January 2005

Zambia

Background

The territory of Northern Rhodesia was administered by the South Africa Company from 1891 until it was taken over by the UK in 1923. During the 1920s and 1930s, advances in mining spurred development and immigration. The name was changed to Zambia upon independence in 1964. In the 1980s and 1990s, declining copper prices and a prolonged drought hurt the economy. Elections in 1991 brought an end to one-party rule, but the subsequent vote in 1996 saw blatant harassment of opposition parties. The election in 2001 was marked by administrative problems with three parties filing a legal petition challenging the election of ruling party candidate Levy Mwanawasa. The new president launched a far-reaching anti-corruption campaign in 2002, which resulted in the 2003 arrest of the former president, Frederick Chiluba, and many of his supporters. Opposition parties hold the majority of seats in the National Assembly.

Government

Government type:
Republic
Capital:
Lusaka
Independence:
24 October 1964 (from UK).
Chief of state:
President Levy Patrick Mwanawasa (since 2 January 2002).
Elections:
President elected by popular vote for a five-year term. Election last held: 27 December 2001. Next election: December 2006.

Source: CIA World Factbook 2004

People

Population:
10 462 436 (July 2004 est.)
(Estimates vary)
Population growth rate:
1.47% (2004 est)
Life expectancy at birth:
Total population: 35.18 years
Male: 35.19 years
Female: 35.17 years (2004 est)
Ethnic groups:
African 98.7%, European 1.1%, other 0.2%.
Religions:
Christian 50%-75%, Muslim and Hindu 24%-49%, indigenous beliefs 1%.
Languages:
English (official), major vernaculars - Bemba, Kaonda, Lozi, Lunda, Luvale, Nyanja, Tonga, and about 70 other indigenous languages.
Adult literacy rate:
Definition: % of population aged 15 and over that can read and write English. 2003 est: 80.6%.

Source: CIA World Factbook 2004

Geography

Area:
Total: 752 614 sq km
Land: 740 724 sq km
Water: 11 890 sq km
Land boundaries:
Total: 5 664 km. Border countries: Angola 1 110 km, Democratic Republic of the Congo 1 930 km, Malawi 837 km, Mozambique 419 km, Namibia 233 km, Tanzania 338 km, Zimbabwe 797 km.
Coastline:
Landlocked
Climate:
Tropical; modified by altitude; rainy season (October to April).
Terrain:
Mostly high plateau with some hills and mountains.
Natural resources:
Copper, cobalt, zinc, lead, coal, emeralds, gold, silver, uranium and hydropower.
Land use:
Arable land: 7.08%.
Permanent crops: 0.03%.
Other: 92.89% (2001).
Irrigated land:
460 sq km (1998 est).
Natural hazards:
Periodic drought, tropical storms (November to April).
Environment:
Air pollution and resulting acid rain in the mineral extraction and refining region; poaching seriously threatens rhinoceros, elephant, antelope and large cat populations; deforestation; soil erosion; and desertification; lack of adequate water treatment presents human health risks.

Source: CIA World Factbook 2004

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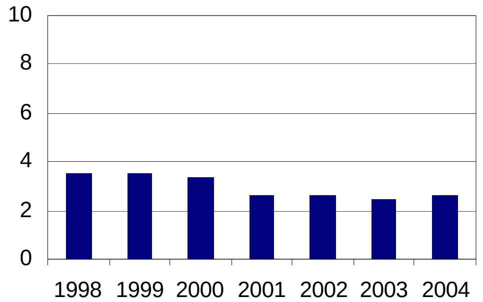
Health

People living with HIV/Aids:
Adults: (age 15-49) 2003: 16.5%
Adults: (age 15-49) 2003: 830 000
Women: (age 15-49) 2003: 470 000
Children: (age 0-14) 2003: 85 000
Tuberculosis cases (per 100 000 people):
2002: 588
Malaria cases (per 100 000 people):
2000: 34 204
Undernourished people (1999/2001):
50% of total population

Source: UNDP Human Development Report 2004

Corruption perceptions index (2004)



Score: 2.6
(where 10 is "highly clean" and 0 is "highly corrupt").
Place: 102
146 countries surveyed, 1 = least corrupt, 146 = most corrupt).
(The surveys reflect the perceptions of business people, academics and country analysts. The surveys were undertaken over the past three years and no country has been included in the index without results from a minimum of three surveys).

Source: Transparency International 2004

Restrictions on capital flows

- There are no exchange controls.

Taxation

- Personal tax (PAYE): 20% above K1.2 million and 30% on the balance. Self-employed persons pay 30% tax.
- There are three general company tax rates: the basic rate is 35%; companies listed on the Lusaka Stock Exchange pay 33%; and banks pay 45% tax if turnover in above K100 million, otherwise 35%. Farming income and fertiliser manufacturers are taxed at a maximum rate of 15% and mining enterprises are taxed at a maximum rate of 10%. A mining royalty tax applies. Non-traditional exporters are taxed at a rate of 15%.
- There is no capital gains tax, but a property transfer tax of 3% applies.
- VAT is 17.5%. There are many VAT exemptions.

Source: Zambia Investment Centre

Sovereign credit rating

Standard & Poor's:
Not rated
Moody's Investor Service:
Not rated
Fitch ratings:
Not rated

Human development

HDI rank 2004
164 out of 177 countries
(1=most developed, 177= least developed)

Norway	**1**
Seychelles	35
Mauritius	64
South Africa	119
Gabon	122
Namibia	126
Botswana	128
Ghana	131
Swaziland	137
Lesotho	145
Uganda	146
Zimbabwe	147
Kenya	148
Madagascar	150
Nigeria	151
Tanzania	162
Ivory Coast	163
Zambia	**164**
Malawi	165
Angola	166
DRC	168
Mozambique	171
Sierra Leone	**177**

The Human Development Index (HDI) measures a country's achievements in three aspects of human development: longevity, knowledge and a decent standard of living. Longevity is measured by life expectancy at birth; knowledge is measured by a combination of the adult literacy rate and the combined gross primary, secondary, and tertiary enrolment ratio; and standard of living, as measured by GDP per capita.

Source: UNDP Human Development Report 2004

		1998	1999	2000	2001	2002	2003	2004e
Population	(Million)	9.7	9.9	10.1	10.1	10.2	10.4	10.5
Nominal GDP¹	(US$bn	3.16	3.13	3.24	3.64	3.70	4.35	-
GDP/head¹	(US$)	326	323	327	361	360	418	-
Exchange reserves² -excluding gold	(US$m)	69.4	45.4	244.8	183.4	535.1	247.7	294.1 OCT
Import cover	(Months)	0.9	0.6	3.0	1.76	5.55	-	-
External debt²	(US$m)	6879	5868	5731	5671	5969	-	-
% of GDP	%	217	187	177	156	161	-	-

1) Year beginning in January. 2) End of period. 3) Preliminary or estimates. 4) November 2003. *e = estimate, f = forecast*

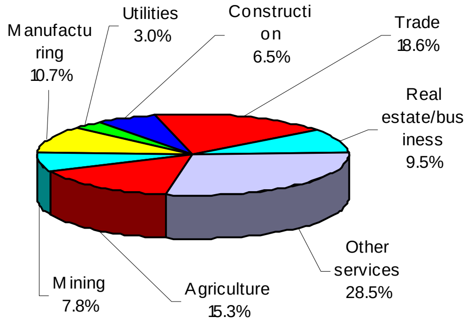
Economic structure

The importance of the copper mining sector has declined since the 1960s with the economy's increasing diversification. In 1990 the mining sector accounted for 18.8% of output, which dropped to 7.8% in 2003, compared to about 50% in the 1960s. Agriculture, manufacturing and trade were the largest sectors in 2003, contributing 15.3%, 10.7% and 18.6% to GDP respectively. Between 1990 and 2003 agriculture's share grew from 12.3% to 15.3% and trade from 15% to 18.3% of GDP. The manufacturing sector's share increased marginally from 9.1% to 10.7% over this period. Generally, the primary sector contracted from a third to a quarter of output, whereas the secondary and tertiary sectors have grown, the latter to over half of output.

The mining sector is an important contributor to economic growth, particularly with the surge in the copper price. Agriculture is also a growth sector, but adverse weather conditions, as in 2001 and 2002, render its contribution to output volatile. Agricultural, floricultural and horticultural exports have risen significantly in recent years. Exports of cotton and tobacco have been boosted by ex-Zimbabwean farmers settling in Zambia. The manufacturing sector has benefited from its close links with agriculture and mining.

The agricultural sector provides the bulk of employment, where about four-fifths of the labour force is employed. Industry and services each employ less than 10% of the labour force.

Contribution to GDP (2003)



Source: IMF, Zambian authorities

Real GDP growth

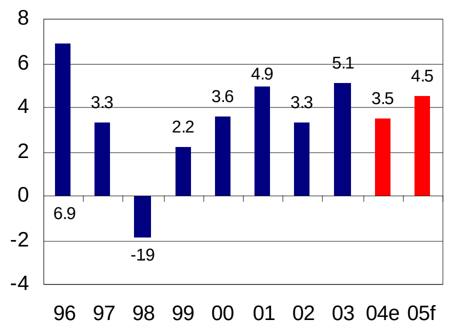
Zambia's growth performance improved to a high of 5.1% in 2003, after contracting by 1.9% in 1998. Increased diversification of the economy has made a positive contribution to growth. The IMF expects growth to have reached 3.5% in 2004 and forecasts 4.5% growth in 2005.

Although the agricultural sector and rising non-traditional exports have supported the growth recovery, overall performance over the past decade has been disappointing, given Zambia's growth potential.

The high copper price in 2003 and 2004 boosted the copper mining industry's output and has rekindled international interest in the industry. The copper price was US$3 150 per metric tonne at the end of December 2004, compared to US$2 301 in December 2003. The average annual price was US$2 791 in 2004, some 56% above the average of US$1 788 in 2003.

The withdrawal of Anglo American from the Copperbelt in January 2002, less than two years after it acquired Konkola Copper Mines (KCM), Zambia's largest copper mine, was a major setback. However, in 2004 Vedanta Resources PLC, a London Stock Exchange-listed company, bought a 51% controlling stake in KCM. This will boost copper production and exports over the next few years. In addition, two other mines will come on stream in the next two years.

Real GDP growth %



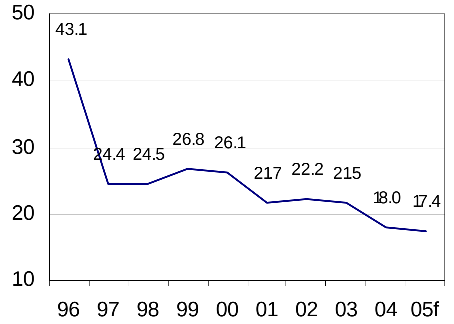
Source: IMF

Consumer inflation (%)

The inflation rate has remained moderately high because of poor fiscal management and external price shocks, such as high crude oil prices. Adverse weather conditions also drove consumer prices higher. Inflation has declined substantially over the past decade, after reaching hyper-inflationary levels in the early 1990s.

Average annual Inflation in 2003 averaged 21.5%, which was mainly driven by high food inflation. Food prices, which reached levels of above 30% in Q4 2002 and which comprise 57% of the consumer price index, rose well above non-food prices, with a 43% weight in the index. In 2004 annual inflation averaged 18%, with food inflation well under control, as normal weather conditions prevailed. To reduce inflation the Bank of Zambia (BoZ), the central bank, intends improving its monetary policy through greater use of open market operations and a year-end inflation target. Money supply growth remains relatively high – M2 grew by nearly 26% on average in 2003. The IMF expects inflation to fall to 17.4% in 2005, this is in line with lower global inflation.

Consumer inflation – annual average %



Source: Bank of Zambia, IMF

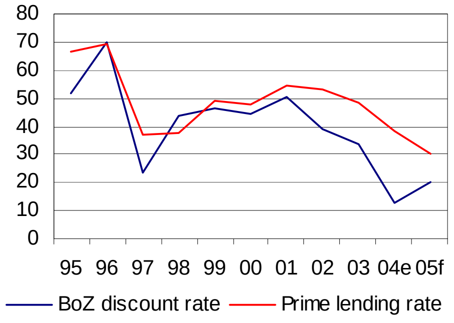
Interest rates (%)

Although Zambia's interest rates, which are underpinned by high inflation, have been at punitive levels for a number of years, the long-term trend appears to be downwards. High inflation and interest rates have been the result of large budget deficits.

Generally, there is a large spread between commercial banks' nominal lending rates and savings rates; moreover, real lending rates are positive but real savings rates are negative. The wide spreads are linked to the high risk of default and high volume of non-performing loans. Commercial banks' high lending rates inhibit investment and economic growth and negative real savings rates discourage saving. The high degree of dollarisation in the economy makes monetary policy difficult to implement. Foreign currency deposits make up a large part of the broad money supply.

The BoZ discount rate (set at two percentage points above the 91-day Treasury bill rate) fell during 2004 to reach a low of 7.8% in June. In comparison, the June 2003 rate was 34.4% and the 2003 average was 33.9%. At year-end 2004 the bank rate was at more realistic levels of above 17%. Excess liquidity from the lowering of the banks' statutory reserve requirements partly resulted in the interest rate drop. The prime lending rate (including the lending margin) is less volatile and fell to 36.9% in June 2004, against 47.8% in June 2003, and averaged 48.3% in 2003. At the end of 2004 prime was just over 37%.

Interest rates – annual average %



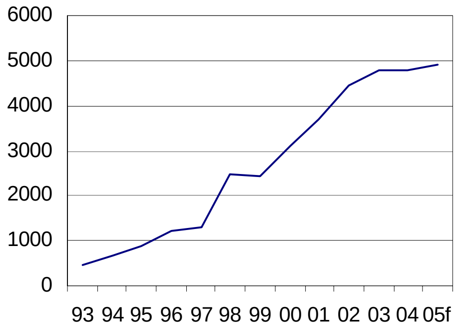
Source: Bank of Zambia

Exchange rate

The value of the kwacha is market determined under a broad-based inter-bank forex system, which was introduced in 2003. Foreign exchange controls have been removed. Trade policies were also liberalised in the early 1990s. The BoZ's policy is aimed at not only maintaining a market-determined exchange rate, but also at smoothing out short-term currency fluctuations. The kwacha stabilised against the US dollar from the end of 2002 through 2004. The weakness of the US dollar, which is reaching new lows to the euro, as well as higher copper exports, supported the kwacha. The kwacha is expected to remain relatively strong against the dollar in 2005.

The Zambian economy is highly dollarised. The BoZ issued a directive in 2002 stating that local transactions must be quoted and settled in the local currency. Dollarisation hinders the BoZ's capacity to implement monetary policy effectively.

Kwacha per US$ - annual average



Source: Bloomberg

Balance of payments

Zambia's main exports are copper, cobalt, agricultural commodities, processed foods, horticultural and floricultural products, and engineering products. Non-traditional (or non-metal) exports, such as horticulture and floriculture products, have risen over the last decade and now represent an increasing share of the country's merchandise exports. This will diversify the country's export market and lessen its dependence on copper and cobalt mining.

Zambia's main export destinations are Thailand, Japan, South Africa and Egypt. Its main import commodities are petroleum products, metals and fertiliser. Food imports, especially maize, fluctuate from year to year, depending on weather conditions.

Imports are mainly sourced from South Africa, China, US and Tanzania. South Africa's share of Zambian imports continues to grow.

Zambia's trade performance is closely linked to copper and cobalt prices, and the Copperbelt's performance. Investment in the copper-mining sector will require increased imports, such as machinery. The country's export performance is also largely linked to copper, as it is a significant source of foreign exchange. The recent improved performance of non-traditional exports is a positive sign that the economy is diversifying.

The poor transport infrastructure hampers development and investment. Zambia is land-locked and access to ports is important for mining and other exports.

Farmers from Zimbabwe and elsewhere, settling on free land set aside for them by the Zambian authorities should boost agricultural output, particularly for export.

The current account has registered deficits in recent years, despite positive net transfers. Service outflows have also contributed to the current account deficit. Interest payments on official debt have also put pressure on the current account. The current account deficit (including grants) as a percentage of GDP declined from 11.6% in 1998 to 6.2% in 2003. The current account is expected to remain in deficit in the medium term.

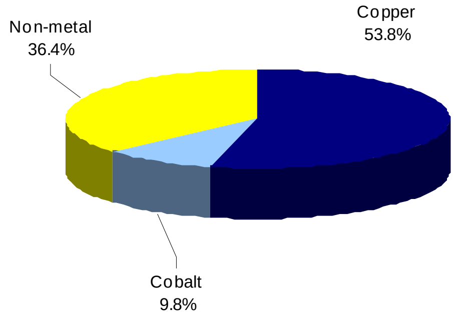
The capital account has been underpinned by inflows mainly from project grants, disbursements and private capital. Official amortizations in the capital account have registered large net outflows, resulting in a deficit in the overall balance as capital account inflows have been insufficient to cover the current account deficit.

The overall balance is financed largely by debt relief (including HIPC and non-HIPC).

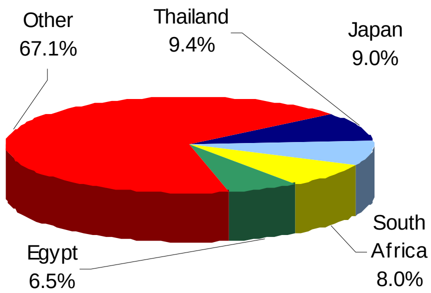
US$ (million)	1998	1999	2000	2001	2002	2003
Exports	816	755	746	884	916	1 117
Imports	-971	-870	-978	-1 253	-1 204	-1 388
Trade balance	-155	-115	-232	-369	-288	-271
Services & transfers	-424	-314	-358	-358	-295	-322
Current account	-579	-429	-590	-727	-583	-593
Capital account	285	452	355	510	324	355
Overall balance	-453	-156	-231	-324	-245	-266

Source: IMF

Composition of exports (2003)

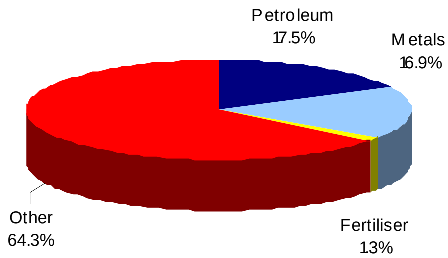


Destination of exports (2002)

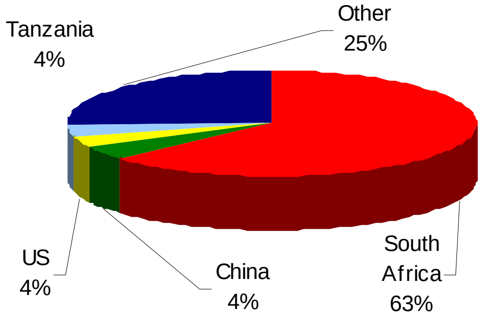


Source: EIU

Composition of imports (2000)



Origin of imports (2002)



Source: EIU

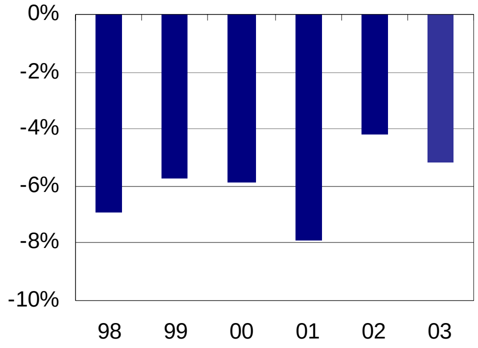
Government finances

Fiscal policy is aimed at sustainable growth and poverty reduction through targeted social spending.

Despite undertakings to reduce the budget deficit, the government has often come under pressure to exceed its expenditure estimates. Although the government has undertaken to reduce its budget deficits, it granted unbudgeted wage increases and a new housing allowance to public servants in 2003. The government is committed to limiting the wage bill to 8% of GDP. The wage bill rose sharply from about 5% of GDP in 2000 to 8% in 2002. Generally, government borrowing to finance the large budget deficits has resulted in high interest rates.

Domestic debt amounted to about 5% of GDP in 2003. In 2004 about 63% of government revenue was expected to come from domestic sources, and the rest from external donors, such as the IMF. This highlights the country's dependence on foreign assistance.

Budget deficit - % of GDP



Source: Bank of Zambia

Economic outlook

Zambia is classified by the World Bank as a severely indebted low-income country. Its per capita GDP was US$380 in 2003.

The growth outlook is relatively positive and 4.5% real GDP growth can be expected in 2005, up from 3.5% in 2004, according to the IMF. Copper production will be boosted with the opening of two new copper mines in the next few years.

However, the boost from the copper sector is a mixed blessing, which has contributed to the relative strength of the kwacha against the US dollar since 2003, as the booming mining sector is making non-traditional exports less price competitive on international markets, thus hindering the much-needed diversification of the economy. A more diversified economy can better cope with external shocks, such as volatile copper prices, as well as internal shocks. The "curse of natural resources" is but one factor contributing to Zambia's fragile economy.

Non-traditional exports, such as agriculture, floriculture and horticulture, should, however, help boost economic performance. In 2002 non-traditional exports grew by almost 11% and accounted for about 35% of export earnings.

The regional drought, which sent food inflation soaring to 35.5% y/y in December 2002, negatively affected many parts of the country and was a setback for agricultural development. However, good rains and the agricultural recovery in late 2003 will boost output and economic growth.

There is considerable scope for the country to develop its tourism and apparel and textile sectors. The tourism sector can expand if recent positive developments, such as the opening of new hotels in Livingstone on the Zambezi River, are sustained. The US African Growth and Opportunity Act (Agoa) provides duty- and quota-free access to the US for locally manufactured textiles and apparel. The country has not made significant use of the act to boost its exports.

A contributor to a positive outlook is the country's eligibility for the Heavily Indebted Poor Country (HIPC) Initiative. Some US$3.8 billion external debt will be cancelled over the next 22 years. After several delays, Zambia is now expected to reach the HIPC completion point in early 2005. Zambia remains highly dependent on foreign aid.

Of concern are the high poverty and unemployment levels. Some 73% of the population lives below the national poverty line. Further hardship is caused by the HIV/Aids infection rate of about 16.5% of the adult population. The pandemic is expected to have a negative impact on growth in the years to come.

Zambian authorities are committed to privatising 281 state-owned enterprises, 257 of which were sold at the beginning of 2003. There is still no consensus about privatisation and the government now appears to be opposed to sales of state-owned firms. Government prefers commercialisation, but this option may discourage investment and be in breach of World Bank and IMF agreements.

The president has taken a strong stance against corruption. Ex-president Chiluba has been accused of graft and corruption and charged, but the litigation has been unsuccessful. President Mwanawasa faces court action relating to the 2001 presidential election. Corruption is a perennial problem in Zambia and is seen as a strong deterrent to investment and growth.

The government has reduced its domestic borrowing and contained its domestic debt. In the 2004 budget, the government undertook to limit domestic debt to 2% of GDP and to eliminate it by 2007.

It is essential that the stagnation in per capita incomes over the past few decades be reversed to help alleviate poverty and hunger. The recent GDP growth record indicates that the economy can perform at growth rates above 5% – as in 1996 and 2003 – which is a key requirement for lifting people out of poverty and improving the standard of living. The country remains vulnerable to external shocks, such as the volatile copper price. The continuing expansion and success of its non-traditional export sector is being held back by a weak infrastructure.

Finally, to achieve higher GDP growth, policy reversals must be avoided, particularly on the fiscal side, as this could jeopardise macroeconomic stability.

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