BANK *Of* ZAMBIA

**BI-ANNUAL SURVEY OF BUSINESS
OPINIONS AND EXPECTATIONS
REPORT**

Disclaimer:
The opinions and expectations presented herein are of the respondents and not of the Bank of Zambia.

NOVEMBER 2016

Executive Summary[1]

Results of the Business Opinion and Expectations Survey conducted in September-October 2016, indicate that economic activity remained relatively subdued and below the historical average during the third quarter 2016, although performance was better than the previous quarter. Respondents were generally pessimistic about activity during the fourth quarter 2016, but anticipate a turnaround in the economy over the next twelve months after the country settles into an IMF program and macroeconomic stability is restored.

During the third quarter 2016, output and capacity utilisation expanded due to the agricultural harvest surplus and the higher volume of services in the tourism and telecommunications sectors. The improvement in supply of electricity and relative exchange rate stability during this period positively impacted manufacturing, retail and service sectors, as average input costs declined. In line with these developments, domestic sales and profitability rose when compared to the first quarter 2016. However, employment levels declined following the suspension of most construction projects, while other companies streamlined their operations to cope with economic conditions.

Respondents anticipate weaker output and capacity utilisation in the fourth quarter 2016, mainly on account of expected higher input and operational costs, following the rise in energy prices after the removal of Government subsidies, prolonged electricity load shedding, high fertiliser prices and lower seasonal supply of agriculture produce. The service sector is also expected to be negatively affected by reduced demand for tourist services during the rainy season. Therefore, most respondents expect a decline in both domestic sales and profitability. Monetary policy is likely to remain tight as the country prepares to adopt an IMF program. Consistent with this, interest rates will continue to be above the historical average, thus constraining availability of credit. Despite slowing down, inflationary pressures are expected to be elevated and above the historical average mainly on account of higher production costs and the expected rise in food prices due to seasonal factors.

Overall Survey Response Patterns*
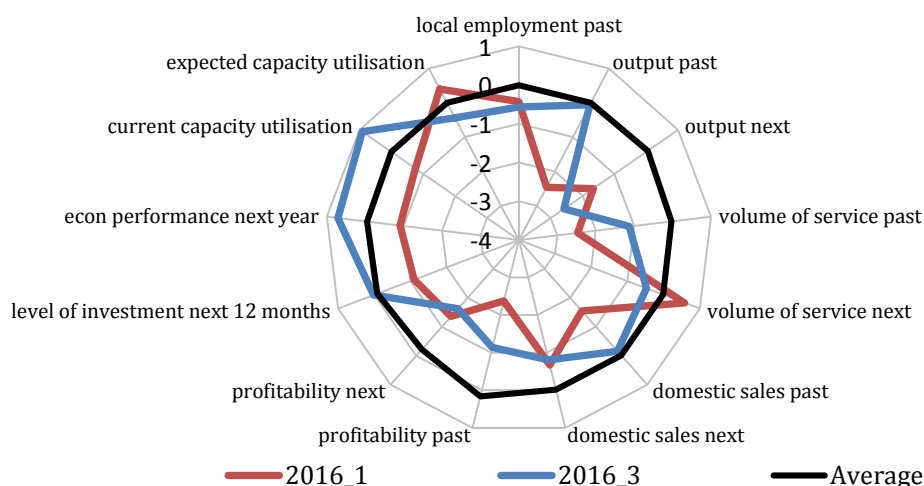
Note: The survey indicators are standardized net balances with mean=0 and standard deviation=1. A value within the black circle entails weaker economic conditions than historical average and a value outside the black line is better than historical average

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[1] This Report presents findings of the Survey of Business Opinions and Expectations conducted during the third quarter of 2016. The results are based on responses from 558 firms covering manufacturing, merchants, services, tourism, agriculture and construction sectors, thus representing a response rate of 89.0%.

Introduction

This Business Opinions and Expectations Survey Report is divided into four sections. The first section presents the response patterns related to economic performance during the third quarter of 2016 and expectations for the fourth quarter, while section II presents opinions and expectations on input costs, wages and selling prices. Section III provides perceptions on monetary policy for the fourth quarter and section IV provides the general conclusion.

I Opinions and Expectations of Economic Activity

The Business opinions survey overall response pattern for the third quarter of 2016, revealed that economic activity improved slightly, but remained below the historical average (see Chart 1). Output, volume of services, domestic sales and profitability were better than the previous quarter. Capacity utilization also rose above the historical average. Economic activity is expected to weaken in the fourth quarter but will rebound in line with the historical average over the next twelve months, after adoption of the IMF program which is anticipated to help restore macroeconomic stability and growth.

Chart 1: The Business Opinions & Expectations Survey Response Patterns*
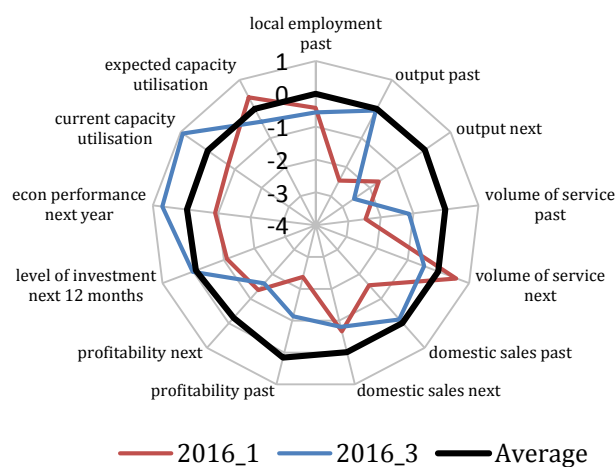
— 2016_1   — 2016_3   — Average

Note: The survey indicators are standardized net balances with mean=0 and standard deviation=1. A value within the black circle entails weaker economic conditions than historical average and a value outside the black line is better than historical average.
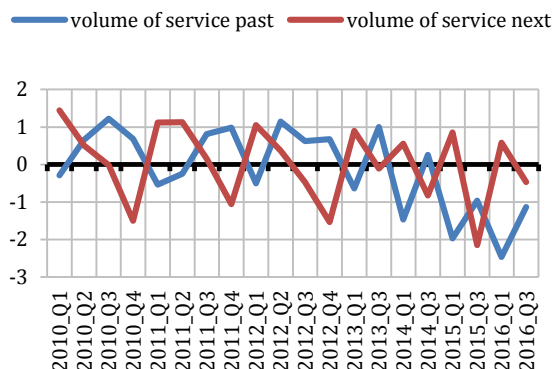
Overall Output improved during the third quarter 2016, (see Chart 2) with a net balance of -3% compared to -36% in the first quarter of 2016. This was mainly on account of the agriculture surplus, reduction in electricity load shedding and stability in the exchange rate, which positively impacted manufacturing and retail sectors, as average input costs declined. Nonetheless, output remained below historical average levels. During the fourth quarter 2016, a decline in output and capacity utilization is anticipated due to higher input and operational costs, following the rise in energy prices after the removal of Government subsidies, prolonged electricity load shedding, high fertiliser prices and lower seasonal supply of agriculture produce (see Chart 2).

Chart 2: Opinion on Output
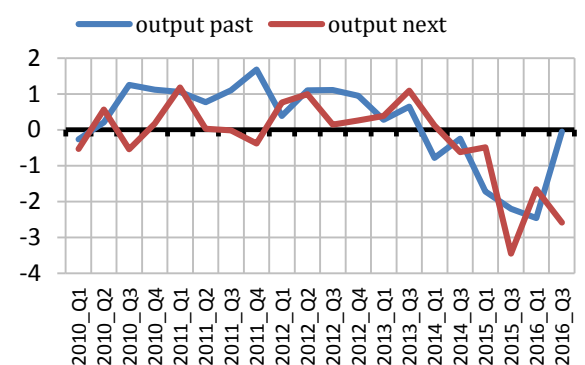
The volume of services rose during the third quarter of 2016, although below the historical average, as reported by the tourism and service sectors, with a net balances of -24.2% against -47.4% in the previous quarter. This increase in services was attributed to a higher number of tourists and subscribers in mobile and telecommunications services. Respondents, however, anticipate the volume of services to decline in the fourth quarter of 2016, largely on account of reduced demand for tourist services during the rainy season and higher operational costs associated with the upward adjustment of fuel prices (see Chart 3).

Chart 3: Volume of Services

Domestic Sales improved during the third quarter 2016, but remained below the historical average, with a net balance of -6% compared with -28.2% in the first quarter of 2016. The rise in sales was particularly credited to higher output and activity in the manufacturing, retail, agriculture and service sectors.

Chart 4: Domestic Sales
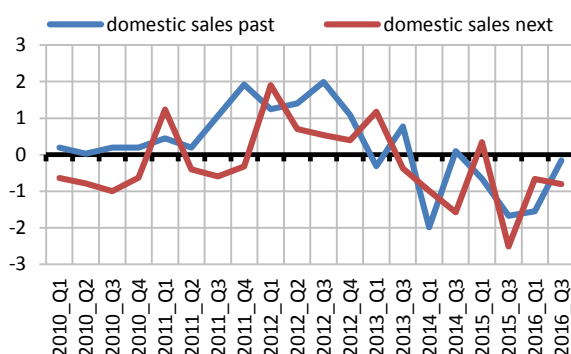
However, rising costs of production, reduced supply of agricultural produce and lower demand are expected to negatively affect output and result in a decline in domestic sales during the fourth quarter (see Chart 4).

Credit conditions continued to be tight in the third quarter of 2016, with a net balance of 73.2% compared to 68.7% in the first quarter of 2016 (see Chart 6). The high interest rates were attributed to tight monetary conditions, high Government

borrowing and high default risk. Consistent with this, 72.6% of respondents utilised retained earnings for investment finance in the third quarter against 67.1% in the first quarter. In terms of working capital, 73.4% of respondents utilized retained earnings in the third quarter against 75.9% in the first quarter.

Chart 6: Credit conditions and lending rates
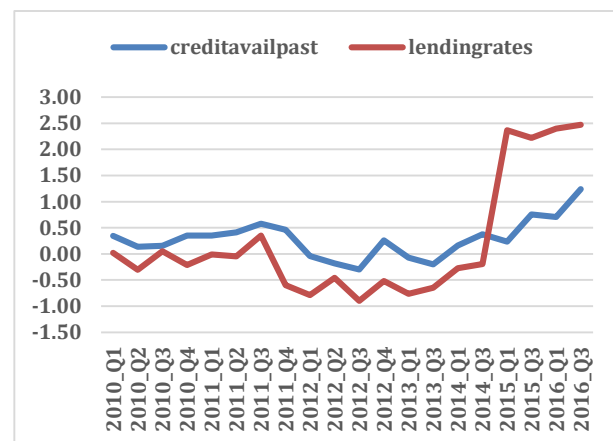
Investment spending continued to be largely driven by firms' retained earnings due to continued tight credit conditions and higher lending rates. Over the next 12 months, respondents anticipate an improvement in economic conditions after adoption of the IMF program which is anticipated to help restore macroeconomic stability and growth. This is expected to spur investment activities to historical average levels (see Chart 5).

Chart 5: Investment plans in next 12 months
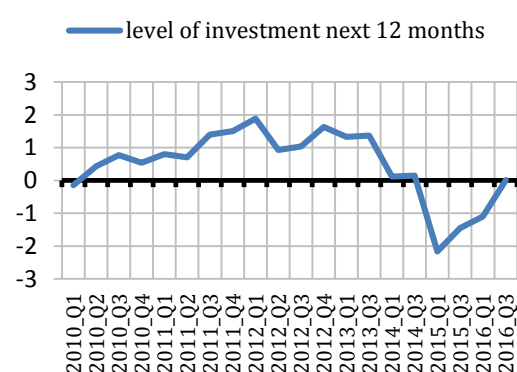
II   Evolution of Costs, Wages and Prices

The survey results indicate that **average input costs** declined during the third quarter of 2016, with a net balance of 26.3% compared with 36.2% in the first quarter of 2016 (see Chart 7). This was mainly attributed to exchange rate stability, increased supply of agricultural produce and reduced electricity load shedding.

Chart 7: Evolution of average input costs
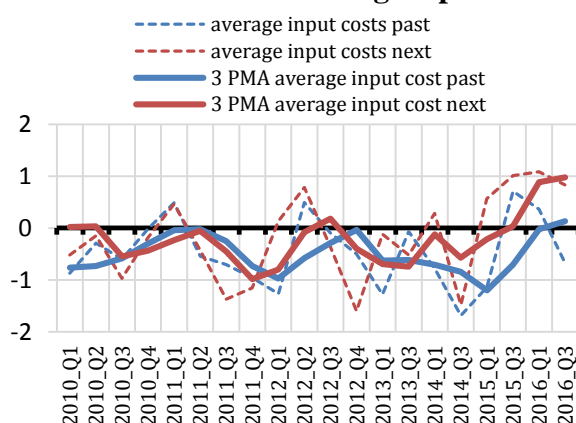
However, input costs are expected to rise above the historical average during the fourth quarter (see Chart 7). Respondents expect average input costs to increase due to higher energy prices, continued power deficits, high fertiliser prices, low supply of agricultural produce and the slight depreciation of the Kwacha exchange rate against the US dollar.

Wages declined in the third quarter of 2016 and remained below the historical average, mainly due to the suspension in construction projects and employment cuts in various sectors undertaken to cope with economic condition (see Chart 8). Accordingly, the net balance fell to 7.3% from 12.2% in the first quarter of 2016. Wages are expected to fall and remain below the historical average during the fourth quarter in line with the expected deterioration in economic activity.

Chart 8: Evolution of wages
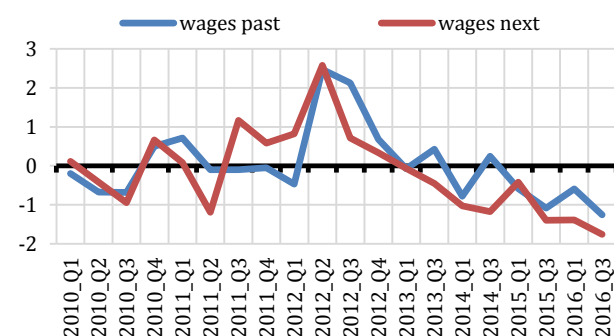
Average selling prices continued to decrease during the third quarter of 2016, but remained above the historical average. The net balance fell to 8.6% from 21.4% in the first quarter of 2016. The decline in average selling prices was largely attributed to lower input costs on account of exchange rate stability, increased supply of agricultural produce and reduced electricity load shedding. Companies also felt there was stiff competition and low demand therefore they were reluctant to raise prices significantly and instead offered sales to clear goods.

**Chart 9: Evolution of average selling prices**
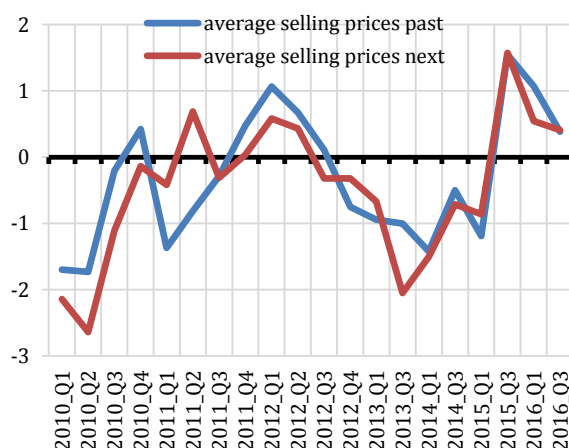
During the fourth quarter, average selling prices are expected to rise and remain above the historical average owing to an anticipated increase of input and production costs (see Chart 9).

## III   Perceptions and Expectations on Monetary Policy

Survey respondents expect **monetary policy** to remain tight during the fourth quarter 2016, as the country prepares to adopt an IMF program.

Despite slowing down, **inflationary pressures** are likely to be elevated and above the historical average during the fourth quarter 2016 (see Chart 10). This is mainly on account of past prices, higher energy prices following the removal of Government subsidies and the increase in prices of food commodities due to seasonal factors.

**Chart 10: Inflation expectations for the next quarter**
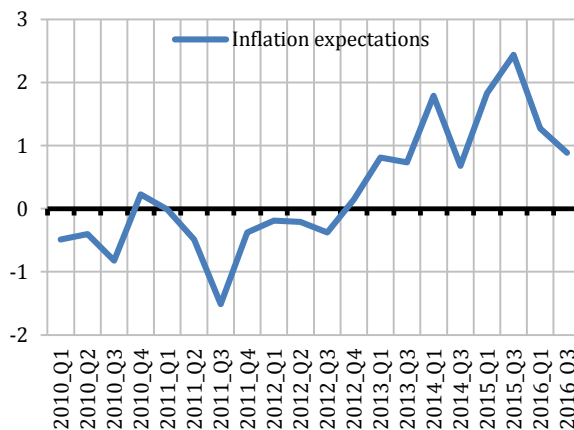
Chart 11: Inflation expectations driven more by past prices, exchange rate pass through effects and cost of production
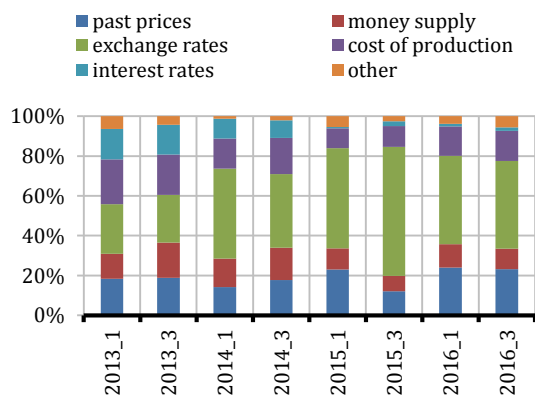
**Interest rates** are expected to remain high and above the historical average in the fourth quarter 2016, owing to continued tight monetary policy, elevated inflation rate, and high default risk and profit motive by commercial banks (see Chart 12).

Chart 12: Interest rate expectations next quarter
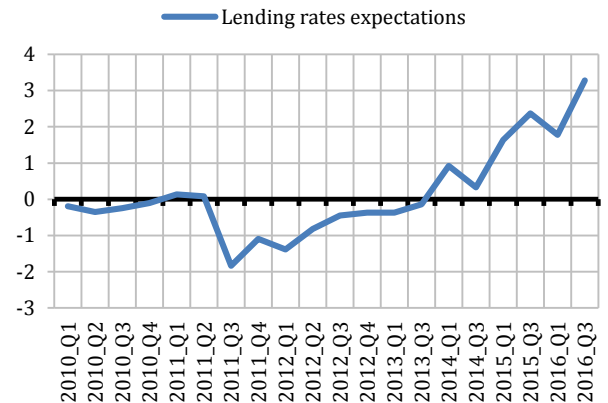
Respondents indicated that **credit conditions** would tighten further in the fourth quarter of 2016, owing to increased Government borrowing, high interest rates, tight liquidity and economic uncertainty in the country (see Chart 13).

**Chart 13: Credit expectations for the next quarter**
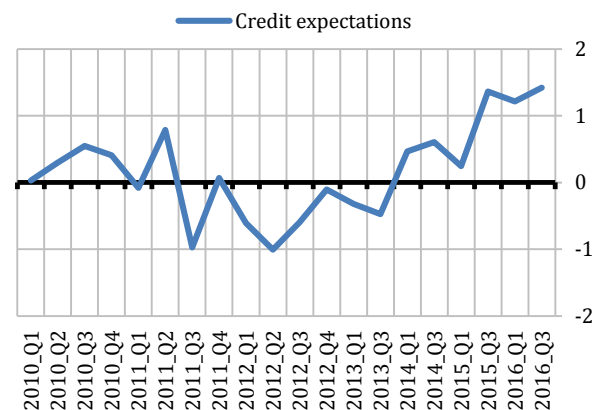
The Kwacha exchange rate against the US dollar is anticipated to remain weak in the fourth quarter 2016, mainly due to reduced foreign exchange supply as a result of low export earnings, as well as the expected rise in demand for foreign currency due to the festive season (see Chart 14). However, the

tight monetary policy stance is likely to moderate the rate of depreciation.

Chart 14: Exchange rate expectations next quarter
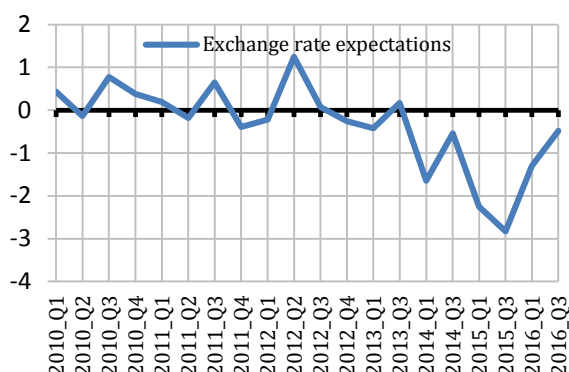
Chart 15: Generally the survey indicated tighter conditions with lower inflation expectations
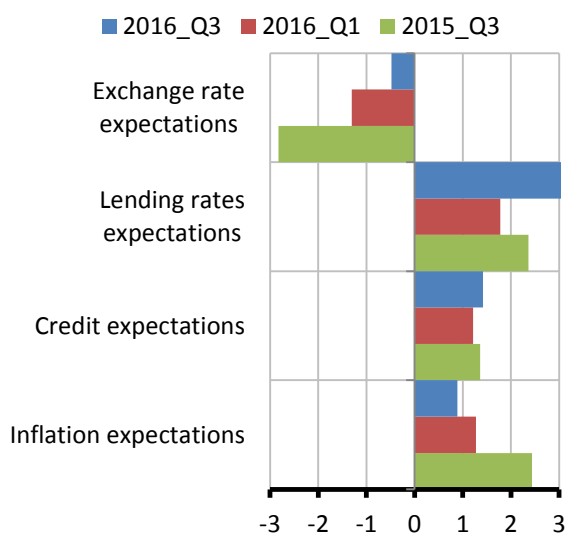
IV   Conclusion

According to the results of the Business Opinion Survey conducted in September – October 2016, economic activity remained weak and below the historical average during the third quarter, although performance was better than the previous quarter. Output and capacity utilisation increased largely due to the agriculture harvest surplus which boosted manufacturing (food processing) and higher activity in the tourism and telecommunications sectors. The

improvement in supply of electricity and relative exchange rate stability positively impacted manufacturing, retail and service sectors as average input costs declined. In line with these developments, domestic sales and profitability were higher when compared to the first quarter 2016. However, employment levels declined following the suspension of most construction projects, while other companies streamlined their operations to cope with economic conditions.

Respondents were pessimistic about performance in the fourth quarter 2016. Weaker output and capacity utilisation is anticipated mainly on account of higher input and operational costs following the rise in energy prices after the removal of Government subsidies, prolonged electricity load shedding, high fertiliser prices and lower seasonal supply of agriculture produce. The service sector is also expected to be negatively affected by reduced demand for tourist activity during the rainy season. Therefore, most respondents expect lower domestic sales and profitability during the fourth quarter 2016.

Monetary policy is expected to remain tight during the fourth quarter 2016, as the country prepares to adopt an IMF program. Consistent with this, interest rates are likely to be high and above the historical average, thus constraining availability of credit. Despite slowing down, inflationary pressures are expected to be elevated and above the historical average mainly on account of the higher input and production costs as well as the expected rise in food prices due to seasonal factors.

A turnaround in the economy is however anticipated over the next twelve months, after the country settles into an IMF program and macroeconomic stability gets restored.

Appendix: Background on the BSBOE

Business surveys are useful indicators of current and future economic activity and assist in the formulation of decisions today that impact on future economic activity. The Bi-Annual Survey of Business Opinion and Expectations (BSBOE) undertaken by the Bank of Zambia is designed as a supplementary tool to provide information on the business community's opinion and expectations about the current and future direction of the economy for macroeconomic analysis. Business opinions and expectations provide a guide to likely developments because of the powerful role expectations play in shaping economic behavior.

This Report is based on the results of the BSBOE conducted in September - October 2016. Out of the 627 questionnaires distributed, 558 firms responded representing a response rate of 89.0%.

Survey Methodology

Data collection for the Bi-Annual Survey of Business Opinion and Expectations is done by means of a questionnaire which is designed to capture information on economic performance, sources of finance, and operational constraints for the current quarter, as well as expectations for the following quarter and the consecutive twelve months. The questionnaire is administered to a sample of respondents in manufacturing, trading, tourism, services, construction and agriculture sectors. The sectors covered were selected on the basis of their contribution to GDP.

The Survey area covers the Copperbelt province (Luanshya, Ndola, Kitwe and Chingola), Southern (Mazabuka, Choma, Kalomo and Livingstone), Central (Chisamba, Kabwe and Mukushi Farming Block), Eastern (Petauke, Chipata and Mfuwe), North-Western (Kasempa and Solwezi), Northern (Kasama, Mbala and Mpulungu), Muchinga (Mpika, Chinsali, Isoka and Nakonde), Luapula (Samfya and Mansa) and Lusaka (Lusaka City).

Data analysis is done using the Net Balance Statistic (N) where qualitative responses are converted into quantitative measures using the following equation:

$$N = \frac{U - D}{U + D + S} * 100$$

Where U, D and S represent the number of respondents indicating Up, Down and Same, respectively.

The Net Balance Statistic method has the advantage of detecting the directional changes in performance/expectations of respondents in such surveys. The method indicates the predominance of either an improvement or deterioration in a variable. A positive net percentage indicates that more respondents reported/expected an increase/improvement/tightening and a negative net percentage means a decrease /deterioration/loosening, depending on the variable under consideration. This method has been used widely in the analysis of survey data.