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Zambia: 2009 Article IV Consultation, Third Review Under the Three-Year Arrangement Under the Poverty and Reduction and Growth Facility, and Request for Modification of Performance Criteria—Staff Report; Staff Supplement: Public Information Notice and Press Release on the Executive Board Discussion; and Statement by the Executive Director for Zambia

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of a combined discussion of the 2009 Article IV consultation with Zambia and the Third Review Under the Three-Year Arrangement Under the Poverty and Reduction and Growth Facility, and Request for Modification of Performance Criteria, the following documents have been released and are included in this package:

- The staff report for the combined 2009 Article IV Consultation, the Third Review Under the Three-Year Arrangement Under the Poverty and Reduction and Growth Facility, and Request for Modification of Performance Criteria , prepared by a staff team of the IMF, following discussions that ended on October 28, 2009, with the officials of Zambia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on December 3, 2009. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A Staff Supplement

- A Public Information Notice (PIN) and Press Release, summarizing the views of the Executive Board as expressed during its December 14, 2009, discussion of the staff report on issues related to the Article IV consultation and the IMF arrangement, respectively.

- A statement by the Executive Director for Zambia.

- The documents listed below have been or will be separately released.

  Letter of Intent sent to the IMF by the authorities of Zambia*
  Memorandum of Economic and Financial Policies by the authorities of Zambia*
  Technical Memorandum of Understanding*
  *Also included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

ZAMBIA

Staff Report for the 2009 Article IV Consultation, Third Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, and Request for Modification of Performance Criteria

Prepared by the African Department
(In consultation with other departments)

Approved by Seán Nolan and Dhaneshwar Ghura

December 3, 2009

Discussions for the 2009 Article IV consultation and the third review under the PRGF arrangement were held in Lusaka during October 15–28, 2009. The staff team consisted of George Tsibouris (head), Alfredo Baldini, Mame Astou Diouf, Jean Noah Ndela (all AFR), Birgir Arnason (Resident Representative), Ding Ding (FAD), and Axel Palmason (SPR).

The mission met with the Minister of Finance and National Planning, Dr. Musokotwane; the Governor of the Bank of Zambia, Dr. Fundanga; other senior officials; and representatives of the business community, labor unions, civil society, and Zambia's development partners.

Fund relations — Zambia joined the Fund on September 23, 1965, and has accepted the obligations of Article VIII, Sections 2, 3, and 4. It maintains a floating exchange rate regime. The 2007 Article IV consultation with Zambia was concluded in December 2007. Zambia's current three-year PRGF arrangement was approved in June 2008 with access of SDR 48.9 million (10 percent of quota). On the occasion of the first and second reviews of the arrangement in May 2009, access was increased to SDR 220.1 million (45 percent of quota). Zambia was allocated a total of SDR 400.8 million through the general and special allocations in August and September 2009.

In the attached letter of intent (LoI) and Memorandum of Economic and Financial Policies (MEFP), the authorities review program implementation and outline their policies for the remainder of 2009 and for 2010.

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EXECUTIVE SUMMARY

The Zambian economy has shown some resilience to the global economic crisis. Real GDP growth for 2009 is now projected at 5.3 percent, boosted by a significant increase in copper production and a bumper crop, while inflation is easing gradually from the food and fuel price-induced highs of 2008. The budget deficit is projected to widen somewhat in 2009 on weak revenue collections; the current account deficit has narrowed on lower imports; and international reserves have increased significantly, boosted by the SDR allocation.

The PRGF-supported program is on track; all of the quantitative performance criteria and indicative targets for end-June 2009 have been met. There were delays in implementing two of the structural benchmarks: (i) the establishment of a supervisory regime for the secondary market in government securities has required an extended consultation process and the benchmark has been reset for end-March 2010; (ii) the benchmark on introducing a standing overnight lending facility by the Bank of Zambia was met with a two-month delay.

Fiscal policy in 2010 retains the focus on harnessing domestically-generated resources to support the diversification of the economy. The 2010 budget, which envisages some recovery in tax collections, seeks to preserve capital spending and to shift resources to the health sector to make up for an expected decline in donor support. The wage bill as a share of GDP is to be restrained.

The structural reform agenda for 2010 will focus on: (i) reviewing tax policy and administration so as to strengthen tax performance; (ii) improving public financial management; (iii) advancing civil service reform; (iv) reinforcing monetary operations and supervision; and (v) ensuring an adequate and reliable supply of electricity.

The Article IV consultation discussions elaborated on the macroeconomic environment and on policies for sustaining medium-term growth through diversification. Lessening the dependence on mining and diversifying the economy will require creating fiscal space, on both the revenue and expenditure sides, to increase investment in infrastructure and the social sectors. A large foreign exchange reserve cushion will help the economy better withstand shocks and buffer excessive exchange rate swings, which undermine the competitiveness of the non-mining sector.

Zambia continues to be at low risk of debt distress, and there is no clear evidence of misalignment of the exchange rate.

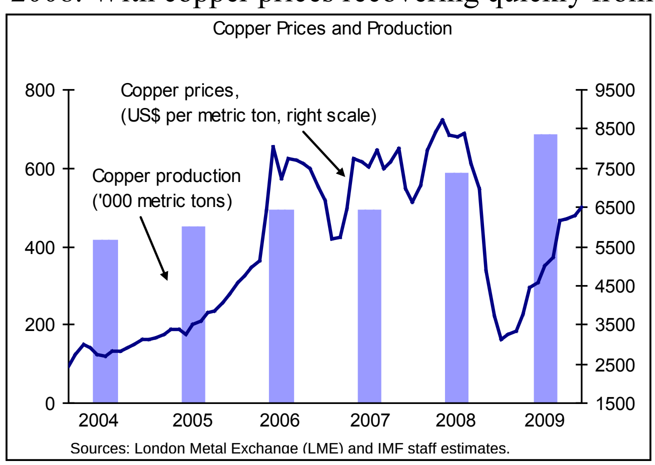
I. Background

1. **Compared to the first three decades after independence, Zambia's economic performance has improved markedly in recent years**. Sustained per capita GDP growth began in the late 1990s as a belated response to the extensive structural reforms and liberalization of the economy in the 1990s. This trend was given further impetus by the boom in the copper sector that followed privatization, the subsequent rise in copper prices globally, and better management of macroeconomic policies, both fiscal and monetary. With fiscal dominance no longer an issue, the Bank of Zambia (BoZ) has been able to pursue its goal of bringing down inflation and creating scope for a solid expansion (though from a low base) of credit to the private sector. The external position of the economy has benefited from the debt cancellation under the Heavily Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI). Zambia's gross international reserves have risen to more than four months of import cover, a dramatic turnaround from only a few years earlier.

II. Recent Developments

2. **The Zambian economy has shown some resilience to the global economic crisis**. Growth in 2009 is now projected to be in line with the average for recent years, with the slowdown in the tertiary sector compensated for by a significant increase in copper production and a bumper crop. Inflation has moderated steadily from the food and fuel price-induced highs of 2008. The current account deficit has narrowed, helped by a recovery of copper prices and import compression after a sharp depreciation of the Kwacha. Though still below the levels seen in other SADC countries, Zambia's reserve position is now stronger than it has been in almost four decades at 4½ months of import cover, thanks in part to the augmentation of PRGF access and the recent SDR allocation.

- Real GDP growth in 2009 is now projected to be 5.3 percent, somewhat lower than the 5.7 percent growth recorded for 2008. With copper prices recovering quickly from their plunge in late 2008 and the coming on-line of a large new mine, mining output has significantly increased. A bumper harvest has also pushed up agricultural output markedly, and construction has continued to expand rapidly. Tourism, manufacturing, and banking have, however, been adversely affected (Table 1 and Figure 1).



- Consumer price inflation eased to 12.3 percent through October 2009, down from 16.6 percent at the end of 2008. Due to some persistence in food price inflation, the year-end target was revised to 12 percent and is well within reach.

- The external current account deficit (including grants) is projected to be 1.8 percent of GDP in 2009, down from 5.6 percent in 2008. The decline in export values is expected to be more than offset by a marked contraction in imports and by lower copper sector profit remittances.

- The tax revenue shortfall relative to the program is estimated at 0.6 percentage points of GDP in 2009, due primarily to import-related taxes. There have also been some shortfalls in donor disbursements. The government has sought to preserve its domestically-financed capital spending targets by increasing domestic borrowing, including from the BoZ. As a result, domestic financing is projected at 2.2 percent of GDP at year-end (0.4 percentage points of GDP higher than programmed). Social sector spending (particularly on health), and foreign-financed capital spending (particularly on roads) have, however, suffered. Overall, spending is estimated to be 0.6 percentage points of GDP lower than programmed.

- The kwacha has continued to be volatile. After coming under sustained pressure in late 2008 and early 2009, the exchange rate has recently strengthened and stabilized, supported by the recovery in copper prices. During the period of downward pressure, the BoZ intervened heavily to maintain orderly conditions in the foreign exchange market, drawing on the reserves it had built up. Foreign exchange sales also helped the BoZ meet its reserve money target for the first half of 2009. More recently, the BoZ has relied primarily on open market operations to manage liquidity.

- While there has been a significant increase in non-performing loans, the banking sector remains adequately capitalized and liquid (Table 6). The rise in non-performing loans has been most pronounced for households and commercial agriculture.

- Zambia is making progress toward meeting the Millennium Development Goals (Table 9). Poverty indicators have improved over the past decade, though the issue of rural poverty and service delivery remains a challenge. Health indicators have been improving, and Zambia is on track to meet its goal of universal primary education.

III. Program Performance

3. **Performance under the PRGF arrangement has been satisfactory**. All quantitative performance criteria and indicative targets for end-June 2009 were met (MEFP, Table 1), as were two of three structural benchmarks (MEFP, Table 3). On the third benchmark, establishment of a supervisory regime for the secondary market in government

securities, delays were encountered because the consultation process was broadened; nonetheless, considerable progress has been made and the benchmark has been reset for end-March 2010. Of the two structural benchmarks for end-September 2009, one was met on time; the other—the introduction by the BoZ of a standing overnight lending facility—was met on December 1, 2009.

IV. Economic Program For 2010

4. **As the world economy emerges from recession, prospects for the Zambian economy are improving**. Economic growth is expected to pick up speed in 2010, to about 5½ percent; the unwinding of the one-off factors in 2009 will be compensated for by a more broad-based recovery, particularly in the tertiary sector. Inflation is targeted to decline to 8 percent by the end of the year. The external position should be generally unchanged; increased export earnings will be offset by a recovery in imports and profit remittances.

A. Fiscal Policy

5. **The 2010 budget again focuses on harnessing domestically-generated resources to support diversification of the economy through investment in infrastructure and human capital** (MEFP, ¶11, 12, 13, 14). The overall fiscal deficit is projected to narrow slightly to 2.4 percent of GDP, with domestic financing amounting to 2 percent of GDP.[1] Revenue collections are projected to increase somewhat to 15.9 percent of GDP, mainly because administrative efforts are being intensified as an offset to a drawdown of income tax loss carryovers. On the expenditure side, the government's ability to increase the share of capital spending in total government outlays was constrained by the size of the wage bill and by constitutionally required spending on a national census and voter registration before the 2011 presidential and parliamentary elections. The authorities pointed to the political difficulty of resisting wage demands with elections looming on the horizon, but are nonetheless aiming to contain the wage bill as a share of GDP in 2010. The government is also committed to pursuing civil service reform, including right-sizing and pay reform while at the same time protecting the social sectors, with a view to putting the wage bill on a sustainable path.

[1] The domestic debt-to-GDP ratio continues to decline gradually in the period ahead.

A performance based pay system is expected to be approved by Cabinet in 2010 (structural benchmark).

B. Monetary Policy

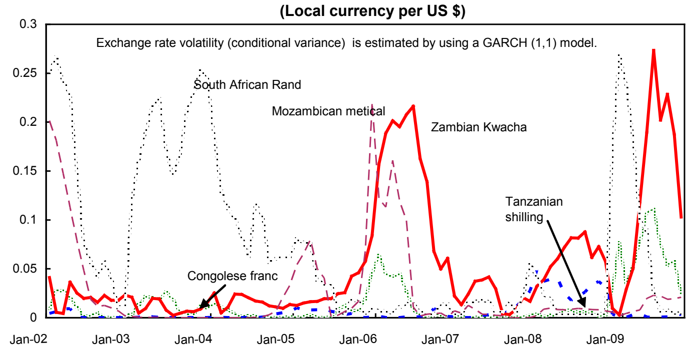
6. **Monetary policy will be geared to bringing inflation firmly into the single-digit range by end-2010** (MEFP, ¶17). Reserve money growth is to be limited to 19 percent, which, with government borrowing plans as described above, would allow credit to the private sector to grow to about 20 percent, up from 14 percent in 2009, but below the rates seen in 2007 and 2008. The envisaged growth rate seems consistent with more conservative bank lending plans, since non-performing loans have risen.

7. **The authorities remain committed to a floating exchange rate regime** (MEFP, ¶17). The flexible, yet orderly, response of the exchange rate to external shocks, whether positive or negative, has enabled the Zambian economy to adjust relatively smoothly to new circumstances. However, the exchange rate has at times been excessively volatile and staff expressed support for the BoZ's intention to become more active in mitigating unwarranted exchange rate volatility by relying on its healthier reserve position, that has now been bolstered by the SDR allocation (see Box 1).

Box 1. Exchange Rate Volatility in Zambia

Zambia's exchange rate has suffered bouts of increased volatility in recent years, and particularly in the first half of 2009 (Text Figure 1). The kwacha has tended to be more volatile than the currencies of neighboring countries with free-floating exchange rates (Text Table 1).

Text Fig 1. Exchange rate volatility in Selected African Countries (Local currency per US $)



Source: IMF staff estimates

Exogenous shocks, such as productivity shocks in the tradable and non-tradable goods sectors, government spending shocks, copper price shocks, and foreign interest rate shocks have been the primary cause of the volatility of Zambia's exchange rate. The Zambian economy also features a high exchange rate pass-through, with exchange rate shocks transmitted very quickly to the inflation rate and fully incorporated within three quarters. Inflationary shocks also feed into the exchange rate, which results in a feedback effect from the formulation of inflation expectations.

Text Table 1. Simple Standard deviations of the 12-month change exchange rate (national currency/US dollar) over the period 2002 Jan-2009 Sep

Currency	Standard deviation
Zambian kwacha	0.209
South African rand	0.205
Mozambican metical	0.121
Congolese franc	0.095
Tanzanian shilling	0.067

Source: IMF staff estimates

The government and the Bank of Zambia also plan to retire some domestic debt, as treasury securities mature, through a limited sale of foreign exchange from international reserves.[2] The expectation is that the more limited supply of treasury bills will put downward pressure on interest rates, lessen the interest burden on the budget, and make Kwacha credit available to the private sector on more favorable terms. Staff supported this plan provided it would be pursued cautiously and held under constant review.

C. Structural Policies

Public financial management

8. **Zambia is making progress in the implementation of public financial management reforms** (MEFP, ¶21, 22, 23). After protracted delays, for instance, the budget cycle has been aligned to the fiscal year through a constitutional amendment. This would ensure that the budget is approved before the start of the fiscal year, thus allowing more time for budget execution. In 2010, the government also intends to introduce a planning and budgeting act (structural benchmark) to reinforce budget planning and execution, and accountability to stakeholders. Long-awaited public procurement regulations have also been issued, and the government is close to finalizing its strategy for setting up a treasury single account (TSA) system, with milestones already set for 2010 (structural benchmark). Moreover, the launch of the integrated financial management information system (IFMIS) should gather significant steam in 2010. Staff welcomed these developments and underscored that effective PFM systems are essential for the efficient use of public resources.

Financial sector development

9. **Financial sector development is also moving ahead** (MEFP, ¶24, 25, 26). The first phase in the financial sector development plan (FSDP I) was recently completed and the second phase (FSDP II) has just been launched. The overriding goals of the FSDP are to enhance financial system stability and financial intermediation. Among welcome developments, the BoZ has set up a standing overnight lending facility that should reduce excess liquidity in the banking system and is drafting a plan for the secondary market in government securities that should be in place by early next year. The government is also committed to enacting a lender of last resort policy for the BoZ by the middle of 2010 (structural benchmark).

Debt and aid management

10. **The government is adopting a comprehensive debt management strategy**, based on technical assistance provided jointly by the IMF and the World Bank (MEFP, ¶29, 30). Adherence to this strategy is needed because it is likely that the government's only option in the coming years will be to engage in external borrowing on commercial terms to fund its share of the cost of

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[2] As indicated in MEFP ¶20, the authorities envisage a phased domestic debt redemption.

high-priority infrastructure projects in the context of PPPs, particularly for electricity generation.[3] Zambia continues to be a low risk of debt distress, even once such nonconcessional borrowing is taken into account (see paragraph 19).

11. **The government is committed to managing aid better**. Closer coordination with donors will help enhance the consistency and timeliness of aid data. The alleged misappropriation of donor funds at the Ministry of Health, along with broader donor concerns about governance issues, could put at risk both direct budget support and sector support for health and roads, which could ultimately threaten the financing of the budget. The authorities expressed their intention to fully address donor concerns about governance.

Electricity sector development and the fuel situation

12. **The government continues to implement its strategy of bolstering the electricity sector** (MEFP, ¶27, 28). Zambia experienced serious power shortages in 2008, after years of neglected maintenance and lack of new investment in power generating capacity. At that time, the government adopted a strategy to tackle the power deficit that is centered on the following elements: (i) raise electricity tariffs over time to cost recovery levels to attract private investment, (ii) open the transmission network to power generators, other than the state-owned electricity utility ZESCO; and (iii) make ZESCO more operationally efficient, while not providing budgetary subsidies. A major first step towards cost recovery was taken in August 2009, when electricity tariffs were raised by 35 percent. A further tariff increase is envisaged by mid-2010 (structural benchmark), and the authorities reaffirmed their commitment to the objective of eliminating the remaining gap over time. The government also intends to approve a grid code to facilitate access to the transmission and distribution systems in 2010. Moreover, ZESCO has agreed with the Zambian Energy Regulation Board (ERD) on a set of key performance indicators to improve its financial and operational efficiency. However, initial performance relative to these targets has lagged.

13. **The cost of fuels is high in Zambia and their supply is unreliable**. From a regional perspective and even factoring in Zambia's landlocked nature, the cost of fuels is relatively high, to the detriment of both businesses and consumers. There are also periodic shortages of fuel, usually because of unscheduled shutdowns of the Indeni refinery. Staff cautioned that pump prices (which have not changed since December 2008) need to reflect underlying kwacha-denominated costs, in order to avoid distortions and eventual subsidization by the budget. The authorities indicated that they wanted to avoid subsidizing fuels at all costs and were considering alternative fuel supply arrangements.

[3] Consultations with the World Bank and other relevant institutions would inform the authorities on the economic viability of such projects; only projects with high rates of return would be considered.

D. Program Monitoring

14. **The program is being monitored semiannually**. Quantitative performance criteria are proposed to be revised for end-December 2009 and set for end-June 2010. Indicative targets have been set for end-March 2010, end-September 2010, and end-December 2010. Structural benchmarks have been set for 2010. In the structural area, reviews will be based on an assessment of the authorities' reform program, particularly in the areas of PFM, financial sector development, and electricity sector development, in order to achieve the macroeconomic objectives described in the MEFP.

V. Sustaining Growth Through Diversification

A. Medium-Term Macroeconomic Outlook

15. **The government's main economic policy objective is to sustain robust and diversified growth over the medium term to create jobs and income opportunities, especially for the poor**. The authorities recognize that attaining this objective will depend on the creation of a competitive environment for the private sector. They also recognize the variety of ingredients that are necessary: (i) skilled and healthy human resources; (ii) good transportation infrastructure; (iii) efficient and reliable utilities; (iv) well-functioning financial markets; (v) limited red-tape; and, last but not least, (vi) macroeconomic stability. To accomplish all of these, the government will need to invest significant resources in human capital and infrastructure, as well as make efforts to reduce bureaucracy, while keeping macroeconomic policies prudent.

16. **The government's medium-term macroeconomic framework envisages that economic growth will gradually move to above 6 percent a year**. Inflation will become firmly entrenched below 10 percent. The external current account deficit (including and excluding grants) will trend modestly upwards relative to GDP because of an upswing in investment related imports. International reserves will stay above four months of import cover and increase over the medium term.

B. Increasing Fiscal Space

17. **Reaching Zambia's development objectives will require increasing the resources for infrastructure and human capital spending.** A sustained effort to open up fiscal space is needed both on the revenue and spending fronts. Reversing the trend decline in tax revenue relative to the size of the economy that has been experienced over the past few years will be a major challenge. The government is therefore committed to reviewing tax policy and administration during 2010 in order to boost its tax take (structural benchmark). Meanwhile, there has been upward pressure on current spending, particularly for salaries and benefits of government workers, that would need to be addressed. (see Box 2).

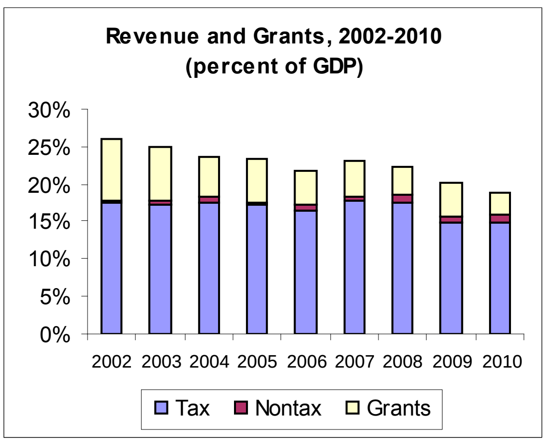
Box 2. Increasing Fiscal Space

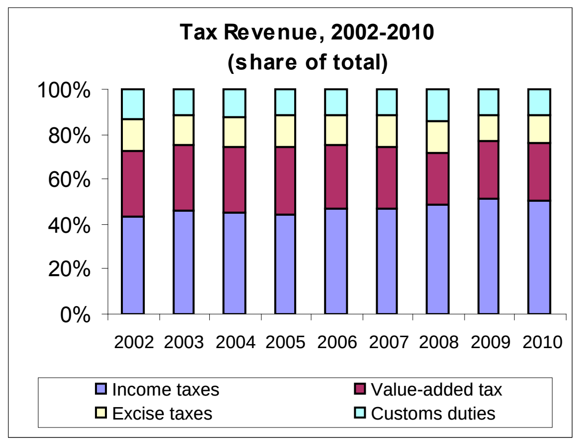
Increasing fiscal space is a central challenge for Zambia over the medium term. To attain its development objectives, it must devote increasing amounts of resources to capital and social sector spending.

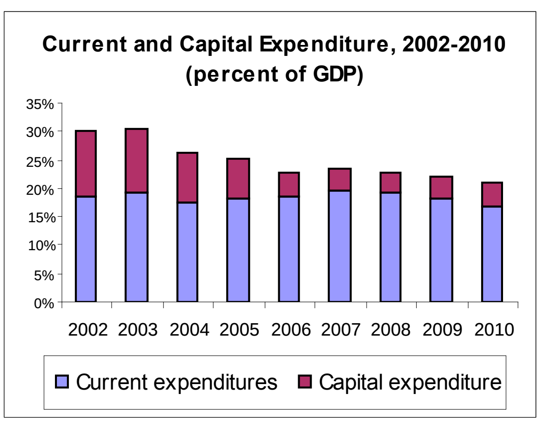
On the resource side, tax revenue will need to make the largest contribution to added fiscal space. Given the observed downward trend in donor aid and with prospects difficult to predict, and given the need for continued caution in foreign borrowing, the government will need to finance a large share of investment and social sector spending from domestically generated resources—tax revenue.

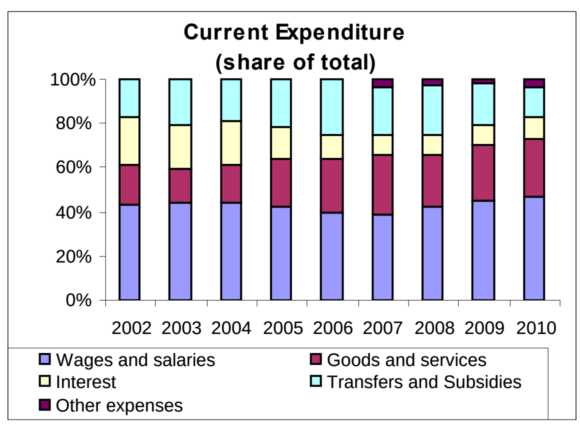
Restoring these revenue sources by broadening the tax base and reinforcing tax collection is essential to generate more resources for government. The mining tax regime should, over time, yield more revenue as carryover losses and investment allowances are exhausted, provided, of course, that copper prices stay reasonably high. The government is aware of the need to reform both tax policy and tax administration in order to reverse the revenue erosion. The government thus plans to undertake a comprehensive review of tax policy and administration before preparing the 2011 budget.

Lower current spending is another potential source of increased fiscal space. Here, the wage bill stands out in that it takes up more than one half of domestically generated resources.









Source: Zambian authorities, and IMF staff estimates

C. Reform of the Monetary Policy Framework

18. **The floating exchange rate regime has served Zambia well in recent years**. The authorities are also weighing the pros and cons of moving away from the reserve money targeting regime to directly targeting inflation using a money market interest rate as the principal operating target. Staff encouraged the authorities to continue exploring this possibility and noted that inflation targeting needs to be built on a well-functioning money market and a thorough understanding of how monetary policy is transmitted. Therefore, further analysis would likely be necessary (see Box 3).

Box 3. Strengthening Monetary Policy Implementation

In the past few years, the BoZ has done well in adhering to its operating target, the reserve money path, within a floating exchange rate regime. This has helped to keep broad money close to the targeted reserve and M3 path and, together with fiscal restraint, has helped to steadily bring down inflation (see Figure 3). However, with the gradual deepening of the financial system and the economy's vulnerability to large exogenous shocks, the authorities are considering a gradual shift from strict monetary targets to a framework that would use interest rates as the main instrument to anchor inflationary expectations, with the ultimate goal of implementing an explicit inflation targeting (IT) regime in the medium term.

Staff noted that monetary policy in Zambia is hampered by large and volatile foreign exchange inflows, exposure to copper-related terms-of-trade shocks, and a high degree of exchange rate pass-through to domestic prices. In addition, banks liquidity and government cash-flow are hard to predict due to thin money markets and public financial management constraints that make it difficult for the BOZ to sterilize the required amounts and stabilize the liquidity base.

The authorities concurred that a number of pre-conditions would need to be fulfilled before they move to an explicit IT framework, such as (i) improving information flows, especially on the real sector and CPI; (ii) understanding how monetary policy is transmitted: (iii) expanding the communication strategy by increasing transparency and accountability through media exposure (e.g. inflation reports); and (iv) formulating a core projection model for forecasting and policy analysis.

D. Debt Sustainability

19. **The updated debt sustainability analysis (DSA) for Zambia shows that the country is still at low risk of debt distress and that there is some scope for external borrowing on commercial terms to finance high-priority infrastructure projects**. The DSA is based on assumptions that are consistent with the authorities' medium-term macroeconomic framework. The baseline scenario incorporates a substantial amount of external borrowing by the government to finance its share of the cost of major infrastructure projects, particularly for electricity generation. Even with extreme shocks, and taking into account the contingent statutory liabilities of central government, the debt sustainability indicators stay well below the relevant thresholds for the risk of debt distress.

E. Exchange Rate Assessment

20. **There is no clear evidence of misalignment of the exchange rate** (see Box 4). Its movements in recent years have closely mirrored movements in the terms of trade. While data limitations impede a robust assessment, indications are that the real exchange rate does not appear to be too far from its equilibrium level. Moreover, the balance of payments position does not point to any disruptive movements in the exchange rate.

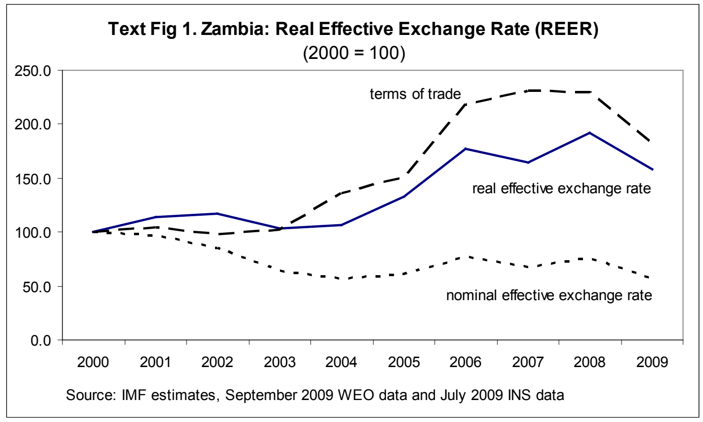
F. Other Issues

21. **The authorities have made efforts to settle arrears to external private creditors stemming from the past imposition of exchange controls**. Settlement of the outstanding arrears to commercial creditors was offered on terms similar to those provided by the Paris Club. The authorities are continuing to verify claims outstanding to private individuals. The exchange restrictions evidenced by the accumulation of these external payments arrears are subject to Fund approval under Article VIII.

VI. Economic Statistics

22. **Weaknesses in the quality and timeliness of economic statistics for Zambia represent a significant obstacle to effective economic analysis and policy making**. The base years for both the national accounts and the CPI are in the early 1990s and are thus no longer representative of the structure and composition of the economy. Lags in presentation of reliable national accounts data and unresolved methodological issues also unduly complicate economic analysis. The authorities recognize that this situation makes them less effective and are committed to making available to the Central Statistical Office (CSO) sufficient financial and human resources to ensure that it can quickly re-base the national accounts and the CPI and publish reliable economic statistics regularly and promptly.

Box 4. Zambia: Exchange Rate Assessment



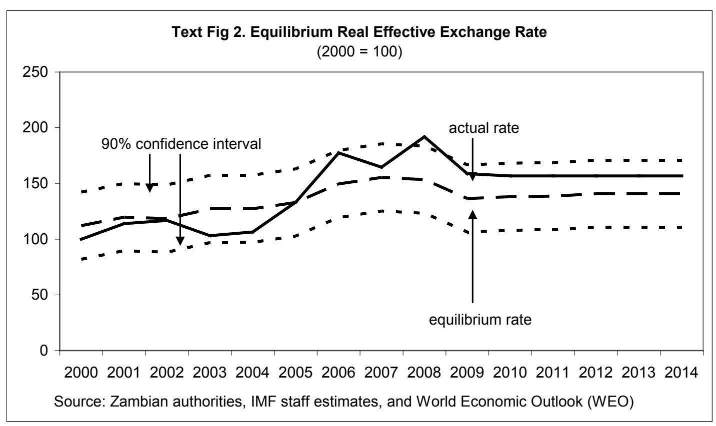
The real effective exchange rate (REER) has appreciated steadily since the early 2000s, mostly because the terms of trade have improved (Text Figure 1). High copper prices were a major driver of the terms of trade, and copper contributed about three-fourths of export earnings. Sizable inflows of portfolio capital also stimulated the appreciation. The subsequent depreciation in 2008–09 was driven by a plunge in copper prices, and outflows of portfolio capital, during the global financial crisis.

Text Table 1. Exchange Rate Assessment Results [1, 2]

Approach	Current Account/GDP norm	Current Account/GDP underlying	REER gap
External Sustainability	-6.7	-4.4	-15.3
Macroeconomic Balance	-3.1	-4.4	8.5
Equilibrium Real Exchange Rate			16.5

[1]Based on IMF CGER methodology and extension by Francis Vitek (IMF 2009, unpublished)
[2]September 2009 WEO data and July 2009 INS data

Assessing the exchange rate with tools developed by the IMF's Consultative Group on Exchange Rates (CGER), it appears that the real effective exchange rate is close to its estimated equilibrium level, with no clear evidence of misalignment (Text Table 1), which implies that the underlying current account deficit relative to GDP is broadly in line with its estimated norm. It is duly noted, however, that data limitations, model selection, and structural changes in the Zambian economy limit the scope for precise point estimates.



The balance of payments position does not appear to give rise to disruptive exchange rate movements. Absent a boom in copper prices and FDI inflows, the REER is expected to hold at or near the current level over the medium-term (Text Figure 2). The nominal exchange rate reflects market conditions, fiscal and monetary policies are consistent with domestic stability and internal balances, and the current structure of the capital and financial accounts poses no apparent risk to external stability. Finally, the appreciation of the real exchange rate in recent years does not appear to have hindered growth and development of non-metals exports, which have enjoyed double digit growth in recent years, even though copper still dominates exports in both absolute and relative terms.

VII. Staff Appraisal

23. **The Zambian economy has shown some resilience to the global economic crisis**. Overall, growth in 2009 is expected to be in line with the average for recent years. Inflation is moderating, and is now expected to fall to below 10 percent by the second half of 2010. The current account deficit has narrowed, and international reserves have strengthened significantly, boosted by the SDR allocation from the IMF.

24. **The government responded appropriately to the revenue shortfall and delays in release of donor funds**. The government has sought to sustain budgeted domestically-financed capital spending, drawing on domestic financing from the BoZ and others. Social sector spending, particularly in health, has however been adversely affected. The way in which government has responded to the spending pressures in 2009 is to be commended.

25. **Despite revenue challenges and required constitutional spending, the 2010 budget is well balanced**. In particular, it preserves capital spending and shifts some domestic resources to the health sector to make up for an expected decline in donor support. Economic objectives for 2010, including a modest pick-up in growth and a further easing of inflation, are prudent.

26. **The Bank of Zambia has been able to maintain orderly conditions in the foreign exchange market during a turbulent period**. The value of maintaining large reserves was amply demonstrated in late 2008 and early 2009 when the kwacha came under sustained pressure. The sale of foreign exchange during this period also helped the BoZ in meeting the end-June 2009 reserve money target. Against this background, the BoZ envisages a modest further increase in international reserves during 2010.

27. **One of the government's major challenges is to increase fiscal space for infrastructure and social sector spending**. The government's objective of sustaining high growth over the medium term by diversifying of the economy--which is premised on investment in infrastructure and human capital--will require substantial resources, most of which will have to come from domestic sources. A sustained effort is needed on both the resource and spending sides to create additional fiscal space.

28. **The government needs to reverse the erosion of tax revenue by reforming tax policy and administration**. While the decline in the revenue ratio has been particularly marked in 2009, it is part of a multi-year declining trend. The trend is evident for all taxes, with the exception of the personal income tax. A thorough review of the tax system and administration is necessary to identify measures that can be taken to raise the tax take over the medium term.

29. **Public financial management reforms need to continue**. The alignment of the budget cycle to the fiscal year is a welcome development that should strengthen budget execution. However, it is necessary to ensure closer conformity between the adopted and

executed budget. A new budget act represents one step in that direction, as do the ongoing reforms related to the TSA and IFMIS. In general, PFM reforms should aim to ensure that government spending becomes more efficient.

30. **Reversing the upward trend in the wage bill will free up resources for other important government priorities**. Salaries and benefits of civil servants have taken up a rather large and rising share of domestically-generated resources. Civil service and pay reform, and resistance to unaffordable wage demands are necessary.

31. **Zambia's risk of debt distress is low and there is some scope for external borrowing on non-concessional terms**. The updated DSA shows that, even with extreme shocks and allowing for substantial external borrowing on commercial terms, Zambia is unlikely to breach debt sustainability thresholds for the foreseeable future. Thus, there is some scope for non-concessional borrowing to finance government's share in essential infrastructure projects, particularly in electricity generation. External borrowing for this purpose should be undertaken in the context of a robust debt management strategy.

32. **The floating exchange rate regime and reserve money targeting have served Zambia well**. Developments over the last year demonstrate the important role the floating exchange rate plays for enabling the Zambian economy to adjust to external shocks. Adherence to a reserve money targeting regime has also brought greater price stability. Any decision to transition to an inflation targeting regime, centered on an interest rate-based monetary policy, should be premised on further analysis and on ensuring that the necessary preconditions are put in place. Meanwhile, the exchange rate and domestic, economic and financial policies are consistent with external stability.

33. **Continued financial sector reforms will serve towards enhancing financial intermediation**. Although a large number of banks operate in Zambia, lending rates and interest rate spreads remain high, slowing the deepening of financial intermediation. Further financial sector reforms and changes in how the BoZ interacts with financial markets are needed. To test the interest rate response, the authorities are considering a limited redemption of government domestic debt through the sale of foreign exchange from international reserves. The implementation of the second phase of the financial sector development plan should be pursued assiduously.

34. **An important step has been taken to raise electricity tariffs towards cost recovery levels**. The August 2009 increase in electricity tariffs is the first move toward creating an attractive environment for private sector investment in electricity generation in Zambia, However, tariffs still remain well below cost recovery levels and it will be necessary to adhere to a multiyear program of tariff increases is needed. Moreover, progress in strengthening the financial and operational efficiency of ZESCO needs to be accelerated.

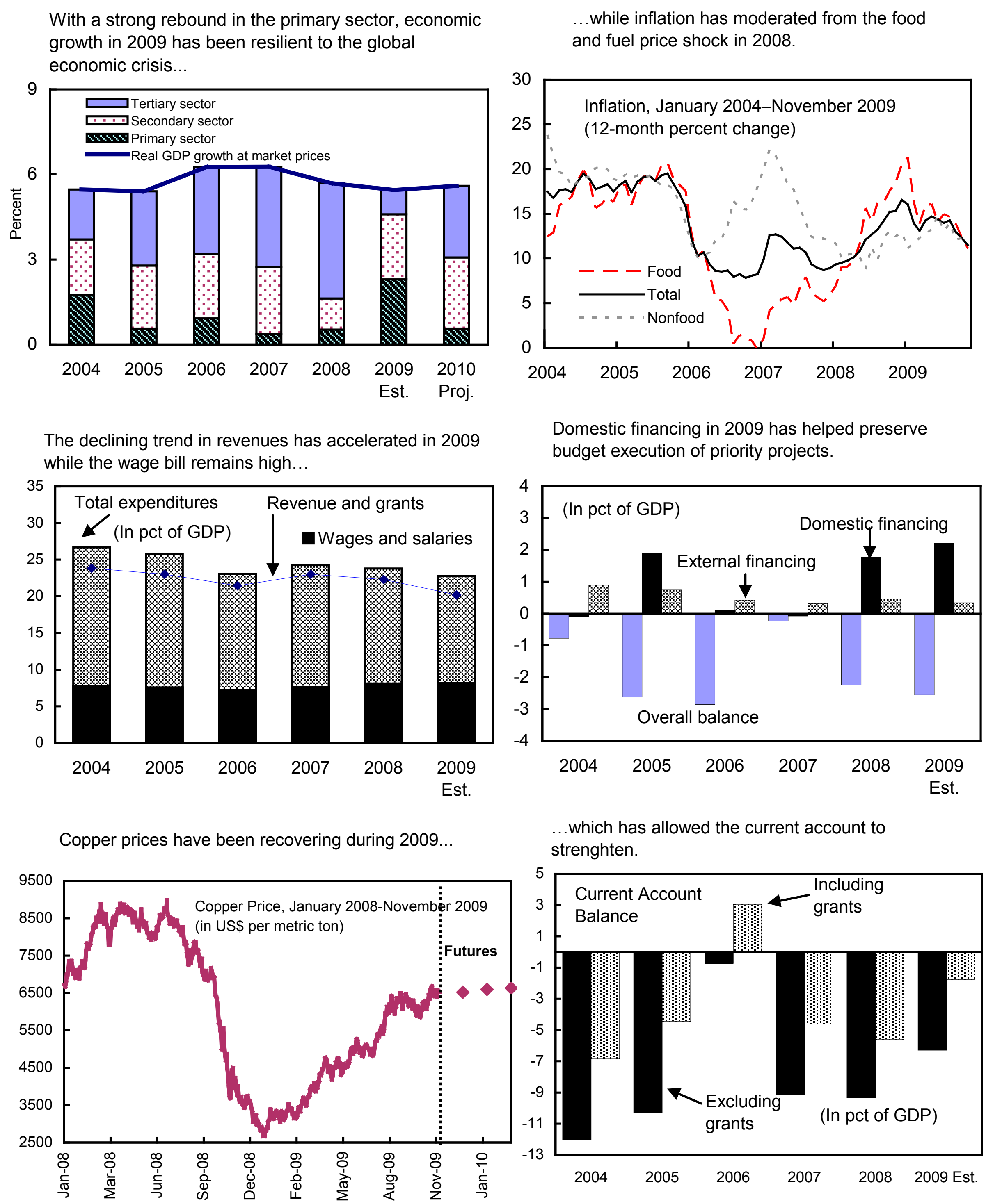
35. **Improvements in the compilation of economic statistics are needed**. The rebasing of the national accounts and the consumer price index is a priority matter. The government

needs to ensure that adequate human and financial resources are made available for this purpose.

36. **It is recommended that the third review of the PRGF arrangement be completed**. All quantitative performance criteria for the review were met and satisfactory progress was made on structural reforms.

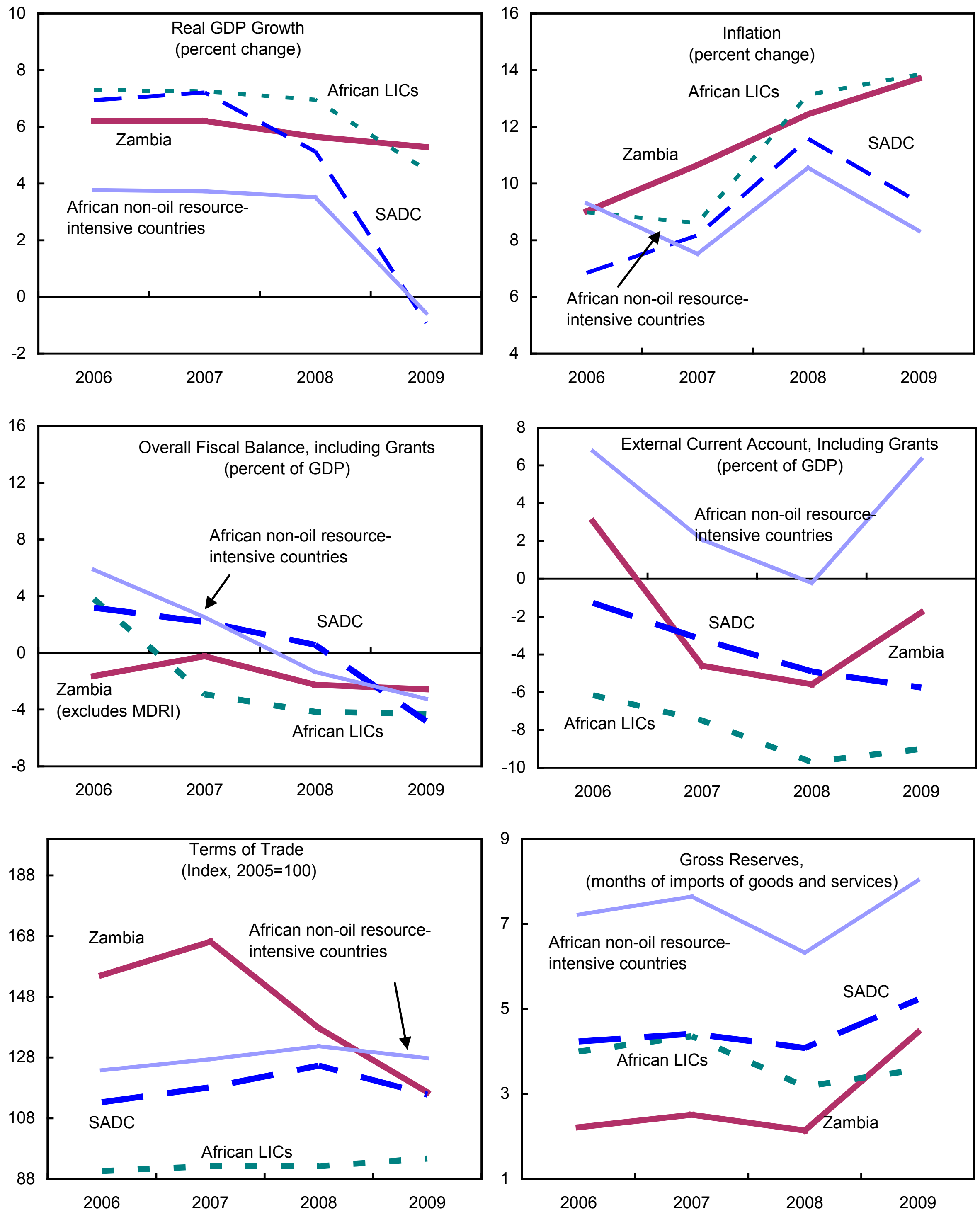
37. It is proposed that the next Article IV consultation be held on the 24-month consultation cycle, subject to the provisions of the decision on consultation cycles approved on July 15, 2003.

Figure 1. Zambia: Selected Macroeconomic Indicators



Sources: Zambian authorities, IMF staff, and World Economic Outlook (WEO).

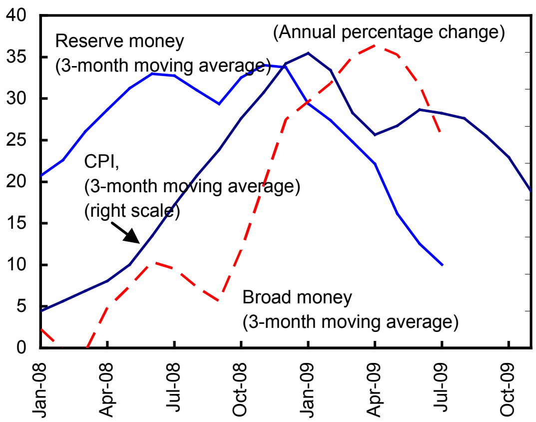
Figure 2. Zambia: Cross Country Comparison, 2006–09[1,2]



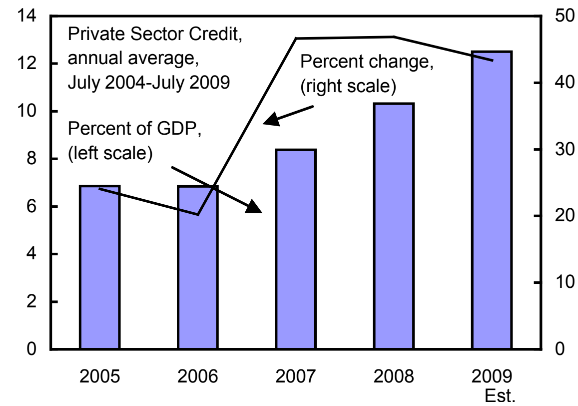
Sources: IMF, African Department database, March 20, 2009; and World Economic Outlook (WEO) database, June 15, 2009.
[1]African LICs are: Benin, Burkina Faso, Ethiopia, Ghana, Kenya, Madagascar, Malawi, Mali, Mozambique, Niger, Rwanda, Senegal, Tanzania, Uganda, and Zambia.
[2] African non-oil resource-intensive countries are: Botswana,Côte d'Ivoire, Guinea, Namibia, São Tomé and Principe, Sierra Leone, and Zambia.

Figure 3. Zambia: Selected Financial Market Indicators

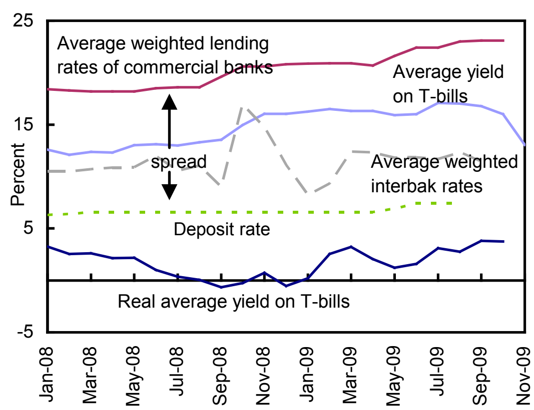
Monetary policy has remained sufficiently firm in order to keep inflation on a downward path...



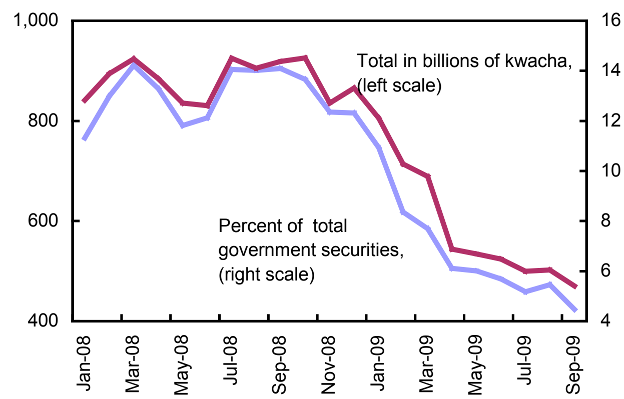
...while providing enough room for growth-enhancing private sector credit expansion.



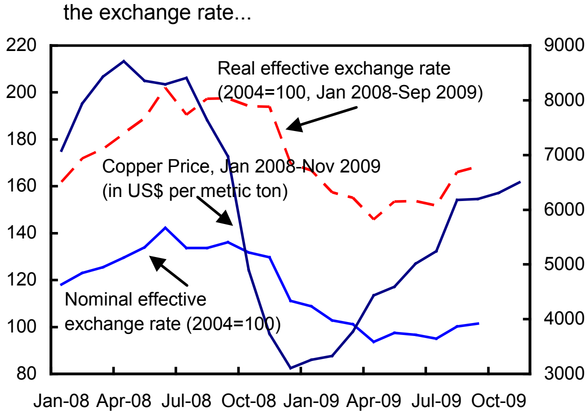
However, interest rate spreads remain among the highest in the SSA region.



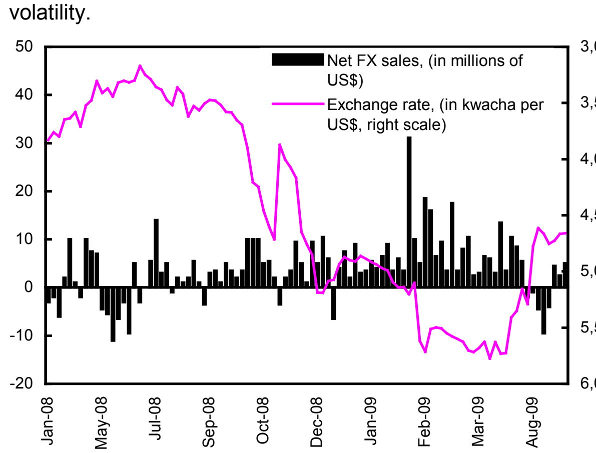
In the midst of the global economic crisis, foreign demand for government securities has declined.



Fluctuations in the copper price have influenced the exchange rate...



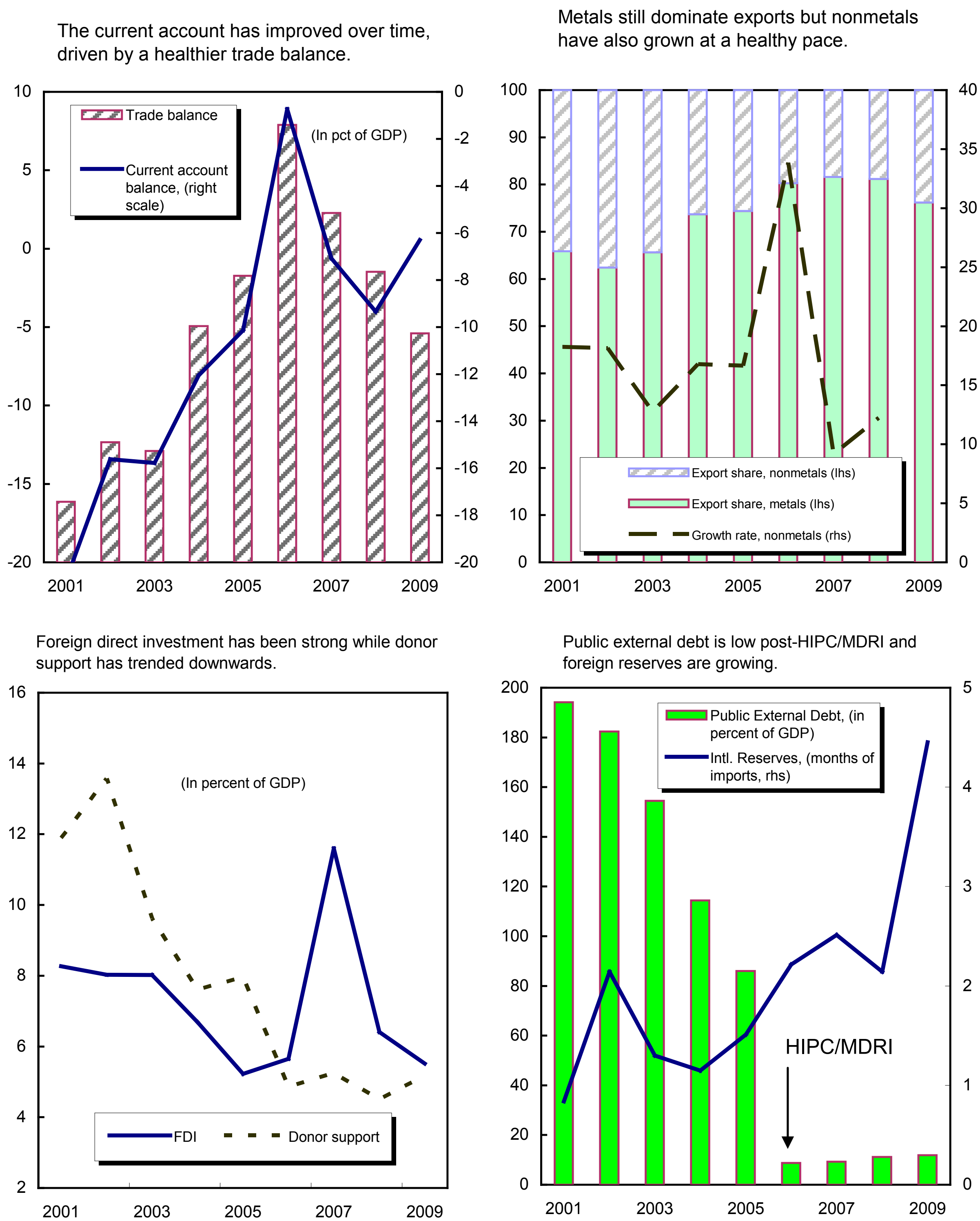
…while the central bank has intervened in times of high volatility.



[1] Excludes Zimbabwe.

Source: Zambian authorities, IMF staff, and World Economic Outlook (WEO).

Figure 4. Zambia: External Developments



Source: Zambian authorities, IMF staff, and World Economic Outlook (WEO).

Table 1. Zambia: Selected Economic Indicators

	2008	2009		2010	2011	2012
		Prog.	Rev. Prog.	Prog.	Proj.	Proj.
National account and prices						
GDP at constant prices	5.7	4.0	5.3	5.5	6.0	6.2
GDP deflator	12.9	7.8	12.4	10.7	8.3	7.3
GDP at market prices	55,079	60,232	65,196	76,191	87,446	99,726
(Billions of kwacha)						
Consumer prices						
Consumer prices (average)	12.4	12.5	13.7	10.1	7.5	6.5
Consumer prices (end of period)	16.6	10.0	12.0	8.0	7.0	6.0
External sector						
Terms of trade (deterioration -)	-17.1	-34.0	-15.4	7.4	-2.0	-4.5
Average exchange rate (kwacha per U.S. dollar)	3,754	…	…	…	…	…
(percentage change; depreciation -)	6.2	…	…	…	…	…
Real effective exchange rate (depreciation -)[1]	-16.5	…	…	…	…	…
Money and credit (end of period)						
Domestic credit to the private sector	50.2	16.2	14.3	20.1	…	…
Reserve money[2]	28.4	14.0	19.0	19.0	…	…
Broad Money (M3)	22.0	13.8	19.0	19.0	…	…
National accounts						
Gross investments	19.4	22.1	22.1	23.5	22.3	22.2
Government	3.6	5.2	4.2	5.0	5.0	5.1
Private	15.9	16.9	17.9	18.5	18.7	18.6
National savings	13.9	15.0	20.3	21.0	19.4	19.1
Gross foreign savings	5.6	7.1	1.8	2.5	2.9	3.1
Central government budget						
Overall balance[3]	-2.2	-2.4	-2.6	-2.4	-1.6	-1.5
(excluding grants)	-6.0	-7.1	-7.1	-5.3	-4.1	-3.7
Revenue	18.6	16.3	15.7	15.9	15.9	16.4
Tax	17.5	15.6	15.0	14.9	15.4	15.8
Nontax	1.0	0.7	0.7	0.9	0.5	0.5
Grants	3.8	4.7	4.5	2.9	2.5	2.2
Total expenditure	23.8	23.4	22.8	21.2	20.0	20.1
Current expenditures	19.1	18.3	18.0	16.9	15.6	14.2
Of which: Wages and salaries	8.1	7.8	8.2	7.9	7.5	7.2
Capital expenditure	3.6	4.5	4.2	4.0	4.1	5.6
Domestic arrears payments	1.1	0.5	0.5	0.4	0.2	0.2
External sector						
Current account balance						
(including current and capital grants)	-5.6	-7.1	-1.8	-2.5	-2.9	-3.1
(excluding grants)	-9.3	-12.1	-6.3	-5.5	-5.5	-5.4
Gross international reserves (months of imports)[4]	2.1	3.1	4.5	4.1	4.1	4.2
Public debt						
Total central government debt (end-period)	26.7	22.3	26.4	27.6	28.0	27.9
External	11.2	10.1	11.9	14.2	15.3	15.9
Domestic	15.5	12.3	14.5	13.4	12.6	11.9

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

[1]Excludes Zimbabwe.

[2]The projected reduction in reserve money for December 2007 reflects the lowering of statutory reserve requirements from 14 to 8 percent on October 1, 2007.

[3] Including discrepancy between the above-the-line balance and below-the-line financing.

[4]Imports in current year. Includes the new SDR allocation of SDR 401 millions in 2009.

Table 2. Zambia: Fiscal Operations of the Central Government
(Billions of kwacha)

	2008	Jun 2009		2009		2010	2011	2012
		Prog.	Prel.	Prog.	Rev. Prog.	Prog.	Proj.	Proj.
Revenue and grants	12,290	6,871	6,441	13,681	13,174	14,343	16,092	18,533
Revenue	10,221	5,009	4,660	10,649	10,226	12,107	13,876	16,306
Tax	9,653	4,824	4,470	10,195	9,757	11,385	13,429	15,794
Income taxes	4,678	2,258	2,362	4,657	5,024	5,730	6,842	8,221
Value-added tax	2,201	1,161	1,095	2,448	2,496	2,940	3,464	3,958
Excise taxes	1,424	742	486	1,657	1,082	1,397	1,616	1,893
Customs duties	1,351	661	527	1,432	1,155	1,318	1,506	1,722
Nontax	567	186	190	454	469	722	447	512
Grants[1]	2,069	1,861	1,781	3,032	2,948	2,236	2,216	2,227
Budget support	642	761	362	832	990	790	924	952
Project grants	1,427	1,100	1,419	2,200	1,958	1,446	1,293	1,274
Expenditures	13,098	7,642	7,469	15,248	14,841	16,178	17,476	19,997
Current expenditures	10,539	6,120	6,054	11,943	11,760	12,874	13,663	14,202
Wages and salaries	4,465	2,484	2,441	5,100	5,317	6,019	6,575	7,157
Goods and services	2,808	1,607	1,828	3,491	3,147	3,793	3,184	3,106
Interest payments	950	545	515	1,068	1,017	1,246	1,281	1,292
Other	2,315	1,484	1,270	2,284	2,279	1,815	2,623	2,646
Capital expenditure	1,966	1,362	1,216	2,953	2,729	3,035	3,628	5,599
Of which: domestically financed	1,271	799	620	1,828	1,810	1,882	2,901	4,931
Domestic arrears payments	593	161	199	352	352	269	185	196
Discrepancy (-overfinancing)[2]	-427	0	892	0	0	0	0	0
Overall balance								
Including grants	-1,236	-772	-135	-1,567	-1,667	-1,835	-1,384	-1,464
Excluding grants	-3,304	-2,633	-1,916	-4,600	-4,615	-4,071	-3,600	-3,690
Financing	1,236	772	135	1,567	1,667	1,835	1,384	1,464
External financing (net)	257	325	100	397	224	348	281	123
Of which: budget support	113	209	108	209	108	156	167	173
Domestic financing (net)	979	447	35	1,170	1,443	1,487	1,103	1,341
Bank financing	1,189	347	86	970	1,393	1,187	803	791
Of which: BoZ onlending of IMF PRGF	0	0	0	0	423	0	0	0
Nonbank financing	-210	100	-51	200	50	300	300	550
Memorandum items:								
Overall balance, excl. budget grants and mining taxe	-2,654	-1,728	-769	-2,726	-3,282	-3,173	-3,178	-3,756
Primary balance	-285	-227	380	-499	-650	-588	-103	-171
Primary balance, excluding mining taxes	-1,062	-422	108	-826	-1,275	-1,136	-974	-1,511
Mining taxes	776	195	271	327	625	548	871	1,340
External budget support	755	970	470	1,041	1,099	946	1,090	1,125
Stock of domestic arrears	249	88	50	0	269	185	196	0
Stock of domestic government securities	8,517	…	…	7,385	9,458	10,215	11,032	11,915

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

[1] In 2006, this line includes MDRI debt reduction of kwacha 8410 billion.

[2] Discrepancy largely reflects changes in the carryover of budgetary releases. In 2008, this line also includes kwacha 416 billion in offsetting expenditure measures.

Table 3. Zambia: Fiscal Operations of the Central Government
(Percent of GDP)

	2008	Jun 2009		2009		2010	2011	2012
		Prog.	Prel.	Prog.	Rev. Prog.	Prog.	Proj.	Proj.
Revenue and grants	22.3	10.5	9.9	21.0	20.2	18.8	18.4	18.6
Revenue	18.6	7.7	7.1	16.3	15.7	15.9	15.9	16.4
Tax	17.5	7.4	6.9	15.6	15.0	14.9	15.4	15.8
Income taxes	8.5	3.5	3.6	7.1	7.7	7.5	7.8	8.2
Value-added tax	4.0	1.8	1.7	3.8	3.8	3.9	4.0	4.0
Excise taxes	2.6	1.1	0.7	2.5	1.7	1.8	1.8	1.9
Customs duties	2.5	1.0	0.8	2.2	1.8	1.7	1.7	1.7
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Nontax	1.0	0.3	0.3	0.7	0.7	0.9	0.5	0.5
Grants[1]	3.8	2.9	2.7	4.7	4.5	2.9	2.5	2.2
Budget support	1.2	1.2	0.6	1.3	1.5	1.0	1.1	1.0
Project grants	2.6	1.7	2.2	3.4	3.0	1.9	1.5	1.3
Expenditures	23.8	11.7	11.5	23.4	22.8	21.2	20.0	20.1
Current expenditures	19.1	9.4	9.3	18.3	18.0	16.9	15.6	14.2
Wages and salaries	8.1	3.8	3.7	7.8	8.2	7.9	7.5	7.2
Goods and services	5.1	2.5	2.8	5.4	4.8	5.0	3.6	3.1
Interest payments	1.7	0.8	0.8	1.6	1.6	1.6	1.5	1.3
Other	4.2	2.3	1.9	3.5	3.5	2.4	3.0	2.7
Capital expenditure	3.6	2.1	1.9	4.5	4.2	4.0	4.1	5.6
Of which: domestically financed	2.3	1.2	1.0	2.8	2.8	2.5	3.3	4.9
Domestic arrears payments	1.1	0.2	0.3	0.5	0.5	0.4	0.2	0.2
Discrepancy (-overfinancing)[2]	-0.8	0.0	1.4	0.0	0.0	0.0	0.0	0.0
Overall balance								
Including grants	-2.2	-1.2	-0.2	-2.4	-2.6	-2.4	-1.6	-1.5
Excluding grants	-6.0	-4.0	-2.9	-7.1	-7.1	-5.3	-4.1	-3.7
Financing	2.2	1.2	0.2	2.4	2.6	2.4	1.6	1.5
External financing (net)	0.5	0.5	0.2	0.6	0.3	0.5	0.3	0.1
Of which: budget support	0.2	0.3	0.2	0.3	0.2	0.2	0.2	0.2
Domestic financing (net)	1.8	0.7	0.1	1.8	2.2	2.0	1.3	1.3
Bank financing	2.2	0.5	0.1	1.5	2.1	1.6	0.9	0.8
Nonbank financing	-0.4	0.2	-0.1	0.3	0.1	0.4	0.3	0.6
Memorandum items:								
Overall balance, excl. budget grants and mining taxes	-4.8	-2.7	-1.2	-4.6	-5.0	-4.2	-3.6	-3.8
Primary balance	-0.5	-0.3	0.6	-0.8	-1.0	-0.8	-0.1	-0.2
Primary balance, excluding mining taxes	-1.9	-0.6	0.2	-1.7	-2.0	-1.5	-1.1	-1.5
Mining taxes	1.4	0.3	0.4	1.0	1.0	0.7	1.0	1.3
External budget support	1.4	1.5	0.7	1.6	1.7	1.2	1.2	1.1
Stock of domestic arrears	0.5	0.1	0.1	0.4	0.4	0.2	0.2	0.0
Stock of domestic government securities	15.5	…	…	14.5	14.5	13.4	12.6	11.9
Nominal GDP (in billions of kwacha)	55,079	65,196	65,196	65,196	65,196	76,191	87,446	99,726

Sources: Zambian authorities; and IMF staff estimates and projections.
[1]In 2006, this line includes MDRI debt reduction of kwacha 8410 billion.
[2]Discrepancy largely reflects changes in the carryover of budgetary releases. In 2008, this line also includes kwacha 416 billion in offsetting expenditure measures.

Table 4. Zambia: Monetary Accounts[1]
(Billions of kwacha; unless otherwise indicated)

	2007	2008	2009		2010
			Prog.	Rev Prog.	Prog.
Monetary Survey					
Net foreign assets	4,999	5,538	5,045	4,500	4,453
Asset	6,504	7,763	6,626	11,346	11,336
Liabilities	-1,505	-2,224	-1,582	-6,846	-6,883
Net domestic assets	5,708	7,524	9,826	11,045	14,045
Claims on central government (net)	1,894	2,358	3,315	3,751	4,938
Claims on private sector	5,377	8,077	9,382	9,232	11,088
Claims on public enterprises	379	148	160	160	160
Other items (net)[2]	-1,940	-3,058	-3,030	-2,098	-2,141
Broad Money (M3)	10,707	13,063	14,870	15,545	18,498
Quasi money (M2)	6,801	8,691	9,894	9,894	12,307
Foreign exchange deposits	3,906	4,372	4,977	5,651	6,191
Monetary Authorities					
Net foreign assets	3,743	4,660	4,145	3,600	3,553
Asset	4,165	5,223	5,726	8,744	8,734
Liabilities	-422	-563	-1,582	-5,145	-5,181
Of which: IMF liabilities	-361	-503	-1,582	-5,145	-5,181
Net domestic assets	-1,242	-1,449	-484	221	994
Claims on central government (net)	-13	572	165	995	1,351
Claims on nongovernment	235	187	265	202	202
Claims on private sector	56	45	65	60	60
Claims on public enterprises	0	0	0	0	0
Claims on other depository corporations (net)	179	142	200	142	142
Other items (net)[2]	-1,464	-2,209	-914	-976	-559
Reserve money	2,500	3,211	3,661	3,821	4,547
Currency outside banks and cash in vaults	1,513	1,932	…	2,299	2,736
Other depository corporation reserves	987	1,279	…	1,522	1,812
Memorandum items:					
Reserve money	1.6	28.4	14.0	19.0	19.0
Broad Money (M3)	26.3	22.0	13.8	19.0	19.0
Credit to the private sector	43.0	50.2	16.2	14.3	20.1
Velocity (M3/Nominal GDP)	4.3	4.2	4.4	4.2	4.1
Money multiplier (M3/reserve money)	4.3	4.1	4.1	4.1	4.1
Credit to the private sector (percent of GDP)	11.6	14.7	14.4	14.2	14.6
Gross foreign exchange reserves of the Bank of Zambia (millions of U.S. dollars)	947	976	1,076	1,740	1,821
Exchange rate (kwacha per U.S. dollar, end period)	3,845	4,832	…	…	…

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

[1]End of period.

[2]Include valuation and HIPC Initiative Account (balances were K3,253 billion and K2,209 billion at end-2005 and end-2006, respectively).

Table 5. Zambia: Balance of Payments[1]

(Millions of U.S. dollars, unless otherwise indicated)

	2007	2008 Prel.	2009 Proj.	2010 Proj.	2011 Proj.	2012 Proj.
Current account	-754	-1,049	-522	-597	-657	-728
Trade balance	899	404	245	481	580	575
Exports, f.o.b.	4,510	4,959	4,175	4,928	5,241	5,429
Of which: copper	3,407	3,684	3,147	3,836	4,063	4,169
Imports, f.o.b	-3,611	-4,554	-3,931	-4,447	-4,661	-4,854
Of which: oil	-493	-816	-474	-622	-686	-742
Services (net)	-640	-615	-524	-651	-688	-719
Income (net)	-1,545	-1,399	-641	-834	-1,015	-1,040
Of which: interest on public debt	-13	-20	-12	-12	-16	-22
Current transfers (net)	530	560	398	407	466	456
Budget support grants	147	171	191	162	176	175
Sector-wide approach grants	156	150	79	92	83	84
Private transfers	228	239	128	152	207	197
Capital and financial account	1,065	1,046	1,049	622	763	871
Capital account	223	230	299	204	164	151
Project grants	223	230	299	204	164	151
External debt cancellation	0	0	0	0	0	0
Financial account	843	816	751	418	599	720
Foreign direct and portfolio investments	1,366	933	688	723	671	610
Other investments	-523	-116	63	-305	-72	110
Medium and long-term	-523	-116	63	-305	-72	110
Public sector (net)	34	67	43	97	54	23
Disbursements	83	111	83	140	129	102
Of which: budget support	0	32	21	32	32	32
Amortization due	-49	-43	-40	-42	-76	-80
Monetary authority[2]	0	0	627	0	0	0
Commercial banks (net)	-67	143	-13	19	7	5
Other sectors	-490	-327	-595	-422	-133	82
Short-term	0	0	0	0	0	0
Errors and omissions	0	16	0	0	0	0
Overall balance	310	13	527	25	107	143
Financing						
Central bank net reserves (- increase)	-310	-13	-527	-25	-107	-143
Of which: gross reserve change	-352	-29	-764	-80	-129	-131
Of which: Use of Fund loans	42	16	237	56	22	-12
Exceptional financing	0	0	0	0	0	0
Financing gap	0	0	0	0	0	0
Memorandum items:						
Current account, including capital grants (percent of GDP)	-4.6	-5.6	-1.8	-2.5	-2.9	-3.1
Current account, excluding grants (percent of GDP)	-9.2	-9.3	-6.3	-5.5	-5.5	-5.4
Change in copper export volume (percent)	-0.2	2.0	16.9	5.6	5.9	7.1
Copper export price (U.S. dollars per tonne)	7,132	6,275	4,585	5,291	5,291	5,071
Total official grants (percent of GDP)	4.6	3.8	4.5	2.9	2.5	2.2
Gross international reserves	947	976	1,740	1,821	1,949	2,080
In months of imports[3]	2.5	2.1	4.5	4.1	4.1	4.2
GDP (millions of U.S. dollars)	11,542	14,671	12,581	15,630	16,697	18,364

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

[1]Disbursements and imports related to possible future hydropower projects are not included.

[2]SDR allocation, long term liability.

[3]Imports in current year.

Table 6. Zambia: Financial Soundness Indicators

(Percent, unless otherwise indicated)

	2006	2007	2008	2009		
				Mar	Jun	Sep
Capital adequacy						
Regulatory capital to risk-weighted assets	20.4	18.6	18.6	19.0	20.3	20.7
Tier 1 regulatory capital to risk-weighted assets	18.0	15.9	15.7	15.9	16.7	17.4
Capital to total assets	9.1	9.2	9.9	10.8	11.5	11.2
Asset quality						
Past due advances (NPL) to total advances	11.3	8.8	7.2	8.8	10.4	13.1
Loan loss provisions to nonperforming loans	83.3	73.2	104.6	78.5	80.6	86.6
Bad debt provisions to advances	6.8	6.4	6.1	6.9	8.4	11.3
Loan concentration						
Households	16.1	15.5	30.1	28.8	28.6	30.0
Government and parastatals	6.2	9.1	1.9	1.8	1.9	2.5
Agriculture	23.9	18.4	16.0	17.0	17.5	16.2
Mining	4.4	4.1	5.0	5.0	4.9	4.3
Manufacturing	14	11.0	11.0	11.0	11.1	10.9
Construction	2.4	3.7	4.0	3.0	2.9	3.1
Services	9.8	13.3	9.0	13.0	10.4	11.4
Others	23.2	25.0	23.0	20.4	22.7	21.6
Earnings and profitability						
Return on average assets	5.1	4.7	3.6	3.2	2.2	1.3
Return on equity	30.6	35.1	20.8	18.0	10.0	3.2
Gross interest income to total gross income	60.2	63.1	66.6	64.9	62.0	64.8
Gross noninterest income to total gross income	39.8	36.9	33.4	35.1	38.0	35.2
Net interest margin	12.8	11.5	10.4	10.5	10.6	10.8
Liquidity [1]						
Liquid assets to total assets	41.3	37.6	35.5	33.2	34.0	35.6
Liquid assets to total deposits	49.6	46	49.9	47.3	47.9	59.5
Advances to deposits ratio	49	57.4	66.3	72.1	69.0	66.3
Exposure to foreign currency						
Foreign currency loans to total gross loans	34.0	32.5	42.1	51.7	38.6	34.3
Foreign currency liabilities to total liabilities	61.2	27.1	35.8	42.1	41.6	38.4
Net open position in foreign exchange to capital	9.4	7.1	6.9	4.8	5.8	5.8
Exposure to household debt						
Household debt to GDP	1.5	…	…	…	…	…

Source: Bank of Zambia.

[1] Liquid assets were redefined to exclude one-year Treasury bills beginning in 2005.

Table 7. Zambia: Indicators of Capacity to Repay the Fund[1]

		Projection					
	2009	2010	2011	2012	2013	2014	2015
Fund obligations based on existing credit							
(in millions of SDRs)							
Principal	0.0	0.6	3.3	7.7	11.7	23.1	33.2
Charges and interest	0.5	1.0	1.0	1.0	1.0	0.9	0.7
Fund obligations based on existing and prospective credit							
(in millions of SDRs)							
Principal	0.0	0.6	3.3	7.7	11.7	23.1	45.3
Charges and interest	0.6	1.4	1.5	1.5	1.5	1.4	1.3
Total obligations based on existing and prospective credit							
In millions of SDRs	0.6	1.9	4.8	9.2	13.2	24.5	46.5
In millions of US$	0.9	3.0	7.5	14.3	20.5	38.0	72.1
In percent of exports of goods and services	0.0	0.1	0.1	0.2	0.3	0.6	1.0
In percent of debt service[2]	1.7	5.4	7.7	12.6	17.3	27.0	40.3
In percent of GDP	0.0	0.0	0.0	0.1	0.1	0.2	0.3
In percent of Gross International Reserves	0.0	0.2	0.4	0.7	0.9	1.5	2.9
In percent of quota	0.1	0.4	1.0	1.9	2.7	5.0	9.5
Outstanding Fund credit							
In millions of SDRs	219.9	256.2	271.3	263.6	251.9	228.8	183.5
In millions of US$	337.0	398.7	421.5	409.2	390.7	354.3	284.1
In percent of exports of goods and services	7.6	7.6	7.6	7.1	6.3	5.3	3.9
In percent of debt service[2]	649.6	718.6	433.3	359.4	330.6	251.8	158.9
In percent of GDP	2.7	2.6	2.5	2.2	1.9	1.6	1.2
In percent of Gross International Reserves	19.4	21.9	21.6	19.7	17.3	14.5	11.3
In percent of quota	45.0	52.4	55.5	53.9	51.5	46.8	37.5
Net use of Fund credit (in millions of SDRs)	157.9	36.2	15.1	-7.7	-11.7	-23.1	-45.3
Disbursements	157.9	36.8	18.4	0.0	0.0	0.0	0.0
Repayments	0.0	-0.6	-3.3	-7.7	-11.7	-23.1	-45.3
Memorandum items:							
Exports of goods and services (in millions of US$)	4,413	5,224	5,557	5,777	6,186	6,648	7,302
Debt service (in millions of US$)[2]	52	55	97	114	118	141	179
Nominal GDP (in millions of US$)	12,581	15,630	16,697	18,364	20,166	22,195	24,366
Gross International Reserves (in millions of US$)	1,740	1,821	1,949	2,080	2,260	2,451	2,520
Quota (millions of SDRs)	489	489	489	489	489	489	489

Sources: IMF staff estimates and projections.

[1]Original PRGF disbursements of SDR 48.91 million (10 percent of quota) during 2008-11; and augmentation of SDR 171.2 million (35 percent of quota) during 2009-11; in total, SDR 200.1 million (45 percent of quota) during 2008-11.

[2]Total debt service includes IMF repayments.

Table 8. Zambia: Schedule of Disbursements Under the PRGF Arrangement[1]

Availability	Current: Millions of SDRs	Current: Percent of quota	Conditions for Disbursement
June 4, 2008	6.987	1.429	Board approval of the three-year PRGF arrangement
November 30, 2008[2]	6.987	1.429	Board completion of the first review based on observance of performance criteria for June 30, 2008
May 1, 2009[2]	99.923	20.430	Board completion of the first and second review based on observance of performance criteria for June 30 and December 31, 2008
November 30, 2009	51.013	10.430	Board completion of the third review based on observance of performance criteria for June 30, 2009
May 30, 2010	18.395	3.761	Board completion of the fourth review based on observance of performance criteria for December 31, 2009
November 30, 2010	18.395	3.761	Board completion of the fifth review based on observance of performance criteria for June 30, 2010
May 30, 2011	18.395	3.761	Board completion of the sixth review based on observance of performance criteria for December 31, 2010
Total disbursements	**220.095**	**45.0**	

Source: IMF staff estimates.

[1]Original PRGF disbursements of SDR 48.91 million (10 percent of quota) during 2008–11; and augmentation of SDR 171.2 million (35 percent of quota) during 2009–11; in total, SDR 220.1 million (45 percent of quota) during 2008–11.

[2]Disbursements made available upon completion of the first and second reviews on May 1, 2009.

Table 9. Zambia: Millennium Development Goals

	1997	2000	2003	2005	2007	2015 Target
Goal 1: Eradicate extreme poverty and hunger[1]						
Population below US$ 1 dollar a day (in percent)	66.0	…	76.0	64.0	…	29.0
Poverty gap ratio at US$ 1 dollar a day (in percent)	34.0	…	36.0	33.0	…	31.0
Percentage share of income or consumption held by poorest 20 percent	3.3	…	6.0	4.0	…	
Poverty headcount, national (percent of population)	72.9	…	…	68.0	…	
Prevalence of underweight children (percent of children under 5)	23.5	…	23.0	…	19.3	11.0
Population below minimum level of dietary energy consumption (in percent)	48.0	…	47.0	46.0	…	29.0
Goal 2: Achieve universal primary education[2]						
Net primary enrollment ratio (percent of relevant age group)	64.9	62.6	79.8	88.9	95.4	100.0
Primary completion rate, total (percent of relevant age group)	61.6	56.3	66.2	77.5	88.1	
Percentage of pupils starting grade 1 who reach grade 5 (in percent)	78.2	98.5	…	…	…	100.0
Youth literacy rate (percent ages 15–24)	...	69.4	…	69.5	75.1	100.0
Goal 3: Promote gender equality[3]						
Ratio of girls to boys in primary and secondary education (in percent)	89.7	90.4	92.3	…	93.0	100.0
Ratio of young literate females to males (percent ages 15–24)	...	...	...	91.2	…	100.0
Share of women employed in the nonagricultural sector (in percent)	...	...	...	...	…	
Proportion of seats held by women in national parliament (in percent)	10.0	10.0	12.0	15.0	14.6	30.0
Goal 4: Reduce child mortality[4]						
Under 5 mortality rate (per 1,000)	...	182.0	182.0	182.0	170	56.0
Infant mortality rate (per 1,000 live births)	...	102.0	102.0	102.0	103	30.0
Immunization, measles (percent of children under 12 months)	86.0	85.0	84.0	84.0	85	
Goal 5: Improve maternal health[5]						
Maternal mortality ratio (modeled estimate, per 100,000 live births)	...	750.0	...	830.0	…	162.0
Births attended by skilled health staff (percent of total)	46.5	47.1	43.4	...	46.5	
Goal 6: Combat HIV/AIDS, malaria, and other diseases[6]						
Prevalence of HIV, total (percent of population ages 15-49)	...	16.7	16.9	17.0	15.2	16 or less
Contraceptive prevalence rate (percent of women ages 15-49)	25.9	53.5	34.0	...	…	
Number of children orphaned by HIV/AIDS	...	570,000	630,000	...	600,000	
Incidence of tuberculosis (per 100,000 people)	575.5	605.0	658.3	600.1	506.1	
Tuberculosis cases detected under DOTS (in percent)	...	...	62.0	51.6	58.3	
Goal 7: Ensure environmental sustainability[7]						
Forest area (percent of total land area)	...	60.1	...	57.1	…	
Nationally protected areas (percent of total land area)	...	...	42.0	...	41.1	
GDP per unit of energy use (PPP US$ per kg oil equivalent)	1.3	1.3	1.4	1.5	…	
CO_2 emissions (metric tons per capita)	0.24	0.17	0.19	...	0.21	
Access to an improved water source (percent of population)	...	...	58.0	...	58	75.5
Access to improved sanitation (percent of population)	...	...	55.0	...	52	87.0
Access to secure tenure (percent of population)	...	...	...	...	…	
Goal 8: Develop a Global Partnership for Development[8]						
Youth unemployment rate (percent of total labor force ages 15–24)	...	...	...	...	…	
Fixed line and mobile telephones (per 1,000 people)	8.2	17.0	29.2	89.2	…	
Internet users (per 1,000 people)	0.0	0.2	1.0	2.9	5.03	

Source: *World Development Indicators* Database, April 2008.

Note: In some cases the data are for earlier or later years than those stated.

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

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

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

[4] Goal 4 target: Reduce by two-thirds, between 1990 and 2015, the under-5 mortality rate.

[5] Goal 5 target: Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio.

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

[7] Goal 7 targets: Integrate the principles of sustainable development into country policies and programs and reverse the loss of environmental resources. Halve, by 2015, the proportion of people without sustainable

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

APPENDIX I. LETTER OF INTENT

December 3, 2009

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, D.C. 20431, U.S.A.

Dear Mr. Strauss-Kahn,

The attached Memorandum of Economic and Financial Policies (MEFP) reviews recent economic developments and progress in implementing the Government of Zambia's macroeconomic and structural program under the country's three-year Poverty Reduction and Growth Facility (PRGF), approved by the IMF Executive Board on June 4, 2008. It also sets out macroeconomic policies and structural reforms that the government will pursue for the remainder of 2009, in 2010 and over the medium term.

All of the performance criteria for the third review under the PRGF were met. There was good progress overall in terms of structural reforms, though there were modest delays in the implementation of two of the structural benchmarks. The Government requests that the fourth disbursement be made available upon completion of the third review by the Executive Board of the IMF.

The Government believes that the policies and measures set forth in the attached MEFP are adequate to achieve the objectives of the program. Our economic program for the remainder of the year has been revised to take into account recent developments, and we request modifications to the end-December 2009 performance criteria on net domestic assets, net domestic financing, and gross international reserves. Given the Government's commitment to these objectives, it will promptly take any additional measures necessary for their achievement. The Government will consult with the IMF—at its own initiative or whenever the Managing Director of the IMF requests such a consultation—on the adoption of these measures and in advance of revisions to policies contained in the MEFP, in accordance with the Fund's policies on such consultation.

The Government will provide the Fund with such information as the Fund may request in connection with the progress made in implementing the economic and financial policies and achieving the objectives of the program.

The Government authorizes the IMF to publish this letter, the attached Memorandum of Economic and Financial Policies, and the related Staff Report, including placement of these documents on the IMF website subject to the removal of market-sensitive information, following the IMF Executive Board's conclusion of the review.

Yours sincerely,

/s/
Dr. Situmbeko Musokotwane
Minister of Finance and National Planning

Attachments (2)

ATTACHMENT I

Memorandum of Economic and Financial Policies

1. This memorandum reviews recent economic developments and outlines policies and targets that the Government of the Republic of Zambia will pursue for the remainder of 2009, in 2010, and in the medium-term under the Poverty Reduction and Growth Facility (PRGF) arrangement.

I: RECENT ECONOMIC DEVELOPMENTS

2. **The impact of the global financial crisis on the Zambian economy has been less severe than was expected earlier this year**. The projection for real GDP growth has been revised upwards to 5.3 percent for 2009, as a result of historically high growth in mining and agriculture. Copper prices, which had dropped rather sharply in the second half of 2008, recovered steadily during 2009, reducing the impact of the crisis on the mining sector, and the economy as a whole. Copper production reached thirty-year highs as a result of a large new mine commencing operations, while the agricultural harvest was the highest recorded in ten years. Notwithstanding the strong performance of the primary sector, overall growth has been offset by a sharp decline in tourism and a deceleration in other tertiary sectors. Accounting for increases from the SDR allocation and earlier augmentation under the PRGF, gross international reserves rose by US$714 million in 2009 to reach a projected US$1.74 billion at end-2009 (equivalent to 4.5 months of import cover). Whereas the kwacha depreciated sharply in the first half of the year, it subsequently recovered. The end-year inflation target of 10 percent is unlikely to be met as a result of somewhat persistent food inflation and a rise in energy prices. Inflation is currently projected to decline to 12 percent by end-2009.

3. **Fiscal developments have been characterized by a shortfall in tax collections and in pledged inflows from** cooperating **partners in 2009.** The shortfall in total revenues and grants relative to the program is projected to reach 0.8 percent of GDP by the end of the year. Significant declines in import-related tax collections, amounting to an estimated 1.3 percent of GDP, were the main contributing factor. Pledged cooperating partner resources amounting to US$60 million (0.5 percent of GDP) are yet to be disbursed, leading to further potential shortfalls. The government has committed to contain administrative expenditures to reduce budgetary pressures and protect the monetary program. Simultaneously, it is committed to safeguarding poverty reducing capital and social expenditures. As a result, the overall fiscal deficit is expected to widen marginally to 2.5 percent of GDP, supported by an increase in net domestic financing.

4. **The monetary program was in line with the program's targets for the year to June 2009.** This largely reflected the net sales of foreign exchange by the Bank of Zambia early in the year to dampen excessive volatility in the exchange rate on account of elevated

demand pressures. These demand pressures emanated from the continued effects of the global financial crisis on the domestic economy as well as bunched agricultural input and oil import requirements. Reserve money declined by 3 percent in the six-month period through June 2009, compared to the programmed decline of 13 percent. Consistent with the development in the monetary aggregates, credit to the private sector also slowed sharply from 50.2 percent annual growth in December 2008 to 34 percent growth in June as financial institutions continued to tighten lending standards as credit quality deteriorated. This deterioration was evidenced by an increase in non-performing loans in the banking system from 7.2 percent in December 2008 to 13.8 percent in September 2009.

5. **Having been impacted negatively by the global financial crisis in the first half of 2009, the balance of payments position is expected to improve in the second half of the year.** Imports contracted, as demand from households and firms responded to the movement in relative prices associated with the sharp depreciation of the exchange rate earlier in the year. The robust rebound in copper prices from the second quarter of 2009 will also contribute to the narrower current account deficit (including grants) of 4.7 percent of GDP in 2009 compared to 7.8 percent in 2008. The trade balance is expected to narrow to 1.3 percent of GDP in 2009 from 2.8 percent of GDP in 2008.

6. **The program was on track through the first half of 2009, with all of the quantitative performance criteria and indicative targets being met.** Two of the three structural benchmarks were met through end-June, with some delays occurring on the efforts to set up a supervisory regime for the secondary market in Government securities. This delay was due to the need to complete a wider consultation process in order to allow for effective implementation. The intention is now to put the framework for the secondary market in place by end-March 2010.

7. **Significant strides have been made in poverty reduction efforts, and Zambia is progressing well towards attaining its millennium development goals.** Revised data from the 2006 Living Conditions Monitoring Survey indicate that the proportion of Zambians living below the poverty line fell to 59.7 percent from 68 percent in 2004. While there has been significant progress in urban poverty reduction, the challenge for the government remains to tackle rural poverty and service delivery in the medium term. Data from the 2007 Zambian Demographic Health Survey has also shown significant reductions in maternal, infant, and child mortality rates, and in the incidence of major diseases. In addition, Zambia is well on track to meeting its millennium development goal of universal primary education.

II: MEDIUM-TERM MACROECONOMIC FRAMEWORK

8. **Economic growth is expected to strengthen over the medium term.** Real GDP growth is expected to rise marginally to 5.5 percent in 2010 and further to 6.5 percent over the medium term. Growth in 2010 will be driven by a recovery in the tertiary sector, and continued increases in mining and construction activities. Mines that had been closed down as a result of the crisis are expected to reopen in 2010, and a rebound in tourism activity is expected in connection with the 2010 Football World Cup in South Africa. Downside risks, however, still remain amidst uncertainties about a full-fledged global recovery in 2010 and steadily rising oil prices. Growth over the medium term is premised on the realization of policy initiatives and structural reforms aimed at economic diversification and enhanced competitiveness. Additionally, growth will be boosted by new investments in mining and electricity generation.

9. **The creation of fiscal space will continue to be an important goal of the government, in order to provide space for increased expenditures on infrastructure and social sector spending.** Despite a favorable medium-term outlook for economic growth, there are some near-term fiscal challenges relating to containing the rise of public service wage bill as well as reversing the decline in tax revenues as a proportion of GDP that has been experienced over the past few years. In addition, there will be some one-time outlays that will need to be financed, such as statutory expenditures relating to the national census and the forthcoming presidential elections in 2011.

10. **Over the medium term, mining and non-mining imports are expected to rise strongly as mines prepare to ramp up production in 2010 and beyond, foreign direct investment (FDI) inflows rebound, and economic growth gathers pace.** Furthermore, large new import-intensive infrastructure projects, particularly in the energy sector, will require sizable financing. In most of these projects, the Government is likely to have some equity participation in order to attract private sector investment.

III: POLICIES FOR 2010

A: Fiscal Policy

11. **Fiscal policy will continue to remain focused on supporting the government's diversification agenda.** Domestic revenues are expected to rise modestly to 15.7 percent of GDP, premised on tax administration gains and the introduction of some tax measures, such as the increase in the excise tax on diesel from 7 to 10 percent. Current expenditures will be curtailed by 1.2 percentage points of GDP, due to declines in cooperating partner support and in order to provide some fiscal space for capital spending which is expected to reach 4 percent of GDP. The overall fiscal deficit is expected to remain broadly unchanged at 2.4 percent of GDP, and domestic financing is expected to be about 2 percent of GDP. This

fiscal framework is consistent with the inflation target and provides reasonable scope for private sector credit growth.

12. **Strengthening revenue performance will be an important component in medium-term policy.** Income tax revenues have remained fairly steady over the years. While the mining tax regime has received significant attention in recent years, there is need to improve the performance of non-mining corporate tax collections. VAT collections are also a source of concern for the Government. In order to address these challenges, the Government will undertake a comprehensive review of tax policy and administration this year, drawing on past and prospective IMF technical assistance (structural benchmark for end-September 2010).

13. **Tax administration reforms are expected to continue, following the successful completion of the first phase of implementation.** Work is underway to further register the medium and small taxpayer population, re-engineer business processes, institute new systems and to reform tax administration legislation. Data quality continues to be a challenge in that it limits the evaluation of the effectiveness of the recently launched Large Taxpayer Office (LTO), and also delays the establishment of Medium and Small Taxpayer Offices (MSTOs). The implementation of a new information communications technology (ICT) system and the legislation reform are among the key components of the modernization of the ZRA in the near term.

14. **The high and increasing cost of personal emoluments as a proportion of domestically generated revenues are another source of concern in the medium-term.** Wages and salaries currently account for slightly over 50 percent of domestic revenues, which has curtailed fiscal space for infrastructure spending. The government, cognizant of the need to curb this trend, undertook a review of pay policy and the recommendations of this review are being considered. It is expected that a new performance based pay policy will be approved in 2010 (structural benchmark for end-June 2010), and implemented over the medium term. This reform will go hand-in-hand with the right-sizing exercise, as well as the payroll management and establishment control (PMEC), which has been rolled out to all provinces and will be extended to ministries during 2010.

B: Monetary and Exchange Rate Policies

15. **The global financial and economic crisis and the commodity price shocks of 2008 have provided an important stress test for Zambia's monetary policy framework.** These shocks increased inflation beyond single digits and created a more volatile exchange rate. However, the maintenance of a flexible exchange rate regime and the implementation of a monetary program that provided the Bank of Zambia with the flexibility to intervene in the foreign exchange market to address excess volatility enabled the Zambian economy to adjust

to the external shocks, particularly the decline in copper prices. This has helped in preserving a viable external sector over the medium-term.

16. **The crisis also exposed the fragile nature of Zambia's financial markets**, as price adjustments were volatile over an extended period of time and the market for primary auctions of government securities came under stress. The reversal of short term capital flows also proved disruptive, despite a level of foreign exchange reserves that was more than adequate to meet these outflows.

17. **Looking ahead, monetary policy will aim to restore inflation to single digits in 2010, and to strengthen the framework that minimizes exchange rate volatility without targeting the level of the exchange rate**. The government and the Bank of Zambia will aim to reduce inflation to 8 percent by end-2010 and aim to contain reserve money growth to 19 percent over the same period. After several years of rapid private sector credit expansion, domestic credit is projected to moderate to 20 percent in 2010.

18. **The Bank of Zambia is actively reviewing its monetary policy framework, with a view to shift to using interest rates as the main instrument to anchor inflationary expectations.** This could help better entrench the goal of singe-digit inflation. To this end, work is underway on the institutional, analytical, and communication elements that would be necessary.

19. **The Government will continue to maintain a fully flexible exchange rate regime**. Interventions in the foreign exchange market by the Bank of Zambia will be limited to the smoothing of fluctuations, while allowing for a gradual buildup of international reserves. We welcome the recent SDR allocation of US$627 million from the IMF, the bulk of which we intend to keep as international reserves.

20. **In an effort to improve the efficiency of public debt, the Government is considering a restructuring of public debt to reduce costly domestic borrowing and increase concessional external financing.** Domestic debt dominates the current public debt portfolio, and has served as an expensive source of development financing for Zambia. While remaining fully respectful of debt sustainability indicators, the Government is actively examining the possibility of redeeming domestic debt securities, financed through a drawdown in reserves. It is expected that this portfolio swap will lead to lower debt service burdens, and create additional room for private sector credit through lower government borrowing in domestic markets. By reducing government demand for domestic debt, lower interest rate spreads are also expected. Such an arrangement would be undertaken within the agreed monetary framework for 2010.

C: Structural Policies

Public Financial Management

21. **Considerable progress has been made in implementing public financial management reforms.** After consultation with stakeholders, the government has altered its budget cycle to ensure parliamentary approval of the budget in advance of the fiscal year. This is expected to improve budget execution and the legislature's participation in the budgeting process. In addition, the government is expected to introduce a planning and budgeting act in 2010 in order to clearly define the budgeting process and key deliverables by the government as part of the budget (structural benchmark for end-June 2010).

22. **The government is in the advanced stages of finalizing its implementation strategy for the establishment of a Treasury Single Account** (TSA)**.** A draft strategy was approved in early 2009 and various modalities of implementation have now been addressed. The implementation will commence with trial runs at the Ministry of Finance and National Planning, followed by a full pilot in early 2010, with other Ministries, Provinces, and Spending Agencies (MPSAs) being added to the pilot in due course. The full introduction of the Treasury Single Account will be phased, commencing in 2010 when six MPSAs will adopt the TSA (structural benchmark for end-December 2010), and all MPSAs expected to use the TSA subsequently.

23. **The implementation of the integrated financial management information system (IFMIS) will gather significant momentum in 2010, with the first full pilot commencing in January 2010.** Comprising of thirteen technology modules, the IFMIS project will create substantial efficiencies across government institutions, providing for greater financial information flows and improved accountability and control. The first pilot site will be the Ministry of Finance and National Planning, which will operate all thirteen modules starting in January 2010. Over the course of the year, additional MPSAs will be included, with a full rollout expected by end-2011.

Financial Sector Development

24. **The government remains committed to a comprehensive and inclusive mechanism of developing the financial sector through the implementation of the second phase of the Financial Sector Development Plan (FSDP II).** The successful implementation of the FSDP II is expected to: (i) support the achievement of low and stable inflation by enhancing the efficiency of monetary policy; (ii) strengthen the supervision of the financial sector and build its resilience to system shocks; (iii) continue to develop the payment system; (iv) enhance the secondary market trading for government securities and corporate debt; and (v) promote financial inclusiveness. The objectives of the FSDP will be to improve access to credit, as well as reduce the high cost of borrowing.

25. **In order to enhance the efficiency of monetary policy, an overnight lending facility will be introduced by end-November 2009.** It is anticipated that the introduction of this facility will provide for lower volatility in short term interest rates as well as an easing of structural rigidities relating to market segmentation amongst financial institutions.

26. **The Bank of Zambia will also revise the lender of last resort policy to align it with accepted international standards and ensure that it remains effective and relevant.** In addition, a financial sector contingency plan will be drafted to address the impact of a system-wide crisis in the financial sector and broader economy (structural benchmark for end-December 2010).

Energy

27. **The government remains committed to addressing medium-term capacity constraints in electricity generation.** While the completion of rehabilitation projects by the public utility ZESCO has improved the reliability of electricity supply, the medium-term focus remains to increase generating capacity through the commissioning of new generation projects. Commencing in 2009, a multi-year tariff framework was announced to raise electricity tariffs to cost-recovery levels by 2011. A first adjustment of 35 percent has been implemented in 2009 and concurrently an indicative increase of 26 percent was announced for 2010. The exact percentage of the next increase will be announced after statutory public consultation (structural benchmark for end-June 2010). Efforts are under way to improve the efficiency and effectiveness of the utility. Plans to expand the installation of pre-paid electricity meters across the country are progressing, and performance on the key performance indicators[1] is expected to improve in 2010.

28. **Several sizable electricity generation projects are underway or are being considered.** Work has commenced at the Kariba North Bank extension project, which will add 360 MW of additional capacity in the medium term. In addition, the government is close to finalizing technical discussions and will soon commence financial negotiations for the Kafue Gorge Lower (KGL) project, which is expected to add another 600-750 MW of capacity by 2017. Given the size of the KGL project, expected to be one of the continent's largest public private partnerships in the electricity generation sector, the government may have to contract new non-concessional external financing. It is now expected that this non-concessional financing will be undertaken in 2010.

[1] Each quarter, ZESCO reports on its performance of select indicators that are specified by the Energy Regulation Board. These Key Performance Indicators (KPIs) are used as part of the tariff review process to ensure that any tariff awards are measured against performance by the public utility.

Debt and Aid Management

29. **The government is committed to improving public debt management**. The debt management strategy seeks to: improve risk management; ensure that financial obligations are settled as scheduled; control contingent liabilities; minimize the cost of financing the budget; support the development and deepening of financial markets; and facilitate effective coordination between monetary, fiscal and debt management policies. In this context, the Government will continue working on enhancing and unifying the legal framework, enhancing the monitoring of public sector debt, including debt contracted by public enterprises, and strengthening institutional capacity to manage and monitor debt. Efforts in these areas have been supported by technical assistance from the IMF and World Bank.

30. **There is a growing demand for resources to finance large infrastructure projects of high economic return in Zambia.** Given the constraints of limited concessional financing, the government has moved to develop a Public Private Partnership (PPP) framework through which the private sector can be engaged to participate in the process of national development. In certain cases, however, it may be necessary for the government to participate as an equity partner in such projects. In order to engage in these infrastructure initiatives, the there may be a need to raise non-concessional debt to finance such participation. Any such need would be measured against the economic return of such projects (after consulting with the World Bank or other relevant institutions, and only high quality projects yielding substantially high economic returns will be candidates for such financing. The government expects that such financing needs shall be considered for inclusion into the program on a case-by-case basis.

31. **The government will continue to strengthen the management of aid**. Priority will be given to further enhancing cooperation with the donor community, including with respect to the compilation of consistent and timely aid data. In an effort to reconcile data on grant financing across government ministries, a closer dialogue between cooperating partners, the Ministry of Finance and National Planning, and the Bank of Zambia is being facilitated. The government is committed to addressing concerns that cooperating partners may have on governance issues that may hold back the disbursement of donor funds, as agreed under the Poverty Reduction Budget Support Memorandum of Understanding with cooperating partners.

Economic Statistics

32. **Improving Zambia's statistical data collection and dissemination, particularly with regard to the quality of national accounts and consumer price data, will be a priority for the Government in 2010.** Resources will be made available to finalize the economic census, which began in 2008, with the aim to rebase national accounts from the current 1994 base year. Simultaneously, there will be a comprehensive review of methodologies that are used to calculate national accounts, with the aim to align them to best

practices. A corresponding rebasing exercise is needed for the consumer price index. The government is also working with cooperating partners to finalize the 2006 Living Conditions Monitoring Survey, and to undertake a full national census of population in 2010.

IV: Program Monitoring

33. **Semi-annual disbursements under the PRGF arrangement will be based on the observance of quantitative performance criteria.** Completion of the fourth and fifth reviews of the arrangement will be based on the observance of quantitative performance criteria through end-December 2009 and end-June 2010, respectively (Tables 1 and 2). The fourth review is expected to be completed by June 2010 and the fifth and sixth reviews are expected to be completed, respectively, by end-November 2010 and end-May 2011.

MEFP Table 1. Zambia: Quantitative Performance Criteria (PC) and Indicative Targets, 2009[1]
(Billions of kwacha, unless otherwise indicated)

	2008	2009						
	Dec	June			September		December	
	Level	Prog.	Act.	Status	Indicative	Est.	Prog.	Rev. Prog.
Performance criteria:								
Ceiling on the cumulative increase in net domestic assets (NDA) of the Bank of Zambia[2,3]	-1,449	397	515	Met	642	658	965	1670
Adjusted ceiling		542						
Ceiling on the cumulative increase in net domestic financing (NDF)[2]	5,291	447	35	Met	844	622	1,170	1,443
Adjusted ceiling		605						
Floor on the cumulative increase in gross international reserves (GIR) of the Bank of Zambia (Millions of U.S. dollars)[2,4]	976	44	16	Met	29	634	100	714
Adjusted floor		14						
Ceiling on new external payment arrears[5]	0	0	0	Met	0	0	0	0
Ceiling on short-term external debt and on contracting or guaranteeing of nonconcessional debt by central government, BoZ, and ZESCO, ZAMTEL, and Zambia Railways Limited (millions of U.S. dollars)[5,6]	…	0	0	Met	0	0	0	0
Ceiling on medium- and long-term external debt and on contracting or guaranteeing of nonconcessional debt by central government, BoZ, and ZESCO, ZAMTEL, and Zambia Railways Limited (millions of U.S. dollars)[6]								
Electricity projects	0	400	0	Met	400	0	400	400
Other sectors	0	0	0	Met	0	0	0	0
Indicative targets:								
Floor on the cumulative payment of domestic arrears BoZ, and ZESCO, ZAMTEL, and Zambia Railways Limited (millions of U.S. dollars)[6]		161	199	Met	264	…	352	352
Cumulative increase in reserve money	3,211	-60	-92	Met	112	…	450	610
Memorandum items:								
Cumulative net budget support (U.S. dollars, unless otherwise specified)	142	110	80		126	…	106	160
General budget support up to allowed limits	203	110	80		201	…	201	212
Central Government debt service obligations (excl. IMF)	-61	0	0		-75	…	-95	-52
Domestically financed capital expenditure	1271	…	…		…	…	…	1810
Program exchange rate (Kwacha per U.S. dollar)	4,832.3	4,832.3	…		4,832.3	4,832.3	4,832.3	4,832.3

Sources:

[1] The definitions of the items in the quantitative program are contained in the Technical Memorandum of Understanding (TMU)
[2] Adjustors, including for general budget support, are defined in the TMU.
[3] The ceiling will be adjusted for changes in the legal reserve requirements as specified in the TMU.
[4] Reserves are calculated at program exchange rates.
[5] Continuous performance criteria.
[6] Nonconcessional loans are those having a grant element of less than 35 percent.

MEFP Table 2. Zambia: Quantitative Performance Criteria (PC) and Indicative Targets, 2010[1]
(Billions of kwacha, unless otherwise indicated)

	2009	2010			
	Dec	Mar	Jun	Sep	Dec
	Proj. Stock	Indicative	Prog.	Indicative	Indicative
Performance criteria:					
Ceiling on the cumulative increase in net domestic assets (NDA) of the Bank of Zambia[2,3]	221	405	376	663	773
Adjusted ceiling					
Ceiling on the cumulative increase in net domestic financing (NDF)2	6,734	321	735	1,211	1,487
Floor on the cumulative increase in gross international reserves (GIR) of the Bank of Zambia (Millions of U.S. dollars)[2,4]	1,690	-2	71	45	80
Ceiling on new external payment arrears[5]	0	0	0	0	0
Ceiling on short-term external debt and on contracting or guaranteeing of nonconcessional debt by central government, BoZ, and ZESCO, ZAMTEL, and Zambia Railways Limited (millions of U.S. dollars)[5,6]	…	0	0	0	0
Ceiling on medium- and long-term external debt and on contracting or guaranteeing of nonconcessional debt by central government, BoZ, and ZESCO, ZAMTEL, and Zambia Railways Limited (millions of U.S. dollars)[6]					
Electricity projects[7]	…	600	600	600	600
Indicative targets (cumulative):					
Floor on payment of domestic arrears of the government	…	59	153	157	269
Increase in reserve money	3,821	239	415	584	726
Floor on social spending by the government of Zambia	…	930	1,875	2,838	3,938
Memorandum items:					
Cumulative net budget support (U.S. dollars)		61	133	123	140
General budget support up to allowed limits		78	160	174	194
Central Government debt service obligations (excl. IMF)	…	-17	-26	-51	-54
Program exchange rate (Kwacha per U.S. dollar)	4,832	4,622	4,622	4,622	4,622

Sources:

[1] The definitions of the items in the quantitative program are contained in the Technical Memorandum of Understanding (TMU)
[2] Adjustors, including for general budget support, are defined in the TMU.
[3] The ceiling will be adjusted for changes in the legal reserve requirements as specified in the TMU.
[4] Reserves are calculated at program exchange rates.
[5] Continuous performance criteria.
[6] Nonconcessional loans are those having a grant element of less than 35 percent.
[7] The projects are: Kariba North bank extension, Itezhi-Tehzi power station, Kafue Gorge Lower.

Table 3 MEFP. Zambia: Structural Benchmarks for 2009

Measure	Timing	Macro Rationale	Status
Prepare a comprehensive strategy for phased implementation of the establishment of the treasury single account system.	End-June 2009	Strengthen public expenditure management and budget execution. In particular, the measures will improve cash flow management and forecasts and thereby contribute to improved fiscal and monetary policy coordination.	Met
Approval by Cabinet of all necessary amendments to the Public Finance Management Act specifying the general principles of the treasury single account system.	End-September 2009		Met
Set up a supervisory regime for the secondary market in government securities.	End-June 2009	Financial sector deepening which is vital to achieving the growth objectives of the program.	Not met -- Reset to end-March 2010
Bank of Zambia will introduce a new standing overnight lending facility.	End-September 2009	Strengthen liquidity management, reduce volatillity in the money market, and enhance the effectiveness of monetary policy.	Met with delay (December 1, 2009)
Raise the average electricity tariff in 2009 and publicly announce indicative tariffs for 2010-11consistent with the policy to reach cost-reflective levels by 2011.	End-June 2009	To ensure an efficient and sustainable power supply. Solving the current problems in the energy sector is essential to achieving the growth objectives of the program.	Met

Source: Zambian authorities and IMF staff estimates.

Table 4 MEFP Zambia: Structural Benchmarks for 2010

Measure	Timing	Macro Rationale
Approval by Cabinet of the pay policy reform	End-June 2010	Strengthen payroll management, and increase productivity of the public sector.
Establish a Lender-of-Last Resort Framework and draft legislation and procedures for a financial sector contingency plan in the event of a crisis.	End-June 2010	Strengthen the Central Bank's crisis preparedness.
Adoption of Treasury Single Account by six ministries, provinces, and spending agencies.	End-December 2010	Strengthen public expenditure management and budget execution. In particular, the measures will improve cash flow management and forecasts and thereby contribute to improved fiscal and monetary policy coordination.
Submit to parliament the Planning and Budgeting Act.	End-June 2010	
Prepare a review of tax administration and policy	End-September 2010	Strenghten revenue performance
Raise the average electricity tariff in 2010 and publicly announce indicative tariffs for 2011 consistent with the policy to reach cost-reflective levels by 2011.	End-June 2010	To ensure an efficient and sustainable power supply. Solving the current problems in the energy sector is essential to achieving the growth objectives of the program.

Source: Zambian authorities and IMF staff estimates.

ATTACHMENT II. TMU

Technical Memorandum of Understanding for the 2008–10 Poverty Reduction and Growth Facility (PRGF) Arrangement

I. INTRODUCTION

1. This memorandum sets out the understandings between the Zambian authorities and the International Monetary Fund (IMF) regarding the definitions of the quantitative performance criteria and indicative targets for the program supported by the PRGF arrangement, as well as the program adjusters and the related reporting requirements.

II. QUANTITATIVE PERFORMANCE CRITERIA AND INDICATIVE TARGETS: DEFINITIONS AND DATA SOURCES

A. Net Domestic Assets (NDA) of the Bank of Zambia (BoZ)

2. Net domestic assets (NDA) of the BoZ are defined as the monthly average (based on daily data) of reserve money (as defined below) less net foreign assets of the BoZ calculated at kwacha 4,622.0 per U.S. dollar for 2010.[1] Net foreign assets of the BoZ are defined as gross international reserves (defined in paragraph 8) plus any other foreign assets, including US$120 million encumbered reserves at end-December 2009, minus foreign reserve liabilities (defined below). The kwacha values of net foreign assets are derived from the U.S. dollar values using the program exchange rate.

3. Foreign reserve liabilities are defined as short term (one year or less in original maturity) foreign currency-denominated liabilities of the BoZ to nonresidents and outstanding use of IMF credit.

B. Reserve Money

4. Reserve money (monthly average based on daily data) consists of currency issued, required reserves on kwacha deposits, required reserves on foreign currency deposits (at the program exchange rate), positive current account balances of banks with the BoZ, and deposits in the BoZ of non-central government institutions.

5. Data on reserve money, including its components, will be reported by the BoZ on weekly and end-month basis.

[1] Unless otherwise defined, program exchange rates for 2010 between the U.S. dollar and other (non-kwacha) currencies will be equal to the end-December 2009 values. The U.S. dollar/SDR rate for program purposes is 1.557 for 2010. All other assets (e.g. gold) would be revalued at their end-December 2009 market prices for 2010.

C. Net Domestic Financing (NDF)

6. Net domestic financing (NDF) is defined as the Central Government's net borrowing from the banking and non-banking sectors (See Table 1).[2] All government-issued securities will be recorded at cost (face value less discount). NDF will comprise:

(a) the net position of the central Government with commercial banks, including: (i) Treasury bills; (ii) government bonds; (iii) loans and advances; less (iv) support to MBZ; and (v) central government deposits (defined to include account balances under the authority of controlling officers); plus

(b) BoZ holdings of: (i) Treasury bills; (ii) government bonds; (iii) kwacha bridge loan (overdraft facility); less (iv) the government's deposits at the BoZ; and (v) the donor suspense account; plus (vi) the outstanding amount of the long-term non-transferable security issued against the government's indebtedness to BoZ as at end-2002; plus

(c) Nonbank holdings of: Treasury bills; and government bonds.

7. The data source for NDF will be the "Net Domestic Financing" Table produced by the Economics Department of the BoZ. The Table will be submitted on a weekly basis, and will be reconciled with the monthly monetary survey.

D. Gross International Reserves of the BOZ

8. Unless otherwise noted here, gross international reserves of the BoZ will be defined as reserve assets of the BoZ (See Table 2). Reserve assets are defined in the IMF BOP manual (5^{th} edition) and elaborated in the reserve template of the IMF's special data dissemination standards (SDDS). They exclude, for example, foreign assets not readily available to or controlled by the monetary authorities, and foreign currency claims on Zambian residents.

9. Gross international reserves consist of: (i) monetary gold; (ii) foreign currency in cash; (iii) unencumbered foreign-currency deposits at non-resident banks; (iv) foreign securities and deposits; and (v) SDR holdings and Zambia's reserve position with the IMF. Gross reserves exclude non-convertible currencies, any encumbered reserve assets including but not limited to reserve assets pledged, swapped or used as collateral or guarantee for third-party external liabilities, commercial bank reserve requirements on foreign currency deposits, and the US$25 million deposit in MBZ (in liquidation).

10. For the purpose of this target, as well as those for external debt and arrears, valuation will be in U.S. dollars at program exchange rates.

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[2] The Central Government includes all the administrations identified by the budget heads listed in the Yellow Book for 2010.

11. Data on gross international reserves, including its components, will be reported by the BoZ on a weekly and end-month basis.

E. External Payment Arrears

12. The performance criterion on the non-accumulation of new external payment arrears is continuous. Official external payment arrears are defined as unpaid debt service by the central Government and BoZ 30 days beyond the due date and/or the grace period. This definition excludes arrears on debt subject to rescheduling.

13. Data on arrears are compiled jointly by the Ministry of Finance and National Planning (MoFNP) and BoZ and will be reported by the MoFNP on a quarterly basis.

F. Official External Debt

14. Official medium- and long-term concessional external debt is defined as all forms of official debt with original maturity of more than one year contracted or guaranteed by the central Government, BoZ, ZESCO, ZAMTEL and Zambia Railways Limited having a grant element of no less than 35 percent, since the beginning of the calendar year. The grant element is to be calculated by using currency-specific commercial interest reference rates (CIRRs) reported by the DAC of the OECD. For maturities of less than 15 years, the grant element will be calculated based on six-month averages of CIRRs, and for maturities longer than 15 years, the grant element will be calculated based on 10-year averages. Lending from the IMF will be excluded.

15. This minimum grant element applies not only to debt as defined in Point 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85) of August 24, 2000; see Country Report 08/187), but also to commitments contracted or guaranteed for which value has not been received.

16. Official external non-concessional debt is defined as the contracting or guaranteeing of external debt other than concessional debt as defined in paragraph 14, owed or guaranteed by the central Government, BoZ, ZESCO, ZAMTEL and Zambia Railways Limited.

17. The ceiling on contracting or guaranteeing of medium and long-term non-concessional external debt by the central government, BoZ, ZESCO, ZAMTEL and Zambia Railways Limited excludes: (i) non-concessional loans stemming from the rescheduling of external debt; and (ii) central government securities issued in domestic currency, placed in the domestic primary or secondary markets, and held by non-residents.

18. Official external short-term debt is defined as the contracting or guaranteeing of external debt with original maturity of less than one year, and includes forward commodity sales but will exclude normal trade credit for imports, incurred since the beginning of the calendar year.

19. The term "debt" has the meaning set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85) of August 24, 2000; see Annex).

20. Detailed data on all new external debt (concessional and non-concessional) contracted or guaranteed by the central government, BoZ, ZESCO, ZAMTEL and Zambia Railways Limited will be provided by the MoFNP on a monthly basis. Information will include (i) amounts contracted or guaranteed; (ii) currencies; and (iii) terms and conditions, including interest rate, maturity, grace period, payments per year, commissions and fees, and collaterals.

G. Domestic Arrears of Central Government

21. Domestic arrears are defined as: (i) any bill that has been received by a spending ministry from a supplier for goods and services delivered (and verified) and for which payment has not been made within 30 days after the due date of payments; (ii) wage, salary and any other payment to government employees, including pension contributions and all forms of housing allowances, that were due to be paid in a given month but remained unpaid on the 15th of the following month; and (iii) interest or principal obligations which remain unpaid 30 days after the due date of payment.

22. Information regarding domestic arrears is to be compiled through audits of the accounts of spending Ministries and agencies, conducted by the Internal Audit division of the MoFNP**.** The audits will be completed and data submitted to IMF staff by the Secretary of the Treasury within six weeks of the end of each quarter.

H. Floor on Social Spending

23. Social spending is defined as central government domestically financed expenditure on health and education as listed in the 2010 Yellow Book under the functional classification. The corresponding indicative target sets the minimum spending on these sectors combined.

III. ADJUSTERS

24. The quantitative performance criteria specified under the program are subject to the following adjusters:

General budget support (GBS) net of debt service[3]

(i) The ceilings on NDA and NDF will be adjusted downward (upward) by the full amount of the excess (shortfall) in GBS net of debt service relative to the programmed levels specified in Table 1 of the MEFP.[4,5]

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[3] General budget support consists of grants and loans received by the central Government for financing its overall policy and budget priorities following Zambian budget procedures.

(a) The total adjustment for shortfalls will be limited to US$30 million for January-June and US$60 million for January-December 2009.

(b) The total adjustment for shortfalls will be limited to US$40 million for January-June 2010 and US$60 million for January-December 2010.

(ii) The floors on GIR will be adjusted upward (downward) by the full amount of the excess (shortfall) in GBS net of debt service relative to the programmed levels (Table 1 of the MEFP).

Change in reserve requirements

(iv) The ceiling on NDA will be adjusted downward/upward to reflect decreases/increases in the legal reserve requirements on deposits in commercial banks. The adjuster will be calculated as the percent change in the reserve requirement multiplied by the actual amount of required reserves (kwacha and foreign-currency denominated) at the end of the previous calendar month.

IMF disbursement

(v) The floors on GIR will be adjusted upward (downward) for any excess (shortfall) in the disbursements from the IMF (US dollar value) relative to the programmed levels.

BoZ short-term debt

(vi) The floor on GIR will be adjusted upward for any increase in BoZ short-term debt denominated in foreign currency, (see definition of short-term debt above).

Domestically-financed capital expenditure

(vii) The ceilings on NDA and NDF in 2009 will be adjusted downwards by the full amount of the shortfall in domestically-financed capital expenditure relative to the programmed levels specified in Table 1 of the MEFP.

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[4] For the purpose of adjusting the NDA ceiling, external disbursements will be treated as if they were received the first day of the month. The targeted NDA will be increased by the amount of the disbursement divided by the number of business days in the month multiplied by the number of business days from the beginning of the month to the day prior to the disbursement.

[5] For purpose of adjusting the NDF ceiling, the cumulative excess/shortfall will be converted to kwacha value using the program exchange rate.

Appendix II. Zambia—Joint IMF/World Bank Debt Sustainability Analysis 2009 Under the Debt Sustainability Framework for Low Income Countries

Based on the Joint Fund-Bank Debt Sustainability Framework for Low-income Countries (LIC DSA), Zambia's risk of external debt distress remains low as all debt indicators stay well below the indicative policy thresholds throughout the projection period (2009–29).[1] Due to the authorities' conservative debt policy and strategy, the debt level has remained broadly unchanged since Zambia received debt relief under HIPC and MDRI in early 2006. The authorities have received technical assistance from the Bank and the Fund to further improve on debt management practices.[2] While this favorable situation leaves some room for new borrowing, particularly to invest in much needed projects in the energy sector,[3] the authorities' intention to contract substantial amounts of new non-concessional external debt bears close monitoring, to ensure that projects so financed are viable, that debt remains properly managed, and that debt burden indicators do not start increasing sharply. While some of this financing should preferably come in the form of FDI, it is prudent to assume at this stage that it will be in the form of non-concessional borrowing. For this reason, this DSA incorporates an amount for such anticipated borrowing in the baseline scenario, even if the debt has not been contracted.

I. Background

1. Zambia's stock of external debt declined substantially with the advent of the HIPC Initiative and MDRI; external debt-to-GDP declined from about 86 percent in 2005 to around 9 percent in 2006. The debt ratio increased marginally to 11.5 percent of GDP in 2008, most of which is public and publicly guaranteed debt (PPG).[4]

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[1] Previous LIC DSAs in 2005 and 2007 (Country Report No. 06/39, Appendix VI, and Country Report 08/41) indicated that Zambia is at a low risk of debt distress.

[2] At the request of the Ministry of Finance and National Planning, a joint IMF-World Bank mission visited Lusaka, August 26–September 7, 2009, to provide technical assistance in debt management strategy formulation and feedback on the authorities' existing debt management strategy.

[3] Preliminary estimates indicate that the construction of three hydropower plants (Itezhi Tezhi, Kariba North, and Lower Kafue Gorge) during 2010–16, would require financing in the order of US$1.7 billion.

[4] Statutory obligations attributed to state owned enterprises are accounted for under PPG as contingent liabilities. While private debt constitutes debt of non-mining private companies, some of it stems from former state owned enterprises operating under the commercial code.

Zambia: Public External Debt

	In percent of GDP			In percent of goods and services exports	
	2005	2006	2008	2006	2008
Gross external debt	86.0	8.8	11.0	24.5	23.9
Medium- and long-term debt	86.0	8.8	11.0	24.5	23.9
Multilateral	49.1	5.5	5.3	13.5	14.8
IMF	8.1	0.4	0.6	0.8	1.8
Other	41.0	5.1	4.7	12.7	13.0
Bilateral official	35.9	2.7	1.0	9.5	2.9
Paris Club	32.8	1.9	0.9	5.1	2.5
Other	3.0	0.9	0.1	4.4	0.4
Suppliers and other	1.0	0.6	4.7	1.5	6.3

Sources: Bank of Zambia; and staff estimates.

2. **At end 2005, public debt was about 105 percent of GDP, 18 percent of which was domestic debt**. After extensive debt relief from foreign creditors, Zambia's public debt decreased to 27 percent of GDP in 2006 and further to 26 percent in 2009. The share of domestic debt is now just below 60 percent. Treasury bills and bonds comprise 95 percent of domestic debt. Around 15 percent of the total is held by foreigners.[5]

Zambia: Structure of Public Sector Debt

	2005	2006	2008
Public debt	100.0	100.0	100.0
External debt	81.8	32.2	41.7
Domestic debt	18.2	67.8	58.3

Sources: Bank of Zambia; and staff estimates.

[5] Contingent liabilities in kwacha are excluded, estimated at 6 percent of GDP.

II. MACROECONOMIC ASSUMPTIONS[6]

3. **While Zambia was negatively affected by the global economic downturn, the medium-term outlook remains relatively favorable due to productivity increases in recent years on account of high investment in the mining sector**. The mining sector, which was hit hard in the fourth quarter of 2008 due to a steep drop in copper prices, recovered promptly as copper prices recovered in the first half of 2009. Lasting recovery, however, will depend on sustained growth in the sector and the resumption of capital inflows, both of which hinge on the resumption of global demand. Fiscal policy aims to safeguard macroeconomic stability while prioritizing infrastructure development. In concert, monetary policy aims at keeping inflation on a downward path while providing much needed support for growth. Although the balance of payments position has been temporarily weakened by the crisis, full recovery is expected in the medium term. Over time the Zambian economy is expected to diversify as nonmining activity expands in response to improvements in the business environment and infrastructure. There is considerable untapped potential in agriculture and tourism but much remains to be done with respect to investment in infrastructure, particularly in the energy sector.

The baseline scenario incorporates the following assumptions:

- Economic growth: Real GDP is estimated at 5.3 percent in 2009, 5.5 percent in 2010, 6.0 percent by 2011, and 6.4 percent by 2014, supported primarily by activity in mining and construction. While investment in energy is expected to benefit all sectors over time, the mining industry is expected to be the immediate beneficiary. Diversification is, however, necessary in order to make up for the eventual decline in mining activity, as this non-renewable resource will ultimately be depleted. But investment in tourism and agriculture are not expected to be as resource intensive as mining and energy. Hence, once the near-term investment and construction impact slows, growth is expected to stabilize at a rate slightly below 6 percent in the long-run. An average growth rate in the order of 5.4 percent in the period 2015–19 is envisaged.[7]

- Inflation: The current objective of monetary policy is to reduce inflation to 12 percent by end-2009 and to single digits thereafter. Prudent monetary and fiscal policies should make it possible to reduce inflation to around 5 percent in the medium term.

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[6] For more details on the macroeconomic framework see Zambia - 2009 Staff Report for the Article IV Consultation and Third Review Under the PRGF.

[7] The growth story is broadly unchanged since the 2007 DSA: It stated that, real GDP would continue to grow at 6–6½ percent a year through 2012, supported primarily by developments in the copper and construction sectors. Over time, however, the Zambian economy would be expected to diversify as noncopper sectors expand in response to an improved business environment and infrastructure. Hence, long run growth was expected to stabilize at 4½ percent.

- External sector: Long-term mining volume is expected to grow in line with GDP. While copper will undoubtedly remain Zambia's most important export, its share in total exports is expected to decline gradually over time. Foreign direct investment peaked at 12 percent of GDP in 2007. It is expected to decline to around 3 percent of GDP by 2014,[8] as investment in the mining sector slows due to capacity constraints. Diversification into other industries such as agriculture and tourism is unlikely to be as resource intensive as mining.

- Government revenue and expenditure: Government revenues would rise gradually from 15.6 percent of GDP in 2009 to 19 percent by 2029, mainly from improvements in tax administration; no change in the tax system is assumed. Expenditures would rise gradually and stay at about 22 percent of GDP.

- Financing: Grant equivalent external financing is 5.5 percent of GDP in 2009, declines to about 3 percent of GDP over the medium term, and stabilizes at about 2 percent thereafter. Domestic financing is 2.2 percent of GDP in 2009 and declines to around 1 percent of GDP by 2015 where it stabilizes thereafter.

- The baseline scenario assumes new public borrowing for energy projects on commercial terms in the order of US$1.7 billion in 2010-2016. At this relatively modest level, commercial borrowing would not pose any threat to external debt sustainability. It is assumed that commercial debt will continue to grow thereafter, albeit at a slower pace. The average grant element of new borrowing declines thus from 27 percent in 2009 to about 10 percent in 2010–16, and rises thereafter to 21 percent.

III. External Debt Sustainability

Baseline scenario

4. **Although external debt burden indicators rise in the medium term, they are expected to remain well below the indicative policy thresholds over the projection period** (Figure 1 and Table 1).[9] The stock of external debt is expected to remain around 12–17 percent of GDP through 2014 and decline thereafter. The present value (PV) of public and publicly guaranteed (PPG) debt to GDP is in the 8–13 percent range through 2014, well below the 40 percent threshold, and declines thereafter. The PV of debt to exports increases from 21 percent in 2008 to 44 percent by 2014, well below the 150 percent threshold, and declines

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[8] The 2007 DSA concluded in comparison that annual foreign direct investment would decline to an average of 2½ percent for 2008–12 and to 1½ percent of GDP over the long run.

[9] The World Bank's Country Policy and Institutions Assessment (CPIA) ranks Zambia as a medium performer (the average 2006–08 CPIA totals 3.46). Thus, the external debt burden thresholds for Zambia are (i) PV of debt-to-GDP: 40 percent; (ii) PV of debt-to-exports: 150 percent; (iii) PV of debt-to-revenue: 250 percent; (iv) debt service to exports: 20 percent; and (v) debt service to revenue: 30 percent.

thereafter. PV of public and publicly guaranteed (PPG) debt to revenue increases from 41 in 2008 to around 80 in 2012–14 after which it declines. This compares to a threshold of 250. Debt service in percent of exports increases from 1.5 in 2008 to 5 by 2014, compared to the 20 percent threshold. PPG debt service in percent of revenue is in the 2.5-9.0 range through 2014 and declines thereafter, as compared to a threshold of 30.

Stress tests and alternative scenarios

5. **The standard sensitivity analysis points to a low risk of debt distress in absolute an relative terms, particularly as compared to the situation prior to debt relief** (Table 3). Under the historical scenario, debt burden indicators rise significantly over time without, however, breaching the indicative thresholds. This scenario reflects the poor performance of the Zambian economy from 1999 through 2002. Under this scenario, the external non-interest current account deficit remains at 10.1 percent of GDP from 2009 to 2029—significantly higher than the deficit assumed in the baseline scenario (2.4 percent by 2019). As a result, the PV of debt-to-revenue ratio rises steadily from 53 percent in 2009 to 158 by 2019 and 170 by 2029, as compared to the threshold of 250. Similar trajectories are experienced for other solvency indicators, but in all cases the thresholds are not breached.

6. The most extreme stress test reflects the one standard deviation shock to exports of goods and services assumed to occur in 2010 and 2011 before returning to baseline growth rates. As a result of this shock, the PV of debt-to-exports rises from 24 percent in 2009 to its peak of 118 percent in 2013 and dissipates thereafter. This compares to a threshold of 150 percent of GDP. All bound tests result in stable ratios higher than the baseline, but well below the thresholds. Thus, even under difficult circumstances, Zambia's risk of debt distress is low. The scenario based on historical averages points to the need to diversify Zambia's exports away from copper as a means to make it even more resilient to external shocks.

IV. Public Debt Sustainability

Baseline scenario

7. **Zambia's public debt remains stable over the projection period** (Table 2 and Figure 2). t increases marginally from 26 percent of GDP in 2008 to 28 percent by 2011 and declines thereafter to 18 percent by 2019. Thus, public debt is relatively modest and manageable.

Stress tests and alternative scenarios

8. **The standard sensitivity analysis shows that Zambia's public debt is also resilient to shocks** (Table 4). The alternative scenarios and bound tests show that the outlook for public debt sustainability is benign. In an alternative scenario where the primary balance is unchanged from 2009, the PV of debt-to-GDP reaches 21 percent in 2019, as compared to

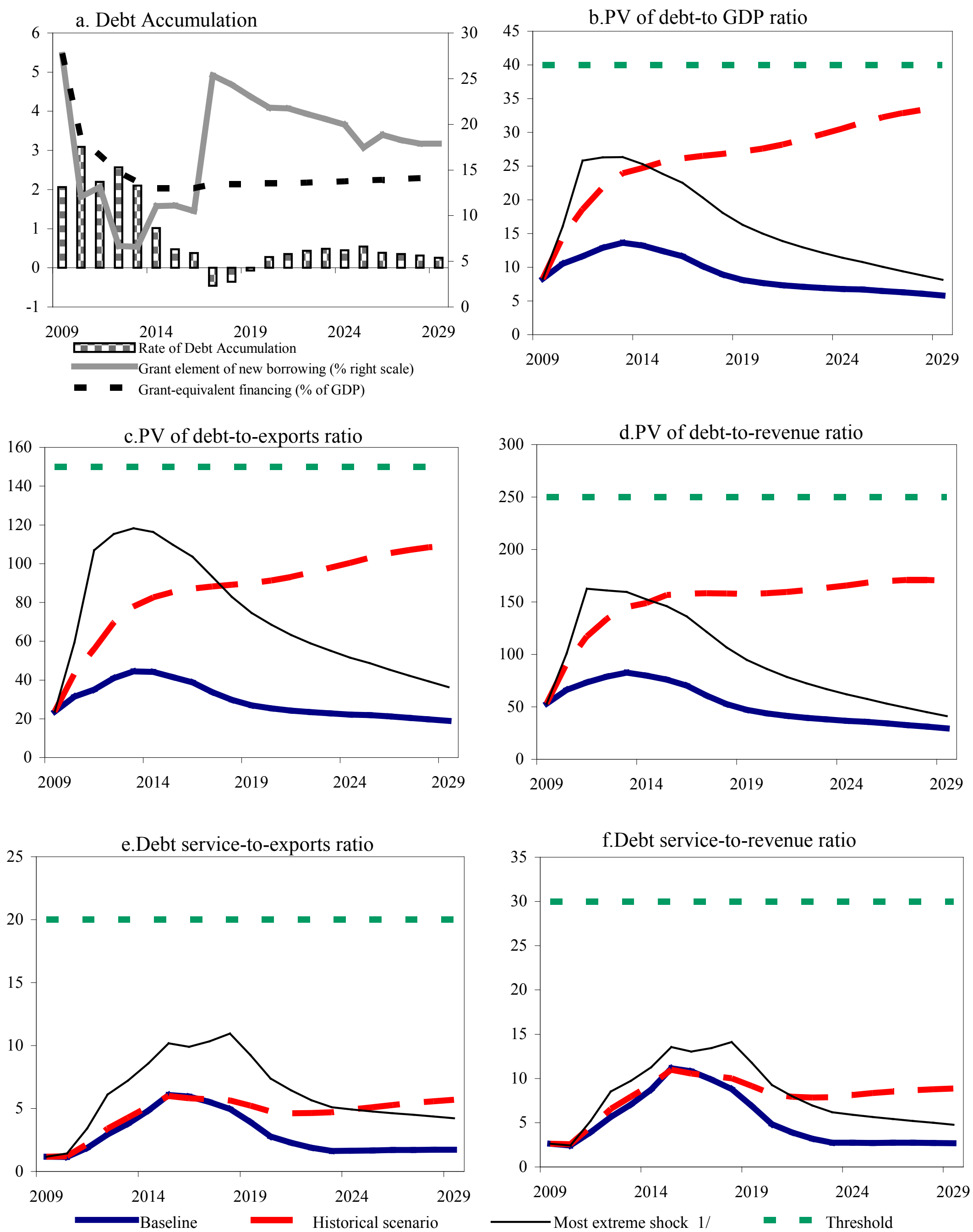
15 in the baseline. This ratio increases marginally to 22 percent under the bound tests (real GDP growth is at historical average minus one standard deviations in 2010–11; and 10 percent of GDP increase in other debt-creating flows in 2010). In contrast, the PV of debt-to-revenue ratio appears to be under some stress in the medium term. It peaks at 185 in 2011, as compared to the baseline of 132, under one alternative bound test (10 percent of GDP increase in other debt creating flows in 2010). This underscores the importance of macroeconomic stability.

V. Conclusion

9. **The application of the Joint Fund-Bank LIC DSA indicates that Zambia's debt outlook remains strong resulting in a low risk of external debt distress rating**. The external debt indicators remain well below the thresholds in the alternative scenarios and the bound stress tests. The risks to public debt are also low. In order to preserve debt sustainability going forward, the authorities will have to continue the practice of constraining external borrowing on non-concessional terms while being mindful that the room for domestic debt accumulation is constrained by high domestic interest rates.

Attachments

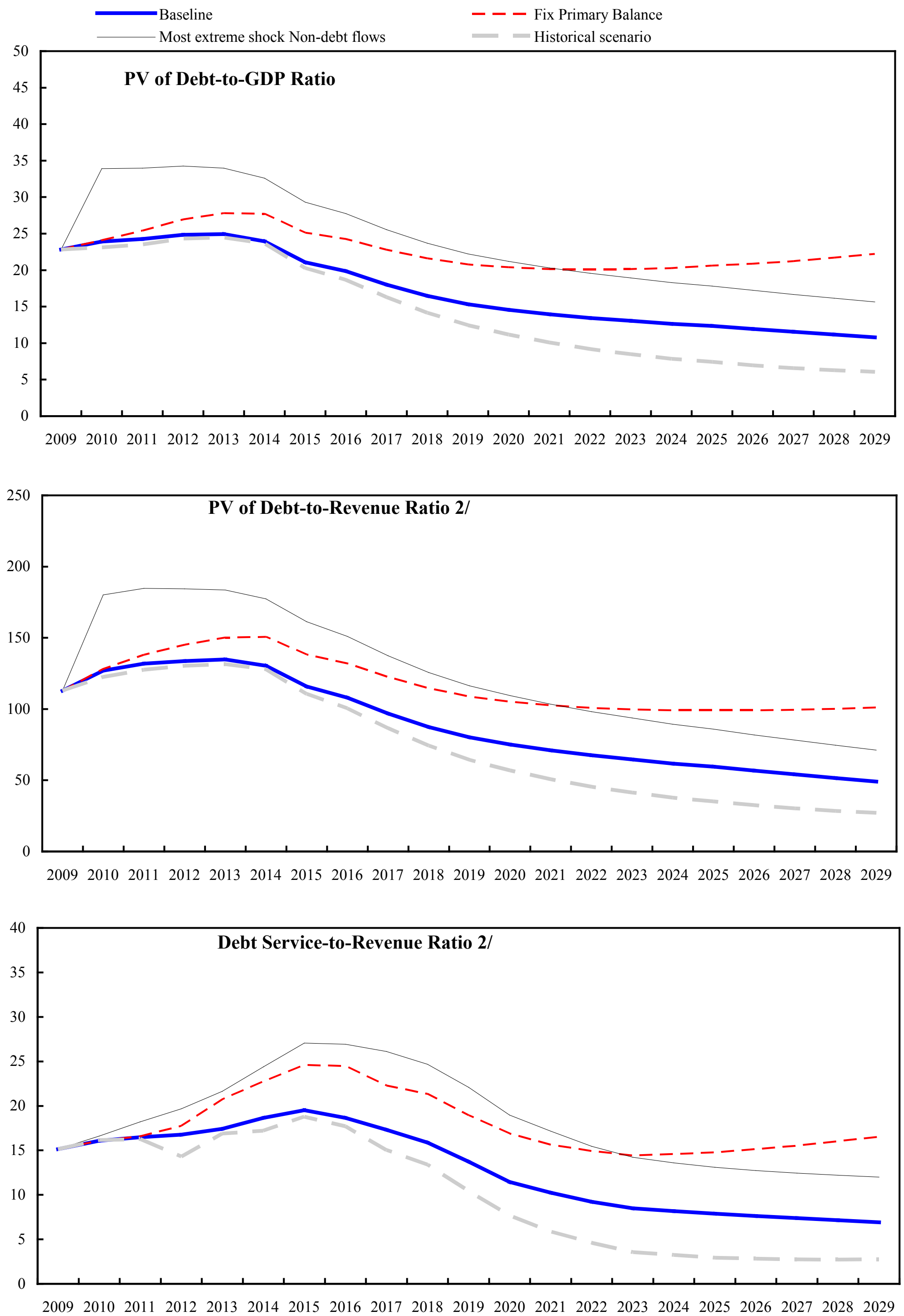
Figure 1. Zambia: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2009-2029 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in 2019. In figure b. it corresponds to a Exports shock; in c. to a Exports shock; in d. to a Exports shock; in e. to a Exports shock and in figure f. to a Exports shock

Figure 2. Zambia: Indicators of Public Debt Under Alternative Scenarios, 2009-2029 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in 2019.

2/ Revenues are defined inclusive of grants.

Table 1: External Debt Sustainability Framework, Baseline Scenario, 2006-2029 1/
(In percent of GDP, unless otherwise indicated)

	Actual			Historical 0 Average 0	Standard Deviation	Projections									
	2006	2007	2008			2009	2010	2011	2012	2013	2014	2009-2014 Average	2019	2029	2015-2029 Average
External debt (nominal) 1/	**8.8**	**9.4**	**11.5**			**12.3**	**14.4**	**15.4**	**16.5**	**17.0**	**16.5**		**11.1**	**7.8**	
o/w public and publicly guaranteed (PPG)	8.8	9.2	11.0			11.8	13.9	15.0	16.0	16.5	16.0		10.6	7.3	
Change in external debt	-80.0	0.6	2.1			0.8	2.1	1.0	1.0	0.5	-0.5		-0.9	-0.3	
Identified net debt-creating flows	-33.8	-5.4	-1.3			-2.0	-0.8	-0.9	-0.3	0.2	0.2		-0.6	-1.2	
Non-interest current account deficit	**-0.2**	**6.5**	**7.0**	**10.1**	**5.2**	**4.0**	**3.7**	**3.7**	**3.7**	**3.8**	**3.9**		**2.4**	**0.2**	1.7
Deficit in balance of goods and services	-8.0	-2.2	1.4			2.2	1.1	0.6	0.8	1.3	1.8		1.2	0.1	
Exports	37.5	41.4	35.8			35.1	33.4	33.3	31.5	30.7	30.0		30.2	30.8	
Imports	29.6	39.2	37.3			37.3	34.5	33.9	32.2	32.0	31.8		31.4	30.9	
Net current transfers (negative = inflow)	-2.4	-4.6	-3.8	-4.4	1.2	-3.2	-2.6	-2.8	-2.5	-2.3	-2.1		-1.5	-0.8	-1.3
o/w official	-3.1	-2.6	-2.2			-2.1	-1.6	-1.6	-1.4	-1.3	-1.2		-0.9	-0.5	
Other current account flows (negative = net inflow)	10.2	13.3	9.4			4.9	5.2	5.8	5.4	4.7	4.2		2.6	1.0	
Net FDI (negative = inflow)	**-4.3**	**-11.5**	**-6.4**	**-6.1**	**2.7**	**-5.5**	**-4.1**	**-4.1**	**-3.4**	**-3.1**	**-3.2**		**-2.6**	**-1.3**	-2.3
Endogenous debt dynamics 2/	**-29.4**	**-0.4**	**-1.9**			**-0.5**	**-0.4**	**-0.6**	**-0.6**	**-0.5**	**-0.5**		**-0.4**	**-0.2**	
Contribution from nominal interest rate	0.2	0.1	0.2			0.2	0.1	0.2	0.3	0.4	0.5		0.3	0.2	
Contribution from real GDP growth	-3.7	-0.5	-0.4			-0.7	-0.5	-0.8	-0.9	-0.9	-1.0		-0.6	-0.3	
Contribution from price and exchange rate changes	-25.8	0.0	-1.6			…	…	…	…	…	…		…	…	
Residual (3-4) 3/	**-46.2**	**6.0**	**3.4**			**2.8**	**2.9**	**1.9**	**1.3**	**0.3**	**-0.7**		**-0.3**	**0.9**	
o/w exceptional financing	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	8.1			8.9	11.0	12.1	13.4	14.1	13.7		8.6	6.3	
In percent of exports	...	...	22.6			25.3	32.9	36.4	42.5	46.0	45.8		28.5	20.5	
PV of PPG external debt	**...**	**...**	**7.6**			**8.3**	**10.5**	**11.6**	**12.9**	**13.6**	**13.2**		**8.1**	**5.8**	
In percent of exports	**...**	**...**	**21.3**			**23.7**	**31.4**	**35.0**	**41.0**	**44.4**	**44.2**		**26.9**	**18.9**	
In percent of government revenues	**...**	**...**	**41.1**			**53.0**	**66.1**	**73.4**	**78.9**	**82.5**	**79.8**		**47.1**	**29.5**	
Debt service-to-exports ratio (in percent)	**60.4**	**1.4**	**1.5**			**1.5**	**1.5**	**2.2**	**3.3**	**4.2**	**5.2**		**4.3**	**2.1**	
PPG debt service-to-exports ratio (in percent)	**60.4**	**1.2**	**1.2**			**1.2**	**1.2**	**1.9**	**2.9**	**3.8**	**4.8**		**3.9**	**1.7**	
PPG debt service-to-revenue ratio (in percent)	**105.7**	**2.8**	**2.3**			**2.6**	**2.4**	**3.9**	**5.6**	**7.1**	**8.7**		**6.9**	**2.7**	
Total gross financing need (Billions of U.S. dollars)	2.0	-0.5	0.2			-0.1	0.0	0.1	0.2	0.4	0.5		0.4	-0.3	
Non-interest current account deficit that stabilizes debt ratio	79.8	5.8	4.9			3.2	1.6	2.7	2.6	3.3	4.4		3.3	0.6	
Key macroeconomic assumptions															
Real GDP growth (in percent)	6.2	6.2	5.7	4.8	1.3	5.3	5.5	6.0	6.2	6.3	6.4	6.0	5.7	4.5	5.4
GDP deflator in US dollar terms (change in percent)	41.0	-0.2	20.3	11.8	14.8	-18.6	17.7	0.8	3.5	3.3	3.4	1.7	3.0	3.0	3.0
Effective interest rate (percent) 5/	0.3	0.9	2.1	1.7	0.7	1.4	1.2	1.8	2.3	2.8	3.1	2.1	2.5	2.2	2.4
Growth of exports of G&S (US dollar terms, in percent)	66.8	17.0	9.9	21.3	25.7	-16.1	18.4	6.4	3.9	7.1	7.5	4.5	9.1	7.9	8.8
Growth of imports of G&S (US dollar terms, in percent)	22.4	40.4	20.9	16.7	14.0	-14.2	14.9	5.0	4.5	9.1	9.2	4.8	8.7	7.5	8.4
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	27.6	12.1	13.1	6.7	6.6	11.1	12.9	23.0	17.9	19.3
Government revenues (excluding grants, in percent of GDP)	21.5	18.4	18.6			15.7	15.9	15.9	16.4	16.5	16.6		17.2	19.8	18.0
Aid flows (in Billions of US dollars) 7/	0.7	0.7	0.8			0.6	0.5	0.5	0.5	0.5	0.5		0.8	1.8	
o/w Grants	0.6	0.5	0.6			0.6	0.5	0.4	0.4	0.4	0.4		0.7	1.7	
o/w Concessional loans	0.1	0.2	0.2			0.1	0.1	0.1	0.1	0.1	0.1		0.1	0.1	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			5.5	3.3	2.9	2.4	2.2	2.0		2.1	2.3	2.2
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			68.6	56.1	55.6	46.1	45.7	51.9		73.1	81.3	73.3
Memorandum items:															
Nominal GDP (Billions of US dollars)	10.9	11.5	14.7			12.6	15.6	16.7	18.4	20.2	22.2		34.6	76.5	
Nominal dollar GDP growth	49.8	6.0	27.1			-14.2	24.2	6.8	10.0	9.8	10.1	7.8	8.9	7.7	8.6
PV of PPG external debt (in Billions of US dollars)			0.9			1.2	1.6	1.9	2.3	2.7	2.9		2.9	4.8	
(PVt-PVt-1)/GDPt-1 (in percent)						2.1	3.1	2.2	2.6	2.1	1.0	2.2	-0.1	0.3	0.3

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)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.
3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.
4/ Assumes that PV of private sector debt is equivalent to its face value.
5/ Current-year interest payments divided by previous period debt stock.
6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.
7/ Defined as grants, concessional loans, and debt relief.
8/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

Table 2. Zambia: Public Sector Debt Sustainability Framework, Baseline Scenario, 2006-2029
(In percent of GDP, unless otherwise indicated)

	Actual			Average	Standard Deviation	Estimate	Projections								
	2006	2007	2008			2009	2010	2011	2012	2013	2014	2009-14 Average	2019	2029	2015-29 Average
Public sector debt 1/	27.4	25.8	26.5			26.3	27.4	27.6	27.9	27.8	26.8		17.9	12.2	
o/w foreign-currency denominated	8.8	9.2	11.0			11.8	13.9	15.0	16.0	16.5	16.0		10.6	7.3	
Change in public sector debt	-77.8	-1.6	0.7			-0.2	1.1	0.2	0.3	-0.1	-1.1		-1.2	-0.5	
Identified debt-creating flows	-30.2	-2.4	-0.7			-2.0	-0.3	-1.4	-1.5	-1.3	-1.5		-0.5	-0.7	
Primary deficit	-0.2	-0.3	-0.4	-0.3	1.1	0.9	0.7	-0.1	-0.1	0.0	-0.1	0.2	0.3	-0.3	0.1
Revenue and grants	27.1	23.0	22.3			20.2	18.8	18.4	18.6	18.5	18.4		19.1	22.0	
of which: grants	5.7	4.6	3.8			4.5	2.9	2.5	2.2	2.0	1.8		1.9	2.2	
Primary (noninterest) expenditure	26.9	22.7	21.9			21.1	19.5	18.3	18.5	18.6	18.3		19.5	21.7	
Automatic debt dynamics	-30.0	-2.1	-0.3			-2.8	-0.9	-1.3	-1.4	-1.4	-1.4		-0.8	-0.4	
Contribution from interest rate/growth differential	-8.9	-2.0	-1.5			-1.4	-1.1	-1.0	-1.1	-1.1	-1.1		-0.6	-0.3	
of which: contribution from average real interest rate	-2.8	-0.4	-0.1			-0.1	0.2	0.5	0.5	0.6	0.6		0.4	0.2	
of which: contribution from real GDP growth	-6.2	-1.6	-1.4			-1.3	-1.4	-1.5	-1.6	-1.6	-1.7		-1.0	-0.6	
Contribution from real exchange rate depreciation	-21.1	-0.1	1.2			-1.4	0.2	-0.3	-0.3	-0.3	-0.3		...	...	
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	
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 implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	-47.6	0.8	1.4			1.7	1.4	1.6	1.9	1.2	0.4		-0.8	0.2	
Other Sustainability Indicators															
PV of public sector debt	18.5	16.6	23.1			22.8	23.9	24.3	24.8	24.9	24.0		15.3	10.8	
o/w foreign-currency denominated	0.0	0.0	7.6			8.3	10.5	11.6	12.9	13.6	13.2		8.1	5.8	
o/w external	...	...	7.6			8.3	10.5	11.6	12.9	13.6	13.2		8.1	5.8	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	29.0	6.4	7.2			9.7	9.9	8.8	8.5	8.5	8.3		5.7	3.1	
PV of public sector debt-to-revenue and grants ratio (in percent)	68.3	72.2	103.5			112.9	127.0	131.8	133.7	134.8	130.3		80.1	49.1	
PV of public sector debt-to-revenue ratio (in percent)	86.4	90.0	124.5			145.5	150.5	152.9	152.0	151.2	144.5		89.0	54.5	
o/w external 3/	…	…	41.1			53.0	66.1	73.4	78.9	82.5	79.8		47.1	29.5	
Debt service-to-revenue and grants ratio (in percent) 4/	90.0	8.7	15.5			15.1	16.1	16.5	16.8	17.4	18.7		13.7	6.9	
Debt service-to-revenue ratio (in percent) 4/	113.8	10.9	18.6			19.5	19.0	19.1	19.0	19.5	20.7		15.2	7.7	
Primary deficit that stabilizes the debt-to-GDP ratio	77.6	1.3	-1.1			1.1	-0.4	-0.3	-0.5	0.1	1.0		1.6	0.2	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	6.2	6.2	5.7	4.8	1.3	5.3	5.5	6.0	6.2	6.3	6.4	6.0	5.7	4.5	5.4
Average nominal interest rate on forex debt (in percent)	0.3	0.7	1.8	1.7	0.7	1.3	1.0	1.7	2.1	2.7	3.0	2.0	2.4	2.0	2.2
Average real interest rate on domestic debt (in percent)	-2.4	-1.3	-0.4	-5.1	3.9	-0.4	2.2	3.9	4.1	4.1	4.3	3.0	4.8	4.8	4.7
Real exchange rate depreciation (in percent, + indicates depreciation)	-26.8	-1.0	13.7	-7.0	12.6	-13.6	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	13.8	10.9	12.9	19.1	5.5	12.4	10.7	8.3	7.3	7.2	7.3	8.9	6.8	6.8	6.8
Growth of real primary spending (deflated by GDP deflator, in percent)	0.1	-0.1	0.0	0.0	0.1	0.0	0.0	0.0	0.1	0.1	0.0	0.0	0.1	0.1	0.1
Grant element of new external borrowing (in percent)	...	...	...	…	…	27.6	12.1	13.1	6.7	6.6	11.1	12.9	23.0	17.9	...

Sources: Country authorities; and staff estimates and projections.

1/ [Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.]

2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.

3/ Revenues excluding grants.

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

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

Table 3. Zambia: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2009-2029

(In percent)

	Projections											
	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	**2019**	2029
PV of debt-to GDP ratio												
Baseline	8	11	12	13	14	13	12	12	10	9	**8**	6
A. Alternative Scenarios												
A1. Key variables at their historical averages in 2009-2029 1/	8	14	19	22	24	25	26	26	27	27	**27**	34
A2. New public sector loans on less favorable terms in 2009-2029 2	8	10	12	14	16	16	15	15	14	13	**12**	11
B. Bound Tests												
B1. Real GDP growth at historical average minus one standard deviation in 2010-2011	8	10	12	13	14	14	13	12	11	9	**9**	7
B2. Export value growth at historical average minus one standard deviation in 2010-2011 3/	8	16	26	26	26	25	24	23	20	18	**16**	8
B3. US dollar GDP deflator at historical average minus one standard deviation in 2010-2011	8	12	14	16	17	17	16	15	13	11	**10**	8
B4. Net non-debt creating flows at historical average minus one standard deviation in 2010-2011 4/	8	10	11	13	14	13	12	12	10	9	**8**	6
B5. Combination of B1-B4 using one-half standard deviation shocks	8	13	16	17	18	18	17	16	14	12	**11**	8
B6. One-time 30 percent nominal depreciation relative to the baseline in 2010 5/	8	13	15	17	18	18	17	16	14	12	**11**	9
PV of debt-to-exports ratio												
Baseline	24	31	35	41	44	44	41	39	34	30	**27**	19
A. Alternative Scenarios												
A1. Key variables at their historical averages in 2009-2029 1/	24	43	56	70	78	83	85	87	88	89	**90**	109
A2. New public sector loans on less favorable terms in 2009-2029 2	24	30	37	45	51	53	52	50	46	43	**40**	36
B. Bound Tests												
B1. Real GDP growth at historical average minus one standard deviation in 2010-2011	24	30	34	40	44	44	41	39	34	30	**27**	21
B2. Export value growth at historical average minus one standard deviation in 2010-2011 3/	24	59	107	115	118	116	110	104	93	83	**75**	36
B3. US dollar GDP deflator at historical average minus one standard deviation in 2010-2011	24	30	34	40	44	44	41	39	34	30	**27**	21
B4. Net non-debt creating flows at historical average minus one standard deviation in 2010-2011 4/	24	30	35	41	44	44	42	39	34	30	**28**	21
B5. Combination of B1-B4 using one-half standard deviation shocks	24	39	47	53	57	56	53	50	44	39	**35**	23
B6. One-time 30 percent nominal depreciation relative to the baseline in 2010 5/	24	30	34	40	44	44	41	39	34	30	**27**	21
PV of debt-to-revenue ratio												
Baseline	53	66	73	79	83	80	76	70	61	53	**47**	29
A. Alternative Scenarios												
A1. Key variables at their historical averages in 2009-2029 1/	53	91	117	134	145	149	157	158	158	158	**158**	170
A2. New public sector loans on less favorable terms in 2009-2029 2	53	63	78	87	95	96	95	91	83	76	**71**	56
B. Bound Tests												
B1. Real GDP growth at historical average minus one standard deviation in 2010-2011	53	64	75	81	85	83	79	74	64	56	**50**	34
B2. Export value growth at historical average minus one standard deviation in 2010-2011 3/	53	101	163	161	160	152	146	136	121	107	**95**	41
B3. US dollar GDP deflator at historical average minus one standard deviation in 2010-2011	53	76	91	98	103	100	96	89	77	68	**61**	41
B4. Net non-debt creating flows at historical average minus one standard deviation in 2010-2011 4/	53	63	72	78	82	80	76	71	62	54	**48**	32
B5. Combination of B1-B4 using one-half standard deviation shocks	53	85	102	107	110	106	102	95	83	73	**65**	38
B6. One-time 30 percent nominal depreciation relative to the baseline in 2010 5/	53	84	96	104	110	107	102	95	82	72	**65**	43
(In percent)												
Debt service-to-exports ratio												
Baseline	1	1	2	3	4	5	6	6	6	5	**4**	2
A. Alternative Scenarios												
A1. Key variables at their historical averages in 2009-2029 1/	1	1	2	3	4	5	6	6	6	6	**5**	6
A2. New public sector loans on less favorable terms in 2009-2029 2	1	1	2	2	3	3	3	4	4	4	**4**	2
B. Bound Tests												
B1. Real GDP growth at historical average minus one standard deviation in 2010-2011	1	1	2	3	4	5	6	6	6	5	**4**	2
B2. Export value growth at historical average minus one standard deviation in 2010-2011 3/	1	1	3	6	7	9	10	10	10	11	**9**	4
B3. US dollar GDP deflator at historical average minus one standard deviation in 2010-2011	1	1	2	3	4	5	6	6	6	5	**4**	2
B4. Net non-debt creating flows at historical average minus one standard deviation in 2010-2011 4/	1	1	2	3	4	5	6	6	6	5	**4**	2
B5. Combination of B1-B4 using one-half standard deviation shocks	1	1	2	3	4	5	7	7	6	6	**5**	2
B6. One-time 30 percent nominal depreciation relative to the baseline in 2010 5/	1	1	2	3	4	5	6	6	6	5	**4**	2
Debt service-to-revenue ratio												
Baseline	3	2	4	6	7	9	11	11	10	9	**7**	3
A. Alternative Scenarios												
A1. Key variables at their historical averages in 2009-2029 1/	3	3	5	7	8	9	11	11	10	10	**9**	9
A2. New public sector loans on less favorable terms in 2009-2029 2	3	2	4	4	5	5	5	6	8	8	**7**	4
B. Bound Tests												
B1. Real GDP growth at historical average minus one standard deviation in 2010-2011	3	2	4	6	7	9	12	11	10	9	**7**	3
B2. Export value growth at historical average minus one standard deviation in 2010-2011 3/	3	2	5	9	10	11	14	13	13	14	**12**	5
B3. US dollar GDP deflator at historical average minus one standard deviation in 2010-2011	3	3	5	7	9	11	14	14	12	11	**9**	3
B4. Net non-debt creating flows at historical average minus one standard deviation in 2010-2011 4/	3	2	4	6	7	9	11	11	10	9	**7**	3
B5. Combination of B1-B4 using one-half standard deviation shocks	3	3	5	7	9	10	13	13	12	11	**9**	4
B6. One-time 30 percent nominal depreciation relative to the baseline in 2010 5/	3	3	5	8	9	12	15	15	13	12	**9**	4
Memorandum item:												
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	6	6	6	6	6	6	6	6	6	6	**6**	6

Sources: Country authorities; and staff estimates and projections.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (impli an offsetting adjustment in import levels).
4/ Includes official and private transfers and FDI.
5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.
6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Table 4. Zambia: Sensitivity Analysis for Key Indicators of Public Debt 2009-2029

	Projections							
	2009	2010	2011	2012	2013	2014	2019	2029
PV of Debt-to-GDP Ratio								
Baseline	23	24	24	25	25	24	15	11
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	23	23	24	24	24	24	12	6
A2. Primary balance is unchanged from 2009	23	24	25	27	28	28	21	22
A3. Permanently lower GDP growth 1/	23	24	25	25	26	25	18	20
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2010-2011	23	25	26	28	28	28	22	23
B2. Primary balance is at historical average minus one standard deviations in 2010-2011	23	24	25	26	26	25	16	11
B3. Combination of B1-B2 using one half standard deviation shocks	23	24	25	26	27	26	19	19
B4. One-time 30 percent real depreciation in 2010	23	28	28	28	28	27	19	15
B5. 10 percent of GDP increase in other debt-creating flows in 2010	23	34	34	34	34	33	22	16
PV of Debt-to-Revenue Ratio 2/								
Baseline	113	127	132	134	135	130	80	49
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	113	123	128	130	131	128	64	27
A2. Primary balance is unchanged from 2009	113	128	138	145	150	151	109	101
A3. Permanently lower GDP growth 1/	113	128	133	136	138	135	94	92
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2010-2011	113	131	142	148	152	151	113	102
B2. Primary balance is at historical average minus one standard deviations in 2010-2011	113	128	137	139	140	135	84	51
B3. Combination of B1-B2 using one half standard deviation shocks	113	126	135	140	143	141	101	85
B4. One-time 30 percent real depreciation in 2010	113	148	152	153	154	149	101	70
B5. 10 percent of GDP increase in other debt-creating flows in 2010	113	180	185	184	184	177	116	71
Debt Service-to-Revenue Ratio 2/								
Baseline	15	16	16	17	17	19	14	7
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	15	16	16	14	17	17	10	3
A2. Primary balance is unchanged from 2009	15	16	17	18	21	23	19	17
A3. Permanently lower GDP growth 1/	15	16	17	17	18	19	16	15
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2010-2011	15	16	17	19	21	23	20	17
B2. Primary balance is at historical average minus one standard deviations in 2010-2011	15	16	17	18	20	19	14	7
B3. Combination of B1-B2 using one half standard deviation shocks	15	16	17	16	19	20	18	13
B4. One-time 30 percent real depreciation in 2010	15	17	18	20	22	24	22	12
B5. 10 percent of GDP increase in other debt-creating flows in 2010	15	16	21	46	23	35	18	12

Sources: Country authorities; and staff estimates and projections.

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

2/ Revenues are defined inclusive of grants.

ANNEX I. ZAMBIA: RELATIONS WITH THE FUND
(As of October 31, 2009)

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

II. **General Resources Account:**

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

III. **SDR Department:**

	SDR Million	Percent Allocation
Net cumulative allocation	469.14	100.0
Holdings	407.19	86.8

IV. **Outstanding Purchases and Loans:**

	SDR Million	Percent Quota
PRGF arrangements	168.92	34.54

V. **Latest Financial Arrangements:**

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
PRGF	06/04/2008	06/03/2011	220.10	113.90
PRGF	06/16/2004	09/30/2007	220.10	220.10
PRGF	03/25/1999	03/28/2003	278.90	237.52

VI. **Projected Payments to the Fund**
(SDR million; based on existing use of resources and present holdings of SDRs)

	Forthcoming				
	2009	2010	2011	2012	2013
Principal	…	0.55	3.30	7.70	11.70
Charges/interest	0.47	1.05	1.04	1.01	0.96
Total	0.47	1.60	4.34	8.71	12.67

VII. **Implementation of HIPC Initiative**

	Enhanced Framework
Commitment of HIPC assistance	
Decision point date	Dec. 2000
Assistance committed (1999 NPV terms)[1]	
by all creditors (US$ million)	2,499.20
Of which: Fund assistance (US$ million)	602.00
(SDR equivalent in million)	468.80
Completion point date	April 2005
Disbursement of IMF assistance (SDR million)	
Assistance disbursed to Zambia	468.80
Interim assistance	351.60
Completion point balance	117.20
Additional disbursements of interest income[2]	39.47
Total disbursements	508.27

VIII. **Implementation of MDRI Assistance**

I.	Total debt relief (SDR million)[3]	402.59
	Of which: MDRI	398.47
	HIPC	4.12
II.	Debt relief by facility (SDR million)	

Delivery Date	GRA	PRGF	Total
January 2006	N/A	402.59	402.59

[1] Net present value (NPV) terms at the decision point under the enhanced framework.

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

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

IX. Safeguards Assessment

An update of the previous safeguards assessment, completed on January 13, 2009, of the Bank of Zambia (BoZ) is currently underway in conjunction with the augmentation under the PRGF arrangement approved in June 2009. The previous safeguards assessment found that aspects of the BoZ safeguards framework have been strengthened since the previous assessment, completed in 2004. Specifically, the BoZ implemented IFRS in 2005 and strengthened foreign reserves management and oversight in 2008. Weak statutory independence, protracted external audit completion, and incomplete publication of audited information remain safeguards concerns. The assessment recommended specific measures to address these issues, the implementation of which are being monitored under the program.

X. Exchange Rate Arrangement

The currency of Zambia is the kwacha. The exchange rate arrangement is a “float”, with the kwacha exchange rate determined in the interbank market. The buying rate of the Bank of Zambia (BoZ) is a simple average of the primary dealers’ low bid rates and the BoZ’s selling rate is the simple average of the primary dealers’ high offer rates. On April 19, 2002, Zambia accepted the obligations of Article VIII, Section 2, 3, and 4 of the Articles of Agreement. However, the Fund urged the authorities to eliminate the exchange restriction evidenced by the accumulation of external payments arrears, which is subject to Fund approval under Article VIII, as soon as possible.

XI. Article IV Consultations

Zambia is on the standard 24-month Article IV consultation cycle, subject to the provisions of the decision on consultation cycles approved on July 15, 2002. The Executive Board concluded the last Article IV consultation on December 7, 2007.

XII. FSAP Participation and ROSC

Zambia has participated in the financial sector assessment program (FSAP); an FSAP mission from the Fund and the World Bank conducted a comprehensive external assessment of the financial system April 30-May 15 and July 15–26, 2002. A mission from the Fund and the World Bank conducted a follow up FSAP in November, 2008.

The fiscal transparency module of a Report on Observance of Standards and Codes (ROSC) assessing compliance with the IMF’s Code of Good Practices on Fiscal Transparency—Declaration of Principles was issued to the Executive Board on October 31, 2001. A ROSC-data module was issued to the Executive Board on January 18, 2005.

XIII. Technical Assistance (since 2003)

Resident advisors

Department	Dates	Position
FAD	2002–03	Advisor on public expenditure management

Technical assistance missions

Department	Dates	Purpose
MFD	January and May 2003	Development of foreign exchange interbank market, monetary operations, and reform of the financial system
	September 2003	Monetary operations, reform of the financial system, government securities market, and payments system
	April–October 2004	Resolution of nonbank financial institutions (three missions)
	April–May 2005	Liquidity management operations
	March 2006	Liquidity management, monetary and exchange rate policies
MCM	March 2009	Contingency planning and lender of last resort
	September 2007	Institutional arrangements and operation of the foreign exchange market.
	September 2007	Foreign exchange market
	November 2007	Risk-based supervision
	July 2008	Bank Restructuring
	July 2009	Debt Management Strategy
STA	June 2004	Data ROSC
	April–May 2005	Monetary Statistics (GDDS)
	May 2005	Government Finance Statistics (GDDS)
	February 2006	Real Sector (GDDS)
	July 2006	Real Sector (GDDS)
	April 2008	Monetary and Financial Statistics
	January 2009	Consumer Price Index

FAD	July–August 2005	Regulations for the Public Finance Act
	November 2005	Fiscal regime for copper mining
	July 2006	Revenue administration
	August 2006	Follow up on fiscal arrangements for the mining sector
	October 2006	Review of tax policy
	June 2008	Tax administration
	November 2008	Tax administration
	January 2009	Tax administration
	April 2009	Public Financial Management
	November 2009	Tax Administration
LEG	August 2004–February 2005	Assistance on amending legislation on nonbank financial institutions
	May 2005	Strengthening the regulatory framework for nonbank financial institutions

XIV. **Resident Representative**

A Fund Resident Representative first took up the position in Lusaka in June 1990. Mr. Perry Perone has been the Resident Representative since December 2009.

ANNEX II. ZAMBIA: JOINT WORLD BANK-FUND WORK PROGRAM, 2009–10

Title	Products	Expected delivery date
World Bank work program in next 12 months	1. Investment Climate Assessment.	January 2010
	2. Water Resources Assistance Strategy	December 2009
	3. Political Economy of Mining	March 2010
	4. Fertilizer Support Program – Public Expenditure Tracking Study	December 2009
	5. Public Expenditure Review	March 2010
	6. Jobs, Prosperity and Competitiveness Study	March 2010
	7. Institutional Review of the Transport Sector	August 2010
	8. Health Sector Assessment	June 2010
	9. Review of Oversight Institutions	March 2010
	10. Zambia Business Survey	January 2010
	11. Improved Access to ACT – Malaria	August 2010
IMF work program in next 12 months	1. Fourth PRGF review	May 2010
	2. Fifth PRGF review	December 2010
	3. Technical assistance: public financial management	February 2010 (and follow up)
	4. Technical assistance: tax administration	January 2010 (and follow up)
Fund request to Bank	1. Public Expenditure Review.	March 2010
	2. Review the Fertilizer Support Program (FSP). With significant increase in budget allocation, there is an urgent need to assess the FSP's poverty targeting goals.	December 2009
Bank request to Fund	1. Medium-term macroeconomic framework	
	2. Real exchange rate study	September 2010
Joint products in next 12 months	1. DSA	September 2010

ANNEX III. ZAMBIA : STATISTICAL ISSUES

As of November 23, 2009

I. Assessment of Data Adequacy for Surveillance
General: Data provision has some shortcomings, but is broadly adequate for surveillance. Issues with source data and compilation affect most datasets, but are particularly problematic in the national accounts, balance of payments, and consumer prices.
1. **National Accounts:** There is a high degree of uncertainty attached to estimates of the level and growth rate of real GDP, as 1994 is the latest benchmark year for value-added ratios to estimate GDP under the production approach. For many important industry areas, such as wholesale and retail trade, construction, business services and many other service industries, (consisting mainly of small-scale private service providers) there are no appropriate indicators. Data on total production and intermediate consumption of establishments are not available. On the expenditure side, there are no reliable indicators of household consumption and private final consumption expenditure is derived as a residual. Source data for estimating gross fixed capital formation and changes in stocks are incomplete. The situation largely reflects resource constraints and organizational weakness within the CSO that have affected its ability to produce economic statistics on a timely basis.
Price statistics: The CPI broadly adheres to international methodological standards. The classification system used for compilation closely follows the Classification of Individual Consumption by Purpose. However, the measurement of inflation is also subject to a high degree of uncertainty since the weights for Zambia's CPI are derived from the Household Budget Survey (HBS) of 1993/94 and thus are out-of-date. STA is providing technical assistance in this area.
Government finance statistics: Data provision is broadly adequate for surveillance purposes. The transactional coverage of these data is however limited to government operations and transactions in nonfinancial assets. Data on transactions in financial assets and liabilities are still unavailable. The authorities report monthly budget data to AFR for operational use in a timely manner, but the data are often subject to substantial revisions, and data on extra-budgetary institutions and local governments are not available. STA is providing technical assistance in this area.
Monetary statistics: Data provision is broadly adequate for surveillance purposes. As a result of implementation of a 2005 monetary and financial statistics mission, there has been a noticeable improvement in the quality of monetary accounts compiled and reported in accordance with the standardized report forms (SRFs) for the BoZ and other depository corporations (ODCs). However, the implementation of some recommendations pertaining to

the ODCs accounts still has some way to go and in some instances the pace of implementation could have been accelerated.	
Balance of payments statistics: Little progress had been made since the assessment by the 2004 Data ROSC mission. Data sources remain poor (some items are estimated without reference to current source data) and compilation methods are inadequate. Resources available for balance of payments compilation have been increased, but are still inadequate, while coordination between the BoZ and CSO had improved. As a result, significant gaps in data remain in many areas including reinvested earnings, trade in services, and the financial account (including export proceeds held abroad by mining and nontraditional exporters). While the source data are generally adequate in terms of timeliness, they fall short in terms of coverage. As a result the shortcomings in source data coverage, indirect estimation methods are used, some of which have remained unchanged for many years and are out of date. Source data on private sector foreign assets and liabilities are insufficient to compile an International Investment Position statement.	
External and domestic debt statistics: Data provision is broadly adequate for surveillance purposes. Recent efforts, facilitated by technical assistance, have led to an improvement in the consolidation of the debt databases, both in terms of external and domestic debt. Further work is underway in these areas.	
II. Data Standards and Quality	
Zambia has participated in the General Data Dissemination System (GDDS) since November 2002.	A Data ROSC Assessment was published in February 2005.

Zambia: Table of Common Indicators Required for Surveillance
As of November 23, 2009

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of publication[7]	Memo Items:	
						Data Quality – Methodological soundness[8]	Data Quality – Accuracy and reliability[9]
Exchange Rates	Nov. 2008	Nov. 20, 2009	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Nov. 2009	Nov. 20, 2009	W	W	M		
Reserve/Base Money	Sep. 2009	Nov. 20, 2009	W	W	F	LO, LO, LO, LO	LO, O, O, O, O
Broad Money	Sep. 2009	Nov. 20, 2009	M	M	M		
Central Bank Balance Sheet	Sep. 2009	Nov. 20, 2009	M	M	M		
Consolidated Balance Sheet of the Banking System	Sep. 2009	Nov. 20, 2009	M	M	M		
Interest Rates[2]	Sep. 2009	Nov. 20, 2009	W	W	F		
Consumer Price Index	Oct. 2009	Oct. 31, 2009	M	M	M	O, LO, O, LO	LNO, LO, LO, LNO, LO
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	NA					LO, LNO, LNO, LO	LNO, LO, O, O, LNO
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	Sep. 2009	Oct. 15, 2009	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Sep. 2009	Oct. 15, 2009	M	M	A		
External Current Account Balance	2008	Oct. 15, 2009	A	A	A	LO, LNO, LNO, O	LNO, O, LNO, LO, LNO
Exports and Imports of Goods and Services	2008	Oct. 15, 2009	A	A	A		
GDP/GNP	2008	Oct. 15, 2009	A	A	A	LO, LO, LO, LO	LNO, LO, LNO, LNO, LNO
Gross External Debt	Sep. 2009	Oct. 15, 2009	Q	I	I		
International Investment Position [6]	NA	NA					

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially determined, including discounts rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[7] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); or Not Available (NA).
[8] Reflects the assessment provided in the data ROSC, published February 1, 2005, and based on the findings of the mission that took place during May 18-June 3, 2004 for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning (respectively) concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).
[9] Same as footnote 8, except referring to international standards concerning (respectively) source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

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International Monetary Fund
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Washington, D. C. 20431 USA

IMF Executive Board Concludes 2009 Article IV Consultation with Zambia

On December 14, 2009, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Zambia.[1] The Executive Board also completed the third review under Zambia's Poverty Reduction and Growth Facility arrangement.

Background

The Zambian economy has performed well in recent years and showed some resilience to the recent global recession. Growth in 2009 is now projected at 5.3 percent, in line with the average for recent years, as the slowdown in the tertiary sector was compensated by a significant increase in copper production and a bumper crop. Inflation has moderated steadily from the food and fuel price induced highs of 2008 and stood at 12.3 percent in October 2009. The current account deficit has narrowed, helped by a recovery of copper prices and import compression following a sharp depreciation of the Kwacha. Zambia's reserve position is now stronger than it has been in almost four decades at about 4½ months of import cover, thanks in part to the augmentation of access under the PRGF arrangement and the recent SDR allocation. Progress is being made towards the attainment of the Millennium Development Goals. Poverty indicators have improved over the past decade, though the issue of rural poverty and service delivery remains a challenge. Health indicators have been improving, while the country is on-track towards meeting its goal of universal primary education.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

While the overall performance of the economy has held up well, government revenue collections, particularly of import-related taxes, have fallen short of expectations. In order to preserve targets for domestically-financed capital spending, the government has accessed additional domestic financing, including from the BoZ. Delays in the disbursement of donor aid have further hampered government's ability to meet spending targets.

After coming under sustained pressure in late 2008 and early 2009, the Kwacha has more recently strengthened and stabilized, supported by the recovery in copper prices. During the period of downward pressure, the Bank of Zambia intervened to maintain orderly conditions in the foreign exchange market, drawing on its earlier build up of reserves. Foreign exchange sales also helped the Bank meet its reserve money target for the first half of 2009. More recently, the Bank has relied to a greater extent on open market operations for liquidity management. While there has been an increase in non-performing loans, the banking sector remains adequately capitalized and liquid.

Executive Board Assessment

Executive Directors commended the Zambian authorities for their prudent macroeconomic management, observing that the Zambian economy has proven resilient to the global economic crisis. Growth is expected to be in line with its average for recent years and inflation is projected to moderate, while international reserves have risen to new highs owing in part to the PRGF augmentation and to the SDR allocation.

Directors commended the government for their response to spending pressures in 2009, and noted that the 2010 budget is well balanced. They supported the authorities' emphasis on creating fiscal space for pro-poor expenditure and for infrastructure investment to sustain robust and diversified growth. Directors welcomed the authorities' plans to undertake a comprehensive review of tax policy and administration, broaden the tax base, and reinforce tax collection efforts. They underscored the need to reverse the upward trend in the wage bill in order to free resources for other government priority outlays and social spending, and encouraged the authorities to make progress in implementing the civil service and pay reform program in 2010. Further measures to improve government spending efficiency will be necessary, building on the recent alignment of the budget cycle to the fiscal year and the ongoing reforms related to the treasury single account and the integrated financial management and information system.

Directors noted that staff assessed Zambia's risk of debt distress as low. They concurred that there is some scope for non-concessional borrowing to finance the government's share in essential infrastructure projects, particularly in electricity generation. Nonetheless, a robust debt management strategy is needed to maintain debt sustainability. The government's commitment to improve aid management was welcomed along with closer coordination with donors, including on governance concerns.

Directors agreed that the floating exchange rate regime and reserve money-based monetary program have served Zambia well. They noted the staff's assessment that the exchange rate is broadly in line with fundamentals. They encouraged the authorities to continue to limit foreign exchange interventions to reducing excessive exchange rate volatility. They saw scope for a gradual shift toward interest rates as the main instrument to anchor inflationary expectations. They stressed that a transition to an inflation targeting regime should be premised on further analysis and on ensuring that the necessary preconditions are in place.

Although the banking sector remains adequately capitalized and liquid, deeper financial intermediation is needed to spur growth. Directors encouraged the authorities to implement the second phase of the financial sector development plan to enhance financial system stability and financial intermediation. They welcomed plans to develop a secondary market in government securities and to enact a lender of last resort policy for the Bank of Zambia. A few Directors stressed the importance of strengthening efforts to fight money laundering.

Directors welcomed the move to raise electricity tariffs toward cost recovery levels and emphasized the importance of ensuring full cost recovery to attract private sector investment. They supported strict adherence to a multiyear program of tariff increases. They encouraged the authorities to accelerate efforts to strengthen the financial and operational efficiency of ZESCO. A few Directors underscored the importance of a reliable legal framework to govern public-private partnerships in infrastructure investment. Directors called on the authorities to address the weaknesses in the quality and timeliness of economic statistics, which pose a significant obstacle to economic analysis and policymaking.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Zambia: Selected Economic Indicators

	2006	2007	2008	2009 Est.
	(Percent changes; unless otherwise indicated)			
National account and prices				
GDP at constant prices	6.2	6.2	5.7	5.3
GDP deflator	13.3	12.8	12.9	12.4
GDP at market prices	38,561	46,195	55,079	65,196
(Billions of kwacha)				
Consumer prices				
Consumer prices (average)	9.0	10.7	12.4	13.7
Consumer prices (end of period)	8.2	8.9	16.6	12.0
External sector				
Terms of trade (deterioration -)	55.2	8.4	-17.1	-15.4
Average exchange rate (kwacha per U.S. dollar)	3,601	4,002	3,754	…
(percentage change; depreciation -)	19.3	-11.1	6.2	…
Real effective exchange rate (depreciation -)[1]	-33.1	7.2	-16.5	…
Money and credit (end of period)				
Domestic credit to the private sector	54.3	43.0	50.2	14.3
Reserve money[2]	29.7	1.6	28.4	19.0
Broad Money (M3)	45.1	26.3	22.0	19.0
	(Percent of GDP; unless otherwise indicated)			
National accounts				
Gross investments	20.8	20.6	19.4	22.1
Government	4.2	4.0	3.6	4.2
Private	16.6	16.6	15.9	17.9
National savings	23.8	16.0	13.9	20.3
Gross foreign savings	-3.0	4.6	5.6	1.8
Central government budget				
Overall balance[3]	18.9	-0.2	-2.2	-2.6
(excluding grants)	-7.6	-4.8	-6.0	-7.1
Revenue	17.2	18.4	18.6	15.7
Grants	26.5	4.6	3.8	4.5
Total expenditure	23.5	24.3	23.8	22.8
External sector				
Current account balance (including current and capital grants)	3.0	-4.6	-5.6	-1.8
Gross international reserves (months of imports)[4]	2.2	2.5	2.1	4.5
Public debt				
Total central government debt (end-period)	27.2	24.3	26.7	26.4
External	11.0	9.2	11.2	11.9
Domestic	16.2	15.1	15.5	14.5

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

[1]Excludes Zimbabwe.

[2]The projected reduction in reserve money for December 2007 reflects the lowering of statutory reserve requirements from 14 to 8 percent on October 1, 2007.

[3] Including discrepancy between the above-the-line balance and below-the-line financing.

[4]Imports in current year. Includes the new SDR allocation of SDR 401 millions in 2009.

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

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International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Third Review Under the PRGF Arrangement with Zambia and Approves US$ 81.2 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the third review of Zambia's economic performance under the Poverty Reduction and Growth Facility (PRGF) arrangement. The completion of the review will enable the immediate disbursement of an amount equivalent to SDR 51.013 million (about US$ 81.2 million), bringing total disbursements to SDR 164.91 million (about US$ 262.5 million).

The PRGF arrangement for Zambia in the amount of SDR 48.91 million (about US$79.2 million) was originally approved in June 2008 (see Press Release No. 08/134), and later augmented by SDR171.185 million (about US$256.4 million) to SDR 220.095 million (about US$329.7 million) in May 2009 (see Press Release No. 09/147).

The Executive Board today also concluded the 2009 Article IV consultation with Zambia. A Public Information Notice and the staff report will be published in due course.

Following the Executive Board's discussion, Mr. Murilo Portugal, Deputy Managing Director and Acting Chair, stated:

"The Zambian authorities are to be commended for their solid performance under the PRGF-supported program. Their prudent macroeconomic management was demonstrated by the Zambian economy's resilience to the global economic crisis.

"The 2010 budget is well balanced. The authorities aim to create fiscal space for poverty reducing expenditure and for infrastructure investment to sustain robust and diversified growth. The authorities will review tax policy and administration, with a view to broadening the tax base and reinforcing tax collection. The upward trend in the wage bill needs to be reversed to free resources for other priority outlays and social spending. Further reforms to enhance government spending efficiency are also needed.

"The 2010 budget is well balanced. The authorities aim to create fiscal space for poverty reducing expenditure and for infrastructure investment to sustain robust and diversified growth. The authorities will review tax policy and administration, with a view to broadening the tax base and reinforcing tax collection. The upward trend in the wage bill needs to be reversed to free resources for other priority outlays and social spending. Further reforms to enhance government spending efficiency are also needed.

"Zambia's risk of debt distress is low and there is some scope for external borrowing on non-concessional terms to finance the government's share in essential infrastructure projects, particularly in electricity generation. The authorities plan to adopt a comprehensive debt management strategy, which will ensure that external borrowing is consistent with continued low risk of debt distress. The authorities are committed to improve aid management and to coordinate closely with donors.

" The floating exchange rate regime and reserve money-based monetary program have served Zambia well. The authorities' plans to transition to an inflation targeting regime should be premised on the establishment of the necessary preconditions. The authorities aim to implement the second phase of their financial sector development plan to enhance financial system stability and financial intermediation.

"Attracting private sector investment in the electricity sector requires aligning tariffs with cost recovery levels. Efforts to strengthen the financial and operational efficiency of the

Statement by Samuel Itam, Executive Director for Zambia
December 14, 2009

Zambia's economic performance in 2009 has been affected by the global economic contraction largely through the trade channels. Mining companies reacted to the sharp drop in copper prices by cutting back on project development, scaling down operations, and placing some mines under care and maintenance. The authorities put in place tax and expenditure measures to safeguard operations and employment in the mining and other sectors. These measures coupled with a re-bound in copper prices and bumper maize harvest, have led to an incipient recovery in economic activity. Consequently, economic growth in 2009 has been revised upwards to 5.3 percent from an earlier forecast of 4 percent. The end-year inflation target of 12 percent is within reach as a consequence of this favorable development. Progress has also been recorded in meeting the Millennium Development Goals with respect to health indicators and universal primary education. Moving forward, the key challenges are to improve revenue performance and consolidate the fiscal position, enhance the financing of priority infrastructure projects, address rural poverty and improve service delivery with increased vigor.

My authorities thank the Fund for helpful policy guidance, financial support and technical assistance. They also appreciate the candid policy exchange with staff and are in general agreement with the staff reports.

Program performance

Program performance has been satisfactory, with all the end- June 2009 quantitative performance criteria and indicative targets being met and two of the three structural benchmarks observed. Delays regarding the third structural benchmark of setting up a supervisory regime for the secondary market in government securities was because of the need to widen the consultation process. However, considerable progress has been made and the benchmark has now been reset for end-March 2010. Two end-September 2009 benchmarks have also been met, although one—introduction of a new standing overnight lending facility—was delayed by 2 months on account of delay in completing the consultation process with the market players.

Macro-economic policy framework

The authorities' economic agenda of the for 2010 and beyond focuses on consolidating recovery of the domestic economy and accelerating growth through economic diversification and business-friendly macroeconomic policies, and protecting key social expenditures, such as education and health. The macroeconomic objectives are to exceed 5 percent in annual GDP growth, reduce end-year inflation to 8 percent, and limit annual domestic borrowing to 2 percent of GDP.

Fiscal policy

Domestic revenue performance has not matched the rebound in growth and is estimated to have declined by 6.5 percent in 2009, because of lower receipts from trade taxes. The budgetary impact of the underperformance in revenue has been exacerbated by the withholding of sector and budget support by development partners, particularly in the health sector (because of financial mismanagement allegations). In order to mitigate the adverse impact of the global contraction and safeguard priority infrastructure programs in the transport, education and health sectors, the authorities reduced spending in low priority areas but had to increase domestic borrowing. Consequently, total expenditure in 2009 is projected to be about 8.3 percent lower than budget provision. However, domestic borrowing is projected to increase by 2.2 percent of GDP.

The need to restore and accelerate economic growth, and protect social spending will expand expenditure in 2010. Non-priority spending will be constrained in preference for spending aimed at stimulating growth, diversifying the economy and better targeting support to vulnerable groups. Moreover, the authorities will continue contracting debt only on concessional basis as a first option. However, consideration may be given to limited non-concessional financing for high return investment projects. In this regard, infrastructure provision remains a priority with a focus on essential roads, bridges, electricity generation, education and health facilities.

My authorities consider financial mismanagement in the health sector as unacceptable, particularly considering the substantial progress made in improving the management of public resources. The authorities have provided all the support needed to successful conclude the investigations. In addition, resources to the office of the Auditor General and the Anti-Corruption Commission are being increased in order to swiftly detect and prevent financial irregularities, as well as fight corruption. In this connection, the authorities will establish a Financial Intelligence Unit to further enhance the fight against financial crime. To resolve the problems in the health sector, the authorities and development partners have a joint action plan. Progress is on course and the second part of plan to improve system and procurement audits will trigger further funding in mid-2010.

Monetary policy and exchange rate policy

The monetary policy framework has been underpinned by the objective of attaining single digit inflation and allowing appropriate private sector credit expansion. The contraction in domestic credit in 2009 is largely attributed to weaker domestic demand and stricter lending conditions in the wake of the global financial crisis. Financial conditions remained satisfactory and all banks remain well capitalized and liquid, despite the global financial crisis. Even though the quality of loan performance declined, non-performing loans are adequately provisioned.

Monetary policy will continue to focus on maintaining a single digit inflation and macroeconomic stability. However, the authorities have realized that the current framework of reserve money targeting provides little room to counter adverse cyclical conditions by lowering interest rates. In this respect, the monetary policy framework is being reviewed to shift from the strict use of monetary aggregates to short-term interest rates as a monetary anchor. The ultimate objective in the medium-term is to gradually shift to inflation targeting when conditions are right and operational autonomy of the Bank of Zambia is provided by an Act of parliament.

Structural reform

The authorities are committed to a structural reform agenda that complements the macroeconomic framework to improve economic diversification and competitiveness. In this regard, a review of business licensing procedures have been completed; a legal framework for public-private partnership has been introduced; and a multi-year tariff adjustment framework has been approved for electricity to enhance investment in the sector while ensuring improvement in service delivery. In the fiscal area, a new law has been put in place to enable the budget to be presented and approved before the commencement of the financial year; and a Treasury Single Account will be established in 2010 to further improve budget execution and cash management of public finances. To improve access to credit and reduce the high cost of borrowing, the implementation of the second phase of the financial sector development program will commence in 2010. My authorities believe that these measures, together with the unwavering support from development partners would result is the achievement of their development agenda.

Conclusion

The Zambian authorities consider Fund support as important in helping to address the developmental challenges the country is facing. The authorities are requesting the completion of the third review of the PRGF and modification of the performance criteria in line with recent developments in order to consolidate economic recovery and enhance the country's growth momentum.