



ZAMBIA

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

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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).**¹ The stock of external debt is expected to peak at 35 percent of GDP in 2017 and decrease to 24 percent by 2035.

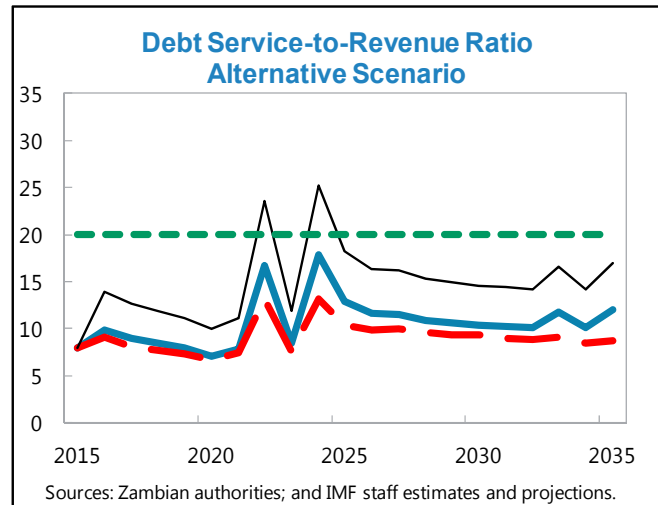
¹ The World Bank's Country Policy and Institutions Assessment (CPIA) ranks Zambia as a medium performer (the average 2010–12 CPIA score is 3.45). Thus, the external debt burden thresholds for Zambia are (i) a PV of debt-to-GDP at 40 percent; (ii) a PV of debt-to-exports at 150 percent; (iii) a PV of 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.² 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.³

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,⁴ 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 debt⁵).



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.

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

³ 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).

⁴ 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.

⁵ 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.**⁶ 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

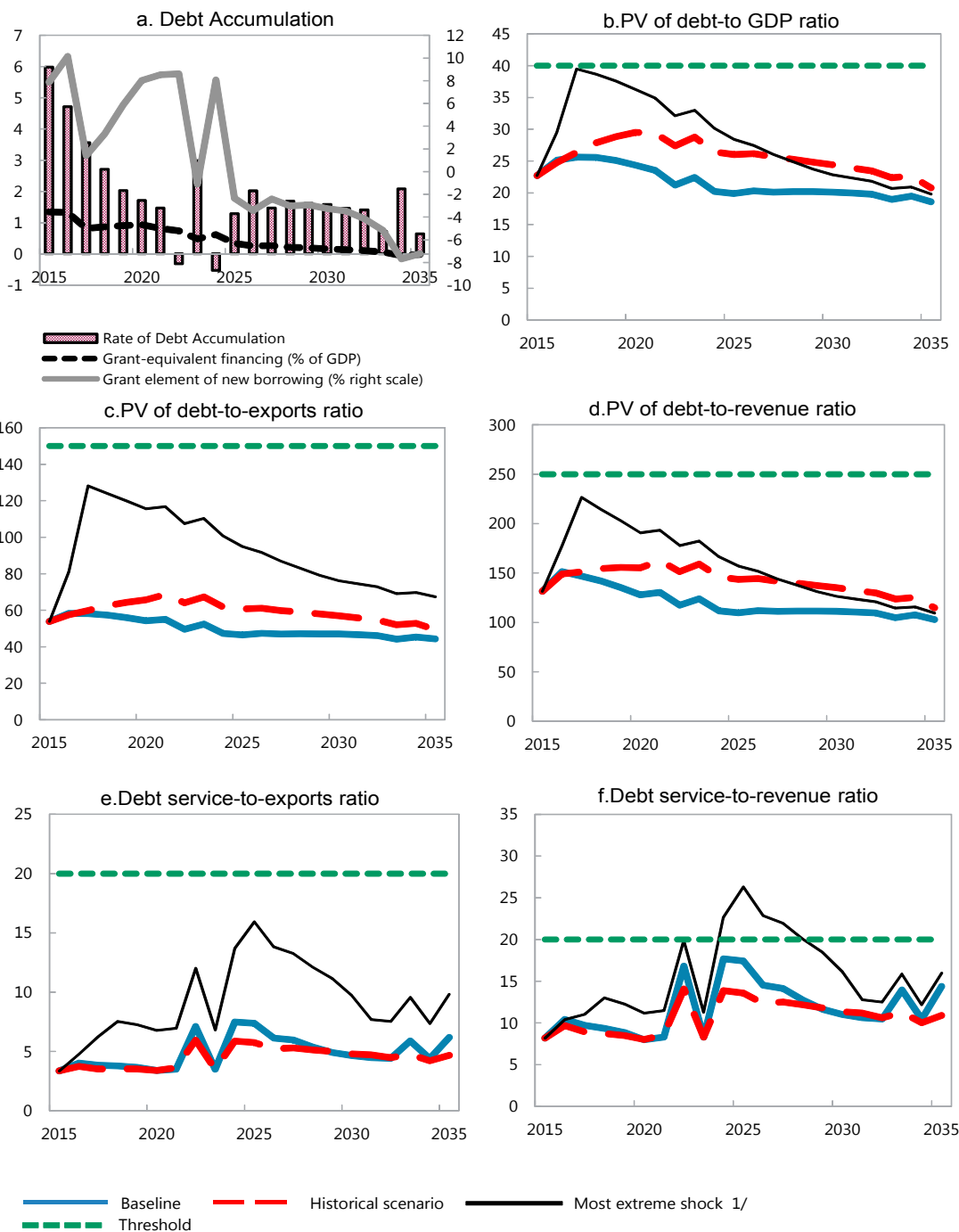
⁶ Per page 35 of the DSA guidance note (<http://www.imf.org/external/np/pp/eng/2013/110513.pdf>): "Moderate risk: although the baseline scenario does not lead to breaches of thresholds, stress tests result in one or more breaches."

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.

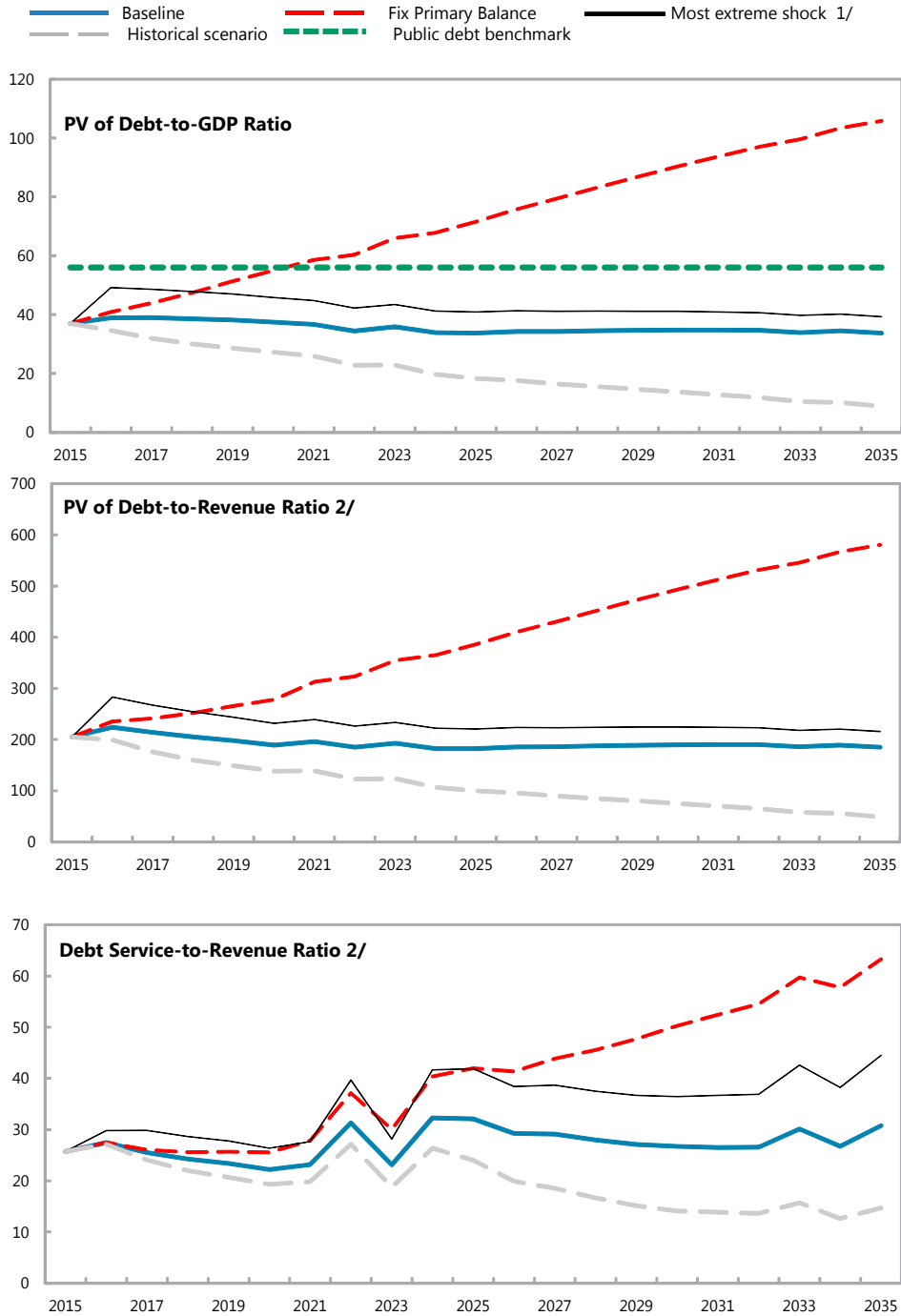
Figure 1. Zambia: Indicators of Public and Publicly Guaranteed External Debt under Alternative Scenarios, 2015–2035 1/



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 ^{6/} Standard ^{6/}		Projections							2015-2035		
	2012	2013	2014	Average	Deviation	2015	2016	2017	2018	2019	2020	Average	2025	2035	Average
External debt (nominal) 1/	17.2	20.1	23.9			32.4	35.1	35.2	34.8	34.1	33.1		27.2	24.2	
<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	
Non-interest current account deficit	-5.8	0.2	1.1	-2.4	4.0	-0.7	-2.8	-4.0	-4.5	-4.8	-4.8		-4.2	-3.4	-4.2
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	
Net FDI (negative = inflow)	-9.8	-6.3	-9.3	-6.0	2.6	-6.6	-6.6	-6.6	-6.6	-6.6	-6.6		-6.2	-6.2	-6.2
Endogenous debt dynamics 2/	-0.4	-0.8	0.8			-0.1	-0.3	-0.6	-0.7	-0.6	-0.7		-0.1	0.1	
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			...	...	...	...	...	...		...	...
Residual (3-4) 3/	17.8	9.8	11.2			15.9	12.4	11.3	11.4	11.3	11.0		9.9	8.6	
<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	
PV of PPG external debt	...	...	15.6			22.7	25.1	25.6	25.6	25.1	24.4		19.9	18.6	
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	
Debt service-to-exports ratio (in percent)	5.3	2.6	3.0			4.6	5.2	5.0	4.9	4.8	4.6		8.5	7.3	
PPG debt service-to-exports ratio (in percent)	2.7	1.5	1.8			3.4	4.0	3.8	3.8	3.7	3.4		7.4	6.2	
PPG debt service-to-revenue ratio (in percent)	6.4	3.9	4.1			8.2	10.4	9.7	9.3	8.9	8.0		17.4	14.4	
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	
Key macroeconomic assumptions															
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
Memorandum items:															
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 ρ = 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 ^{5/}	Standard Deviation ^{5/}	Estimate		Projections							
	2012	2013	2014			2015	2016	2017	2018	2019	2020	2015-20		2021-35	
											Average	2025	2035	Average	
Public sector debt 1/	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	
Other Sustainability Indicators															
PV of public sector debt	...	...	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	
Key macroeconomic and fiscal assumptions															
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
PV of debt-to GDP ratio								
Baseline	23	25	26	26	25	24	20	19
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	23	25	26	28	29	30	26	21
A2. New public sector loans on less favorable terms in 2015-2035 2	23	26	27	28	28	27	24	26
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	23	25	26	25	25	24	20	18
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	23	29	39	39	38	36	28	20
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	23	28	33	33	32	31	25	24
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	23	28	31	31	30	29	23	19
B5. Combination of B1-B4 using one-half standard deviation shocks	23	29	37	36	35	34	27	20
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	23	35	36	36	35	34	28	26
PV of debt-to-exports ratio								
Baseline	54	58	58	57	56	54	47	44
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	54	57	60	63	64	66	61	49
A2. New public sector loans on less favorable terms in 2015-2035 2	54	60	62	62	61	60	56	62
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	54	57	58	57	55	54	46	44
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	54	81	128	124	120	116	95	67
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	54	57	58	57	55	54	46	44
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	54	64	71	69	67	65	54	45
B5. Combination of B1-B4 using one-half standard deviation shocks	54	68	88	85	83	80	66	51
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	54	57	58	57	55	54	46	44
PV of debt-to-revenue ratio								
Baseline	132	151	147	142	135	128	110	103
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	132	149	151	154	156	155	144	115
A2. New public sector loans on less favorable terms in 2015-2035 2	132	156	156	153	149	142	133	144
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	132	148	147	141	135	127	109	102
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	132	178	226	214	203	191	157	110
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	132	168	188	181	173	164	140	131
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	132	167	180	171	163	154	128	105
B5. Combination of B1-B4 using one-half standard deviation shocks	132	172	212	201	191	179	149	113
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	132	210	206	198	189	179	153	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
Debt service-to-exports ratio								
Baseline	3	4	4	4	4	3	7	6
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	3	4	4	4	4	3	6	5
A2. New public sector loans on less favorable terms in 2015-2035 2	3	4	3	3	3	3	5	6
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	3	4	4	4	4	3	7	6
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	3	5	6	8	7	7	16	10
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	3	4	4	4	4	3	7	6
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	3	4	4	4	4	4	9	6
B5. Combination of B1-B4 using one-half standard deviation shocks	3	4	5	5	5	5	11	7
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	3	4	4	4	4	3	7	6
Debt service-to-revenue ratio								
Baseline	8	10	10	9	9	8	17	14
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	8	10	9	9	9	8	14	11
A2. New public sector loans on less favorable terms in 2015-2035 2	8	10	8	8	8	8	11	15
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	8	10	10	9	9	8	18	14
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	8	10	11	13	12	11	26	16
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	8	12	13	12	11	10	22	19
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	8	10	11	11	10	9	21	15
B5. Combination of B1-B4 using one-half standard deviation shocks	8	11	11	12	12	11	25	16
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	8	15	14	13	13	11	25	20
<i>Memorandum item:</i>								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	-3	-3	-3	-3	-3	-3	-3	-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
PV of Debt-to-GDP Ratio								
Baseline	37	39	39	39	38	37	34	34
A. Alternative scenarios								
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. Bound tests								
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
PV of Debt-to-Revenue Ratio 2/								
Baseline	205	224	214	205	198	189	182	185
A. Alternative scenarios								
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. Bound tests								
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
Debt Service-to-Revenue Ratio 2/								
Baseline	26	27	26	24	23	22	32	31
A. Alternative scenarios								
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. Bound tests								
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 ¹	06/04/2008	06/29/2011	220.10	220.10
ECF ¹	06/16/2004	09/30/2007	220.10	220.10
ECF ¹	03/25/1999	03/28/2003	278.90	237.52

Projected Payments to the Fund²

(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>

¹ Formerly PRGF.

² 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

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

Implementation of MDRI Assistance

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

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

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

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

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**

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

Technical assistance missions

Department	Dates	Purpose
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

Department	Dates	Purpose
	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 ⁷	Frequency of Reporting ⁷	Frequency of Publication ⁷	Memo Items:	
						Data Quality – Methodological soundness ⁸	Data Quality – Accuracy and Reliability ⁹
Exchange rates	April 24, 2015	April 24, 2015	D	D	D		
International reserve assets and reserve liabilities of the monetary authorities ¹	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 ²	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 ³ —general government ⁴	NA	NA				LO, LNO, LNO, LO	LNO, LO, O, O, LNO
Revenue, expenditure, balance and composition of financing ³ —central government	March, 2015	April 24, 2015	M	M	M		
Stocks of central government and central government-guaranteed debt ⁵	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 ⁶	2013	April 2015	A				

¹Any 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.

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

³Foreign, domestic bank, and domestic nonbank financing.

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

⁵Including currency and maturity composition.

⁶Includes external gross financial asset and liability positions vis-à-vis nonresidents.

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

⁸Reflects 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.