



KUKULA



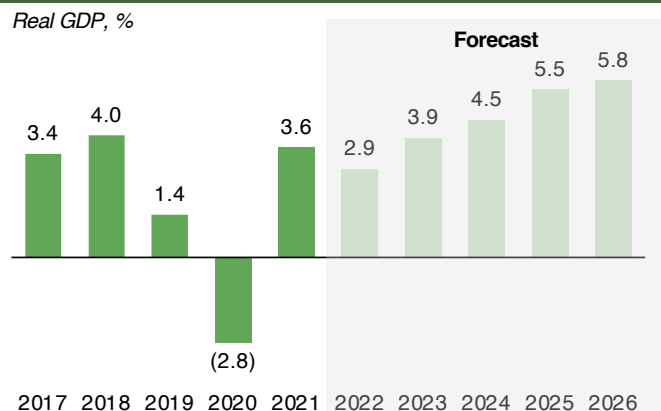
Macroeconomic Outlook

Zambia Q1 2023

27 January 2023

OVERVIEW OF THE MACROENVIRONMENT IN ZAMBIA

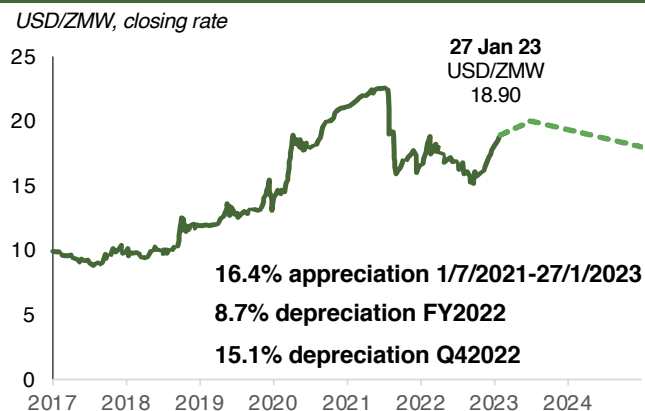
Real GDP growth rate (%)



GDP growth

Economic growth has slowed down in 2022 due to lower output in the agriculture sector and a weaker performance in the construction sector combined with higher prices of critical commodities such as petroleum and fertiliser. Furthermore, the first half of 2021 saw expansionary fiscal spending leading up to the election in August 2021, which has now impaired Zambia's fiscal position and plays a role in the low growth numbers for 2022. We expect substantial FDI inflows going forward directed toward energy, mining and agriculture. This combined with a strong global demand for copper and nickel and a shift to an increasingly business-friendly policy environment with restored access to international credit will contribute greatly towards increased GDP in the future.

USD/ZMW exchange rate

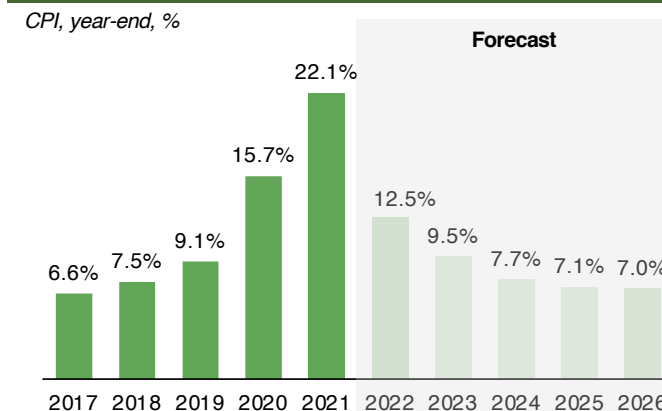


USD/ZMW exchange rate

The Kwacha depreciated a total of 8.7% in 2022. This was driven by significant depreciation of 15.1% in Q4 of 2022, which replaced trends toward appreciation in Q3 of 2022. Nevertheless, the Kwacha has appreciated 16.4% since July 2021, replacing the depreciation that occurred leading up to the Zambian presidential election. The stronger currency has been driven by renewed investor confidence coming from IMF supporting Zambia combined with an improved supply of foreign exchange and greater confidence in the government.

Despite greater political certainty and progress in Zambia's sovereign debt restructuring, we expect the Kwacha to depreciate slightly over the short term due to recession fears globally before appreciating as IMF's ECF of USD 1.3 bn is received (expected Q2 2023).

Inflation rate (%)



Inflation rate

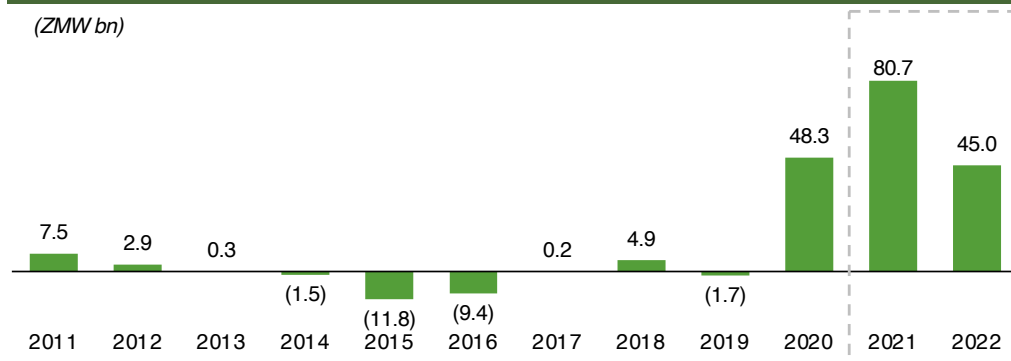
The annual inflation rate decreased significantly in 2022 relative to 2021, where it peaked at 22.1%, which was one of the highest rates in Africa. YoY inflation for December represents a substantial reduction in inflation - with inflation closing at 9.9% compared to 16.4% measured in December 2021.

The key driver of lower inflation has been improved supply of food items and appreciation of the Kwacha since peak depreciation in July 2021. The current weakening of the Kwacha may drive up inflation short-term, but it is expected to stabilize. In connection to this, BoZ projects inflation to return to the target range of 6-8% in Q1 2024. Therefore, BoZ maintained the rate at 9% in its recent committee meeting and long-term rates are expected to stabilize around 8.5%.

POSITIVE TRADE BALANCE WHICH IS EXPECTED TO REMAIN POSITIVE IN THE MEDIUM TERM

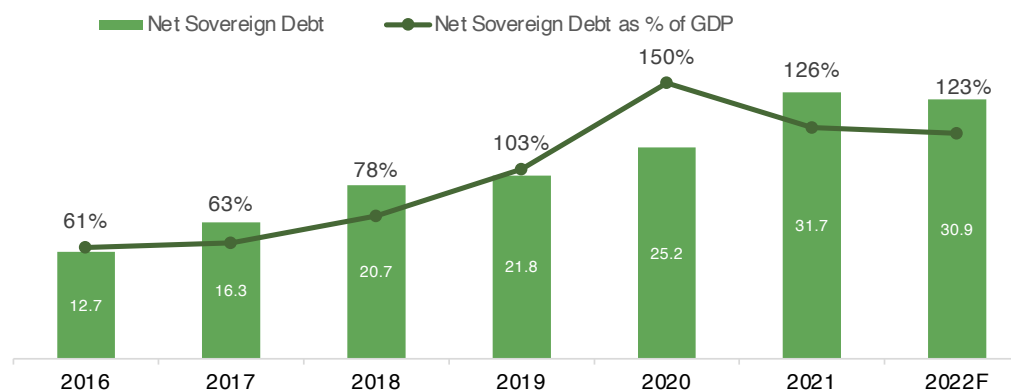
Historical annual aggregated trade balance

(ZMW bn)



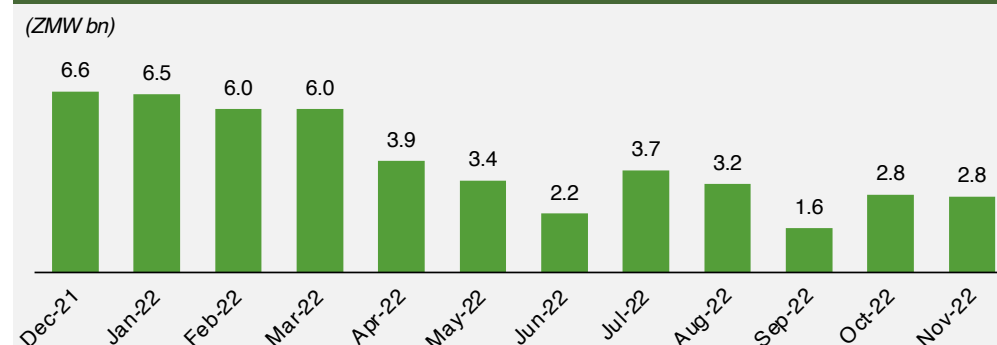
Net sovereign debt

(USD bn)



Monthly trade balance – LTM

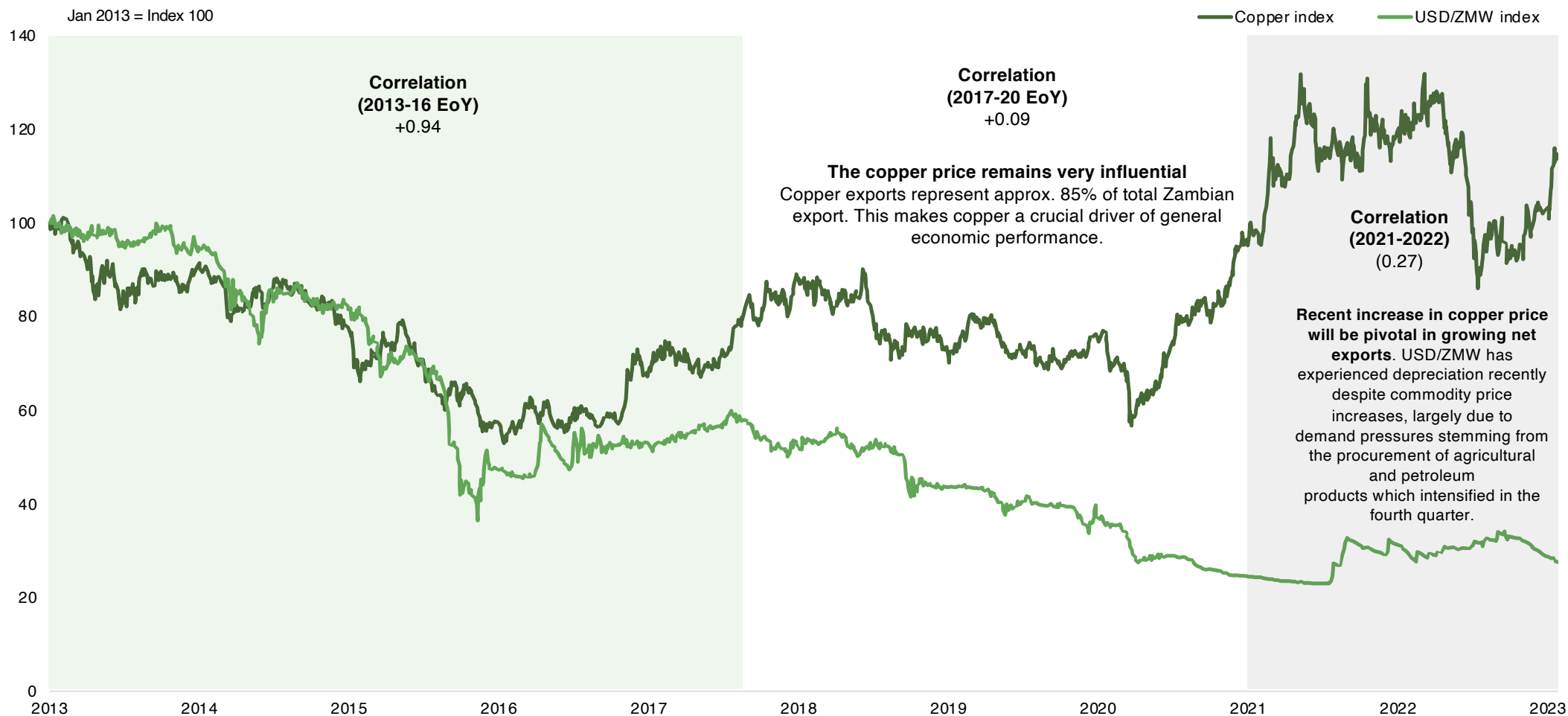
(ZMW bn)



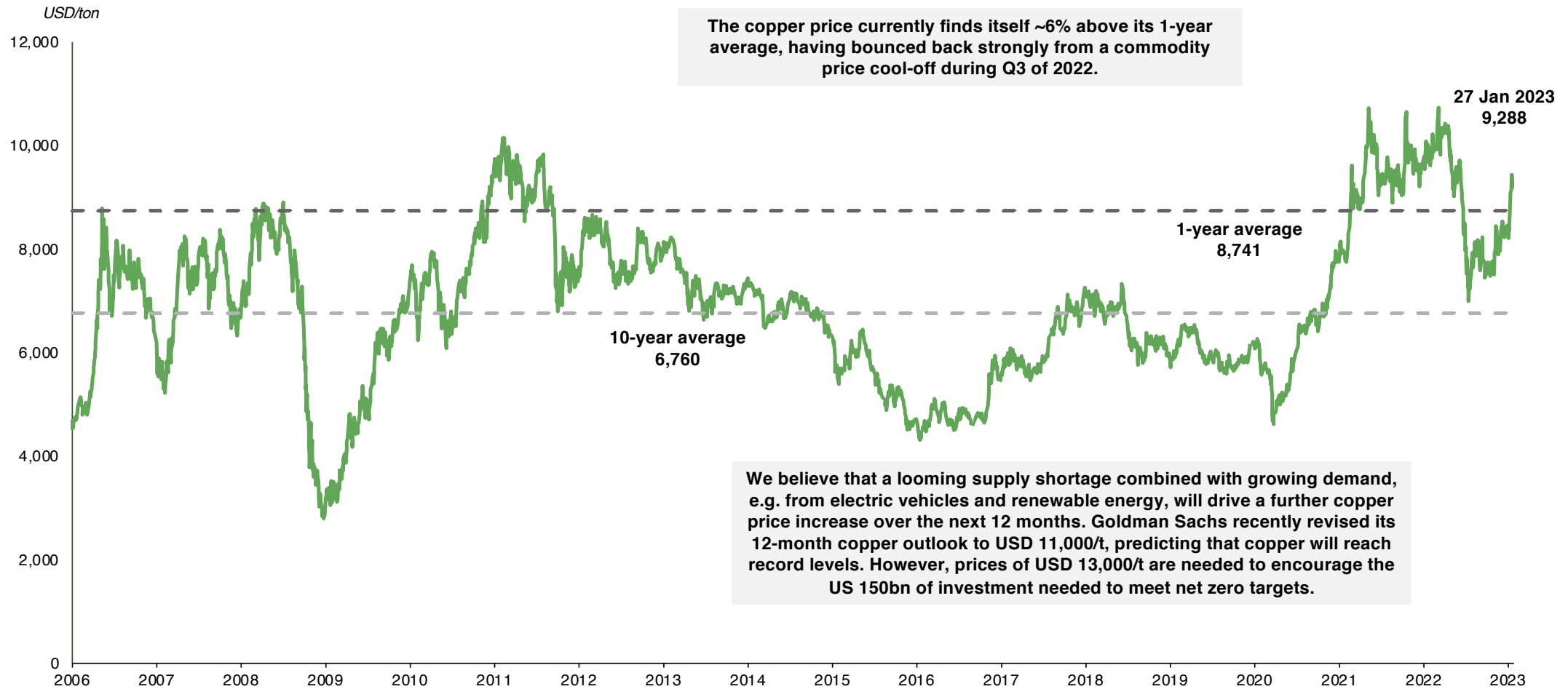
Observations

- Zambia registered a positive trade balance of approx. ZMW 2.8bn for the month of November 2022. This represents a 2.3% decrease MoM compared to ZMW 2.8bn registered in October 2022. Exports increased by 6.8% due to account of increase from intermediate goods and consumer goods. Imports increased by 8.9% mainly as a result of increases in import bills of intermediate goods, capital goods and consumer goods. Ultimately, we expect the trade balance to remain positive, especially as copper prices stabilize above its long-term average⁽¹⁾.
- While the trade balance remains strong, the drop in the balance from April 2022 and onwards has been driven by the war in Ukraine, increasing prices on imported goods such as fertilizer and fuel.
- Nevertheless, the consistent positive trade balance, sovereign debt restructuring, IMF programme and expected FDI inflows are all expected to contribute toward a relatively stable exchange rate going forward.

CORRELATION BETWEEN COPPER AND THE KWACHA REMAINS DETACHED FROM HISTORICAL TREND

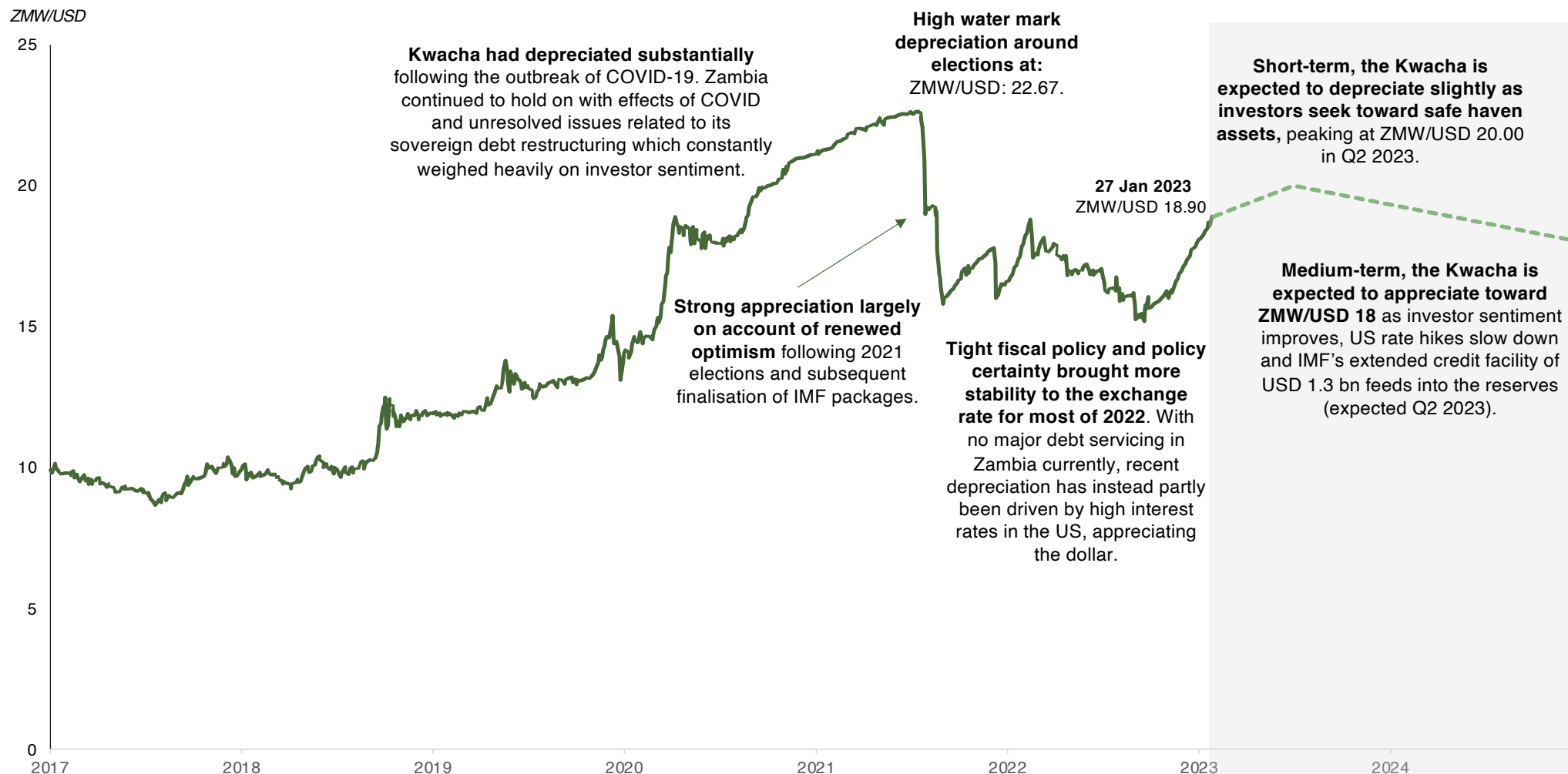


COPPER PRICES EXPERIENCE STRONG RECOVERY AFTER SELLOFF IN MID-2022



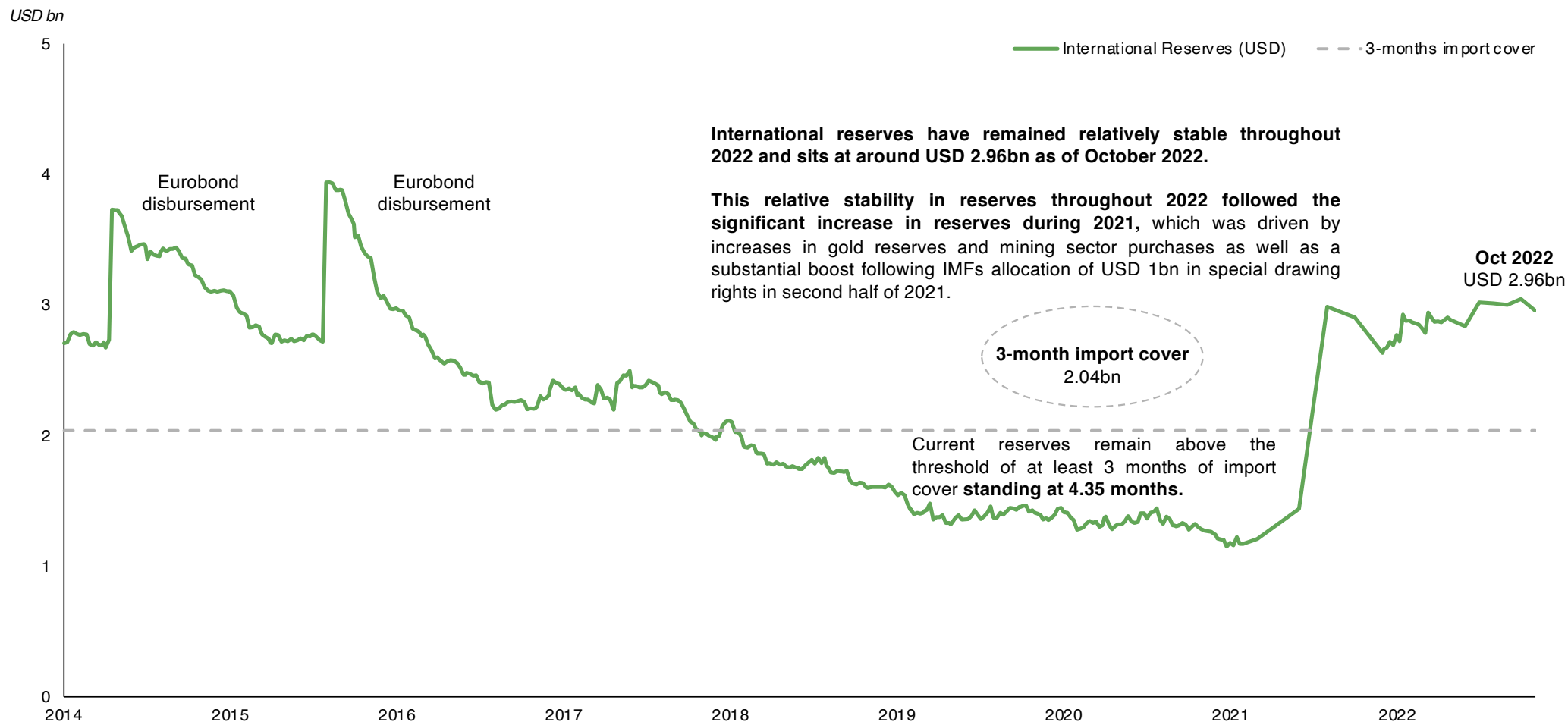
Source(s): BoZ, EIU, Bloomberg, S&P Global & London Metal Exchange.

CURRENCY HAS DEPRECIATED AS OF RECENT BUT REMAINS SIGNIFICANTLY STRONGER RELATIVE TO PEAK DEPRECIATION IN 2021



Source(s): BoZ, ZamStats & Kukula Analysis.

INTERNATIONAL RESERVES REMAINED STABLE TOWARD THE END OF 2022



ZAMBIAN GOVERNMENT HAVE OUTLINED KEY AREAS OF PRIORITIZATION



Source(s): BoZ, ZamStats & Kukula Analysis.

Note(s): (1) Rural Electrification Master Plan is the governments programme to electrify 1,217 rural growth centers across Zambia.

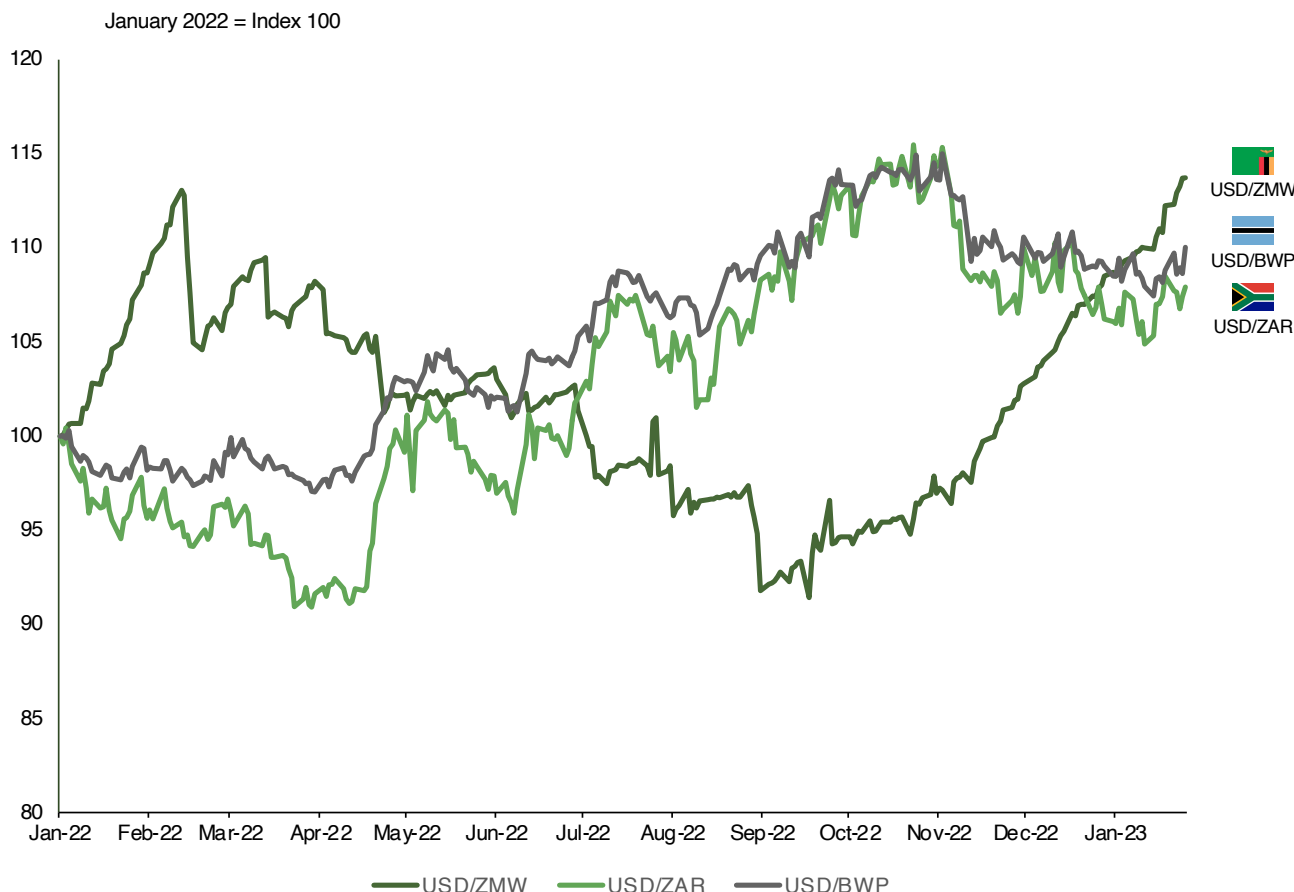
MACRO ENVIRONMENT – FORWARD LOOKING

Theme	Outlook	Macroeconomic developments
Economic Growth		<ul style="list-style-type: none"> In the near-term, economic growth is expected to be below Zambia's long-term potential as Zambia battles with limited fiscal flexibility and in the very near term, intermittent power supply brought on by low water levels at key dams (for hydro power generation). Government expects the budget deficit to have been 9.8% of GDP in 2022 resulting from increased spending pressure in the second half of 2022. Copper prices have recently experienced a strong recovery after a broader selloff in commodities during parts of 2022 due to recession fears. Copper demand is expected to remain resilient in the long term and increased prices are expected in the short to medium term. 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		<ul style="list-style-type: none"> Inflation for the month of December registered at 9.9%, up 0.1% from 9.8% the previous month, narrowly remaining in single digits. . Fuel prices are expected to normalize in the medium term which will contribute to a reduction in inflation. BoZ has again left the monetary policy rate unchanged at 9% following its November 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 current weakening of the Kwacha may in the short term increase the inflationary pressure Zambia has been experiencing, but we expect the Kwacha to stabilize in the medium term, contributing to decreased inflationary pressure.
Exchange Rates		<ul style="list-style-type: none"> Despite debt restructuring, increases in copper prices and disciplined government spending, we expect the Kwacha to continue depreciating marginally toward Q2 2023 due to the looming recession fears. Hereafter, we expect the Kwacha to slowly appreciate again toward 2024 as investor sentiment improves, US rate hikes slow down and IMF's ECF of USD 1.3n is received (expected Q2 2023). We expect a flexible exchange rate regime while mitigating excessive volatility. To cushion the economy against external shocks, accumulation of international reserves will be enhanced through export earnings and promotion of sustainable foreign investment flows. New capital inflows at both private and sovereign level to further develop copper production capacity is likely to strengthen the Kwacha.
External Sector		<ul style="list-style-type: none"> We expect a positive trade surplus growth in the near term as global commodity prices look to increase. Increased import is expected due to improved economic activity which strengthen demand for capital items and raw materials. While Zambia's inflation seems to be easing, South Africa's headline consumer inflation continues to be above the South African Reserve Bank's upper limit of 6%, coming in at 7.2% in December. Empirical evidence suggests that South African inflation tends to be imported into Zambia considering South Africa's role as a major import origin. This is expected to put pressure on local prices for both food and non-food items in Zambia.

APPENDIX: REGIONAL FX PERFORMANCE

THE KWACHA ENDED THE YEAR WITH SIGNIFICANT DEPRECIATION, MAKING IT THE POOREST PERFORMER REGIONALLY

Regional FX performance YTD



Comments

The Zambian Kwacha depreciated in 2022 but has appreciated significantly since mid-2021, having been boosted substantially by the reduced political uncertainty, firming up of international reserves and FDI inflows. The Kwacha ended the year at around parity with the rand.

The South African rand appreciated slightly toward the end of 2022 after depreciating substantially in spite of South African Reserve Bank's rate hikes throughout 2022. In November, the SARB once again raised the rate with 75 bps to 7% following an unexpectedly high inflation rate of 7.6% in October. Inflation numbers for November and December continued to be at +7%, making it eight straight months above the target range of 3-6%. The weakening of the currency is pushed by the risk-off sentiment of global investors due to geopolitical risks affecting emerging market currencies where global investors drop riskier assets in favor of safe-haven assets such as gold and currencies like the USD and GBP.

Botswanan Pula depreciated during 2022, being closely tied to the ZAR. 64% of Botswanan import comes from South Africa and when the ZAR is depreciating this is reflected almost identically on the BWP.