Country Report

Zambia

Zambia at a glance: 2005-06

OVERVIEW

Before the president, Levy Mwanawasa, and the ruling Movement for Multiparty Democracy (MMD) can contest the presidential and legislative elections set for 2006, they must deal with accusations from the former vice-president, Nevers Mumba, that Mr Mwanawasa has engaged in corrupt practises. Mr Mwanawasa and his supporters are likely to remove the threat posed by Mr Mumba by engineering his expulsion from the MMD. However, the episode is likely to further divide the MMD and increase its unpopularity with the public. On balance, the Economist Intelligence Unit expects both Mr Mwanawasa and the MMD to be re-elected in 2006, owing to their position as incumbents, the strong support of rural voters and the disunity of the opposition. We expect the government to remain broadly on track with its agreed economic reforms, although it could slip in the run-up to the 2006 polls, which would strain, but not break, relations with the IMF and other donors. Increased copper production will boost economic growth, but this expansion will be tempered by poor agricultural performance, and so real GDP growth will be below potential, at 5.6% in 2005 and 6.4% in 2006. Drought has hit much of Zambia this year, adversely affecting agricultural output and putting upward pressure on inflation, which is forecast to average 20% in 2005. Even assuming normal weather conditions in 2006, lax fiscal policy and the ongoing depreciation of the kwacha mean that inflation is forecast to stay high, at 19%.

Key changes from last month

Political outlook

- There has been no change to our political outlook.

Economic policy outlook

- There has been no change to our economic policy outlook.

Economic forecast

- New data from the IMF showed that import growth was not as high as estimated in 2004, and as a result the current-account deficit was 4.8% of GDP, compared with our previous estimate of 6.3% of GDP. Given the surging copper production, we forecast that the current-account deficit will decline to 4.4% of GDP in 2005. Higher profit remittances are expected to cause the current-account deficit to widen slightly to 4.7% of GDP in 2006.

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The Economist Intelligence Unit

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Zambia

June 2005

Summary

Outlook for 2005-06

Political activity in Zambia will remain focussed on the deepening divisions within the ruling Movement for Multiparty Democracy (MMD) and the presidential and legislative elections due in 2006. Both the president, Levy Mwanawasa, and the MMD are expected to be re-elected owing to their strong rural support and the advantages of incumbency. The main thrust of economic policy will be to maintain progress in fiscal consolidation, and to remain broadly on track with donor-led reforms, although it could slip in the run-up to the 2006 polls—which may provoke tensions with the IMF and other donors. Strong copper production is expected to be the main factor behind impressive economic growth, with real GDP growth forecast at 5.6% in 2005 and 6.4% in 2006. However, owing to drought and lax fiscal policy around the elections, inflation will remain in double digits during the forecast period.

The political scene

The former vice-president, Nevers Mumba, announced that he would challenge Mr Mwanawasa for the party presidency, but senior MMD officials have acted quickly to suppress the threat posed to Mr Mwanawasa. The MMD has won a further three by-elections, raising its parliamentary majority. The opposition, Forum for Democracy and Development (FDD), has elected Edith Nawakwi as its president. Political divisions within the MMD have caused Chitalu Sampa to leave to join the Party for Unity, Democracy and Development (PUDD).

Economic policy

The IMF was broadly positive in its latest review of Zambia's performance under it's Poverty Reduction and Growth Facility (PRGF). The government has created the Zambia Development Agency in a bid to stimulate private-sector led economic growth. A fresh search for investors to take a 49% stake in the Zambia National Commercial Bank has begun. Zambia has created an oil-stability fund through which oil prices will be subsidised in an attempt to rein in inflation.

The domestic economy

Inflation has remained high in 2005, largely owing to strong international oil prices. The government now believes that it can deal with a maize shortfall without resulting to costly food imports. A new US$600m deep mine project has been launched by the Konkola Copper Mines company.

Foreign trade and payments

Zambia is to receive a US$3.9bn debt write-off after reaching completion point under the IMF-World Bank's heavily indebted poor countries (HIPC) initiative. The current-account deficit fell to 4.8% of GDP in 2004, from 7.5% of GDP in 2003, supported largely by higher metal exports, particularly copper.

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Political structure

Official name	Republic of Zambia
Form of state	Unitary republic
Legal system	Based on the 1996 constitution
National legislature	National Assembly; 150 members elected by universal suffrage, serving a five-year term. The president can appoint eight further members
National elections	Presidential and legislative elections due in late 2006 (last presidential and legislative elections December 2001)
Head of state	President, elected by universal suffrage for a term of five years
National government	The president and his appointed cabinet. The last major reshuffle was in May 2003
Main political parties	The Movement for Multiparty Democracy (MMD) is the ruling party and holds a slim parliamentary majority. The United Party for National Development (UPND), formed in late 1998, is the largest opposition party in parliament, followed by the former sole party, the United National Independence Party (UNIP) and the recently formed Forum for Democracy and Development (FDD). Other parties represented in parliament are the Heritage Party, the Zambia Republican Party (ZRP) and the Patriotic Front

	President & minister of defence	Levy Mwanawasa
	Vice-president	Lupando Mwape
Key ministers	**Agriculture & co-operatives**	Mundia Sikatana
	Commerce, trade & industry	Dipak Patel
	Communications & transport	Abel Chambeshi
	Education	Andrew Mulenga
	Energy & water development	George Mpombo
	Finance & national planning	Ng'andu Magande
	Foreign affairs	Ronnie Shikapwasha
	Health	Brian Chituwo
	Home affairs	Kalombo Mwansa
	Information & broadcasting	Mutale Nalumango
	Labour & social security	Bates Namuyamba
	Lands	Judith Kangoma-Kapijimpanga
	Legal affairs	George Kunda
	Local government & housing	Silvia Masebo
	Mines & minerals development	Kaunda Lembalemba
	Science, technology & vocational training	Kabinga Pande
	Tourism, environment & natural resources	Patrick Kalifungwa
	Works & energy development	Marina Nsingo
Central bank governor	Caleb Fundanga	

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Economic structure

Annual indicators

	2000 [a]	2001 [a]	2002 [a]	2003 [a]	2004 [b]
GDP at market prices (ZK bn)	12.2	13.5	17.6	22.8 [b]	28.6
GDP (US$ bn)	3.9	3.7	4.1	4.8 [b]	6.0
Real GDP growth (%)	3.6	4.9	3.3	5.1 [b]	5.0
Consumer price inflation (av; %)	26.0	21.4	22.2	21.4	18.0 [a]
Population (m)	10.4	10.6	10.7	10.8	10.9
Exports of goods fob (US$ m)	757.0	912.0	945.0	1,081.0	1,619.0 [a]
Imports of goods fob (US$ m)	978.0	1,253.0	1,204.0	1,393.0	1,727.0 [a]
Current-account balance (US$ m)	-264.0	-414.0	-265.0 [b]	-360.0 [b]	-289.0
Foreign-exchange reserves excl gold (US$ m)	244.8	183.4	535.1	247.7	337.1 [a]
Total external debt (US$ bn)	5.7	5.7	6.0	6.4	6.4
Debt-service ratio, paid (%)	20.9	27.5	40.2	41.3 [b]	30.8
Exchange rate (av) ZK:US$	3,110.8	3,610.9	4,307.0	4,733.3	4,778.9 [a]

[a] Actual. [b] Economist Intelligence Unit estimates.

Origins of gross domestic product 2003 [a]	% of total	Components of gross domestic product 2002	% of total
Agriculture	15.2	Private consumption	52.2
Industry	28.3	Government consumption	11.1
Manufacturing	10.9	Gross fixed capital formation	41.4
Construction	6.9	Change in stocks	1.3
Mining	7.7	Exports of goods & services	35.3
Services	56.5	Imports of goods & services	-41.3

Principal exports 2003 [a]	US$ m	Principal imports 2003 [b]	US$ m
Copper	610	Metals	292
Cobalt	67	Others	1,092

Main destinations of exports 2003 [c]	% of total	Main origins of imports 2003 [c]	% of total
South Africa	28.3	South Africa	71.4
Malawi	8.7	China	2.8
Japan	6.8	UK	2.8
Egypt	5. 4	Tanzania	1.7

[a] Official estimates. [b] This is the only breakdown that the Bank of Zambia provides. [c] Based on partners' trade returns; subject to a wide margin of error.

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Quarterly indicators

	2003			2004				2005
	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr
Prices								
Consumer prices (1994=100)	843.5	858.3	911.7	971.5	994.8	1,018.8	1,075.3	1,147.5
Consumer prices (% change, year on year)	23.2	20.5	19.1	17.3	17.9	18.7	17.9	18.1
Copper, LME (US$/tonne)	1,641.4	1,753.1	2,060.3	2,724.5	2,781.5	2,854.7	3,093.2	3,264.7
Financial indicators								
Exchange rate ZK:US$ (av)	4,846	4,741	4,694	4,751	4,774	4,809	4,782	4,751
Exchange rate ZK:US$ (end-period)	4,828	4,807	4,645	4,722	4,789	4,906	4,771	4,678
Deposit rate (av; %)	22.43	21.50	21.37	14.80	10.44	10.10	10.77	n/a
Weighted lending base rate (av; %)	41.42	39.10	38.30	33.27	30.0	29.90	29.77	n/a
Treasury bill, 91-day rate (av; %)	31.32	30.97	25.64	13.63	7.15	12.48	17.42	n/a
M1 (end-period; ZK bn)	1,238.3	1,308.2	1,513.9	1,499.3	1,767.9	1,849.1	1,860.4	n/a
M1 (% change, year on year)	17.2	15.5	13.0	44.6	42.8	41.3	22.9	n/a
M2 (end-period; ZK bn)	3,723.3	3,937.4	4,268.5	4,459.0	5,039.9	5,235.2	5,639.3	n/a
M2 (% change, year on year)	19.0	22.0	17.9	28.7	35.4	33.0	32.1	n/a
Sectoral trends								
Copper in concentrates, production (‘000 tonnes	87.4	91.9	96.2	96.8	101.4	101.0	99.0	84.4
Copper in concentrates, exports (‘000 tonnes)	90.1	97.0	87.0	90.8	99.4	99.2	94.9	80.1
Cobalt production (tonnes)	859	953	649	703	541	631	606	612
Cobalt exports (tonnes)	858	822	938	637	533	638	520	483
Foreign trade (US$ m)[a]								
Exports fob	212.3	198.8	208.0	278.8	308.8	311.3	269.9	n/a
Imports fob	-394.1	-388.0	-396.4	-356.9	-381.9	-402.3	-451.5	n/a
Trade balance	-181.7	-189.2	-188.4	-78.2	-73.1	-91.0	-181.6	n/a
Foreign reserves (US$ m)								
Reserves excl gold (end-period)	415.6	403.7	247.7	228.4	260.3	304.1	337.1	332.6

[a] *DOTS* estimates.

Sources: Bank of Zambia, *Statistics Fortnightly*; IMF, *International Financial Statistics*; *Direction of Trade Statistics*.

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Outlook for 2005-06

Political outlook

Domestic politics

Before the president, Levy Mwanawasa, and the ruling Movement for Multiparty Democracy (MMD) can contest the 2006 presidential and legislative elections, Mr Mwanawasa may have to face a leadership challenge from within his own party. The former vice-president, Nevers Mumba, has challenged Mr Mwanawasa's leadership of the MMD, claiming to have evidence that the president has been involved in corrupt practices. Mr Mwanawasa and his supporters have acted quickly to undermine the challenge, and Mr Mumba was suspended from the MMD's National Executive Committee over his accusations regarding Mr Mwanawasa's integrity. Moves are now afoot to expel Mr Mumba from the MMD all together. This would be an immediate solution for Mr Mwanawasa as it would mean that Mr Mumba could no longer challenge his leadership.

Even though Mr Mwanawasa is expected to head off any further challenges to his leadership, the MMD will remain a divided party. Efforts to undermine Mr Mumba, coupled with the prosecution of the president's predecessor, Frederick Chiluba, on corruption charges, have split the party. Senior MMD figures who are unhappy with Mr Mwanawasa's rule are rumoured to have been behind the formation of a new party—the Party for Unity, Democracy and Development (PUDD)—in the second half of 2004. The PUDD is securing support from those close to Mr Chiluba, and this may force Mr Mwanawasa to mount a purge of MMD members suspected of being aligned with the PUDD.

Election watch

The Economist Intelligence Unit expects both Mr Mwanawasa and the MMD to be re-elected at the 2006 elections. Although support for Mr Mwanawasa in urban areas has been undermined by infighting and corruption allegations within the MMD, coupled with the implementation of tough economic austerity policies—such as a public-sector pay freeze during 2004 in order to secure a new deal with the IMF—his standing is likely to be boosted by a number of events prior to the polls. In particular, substantial external debt relief will be awarded now that completion point has been reached under the IMF-World Bank's heavily indebted poor countries (HIPC) debt-relief initiative; the opening of new copper mines will boost real GDP growth and export revenue; and the 2005 budget has awarded public-sector pay increases as well as tax cuts. Crucially, Mr Mwanawasa should also be able to count on the support of rural voters, as government programmes to supply subsidised pesticide and seed have contributed to rises in the maize harvest in the past two years. The exploitation of the powers of incumbency will also help the president's bid for re-election.

The MMD will continue to benefit from the ongoing disunity within the opposition. At least five opposition presidential candidates will be capable of securing a reasonable level of support in the polls because of the backing of various ethnic groups. However, owing to personal ambition and rivalry, most of them will not be prepared to step down to clear the way for a single

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opposition candidate, even though such a candidate would be in a stronger position to pose a real challenge to Mr Mwanawasa. The opposition's best hope of achieving victory in the presidential election has been dashed by the government's refusal to change the voting system to one where the victor has to secure 51% of the ballots cast. This would have allowed the opposition to unify around one potential candidate in a second-round run-off.

Aside from the unlikely prospect of opposition unity, another risk to Mr Mwanawasa's re-election would be the collapse of the trial of Mr Chiluba and other officials in his government. The trial forms the centrepiece of the president's much-vaunted campaign against corruption. Much of the public are convinced that the anti-corruption crusade is simply a political "witch-hunt" of those people opposed to Mr Mwanawasa's rule—a feeling that will be bolstered should Mr Mumba produce credible evidence linking Mr Mwanawasa himself to corrupt practises. Further disenfranchising the public is the fact that little has been done to combat the petty corruption that affects many people on a daily basis. An early collapse of the trial, or further evidence of the president's own misdemeanours, would damage Mr Mwanawasa's standing with the public and with donors.

International relations

Zambia is not expected to face any external threats during the forecast period, although there will be tension with the Democratic Republic of Congo, caused by the occasional inflow of refugees across the border from there. The government will remain focused on building relations with key donors. Although adherence to donor requirements has been good during the last 18 months, donors will remain vigilant over governance issues. The president's reputation with Zambia's donors would obviously deteriorate if claims that he has been directly involved in corruption are substantiated. However, as long as relatively free and fair elections are conducted in 2006, donor support is expected to remain on track.

Economic policy outlook

Policy trends

Fiscal consolidation is the main goal of Zambia's three-year poverty reduction and growth facility (PRGF), which was approved by the IMF in June 2004. The second review was completed in April and a further US$8.3m was disbursed, bringing the total drawn so far to about US$257m. In particular, the government has focused on reducing non-priority spending and containing the civil-service wage bill at 8% of GDP. Expenditure will be redirected towards poverty-reduction programmes in areas such as education and healthcare (including combating HIV/AIDS). A reduced fiscal deficit will also limit the need for the government to borrow domestically, curbing inflationary pressure and leading to a cut in interest rates, with the aim of boosting private-sector borrowing.

However, this process will face obstacles. First, mindful of approaching elections, the government has begun awarding large pay increases to civil servants to compensate for a wage freeze imposed in 2004. These increases are likely to exceed the benchmarks set by the Fund. Second, even if the government is able to reduce its domestic debt stock (currently estimated at

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around 20% of GDP), commercial banks are risk averse and may prove unwilling to increase lending to the private sector. The Economist Intelligence Unit does not expect the government to adhere fully to the Fund's spending criteria, although it is likely to demonstrate sufficient commitment to prevent the PRGF from going drastically off track during 2005. However, unbudgeted election-related spending is expected during 2006, and we anticipate that this will prompt the IMF to withhold at least one PRGF disbursement.

Other priorities under the PRGF are improving governance, enhancing the efficiency of the private sector and completing the privatisation programme. Privatisation remains a potential source of conflict between the government and the IMF—both Mr Mwanawasa and the finance and national planning minister, Ng'andu Magande, oppose it. Nevertheless, the government has done enough to reach completion point under the HIPC initiative. The IMF and World Bank boards endorsed Zambia's reaching of the completion point in early April 2005, and debt relief of over US$3.9bn has been promised in total. This should allow economic policy to concentrate even more on reducing the prevalence of poverty, although the debt relief will be spread over a number of years and so no immediate dramatic increases in resources are expected.

Fiscal policy

According to the latest information from the IMF, improved fiscal discipline in 2004 led to a reduction in the budget deficit to 1.7% of GDP. In 2005 ongoing reforms of public finance management and accountability will create further savings by improving the quality and coherence of spending plans. However, the government will still struggle to control spending, particularly as it seeks to reorientate expenditure towards pro-poor activities such as education and healthcare. Also, the 2005 budget has been drawn up with the 2006 elections firmly in mind, and includes large expenditure increases and tax cuts. Nonetheless, owing to the boost given to fiscal revenue by a full year of donor support and continued strong real GDP growth, we forecast only a modest increase in the fiscal deficit, to 2.8% of GDP, compared with the Fund's target of 2.5% of GDP.

Government spending in 2006 is likely to increase fairly rapidly as the elections approach. This could cause problems with the IMF, as the government will struggle to meet PRGF commitments such as keeping the public-sector wage bill below 8% of GDP. However, even if some donor disbursements are delayed, we still expect strong growth in domestic revenue in 2006. To some extent this will act to offset the expenditure increases, but the fiscal deficit is still projected to increase to 3% of GDP. The lower deficits over the forecast period should limit the need to issue large amounts of new domestic debt. Therefore domestic debt is forecast to rise only slightly, from 19.2% of GDP in 2004 to 20% of GDP in 2005, and 21% of GDP in 2006.

Monetary policy

Monetary policy is expected to focus on reducing inflation to 10%, from the current rate of around 20%, by the end of 2006 by slowing growth in reserve money through the use of open-market operations. However, a significant tightening of fiscal policy and lower domestic debt issuance is required for inflation to hit this level, and given that this is unlikely in 2006, we do not expect this target to be achieved during the forecast period. In addition to trying

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to contain inflation, the main focus of the Bank of Zambia (BoZ, the central bank) will be to try to increase commercial bank lending to the private sector. Despite these attempts, lending rates have remained high and deposit rates negligible as a result of the low level of financial intermediation. Because of this, commercial banks have invested the funds released by the reduction in the reserve requirement in Treasury bills. More fundamental structural reforms, such as revisions to bankruptcy laws, may be necessary to give a real boost to lending. Moreover, even if the spread between lending and deposit rates is lowered substantially, there are many other bank charges that borrowers face, which will keep the cost of borrowing from banks high.

Economic forecast

International assumptions

International assumptions summary
(% unless otherwise indicated)

	2003	2004	2005	2006
Real GDP growth				
World	3.9	5.1	4.3	4.0
OECD	2.0	3.3	2.4	2.3
EU25	1.2	2.4	1.8	2.1
Exchange rates				
¥:US$	115.9	108.1	103.4	94.3
US$:€	1.132	1.244	1.320	1.395
SDR:US$	0.714	0.675	0.653	0.628
Financial indicators				
€ 3-month interbank rate	2.33	2.13	2.10	2.15
US$ 3-month Libor	1.21	1.62	3.46	4.77
Commodity prices				
Oil (Brent; US$/b)	28.8	38.5	46.0	40.0
Gold (US$/troy oz)	363.3	409.5	425.6	402.5
Copper (US cents/lb)	80.3	129.5	143.0	119.0
Industrial raw materials (% change in US$ terms)	13.0	21.0	3.9	-7.0

Note. Regional GDP growth rates weighted using purchasing power parity exchange rates.

World GDP growth (on a purchasing power parity basis) is forecast to fall from 5.1% in 2004 to 4.3% in 2005 and 4% in 2006 in response to policy-tightening in leading economies. In South Africa, Zambia's main trading partner, real GDP growth is forecast to rise to around 4% in 2005-06. The slowdown in global growth means that the booming demand for copper in 2004, Zambia's largest export, is not expected to continue in 2005. Demand growth may be slowing, but little new capacity is committed to come on stream, and a global deficit is expected to push up prices in 2005 to 143 US cents/lb. The global balance will shift further in favour of consumers in 2006 and prices are forecast to decline to 119 US cents/lb. The strength of copper prices should encourage further investment in Zambian copper mines.

Prolonged cool weather in Europe and North America, as well as continued industrial growth in India and China, have contributed to a surge in oil demand in the first five months of 2005. On the supply side, there are growing concerns that spare capacity among OPEC producers is getting thin. As a consequence, we expect the price of the benchmark dated Brent Blend to rise to

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an average of US$46/barrel in 2005, before prices ease to US$40/b in 2006 as stocks and spare capacity are raised.

Economic growth

Strong growth in copper production is expected to boost real GDP growth from an estimated 5% in 2004 to 5.6% in 2005 and 6.4% in 2006. Two large new mines are set to open during the forecast period at Kansanshi and Lumwana. Konkola Copper Mines and Mopani Copper Mines—Zambia's two largest producers—undertook massive rehabilitation in 2004 to increase their copper output, the results of which will start to come on line during 2005. The government said that output for 2004 came to 409,000 tonnes—although central bank data put the figure at 398,000 tonnes—and that production will reach 550,000 tonnes in 2005. The 2005 official target may prove to be slightly optimistic, and we forecast output of 480,000 tonnes. In 2006 production is forecast to reach 575,000 tonnes.

A drought is currently affecting many areas of the country after the rainy season (December to April) finished early. Maize output has been hit hard, so food security problems are likely to affect a large proportion of the population. This will reduce the productivity of those affected and therefore also their earnings and consumption. Assuming normal weather conditions in 2006, a modest pick-up in agricultural growth is expected. Output of the more drought-resistant non-food crops, such as tobacco, is set to expand as the farmers that have relocated from Zimbabwe to Zambia make an impact. Manufacturing growth is heavily influenced by food processing, and the sector is expected to remain moribund over the forecast period. Donor-funded work on the rehabilitation of major roads and the construction of private housing will ensure continued strong growth in construction. There will be reasonable services growth, in line with increasing economic activity and greater demand from the mining sector as copper production increases. Strong tourism growth will also support the services sector.

Inflation

Average annual inflation eased to 18% in 2004, the first time in decades that annual price growth has been below 20%. The decline in inflation was mainly the result of a good harvest and tighter fiscal policy. This is a significant achievement, but much remains to be done to bring inflation down further. Continued donor support and relatively tight fiscal policy will reduce the need for inflationary deficit financing in 2005, but the main determinant of inflation during the forecast period will be trends in food prices. This means that the drought currently being experienced is of great significance, and we expect inflation to increase to an average of 20% for the year. Assuming a return to normal weather conditions, food prices should come down in 2006. However, election-related expenditure and the possible delay of donor disbursements leading to higher levels of government borrowing are expected to mean that inflation will decline only slightly, to an average of 19% for the year.

Exchange rates

We forecast that the kwacha will remain relatively stable in 2005. This will be made possible by steady inflows of donor support, impressive export earnings for copper and a weak US dollar. High inflation and increasing import demand will offset this, and we forecast a slight depreciation of the average exchange

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rate in 2005 to ZK4,852:US$1, from ZK4,779:US$1 in 2004. The depreciation is expected to be a little more marked in 2006 as high inflation remains and copper prices fall, with the exchange rate averaging ZK5,106:US$1.

Historically, the kwacha has been vulnerable to sharp bouts of depreciation, and these could recur in the forecast period. Predicting the timing of these is difficult, but possible triggers could be a deterioration in relations with the IMF or a collapse in copper prices. Although central-bank intervention can smooth out short-term fluctuations, this will postpone, rather than avert, a sharp depreciation.

External sector

Exports are projected to rise over the forecast period, from US$1.6bn in 2004 to US$2bn in 2006. Much of this increase is owing to the expected growth in copper production, although this will be mitigated by lower prices in 2006. Non-metal exports, such as tobacco and horticultural products, are also forecast to perform strongly. Imports are also projected to rise, from US$1.7bn in 2004 to US$2bn in 2006. A major source of import growth will be high energy costs (owing to high oil prices) and the investment goods required for ongoing mining development, although these imports will also slow in 2006, as the bulk of the work will be complete. The final major determinant of import expansion will be election-related expenditure in 2006. An increase in trade-related costs associated with the rise in imports and election-related spending in 2006 will more than offset higher tourism revenue, causing the services deficit to widen. In addition, increased profit remittances by mining companies will cause the income deficit to widen. A full year of donor funding in 2005 will lift inflows of current transfers, but growth in transfers credits is expected to be stagnant in 2006 as relations with donors deteriorate owing to high pre-election spending. Overall, the current-account deficit is forecast to narrow from 4.8% of GDP in 2004 to 4.4% of GDP in 2005 as copper exports and donor funding both increase. The current-account deficit is then expected to widen slightly in 2006, to 4.7% of GDP, owing mainly to election-related expenditure and rising profit remittances from the foreign-owned copper producers.

Forecast summary

(% unless otherwise indicated)

	2003[a]	2004[a]	2005[b]	2006[b]
Real GDP growth	5.1[c]	5.0[c]	5.6	6.4
Gross industrial growth	8.7	8.8[c]	9.4	9.6
Gross agricultural production growth	5.1	4.3[c]	1.0	3.0
Consumer price inflation (av)	21.4	18.0	20.0	19.0
Consumer price inflation (year-end)	17.2	17.5	20.7	18.1
Short-term interbank rate	40.6	30.7	32.0	32.0
Government balance (% of GDP)	-6.6[c]	-1.7[c]	-2.8	-3.0
Exports of goods fob (US$ m)	1,081.0	1,619.0	1,988.5	2,017.8
Imports of goods fob (US$ m)	1,393.0	1,727.0	1,934.2	1,972.9
Current-account balance (US$ m)	-360.0[c]	-289.0[c]	-328.8	-409.4
Current-account balance (% of GDP)	-7.5[c]	-4.8[c]	-4.4	-4.7
External debt (year-end; US$ bn)	6.4	6.4[c]	5.8	6.0
Exchange rate ZK:US$ (av)	4,733.3	4,778.9	4,852.4	5,105.5
Exchange rate ZK:SDR (av)	6,630.9	7,078.3	7,431.4	8,127.1

[a] Actual. [b] Economist Intelligence Unit forecasts. [c] Economist Intelligence Unit estimates.

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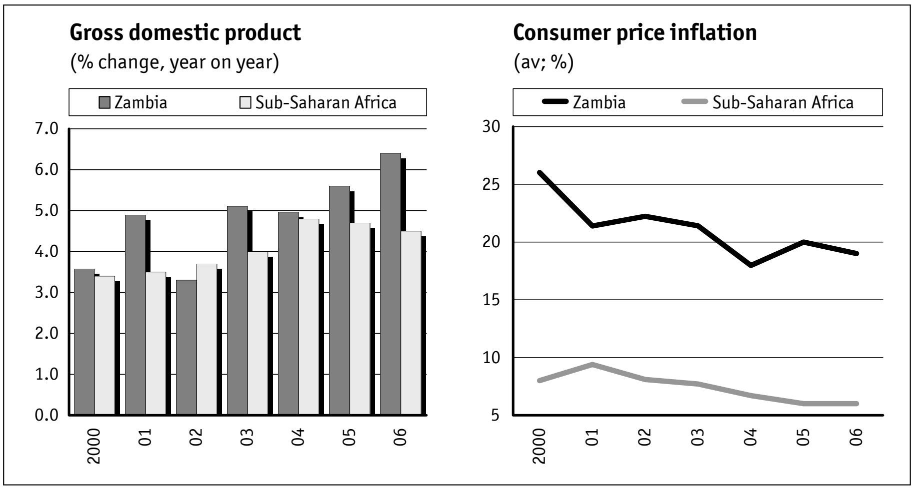

The political scene

President Mwanawasa faces a leadership challenge

In mid-March Zambia's former vice-president, Nevers Mumba, announced that he intended to challenge the president, Levy Mwanawasa, for the leadership of the ruling party, the Movement for Multiparty Democracy (MMD), at the party convention, which was scheduled for May. Mr Mumba claimed that he had discussed his leadership challenge with former presidents, Kenneth Kaunda and Frederick Chiluba, both of whom supported his move. Should Mr Mumba win the leadership contest, he would go on to be the MMD presidential candidate in the next election, scheduled for 2006, leaving Mr Mwanawasa unable to stand for re-election unless he left the MMD. Rumours that Mr Mwanawasa would face a leadership challenge from a senior MMD member had been circulating for some time, but it was thought that Mr Mumba only intended to contest the vice-presidency (March 2005, The political scene). It appears that Mr Mumba believes that now is his best chance of rising to take the position of presidency that he has coveted for some time.

As a former television evangelist, Mr Mumba rose to prominence with impassioned speeches concerning the future of Zambia. He formed the National Citizens Coalition (NCC) party and contested the 2001 presidential election, but polled less than 3% of the vote. In May 2003 the NCC was absorbed into the MMD and Mr Mumba was made vice-president (June 2003, The political scene). This came at a time when the MMD lacked an overall majority in parliament, and Mr Mwanawasa was actively recruiting opposition MPs into government as a way of bolstering support. Relations between the two men deteriorated over the next year as Mr Mumba's presidential aspirations became apparent. In October 2004 Mr Mumba was sacked, ostensibly because he had sparked a minor diplomatic row with the government of the Democratic Republic of Congo (DRC), but also because the MMD by then had a parliamentary majority, thus reducing Mr Mumba's political influence (December 2004, The political scene).

Mr Mumba expelled from the MMD decision-making body

Since Mr Mumba announced he would be challenging Mr Mwanawasa, relations between the two soured even further. Close Mwanawasa allies,

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including the information minister, Mutale Nalumamngo, branded Mr Mumba an "ungrateful man" because it was Mr Mwanawasa who originally gave Mr Mumba the high-profile position of vice-president. Initial indications of Mr Mumba's support within the MMD, along with the possibility that Mr Kaunda and Mr Chiluba would come out in support of him, raised a real prospect that Mr Mwanawasa could be defeated.

Developments escalated in April as the MMD set up an internal tribunal ahead of the convention to investigate accusations of corruption and vote buying. Mr Mwanawasa has previously admitted that there is widespread graft in the MMD, with recent accusations that one of the MMD members vying to become vice-president at the convention, Austin Chewe, distributed vehicles to his campaign managers in all nine provinces of Zambia. On April 8th, shortly after the tribunal was announced, comments made by Mr Mumba were published in a newspaper article where he stated that President Mwanawasa should also be investigated because he had equally been involved in corruption. His comments to the press were in breach of party rules, which bars members from raising "sensitive issues" with the media before they have been officially brought to the attention of the relevant party organs. As a result of his transgression, Mr Mumba was suspended from the MMD's decision-making body, the National Executive Council (NEC) towards the end of April. Mr Mumba was given ten days in which to exculpate himself but, according to Mr Mwanawasa, failed to do so and was expelled.

After his suspension from the NEC, Mr Mumba went on the offensive, telling state media that he had evidence of Mr Mwanawasa being involved in corruption. He may yet be proved right, as some MMD members from northern Zambia later informed the MMD tribunal that they had each received ZMk100,000 (US$21) and been told to vote for Mr Mwanawasa at the forthcoming convention. The northern province officials told the tribunal that the money was given to them by Mr Mwanawasa's campaign agent, Ester Nakawala. They explained to the tribunal that Ms Nakawala had told them that she received the money from the first lady, Maureen Mwanawasa. Ms Nakawala is yet to give her testimony to the MMD tribunal and has elected not to respond to the accusations. Mrs Mwanawasa said in April that she would testify on the bribery scandal although she has yet to do so. It is difficult to establish the validity of the claims and counter claims being made. What is certain is that the accusations of graft against Mr Mwanawasa are tarnishing his image, both at home and abroad, and also eroding his much-vaunted anti-corruption crusade.

Mr Mumba's influence has been drastically curtailed

Although Mr Mwanawasa has previously said that he would allow those wishing to challenge his leadership to do so, the recent political manoeuvrings within the MMD suggest that is not the case. The dismissal of Mr Mumba from the NEC was widely seen as an attempt to reduce his influence within the party. It cut him from the party's top decision-making body and meant he would not be privy to important decisions the party takes. The expulsion will also restrict his movements within MMD constituencies and branches of the party, preventing him from campaigning effectively.

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In addition to his expulsion from the NEC, it soon became apparent that moves were afoot to remove Mr Mumba from the MMD altogether, therefore ending his leadership challenge. Demonstrations by MMD supporters in the capital, Lusaka, the Copperbelt and Northern provinces calling for the expulsion of Mr Mumba were held during late April. Soon after these demonstrations MMD regional committees submitted petitions to the NEC asking the party's top organ to expel Mr Mumba. On May 2nd Mr Mwanawasa told state media that "visitors" would never lead the MMD, a remark almost certainly referring to Mr Mumba, who was previously a member of a rival party to the MMD. However, the MMD tactic of expelling its senior officials following mounting pressure from the grassroots is not a new one. Political observers have previously noted that the MMD leadership is adept at organising political expulsions as per the desire of its lower ranks so it can be seen to be a democratic party.

Support for Mr Mwanawasa appears to remain strong

The swift actions of the MMD leadership to remove the threat posed by Mr Mumba suggests that support for Mr Mwanawasa's leadership is still strong. However, the motivations behind these supporters are open to question. Many senior MMD officials appear to favour Mr Mwanawasa over supporting a new candidate because they want to maintain their ministerial jobs and continue to receive the financial benefits such positions confer on the holders. Others want Mr Mwanawasa to stay in power and serve a (final) second term as president because they either have ambitions to stand for the presidency after he has left office or see him as someone who will be able to hold the party together for a while as they build their political bases.

The MMD convention is deferred

The MMD convention, originally scheduled for May 4th-8th, was postponed indefinitely in the wake of the various corruption accusations. The MMD national secretary, Vernon Mwaanga, explained that this was done in order to enable the MMD tribunal on corruption to collect evidence from relevant members in the provinces. Consequently, the convention's list of delegates was dissolved and a new list is now expected to be drawn up. A decision was taken by the MMD not to re-invite any of the delegates who were purported to have received money from Mr Mwanawasa's campaign agent in a bid to restore the party's dented image. However, Mr Mumba claimed that the expunging of the delegates list was meant to remove his supporters from the list and to enable Mr Mwanawasa and his close allies to handpick mainly his supporters to attend the convention.

Historically, MMD conventions are never short of controversy and the postponement of the convention is widely seen as a bid to deal with the threat Mr Mumba has posed to Mr Mwanawasa's hold on power. The Economist Intelligence Unit expects that the MMD will eventually hold its conference with a delegates list that will be disputed by many senior officials vying for various positions because their supporters have been left out at the last minute. Mr Mwanawasa said on May 10th that the MMD would hold its convention no later than July, but he did not give an exact date.

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A scramble takes place for the MMD vice-presidency

The former vice-president, Enoch Kavindele, who was expelled from the MMD in 2003, but later reprieved (December 2004, The political scene), has recently joined the race for the vice presidency of the party. Mr Kavindele joins Lupando Mwape, Austin Chewe and Bwalya Chiti, as well as other less prominent MMD members, in the vice presidential race. Mr Kavindele will benefit from the fact that Mr Mwape, Mr Chewe and Mr Chiti are all from the Bemba ethnic group in the north of the country and are therefore likely to split the Bemba vote. Apart from Mr Chewe, who has worked hard to marshal support in other provinces, Mr Kavindele is the only other contender in the race that commands support across many areas of Zambia. Although any of the four main candidates are capable of winning the vice presidency, the main battle will probably be between Mr Kavindele and Mr Chewe. Much will depend on who has the most of their supporters on the delegates list for the convention.

An ex-finance minister is elected as FDD president

The opposition Forum for Democracy and Development (FDD) elected Edith Nawakwi as its new president party on April 30th. She became the first woman in Zambia's history to be elected as leader of a political party. Ms Nawakwi was a former finance minister during Mr Chiluba's ten-year rule, but was among 22 ministers expelled from the MMD in 2001 for revolting against Mr Chiluba when he attempted to amend the constitution to stand for a third term. She won the FDD presidency after she defeated Ernest Mwansa, a prominent Lusaka lawyer and former deputy minister in the administration of Mr Chiluba, at the FDD convention, which finally went ahead after some delay (March 2005, The political scene). The FDD also elected Chifumu Banda as its vice president and Newton Ng'uni as its national secretary. FDD founding president, Christon Tembo, a former vice president, has retired from politics and did not seek re-election at the convention.

Zambians may now be ready to accept a female president

Ms Nawakwi's election indicates that conservative Zambians may be moving towards accepting a woman as their national president, and she could pose a serious threat to Mr Mwanawasa's re-election in the 2006 elections. Ms Nawakwi is the most popular female politician in Zambia and is also a shrewd campaigner, who has been a legislator for the last 13-years. After all the controversy surrounding the MMD convention, the FDD elections have shown that democracy is achievable in the Zambian political parties. This is likely to win the FDD some supporters, as are some other FDD policies. Ms Nawakwi said the FDD, if it forms the next government, would seek to decentralise the government's functions and give more powers to municipalities, which would be responsible for drawing their own development plans and budgets. This is something traditional rulers (civic leaders), heads of municipal councils and other Zambians have been asking the government to implement.

The opposition parties must unite if they want to be victorious in 2006

Soon after becoming leader of the Forum for Democracy and Development (FDD), Edith Nawakwi stated that she would seek mergers with some other opposition parties. This is a key issue for Zambia's opposition parties to reach agreement on if they want a chance of coming to power at the 2006 legislative and presidential elections. There are currently 35 registered parties in Zambia and their fragmented

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nature plays into the hands of the ruling MMD (as they will split the opposition vote). This was evident in the 2001 elections when opposition parties won over 50% of the parliamentary seats and opposition presidential candidates received around 70% of the votes cast. However, the main barrier to greater opposition unity is agreeing upon a single presidential candidate. The problem is that none of the opposition leaders appear willing to stand down in order to support another opposition candidate. Differences in political and economic beliefs play a part in this, but most of the reluctance to stand down comes from personal ambition and the power that the position of presidency brings with it. Ms Nawakwi, for her part, has said that she is optimistic of winning the 2006 presidential elections because she was a "tested" politician with lots of experience. However, numerous opposition leaders can claim the same, and there is not really one outstanding potential presidential candidate.

The FDD expels three ministers

The FDD convention unanimously voted to expel commerce, trade and industry minister, Dipak Patel, defence deputy minister, Patricia Nawa, and commerce, trade and industry deputy minister, Geoffrey Samukonga, for accepting ministerial positions in the government without their party's consent. The convention pardoned Chance Kabaghe, a former agriculture and co-operatives deputy minister, who was sacked by Mr Mwanawasa in March. Mr Kabaghe apologised to the convention for flouting the party's constitution, but Mr Samukonga and Mr Patel did not attend the convention despite being invited to defend themselves. Although Ms Nawa attended the convention, she did not attempt to justify her actions.

The sacking of the three ministers highlights the divisions that Mr Mwanawasa has created between the ruling party and the opposition by appointing ministers from the opposition without consulting their leadership. It is an indication that the opposition will only accept a government of national unity based on mutual agreement and not imposed on them by the president. Moreover, it puts into question Mr Mwanawasa's ability to unite Zambians after the disputed 2001 elections, which ushered him into office. The FDD's move will scare other legislators from accepting ministerial positions without the consent of their parties. It will also bring relief to many MMD MPs, who see the appointments of opposition members to ministerial positions as a betrayal of trust by the president to his own elected members of parliament.

Although parliament is yet to declare the seats for all three MPs vacant, by-elections will now have to be held. We expect that Mr Patel, Ms Nawa and Mr Samukonga will be adopted by the MDD to re-contest the same parliamentary seats. Ms Nawa and Mr Samukonga have been loyal to Mr Mwanawasa even before their appointments, while Mr Patel is a valued member of the government owing to his experience and also because he is a competent advisor to the government on economic issues. The battle will be stiff during the by-elections as all three seats are in Lusaka, where the MMD is not popular.

The MMD wins three parliamentary by-elections

The MMD raised its parliamentary representation to 84 members of parliament when it won the Kasempa, Sinjembela and Mufulira by-elections held on March 4th:

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- Kabinga Pande, who resigned from his position as head of public relations at the central bank to contest the Kasempa seat, won the by-election when he polled 2,886 votes compared with 293 votes for his nearest rival John Muasa of the United Party for National Development (UPND);
- the MMD candidate in Sinjmebela, Mubika Mubika, polled 2,735 compared with second-placed Mukosiku Kalaluka of the UPND who amassed 2,040 votes; and
- in Mulfulira, which was contested by five political parties, the MMD candidate Emmanuel Sandi got 2,027 votes whilst the Patriotic Front's (PF) Barry Waluzimba achieved 1,063 ballots in second place.

The continued successes of the MMD in by-elections since the 2001 general election is partly owing to the opposition continuing to split their votes through the fielding of several candidates. The resources available to the MMD are another key reason for its success. The opposition have repeatedly accused the MMD of unfairly using government resources in its campaigning. They claim that the government is, in effect, bribing voters when it speeds up the implementation of new development projects in marginal areas, or when it distributes free food in maize-deficit areas during the by-elections. The opposition parties are not entirely guilt-free—UNIP was accused of distributing fish and giving out money to voters during the Kankoyo by-election—but they are unable to operate on the same scale as the MMD. Apathy also continues to mitigate the chances of the opposition winning parliamentary seats, as demonstrated in the Kankoyo by-election, where less than 50% of the 10,000 registered voters cast their ballots, and also in Sinjembela where only 36% of more than 13,000 registered voters cast their ballots. It is the opposition party supporters who are less likely to vote, either because they don't believe it will make a difference, or simply because they can not easily get to the polling stations; the MMD is able to provide transport for its supporters, again something the opposition can not match.

Composition of parliament

(no. of MPs, end-May 2005)

	Elected MPs	Nominated MPs	Total
Movement for Multiparty Democracy (MMD)	76	8	84
United Party for National Development (UPND)	41	-	41
United National Independence Party (UNIP)	13	-	13
Forum for Democracy and Development (FDD)	12	-	12
Heritage Party	2	-	2
Patriotic Front (PF)	2	-	2
Zambia Republican Party (ZRP)	1	-	1
Independent	1	-	1
Vacant seats	n/a	n/a	2
Total seats in parliament	**n/a**	**n/a**	**158**

Note. The president can appoint up to eight members of parliament (MPs). Mr Mwanawasa has appointed all these from the MMD.

Sources: Electoral Commission of Zambia; Economist Intelligence Unit.

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The opposition seek donor intervention over polls

In the aftermath of the three by-elections, the opposition parties wrote letters to the IMF, the World Bank and bilateral donors to seek their intervention into the Zambian political landscape. In late April, the PF general secretary, Guy Scott, said that the UPND, PF, UNIP, Party for Unity, Democracy and Development (PUDD) and Zambia Republican Party (ZRP) had written to the country's donors asking them to put pressure on the government to level the political play field. Mr Scott said that the legitimacy of the elections was questionable because the MMD abused state facilities to campaign for its candidates. Mr Scott drew a comparison with the political situation in Zimbabwe, where the West has been putting pressure on the administration to change electoral rules and organise transparent elections.

The opposition parties are unlikely to get the kind of response they desire because Zambia is currently hailed as one of the models of good economic and political governance in Africa. Donor interest has increased in Zambia since Mr Mwanawasa launched the country's latest anti-corruption crusade, which the donors want to see embraced by other African leaders. It also appears that the opposition is now focussing on taking their grievances to the international stage after the Supreme Court declined to nullify Mr Mwanawasa's election, saying the evidence of graft by the MMD during the 2001 elections was insufficient to quash the elections (March 2005, The political scene).

A founder member of the MMD leaves to join the PUDD

The former defence minister and a founding member of MMD, Chitalu Sampa, resigned from the party in March to join the PUDD. The PUDD, formed in the second half of 2004, is securing support from those close to Mr Chiluba. Numerous senior members of the MMD who are unhappy with Mr Mwanawasa's rule are rumoured to be members, but few are willing to openly declare their support for fear of political repercussions. Mr Sampa held a seat in the Kalulushi constituency on the Copperbelt, which will now go to a by-election. Elsewhere, another by-election will take place in Mapatizya, in southern Zambia, where the previous incumbent, UPND legislator Grace Sialumba, died.

Owing to the MMD's continued by-election successes, opposition parties are becoming increasingly unwilling to contest them. Of the two upcoming by-elections, only the PF has expressed any intent to contest the Kalulushi seat, with the UPND and UNIP only planning on fielding candidates for the Mapatizya seat. The MMD seems likely to win both seats, and it will work especially hard to win the Kalulushi seat, where there were rumours that the PUDD would field a candidate, although that appears not now to be the case. The Kalulushi by-election will be both about retaining the seat for the MMD and confining the PUDD to the political periphery. Mr Mwanawasa told MMD supporters on May 10th that he would spend two days campaigning in Kalulushi, highlighting the importance he attaches to ensuring that any political aspirations the PUDD might have are swiftly countered.

Constitution preparations are stepped up

Preparations for drawing up a new constitution for Zambia are drawing to an end, although the government is yet to reach an agreement with the opposition and civil society on the mode of adopting the new constitution. The

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Constitutional Review Commission (CRC) vice chairperson, Inyambo Yeta, said on May 6th that the CRC was examining 15,000 submissions it received from petitioners throughout Zambia and that it was compiling the first constitution draft, which it would publish in June in order to solicit further public comments. According to the CRC's schedule, the final draft that would be sent to the government for the cabinet to debate would be completed by September. How the new constitution is subsequently approved is the contentious issue. The CRC, along with the opposition parties and many civil society groups, want the constitution to be adopted via a constituent assembly made up of a cross-section of interested parties from Zambian society. This, they believe, would be a fairer solution then adopting the constitution through the national assembly, where the government has a majority and may seek to approve a constitution that suits its desires rather than those of the Zambian people. Mr Mwanawasa has previously said that adopting the constitution through a constituent assembly would not be possible, as it has serious cost implications. Adopting the constitution through a constituent assembly would require Zambia to hold a referendum and Mr Mwanawasa has argued that the country does not have the money for this exercise, especially as the cost of holding elections in 2006 must also be paid for.

A new constitution is still unlikely before 2008

Mr Mwanawasa's concerns over the cost of the implementation of the new constitution is one of the factors behind his attempts to delay the adoption until 2008. Opposition parties and civil society groups have long argued that a new constitution should be in place before the 2006 elections (March 2005, The political scene). Mr Mwanawasa opposes this, cost is one issue, and another is that there are numerous issues on governance and civil liberties which require more detailed analysis. However, the overriding factor behind Mr Mwanawasa's reluctance to speed things up is that he doesn't want to make his re-election any more difficult than it may already be. The new constitution will almost certainly require that for someone to be declared president, he or she must receive 50% plus one of the votes cast in the presidential election. This may entail a second or third round of voting if no single candidate receive enough votes and the less popular candidates drop out. As the losing opposition candidates drop out, opposition voters could unite behind a single candidate, a candidate that would stand a very good chance of beating Mr Mwanawasa, especially bearing in mind that opposition candidates received around 70% of the vote in the 2001 election.

Zambia's donors, who will provide most of the financial assistance for the elections and implementation of the referendum, appear to favour Mr Mwanawasa's constitutional timetable. Envoys from both Britain and Germany have publicly said they would rather Zambians adopt the constitution after serious debate, implying a longer timeframe. These comments have angered the opposition parties, but with the will of the president and donor community against them, they are unlikely to get their own way unless they can harness the support of the Zambian people. However, attempts to organise mass action such as demonstrations and strikes have so far largely failed (March 2005, The political scene).

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Mwanawasa appoints defence minister

Mr Mwanawasa relinquished the position of defence minister when he appointed Wamundila Muliokela in a mini cabinet reshuffle in March. The newly elected legislator, Kabinga Pande, was appointed science, technology and vocational training minister, replacing Bates Namuyamba, who was moved to the ministry of labour, while Stephen Manjata was elevated as community development minister. The appointments completed Zambia's cabinet set-up after some ministries had been vacant for some months.

Economic policy

The IMF completes a second PRGF review

The IMF announced on April 8th that it had completed its second review of Zambia's progress under its Poverty Reduction and Growth Facility (PRGF). The broadly successful review meant that the IMF was able to release a further US$8.3m, bringing the total amount drawn under the agreement to US$256.7m. The IMF report on the second review, published later in April, stated that the Zambian economy had outperformed expectations in 2004, with real GDP growth reaching 5%. The impressive macroeconomic performance was strongly aided by fiscal adjustments, which saw the fiscal deficit narrow to 1.7% of GDP in 2004, from 6.6% of GDP in 2003. This meant that the government had to borrow less—domestic borrowing declined from 5.1% of GDP in 2003 to 0.8% of GDP in 2004—therefore easing interest rate and inflation pressures. Zambia's external position strengthened, with large increases in export revenues (see Foreign trade and payments). The kwacha remained stable against the US dollar and other major international currencies, but appreciated in real terms by about 8% during the year.

Further fiscal reforms are necessary

Despite the largely positive IMF review, it does not alter the fact that there is still much to be done by the Zambian government to ensure stable progress in forthcoming years. The government will need to continue with policies to promote fiscal consolidation, which is an essential path for reducing domestic debt and also lowering interest rates and inflation. Reduced domestic borrowing should then free financial resources that the private sector could make use of, providing a further boost to economic activity. The IMF resident representative in Zambia, Joseph Kakoza, said on May 19th that the Zambian government would be expected to improve efficiency and transparency under its public expenditure management and financial accountability (PEMFA) system, which is being funded by the World Bank and other donors. The five-year PEMFA programme aims to improve public expenditure management.

The IMF also expects Zambia to broaden the tax base and increase the efficiency of the tax regime. Whilst it cannot be denied that the government made impressive progress in its fiscal reforms during 2004, it is likely to struggle with further reforms in 2005. The public-sector wage freeze, which was a big factor behind reducing expenditure, will not last indefinitely. Also, with elections due in 2006, the government will want to win favour with the electorate, something already evident in the 2005 budget (March 2005, The political scene). A more expansionary fiscal policy during 2005 and 2006 will strain relations with donors. However, owing to its recent good track record,

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and the cost requirements of free and fair relations, the government is expected to receive some leeway from its donors, so no significant break in funding is expected.

Banking-sector reform would also be prudent

Enhancing the capacity and independence of the Bank of Zambia (the central bank) is another key area the IMF expects the government to undertake. The IMF expects Zambia to strengthen the capacity and independence of the Bank of Zambia (BoZ, the central bank) to enable it to shore up its financial sector supervision and regulation and to help improve the delivery of rural financial services. Another important policy expectation is the improving of credit services to small and medium-sized enterprises (SMEs)—reforms seen as key to the creation of a vibrant private sector. Dr Kakoza said that the Fund expected the government to carry out extensive reforms aimed at creating strong private-sector led economic growth. This will require the strengthening of regulatory and licensing framework. Perhaps more difficult for the government to implement will be land and labour reforms, which will be critical in enhancing private-sector development.

Threats to macroeconomic stability

There are still a number of threats to macroeconomic stability in Zambia outside of the government's control:

- a fall in international copper prices would seriously affect Zambia's heavily copper-dependent economy. Amongst other things, the current account would rapidly deteriorate, the stability of the kwacha would be threatened and investments in the sector would drop;
- sharp further increases in global oil prices are a major threat to Zambia's economic growth because of its dependence on oil imports for copper mining. Price increases would see imports jump and would also affect inflation;
- an unsustainable domestic debt stock of around $1bn will affect the ability of the government to finance its fiscal deficits and will help keep interest rates high; and
- if donor support falls short of targeted amounts, or is simply delivered later than it is needed, then the government's reform plans could be seriously undermined. Efforts to reduce poverty would almost certainly suffer.

A private-sector reform programme is announced

The Zambian finance minister, Peter Magande, announced in April that the government had prepared a reform programme aimed at stimulating private sector led economic growth. The government plans to create a pool of resources where local investors would receive loans to invest in the production of goods, and to this end, the Zambia Development Agency (ZDA) has been created to facilitate the loans and provide other relevant services to investors. It is hoped that this scheme will help to stimulate the type of economic growth needed to diversify the Zambian economy away from its reliance on copper and cobalt mining. Already the government, with assistance from the World Bank, has created a fund for investors in the tourism sector to improve their businesses. About US$28 million has been provided by the World Bank to Zambia to give loans at concessional rates to investors who include, lodge owners, caterers, handcraft makers, tour operators and other service providers. The government hopes that much of the funding behind future development

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loans will come from the monies saved from debt servicing, now that Zambia has reached completion point under the heavily indebted poor countries (HIPC) initiative (see Foreign trade and payments).

The diversification of Zambia's economy is an extremely important issue and, with copper prices high at present, now is the time to embark upon it whilst the cash is available to fund it. Encouraging the private sector to lead this diversification is also a sensible policy, but there are concerns that the government's new reform programme will not deliver the results it desires. Primarily the reform programme does not address the important issue that commercial banks in Zambia will remain unwilling to provide loans to the private sector. The ZDA currently lacks the financial incentives that the commercial banks are subject to when selecting who to loan to and how much for. This increases the risk that unsuitable investments will be made and the ZDA will see a high proportion of non-performing loans with little progress to show for it. Corruption is another issue, with the experience of similar initiatives in other African countries demonstrating that loans are often made on the grounds of political connections rather than sound business sense.

There is a further setback to the privatisation of ZNCB

The Zambia Privatisation Agency (ZPA), on March 15th, terminated negotiations with Absa, South Africa's largest retail bank, and the Africa International Finance Holdings Zambia Limited (AIFHZL), which were both seeking a 49% stake in the Zambia National Commercial Bank (ZNCB). The ZPA said that although negotiations had been concluded with Absa in November 2004, the bank did not secure the requisite approval from its board to sign for a 49% stake in the ZNCB. The ZPA said the talks were similarly discontinued with the AIFHZL because it was setting new conditions, which were untenable for the government. The sale of the ZNCB was a key IMF condition, but only to the point that Zambia had to advertise the sale of the shares to a strategic equity partner. The completion of the sale was not included as an IMF benchmark, as it would have put the government in a weaker negotiating position.

The ZPA re-advertised the sale of the ZNCB stake in April. Fresh data provided by the ZPA showed that the bank's books had improved, with its total book assets rising to US$314 million in December 2004 from US$161 million in 2000, and reported deposits rising to US$285 million from US$114 million during the same period. For 2004 as a whole, the bank recorded a profit of Zk14bn (US$2.9m). Commerce, trade and industry permanent secretary, Davidson Chilipamushi, said on April 7th that the government was no longer negotiating the partial privatisation of Zanaco from a weak standpoint as the bank's operations had improved tremendously. We predict that with the bank performing well, and also owing to the debt relief accorded to Zambia under the HIPC initiative, the government will drag out the privatisation of ZNCB until it gets a bidder who is prepared to meet its expectations. Neither President Mwanawasa nor senior members of government are in support of the privatisation of the remaining state utilities.

Zambia seeks to subsidise oil prices

Higher global oil prices are threatening the continuation of the impressive levels of economic growth that Zambia has made in the last 12 months. If they continue, the high prices of oil are likely to affect the rebound in agricultural

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production. Perhaps even more importantly for economic growth in Zambia, copper production is also likely to suffer as the mines rely heavily on diesel to power their machinery. In an attempt to ensure that the prices of petroleum products remain stable, and so combat mounting inflation pressures, the government has introduced an oil-price stability fund. Energy and water development minister, George Mpombo, said on May 9th that the impact of higher oil prices was being felt by Zambia and that it threatened macroeconomic stability which would adversely affect plans to reduce poverty if not checked. Mr Mpombo announced that a fund had been established from which the government would draw funds to subsidise prices of petroleum products each time global prices rose. Mr Mpombo added that the government would also introduce strategic oil reserves by stocking three months' consumption in reserves so to maintain lower prices.

This new policy will pose an unexpected financial burden on the government, especially as it attempts to meet its donors' requirements of greater fiscal austerity. Fortunately, Zambia and the World Bank have agreed in principle for the Bank to finance much of the oil subsidy. However, part of the funds for the intended subsidies will still have to come from local revenue, with the financing facility from the World Bank comprising grants and loans. Zambia has already written to the World Bank asking for the financing and the Bank's board will now determine how much the country should receive and when the money will be released.

Teachers get a 25% wage increase

The government and three teachers unions, on May 12th, signed an agreement to raise wages and salaries for teachers by 25% in 2005. An agreement was also signed for a 13% wage increase over the period from April 1st 2006 to December of the same year. Secretary to the cabinet, Joshua Kanganja, said on May 12th that the new salaries would be effected in May and backdated to April 2005. The government has still not reached an agreement with the Civil Servants and Allied Union of Zambia (CSAWUZ) and the National Union of Public Service Workers (NUPSW), which mainly represents nurses and other medical staff, but excluding doctors. The two unions are understood to be pressing for a minimum wage increase of 30%, but Mr Kanganja has argued that that unions should consider the ability of the employer to pay as a major principle of the bargaining process, in what appeared to be a signal that the government will not go beyond wage increases of 25%.

The new agreements, both signed and imminent, will effectively end the government's wage freeze, which it imposed on civil servants and public-sector workers in 2004 to meet the IMF's conditions for the HIPC debt write-off. The conditions included containing the wage bill to within 8.1% of GDP, a mark the government achieved. Now that HIPC competition point has been reached, the incentives for the government to stick to this target have depleted somewhat, especially with elections scheduled for 2006. However, the government will want to remain on good terms with its donors and the incentive of maintaining its PRGF agreement should prevent excessive public-sector wage increases. Indeed, with annual inflation at around 20% and strong economic growth, wage increases of 25% are unlikely to raise their proportion of GDP significantly over the IMF target.

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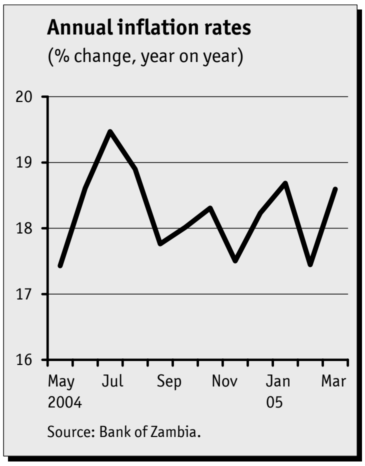
The domestic economy

Economic trends

Inflation remains high



Average annual inflation increased to 18.6% in April from 17.4% in March 2005. The 18.6% inflation figure for April is also higher than 17.8% recorded in the same month in 2004. The growth of inflation was mainly owing to increases in food prices, house rent and household fuels. Annual food inflation was recorded at 18%, up by 2% on the March rate. Annual non-food inflation rate stood at 19.3% in April, compared with 19% the previous month. The increase in non-food inflation was mainly owing to the rise in the cost of fuels, furniture and household appliances. The government faces an extremely difficult challenge to bring inflation down, particularly as there is a large maize deficit anticipated from the 2005 maize harvest. With food shortages likely in some areas, food prices are expected to increase. Alongside higher food prices, the international oil prices is expected to remain high throughout 2005. The Economist Intelligence Unit therefore expects average annual inflation to increase to 20% in 2005, from 18% in 2004, and well above the target set in the government's 2005 budget of 15%.

The BoZ acts to limit broad money growth

Following steady donor disbursements, increasing liquidity in the economy has become evident since the end of 2004 and into 2005. As a result, during early 2005 the Bank of Zambia (BoZ, the central bank) has acted to limit the growth of reserve and broad money through open market operations in order to mitigate inflationary pressures. The high liquidity held by commercial banks has led to increased demand for government securities so far in 2005. The central bank's governor, Caleb Fundanga, said that the amount of bids tendered by investors in the Treasury bill auctions exceeded the amount on offer by 22.6% during the first quarter of 2005, while subscriptions for Government bonds were in excess of the amount on offer by 50.5%. The oversubscription was in contrast with the undersubscription rates of 29% on Treasury bills and 28% on government bonds in the last quarter of 2004.

Despite the oversubscription, the yield rates on government securities have changed little. The composite weighted average yield rate on Treasury Bills rose to 18.1% in the first quarter of 2005, from 17.8% in the fourth quarter of 2004. Meanwhile the composite weighted average yield rate on government bonds remained unchanged at 20.9%. The overall effect of the BoZ's actions has been a fall in the broad money supply to ZMk5,559.9bn (US$1.2bn) at end-February 2005 from ZMk5,816.9bn at the end of December 2004.

Agriculture

The effects of drought have been mitigated

The early end to the rainy season (December to April) and a subsequent drought has affected agricultural output in many parts of Zambia. Particularly badly hit was maize production, a staple food crop for much of the population. The government initially forecast a maize deficit of 300,000 tonnes, and began preparations to cover the deficit through imports, which would have had a

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negative affect on both inflation and the trade deficit. However, after a more thorough analysis of the situation, the government has discovered alternative ways of assisting those affected:

- the agriculture and co-operatives minister, Mundia Sikatana, said that left-over maize stocks had been discovered in some remote areas of Zambia, where it had not been previously collected because of impassable roads;
- a maize export ban, brought in during April, should help ensure that maize is retained within Zambia for consumption;
- the state-run Food Reserve Agency (FRA) has 110,000 tonnes of maize in its strategic reserves, which would be added to this year's harvest to boost available stocks; and
- there is a nationwide surplus of cassava that can be distributed and used as an alternative to maize

This additional maize and cassava is to be collected and distributed to areas in central, southern and eastern Zambia, where the drought has caused most damage to crops. Although the need for a high volume of costly imports has been averted, distribution costs will still be high owing to the poor road infrastructure in much of Zambia. Another cost will be the restocking of the FRA's strategic reserves. Overall, this implies that there will still be an inflationary impact from the maize shortfall.

Mining

A new US$600m mine project is launched

Despite much vaunted plans to diversify economic activity, Zambia appears destined to continue with its dependency on copper and cobalt mining. Given the strong global metals prices, fresh investments are flowing into the Zambian mining sector and several new projects being developed that will raise total copper output. One of the largest is the Konkola Deep mine, which is set to become Zambia's biggest copper mine once it starts production in 2007. The London-listed Vedanta Resources—the owner of a 79% stake in Konkola Copper Mines (KCM), which will develop the Konkola Deep project—plans to spend US$600m to develop the mine. It is expected to produce 6m tonnes of ore per year, or 200,000 tonnes of finished copper, once it comes on stream. The project should also create around 6,000 new jobs The Konkola Deep mine will further increase KCM's lifespan by another 22 years from 2035, when ore reserves at its existing Konkola and Nchanga open-pit mines are expected to be depleted. The booming copper industry means auxiliary industries, many of which shut several years ago, will be revived—there is huge demand for supplies of mining equipment, stationery and other requirements. This will create new jobs and should help raise the standard of living for the people involved, although almost all of the benefits will be restricted to a relatively small geographic area.

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International prices of Zambia's major exports
(US cent/lb)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005[a]	2006[a]
Copper	133.2	104.1	103.3	75.2	71.1	81.3	71.5	70.4	80.3	129.5	143.0	119.0
Cobalt	2,677.5	2,357.5	1,957.5	1,855.0	1,717.5	1,337.5	1,125.0	1,005.0	1,131.3	2,474.3	1,825.0	1,700.0

[a] Forecast

Source: Economist Intelligence Unit

Significant uranium deposits are discovered

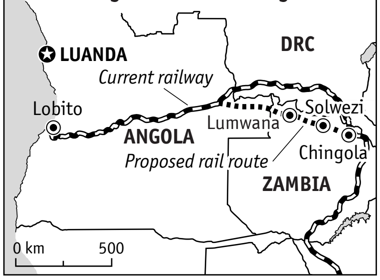
Australia's Equinox Minerals Limited announced on May 3rd that it had discovered uranium at its Lumwana copper and cobalt mine in north-western Zambia. Equinox's president, Craig Williams, said that a feasibility study indicated that 97% of the uranium ore to be mined could yield the commercially desirable uranium yellow-cake. Mr Williams went on to say that the mineral deposits discovered contained estimated uranium resources of 12.1m tonnes and that it occurs as discrete uranium-enriched zones that will be separately mined during the copper mining operation. There was also more uranium potential within the 1,355 sq km Lumwana Mining Licence area.

Infrastructure

A new railway link to Angola is agreed

The government and a private firm, Northwest Railways Limited, signed an agreement in late April giving the firm the go ahead to build a new railway line to link Zambia with Angola's port of Lobito. The project envisages a 685-km railway line running north-west from Zambia's mining hub in the Copperbelt province to join Angola's Benguela railway. The railway line will be constructed in three phases:

The Zambian towns to be linked by a new railway



- it will initially connect the Copperbelt town of Chingola to Solwezi in the North-Western province;
- during phase two, the line will be extended to a new mine at Lumwana in the North-Western province; and
- the final phase will connect the line to Angola's Benguela railway, itself expected to undergo refurbishment.

Although the financing for the project is not yet in place, the chairman of Northwest Railways, Enoch Kavindele, said that there was much interest from South African investors. If successfully completed, the railway line would be of great benefit to Zambia as it would cut the distance and time for its exports, especially copper, to reach the seaports. Zambia currently ships copper through the South African port of Durban and Dar es Salaam in Tanzania, but the Durban route is long and relatively costly while the rusty Chinese-built Tazara railway linking Zambia and Tanzania is unreliable.

Tourism

Tourist arrivals are on the increase

Zambia's tourism sector has continued to benefit from the political chaos in neighbouring Zimbabwe. Zambia is rapidly becoming a major tourist destination for Europeans, Americans and other foreign nationals. Most tourists

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are keen to see Africa's famed Victoria Falls, which is located on the border between Zambia and Zimbabwe. New hotels in Zambia are cashing in on the influx and this is raising revenue collection and creating new jobs. Officials say that the Livingstone airport, near the Victoria Falls, now attracts up to four international flights a day and hotel staff say that if tourists choose to visit the Zimbabwean side of the falls they often do so only for a day, seeking accommodation in Zambia instead. The ministry of tourism, environment and natural resources anticipates that 1m foreign tourists will be visiting Zambia annually by 2010, compared with only 160,000 tourists who visited Zambia in 2000 and 610,000 in 2004. Tourism is increasingly becoming an important foreign-exchange earner, although it currently only contributes around 4% of Zambia's GDP.

Foreign trade and payments

Zambia reaches HIPC competition point

The IMF and the World Bank formerly endorsed a US$3.9bn debt-relief package for Zambia on April 8th, under their initiative for heavily indebted poor countries (HIPC). The debt relief, which will be provided by the Fund, the World Bank and other western lenders, is a vote of confidence and comes after Zambia fulfilled almost all of the 15 key reforms and objectives set by the IMF for debt cancellation. The debt relief will be backdated to 2000 and will run until 2019, over which period lenders will be expected to write-off the country's debt. The IMF had set conditions relating to:

- poverty reduction;
- establishing macroeconomic stability;
- improvements in the social sectors;
- structural reforms; and
- public-expenditure management.

Debt relief, together with bilateral assistance beyond HIPC relief, is estimated by the IMF to have lowered Zambia's debt-to-export ratio to 174% in 2003 and 140% in 2004. The IMF said this will become sustainable. However, it needs to be borne in mind that these ratio was projected to decline steadily thereafter, and so Zambia's debt burden figures assume an immediate cancelling of much of Zambia's debt. This is unlikely to occur in practise as the Zambian government must first negotiate the debt relief with each of its creditors, which in itself will take time, and the subsequent debt cancellations will probably be spread out over the full 20-year period.

The IMF and World Bank pledge debt-service relief

The World Bank's lending arm, the International Development Association (IDA), will provide Zambia with debt-service relief under the enhanced HIPC debt initiative amounting to US$885.2m, to be delivered in the period through to 2020. The IMF will provide debt relief amounting to US$602m in net present value (NPV) terms on payments falling due until 2008, of which US$240m would be received in 2005. It is projected that Zambia will receive an average of US$135m a year in debt relief over the next 20 years and that debt-servicing

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obligations would average US$120m on the country's remaining debt stock. The Fund said debt relief from all of Zambia's creditors could even surpass the US$3.9bn figure, as the IMF, the World Bank and G8 would meet later in 2005 to look at additional debt cancellation.

Paris Club cancels the bulk of Zambia's debt

The Paris Club said on May 12th that it will cut Zambia's debt to the group of 19 rich nations. The creditor nations said they had agreed to cancel US$1.4bn of Zambia's debt in nominal terms, out of the US$1.9bn total debt to the Club. Additionally most members plan to grant Zambia debt relief through bilateral arrangements. The Zambian finance minister, Peter Magande, said that he had hoped for a 100% debt write-off from the Paris Club, but indicated that his request had been undermined by the positive trends in the economy, including strong GDP growth. Most creditors now seem to believe that Zambia will be able to sustain the balance of the debt.

Zambia seeks forgiveness of local debt

Upbeat with the IMF-driven debt cancellation, the government has turned its energy to negotiating for debt relief from local contractors and suppliers in attempts to reduce the estimated debt to this category of creditors of over US$100m. Mr Magande said most of the debt contracted from local suppliers over the last decade was not genuine as some unscrupulous government officials had connived with suppliers and contractors to defraud the Treasury by inflating bills. Mr Magande said on April 10th that the government would honour the bulk of the US$1bn domestic debt—the bulk of which was contracted through Treasury Bills and Government Bonds— as amounts fell due, but that it would ask local suppliers and contractors to cut their debt. Deputy finance minister, Felix Mutati, said on April 12th that it was increasingly becoming difficult for the government to repay its local debt because some creditors were asking for extremely high interest payments. However, the government is likely to be less successful in this avenue of debt cancellations as the domestic suppliers are not bound by the HIPC initiative.

The World Bank releases new debt data

Data recently published in the World Bank's 2005 edition of *Global Development Finance*, the benchmark source of external debt data, showed that Zambia's total external debt stock rose by US$447m to US$6.43bn at end-2003. This was despite principal repayments outweighing new disbursements by US$150m. One factor behind the increase in total debt was a build-up in arrears, following the suspension of IMF assistance during the year. However, the rise in the debt stock was mainly owing to revaluation and the weak US dollar. Around 30% of external debt is not denominated in US dollars. Zambia negotiated a number of debt write-offs in 2003 with bilateral creditors, but these are not fully reflected in the World Bank data, most likely because of delays in the deals being finalised. The write-offs are expected to be more evident in the 2004 debt figures, but new borrowing—including the resumption of IMF assistance—means that the external debt stock is estimated to have remained high, at US$6.45bn at year-end.

Strong metals exports boosted the current account in 2004

The IMF's second review of Zambia's progress under its Poverty Reduction and Growth Facility (PRGF) showed that metals exports, particularly copper and cobalt, rose by 65% to US$1103m in 2004. This leap in export revenues was

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partially a result of higher production, after the copper mines invested in new technology and improved their efficiencies during 2003 and 2004. Another major factor was the 50% rise in the international price of copper. Total imports grew by 24% in 2004, largely owing to large capital imports by the mining industry and the higher global oil prices. This meant that the trade deficit declined from US$311m in 2003 to US$109m in 2004. With only moderate increases in the services and income deficit, and a slight increase in net transfers, the overall current-account deficit was reduced to 4.8% of GDP, from 7.5% of GDP in 2003.

Given that copper prices are expected to remain high in 2005 and production is set to increase as new mines begin production, the Economist Intelligence Unit expects another year of strong export growth in Zambia. Imports are also expected to grow with investment in the mining sector continuing to suck them in, and oil prices remaining high. We expect the services deficit to increase slightly, but forecast a larger increase in the income deficit as the production increases in the mining sector translate into high-profit remittances from the foreign companies involved. Strains with the IMF over the government's slow progress on fiscal consolidation will mean that net transfers stagnate. Overall, we forecast that in 2005 the current-account deficit will narrow slightly, to 4.4% of GDP.

Zambia's current account
(US$ m unless otherwise stated)

	2000	2001	2002	2003	2004
Goods: exports fob	757	912	945	1081	1619
Goods: imports fob	-978	-1253	-1204	-1393	-1727
Trade balance	-221	-341	-259	-312	-108
Services balance	-226	-228	-245	-235	-254
Income balance	-138	-122	-155	-148	-304
Current transfers balance	321	277	394	335	377
Current-account balance	**-264**	**-414**	**-265**	**-360**	**-289**
Current-account balance/GDP (%)	**-6.8**	**-11.0**	**-6.5**	**-7.5**	**-4.8**

Sources: IMF; Economist Intelligence Unit

The US puts up $115m for AIDS funds

The campaign against HIV/AIDS received a major boost when the United States said on May 11th that it would raise its assistance to Zambia in 2005 by 40% to US$114.9 million. The US ambassador to Zambia, Martin Brennan, and the Zambian health minister, Brian Chituwo, jointly launched the new programme where the bulk of the money would be used on HIV prevention, treatment, strengthening care systems, policy analysis and strategic information. The funds are being provided through US president George W Bush's Emergency Plan for AIDS relief, which targets 15 of the world's poor nations, 13 of them in Africa. The US said it would additionally provide US$30.2m directly to US agencies operating in Zambia to implement HIV/AIDS programmes. Data provided by the US embassy showed that 920,000 Zambians where currently living with HIV/AIDS, of which 200,000 people were living under chronic AIDS-related illnesses. The disease is taking a heavy toll on medical facilities—65% of hospital beds in Zambia are being used by HIV/AIDS patients.

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