KUKULA

Macroeconomic Outlook

Zambia Q3 2022

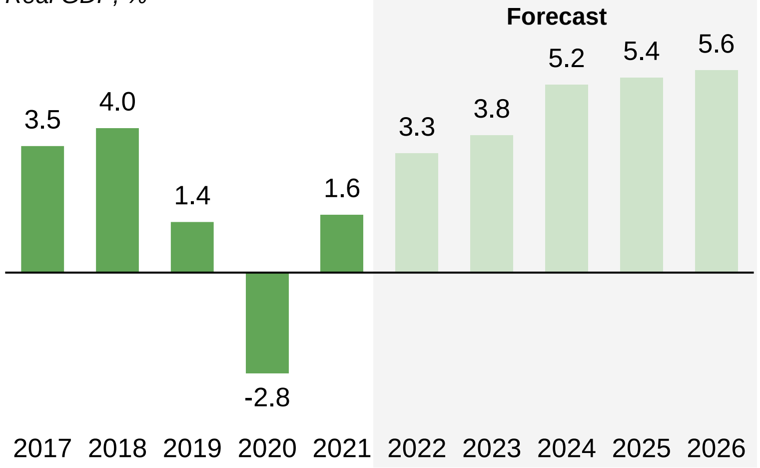
25 May 2022

OVERVIEW OF THE MACROENVIRONMENT IN ZAMBIA

KUKULA

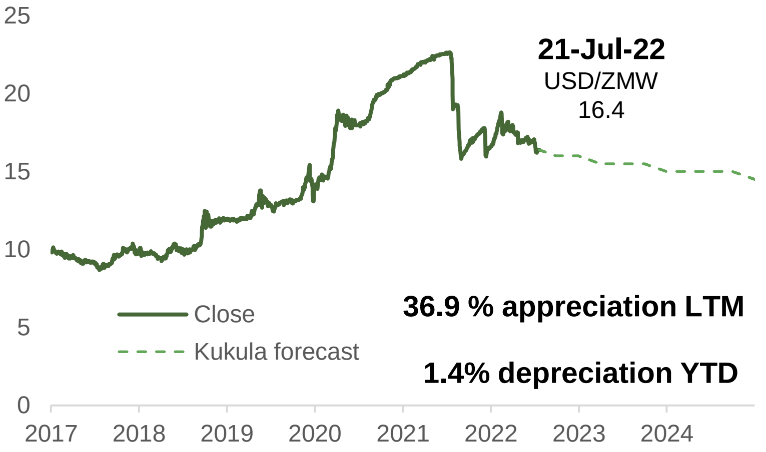
Real GDP growth rate (%)

Real GDP, %



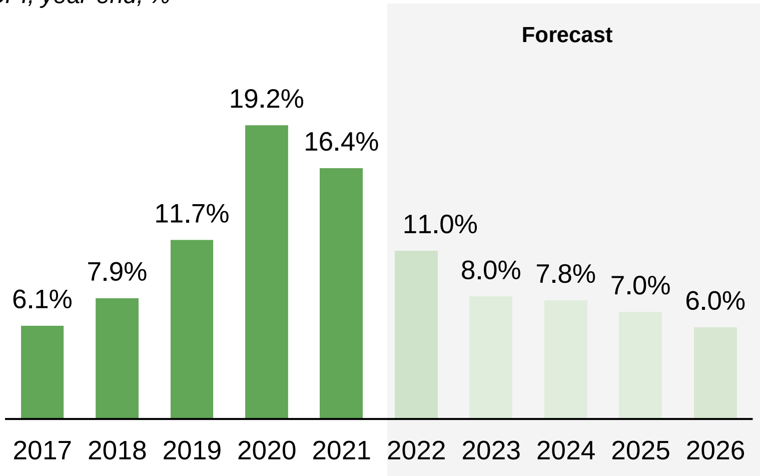
USD/ZMW exchange rate

USD/ZMW, close rate



Inflation rate (%)

CPI, year-end, %



GDP growth

We maintain our moderate forecast for medium term GDP growth. We expect to see substantial FDI inflows directed toward mining and agriculture sectors. In the short term, rising energy costs (oil & fuels) may push up imports - contributing negatively to GDP. However, favourable movements in the US dollar/Kwacha exchange rate in recent weeks have helped alleviate some inflationary pressure. We believe that as inflation stabilises and consumer confidence recovers toward the end of 2023, we will see more robust GDP growth.

Although government has committed to narrowing the fiscal deficit, there remains tremendous pressure to fund short term consumption expenditure and the fuel tax waivers. Government expects fiscal deficit to widen to 9.9% of GDP from previous estimate of 5.5% for 2022.

USD/ZMW exchange rate

The Kwacha has appreciated by 26.9% LTM and has appreciated by 1.4% since the start of the year. The Kwacha experienced substantial depreciation from August 2020 and maintained this downward trajectory until July 2021 leading up to the Zambian presidential election.

Stabilisation in Zambia's international reserves and renewed investor confidence has helped stabilise the FX rate. With greater policy certainty and progress in Zambia's sovereign debt restructuring, we expect Kwacha to strengthen at a moderate pace over the medium term. We also expect there to be reduced volatility in the USD/ZMW exchange rate. The Kwacha hit parity with the rand in Q2 for the first time since 2020 helping ease imported inflation. Stabilisation of inflation also bodes well for Zambia's FX outlook..

Inflation rate

The annual inflation rate for 2021 reduced to 16.4% from 19.2% recorded in 2020 (a decrease of 2.8%). YoY inflation figures for June indicate a substantial reduction in inflation with June 2022 inflation closing in single digits compared to the 10.2% measured in May 2022.

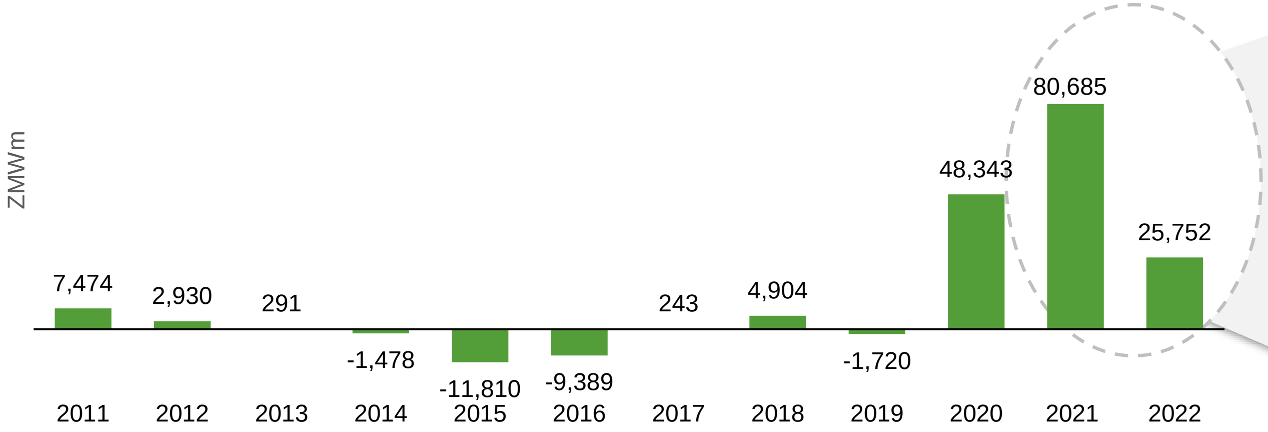
Fiscal policy is expected to remain tight with government making tight fiscal control a top priority. Rising energy costs globally play a role in forward looking inflation as global oil supply is impacted by Russia-Ukraine conflict. High cost of key agricultural inputs may put pressure on agriculture production in tandem with impact of adverse weather conditions across several regions globally. However, the expectedly appreciating Kwacha will help alleviate some inflationary pressures in the medium term.

Source: BoZ, ZamStats, IMF, Kukula Analysis,

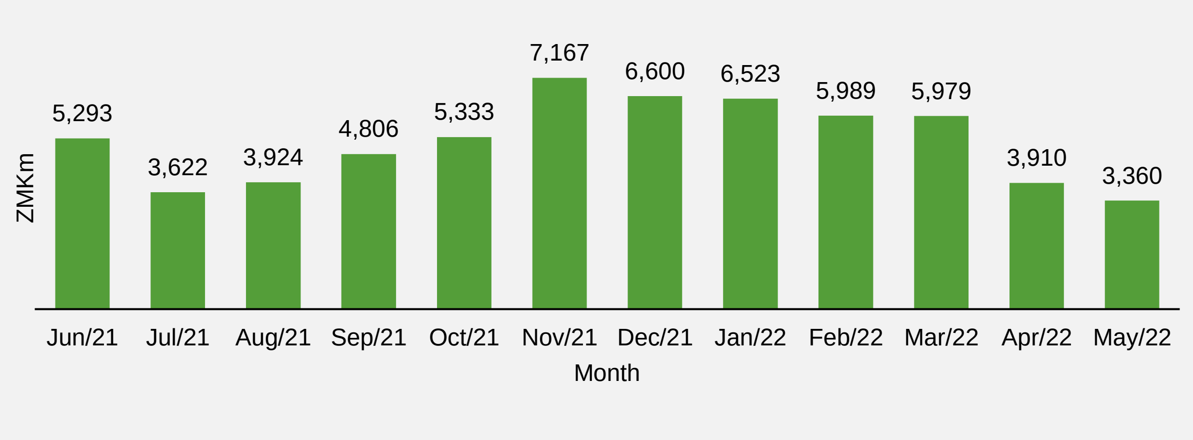
TRADE BALANCE REMAINS POSITIVE, KWACHA FX GAINS HELP EASE PRESSURE OF RISING IMPORT COSTS

KUKULA

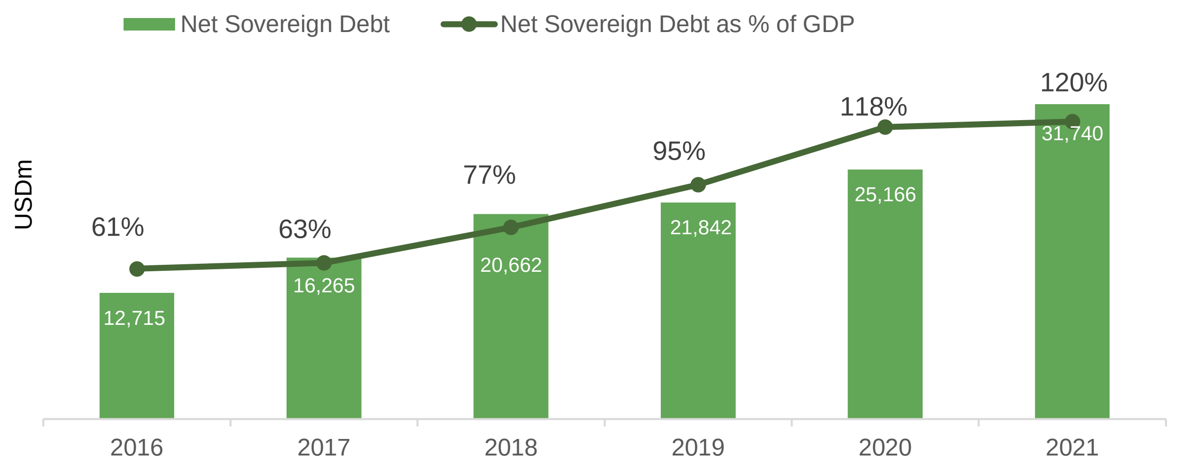
Historical annual aggregated trade balance



Monthly trade balance – LTM



Net sovereign debt



Observations

- Zambia registered a positive trade balance of approximately ZMW 3.4 bil. for the month of May 2022. This represents an 14% reduction MoM compared to ZMW 3.9 bil. registered in April. Net exports remain under pressure mainly due to high import costs as a result of the global rise in oil and gas prices. Despite this, we expect the trade balance to remain positive especially as copper prices stabilise above long-term average (copper and articles thereof are a major component of Zambia's exports). Similarly, a rebound in agriculture exports will help boost the trade balance.

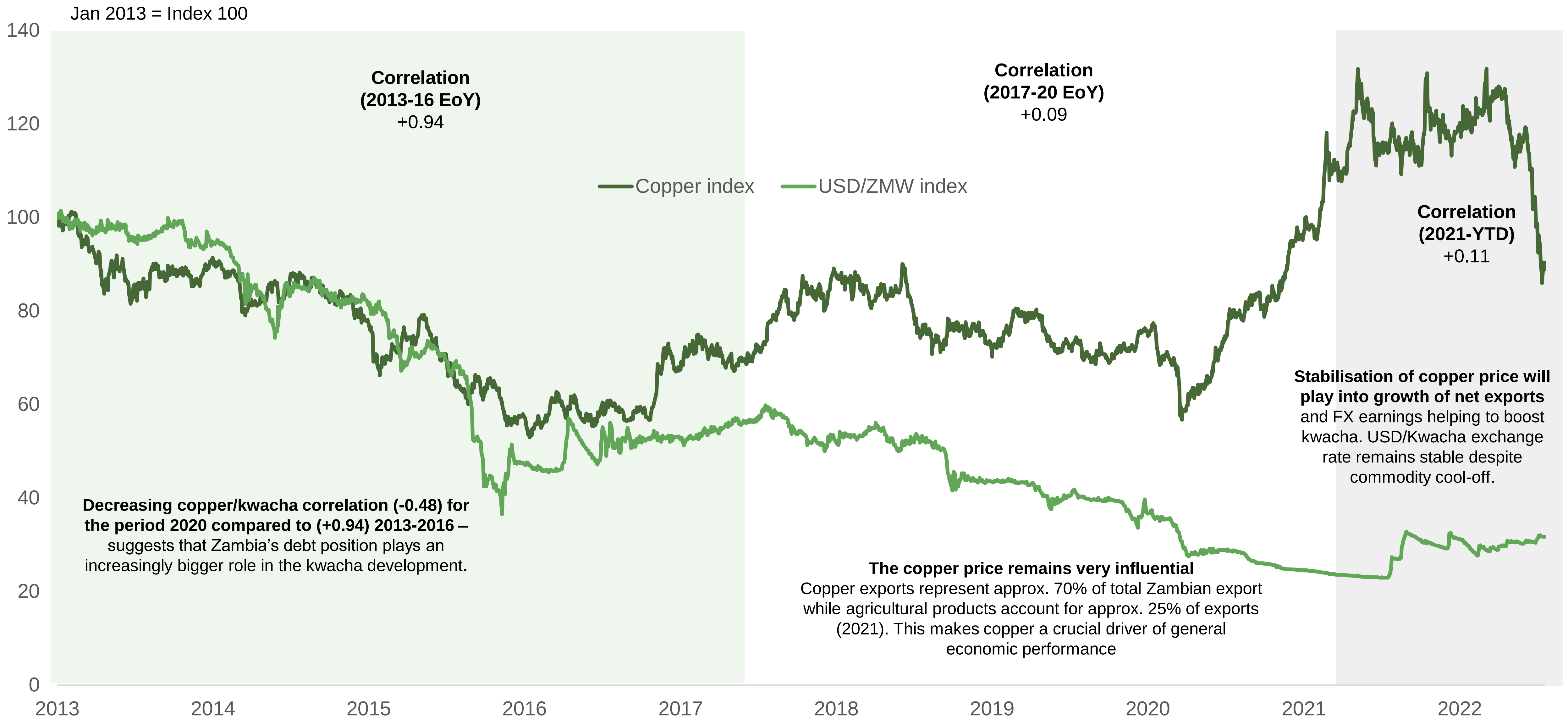
- Zambian Kwacha has made substantial gains against global majors as well as the South African Rand. This has helped ease some of the inflationary pressure caused by the relatively high cost of imports and energy.

- The Ministry of finance published its medium-term budget on 9 July 2022. Take aways include the cancellation nearly USD 2bn capital projects and new measures reduce the accumulation of non-concessional debt. These decisions are part of a larger debt-restructuring plan to tackle Zambia nearly USD 32bil. in sovereign debt (end of 2021).

Source: BoZ, EIU, ZamStats, IMF, Ministry of Finance of Zambia, Bloomberg

COPPER PRICE DECLINES BUT CURRENCY REMAINS STABLE

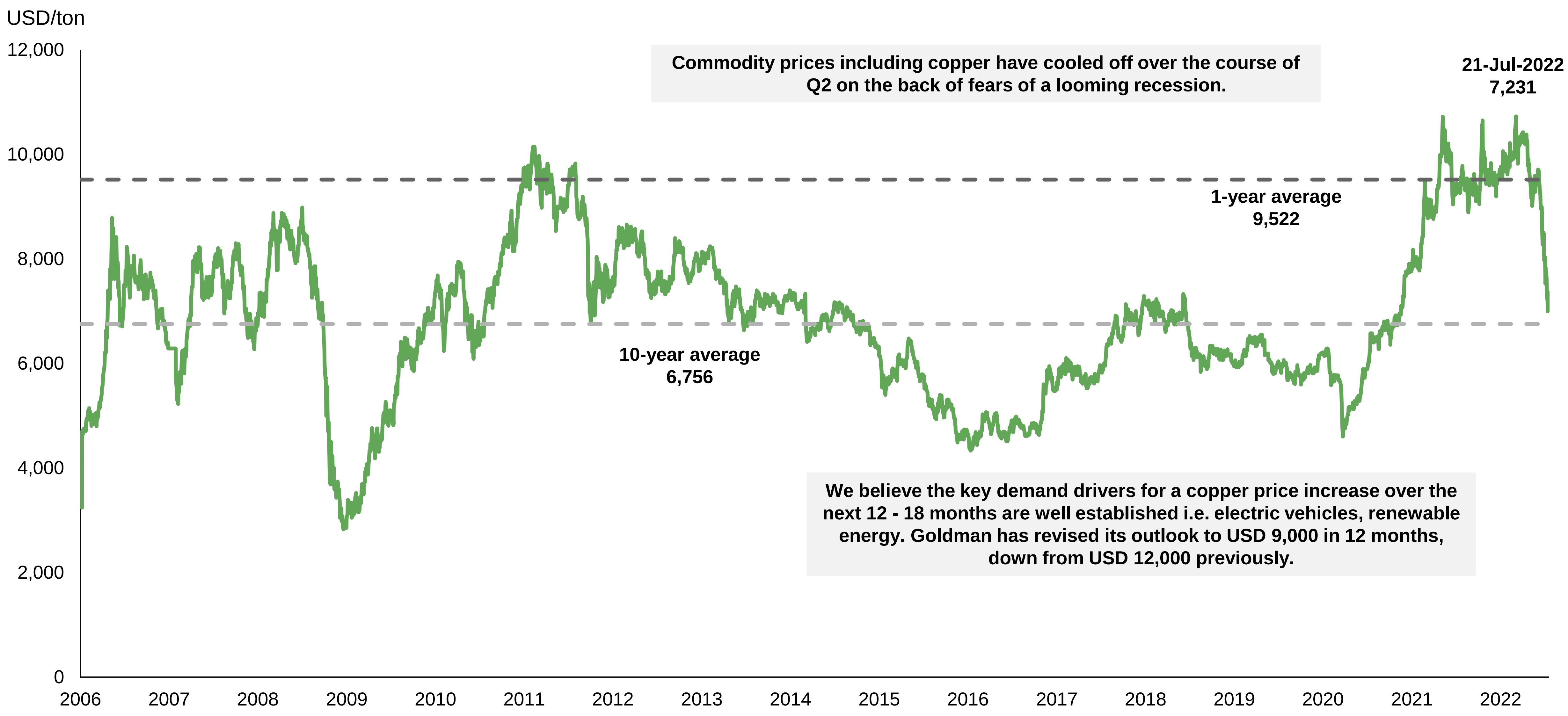
KUKULA



Source: BoZ, Kukula Analysis

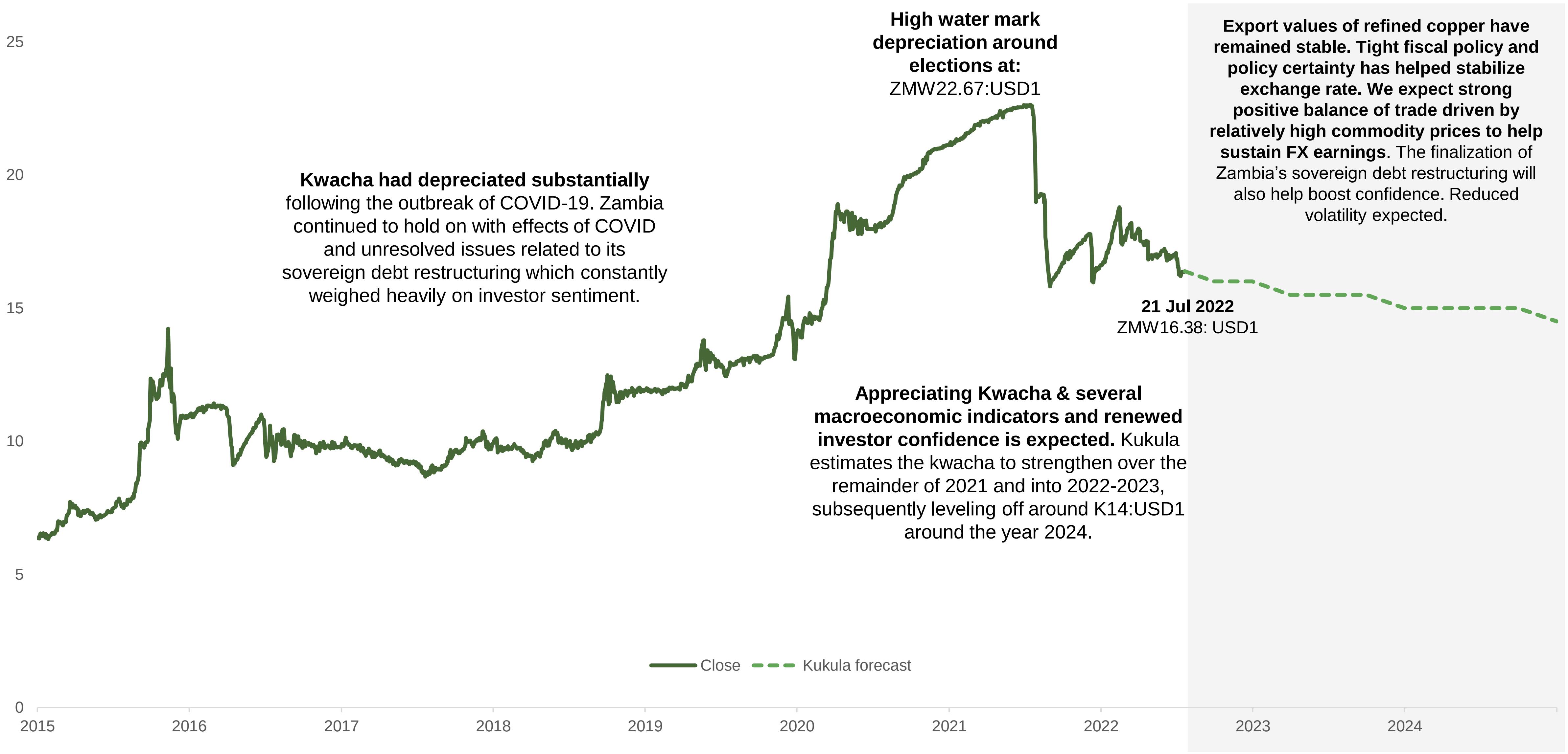
SUBSTANTIAL SELLOFF IN COPPER ON RECESSION FEARS

KUKULA



Source: BoZ, EIU, S&P Global

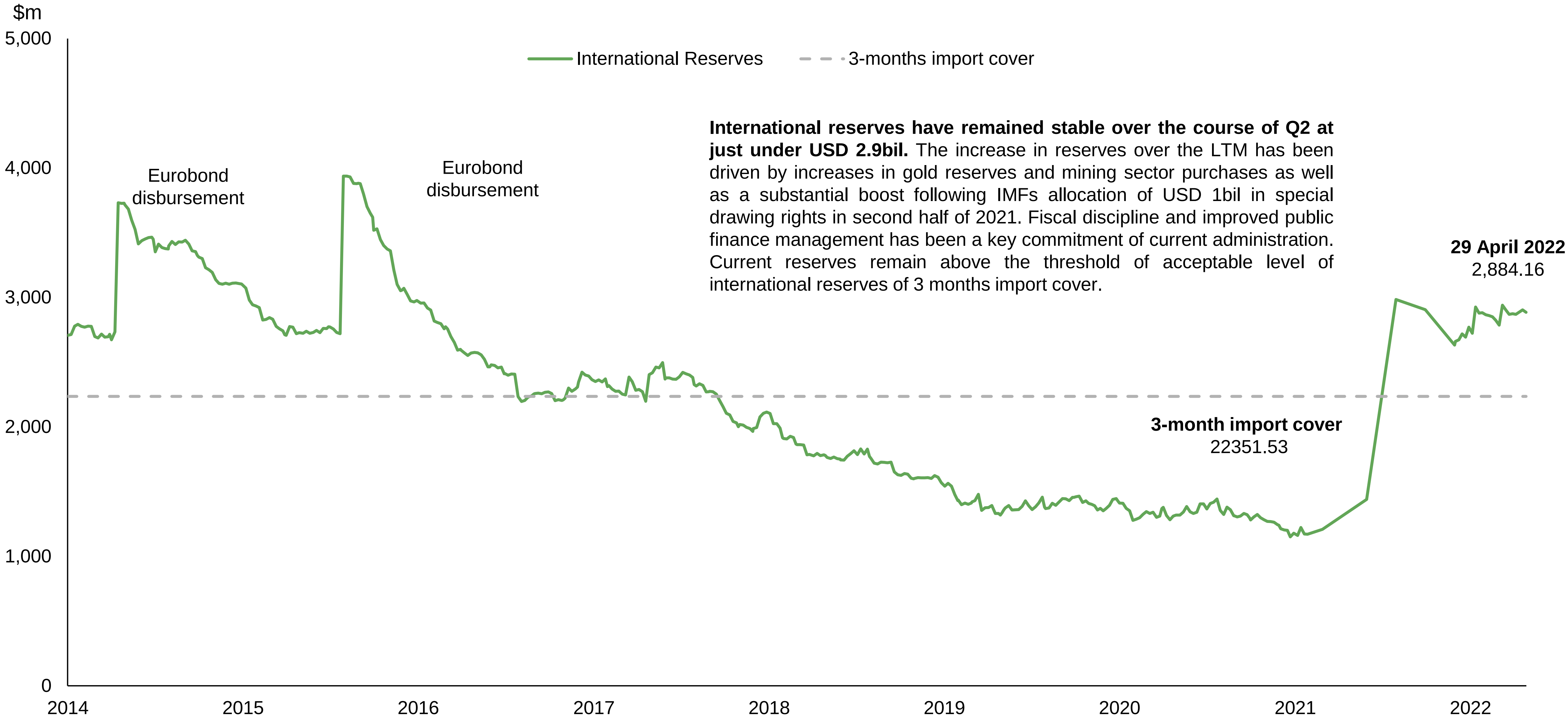
KWACHA EXPECTED TO IMPROVE IF RESTRUCTURING TALKS GO WELL, CURRENCY HOLDS STRONG AMIDST COMMODITY SELLOFF



Source: Kukula analysis

INTERNATIONAL RESERVES REMAIN STABLE DURING Q2 DESPITE PRESSURE FROM HIGH ENERGY COSTS

KUKULA

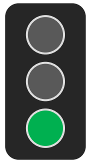
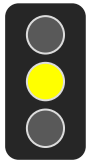
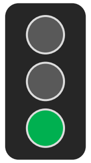
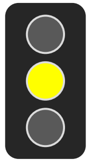


International reserves have remained stable over the course of Q2 at just under USD 2.9bil. The increase in reserves over the LTM has been driven by increases in gold reserves and mining sector purchases as well as a substantial boost following IMFs allocation of USD 1bil in special drawing rights in second half of 2021. Fiscal discipline and improved public finance management has been a key commitment of current administration. Current reserves remain above the threshold of acceptable level of international reserves of 3 months import cover.

Source: BoZ, ZamStats, Kukula Analysis

MACRO ENVIRONMENT – FORWARD LOOKING

KUKULA

Theme	Outlook	Macroeconomic developments
Economic Growth		▪ **In the near-term, economic growth is expected be below Zambia's long-term potential** as the government continues to grapple with limited fiscal flexibility and and high consumption expenditure. ▪ **Government expects fiscal deficit to widen to 9.9% of GDP from the previous estimate of 5.5%** due to increased spending pressure and high cost of energy and health related consumption. ▪ **Copper prices have declined on the back of a broader selloff in commodities due to recession fears.** Copper demand is however expected to remain resilient in the long term. ▪ **High energy costs will dampen growth. T**his has stalled governments plans to undo fuel subsidies which have historically been a drain on government funds. ▪ **FDI directed at manufacturing is expected to arrive in the medium term,** this will have long term benefits in terms of boosting local production and import substitution which will help reduce reliance on imports.
Inflation		▪ **Inflation for the month of June registered at 9.7%., down from 10.2% the previous month,** helped by a strengthening of the kwacha which will help the purchasing power for dollar denominated imports. increased global energy supply will also help drive reduction in inflation in the medium term. ▪ **The BoZ has again left the Monetary Policy Rate unchanged at 9%** following its May 16-17 meeting citing the continued deceleration of inflation as the core factor. ▪ **We expect inflation to remain above the BoZ's target rate of 6-8%** in the medium term driven by high energy costs and imported inflation from core import markets. ▪ **The global cool off in commodity prices** may provide some relief from high in medium term but this may not be felt immediately.
Exchange Rates		▪ **We expect the Kwacha to appreciate at a moderate pace from Q4 2022 onwards** due to debt restructuring, increases in copper output and disciplined government spending. ▪ **International reserves may come under pressure as temptation to subsidies fuel remains,** this may undermine confidence in Government's fiscal position and put pressure on exchange rate. ▪ **Strengthening kwacha will help relieve some of the inflationary pressure** Zambia has been experiencing, especially imported inflation from South Africa ▪ **New capital inflows at both private and sovereign level** to further develop copper production capacity is likely to strengthen the Kwacha.
External Sector		▪ **We expect positive but muted trade surplus growth in the near term** as global commodity prices decline. ▪ **Reduced public infrastructure spending as a result of tightened external credit conditions** will likely cause a reduction in capital good imports for 2022. ▪ **While Zambia's inflation seems to be easing, South Africa's headline consumer inflation rose to 5.9% YoY in March,** Just below the South African reserve banks upper limit of 6%. Empirical evidence suggests SA inflation tends to be imported into Zambia considering South Africa's role as a major import origin. This is expected to put pressure to local prices for both food and non-food items.

Source: EIU, Kukula Analysis, Stanbic, BoZ

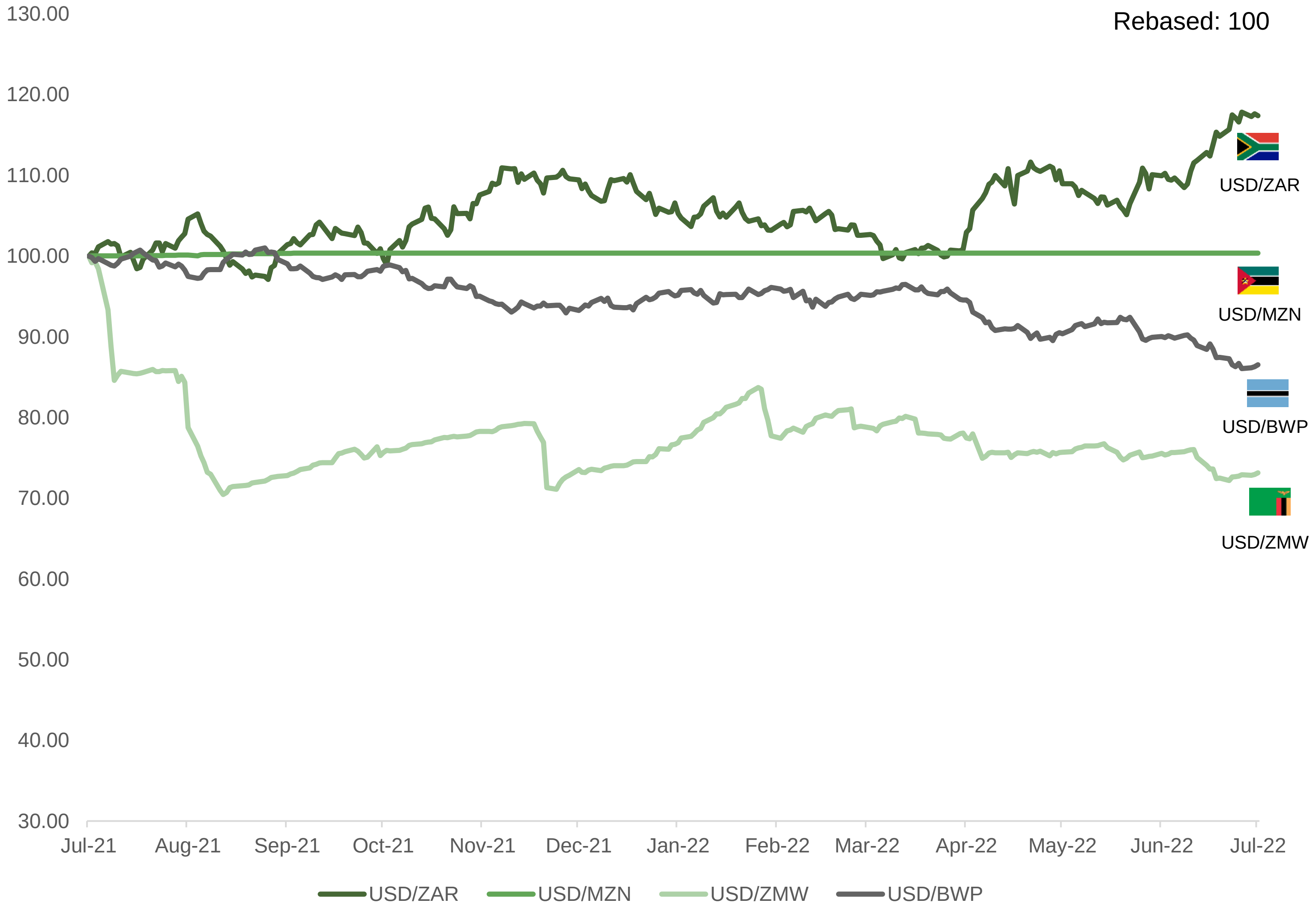
APPENDIX: REGIONAL FX PERFORMANCE

Source: ZamStats, BoZ, Kukula Analysis

KWACHA A STRONG PERFORMER REGIONALLY

KUKULA

Regional FX performance LTM



Comments

The Zambian Kwacha hit parity with the rand for the first time since 2020. The Zambian Kwacha has been boosted substantially by the reduced political uncertainty, Firming up of international reserves and FDI inflows. This has helped offset some of the imported inflation Zambia typically sees from South Africa.

The South African rand has gained ground following the South African Reserve Bank raising rates by 75 bps to 5.5%. South African inflation is currently outside the South African Reserve Bank's (SARB) target range of 3-6%. Inflation stood at 7.4% at the end of June. SARB cited recent currency depreciation as well as increases in food and fuel prices as among key factors driving the decision

Mozambique metical has traded flat over LTM. With the imminent closure of SAPREF and NATREF refineries in South Africa, SADC will have no refining capacity and will be heavily dependent on fuel imports. Maputo may see increased fuel volumes to help supply region - helping to boost FX earnings.