Monetary Policy Report

August 2024

Bank of Zambia

Bank of Zambia

REGISTERED OFFICES

Head Office
Bank of Zambia, Bank Square, Cairo Road
P. O. Box 30080, Lusaka, 10101, Zambia
Tel: (+260) 211 399300
E-mail: info@boz.zm
Website: www.boz.zm

Regional Office
Bank of Zambia, Buteko Avenue,
P. O. Box 71511, Ndola, Zambia
Tel: (+260) 212 399600
E-mail: info@boz.zm
Website: www.boz.zm

Bank *of* Zambia

This *Monetary Policy Report* (MPR) is made pursuant to Section 29(2) of the Bank of Zambia Act, 2022.

This MPR was approved by the Monetary Policy Committee on August 13, 2024 and contains information available as of August 7, 2024.

Composition of the Monetary Policy Committee constituted pursuant to Section 28(1) of the Bank of Zambia Act, 2022:

1. Governor – Chairperson (Dr Denny H. Kalyalya);
2. Deputy Governor – Vice Chairperson (Dr Francis Chipimo);
3. Deputy Governor responsible for administration (Mrs Rekha C. Mhango);
4. Bank of Zambia senior management staff responsible for research (Dr Jonathan M. Chipili);
5. Bank of Zambia senior management staff responsible for monetary policy operations (Mr Isaac Muhanga);
6. Bank of Zambia senior management staff responsible for financial stability (Mr Goodson Kataya);
7. External Member appointed by the Bank of Zambia Board (Professor Munacinga C. Simatele); and
8. External Member appointed by the Bank of Zambia Board (Mr Alex Chakufyali).

TABLE OF CONTENTS

Preface

In line with Article 213(2) (b) of the Constitution of Zambia (Amendment) Act, 2016, the Bank of Zambia determines monetary policy. The nine-member Monetary Policy Committee (MPC) formulates monetary policy to achieve and maintain price stability in line with section 27(2) of the Bank of Zambia Act, 2022. The Committee meets every second month of the quarter in February, May, August and November to decide on the monetary policy stance. In doing so, the Committee reviews macroeconomic developments in the previous quarter and prospects for inflation over the forecast horizon currently eight quarters ahead. This information is published in the Monetary Policy Report (MPR) to strengthen transparency and accountability of the MPC.

The stance of monetary policy is reflected in changes to the Policy Rate introduced in April 2012. This is guided by inflation outcomes, forecasts from inflation models and identified risks, including those associated with growth and financial stability. The MPC relies on a forward-looking monetary policy framework anchored on the Policy Rate as a key signal for the policy stance. The Policy Rate also provides a credible and stable anchor to financial market participants in setting their own interest rates as well as guides the Bank in its implementation of monetary policy. The Bank may use non-price (quantitative) monetary policy instruments, such as, the statutory reserve ratio in its conduct of monetary policy.

The Bank influences the overnight interbank rate (operating target) which in turn impacts on inflation through changes in market interest rates transmitted via the expectations, exchange rate and/or credit channels. To effectively manage the overnight interbank rate, the Bank conducts open market operations to either supply or withdraw liquidity from the banking system to keep the overnight interbank rate within the corridor of +/- 1 percentage points around the Policy Rate. There are, however, exceptional circumstances where the interbank rate may be allowed to drift outside the Policy Rate Corridor.

The monetary policy decision is publicly announced in the Monetary Policy Committee Statement issued via a press release a day after each quarterly MPC meeting. The MPR is published soon after the MPC Meeting. This is intended to provide detailed information used by the MPC in arriving at a Policy Rate decision.

Executive Summary

The Monetary Policy Committee, at its August 12-13, 2024 Meeting, decided to maintain the Monetary Policy Rate at 13.5 percent. Notwithstanding actual and projected inflation remaining elevated relative to the 6-8 percent target band, the Committee judged that the current monetary policy stance was appropriate. The decision took into account the impact of the drought as well as that of the past successive increases in the Policy Rate, upward adjustments in the statutory reserve ratio, and the recent reforms in the foreign exchange market.

In taking the decision to maintain the Policy Rate as opposed to raising it, the Committee also took into account the impact on the stability of the financial system and growth, particularly in 2024, in the wake of the drought. The continued implementation of fiscal consolidation measures, including the completion of external debt restructuring and structural reforms, remains critical to lowering inflation, maintaining financial stability, and creating an environment that promotes growth and resilience of the economy against shocks.

Inflationary pressures persisted in the second quarter of 2024 resulting in inflation rising to an average of 14.6 percent from 13.5 percent in the first quarter. The persistent depreciation of the Kwacha against major currencies, as well as rising prices of food (maize grain, maize products, and vegetables) and energy, particularly fuel, due to constrained supply continued to drive inflation in the second quarter. Inflation is projected to remain above the target band throughout the forecast horizon despite moderating in 2025 and 2026. The aforementioned factors remain key upside risks to the inflation outlook, exacerbated by extended hours of electricity load management, as well as continued geopolitical conflicts and tight global financial conditions.

Credit to Government reduced in the second quarter of 2024 as money market liquidity conditions remained broadly tight. However, lending to the private sector increased. The expansion in lending to the private sector underpinned the growth in credit and money supply.

Preliminary estimates indicate that revenue was broadly in line with the target despite lower tax collections from the mining sector. However, Government spending was lower than planned mainly due to constrained domestic financing occasioned by tight liquidity conditions.

The *current account* balance turned positive in the second quarter as net exports expanded and the secondary income rose. A favourable *current account* is projected for the 2024-2026 period, largely reflecting anticipated retained earnings by foreign owned companies to mitigate increased operating costs due to the impact of loadshedding, particularly in 2024.

Real GDP is estimated to have slowed down further in the second quarter of 2024 to 2.0 percent from 2.2 percent in the first quarter. This was mainly on account of reduced retail sales and tourist arrivals as well as contraction in electricity generation. The growth projection for 2024 remains broadly unchanged at 2.3 percent. Real GDP growth is expected to rebound in 2025 as mining and agriculture sectors recover.


BANK OF

1. Macroeconomic Outlook

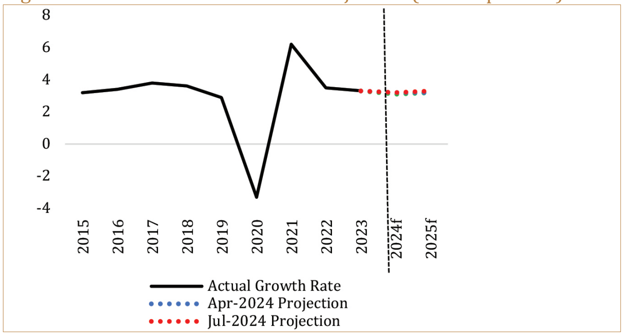
- *Global growth to expand in 2024 on better growth prospects for China supported by stimulus measures, robust exports and private consumption.*
- *Copper prices to rise on strong demand for green energy, upgrade of power grids and military spending as well as anticipated tight global supply disruptions due to geopolitical tensions in the Middle East and Russia-Ukraine war; OPEC+ supply cuts and high global demand to support crude oil prices.*
- *Current account to remain favourable over the 2024-25 period as foreign companies increase retained earnings to mitigate high operating costs induced by load shedding.*
- *Domestic growth for 2024 broadly unchanged at 2.3 percent, but a strong rebound projected in 2025 on expected mining and agriculture sector recovery.*
- *Cash fiscal deficit to temporarily widen in 2024 to accommodate the impact of the drought, but projected to narrow in the medium-term in line with Government's fiscal consolidation programme.*
- *Inflation projected to remain above the 6-8 percent target band throughout the forecast horizon.*

1.1 External Sector Outlook

... global growth to remain broadly stable

Global growth projection for 2024 is unchanged at 3.2 percent[1] (Figure 1). However, the projection for 2025 has been upgraded by 0.1 percentage points to 3.3 percent.

Figure 1: Global Real GDP Growth Projection (annual percent)



Source: IMF WEO, July 2024; Bank of Zambia Compilations

The adjustment to the 2025 growth forecast is mostly attributed to the revision of China's real GDP growth by 0.4 percentage points for both 2024 and 2025 by the IMF. This was influenced by strong first quarter performance on account of stimulus measures[2], robust exports, rebound in manufacturing activity and private consumption.

Consistent with the *May 2024 Monetary Policy Report*, risks to global growth remain broadly balanced, but two short-term downside risks have become more pronounced. These are rising trade tensions and geoeconomic fragmentation that could trigger retaliation and segment the global economy into blocs. This could result in trade restrictions and reduced foreign direct investment.

Easing momentum in global disinflation due to sticky services inflation has raised the likelihood of interest rates staying higher-for-longer to curb inflation. This is likely to strengthen the US dollar and keep borrowing costs elevated with negative cascading effects on emerging market and developing economies through capital outflows and weaker currencies.

On the upside, a faster-than-anticipated decline in global inflation could prompt quicker-than-anticipated easing of monetary policies by central banks in major economies. This, coupled with the rapid growth in artificial intelligence (AI) and increased government spending associated with general elections[3] in some countries, could support growth.

... expansion in economic activity in major trading partner countries to be sustained

Projections based on preliminary data indicate that real GDP in Zambia's major trading partner countries will continue to expand in 2024 and 2025.

[1] IMF WEO update, July 2024.
[2] In the first quarter, the People's Bank of China reduced the required reserve ratio by 50 basis points to enhance liquidity in the banking system and provide support to the struggling property sector and the wider economy.
[3] https://www.forbes.com/sites/siladityaray/2024/01/03/2024-is-the-biggest-election-year-in-history-here-are-the-countries-going-to-the-polls-this-year/?sh=47afd90565f9

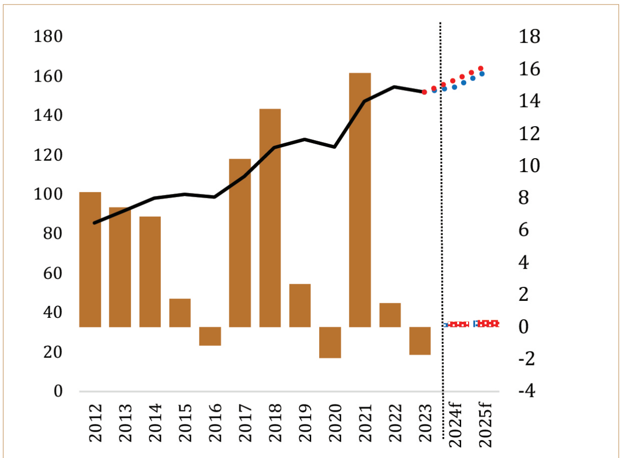
This is reflected in a higher Export-Weighted GDP-9 Index[4] than assumed in the *May 2024 Monetary Policy Report* (Table 1 and Figure 2).

Table 1: GDP-9 Index and Country Contributions[5], 2022 – 25

	Weight	2022	2023p	2024f	2025f
GDP-9 Index (percent change) – Aug 2024		1.81	1.69	4.02	4.27
GDP-9 Index (percent change) –May2024		2.13	0.64	3.69	3.85
Country Contributions to the Change in GDP-9 Index					
China	0.49	0.78	0.76	1.78	1.89
DRC	0.30	0.42	0.43	1.00	1.05
South Africa	0.12	0.27	0.24	0.58	0.62
Singapore	0.00	0.13	0.09	0.23	0.25
UK	0.07	0.07	0.08	0.18	0.19
UAE	0.00	0.05	- 0.03	0.08	0.09
Tanzania	0.00	0.03	0.03	0.07	0.07
Malawi	0.02	0.04	0.03	0.06	0.07
Hong Kong	0.00	0.02	0.02	0.04	0.04

Source: Bank of Zambia Staff Calculations
DRC = Democratic Republic of the Congo, UK = United Kingdom, UAE = United Arab Emirates
p = preliminary, f = forecast

Figure 2: GDP-9 Index



Source: Bank of Zambia

The optimistic outlook is based on upgraded growth for China (2024 and 2025) and the United Kingdom (2024) as shown in Table 2.

Table 2: Trading Partner Growth Rates (percent), 2022-2025

	Weight	2022	2023	2024	2025
China	0.5	3.0	5.2	5.0	4.5
DRC	0.3	8.8	6.1	4.7	5.7
South Africa	0.1	1.9	0.7	0.9	1.2
Singapore	0.0	3.8	1.1	2.1	2.3
UK	0.1	4.3	0.1	0.7	1.5
UAE	0.0	7.9	3.4	3.5	4.2
Tanzania	0.0	4.7	5.0	5.5	6.0
Malawi	0.0	0.8	1.6	3.3	3.8
Hong Kong	0.0	-3.7	3.2	2.9	2.7

Source: IMF WEO, July 2024 and Bank of Zambia Compilations

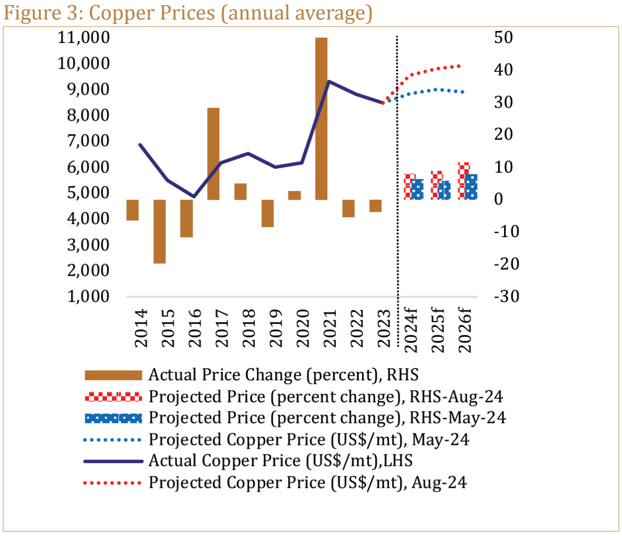
As discussed earlier, the IMF upgraded the growth forecast for China for both 2024 and 2025. In the case of the UK, the upward revision to the 2024 growth forecast[6] reflects declining inflation, which is expected to boost consumer spending and investment as borrowing costs ease.

The risks to the growth outlook remain skewed to the downside as reported in May. They include higher borrowing costs, persistent weakness in the property sector in China, potential supply-chain disruptions due to the escalation of conflict in the Middle East, and occurrence of extreme weather conditions like El Niño.

... copper and crude oil prices to remain buoyant

Copper prices are projected to rise further in 2024, 2025, and 2026, reaching US$9,551.00 per metric tonne (mt), US$9,806.50/mt and US$9,930.42/mt, respectively (Figure 3). This respectively represents an increase of 8.1 percent, 8.9 percent and 11.5 percent over the May projection.

Figure 3: Copper Prices (annual average)



Source: IMF, World Bank, Bloomberg, Reuters Futures, and Bank of Zambia Compilation projection.

[4]The GDP-9 Index is used to assess external demand conditions in Zambia's key trading partner countries. It is computed as a Fisher Ideal Index and constructed based on nine countries: China, DRC, Singapore, South Africa, United Arab Emirates, United Kingdom, Hong Kong, Malawi and Tanzania. In 2020, these countries accounted for 86.9 percent of Zambia's exports, excluding Switzerland—a predominantly invoicing country for copper exports.
[5]The data reported in the *May 2024 Monetary Policy Report* has been significantly revised to reflect recent GDP numbers.

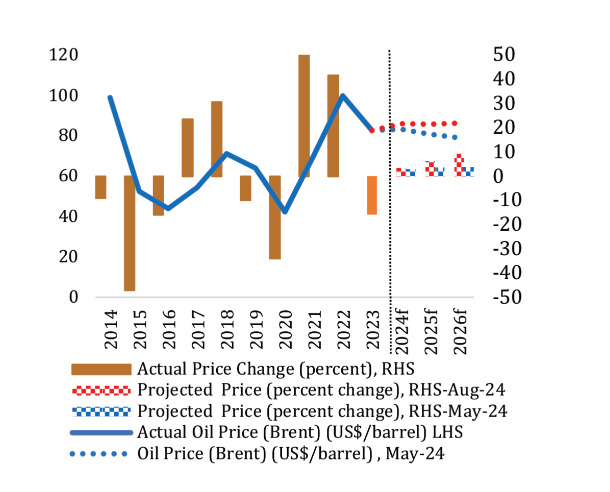
[6]The IMF raised the 2024 growth forecast by 0.2 percentage points to 0.7 percent from the April WEO due to falling inflation: https://www.imf.org/en/News/Articles/2024/05/20/mcs052124-united-kingdom-staff-concluding-statement-of-the-2024-article-iv-mission

The projected rise in copper prices[7] is underpinned by strong demand for green energy transition, particularly in the manufacture of renewable energy, electric vehicles (EVs) and associated infrastructure; upgrade of power grids; and rising military spending[8]. In addition, the rapid growth of artificial intellegence (AI) computing systems and associated data centres[9], along with the electrification of public road transport systems in advanced economies, are expected to drive copper prices. Expectations of a supply deficit[10], interest rate cut by the Federal Reserve and the deployment of additional stimulus measures[11] in China will support copper prices.

Copper prices could rally further if some key upside risks reported in May materialise. These include more disruptions to global supply, a faster-than-expected decline in interest rates resulting in a weaker US dollar, recovery of the property sector in China, and stronger-than-anticipated global economic growth.

Crude oil prices are also projected to increase further in 2024, 2025 and 2026 by 3.9 percent, 6.4 percent and 9.2 percent to US$86.00 per barrel, US$85.80 per barrel, and US$86.30 per barrel, respectively relative to the May projection (Figure 4).

Figure 4: Crude Oil Prices (annual average)



Source: World Bank, Bloomberg, Reuters Futures and Bank of Zambia Compilation

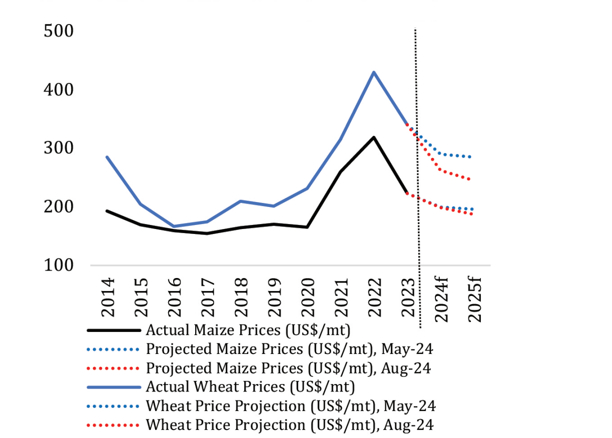
The increase in crude oil prices is largely on account of the anticipated tight global supply[12] induced by the extension of OPEC+ production cuts[13], as well as supply disruptions due to persistent geopolitical tensions in the Middle East and the Russia-Ukraine war. In addition, expectations of easing monetary policy by the Federal Reserve and growth of the petrochemical industry[14] will boost global oil consumption and bolster prices.

The major upside risks to the crude oil price projection are the same as reported in May. They include prospects of reduced US oil production, deeper-than-anticipated supply cuts by OPEC+, elevated interest rates, extreme weather conditions and further escalation of geopolitical tensions in the Middle East and the Russia-Ukraine war. This could potentially disrupt global oil supply-chains, trigger volatility in crude oil supply and lead to higher prices.

... maize and wheat prices on a downward trend

Maize prices are projected to decline to US$198.62 per metric tonne and US$187.20 per metric tonne in 2024 and 2025 from US$200.00 per metric tonne and US$196.00 per metric tonne as indicated in the *May 2024 Monetary Policy Report* (Figure 5). Over the same period, wheat prices are forecast to respectively decline to US$262.15 per metric tonne and US$245.02 per metric tonne from US$290.00 per metric tonne and US$285.00 per metric assumed in May (Figure 5).

Figure 5: Maize and Wheat Prices (annual average)



Source: Organisation of Economic Co-operation and Development (OECD)- Food and Agriculture Organization of the United Nations (FAO) Outlook, 2024-2033

The sustained decline in maize and wheat prices is

[7]Copper prices are averages of Bloomberg, FocusEconomics, Refinitiv, World Bank and IMF projections
[8]https://finance.yahoo.com/news/copper-oil-prices-could-soar-193948923.html
[9]AI could potentially add about 1 million tonnes of copper demand per year by 2030: https://www.mining.com/ai-could-drive-1mtpa-increase-in-copper-demand-trafigura-chief-economist-says/
[10]Copper supply is expected to flip into a deficit as demand outweighs supply since copper mining is extremely capital intensive, high risk and it takes longer to bring greenfield projects online than brownfield exploration. Operational challenges relating to labour disputes, mine closures, extreme weather conditions, compounded by declining ore quality, and reserves exhaustion (aging assets) will weigh on production: https://www.cruxinvestor.com/posts/copper-miners-poised-to-benefit-from-surging-demand-constrained-supply.
[11]https://www.hindustantimes.com/business/china-cuts-1-year-benchmark-rate-to-boost-economy-as-world-markets-languish-101721881140865.html

[12]The US Energy Information Administration (EIA) projects a global oil market supply deficit in 2025:https://www.reuters.com/markets/commodities/global-oil-market-seen-supply-deficit-next-year-eia-says-2024-07-09/
[13]https://edition.cnn.com/2024/06/02/business/opec-oil-production-cuts-2025/index.html
https://www.eia.gov/outlooks/steo/
[14]The petrochemical industry, especially in China, consumes a large amount of crude oil in the production of fertilisers, plastic polyester and other lightweight commodities: https://oilprice.com/Energy/Energy-General/Petrochemicals-Are-Driving-90-Of-Chinas-Oil-Demand-Growth.html

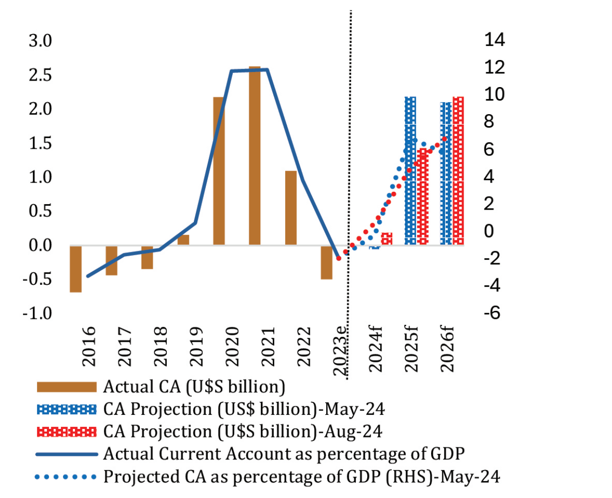
based on higher global supply[15] projection amid weak demand. The enactment of China's food security law[16], aimed at increasing domestic grain production to reduce dependence on imports, is expected to dampen maize and wheat prices.

The key upside risks to the maize and wheat price projection remain the same as reported in May. These are lower production induced by extreme weather conditions like El Niño, intensification of trade restrictions, rising geopolitical tensions, as well as supply disruptions due to attacks on cargo ships in the Red Sea leading to higher freight costs and extended delivery times. Consequently, prices of inputs like fertilizers and oil are likely to increase and result in higher maize and wheat prices.

... current account broadly favourable

A *current account* surplus of US$0.2 billion (0.7 percent of GDP) is now projected for 2024 compared to a deficit of US$0.1 billion (0.2 percent of GDP) reported in May (Figure 6).

Figure 6: Current Account



Source: Bank of Zambia
Note: CA=Current Account

The shift in the *current account* is mostly influenced by the anticipated increase in retained earnings by foreign owned companies on account of increased operating costs to mitigate the impact of loadshedding.

In 2025, the *current account* surplus is expected to moderate to US$1.4 billion (6.9 percent of GDP) from US$2.2 billion projected in May due to relatively lower copper prices[17]. Nonetheless, the current *account* surplus projection of US$2.2 billion (5.7 percent of GDP) for 2026 remains virtually unchanged.

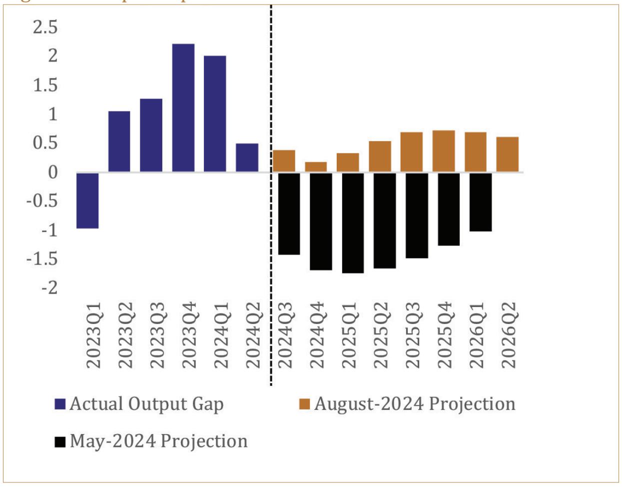
1.2 Prospects for Domestic Economic Growth

... remain favourable over the medium-term

The current real GDP growth projection by the Bank of Zambia for the 2024–2026 period is slightly higher than reported in May. Real GDP growth is now projected to be 3.0 percent, 4.4 percent and 4.7 percent in 2024, 2025 and 2026, respectively (Table 3 and Figure 8). This is based on the anticipated favourable external sector performance (refer to the *current account* projection in section 1.1).

In view of the above, the output gap is now projected to be positive over the forecast horizon (Figure 7)[18]. This is a reversal from the May forecast.

Figure 7: Output Gap



Source: Bank of Zambia

The Ministry of Finance and National Planning (MoFNP) and the International Monetary Fund (IMF) growth projections have not changed from the May 2024 Monetary Policy Report, of 2.3 percent for 2024, 6.6 percent for 2025 and 5.9 percent for 2026 (Table 3 and Figures 8 and 9).

However, FocusEconomics has now revised the growth projection for 2024 downward to 3.3 percent from 4.2 percent to take account of the impact of the drought (Table 3 and Figure 8). Real GDP growth projection for 2025 remains unchanged at 4.6 percent while

[15]The International Grains Council (IGC) projects global grain production for 2024/25 to increase: https://www.world-grain.com/articles/20235-igc-revises-wheat-corn-production-higher
https://thedocs.worldbank.org/en/doc/40ebbf38f5a6b68b-fc11e5273e1405d4-0090012022/related/Food-Security-Update-CVI-May-30-2024.pdf
[16]https://www.tridge.com/news/china-food-security-law-comes-into-force-aim-paouvq

[17]Copper prices have been revised downward to US$10,032.00 per metric tonne from US$10,329.00 per metric tonne projected in May.
[18]The Bank of Zambia real GDP growth and output gap estimates are based on an overall assessment of domestic economic conditions using the Quarterly Projection Model (refer to section 1.4 for details of the model).

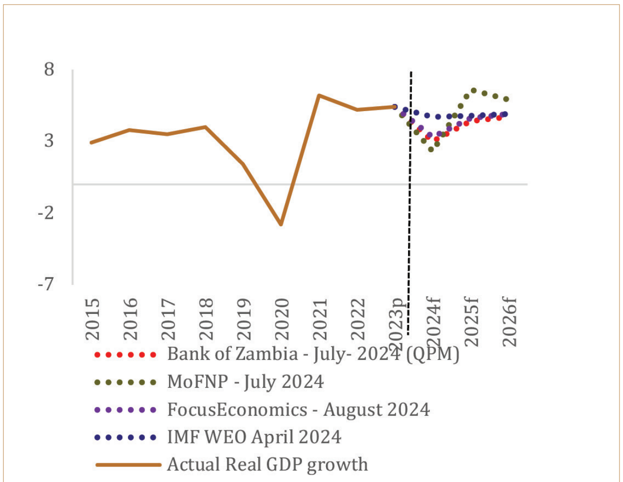
the 2026 forecast has been adjusted slightly upward to 4.9 percent to reflect the expected recovery of the agriculture and energy sectors.

Table 3: Annual Real GDP Growth Projections

	2023p	2024p	2025f	2026f
Bank of Zambia QPM				
BoZ July 2024	5.4	3.0	4.4	4.7
BoZ May 2024	5.4	2.9	4.3	4.5
Ministry of Finance and National Planning				
MoFNP July 2024	5.4	2.3	6.6	5.9
MoFNP April 2024	5.4	2.3	6.6	5.9
International Monetary Fund				
IMF June 2024	5.4	2.3	6.6	5.9
IMF May 2024	5.4	2.3	6.6	5.9
IMF WEO April 2024	4.3	4.7	4.8	4.8
IMF WEO October 2023	3.6	4.3	4.5	4.7
FocusEconomics				
FocusEconomics August 2024	5.8	3.3	4.6	4.9
FocusEconomics May 2024	5.8	4.2	4.6	4.8

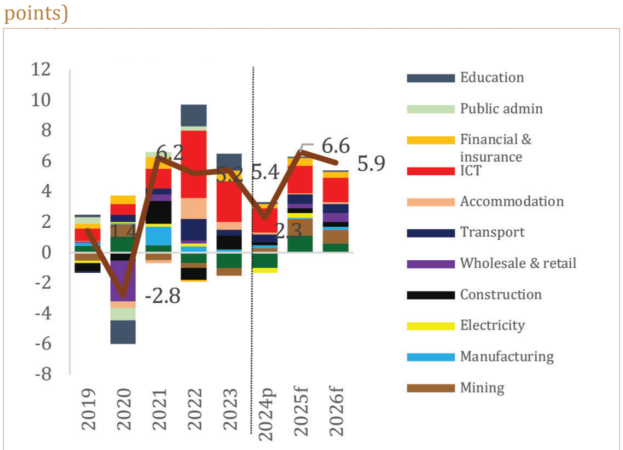
Source: Bank of Zambia, Ministry of Finance and National Planning, IMF WEO, FocusEconomics.
Note: p=preliminary estimate, f=forecast.

Figure 8: Annual Real GDP Growth (percent)



Source: Zambia Statistics Agency, Bank of Zambia (BoZ), Ministry of Finance and National Planning (MoFNP), IMF, Focus Economics.
Note: p=preliminary, f=forecast.

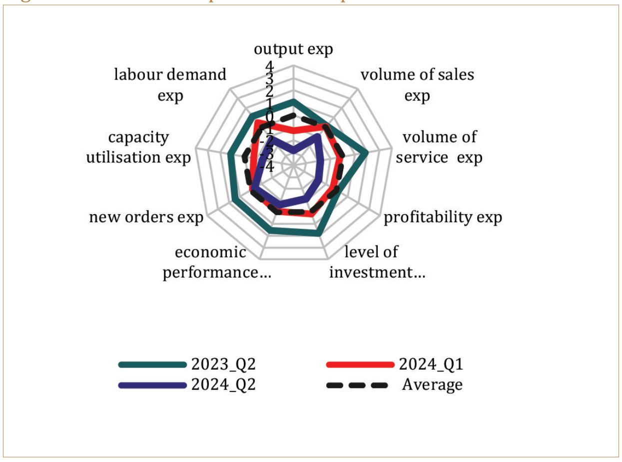
Figure 9: Sectoral Contribution to Real GDP Growth (percentage points)



Source: Ministry of Finance and National Planning, Zambia Statistics Agency
Note: p=preliminary, f=forecast.

The respondents to the *August 2024 Quarterly Survey of Business Opinions and Expectations* were broadly pessimistic about economic performance over the next 12 months based on persistent inflationary pressures, rising operating costs, depreciation of the Kwacha and uncertainty about fuel prices (Figure 10).

Figure 10: Business Expectations Response Patterns[19]



Source: Bank of Zambia

Over the medium-term, copper output is projected to rebound mostly on the back of the resumption of operations at Mopani Copper Mines Plc and Konkola Copper Mines Plc as well as the start-up and increase in output at new mines as reported in May.

The agriculture sector will be supported by the implementation of short and long-term measures by Government mainly under the Comprehensive Agricultural Transformation Support Programme (CATSP), 2024-2033 aimed at boosting agricultural production, enhancing value addition, promoting the adoption of climate-smart technologies, and fostering partnerships to bolster job creation, as well as food and nutrition security.

Increased generation capacity through new investments in solar, thermal and wind energy remain critical to the recovery and growth of the energy sector in the medium-term.

The risks to growth remain broadly unchanged from those articulated in the *May 2024 Monetary Policy Report*. Notably, climate change, particularly El Niño events, continues to pose significant risks to agricultural production and hydropower generation.

1.3 Fiscal Outlook

… wider fiscal deficit path projected

Relative to the *May 2024 MPC Meeting*, fiscal deficits for the period 2024-26 are projected to widen. A higher cash fiscal deficit of 6.2 percent of GDP is projected for

[19]Survey indicators are standardised net balances with mean = 0 and standard deviation = 1. A value within the black circle entails weaker economic conditions than the historical average and a value outside the black line signifies an improvement over the historical average.

2024 than the earlier 4.8 percent largely due to the adverse impact of the drought[20]. Similarly, deficits for 2025 and 2026 have respectively been revised upwards to 3.5 percent and 2.6 percent from 2.8 percent and 2.2 percent in view of lower-than-expected revenue.

The risks to the medium-term fiscal outlook remain mostly unchanged since the May 2024 MPC Meeting.

1.4 Inflation Outlook: Third Quarter 2024 – Second Quarter 2026

... inflation to persist above target band

Initial domestic and foreign conditions have important implications for the future path of inflation. Their assessment is conducted using the Quarterly Projection Model (QPM)[21]. Broadly, initial external and domestic conditions have improved since the May MPC Meeting[22].

The key assumptions shaping the current inflation projection for the period Q3 2024 to Q2 2026 are presented in Table 4 and briefly discussed.

Table 4: Key Assumptions Underlying Inflation Projection

Variables	2024f	2025f	2026f
Average inflation-USA (percent)	3.2 (2.1)	2.4 (2.0)	2.2 (2.0)
Fed funds rate (percent)	5.3 (4.6)	4.8 (3.9)	3.9 (3.1)
Treasury bill rate-USA (percent)	5.1 (5.0)	4.1 (3.8)	3.4 (3.0)
Treasury bill rate - Zambia (percent)	10.80 (9.50)	10.80 (9.50)	10.80 (9.50)
Average inflation - South Africa (percent)	4.9 (5.1)	4.4 (4.6)	4.5 (4.5)
Producer price index-South Africa	171.4 (173.3)	175.1 (181.3)	175.1 (189.5)
Average copper price/ ton (US$)	9,551.00 (8,834.73)	9,806.50 (9,009.00)	9,930.42 (8,904.00)
Average crude oil Price/barrel (US$)	86.00 (83.25)	85.80 (80.65)	86.30 (79.00)
Reserve money growth (percent)*	7.7[23] (5.8)	4.0 (0.6)	-6.8 (-6.9)
Fiscal deficit**	1.27 (1.21)	1.16 (1.11)	1.12 (1.10)
BoZ Policy Rate (percent)	13.5 (12.5)	13.5 (12.5)	13.5 (12.5)
World food price index	118.5 (118.5)	113.9 (113.6)	113.9 (113.6)
Maize grain price - Zambia (K/50Kg)	435.00 (444.50)	435.00 (444.50)	435.00 (444.50)
Diesel price - Zambia (K/litre)	30.05 (30.36)	30.05 (30.36)	30.05 (30.36)

Source: IMF, World Bank, Bloomberg, FocusEconomics Consensus, Reuters, Congressional Budget Office, US Federal Reserve, SARB, Bank of Zambia

Note: the numbers in parenthesis ( ) represent projections in the previous forecasting period.

*Refer to reserve money computation in Table 2.

**Computed as a ratio of expenditure (excluding amortisation) over revenue. A value in excess of 1 implies a deficit.

f = forecast

[20] Statement on the Drought Response Appeal.

[21] The QPM is structured around four behavioural equations: aggregate demand function for output, expectations-augmented Phillips curve for inflation, uncovered interest rate parity for the exchange rate, and a monetary policy reaction function for the interest rate (Vlcek et al., 2020; Laxton et al., 2009; Adrain, Laxton and Obstfeld (eds), 2018). The model is built in gaps—deviations of variables from long-run equilibrium values—thus also referred to as a gap model.

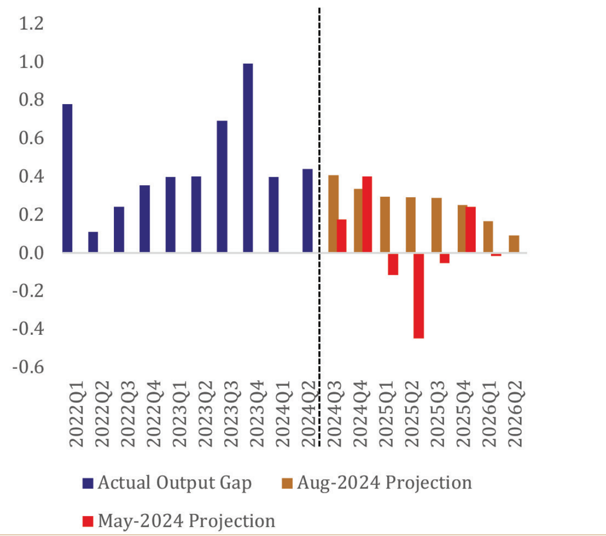
[22] In determining the future path of inflation in the domestic economy, an assessment of domestic and international conditions is conducted. The assessment of these conditions and the methodology used to generate the inflation outlook were outlined in the *February 2024 Monetary Policy Report*.

[23] 2024 Q3 – Q4

External Conditions

Global demand, proxied by the US output gap, is estimated to have slightly expanded in the second quarter (Figure 11). This reflected mostly gains in consumer and Government spending as well as upturn in private inventory investment[24]. However, in the short to medium-term, cooling labour markets, moderation in consumption and fiscal policy tightening are likely to dampen demand.

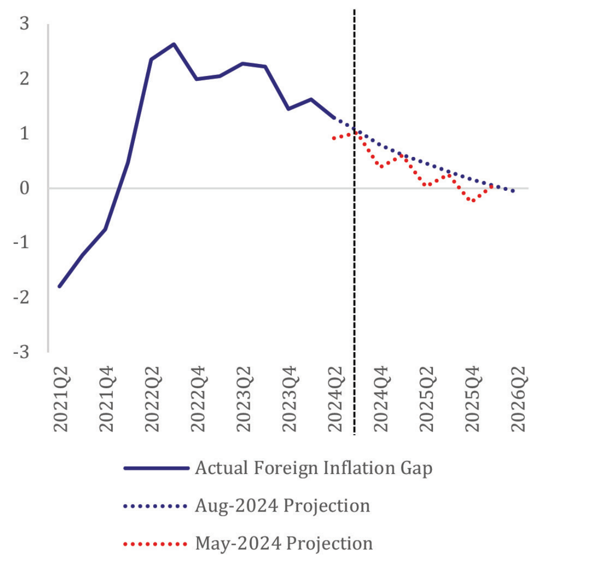
Figure 11: Global (US) Output Gap[25]



source: Bank of Zambia Staff Computations

Foreign inflation, proxied by changes in the US personal consumption expenditure (PCE), moderated in the second quarter, but remained above the 2.0 percent Federal Reserve target (Figure 12). Inflation averaged 3.2 percent, marginally lower than 3.3 percent in the first quarter. The slowdown was attributed to the cooling of the labour market and tight financial conditions.

Figure 12: Foreign (US Personal Consumption Expenditure) Inflation Gap[26]



Source: Bank of Zambia staff computations

The current US inflation projection is more elevated due to the resilience of the services sector (Table 4).

In 2024 and 2025, inflation in South Africa is expected to be lower than the May forecast (Table 4). This is attributed to the moderation in fuel and food prices supported by a stronger rand. Inflation is expected to return to the mid-point of 3-6 percent target band in 2025.

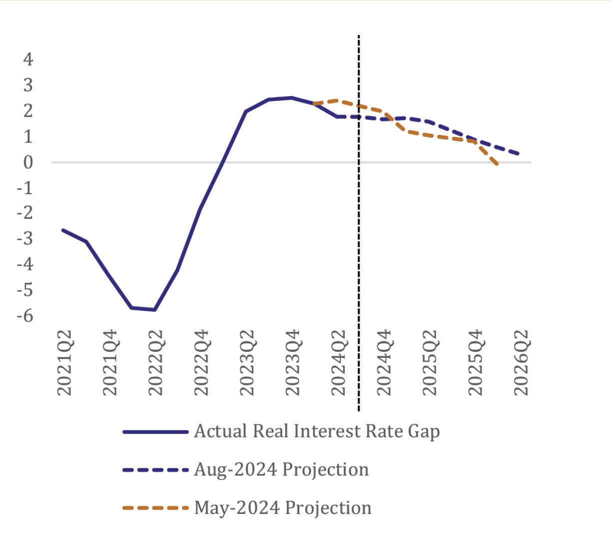
While remaining resolute in fighting inflation, central banks in major economies broadly left interest rates unchanged in the second quarter (Figure 13). This reflected persistence in inflation and the need to maintain a restrictive monetary policy stance for an extended period until inflation risks dissipate. Except for the European Central Bank (ECB) and the Bank of Canada, which reduced benchmark interest rates, interest rates in major economies were held steady. Central banks are expected to keep policy rates sufficiently restrictive for as long as necessary.

[24]https://www.reuters.com/markets/us/us-economic-growth-regains-steam-second-quarter-inflation-slows-2024-07-25/.

[25]The global or foreign output gap is the difference between observed US GDP and the potential. A negative foreign output gap implies slack in demand while a positive gap reflects excess demand.

[26]Foreign inflation gap is the difference between observed US inflation and the inflaiton target. A negative foreign inflation gap implies inflation below its target while while a positive gap reflects the converse.

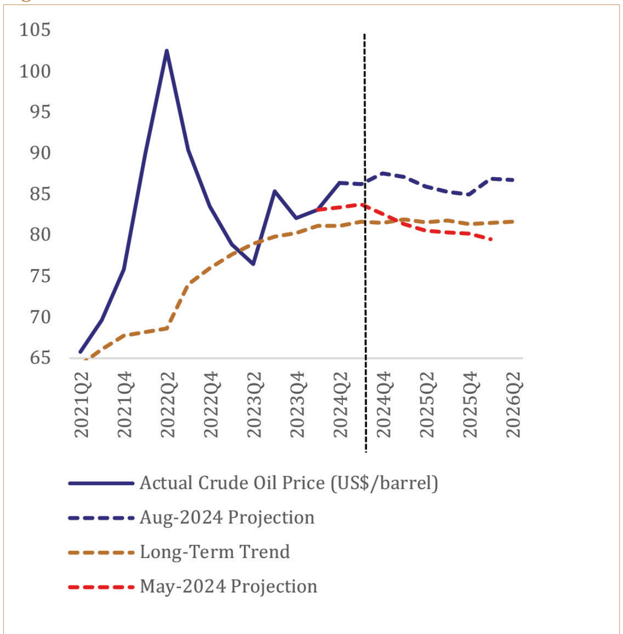
Figure 13: Foreign Real Interest Rate Gap[27]



Source: Bank of Zambia Staff Computations

Crude oil and copper prices increased in the second quarter and are projected to be higher than assumed in May. The rise in crude oil prices is attributed to supply constraints resulting from production cuts by OPEC+ and supply disruptions as the Israeli-Hamas war persisted[28]. The foregoing factors also underpin the expected rise in crude oil prices over the forecast horizon (Table 4 and Figure 14).

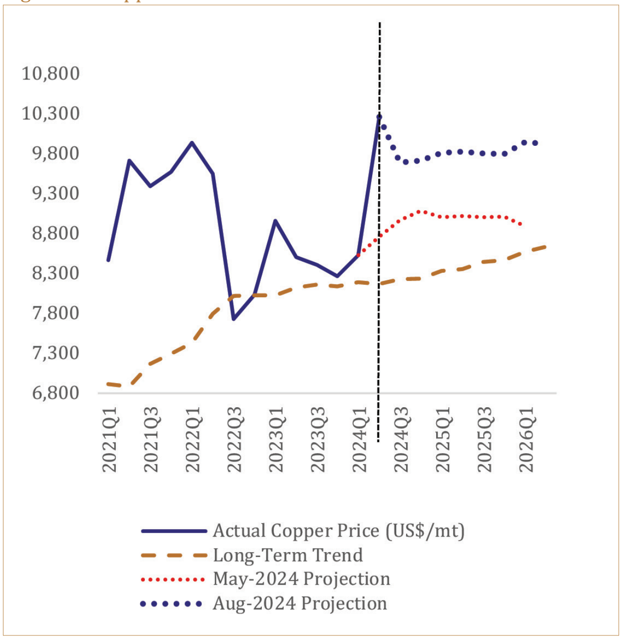
Figure 14: Crude Oil Prices



Source: Bank of Zambia Staff Computations

Higher copper prices were mostly supported by reduced supply in Chile[29] and scaled back production by Chinese smelters. Greater demand stemming from AI applications and the green energy transition, as well as additional stimulus measures to the property sector in China also drove copper prices up. Over the forecast horizon, prices are projected to be higher than the May forecast (Table 4 and Figure 15). Elevated copper prices are expected to be supported by strong global demand in view of the green transition, modernisation of power grids and a growing market deficit.

Figure 15: Copper Prices



Source: Bank of Zambia Staff Computations

World food prices[30] continued to ease in the second quarter owing to increased supply of cereals (Figure 16). The FAO Food Price Index maintained a downward trend on account of increases in production, particularly of rice, meat, sugar and dairy products, as well as higher closing stocks across several basic foodstuffs. Over the forecast horizon, the FAO Food Price Index is projected to continue declining owing to increased production of coarse grains (barley and sorghum), rice, meat and sugar.

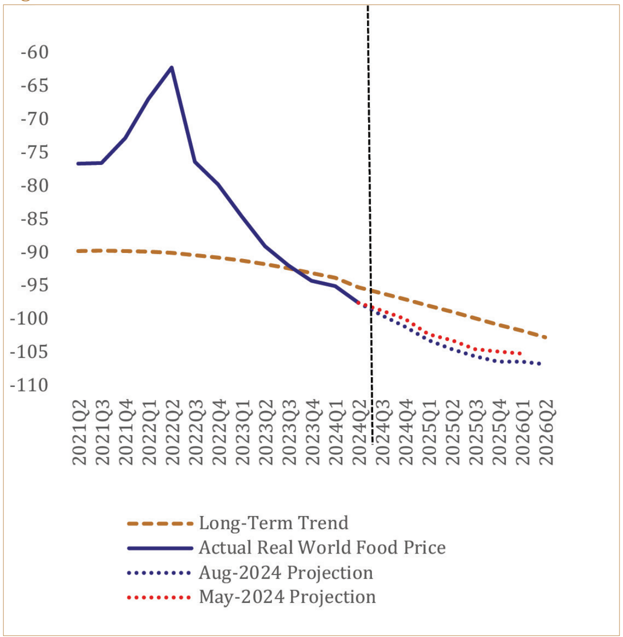
[27]This is the difference between the prevailing foreign interest rate and the long-run equilibrium real interest rate. In the QPM, foreign real interest rates are important for determining the risk premium. A rising foreign real interest rate gap signifies increases in the risk premium, which implies a depreciation in the nominal exchange rate. Like the foreign output gap, the foreign real interest rate gap is also exogenously determined and taken as given in the model.

[28]Tension between Israel and Hezbollah militants in the Middle East escalated as the former launched a drone and missile attack on the latter in May, severely disrupting oil production.

[29]In April, top producer Chile posted the lowest output in over a year.

[30]World food prices are measured by the FAO Food Price Index, a weighted average of five commodity sub-indices, with the weight of the cereals sub-index being the second largest (https://www.fao.org/fileadmin/templates/worldfood/Reports_and_docs/FO-Expanded-SF.pdf). This is relevant to our inflation forecast as CPI basket is dominated by cereals (mostly maize) as a single product.

Figure 16: Real World Food Prices

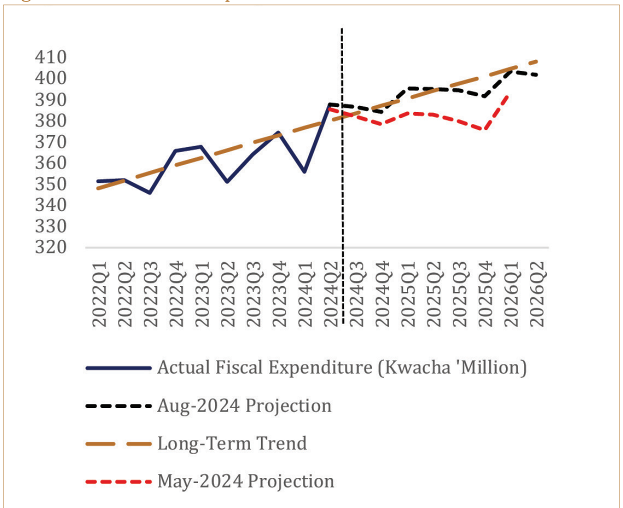


Source: Bank of Zambia Staff Computations

Domestic Conditions

The fiscal deficit is projected to widen over the forecast period largely due to the effects of the drought (Table 4). Relative to the May forecast, real fiscal expenditure (Figure 17) is expected to expand as Government implements measures to mitigate the adverse effects of the drought. However, the contribution to inflation is muted as expenditure remains broadly below the long-term trend over the forecast horizon.

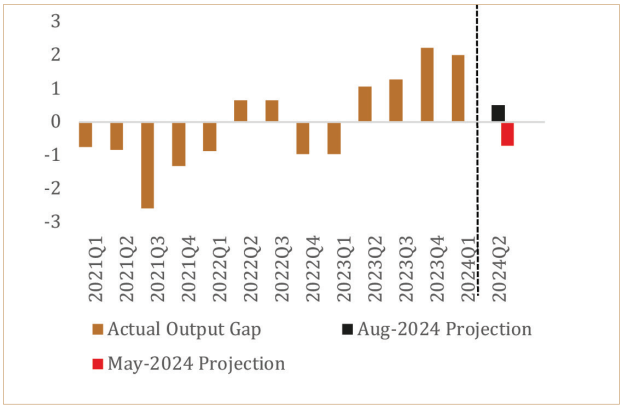
Figure 17: Real Fiscal Expenditure



Source: Bank of Zambia Staff Computations

The domestic output gap is estimated to be positive in the second quarter due to relatively loose monetary conditions, improved terms of trade and elevated foreign demand (Figure 18). Over the forecast horizon, domestic output gap is projected to turn positive relative to the May forecast (refer to section 1.2 for more details).

Figure 18: Domestic Output Gap[31]



Source: Bank of Zambia Staff Computations

Loose monetary conditions moderated in the second quarter as the rate of exchange rate depreciation slowed down[32] *and the Policy Rate was raised by 100 basis points in May*.

Marginal costs of production for importing firms rose on account of the persistent depreciation of the nominal exchange rate.

During the last two quarters of 2024, reserve money is projected to grow by 7.7 percent and further by 4.0 percent in 2025, but contract by 6.8 percent in 2026 (Tables 4). The growth in reserve money is mostly on account of net Government spending. The contraction in 2026 is due to the expected net sales of Government securities.

The maize grain and diesel price profiles are slightly lower in this forecasting round than in May (Table 4). The current average market maize grain price of K435/50kg bag and K30.05 per litre for diesel are assumed and held constant for each quarter throughout the forecast horizon.

Overall, both external and domestic initial conditions have improved although the latter remains unfavourable. Consequently, inflationary pressures are expected to persist throughout the forecast horizon, especially in the early part. Inflation is expected to gradually decelerate, albeit at a slower pace than envisaged in May, after Q3 2025 (Table 5 and Figure 19).

Inflation is projected to be higher than both the May 2024 baseline and MPC forecast mostly due to the current high inflation and persistent depreciation of the exchange rate. However, in 2025, inflation is expected to moderate as global food prices decline and the external sector environment improves.

[31]The domestic output gap estimates the deviation of aggregate demand from its potential. Negative output gap implies slack in demand while positive output gap implies excess demand. The output gap is endogenously determined by expectations, monetary conditions, foreign demand, terms of trade and fiscal policy.

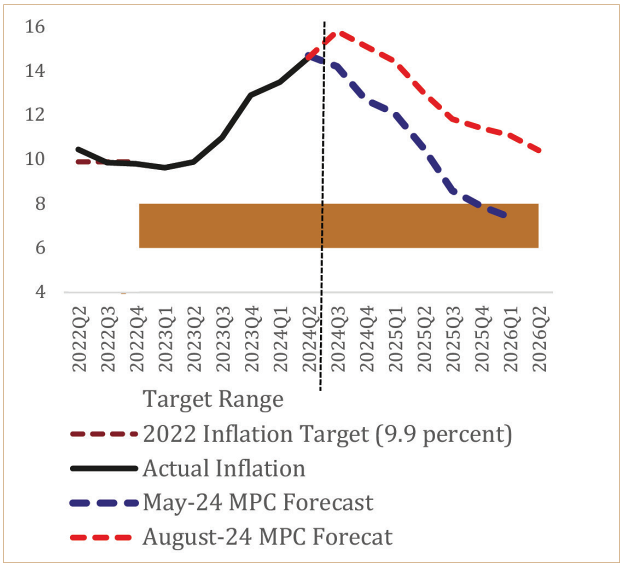
[32]Quarter-on-quarter, the Kwacha depreciated by 3.8 percent in the second quarter of compared to 10.6 percent depreciation in the first quarter of 2024.

Table 5: MPC Projected Average Inflation (percent)

	2024	2025	2026 H1
Aug-24 Forecast	15.3	12.7	10.8
May-24 Forecast	13.7	9.8	

Source: Bank of Zambia Staff Forecasts

Figure 19: Inflation Profiles (percent)



Source: Bank of Zambia Staff Forecasts and Zambia Statistics Agency

Respondents to the *August 2024 Bank of Zambia Quarterly Survey of Business Opinions and Expectations* anticipate inflation to rise, especially in the short-term. They attribute the rise in inflation to higher operating costs due to electricity shortages and elevated fuel prices as firms utilise alternative sources of energy, namely diesel/petrol generators.

Assessment of Risks to the Inflation Outlook

While some risks have materialised since the *May 2024 MPC Meeting*, overall, risks have remained broadly unchanged. These are:

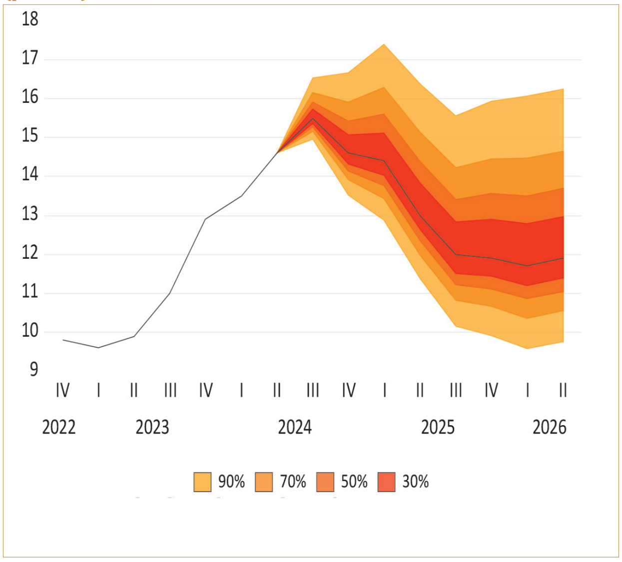
a) Higher maize grain prices. As indicated in the *May 2024 Monetary Policy Report*, the drought experienced in Southern Africa during the 2023/24 farming season has adversely affected maize grain production in the region. Maize production in Zambia has dropped to 1.5 million metric tonnes from the above-average harvest of 3.3 million metric tonnes in the 2022/23 season. As a result, a net deficit of 1.3 million metric tonnes and a price increase of more than 10 percent during the harvest and immediate post-harvest period have been recorded, providing an early indication of thin market supply[33]. This, coupled with below-average maize grain supply in regional markets and elevated demand, is expected to drive prices further up;

b) Higher prices of goods and services due to extended hours of load management. While the country is currently experiencing 12 hours of load management, the number of hours could increase as electricity generation at various power stations continues to be drastically suppressed due to receding water levels (refer to section 1.2). This is likely to increase the cost of production by firms due to the extended usage of expensive alternative sources of energy. As a result, prices of goods and services could rise more rapidly than projected as firms pass on higher costs of production to consumers; and

c) Tighter global financial conditions. Global financial conditions remain tight as inflation in most advanced economies is above medium-term targets despite the declining trend. The slow disinflation process, coupled with heightened geopolitical tensions, which could push energy prices and freight costs higher in the near-term, and the unfolding climate crisis could drive inflation up. This may lead central banks in advanced economies holding interest rates at elevated levels for longer-than-expected or tighten monetary policy further. This will adversely affect currencies in emerging markets and developing economies.

Broadly, the risks are skewed to the upside reflected in the inflation fan chart (Figure 20 and Table 6). This implies that the probability of inflation outcome exceeding the baseline projection is higher than that of it falling below the baseline.

Figure 20: Inflation – Actual and Projected: Q3 2024 – Q2 2026 (percent)



Source: Bank of Zambia and Zambia Statistics Agency

[33] FEWS NET. Southern Africa Regional Supply and Market Outlook – April 2024.

Table 6: Range of Possible Inflation Outcomes and Associated Probabilities

Range of Possible Inflation Outcomes (percent)	Probability (percent)
11.2 – 15.7	30
10.9 – 15.9	50
10.4 – 16.3	70
9.6 – 17.4	90

Source: Bank of Zambia

Monetary Policy Decision

… Policy Rate maintained

At its August 12-13, 2024 Meeting, the Monetary Policy Committee **decided to maintain the Monetary Policy Rate at 13.5 percent**. While actual and projected inflation remain elevated relative to the 6-8 percent target band, the Committee judged that the current monetary policy stance was appropriate. This decision took into account the impact of the drought as well as that of the past successive increases in the Policy Rate, upward adjustments in the statutory reserve ratio, and the recent reforms (May and June) in the foreign exchange market (refer to the appendix).

2. Current Economic Developments

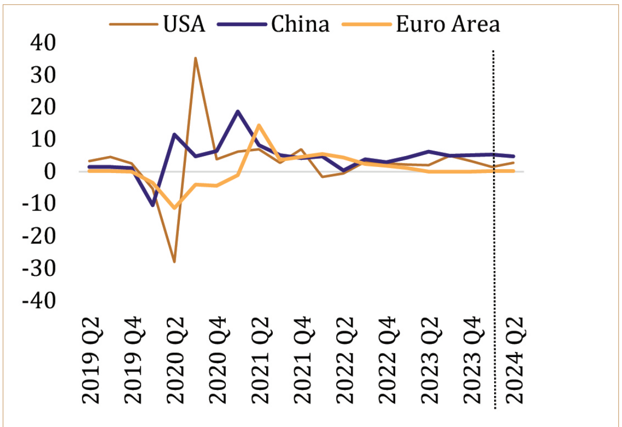
- *Global growth remains positive.*
- *Global financial conditions restrictive as policy rates remain elevated to steer inflation back to target.*
- *Current account positive on net export expansion and rise in secondary income.*
- *Interest rate movement mixed, domestic credit and money supply growth increase as lending to the private sector expands.*
- *Economic activity slows down further on persistent inflationary pressures propelled by sustained increase in maize grain and maize product prices, limited supply of vegetables and fish, high demand for solid fuels and depreciation of the exchange rate.*
- *Budget performance continues to be constrained by financing.*

2.1 External Sector

... growth in major economies mixed

In the second quarter, growth was stronger in the US, stable in the euro area, but slower in China (Figure 21).

Figure 21: Real GDP Growth, year-on-year (percent)



Source: Federal Reserve Bank of St. Louis, National Bureau of Statistics & Eurostat, and Bank of Zambia Staff Compilations

The US economy grew by 2.8 percent compared to 1.4 percent in the first quarter, driven by strong consumer spending, business investment and Government spending.

In the euro area, the 0.3 percent real GDP grow rate was largely supported by a further increase in disposable income, which bolstered consumer spending as inflation continued to moderate, as well as the rebound in foreign demand and business investment.

In contrast, real GDP growth in China slowed down to 4.7 percent from 5.3 percent in the first quarter due to sluggish consumer spending, reduced Government spending, persistent slump in the property sector and adverse weather conditions.

... economic activity in major trading partner countries slows down

Preliminary data indicate a moderation in economic activity in Zambia's major trading partner countries in the second quarter. This is reflected in the reduction in the GDP-9 Index by 0.33 percent, y/y, compared to 1.87 percent in the first quarter (Table 7 and Figure 22).

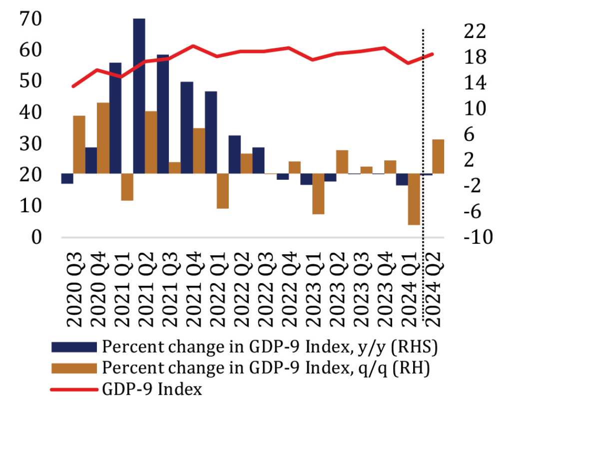
Table 7: Preliminary Year-on-Year Changes in GDP-9 Index and Country Contributions[34]

	Weight	2023 Q2	2023 Q3	2023 Q4	2024 Q1	2024 Q2
GDP-9 Index (percent Change)		-1.26	-0.14	-0.02	-1.87	-0.33
		Contribution to the GDP-9 Index Change				
China	0.5	-0.54	-0.06	-0.01	-0.82	-0.14
DRC	0.3	-0.29	-0.03	0.00	-0.45	-0.08
S/Africa	0.1	-0.19	-0.02	-0.01	-0.27	-0.05
Singapore	0.0	-0.10	-0.01	-0.01	-0.12	-0.02
UK	0.1	-0.05	0.00	0.00	-0.08	-0.01
UAE	0.0	-0.03	0.00	0.00	-0.04	-0.01
Tanzania	0.0	-0.02	0.00	0.00	-0.03	-0.01
Malawi	0.0	-0.03	0.00	0.00	-0.03	-0.01
H/Kong	0.0	-0.02	0.00	0.00	-0.02	0.00

Source: Bank of Zambia Staff Calculations
DRC=The Democratic Republic of the Congo, S/Africa=Republic of South Africa, H/Kong = Hong Kong

[34] The data reported in the May 2024 Monetary Policy Report have been significantly revised to reflect latest GDP numbers.

Figure 22: GDP-9 Index



Source: Bank of Zambia Compilation

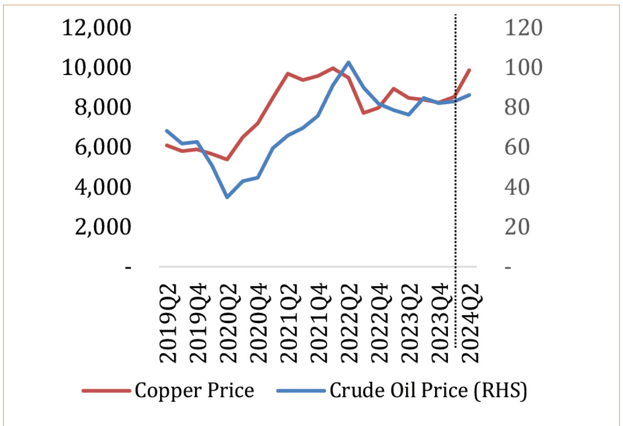
The reduction in economic activity mostly in China, the Democratic Republic of the Congo (DRC) and South Africa explains the slowdown.

The slower-than-expected growth in China was mainly attributed to subdued consumer spending and persistent downturn in the property sector, which weighed on both consumer and business confidence[35]. In DRC, economic activity was dampened by strong import demand and inflationary pressures due to a weaker exchange rate. Economic activity in South Africa was impacted by weak domestic demand in part due to elevated inflation[36].

... copper and crude oil prices sustain gains

In the second quarter, copper prices rose by 15.4 percent to US$9,861.23 per metric tonne, driven by robust demand amid tight supply (Figure 23).

Figure 23: Average Copper and Crude Oil Prices



Source: World Bank Pink Sheet and Bank of Zambia Staff Compilations

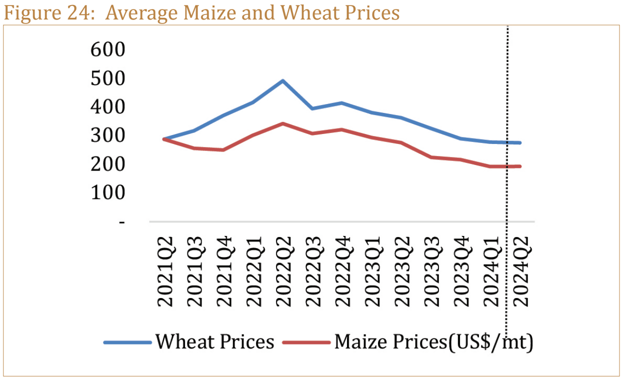
Increased use of copper by the EV industry, renewable energy sector, development of data centers needed to power AI[37] and the property sector support measures in China[38] boosted demand. In addition, the upgrade of power grid infrastructure and increased global military spending[39] contributed to the rise in demand. Supply tightened mostly due to low production by major mines[40].

Crude oil prices also increased by 3.5 percent to US$86.19 per barrel (Figure 23). This was driven by the extension of oil production cuts by OPEC+ until December 2025. Supply disruptions due to ongoing Houthi rebel attacks on cargo ships in the Red Sea and Ukrainian strikes on Russian oil infrastructure also contributed to the rise in prices. Oil prices were further supported by expectations of high fuel demand during the summer, especially in the US[41].

... maize prices rise, but wheat prices decline

Maize prices rose by 0.6 percent to US$193.98 per metric tonne in the second quarter mainly on account of reduced production occasioned by adverse weather conditions, particularly in Argentina and Brazil[42] (Figure 24). In contrast, wheat prices declined by 1.2 percent to US$275.76 per metric tonne. The sustained reduction in wheat prices reflects increased supply, coupled with weak import demand and competitive pricing.

Figure 24: Average Maize and Wheat Prices



Source: World Bank Pink Sheet Data and Bank of Zambia Staff Compilations

[35]https://indianexpress.com/article/world/china-economy-slows-housing-troubles-squeeze-spending-9454080/

[36]The South Africa Reserve Bank projects inflation to gradually improve on the back of easing fuel and food prices and reach the mid-point of the target range in the last quarter of 2024: https://www.investec.com/en_za/focus/economy/sarb-projects-lower-inflation.html

[37]https://directorstalk.net/surging-copper-prices-driven-by-renewable-energy-evs-and-ai-demand

[38]The Chinese Government and the People's Bank of China implemented measures to shore up the ailing property sector: https://www.bbc.com/news/articles/c51nyglznm6o.

[39]The surge in global military expenditures is boosting demand for copper: https://www.mining.com/five-reasons-why-we-are-entering-the-next-copper-super-cycle/.

[40]Production reduced at Codelco Mine in Chile while Cobre Mine in Panama was closed: https://markets.businessinsider.com/news/commodities/copper-commodity-price-rally-outlook-metal-green-industry-first-quantum-2024-4

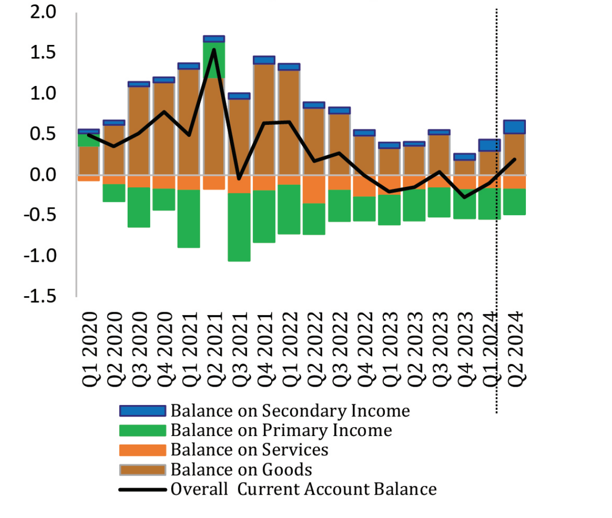
[41]https://www.reuters.com/business/energy/oil-inches-higher-summer-demand-outlook-2024-07-01/

[42]Crops in Argentina and Brazil were impacted by heavy rainfall, which caused flooding: https://www.chemanalyst.com/Pricing-data/maize-1321

… current account balance turns positive

The *current account* balance turned positive (US$0.2 billion or 3.0 percent of GDP) in the second quarter from a deficit (US$0.1 billion or 2.2 percent of GDP) in the first quarter as net exports expanded (*balance on goods*) and secondary income rose (Figure 25).

Figure 25: Current Account (US$ billion)

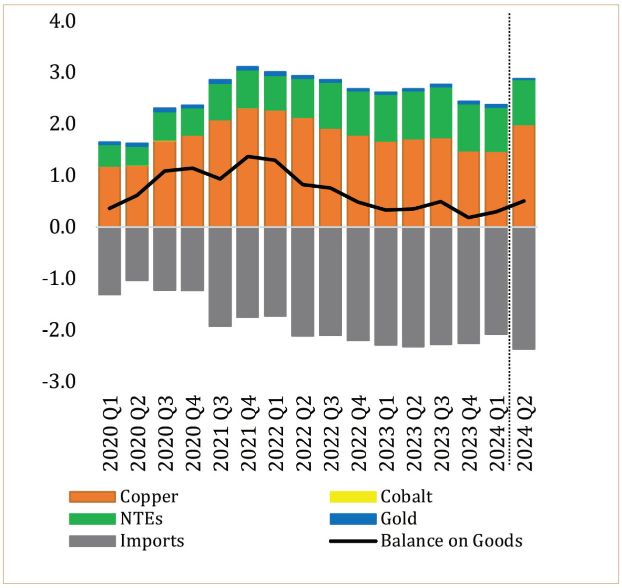


Source: Bank of Zambia

The *balance on goods* increased significantly by 84.8 percent to US$0.5 billion on account of a faster rise in exports than imports. Merchandise exports rose by 21.0 percent to US$2.9 billion, driven by higher copper and non-traditional export (NTEs) earnings. Copper export earnings increased by 34.7 percent to US$2.0 billion as both export volumes and realised prices rose[43]. Higher earnings from nickel ore and concentrates, iron and steel, copper wire, cane sugar and chemical products, as well as electric cables led to a 2.7 percent increase in NTEs to US$0.9 billion.

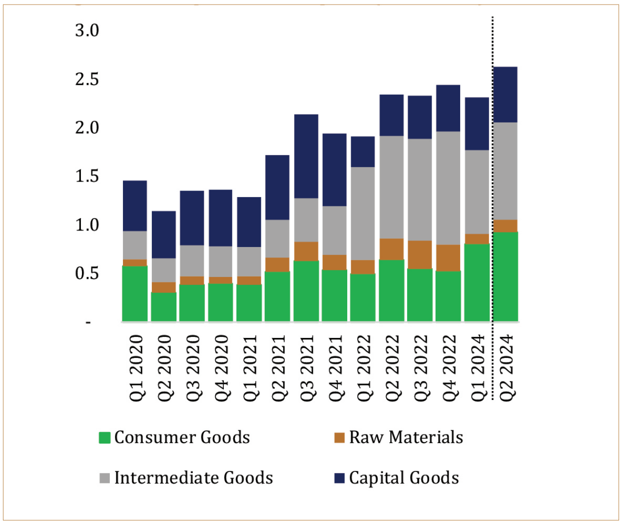
Merchandise imports rose by 12.6 percent to US$2.4 billion as both consumer and intermediate goods, mostly food items, petroleum products, fertilisers, ore slags, motor vehicles, industrial boilers and equipment, as well as electrical machinery, expanded (Figures 26 and 27).

Figure 26: Composition of Trade Balance (US$ billions)



Source: Bank of Zambia

Figure 27: Composition of Imports (US$ billion)



Source: Bank of Zambia

The surplus on the *secondary income account* rose by 14.1 percent to US$0.2 billion, underpinned by support from Cooperating Partner[44] to mitigate the adverse impact of the drought.

2.2 Global Financial Conditions

… still tight

Despite some moderation, inflation in advanced economies remained above target in the second quarter. Consequently, most central banks generally held interest rates steady. The US Federal Reserve and the Bank of England (BoE)[45] left policy interest rates unchanged (Figure 28). On the other hand, the

[43]Copper export volumes rose to 206,333.66 metric tonnes in the second quarter from 171,645.95 metric tonnes in the previous quarter. Similarly, realised copper prices increased to US$9,623.02 per metric tonne from US$8,583.29 per metric tonne in the first quarter.

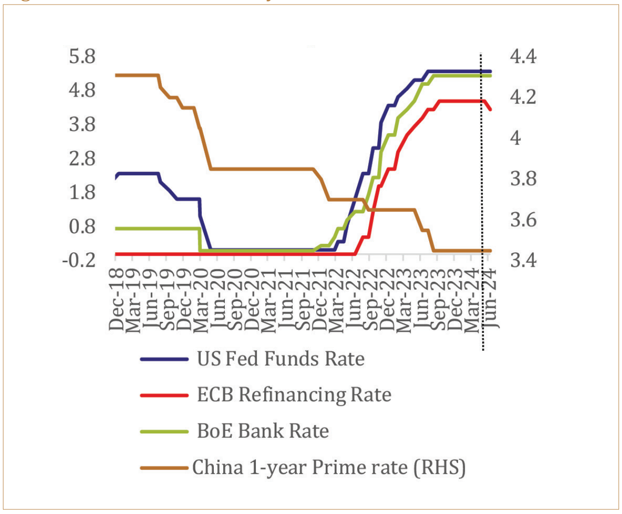
[44]US$160.4 million was received from the World Bank to help address the social and economic impact of the drought.

[45]Inflation in the UK fell to 2.0 percent in June from 2.3 percent in March. However, projections of a rise in inflation in the second half of 2024 informed the decision to keep interest rates high.

European Central Bank (ECB) reduced interest rates by 25 basis points in June after maintaining a tight policy stance from July 2022. This was in response to an improved inflation outlook[46].

The People's Bank of China remained accommodative, leaving interest rates unchanged to revive the economy. Resilient economic activity, notably in the services sector, and tight labour market conditions in most economies point to elevated inflation in the near future, thus expectation of a prolonged high interest rate environment.

Figure 28: Central Bank Policy Rates in Selected Economies

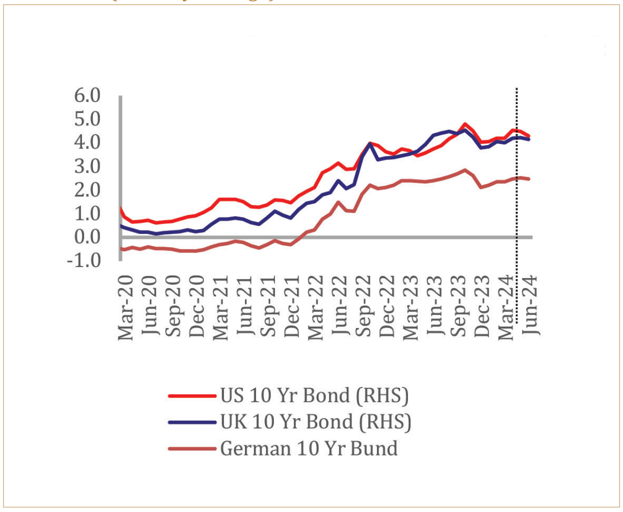


Source: Reuters and Bank of Zambia Compilations

... bond yield rates rise

Yield rates on Government bonds in advanced economies rose in response to concerns about elevated inflation. Yield rates on 10-year Government bonds in the US increased by 10 basis points to 4.31 percent and by 13 basis points in both the UK and Germany to 4.15 percent and 2.49 percent, respectively (Figure 29).

Figure 29: US, UK, and German Average 10-Year Benchmark Bond Yield Rates (monthly average)

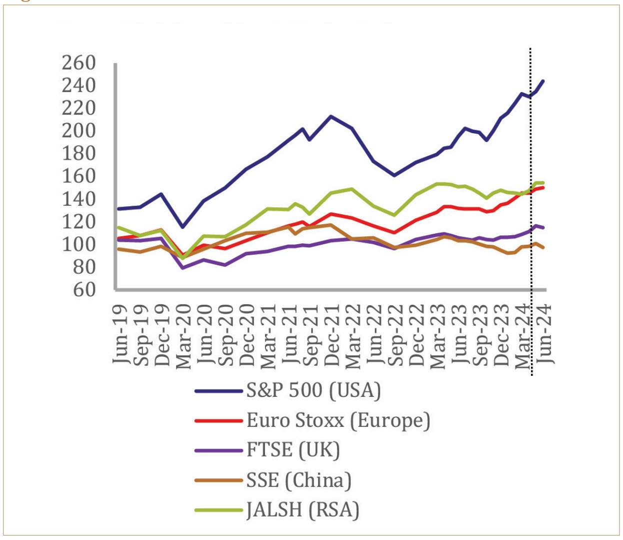


Source: Reuters and Bank of Zambia Compilations

... equities and US dollar gain

Share prices in advanced economies rose to record highs with the S&P 500, FTSE 100 and Euro Stoxx 50 gaining by 4.9 percent, 5.6 percent and 3.3 percent, respectively (Figure 30). US stocks rose as investors projected strong growth in earnings by technology companies given substantial investment in AI. A rebound in economic growth supported stocks in the UK while shares in the euro area benefited from the easing of monetary policy by the ECB.

Figure 30: Selected Stock Market Indices



Source: Reuters and Bank of Zambia Compilations

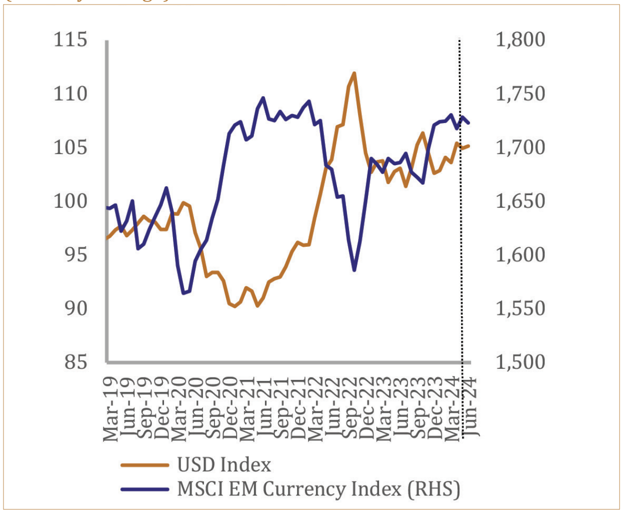
Broadly, equity markets in emerging market economies gained, reflected in the 5.1 percent increase in the MSCI Emerging Market Equity Index. This was on account of idiosyncratic factors largely driven by technology shares in Asia[47] amid growing investor interest in the adoption of AI by corporates. In South Africa, shares gained 6.7 percent on easing political uncertainty in the aftermath of the May 29 elections. However, equities in China declined by 0.9 percent as economic recovery slowed and investors remained cautious about the effectiveness of stimulus measures.

Currencies of emerging market economies generally weakened against the US dollar with the MSCI Emerging Market Currency Index falling by 0.2 percent (Figure 31). Broadly, currencies depreciated on account of a stronger US dollar underpinned by expectations of sustained high interest rates. Thus the US Dollar Index gained by 1.5 percent (Figure 31).

[46]Euro area inflation rose marginally to 2.5 percent in June from 2.4 percent in March. Inflation was higher in May, at 2.6 percent.

[47]Taiwan Semi-conductor Manufacturing Company (TSMC) and Samsung Electronics (South Korea) are some of the companies that gained.

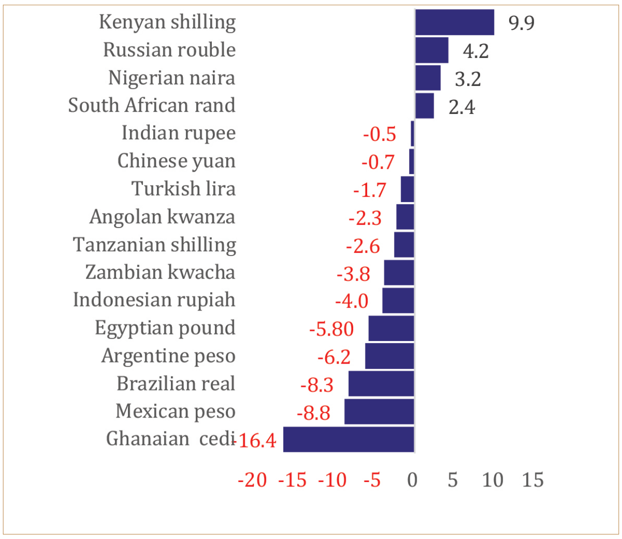
Figure 31: US Dollar and MSCI Emerging Market Currency Indices (monthly average)



Source: Reuters and Bank of Zambia Compilations

Notably, the Chinese yuan and Indian rupee, which make up the largest share of the index[48], recorded higher depreciation rates (Figure 32).

Figure 32: Performance of Selected Emerging Market and Developing Economies Currencies versus the US dollar*



Source: Reuters and Bank of Zambia Compilations

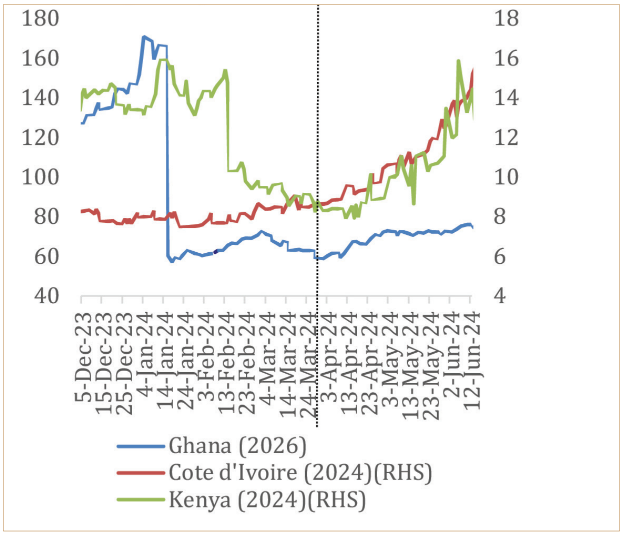
*Negative numbers indicate a depreciation while positive numbers show an appreciation against the US dollar.

With respect to African currencies, the Ghanian cedi[49] and Egyptian pound[50] depreciated the most while the Kenyan shilling[51], Nigerian naira[52], and South African rand[53] appreciated (Figure 32).

... SSA Eurobond yield rates diverge

Yield rates on Eurobonds for Kenya and Côte d'Ivoire rose to 19.4 percent and 12.0 percent from 11.5 percent and 8.1 percent, respectively as expectations of elevated inflation and restrictive monetary policy in the US weighed on prices (Figure 33). Market concerns about the ability of the issuers to repay the bonds also pushed yield rates higher[54]. The yield rate on Ghana's 2026 Eurobond fell to 70.9 percent from 81.2 percent after a Memorandum of Understanding was signed with official creditors in May 2024 and an agreement reached in June to restructure Eurobonds.

Figure 33: Yield Rates for Selected Sub-Sahara Africa Eurobonds (percent)[55]



Source: Reuters and Bank of Zambia Compilations

Prior to the consent solicitation with Eurobond holders, the yield rate on the Zambia 2024 Eurobond surged to 1,298.9 percent from 419.9 percent at end-March. In May, Zambia restructured its Eurobonds resulting in the exchange of the 2022, 2024 and 2027 bonds with two bonds maturing in 2033 and 2053. The yield rate on the 2033 bond opened trading on June 13 at 6.9 percent, but sharply rose to 8.9 percent at end-June reflecting investor caution owing to the adverse effects of the drought on economic activity[56] (Figure 34).

[48]The weight of the Chinese yuan is 30 percent while that of the Indian rupee is around 10-15 percent.

[49]The cedi depreciated significantly as demand for foreign exchange required for oil imports rose.

[50]The Egyptian pound depreciated due to shortages of foreign currency and adverse sentiments stemming from lower projected growth.

[51]The Kenyan shilling strengthened after the central bank raised interest rates and the Government repaid the Eurobond maturing in June.

[52]The increase in international reserves, central bank foreign exchange sales and upward adjustment of policy interest rates supported the naira.

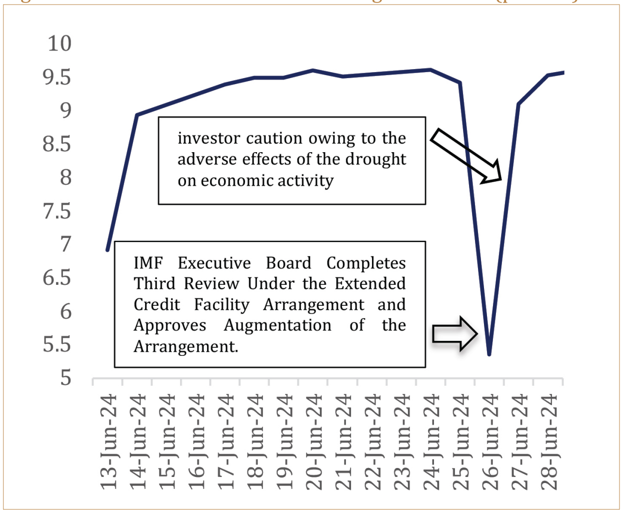
[53]In South Africa, the rand gained due to the formation of a Government of National Unity, moderation in inflation, and improved electricity supply.

[54]These concerns existed prior to the maturity of Kenya's 2024 Eurobond on June 23 and maturity of the 2024 Côte d'Ivoire Eurobond in July.

[55]Figure 33 shows the trading of SSA Eurobonds prior to the issuance of the Zambia 2033 and 2053 Eurobonds. Hence, the figure shows bonds comparable with the Zambia 2024 bond.

[56]https://www.globalcapital.com article/2dcw1izqnds2ebg3hhr0g/emerging-markets/zambia-drought-makes-investors-wary-as-new-bonds-start-trading

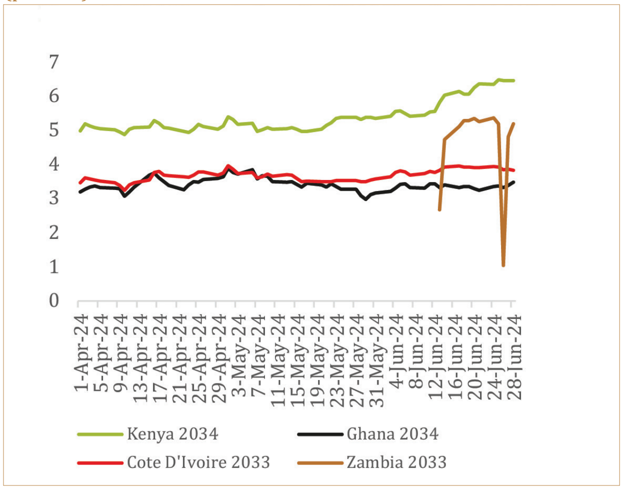
Figure 34: Zambia 2033 Eurobond Average Yield Rate (percent)



Source: Reuters and Bank of Zambia Compilations

By and large, spreads of Eurobonds from SSA over the US 10-year Treasury bond trended upwards in the second quarter (Figure 35). This signalled adverse risk perceptions[57] and higher external funding costs[58].

Figure 35: Yield Spreads Over the US 10-Year Bond Yield Rate (percent)[59]



Source: Reuters and Bank of Zambia Compilations

2.3 Domestic Financial Conditions

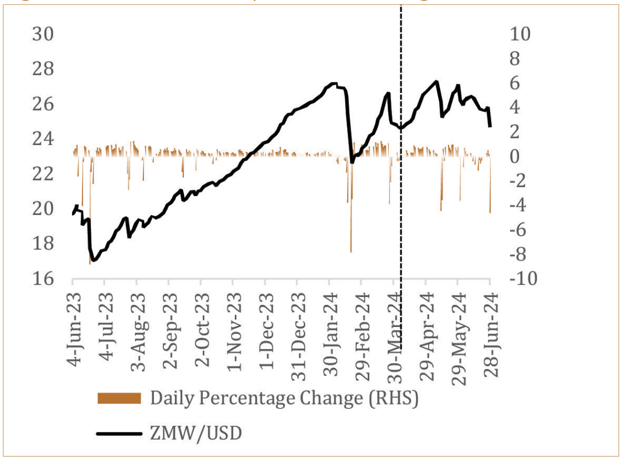
... broadly tight

Domestic financial conditions remained broadly tight owing to the sustained contractionary monetary policy stance.

... exchange rate depreciation slows down further

In the second quarter, the depreciation of the Kwacha against the US dollar moderated further to 3.8 percent from 10.6 percent in the first quarter (Figure 36). This was attributed to improved supply of foreign exchange, particularly by the mining sector, and positive market sentiments following further progress on external debt restructuring and approval of the Third Review under the Extended Credit Facility (ECF) Arrangement by the IMF Board on June 26[60].

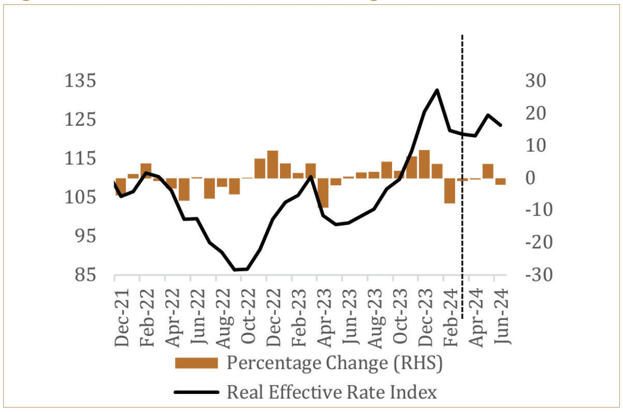
Figure 36: Nominal Kwacha/US Dollar Exchange Rate



Source: Bank of Zambia

In real terms, the Kwacha depreciated by 2.0 percent compared to an appreciation of 4.5 percent in the first quarter (Figure 37). This was due to the depreciation of the nominal exchange rate of the Kwacha against currencies of major trading partners[61].

Figure 37: Real Kwacha Effective Exchange Rate



Source: Bank of Zambia

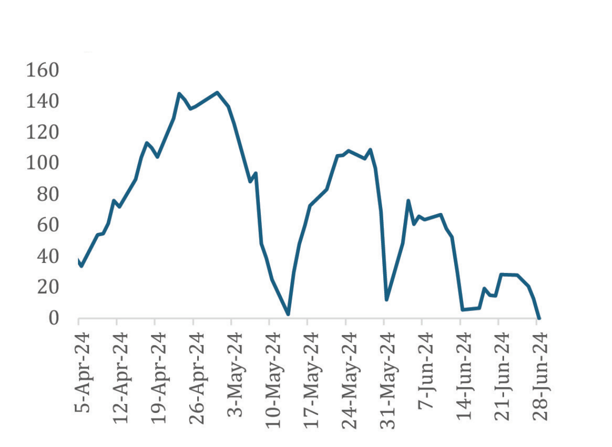
The Kwacha faced persistent pressure in April and early part of May due to elevated demand for foreign exchange relative to supply. This culminated in a sustained increase in demand backlog to US$145.6 million[62] (Figure 38). As a result, the Kwacha weakened

[57]The spread for Kenya's 2034 Eurobond rose the most among peers after protests on the proposed tax increases in the Finance Bill turned into riots.
[58]A fall in spreads signals more favourable refinancing conditions for borrowers as their credit risk is generally perceived to have reduced.
[59]Spread for the Zambia 2033 Eurobond starts from June 13, 2024 when the Eurobond started trading.

[60]The IMF Board also approved an augmentation of the ECF Arrangement by providing Zambia with immediate access to SDR433.34 million (about US$569.6 million), increasing access to SDR1,271.66 million or 130 percent of the quota. This was in view of the need to mobilise additional resources to respond to the impact of the severe drought.
[61]The nominal effective exchange rate, a measure of the value of the Kwacha against a basket of currencies of Zambia's major trading partners, depreciated by 4.9 percent in the second quarter after staying flat in the first quarter.
[62]Demand for foreign exchange was mostly by electricity, gas, and water; financial intermediation; and manufacturing sectors.

to an all-time low of K27.40 per US dollar on May 10 (Figure 36).

Figure 38: Outstanding Demand for Foreign Exchange (US$ million)



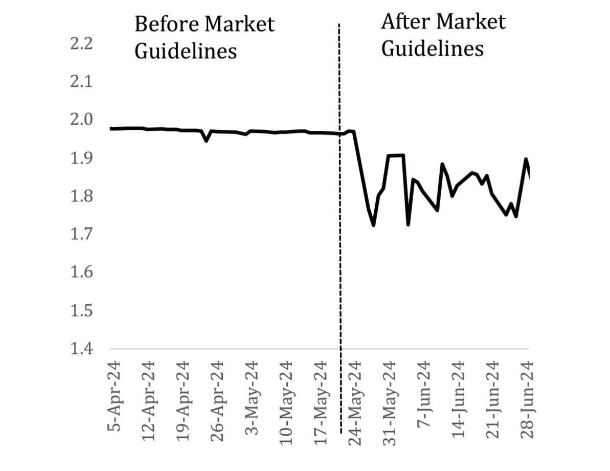
Source Bank of Zambia

The Kwacha rebounded and appreciated sharply to K25.20 per US dollar on May 14 as foreign exchange inflows from non-residents picked up. These inflows were triggered by increased demand for Kwacha to meet domestic obligations amid expectations of monetary policy tightening and a further upward adjustment in the statutory reserve ratio at the May Monetary Policy Committee Meeting. However, the appreciation of the Kwacha was short lived as supply dissipated while a lower exchange rate induced buying interest. This resulted in the build-up in outstanding demand to US$108.9 million by end-May and the return of the exchange rate to around K27.00.

In June, the Kwacha recorded another turn around and appreciated on account of positive sentiments following a successful consent solicitation on restructured Eurobonds and subsequent sovereign credit rating upgrade by Fitch Ratings and Moody's Investor services[63]. In addition, the successful completion of the Third Review under the IMF ECF Arrangement and approval of augmentation, which resulted in immediate access to US$569.6 million on June 26, contributed to positive market sentiments. This led to the strengthening of the Kwacha against the US dollar to K24.70 per US dollar at end-June (Figure 36). With a lower exchange rate, the demand backlog was eliminated at end-June as market players withdrew orders in anticipation of a further appreciation (Figure 38).

The performance of the Kwacha in June was also supported by the issuance of Foreign Exchange Market Guidelines on May 24[64] and Revised Interbank Foreign Exchange Market Rules on June 14. The Rules are intended to enhance transparency, efficiency and effectiveness of the domestic foreign exchange market. The introduction of a negotiable threshold of at least US$1.0 million led to competitive pricing for transactions below this amount (constitute the majority) executed at displayed board rates. As a result, daily spreads on board rates trended downwards to as low as 1.73 percent from 1.97 percent on May 24 (Figure 39).

Figure 39: Commercial Banks' Daily Average Board Rate Spread (percent)



Source: Bank of Zambia

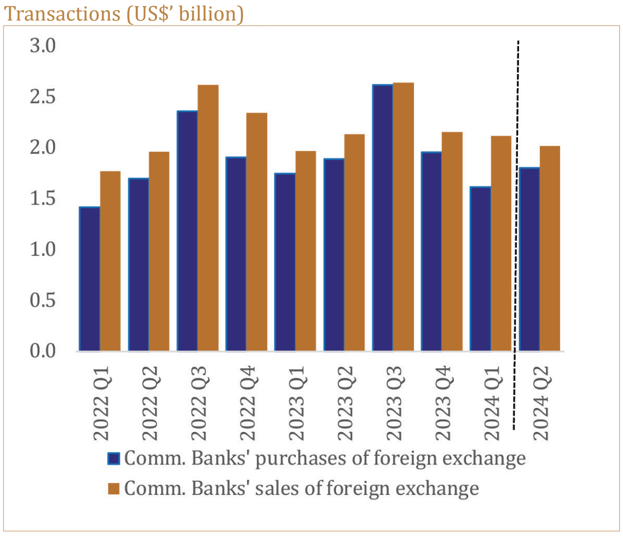
During the quarter, the supply of foreign exchange increased by 12.0 percent to US$1.8 billion largely by the mining sector while demand declined by 5.0 percent to US$2.0 billion[65] (Figure 40). This led to the reduction in net demand and subsequent slowdown in the depreciation of the exchange rate.

[63]Consent solicitation is a process where the issuer of debt, in this case Eurobonds, seeks concurrence of the holders to amend the terms of the debt. In this regard, on May 13, the Government sought agreement from Eurobond holders to amend the terms of the three Eurobonds following a restructuring agreement reached in March 2024. During the consent solicitation, Eurobond holders overwhelmingly (over 90 percent) voted in favour of the proposed restructuring deal as at the Early Consent Deadline of 5:00 p.m. (New York City time) on 24 May: (https://www.mofnp.gov.zm/?p=7873 and https://www.londonstockexchange.com/news-article/92MB/early-results-announcement/16490272. Following a successful consent solicitation, on June 10, Fitch Ratings elevated Zambia's Short-Term Foreign-Currency (STFC) IDR to 'C' from 'RD'. However, Zambia's Long-Term Foreign-Currency (LTFC) Issuer Default Rating (IDR) was affirmed at 'RD'. On the other hand, Moody's Investor Service upgraded both Long-Term Foreign-Currency and Local-Currency Issuer Rating to Caa2 from Ca and Caa3, respectively, and maintained a stable outlook.

[64]Bank of Zambia Foreign Exchange Market Guidelines, 2024.

[65]Foreign exchange supply is measured as commercial banks' purchases of foreign exchange from the non-bank public while demand by commercial banks refers to sales of foreign exchange to the non-bank public.

Figure 40: Commercial Banks' Overall Foreign Exchange Transactions (US$' billion)

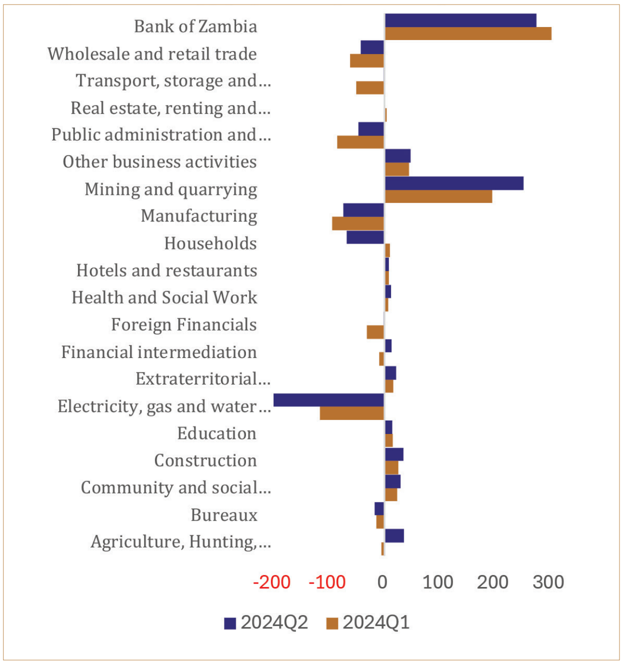


Source: Bank of Zambia

*All spot purchases and sales of respective foreign currencies against the Kwacha are converted into Kwacha using exchange rates at which they were executed and then converted into US dollar using the monthly average Kwacha/US dollar exchange rate.

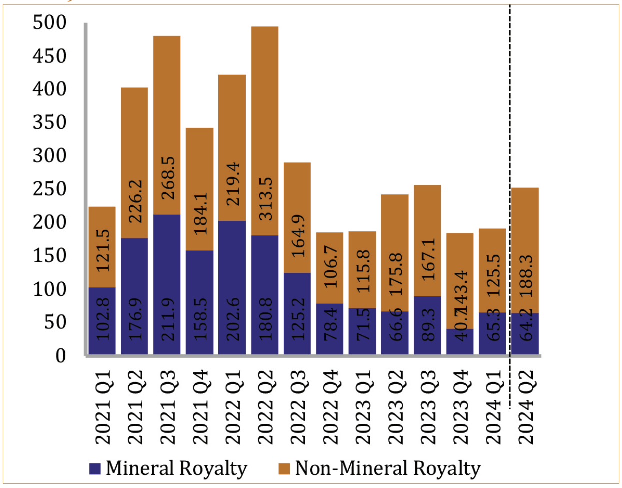
Due to improved supply, the Bank scaled down market support. Net sales of foreign exchange reduced by 24.7 percent to US$275.0 million. Of this amount, US$252.5 million was from mining tax receipts[66] (Figure 41).

Figure 41: Net Supply by Sector (US$ million)



Source: Bank of Zambia

Figure 42: Mining Taxes Paid in US Dollars and Remitted to BoZ (US$ million)

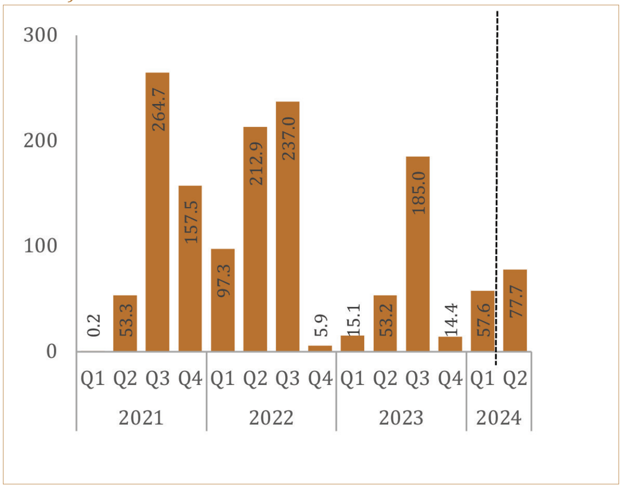


Source: Bank of Zambia

Notable reduction in demand for foreign exchange was observed by manufacturing (US$73.9 million), public (US$47.4 million), wholesale and retail (US$43.5 million), foreign financial institutions (US$0.7 million) and transport (US$0.3 million) sectors (Figure 41).

Activity in the interbank foreign exchange market picked-up as liquidity improved in the second quarter. Hence, the turnover was US$77.7 million compared to US$57.6 million in the first quarter (Figure 43).

Figure 43: Turnover in Interbank Foreign Exchange Market (US$ million)

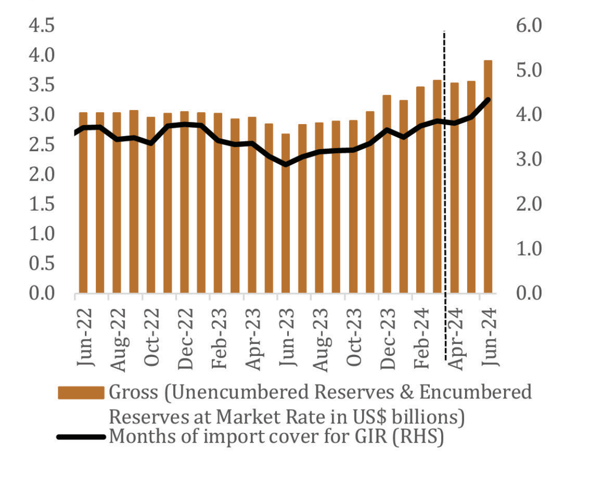


Source: Bank of Zambia

Gross international reserves (GIR) increased to US$3.9 billion (equivalent to 4.3 months of import cover) at end-June from US$3.6 billion (equivalent to 3.9 months of import cover) at end-March (Figure 44). This was mainly on account of the US$569.6 million disbursement by the IMF under the ECF Arrangement.

[66] Mining companies pay taxes in US dollars and remit to the Bank of Zambia.

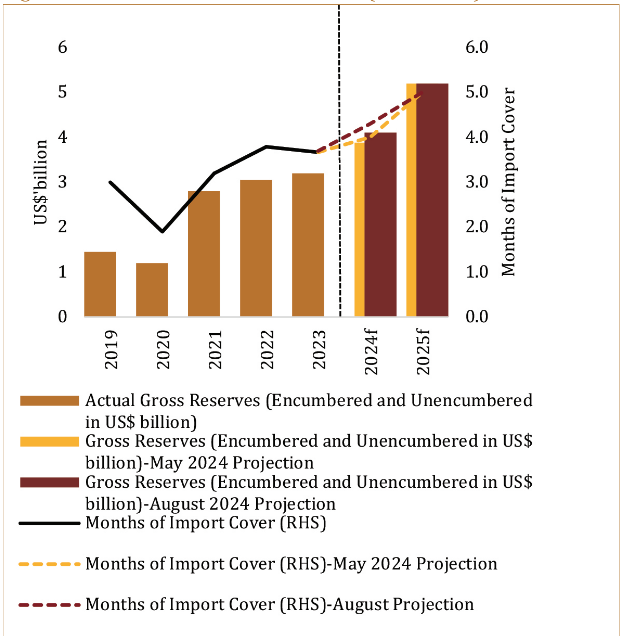
Figure 44: Gross International Reserves, June 2022-June 2024



Source: Bank of Zambia

The GIR target for 2024 has been slightly revised upwards to US$4.1 billion (equivalent to 4.3 months of import cover) at end-December 2024 from US$3.9 billion (equivalent to 4 months of import cover) reported in May (Figure 45). This largely reflects stronger copper prices and augmentation of the IMF ECF Arrangement. The 2025 projection remains unchanged at US$5.2 billion (equivalent to 5.0 months of import cover).

Figure 45: Gross International Reserves (US$ billion), 2022-2025



Source: Bank of Zambia

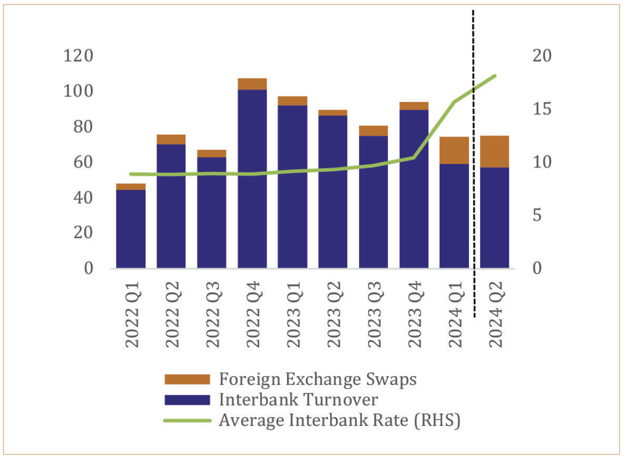
... liquidity conditions remain broadly tight

Liquidity conditions in the money market remained tight during the second quarter, following a sharp increase in the statutory reserve ratio on February 5, 2024. Consequently, the projected liquidity position of commercial banks was mostly short, averaging K4.3 billion per day. To fund their day-to-day liquidity requirements, the banking system relied heavily on the Bank of Zambia (BoZ) Overnight Lending Facility (OLF) under which an average K5.5 billion per day in loans was accessed at an interest rate of 29.0 percent.

It is noteworthy that open market operations (OMOs), under which liquidity is supplied at the BoZ Policy Rate, was not invoked until mid-June. This was meant to increase the effectiveness of tightening domestic liquidity and managing the existing foreign exchange market pressures.

Reflecting the impact of the Bank's strategy to supply liquidity at the relatively high OLF rate, the interbank money market rate rose further to a quarterly average of 18.14 percent from 15.67 percent in the previous quarter. In tandem, the turnover in interbank loans (measured to include foreign exchange swaps) remained virtually unchanged at K74.9 billion[67] (Figure 46).

Figure 46: Interbank Turnover, Overnight Lending Facility and Foreign Exchange Swaps (K' billion)



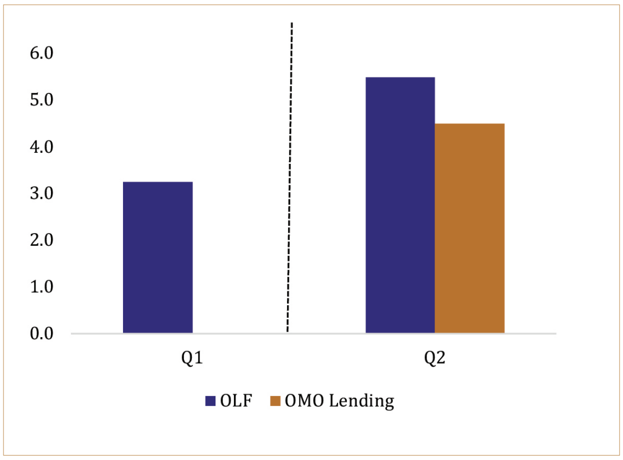
Source: Bank of Zambia

As the quarter progressed, commercial banks drastically reduced their rollover of Government securities investments to rebuild liquidity taken up by statutory reserves.

Relief was provided to commercial banks with the resumption of OMOs in mid-June. By the end of the quarter, commercial banks reduced their OLF loans in favour of borrowing through the relatively more cost-effective OMO window (Figure 47). Ultimately, the aggregate current account balance of commercial banks increased to K6.4 billion at end-June from K1.1 billion at end-March[68] (Figure 48).

[67]With a relatively stronger broad-based demand for liquidity within the banking system, few banks found themselves with excess to lend under the increased statutory reserve requirement scenario.
[68]Prior to the resumption of OMOs, liquidity was mostly absorbed through net sales of foreign exchange, repayment of loans obtained from the Bank of Zambia Overnight Lending Facility (OLF), and currency withdrawals (Table 14).

Figure 47: Daily Average Open Market Operations Lending and Overnight Lending Facility (K' billion)

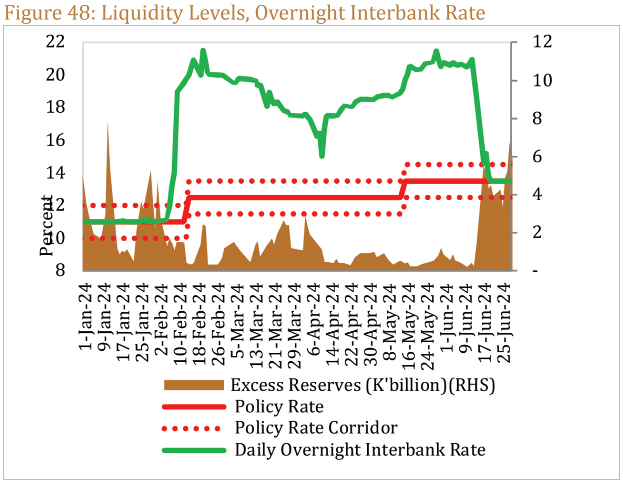


Source: Bank of Zambia

Open market operations were aimed at supporting the broader context of financial stability by steering the overnight interbank rate—which had deliberately been sustained above the Policy Rate Corridor since February 7, 2024—towards the target. Before this, effective June 5, the Bank of Zambia, through Circular No. 11/2024, announced the inclusion of Government securities as eligible assets for statutory reserve requirement compliance[69]. This measure was intended to moderate the cost of intermediation and provide flexibility to statutory reserve compliance.

As a result of OMOs, the interbank rate declined to the Policy Rate of 13.5 percent at end-June (Figure 48).

Figure 48: Liquidity Levels, Overnight Interbank Rate



Source: Bank of Zambia

... interest rate movement mixed

The overnight interbank, 6-month deposit and the Government bond yield rates declined while lending and Treasury bill yield rates increased (Figure 49).

Figure 49: Quarterly Change in Interest Rates (percent)

Source: Bank of Zambia

The overnight interbank rate declined sharply to 13.50 percent at end-June from 17.50 percent at end-March following the resumption of open market operations (Figures 48 and 49). The 6-month deposit rate declined, albeit marginally, to 6.7 percent from 7.0 percent.

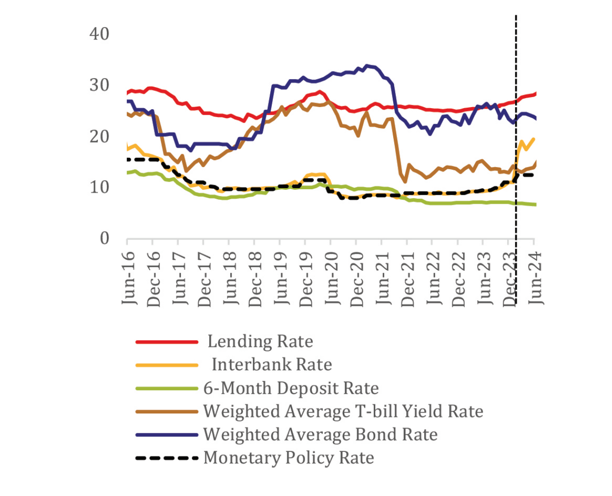
Yield rates on Government securities rose across all tenors prior to the resumption of OMOs in mid-June, reflecting weak demand on the back of tight liquidity conditions. Consequently, the composite Treasury bill yield rate rose by 247 basis points to 15.4 percent (Figures 50). However, demand for Government bonds improved after the resumption of OMOs and was skewed to the shorter end of the yield curve. Hence, the weighted average bond yield rate declined by 104 basis points to 23.4 percent at end-June (Figures 50).

The commercial banks' average nominal lending rate[70] marginally rose by 0.8 percentage points to 28.5 percent in part due to the further hike in the Policy Rate (Figures 49 and 50).

[69]Eligible securities were specific to three Government bonds (2-, 3- and 5-year tenors) offered to commercial banks through an auction held on June 6.

[70]Lending rates for Kwacha loans ranged from 9.0 percent to 36.0 percent while the 6-month deposit rate was between 1.5 percent and 20.0 percent. Lending rates on US dollar denominated loans were between 5.3 percent and 20.3 percent while the deposit rate ranged from 0.1 percent to 16.0 percent.

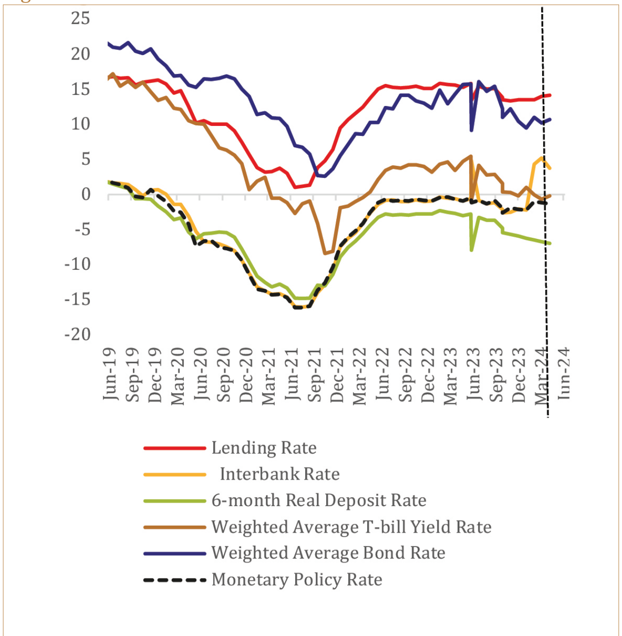
Figure 50: Nominal Interest Rates (percent)



Source: Bank of Zambia

In real terms, all the interest rates declined as inflation increased (Figure 51).

Figure 51: Real Interest Rates



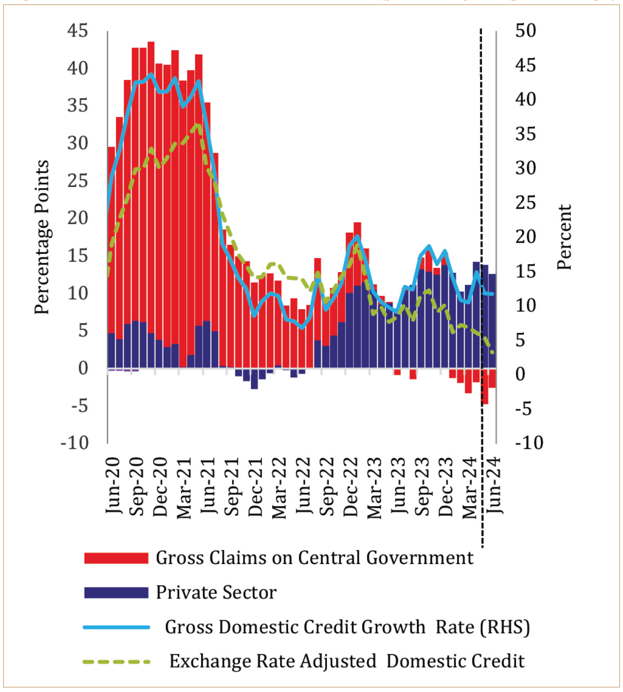
Source: Bank of Zambia

Respondents to the *August 2024 Credit Conditions Survey* and the *August 2024 Quarterly Survey of Business Opinions and Expectation* point to higher lending rates over the next four quarters, ranging from 25.0 percent to 27.6 percent. This is based on the expected tighter monetary policy stance and sustained implementation of fiscal consolidation measures.

... domestic credit growth picks up

Domestic credit[71] grew by 11.7 percent in June compared to 10.5 percent in March (Figure 52). This followed increased lending to the private sector. Adjusted for the exchange rate movement[72], domestic credit growth was 3.3 percent in June (6.9 percent in March). As a result, the contribution to domestic credit by the private sector increased to 12.6 percentage points from 11.1 percentage points in March.

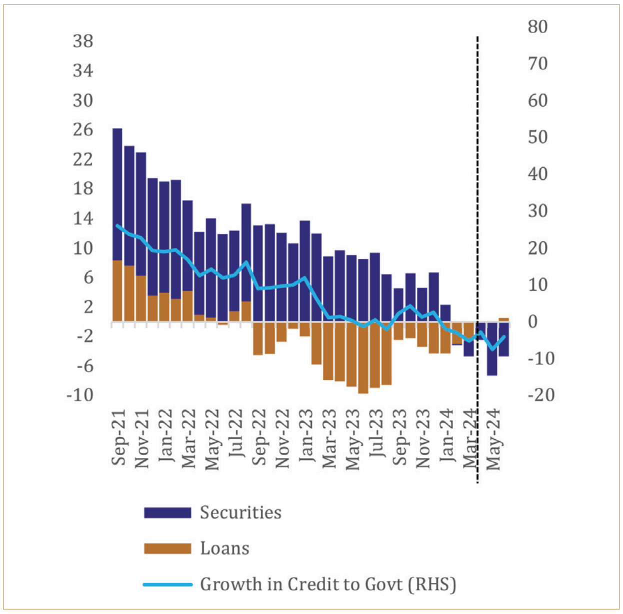
Figure 52: Contribution to Credit Growth (year-on-year, percentage)



Source: Bank of Zambia

Lending to Government through Government securities contracted further as liquidity conditions remained broadly tight (Figure 53).

Figure 53: Credit to Government by Instrument (year-on-year, percent)



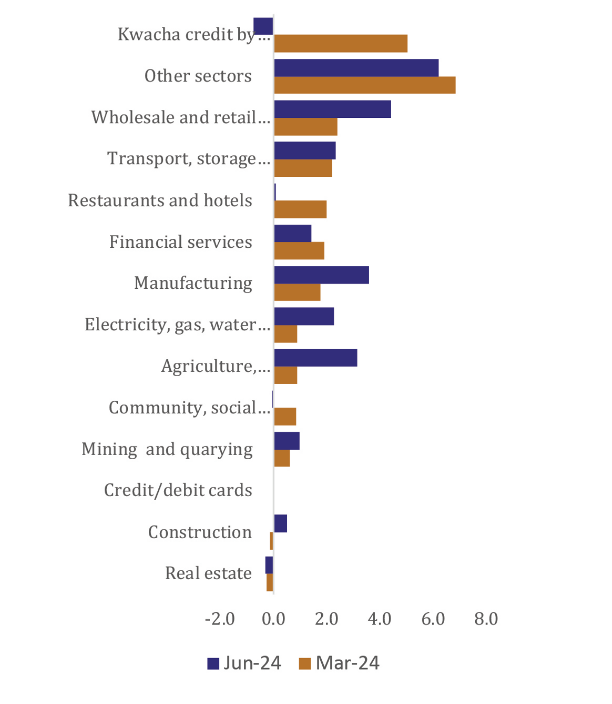
Source: Bank of Zambia

[71]Domestic credit refers to aggregate lending by the Bank of Zambia, commercial banks and other depository corporations in both Kwacha and foreign currency.

[72]Exchange rate adjusted domestic credit is calculated by multiplying the current US dollar amount by the exchange rate in the same month a year ago to eliminate valuation effects. A depreciation magnifies credit growth through valuation effects on foreign currency credit. The opposite is true for an appreciation.

Private sector credit expanded by 35.8 percent in June compared to 30.5 percent in March. This reflects more lending in Kwacha to the wholesale and retail; manufacturing; agriculture; electricity, gas, water and energy; as well as transport, storage and communications sectors (Figure 54).

Figure 54: Sectoral Contribution to Annual Percent Change in Private Sector Kwacha Credit

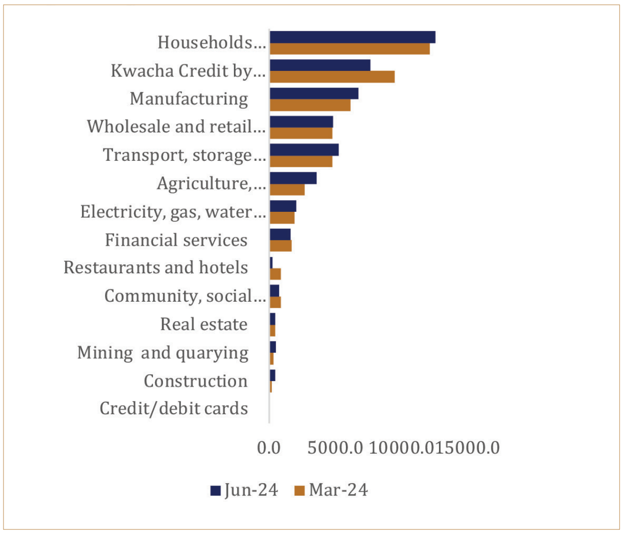


Source: Bank of Zambia

Respondents to the *August 2024 Credit Conditions Survey* cited increased utilisation of overdraft facilities by some SMEs and large corporations to mitigate rising costs and invest in alternative energy sources as the driver of credit demand in the second quarter. In addition, high demand for personal loans[73] persisted in the second quarter to supplement income to cover personal obligations, invest in alternative energy sources, and mitigate the rising cost of living.

As shown in Figure 55, households (personal loans), maintained the largest share of Kwacha denominated credit followed by manufacturing as well as transport, storage and communication sectors.

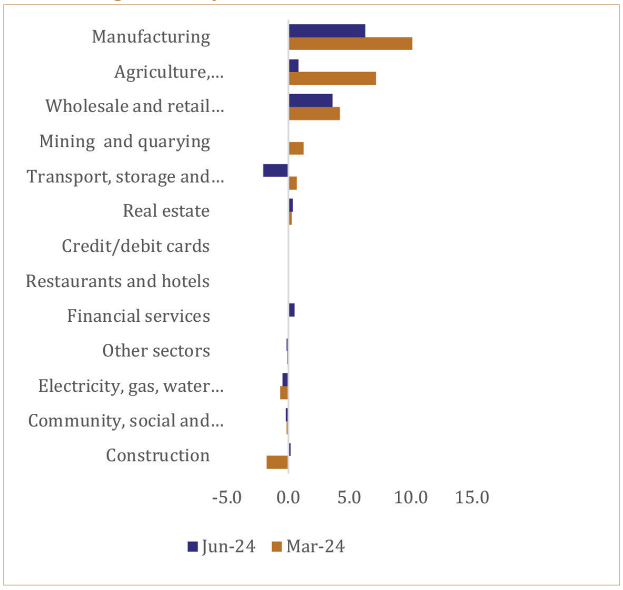
Figure 55: Stock Distribution of Private Sector Kwacha Credit (K'billion)



Source: Bank of Zambia

For foreign currency denominated credit, reduced lending was observed in the construction; community, social and personal services; as well as electricity, gas, water, and energy sectors. This was mostly influenced by the depreciation of the exchange rate, which affected the cost of construction materials and housing (Figure 56).

Figure 56: Sectoral Contribution to Annual Percent Change in Private Sector Foreign Currency Credit

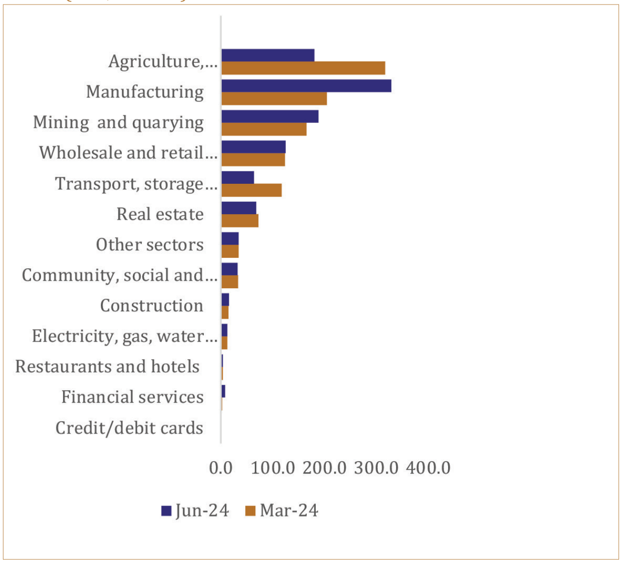


Source: Bank of Zambia

The manufacturing sector accounted for the largest share of foreign currency denominated loans followed by agriculture as well as mining and quarrying sectors (Figure 57).

[73]Demand for personal loans refers to the number of commercial banks that report willingness of clients to acquire personal loans measured in terms of applications and not value or loan amount.

Figure 57: Stock Distribution of Private Sector Foreign Currency Credit (US$, million)



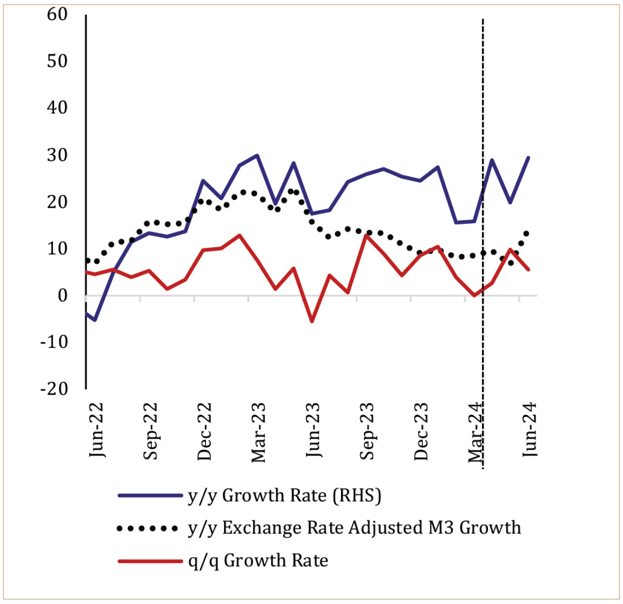
Source: Bank of Zambia

Respondents to the *August 2024 Credit Conditions Survey* expect high demand for credit by the private sector to be sustained in the third quarter on account of rising cost of living and investment in alternative energy sources. In addition, SMEs and large corporations are expected to continue borrowing to mitigate high operating costs caused by a weaker Kwacha.

... money supply growth rebounds

Money supply (M3)[74] growth picked-up to 29.5 percent in June from 15.8 percent in March (Figure 58). Adjusted for exchange rate movement, M3 growth was 14.7 percent (8.6 percent in March). The increase in domestic credit largely explains the higher M3 growth.

Figure 58: Money Supply Growth Rate (year-on-year, percent)

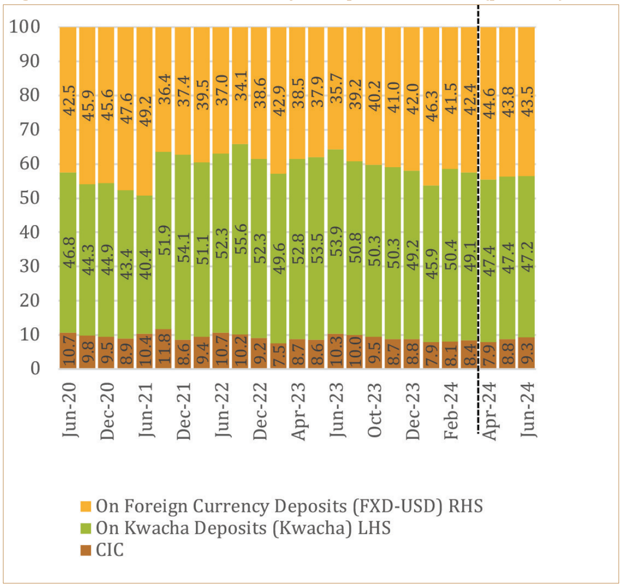


Source: Bank of Zambia

[74]M3 stock remained stable at K178.4 billion at end-June 2024.

The share of Kwacha deposits in money supply fell to 47.2 percent from 49.1 percent while currency held by the non-bank public and foreign currency deposits increased to 9.3 percent and 43.5 percent from 8.4 percent and 42.4 percent, respectively (Figure 59).

Figure 59: Share of Broad Money Components in M3 (percent)



Source: Bank of Zambia

2.4 Domestic Economic Activity

... estimated to have slowed down further in the second quarter

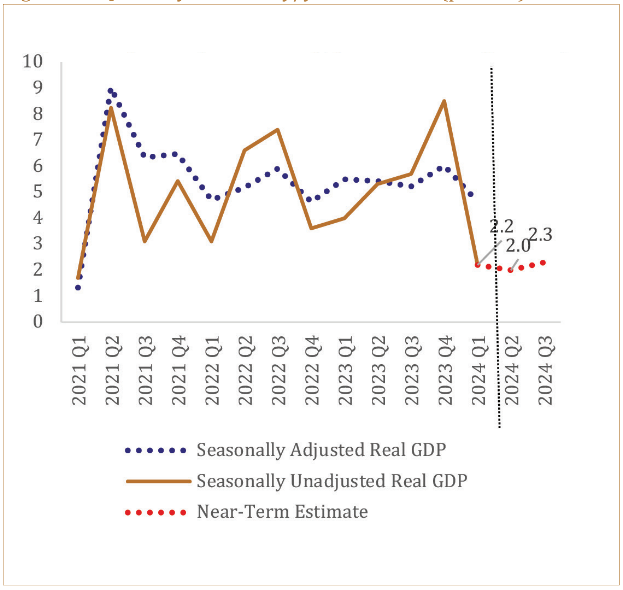
The BoZ near-term estimate, *August 2024 Quarterly Survey of Business Opinion and Expectations* and *Stanbic Bank Zambia[75] PMI™* point to a slowdown in economic activity in the second quarter.

According to the BoZ near-term estimate, real GDP growth decelerated to 2.0 percent, y/y, in the second quarter from 2.2 percent[76] in the first quarter (Figures 60 and 61). The key drivers were reduced retail sales and tourist arrivals as well as the contraction in electricity generation.

[75]The PMI is a composite indicator produced by Stanbic Bank Zambia to provide an overall view of activity in the economy. It is calculated as a weighted average of five sub-components: new orders, output, employment, suppliers' delivery times and stocks of purchases. A reading below 50 means business conditions deteriorated and above 50 reading means an improvement while 50 means no change in the business environment.

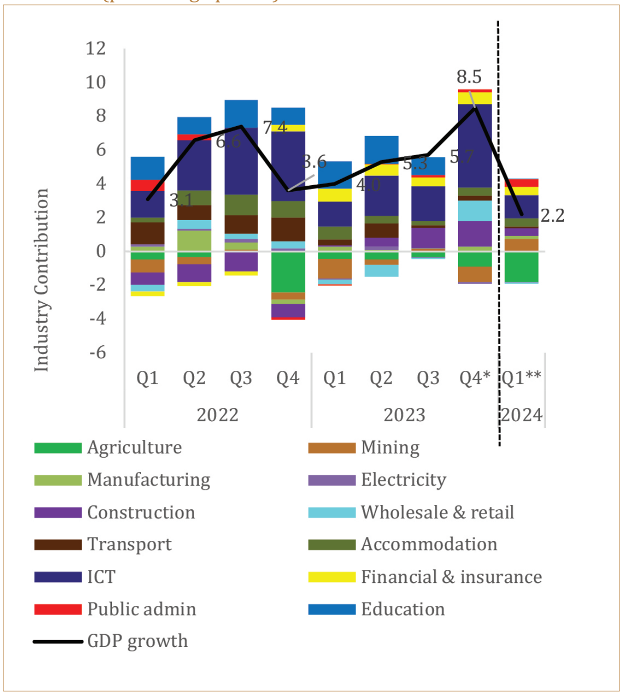
[76]In the first quarter of 2024, growth slowed down sharply owing to negative contributions by agriculture, administrative and support service activities as well as wholesale and retail trade sectors.

Figure 60: Quarterly Real GDP, y/y, Growth Rate (percent)



Source: Bank of Zambia

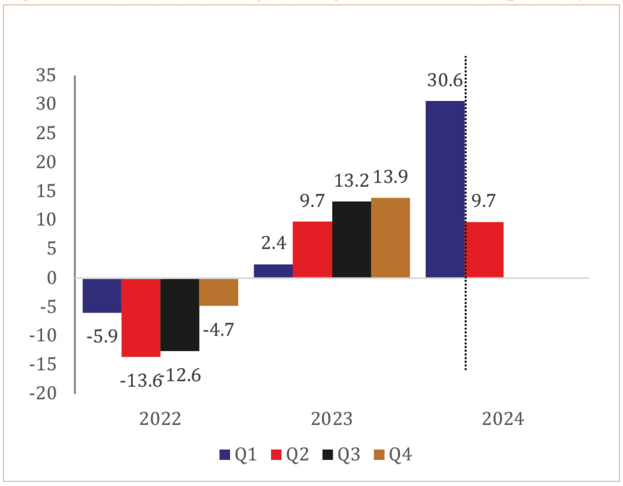
Figure 61: Quarterly Real GDP Growth and Contribution by Selected Industries (percentage points)



Source: Zambia Statistics Agency and Bank of Zambia
* = revised ** = preliminary

The growth in retail sales, a proxy for wholesale and retail trade sector activity, slowed down significantly to 9.7 percent from 30.6 percent recorded in the first quarter (Figure 62). This was mostly due to weak demand occasioned by persistent inflation.

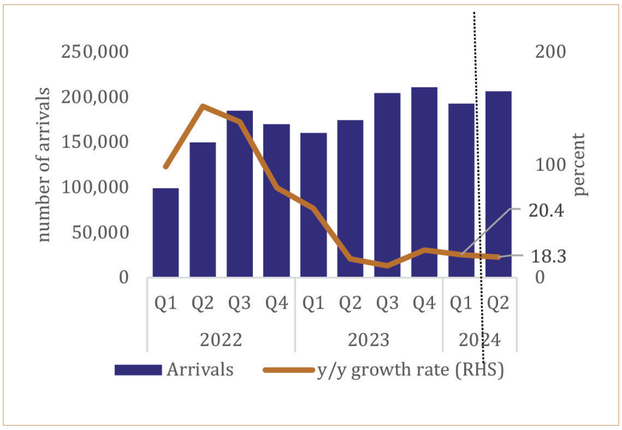
Figure 62: Real Retail Sales, year-on-year, Growth Rate (percent)



Source: Bank of Zambia

Similarly, the growth in international airport arrivals—proxy for the tourism sector—reduced further to 18.3 percent from 20.4 percent (Figure 63). The normalisation of tourist arrivals has continued following the easing of COVID-19 travel restrictions[77] in June 2020.

Figure 63: International Airport Arrivals



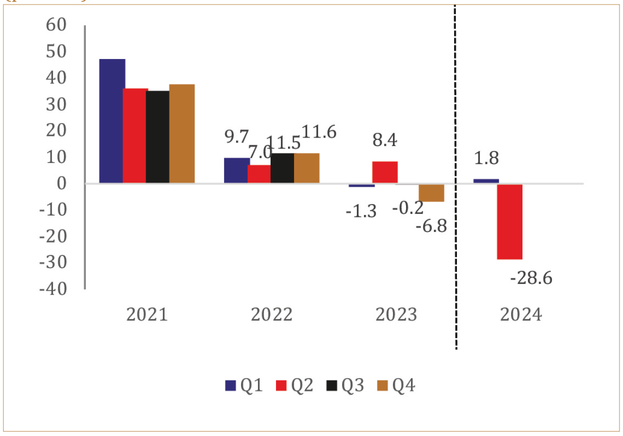
Source: Zambia Airports Corporation Limited, Bank of Zambia Compilations

Electricity generation contracted by 28.6 percent, y/y, to 3,617 gigawatt hours in the second quarter (Figure 64). The drought has significantly reduced water levels in reservoir dams leading to a severe decline in electricity generation. The Kariba Dam Reservoir is at historical low level while Itezhi-Tezhi Hydropower and Kafue Gorge Lower Power Stations are producing below installed capacity[78].

[77]Prior to the COVID-19 pandemic (2016 to 2019), the growth in tourist arrivals averaged 6.5 percent per quarter. In contrast, after easing COVID-19 travel restrictions, as international airports were reopened, the quarterly growth rate surged to 362 percent between 2021 and 2022.

[78]Combined generation was approximately 543 megawatts, significantly below the total designed capacity of 1,800 megawatts.

Figure 64: Electricity Generation, year-on-year Growth Rate (percent)

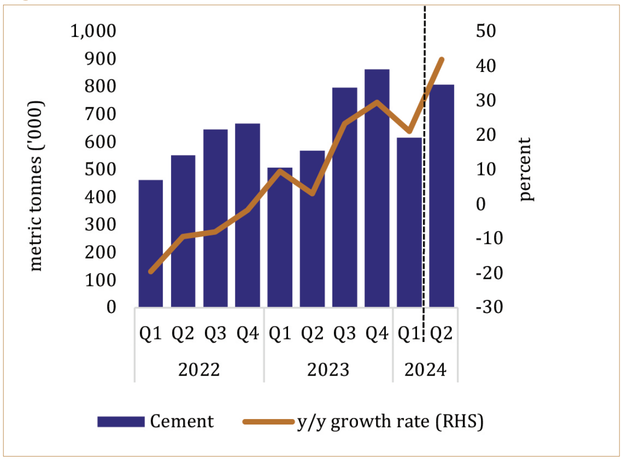


Source: ZESCO, Bank of Zambia Compilations

On the other hand, cement and diesel production expanded in the second quarter.

Cement production—proxy for construction sector—continued to rise, increasing by 42.0 percent, y/y, compared to 21.2 percent in the previous quarter (Figure 65). Low rainfall generally created "favourable conditions" for construction activities, coinciding with the commencement of the 327-Kilometre Lusaka-Ndola Dual Carriage Way upgrade launched on May 21 by the Republican President and the rehabilitation of Masangano-Fisenge-Luanshya Roads.

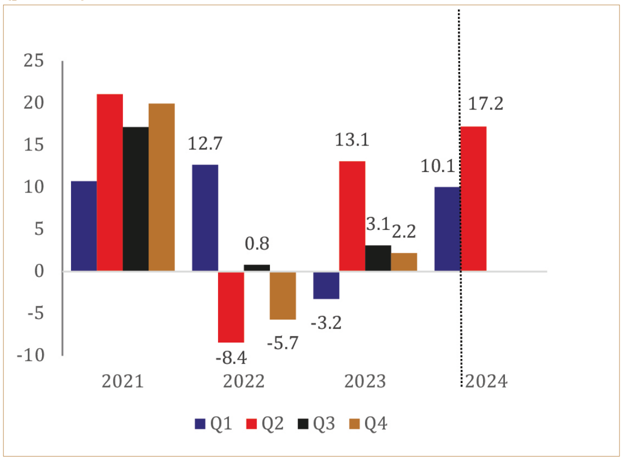
Figure 65: Cement Production



Source: Bank of Zambia

Diesel consumption—proxy for the transportation sector—rose by 17.2 percent to 386.2 million litres (Figure 66). This mostly reflects increased electricity rationing due to the power deficit induced by the drought.

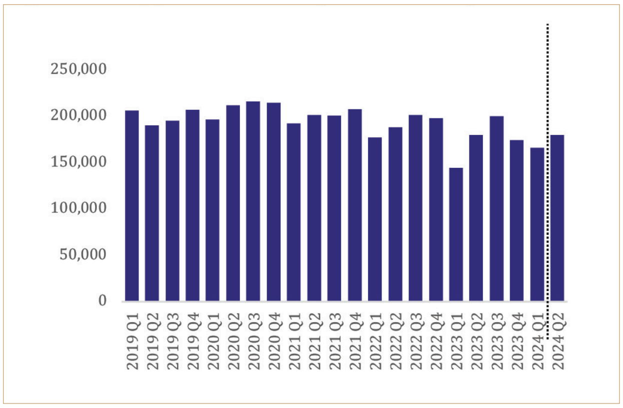
Figure 66: Diesel Consumption, year-on-year, Growth Rate (percent)



Source: Energy Regulation Board, Bank of Zambia Compilations

There was virtually no growth in copper production—proxy for mining sector activity—in the second quarter on a year-on-year basis (Figure 67). Copper production returned to the level recorded a year ago[79] after rebounding in the first quarter.

Figure 67: Copper Production (metric tonnes)

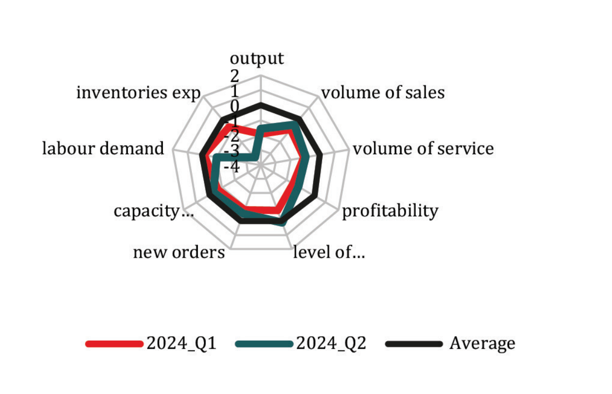


Source: Ministry of Mines and Minerals Development, Bank of Zambia Compilations

Respondents to the *August 2024 Quarterly Survey of Business Opinion and Expectations* indicated sustained sluggish economic activity in the second quarter due to persistent inflationary pressures (Figure 68). Output, new orders, sales volume, service volume, profitability, capacity utilization, and level of investment declined. Electricity shortages and limited availability of agricultural inputs exacerbated production costs leading to reduced output in the manufacturing and merchant sectors while the rising cost of living affected consumer demand.

[79]"Favourable drought conditions" supported the achievement of production levels equivalent to Q2 2023.

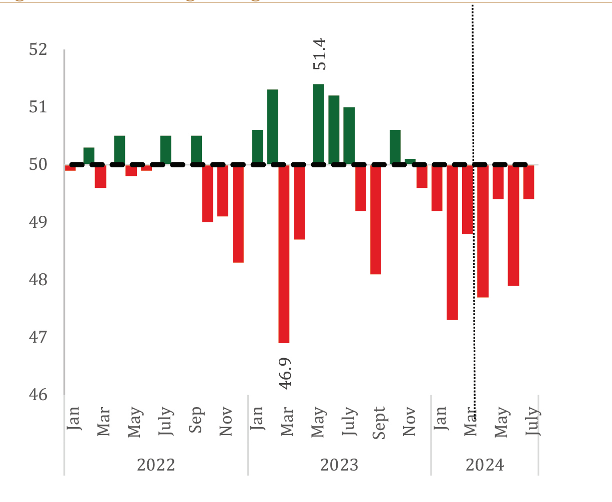
Figure 68: Business Opinion Response Patterns[80]



Source: Bank of Zambia

The *Stanbic Bank Zambia[81] PMI™* also indicated a persistent decline in business conditions for the private sector in the second quarter. The PMI remained below the 50 mark (Figure 69). Output and new orders continued to decline primarily due to dampened demand for goods and services induced by tight liquidity conditions and persistent inflationary pressures, which eroded customer purchasing power. In addition, unpredictable electricity load management adversely affected business conditions.

Figure 69: Purchasing Manager's Index for Zambia



Source: Stanbic Zambia and Bank of Zambia Compilation

2.5 Budget Performance

... constrained by financing

Revenue was broadly in line with the target. Nonetheless, mining sector performance remained subdued despite relatively higher copper price. Value added tax collections remained strong, especially on imports of petrol and diesel, and boosted revenue. However, Government continued to rationalise spending in the second quarter in the wake of constrained domestic financing occasioned by broadly tight liquidity conditions.

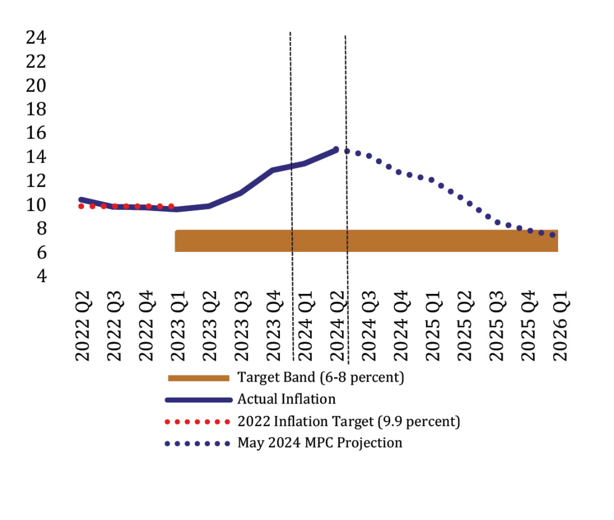
[80]Survey indicators are standardised net balances with mean = 0 and standard deviation = 1. A value within the black circle entails weaker economic conditions than the historical average and a value outside the black line signifies an improvement over the historical average.
[81]The PMI is a composite indicator produced by Stanbic Bank Zambia to provide an overall view of activity in the economy. It is calculated as a weighted average of five sub-components: new orders, output, employment, suppliers' delivery times and stocks of purchases. A reading below 50 means business conditions deteriorated and above 50 reading means an improvement while 50 means no change in the business environment.

2.6 Domestic Prices

... rise further

Inflation rose to 14.6 percent in the second quarter from 13.5 percent in the preceding quarter (Figure 70). This outturn was higher than the May 2024 MPC projection of 13.5 percent mostly attributed to higher crude oil prices and the federal funds rate than assumed (Table 8).

Figure 70: Actual and Projected Annual Overall Inflation (percent



Source: Bank of Zambia Staff Forecast and Zambia Statistics Agency

Table 8: Assumptions underlying Inflation Projection in Q2 2024

	Assumed Value	Actual Value
Average inflation-US (percent)	2.1	2.7
Fed funds rate (percent)	4.6	5.3
Average inflation-South Africa (percent)	5.1	5.2
Average copper price/tonne (US$)	8,760.00	10,258.24
Average crude oil price/barrel (US$)	83.44	86.38
Reserve money growth (percent)	2.8	2.1
Fiscal deficit (ratio of expenditure to revenue)	1.21	1.00
World food price index	118.5	116.6
BoZ monetary policy rate (percent)	12.5	13.5

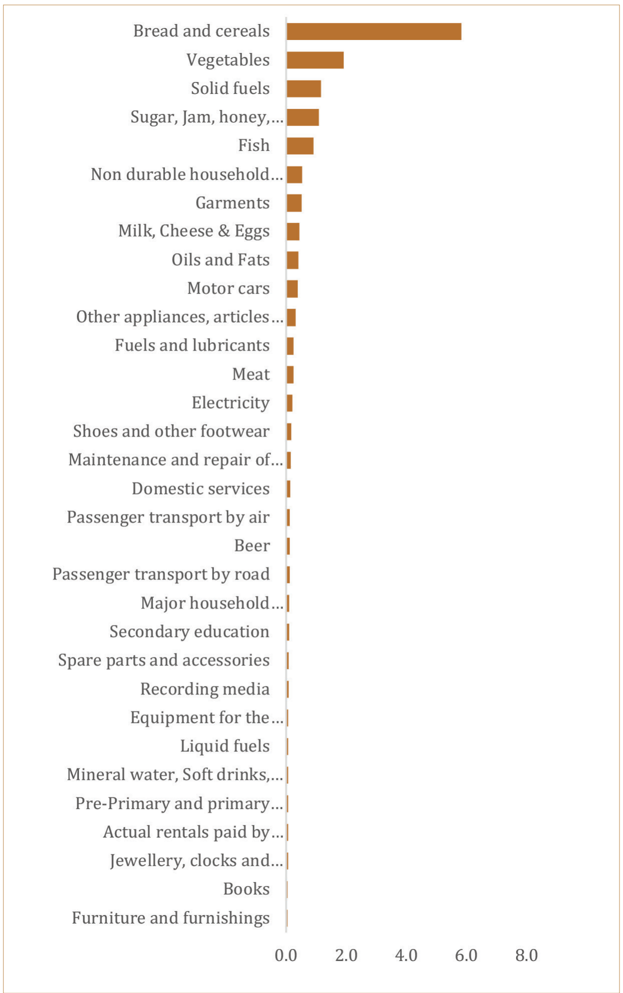
Source: Bank of Zambia Compilations, Reuters, South African Reserve Bank, World Bank Pink Sheet and Survey of Professional Forecasters

The sustained increase in maize grain and maize product prices, limited supply of vegetables and fish, high demand for solid fuels, and the persistent depreciation of the exchange rate remained key drivers of inflation in the quarter. The upward adjustment in electricity tariffs[82] also contributed to the rise in inflation.

As indicated in Figures 71 and 72, the sub-groups (products) that contributed the most to inflation were bread and cereals (mainly breakfast and roller meal, maize grain and imported rice), vegetables (mushrooms, maize cobs, rape, cabbage, peas and onions), solid fuels (charcoal and firewood), sugar, jam, honey, chocolate and confectionery (sugar, ice cream, plain chocolate bar) and fish (dried kapenta and frozen fish).

Bread and cereals prices continued to be driven by higher maize grain prices while the persistent depreciation of the exchange rate accounted for increases in the prices of sugar; non-durable household goods; garments; milk, cheese and eggs; oils and fats; and motor vehicles (Figure 71). Cold weather conditions explain the rise in the prices of vegetables, fish and solid fuels.

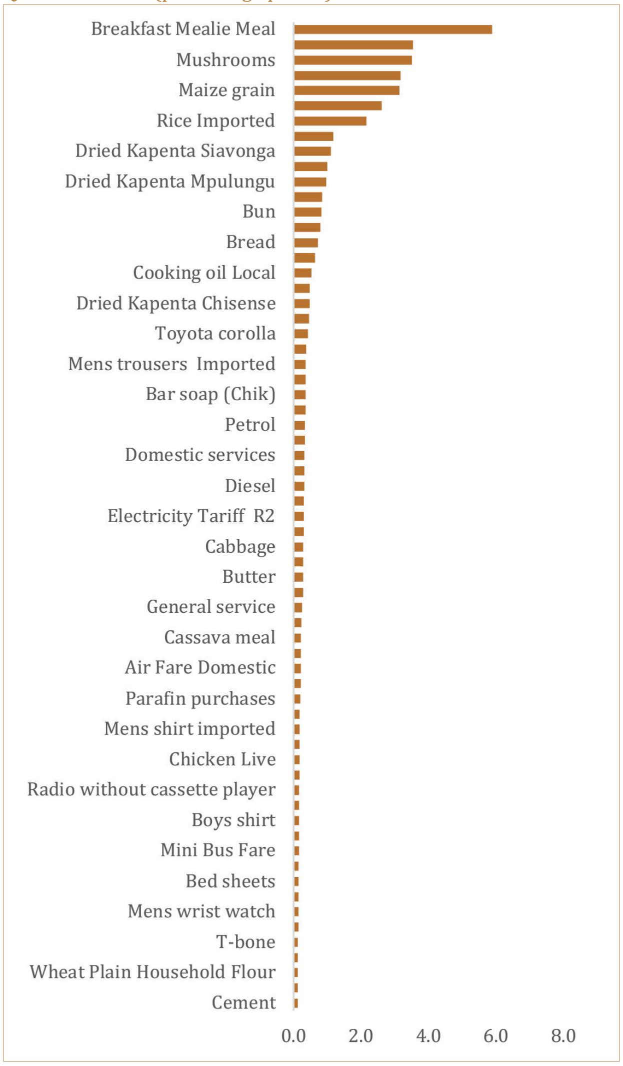
Figure 71: Contribution to Overall Inflation by Sub-Group in the First Quarter of 2024 (percentage points)



Source: Bank of Zambia Staff Computations

[82]Based on the pre-approved Multi-Year Electricity Tariff Plan by the Energy Regulation Board in May 2023, a 10.0 percent increase in electricity tariffs was effected on May 1.

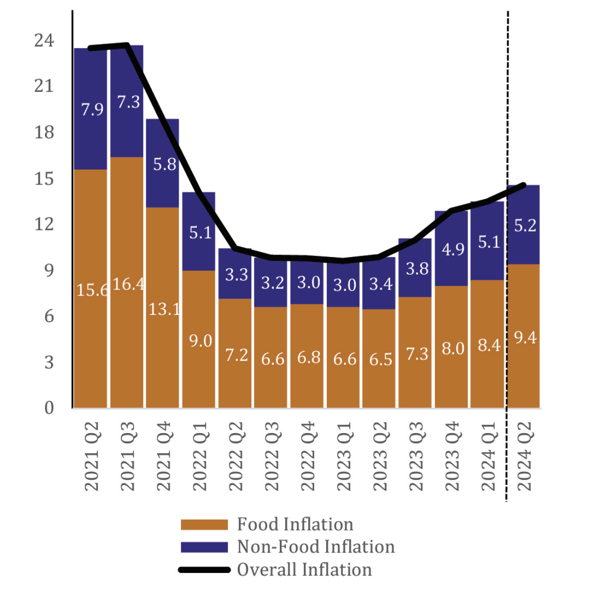
Figure 72 :Contribution to Overall Inflation by Product in the Second Quarter of 2024 (percentage points)



Source: Bank of Zambia Staff Computations

Given price increases for these products, the contribution to overall inflation by food and non-food sub-components rose further to 9.4 percentage points and 5.2 percentage points from 8.4 percentage points and 5.1 percentage points, respectively (Figure 73).

Figure 73: Contribution by Food and Non-Food Sub-Components to Overall Inflation (percentage points)



Source: Zambia Statistics Agency and Bank of Zambia Staff Computations

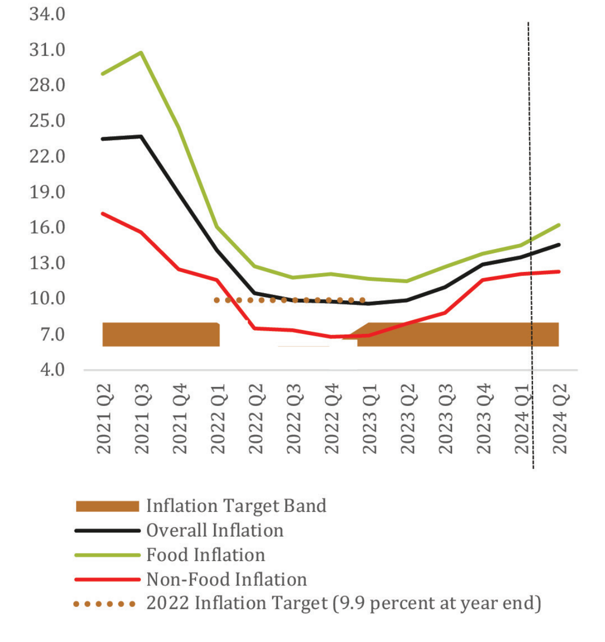
As a result, food inflation rose sharply to 16.2 percent from 14.5 percent while non-food inflation increased marginally to 12.3 percent from 12.1 percent (Table 9 and Figure 74).

Table 9: Quarterly Average and End-Period Inflation Rate (percent)

	Q2 2023	Q3 2023	Q4 2023	Q1 2024	Q2 2024
Average					
Overall Inflation	9.9	11.0	12.9	13.5	14.6
Food Inflation	11.5	12.7	13.8	14.5	16.2
Non-food Inflation	7.9	8.8	11.6	12.1	12.3
End Period					
Overall Inflation	9.8	12.0	13.1	13.7	15.2
Food Inflation	11.2	13.4	14.2	15.6	16.8
Non-food Inflation	7.8	10.1	11.6	11.2	13.0

Source: Zambia Statistics Agency, Bank of Zambia Staff Computations

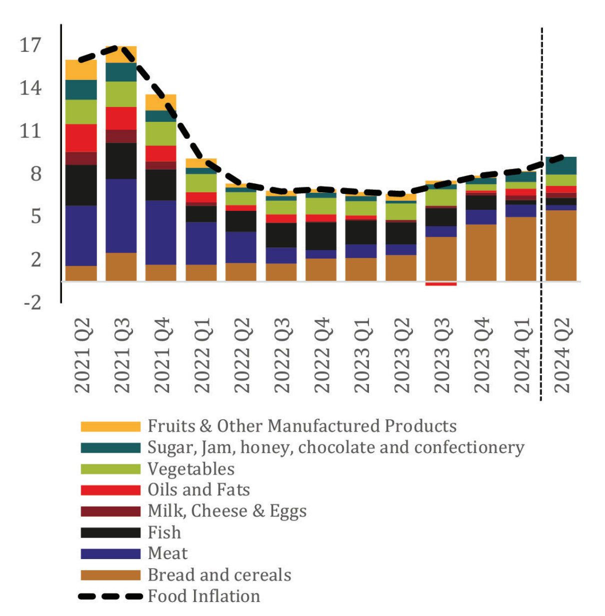
Figure 74: Inflation and its Components (percent)



Source: Zambia Statistics Agency, Bank of Zambia Staff Computations

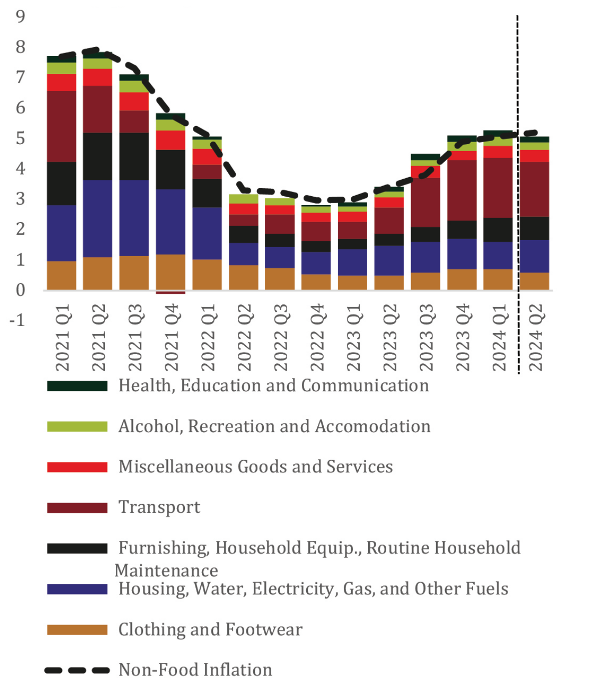
Figures 75 and 76 provide a summary of the contributions by food and non-food sub-groups to overall inflation, respectively.

Figure 75: Contribution to Overall Inflation by Food Sub-Group (percent)



Source: Zambia Statistics Agency, Bank of Zambia Staff Computations

Figure 76: Contribution to Overall Inflation by Non-Food Sub-Group (percent)



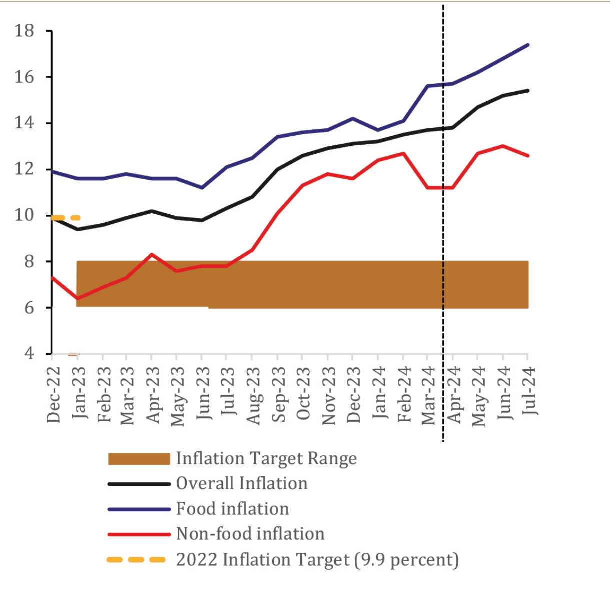
Source: Zambia Statistics Agency, Bank of Zambia Staff Computations

Respondents to the *May 2024 Bank of Zambia Quarterly Survey of Business Opinions and Expectations* expected inflation to rise to 14.9 percent in the second quarter based on higher cost of production induced by rising fuel prices, depreciation of the exchange rate and adverse effects of the drought on agricultural and electricity production.

... inflation rises marginally in July

In July, inflation marginally rose to 15.4 percent from 15.2 percent in June (Figure 77). Higher maize grain prices, exchange rate depreciation, reduced supply of fish and vegetables, as well as increased demand for solid fuels continued to drive inflation.

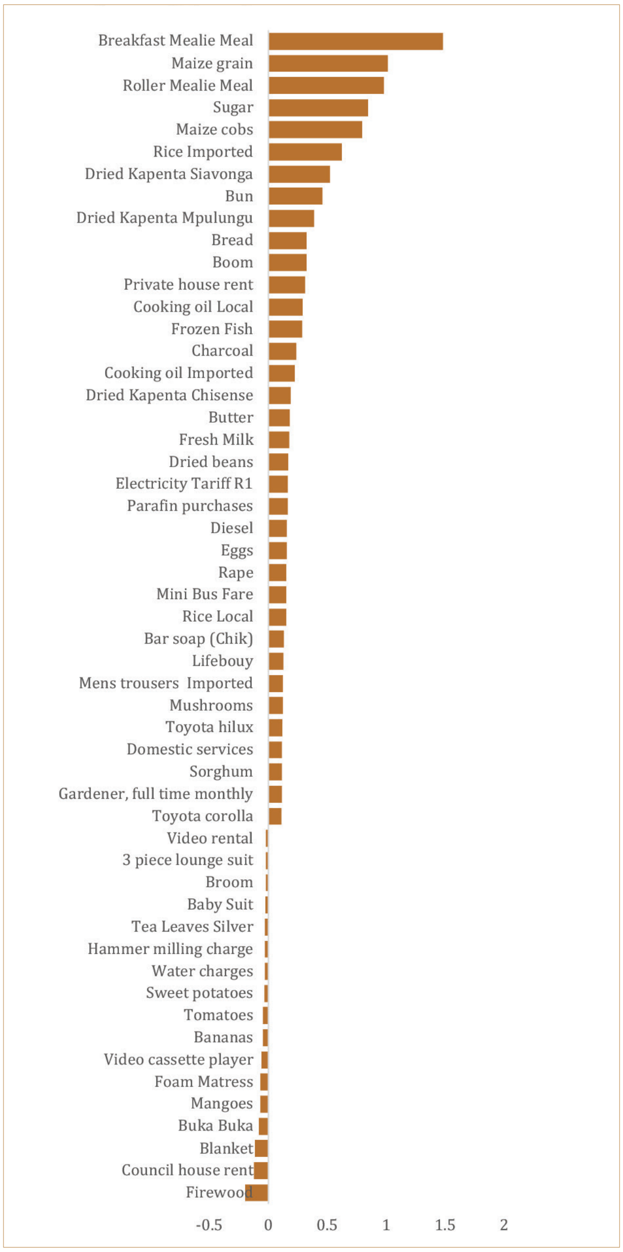
Figure 77: Inflation and its Components (percent)



Source: Zambia Statistics Agency, Bank of Zambia Staff Computations

Notable price increases were recorded for breakfast and roller mealie meal, maize grain, sugar, imported rice, dried kapenta, bread, washing soap, cooking oil, frozen fish, charcoal, fresh milk, dried beans, eggs, rape and bath soap (Figure 78). The bread and cereals sub-group continued to be the dominant contributor to overall inflation (Figure 79). This was followed by vegetables, fish, sugar, oils and fats as well as non-durable household goods sub-groups.

Figure 78: Contribution to Overall Inflation by Product in July 2024 (percentage points)



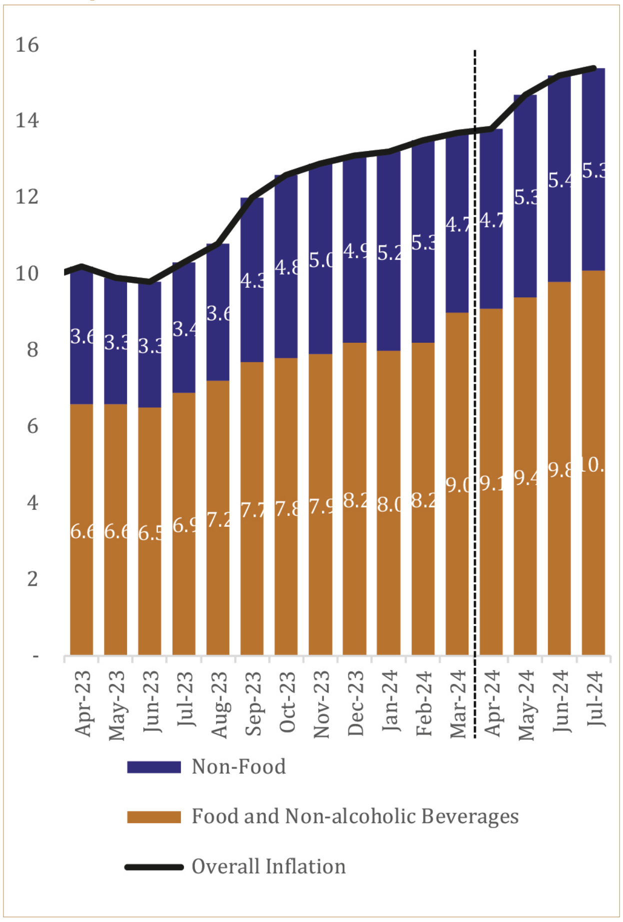
Source: Zambia Statistics Agency, Bank of Zambia Staff Computation

Figure 79: Contribution to Overall Inflation by Sub-Group in July 2024 (percentage points)

Source: Zambia Statistics Agency, Bank of Zambia Staff Computation

The contribution by the food sub-component to overall inflation rose to 10.1 percentage points from 9.8 percentage points (Figure 80). This was mainly due to the persistent increase in the prices of food items. In contrast, the non-food sub-component marginally reduced to 5.3 percentage points from 5.4 percentage points. Consequently, food inflation increased to 17.4 percent from 16.8 percent while non-food inflation declined to 12.6 percent from 13.0 percent (Figure 77).

Figure 80: Contribution to Overall Inflation by Food and Non-Food Sub-Groups



Source: Zambia Statistics Agency, Bank of Zambia Staff Computation

Appendix

Monetary and Foreign Exchange Measures since April 2012

Measure	Date Implemented	Rationale
Policy Rate introduced and set at 9.0 percent	April 2, 2012	Mechanism for signalling monetary policy stance as transition to inflation targeting
Policy Rate raised to 9.25 percent	October 31, 2012	To contain inflationary pressures
Policy Rate raised to 9.50 percent	May 31, 2013	To contain inflationary pressures
Policy Rate raised to 9.75 percent	June 28, 2013	To contain inflationary pressures
Statutory reserve ratio raised to 14.0 percent from 8.0 percent	February 24, 2014	To address excess liquidity in the money market and its impact on inflation
Overnight Lending Facility (OLF) rate set at 600 basis points above the Policy Rate		
Access to OLF window restricted to once a week	March 19, 2014	To address excess liquidity in the money market and its impact on inflation
Marketable amount for two-way quote in the Interbank Foreign Exchange Market (IFEM) revised to US$0.5m-US$1m from US$1m		To moderate exchange rate volatility and bring orderliness in the interbank market
Interbank bid/ask spread increased to a maximum of K0.02 from K0.01	March 28, 2014	To enhance price discovery
Policy Rate raised to 10.25 percent	February 28, 2014	To contain inflationary pressures
Policy Rate raised to 12.0 percent	March 28, 2014	To contain inflationary pressures
Inclusion of Government deposits and vostro account deposits in the computation of statutory reserves		
Daily compliance on statutory reserve ratio re-introduced		
OLF rate set at 10.0 percentage points above the Policy Rate	May 30, 2014	
Policy Rate raised to 12.5 percent	November 19, 2014	To contain inflationary pressures
Once a week access to the OLF Window suspended and intraday loan to lapse into overnight loan allowed	December 10, 2014	
Statutory reserve ratio raised to 18.0 percent from 14.0 percent		
OLF rate set at 6 percentage points above the Policy Rate from 9.5 percentage points	March 20, 2015	
BoZ to discretionary trade any amount beyond marketable threshold on two-way quote		
BoZ to publish individual commercial banks' exchange rates on Reuters platform		To improve order, stability, and transparency in the foreign exchange market
Commercial banks to update board exchange rates three times a day as prescribed	October 5, 2015	
Policy Rate raised to 15.5 percent	November 3, 2015	To contain inflationary pressures
Interest rate caps removed, and consumer protection measures introduced	November 4, 2015	To allow for better functioning of the credit market
OLF rate set at 1,000 basis points above the Policy Rate	November 10, 2015	To contain inflationary pressures
Access to OLF Window restricted to once a week		
Roll-over of intra-day loan into an overnight loan discontinued	November 18, 2015	To contain inflationary pressures
Interbank bid/ask spread increased to a maximum of K0.05 from K0.02	May 19, 2016	To improve price discovery

Measure	Date Implemented	Rationale
Policy Rate reduced to 14.0 percent from 15.5 percent (first reduction since April 2012)	February 22, 2017	Fall in inflation; support economic growth
Statutory reserve ratio reduced to 15.0 percent from 18.0 percent	February 22, 2017	Reduce the cost of funds and promote credit growth
OLF rate set at 600 basis points above the Policy Rate from 1,000 basis points previously	February 22, 2017	Reduce the cost of funds and promote credit growth
Policy Rate reduced to 12.5 percent from 14.0 percent	May 17, 2017	Fall in inflation; support economic growth
Statutory reserve ratio reduced to 12.5 percent from 15.5 percent	May 17, 2017	Reduce the cost of funds and promote credit growth
Narrowed the Policy Rate corridor to +/- 1 percentage point from +/- 2 percentage points	May 17, 2017	To improve clarity of the policy stance and enhance effectiveness of monetary policy.
Policy Rate reduced to 11.0 percent from 12.5 percent	August 10, 2017	Fall in inflation; support economic growth
Statutory reserve ratio reduced to 9.5 percent from 12.5 percent	August 10, 2017	Reduce the cost of funds and promote credit growth
Policy Rate reduced to 10.25 percent from 11.0 percent	November 22, 2017	Fall in inflation; support economic growth
Statutory reserve ratio reduced to 8.0 percent from 9.5 percent	November 22, 2017	Reduce the cost of funds and promote credit growth
Policy Rate reduced to 9.75 percent from 10.25 percent	February 20, 2018	Fall in inflation; support economic growth, financial system stability
Statutory reserve ratio reduced to 5.0 percent from 8.0 percent	February 20, 2018	Fall in inflation and to provide a firm basis for the Policy Rate as the key signal of monetary policy
Policy Rate raised to 10.25 percent from 9.75 percent	May 22, 2019	Rise in inflationary pressures and heightened upside risks
OLF rate adjusted to 775 basis points above the Policy Rate from 600 basis points	May 22, 2019	Reduce volatility in the foreign exchange market contributing to inflationary pressures
OLF rate set at 1,650 basis points above the Policy rate from 775 basis points	November 14, 2019	Reduce volatility in the foreign exchange market contributing to inflationary pressures
Policy Rate raised to 11.5 percent from 10.25 percent	November 20, 2019	Rise in inflationary pressures and heightened upside risks
Statutory reserve ratio raised to 9.0 percent from 5.0 percent	December 23, 2019	Reduce volatility in the foreign exchange market
Policy Rate cut to 9.25 percent from 11.5 percent	May 20, 2020	To mitigate the adverse effects of COVID-19 on economic activity.
Additional standards of professional and ethical conduct for market players to enhance market discipline introduced.	May 2020	To enhance market discipline
Mining companies required to pay non-mineral royalty obligations directly in US dollars.	May 2020	To shore up international reserves.
Policy Rate cut to 8.0 percent from 9.25 percent	August 19, 2020	To safeguard the stability of the financial sector and mitigate the adverse effects of COVID-19 on economic activity.
Pricing rules governing the IFEM amended requiring Authorised Dealers to transact at prevailing market rates.	November 6, 2020	To stabilise the foreign exchange market.
Policy Rate raised to 8.5 percent from 8.0 percent	February 17, 2021	To counter inflationary pressures and anchor inflation expectations.
Policy Rate raised to 9.0 percent from 8.5 percent	November 24, 2021	To steer inflation to single digits in 2022 and within the target range by mid-2023.
Statutory reserve ratio raised to 11.5 percent from 9.0 percent	February 8, 2023	To address volatility in the foreign exchange market and safeguard stability of the foreign exchange market

Measure	Date Implemented	Rationale
Policy Rate raised to 9.25 percent from 9.0 percent	February 15, 2023	To steer inflation to within the target range by end-2023.
Policy Rate raised to 9.50 percent from 9.25 percent	May 17, 2023	To steer inflation back into the target range of 6-8 percent
Policy Rate raised to 10.0 percent from 9.50 percent	August 23, 2023	To steer inflation back into the target range of 6-8 percent
Statutory reserve ratio raised to 14.5 percent from 11.5 percent	November 13, 2023	To relieve persistent foreign exchange market pressure with a view to rein in inflation.
Statutory reserve ratio raised to 17.0 percent from 14.5 percent	November 21, 2023	Necessitated by persistent exchange rate pressures which were contributing to higher inflation.
Policy Rate raised to 11.0 percent from 10.0 percent	November 22, 2023	To steer inflation back into the target range of 6-8 percent
Statutory reserve ratio raised to 26.0 percent from 17.0 percent	February 2, 2024	Necessitated by persistently high demand pressures in the foreign exchange market contributing to higher inflation.
Policy Rate raised to 12.5 percent from 11.0 percent	February 14, 2024	To steer inflation back into the target range of 6-8 percent and help anchor inflation expectations.
Policy Rate raised to 13.5 percent from 12.5 percent	May 15, 2024	To augment earlier actions aimed at containing persistent inflationary pressures, acting mostly through the exchange channel, and addressing rising inflation expectations.
Bank of Zambia Foreign Exchange Market Guidelines Issued	May 24, 2024	To enhance transparency, efficiency and effectiveness of domestic foreign exchange market.
Government Securities Included as an Eligible Asset Class for Minimum Reserve Requirement	June 5, 2024	To moderate the cost of intermediation and provide flexibility to reserve requirement compliance.
Interbank Foreign Exchange Market Rules Amended	June 11, 2024	To improve transparency and strengthen the operations of the domestic foreign exchange market.
Policy Rate maintained at 13.5 percent	August 15, 2024	The Committee judged that the monetary policy stance was appropriate despite actual and projected inflation remaining above the 6-8 percent target band.