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ZAMBIA

September 2022

REQUEST FOR AN ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY—PRESS RELEASE; STAFF REPORT; STAFF SUPPLEMENT; STAFF STATEMENT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR ZAMBIA

In the context of the Request for an Arrangement Under the Extended Credit Facility, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on August 31, 2022, following discussions that ended on June 15, 2022, with the officials of Zambia on economic developments and policies underpinning the IMF arrangement under the Extended Credit Facility. Based on information available at the time of these discussions, the staff report was completed on August 9, 2022.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the International Development Association.
- A **Staff Statement** updating information on recent developments.
- A **Statement by the Executive Director** for Zambia.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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PRESS RELEASE

PR22/297

IMF Executive Board Approves New Extended Credit Facility (ECF) Arrangement for Zambia

FOR IMMEDIATE RELEASE

- The IMF Board approves SDR 978.2 million (about US$1.3 billion) 38-month ECF arrangement for Zambia to help restore macroeconomic stability and foster higher, more resilient, and more inclusive growth.
- The authorities' program, supported by the ECF-arrangement, will advance the authorities' homegrown reform plan to restore debt sustainability, create fiscal space for much-needed social spending, and strengthen economic governance.
- Securing timely restructuring agreements with external creditors will be essential for the successful implementation of the new ECF arrangement.

Washington, DC – **August 31, 2022:** The Executive Board of the International Monetary Fund (IMF) approved a 38-month arrangement under the Extended Credit Facility (ECF) in an amount equivalent to SDR 978.2 million (around US$1.3 billion, or 100 percent of quota). The program is based on the authorities' homegrown economic reform plan that aims to restore macroeconomic stability and foster higher, more resilient, and more inclusive growth.

Zambia is dealing with the legacy of years of economic mismanagement, with an especially inefficient public investment drive. Growth has been too low to reduce rates of poverty, inequality, and malnutrition that are amongst the highest in the world. Zambia is in debt distress and needs a deep and comprehensive debt treatment to place public debt on a sustainable path.

The ECF-supported program will help reestablish sustainability through fiscal adjustment and debt restructuring, create fiscal space for social spending to cushion the burden of adjustment, and strengthen economic governance, including by improving public financial management. The program will also catalyze much needed financial support from development partners. The Executive Board's decision will enable an immediate disbursement equivalent to SDR 139.88 million (about US$185 million).

Following the Executive Board discussion on Zambia, Ms. Kristalina Georgieva, Managing Director, issued the following statement:

"Zambia continues to face profound challenges reflected in high poverty levels and low growth. The ECF-supported program aims to restore macroeconomic stability and foster higher, more resilient, and more inclusive growth.

"Restoring fiscal sustainability will require a sustained fiscal adjustment. The authorities' adjustment plans appropriately focus on eliminating regressive fuel subsidies, enhancing the efficiency of the agricultural subsidy program, and reducing inefficient public investment. Domestic revenue mobilization also needs to support the medium-term adjustment. The adjustment creates fiscal space for increased social spending to cushion the burden on the most vulnerable, help reduce poverty, and to invest in Zambia's people. The ongoing expansion of the authorities' Social Cash Transfer program and their plans to increase public spending on health and education are particularly welcome. Together with the fiscal adjustment, Zambia needs a deep and comprehensive debt treatment under the G20 Common Framework to restore debt sustainability.

"A substantial strengthening of fiscal controls is needed to support the fiscal adjustment, as well as address governance and corruption vulnerabilities. Public investment management and procurement practices need to be strengthened to ensure transparency and the efficient use of scarce resources. It will also be important to bolster the framework for monitoring fiscal risks, particularly those related to large state-owned enterprises.

"The Bank of Zambia should continue its efforts to reduce inflation and preserve financial stability. International reserves should be replenished as conditions allow and the exchange rate should continue to reflect market conditions. Addressing high NPL levels and ensuring adequate capital buffers will also be important."

Table 1. Zambia: Selected Economic Indicators, 2018–25

	2018	2019	2020	2021	2022	2023	2024	2025
					Projections			
National accounts and prices								
GDP growth at constant prices	4.0	1.4	-2.8	3.6	3.0	3.9	4.1	4.5
Agriculture	-21.2	7.7	17.2	-0.7	-4.4	8.8	4.0	4.0
Mining	6.3	-5.1	8.0	-6.3	3.1	3.5	5.6	6.2
Non-mining, non-agricultural	6.1	1.8	-5.3	5.2	3.5	3.5	3.9	4.4
GDP deflator	7.4	7.6	13.7	23.4	8.4	8.7	7.3	6.8
GDP at market prices (millions of kwacha)	275,175	300,449	332,223	424,453	473,917	535,028	597,667	667,213
Consumer prices								
Consumer prices (average)	7.5	9.2	15.7	22.0	13.0	9.5	7.6	7.1
Consumer prices (end of period)	7.9	11.7	19.2	16.4	12.7	8.0	7.3	7.0
External sector								
Terms of trade (deterioration -)	-1.9	-10.5	19.0	21.9	-8.6	-2.3	-0.4	-0.4
Average exchange rate (kwacha per U.S. dollar)	10.5	12.9	18.3	20.0	...	...	...	...
(percentage change; depreciation +)	9.9	23.3	42.3	9.1	...	...	...	...
End-of-period exchange rate (kwacha per U.S. dollar)	11.9	14.1	21.2	16.7	...	...	...	...
Current account balance	-1.3	1.4	12.0	7.6	1.4	0.3	2.5	2.7
Gross international reserves (months of prospective imports)	2.4	3.0	1.9	3.2	3.3	3.9	4.6	5.5
Money and credit								
Reserve money (end of period)	-0.6	25.8	57.0	8.5	14.7	17.8	10.8	17.2
Broad money (M3)	16.5	12.5	46.4	3.7	11.0	12.1	10.8	8.2
Credit to the private sector (percent of GDP)	11.7	12.5	12.3	8.9	9.2	9.3	9.5	9.8
National accounts								
Gross investment	38.6	39.3	32.3	28.7	31.6	31.5	31.5	31.6
Government	8.6	9.4	7.8	4.1	3.0	3.0	3.0	3.1
Private	30.1	29.8	24.5	24.5	28.5	28.5	28.5	28.5
National savings	37.3	40.7	44.3	36.3	32.9	31.8	34.0	34.3
Central government budget								
Revenue	19.4	20.4	20.3	23.3	21.4	22.3	22.7	22.8
Taxes	16.1	16.1	15.7	16.8	16.7	17.6	17.9	18.1
Grants	0.2	0.3	0.5	0.6	0.4	0.3	0.3	0.3
Other revenue	3.1	4.0	4.1	6.0	4.3	4.3	4.4	4.4
Expenditure	27.7	29.8	34.1	31.8	30.8	29.4	28.9	27.7
Expense	19.1	20.4	26.3	27.7	27.7	26.5	25.9	24.6
Net acquisition of nonfinancial assets	8.6	9.4	7.8	4.1	3.0	3.0	3.0	3.1
Net lending/borrowing (cash basis)	-8.3	-9.4	-13.8	-8.5	-9.4	-7.1	-6.3	-4.9
Net lending/borrowing (commitment basis)	-11.7	-13.9	-17.4	-14.5	-6.9	-4.9	-4.3	-3.1
Primary balance (commitment basis)[1]	-6.9	-6.9	-10.1	-6.0	0.7	2.2	2.7	3.2
Primary balance excluding mining revenues (commitment basis)[1]	-9.2	-9.4	-13.3	-11.9	-5.0	-3.0	-2.7	-2.3
Public debt								
Total public debt (gross, end-period)[2,3]	77.8	103.3	150.3	126.0	122.8	115.6	109.7	104.7
External[4]	48.1	62.1	95.8	64.7	69.5	69.1	68.5	67.3
Domestic	29.7	41.2	54.5	61.3	53.3	46.5	41.3	37.4

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

[1] Adjusted for the accumulation/clearance of VAT refund claims and expenditure arrears.

[2] Nonresident holdings of local currency debt are included under domestic debt here, unlike in the DSA, which is conducted on a residency basis.

[3] Including arrears.

[4] Public and publicly guaranteed external debt.

INTERNATIONAL MONETARY FUND

ZAMBIA

REQUEST FOR AN ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY

August 9, 2022

EXECUTIVE SUMMARY

Context. Zambia is dealing with large fiscal and external imbalances resulting from years of economic mismanagement, especially an overly ambitious public investment drive that did not yield any significant boost to growth or revenues. A drought in 2019 and the COVID-19 pandemic exacerbated the acute economic and social challenges facing the country, with poverty, inequality, and malnutrition rates amongst the highest in the world. As a result, Zambia is in debt distress, defaulting on its Eurobonds in November 2020 while also accumulating arrears to other creditors. The war in Ukraine has increased prices of fuel and fertilizer, amplifying pressures further.

Extended Credit Facility Arrangement (ECF). The authorities have requested a 38-month arrangement under the ECF in the amount of SDR 978.2 million (100 percent of Zambia's quota).

Outlook and risks. With a resolution to the debt crisis, economic recovery is anticipated to continue in 2022 and inflation should continue falling. Key risks to the outlook include volatility in copper prices and production, climate shocks, spillovers from the war in Ukraine, and reform fatigue, especially in the face of a large fiscal adjustment.

Program objectives and policies. The proposed ECF-supported program aims to restore macroeconomic stability and foster higher, more resilient, and more inclusive growth. The program reflects the goals of the authorities' Eighth National Development Plan and is tailored to addressing Zambia's most pressing macroeconomic challenges, namely (i) restoring sustainability through fiscal adjustment and debt restructuring; (ii) creating fiscal space for social spending to cushion the burden of adjustment; and (iii) strengthening governance and reducing corruption vulnerabilities, including by improving public financial management. The program will seek to ensure that monetary and exchange rate policies support the restoration of macroeconomic stability, international reserves return to adequate levels, and the financial sector remains stable.

Approved By
Costas Christou (AFR) and Martin Cerisola (SPR)

Discussions took place over 18 months, including during virtual missions in February-March 2021, April-May 2021, and November-December 2021. A staff level agreement was announced on December 3, 2021, with the underpinning macroeconomic framework updated during a June 2022 virtual staff visit. The staff team was led by Mr. Robinson (until June 2021) and Ms. Holland (afterwards), and consisted of Ms. Sharma (Resident Representative), Messrs. Gupta, Mbaye, Meleshchuk, and Slavov (all AFR), Mdmes. Balta and Singh (SPR), Mr. Saab (MCM), Mr. Feher, Ms. Stone, and Ms. Tchelishvili (all FAD). Mr. Mungala and Mr. Mwansa (local office) assisted the team. Ms. Mannathoko (Executive Director), Mr. Damane, and Ms. Maidi (all OED) participated in most discussions. Ms. Bravo, Mr. Guzman, and Ms. Kumar (all AFR) assisted from headquarters. Staff met finance ministers Ng'andu and Musokotwane, Bank of Zambia governors Mvunga and Kalyalya, and many other senior government officials.

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CONTEXT

1. Years of fiscal profligacy led to Zambia accumulating large fiscal and external imbalances. Consistently high fiscal deficits were driven by high spending on wages, subsidies, and inefficient public investment that failed to deliver growth dividends. The accumulation of non-concessional external debt to finance this spending led to a ballooning debt burden, with the associated debt-servicing costs gradually crowding-out social protection and investment in human capital. Spending routinely overshot budget allocations reflecting weak spending controls.

2. The growing debt burden left Zambia vulnerable, with the COVID-19 shock pushing the country into debt distress. Vulnerabilities were aggravated by a succession of shocks: a drop in copper prices in 2015-16 (text chart), droughts (most recently in 2019), and the COVID-19 pandemic. While policy adjustment mitigated earlier shocks, policy resolve waned as the country entered the 2021 election cycle. As the COVID-19 shock unfolded, financing pressures emerged, the kwacha depreciated, and inflation spiked, increasing the external debt burden. Unencumbered reserves shrank to about $970 million by end-October 2020 (about 2.4 months of imports), against contracted public sector FX-denominated 2021 debt service of around $1.4 billion and signs of significant unmet FX demand. As public debt ballooned, the government defaulted on its Eurobonds in November 2020 and stopped servicing most external debt.[1]

Copper Prices, January 2014–June 2022
($ per metric ton)

Source: Bloomberg

3. President Hichilema won a landslide victory in August 2021 with a mandate to turn the economy around. The new administration has already taken decisive steps to reduce the deficit—including removing explicit subsidies on fuel—supported by measures to strengthen spending controls. Markets reacted positively—domestic bond yields dropped markedly, the kwacha appreciated, and the backlog of FX demand cleared. This, combined with higher copper prices and the 2021 general Special Drawing Rights (SDR) allocation, have contributed to an improved outlook for the economy.

4. Despite this more positive outlook, Zambia still faces deep-rooted imbalances. Chief among Zambia's current challenges are (i) restoring fiscal sustainability, including by addressing the unsustainable debt burden; (ii) rebuilding external buffers to enhance resilience;

[1] The authorities remain current on obligations to the AfDB and World Bank, as well as a few still-disbursing loans for priority projects.

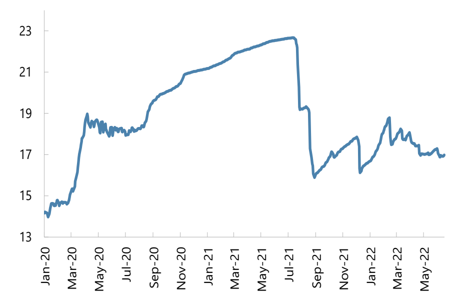
and (iii) reducing Zambia's high levels of inequality and poverty,[2] while addressing the country's growing social needs, particularly in rural areas.

RECENT DEVELOPMENTS

5. **Economic activity is rebounding from a deep contraction in 2020** (Figure 1 and Table 1). The economy shrank by 2.8 percent, with services, transport, manufacturing, and tourism taking the brunt of the COVID-19 shock (Box 1). A moderate recovery started in 2021, with growth estimated at 3.6 percent, though with some key sectors still held back by supply chain disruptions (mining) or weather (agriculture). This recovery is continuing into 2022—real GDP expanded by 2.4 percent in 2022Q1, mostly driven by public sector and education. Inflation has receded from its peak of almost 25 percent in mid-2021 to 9.7 percent in June 2022, in line with the appreciating kwacha (text chart). However, it may accelerate in the second half of 2022, including due to the impact on fuel and fertilizer prices of the war in Ukraine.

6. **Market sentiment has markedly improved but remains fragile**. Financing conditions worsened in 2020 as external financing dried up. Consequently, the government increasingly relied on more expensive domestic debt, including private placements, to finance its budget, while also accumulating large budgetary arrears. The situation has improved since mid-2021—domestic bond yields are 400-1200 basis points lower across the curve and the kwacha has appreciated by 33 percent in the twelve months to end-June 2022 (text chart).

Zambian Kwacha per USD



Source: Bloomberg

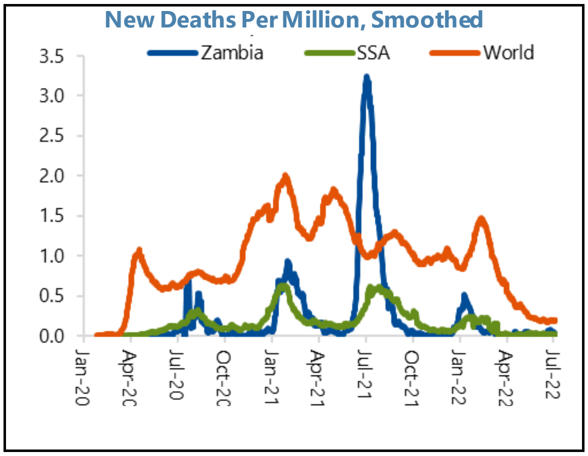
7. **Gross international reserves have increased from a low base** (Figure 2 and Tables 2a-2b). The $1.3 billion SDR allocation, together with higher FX inflows, have brought reserves to $2.9 billion or 3.1 months of prospective 2023 imports at end-March 2022—against an estimated optimal level of 5 months (see ¶37 below). The current account surplus shrank from 12 percent of GDP in 2020 to 7.6 percent in 2021, as the 2020 COVID-19 related import compression reversed, more than offsetting the impact of higher copper prices on exports.

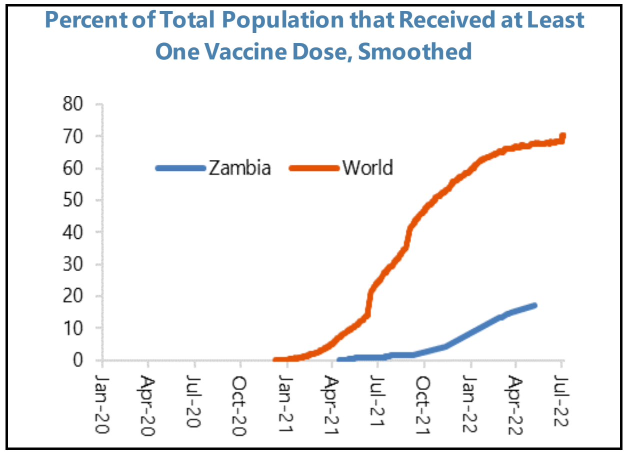
[2] *Macro Poverty Outlook, Spring Meetings 2022: Country-by-country Analysis and Projections for the Developing World*, The World Bank, 2022. The latest available Gini coefficient estimate of 0.57 from 2015 places Zambia as one of the most unequal countries in the world. The poverty rate increased from 58.7 percent in 2015 to 60.1 percent in 2020, and is estimated at 59.9 percent in 2021.

Box 1. Zambia: The COVID-19 Pandemic

The first cases of COVID-19 in Zambia were reported on March 18, 2020. Since then, the country has experienced several waves with a significant impact on health outcomes and economic activity. The third wave, driven by the Delta variant, occurred between June and December 2021, and led to the highest number of infections and deaths. Following the fourth (Omicron) wave, which started in December 2021, the number of infections has dropped and remains relatively low. The government took action to limit the spread of COVID-19 through the introduction of social distancing measures. The stringency of these measures peaked in May 2020, similar to the rest of the world.

The government is targeting at least 70 percent of the eligible population (adults over 18) to be vaccinated. As of end-June 2022, the vaccination rate stood at 41 percent of the eligible population or 25 percent of the total population. While access to vaccines was initially limited due to global shortages, the government was able to secure doses through COVAX and bilateral partners, and availability is now sufficient. To help address vaccine hesitancy, the government has carried out a number of communication campaigns—these have helped to increase the vaccination rate. Nevertheless, with overall vaccination rates still quite low, a more severe outbreak remains a significant risk.





Sources: Our World in Data and IMF staff calculations.

8. **The fiscal position deteriorated further in 2020-21** (Figure 3 and Tables 3a-3b). The fiscal deficit on a commitment basis increased from 13.9 percent of GDP in 2019 to 17.4 percent in 2020 and remained high at 14.5 percent in 2021. This was despite a relatively strong revenue performance due to: (i) large one-off dividends from the Bank of Zambia (BoZ) in 2020 and 2021;[3] (ii) a recovery

[3] In part reflecting large realized gains on foreign currency assets given the kwacha depreciation.

in domestic consumption taxes in 2021; and (iii) the impact of surging copper prices in 2021 on mining sector taxes, including the payment of previously deferred taxes as companies' liquidity situation improved.

9. Domestic debt financed a sharp increase in spending, including to mitigate the impact of the COVID-19 pandemic and in the run-up to the August 2021 presidential election. Spending on agricultural subsidies (fertilizer and seeds) increased from 1.9 percent of GDP in 2019 to 3.0 percent in 2020 and 2.4 percent in 2021, while grain purchases for the Strategic Food Reserve also jumped. Explicit fuel subsidies claimed a combined 3.9 percent of GDP in 2020-21, with fuel prices frozen at December-2019 levels for two years despite rising oil prices and a depreciating kwacha.[4] Spending on social protection increased from 0.1 percent of GDP in 2019 to 1.3 percent in 2021. Spending on goods and services and domestically-financed public investment also increased, reflecting COVID-19 related health spending and election-related outlays. In addition, the authorities recapitalized the National Savings and Credit Bank (NATSAVE) in 2020.[5] As Zambia stopped servicing most external debt in 2020, interest payments on external debt dropped from 3 percent of GDP in 2019 to 0.5 percent in 2021. The effective loss of access to external financing triggered a sharp slowdown in foreign-financed public investment (from 8.4 percent of GDP in 2019 to 1.9 percent in 2021) and explained the surge in net domestic financing (from 3.4 percent of GDP in 2019 to 9.3 percent of GDP in 2020 and 7.3 percent of GDP in 2021), with interest on domestic debt increasing from 3.9 percent of GDP in 2019 to 5.9 percent in 2021.

10. Unmet financing needs resulted in the accumulation of significant budgetary arrears in 2020-21. These included further accumulation of arrears on VAT refunds, bringing the stock to 2.4 percent of GDP at end-2021, and a sharp increase in expenditure arrears (including on fuel), with the stock reaching 13.4 percent of GDP at end-2021.

11. Fiscal outturns for January-May 2022 show the authorities broadly on track to achieve the overall balance targeted in Budget 2022 (text table). On revenues, weakness in indirect taxes has been more than offset by overperformance in income taxes (particularly mining CIT). Overall fiscal expenditure (cash basis) was in line with the budget, with non-payment of external interest offsetting overspending on goods and services, and arrears clearance (recorded under "other" spending). Overall, despite stronger revenues, the primary balance (cash basis) was 0.7 percent of GDP lower than the budget target, mostly reflecting an excessively ambitious compression of primary expenditure in the 2022 budget.

12. Zambia's SDR allocation has supported social spending in 2022. The authorities plan to use about half of the allocation to support the 2022 budget, with the remaining half divided equally between 2023 and 2024. So far in 2022, the allocation has supported the clearance of pension

[4] In addition to budgetary spending on explicit fuel subsidies, the authorities accumulated a large stock of unpaid fuel bills of around 2.3 percent of GDP at end-2021.

[5] The recapitalization cost amounted to 900 million kwacha (0.3 percent of GDP) and was necessary to bring NATSAVE up to the minimum capital requirement and facilitate access to the BoZ's Medium-Term Refinancing Facility (MTRF). NATSAVE is a government owned non-bank financial institution focused on enhancing access to finance for households and SMEs.

arrears, purchases of drugs and medical supplies, the Social Cash Transfer (SCT) program, and the Food Security Pack program. A Memorandum of Understanding will be established between the government and the Bank of Zambia to clarify the roles and responsibilities for servicing the associated financial obligations to the Fund.

Zambia: Year-To-Date Budget Performance
(through May 2022)

	Billions of kwacha		Percent of GDP	
	Budget	Outturn	Budget	Outturn
Revenue	41.6	42.5	8.8	9.0
Revenue excluding grants	40.8	41.8	8.6	8.8
Tax	31.0	32.7	6.5	6.9
Income tax	17.4	20.7	3.7	4.4
Taxes on incomes	10.9	11.1	2.3	2.3
Taxes on profits	6.5	9.7	1.4	2.0
Value-added tax	8.7	8.0	1.8	1.7
Excise taxes	2.3	1.9	0.5	0.4
Taxes on international trade	2.5	2.1	0.5	0.5
Other revenue, including mineral royalties	9.8	9.1	2.1	1.9
Grants	0.8	0.7	0.2	0.1
Expenditure	55.6	55.9	11.7	11.8
Expense	50.1	48.6	10.6	10.2
Compensation of employees	15.8	15.1	3.3	3.2
Use of goods and services	4.4	6.5	0.9	1.4
Interest	15.7	11.3	3.3	2.4
Subsidies	3.4	2.9	0.7	0.6
Intergovernmental transfers	6.0	6.1	1.3	1.3
Social protection	3.7	3.7	0.8	0.8
Other	1.2	3.0	0.3	0.6
Net acquisition of nonfinancial assets	5.5	7.3	1.2	1.5
Net lending/borrowing (overall balance, cash basis)	-14.0	-13.4	-3.0	-2.8
Primary balance (cash basis)	1.6	-2.1	0.3	-0.4

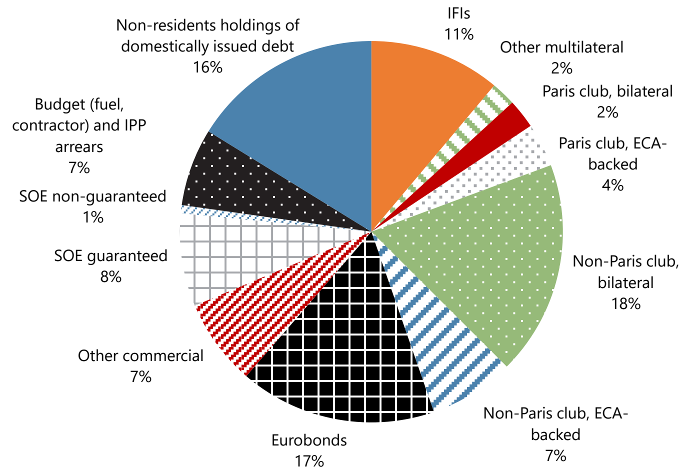
Sources: Zambian authorities; and IMF staff estimates and projections.

13. The improved revenue outlook for 2022 is expected to mitigate the emerging spending pressures due to the impact of the war in Ukraine on fertilizer prices. This will increase the cost of the agricultural input subsidy program (FISP) substantially relative to the budget. In addition, technical and political economy challenges will delay the authorities' objective of reforming the program.[6]

14. Zambia is in debt distress. Over 2014-19, external public and publicly guaranteed (PPG) debt—comprising a diverse set of creditors (text chart)—more than quadrupled and Zambia's debt burden was assessed as unsustainable in the 2019 Article IV Consultation. Reflecting the 2019-20 financing challenges, Zambia fell into arrears on external debt service and defaulted on its Eurobonds in 2020. Principal and interest arrears reached $2.2 billion by end-2021, and $2.4 billion by end-March 2022. By end-2021, external PPG debt, including non-resident holdings of domestic-currency debt and $1.3 billion of arrears to external suppliers (including ZESCO's arrears to independent power producers (IPPs)), reached $20 billion or 78 percent of GDP, with total PPG debt reaching $33.8 billion or 133 percent of GDP.

[6] The goal is to introduce a new Comprehensive Agriculture Support Program (CASP) that will be distributed via electronic vouchers and will enable farmers to procure a wider range of agricultural inputs. This will help secure significant savings for the government, compared to the current distribution mechanism. However, at this conjuncture, the private sector counterparts necessary to support the new delivery mechanism have reportedly been unwilling to bear the associated financial risks given the surge in global fertilizer prices.

Debt Holders Profile of Zambia External PPG Debt, end–2021
(In percent of total external debt)



Source: Authorities and staff estimates.

15. Regulatory forbearance measures have helped the financial sector weather the impact of COVID-19 (Figure 4 and Tables 4-5). Average banking sector capitalization and profitability remain robust at 25 percent of risk-weighted assets and 5.1 percent of total assets, respectively, at end-March 2022. Profitability has been underpinned by earnings on domestically-issued government securities, which represent 29 percent of total banking sector assets, though with wide variations across individual banks. However, COVID-related regulatory forbearance measures continue to mask possible asset quality and capitalization concerns. Specifically, while reported gross non-performing loans (NPLs) stood at 6.4 percent of total loans at end-March 2022, the inclusion of loans restructured during the pandemic (currently not subject to provisioning) would likely bring that figure above 10 percent. Furthermore, given general weaknesses in the recognition of NPLs, the underlying level may also be understated, and banks might also be under-provisioning for credit losses, including to take advantage of pandemic-specific forbearance measures.

OUTLOOK AND RISKS

16. The restoration of macroeconomic stability under the IMF-supported program, together with the assumed successful debt restructuring operation, is expected to underpin a gradual economic recovery. Growth is conservatively projected to reach 3.0 percent in 2022 and to settle around 4½-5 percent over the medium term as confidence strengthens and investment grows. Inflation is projected to maintain its current downward trend, reflecting base effects and the continued impact of the stronger kwacha, and should fall within the BoZ's target band of 6-8 percent by 2023H1. The current account will remain in surplus, supported by robust copper exports, although the surplus is projected to shrink in the near term as imports recover, before increasing again over the medium term as new investment in the mining sector yields higher exports.

17. The balance of risks around the baseline is to the downside (Annex I). The outlook is subject to significant downside risks, including from (i) delays in reaching a final debt restructuring agreement in line with program parameters; (ii) climate, commodity, and COVID-related shocks that could complicate macroeconomic management and raise the cost of adjustment; (iii) reform fatigue due to political and social pressures, particularly in the context of a large fiscal adjustment; and (iv) refinancing risks for domestic government debt stemming from the exit of non-resident investors. These risks are mitigated by the authorities' demonstrated commitment to the program and strong ownership of policies and reforms. There are also upside risks from a potentially stronger recovery in economic activity. However, both currency and inflation pressures could reappear (e.g., if capital inflows reverse) and the authorities should stand ready to tighten monetary policy if these risks materialize.

18. Spillovers from the war in Ukraine could generate additional challenges. In addition to the higher fiscal costs of FISP (see ¶13 above), the political costs of the authorities' fuel subsidy reform have risen due to the marked increase in fuel prices (by 38-57 percent since December 2021) reflecting higher global oil prices.[7] While the inflationary impact has been mitigated so far by the offsetting forces of the kwacha appreciation and a high CPI base, risks remain. Although food security is relatively protected by Zambia's self-sufficiency in maize production, these inflationary risks would be compounded if external demand pressures (or drought conditions) translate into higher food prices. These political and economic costs are likely to grow over time, highlighting the importance of the IMF-supported program.

PROGRAM OBJECTIVES AND POLICIES

The ECF-supported program will underpin the authorities' efforts to restore macroeconomic stability and foster higher, more resilient, and more inclusive growth. It reflects the goals of the authorities' Eighth National Development Plan and is tailored toward addressing Zambia's most pressing macroeconomic challenges, namely (i) restoring fiscal and debt sustainability through a fiscal adjustment and debt restructuring; (ii) creating fiscal space for social spending to cushion the burden of adjustment; and (iii) strengthening governance and reducing corruption vulnerabilities, including by improving public financial management (PFM). The program will seek to ensure that monetary and exchange rate policies support the restoration of macroeconomic stability, international reserves return to adequate levels, and the financial sector remains stable.

A. Restoring Medium-Term Fiscal Sustainability

19. To address fiscal imbalances while creating additional space for social spending, the ECF-supported program will target a large, front-loaded, and sustained fiscal consolidation

[7] Between end-November 2021 and end-June 2022, the price of petrol increased 52 percent, the price of diesel by 57 percent, and the price of kerosene by 38 percent.

(MEFP ¶41, text table). The primary balance (commitment basis)—the program's fiscal anchor—is targeted to improve from a deficit of 6.0 percent of GDP in 2021 to a surplus of 3.2 percent by 2025, placing public debt on a declining path. The consolidation is front-loaded through reforming regressive and wasteful subsidies—removing fuel subsidies in 2022 and reforming agricultural subsidies starting in 2023—and reducing excessive and poorly targeted public investment. To enhance budget credibility and support private sector economic activity, the program will also aim at a net clearance of budgetary arrears on expenditure and VAT refunds (MEFP ¶53-55). A strategy for clearing budgetary arrears by 2026 was published on August 4, 2022 (prior action).[8] Beyond 2022, domestic revenue mobilization—through both policy and administrative reforms—will play a relatively bigger role in the consolidation. This targeted adjustment will also provide increased space to invest in human capital and expand the social safety net. The authorities' proposed Medium-Term Budget Framework (MTBF) for 2023-25 is aligned with these program objectives (prior action).

Zambia: Composition of Recommended Fiscal Adjustment
(Percent of GDP, 2021–25)

	2021	2022	2023	2024	2025	Program Period (2022-25)	Total (2021-25)
Improvement in primary balance (cash basis)	**5.7**	**0.3**	**1.8**	**0.7**	**0.7**	**3.5**	**9.2**
Improvement in primary balance (commitment basis)	**4.1**	**6.7**	**1.5**	**0.5**	**0.5**	**9.2**	**13.3**
Improvement in primary balance excluding large one-off revenues (commitment basis)	**3.4**	**8.2**	**1.5**	**0.5**	**0.5**	**10.7**	**14.1**
Revenue increases (cash basis)	3.0	-2.0	0.9	0.4	0.1	-0.5	2.5
Revenue increases (commitment basis)[1]	3.0	-1.1	0.9	0.3	0.1	0.3	3.3
Revenue increases excluding large one-offs (commitment basis)	2.3	0.4	0.9	0.3	0.1	1.7	4.1
Reduction in primary spending (cash basis)	2.7	2.3	0.9	0.3	0.6	4.0	6.7
Current primary spending	-1.0	1.2	0.8	0.4	0.6	3.0	2.0
Compensation of employees	0.6	-0.4	-0.7	-0.3	0.4	-1.1	-0.5
Goods and services	-0.4	0.2	0.1	0.0	-0.1	0.2	-0.3
Subsidies	-0.2	2.0	1.2	0.5	0.5	4.2	4.0
Of which: Agricultural (FISP and FRA)	0.7	0.1	0.4	0.5	0.4	1.5	2.2
Of which: Energy (fuel and electricity)	-1.0	1.5	0.8	0.0	0.0	2.3	1.3
Social protection	-0.6	0.0	-0.1	0.0	-0.1	-0.3	-0.8
Other	-0.3	-0.5	0.3	0.2	0.0	-0.1	-0.4
Capital spending	3.6	1.1	0.1	0.0	-0.1	1.1	4.7
Increase in net clearance of expenditure arrears	-1.6	5.4	-0.2	-0.2	-0.2	4.9	3.3

Sources: Zambian authorities; and IMF staff estimates and projections.
[1] This line adjusts for the accumulation/clearance of arrears on VAT refund claims.

20. Domestic revenue mobilization is a key program objective (MEFP ¶42-47). Non-grant fiscal revenues (adjusted for arrears on VAT refunds) should increase by about 3¼ percent of GDP by 2025, compared to their pre-COVID 2019 level of 19.6 percent. By end-October 2022, the authorities will prepare and adopt an action plan to boost revenue mobilization (structural benchmark). Taking account of past technical assistance (TA) recommendations and estimated costing of planned reforms, key reform priorities include (text table):

[8] Fuel arrears and arrears to external contractors on foreign-financed capital spending are projected to be cleared by 2031 (MEFP ¶73). The government has hired six independent audit firms to audit the stock of budgetary arrears by end-September 2022.

- **Policy changes to increase revenues from CIT, VAT, and excises.** These would include broadening the VAT base and unifying the CIT rate to around 25-30 percent,[9] limiting VAT exemptions on unprocessed foodstuffs to specific items that figure prominently in the food basket of the poor, raising excises on tobacco and alcoholic beverages, and levying duties on sugar-sweetened beverages, cement, coal, single-use plastics, fertilizers and pesticides.

- **Improvements in tax administration, including from implementing a comprehensive taxpayer compliance program based on data analytics.** This will include improved tax audits and compliance management, increased use of electronic fiscal reporting, and matching tax and customs data on a regular basis.

- **Removing implicit subsidies on fuel.** In January 2021, to ease the impact of higher oil prices and the kwacha depreciation, the authorities reduced excises on petrol and diesel and zero-rated them for VAT purposes. These tax expenditures are projected to cost the budget 1.7 percent of GDP in 2022 but the authorities intend to eliminate them at end-September 2022 (structural benchmark).[10] This would follow the earlier removal of explicit fuel subsidies (see ¶18).

Zambia: Detailed Revenue Measures (2022–25)

	Measures (% of GDP)					
Tax	**2022**	**2023**	**2024**	**2025**	**Total**	**Notes**
Mining CIT	0.0	0.2	0.1	0.1	0.3	better compliance
Non-mining CIT	0.0	0.1	0.1	0.0	0.2	better compliance and tax reform (base broadening, fewer preferential rates)
Value-added tax	1.5	0.4	0.2	0.1	2.2	in 2022, a reversal of measures on fuel and cooking oil
						beyond 2022, possible measures should focus on base broadening and addressing the compliance gap
Excise taxes	0.2	0.1	0.0	0.0	0.4	in 2022, a partial reversal of measures on fuel
						beyond 2022, possible measures should focus on higher and broader excise taxation
Mineral royalties	0.0	0.2	0.1	0.1	0.3	better compliance; any tax policy changes should be revenue-neutral
Total	**1.7**	**0.9**	**0.5**	**0.3**	**3.4**	**of which 1.7 percent of GDP would happen in 2022, with the rest (1.7 percent) over 2023-25**

21. On the expenditure side, key measures include curbing public investment and fuel subsidies. The authorities will scale back their public investment program to focus on the highest priority projects, including by cancelling, rescoping, or postponing a considerable share of the contracted but undisbursed debt (prior action). This will reduce poorly targeted and inefficient public investment that has yielded little in terms of growth or fiscal revenues in recent years (MEFP ¶73). To eliminate explicit fuel subsidies that were known to be regressive and that were crowding-out critical social spending,[11] the authorities restored cost-plus pricing for petroleum products in December 2021, also shortening the pricing cycle from 60 to 30 days (prior action).

[9] In the 2022 budget, the authorities lowered most CIT rates above 30 percent to 30 percent (with the exception of the CIT rate on telecommunication companies) as the first step in a gradual process of harmonizing them. They also made the mineral royalty tax deductible for CIT purposes, in line with international best practice and FAD TA recommendations.

[10] The timing is expected to be aligned with the repurposing of the Tazama pipeline to distribute diesel, which is expected to significantly reduce transport costs.

[11] 90 percent are estimated to go to households in the highest income decile, while the poorest 5 deciles receive only 1 percent.

22. The authorities are also targeting significant improvements in the governance and efficiency of agricultural subsidies (MEFP ¶49 and ¶64-66). The planned reforms will gradually reduce the cost of agricultural subsidies to around 1 percent of GDP by 2025. By end-November 2022, the authorities will publish the official guidelines to implement the new program (structural benchmark), which will be implemented with the 2023-24 agricultural cycle.[12] To strengthen the transparency, governance, and efficiency of the current program, the authorities published summary information on procurement contracts related to the 2021 FISP (prior action), and are following the regulations of the new Public Procurement Act for the 2022 FISP, including undertaking a public tender process for procuring inputs and planned publication of key information on contracts awarded (which will now include beneficial ownership information). In addition, they will introduce biometric registration of beneficiaries to ensure benefits are reaching their intended target.

B. Enhanced Social Spending

23. A key objective of the authorities' reform program is to gradually increase the level and quality of social spending to reduce poverty and inequality, as well as improve access to basic social services, especially in rural areas (MEFP ¶67-69). This will be critical to reverse the increase in the poverty rate from 58.7 to 60.1 percent between 2015 and 2020. To achieve these goals, the authorities need to address the low budget execution rates for social spending—averaging only 65 percent over 2014-21—that have compromised the effectiveness of the government's pro-poor policies.[13] The above fiscal measures will not only contribute to fiscal consolidation but will also free-up critical resources to ensure this desired increase in social spending can be executed as planned.

24. Spending on social protection is projected to more than double from 0.7 percent of GDP in 2020 to 1.6 percent by 2025 (around the average for Sub-Saharan African countries). Over the course of 2021, with World Bank (WB) support, the number of recipients of the SCT increased to 994,000—an almost 50 percent increase over 2019 recipients—and the monthly benefit increased from 90 to 110 kwacha. Providing a critical mitigant against food security risks, the number of recipient households for the Food Security Pack program similarly increased in 2021—from 80,000 to 263,000 households—with a further expansion to 290,000 households planned for 2022. Other key social safety net programs—Keeping Girls in School and the Home-Grown School Feeding Program—are seeing similar expansions. In addition, the authorities will continue implementing the WB-financed Girls' Education and Women's Empowerment and Livelihood (GEWEL) Project, which will be complemented with budgetary funds (MEFP ¶106). This expansion in the social safety net will not only help address the fundamental poverty issue but will also mitigate adverse effects on the poorest from the elimination of fuel and electricity subsidies (Box 2).

[12] See footnote 6.

[13] Budget allocations for the social safety net have fared particularly poorly, with an average execution rate of only 54 percent.

25. Increased spending on health and education will provide greater access to these critical services. In the health sector, expenditure projections reflect the authorities' plans to hire 11,000 additional medical staff in 2022 (MEFP ¶48). In education, the authorities plan to add 30,000 teachers in 2022, while also providing access to free education for all.[14] Improved access to services at the local level will also be supported by increased transfers to local governments, including for school bursaries, as part of a fiscal decentralization strategy (MEFP ¶105). To ensure transparency and accountability for this spending, credible steps are planned to strengthen fiscal institutions at the subnational level (MEFP ¶51). Overall, for low-income households, the benefits from increased social spending should outweigh the impact from the removal of fuel and electricity subsidies.

C. Restoring Debt Sustainability and Improving Debt Management and Transparency

26. The debt sustainability analysis (DSA) confirms that, without restructuring, public debt is in distress. All external debt burden indicators exhibit large and persistent breaches of their prudent thresholds through the medium term and beyond under both baseline and stress scenarios.

27. To restore debt sustainability and achieve a "moderate" risk of debt distress over the medium term, the authorities have requested a debt restructuring from creditors. The authorities appointed financial and legal advisors in mid-2020 and have engaged all creditors in early and constructive dialogue to lay the foundations for an orderly restructuring. They requested a debt treatment under the G20 Common Framework (CF) in January 2021 and wrote to all private creditors announcing the need for a debt treatment. Bondholders established a creditors committee and hired their own advisors in mid-2020, and the Official Creditor Committee (OCC) under the G20 CF was formed in June 2022.

28. Given the material spillover risks, the authorities intend to exclude domestically-issued debt from the restructuring perimeter. Domestically-issued debt accounts for 48 percent of GDP and represents the most significant source of budget financing in the near to medium term. While non-residents hold about 26 percent of this stock, the Zambian financial sector holds the bulk. In particular, these securities account for almost one third of banking sector assets (or about 12 percent of GDP). Therefore, any restructuring of this debt could trigger significant financial instability, potentially requiring public resources to support the sector. It would also raise broader economic risks by weakening market and business confidence, triggering capital outflows, and reducing the private sector's access to finance.

29. The authorities are planning a number of steps to strengthen debt management and transparency going forward (MEFP ¶74-76). A new Public Debt Management (PDM) bill has been submitted to the National Assembly, with timely enactment critical to controlling debt accumulation

[14] Projections for the public wage bill in Tables 3a-3b reflect these plans. In addition, measures will be put in place to ensure that staff recruited to serve rural communities remain in those communities.

going forward (structural benchmark).[15] The draft bill, reflecting input from Fund staff, addresses key weaknesses in the current Act that contributed to Zambia's debt problems. The bill aims to strengthen oversight, clarify objectives, tighten control on the authority to borrow, and enhance risk management around guarantees for government on-lending. In addition, the bill usefully clarifies the respective roles of various central government units involved in debt management. The authorities have also started publishing a quarterly debt statistics bulletin with comprehensive statistics (structural benchmark), and will also start publishing summary information on all newly contracted external loans (structural benchmark). Finally, the authorities have provided detailed information to Fund staff on all external debt contracted or guaranteed by the public sector, for both disbursed and undisbursed debt (prior action).

30. In parallel, the authorities will limit the accumulation of new debt vulnerabilities. As discussed in ¶21 above, the authorities have reviewed their pipeline of investment projects, addressing the overhang of undisbursed debt. In line with the program ceiling, new disbursements on contracted but undisbursed project loans will be limited to $1.4 billion during 2022-25 (including $834 million from the World Bank and AfDB). New external borrowing will be limited to only concessional debt—reflected in a continuous zero ceiling performance criterion on new non-concessional borrowing and a ceiling on the present value of new external borrowing (MEFP Table 3). The limit on the present value of new external borrowing is set in line with the expected borrowing plan for 2022-23 (text table).

Zambia: Summary Table of Projected External Borrowing 1/
(January 1 to December 31, 2022)

PPG external debt	Volume of new debt in 2022		PV of new debt in 2022 (program purposes)		PV of new debt in 2022 (including negative GEs)	
	USD million	Percent	USD million	Percent	USD million	Percent
By sources of debt financing	**175.0**	**100**	**71.9**	**100**	**71.9**	**100**
Concessional debt, of which	**175.0**	**100**	**71.9**	**100**	**71.9**	**100**
IFI debt	175.0	100	71.9	100	71.9	100
Other	0.0	0	0.0	0	0.0	0
Non-concessional debt, of which	**0.0**	**0**	**0.0**	**0**	**0.0**	**0**
By Creditor Type	**175.0**	**100**	**71.9**	**100**	**71.9**	**100**
IFI	175.0	100	71.9	100	71.9	100
Other	0.0	0	0.0	0	0.0	0
Uses of debt financing	**175.0**	**100**	**71.9**	**100**	**71.9**	**100**
Infrastructure	175.0	100	71.9	100	71.9	100
Memo Items						
Indicative projections						
Year 2	**0.0**		**0.0**		**0.0**	
Year 3	**0.0**		**0.0**		**0.0**	

1/ In line with the TMU definition of the debt ceilings, it does not include new financing from IMF, World Bank, and projected issuances of local-currency debt to non-residents
Source: IMF staff calculations based on authorities' reported data.

15 This will replace the existing Loans and Guarantees Authorization Act.

D. Strengthening Governance

31. Further sustained efforts to tackle corruption and strengthen the anti-corruption framework will be important for achieving program objectives. The authorities have signaled a zero-tolerance approach to corruption (MEFP ¶80). At their request, a comprehensive IMF-staff supported governance diagnostic assessment was launched in January 2022 to identify the main governance weaknesses and corruption vulnerabilities, as well as measures to address them.[16] Once completed, the authorities plan to publish the diagnostic report, including its specific recommendations (structural benchmark) and to develop and implement a comprehensive action plan based on its recommendations.

32. To strengthen accountability and ensure the appropriate use of public resources going forward, progress is being made on reforming key elements of the legal framework, as well as on improving information systems and reporting standards. In addition to the ongoing work on the PDM bill, the authorities have issued the regulations to implement the 2020 Public Procurement Act (prior action, MEFP ¶63). The Act was revised in 2020, with the implementing regulations finalized and issued in May 2022. The changes are intended to ensure public procurement becomes more competitive (typically subject to public tender); more cost-effective, including by introducing benchmark pricing provisions; and more transparent, with publication of the relevant details of awarded contracts, including the names of the beneficial owners.[17]

33. A new Public-Private Partnerships (PPPs) Act is also being developed to address key weaknesses in the current framework and strengthen the management of fiscal risks (structural benchmark, MEFP ¶82). The goal of the revisions is to ensure the transparent evaluation of projects, align PPPs with fiscal realities, and limit unsolicited proposals. The revised Act should also ensure greater control over SOEs' PPP commitments. In addition to improving project selection and appraisal, the new framework should strengthen the assessment and reporting of contingent liabilities. To support a stronger PPP framework, the government also intends to issue revised guidelines and train stakeholders involved in PPPs.

34. The authorities are planning other measures to help contain fiscal risks, particularly those related to large SOEs (MEFP ¶81 and ¶83-84). Chief amongst these will be a move to restore cost-reflective electricity tariffs and other measures outlined in Box 2. Furthermore, supported by IMF staff's TA, the authorities are developing a fiscal risk monitoring and management framework. In addition to SOEs, the framework will also capture risks related to local governments, PPPs, and climate shocks.

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[16] These measures will address fiscal governance (including public financial management, revenue administration, public procurement, extractive industries, and state-owned enterprises), central bank governance, financial sector oversight, anti-money laundering, and protection of property rights and contract enforcement.

[17] Further work is needed to fully operationalize the associated register of beneficial owners, including to ensure information collected is publicly accessible and as accurate, up-to-date, and complete as possible.

Box 2. Zambia: Electricity Sector Reforms

ZESCO, the state-owned electricity company, is financially weak and represents a significant fiscal risk (MEFP ¶59). The company has elevated operating costs largely driven by purchase agreements with IPPs and high labor costs. It has also had significant capital investment needs in recent years. However, electricity tariffs and fees are currently below cost-reflective levels, leading to the accumulation of significant losses during 2018-20. These losses also reflected the need to import electricity during the 2019 drought and the kwacha's depreciation during that period. Consequently, all of ZESCO's debt—both explicitly guaranteed and non-guaranteed—is included in the measure of PPG debt used in the DSA. As of end-2021, ZESCO's debt amounts to about $1.5 billion in loans (including to finance the Kafue Gorge Lower hydro project), on top of $1.4 billion of payables outstanding to local and external IPPs.

In December 2020, the ZESCO board approved a turnaround strategy to help restore the company's financial viability (MEFP ¶60 and ¶101). Introducing cost-reflective tariffs—while maintaining lifeline tariffs for low-income households—is expected to address ZESCO's chronic revenue shortfall. Operating costs are expected to be curtailed through re-negotiated power purchase agreements and a voluntary separation scheme to support a reduction in labor costs. Capital expenditures will also be optimized, including through a review of non-committed investment projects. The government is planning to initiate a process of optimizing and strategically divesting ZESCO's operating assets in 2023. Finally, ZESCO's external debt is expected to be included in the restructuring operation which will help improve the company's balance sheet structure.

Efforts to boost revenue collection and reduce operating expenses are already yielding early results. In 2021, ZESCO recorded a substantial operating profit, with overall earnings also benefiting from kwacha appreciation. Introducing a multi-year tariff framework (MYTF) that will restore cost-reflective tariffs, and ensure future tariff adjustments when underlying cost conditions change, will be critical to a more durable recovery (structural benchmark). Such a framework will be based on the recently completed Cost-of-Service Study (COSS). To inform the authorities' response to the COSS, key stakeholders were invited to review the study. Once Cabinet has approved the response, which will also outline the authorities' policy intentions with respect to the MYTF, they will publish both the COSS and their response (prior action). At that point, ZESCO will request the adoption of the MYTF from the Energy Regulation Board (ERB). That will be subject to a public consultation before the ERB can make its decision.

35. **The government has committed to strengthen commitment controls (structural benchmark, MEFP ¶56 and ¶78).** The goal is for all commitments assumed by 59 ministries, provinces, and spending agencies (MPSAs) to be registered electronically, through IFMIS, by mid-2023. Currently, only approximately 30 percent of commitments against budget allocations are recorded electronically. Work on enhancing the functionality of IFMIS to support this has been completed, controlling officers and budget personnel have been trained, and the roll-out of these new IFMIS functionalities has begun.

E. Strengthening Monetary Policy and Re-Building External Resilience

36. **Inflation and FX pressures have abated but risks remain.** Inflation is expected to continue receding, helped by a stronger kwacha, and despite the one-off impact from energy price adjustments. Over the course of the program, inflation is expected to return to the BoZ's 6-8 percent policy band, supported by the planned fiscal consolidation. FX market conditions are also expected to continue improving on the back of better supply, including disbursements from international financial institutions (IFIs). However, both currency and inflation pressures could reappear—for

example, due to a reversal in recent capital inflows, copper price volatility, or climate shocks—and the BoZ confirmed its readiness to tighten policy should these risks materialize (MEFP ¶85).

37. The program targets a gradual build-up in international reserves to strengthen resilience to external shocks. A cost-benefit analysis developed by Fund staff for low-income countries suggests—after taking account of Zambia's open capital account and vulnerability to copper price and climate shocks—an optimal level of unencumbered reserves of around five months of prospective imports.[18] Achieving this level of reserves should be feasible by 2025, thanks to the supply factors mentioned above and the planned fiscal adjustment and energy reforms, both of which should reduce FX demand. This, together with addressing the external debt overhang, should strengthen Zambia's external position, which is currently assessed to be weaker than the level implied by fundamentals and desirable policies (Annex II).

38. The BoZ has committed to reviewing current FX market rules, and normalizing its interaction with the FX market (MEFP ¶89). As the pandemic unfolded and pressures on the kwacha mounted, the authorities took a number of measures to manage the market, including (i) tightening interbank foreign exchange market quotation rules; (ii) use of moral suasion; and (iii) informal prioritization of FX demand from specific sectors. In addition, the BoZ became the dominate supplier of FX to the market due to a new administrative measure that resulted in mining taxes being paid in U.S. dollars directly to the government, significantly changing the dynamics of the market. As pressures have started to wane, the authorities have begun reversing some of these measures.

39. The BoZ will continue upgrading its monetary policy framework and improving monetary policy transmission (MEFP ¶85-88). The new Bank of Zambia Act (submission is a prior action), which is pending Presidential assent, should enhance monetary policy credibility. The new Act will strengthen the BoZ's mandate, autonomy (operational, personal, and financial), and governance. Other IMF staff's TA-supported reforms to enhance the monetary policy framework, central bank operations, and its forecasting capacity are being considered.

F. Safeguarding Financial Stability

40. Safeguarding financial stability remains a priority (MEFP ¶90-95). The BoZ will unwind the temporary prudential measures taken to address the COVID-19 pandemic in accordance with the original timelines or as financial conditions allow. In the interim, it will maintain its guidance that banks should follow standard prudential rules, while using the temporary flexibility to support borrowers hit by the pandemic. The BoZ will continue to enhance its supervisory capacity and closely monitor the evolution of loans linked to temporarily-relaxed prudential rules. A review of the

[18] This corresponds to a total (encumbered and unencumbered) reserve target of about 5.5 months of imports. Encumbered reserves typically include commercial banks' FX deposits held at the BoZ in fulfillment of reserve requirements and aid-related funds temporarily held in escrow. For a general description of the IMF reserve adequacy assessment methodology, see *Assessing Reserve Adequacy, IMF Policy Paper, February 2011*, and *Guidance Note on the Assessment of Reserve Adequacy and Related Considerations, June 2016.*

banking sector is also underway to prepare for the post-pandemic period. It will assess the effectiveness of banking sector intermediation during the pandemic, as well as the impact of the pandemic on banks' capital and systemic risk. The review will incorporate the planned thematic examination of asset quality. The review, scheduled for completion by end-2022 (structural benchmark), will also include an assessment of the implications of increased digitalization of the economy (and related developments in the payment systems) for competition in the banking sector and more broadly for financial sector development. As part of efforts to strengthen safety net arrangements, the BoZ will implement a Deposit Protection Scheme, supported by a dedicated unit established in June 2022. Furthermore, a crisis management and resolution framework has been established, and will be fully operational once the governance arrangements have been finalized, as provided for in the new Bank of Zambia Act. The BoZ is also working to enhance its macro-prudential surveillance framework and has developed a macro-prudential toolkit aimed at mitigating risks due to excessive credit growth, leverage, maturity mismatches, market illiquidity, exposure concentration, and moral hazard.

G. Improving Statistical Capacity

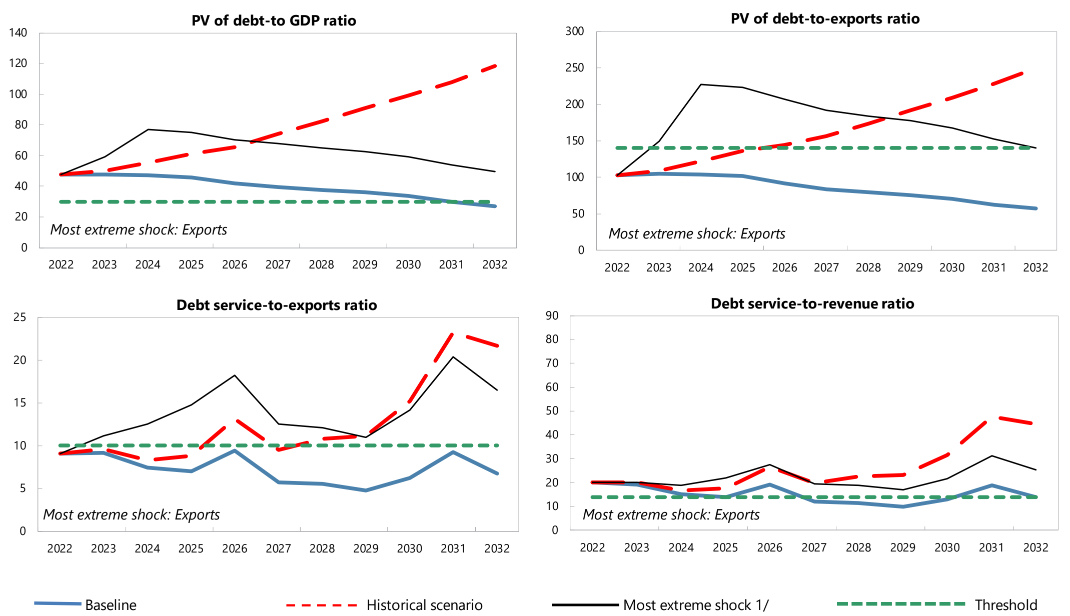
41. The authorities are working on addressing existing gaps in BOP statistics (MEFP ¶112-114). Zambia's BOP has historically been characterized by diverging trends between the current account and reserve assets—e.g., reserves declined in 2020 despite a large current account surplus. This was previously believed to be driven by non-repatriated copper export receipts, as mining companies take full advantage of Zambia's open capital account to accumulate assets abroad. However, recent analysis of cross-border transactions points to some underreporting of BOP outflows, including imports of goods and services. An IMF-supported TA program is ongoing, with the objective of further understanding the nature of these underreported flows and addressing the uncertainties surrounding the BoP, including through outreach to the mining sector. The authorities have committed to improving their BOP compilation process by (i) strengthening data analysis capacity and systematically cross-referencing BOP transactions across various data sources; (ii) stepping up outreach to private operators involved in cross-border transactions; and (iii) improving the quality of the underlying BOP surveys.

PROGRAM MODALITIES AND OTHER ISSUES

42. Overall financing needs. Zambia's BOP financing needs are estimated at $11 billion over 2022-25 (Table 6), consistent with the objective of bringing unencumbered reserves to a level of five months of prospective imports.

43. The authorities are seeking a debt restructuring to ensure the program is fully financed and to achieve the objective of bringing the risk of debt distress to "moderate" over the medium term. To close the BOP financing gap, the authorities are seeking cash debt relief from the debt restructuring amounting to $8.4 billion during the program period (2022-25). To bring Zambia's risk of debt distress to "moderate" over the medium term, the requested debt relief would need to bring the debt service-to-revenue ratio to 14 percent by 2025, and maintain it at this level (on average) for the remainder of the 10-year horizon (2026-2031). This would imply some additional cash debt relief will be needed over 2026-31. Achieving this goal also implies the restructuring would need to bring the PV of external debt-to-exports ratio to a level consistent with "substantial space" to absorb shocks by 2027. For countries with weak debt-carrying capacity like Zambia, this level is 84 percent.[19,20] An illustrative restructuring scenario that meets these goals is reflected in the text figure below.

Illustrative Restructuring Scenario - Indicators of PPG External Debt, 2022–32



Source: IMF staff projections based on LIC DSF.

44. Program access and phasing. To help fill the residual financing gap of $2.6 billion, the authorities have requested a 38-month arrangement under the Extended Credit Facility (ECF) in the amount of SDR 978.2 million (100 percent of quota, about $1.3 billion, or 5.0 percent of GDP). The proposed access reflects both the size of Zambia's BOP needs and the strength of its policy ambitions under the program. Fifty percent of each disbursement will be on-lent by the central bank to the government to help finance the budget, while the remainder will help rebuild BoZ reserves. A Memorandum of Understanding between the government and the BoZ will be established to set their respective responsibilities for servicing financial obligations to the Fund. Access will be phased uniformly over the life of the program, in line with the proposed schedule of reviews and disbursements in Table 7.

[19] In line with the criteria set out in the LIC-DSF.

[20] Given the ongoing work to rebase GDP and the associated measurement challenges, the PV of debt-to-exports ratio was used as the main indicator to assess the evolution of the debt stock.

45. Fund financing is expected to close about 12 percent of the projected 2022-25 overall BOP financing gap, while playing an important catalytic role in attracting external financing. Access under the proposed ECF-supported arrangement will cover 51 percent of the residual financing gap after accounting for the financing from the external debt restructuring. The remainder will be filled by other development partners (principally the World Bank), for which firm commitments are in place for the upcoming 12-month period. Good prospects for full program financing exist for the remainder of the program period.

Zambia: Proposed Program Financing
($ million)

	2022	2023	2024	2025	**Total**
Financing Gap	**3,068**	**2,346**	**3,192**	**2,430**	**11,036**
Official financing	**737**	**664**	**633**	**592**	**2,626**
IMF ECF	190	382	386	388	1,346
World Bank [1/]	547	282	247	204	1,280
Financing from external debt restructuring	**2,331**	**1,682**	**2,559**	**1,838**	**8,410**

Source: IMF staff estimates and projections.

1/ Includes assumed financing from the World Bank of, among others, a Development Policy Operation of $275 million and emergency health sector financing of $150 million that will support budget implementation.

46. Staff's assessment is that there are sufficient assurances regarding the debt restructuring needed to restore debt sustainability. The OCC provided financing assurances through committee discussions and a joint statement published on July 30. The authorities are committed to finalizing the MOUs with official creditors by the time of the first review, and to reaching agreements on comparable terms with other creditors by the time of the second review, at the latest (MEFP ¶73).

47. The authorities have engaged actively with all external private creditors on the need for debt restructuring. This has been done through creditors' financial and legal advisors, as well as by sharing relevant non-confidential information through open discussion forums and the publication of debt statistics reports and technical presentations summarizing key macro developments and the government's economic program. The authorities' advisors have also shared, under non-disclosure agreements, key information presented to the G20 OCC so that private creditors have an early opportunity to provide input on the design of restructuring strategies. Staff assesses that prompt Fund support is considered essential for the successful implementation of the member's adjustment program and that the authorities are making a good faith effort to reach a collaborative restructuring agreement, as required under the Fund's Lending into Arrears (LIA) policy. At end-2021, Zambia reported $280 million in interest arrears to Eurobond holders, $632 million to other private external creditors (both interest and principal), and about $1.3 billion in other accounts payable to external suppliers (ZESCO IPP external arrears, fuel and contractor arrears).[21]

48. Zambia reported $1.3 billion of interest and principal arrears to official bilateral creditors as at end-2021. As the OCC has provided financing assurances that are adequately representative and include representatives of the Paris Club creditors, arrears to other official bilateral creditors are deemed away under the Lending into Official Arrears (LIOA) Policy.

49. Zambia reported $6.1 million of interest and principal arrears to IFIs as at end-2021,[22] of which $0.93 million are estimated to be technical interest arrears owed to the World Bank, AfDB, IFAD, and EIB. These arrears were cleared by end-March 2022, with the exception of arrears owed to the Nordic Development Fund (NDF). Arrears to the NDF reached $1.16 million as at end-March 2022. There is no indication yet whether the OCC would expect comparability of treatment (CoT) from the NDF. While NDF is not a global IFI, staff understands that it participated in the Heavily Indebted Poor Countries Initiative and was previously excluded from CoT by the Paris Club. Based on available information, staff assesses that there is a credible plan in place to clear these arrears.

50. Capacity to repay and program risks (Table 8). Zambia's capacity to repay the Fund is adequate under the baseline, with debt service to the Fund projected to peak at 1.2 percent of exports. Fund credit outstanding to GDP peaks at 4.2 percent in 2025 and debt service to revenue excluding grants at 2.4 percent in 2031, both above the third quartile of past UCT-quality arrangement for low-income countries (Figure 5). This is subject to significant risks and contingent on full program implementation and financing from other creditors. Risks to the program and to the Fund are elevated given the complexity, scale, and scope of the needed reforms; the constrained institutional capacity; the ongoing debt restructuring discussions; and broader risks to the outlook, including from copper prices. These risks could lead to policy slippages and reversals, as well as larger-than-envisaged financing gaps, and slippages in key fiscal targets.[23] Risks are mitigated by the strong political support for the program, the comprehensive and ambitious set of prior actions, the front-loading of the proposed fiscal adjustment and structural reforms, and Zambia's strong track record of repaying the Fund.

51. The PRGT enhanced safeguard requirement on debt composition is met. While the share of multilaterals and other IFIs in Zambia's FX-denominated external debt is expected to increase to 30 percent over the program period (from 16 percent at end-2021, see Text Table 1, DSA), it remains well below the mean and median for PRGT programs, indicating a significant buffer of restructurable debt. FX-denominated external debt with some form of security or escrow arrangement that could be considered as collateralized debt stood at about 9.5 percent of GDP at

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[21] According to the authorities' financial and legal advisors, no claims in default have been accelerated and, therefore, the amount of arrears reflects only unpaid amounts as at end-2021.

[22] This amount includes arrears owed to IFIs (IDA, AfDB, IFAD, EIB, BADEA, NDF and OFID), but excludes arrears owed to regional banks such as ESA Trade Development Bank and Afreximbank, which also have non-sovereign shareholders.

[23] Including due to the measurement challenges in the BOP.

end-2021, and is expected to decline under program as it is included in the authorities' restructuring request.

52. Prior actions (MEFP Table 1). To partially mitigate the significant risks associated with the program, and as a demonstration of their commitment to program objectives, the authorities have completed all but one prior action. The publication of the COSS and the government's response will be completed ahead of the Executive Board's consideration of the program request (MEFP ¶60).

53. Monitoring of program performance. Program performance will be monitored through semi-annual program reviews based on quarterly and continuous quantitative targets and structural benchmarks, as follows:

- **Quarterly and continuous quantitative targets** (MEFP Table 3). The program will include quantitative performance criteria on the primary balance, new central bank credit to the central government, and net official international reserves. Continuous performance criteria will cover new external debt arrears and the contracting or guaranteeing of new non-concessional external debt. Inflation will be monitored through a monetary policy consultation clause. Indicative targets will target fiscal revenues, new external borrowing, the disbursement of contracted but undisbursed external debt, social spending, and the net clearance of budgetary arrears.

- **Structural benchmarks** (MEFP Table 2) will aim to support the key objectives of the program, namely, to restore fiscal and debt sustainability, improve debt management and transparency, strengthen governance and financial stability, and reduce corruption vulnerabilities.

54. An updated safeguards assessment of the BoZ is in progress. The assessment identified areas for improvement in the BoZ's safeguards framework. Transparency and accountability mechanisms need to be enhanced through stronger oversight and audit quality procedures. The process for compilation of program monetary data should be reinforced.

55. Statistical issues and capacity development (CD) priorities. Data provision is broadly adequate for surveillance but there are shortcomings in national accounts, monetary, fiscal, and external sector statistics. Staff encouraged the authorities to implement Fund TA advice and to seek further TA in the areas where Zambia needs to strengthen its data provision capacity. CD priorities, driven by the authorities' policy objectives, include tax policy and administration, PFM, debt management, real and external sectors statistics, and governance reforms. Zambia is a medium-intensity user of Fund TA with a mixed implementation record.

STAFF APPRAISAL

56. Despite some positive signs, Zambia continues to face deep socio-economic challenges reflected in high poverty levels and low growth. The roots of the current economic crisis lie in years of economic mismanagement and especially in an overly ambitious and inefficiently managed public investment drive. However, dividends in the form of faster growth or higher tax revenues have yet to materialize. A drought in 2019 and the COVID-19 pandemic exacerbated the acute economic and social challenges already facing the country, with poverty, inequality, and malnutrition rates amongst the highest in the world. As a result, Zambia is in debt distress, defaulting on its Eurobonds in November 2020 while also accumulating arrears to other creditors. The war in Ukraine has amplified macroeconomic pressures by increasing global prices of fuel and fertilizer. With significant downside risks to the outlook, including from copper prices, the authorities need to adhere to a strong implementation of policies and reforms, and adequately plan for any contingencies.

57. Fiscal sustainability urgently needs to be restored through a large, upfront, and sustained fiscal consolidation. The authorities' fiscal consolidation plans are appropriately anchored on sharply reducing public investment, eliminating regressive fuel subsidies, and reforming the agricultural subsidy program, where decisive action is needed to ensure implementation of the reforms in time for the 2023/24 growing season. Domestic revenue mobilization should also support the adjustment over the medium term. The adjustment should create fiscal space for increased social spending to cushion the burden on the most vulnerable. The expansion of the Social Cash Transfer program is particularly welcome, as are the authorities' plans to increase public spending on health and education.

58. Together with the fiscal adjustment, Zambia needs a deep and comprehensive debt treatment under the G20 Common Framework to place public debt on a sustainable path. A considerable share of the contracted but undisbursed debt—and associated public investment projects—needs to be canceled, rescoped, or postponed. Significant improvements in debt management and transparency will be required to contain debt vulnerabilities and upgrade the country's debt-carrying capacity.

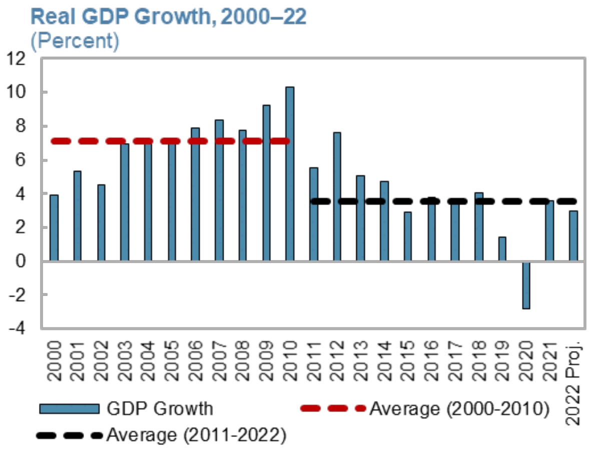
59. A substantial strengthening of fiscal controls and governance is needed to support fiscal adjustment, as well as address governance and corruption vulnerabilities. The authorities have appropriately adopted a strategy to halt the accumulation of domestic arrears and gradually clear the existing stock. All government agencies should be required to register their purchase orders in IFMIS to ensure that ongoing spending commitments are adequately monitored. Public investment management and procurement practices need to be strengthened to ensure transparency and the efficient use of scarce resources. The framework for monitoring fiscal risks, particularly those related to large SOEs, needs to be urgently bolstered. The anti-corruption and AML/CFT frameworks should be strengthened in line with the recommendations of the ongoing Governance Diagnostic Assessment.

60. The Bank of Zambia should persist in its efforts to reduce inflation, support the recovery, and preserve financial stability. The exchange rate should continue to reflect market conditions, and international reserves should gradually be replenished as market conditions allow, with market interventions otherwise limited to smoothing out excessive volatility. Financial stability should be preserved by addressing high NPL levels and deteriorating capital buffers, as well as by enhancing policies to safeguard financial sector stability.

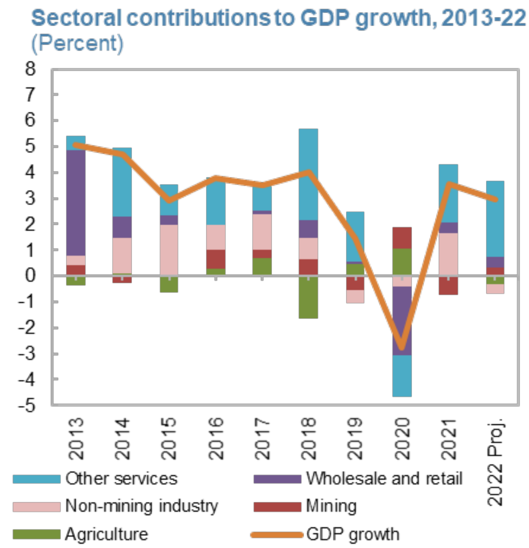
61. Based on the strength of the proposed program, the prior actions taken by the Government of Zambia, and the financing assurances provided by official bilateral creditors, staff supports the authorities' request for a 38-month ECF arrangement in the amount equivalent to SDR 978.20 million (100 percent of Zambia's quota).

Figure 1. Zambia: Recent Developments, 2000–22

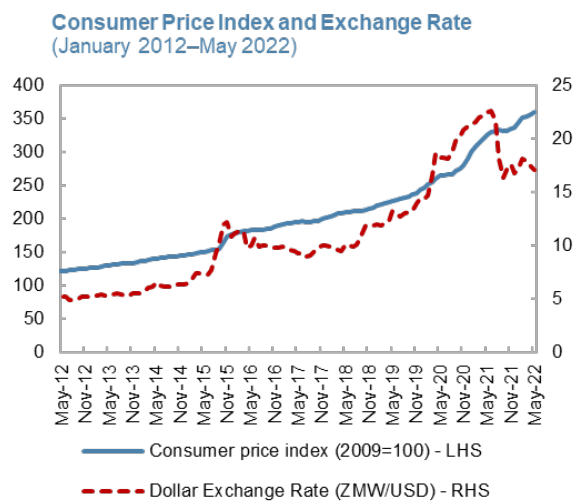
Growth is expected to slow down in 2022 after a strong recovery in 2021.



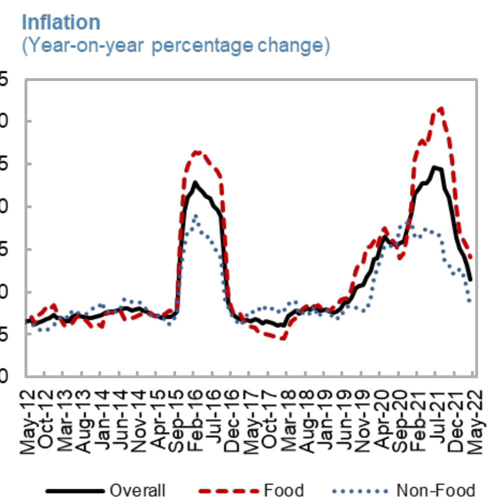
The 2022 slowdown is driven by a contraction in agriculture and the mining sector.



The kwacha depreciated through mid-2021 but has appreciated sharply since the August 2021 elections.



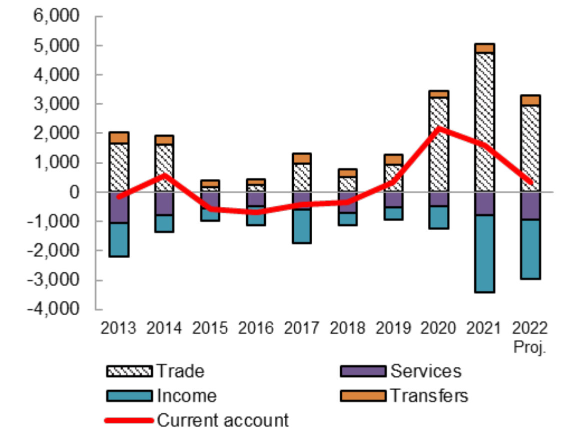
Inflation has slowed down markedly from its 25 percent peak in July 2021 to under 10 percent in June 2022.



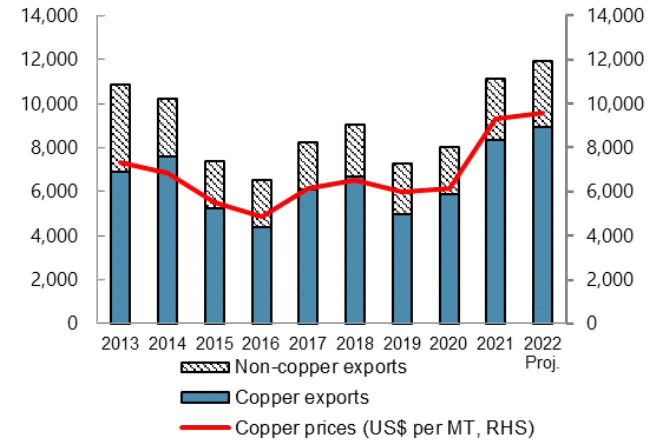
Sources: Zambia Central Statistics Office; LME; IMF, World Economic Outlook database; and IMF staff estimates and projections.

Figure 2. Zambia: External Sector, 2013–22
(Thousands of U.S. dollars, unless otherwise specified)

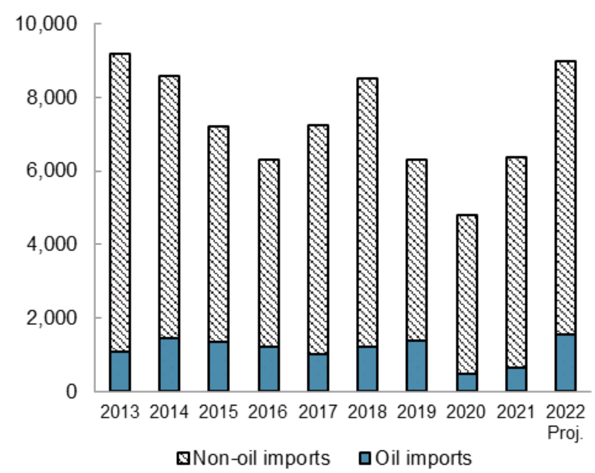
The current account deficit has turned into a large surplus…



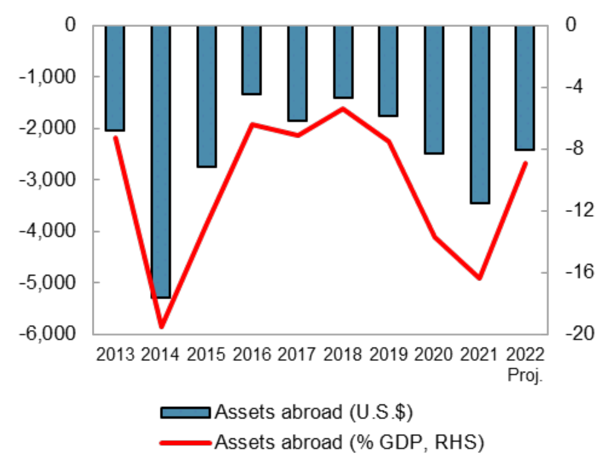
…reflecting higher copper prices…



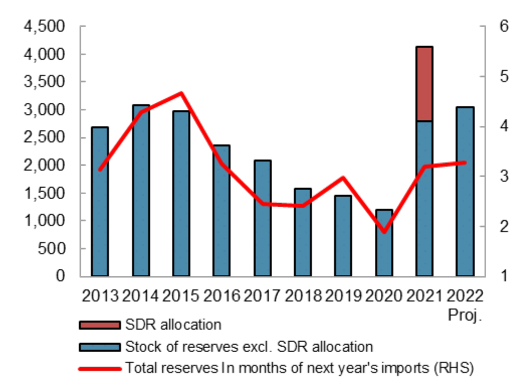
…and depressed imports.



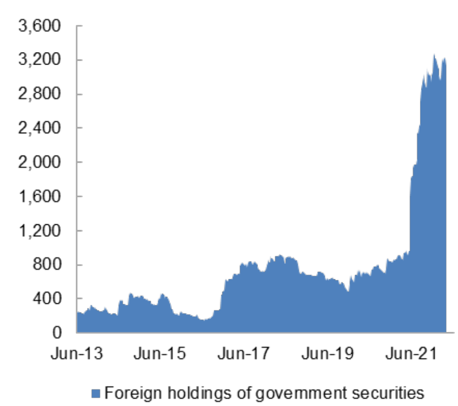
Despite sizable other outflows that proxy for copper receipts held abroad…



…the stock of reserves grew in 2021, boosted by the SDR allocation and higher copper prices…



…as well as large inflows of foreign investment.

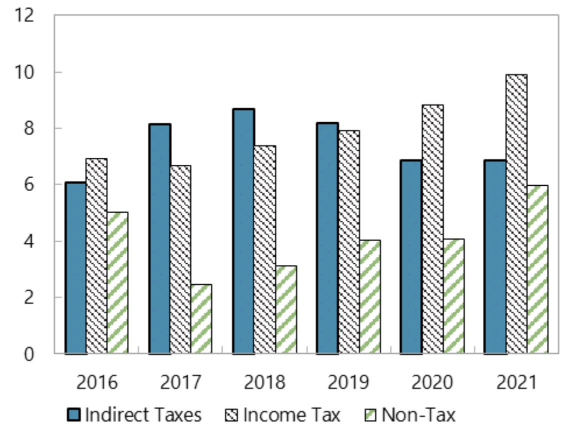


Sources: Bank of Zambia and IMF staff forecasts.

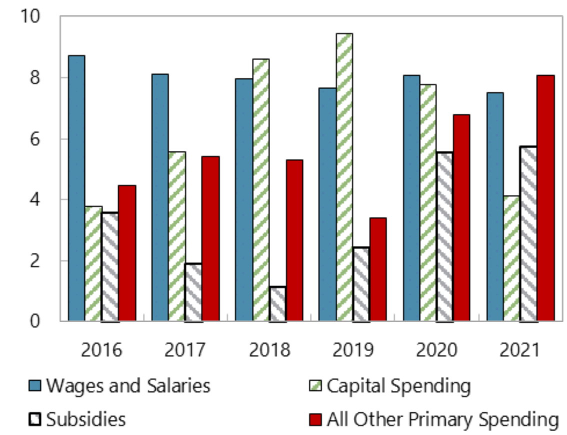
Figure 3. Zambia: Fiscal Developments, 2016–21

(Percent of GDP, unless otherwise specified)

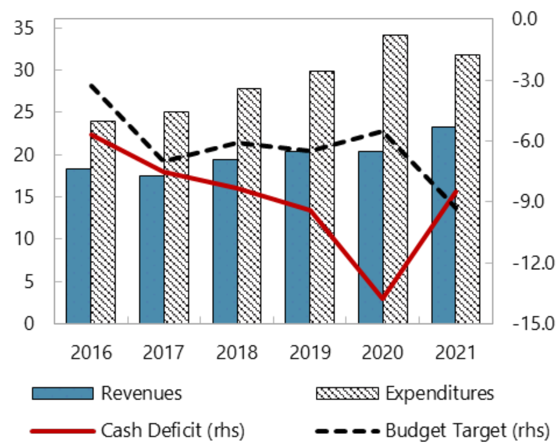
Indirect taxes bore the brunt of the COVID shock, while income taxes and non-tax revenues held up well.



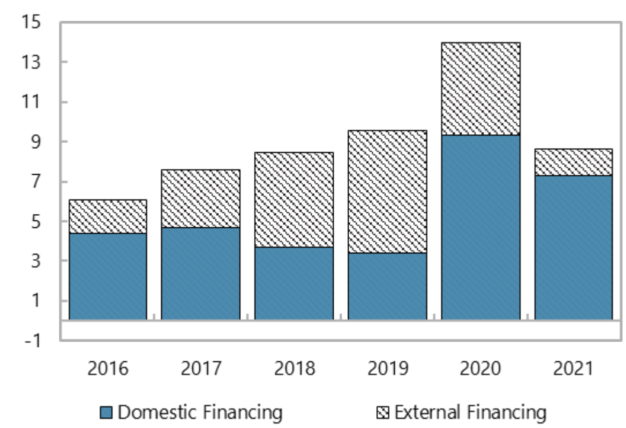
Primary budget spending was dominated by the wage bill, public investment, and (increasingly) subsidies.



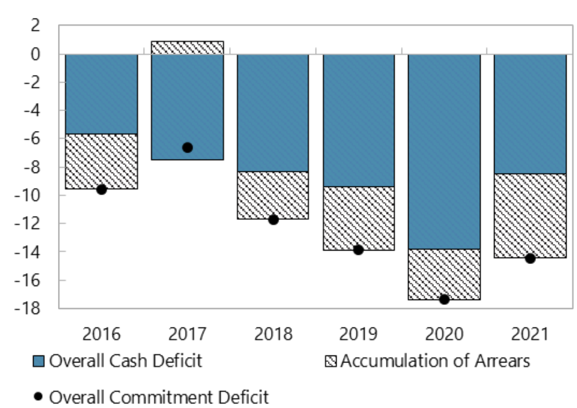
Larger-than-budgeted cash deficits were driven mostly by spending overruns.



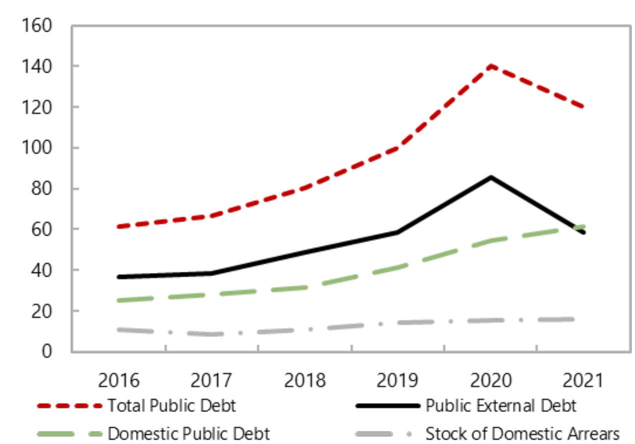
The cash deficit was increasingly financed with domestic resources.



There was a substantial accumulation of arrears (including on VAT refunds).



Public debt rose rapidly in recent years.

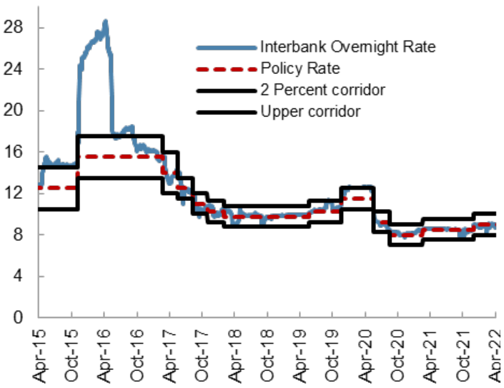


Sources: MoF and IMF staff forecasts.

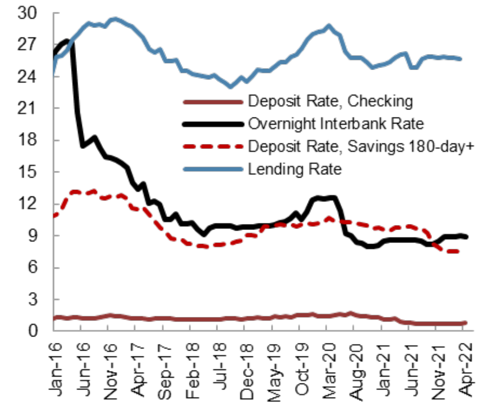
Note: Public debt as shown here covers central government and is divided into domestic and external on a currency basis.

Figure 4. Zambia: Monetary & Financial Developments

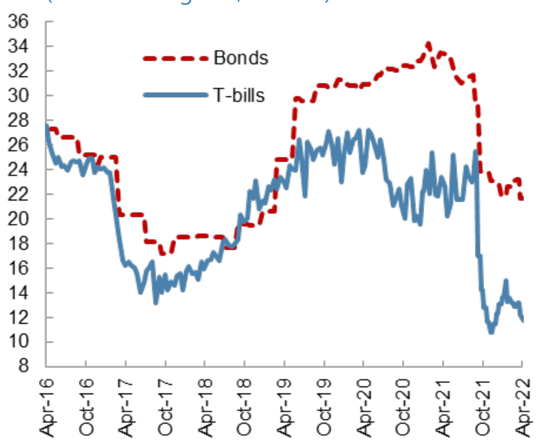
Policy Rate and Interbank Rate
(Percent)



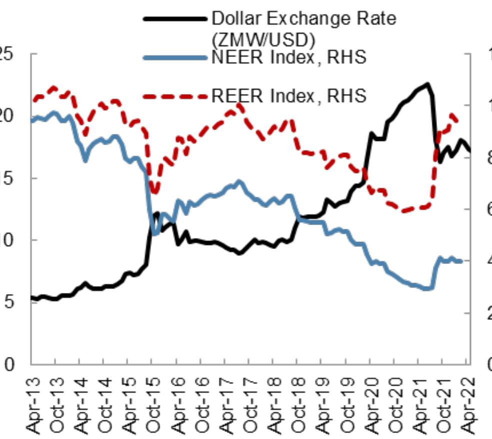
Average Lending and Deposit Rates
(Percent)



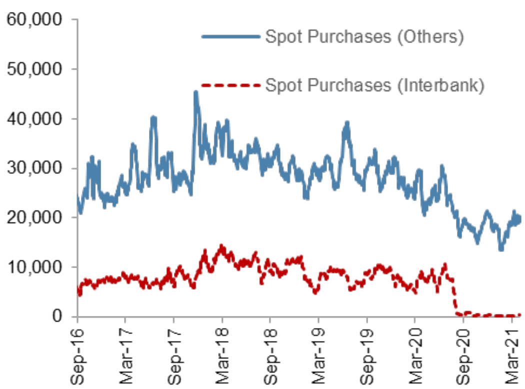
Government T-Bills and Bonds Yields
(Volume-weighted, Percent)



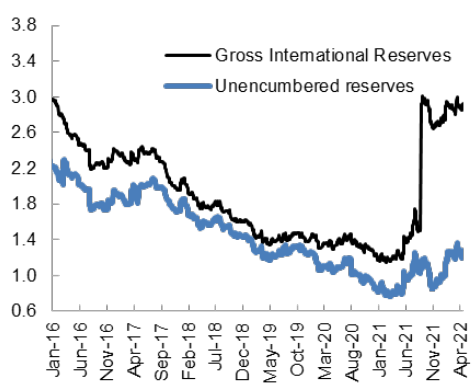
Exchange Rates
(Average Kwacha per USD; 2010=100)



Commercial Banks' Forex Purchase
(14-day average, millions of U.S. dollars)

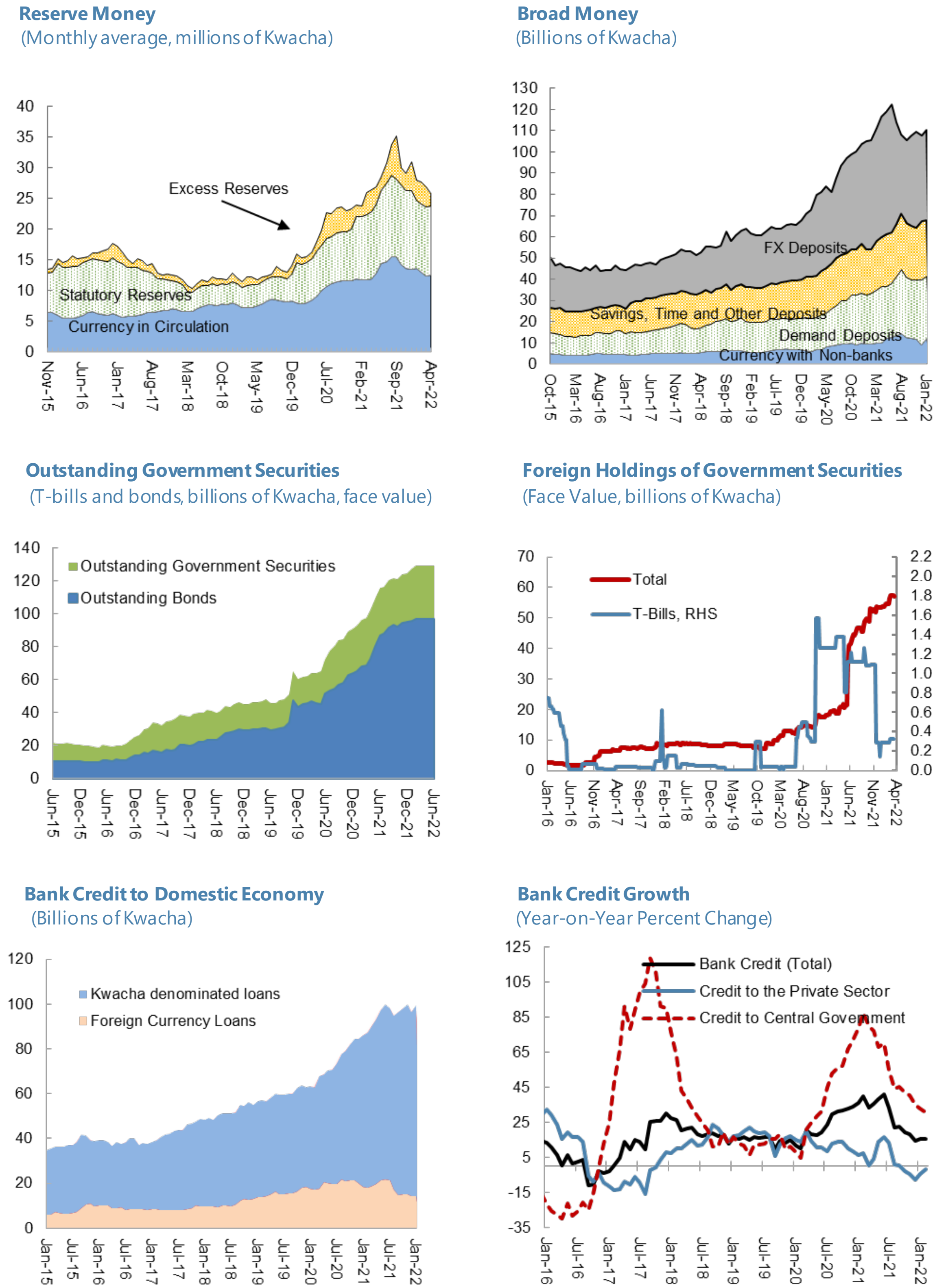


International Reserves
(billions of U.S. dollars)



Sources: Bank of Zambia.

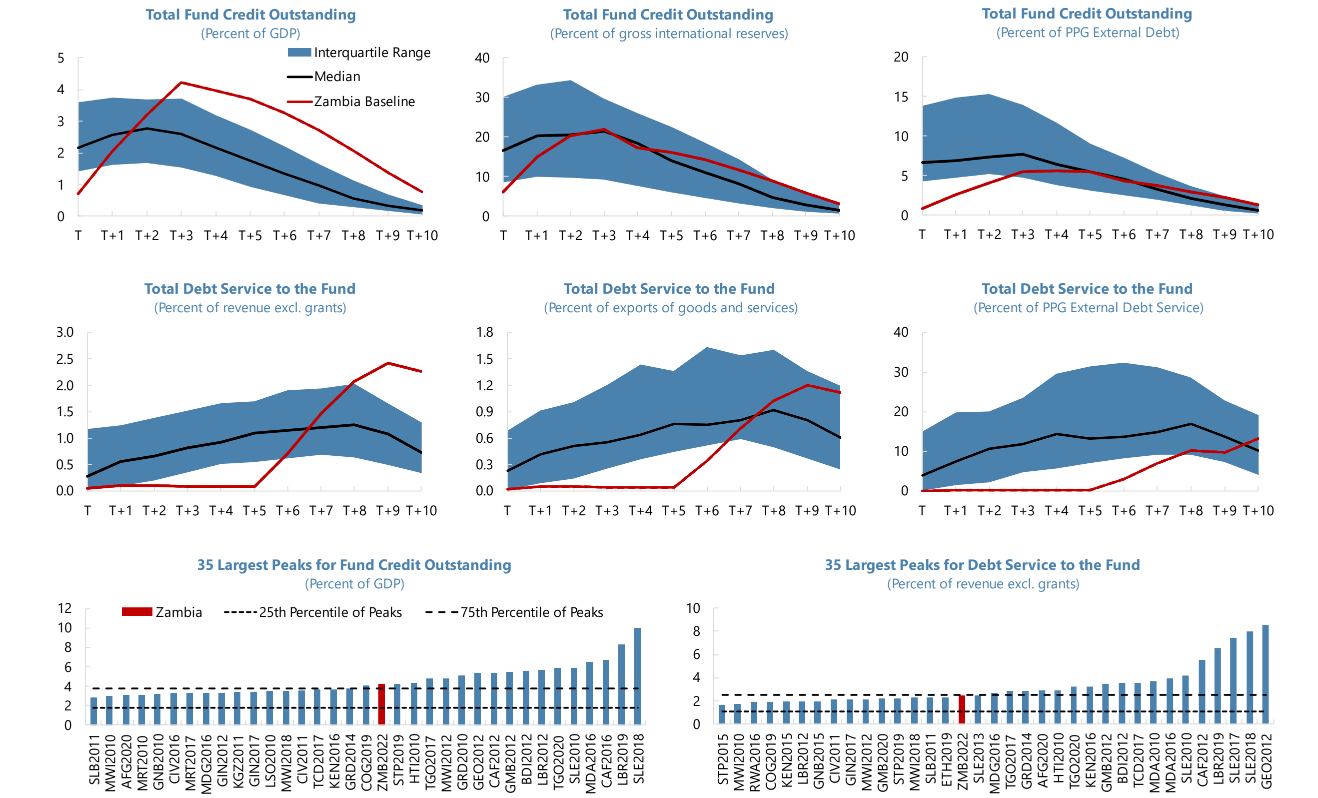
Figure 4. Zambia: Monetary & Financial Developments (concluded)



Sources: Bank of Zambia.

Figure 5. Zambia: Capacity to Repay Indicators Compared to UCT Arrangements for PRGT Countries

(In Percent of the indicated variable)



Notes:

1) T = date of arrangement approval. PPG = public and publicly guaranteed.

2) Red lines/bars indicate the CtR indicator for the arrangement of interest.

3) The median, interquartile range, and comparator bars reflect all UCT arrangements (including blends) approved for PRGT countries between 2010 and 2020.

4) PRGT countries in the control group with multiple arrangements are entered as separate events in the database.

Table 1. Zambia: Selected Economic Indicators, 2018–25

	2018	2019	2020	2021	2022	2023	2024	2025
					Projections			
National accounts and prices								
GDP growth at constant prices	4.0	1.4	-2.8	3.6	3.0	3.9	4.1	4.5
Agriculture	-21.2	7.7	17.2	-0.7	-4.4	8.8	4.0	4.0
Mining	6.3	-5.1	8.0	-6.3	3.1	3.5	5.6	6.2
Non-mining, non-agricultural	6.1	1.8	-5.3	5.2	3.5	3.5	3.9	4.4
GDP deflator	7.4	7.6	13.7	23.4	8.4	8.7	7.3	6.8
GDP at market prices (millions of kwacha)	275,175	300,449	332,223	424,453	473,917	535,028	597,667	667,213
Consumer prices								
Consumer prices (average)	7.5	9.2	15.7	22.0	13.0	9.5	7.6	7.1
Consumer prices (end of period)	7.9	11.7	19.2	16.4	12.7	8.0	7.3	7.0
External sector								
Terms of trade (deterioration -)	-1.9	-10.5	19.0	21.9	-8.6	-2.3	-0.4	-0.4
Average exchange rate (kwacha per U.S. dollar)	10.5	12.9	18.3	20.0	…	…	…	…
(percentage change; depreciation +)	9.9	23.3	42.3	9.1	…	…	…	…
End-of-period exchange rate (kwacha per U.S. dollar)	11.9	14.1	21.2	16.7	…	…	…	…
Current account balance	-1.3	1.4	12.0	7.6	1.4	0.3	2.5	2.7
Gross international reserves (months of prospective imports)	2.4	3.0	1.9	3.2	3.3	3.9	4.6	5.5
Money and credit								
Reserve money (end of period)	-0.6	25.8	57.0	8.5	14.7	17.8	10.8	17.2
Broad money (M3)	16.5	12.5	46.4	3.7	11.0	12.1	10.8	8.2
Credit to the private sector (percent of GDP)	11.7	12.5	12.3	8.9	9.2	9.3	9.5	9.8
National accounts								
Gross investment	38.6	39.3	32.3	28.7	31.6	31.5	31.5	31.6
Government	8.6	9.4	7.8	4.1	3.0	3.0	3.0	3.1
Private	30.1	29.8	24.5	24.5	28.5	28.5	28.5	28.5
National savings	37.3	40.7	44.3	36.3	32.9	31.8	34.0	34.3
Central government budget								
Revenue	19.4	20.4	20.3	23.3	21.4	22.3	22.7	22.8
Taxes	16.1	16.1	15.7	16.8	16.7	17.6	17.9	18.1
Grants	0.2	0.3	0.5	0.6	0.4	0.3	0.3	0.3
Other revenue	3.1	4.0	4.1	6.0	4.3	4.3	4.4	4.4
Expenditure	27.7	29.8	34.1	31.8	30.8	29.4	28.9	27.7
Expense	19.1	20.4	26.3	27.7	27.7	26.5	25.9	24.6
Net acquisition of nonfinancial assets	8.6	9.4	7.8	4.1	3.0	3.0	3.0	3.1
Net lending/borrowing (cash basis)	-8.3	-9.4	-13.8	-8.5	-9.4	-7.1	-6.3	-4.9
Net lending/borrowing (commitment basis)	-11.7	-13.9	-17.4	-14.5	-6.9	-4.9	-4.3	-3.1
Primary balance (commitment basis)[1]	-6.9	-6.9	-10.1	-6.0	0.7	2.2	2.7	3.2
Primary balance excluding mining revenues (commitment basis)[1]	-9.2	-9.4	-13.3	-11.9	-5.0	-3.0	-2.7	-2.3
Public debt								
Total public debt (gross, end-period)[2,3]	77.8	103.3	150.3	126.0	122.8	115.6	109.7	104.7
External[4]	48.1	62.1	95.8	64.7	69.5	69.1	68.5	67.3
Domestic	29.7	41.2	54.5	61.3	53.3	46.5	41.3	37.4

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

[1] Adjusted for the accumulation/clearance of VAT refund claims and expenditure arrears.

[2] Nonresident holdings of local currency debt are included under domestic debt here, unlike in the DSA, which is conducted on a residency basis.

[3] Including arrears.

[4] Public and publicly guaranteed external debt.

Table 2a. Zambia: Balance of Payments, 2018–25
(Millions of U.S. dollars, unless otherwise indicated)

	2018	2019	2020	2021	2022	2023	2024	2025
						Projections		
Current account	-341	325	2,181	1,616	371	85	759	858
Trade balance	514	938	3,216	4,731	2,935	2,561	2,897	3,100
Exports, f.o.b.	9,029	7,246	8,003	11,115	11,908	12,211	12,982	13,851
Of which: Copper	6,658	4,995	5,868	8,345	8,920	9,081	9,620	10,249
Imports, f.o.b	-8,515	-6,308	-4,787	-6,384	-8,973	-9,650	-10,085	-10,751
Services (net)	-724	-522	-494	-776	-940	-976	-1,044	-1,119
Income (net)	-407	-414	-763	-2,658	-1,990	-1,884	-1,524	-1,581
Of which: Interest on public debt	-567	-627	-635	-736	-936	-922	-822	-770
Current transfers (net)	276	322	221	319	366	384	429	459
Budget support grants	0	0	0	0	0	0	0	0
Sector-wide approach grants	0	0	0	0	0	0	0	0
Private transfers	276	322	221	319	366	384	429	459
Capital and financial account	123	-522	-3,448	-1,496	-3,175	-1,650	-2,977	-1,865
Capital account	66	97	80	77	88	83	80	77
Project grants	66	97	80	77	88	83	80	77
Financial account	57	-618	-3,528	-1,573	-3,263	-1,733	-3,057	-1,943
Foreign direct investment (net)	363	-148	-208	-3	1,075	1,113	1,476	1,628
Portfolio investment (net)	-238	-53	194	717	229	329	414	591
Financial derivatives (net)	32	84	-10	-30	39	60	110	218
Other investments (net)	-100	-501	-3,503	-2,256	-4,606	-3,234	-5,057	-4,380
Public sector (net)	1,740	1,416	-2	-1,346	-2,003	-1,440	-2,347	-1,805
Disbursements	2,189	2,073	1,424	571	511	469	382	265
Of which: Budget support	0	0	0	0	0	0	0	0
Amortization due	-449	-657	-1,426	-1,917	-2,513	-1,909	-2,729	-2,070
Monetary Authority (SDR Allocation)	0	0	0	1,328	0	0	0	0
Commercial banks (net)	-130	295	-413	-205	-164	20	54	165
Other sectors	-1,709	-2,212	-3,088	-2,033	-2,440	-1,814	-2,764	-2,740
Errors and omissions	-226	61	-288	-621	0	0	0	0
Overall balance	-444	-136	-1,555	-501	-2,804	-1,565	-2,219	-1,008
Financing	444	75	233	-1,671	-265	-781	-973	-1,422
Central bank net reserves (- increase)	444	75	233	-1,671	-265	-781	-973	-1,422
Exceptional financing	0	61	1,322	2,172	2,878	1,964	2,806	2,042
Financing gap	0	61	1,322	2,172	3,068	2,346	3,192	2,430
Memorandum items:								
Current account (percent of GDP)	-1.3	1.4	12.0	7.6	1.4	0.3	2.5	2.7
Total official grants (percent of GDP)	0.3	0.4	0.4	0.4	0.3	0.3	0.3	0.2
Change in copper export volume (percent)	2.8	-18.5	14.4	-5.7	6.7	6.6	6.5	6.5
Copper export price (U.S. dollars per tonne)	6,530	6,010	6,175	9,317	9,595	9,374	9,342	9,310
Crude oil price	68	61	41	69	106	95	84	77
Gross international reserves (millions of U.S. dollars)	1,569	1,450	1,203	2,796	3,060	3,841	4,814	6,237
In months of prospective imports	2.4	3.0	1.9	3.2	3.3	3.9	4.6	5.5

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

Table 2b. Zambia: Balance of Payments, 2018–25

(Percent of GDP, unless otherwise indicated)

	2018	2019	2020	2021	2022	2023	2024	2025
					Projections			
Current account	-1.3	1.4	12.0	7.6	1.4	0.3	2.5	2.7
Trade balance	2.0	4.0	17.8	22.3	10.9	9.1	9.6	9.6
Exports, f.o.b.	34.3	31.1	44.2	52.4	44.3	43.4	43.1	42.9
Of which: Copper	25.3	21.4	32.4	39.4	33.2	32.3	31.9	31.7
Imports, f.o.b	-32.4	-27.1	-26.4	-30.1	-33.4	-34.3	-33.5	-33.3
Services (net)	-2.8	-2.2	-2.7	-3.7	-3.5	-3.5	-3.5	-3.5
Income (net)	-1.5	-1.8	-4.2	-12.5	-7.4	-6.7	-5.1	-4.9
Of which: Interest on public debt	-2.2	-2.7	-3.5	-3.5	-3.5	-3.3	-2.7	-2.4
Current transfers (net)	1.0	1.4	1.2	1.5	1.4	1.4	1.4	1.4
Budget support grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Sector-wide approach grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Private transfers	1.0	1.4	1.2	1.5	1.4	1.4	1.4	1.4
Capital and financial account	0.5	-2.2	-19.0	-7.1	-11.8	-5.9	-9.9	-5.8
Capital account	0.3	0.4	0.4	0.4	0.3	0.3	0.3	0.2
Project grants	0.3	0.4	0.4	0.4	0.3	0.3	0.3	0.2
Financial account	0.2	-2.7	-19.5	-7.4	-12.1	-6.2	-10.1	-6.0
Foreign direct investment (net)	1.4	-0.6	-1.1	0.0	4.0	4.0	4.9	5.0
Portfolio investment (net)	-0.9	-0.2	1.1	3.4	0.9	1.2	1.4	1.8
Financial derivatives (net)	0.1	0.4	-0.1	-0.1	0.1	0.2	0.4	0.7
Other investments (net)	-0.4	-2.1	-19.3	-10.6	-17.1	-11.5	-16.8	-13.6
Public sector (net)	6.6	6.1	0.0	-6.3	-7.4	-5.1	-7.8	-5.6
Disbursements	8.3	8.9	7.9	2.7	1.9	1.7	1.3	0.8
Of which: Budget support	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Amortization due	-1.7	-2.8	-7.9	-9.0	-9.3	-6.8	-9.1	-6.4
Monetary Authorities (SDR Allocation)	0.0	0.0	0.0	6.3	0.0	0.0	0.0	0.0
Commercial banks (net)	-0.5	1.3	-2.3	-1.0	-0.6	0.1	0.2	0.5
Other sectors	-6.5	-9.5	-17.1	-9.6	-9.1	-6.4	-9.2	-8.5
Errors and omissions	-0.9	0.3	-1.6	-2.9	0.0	0.0	0.0	0.0
Overall balance	-1.7	-0.6	-8.6	-2.4	-10.4	-5.6	-7.4	-3.1
Financing	1.7	0.3	1.3	-7.9	-1.0	-2.8	-3.2	-4.4
Central bank net reserves (- increase)	1.7	0.3	1.3	-7.9	-1.0	-2.8	-3.2	-4.4
Exceptional financing	0.0	0.3	7.3	10.2	10.7	7.0	9.3	6.3
Financing gap	0.0	0.3	7.3	10.2	11.4	8.3	10.6	7.5
Memorandum items:								
Current account (percent of GDP)	-1.3	1.4	12.0	7.6	1.4	0.3	2.5	2.7
Total official grants (percent of GDP)	0.3	0.4	0.4	0.4	0.3	0.3	0.3	0.2
Change in copper export volume (percent)	2.8	-18.5	14.4	-5.7	6.7	6.6	6.5	6.5
Copper export price (U.S. dollars per tonne)	6,530	6,010	6,175	9,317	9,595	9,374	9,342	9,310
Crude oil price	68	61	41	69	106	95	84	77
Gross international reserves (millions of U.S. dollars)	1,569	1,450	1,203	2,796	3,060	3,841	4,814	6,237
In months of prospective imports	2.4	3.0	1.9	3.2	3.3	3.9	4.6	5.5

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

Table 3a. Zambia: Fiscal Operations of the Budgetary Central Government, 2018–25

(Millions of Kwacha)

	2018	2019	2020	2021	2022		2023	2024	2025
					Budget	Proj.	Projections		
Revenue	53,450	61,331	67,437	98,945	100,681	101,231	119,221	135,396	152,151
Revenue excluding grants	52,802	60,492	65,722	96,463	98,859	99,556	117,417	133,468	150,088
Revenue excluding grants adjusted by the backlog of VAT refunds	49,227	58,977	64,163	94,547	n.a.	101,629	119,491	135,542	152,161
Tax	44,240	48,412	52,182	71,151	77,901	78,971	94,160	107,142	120,816
Taxes on incomes	14,333	16,243	19,831	22,815	25,882	25,974	29,223	33,144	36,201
Taxes on profits	5,973	7,537	9,513	19,242	16,394	21,805	21,589	24,563	28,207
Mining	2,451	3,231	5,300	12,702	10,928	14,503	13,945	16,024	18,275
Non-mining	3,522	4,305	4,213	6,540	5,466	7,302	7,644	8,539	9,933
Value-added tax	17,352	16,835	14,639	19,516	22,952	19,650	29,038	33,531	38,029
Excise taxes	3,438	3,990	4,661	4,327	6,184	5,222	6,926	7,857	9,452
Taxes on international trade	3,144	3,808	3,538	5,250	6,489	6,319	7,384	8,047	8,928
Other revenue, including mineral royalties[1]	8,563	12,080	13,540	25,312	20,958	20,585	23,257	26,326	29,272
Of which: Mineral royalties	3,937	4,269	5,241	12,417	12,839	12,187	13,776	16,235	18,007
Grants	647	839	1,715	2,481	1,822	1,675	1,804	1,927	2,063
Expenditure	76,313	89,595	113,227	134,929	132,126	145,800	157,320	172,927	184,657
Expense	52,684	61,268	87,478	117,477	117,453	131,466	141,524	155,079	164,284
Compensation of employees	21,856	22,982	26,881	31,881	37,823	37,715	46,419	53,365	57,180
Use of goods and services	7,944	4,460	10,330	15,094	10,551	15,828	17,403	19,503	22,433
Interest	13,103	20,762	19,762	26,910	37,819	36,036	37,960	41,524	41,688
Domestic	7,529	11,755	14,525	24,929	27,365	27,992	30,217	34,400	35,347
Foreign	5,574	9,006	5,237	1,980	10,454	8,044	7,743	7,124	6,340
Subsidies	3,136	7,342	18,368	24,345	8,533	17,827	13,530	12,188	10,522
Of which: Agricultural (FISP and FRA)	3,136	5,907	11,748	11,845	6,333	12,615	11,986	10,546	8,778
Of which: Energy (fuel and electricity)	0	1,434	5,099	10,610	1,850	4,841	1,135	1,185	1,234
Intergovernmental transfers	5,631	5,279	7,487	8,799	13,151	13,038	13,849	14,944	16,550
Social protection	1,015	306	2,468	5,538	6,267	6,313	7,577	8,735	10,441
Other	0	137	2,183	4,911	3,310	4,708	4,786	4,820	5,470
Net acquisition of nonfinancial assets	23,629	28,327	25,749	17,451	14,672	14,334	15,796	17,848	20,373
Of which: Domestically-financed	5,275	3,153	4,901	9,296	6,173	7,555	9,556	10,449	14,615
Of which: Foreign-financed	18,354	25,174	20,848	8,155	8,500	6,779	6,240	7,399	5,758
Net lending/borrowing (overall balance, cash basis)	-22,863	-28,264	-45,789	-35,984	-31,445	-44,569	-38,099	-37,531	-32,507
Primary balance (cash basis)	-9,761	-7,502	-26,027	-9,074	6,374	-8,533	-139	3,993	9,181
Expenditure arrears (- payments)	5,729	11,721	6,008	14,533	n.a.	-9,583	-9,743	-9,840	-9,935
Backlog of VAT refunds (flow)	3,575	1,515	1,558	1,916	n.a.	-2,074	-2,074	-2,074	-2,074
Arrears on external interest (flow)	0	127	4,327	8,922	n.a.	0	0	0	0
Overall balance, (commitment basis)[2]	-32,167	-41,627	-57,682	-61,355	n.a.	-32,912	-26,282	-25,617	-20,499
Primary balance (commitment basis)[2]	-19,064	-20,738	-33,594	-25,523	n.a.	3,124	11,678	15,907	21,189
Financing	22,863	28,264	45,789	35,984	31,445	44,569	38,099	37,531	32,507
Net acquisition of financial assets	-2,281	153	816	2,674	0	0	0	0	0
Domestic	-2,281	153	816	2,674	0	0	0	0	0
Foreign	0	0	0	0	0	0	0	0	0
Net incurrence of liabilities	21,059	28,867	47,315	39,173	-7,903	-4,606	2,417	-16,640	-8,481
Domestic	7,879	10,424	31,747	33,655	24,459	11,121	12,792	15,140	20,411
Foreign	13,179	18,443	15,568	5,518	-32,362	-15,727	-10,376	-31,781	-28,892
Loans	13,179	18,443	15,568	5,518	-32,362	-15,727	-10,376	-31,781	-28,892
Budget support, gross	0	0	0	0	0	0	0	0	0
Project loans, gross	17,873	25,174	20,753	8,155	8,500	9,000	8,911	7,574	5,471
Other, gross	0	0	0	0	0	12,339	6,043	6,146	0
Amortization	-4,694	-6,731	-5,184	-2,637	-40,861	-37,067	-25,330	-45,501	-34,363
Debt securities	0	0	0	0	0	0	0	0	0
Statistical discrepancy / financing gap	-476	-450	-709	-515	39,347	49,175	35,682	54,172	40,988
Memorandum items:									
Primary expenditure (commitment basis)	68,939	80,554	99,472	122,552	n.a.	100,181	109,617	121,563	133,035
Net domestic financing	10,160	10,271	30,930	30,981	24,459	11,121	12,792	15,140	20,411
Primary balance excluding mining revenues (commitment basis)[2]	-25,452	-28,239	-44,134	-50,643	n.a.	-23,566	-16,044	-16,353	-15,092
Backlog of VAT refunds (stock)	5,378	6,893	8,451	10,368	n.a.	8,294	6,221	4,147	2,074
Stock of expenditure arrears	24,777	36,498	42,506	57,039	n.a.	49,559	40,651	31,529	22,199

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

[1] The large increase in 2021 is due to a dividend paid by the Bank of Zambia to the budget.

[2] Adjusted for the accumulation/clearance of arrears on VAT refund claims and expenditure arrears.

Table 3b. Fiscal Operations of the Budgetary Central Government, 2018–25 (Percent of GDP)

	2018	2019	2020	2021	2022		2023	2024	2025
					Budget	Proj.	Projections		
Revenue	19.4	20.4	20.3	23.3	21.6	21.4	22.3	22.7	22.8
Revenue excluding grants	19.2	20.1	19.8	22.7	21.2	21.0	21.9	22.3	22.5
Revenue excluding grants adjusted by the backlog of VAT refunds	17.9	19.6	19.3	22.3	n.a.	21.4	22.3	22.7	22.8
Tax	16.1	16.1	15.7	16.8	16.7	16.7	17.6	17.9	18.1
Taxes on incomes	5.2	5.4	6.0	5.4	5.6	5.5	5.5	5.5	5.4
Taxes on profits	2.2	2.5	2.9	4.5	3.5	4.6	4.0	4.1	4.2
Mining	0.9	1.1	1.6	3.0	2.3	3.1	2.6	2.7	2.7
Non-mining	1.3	1.4	1.3	1.5	1.2	1.5	1.4	1.4	1.5
Value-added tax	6.3	5.6	4.4	4.6	4.9	4.1	5.4	5.6	5.7
Excise taxes	1.2	1.3	1.4	1.0	1.3	1.1	1.3	1.3	1.4
Taxes on international trade	1.1	1.3	1.1	1.2	1.4	1.3	1.4	1.3	1.3
Other revenue, including mineral royalties[1]	3.1	4.0	4.1	6.0	4.5	4.3	4.3	4.4	4.4
Of which: Mineral royalties	1.4	1.4	1.6	2.9	2.8	2.6	2.6	2.7	2.7
Grants	0.2	0.3	0.5	0.6	0.4	0.4	0.3	0.3	0.3
Expenditure	27.7	29.8	34.1	31.8	28.3	30.8	29.4	28.9	27.7
Expense	19.1	20.4	26.3	27.7	25.2	27.7	26.5	25.9	24.6
Compensation of employees	7.9	7.6	8.1	7.5	8.1	8.0	8.7	8.9	8.6
Use of goods and services	2.9	1.5	3.1	3.6	2.3	3.3	3.3	3.3	3.4
Interest	4.8	6.9	5.9	6.3	8.1	7.6	7.1	6.9	6.2
Domestic	2.7	3.9	4.4	5.9	5.9	5.9	5.6	5.8	5.3
Foreign	2.0	3.0	1.6	0.5	2.2	1.7	1.4	1.2	1.0
Subsidies	1.1	2.4	5.5	5.7	1.8	3.8	2.5	2.0	1.6
Of which: Agricultural (FISP and FRA)	1.1	2.0	3.5	2.8	1.4	2.7	2.2	1.8	1.3
Of which: Energy (fuel and electricity)	0.0	0.5	1.5	2.5	0.4	1.0	0.2	0.2	0.2
Intergovernmental transfers	2.0	1.8	2.3	2.1	2.8	2.8	2.6	2.5	2.5
Social protection	0.4	0.1	0.7	1.3	1.3	1.3	1.4	1.5	1.6
Other	0.0	0.0	0.7	1.2	0.7	1.0	0.9	0.8	0.8
Net acquisition of nonfinancial assets	8.6	9.4	7.8	4.1	3.1	3.0	3.0	3.0	3.1
Of which: Domestically-financed	1.9	1.0	1.5	2.2	1.3	1.6	1.8	1.7	2.2
Of which: Foreign-financed	6.7	8.4	6.3	1.9	1.8	1.4	1.2	1.2	0.9
Net lending/borrowing (overall balance, cash basis)	-8.3	-9.4	-13.8	-8.5	-6.7	-9.4	-7.1	-6.3	-4.9
Primary balance (cash basis)	-3.5	-2.5	-7.8	-2.1	1.4	-1.8	0.0	0.7	1.4
Expenditure arrears (- payments)	2.1	3.9	1.8	3.4	n.a.	-2.0	-1.8	-1.6	-1.5
Backlog of VAT refunds (flow)	1.3	0.5	0.5	0.5	n.a.	-0.4	-0.4	-0.3	-0.3
Arrears on external interest (flow)	0.0	0.0	1.3	2.1	n.a.	0.0	0.0	0.0	0.0
Overall balance, (commitment basis)[2]	-11.7	-13.9	-17.4	-14.5	n.a.	-6.9	-4.9	-4.3	-3.1
Primary balance (commitment basis)[2]	-6.9	-6.9	-10.1	-6.0	n.a.	0.7	2.2	2.7	3.2
Financing	8.3	9.4	13.8	8.5	6.7	9.4	7.1	6.3	4.9
Net acquisition of financial assets	-0.8	0.1	0.2	0.6	0.0	0.0	0.0	0.0	0.0
Domestic	-0.8	0.1	0.2	0.6	0.0	0.0	0.0	0.0	0.0
Foreign	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	7.7	9.6	14.2	9.2	-1.7	-1.0	0.5	-2.8	-1.3
Domestic	2.9	3.5	9.6	7.9	5.2	2.3	2.4	2.5	3.1
Foreign	4.8	6.1	4.7	1.3	-6.9	-3.3	-1.9	-5.3	-4.3
Loans	4.8	6.1	4.7	1.3	-6.9	-3.3	-1.9	-5.3	-4.3
Budget support, gross	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Project loans, gross	6.5	8.4	6.2	1.9	1.8	1.9	1.7	1.3	0.8
Other, gross	0.0	0.0	0.0	0.0	0.0	2.6	1.1	1.0	0.0
Amortization	-1.7	-2.2	-1.6	-0.6	-8.8	-7.8	-4.7	-7.6	-5.2
Debt securities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Statistical discrepancy / financing gap	-0.2	-0.1	-0.2	-0.1	8.4	10.4	6.7	9.1	6.1
Memorandum items:									
Primary expenditure (commitment basis)	25.1	26.8	29.9	28.9	n.a.	21.1	20.5	20.3	19.9
Net domestic financing	3.7	3.4	9.3	7.3	5.2	2.3	2.4	2.5	3.1
Primary balance excluding mining revenues (commitment basis)[2]	-9.2	-9.4	-13.3	-11.9	n.a.	-5.0	-3.0	-2.7	-2.3
Backlog of VAT refunds (stock)	2.0	2.3	2.5	2.4	n.a.	1.8	1.2	0.7	0.3
Stock of expenditure arrears	9.0	12.1	12.8	13.4	n.a.	10.5	7.6	5.3	3.3
Nominal GDP (millions of kwacha)	275,175	300,449	332,223	424,453	466,179	473,917	535,028	597,667	667,213

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

[1] The large increase in 2021 is due to a dividend paid by the Bank of Zambia to the budget.

[2] Adjusted for the accumulation/clearance of arrears on VAT refund claims and expenditure arrears.

Table 4. Zambia: Monetary Accounts, 2018–25
(Millions of Kwacha, unless otherwise indicated)

	2018	2019	2020	2021	2022	2023	2024	2025
					Projections			
Depository corporations survey								
Net foreign assets	24,810	24,248	38,980	37,624	42,089	45,771	49,179	58,922
Net domestic assets	38,187	46,652	64,848	70,002	77,407	88,138	99,151	101,503
Domestic claims	62,219	73,134	102,655	103,414	113,127	121,743	130,125	140,937
Net claims on central government	28,998	34,461	60,446	64,641	68,387	70,584	71,719	74,328
Claims on other sectors	33,222	38,673	42,209	38,773	44,740	51,160	58,406	66,609
Claims on other financial corporations	549	221	168	189	227	273	363	363
Claims on state and local government	67	83	51	41	59	87	118	125
Claims on public non-financial corporations	489	725	1,148	871	871	871	871	871
Claims on private sector	32,117	37,644	40,842	37,672	43,583	49,930	57,055	65,250
Other items net	-24,032	-26,482	-37,806	-33,412	-35,720	-33,605	-35,485	-39,433
Broad money (M3)	62,997	70,900	103,829	107,626	119,496	133,909	148,330	160,426
Central bank survey								
Net foreign assets	10,256	11,197	10,921	12,127	14,980	19,471	30,625	50,000
Asset	18,827	20,641	26,230	47,101	55,202	69,126	90,315	120,291
Liabilities	-8,571	-9,444	-15,309	-34,974	-40,222	-49,655	-59,690	-70,290
Net domestic assets	3,299	5,854	15,856	16,939	18,345	19,774	12,845	948
Net domestic claims	13,327	17,047	33,862	28,710	34,824	36,418	30,322	20,171
Net claims on other depository corporations	30	271	5,383	6,984	11,199	12,419	5,858	-4,827
Net claims on central government	13,204	16,678	28,389	21,631	23,497	23,811	24,190	24,725
Claims on other sectors	94	98	90	95	128	187	274	274
Other items (net)	-10,028	-11,193	-18,007	-11,771	-16,479	-16,644	-17,476	-19,224
Reserve money	13,555	17,051	26,777	29,066	33,325	39,244	43,471	50,948
Currency outside banks and cash in vaults	8,292	8,622	12,389	13,550	19,411	24,648	32,823	35,644
Other depository corporation reserves	5,207	8,361	14,304	15,426	13,816	14,486	15,036	15,171
Liabilities to other sectors	56	68	84	90	97	111	123	133
Memorandum items:								
Reserve money (end-of-period, annual percentage change)	-0.6	25.8	57.0	8.5	14.7	17.8	10.8	17.2
Broad money (M3) (annual percentage change)	16.5	12.5	46.4	3.7	11.0	12.1	10.8	8.2
Credit to the private sector (annual percentage change)	16.7	17.2	8.5	-7.8	15.7	14.6	14.3	14.4
Velocity (nominal GDP/M3)	4.4	4.2	3.2	3.9	4.0	4.0	4.0	4.2
Money multiplier (M3/reserve money)	4.6	4.2	3.9	3.7	3.6	3.4	3.4	3.1
Credit to the private sector (percent of GDP)	11.7	12.5	12.3	8.9	9.2	9.3	9.5	9.8
Gross foreign exchange reserves of the Bank of Zambia (millions of U.S. dollars)	1,569	1,450	1,203	2,796	3,060	3,841	4,814	6,237
Exchange rate (kwacha per U.S. dollar, end period)	11.9	14.1	21.2	16.7	…	…	…	…
Nominal GDP (million kwacha)	275,175	300,449	332,223	424,453	473,917	535,028	597,667	667,213

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

Table 5. Zambia: Financial Soundness Indicators, 2013–22
(Percent, unless otherwise indicated)

	2013	2014	2015	2016	2017	2018	2019	2020	2021				2022
									Mar	Jun	Sep	Dec	Mar
Capital adequacy													
Regulatory capital to risk-weighted assets	26.8	27.0	21.0	26.2	26.5	22.1	22.2	20.1	19.7	19.2	22.8	24.7	25.0
Tier 1 regulatory capital to risk-weighted assets	24.5	24.6	19.2	23.4	24.5	20.1	20.1	17.8	17.3	17.0	21.2	23.3	23.8
Capital to total assets	14.1	15.1	12.2	13.5	12.6	12.3	12.2	8.4	8.3	8.7	10.3	10.9	11.0
Asset quality													
Past due advances (NPL) to total advances	7.0	6.1	7.3	9.7	12.0	11.0	8.9	11.6	11.4	9.1	6.9	5.8	6.4
Loan loss provisions to nonperforming loans	83.2	76.5	70.5	71.5	69.2	86.4	91.6	75.9	75.3	77.9	92.3	102.8	93.8
Bad debt provisions to advances	5.8	3.9	4.6	5.6	8.0	9.5	8.2	8.8	8.6	7.1	6.3	6.0	6.0
Loan concentration													
Of Which													
Households	34.5	36.0	30.2	28.7	28.8	29.0	25.6	20.4	19.9	17.0	18.3	18.8	19.8
Government and parastatals	2.1	4.3	3.0	4.8	5.4	7.5	11.0	20.0	25.7	27.6	29.0	30.1	28.1
Sectoral Breakdown													
Agriculture	20.2	16.6	17.3	17.0	20.3	16.8	16.3	16.3	13.7	14.7	13.1	10.7	11.0
Mining	6.6	5.0	6.4	6.3	7.5	7.1	7.5	6.2	5.0	4.8	4.6	4.0	4.7
Manufacturing	9.5	11.5	13.5	12.8	8.2	9.2	9.0	1.7	1.6	1.4	1.0	1.3	11.1
Construction	3.5	3.4	3.4	3.9	3.7	3.0	2.1	1.7	1.6	1.4	1.0	1.3	1.5
Services	4.1	2.5	2.7	1.8	2.4	4.2	2.1	1.9	3.8	3.5	3.8	1.3	0.9
Others	56.1	61.0	56.7	58.2	58.1	59.8	63.0	72.1	74.4	74.2	67.3	72.5	70.9
Earnings and profitability													
Return on average assets	3.2	3.7	2.8	2.5	3.1	3.0	3.3	2.1	2.9	3.7	5.2	5.2	5.1
Return on equity	18.2	17.3	13.1	12.3	15.4	14.7	16.2	12.9	19.8	27.5	38.4	35.1	32.8
Gross interest income to total gross income	64.5	66.4	67.1	68.6	69.0	67.9	72.7	72.6	72.2	72.1	72.1	71.9	76.4
Gross noninterest income to total gross income	35.5	33.7	32.9	31.4	31.0	32.1	27.3	27.4	27.8	27.9	27.9	28.1	23.6
Net interest margin	8.3	8.5	8.2	8.7	9.1	9.1	9.3	9.4	9.4	9.3	9.7	9.9	10.1
Liquidity													
Liquid assets to total assets	38.9	35.8	34.8	39.1	45.5	47.0	42.2	48.6	49.7	48.3	43.6	46.6	46.8
Liquid assets to total deposits	52.6	49.8	47.9	54.2	56.5	57.0	51.5	57.4	58.5	57.3	52.7	56.3	56.9
Advances to deposits ratio	61.4	62.0	56.4	50.0	45.2	47.3	51.5	41.0	39.7	40.7	42.2	39.4	37.1
Exposure to foreign currency													
Foreign currency loans to total gross loans	25.6	29.0	36.9	35.7	41.6	44.5	50.3	47.1	43.8	44.6	34.3	33.7	39.8
Foreign currency liabilities to total liabilities	30.4	32.1	48.9	45.0	44.0	46.6	47.4	52.2	53.9	56.4	43.1	41.9	44.1
Net open position in foreign exchange to capital	3.6	1.6	4.7	0.8	1.4	1.7	1.3	1.1	2.3	0.8	1.4	0.2	0.1

Source: Bank of Zambia.

Table 6. Zambia: External Financing Needs and Sources, 2018–25
(Millions of U.S. dollars, unless otherwise indicated)

	2018	2019	2020	2021	2022	2023	2024	2025
I. Total requirement	**2,555**	**2,030**	**2,412**	**6,251**	**5,164**	**4,541**	**5,759**	**5,222**
Current Account Deficit, excluding Official Transfers	341	-325	-2,181	-1,616	-371	-85	-759	-858
Debt Amortization	921	1,051	1,922	2,497	3,248	2,679	3,553	2,953
Gross Reserves Accumulation, incl SDR allocation	-506	-119	-248	1,668	265	781	973	1,422
Repayments to the Fund	0	44	15	3	0	0	0	0
Other Capital Flows 1/	1,798	1,379	2,903	3,699	2,022	1,166	1,991	1,704
II. Total sources	**2,554**	**2,122**	**1,620**	**2,841**	**2,095**	**2,195**	**2,567**	**2,792**
Official Transfers (Current and Capital)	66	97	80	77	88	83	80	77
BoZ Liabilities, incl. SDR allocation	0	0	0	1,328	0	0	0	0
Foreign Direct Investment, net	363	-148	-208	-3	1,075	1,113	1,476	1,628
Loan Disbursements to Private Sector	174	154	130	152	193	202	216	231
Loan Disbursements to Public Sector	2,189	2,073	1,424	571	511	469	382	265
Portfolio Investment, net 2/	-238	-53	194	717	229	329	414	591
III. Financing gap (I-II)	**1**	**-92**	**792**	**3,410**	**3,068**	**2,346**	**3,192**	**2,430**
IV. Expected sources of financing	**0**	**61**	**1,322**	**2,172**	**3,068**	**2,346**	**3,192**	**2,430**
Donor Support (WB/AfDB)	0	0	0	0	547	282	247	204
Exceptional Financing (Restructuring)	0	61	1,322	2,172	2,331	1,682	2,559	1,838
IMF ECF Arrangement				0	190	382	386	388
Memo Item								
Gross International Reserves (GIR), total	1,569	1,450	1,203	2,796	3,060	3,841	4,814	6,237
o/w unencumbered reserves	1,392	1,248	812	1,000	1,175	1,862	2,736	4,054
Financing Gap (percent of GDP)	0	0	4	16	11	8	11	8
In months of perspective imports	2.4	3.0	1.9	3.2	3.3	3.9	4.6	5.5
o/w unencumbered reserves	2.1	2.6	1.3	1.1	1.3	1.9	2.6	3.6

1/ Includes financial derivatives, other assets, errors and omissions.

2/ Exceptional financing from commercial creditors for May 1 to Dec 31, 2020 is $674 million.

Table 7. Zambia: Schedule of Reviews and Disbursements[1]

Availability Date	Millions of SDR	In Percent of Quota	Conditions
August 31, 2022	139.88	14.3	Board approval of arrangement
April 1, 2023	139.88	14.3	Observance of end-December 2022 and continuous performance criteria and completion of first review
October 1, 2023	139.88	14.3	Observance of end-June 2023 and continuous performance criteria and completion of second review
April 1, 2024	139.88	14.3	Observance of end-December 2023 and continuous performance criteria and completion of third review
October 1, 2024	139.88	14.3	Observance of end-June 2024 and continuous performance criteria and completion of fourth review
April 1, 2025	139.88	14.3	Observance of end-December 2024 and continuous performance criteria and completion of fifth review
October 1, 2025	138.92	14.2	Observance of end-June 2025 and continuous performance criteria and completion of sixth review
Total	**978.20**	**100.0**	

[1] Zambia's IMF quota is SDR 978.2 million.

Table 8. Zambia: Indicators of Capacity to Repay the Fund, 2022–32

	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
Fund obligations based on existing credit (millions of SDRs)											
Principal	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Charges and interest	1.5	3.4	3.4	3.4	3.4	3.4	3.4	3.4	3.4	3.4	3.4
Fund obligations based on existing and prospective credit (millions of SDRs)											
Principal	0.0	0.0	0.0	0.0	0.0	0.0	42.0	97.9	153.9	195.6	195.6
Charges and interest	1.5	3.4	3.4	3.4	3.4	3.4	3.4	3.4	3.4	3.4	3.4
Total obligations based on existing and prospective credit											
Millions of SDRs	3.0	6.8	6.8	6.8	6.8	6.8	48.7	104.7	160.6	202.4	202.4
Millions of U.S. dollars	4.1	9.2	9.4	9.4	9.5	9.5	68.5	147.2	225.9	284.6	284.7
Percent of exports of goods and services	0.0	0.1	0.1	0.1	0.1	0.1	0.4	0.7	1.0	1.2	1.1
Percent of debt service	0.1	0.3	0.2	0.3	0.3	0.4	3.2	7.0	10.3	9.7	13.3
Percent of quota	0.3	0.7	0.7	0.7	0.7	0.7	5.0	10.7	16.4	20.7	20.7
Percent of gross international reserves	0.1	0.2	0.2	0.2	0.1	0.1	0.7	1.5	2.1	2.5	2.1
percent of GDP	0.0	0.0	0.0	0.0	0.0	0.0	0.2	0.3	0.5	0.6	0.5
Outstanding Fund credit based on existing and prospective credit											
Millions of SDRs	139.9	419.6	699.4	978.2	978.2	978.2	936.2	838.3	684.5	488.8	293.2
Millions of U.S. dollars	189.5	575.8	968.7	1364.1	1372.1	1378.6	1319.5	1181.5	964.6	688.9	413.2
Percent of exports of goods and services	1.5	4.5	7.1	9.4	8.7	7.9	7.0	5.8	4.4	2.9	1.6
Percent of debt service	5.5	19.5	25.7	42.8	39.3	53.5	61.4	56.5	43.9	23.5	19.3
Percent of quota	14.3	42.9	71.5	100.0	100.0	100.0	95.7	85.7	70.0	50.0	30.0
Percent of gross international reserves	6.2	15.1	20.2	22.0	17.2	16.0	14.2	11.8	9.0	6.0	3.0
percent of GDP	0.7	2.0	3.2	4.2	3.9	3.7	3.3	2.7	2.1	1.4	0.8
Memorandum items:											
Exports of goods and services (millions of U.S. dollars)	12,475	12,812	13,625	14,540	15,817	17,469	18,841	20,324	21,856	23,537	25,273
External Debt service (millions of U.S. dollars)[1]	3,459	2,956	3,763	3,189	3,491	2,577	2,148	2,091	2,200	2,929	2,144
Gross international reserves (millions of U.S. dollars)	3,048	3,823	4,790	6,205	7,965	8,600	9,286	10,025	10,756	11,540	13,715
Quota (millions of SDRs)	978.2	978.2	978.2	978.2	978.2	978.2	978.2	978.2	978.2	978.2	978.2
Nominal GDP (millions of U.S. dollars)	26,885	28,153	30,124	32,304	34,739	37,382	40,303	43,458	46,807	50,361	54,137

Sources: IMF staff estimates and projections.

[1]Total debt service includes IMF repayments.

Annex I. Risk Assessment Matrix[1]

Source of Risk	Relative Likelihood	Impact if Realized	Policy Response
Domestic Risks			
Outbreaks of lethal and highly contagious COVID-19 variants. Rapidly increasing hospitalizations and deaths due to low vaccine protection or vaccine-resistant variants force more social distancing and/or new lockdowns.	**M**	**H.** Growth could decelerate and public financing needs could increase sharply, further undermining debt sustainability. Financial sector stress could increase.	The government should step up support for the health system and adopt measures to contain the spread of the pandemic while limiting its impact on the economy. The BoZ should closely monitor growing stress in the financial system.
Natural disasters related to climate change. Higher frequency of natural disasters causes severe economic damage to smaller vulnerable economies and accelerate emigration.	**M**	**H.** Adverse impact on the agriculture sector and on the poor, through higher food prices, reduced maize exports, higher spending on social safety nets and on subsidies for agricultural inputs, negative impact on hydropower generation, downward pressures on growth.	Provide effective support to vulnerable populations. Diversify food crops away from maize to crop varieties that are better aligned to shortened rainy seasons. Consider medium-term strategies such as building reservoir dams to help regulate water flow to main dams during high or low rain periods.
Widespread social discontent and political instability. Social unrest fueled by increasing prices, rising inequality, inadequate healthcare triggers political instability, capital outflows, higher unemployment, and slower economic growth.	**H**	**M.** Further increases in fuel and electricity prices may lead to social unrest. This could slow down much needed reforms and dent investor confidence.	Take measures to strengthen governance and anti-corruption frameworks. Implement orderly fiscal adjustment, notably by increasing domestic revenue and reducing capital expenditures and reforming subsidies for agricultural inputs. Use some of the fiscal space to boost spending on social assistance. Improve the efficiency in fuel procurement.
Financial instability caused by a rise in non-performing loans.	**H**	**M.** Deteriorating bank balance sheets could lead to a contraction in credit to the private sector and dampen economic activity.	Closely monitor the buildup of vulnerabilities on financial sector balance sheets and implement swift and decisive prudential corrective actions if required.

[1] Based on the April 2022 update of the Global Risk Assessment Matrix.

Source of Risk	Relative Likelihood	Impact if Realized	Policy Response
External Risks			
Russia's invasion of Ukraine leads to escalation of sanctions and other disruptions. This leads to lower global growth and rising and volatile food and energy prices.	**H**	**H.** Expensive fertilizer could negatively affects the budget or agricultural productivity. Lower global growth could reduce demand for Zambia's exports, notably copper and tourism, leading to a loss of reserves and increased pressure on the kwacha. Negative impact on debt sustainability.	Accelerate reforms enhancing export competitiveness. Diversify the economy to build resilience against external shocks. Enhance regional integration, including through existing SADC and AfCFTA protocols. Maintain exchange rate flexibility.
Abrupt growth slowdown in China. A combination of extended COVID-19 lockdowns, rising geopolitical tensions, a sharper-than-expected slowdown in the property sector, and/or inadequate policy responses result in a sharp slowdown of economic activity, leading to low and volatile copper prices.	**M**	**H.** Declines in tax and export revenues could lead to fiscal and exchange rate pressures.	Accelerate reforms enhancing export competitiveness. Diversify the economy to build resilience against external shocks.
Financing risks driven by slow progress in debt restructuring negotiations or exit of non-resident investors from domestic debt market.	**M**	**H.** Continued accumulation of domestic arrears would increase stress on the financial sector through higher NPLs and hamper private sector activity. Domestic refinancing risks for government securities would increase. Uncertainty over VAT refund claims could hurt revenue collection and exacerbate the fiscal deficit, while weakening incentives for new investment. Exiting non-resident investors from the government domestic securities market would adversely impact reserves and exert pressure on the exchange rate. Significant downward pressures on growth.	Implement credible fiscal adjustment measures. Broaden the tax base to increase domestic fiscal revenues. Consolidate capital expenditures by prioritizing infrastructure projects and postponing those with a smaller growth impact and those not aligned with development priorities. Reduce the public sector wage bill by restricting new hires to priority sectors only. Stand ready to tighten monetary policy as appropriate.

Annex II. External Sector Assessment

Overall Assessment: *Zambia's external position in 2021 was weaker than the level implied by fundamentals and desirable policies. This is evident in the country's unsustainable external debt, inadequate level of FX reserves, and very weak net international investment position.*

Potential Policy Responses: *Restoring external sustainability will require adjustment policies in line with the ECF-supported program to set the foundations for a strong recovery and re-position the economy on a sustainable growth path. This should include upfront and sustained fiscal adjustment, including a shift in spending away from wasteful subsidies and towards social spending. Structural reforms should focus on addressing inefficiencies in the energy and agricultural input markets, enhancing governance and reducing corruption risks, shoring up social safety nets, as well as boosting and diversifying exports. The authorities should continue to closely monitor the risks of a potentially disorderly reversal of recent portfolio inflows and stand ready to deploy counter measures. However, restoring sustainability will also require actions to address the external debt overhang through a comprehensive restructuring as requested by the authorities under the G20 Common Framework.*

Foreign Assets and Liabilities: Position and Trajectory

Background. Zambia's net international investment position (NIIP) has deteriorated significantly to -142 percent of GDP at end-December 2021, compared to -110 percent of GDP at end-2018, mainly driven by high levels of government borrowing and a sharp currency depreciation.[1,2] Zambia's foreign assets stood at 32 percent of GDP, mostly in the form of currency and deposits held abroad by non-financial corporates (NFCs) and commercial banks as well as reserve assets held by the Bank of Zambia (BoZ). Gross liabilities at end-December 2021 were five times higher than assets, at 174 percent of GDP, with FDI and public debt liabilities accounting for the lion's share.

Assessment. Zambia's large negative NIIP poses a significant risk to external sustainability and points to the urgent need for adjustment and external public debt reduction. Policy reforms planned under the ECF-supported program, along with the expected debt restructuring, should help significantly reduce IIP liabilities and boost reserve assets over the medium term, with a consequent expected improvement in the NIIP. As discussed in the 2019 Article IV, stabilizing at a stronger NIIP would be more appropriate. Specifically, actions to bring the NIIP down to around -58 percent of GDP—the median NIIP among LICs in 2021 and the average for Zambia over 2011-14 before it began deteriorating sharply—would seem appropriate.

End-2021 (% GDP)	NIIP: -142	Gross Assets: 32	Debt Assets: 21	Gross Liabilities: 174	Debt Liabilities: 127

[1] All NIIP figures in this note are based on Bank of Zambia statistics. Significant technical assistance is being provided to strengthen BOP and IIP statistics in Zambia.

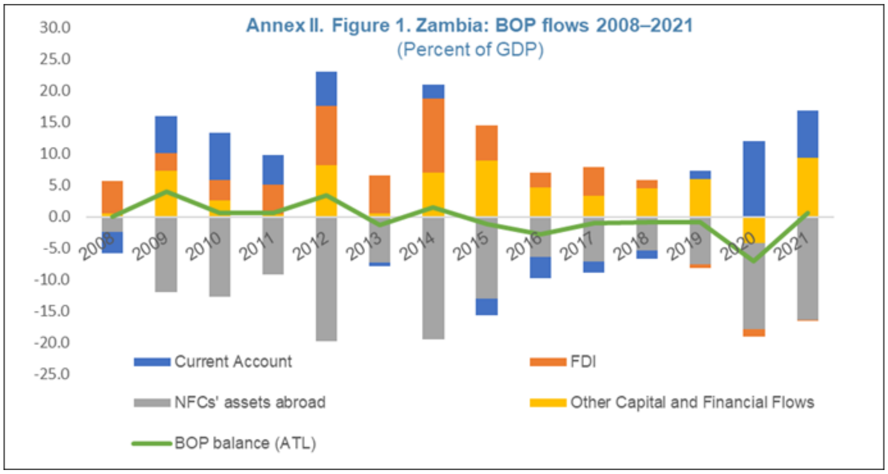
[2] The Zambian kwacha has recovered some of its value against the dollar in the second half of 2021 but remains weaker than its pre-2020 level, implying a large net impact of recent currency movements on NIIP.

Current Account

Background. The current account (CA) surplus shrank in 2021—from 12 percent of GDP in 2020—to 7.6 percent of GDP (Annex Figure 1). The lower 2021 surplus is mostly a product of the strong rebound in imports from the COVID-related compression in 2020 and, to a lesser extent, higher reinvested earnings. However, both 2020 and 2021 outcomes stand in stark contrast to the current account trends of 2015-19, reflecting the pronounced increase in copper prices, bringing them close to all-time highs. The increase in copper prices is expected to be sustained over the medium term. This, combined with the projected increase in production to record levels in coming years, is expected to keep the current account structurally in surplus over the medium term.

Despite the large surpluses of 2020 and 2021, BoZ gross reserves—excluding the recent one-off SDR allocation—declined from $1.45 billion to $1.29 billion between January 2020 and December 2021. This divergence between current account and reserve trends is a long-standing feature of Zambia's balance of payments (BOP) and, according to BoZ statistics, is a result of large outflows in the financial account in the form of sizable private sector assets abroad. Better understanding the nature of these flows is the focus of ongoing work by Zambian authorities, with IMF support.

Annex II. Figure 1. Zambia: BOP flows 2008–2021
(Percent of GDP)



Assessment. The disconnect among Zambia's current account trends, the overall external stock position, and reserves accumulation complicates any assessment of Zambia's external position based on the current account alone. Indeed, estimates based on the CA model (Annex Table 1) yield a CA gap of 0.5 percent of GDP, which is equivalent to an estimated real effective exchange rate (REER) gap of -1.8 percent. This suggests that Zambia's external position in 2021 was broadly in line with the level implied by fundamentals and desirable policies, which stands at odds with the country's current situation of external default, inadequate reserves, and large negative NIIP. This is despite an upward adjustment of the CA norm—the expected CA balance given fundamentals and under optimal policies—by 7.2 percentage points of GDP to bring it into line with the estimated CA surplus necessary to reach the targeted NIIP of -58 percent by 2025 (the end of the program period).[3]

At the current juncture, with the weakness in the external stock position dominating the apparent strength implied by the current account, staff assigns more weight in the overall assessment to the stock indicators, such as reserves and the NIIP.

[3] This adjusted current account norm was computed under the assumption of an average nominal GDP growth rate of 12 percent (the expected average over the program period).

Annex II. Table 1. Zambia: Model Estimates for 2021
(In Percent of GDP)

	CA model 1/	REER model 1/
	(in percent of GDP)	
CA-Actual	**7.6**	
Cyclical contributions (from model) (-)	2.5	
COVID-19 adjustor (-) 2/	-0.4	
Additional temporary/statistical factors (-)	0.0	
Natural disasters and conflicts (-)	-0.2	
Adjusted CA	**5.7**	
CA Norm (from model) 3/	**-2.0**	
Adjustments to the norm (-)	7.2	
Adjusted CA Norm	**5.2**	
CA Gap	**0.5**	**1.2**
o/w Relative policy gap	-3.9	
Elasticity	-0.29	
REER Gap (in percent)	**-1.8**	**-4.1**

1/ Based on the EBA-lite 3.0 methodology
2/ Reflects the estimated impact of the pandemic on tourism
3/ Cyclically adjusted, including multilateral consistency adjustments

Real Exchange Rate

Background. Following a 25 percent depreciation in 2020, the average REER appreciated by 8 percent in 2021, driven by successive bouts of nominal appreciation of the Zambian kwacha over the second half of 2021. This sudden reversal was driven by a combination of confidence effects (from the election outcome, SDR allocation, staff-level agreement on an IMF-supported program) and improved FX supply (from higher copper receipts and portfolio inflows). While the recent kwacha appreciation is expected to significantly attenuate inflation pressures (with a two-quarter lag), the expected impact on the current account is likely to be limited, based on observed historical elasticities.

Assessment. The REER model in the EBA-lite methodology is based on a panel regression of the real effective exchange rate which generates an estimated "norm" consistent with medium-term fundamentals and desirable policies. Similar to the current account model estimates, it may not capture well the structurally large outflows in Zambia's financial account, nor the fact that Zambia is in external debt default. Indeed, REER model estimates for 2021 suggest an REER gap of –4.1 percent and a corresponding CA gap of 1.2 percent of GDP, which together imply that the exchange rate is under-valued and the external position is stronger than fundamentals (Annex Table 1). Again, this appears inconsistent with Zambia's structurally weak external stock positions described above and is more likely a reflection of the models' inability to fully account for Zambia's particular situation.

Capital and Financial Accounts: Flows and Policy Measures

Background. Capital and financial account transactions resulted in large net outflows both in 2020 and 2021, mainly reflecting sizable NFCs' assets held abroad, per BoZ statistics (see above). These outflows accounted for 42 percent of copper exports both in 2020 and 2021, more than offsetting the large influx of portfolio inflows as foreign investors came into the domestic bond market—estimated at more than a $1 billion over May-November 2021, of which about 60 percent went into bonds of 10-year or longer maturities. Net FDI inflows remained depressed in 2021, with outflows broadly matching reported inflows. The Zambian government accumulated about $1.8 billion in further debt service and payment arrears, which together with debt service benefiting from the G20 Debt Service Suspension Initiative, were reflected under exceptional financing in 2021.

Capital and Financial Accounts: Flows and Policy Measures

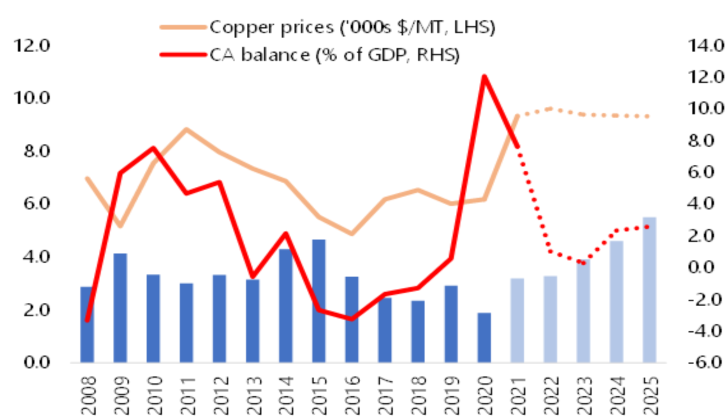
Assessment. While generally positive, the sudden influx of portfolio flows also comes with the increased risk of a disorderly exit should market sentiment change. The authorities should continue to carefully monitor these risks, assess their implications, and prepare potential mitigation strategies, such as prudent reserves management, close oversight of banks' FX exposure, and a strengthening of micro- and macroprudential policies, among others.

FX Intervention and Reserves Level

Background. While the BoZ closed 2021 with higher levels of gross reserves—$2.6 billion or 3.2 months of prospective imports—this was mainly due to the one-off SDR allocation in August. Underlying gross reserves excluding the SDR allocation barely increased from $1.2 billion to $1.3 billion over the course of 2021. As discussed above, this is despite the large current account surplus and is mainly a reflection of leakages in the financial account in the form of large reported NFC foreign assets, per BoZ statistics. A new regulation requiring the payment of mining taxes to be made in US dollars directly to the government changed the dynamics in the FX market and has resulted in the central bank becoming the dominant supplier of FX to the market. To help meet increased demand for FX in the face of constrained supply, the BoZ has adopted a policy of systematically selling all copper tax proceeds into the market. The BoZ also recently initiated purchases of gold from domestic mining companies, though the scope and implication of such operations on reserves are currently unclear. The authorities have indicated their intention to use the SDR allocation to help finance the budget over 2022-24, with a little over half expected to be drawn in 2022 and the rest over 2023-2024.

Assessment. Zambia's reserve position has improved, thanks to the one-off SDR allocation, but remains below adequate levels. Zambia's heavy reliance on copper exports and the need to protect against current account shocks driven by volatility in copper prices suggests that a higher reserve buffer than that implied by the three-month rule may be needed. Indeed, a cost-benefit analysis developed by Fund staff for low-income countries suggests an optimal level of 5.5 months of prospective imports. Building reserves to this level should be achievable over the course of the program, thanks to a combination of planned fiscal adjustment, subsidy reform, successful debt restructuring, higher copper prices, and IMF disbursements.

Annex II. Figure 2. Zambia: Copper Prices, Current Account and Reserves



Appendix I. Letter of Intent

August 8, 2022

Ms. Kristalina Georgieva
Managing Director
International Monetary Fund
700 19th Street NW
Washington, DC 20431
United States of America

Dear Ms. Georgieva,

1. The attached Memorandum of Economic and Financial Policies (MEFP) describes the economic and social objectives and policies of the Government of the Republic of Zambia from 2022 to 2025. Also attached is a Technical Memorandum of Understanding (TMU) that defines the information that will be used to monitor the program, and reflects the understanding reached between the Zambian authorities and the IMF.

2. Madam, the Zambian Government requests the IMF's support for this policy program. The program is carefully calibrated to the country's specific circumstances, notably, an untenable fiscal position, including debt distress and limited buffers to mitigate and deal with external shocks, exacerbated by low economic activity and growth. The request is for financial assistance through a 38-month arrangement under the Extended Credit Facility (ECF), covering the period 2022 to 2025, in an amount of SDR 978.2 million (100 percent of Zambia's quota), to be disbursed in seven installments, with the first disbursement equivalent to SDR 139.88 million (or 14.3 percent of quota). This financial support and the catalytic impact of the Fund programme would help us address our pressing balance of payments needs (totaling $11 billion over 2022-25) and support our reform agenda. We intend to use half of the IMF financing as budget support and the other half to rebuild buffers by boosting the country's international reserve position.

3. In line with our Eighth National Development Plan, we are of the considered view that implementation of our economic plan will help strengthen Zambia's economic and social prospects for the benefit of every citizen. The on-going debt restructuring exercise with official and commercial creditors is the foundation underlying the reform program. Further, the plan prioritizes protecting and upscaling social sector spending, including on social safety nets; improving the design and implementation of the subsidy program in agriculture; restructuring and removing subsidies in the petroleum sub-sector; and promoting infrastructure development by leveraging the Public Private Partnership financing model.

4. The policies of the Zambian Government in the MEFP have been tailor-made in order to:

- return to debt sustainability through debt restructuring with official and commercial creditors;
- gradually and sustainably improve public finances through revenue enhancement and expenditure rationalization;
- enhance commitment controls to reduce wasteful expenditure and build up in domestic arrears;
- maintain recent gains in inflation to single digit after more than three years of double-digit inflation, through a multi-pronged strategy involving a combination of fiscal and monetary policy measures as well as improved agricultural production, particularly food;
- strengthen external resilience and reserve buffers through policies that support trade surpluses, and encourage net exports and foreign direct investment;
- enhance the sustainability of growth through creation of a supportive environment for the major sectors of agriculture, mining, tourism, manufacturing, and services; and
- fight corruption and strengthen AML/CFT while promoting good governance overall.

5. To begin the implementation of our program, we have taken several prior actions, as described in Table 1 of the MEFP. So far, eight of the nine prior actions have been implemented, and the remaining one will be completed ahead of the IMF Executive Board consideration of our program request. We commit to ensuring the appropriate use, monitoring, and reporting of the recent increase in our SDR allocation, which will be used for social and priority spending. Furthermore, we reaffirm our commitment to upholding the obligations of Article VIII of the Fund's Articles of Agreement. We shall provide timely information necessary for monitoring economic developments and the implementation of policies defined in the program as agreed in the TMU, or upon request.

6. The Zambian Government believes that the measures and policies set forth in the attached MEFP are appropriate and sufficient to achieve the objectives of the program, but stands ready to take any additional measures that may be necessary. We will consult with the IMF on the adoption of such measures in advance of any revision of the policies contained in the MEFP, in accordance with the IMF's policies on such consultations.

7. The government commits to providing the IMF with information on the implementation of the agreed measures and the execution of the program, as provided for in the TMU. In addition, the government authorizes the IMF to publish this letter and its attachments, as well as the staff report and debt sustainability analysis, after the program has been approved by the IMF's Executive Board.

Yours sincerely,

/s/	/s/
Situmbeko Musokotwane, MP	Denny K. Kalyalya
Minister of Finance and National Planning	Governor, Bank of Zambia
Republic of Zambia	Republic of Zambia

Attachments:

I. Memorandum of Economic and Financial Policies (MEFP)

II. Technical Memorandum of Understanding (TMU)

Attachment I. Memorandum of Economic and Financial Policies, 2022–25

1. **This Memorandum contains the Government of the Republic of Zambia's economic and financial policies for the period 2022 to 2025, supported by the IMF under a three-year Extended Credit Facility (ECF) arrangement.** It provides an assessment of recent economic developments (Section I), medium term outlook and risks (Section II), policies for 2022 and the medium term (Section III), economic statistics (Section IV), and programme funding and monitoring (Section V).

2. **The Zambian economy recorded improvements in 2021 compared to 2020, but macro fundamentals still remain weak.** Entrenching macroeconomic stability, attaining higher and more sustainable growth, building resilience to external shocks, and returning to debt sustainability remain key medium-term objectives. Other key objectives are improvements in human development, and attainment of a conducive governance environment.

3. **In pursuit of these overarching socio-economic objectives, the Zambian Government has an economic transformation agenda anchored on four pillars, namely: economic transformation and job creation; human and social development; environmental sustainability; and a good governance environment.** These pillars form the bedrock of the Eighth National Development Plan (8NDP), 2022-2026. The Plan also contains structural and legal reforms aimed at addressing impediments to higher and more sustainable growth.

I. RECENT ECONOMIC DEVELOPMENTS

COVID-19 Impact

4. **As in other countries around the World, Zambia continues to face the lingering effect of the COVID-19 Pandemic.** As at 27th June, 2022, the country had recorded 325,348 cases, with 4,003 deaths, since the first case was reported in mid-March 2020.

5. **To mitigate the effects of the COVID-19 Pandemic, Government has continued with the national vaccination programme.** In the 2022 Budget, K704.3 million was allocated towards the procurement of vaccines. Part of the $1.33 billion received from the International Monetary Fund under the SDR allocation, has been earmarked for utilization in the health sector, including procurement of drugs and medical supplies. As at 27th June, 2022, the vaccination coverage was 40.4 percent full vaccination, against a target of 70 percent by end-June 2022. This remains relatively low compared to the country's COVID-19 Vaccine Deployment Strategy and is largely due to vaccine hesitance, myths and misconceptions about vaccination and limited funds for various aspects of service delivery.

6. Vaccine sourcing has continued, either through procurement or donations by bilateral and multilateral organizations. The vaccines being sourced include AstraZeneca, Johnson & Johnson, Sinopharm, Moderna and Pfizer.

Growth

7. Economic activity picked up in 2021 from a contraction in 2020, but growth still remains below trend and levels required to have a meaningful impact on poverty and inequality. Preliminary estimates indicate that Real Gross Domestic Product (GDP), was recorded at 3.6 percent, from a contraction of 2.8 percent in 2020. In 2019, real GDP growth was 1.4 percent. The increase in the GDP outturn in 2021 was mainly driven by the information and communication technology and construction sectors. Sectors such as manufacturing, wholesale and retail trade, transport and tourism also returned to positive growth. The contribution by the agricultural sector to growth was negligible while the mining sector contracted, mainly due to operational challenges at some mining companies and a drop in ore-grades. This was despite copper prices remaining generally high during the year.

Fiscal Performance

8. Fiscal performance has been challenging over the past three years. On cash basis, the fiscal deficit was 8.7 percent of GDP in 2019, 14.2 percent and 9.0 percent of GDP in 2020 and 2021, respectively. This was against the targeted budget deficits of 6.5 percent of GDP in 2019, 5.5 percent and 9.3 percent of GDP in 2020 and 2021, respectively.

9. Revenues and grants performed strongly in 2021, relative to target. At K98.9 billion, total revenues and grants were higher than the target by 45.6 percent, driven by over-performance in income taxes of 55.4 percent, 14.4 percent for VAT, and 4.2 percent for Customs and Excise duties. The over-performance in income taxes was largely associated with higher corporate income tax from mining firms, reflecting higher copper prices, and depreciation of the Kwacha in the first half of 2021. Improved domestic economic activity explains the higher outturn in domestic VAT and customs duty. Non-tax revenues amounted to K25.3 billion and therefore exceeded the target by 101 percent, mainly attributed to mineral royalties and a dividend receipt from Bank of Zambia. Although mineral production levels were lower compared to 2020, mineral royalty collections at K12.4 billion, more than doubled the target of K5.7 billion, largely due to the depreciation of the Kwacha in the first half of the year, as they are receipted and paid in U.S. dollars.

10. Government spending, including amortization, in 2021, was K138.0 billion which was 15.4 percent higher than the target of K119.6 billion. Notable over-expenditure was recorded for personnel emoluments (associated with higher costs for staff in foreign embassies due to the depreciation of the Kwacha), use of goods and services (for the General and Presidential Elections held in August 2021, as well as the fight against the COVID-19 Pandemic), and transfers and payments (mostly overruns associated with modernization of the Zambia Revenue Authority, the Farmer Input Support Programme and an unbudgeted outlay of K235 million to pay off some ZESCO arrears to IPPs). Spending on social benefits was above target by 29.7 percent. On the other hand, expenditure on capital projects was below target by 5.9 percent.

Financing and Debt

11. Rapid debt accumulation on the backdrop of deteriorating economic fundamentals has led to unsustainable debt levels and subsequent accumulation of arrears. Debt contracted has mainly been for infrastructure projects in sectors such as roads, education, health and defence.

12. On account of challenges in obtaining external budget support, disproportionate reliance was placed on domestic borrowing. Over the period 2019-2021, net external financing averaged 5.3 percent of GDP. All external financing during the period was attributed to project loans only, as no programme loans were contracted. High debt levels and debt servicing requirements amidst reduced fiscal space, were the main factors that hindered access to external programme financing. This led to central government financing having to be met from domestic borrowing, which peaked at 14.4 percent of GDP in 2020.

13. Domestic financing in 2020 included a COVID-19 Bond (2.1 percent of GDP), and Government Securities (10.5 percent of GDP), part of which were used to pay FISP arrears (2.8 percent of GDP) and to refinance fuel arrears (0.9 percent of GDP). The remaining balance on Government securities issued, of 6.8 percent of GDP, was for ordinary budgetary purposes.

14. In 2021, domestic financing amounted to K31.2 billion, against a target of K17.5 billion. As in 2020, much of this financing comprised Government securities, K16.0 billion (4.4 Percent of GDP), of which FISP and fuel refinancing amounted to K14.0 billion (3.8 percent of GDP). The uptake of FISP and fuel financing, therefore, continued to dominate at the expense of ordinary categories of expenditure. In view of the above, the stock of Government securities increased to K189.7 billion, as at end-September 2021, an increase of 45.7 percent from the position at end-December 2020. Apart from financing FISP and fuel arrears, the increased financing went towards COVID-19 Pandemic related expenditures, which included drug procurement, dismantling of arrears, and economic empowerment programmes. This was done mainly through issuance of Government securities through private placements.

15. Regarding external debt[1], the stock has increased marginally to $13.22 billion as at end March 2022[2] from $13.04 billion at end-December 2021. This marginal increase was attributed to the few disbursements on existing project loans from multilateral creditors who have not been affected by the debt service standstill and hence have continued to disburse. The proportion of commercial debt out of the total central Government external debt at end-March 2022 was 44.7

[1] The definition of external debt and creditor classification reflect the concepts used in the government's quarterly debt statistics bulletin.

[2] This amount excludes interest arrears and other debt related charges.

percent, while multilaterals (including plurilaterals)[3] and bilateral creditors accounted for 25.3 and 30.0 percent, respectively.

16. The Government's stock of publicly guaranteed debt was $1.51 billion[4] as at end March 2022 from $1.55 billion at end 2021. The bulk of the guaranteed debt relates to the state-owned power utility company ZESCO (92.7 percent), including the Kafue Gorge Lower power project.

17. As a consequence, the stock of public and publicly guaranteed external debt, excluding interest arrears, fuel arrears and guarantees on ZESCO payables, increased to $14.73 billion (67.7 percent of GDP) at end March 2022 from $14.57 billion at end 2021. However, the stock of public and publicly guaranteed debt reduced from $26.15 billion at end December 2021 to $25.87 billion at end March 2022 mainly due to changes in the exchange rate[5] used to convert domestic debt into the US dollar equivalent. At end March 2022, the stock of undisbursed Central Government External debt was $3.93 billion and $787.49 million in guaranteed external loans.

Arrears

18. Zambia has accrued significant external arrears. External public debt arrears amounted to $2.43 billion as at end-March 2022 composed of $1.63 billion in principal arrears (included in the debt stock) and $793.9 million in interest arrears. The accumulation of arrears follows the inability of Government to meet fully its debt obligations to all creditors which led to Government implementing the debt service standstill. As at end January 2022, a further $563 million in arrears had accrued to contractors who continued to undertake works even where the financiers had discontinued disbursements.

19. To ensure fair, transparent and equitable treatment of all its creditors, Government in October 2020 communicated suspension of debt service to all its non-multilateral external creditors. This was with the exception of very few bilateral and/or commercial creditors financing nearly completed priority projects, which were deemed of critical social and/or economic significance. In this regard, actual debt service in 2021 was $232.58 million against the budgeted $1.39 billion. As at end March 2022, total debt service amounted to $ 19.65 million.

20. The stock of central Government domestic arrears has also increased. Excluding fuel, ZESCO arrears and unverified VAT refund claims, the stock of domestic arrears amounted to K48.1billion at end December 2021, from K41.1 billion at end December 2020. The bulk of the arrears are on road projects, goods and services, capital expenditure in health and education, pensions and

[3] Plurilateral institutions include concessional lenders, such as BADEA, EIB, OFID, and NDF, and commercial lenders, such as Afrieximbank and ESA TDB.

[4] Excluding guarantees on ZESCO's outstanding payables (mainly PPA arrears).

[5] End December 2021 Exchange Rate used was ZMW16.67/ $1 while end March Exchange Rate used was ZMW18.04/$1.

compensation and awards. The build-up in domestic arrears is reflective of revenue shortfalls, financing challenges and weak commitment control systems.

21. The national power utility company, ZESCO, has significant arrears, posing a fiscal risk to the Treasury. As at end-March 2022, ZESCO had outstanding payables amounting to $1,873 million to various suppliers as well as independent local and international power producers (IPPs). In addition, arrears for Government guaranteed loans amounted to $64.5 million of which $41.4 million were external and $23.1 million were domestic. The company accrued substantial arrears due to the impact of drought on its generation capacity, higher purchase price of power from IPPs relative to the tariff, high overhead costs and non-cost reflective tariffs.

22. Fuel arrears have risen significantly. This was due to the lack of financing to pay for the explicit subsidies arising from the price differential between the landed cost of petroleum products and the pump price. Further, pump prices had not been adjusted since 2019, partly reflecting concerns on the impact of such increases on inflation and incomes of the poor, particularly in the midst of the pandemic. Due to non-adjustment of fuel pump prices to cost reflective levels till mid-December 2021, the stock of fuel arrears as at end-December 2021 amounted to $597 million, including $169 million of late payment interest.

Monetary and Financial Sector Developments

23. Inflationary pressures intensified in 2020 and over the first half of 2021, with inflation deviating further away from the 6-8 percent target range and remaining firmly in double digits. Inflation, which averaged 9.1 percent in 2019 rose to an average of 15.6 percent in 2020 and further to 22.1 percent in 2021. The increase in inflation was mainly attributed to the pass-through from the depreciation of the Kwacha against the US dollar and upward adjustments in energy prices (fuel pump prices and electricity tariffs) in December 2019 and early 2020. Upward pressures on food prices following the adverse impact of the 2018/19 drought and trade disruptions, arising from restrictive measures taken in response to the COVID-19 Pandemic in early 2020, also contributed to the rise in inflation.

24. To help mitigate the adverse consequences of the COVID 19 Pandemic on lives and livelihoods and ultimately on financial stability, the Bank of Zambia reduced the Policy Rate by a cumulative 350 basis points in 2020 to 8.0 percent. In addition, the Bank launched the K10.0 billion Targeted Medium-Term Refinancing Facility (TMTR) and the K8.0 billion Secondary Market Bond Purchase Program (SMBPP). The primary objective of these measures was to safeguard financial sector stability by making liquidity readily available to the financial intermediaries. As at June 30, 2022, K9.8 billion was disbursed under the TMTRF. The SMBPP, on the other hand, was fully executed by November 2020 with banks and pension funds as the main takers. Following the upsurge in COVID-19 cases at the beginning of 2021 and the increased uncertainty on the path of the pandemic, in February 2021 the Bank of Zambia, as a precautionary measure, augmented the SMBPP with a further K10.0 billion. A further K5.0 billion was set aside to support the potential credit guarantee scheme under the TMTRF. Out of this additional SMBPP amount, only K2.3 billion was executed under the SMBPP as market liquidity conditions in the market subsequently improved.

25. Faced with escalating inflationary pressures, in February 2021, the Bank of Zambia raised the policy rate and also signaled its intention to progressively unwind the accommodative monetary policy measures, as conditions allowed. In this vein, and to anchor inflation expectations, a 50 basis point upward adjustment in the policy rate was made brining the rate to 8.5 percent. As inflation remained persistently high and well above the target range, in November 2021, the policy rate was raised by a further 50 basis points to 9.0 percent. The policy rate has since been maintained at 9 percent owing to projected lower inflation and the expectation that it will revert into the target range by the end of 2023.

26. In 2022, inflation has trended downwards, continuing the trend that began in the second half of 2021, despite the upward adjustment in fuel pump prices in December 2021. This was mainly as a result of strong dissipation of base effects in prices of fish, meat and poultry products as well as seasonal increases in the supply of vegetables. In the first quarter of 2022, annual overall inflation fell sharply to an average of 14.1 percent from 18.9 percent in the last quarter of 2021. The decline was mainly attributed to the dissipation of base effects in prices of meat products and fish. The lagged pass-through from the appreciation of the Kwacha coupled with improved supply of some food items also contributed to the decline in inflation. In June 2022, inflation declined further to 9.7 percent from 11.5 percent in April. Continued dissipation of base effects in prices of meat and poultry products, improved supply of some vegetables and the reduction in fuel pump prices were the main drivers of the fall in inflation.

27. Rising inflationary pressures, high lending rates, the sustained depreciation of the Kwacha, and the sharp deceleration in economic growth have negatively affected the performance of the banking sector over the past three years. These factors contributed to the high cost of doing business and consequently weakened borrowers' ability to repay loans leading to a rise in non-performing loans (NPL). The NPL ratio averaged 12.2 percent in 2018, but improved to 9.7 percent in 2019. However, in 2020, despite regulatory forbearance measures in the wake of the COVID-19 Pandemic, the ratio deteriorated to an average of 11.2 percent. In addition, the country experienced sovereign credit rating downgrades, which led to increased asset impairment on loans, off-balance sheet exposures, and Government securities as per the International Financial Reporting Standard 9 (IFRS 9) expected credit loss model. This exerted pressure on profitability as both return on assets (ROA) and return on equity (ROE) significantly trended downwards thereby constraining capital formation through retained earnings. However, as of 31st December 2021, the NPL ratio improved to 5.8 percent owing to repayments and write-offs of some NPLs. Despite the low NPL ratio, asset quality remains exposed to COVID-19 restructured loans which accounted for 7.2 percent of the loan book.

28. The onset of the COVID-19 Pandemic compounded the unfavorable pre-existing macroeconomic conditions thereby adversely affecting the business environment and heightened credit risk. However, the high capital levels of the banks helped to buffer the impact on their asset quality and their capital adequacy ratios which, at 23.2 and 24.6 percent at end December 2021, remained well above the minimum requirements of 5.0 percent and 10.0 percent for primary and total regulatory capital, respectively. The corresponding figures as at end-May 2022 were 23.7

percent and 24.8 percent, respectively. To safeguard financial system stability, in the wake of the COVID-19 Pandemic and its potential devastating effects on the financial sector, the Bank of Zambia undertook the following prudential measures:

- Revised the loan classification and provisioning rules to allow financial institutions to better accommodate lending and refinancing to critical sectors of the economy by introducing more permissible collateral types. In addition, the period for this relief was extended from one year to five years;

- Allowed financial institutions to renegotiate terms and conditions for credit facilities to counterparties negatively impacted by COVID-19 pandemic through restructuring or modifying the loan agreements. Such renegotiated facilities were to be treated as current with no adverse classification and provisions for loan losses; and

- Extended the International Financial Reporting Standard 9 transitional arrangement for financial institutions to amortise the '*Day 1 Impact*' of the implementation of the IFRS 9 for regulatory capital adequacy purposes to 31st December 2022. Financial institutions were also allowed to add back to regulatory capital any expected credit losses arising from the COVID-19 Pandemic. Therefore, in the computation of regulatory capital, the add back would not only include the '*IFRS 9 Day 1 Impact,*' but also any increases in provisions on account of the COVID-19 Pandemic, and the total would be amortised over the period 1st April, 2020 to 31st December, 2022.

29. The overall financial performance and condition of the non-bank financial institutions (NBFIs) sector has been less than satisfactory over the past three years. This has largely been due to poor asset quality and unsatisfactory earnings performance by two state-owned institutions. Overall, delays by the Government to extinguish the arrears that had built up on loans extended to civil servants and the adverse effects of COVID-19 Pandemic were the main drivers of the observed poor asset quality. However, the Government reduced its arrears to NBFIs by July 2021 and has since remained current. These developments are expected to lead to improvements in asset quality. Further, the Bank of Zambia is closely monitoring the implementation of the expected cost rationalisation measures at loss-making NBFIs.

30. Growth of credit to the private sector slowed down significantly, to 7.8 percent in 2021 from growth of 8.5 percent in 2020 and 17.2 percent in 2019. The slowdown in credit was largely attributed to the deterioration in the macroeconomic environment and strict lending conditions by banks as credit default risk heightened in the wake of COVID-19 Pandemic. In 2021, the reduction in foreign currency denominated credit also contributed to the contraction in private sector credit growth. However, Kwacha denominated credit expanded largely on account of increased drawdowns on the Bank of Zambia Targeted Medium-Term Refinancing Facility (TMTRF) and the switch from the foreign currency denominated loans to local currency loans.

31. Lending to the private sector showed some recovery in the first quarter of 2022, growing by 1.3 percent, year-on-year. This was mainly on the back of increased Kwacha denominated credit, partly attributed to continued drawdowns on the Bank of Zambia TMTRF and increased utilisation of overdraft lending facilities for working capital needs. Businesses needed liquidity to meet rising operating costs following the increase in fuel prices and high cost of raw materials as the Kwacha depreciated against the US dollar.

32. Commercial banks' average lending rates remained elevated over the period 2019-2021, averaging 26.0 percent, despite the accommodative monetary policy stance adopted in 2020. This largely reflected the high cost of funds on account of deteriorating macroeconomic conditions and high Government security yield rates. The latter reflected large Government borrowing needs in the face of higher than programmed expenditures, which were largely financed from domestic borrowing. Commercial banks' average lending rates remained elevated at 25.9 percent in December 2021, largely on account of the upward adjustment in the Policy Rate, high inflation, and Government's recourse to the domestic market to finance its budget. During the first quarter of 2022, the lending rate remained broadly unchanged at 26.0 percent.

33. The exchange rate of the Kwacha against the US dollar depreciated significantly to K21.17/USD at end 2020 from K14.05/USD in December 2019, before appreciating to 16.67/USD at end-December 2021. Since 2018, the sources of foreign exchange liquidity in the market progressively reduced amidst unprecedented increase in demand, mostly for debt service and the importation of agricultural inputs and clearance of fuel arrears. This has posed a challenge to the smooth functioning of the foreign exchange market and hence, the entire economy, as it has resulted in reduced availability of foreign exchange on the market. The reduction in the supply of foreign exchange eventually led to a substantial fall in the interbank market turnover. However, between May and August 2021the Kwacha strengthened sharply to K15.95/US dollar. This was precipitated by a sudden surge in portfolio inflows, on the back of the news that Zambia received an allocation of SDR 937.5 million (equivalent to US $1.33 billion) from the IMF as part of the general SDR allocation to all members. Positive sentiments regarding the country's macroeconomic outlook following the Presidential and General Elections in August 2021 as well as the peaceful change of Government and the anticipated improved prospects to secure an IMF-supported programme were the other contributing factors to the sudden appreciation of the Kwacha against the US dollar. For 2021 as a whole, the Kwacha appreciated by 21.7 percent to K16.67/US dollar. In 2022, the Kwacha has depreciated moderately by 1.8 percent to K16.96/US dollar as at 30th June, 2022 on account of heightened demand, chiefly from the energy sector and non-resident financial institutions.

34. To promote orderly market conduct and provide clarity on market rules during periods of extreme volatility in 2020 the Bank of Zambia strengthened the rules and regulations governing the foreign exchange market. Enhancements to the trading rules included clarifying the mechanism for declaring a market stress condition under which interbank trading could be suspended until normal trading was restored and by registering all foreign exchange brokers to improve the flow of information in the market. To help meet the increased demand for foreign exchange in the face of constrained supply, the Bank also increased its support to the market by selling back into the market all of the foreign exchange directly purchased from the mining companies as tax payments.

External Sector Performance

35. External sector performance deteriorated over the last three years. The deterioration largely reflected higher external financing needs, particularly for debt service, at the time when financial inflows from foreign direct investment were subdued. This was despite recording current account (CA) surpluses of 0.6 percent, 12.0 percent and 7.6 percent of GDP in 2019, 2020, and 2021 respectively, which were largely driven by increases in net exports occasioned by higher copper export earnings and subdued imports. In the first quarter of 2022, the current account surplus remained robust at an estimated 19.6 percent of GDP, from 21.2 percent in the fourth quarter of 2021.

36. Gross international reserves declined to $1.2 billion in 2020 from $1.6 billion in 2018, largely on account of external debt service. Waning balance of payments support during the period did not help the situation. However, the fall in reserves was moderated by Bank of Zambia purchases of foreign exchange from the market and mineral royalties directly from the mining sector since mid-2019. In June 2020, the mining companies also started channeling their other U.S. dollars denominated tax obligations through the Bank of Zambia in an effort to shore up reserves. Further, in December 2020, the Bank of Zambia started purchasing locally produced gold to strengthen the reserve position. As at end-December 2021, reserves stood at $2.8 billion mainly due to receipt of SDR equivalent to $1.33 billion from the IMF in August 2021. Reserves increased further to $3.03 billion at end-June 2022. Receipt of $156.8 million World Bank support to the Ministry of Health as well as mining tax payments were key to this outturn.

II. MEDIUM TERM OUTLOOK AND RISKS

37. The economy's medium-term outlook is positive but its realization is uncertain. With strong policy action and effective implementation of structural reforms, some traction can be made to enhance macroeconomic stability and growth. Consistent movement towards fiscal and debt sustainability, reducing arrears and increasing social sector spending will be key components of this strategy.

38. In the medium term, growth is projected at 3.1 percent, 4.0 percent, and 4.1 percent in 2022, 2023, and 2024, respectively, way below the trend growth of around 5 percent. The general assumption is that there will be a gradual return to normalcy in global and domestic economic activity. However, a stronger growth outcome can be achieved depending on the pace and depth of policy reforms, and the buoyancy of commodity prices.

39. The medium-term economic outlook is subject to several risks. These include:

- Increases in global energy and food prices, exacerbated by the on-going Russia-Ukraine conflict. This threatens supply chains of commodities by causing disruptions especially in the energy and agriculture sectors and thereby likely to pose an inflation risk;

- A fall in the copper prices. This might reduce foreign exchange in the country, stifle investment and hinder growth in the mining sector and other sectors that depend on the mines and reduce revenues for the Treasury;
- Unfavorable weather conditions which could adversely affect sectors such as agriculture, mining and energy;
- Delayed and weak implementation of policy reforms;
- Protracted and/or delays in undertaking debt restructuring; and
- Outbreaks of more infectious strains of COV1D-19.

III. POLICIES FOR 2022 AND THE MEDIUM TERM

40. The goal of Government's economic policies in the medium term is to entrench macroeconomic stability and growth, attain debt and fiscal sustainability, and improve the livelihoods of the Zambian people, especially the vulnerable. These objectives rest on the four Pillars in the Eighth National Development Plan.

A. FISCAL POLICY AND REFORMS

41. Fiscal Deficit. The overriding objective of fiscal policy is to progressively improve the primary balance, on a cash basis, from a deficit of 2.1 percent of GDP in 2021 to a surplus of 0.7 percent of GDP in 2024. On commitment basis, the target is to improve the primary balance to a surplus of 3.2 percent of GDP by 2024 from a deficit of 6.0 percent of GDP in 2021. Government undertakes to adhere to these overriding fiscal objectives. It commits to therefore take appropriate revenue, expenditure, and contingency measures to ensure their attainment so as to enhance the credibility of the budget. The recently published Green Paper for the 2023-25 Medium Term Budget Plan and the 2023 Annual Budget is aligned with these objectives (prior action, see Table 1).

42. On the revenue side, domestic revenues are projected to remain above 20 percent of GDP at 22.2 percent of GDP in 2024 from 22.7 percent of GDP in 2021, in line with the 2023-2025 Medium Term Expenditure Framework (MTEF). Government will employ a combination of revenue mobilisation and administration reforms, expenditure rationalisation, strengthening public financial management to enhance public spending, as well as debt restructuring, to attain its medium-term fiscal objectives.

43. Tax Policy. To broaden the tax base, Government made an upward adjustment of excise duties on alcohol and cigarettes as well as expanded the scope on goods subject to excise duty, and streamlined the tax incentives structure to avoid wastage in 2022. Further, by end-September 2022, Government will reinstate VAT and excise duty on petroleum products (structural benchmark, see Table 2). Excise duty for diesel will be restored to the level of the Road levy. Reinstatement of VAT and excise duty, coupled with elimination of price support that was undertaken in mid-December

2021, will result in elimination of all fuel subsidies. Undertaking these measures will lead to an improvement in VAT collections to 5.7 percent of GDP in 2024 from 4.5 percent of GDP in 2021 while customs and excise duties are projected to increase to 2.7 percent of GDP in 2024 from 2.4 percent of GDP in 2021. Income taxes are projected to increase to 5.5 percent of GDP in 2024 from 5.4 percent of GDP in 2021.

44. Tax Administration. To augment domestic resource mobilization, Government will continue to strengthen tax administration during the medium term. This will be done by fast tracking the rolling out of electronic fiscal devices to enhance VAT compliance, introduce digital stamps on excisable products to improve excise duty collection and complete implementation of the Telecommunications Traffic Monitoring System (TTMS) by end-2022. The Zambia Revenue Authority will enhance its collaboration with local authorities to expand the tax base and increased revenue collection. The Government will implement a data matching project which will enhance compliance by matching customs and inland-revenue declarations as well as interfacing with national data registers on the Government Service Bus platform in 2022. To further support the efficient collection of taxes by reforming revenue collection administration, a Tax Administration Diagnostic Assessment Tool (TADAT) assessment was conducted in the first quarter of 2022 to determine the strengths and weaknesses of the tax administration system. The gains from both tax administration and policy measures are expected to yield 3.2 percent of GDP over the period 2022-2024.

45. Non-Tax Revenue. Non-tax revenue is projected at 4.0 percent of GDP in 2024 from 3.4 percent of GDP in 2021. Non-tax revenue will rise substantially in nominal terms mainly as a result of utilization of e-payment platforms for Government services. Mineral royalty is also projected to increase substantially in nominal terms mainly due to the projected increase in both copper production and copper prices.

46. Government is working in collaboration with cooperating partners to improve tax policy and administration. The measures envisaged to be undertaken include review of the appropriateness of the bands for Personal Income Tax and the multiplicity of rates for Corporate Income Tax with a view towards consolidation in the medium term. The revenue effort will be enhanced by increasing tax compliance, enhancing customer focus and collaboration, improving process efficiency and enhancing the performance of the Zambia Revenue Authority, in line with its 2022-2024 Corporate Strategic Plan. To enhance the monitoring of mineral production in the country, ZRA will leverage on the exit strategy of the Mineral Value Chain Monitoring Project by re-establishing the Mineral Data Analysis Centre under the Large and Specialised Tax-Payer Office by March 2022. The centre will undertake regular mineral data analysis and make recommendations to audit and enforcement teams.

47. Government will amalgamate all the tax policy and administration measures into a comprehensive and holistic strategy and action plan. This is aimed at durably boosting revenues. The action plan will be prepared by end-October 2022 (structural benchmark, see Table 2).

48. Expenditure Rationalisation. On the expenditure side, total expenditure (including amortization) is projected to increase to 36.6 percent of GDP in 2024 from 32.4 percent of GDP in

2021. This is largely on account of an increase in the public service wage bill to 8.9 percent of GDP in 2024 from 7.5 percent of GDP in 2021 following recruitments of mainly frontline personnel in the health and education sectors in 2022 and the medium term as well as government's ambitious arrears dismantling strategy in the medium term. Government intends to recruit 30,000 teachers and 11,726 health personnel in 2022. Recruitment will also be done for extension officers in the livestock sub-sector. Significant resources have also been allocated for the Constituency Development Fund (CDF), whose utilisation scope has been widened.

49. Government had intended to create space for greater social sector spending by limiting expenditure on the Farmer Input Support Programme (FISP) through migration to the more cost-effective e-Voucher system from the 2022/2023 farming season. However, due to tight supply conditions and high prevailing prices on the international market, migration to a broader and more efficient system will be done from the 2023/2024 farming season. Consequently, expenditure on FISP in 2022 will remain elevated at 2.1 percent of GDP but reduce to 1.3 percent of GDP in 2024 mainly due to implementation of a new comprehensive agriculture support programme from the 2023/2024 farming season.

50. Capital expenditure is projected to reduce to 2.9 percent of GDP in 2024 from 4.1 percent of GDP in 2021. This is in line with the Public Investment Strategy that aims at cost effectiveness in undertaking public investment projects and limiting Government's exposure to such projects to within approved budgets.

51. In view of the increased resource allocation to Local Authorities through the CDF which commenced in 2022, public financial management systems at local level are being strengthened. This has entailed preparation of guidelines and standards for utilization, management, monitoring and evaluation of resource use coupled with capacity building, in line with the Constituency Development Fund Act No. 11 of 2018. The guidelines and standards were finalized in January 2022 and launched in February 2022. Subsequent work has involved sensitization and training of stakeholders, especially local authorities. To ensure adherence, the provisions in the Public Finance Management Act of 2018 including the sanction regime, will be applied in managing the resources under the CDF.

52. Use of the SDR Allocation. In August, 2021 Zambia received Special Drawing Rights equivalent to $1.33 billion from the International Monetary Fund. Government intends to use at least 50 percent of the proceeds to finance the 2022 Budget, while the balance of 50 percent will be used as a buffer against any financing shocks in the domestic market. A Memorandum of Understanding will be established between the government and the Bank of Zambia to clarify the roles and responsibilities for servicing the associated financial obligations to the Fund.

53. Arrears on Expenditure and VAT Refunds. Government has developed and published a strategy for clearance of expenditure arrears and VAT refunds (prior action, see Table 1). The arrears are owed for Personal Emoluments, bills for consumption of public utilities (telephone, water and electricity), VAT refunds, FISP, maize purchases under FRA, unpaid pension benefits, outstanding bills on Road Construction Programme under the Road Development Agency (RDA), Other Recurrent

Departmental Charges (RDC's), Provisions (Rations), awards and compensation and Capital Expenditure on other civil works/contracts other than Road Projects.

54. Fuel arrears, which are foreign currency denominated will also be addressed through the strategy. In addition, ZESCO arrears owed to Independent Power Producers (IPP) and for emergency power imports (some of which are foreign currency denominated), will be addressed as part of the overall debt restructuring exercise.

55. The medium-term expenditure and VAT refund arrears clearance strategy involves halting the accumulation of new arrears and dismantling the existing stock, for which a sum of K30.5 billion has been earmarked over the period 2022-2024. The key features of the strategy include increased budget provision, debt and/or cheque swaps, as well as debt refinancing and restructuring. Due to the huge amounts involved, clearance of domestic arrears can only be done in the medium to long-term. The target is to eliminate domestic arrears by end 2026. As a start, Government has dismantled all outstanding pension arrears accumulated for the period ending December 2021 for public service workers.

56. To halt the accumulation of arrears, a Commitment Control Module was developed in the Integrated Financial Management Information System (IFMIS) that links procurement commitments to the approved budget. Further, to support the use of IFMIS, Government adopted provisions to separate budget releases from cash releases, with budget releases done on a quarterly basis and based on procurement and cash plans. The configuration of Commitment Control Module in IFMIS was completed at the end of May 2022. Training of end users was completed in June 2022, and the module became operational in July 2022. Government will ensure that all ministries and provinces register purchase orders and other financial commitments in the IFMIS by end-June 2023 (structural benchmark, see Table 2).

57. To enhance the commitment control system as well as expand the scope and capture of arrears, Government sought technical assistance from the IMF. The recommendations from the technical assistance are currently being implemented. The recommendations relate to key areas such as payroll processes and controls, arrears management and clearance, and strengthening the Treasury Single Account.

58. Enforcement of the Public Finance Management Act and regulations, which contain stringent punitive measures to non-adherence will be another key deterrent in preventing the accumulation of arrears. In this regard, the Ministry of Finance and National Planning issued a Treasury Circular at the beginning of 2022 on the punitive measures for non-adherence to the arrears clearance strategy, sticking to the budgetary allocations and controls required before commitments are made to all MPSAs. Further, a Treasury Circular providing guidance on clearance of arrears was issued in February 2022.

ZESCO Arrears and Reforms

59. The power utility company ZESCO is faced with a number of financial and operational challenges that have plagued it. These are summarised as follows:

a) **Debt:** ZESCO's total outstanding debt as at end March 2022 amounted to $3 billion, comprising $1.87 billion in payables (including $1.7 billion for power purchases) and $1.13 billion in both domestic and external loans[6]. The stock of on-lending facilities owed to the Central Government amounted to $368.6 million, $120.6 million to commercial lenders and $638.2 million Government guaranteed loans.

b) **Revenue:** Over the years, ZESCO's revenues have been adversely impacted by non-cost reflective tariffs coupled with low electricity generation due to low water levels as a consequence of frequent droughts and climate change effects. In 2021, however, an improvement in ZESCO's revenues of 19 percent compared with 2020 was recorded, driven by an increase in exports and sales volumes to domestic customers coupled with the depreciation of the Kwacha against the United States dollar. The increase in domestic sales is attributed to reduced load management owing to an improved electricity generation during the 2021 fiscal year;

c) **Costs:** ZESCO has had a phenomenal growth in operating costs from 2015 to 2019 of about 135 percent. This has hampered ZESCO's ability to service its debt obligations. Operating expenditure (OPEX) in 2020 totaled $650 million mainly caused by ZESCO purchasing the electricity at higher prices from IPPs than the electricity tariff it charged customers, emergency power imports and the implementation of capital projects to increase production. However, in 2021, ZESCO's operating costs were lower than 2020 driven by lower purchases of electricity from Ndola Energy, Maamba collieries and Lunsemfwa; and

d) **Operations:** Over the years, ZESCO has been facing challenges leading to load shedding that has resulted in reduced revenue amidst increasing operational costs. In the financial year ended 31st December 2020, management accounts indicate that the company posted a huge net loss margin of K12.2 billion (USD580 million). During the 2021 financial year, however, the company recorded an increase in power generation at Kafue Gorge Upper, Kariba North bank and Kafue Gorge Lower (arising from pre-recommissioning testing). As a result, the company was able to meet demand using own generation despite a drop in available power from the IPPs resulting in an overall lower cost of sales. According to unaudited financial statements for the year ended 31st December 2021, the company recorded a net profit of K12.1 billion ($607 million) driven by lower cost of power purchases, reduced provision for doubtful debts and exchange rate gains.

[6] As at end 2021, ZESCO had accumulated arrears on debt service amounting to $91.3 million.

60. The improvements in 2021 notwithstanding, Government recognises the precarious financial condition that ZESCO Limited is currently in and seeks to transform it by implementing a 5-year turn-around Strategy that covers the period 2021 to 2025. The strategy has five key focus areas as follows:

a) **Debt Restructuring:** The Government is working with ZESCO to have its external debt restructured to ensure financial sustainability of the company. ZESCO's guaranteed external debt will be restructured as part of the overall debt restructuring exercise for central Government while the non-guaranteed external debt including emergency power imports will be restructured bilaterally between ZESCO and the respective creditors. ZESCO negotiations on tariff revision have concluded with Maamba, Itezhi Tezhi Power Corporation (ITPC) and Copperbelt Energy Company (CEC). The effective date of the revised tariffs for Maamba was 1st June, 2022, while finalization of the agreement with ITPC awaits conclusion of discussions on a payment plan for accrued arrears. The negotiations are expected to be completed by end September 2022.

b) **Optimisation of CAPEX:** ZESCO will by end December 2022 reevaluate all non-committed CAPEX projects sitting in the 2019- 2025 corporate strategic plan that have not yet been drawn down to derive the best economic value, while all major projects that require to be financed from ZESCO's balance sheet will not be embarked on during the stabilisation and recovery period of the turnaround period. Going forward, ZESCO will also implement a new criteria of project selection (Guiding Principles) to ensure that projects are self-financing and meet the strict minimum investment criteria of 14 percent Internal Rate of Return (IRR), 30 percent EBITDA margin, and 1.2 Debt Service Coverage Ratio. The investment policy is in place and will undergo regular reviews. Further, Government driven projects which neither contribute to ZESCO's profitability nor support the turnaround will be suspended.

c) **Optimisation of OPEX:** This will entail reduction of operating expenditure across the entire value chain which includes a reduction in labour costs through rationalisation and reduction of staff numbers and implementing a Voluntary Separation Scheme (VSS), automating processes and outsourcing some services via cost benefit analysis. Other efforts will include targeted measures such as suspending donations and grants and suspension of non-critical trainings. All of the above measures are expected to yield a 20 percent reduction in operating expenditure and a 10 percent reduction in the cost of labour in 2022.

d) **Tariff Adjustment and Revenue Efficiency:** the Cost-of-Service Study (CoSS) was completed in October 2021 and handed-over to the Government in December 2021. A key finding of the CoSS was that mining companies should pay a lower tariff, while upward adjustments should be made for retail and commercial consumers. This finding was largely on the basis of the methodology used which focused on cost accumulation. To authenticate the results, Government subjected the findings to peer review from local and international energy experts, as well as multilateral institutions such as the World Bank and the African Development Bank. The peer review process was concluded in July and Government will finalize its policy response and publish it together with the cost of service study prior to consideration of the programme request by the IMF Executive Board (prior action). The policy objective remains a multi-year migration to cost-reflective electricity tariffs, with the migration path published by end-December 2022 (structural benchmark). For the retail customers, ZESCO will apply to the ERB for tariff adjustment considering the lifeline tariff to cushion low income households, in line with the Electricity Act No. 11 of 2019.

e) **Asset Optimisation:** ZESCO plans to focus on assets in which it has a stake and are standalone by carrying out valuation of all these assets that are separate entities and pursue a dilution of its holding in them; and outright sale of identified assets, including through IPOs**.** As regards the timelines for optimisation of assets, ZESCO will embark on this intervention during the recovery phase of its turnaround strategy expected to begin in January 2023. The intention is to divest from ventures that are not delivering the expected value and partially divest from investments that are delivering value in order to release the capital therein for investment in assets core to the survival of the business.

Fuel Arrears and Reforms

61. Arrears accumulation on fuel supply remains a challenge. The Ministry of Energy has since 2016 been accumulating arrears on petroleum products arising from the landed cost being lower than the pump price. As at December 2019, fuel arrears amounted to $499.39 million, which increased to $ 717.26 million at end-June 2020, and closed at $467.3 million at end-December 2020, following payments that were made to reduce the arrears. The stock of fuel arrears as at end-December 2021 was $597 million. Government will undertake an audit on the evolution of the fuel arrears to authenticate the quantum owed to fuel suppliers.

62. Whilst price adjustments were made periodically prior to 2016, the sharp depreciation of the exchange rate of the kwacha and increases in the global price of petroleum products have led to challenges in attaining cost reflectivity in pricing. The increase in inflation, particularly in 2020 and 2021, has further made adjustment of prices challenging. The accumulation of arrears resulted in the Government reducing Excise duties on fuel while VAT was zero-rated for diesel and petrol.

63. To gradually return to cost-reflective pricing and cushion against a rapid raise in the cost of production and the cost of living, a multi-step petroleum price adjustment and reform process will be implemented. In the first step, an upward revision of petroleum prices to eliminate price support was effected in December 2021. Further, commencing 31st January, 2022, the pricing cycle for petroleum products was adjusted from 60 days to 30 days with prices adjusted based on the cost-plus pricing model, while maintaining the pricing trigger band of +/- 2.5 percent (prior action). In the second phase, reforms to remove the inefficiencies in the fuel supply chain, by among others, supplying of diesel through the pipeline and procurement reforms to standardize supply contract prices will be undertaken in line with the recently adopted procurement regulations (prior action). As a final push towards cost-reflectivity, Government will reinstate VAT and Excise duty on petroleum products by end-September 2022 (structural benchmark), concurrently with pumping diesel through the pipeline and the procurement reforms.

FISP Reforms

64. The Farmer Input Support Programme is the flagship input delivery programme for more than one million small scale farmers. Over the past few years, the delivery mode for the programme has been through direct input supply and use of electronic platforms. Farmers under the electronic platform were getting fewer bags of fertilizer and seed, relative to those under the direct input support mode. This was due to the escalation in prices which lowered the number of bags they could purchase from the funds they received. The direct input supply mode has been associated with a large monetary outlay, which has been consistently above budgetary allocations due to high administrative and transportation costs as well as input price escalations.

65. To make the FISP programme more cost effective, better targeted and equitable across beneficiaries, Government will implement a new Comprehensive Agriculture Support Programme (CASP) beginning in the 2023/2024 farming season. The scope of the programme will be expanded over and above the provision of subsidised inputs to farmers through the electronic agro-input system to include extension service support, access to finance, support to value addition, storage and logistics. The design of the programme, including publication of its guidelines will be undertaken by end-December 2022 (structural benchmark).

66. In order to enhance transparency relating to FISP, Government has published (prior action) and will publish the list of future suppliers of inputs on the Ministry of Agriculture website. The information will include the name of the suppliers, products, quantity to be supplied, and contract amount. In line with the Public Procurement Act, the information will also include the beneficial owners. With regard to the audit of FISP, the Controller of Internal Audit (CIA) undertook a value for money audit of the programme in 2021. Some of the findings of the audit indicate that the programme had no accountable documents used in the stock management system, there was no benchmarking in the landed cost of inputs with the average market price, no certification and verification of the quality and weights of the delivered inputs. Further, with respect to the e-voucher system, there were uncollected inputs despite swiping by farmers. The findings also revealed lack of an oversight committee to oversee the implementation of the programme while the administrative structures are not clearly defined with respect to the responsibility and accountability of FISP resources. To increase the coverage of the audit to cover the whole country, a firm of independent auditors has been engaged and the work is currently on-going. The findings, as well as those from the CIA will help to shape the design of the new programme. In line with its constitutional mandate, the office of the Auditor General, will continue with annual audits to ascertain compliance.

Social Protection

67. To ensure sustained and continued protection of the poor and vulnerable, in particular given the continued negative effects of the COVID-19 Pandemic on livelihoods, scaling up of social protection programmes will be undertaken in 2022 and over the medium term. Specific actions to be undertaken include:

- Increasing the number of beneficiaries under the flagship Social Cash Transfer Programme to over 1, 024,000 households in 2022 from 880,539 households in August 2021;

- Increasing the transfer value per household in 2022 to K200 per month from K150. For households with a severely disabled member, the transfer value will be increased to K400 per month from K300;

- Increasing the number of beneficiaries under the Food Security Pack Programme[7] to 290,000 households in 2022 from 263,700 in August 2021;

- Expand support to the girl child through the Keeping Girls in School Programme to 43,520 girls in 2022 from 28,964 girls in 2021;

- Scaling up of the home-grown school feeding programme[8] from 39 to 59 districts;

- Continued implementation and scaling up of the public welfare assistance scheme[9];and women empowerment programme[10]; and

- Clear all outstanding pension arrears as at end 2021 for public service workers and eliminate the accumulation of arrears by staying current on pension employee and employer contributions.

68. Pension Reform. The Pension system will be reformed to make it financially sustainable and provide social security to retirees. The key reforms include creation of a statutory pension and an occupational pension. Reform measures being considered include a complete review and amendment of relevant legislation including Public Service Pension Fund, Local Authorities Superannuation Fund and the Pension Scheme Regulation Act, all with the aim of providing adequate safeguards to retirees. Government will make appropriate consultations including with trade unions and the World Bank, as it undertakes the pension reforms.

69. The Zambia Integrated Social Protection Information System was implemented in 2021 to assist in planning, policy formulation and eliminating duplications within social protection programmes. Further, the coverage of social health insurance, which is currently in the formal sector has been extended to the informal sector. The registration of the informal sector to the scheme will be a continuous process. This will be achieved by engagement with various associations which

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[7] The **Food Security Pack (FSP) is an agricultural** – based Social Protection programme that provides agriculture inputs and accompanying services to poor and vulnerable farming household.

[8] **Home Grown School Feeding Programme (HGSFP**) is a social safety net used to tackle the problem of malnutrition and hunger among pupils. It is also used to help improve access and retention of pupils in schools.

[9] **The Public Welfare Assistance Scheme (PWAS)** supports the most vulnerable in society to fulfil their basic needs particularly health, education, food and shelter. It is aimed at mitigating social economic shocks and other negative effects such as, poverty and the HIV and AIDS pandemic.

[10] The **Women Empowerment Programme** offers women technical, financial and material empowerment to promote their participation in economic and social development.

represent the informal sector such as the marketeer's association, door to door registration and utilization of the Zambia Integrated Social Protection Information System for vulnerable households. Also, informal sector players may be required to be National Health Insurance Management Authority (NHIMA) compliant to participate in Government programmes such as FISP or Food Security Pack (FSP).

Public Investment Management Strategy

70. In line with the Public Investment Management Strategy, the multisectoral public investment board will scrutinize investment proposals prior to inclusion in the budget. All projects will be required to undergo project appraisal, including cost effectiveness reviews. This will inform costs to be included in the budget and inform prioritization criteria. Further, MPSAs will be required to develop projects whose objectives, outputs and indicators are in line with National Development Plans, Sectoral plans, Provincial, District Development Plans and Cabinet directives. Projects that are not aligned with the aforementioned requirements will not receive necessary approvals for project development and implementation.

71. While capital projects will be budgeted within the approved budget ceilings by MPSAs, comprehensive criteria will be developed on the selection and prioritisation of projects to be included in the Budget. At implementation stage, and following a successful appraisal process, the Public Investment Planning Department (PIPD) in the Ministry of Finance and National Planning will oversee capital budget commitments and execution. All capital projects will be outlined in the Public Investment Plan for the country and a database of the projects will be maintained by the PIPD.

B. RESTORING DEBT SUSTAINABILITY AND IMPROVING DEBT MANAGEMENT AND TRANSPARENCY

72. Zambia's public debt is unsustainable, using both solvency and liquidity thresholds. To address this, Government is implementing various measures targeting both external and domestic debt which are discussed hereunder.

73. Government will implement the following external debt measures:

i. **Non-contracting of non-concessional debt** (continuous performance criterion, see Table 3): Cabinet in December 2019 directed that Government halts contraction of non-concessional public external debt. In keeping with this directive, no commercial facilities have been executed since 2020. Government will continue the implementation of this measure until public debt sustainability is restored. Further, Government is reviewing the contraction of concessional debt mostly from Multilateral creditors to manage the pace of external debt accumulation (indicative target on the present value of new external concessional borrowing);

ii. **Cancellation and rescoping of external debt financed projects** (IT ceiling on disbursements on contracted but undisbursed debt): In 2020, Government undertook an exercise to cancel and scale down some loan financed projects by $5 billion to reduce the stock of contracted but undisbursed loans. This exercise resulted into cancellation and re-scoping of loans amounting to $1.1 billion and $280 million, respectively. Government has continued to review its stock of contracted but undisbursed external commercial loans with a view to cancel an additional $2.1 billion during the 2022 fiscal year. The cancellation of $2.1 billion worth of undisbursed loans has advanced and will imply that implementation of the affected project will have to be financed through general budget revenues in a phased manner. As at end-December 2021, the stock of contracted but undisbursed external debt stood at $4.02 billion. The ongoing review also indicates that the halting of disbursements by non-multilateral creditors following accumulation of debt service arrears, has resulted in unpaid IPCs of around $563 million[11] as at end January 2022. Having concluded the engagements with the contractors on the cancellation, rescoping and postponement of projects works, Government has published the list of loan financed projects whose implementation is intended to continue (prior action, see Table 1).

iii. **Asset Liability Management exercise:** Government has been working with financial and legal advisors since July 2020 to carry out an Asset Liability Management exercise which will culminate into restructuring of the country's debt in order to restore debt sustainability. Zambia is utilizing the G20 Common Framework for debt treatments beyond the DSSI, as it provides traction in the debt restructuring effort. The country made the application to the Common Framework in January 2021 and the Official Creditor Committee started considering the debt restructuring exercise for Zambia on 16th June 2022. Prior to the framework coming into effect, Zambia had made use of the Debt Service Suspension Initiative (DSSI) to obtain debt suspension from various creditors. In view of the liquidity challenges, coupled with the need to ensure inter-creditor equity, Government has continued to implement a debt service standstill for creditors that did not grant Zambia DSSI with the exception of multilaterals and a few creditors financing priority projects of high economic and social importance. Government has continued to engage private creditors on formation of creditor groupings for the purpose of expedited negotiations during the debt restructuring process. We are committed to finalizing the MOU with official creditors by the time of the first program review, and reaching agreements on comparable terms with other creditors soon after, by the time of the second review at the latest.

iv. **External arrears to contractors** (continuous ceiling on the accumulation of new external debt arrears, see Table 3). To address the arrears amounting to $563 million to contractors for works done on non-disbursing loans, Government will clear the arrears over a ten-year period through budgetary allocations. Fuel arrears which amounted to $597 million as at end-December 2021 will also be cleared over the same period through budgetary allocations, subject to the outcome of the planned audit; and

[11] This is a preliminary position from most of the projects reviewed so far as the actual figure is expected to be higher than $563 million after reviewing all the projects.

v. **Achievement of higher economic growth.** This will improve the country's revenue mobilisation and debt carrying capacity.

74. To enhance external debt management and transparency, Government will develop a Medium-Term Debt Management Strategy covering the period 2023-2025, subject to finalization of the debt restructuring exercise, and an Annual Borrowing Plan for 2023 by end-December 2022. In addition, Government has on a regular basis, been undertaking debt data validation and reconciliation activities through engagements with its creditors in a transparent and highly collaborative process, and provided to the IMF detailed information on all external debt contracted or guaranteed by the public sector, for both disbursed and undisbursed debt (prior action, see Table 1). Government has also on a regular basis published debt information in its semiannual and annual economic reports. Government will also continue to publish on a quarterly basis, a Debt Statistical Bulletin to cover external and domestic debt including loans contracted, new disbursements, information on guaranteed loans and any liabilities arising out of public private partnerships (structural benchmarks, see Table 2). Further, Government intends to expand coverage of the bulletin to include non-guaranteed State-Owned Enterprises (SOEs) debt among others.

75. Revision of the Loans and Guarantees Legislation: To enhance transparency in debt management, including loan contraction and provide a framework for evaluation, issuance and monitoring of public guarantees, the Ministry of Finance and National Planning will submit the Loans and Guarantees, Grants (Authorisation) Bill to Parliament to repeal the current Loans and Guarantees (Authorisation) Act. The new law is expected to be enacted by the end-September 2022 (structural benchmark, see Table 2). The revision of the law is due to the need to align it to the Constitution which requires Parliamentary oversight on loan contraction. Further, it aims at addressing the weaknesses in the current Act such as the definition of public debt, reporting requirements and adherence to international best practice in public debt management. The regulations of the Act will ensure strong oversight, recording and monitoring of all contracted debt and guarantees.

76. Regarding domestic debt sustainability, Government will ensure that the issuance of Government securities will be primarily from the market, i.e. issuance of treasury bills and bonds through the auction. In addition, the issuance programme will focus on longer dated instruments taking into account market conditions and costs, in order to reduce refinancing risk. The target is to attain a debt stock ratio of treasury bills to Government bonds of 40 percent to 60 percent over the medium term i.e., treasury bills will be limited to 40 percent of the domestic debt stock. Further, raising funds domestically will avoid increasing the use of instruments that are of foreign currency denomination. Government is cognizant of the adverse impact of exchange rate volatility on domestic debt denominated in foreign currency maturities.

77. Government commenced talks with official creditors on 16th June, 2022. The request made to the official creditors is anchored on overcoming current debt challenges without jeopardizing the country's ability to rebound and fund its future development. Discussions with creditors are grounded on the following considerations: (i) A comprehensive debt treatment, encompassing both Government and SOEs debt, whether guaranteed or not, to achieve the objective of "moderate" risk rating of debt distress over the medium term; (ii) The exclusion of non-resident holdings of T-bills and bonds (classified by the IMF as external debt) as inclusion of these instruments within the perimeter would be a threat to financial stability, would raise multiple issues from practical, legal and fairness considerations (if limited to non-resident holders), and would trigger massive foreign exchange outflows and jeopardize the Government's ability to finance the budget; and (iii) The exclusion of short-term payables i.e. non-financial claims mostly due to suppliers of petroleum products and contractors; however appropriate repayment terms will be sought, recognizing the country's difficulties.

C. STRENGTHENING FISCAL CONTROLS AND GOVERNANCE

78. Entrenching medium term fiscal sustainability requires the successful implementation of public financial management reforms. Strengthening the Public Financial Management Framework (PFM) is a central pillar to restoring budget credibility, improving the efficiency of public expenditures, and supporting private sector led growth. The goals of the PFM are enhancing domestic resource mobilization; increasing the efficiency of public expenditure; halting the accumulation of arrears; and improving fiscal transparency. The following reforms will be undertaken in the medium term:

i. Enhancement of Domestic Revenue Mobilisation and service delivery by effective implementation of the Government Service Bus and Payment Gateway. A total of 82 services from Immigration Department, Zambia Police, Registrar of Societies, Patents and Companies Registration Agency, the Road Transport and Safety Agency and Ministry of Lands (ground rent) are already online. Substantial progress has been made in enabling more services provided by Government Ministries and Agencies to be provided online. The target is to bring online an additional 79 services by end-December 2022, and more services by 2023. The interface of various Government services will lead to interoperability of Government services and system-based controls, which will enhance tax compliance and the management of tax debt and other arrears;

ii. Implementation of the Planning and Budgeting Act. Key objectives of the law are to ensure that all key stakeholders are involved in the planning and budgeting process. All major projects are appraised before being included in the short and medium-term plans, including the annual budget;

iii. Continued enforcement of the provisions in the Public Finance Management Act and regulations to strengthen the sanction regime for financial mismanagement.

iv. Repeal and replacement of the Loans and Guarantees (Authorisation) Act to enhance Parliamentary oversight on loan contraction and issuance of guarantees. For defence and security contracts, Parliament will establish a standing committee to review these loans.

v. Enhancement of Commitment Control in IFMIS to facilitate the capture of expenditure arrears.

79. Budget Execution and Financial Reports. To enhance fiscal transparency, the Government will continue with the publication of Quarterly Economic Reviews, which also contain information on Budget performance. The financial report will continue to be published on an annual basis. The scope for the Budget Execution Report will be expanded to include performance on broad revenue and expenditure categories including social spending and its quality will be improved. Government will migrate to the International Public Sector Accounting Standards (IPSAS) Accrual Accounting Basis in 2024 based on the approved roadmap.

80. Fighting Corruption. The Zambian Government has a zero tolerance for corruption. To this effect, disciplinary action was taken in 2021 against erring officers at the Ministry of Health, who were involved in misappropriation of resources intended for the fight against the COVID-19 Pandemic, including at Controlling Officer level. The cases were also reported to law enforcement wings who have taken the cases to court. To entrench the fight against corruption, a committee headed by the Secretary to the Cabinet regularly meets to discuss audit queries of all affected MPAs. Where required, disciplinary action has been taken by the Secretary to the Treasury for erring officers. In addition, with the support of the IMF, a Comprehensive Governance Assessment is currently being undertaken and the initial diagnostic work will be completed and published by end-December 2022 (structural benchmark, see Table 2). The final report of the Assessment will be made public and will inform an action plan outlining future effort to strengthen governance and reduce corruption.

81. Fiscal risks. In light of slowing growth, tighter fiscal conditions, and growing debt burden, Government will closely monitor fiscal risks. To this end, Government is developing a fiscal risk management framework aimed at anticipating expenditure pressures and revenue shocks. This framework will be finalized by end-September 2022. The key elements that will be monitored include Local Authorities, PPPs, SOEs and climate/natural disasters.

82. Public Private Partnership. To leverage the Public Private Partnership (PPP) financing mode to finance developmental projects, while reducing the fiscal risks related to PPPs, Government will submit to Parliament by end-June 2023, amendments to the PPP Act (structural benchmark, see Table 2). The amendments will include provisions for the Minister of Finance and National Planning with the mandate to approve or reject PPP projects based on potential fiscal implications. The review of the law will also provide support for the delivery of cost effective, value for money, and sustainable infrastructure projects and service delivery as a means to stimulate economic recovery. In addition, Government will take a proactive stance in risk management of PPPs to avoid or minimize the incurring of contingent liabilities from PPP projects. This will be supported by the finalization, implementation of and adherence to the fiscal commitment and contingent liabilities guidelines.

83. SOEs. Government has been implementing various measures aimed at strengthening fiscal control and governance of State-Owned Enterprises (SOEs). These include enactment of the Public Finance Management Act No. 1 of 2018 and development of an SOE Policy. The Act gives the

Treasury mandate to develop the code of governance guidelines and a supervisory and performance monitoring framework for SOEs. Additionally, it requires SOEs to submit to the Treasury annual financial statements for analysis of performance. Further, Ministry of Finance and National Planning will be preparing periodic reports with an in-depth analysis on the health of SOEs. Where an SOE's performance is poor, the Act empowers the Treasury to take appropriate action. Government has also drafted an SOE Policy that is envisaged to strengthen governance of these institutions. Cabinet approval of the Policy will be done by end-September 2022.

84. **Further, the IDC has continued to put in place controls to ring-fence the Treasury from the operations of SOEs under its portfolio.** Measures instituted include limiting the contracting of debt financing by only permitting commitments for areas where a business case exists, and where debt is serviceable from incremental cash flows to be derived from the debt. In addition, IDC will roll out the Group Treasury Management Policy which provides a framework for prudent treasury management, efficient capital allocation and best practice reporting.

D. ENHANCING MONETARY POLICY

85. **The Bank of Zambia will continue to rely on the forward-looking monetary policy framework anchored on the Policy Rate as a key signal for the monetary policy stance.** Decisions on the policy rate will continue to be guided by inflation forecasts, outcomes, and identified risks that include those associated with financial stability and economic growth. The Bank will make effective use of open market operations, as well as enhance competition, transparency, and protection of consumers in financial markets. Overall, monetary policy will focus on bringing inflation back to the 6-8 percent target range by mid-2023. The unwinding of the accommodative monetary policy measures implemented in 2020 to mitigate the adverse effects of the pandemic will continue, as conditions allow and in the context of the overall review of credit quality and health of the financial sector.

86. **The Bank will continue to pursue measures aimed at deepening the secondary market for Government securities.** These measures include developing and implementing simplified registration of accounts and investing in Government securities. This is expected to contribute to wider participation by different categories of investors, particularly households. In this regard, the full rollout of the Bloomberg E- Bond platform for secondary trading which was envisaged by the end of the first quarter 2022 has been extended to the fourth quarter of 2022 to allow for the inclusion of all key market players. Effective implementation of the platform is expected to contribute to greater transparency in pricing and therefore improve secondary market liquidity for participants. In general, the broadening of investor participation, that results in improved price discovery, is expected to strengthen the interest rate channel of monetary policy transmission.

87. **The Bank will also introduce, on a pilot basis initially, a Credit Guarantee Fund (CGF) which will leverage private sector participation to support the provision of affordable credit to MSMEs.** Prior to the COVID-19 Pandemic, MSMEs already faced high information costs and credit risks (both real and perceived). This was exacerbated by the pandemic, with MSMEs bearing the burden of adjustment and were not the predominant beneficiaries under the TMTRF. The pilot will

take into account the need to encourage environmentally sustainable growth. It is anticipated that the initial amount of the CGF will be K3 billion, including administrative costs.

88. To ensure its operational independence and thereby enhance monetary policy credibility, the Bank has completed a review of the Bank of Zambia Act No. 43 of 1996. The bill has been submitted to Parliament (prior action). Two main issues emerged that precipitated the review of the Act. These are the enactment of the Constitutional (Amendment) Act No.2 of 2016 and the adoption of the SADC Central Bank Model Law by the Council of Ministers of Finance in 2009. Article 213(1) of the Constitution (Amendment) Act No. 2 of 2016 establishes the Bank of Zambia as the Central Bank of Zambia and Article 213 (5) provides for the operational independence of the Bank of Zambia. In this regard, the proposed amendments to the Bank of Zambia Act are based on three main principles: (1) operational, financial, and personal autonomy for the Central Bank as enshrined in the Constitution of the Republic of Zambia; (2) strengthening its mandate; (3) corporate governance in line with best practices; and (4) enhancing Central Bank transparency and accountability. The Bill has provided for the establishment of the Monetary Policy and Financial Stability Committees. The Monetary Policy Committee shall be responsible for the formulation of monetary policy while the Financial Stability Committee shall superintend over the formulation of macro-prudential policies aimed at achieving and maintaining financial stability. To enhance accountability and transparency, the Reports of the Committees will be published. The Bill was presented to Parliament and is pending Presidential assent.

89. The primary objective of the exchange rate policy is to maintain a flexible system whilst mitigating excessive volatility, which can undermine the achievement of the Bank's inflation objective. The Bank of Zambia is also committed to building international reserves to provide a level of confidence to the market that the country can meet its current and future external obligations. In this vein, the Bank of Zambia will step up monitoring of foreign exchange flows and, to help build up foreign exchange reserves, mining companies will continue to pay all tax obligations directly in U.S. dollars and through the Bank. The Bank will in addition continue with the gold purchase programme with a target of at least 783.8kg of refined gold for 2022. Further, the Bank will review foreign exchange market rules and policies, with a view to normalizing policies as market pressures continue to abate. The review will focus particularly in areas that support efficiency in price discovery, transparency in trading, and promotion of a well-functioning market.

E. SAFEGUARDING FINANCIAL STABILITY

90. To improve its surveillance capacity of the banking sector, given the challenging macroeconomic environment, which was worsened by the COVID-19 Pandemic, the Bank of Zambia has developed a Problem Bank Framework. The Framework was approved by the Board at its second quarter meeting held in May 2022.The key goals of this framework include: providing clear and consistent criteria for designating an institution as a problem institution; clearly defining the actions, both pre-emptive and after a problem has crystalized, to be taken in dealing with weak institutions; and minimizing the risk of economic and financial contagion and their potential fiscal risks. The Bank has also been working on enhancing off-site analysis to better align it to the risk-based supervision framework. As part of this process, the Bank has revised the templates and conducted a pilot of the enhanced returns. The launch of the new Returns is expected in quarter three 2022. In 2022, the Bank plans to conduct thematic examinations on asset quality, which will include restructured facilities due to the COVID-19 Pandemic. In addition, the examination will review the facilities granted under the TMTRF to validate whether the Financial Service Providers (FSPs) extended the credit on agreed terms and conditions and draw lessons for the future. The thematic on-site examinations commenced in April 2022 and are expected to be concluded by end-December 2022 (structural benchmark, see Table 2).

91. As part of its 2020-2023 Strategic Plan, the Bank of Zambia is working to strengthen micro-prudential regulation and supervision. In this regard, a micro-prudential stress testing framework has since been developed. The Framework will be used to assess the resilience of individual financial institutions and expected to be implemented by December 2022. Further, the Bank of Zambia has initiated a supervisory technology project to improve the analytical capabilities of staff and timeliness of analysis as well as data integrity by December 2023. To enhance cyber resilience, the Bank of Zambia has developed Cyber and Information Security Guidelines. The Bank has since completed the regulatory impact assessment. The process also benefited from IMF-AFRITAC South under the AFRITAC Cyber Security Technical Assistance. The Guidelines will be issued by the end of quarter three 2022.

92. The Bank of Zambia will undertake a review of the banking sector to prepare for the post-COVID-19 Pandemic period, including unwinding of the prudential measures taken. The review will assess the effectiveness of the banking sector in playing its key role of financial intermediation during the pandemic, as well as the impact of the COVID-19 Pandemic on the banks' capital and on systemic risks in general, and will incorporate the planned thematic examination of asset quality. The review will also include an assessment of the implications of increased digitalization of the economy and developments in the payment systems on bank competition and more broadly on financial sector development. The Bank of Zambia will unwind the prudential measures taken to address the COVID-19 pandemic in accordance with the timelines indicated when they were introduced and as financial conditions allow. These measures largely provided relief to FSPs on the impact of the COVID-19 pandemic on regulatory capital and all had specific termination dates. Some of the key measures included relief on: (i) IFRS impairment losses up to December 31, 2022; (ii) impairment losses on restructuring of existing credit facilities for bank funded facilities for one year up to March 31, 2021. However, in view of the evolution of the pandemic, this measure was not unwound and will be reviewed as part of the planned thematic examination in 2022; and (iii) impairment losses on restructuring of facilities granted under the TMTRF for the periods of the facility, which range from three years to five years.

93. As part of the safety net arrangements, the Bank of Zambia will implement a Deposit Protection Scheme through a dedicated unit to be established by end-September 2022. The unit will initially fall under the Bank Supervision Department with a view of establishing a fully-fledged separate department once it is ready to operate independently. The Bank of Zambia has developed directives to operationalize the Scheme. Further, a crisis management and resolution framework has been established, which will be fully operational once the governance arrangements have been finalized as provided for in the new Bank of Zambia Act.

94. The Bank of Zambia is also working to enhance its macro-prudential surveillance framework. A macro-prudential toolkit aimed at mitigating the buildup in excessive credit growth and leverage, maturity mismatches and market illiquidity, exposure concentration, and moral hazard, due to misaligned incentives has been developed. The identified macro-prudential tools will be operationalized within the 2020-23 strategic planning cycle. Further, regulations and guidelines for the use of countercyclical capital buffers and loan-to-value ratio as well as buffers to manage domestic systemically important banks will be developed in line with annual operational plans. The conduct of macro stress tests to ascertain the resilience of the system will continue.

95. The Bank of Zambia will establish and resource a dedicated AML/CFT/PF[12] supervision unit to address the deficiencies identified in the 2019 ESAAMLG[13] Mutual Evaluation, 2022 Enhanced Follow-Up Report, and Zambia's 2016 National Risk Assessment. In the interim, risk-based AML/CFT focused on on-site examinations are being conducted. The establishment of the dedicated AML/CFT/PF unit will support the BoZ's risk-based approach to AML/CFT/PF supervision and the effective application of sanctions, in particular for identified high-risk entities and customers including politically exposed persons.

F. ACHIEVING HIGHER AND MORE INCLUSIVE GROWTH

96. The goal of the Government's economic policies is to raise living standards, and reduce poverty and inequality by creating conditions for strong and inclusive growth. These objectives rest on economic transformation and job creation through implementation of interventions to enhance production and productivity in the agriculture, tourism, mining, manufacturing, energy and transport sectors. Improving the investment climate will be crucial in promoting productivity in these sectors.

97. Agriculture. The agricultural sector will continue to be a key driver of growth and job creation for the Zambian economy. The focus will be on addressing the challenges faced by the sector, which include low production and productivity, dependence on rain-fed farming, limited crop diversity, and restrictions on agriculture exports. The frequency and intensity of climate event has also adversely affected the sector.

98. To reduce dependence on rain fed agriculture and to promote all year-round production as well as responding to climate change events, Government will continue with irrigation infrastructure development at Chiansi in Kafue District, Mwomboshi in Chisamba, Musakashi in Mufulira and Lusitu in Chirundu. All these projects are at (or above) 80 percent completion, and will bring in excess of 3,000 hectares of land under irrigation, mainly for small scale

[12] Anti-Money Laundering/Counter Financing of Terrorism/Proliferation Financing.

[13] Eastern and Southern Africa Anti-Money Laundering Group.

farmers. To Increase area under cultivation and promote out-grower schemes, development of farm blocks will be prioritised beginning with Nansanga Farm Block[14] whose works are scheduled to begin by mid-2022. To improve productivity through mechanization, tax incentives have been provided in the 2022 Budget on selected agricultural equipment and accessories, such as manure spreaders, combined harvesters and commercial sprinkler irrigation systems. In the livestock sub-sector, Government will recruit extension officers, provide training in open grazing management and continue animal disease prevention and control programmes. In the fisheries sub-sector, strengthening monitoring and fisheries conservation efforts in the natural water bodies will be prioritized in the short to medium-term. Further, establishment of additional hatcheries and completion of other infrastructure such as aquaculture parks will compliment private sector efforts to increase fish production.

99. Tourism. In the Tourism sector, Government will develop other parts of the country by establishing the necessary infrastructure and regulatory framework that will make them attractive for the private sector to establish hotels, lodges and other tourism facilities. Strategic investments will be made in the Northern Tourism Circuit to fully exploit the tourism potential in the region. Development partners and other stakeholders have been engaged to undertake studies with a view to launching some tourism related projects in 2022.

100. Manufacturing. With enhanced support, manufacturing can contribute more to economic transformation and job creation. Government will support value addition to products from the agriculture, forestry and mining sectors. Government will reinvigorate the programme of Multi-Facility Economic Zones (MFEZs) and industrial parks. To ensure the success of the MFEZs, Government working with cooperating partners will undertake an assessment of the MFEZs so as to draw lessons from past implementation and programme design going forward. To reduce the cost of doing business, Government will rationalize the number of licenses and permits required to operate a business. Further, Government will take advantage of market opportunities presented by neighbouring countries such as the Democratic Republic of Congo (DRC) as well regional and continent-wide initiatives such as the Tripartite Free Trade Agreement and the Africa Common Free Trade Area (AfCFTA). Export duty on maize and maize products was lifted in November 2021, and exports have since commenced to the DRC.

101. Energy. Energy is a critical catalyst in restoring growth and achieving economic diversification. Therefore, implementation of reforms to improve efficiency and enhance the sector's support to growth will be undertaken. Key reforms to be undertaken include finalization and publication of the multi-year tariff adjustment framework by end-December 2022 (structural benchmark); implementation of revised tariffs with Independent Power Producers to give financial stability to ZESCO by end-December 2022; and development of regulations for open market access to give an opportunity for other off-takers other than ZESCO by end-December 2022. Further, Government intends to shift focus towards renewable energy sources such as solar and geo-thermal

[14] A farm block is a dedicated land under the control of the processor (anchor farmers), that achieves the goal of small holder inclusiveness in the supply chain.

and less dependence on fossil fuels. The Government's commitment under the country's Intended Nationally Determined Contribution (INDC) to the 2015 Agreement on climate change is to reduce emissions by 47 percent by 2030 using 2010 as the base year.

102. Mining. To ensure predictability and in turn create sustained investment in the sector, Government reviewed the mining tax policy framework with a view to introduce a more stable mining tax regime. The first step was reintroduction of the deductibility of mineral royalties for income tax purposes in 2022. In the medium-term, Government will amend the law so that mineral royalty determination reflects a measure of both incremental and aggregate norm values. This is aimed at attracting investment into the sector. Government will also implement strategies aimed at increasing production at mining companies where it owns a significant stake. To facilitate green field investments, geological mapping of the country will be intensified to cover the whole country from the current coverage of 70 percent over the medium term. Further, value addition will be enhanced by facilitating investments in processing and refining capacity for minerals by 2023. Stumbling blocks to these investments by the private sector, including mining companies are being addressed. Government will also dismantle the backlog of VAT Refunds to mining companies. Formalisation of the largely informal small mining sub-sector will be promoted through the establishment of cooperatives and trading centers in 2022.

103. Enhancing resilience to climate shocks. Climate change remains a significant threat to Zambia's sustainable development. To demonstrate Government's commitment towards climate resilience and low carbon development, a Ministry of Green Economy and Environment, dedicated to champion the development of a green economy and a sustainable environment has been created by the Government. The work of the ministry will involve mainstreaming climate change adaptation and mitigation across all policy and programme interventions to build the resilience and promote low carbon development of the economy. Government will also develop legislation on climate change to strengthen its response to this challenge. In addition, a National Climate Change Fund will be established to spearhead resource mobilisation. As a Party to the United Nations Framework Convention on Climate Change (UNFCCC), the Kyoto Protocol as well as the Paris Agreement, Zambia attended the COP26 in Glasgow, Scotland in November 2021, where the country committed to reduce emissions by 25 percent based on its domestic resources and the level of support it received in 2015, but indicated its willingness to reduce its emissions even further up to 47 percent with substantial support from advanced economies.

104. Human Development. Government will continue implementing policies and strategies aimed at enhancing human development. To this end, budgetary allocations were increased in education and health in the 2022 budget, including to support the increased hiring of teachers and health workers. Government has also extended the free education policy to include secondary schools and early childhood education other than primary school education in 2022.

105. Government has taken additional resources closer to the people through the Constituency Development Fund. These resources will be used for implementation of community-based projects, empowerment funds for youth and women as well as bursaries for secondary and skills training. Of the total of K4 billion allocated for the CDF in the 2022 National Budget, 60.1

percent of the resources have been targeted for community-based projects, 20.1 percent for empowerment programmes and 19.8 percent for secondary schools and skills training bursaries. Sector Ministries will continue to provide policy direction and expert advice in the implementation of CDF financed activities.

106. Girls and Women Empowerment. Government remains committed to girls and women empowerment. In this regard, the Girls' Education and Women's Empowerment and Livelihood (GEWEL) Project will continue to be implemented. The project will help keep more than 43,000 girls in school, while more than 129,000 women will be empowered. The GEWEL project will be complimented by financing for women empowerment programmes under the CDF.

107. Financial inclusion. Government's commitment to enhancing financial inclusion has been articulated in the National Financial Inclusion Strategy (2017- 2022). The key target of the Strategy is to increase overall financial inclusion (both formal and informal) from 59 to 80 percent and informal financial inclusion from 38 to 70 percent by 2022. To achieve this target, the Government in collaboration with the Bank of Zambia, financial sector regulators and international partners has undertaken the following measures:

i. Enacted legislation to enhance the provision of digital financial services, secured transactions using movable assets, data protection for borrowers and the regulation of credit reporting agencies;

ii. Migrated government-to-person and person-to-government payments to digital platforms;

iii. Implemented the National Financial Switch (NFS), which has resulted in enhanced interoperability of digital financial services; and

iv. Implemented a gender based supply-side financial inclusion data framework.

108. The 2020 FinScope Survey findings indicated that financial inclusion increased to 69.4 percent in 2020 from 59.3 percent in 2015. Consistent with this, formal financial inclusion rose to 61.3 percent in 2020 from 38.2 percent 2015. This growth was mainly attributed to policy interventions and reforms in the financial sector that led to increased uptake of mobile money services to 58.5 percent in 2020 from 14.0 percent in 2015.

109. In the medium term, Government is committed to improve access to affordable finance for farmers, agribusinesses, MSMEs and exporters of high value agricultural products. Financial inclusion interventions will also focus on increasing access to finance for the rural population, women and children primarily through the promotion of digital financial services. Interventions will also include enhancement of financial consumer protection and capability by strengthening the regulatory capacity of financial sector regulators and the establishment of an external dispute resolution mechanism (Financial Ombudsperson). The implementation of the financial inclusion objectives will continue to be coordinated through the NFIS Steering Committee chaired by the Ministry of Finance and National Planning.

IV. ECONOMIC STATISTICS

110. Government will continue strengthening data collection and estimation of key national economic statistics such as GDP and employment. The focus will be on, developing cost effective instruments and methods for the collection of data such as enhancement of online data collection. This is in line with the Second-Generation Strategy for the Development of Statistics (NSDS2). The strategy is sector inclusive and is one of the tools for the development of statistical systems in all sectors of the economy. Overtime, all Ministries, Provinces and other Agencies (MPAs) will be required to establish functional Statistics Units as well as Management Information Systems, with the view to strengthen sector capacities to produce statistics from administrative records.

111. The Census of Population and Housing will be undertaken in August 2022 to provide statistics on Zambia's population and housing stock. To update the national accounts, the Zambia Statistics Agency will rebase the national accounts to 2015, from the current estimates which use 2010 as the base year, by end 2024. Further, the Ministry of Finance and National Planning will continue with the timely publication of fiscal and debt statistics on its website. The Bank of Zambia will also continue with the publication of monetary and financial statistics.

112. The Bank of Zambia will strengthen the electronic Balance of Payments (e-BoP) monitoring system by extending its coverage to all BoP transactions and enhancing collaboration with other Government regulatory agencies. The Bank of Zambia has gradually improved the compilation of external sector statistics by strengthening the regulatory framework requiring the submission of statistics, conducting the private capital flows survey, and implementing the e-BoP monitoring system. This has enabled the publication of the BoP and International Investment Position (IIP) statistics on a regular basis. The e-BoP currently requires all authorized foreign exchange dealers (primarily commercial banks) to report foreign exchange receipts and payments of their clients. This is provided for under section 40A of the Bank of Zambia (Amendment) Act of 2013.[15] There will be no restrictions on the use of foreign exchange, outside existing restrictions relating to AML/CFT/PF obligations. However, significant gaps remain in the coverage of external sector statistics, particularly the estimates of balances held abroad by resident enterprises, and the capture of all export earnings and other current as well as financial account flows.

113. Gaps related to unidentified flows were identified in the compilation of balance of payments statistics; these are largely attributed to the accumulation of foreign assets by the private sector. To understand the nature of these flows, the Bank is conducting a detailed review of available data sources with the support of technical assistance (TA) from the IMF. The TA has examined existing mining sector statistics across various data sources, which include: the electronic balance of payments monitoring system (e-BoP); private capital flows (PCF) survey; financial

[15] This amendment incorporated detailed reporting requirements for Balance of Payments monitoring purposes, and was developed under the auspices of the SADC Balance of Payments monitoring committee.

statements; and customs data. In addition, the TA mission is supporting the preparation of flow of funds for selected companies. This work is expected to culminate in an in-depth understanding of the operations of the relevant sectors so as to comprehensively capture information on external sector flows.

114. To support these improvements, a technical team comprising the Bank of Zambia and ZRA has been established to facilitated information sharing and analysis. A detailed action plan to implement the recommendations will be developed and implemented by end-December 2022. The Bank of Zambia, Zambia Revenue Authority and the Ministry of Finance and National Planning will engage the corporate sector to improve the quality of its reporting as these measures are formulated and implemented.

V. PROGRAM MONITORING AND PHASING

115. Our programme is fully funded over the medium term. We have obtained financing commitments from our external partners—including firm assurances for the next 12 months and good prospects for the duration of the programme—to complement the financing provided by the restructuring of external debt. Over the medium term, we will continue to work with our partners to ensure we receive financing that will fully cover the financing gap for the remainder of the programme.

116. Progress in the implementation of the policies under this programme will be monitored through semi-annual reviews of the quantitative performance criteria, indicative targets, and structural benchmarks in the attached Tables 2 and 3. These are defined in the attached Technical Memorandum of Understanding (TMU), which also sets out the reporting requirements under the ECF arrangement. The first semi-annual review will be based on data and performance criteria at end-December 2022 and should take place on or after April 1, 2023. The second semi-annual review will be based on data and performance criteria at end-June 2023 and is expected to take place on or after October 1, 2023.

117. We will strengthen internal monitoring mechanisms to ensure strong programme implementation. The Ministry of Finance and National Planning will establish a Technical Committee that will be monitoring the programme and will be submitting monthly programme reports to the Minister.

118. As outlined in our Letter of Intent, we intend to use half of the IMF financing as budget support and the other half as a buffer to boost Zambia's international reserve position. In line with IMF safeguards policies, we will sign by end-August 2022 a Memorandum of Understanding between the Government and the Bank of Zambia clarifying our respective roles and responsibilities for servicing the associated financial obligations to the Fund.

Table 1. Zambia: Prior Actions

Measure	Status	Macroeconomic Rationale
1. Publish an updated MTEF revised in line with program objectives.	Completed.	Communicate a credible plan for fiscal adjustment.
2. Publish summary information on all procurement contracts related to the 2021 Farmer Input Support Program (FISP), including types of inputs the names of the companies awarded, and the contract amounts.	Completed.	Strengthen the transparency, governance, and efficiency of public spending.
3. Provide detailed information to Fund staff on all external debt contracted or guaranteed by the public sector, for both disbursed and undisbursed debt.	Completed.	Enhance debt transparency.
4. Publish a list of priority foreign-financed projects that the government intends to continue. Government to confirm to contractors on non-priority projects that any arrears incurred would be subject to restructuring. Government to confirm to IMF staff the list of priority and non-priority projects.	Completed.	Enhance debt transparency.
5. Submit to Parliament amendments to the Bank of Zambia Act, in line with IMF advice to safeguard the central bank's autonomy (operational and financial) and strengthen its governance.	Completed.	Strengthen the independence of the BoZ.
6. Restore the practice of adjusting the price of petroleum prices in line with the cost-plus pricing model, with the pricing cycle reduced from 60 to 30 days.	Completed	Contain fiscal risks and reduce inefficient fuel subsidies.
7. Publish the electricity sector cost-of-service study and government response.	To be completed.	Contain fiscal risks and enhance efficiency.
8. Publish a strategy for clearing expenditure and VAT refund arrears, including criteria for prioritization and timing of payments, and consistent with program parameters.	Completed.	Enhance fiscal controls.
9. Publish the implementing regulations for the new Public Procurement Act, reflecting feedback from WB and Fund experts.	Completed.	Enhance fiscal controls and reduce corruption risks.

Table 2. Zambia: Structural Benchmarks		
Measure	**Target Date**	**Macroeconomic Rationale**
A. Fiscal measures		
1. Reinstate VAT and excise taxes on fuel, adjusting fuel prices accordingly.	End-September 2022	Eliminate implicit fuel subsidies.
2. Publish the guidelines to implement the new comprehensive agricultural support program and ensure a full migration of FISP to an electronic agro-input system.	End-December 2022	Reduce the cost of FISP.
3. Adopt an action plan to boost revenue collections through changes in tax policy and improvements in revenue administration.	End-October 2022	Strengthen domestic revenue mobilization.
B. Public debt management and transparency		
4. Publish a quarterly debt statistics bulletin.	Quarterly (on an ongoing basis)	Improve debt management and transparency.
5. Publish summary information on the financing agreements for all newly contracted external loans by the general government, including new loan contracts guaranteed or new guarantees on existing loan contracts.	Quarterly (on an ongoing basis)	Improve debt management and transparency.
6. Enact a revised Loans and Guarantees Authorization Act.	End-September 2022	Improve debt management and transparency.
C. Public financial management		
7. Ensure that at least 59 ministries, provinces, and spending agencies (MPSAs) register all purchase orders and other financial commitments in the IFMIS.	End-June 2023	Strengthen fiscal governance, reduce corruption risks, and prevent the accumulation of arrears.
8. In consultation with Fund staff, submit to Parliament an amended PPP Act.	End-June 2023	Strengthen the management of fiscal risks related to PPPs.
D. Public enterprises		
9. Cabinet to endorse and publish a multi-year tariff framework and a related action plan to ensure cost-reflective and sustainable electricity tariffs, regulations for periodic tariff reviews, and medium-term policies for targeted tariff subsidies.	End-December 2022	Limit fiscal risks and ensure medium-term fiscal sustainability of the energy sector.

Table 2. Zambia: Structural Benchmarks		
Measure	**Target Date**	**Macroeconomic Rationale**
E. Governance		
10. Prepare, with IMF staff's support, and publish a comprehensive governance diagnostic, including specific recommendations and a time-bound action plan for implementing them.	End-December 2022	Identify and address governance weaknesses and corruption risks.
F. Financial stability		
11. Undertake a comprehensive review of the health of the banking sector, including to assess the impact of the COVID-19 pandemic on bank balance sheets.	End-December 2022	Strengthen financial stability.

Table 3. Zambia: Quantitative Performance Criteria and Indicative Targets for 2022–23

(Millions of kwacha; cumulative from the beginning of the calendar year; except where indicated)[1]

	September 2022		December 2022		March 2023		June 2023	
	Prog.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Act.
I. Quantitative Performance Criteria[2]								
1. Floor on the central government's primary balance (cash basis)	-5,296		-8,533		1,644		1,866	
2. Ceiling on new central bank credit to the central government[3]	0		0		0		0	
3. Floor on the net official international reserves of the Bank of Zambia (millions of US dollars)	2,169		2,225		2,244		2,403	
II. Continuous Performance Criteria								
4. Ceiling on new external debt arrears by central government, the Bank of Zambia, and ZESCO (millions of US dollars)[4]	0		0		0		0	
5. Ceiling on the contracting or guaranteeing of new non-concessional external debt by central government, the Bank of Zambia, and ZESCO (millions of US dollars)[5]	0		0		0		0	
III. Monetary Policy Consultation								
6. Average CPI inflation[6]								
Upper outer band	17.3		17.1		15.9		14.4	
Upper inner band	15.3		15.1		13.9		12.4	
Mid-point	13.3		13.1		11.9		10.4	
Lower inner band	9.3		8.5		8.2		8.0	
Lower outer band	7.2		6.3		6.0		6.0	
IV. Indicative Targets								
7. Floor on the fiscal revenues of central government excluding grants and mining revenues, adjusted by the backlog of VAT refunds	55,421		74,939		20,731		44,099	
8. Ceiling on the present value of new external borrowing (millions of US dollars)[7]	75.0		75.0		0.0		0.0	
9. Ceiling on the disbursement of contracted but undisbursed external debt to central government and ZESCO (millions of US dollars)[8]	205.0		205.0		200.0		200.0	
10. Floor on social spending by the central government	26,560		36,022		8,551		18,103	
11. Floor on the net clearance of arrears on expenditure and tax refunds	8,743		11,657		2,954		5,908	
V. Memorandum Items								
12. Expected public sector disbursements into the Treasury Single Account at the Bank of Zambia (millions of US dollars)	274		547		71		141	

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

[1] All definitions and adjustors are available in the Technical Memorandum of Understanding (TMU).

[2] Indicative targets for March and September.

[3] Without prejudice to the relevant provisions in the BoZ Act.

[4] Cumulative from the date of program approval.

[5] The ceiling is defined on a currency basis and will exclude non-resident holdings of local currency debt.

[6] As inflation is currently outside the top of the authorities 6-8 percent policy band, asymmetric bands have been set to allow for a faster deceleration than anticipated wihtout triggering the consultation clause. It is expected that the bands will become symmetric once inflation is close to or within the formal policy band.

[7] Excludes borrowing from the IMF, IDA, and the AfDB.

[8] Excludes disbursements from IDA and the AfDB.

Attachment II. Technical Memorandum of Understanding

1. **This Technical Memorandum of Understanding (TMU) defines the indicators used to monitor the program, and reflects the understandings between the Zambian authorities and the IMF.** The TMU also defines the associated reporting requirements.

2. **The exchange rates for the purposes of the program are specified in Table 1 below.**

Table 1. Zambia: Program Exchange Rates
(Rates as of May 31, 2022)

Currency	Zambian Kwacha per currency unit	Currency units per US Dollar
US Dollar	17.28	1.00
GB Pound	21.71	0.80
Euro	18.46	0.94
Rand	1.10	15.67
SDR	23.32	0.74

Source: Bank of Zambia.

3. **For the purposes of the program, the central government of Zambia corresponds to the budgetary central government encompassing the activities of the national executive, legislative, and judiciary branches covered by the national budget.** Specifically, it includes Parliament, the Office of the President, the national judiciary, all ministries, departments, agencies, constitutional commissions, and independent offices. See Annex Table 1.

4. **The fiscal year starts on January 1 and ends on December 31.**

Quantitative Performance Criteria

A. Floor on the Central Government's Primary Balance (Cash Basis)

Definition

5. **The floor on the primary balance of the central government will be measured from the financing side ("below the line") at current exchange rates and on a cash basis.** Data on net domestic financing (NDF) will be reconciled between the Ministry of Finance and National Planning (MoFNP) and the Bank of Zambia (BoZ). The primary fiscal balance is calculated as the difference between government primary revenue and primary expenditure. Government primary revenue includes all tax and non-tax receipts, including external grants but excluding all interest revenue. Primary expenditure consists of current plus capital expenditure, excluding all interest payments.

Reporting

6. Data will be provided to the Fund, using current exchange rates, with a lag of no more than 60 days after the test date for December test dates. For all other test dates, data should be provided with a lag of no more than 30 days after the test date.

B. Ceiling on New Central Bank Credit to the Central Government

7. New central bank credit to the central government is defined as the change in the total stock of outstanding loans and advances by the BoZ to the central government. It excludes:

- purchases by the BoZ of debt securities issued by the Government in the open market for purposes of implementing monetary and financial stability policies;
- on-lending of IMF credit; and
- interest accrued on the stock of outstanding loans and advances by the BoZ to the Government, its institutions, agencies, statutory bodies, and local authorities.

Reporting

8. The data for new central bank credit to the central government will be reconciled with the monthly monetary survey and submitted within 25 business days of the end of the month.

9. Data submissions should include a breakdown of outstanding loans and advances, as well as outstanding amounts of other central bank claims on the government, including debt securities and on-lending of IMF credit.

C. Floor on the Net Official International Reserves of the Bank of Zambia

Definition

10. The net official international reserves (NIR) of the BoZ will be calculated as the difference between its gross international reserves and official reserve liabilities.

11. Gross international reserves consist of:

- monetary gold;
- foreign currency;
- unencumbered foreign-currency deposits at non-resident banks;
- foreign securities and deposits; and

- SDR holdings and Zambia's reserve position with the IMF.

12. Gross international reserves exclude:

- non-convertible currencies, except for operational balances in Rand with the South African Reserve Bank;
- any encumbered reserve assets including but not limited to reserve assets pledged, swapped (maturing in less than one year), or used as collateral or guarantee for third-party external liabilities;
- reserve requirements on other depository corporations' foreign currency deposits;
- any foreign assets not readily available to or not controlled by the BoZ; and
- any foreign currency claims on Zambian residents.

13. Foreign liabilities are defined as short-term (one year or less in original maturity) liabilities of the BoZ to non-residents, plus any outstanding use of IMF credit. Short-term liabilities exclude liabilities with an asset counterpart that is encumbered (excluded from the asset side as well).

14. All values not in U.S. dollars are to be converted to U.S. dollars using the program exchange rates defined in paragraph 2 above.

Reporting

15. Daily data on net international reserves, including their components, will be reported by the BoZ on a weekly basis, within 15 business days from the end of each week.

Adjustor

16. If the amount of public sector disbursements expected to be channeled through the Treasury Single Account (TSA) at the BoZ falls short of the programmed amount (e.g., due to disbursement delays), the NIR target will be adjusted downward by the amount of the shortfall.

Continuous Performance Criteria

D. Ceiling on New External Debt Arrears by Central Government, the Bank of Zambia, and ZESCO

Definition

17. The performance criterion on the non-accumulation of new external debt arrears is defined as a cumulative flow in gross terms starting from the date of program approval (August 31, 2022), and applies on a continuous basis. External debt arrears are defined here as debt service (principal and interest) that is overdue (taking into account any contractually agreed grace periods) on external debt contracted or guaranteed by the central government, the BoZ, and ZESCO with non-residents. This performance criterion does not cover arrears on debt subject to renegotiation or restructuring.

18. External debt is defined on a residency basis. The term "debt" has the meaning set forth in paragraph 8 of the Guidelines on Public Debt Conditionality in Fund Arrangements, adopted by Decision No. 16919-(20/103) of the Executive Board (October 28, 2020).

a) For the purpose of these guidelines, the term "debt" will be understood to mean a current (i.e., not contingent) liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time. These payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows:

- loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans, and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);

- suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until sometime after the date on which the goods are delivered or services are provided; and

- leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified periods of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of these guidelines, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair, or maintenance of the property.

b) Under the definition of debt set out above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

Reporting

19. Arrears will be monitored continuously by the MoFNP, including for ZESCO, and the BoZ. The MoFNP will immediately report to the IMF staff any new accumulation of external arrears; otherwise, data will be compiled jointly by the two institutions, and will be reported by the MoFNP on a quarterly basis, within 30 days from the end of each quarter.

E. Ceiling on the Contracting or Guaranteeing of New Non-Concessional External Debt by Central Government, the Bank of Zambia, and ZESCO

Definition

20. For the purpose of the ceiling, the newly contracted or guaranteed external debt by the central government, the BoZ and ZESCO with non-residents is concessional if it includes a grant element of no less than 35 percent. The grant element is the difference between the net present value (NPV) of debt and its nominal value and is expressed as a percentage of the nominal value of the debt. The NPV of debt at the time of its contracting is calculated by discounting the future stream of payments of debt service due. The discount rate used for this purpose is 5 percent. Loans provided by a private entity will not be considered concessional unless accompanied by a grant or grant element provided by a foreign official entity, such that both components constitute an integrated financing package with a combined grant element equal to at least 35 percent. External debt is defined as in paragraph 18 above.

21. For debts carrying a variable interest rate in the form of a benchmark interest rate plus a fixed spread, the PV of the debt would be calculated using a program reference rate plus the fixed spread (in basis points) specified in the debt contract. The program reference rate for the three-month U.S. Secured Overnight Financing Rate (SOFR) is 2.38 percent and will remain fixed for the duration of the program. The spread of three-month Euro EURIBOR over three-month USD SOFR is -150 basis points. The spread of three-month JPY Tokyo Interbank Offered Rate (TIBOR) over three-month USD SOFR is -250 basis points. The spread of three-month U.K. Sterling Overnight Index Average (SONIA) over three-month USD SOFR is -50 basis points. For interest rates on currencies other than Euro, JPY, and GBP, the spread over three-month USD SOFR is -50 basis points. Where the variable rate is linked to a benchmark interest rate other than the three-month U.S. SOFR, a spread reflecting the difference between the benchmark rate and the three-month U.S. SOFR (rounded to the nearest 50 basis points) will be added. Given the ongoing transition away from

LIBOR, once operationally feasible, this TMU can be updated to reflect the benchmark replacement for JPY LIBOR, the Tokyo Overnight Average Rate (TONAR).

22. This minimum grant element applies not only to debt as defined in Point 9 of the Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements (Decision No. 6230-(79/140), as subsequently amended, including by Executive Board Decision No. 14416-(09/91), effective December 1, 2009), but also to commitments contracted or guaranteed for which value has not been received.

23. New non-concessional external debt is defined as any form of new debt other than concessional debt as defined in paragraph 20 above, contracted or guaranteed by the central government, BoZ, and ZESCO with non-residents.

24. For the purpose of this performance criteria, the ceiling on contracting or guaranteeing of new non-concessional external debt by the central government, BoZ, and ZESCO excludes: (i) loans stemming from the restructuring or rescheduling of external debt; (ii) central government securities issued in domestic currency, placed in the domestic primary or secondary markets, and held by non-residents; (iii) debt contracted from IMF, World Bank and AfDB; iv) short-term trade credits for imports, incurred since the beginning of the calendar year; and v) central bank debt issuance for the purposes of monetary policy or reserves management and foreign exchange swaps for the purposes of monetary policy or reserves management.

25. For program purposes, a debt is considered to be contracted when all conditions for its entry into effect have been met in accordance with the terms of the contract and as provided in the national legislation. Contracting of credit lines (which can be drawn at any time and entered into effect) with no predetermined disbursement schedules or with multiple disbursements will be also considered as contracting of debt.

Reporting

26. For the purposes of this PC, which will be monitored continuously, the MoFNP will immediately report to the IMF staff details of any new external loans contracted or guarantees issued. Otherwise, detailed data on all new external debt (concessional and non-concessional) contracted or guaranteed by the central government, BoZ, and ZESCO will be provided by the MoFNP on a monthly basis, within 30 days from the end of each month. The information will include (i) amounts contracted or guaranteed; (ii) currencies; and (iii) terms and conditions, including interest rates, maturities, grace periods, payments per year, commissions and fees, and collaterals.

Monetary Policy Consultation Clause

27. **The consultation bands apply to the average rate of inflation in consumer prices as measured by the overall consumer price index (CPI) published by ZamStats.** If the observed quarterly average rate of CPI inflation (calculated as the average of the 3 monthly year-on-year inflation rates within a quarter) falls outside the outer bands for June and December test dates, the authorities will complete a consultation with the IMF Executive Board which would focus on: (i) the stance of monetary policy and whether the Fund-supported program remains on track; (ii) the reasons for program deviations, taking into account compensating factors; and (iii) proposed remedial actions if deemed necessary. When the consultation with the IMF Executive Board is triggered, access to Fund resources would be interrupted until the consultation takes place and the relevant program review is completed. If the observed quarterly average rate of CPI inflation falls outside the inner bands for each test date, the authorities will conduct discussions with Fund staff.

Indicative Targets

F. Floor on the Fiscal Revenues of the Central Government Excluding Grants and Mining Revenues, Adjusted by the Backlog of VAT Refunds

Definition

28. **The fiscal revenues of the central government include all tax and non-tax receipts, but exclude external grants as well as revenues from corporate income tax on the mining sector and the mineral royalty tax.** They will also be adjusted upward (downward) by the reduction (increase) in the backlog of VAT refunds (see paragraph 38 below).

Reporting

29. **Data on fiscal revenues (cash basis) will be provided to the IMF staff, using current exchange rates, with a lag of no more than 60 days after the test date for December test dates.** For all other test dates, data should be provided with a lag of no more than 30 days after the test date.

G. Ceiling on the Present Value of New External Borrowing

Definition

30. **This indicative target is a ceiling and applies to the present value of all new external debt contracted or guaranteed by the central government, the BoZ and ZESCO, including commitments contracted or guaranteed for which no value has been received.** External debt is defined as in paragraphs 18 above. The present value (PV) of new external debt is calculated by discounting the future stream of payments of debt service (principal and interest) due on this debt

on the basis of a discount rate of 5 percent and taking account of all aspects of the debt agreement including the maturity, grace period, payment schedule, upfront commissions, and management fees. In the case of loans for which the grant element is zero or less than zero, the PV is set at an amount equal to the nominal value of the debt.

31. For the purpose of this indicative target, the guarantee of a debt arises from any explicit legal obligation of the government to service a debt in the event of nonpayment by the debtor (involving payments in cash or kind).

32. For the purposes of this indicative target, the ceiling excludes: (i) loans stemming from the restructuring or rescheduling of external debt; (ii) central government securities issued in domestic currency, placed in the domestic primary or secondary markets, and held by non-residents; (iii) debt contracted from IMF, World Bank and AfDB; (iv) short-term trade credits for imports, incurred since the beginning of the calendar year.; and (v) central bank debt issuance and foreign exchange swaps for the purposes of monetary policy or reserves management.

Reporting

33. The authorities will inform the IMF staff of any planned external borrowing and the conditions on such borrowing before the loans are either contracted or guaranteed by the government and will consult with staff on any potential debt management operations.

H. Ceiling on the Disbursement of Contracted but Undisbursed External Debt to Central Government and ZESCO

Definition

34. This ceiling applies to the disbursement of contracted but undisbursed external debt to the central government and ZESCO, and of contracted but undisbursed government-guaranteed external debt to ZESCO. The ceiling is set based on data shared by the authorities with staff on projected disbursements of contracted but undisbursed external debt between 2022 and 2025, after taking into account the authorities' estimates for the cancelation and rescoping of contracted but undisbursed external loans and applies to this list. External debt is defined as in paragraph 18 above. Disbursements from IDA and AfDB will be excluded from this ceiling.

Reporting

35. Detailed data on disbursements of contracted but undisbursed external loans of the central government and contracted but undisbursed external loans of ZESCO (government-guaranteed or not) will be provided on a quarterly basis, within 30 days from the end of each quarter, including amounts, currencies, creditors, and project names.

I. Floor on Social Spending by the Central Government

Definition

36. Social spending is defined as central government expenditure on the Social Cash Transfer, Food Security Pack, Empowerment Fund (Women and Youth), the Public Welfare Assistance Scheme, Water and Sanitation, budget transfers to the Public Service Pensions Fund, the Health Sector, and the Education Sector. It is computed on a cash basis.

Reporting

37. Data will be provided to the IMF staff, using current exchange rates, with a lag of no more than 60 days after the test date for December test dates. For all other test dates, data should be provided with a lag of no more than 30 days after the test date.

J. Floor on the Net Clearance of Arrears on Expenditure and Tax Refunds by Central Government

Definition

38. Arrears on expenditure and tax refunds are defined as:

- For wages, salaries, and pension contributions: any payments outstanding after the agreed date for payment of staff and for payroll deductions to third parties.
- For goods & services and capital spending (including contractor payments): an arrear arises when the bill has been received and delivery verified, but payment has not been made within the normal period per standard GRZ policy (30 days), or as stated in the supplier's contract.
- For utilities: if unpaid for 30 days or more after receipt of invoice.
- For subscriptions and leases: amounts outstanding after the due date.
- For VAT refunds: overdue if unpaid one month after the claims were validated and approved for payment.

Reporting

39. Information regarding central government arrears on expenditure and tax refunds will be compiled through quarterly audits of the accounts of the ZRA and spending ministries and agencies, conducted by the Internal Audit Department of the MoFNP. The audits will be completed and data submitted within 90 days from the end of each quarter.

Structural Benchmarks

40. Publish the guidelines to implement the new comprehensive agricultural support program and ensure a full migration of FISP to an electronic agricultural input system. This structural benchmark will be met when the action plan is adopted by Cabinet and published. The action plan should include specific measures and a timeline for implementation.

41. Adopt an action plan to boost revenue collections through changes in tax policy and improvements in revenue administration. This structural benchmark will be met when the action plan is adopted by Cabinet and shared with Fund staff. The action plan should include specific measures, their revenue impact, and an implementation timeline which is in line with program objectives for domestic revenue mobilization.

42. Publish a quarterly debt statistics bulletin. The bulletin should contain comprehensive statistics by currency, residency of creditors, and debt instrument for general government debt (including guaranteed debt), the debt of non-financial public enterprises (including non-guaranteed external debt), and contracted but undisbursed debt. The bulletin should be published within 90 days of the end of each quarter.

43. Publish summary information on the financing agreements for all newly contracted external loans by the general government, including new loan contracts guaranteed or new guarantees on existing loan contracts. The summary information should include at a minimum amounts, beneficiary, use of proceeds, interest rate, maturity, grace period, and be published within 90 days of the end of each quarter.

44. Enact a revised Loans and Guarantees Authorization Act. The revised Act should establish, in line with Fund advice: i) a clear definition of public debt; ii) a comprehensive institutional scope and debt instruments coverage; iii) timely publication of the medium-term debt strategy, annual borrowing plan, and annual evaluation reports; iv) a robust framework for, managing government guarantees, and mitigating associated risks; v) well-defined institutional arrangements; and vi) a sound transparency and accountability framework.

45. Ensure that at least 59 ministries, provinces, and spending agencies (MPSAs) register all purchase orders and other financial commitments in the IFMIS. This structural benchmark will be met when all of the following conditions have been met: (i) MoFNP has regulations in place that require all commitments where government has a legal obligation to make expenditures at a future date (including contracts signed or purchase orders issued) to be entered into the IFMIS at the time when those commitments are made; (ii) the commitment module in the IFMIS is functional at 59 MPSAs or more; and (iii) those MPSAs are using the system to systematically enter all commitments as they are made. MoFNP will verify (iii) above through quarterly reviews, whereby total commitments, expenditures, and arrears will be compared to those registered in IFMIS.

46. In consultation with the IMF staff, submit to Parliament an amended PPP Act. The amended act should strengthen the framework for managing the fiscal risks related to PPPs, including by establishing a clear and comprehensive definition of PPP projects, providing the Minister of Finance and National Planning with the mandate to approve or reject PPP projects based on potential fiscal implications, and requiring public disclosure of key risks and fiscal implications of proposed PPP projects and awarded PPP contracts.

47. Cabinet to endorse and publish a multi-year tariff framework and a related action plan to ensure cost-reflective and sustainable electricity tariffs, regulations for periodic tariff reviews, and medium-term policies for targeted tariff subsidies. The package should include timelines for implementation and be based on the cost-of-service study and the integrated resource plan.

48. Undertake a comprehensive review of the health of the banking sector, including to assess the impact of the COVID-19 pandemic on bank balance sheets. This structural benchmark will be met when the BoZ completes a comprehensive internal review of the banking sector (including an action plan for the unwinding of the prudential measures taken to address the COVID-19 pandemic, as financial conditions allow) and an asset quality review as part of the planned resumption of on-site inspections of financial institutions.

Monitoring and Reporting Requirements

49. To facilitate the monitoring of the program, the information listed in Annex Table 2 below will be reported to the IMF staff within the timeframe indicated. These data will be provided electronically by email to AFRZMB@IMF.ORG.

Table 1. Administrative Units Comprising the Budgetary Central Government
Office of the President - State House
Office of the Vice President
National Assembly
Electoral Commission of Zambia
Civil Service Commission
Office of the Auditor General
Cabinet Office - Office of the President
Teaching Service Commission - Office of the President
Zambia Police Service Commission
Zambia Police Service
Office of the Public Protector
Ministry of Mines and Mineral Development
Ministry of Home Affairs and Internal Security
Drug Enforcement Commission
Ministry of Foreign Affairs and International Cooperation
Judiciary
Disaster Management and Mitigation Unit
Local Government Service Commission
Ministry of Information and Media
Public Service Management Division
Ministry of Local Government and Rural Development
Zambia Correctional Services
Ministry of Justice
Ministry of Commerce, Trade and Industry
Human Rights Commission
Ministry of Small and Medium Enterprise Development
Zambia Correctional Service Commission
Ministry of Finance and National Planning
Smart Zambia Institute
Ministry of Labor and Social Security
Ministry of Water Development and Sanitation
Ministry of Green Economy and Environment
Ministry of Infrastructure, Housing and Urban Development
Ministry of Energy
Ministry of Technology and Science
Ministry of Tourism
Ministry of Youth, Sport and Arts
Ministry of Defense
Zambia Security Intelligence Services - Office of the President
Ministry of Education
Ministry of Lands and Natural Resources
Ministry of Fisheries and Livestock
Anti-Corruption Commission
Muchinga Province
Ministry of Agriculture
Lusaka Province
Copperbelt Province
Central Province
Northern Province
Western Province
Eastern Province
Luapula Province
North-Western Province
Southern Province

Table 2: Reporting Requirements

Data Description	Data Freq.	Reporting Agency	Reporting Freq.	Reporting Date
Monetary and financial sector				
1. Reserve money and its components (NDA and NFA) at current and program exchange rates	D	BoZ	W	T15
2. Excess reserves	D	BoZ	M	T15
3. Overnight interbank rates	D	BoZ	W	T15
4. Treasury bill and BoZ bill auction results	W	BoZ	W	T15
5. Interest rates	M	BoZ	M	T15
6. Holdings of government and BoZ securities by maturity and type of investors (local commercial banks, non-banks, and foreigners)	M	BoZ	M	T15
7. Monetary survey (incl. the BoZ and ODC surveys)	M	BoZ	M	T15
8. Financial soundness indicators by bank	M	BoZ	M	T15
External sector				
9. Exchange rates	D	BoZ	W	T15
10. Gross international reserves and foreign exchange purchases and sales	D	BoZ	W	T15
11. BoZ FX cash flow	M	BoZ	M	T15
12. FX backlog	W	BoZ	M	T15
Fiscal				
13. Net domestic financing	D	BoZ	W	T7
14. Fiscal table including revenue, expenditure, and financing	M	MoFNP	M	T30
15. Social spending	Q	MoFNP	Q	T30
16. Stocks of arrears on expenditure, tax refunds, and domestic debt service	Q	MoFNP	Q	T90
Real sector				
17. Consumer price index and monthly statistical bulletin	M	ZamStats	M	T15
18. National accounts	BA	ZamStats	BA	Mar. 15 Sep. 15
External debt				
19. New external loans contracted or guaranteed by the central government, BoZ, and ZESCO, or any other agency on their behalf, with detailed information on the amounts, currencies, terms, conditions, and purposes.	Q	MoFNP	Q	T30
20. Disbursements of contracted but undisbursed external loans to the central government and contracted but undisbursed external loans to ZESCO (government-guaranteed or not)	M	MoFNP	Q	T30
Program monitoring				
21. Report on program performance	Q	MoFNP	Q	T90

D = Daily, W = Weekly, M = Monthly, Q = Quarterly, BA = Bi-annual, A = Annual; TX = X days after the date of the last observation

ZAMBIA

REQUEST FOR AN ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY—DEBT SUSTAINABILITY ANALYSIS

August 9, 2022

Approved By
Costas Christou (AFR) and Martin Cerisola (IMF) and Asad Alam and Marcello Estevão (IDA)

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

Zambia: Joint Bank-Fund Debt Sustainability Analysis	
Risk of external debt distress	*In debt distress*
Overall risk of debt distress	*In debt distress*
Granularity in the risk rating	*Unsustainable*
Application of judgment	*No*

Even before the COVID-19 pandemic, Zambia's debt burden indicators had deteriorated relative to the July 2019 DSA. The fiscal and external positions had worsened further, reflecting continued high public investment spending and a collapse in growth due to a drought, and the exchange rate had weakened. The impact of the COVID-19 pandemic exacerbated these fiscal and external imbalances in 2020—with the economy estimated to have contracted by 2¾ percent, the exchange rate depreciating by 50 percent y/y, and an unmet external financing need of 7¼ percent of GDP financed through the accumulation of arrears—further increasing debt vulnerabilities. These imbalances continued in 2021, with a further accumulation of arrears to reach 10 ½ percent of GDP. The authorities hired financial and legal advisors in mid-2020 to help devise a comprehensive debt restructuring strategy, and requested a temporary debt service standstill from all external creditors.[1] *Nonetheless, amidst severe liquidity shortages and burgeoning budget arrears, Zambia was unable to avoid the accumulation of arrears on external debt, culminating in a default on Eurobonds in November 2020. Absent deep debt*

[1] The Zambian government requested debt relief through the G20 Debt Service Suspension Initiative (DSSI), as well as a deferral of debt service payments from all official and commercial external creditors. In accordance with this, they signed an MOU with Paris Club creditors that extended through end-2021, and are treating all other external creditors comparably, with the exception of multilaterals and a few earmarked priority projects. Their solicitation of consent to Eurobond holders was rejected by bondholders on November 13, 2020.

restructuring and significant fiscal adjustment, Zambia's public debt is unsustainable. Under the baseline, all four external debt burden indicators would breach their indicative thresholds by large margins throughout the medium term.[2] *In light of these challenges, the Zambian government has requested a debt treatment under the G20 Common Framework (CF).*

Debt Coverage

1. The public debt definition used in this DSA covers central government direct and guaranteed debt (including expenditure arrears), the nonguaranteed external debt of a fiscally important state-owned enterprise (SOE), and the guaranteed and nonguaranteed domestic and external arrears of the same enterprise.

- This is a broader debt metric than the authorities' official debt definition which, as in many other developing economies, covers the central government direct and guaranteed debt only, as well as budget expenditure arrears. Using the authorities' definition, total public and publicly guaranteed (PPG) debt stood at $23.6 billion (150 percent of GDP) at end-2020 and is projected to stand at $32.1 billion (126 percent of GDP) at end-2021.

- The nonguaranteed external debt of the financially challenged state-owned utility company—ZESCO—is included in the debt perimeter for DSA purposes, given the significant fiscal risks posed by the company and in accordance with the LIC-DSF Guidance Note.[3] These contingent liabilities to the central government are expected to add $139 million (or 0.5 percent of GDP) to the external debt stock by end-2021.[4] Furthermore, given the mounting risks posed by ZESCO's outstanding payables to domestic and external independent power producers (IPPs), estimated at $1.56 billion at end-December 2021 (all FX-denominated), these are also included: $161 million owed to nonresident IPPs on the external side, and about $1.40 billion owed to resident IPPs on the domestic side. The authorities are taking steps to restore ZESCOs' financial viability over the medium term, including a commitment to gradually move to cost-reflective tariffs, ongoing efforts to renegotiate power purchase agreements, and steps to improve operational efficiencies and rationalize assets. As progress is made, the inclusion of the non-guaranteed debt in the DSA debt perimeter will be reassessed.

[2] Zambia's debt-carrying capacity is currently rated as low based on the composite indicator (CI). As a result, the external debt burden thresholds for Zambia are (i) 30 percent for the PV of debt-to-GDP ratio; (ii) 140 percent for the PV of debt-to-exports ratio; (iii) 10 percent for the debt service-to-exports ratio; and (iv) 14 percent for the debt service-to-revenue ratio.

[3] ZESCO and other SOEs' guaranteed debt has always been included in DSAs and is now also part of the authorities' officially published debt metric. ZESCO's contingent risks to the sovereign relate to its persistent and large cash deficits. See *Guidance Note on the Bank-Fund Debt Sustainability Framework for Low Income Countries*, 2018, https://www.imf.org/en/Publications/Policy-Papers/Issues/2018/02/14/pp122617guidance-note-on-lic-dsf.

[4] Given ZESCO's operating losses and large arrears position, no net income for the company is included in the DSA, with any positive net income in the medium term assumed to pay off IPP arrears.

- The authorities reported no other outstanding nonguaranteed external debt of nonfinancial SOEs that staff consider to pose a contingent fiscal risk warranting inclusion in the DSA.[5] However, an additional 10 percent of GDP has been added to the standard SOE shock in the contingent liability stress test to account for risks stemming from foreign currency-denominated domestic debt of SOEs, as well as potential risks arising from the acquisition of the Mopani mine by ZCCM-IH, a majority state-owned investment holding company.[6]

- The stock of arrears owed to fuel distributors and suppliers stood at $467 million at end-2020, and grew to $597 million by end-December 2021. These are owed to nonresident entities and are thus included as external debt in the DSA.

- As of end-December 2021, arrears amounting to $563 million had also accrued to external contractors for services delivered on foreign-financed capital investment projects where project implementation continued but financing dried up in light of the impending restructuring. These are included as external debt in the DSA.

- Central bank external debt (including outstanding Fund credit), together with the debt of social security funds guaranteed by the central government, are also included in the coverage. As of end-December 2021, this debt consists solely of an outstanding government guaranteed external loan to the Public Service Pension Fund of $52.7 million. Looking ahead, this will include the projected IMF disbursements to the central bank.

- The authorities plan to use the SDR allocation (approved by the IMF in August 2021) to finance the budget over 2022-24;[7] the current intention is to use 50 percent of the allocation in 2022 and 25 percent in each of 2023 and 2024. This is incorporated into the DSA in line with the staff guidance note and taking account of the fact that the allocation sits on the government balance sheet.[8]

- Local governments in Zambia currently do not have the capacity to borrow without the central government's guarantee.

- The authorities confirmed that no extrabudgetary funds currently exist with outstanding debt.

[5] The standard contingent liability shock also provides for the contingent risk arising from potential financial sector support.

[6] Sensitivity analysis conducted by staff at the time of Staff Level Agreement in December 2021 showed that the Mopani mine would be financially viable even if copper prices fell to $7,070 per metric ton and copper output only reached 86,000 metric tons. It would take ZCCM-IH until 2040 to repay the debt due to Glencore. However, the net cash flow would remain marginally positive after royalties and capital expenditure.

[7] Equivalent to about $1.3 billion.

[8] See Guidance Note for Fund Staff on the Treatment and Use of SDR Allocations, August 2021, https://www.imf.org/en/Publications/Policy-Papers/Issues/2021/08/19/Guidance-Note-for-Fund-Staff-on-the-Treatment-and-Use-of-SDR-Allocations-464319.

- Going forward, Zambia will continue to benefit from IMF capacity development support to improve debt management and gradually broaden the debt and fiscal coverage to fully include SOE debt.

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

	Subsectors of the public sector	Sub-sectors covered
1	Central government	X
2	State and local government	
3	Other elements in the general government	
4	o/w: Social security fund	X
5	o/w: Extra budgetary funds (EBFs)	
6	Guarantees (to other entities in the public and private sector, including to SOEs)	X
7	Central bank (borrowed on behalf of the government)	X
8	Non-guaranteed SOE debt	X

1	**The country's coverage of public debt**	The central government plus social security, central bank, government-guaranteed debt, non-guaranteed SOE debt			
		Default		**Used for the analysis**	**Reasons for deviations from the default settings**
2	Other elements of the general government not captured in 1.	0	percent of GDP	0.0	
3	SoE's debt (guaranteed and not guaranteed by the government) 1/	2	percent of GDP	12.0	ZCCM-IH purchase of Mopani from Glencore.
4	PPP	35	percent of PPP stock	1.4	
5	Financial market (the default value of 5 percent of GDP is the minimum value)	5	percent of GDP	5.0	
	Total (2+3+4+5) (in percent of GDP)			18.4	

1/ The default shock of 2% of GDP will be triggered for countries whose government-guaranteed debt is not fully captured under the country's public debt definition (1.). If it is already included in the government debt

2. **The DSA is conducted on a residency basis**. In line with the LIC-DSF Guidance Note, while recognizing the underlying measurement challenges, nonresident holdings of domestic-currency debt (as recorded by the authorities) are treated as external debt for the purpose of this DSA. The stock of such holdings at end-2020 was about 18 billion kwacha or $853 million (14 percent of outstanding domestic-currency government securities), equivalent to 5¼ percent of GDP. End-December 2021 data indicates this has grown to 54 billion kwacha or about $3.2 billion (28 percent of outstanding domestic-currency government securities) by end-2021.

Background

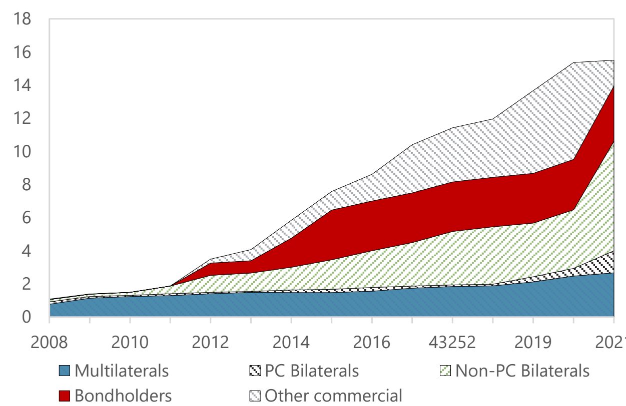
3. **Zambia's debt burden was already assessed as unsustainable in 2019, with the added pressure of the global COVID-19 crisis eventually triggering a sovereign default in 2020.** External central government and government guaranteed debt had already more than quadrupled relative to GDP over 2014-19, pushing total PPG debt from 23 percent of GDP at end-2014 to 105 percent by end-2019. This reflected several years of high public investment financed through nonconcessional external loans but which failed to deliver a meaningful growth dividend. The onset of the COVID-19 pandemic exacerbated the already precarious position, and spreads on Zambia's Eurobonds widened sharply from 1,650 basis points in mid-February 2020 to a peak of 4,250 basis points on April 1, 2020 amidst capital flight from EM and frontier markets. In mid-2020, the government appointed financial and legal advisors to help prepare a comprehensive debt restructuring strategy and requested a temporary debt service standstill from all external creditors. They subsequently signed a Memorandum of Understanding (MOU) for the G-20 DSSI with Paris Club creditors, and were able to reach agreement on DSSI terms with some other non-Paris Club official bilateral and commercial creditors. However, spreads started to rise again from end-September 2020 as discussions with the IMF on emergency financing fell through. By the time the Eurobond default occurred on November 14, 2020, following the rejection of Zambia's consent solicitation

to defer interest payments for six months, it had already been priced in, with spreads peaking at 3,899 at end-October.

4. In 2021, fiscal overruns and burgeoning budget and debt arrears are expected to result in public and publicly guaranteed debt climbing to an estimated $33.8 billion (or 133 percent of GDP) by year-end (Table 1).[9] External PPG debt reached $20 billion (78.6 percent of GDP) at end-2021 (or $16.8 billion or 66 percent of GDP excluding nonresident holdings of domestic-currency debt). The domestically issued local-currency PPG debt stock (including nonresident holdings) reached $11.6 billion (or 192 billion kwacha) or 45.5 percent of GDP at end-2021). Domestic budget arrears and ZESCO domestic IPP arrears represent an additional 21.4 percent of GDP (or 32 percent of domestic-currency debt).

5. The current creditor composition of external debt reflects a noteworthy shift away from traditional multilateral sources over time (Text Figure 1).[10] Multilateral and other IFIs, now represent only 16 percent of Zambia's FX-denominated external debt stock, while bilateral creditors represent 47 percent, of which non-Paris Club creditors comprise 39 percent. Of the remainder, Eurobonds represent 20 percent, while other commercial creditors account for 9 percent. Government guaranteed debt (mostly to Chinese commercial creditors) accounted for 9 percent of total FX-denominated external PPG at end-2021.[11]

Text Figure 1. Zambia: External FX-denominated PPG Debt—Creditor Landscape
($ billions)



Sources: Zambian authorities and IMF staff estimates.

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[9] For the purposes of this DSA, budget arrears are defined to cover both arrears due on VAT refunds plus expenditure arrears on payments, including on pension contributions and payments due to suppliers.

[10] Other accounts payables to external suppliers (budget and IPP external arrears) as well as non-guaranteed SOE external debt are not included in Text Figure 1 due to a lack of historical data.

[11] The figures in Text Figure 1 for 2021 include as official bilaterals also the commercial central government and guaranteed SOE external debt backed by guarantee from official export-credit agencies, as most of these loans were in arrears. Other commercial creditors include as well the guaranteed SOE debt not backed by a guarantee from official export-credit agencies.

Table 1. Zambia: Public and Publicly Guaranteed Debt Stock—Creditor Composition and Contracted Debt Service[1]

(as of end-2021)

	Debt stock (end of period) [2]						
	2021			2022	2023	2022	2023
	(In US$)	*(Percent total debt)*	*(Percent GDP)* [9]	*(In US$)*		*(Percent GDP)*	
Total	33,786	100.0	132.7	6,334	3,441	29.9	16.2
External foreign-currency debt	16,763	49.6	65.8	2,308	1,560	10.9	7.4
Multilateral creditors[3]	2,655	7.9	10.4	112	126	0.5	0.6
IMF	-	-	-				
World Bank	1,405	4.2	5.5				
ADB/AfDB/IADB	835	2.5	3.3				
Other Multilaterals	416	1.2	1.6				
o/w EIB	181	0.5	0.7				
o/w IFAD	144	0.4	0.6				
Bilateral creditors[4]	7,952	23.5	31.2	851	982	4.0	4.6
Paris Club	1,332	3.9	5.2	180	195	0.8	0.9
o/w: Israel	458	1.4	1.8				
o/w: UK	172	0.5	0.7				
Non-Paris Club	6,620	19.6	26.0	671	787	3.2	3.7
o/w: China	5,935	17.6	23.3				
o/w: India	326	1.0	1.3				
Eurobonds	3,280	9.7	12.9	987	197	4.7	0.9
Commercial creditors	1,555	4.6	6.1	356	255	1.7	1.2
Fuel arrears	597	1.8	2.3	n/a	n/a	n/a	n/a
Arrears to external contractors	563	1.7	2.2	n/a	n/a	n/a	n/a
ZESCO external IPP arrears	161	0.5	0.6	n/a	n/a	n/a	n/a
Domestic-currency debt	17,024	50.4	66.9	4,027	1,881	19	9
Held by residents, total	8,328	24.7	32.7	3,466	1,250	16.3	5.9
Held by non-residents, total	3,246	9.6	12.8	561	631	2.6	3.0
T-Bills	2,094	6.2	8.2	1,980	-	9.3	-
Bonds	9,481	28.1	37.2	2,046	1,881	9.7	8.9
Loans	0	-	-				
Domestic budget arrears and ZESCO domestic IPP arrears	5,449	16.1	21.4				
Memo items:							
Collateralized debt[5]	2,428	7.2	9.5				
o/w: Related							
o/w: Unrelated							
Contingent liabilities	n/a	n/a	n/a				
o/w: Public guarantees							
o/w: Other explicit contingent liabilities[6]							
SOE guaranteed external debt[7]	1,580		6.2				
SOE non-guaranteed external debt (ZESCO)[7]	139		0.5				
Total external PPG debt[8]	20,009		78.6				
Nominal GDP	21,203						

1/ Based on end-December 2021 data from the authorities and IMF staff estimates. It includes arrears on principal and interest. It does not include any penalty fees or interest on the arrears.

2/ Includes direct debt to central government, SOE guaranteed debt and non-guaranteed debt of ZESCO

3/ "Multilateral creditors" are simply institutions with more than one sovereign as a shareholder and may not necessarily align with creditor classification under other IMF policies (e.g. Lending Into Arrears).

4/ Includes loans to central government and loans backed by guarantee from an official export-credit agencies.

5/ Based on latest available data, as of end-December 2021, there was $2.4 billion of disbursed external foreign-currency debt with some form of security or escrow arrangement that could be considered as collateralized debt, including debt with a government guarantee or third-party (exporter) guarantee as security. All this debt is in arrears and, where the security or escrow provides for a claim on funds in a specific account, the authorities have reported zero balances in those accounts. Debt is collateralized when the creditor has rights over an asset or revenue stream that would allow it, if the borrower defaults on its payment obligations, to rely on the asset or revenue stream to secure repayment of the debt. Collateralization entails a borrower granting liens over specific existing assets or future receivables to a lender as security against repayment of the loan. Collateral is "unrelated" when it has no relationship to a project financed by the loan. An example would be borrowing to finance the budget deficit, collateralized by oil revenue receipts. See the joint IMF-World Bank note for the G20 "Collateralized Transactions: Key Considerations for Public Lenders and Borrowers" for a discussion of issues raised by collateral.

6/ Based on information received, there are no such contingent liabilities. Includes other-one off guarantees not included in publicly guaranteed debt (e.g. credit lines) and other explicit contingent liabilities not elsewhere classified (e.g. potential legal claims, payments resulting from PPP arrangements).

7/ Reflected in external foreign-currency public debt in this table.

debt and arrears.

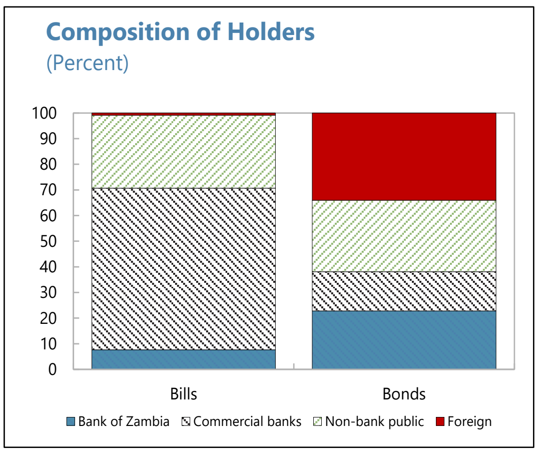
9/ The debt-to-GDP ratios are calculated from the value in national currency by converting outstanding debt in US dollars at eop exchange rate, and nominal GDP at average period exchange rate.

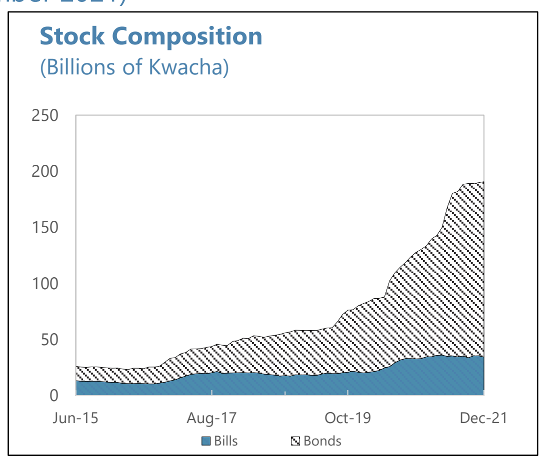
Sources: Zambian authorities and IMF staff calculations.

6. While market sentiment has improved and refinancing risks in the domestic debt market receded since the elections, liquidity pressures remain elevated. Spreads on Zambia's Eurobonds dropped sharply since the August 2021 elections but have started to increase since April 2022, standing at 3,541 basis points as of July 5, 2022, among the highest in EM and frontier markets. On the domestic side, tight financing conditions through 2019 to the first half of 2021, led to growing budgetary financing challenges and expenditure arrears (reaching 12.8 percent of GDP by the start of 2021), and, despite some support from liquidity injections from the Bank of Zambia,[12] forced the government to rely on short-term domestic debt at increasing interest rates, together with private placements, including to help clear some expenditure arrears. Since mid-2021, the situation has improved dramatically on account of multiple factors—higher copper prices, the SDR allocation, and post-election optimism—leading to a large influx of foreign investors in the local currency market, a marked appreciation of the kwacha against the US dollar (close to 30 percent since end-March) and a sharp drop in yields (400-800 basis points across the yield curve) (Text Figure 2).[13] Nonetheless, given sustained large gross financing needs over the period ahead and limited financing options given the need for a debt restructuring, financing risks remain elevated consistent with the DSF market-financing module (Figure 5).

Text Figure 2. Zambia: Profile of Central Government Domestically Issued Securities

(end–December 2021)





Sources: Zambia authorities and IMF staff estimates

[12] In 2020, the stock of Treasury bills rose to 33 billion Kwacha at end-December 2020, from 21 billion Kwacha at end-2019; private placements provided support amounting to 23.6 billion Kwacha; and the Bank of Zambia injected liquidity through an 18 billion Kwacha (5 percent of GDP) targeted medium-term refinancing facility to provide loans to SMEs, and a secondary market bond repurchase program. In 2021, the stock of Treasury bills stabilized at 34 billion Kwacha at end-December 2021.

[13] The total stock of local currency debt held by foreign investors increased from 18 billion kwacha at end-2020 (or 14 percent of the stock outstanding) to 45 billion (or about 25 percent of the stock outstanding) at end-June 2021, and further 51 billion (or about 34 percent of the stock outstanding) at end-December 2021. The average maturity of local currency debt securities held by non-resident investors was about 6.6 years.

7. Liquidity pressures stem in large part from large external debt payments. In 2020-2021, contracted FX-denominated external debt service (on PPG debt)[14] amounted to about $3.6 billion (from about $1 billion in 2018), larger than the level of FX reserves ($2.7 billion as of November 26, 2021). Given the authorities' resource constraints, this resulted in the accumulation of large external debt arrears, despite the debt service relief received under the G20-DSSI. On the current contracted terms, a similar amount of FX-denominated external debt service would fall due over 2022-23.

Macroeconomic and Debt Assumptions

The macroeconomic framework underpinning this DSA—staff's baseline scenario—is predicated on the Zambian authorities' commitment to undertake credible steps to restore medium-term debt sustainability, including scaling back the public investment program, and assumes a gradual economic recovery from the pandemic together with a significant, but feasible, fiscal adjustment starting from 2022.

8. The COVID-19 pandemic exacerbated fiscal and external imbalances that had already deteriorated since the July 2019 DSA. Before the COVID-19 pandemic hit, Zambia's fiscal and external positions had weakened further relative to the July 2019 DSA that assessed debt to be unsustainable, on account of continued high public investment spending, a collapse in growth due to drought, and a weaker exchange rate. Thus, it was clear even before the pandemic that, absent reform, Zambia's macroeconomic imbalances and financing constraints would eventually force a disorderly fiscal adjustment that would depress economic activity and confidence, potentially prompting large capital outflows and exchange rate pressures. In 2020, the socio-economic shock imposed by the COVID-19 pandemic exacerbated Zambia's imbalances, triggering some of these eventualities. Economic activity contracted by 2¾ percent, including due to a fall in external demand for mining and tourism. Export volumes collapsed; however, import compression and a positive terms of trade shock— after dipping to $5000 per metric ton (mt) in April 2020, copper prices rebounded to $8000 per mt by year-end—resulted in a current account registering a surplus of 12 percent of GDP. Nonetheless, the overall fiscal deficit of 17.4 percent of GDP (13.8 percent of GDP on a cash basis) and an unmet external financing need of the order of 7¼ percent of GDP resulted in the accumulation of sizeable external arrears. In parallel, the exchange rate depreciated by 50 percent year-on-year, pushing year-end inflation to 19.2 percent, and further compounding debt vulnerabilities.

Text Figure 3. Zambia: Copper Prices, May 2020–June 2022
(U.S. $ per metric ton)

Source: Bloomberg

[14] Including ZESCO's nonguaranteed debt.

9. While growth returned in 2021, underlying macroeconomic imbalances remained stark, with expenditure overruns ahead of the August elections financed through mounting expenditure arrears. The economy grew by 3.6 percent in 2021 on the back of strong agricultural growth and electricity production, and a rebound in wholesale and retail trade. On the external side, the current account surplus remained elevated at 7.6 percent of GDP as copper prices remain at record highs (peaking at $10,000 per mt in May, with a projected average of $9,225 over 2022-26), export volumes recover, and imports remain relatively compressed. Furthermore, since June, the SDR allocation and post-election optimism have helped improve market sentiment, attracting significant portfolio inflows, reversing the kwacha's fall against the U.S. dollar and easing inflationary pressures. Notwithstanding these positive developments, the overall fiscal deficit in 2021 reached 14.7 percent of GDP (8.5 percent of GDP on a cash basis) and the stock of budget arrears reached 15.9 percent of GDP at end-2021.

10. This DSA is based on the macroeconomic trajectory envisaged under the proposed Fund-supported program that involves a steady economic recovery from the pandemic and significant fiscal adjustment during 2022-25 (Text Table). The economy is projected to grow by about 3 percent in 2022. In the medium term, growth gradually picks up towards 4½ percent as the economy recovers fully from the pandemic, private sector activity picks up with the clearance of domestic budget arrears, and overall macroeconomic management improves. The current account surplus tapers to about 2.7 percent of GDP as private imports normalize; and inflation gradually converges to 7 percent. Text Table 3 shows a comparison of key macroeconomic variables under the program relative to the 2019 Article IV consultation.

11. Growth is expected to average around 4.5 percent over 2022-31 (Box 1). While this does imply a sustained 1.1 ppt increase relative to the average over the most recent ten years (3.4 percent),[15] it is a substantially lower level than that experienced in other periods. For instance, in the ten years following Zambia reaching the HIPC Decision Point (December 2000), which spanned the global financial crisis, it experienced average growth of 7.5 percent. However, given an expected medium-term loss of market access, including as a possible consequence of tighter global financial conditions going forward, Zambia is anticipated to face continuing financing constraints that will require it to maintain a relatively tight fiscal stance and limit the scope for public-sector-led growth.

[15] 2020 was the first recession since 1998 and so can be considered an outlier. As an alternative comparison, growth averaged 4.3 percent over the nine years of 2011-2019, and 4.9 percent over the ten years of 2010-2019.

Zambia: Macro and Debt Assumptions

	2020	2021	2022	2023	2024	2025	2026
	(Annual percentage change)						
Real GDP growth							
2019 Article IV	1.7	1.7	1.6	1.5	1.5	1.5	1.6
Program	-2.8	3.6	3.0	3.9	4.1	4.5	4.7
Inflation							
2019 Article IV	10.0	8.0	8.0	8.0	8.0	8.0	8.0
Program	15.7	20.5	13.0	9.6	7.7	7.2	7.0
GDP deflator							
2019 Article IV	9.7	8.2	8.3	8.0	7.7	7.4	7.2
Program	13.7	23.4	8.4	8.7	7.3	6.8	6.8
	(Percent of GDP)						
Primary deficit (on commitment basis)							
2019 Article IV	1.7	-1.8	-2.4	-2.9	-3.2	-3.6	-3.9
Program	10.1	6.0	-0.7	-2.2	-2.7	-3.2	-3.2
Non-interest current account balance							
2019 Article IV	-0.1	0.6	1.2	1.9	2.1	2.7	2.8
Program	16.8	11.3	5.2	4.4	6.4	6.8	6.9
Net FDI inflows							
2019 Article IV	2.9	3.7	4.4	4.4	4.4	4.4	4.4
Program	-1.1	0.0	4.0	4.0	4.9	5.0	5.1
	(Percent)						
Avg. nominal interest rate on external debt							
2019 Article IV	4.9	4.7	4.7	5.1	4.8	5.5	5.7
Program	4.2	3.0	4.3	4.3	4.3	4.4	4.5
	(Millions of dollars)						
Project loan disbursements (incl. guarantees)							
2019 Article IV	2224	1740	1251	1100	1103	1158	1216
Program	1424	522	468	445	363	265	200

Source: IMF staff projections.

12. **The fiscal adjustment envisaged under the program is significant but feasible.** The program's anchor will be the primary balance on a commitment basis.[16] To place public debt on a declining path, the primary balance is targeted to improve from a primary deficit of 6.0 percent of GDP in 2021 to a surplus of 3.2 percent of GDP by 2025 (a 9¼ percent improvement).

13. **Front-loaded expenditure rationalization focused on reducing poorly targeted and wasteful spending, supported by reforms to strengthen commitment controls and enhance fiscal governance, will contribute the majority of the consolidation effort**. A key element will be a sharp reduction in spending on fuel subsidies in 2022. In December 2021, the authorities removed explicit subsidies on petroleum products that overwhelmingly benefited the richest, reinstating the automatic pricing mechanism, with pump prices of petrol and diesel increasing by an initial 20 and 30 percent, respectively. The authorities have adjusted fuel prices every month since then, to prevent the re-emergence

[16] This will be monitored through a quantitative performance criterion on the primary balance on a cash basis, together with an indicative target on net arrears accumulation.

of explicit fuel subsidies. Reforms to the Farmer Input Support Program (FISP) announced in the 2022 budget are intended to reduce spending on these from nearly 3 percent of GDP in 2020-21 to around 1 percent of GDP by 2025—by changing the mode of delivery, while maintaining the number of beneficiaries and giving farmers more choice on what inputs they can purchase.

14. In parallel, the authorities plan to scale back their public investment program to focus on the highest priority projects. This will reduce poorly targeted and inefficient spending on public investment that has yielded little positive spillovers to growth in the past. As a consequence, the authorities expect new disbursements on contracted but undisbursed project loans of only $1.4 billion during 2022-25 (including $834 million from the World Bank and AfDB) relative to the underlying stock of contracted but undisbursed external debt, estimated at $3.9 billion at end-December 2021. Indeed, with the exception of multilateral institutions, almost all creditors have already halted new disbursements on this debt given the impending debt restructuring.

15. The fiscal consolidation will also be supported by domestic revenue mobilization efforts. Revenues (adjusted for arrears on VAT refunds) are projected to increase by about 3¼ percent of GDP by 2025, compared to their 2019 (pre-COVID) level of 19.6 percent of GDP. This will include the expected elimination of tax expenditures (implicit subsidies) on fuel worth about 1.6 percent of GDP by end-September 2022, together with other measures to broaden the tax base and strengthen compliance.

16. Although this fiscal adjustment is large, the negative impact on growth is expected to be minimal given the space created for the authorities to increase investment in human capital (health and education) and to also expand the social safety net. For instance, spending on social protection is projected to gradually increase to 1.6 percent of GDP by 2025, around the average for AFR countries, from 0.7 percent in 2020. This increased social spending will support domestic consumption and enhance growth prospects. In addition, the authorities' commitment to halt the accumulation of new budget arrears (including on VAT refunds), coupled with plans to begin clearing the existing stock of these arrears, should also improve private sector cash flow. At the same time, the reduced domestic financing requirements should also improve the private sector's access to finance and support private sector economic activity.

Box 1. Zambia: Drivers of GDP growth in the DSA baseline

The baseline growth trajectory reflects the government's planned and ongoing policy reforms with a focus on stimulating private sector-led growth, underpinned by macroeconomic stability, stronger fiscal management and supported by debt relief.

Short term (2021-22): 3.3 percent p.a. The rebound from initial COVID-19 shock and post-election market confidence pushed GDP growth through Q3 2021 to 4.0 percent year-on-year. Improved global copper prices and commissioning of a new 750MW power plant in Kafue are increasing industrial output and providing support to short-term growth.

Medium term (through 2025): 3.8 percent p.a. The business sector is projected to get a boost as their cashflows improve with the clearance of arrears (of 8.4 percent of GDP).

Box 1. Zambia: Drivers of GDP growth in the DSA baseline (concluded)

The revision of the Zambia Development Agency Act to improve market access and investor participation, along with other economic reforms, would encourage greater private investment.

A stable and predictable mining policy (including the recent change to make mineral royalty tax deductible) and high copper prices are projected to attract new FDI, boosting production and exports. Financial stabilization of the power utility (ZESCO) is expected to further spur industrial output, while improved productivity resulting from input subsidy reforms revives agriculture. Reforms supported via the proposed IMF ECF and World Bank-supported programs will help support macroeconomic stability.

Long term (through 2031): 4.4 percent p.a. Structural, fiscal, and institutional reforms are projected to build the foundation for sustained growth that is driven by a competitive private sector rather than debt-financed government spending. Removal of market distortions should bring financial sustainability to the energy sector (electricity and petroleum) and, the removal of agricultural export bans should support a more productive agriculture sector. The reorienting of expenditure away from inefficient subsidies and toward investments in education, health, and social protection will help build human capital. Decentralization of public services to the communities is anticipated to increase the efficiency of spending and aid reforms to increase budget credibility and fight corruption.

17. **Financing assumptions in the scenario are based on the most recent information, and guided by debt conditionality under the program; this DSA corresponds to a pre-restructuring scenario.** With respect to external financing during 2022-25, apart from disbursements of $1.4 billion on contracted but undisbursed priority project loans, pipeline loans amounting to about $175 million (from World Bank, AfDB, IFAD, and EIB) are included. New financing is also assumed starting in 2022 from the IMF and World Bank, which is conditional on the receipt of credible and specific financing assurances from official creditors and a credible process toward debt restructuring of private claims, and ultimately a successful debt restructuring. Taking account of the planned fiscal consolidation and identified financing, the baseline DSA assumes residual external financing gaps are effectively filled through the accumulation of further arrears.[17]

[17] Through the simulated issuance of a stylized "arrears bond".

18. Access to international capital markets is assumed to be lost through the medium term. Given the magnitude of debt relief required, and the fact that this will be a post-default rather than a preemptive restructuring, the probability of regaining meaningful access to international markets in the medium term would appear low, although this will largely depend on progress under the authorities' reform program. Access to the domestic market is assumed to remain intact under the baseline scenario, with net financing from the domestic market critical to fund government operations during the consolidation period; this is predicated on an assumption that this debt would be excluded from restructuring. Moreover, the recent improvement in domestic financing conditions is expected to be preserved given the assumed underlying reform progress. Given global financial conditions are likely to tighten, as advanced economies move to a less accommodative monetary policy stance, the participation of nonresident investors is anticipated to decline back to historical trends (absorbing about 15 percent of new issuance) going forward.[18]

19. Downside risks to the outlook are substantial. The DSA realism tools (Figure 3, 4) highlight the large size of the programmed fiscal adjustment relative to outcomes in other LIC programs, and the likelihood of a diminished growth contribution from public investment over the forecast period; however, the risk that the adjustment proves infeasible is mitigated by the specific plans already being implemented to cut wasteful expenditures, especially on subsidies, and the actual financing constraints on investment, while the latter concern is mitigated by the low efficiency of public investment in recent years, and the positive impact of higher, more efficient social spending and reducing the economic drag of arrears.

20. Uncertainty around the duration of the COVID-19 pandemic, and the outlook for copper prices, add to the risks. The emergence of new COVID-19 variants could prolong the pandemic and induce renewed economic disruptions, especially given the continued low rates of vaccination in Zambia. Copper prices are vulnerable to global economic demand and global copper supply developments, and could also decline relative to the baseline.[19] For reference, were copper prices to turn out 10 percent lower than projected over the program period (or about $930 lower per metric ton), fiscal revenues could be up to $1 billion lower and export receipts $3 billion lower in aggregate over program period, or about 1 percent and 3 percent of GDP a year on average. Rainfall variability remains a structural risk to Zambia's sustainable growth, affecting key sectors like agriculture and electricity and also likely to aggravate external vulnerabilities, although the authorities' reform agenda aims to mitigate these risks over time. The materialization of these risks could reverse the recent positive sentiment seen in domestic markets, and intensify already elevated financing pressures.

21. And risks surrounding the debt restructuring process itself are high. The diversity of Zambia's creditor base raises coordination challenges and could complicate and delay the process of securing support for the needed restructuring. The availability and quality of assumed domestic market financing could also come under pressure if restructuring negotiations are protracted and broader investor sentiment

[18] The average contribution of non-residents to net financing through the domestic debt market was 9 percent over 2015-2019 and 11 percent over 2015-2020.

[19] The baseline is based on futures market prices, which suggest prices will remain elevated, and are consistent with the assumptions under underpinning the July 2022 IMF World Economic Outlook.

deteriorates. Given domestic financial institutions' exposure to domestically-issued debt, financial stability risks would be aggravated were the assumed treatment of this debt to come under pressure. And, in addition to the direct impact on financial stability, that could trigger broader economic risks by weakening market and business confidence, impacting capital flows, reducing the private sector's access to finance, thereby dampening private sector activity and long-term investment.

22. **Upside risks also exist.** These stem mainly from a faster global and domestic recovery from the pandemic aided by widespread and efficient distribution of the vaccine, a successful debt operation, greater confidence effects, including from stronger and broader reform momentum, and higher copper production and prices.

Debt-Carrying Capacity

23. **Zambia's debt-carrying capacity under the Composite Indicator (CI) rating is assessed as weak.**[20] In the 2019 DSA, Zambia was already assessed as having weak debt-carrying capacity, with the low level of reserves playing a key role in the rating. Given the deterioration in outlook since then, exacerbated by the COVID-19 pandemic, the latest CI score of 2.59 remains below the cut-off for medium debt-carrying capacity of 2.69.[21] The assessment of weak debt-carrying capacity lowers the debt burden thresholds for Zambia.

CI score

Components	Coefficients (A)	10-year average values (B)	CI Score components (A*B) = (C)	Contribution of components
CPIA	0.385	3.163	1.22	47%
Real growth rate (in percent)	2.719	2.987	0.08	3%
Import coverage of reserves (in percent)	4.052	29.211	1.18	46%
Import coverage of reserves^2 (in percent)	-3.990	8.533	-0.34	-13%
Remittances (in percent)	2.022	1.537	0.03	1%
World economic growth (in percent)	13.520	3.050	0.41	16%
CI Score			2.59	100%
CI rating			Weak	

Source: IMF staff calculations based on LIC DSF.

External DSA Assessment

24. **Under the baseline, all four external debt burden indicators breach their prudent thresholds, mostly by large margins through the medium term and beyond (Figure 1).** The debt service-to-revenue ratio soars to a peak of 61 percent in 2022 given the redemption of Eurobond I and the relatively low revenue base, and remains well above the 14 percent threshold until 2034 (averaging about 37½

[20] The composite indicator is calculated using data from the April 2022 WEO and the latest available 2020 CPIA.

[21] The import coverage of reserves projections, which have an important contribution to the CI score (see text table) are likely to be overestimated due to data quality and likely some misclassification of items that should be recorded more accurately as imports rather than elsewhere in the financial account (e.g., the case of multinational companies, intragroup provision of services). Ongoing technical assistance engaged with the authorities will address this weakness in the balance of payments statistics over the program period.

percent in 2022-31). Similarly, the debt service-to-exports ratio peaks at around 27¾ percent in 2022 and only falls to the threshold of 10 percent in 2030 and breaches again in 2031 (averaging about 18 percent over 2022-31). On the stock side, the PV of PPG external debt-to-GDP averages about 62 percent from 2022-31, falling below the prudent threshold of 30 percent only in 2039,[22] while the PV of PPG external debt-to-exports indicator also breaches the 140 percent threshold through 2022-25 (averaging about 134 percent over 2022-31).

25. The thresholds for all four external debt indicators are breached by large margins under stress tests. The standardized exports shock is the most extreme for all external debt burden indicators except for the debt service-to-revenue, for which the one-time depreciation shock is most extreme. Under the standardized exports shock, the PV of PPG external debt-to-exports ratio peaks at 302 percent in 2024 and remains well above the threshold throughout the medium and long term.

Public DSA Assessment

Under the baseline, the prudent threshold of 35 percent for the PV of total PPG debt-to-GDP is breached throughout the medium and long term (Figure 2). After peaking at 125¼ percent in 2021, the ratio remains elevated at an average of about 93 percent from 2022-31, before finally falling below the threshold in 2039. The most extreme shock for this indicator is still the standardized export shock, which peaks at 129 percent in 2024. Similarly, the combined contingent liabilities shock, which accounts for risks from SOE debt, PPPs and the financial sector, peaks at 130 percent in 2023 and remains above the threshold throughout the long-term forecast horizon.

Conclusion and Sustainability Assessment

26. Zambia's is in debt distress. Even before the COVID-19 pandemic, the fiscal and external positions had weakened further relative to the July 2019 DSA, reflecting continued high public investment spending, a collapse in growth due to a drought, and a weaker exchange rate. The impact of the COVID-19 pandemic exacerbated these fiscal and external imbalances, further compounding debt vulnerabilities. In view of this, the authorities hired financial and legal advisors in mid-2020 to help devise a comprehensive restructuring strategy, and requested a temporary debt service standstill from all external creditors, including through a consent solicitation to Eurobond holders. Not all creditors agreed, and amidst severe liquidity shortages and burgeoning domestic payment arrears, the authorities were unable to avoid the accumulation of arrears on external debt, culminating in Zambia's default on Eurobonds on November 14, 2020.

27. Restoring debt sustainability will require a deep restructuring of public debt under the G20 CF, together with significant and sustained fiscal adjustment. This DSA is predicated on the Zambian authorities' commitment under their program to undertake credible steps to restore medium-term debt sustainability, and the baseline macroeconomic framework underpinning this DSA entails significant fiscal adjustment, including a scaling back of the public investment program, and incorporates projected new

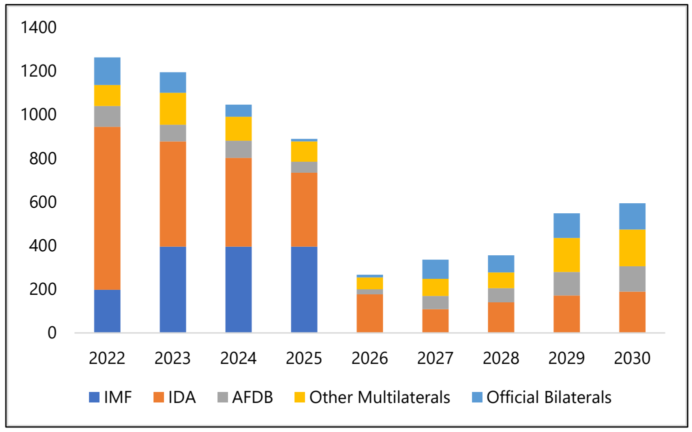
[22] Note the measurement of this indicator is complicated by the fact that the authorities are currently working on rebasing GDP; however, this work is not expected to be concluded until end-2023 at the earliest.

financing of around $2.6 billion from the IMF and World Bank together over 2022-25 (Text Figure 4).[23] Nevertheless, large financing gaps would remain over this period and would need to be filled through a debt restructuring operation.

28. A debt restructuring operation should provide sufficient relief to support a return to an assessment of a moderate risk of debt distress over the medium term. This will require addressing the large threshold breaches for the external debt service-to-revenue ratio, and ensuring that the PV of debt-to-exports ratio is brought substantially below its threshold after the program, both as a buffer against shocks, and to mitigate against the elevated PV of external debt-to-GDP ratio.[24]

Text Figure 4. Zambia: Projected Official Sector Gross External Financing Flows[1/]

(Gross, $ millions)



Sources: Zambian authorities, IMF and World Bank staff estimates.
1/ For 2022-25, this reflects projected disbursements on current committed project grants, together with requested IMF financing and new World Bank financing. For 2026 onwards, this reflects the broad official sector financing assumptions embedded in the DSA.

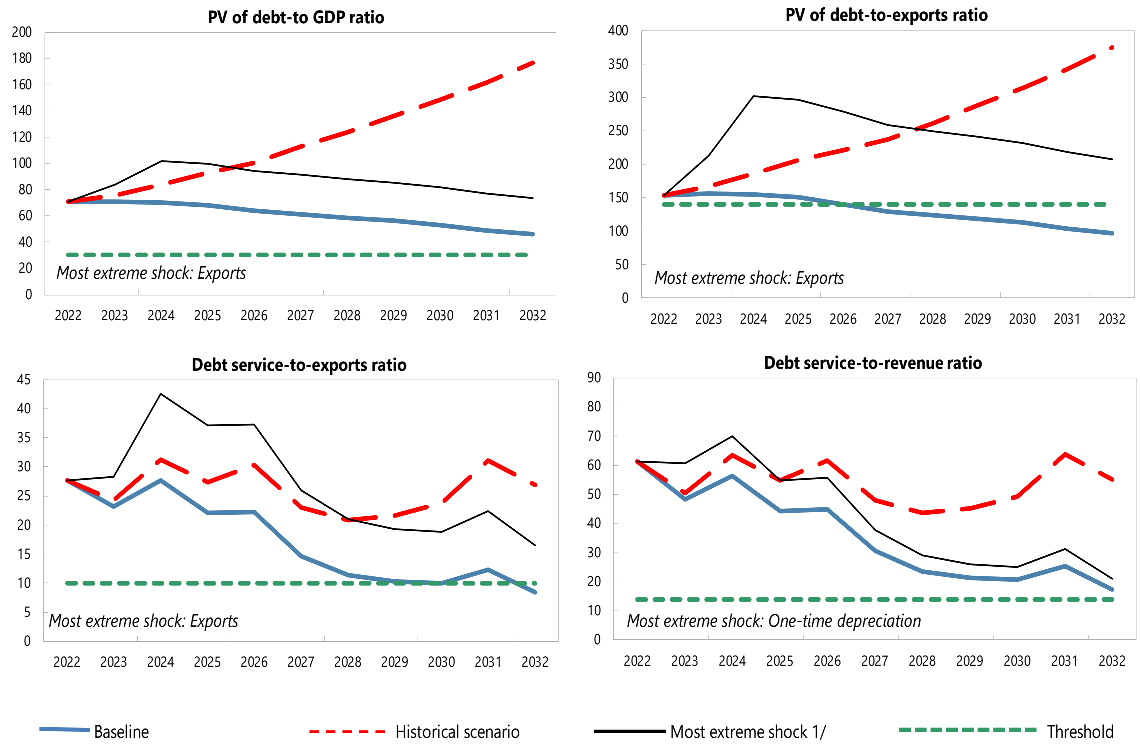
29. To support debt sustainability following debt restructuring, various reforms are in train. To strengthen the institutional framework, the authorities are revising the Loans and Guarantees Act to provide for greater oversight on the contracting of debt and to modernize the debt management framework. This will be supported by ongoing efforts to strengthen public financial management more broadly. At the operational level, debt sustainability will also be supported by the debt conditionality under the IMF program, which stipulates a zero ceiling on new nonconcessional external borrowing during the program period, as well as a ceiling on the PV of new concessional external borrowing.[25]

[23] Assumed financing from the World Bank in 2022 includes, among others, a Development Policy Operation of $275 million and emergency health sector financing of $150 million.

[24] Given the ongoing work on rebasing GDP, and associated GDP-measurement challenges, the PV of debt-to-exports ratio is treated as the main indicator for assessing the evolution of the debt stock.

[25] This conditionality excludes nonresident holdings of local currency debt as well as loans from the IMF, World Bank and AfDB.

Figure 1. Zambia: Indicators of Public and Publicly Guaranteed External Debt Under Alternatives Scenarios, 2022–32



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

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

Borrowing assumptions on additional financing needs resulting from the stress tests*		
	Default	User defined
Shares of marginal debt		
External PPG MLT debt	100%	
Terms of marginal debt		
Avg. nominal interest rate on new borrowing in USD	4.6%	6.6%
USD Discount rate	5.0%	5.0%
Avg. maturity (incl. grace period)	32	32
Avg. grace period	14	14

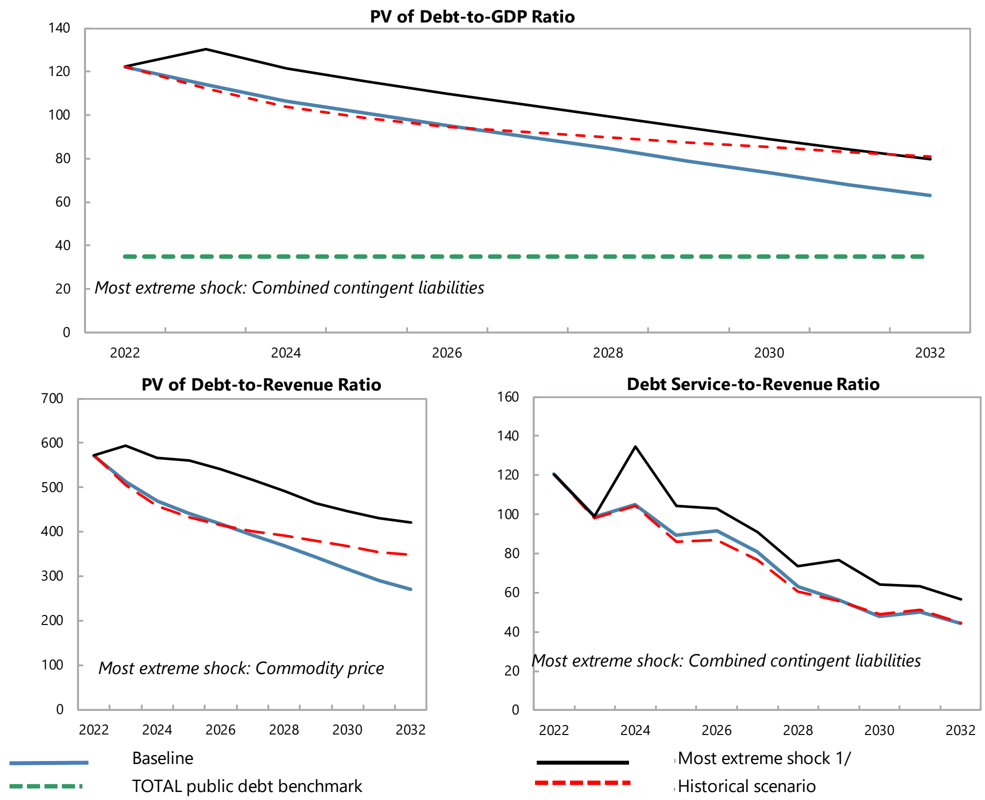
* Note: All the additional financing needs generated by the shocks under the stress tests are assumed to be covered by PPG external MLT debt in the external DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2032. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

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

Figure 2. Zambia: Indicators of Public Debt Under Alternative Scenarios, 2022–32



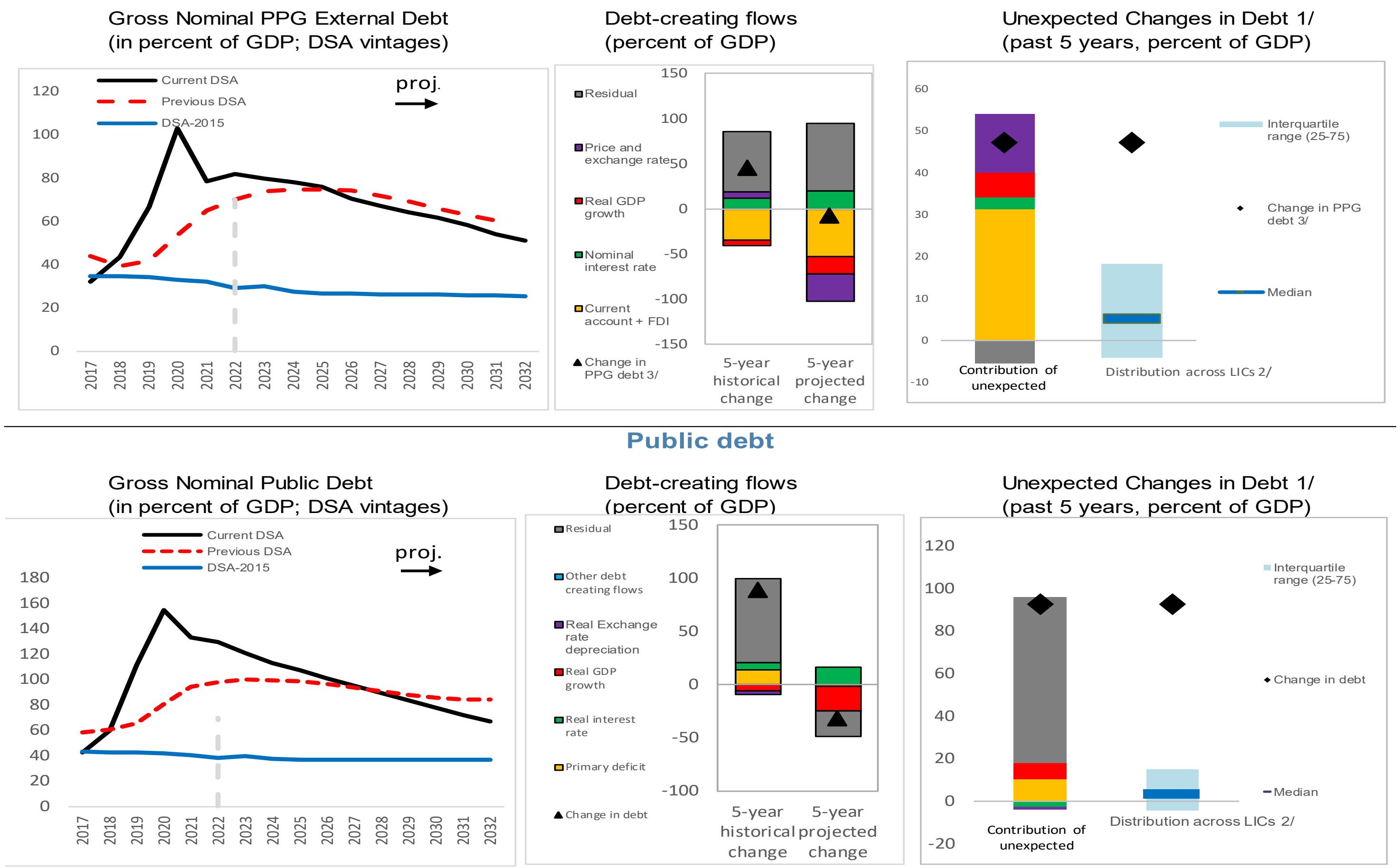
Borrowing assumptions on additional financing needs resulting from the stress tests*	Default	User defined
Shares of marginal debt		
External PPG medium and long-term	46%	46%
Domestic medium and long-term	24%	24%
Domestic short-term	30%	30%
Terms of marginal debt		
External MLT debt		
Avg. nominal interest rate on new borrowing in USD	4.6%	6.6%
Avg. maturity (incl. grace period)	32	32
Avg. grace period	14	14
Domestic MLT debt		
Avg. real interest rate on new borrowing	5.8%	5.8%
Avg. maturity (incl. grace period)	6	6
Avg. grace period	5	5
Domestic short-term debt		
Avg. real interest rate	1.8%	1.8%

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

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2032. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

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



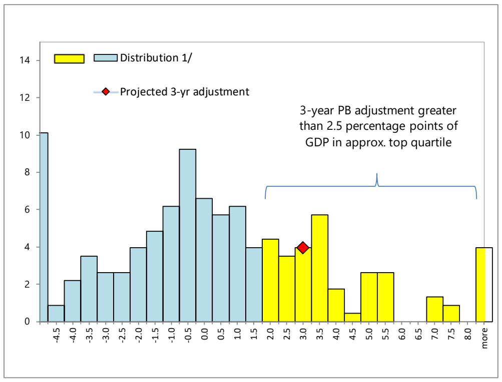
1/ Difference between anticipated and actual contributions on debt ratios.

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

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

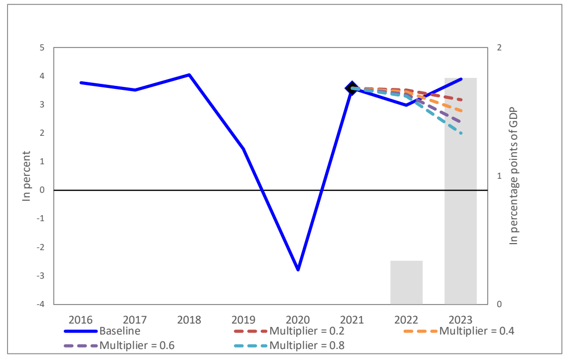
Figure 4. Zambia: Realism tools

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



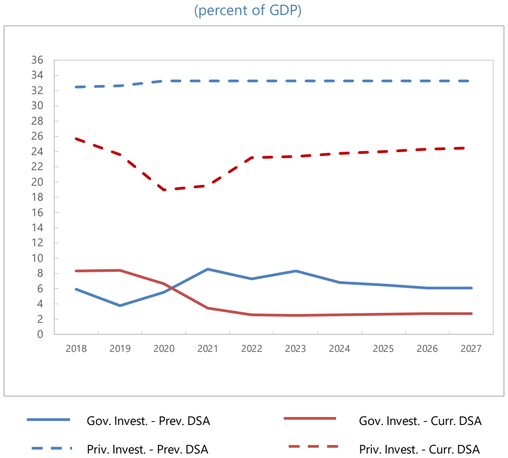
1/ Data cover Fund-supported programs for LICs (excluding emergency financing) approved since 1990. The size of 3-year adjustment from program inception is found on the horizontal axis; the percent of sample is found on the vertical axis.

Fiscal Adjustment and Possible Growth Paths 1/



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

Public and Private Investment Rates
(percent of GDP)



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

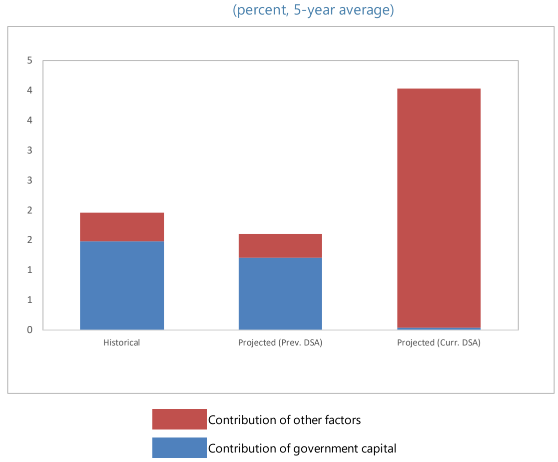
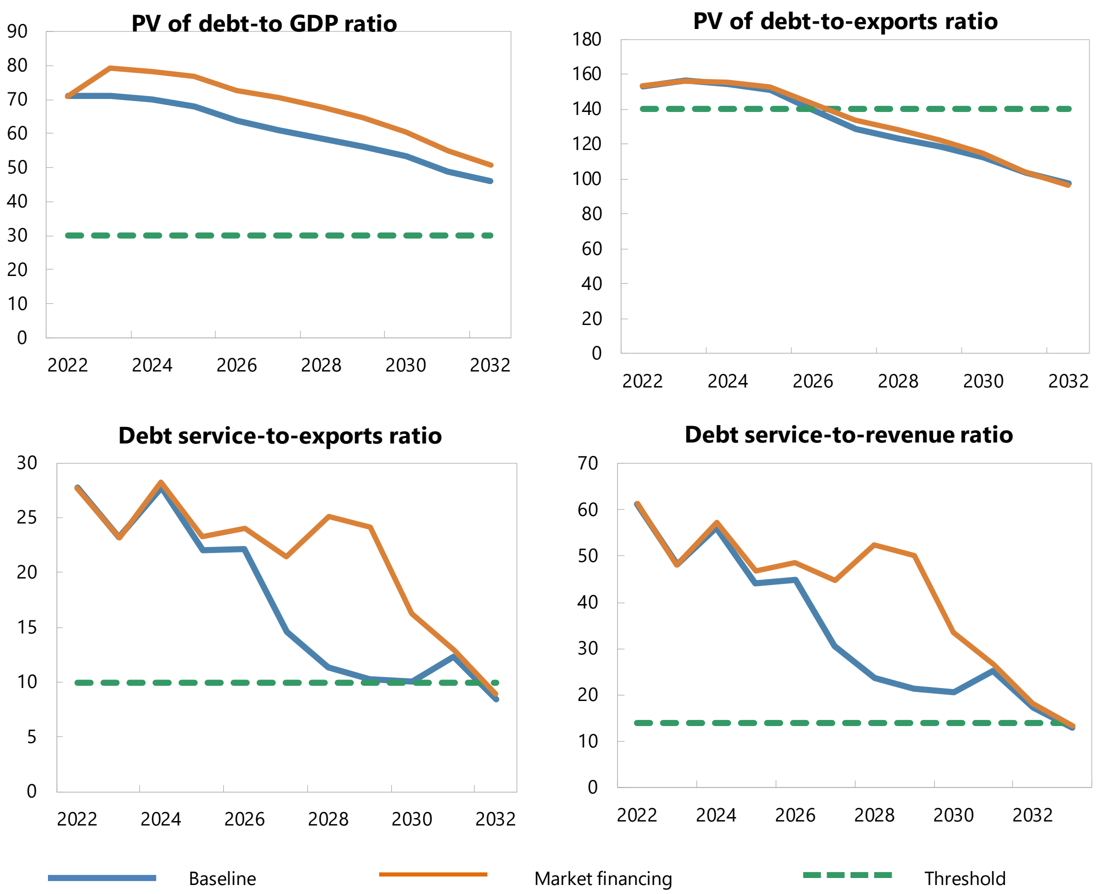


Figure 5. Zambia: Market-Financing Risk Indicators

	GFN 1/	EMBI 2/
Benchmarks	14	570
Values	27	2100
Breach of benchmark	Yes	Yes
Potential heightened liquidity needs	High	

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



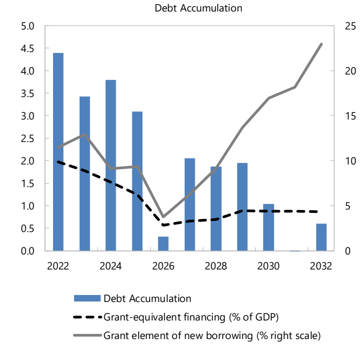
Sources: Country authorities; and staff estimates and projections.

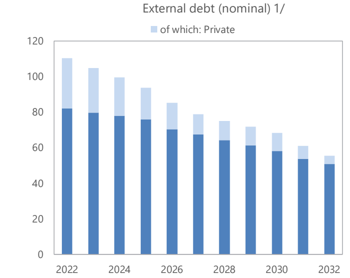
Table 2. Zambia: External Debt Sustainability Framework, Baseline Scenario, 2019–37

(In Percent of GDP, unless otherwise indicated)

	Actual			Projections								Average 8/	
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2032	2037	Historical	Projections
External debt (nominal) 1/	105.1	150.2	116.9	110.3	104.6	99.3	93.7	85.1	78.8	55.5	46.9	71.6	82.1
of which: public and publicly guaranteed (PPG)	66.8	103.0	78.6	81.97	79.6	77.9	75.8	70.4	67.2	50.7	37.4	42.5	67.3
Change in external debt	27.0	45.1	-33.3	-6.5	-5.7	-5.3	-5.6	-8.6	-6.2	-5.4	0.3		
Identified net debt-creating flows	8.8	18.1	-29.9	-8.1	-8.4	-11.4	-11.9	-11.9	-14.2	-13.3	-12.7	-5.2	-12.2
Non-interest current account deficit	-3.5	-16.8	-11.3	-5.5	-4.4	-6.6	-6.8	-6.7	-8.9	-7.9	-7.4	-3.4	-7.3
Deficit in balance of goods and services	-1.8	-15.0	-18.7	-7.4	-5.6	-6.2	-6.1	-6.4	-7.8	-7.7	-7.6	-5.1	-7.1
Exports	35.4	47.3	54.8	46.4	45.5	45.2	45.0	45.5	47.3	47.3	43.8		
Imports	33.6	32.2	36.1	39.0	39.9	39.1	38.9	39.2	39.5	39.6	36.1		
Net current transfers (negative = inflow)	-1.4	-1.2	-1.5	-1.4	-1.4	-1.4	-1.4	-1.4	-1.4	-1.4	-1.3	-1.3	-1.4
of which: official	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Other current account flows (negative = net inflow)	-0.3	-0.5	8.9	3.3	2.6	1.0	0.7	1.1	0.3	1.3	1.5	3.0	1.2
Net FDI (negative = inflow)	0.6	1.1	0.0	-4.0	-4.0	-4.9	-5.0	-5.1	-5.1	-5.2	-4.9	-3.9	-4.9
Endogenous debt dynamics 2/	11.7	33.8	-18.7	1.4	0.0	0.0	0.0	-0.1	-0.2	-0.2	-0.4		
Contribution from nominal interest rate	2.1	4.7	3.6	4.1	4.1	4.1	4.2	3.9	3.7	2.5	1.7		
Contribution from real GDP growth	-1.3	3.8	-4.6	-2.7	-4.1	-4.0	-4.2	-4.1	-3.9	-2.7	-2.1		
Contribution from price and exchange rate changes	10.9	25.3	-17.7	...	...	...	...	...	...	...	...		
Residual 3/	18.1	27.0	-3.4	1.6	2.7	6.1	6.3	3.2	7.9	7.9	13.0	15.5	6.6
of which: exceptional financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Sustainability indicators													
PV of PPG external debt-to-GDP ratio	...	...	85.5	70.9	71.0	69.9	68.1	63.6	61.0	45.7	32.8		
PV of PPG external debt-to-exports ratio	...	...	156.1	152.8	156.0	154.5	151.2	139.6	128.9	96.7	74.9		
PPG debt service-to-exports ratio	18.8	26.6	11.0	27.6	23.1	27.6	21.9	22.1	14.6	8.1	4.9		
PPG debt service-to-revenue ratio	33.1	63.5	26.5	61.1	47.9	56.0	43.9	44.7	30.5	16.7	9.3		
Gross external financing need (Million of U.S. dollars)	1091.3	127.0	-188.1	2004.7	1735.8	1530.0	687.2	816.9	-1174.3	-3090.5	-9554.0		
Key macroeconomic assumptions													
Real GDP growth (in percent)	1.4	-2.8	3.6	3.0	3.9	4.1	4.5	4.7	4.9	4.8	4.9	3.4	4.6
GDP deflator in US dollar terms (change in percent)	-12.7	-20.1	13.0	23.1	0.8	2.8	2.6	2.8	2.6	2.5	2.7	-3.3	4.3
Effective interest rate (percent) 4/	2.3	3.5	2.8	4.5	3.9	4.2	4.5	4.5	4.6	4.5	3.9	2.2	4.5
Growth of exports of G&S (US dollar terms, in percent)	-17.3	3.6	35.7	7.4	2.7	6.3	6.7	8.8	11.9	7.4	0.0	3.6	7.5
Growth of imports of G&S (US dollar terms, in percent)	-10.2	-25.6	31.3	36.8	7.1	4.9	6.7	8.3	8.6	7.3	0.0	5.2	10.1
Grant element of new public sector borrowing (in percent)	...	...	...	11.5	12.9	9.1	9.3	3.8	6.3	22.9	35.0	...	12.2
Government revenues (excluding grants, in percent of GDP)	20.1	19.8	22.7	21.0	21.9	22.3	22.5	22.5	22.7	23.1	23.1	18.7	22.5
Aid flows (in Million of US dollars) 5/	320.3	394.2	262.5	440.8	371.7	342.1	266.9	239.2	290.1	604.7	629.0		
Grant-equivalent financing (in percent of GDP) 6/	...	...	...	2.0	1.8	1.5	1.2	0.6	0.7	0.9	0.6	...	1.1
Grant-equivalent financing (in percent of external financing) 6/	...	...	...	13.6	15.5	11.3	12.0	7.6	10.6	29.4	45.3	...	16.3
Nominal GDP (Million of US dollars)	23,309	18,111	21,203	26,885	28,153	30,124	32,304	34,739	37,382	54,137	78,173		
Nominal dollar GDP growth	-11.4	-22.3	17.1	26.8	4.7	7.0	7.2	7.5	7.6	7.5	7.7	0.1	9.0
Memorandum items:													
PV of external debt 7/	...	...	123.8	99.3	96.0	91.3	86.0	78.3	72.6	50.5	42.3		
In percent of exports	...	...	225.9	213.9	211.1	201.9	191.1	171.9	153.4	106.7	96.7		
Total external debt service-to-exports ratio	21.2	34.6	18.9	36.6	31.9	36.6	31.1	30.9	22.9	15.5	0.2		
PV of PPG external debt (in Million of US dollars)			18130.5	19061.8	19984.1	21053.7	21985.6	22088.5	22803.4	24748.4	25612.0		
(PVt-PVt-1)/GDPt-1 (in percent)				4.4	3.4	3.8	3.1	0.3	2.1	0.6	0.3		
Non-interest current account deficit that stabilizes debt ratio	-30.4	-61.9	22.1	1.0	1.3	-1.3	-1.2	2.0	-2.7	-2.5	-7.7		

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





Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

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

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

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

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

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

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

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

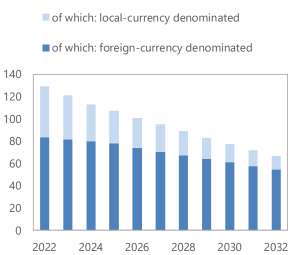
Table 3. Zambia: Public Sector Debt Sustainability Framework, Baseline Scenario, 2019–37

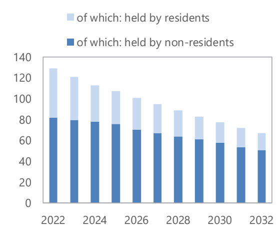
(In Percent of GDP, unless otherwise indicated)

	Actual			Projections								Average 6/	
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2032	2037	Historical	Projections
Public sector debt 1/	111.6	154.9	132.7	129.3	120.8	112.7	107.1	100.7	94.9	66.8	45.5	64.3	95.7
of which: external debt	66.8	103.0	78.6	82.0	79.6	77.9	75.8	70.4	67.2	50.7	37.4	42.5	67.3
Change in public sector debt	51.6	43.3	-22.2	-3.4	-8.5	-8.1	-5.6	-6.4	-5.8	-4.9	-3.8		
Identified debt-creating flows	11.9	37.0	-39.4	2.6	-2.8	-2.0	-2.7	-3.4	-4.5	-4.4	-3.8	1.7	-3.2
Primary deficit (cash basis)	3.6	7.8	2.1	1.8	0.0	-0.7	-1.4	-1.6	-2.8	-2.6	-2.1	1.7	-1.6
Revenue and grants	20.4	20.3	23.3	21.4	22.3	22.7	22.8	22.8	23.0	23.3	23.3	19.3	22.8
of which: grants	0.3	0.5	0.6	0.4	0.3	0.3	0.3	0.3	0.3	0.2	0.2		
Primary (noninterest) expenditure	22.9	28.1	25.4	23.2	22.3	22.0	21.4	21.2	20.2	20.7	21.2	20.9	21.2
Automatic debt dynamics	8.3	29.2	-41.5	0.8	-2.8	-1.3	-1.3	-1.7	-1.7	-1.8	-1.6		
Contribution from interest rate/growth differential	3.5	6.0	-8.4	-2.2	-1.4	-0.7	-0.8	-1.2	-1.4	-1.6	-1.4		
of which: contribution from average real interest rate	4.4	2.8	-3.0	1.6	3.5	4.1	4.1	3.5	3.3	1.7	0.9		
of which: contribution from real GDP growth	-0.9	3.2	-5.3	-3.8	-4.8	-4.8	-4.9	-4.8	-4.7	-3.3	-2.3		
Contribution from real exchange rate depreciation	4.8	23.2	-33.2	...	...	...	...	...	...	...	...		
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Recognition of contingent liabilities (e.g., bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Debt relief (HIPC and other)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Other debt creating or reducing flow (please specify)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Residual	39.7	6.3	17.2	-3.0	-7.1	-6.8	-3.5	-3.5	-1.6	-0.7	-0.3	10.2	-2.9
Sustainability indicators													
PV of public debt-to-GDP ratio 2/	...	...	125.3	122.1	113.8	106.1	100.7	95.1	89.9	62.7	41.6		
PV of public debt-to-revenue and grants ratio	...	...	537.7	571.4	510.8	468.5	441.5	417.3	390.9	268.9	178.4		
Debt service-to-revenue and grants ratio 3/	87.1	124.3	94.1	120.4	98.6	104.7	88.9	91.1	80.5	43.8	23.2		
Gross financing need 4/	20.3	33.1	24.1	27.1	21.5	22.6	18.5	18.7	15.4	7.6	3.2		
Key macroeconomic and fiscal assumptions													
Real GDP growth (in percent)	1.4	-2.8	3.6	3.0	3.9	4.1	4.5	4.7	4.9	4.8	4.9	3.4	4.6
Average nominal interest rate on external debt (in percent)	6.8	4.7	3.7	4.5	4.6	4.5	4.6	4.5	4.5	4.2	3.9	3.8	4.4
Average real interest rate on domestic debt (in percent)	11.2	1.9	-7.8	-0.2	3.4	6.0	7.0	6.4	6.3	4.3	2.8	4.6	4.8
Real exchange rate depreciation (in percent, + indicates depreciation)	11.2	34.4	-34.7	...	...	...	...	...	...	...	...	6.7	...
Inflation rate (GDP deflator, in percent)	7.6	13.7	23.4	8.4	8.7	7.3	6.8	6.8	6.6	6.6	6.7	10.5	7.1
Growth of real primary spending (deflated by GDP deflator, in percent)	23.8	19.4	-6.3	-6.3	0.1	2.6	1.9	3.4	0.2	3.7	5.2	10.2	2.7
Primary deficit that stabilizes the debt-to-GDP ratio 5/	-48.0	-35.5	24.3	5.2	8.5	7.5	4.3	4.8	3.0	2.3	1.7	-19.7	4.4
PV of contingent liabilities (not included in public sector debt)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		

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

Public sector debt 1/





Sources: Country authorities; and staff estimates and projections.

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

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

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

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

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

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

Table 4. Zambia: Sensitivity Analysis for Key Indicators and Publicly Guaranteed External Debt, 2022–32 (In Percent)

	Projections 1/										
	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
PV of debt-to GDP ratio											
Baseline	71	71	70	68	64	61	58	56	53	49	46
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2022-2032 2/	71	76	84	93	100	112	124	136	148	161	176
A2. Alternative Scenario : Contingent Liabilities + FX debt	71	89	91	90	86	84	82	81	78	74	72
B. Bound Tests											
B1. Real GDP growth	71	75	78	76	71	68	65	62	59	54	51
B2. Primary balance	71	73	78	78	74	71	69	67	64	60	58
B3. Exports	71	84	102	100	94	91	88	85	81	76	73
B4. Other flows 3/	71	76	80	78	74	71	68	66	62	58	55
B5. Depreciation	71	86	85	82	77	74	70	67	63	58	55
B6. Combination of B1-B5	71	81	86	85	80	78	75	73	70	65	62
C. Tailored Tests											
C1. Combined contingent liabilities	71	80	81	81	77	74	72	71	69	65	62
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	71	79	85	85	81	79	77	75	72	68	65
C4. Market Financing	71	79	78	77	73	70	68	64	60	54	51
Threshold	30	30	30	30	30	30	30	30	30	30	30
PV of debt-to-exports ratio											
Baseline	153	156	155	151	140	129	123.1	118	112	103	97
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2022-2032 2/	153	166	186	207	221	238	262	287	313	340	372
A2. Alternative Scenario : Contingent Liabilities + FX debt	153	196	202	201	190	178	172	170	165	157	151
B. Bound Tests											
B1. Real GDP growth	153	156	155	151	140	129	123	118	112	103	97
B2. Primary balance	153	161	174	172	162	150	145	141	136	127	122
B3. Exports	153	212	302	297	278	259	249	241	231	216	207
B4. Other flows 3/	153	166	177	174	162	150	144	139	132	123	117
B5. Depreciation	153	150	148	145	134	123	118	112	106	97	91
B6. Combination of B1-B5	153	185	175	208	195	182	175	170	163	152	145
C. Tailored Tests											
C1. Combined contingent liabilities	153	175	180	179	168	157	152	149	145	137	131
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	153	198	211	206	191	175	167	162	156	146	141
C4. Market Financing	153	156	155	153	143	133	128	122	114	103	96
Threshold	140	140	140	140	140	140	140	140	140	140	140
Debt service-to-exports ratio											
Baseline	28	23	28	22	22	15	12	11	10	12	8
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2022-2032 2/	28	24	31	27	30	23	21	22	24	31	26
A2. Alternative Scenario : Contingent Liabilities + FX debt	28	23	30	24	25	17	14	13	13	15	11
B. Bound Tests											
B1. Real GDP growth	28	23	28	22	22	15	12	11	10	12	8
B2. Primary balance	28	23	28	23	23	16	13	12	12	14	10
B3. Exports	28	28	42	37	37	26	21	20	19	22	16
B4. Other flows 3/	28	23	28	23	23	16	13	12	11	14	9
B5. Depreciation	28	23	27	22	22	14	11	10	10	12	8
B6. Combination of B1-B5	28	25	35	29	29	20	16	15	15	18	12
C. Tailored Tests											
C1. Combined contingent liabilities	28	23	29	24	24	16	13	12	12	14	10
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	28	27	33	27	27	18	15	13	13	16	11
C4. Market Financing	28	23	28	23	24	21	25	24	16	13	9
Threshold	10	10	10	10	10	10	10	10	10	10	10
Debt service-to-revenue ratio											
Baseline	61	48	56	44	45	30	24	22	21	25	17
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2022-2032 2/	61	50	63	55	61	48	44	46	50	64	54
A2. Alternative Scenario : Contingent Liabilities + FX debt	61	48	60	49	50	36	29	27	27	31	22
B. Bound Tests	61	48	60	49	50	36	29	27	27	31	22
B1. Real GDP growth	61	50	62	49	50	34	27	24	23	28	19
B2. Primary balance	61	48	57	46	47	33	27	25	24	28	20
B3. Exports	61	51	64	55	56	40	33	31	29	34	25
B4. Other flows 3/	61	48	57	47	48	33	27	25	24	28	19
B5. Depreciation	61	60	70	54	56	38	29	27	26	31	20
B6. Combination of B1-B5	61	50	64	53	54	38	31	29	28	32	23
C. Tailored Tests											
C1. Combined contingent liabilities	61	48	58	47	48	34	28	26	25	30	21
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	61	55	67	55	56	38	30	27	27	31	22
C4. Market Financing	61	48	57	47	48	45	53	51	34	27	18
Threshold	14	14	14	14	14	14	14	14	14	14	14

Sources: Country authorities; and staff estimates and projections.
1/ A bold value indicates a breach of the threshold.
2/ Variables include real GDP growth, GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
3/ Includes official and private transfers and FDI.

Table 5. Zambia: Sensitivity Analysis for Key Indicators of Public Debt, 2022–32
(In Percent)

	Projections 1/										
	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
	PV of Debt-to-GDP Ratio										
Baseline	**122**	**114**	**106**	**101**	**95**	**90**	**84**	**79**	**73**	**68**	**63**
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2022-2032 2/	**122**	**112**	**104**	**99**	**94**	**92**	**90**	**87**	**85**	**83**	**81**
B. Bound Tests											
B1. Real GDP growth	**122**	**119**	**118**	**113**	**109**	**106**	**103**	**100**	**96**	**93**	**91**
B2. Primary balance	**122**	**116**	**116**	**110**	**104**	**99**	**94**	**88**	**83**	**78**	**74**
B3. Exports	**122**	**122**	**129**	**124**	**118**	**112**	**106**	**100**	**95**	**89**	**84**
B4. Other flows 3/	**122**	**119**	**117**	**111**	**105**	**100**	**94**	**88**	**83**	**77**	**72**
B5. Depreciation	**122**	**127**	**117**	**109**	**103**	**97**	**91**	**86**	**80**	**74**	**69**
B6. Combination of B1-B5	**122**	**113**	**110**	**104**	**99**	**94**	**89**	**84**	**79**	**74**	**70**
C. Tailored Tests											
C1. Combined contingent liabilities	**122**	**130**	**121**	**115**	**110**	**105**	**99**	**94**	**89**	**84**	**79**
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	**122**	**118**	**115**	**115**	**114**	**112**	**110**	**107**	**103**	**100**	**98**
C4. Market Financing	**122**	**114**	**106**	**101**	**97**	**92**	**87**	**80**	**74**	**68**	**62**
TOTAL public debt benchmark	35	35	35	35	35	35	35	35	35	35	35
	PV of Debt-to-Revenue Ratio										
Baseline	571	511	468	441	417	391	367	341	314	289	269
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2022-2032 2/	571	504	457	432	414	401	391	379	366	353	348
B. Bound Tests											
B1. Real GDP growth	571	532	518	496	480	462	448	431	414	398	389
B2. Primary balance	571	522	510	480	456	430	407	383	357	333	316
B3. Exports	571	548	571	542	517	488	463	435	407	380	359
B4. Other flows 3/	571	532	515	487	463	435	411	384	356	330	310
B5. Depreciation	571	571	515	480	452	424	398	372	344	318	298
B6. Combination of B1-B5	571	505	485	456	433	409	387	364	340	317	300
C. Tailored Tests											
C1. Combined contingent liabilities	571	585	535	505	481	455	432	407	382	357	340
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	571	592	565	560	540	515	491	462	444	428	420
C4. Market Financing	571	511	470	445	424	400	377	349	319	290	267
	Debt Service-to-Revenue Ratio										
Baseline	120	99	105	89	91	80	63	57	48	50	44
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2022-2032 2/	120	98	104	86	87	76	61	56	49	51	44
B. Bound Tests											
B1. Real GDP growth	120	104	118	104	108	98	80	75	68	72	66
B2. Primary balance	120	99	113	103	100	88	71	67	60	61	53
B3. Exports	120	99	107	95	97	86	69	63	54	56	49
B4. Other flows 3/	120	99	106	92	94	83	66	59	51	53	46
B5. Depreciation	120	99	117	102	105	92	73	66	59	63	55
B6. Combination of B1-B5	120	97	106	94	96	85	69	62	54	56	50
C. Tailored Tests											
C1. Combined contingent liabilities	120	99	134	104	102	91	74	77	64	63	56
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	120	113	122	107	116	105	86	77	68	74	70
C4. Market Financing	120	99	106	91	95	95	92	85	61	51	45

Sources: Country authorities; and staff estimates and projections.

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

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

3/ Includes official and private transfers and FDI.

Statement by the Staff Representative on Zambia
Executive Board Meeting

August 31, 2022

This statement provides information that has become available since the issuance of the Staff Report for the Request for an Arrangement under the Extended Credit Facility (EBS/22/73). The information does not alter the thrust of the staff appraisal.

1. **Prior actions and other policy reforms.** On August 29, the authorities published their response to the electricity cost-of-service study, alongside the study itself, fulfilling the remaining prior action for the program. The new Bank of Zambia Act has received Presidential assent and was published on August 24. The new Act strengthens the Bank of Zambia's mandate, autonomy, and governance, in line with Fund advice.

2. **Growth.** The growth outlook appears marginally better. The outturn for 2021 exceeded staff's estimate by a full percentage point (4.6 versus 3.6 percent), largely explained by a much stronger outturn for the agricultural sector (6.9 versus -0.7 percent). In addition, announced mining expansion plans appear to be moving faster than anticipated. The better outlook for mining production, with more granular information on the prospects for cobalt and nickel production, will help mitigate the impact on exports and revenues of the recent drop in copper prices.

3. **Exchange rate and price developments.** The exchange rate has appreciated by a further seven percent since the end of June and is now 40 percent stronger than end-June 2021. On July 31, the Energy Regulation Board reduced fuel prices by 11-13 percent, reflecting recent movements in international crude oil prices and the exchange rate. Overall inflation has remained broadly stable, with the annual inflation rate marginally ticking up from 9.7 percent in June to 9.8 percent in August (with annual inflation of 9.9 percent in July).

4. **Fiscal developments.** The budget outturns through July are broadly in line with the proposed program targets, with fiscal revenues exceeding and primary expenditure falling just short of programmed levels.

Statement by Ms. Mannathoko, Executive Director for Zambia
and Mr. Mengistu, Advisor to the Executive Director

Having inherited sizable debt and macroeconomic imbalances, the current Government, elected a year ago, is burdened with significant legacy issues amidst ongoing shocks including the Covid-19 pandemic, drought and spillovers from the Russia war in Ukraine. Immediately upon assuming office, the government engaged with the IMF and G20 creditors, on the process to restructure debt under the G20 common framework and plans to restore macroeconomic stability and debt sustainability and deliver sustainable and inclusive economic growth. The authorities have embarked on an ambitious economic transformation agenda which seeks to grow Zambia into a prosperous middle-income country, guided by the Eighth National Development Plan (2022-2026), which includes structural, legal and governance reforms aimed at addressing impediments to higher and more sustainable growth. The authorities are committed to securing and entrenching macroeconomic stability with bold measures taken over the past year generating a positive response from markets, evidenced by a significant drop in bond yields. Nevertheless, imbalances remain sizable, and risks persist. Against this backdrop, they seek a 38-month Extended Credit Facility (ECF) arrangement to help stabilize the economy and place it on a path towards sustainable, inclusive growth.

Introduction

1. Our Zambian authorities appreciate the candid discussions with Fund staff during the ECF program negotiations. They consider the proposed program to be firmly aligned with their own reform plans and the eighth national development plan (NDP8) and are in broad agreement with staff's assessment and policy recommendations.
2. While growth resumed in 2021 and 2022, following a pandemic-induced recession in 2020, macroeconomic pressures from successive shocks remain, generating large fiscal and balance of payments needs. Lower copper prices in 2015-16 and 2020, drought in 2019, the pandemic, and recent global food and fuel price inflation shocks, have had a cumulative impact which has in turn exacerbated poverty and inequality.
3. Over the past year, the authorities have undertaken a range of measures aimed, among other things, at providing a credible plan for fiscal adjustment (they published an updated medium-term expenditure framework, ensuring it is aligned with ECF program objectives). Other actions were geared at strengthening transparency, governance, and efficiency of public spending; at enhancing debt transparency, at strengthening central bank independence, at containing fiscal risks related to inefficient subsidies and the electricity SOE, and at enhancing fiscal controls (they published new IMF and World Bank vetted public procurement regulations and a strategy for clearing expenditure and VAT refund arrears). Further reform measures under the ECF program, will build on this progress.
4. The authorities seek Executive Directors' support for a 38-month ECF arrangement to anchor reforms under NDP8 and place debt on a sustainable footing. The authorities hope that the backing provided by the ECF will catalyze additional donor support, while the accompanying debt restructuring under the Common Framework will entrench debt sustainability. The ECF will complement the authorities' reform agenda while addressing protracted balance of payment challenges alongside provision of valuable technical assistance.

Recent Economic Developments and Outlook

5. Real GDP recovered in 2021, with 3.6 percent growth recorded after a 2.8 percent contraction in 2020. While the GDP outturn in 2021 reflected a relatively broad-based recovery led by construction and ICT, other key sectors still lagged. The agricultural sector stagnated due to climate -induced impacts and is expected to contract in 2022; and notwithstanding higher copper prices, the mining sector contracted significantly in 2021, reflecting supply-chain disruptions and operational challenges at some mines, and a drop in ore-grades. In the medium-term, growth is expected to average about 4.2 percent, up from a projected 3.0 percent in 2022, supported by effective implementation of the reform agenda. In the meantime, the vaccination campaign which aims to protect lives and sustain economic activity, is ongoing, with 41 percent of adults over 18 vaccinated by June 2022. The authorities are working to increase the vaccine rollout and improve vaccine sourcing, as a higher vaccination rate will help protect the recovery.
6. Inflation decelerated, from an average 22.1 percent in 2021 to 9.7 percent in June 2022, reflecting the continued appreciation of the Kwacha with increased supply of foreign exchange, and dissipation of base effects in prices of some food products alongside seasonal increases in the supply of vegetables. This helped to counter the upward adjustment in fuel pump prices in December 2021. The latest Monetary Policy Statement projects inflation averaging 11.4 percent and 8.4 percent in 2022 and 2023 respectively. Inflation is expected to reach the Bank of Zambia target range of 6 - 8 percent by the first quarter of 2024.
7. The growth in exports that is boosting current account surpluses is being offset by large external financing needs, including for debt service, resulting in a balance of payments deficit. Foreign exchange reserves, however, have improved, increasing from 1.9 months of prospective import cover in 2020 to 3.2 months cover in 2021, reflecting various measures by the Bank of Zambia including building trust, alongside the general SDR allocation in August 2021, and some disbursement from the World Bank. Reserves have continued to grow in 2022 and are projected to reach 5.5 months of (prospective) import cover by 2025.
8. The outlook remains subject to downside risks, including from the pandemic and droughts that impact agricultural output and food prices as well as electricity supply. A prolonged Russia-Ukraine war with persistently elevated food and energy prices, alongside tightening global financial conditions and slowing global growth, as well as spillovers from pandemic-linked supply chain disruptions, are all potential concerns. These risks could exacerbate imbalances while deepening economic scarring and poverty. Delays in debt restructuring are also a risk. These risks highlight the significant importance of an IMF program for Zambia at this juncture. They should be mitigated via flexibility in program design alongside the authorities' strong ownership of and commitment to reforms.

Fiscal Policy and Debt Management

9. The main fiscal policy objective is to improve the primary balance. The authorities' medium-term Budget Plan (2023-25) and the 2023 Annual Budget reflects their commitment to appropriate revenue, expenditure, and contingency measures needed to support fiscal and debt sustainability and secure the primary balance goal. The Budget Plan (2023-25) aims to achieve a primary balance surplus of 3.2 percent of GDP by 2024 (commitment basis) starting from the 6.0 percent of GDP deficit in 2021. This will be supported by more effective revenue mobilization, rationalizing expenditures and restructuring debt.

10. Deep and comprehensive debt treatment under the G20 Common Framework will be an essential complement to fiscal restraint, and in this regard, we are hopeful that G20 creditors can provide substantive debt relief and so motivate other creditors to do likewise. Our authorities greatly appreciate the July decision by the official creditor committee and those financing assurances already provided by members of the committee. The Zambian authorities are now seeking debt treatment from private creditors and other official bilateral creditors on terms at least as favorable as those being considered by the creditor committee, and we urge the Fund to back the authorities' efforts to engage private creditors (including bondholders) and other official bilateral creditors in timely and effectual negotiations of these critical debt treatments. We also join the creditor committee in encouraging multilateral development banks to maximize their support for Zambia to help it meet long-term financial needs.

11. With prudent debt management a top priority in the authorities' reform agenda, halting non-concessional borrowing, cancelling and rescoping some externally financed projects, and working to gradually eliminate arrears to contractors, while advancing debt restructuring under the G20 Common Framework, remain key for them. They will also continue to cancel any contracted but undisbursed commercial loans. On the domestic front, the authorities intend to strengthen local currency financing through increased issuance of longer-term instruments and broadening of the investor base. This will help to reduce currency and refinancing risk.

12. Our authorities are committed to enhancing debt management and transparency. They are advancing work to strengthen debt governance with a medium-term debt management strategy and annual borrowing plan. This includes a new public debt management bill (the Loans and Guarantees, Grants Authorization Bill). Amendments in the new bill will enable the parliamentary oversight of loan contracts and align the public debt definition, and reporting, with international best practice. Work on public debt data validation and reconciliation with creditors is also progressing with further commitments to regularly publish the information to enhance debt management and transparency.

13. On domestic arrears, the authorities have cleared all outstanding pension arrears and published a medium-term expenditure and VAT refund arrears clearance strategy, its main elements being increased budget provision and debt and cheque swaps, alongside refinancing and restructuring of debt. Furthermore, a Commitment Control Module linking procurement commitments to the budget was added in the Integrated Financial Management Information System (IFMIS) to halt the accumulation of new arrears and became operational in July. This complements the commitment to enforce the provisions of Public Financial Management Act and Public Procurement Act, including enforcing penalty regimes for noncompliance. Associated Treasury circulars were issued earlier this year.

14. Revenue generating reforms have begun. Among other things, the authorities eliminated explicit fuel subsidies at the end of 2021, by restoring cost-plus pricing for petroleum products, while the restoration of excise taxes on petrol and diesel later this year, will remove the implicit fuel subsidy. In addition, firming copper prices and improved production are expected to generate additional fiscal revenues in the short term.

15. The authorities are also merging all tax policy and administration measures into a comprehensive and holistic strategy and action plan, while the digitalization of government services with interoperability and system-based controls is expected to improve tax compliance and the management of tax debt and arrears. Reforms will seek to widen the tax base, revise tax rates and improve revenue administration.

Specific measures will include upward adjustment of excise duties on alcohol and cigarettes, streamlining tax incentives and subsidies, reinstating VAT and excise duty on petroleum products, and enhancing collaboration between the Zambian Revenue Authority and local authorities to expand their local tax base and enable better mobilization of resources. Other measures to strengthen tax administration will include fast tracking the rolling out of electronic fiscal devices, introducing digital stamps on excisable products, and matching custom and in-land revenue data.

16. Given poverty levels and the large youth population, protecting the most vulnerable from the adverse impacts of fiscal adjustment amidst ongoing pandemic and price pressures is essential, and with this in mind, the authorities intend to scale up social protection programs in 2022 and over the medium term. Measures include increases in cash transfers and budget provision for health and education spending. There is also a plan to allocate significant resources to the Constituency Development Fund that mainly finances community-based projects while enhancing implementation capacity of local authorities and improving project monitoring and evaluation. Spending on the Farmer Input Support Program (FISP) will be streamlined with the introduction of a more cost-effective e-Voucher system, and FISP cost reduction, under a new comprehensive agricultural support programme. Given limited fiscal space, the authorities will reduce capital spending during the program period while leveraging the PPP financing model to fill infrastructure gaps. There will be cautious, structured selection of projects without creating fiscal risks.

Monetary, Exchange Rate, and Financial Sector Policies

17. The monetary policy stance is guided by a forward-looking monetary policy framework with the policy rate signaling the policy stance. Following significant tightening with interest rate hikes and some unwinding of pandemic-related support in 2021, the authorities, in their August 2022 monetary policy statement, decided to hold the monetary policy rate at 9 percent notwithstanding recent declines in inflation. This suggests a balanced approach, as inflation is still above the target range, and there remain notable risks to the inflation outlook, while at the same time domestic credit growth has slowed notably, probably reflecting earlier tightening. Increased agricultural production can also help to contain food prices. Meanwhile Parliament's recent enactment of an amendment to the Bank of Zambia Act to enhance the bank's operational independence should also support its ability to pursue price stability. Exchange rate appreciation is also alleviating imported price pressures, with the exchange rate remaining flexible and interventions limited to smoothing excessive volatility in the market. Inflation is projected to return to the target range by mid-2023, with continued implementation of fiscal consolidation measures and structural reforms under the NDP8 and as the ECF program is rolled out.

18. The central bank will continue to pursue the development of a secondary market for government securities. Effective implementation of the Bloomberg E-Bond platform for secondary trading is expected to enhance transparency in pricing and improve secondary market liquidity for participants. Improvements in price discovery are expected to strengthen the interest rate channel of monetary policy transmission.

19. The financial system is assessed as sound with ample liquidity and capital buffers, and profitable operations. Nevertheless, given elevated economic risks, the central bank introduced reform measures to strengthen its surveillance and supervision of the banking system and has plans to undertake a review of the banking sector's health post-COVID. Meanwhile the authorities have been vigilant in monitoring and lowering non-performing loan rates. The central bank also developed a new Problem Bank Framework in May 2022. It is also strengthening micro prudential surveillance and regulation

and has developed a micro-prudential stress testing framework. A deposit protection scheme is also being established this year as part of the safety net arrangement.

Structural Reforms

20. The authorities' structural reform agenda aims to achieve a conducive environment for strong and inclusive growth. Reforms seek to enhance transparency and accountability and good governance, and improve access to finance and the business climate, while supporting job-intensive productive sectors such as agriculture and manufacturing. Amendment of the Public Private Partnership (PPP) Act will also help to manage fiscal risks arising from weaknesses in the current PPP financing framework.

21. Cognizant of the importance of stemming corruption and governance vulnerabilities, the authorities' reforms aim to strengthen fiscal controls, transparency and PFM. At the same time, the new administration has tried to enforce a zero tolerance for corruption policy, with disciplinary action taken in 2021 against Ministry of Health officials involved in misappropriation of resources. Looking ahead, a comprehensive governance diagnostic assessment, was launched with the help of IMF technical assistance and the outcome will identify governance vulnerabilities and help in the design of appropriate corrective measures. The authorities are also addressing deficiencies identified in the AML/CFT Mutual Evaluation Report.

22. In the financial sector, the authorities are committed to enhancing financial inclusion. Accordingly, legislation is being revised to encourage the provision of digital financial services, while also digitalizing government services, and implementing the national Financial Switch to promote interoperability.

23. Energy sector reforms are a priority with a view to removing inefficiencies in the supply chain and mitigating fiscal risks from the electricity SOE, ZESCO. The authorities are implementing a five-year turnaround strategy for ZESCO (2021-25) that focuses on debt restructuring, optimization of capital expenditure, tariff adjustment and revenue efficiency, and asset optimization. There are also plans to shift to renewable energy sources such as such as solar and geo-thermal.

24. On sector-specific and investment climate reforms, given the central role of agriculture in food security, inflation and jobs, and the disruptive impact of climate shocks, the authorities are using investments in irrigation infrastructure to reduce the sector's dependency on seasonal rainfall. The authorities intend to continue investing in expanding access to affordable finance, while also providing capacity development, and tax incentives. In the manufacturing sector, the authorities will improve Multi-Facility Economic Zones and industrial parks by rationalizing the number of licenses and permits required to operate businesses, among other things. The mining tax policy framework will also be reviewed to encourage investment in the sector.

25. Adaptation needs and resilience building in response to climate change are a growing concern that is now at the top of the authorities' agenda, given recent agricultural and electricity generation capacity impacts and food and energy security considerations in the wake of droughts. The Ministry of Green Economy and Environment has been established to mainstream climate change adaptation across all policy; and to program interventions to build resilience, adapt and promote green investment. The authorities also intend to establish a National Climate Change Fund to lead resource mobilization efforts for greener economic growth.

Conclusion

26. The Zambian authorities are committed to the implementation of NDP8 reforms, and corresponding ECF program measures needed to restore macroeconomic stability, entrench debt sustainability, and support high, inclusive economic growth. They have already undertaken significant reform measures and completed prior actions agreed with staff, notwithstanding the extremely challenging context. They value Fund support which they consider critical to the country's advancement in the current shock-prone environment, and hope for Executive Directors' approval of the ECF program, which should also help to catalyze donor and creditor support.