%eop)	7.51	7.00	9.48	7.95	7.95	9.45	9.45
ZMW/US\$ (re-based) (eop)	4.78	5.12	5.19	5.54	6.14	6.30	6.82
Copper (US\$/tonne, eop)	7,543.04	8,813.19	7,958.33	7,328.00	6,650.00	6,659.50	6,919.00

Sources: NKC Research, Reuters, Bloomberg, BoZ

Note: In the table above, E and F are the abbreviations for estimate and forecast respectively.