



BANK *Of* ZAMBIA

**QUARTERLY SURVEY OF BUSINESS
OPINIONS AND EXPECTATIONS
REPORT**

Third Quarter 2018, Vol 2.3

Disclaimer:

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

OCTOBER 2018

PREFACE

The Quarterly Survey of Business Opinions and Expectations (QSBOEs) undertaken by the Bank of Zambia is designed as a supplementary tool to provide information on the business community’s opinions and expectations about the current and future direction of the economy.

The business opinions and expectations survey provides useful indications about current and future economic activity and assists in the formulation of decisions today that impact on future economic performance. The survey provides a guide to likely future developments because of the dominant role expectations play in shaping economic behaviour.

This Report is based on the results of the QSBOEs conducted from September – October 2018. A total of 280 questionnaires were distributed. Of these, 253 firms responded, thus representing a response rate of 90.4%. Of the 253 firms that responded, 36.4% were from tourism, 22.9% were merchants and 16.6 % were from the manufacturing sector (see Figures 1 and 2).

Figure 1: Response Rates by Sector (%)

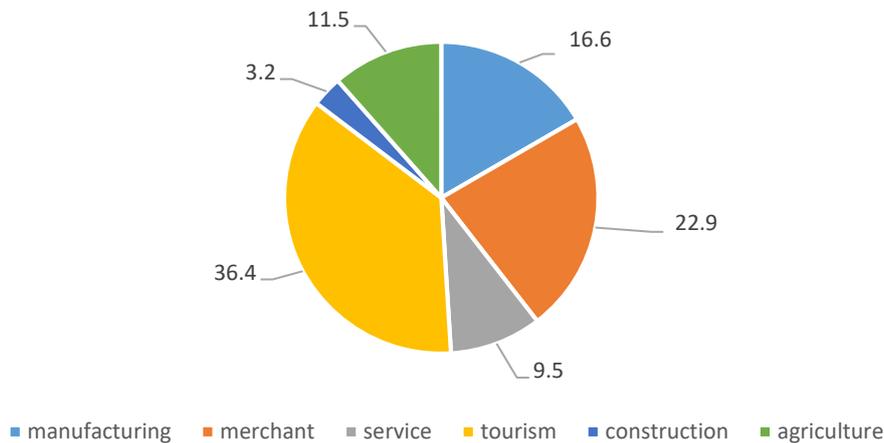
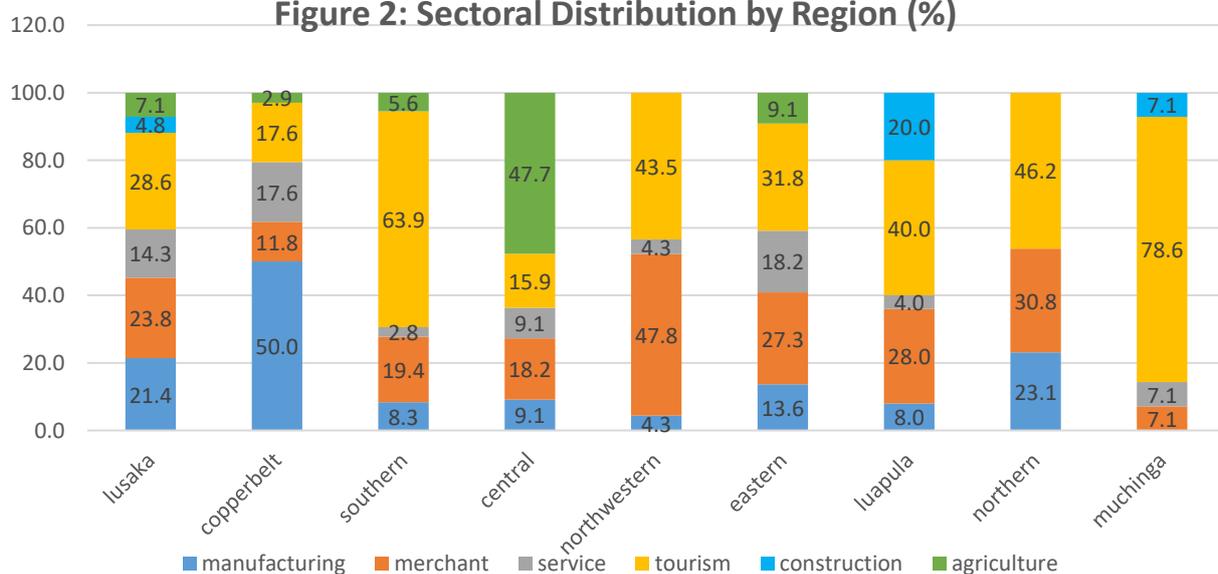


Figure 2: Sectoral Distribution by Region (%)



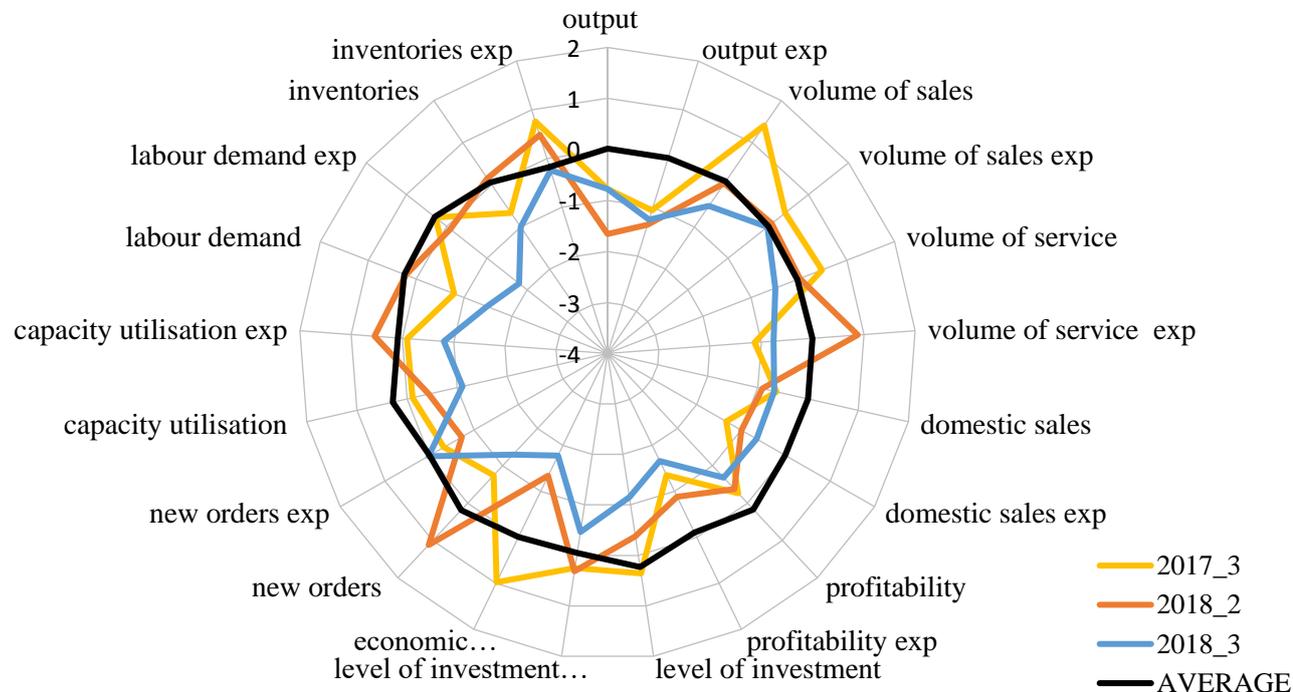
Executive Summary¹

The third quarter 2018 Survey of Business Opinions and Expectations showed a deterioration in economic activity when compared to the second quarter 2018 as well as the third quarter of 2017. All the monitored indicators including the volume of sales, volume of service, capacity utilisation, profitability, level of investment, new orders, labour demand and inventories declined, with the exception of output and domestic sales of the agriculture sector which improved due to the marketing period. Generally, the business environment was negatively affected by the rise in costs of production, the depreciation of the Kwacha exchange rate against the US Dollar, upward adjustment in the minimum wage, as well as the unfavourable competition from cheap Chinese goods and subdued demand.

The outlook for the fourth quarter of 2018 indicated weaker economic activity as reflected in the decline in most of the monitored indicators compared to the previous quarter and the same period during 2017. The fragile business conditions are mainly attributed to rising costs of production, weaker Kwacha exchange rate against major foreign currencies, anticipated slowdown in demand for tourism services during the rainy season, lower agriculture activity, high Government appetite for domestic borrowing and lack of demand. Nonetheless the merchant sector anticipated a pickup in domestic sales and new orders of consumer goods on account of the expected rise in demand associated with the festive season.

Expectations for economic performance over the next twelve months have weakened progressively since the first quarter of the year (see Figure 3). The anticipated lower economic activity is premised largely on increased costs of production, higher agricultural input costs, the effect of the recent fuel increase, coupled with the exchange rate depreciation and inadequate demand, poor fiscal policy management, excessive taxes, high government debt and withdrawal of support from some donor countries.

Figure 3: Overall Survey Response Patterns*



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

¹ This Report presents findings of the Quarterly Survey of Business Opinions and Expectations conducted during the third quarter of 2018. The results are based on responses from 253 firms of the 280 questionnaires distributed, covering manufacturing, merchants, tourism and services, agriculture and construction sectors. This outturn represented a response rate of 90.4%.

Introduction

This Business Opinions and Expectations Survey Report is divided into four sections. The first section presents the overall response patterns related to economic performance during the third quarter of 2018 as well as expectations for the fourth quarter, while section II provides opinions and expectations on input costs, wages and selling prices, for the same period. Section III presents fourth quarter 2018 perceptions on variables that influence monetary policy, while section IV provides the general conclusion.

I. Opinions and expectations of economic activity

Economic Activity declined in Q3 2018 and expected to remain weak over next 12 months

In the second quarter report, respondents' anticipated a decline in economic activity during the third quarter of 2018. As expected, the overall response pattern from the survey showed weaker economic performance during the third quarter. This was reflected in a decline of all monitored indicators when compared with the previous quarter as well as the third quarter 2017. Only agricultural output and domestic sales, improved due to the marketing period (see Chart 1).

With regard to expectations for the fourth quarter 2018, most respondents were of the view that the business environment would continue to face challenges. Thus most of the monitored indicators would continue to decline in the fourth quarter of the year (see Chart 2). The Merchants and manufacturers of beverages and consumer goods however, anticipated a rise in new orders and domestic sales associated with the seasonal increase in demand during the festive period.

Over the next 12 months, economic performance is expected to remain subdued. Respondents attributed the weak economic performance largely to inadequate support to the agriculture sector, poor fiscal policy management, lack of demand, increased costs of production, high government debt, exchange rate volatility and withdrawal of donor support.

Chart 1: Business Opinions Response Patterns

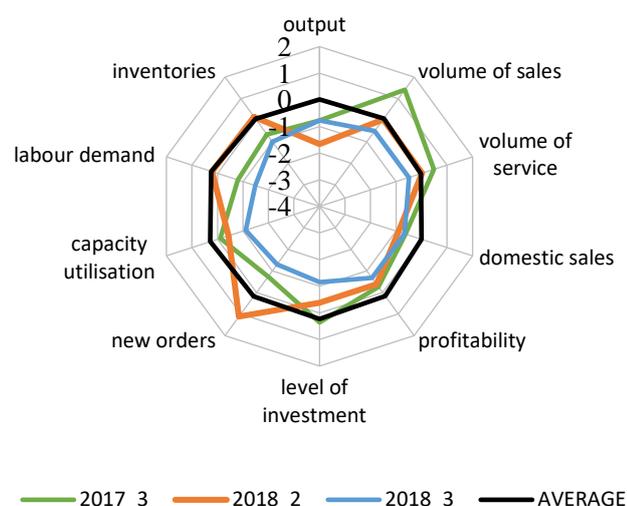
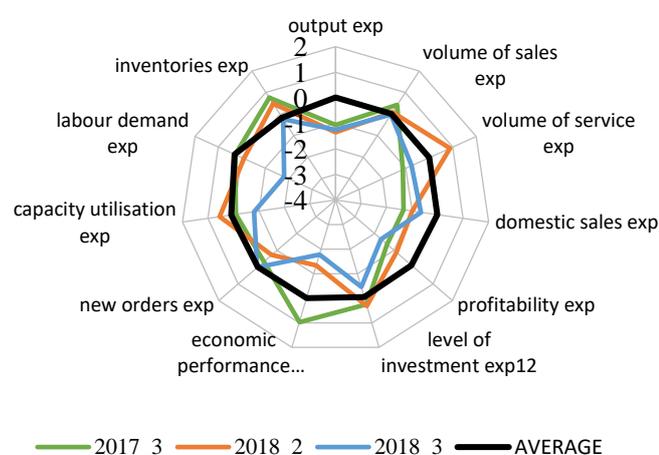


Chart 2: Business Expectations Response Patterns



Q: What has been your firm's experience with respect to output?

(Net balance, -14.5%; Q2 2018, -27.1%)

Although output remained below the historical average, an improvement was reported during the third quarter, when compared to the second quarter 2018 (see Chart 3). This was largely due to the harvest of wheat and sugarcane and agricultural marketing period.

The level of output is expected to remain relatively unchanged in the fourth quarter, but lower than that recorded during the same period in 2017.

Q: What has been your firm's experience with respect to capacity utilisation?

(Net balance, -26.5%; Q2 2018, -18.4%)

According to the manufacturing sector, most firms reported a further decline in capacity utilisation during the third quarter compared to the second quarter of 2018 and third quarter of 2017 (see Chart 5). This was mainly due to the rise in the cost of raw materials, high cost of doing business, lack of demand as well as a slowdown in economic activity.

Although capacity utilisation remained below the historical average, it is expected to slightly improve in the fourth quarter of 2018. The anticipated increase in consumer demand associated with the festive season explains this expectation. In particular, companies engaged in the production of beverages and consumer products anticipate a rise in new orders.

Chart 3: Opinion on Output

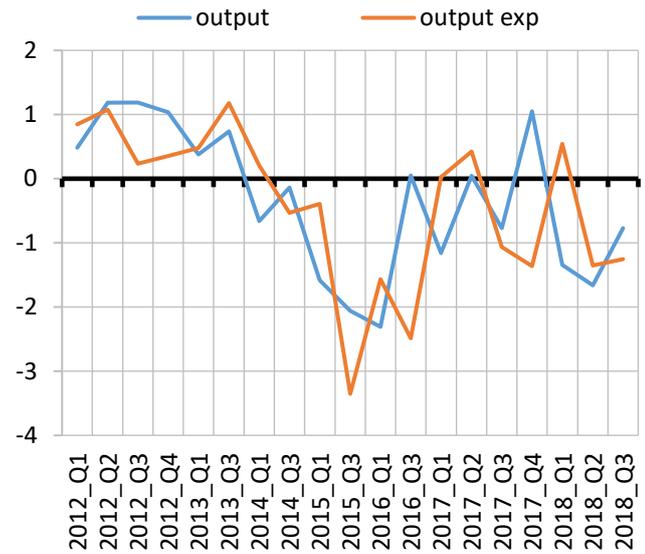
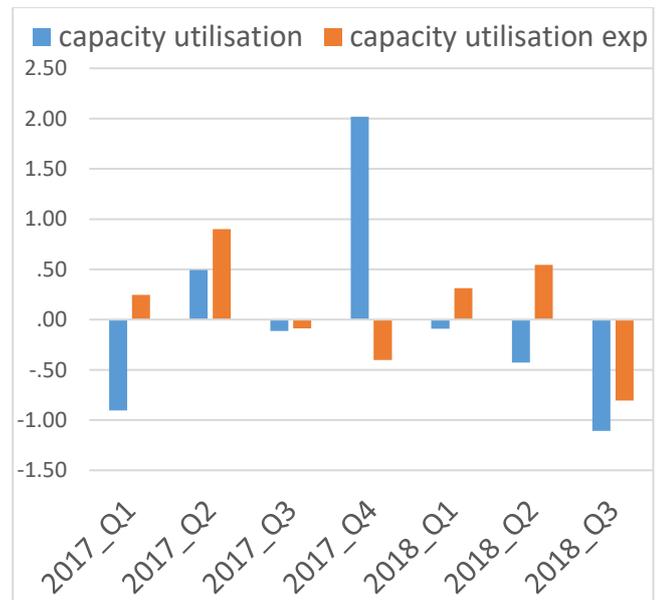


Chart 5: Capacity Utilisation



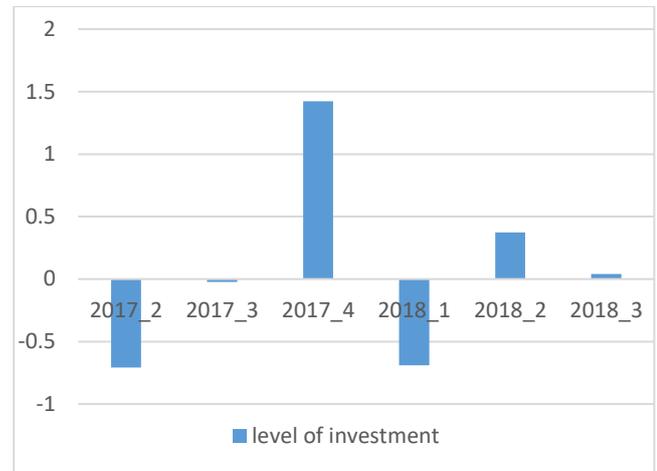
consumer demand associated with the festive period explains this expectation.

Q: How was your firm's level of investment?

(Net balance, 4.1 %; Q2 2018, 8.6%)

Most respondents indicated that total investment decreased during the third quarter of 2018 in comparison with the second quarter and third quarter of 2017 (see Chart 4. This was mainly due to liquidity constraints, low demand and implementation of tourism levies as well as the high cost of doing business in the manufacturing sector. In addition, increased competition from cheap Chinese imports negatively affected investment in the merchant sector.

Chart 4: Level of investment

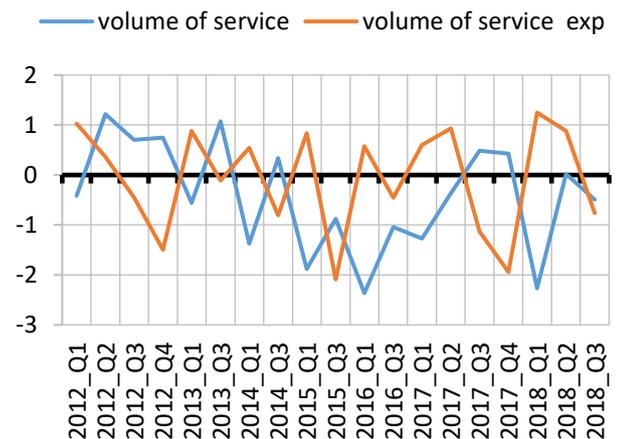


Q: What has been your firm's experience with respect to volume of service?

(Net balance, -14.5%; Q1 2018, -5.6%)

The volume of service remained below the historical average and was lower than the previous quarter as well as the third quarter of 2017(see Chart 6). This was mainly attributed to lack of demand, high operational costs and stiff competition, particularly in the tourism sector.

Chart 6: Volume of Service



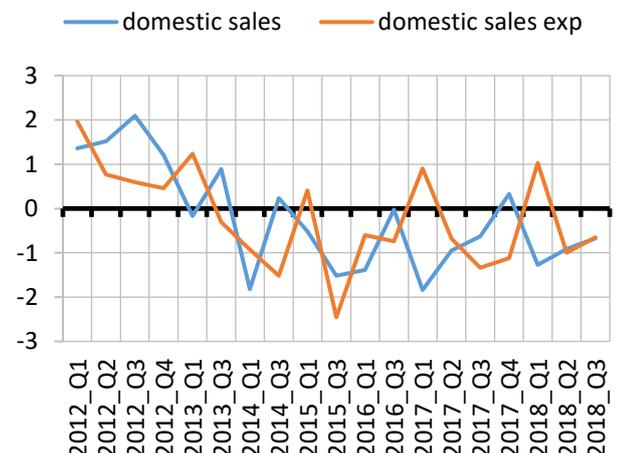
Expectations indicated a continued decrease in the volume of service during the fourth quarter of 2018 (lower than q3 2017) due to a slowdown in demand for tourism services, with some camps expected to close during the rainy season.

Q: What has been your firm's experience with respect to domestic sales?

(Net balance, -16.4%; Q2 2018, -20.3%)

Although below the historical average, domestic sales were better than the second quarter of 2018 (see Chart 7). This was mainly due to sales of agricultural produce during the marketing period.

Chart 7: Domestic Sales



In the fourth quarter, domestic sales are expected to improve further, but remain below the historical average. The anticipated rise in

Q: How do you rate your firm's labour demand?

(Net balance, -5.1%; Q2 2018 21.8%)

Labour demand has remained below the historical average since the first quarter of 2018 and was lower than the previous quarter as well as the third quarter 2017 (see Chart 8). Most businesses reported an increase in redundancies on account of the rise in the minimum wage, tight liquidity, as well as technological advancements leading to reduced labour demand in the services sector

In the fourth quarter 2018, labour demand is expected to remain below the historical average and decline further, despite activities related to the commencement of the agriculture planting season. This is explained by the reasons outlined in the previous paragraph coupled with reduced construction activities during the rainy season and closure of some tourist facilities which will result in less labour demand during the fourth quarter of the year.

Q: What has been your firm's experience with respect to volume of sales?

(Net balance, -34.5%; Q2 2018, -7.9%)

Most respondents indicated a decline in the volume of sales during the third quarter of 2018 compared to the previous quarter and the third quarter of 2017 (see Chart 9). This was mainly attributed to low demand due to tight liquidity conditions.

The volume of sales is expected to improve during the fourth quarter, but remains lower than the third quarter 2017. The anticipated rise in consumer demand associated with the festive period largely explains the anticipated increase in the volume of sales. The commencement of the agriculture-planting season is also expected to stimulate demand for agro-chemicals in the Merchant sector.

Chart 8: Labour Demand

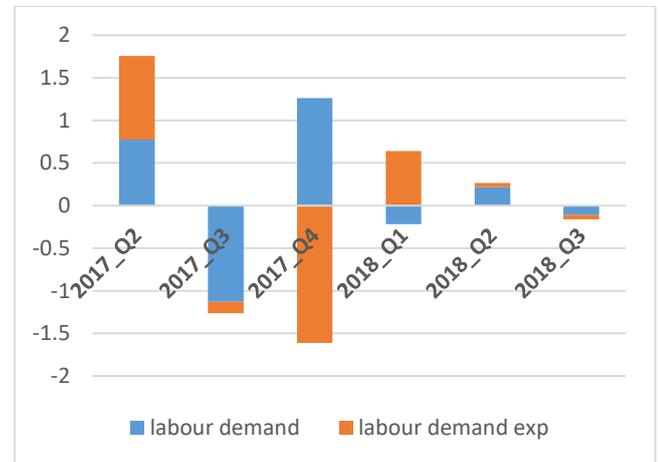
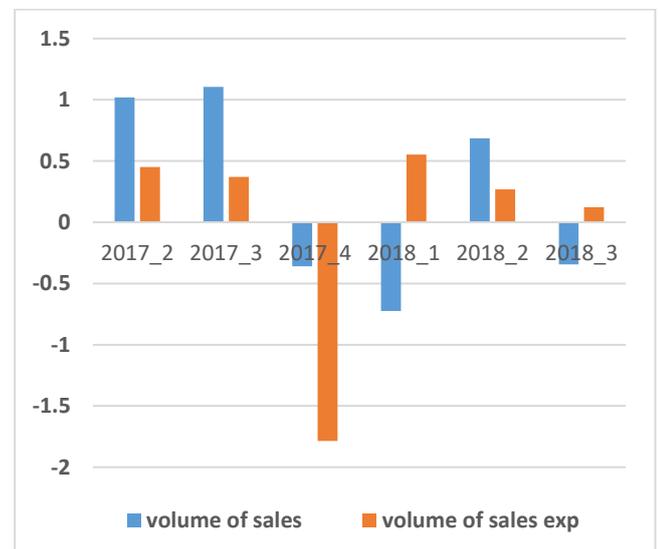


Chart 9: Volume of Sales



Q: What is your current main source of investment finance and working capital?

Most respondents indicated that retained earnings were the main source of investment finance and working capital, with 72.1% (66.4%) and 71.7% (68.2%) response rates, respectively. Fewer respondents relied on bank borrowing when compared to the previous quarter, with bank borrowing at 13.3% (19.8%) and 15.5% (18.4%), respectively (see Charts 10A and 10B).

Chart 10A: Sources of Investment Finance

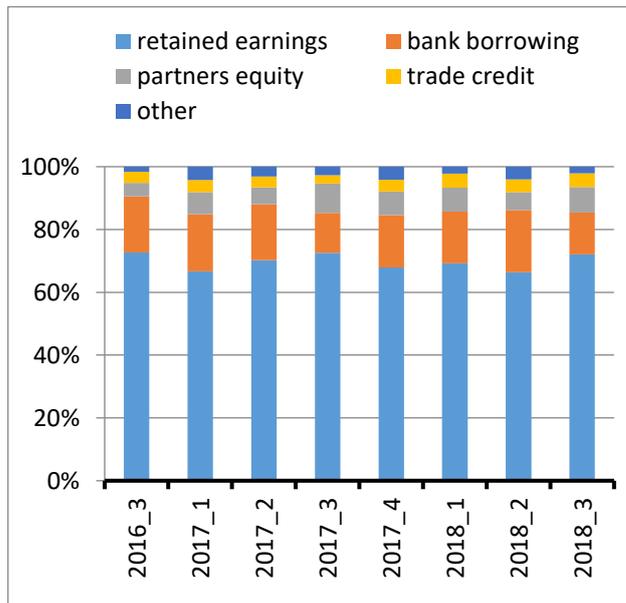
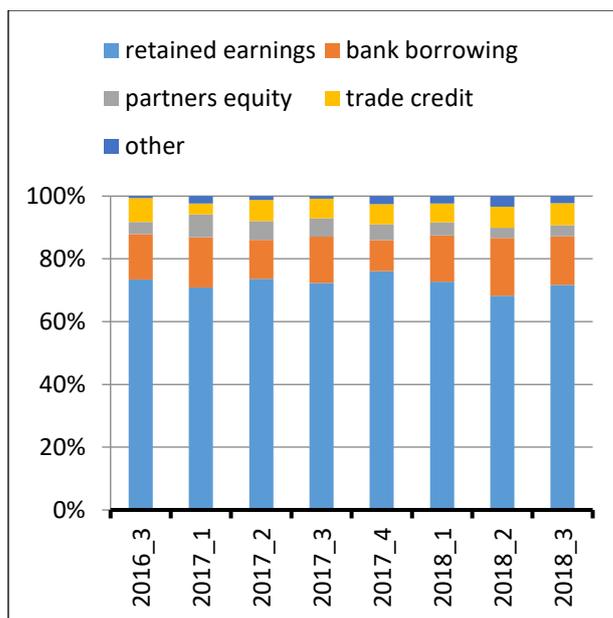


Chart 10B: Sources of Working Capital



II EVOLUTION OF COSTS, WAGES AND PRICES

Q: What has been your firm's experience during the quarter under review with respect to average input costs?

(Net balance, 22.0%; Q2 2018, 30.1%)

During the third quarter, input costs remained high, although lower than the second quarter of 2018. The increased cost of inputs was mainly attributed to high prices of raw materials, the weaker Kwacha exchange rate against the US dollar as well as the upward adjustment in the minimum wage and fuel prices.

Input costs are expected to rise further in the fourth quarter of 2018 (see Chart 11). The recent hike in transport charges, depreciation of the exchange rate of the Kwacha against major foreign currencies as well as levies and indirect taxes in tourism, largely explain the expected increase in average input costs.

Q: What has been your firm's experience with respect to the wage bill?

(Net balance, 6.8%; Q2 2018, 15.1%)

During the third quarter of 2018, the wage bill declined in comparison to the second quarter of 2018. This outturn was mainly due to job cuts following the increase in the minimum wage as well as seasonal lower activity in the agriculture and tourism sectors.

The wage bill is, however, expected to increase in the fourth quarter of 2018 (see Chart 12), due to the commencement of the agricultural planting season and the end of the year staff bonuses.

Chart 11: Average input costs

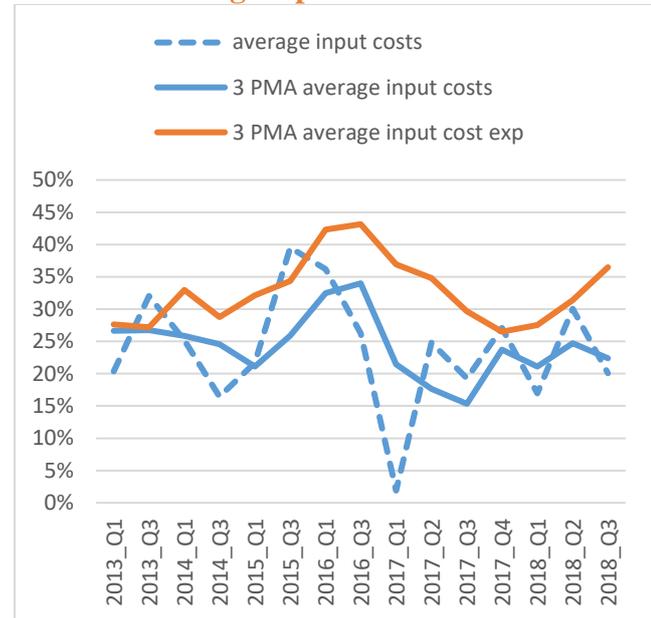
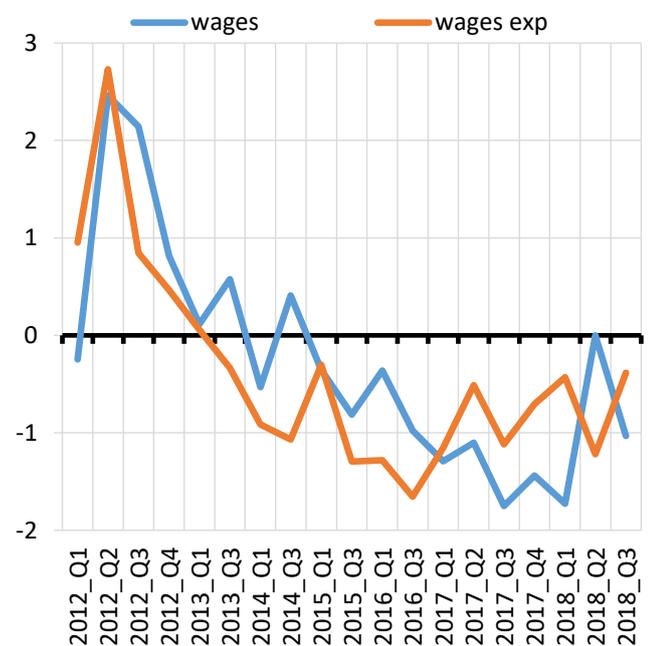


Chart 12: Evolution of wages



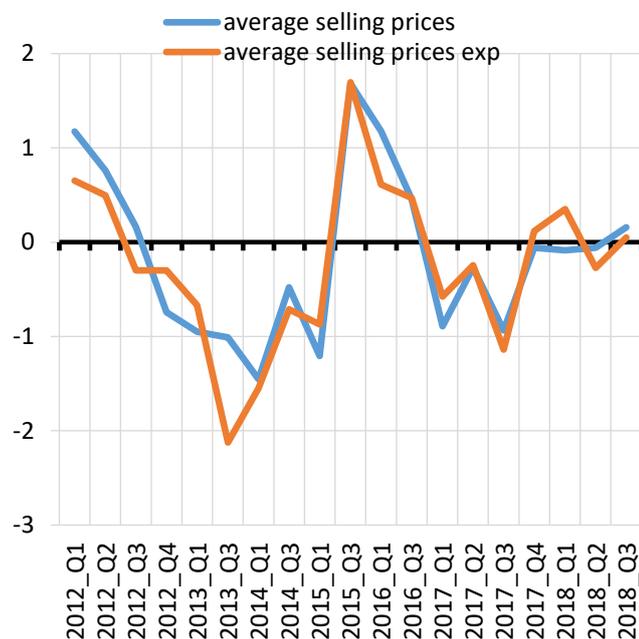
Q: What has been your firm's experience during the quarter under review with respect to average selling prices?

(Net balance, 3.4%; Q2 2018, 0.0%)

Most respondents reported an increase in average selling prices, above the historical average, during the third quarter of 2018, in comparison to the second quarter 2018. The high average selling prices were largely attributed to rising costs of production coupled with the pass through of the Kwacha depreciation against the US Dollar.

The average selling prices are expected to remain elevated during the fourth quarter of 2018 (see Chart 13) largely due to the effect of the weaker Kwacha exchange rate against major foreign currencies as most commodities are imported, the upward adjustment in fuel prices which would result in higher transport charges as well as an anticipated increase in demand during the festive period.

Chart 13: Evolution of average selling prices



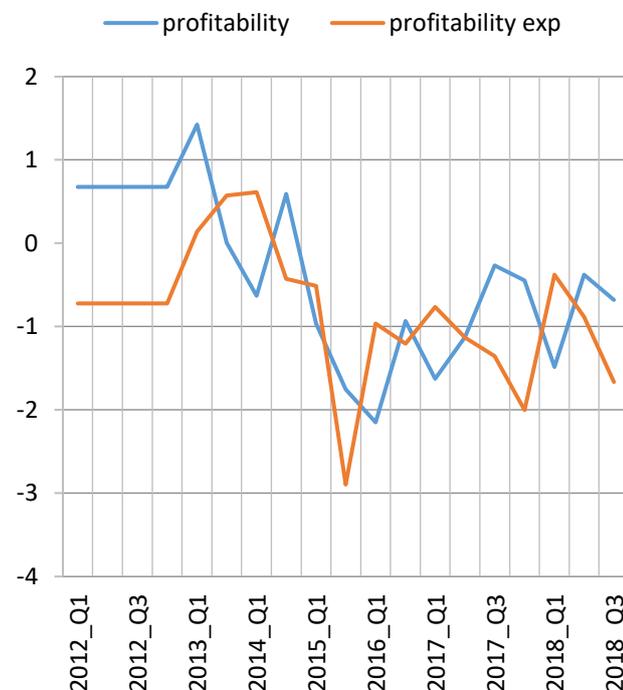
Q: What has been your firm's experience with respect to profitability?

(Net balance, -27.5%; Q2 2018, -21.4%)

Profitability decreased during the third quarter of 2018 as reported by most respondents, and was lower than the third quarter of 2017. This was mainly attributed to higher input costs, low demand, lower wheat and tobacco sales, as well as unfavourable competition from cheap Chinese goods.

In the fourth quarter of 2018, most respondents expect profitability to decline despite the anticipated pick-up in festive demand (see Chart 14). Expectations of lower profitability are premised on increased costs of production (wages, agricultural inputs, fuel prices, imports, service charges) as well as lower activity in the Tourism sector.

Chart 14: Profitability



III EXPECTATIONS ON MONETARY POLICY FOR FOURTH QUARTER 2018

The fourth quarter of 2018 expectations showed rising inflation, exchange rate depreciation, high lending rates and tight credit conditions (see Chart 15).

Q: Over the next quarter what do you expect the price level to be?

(Net balance, 60.6%; Q2 2018, 47.8%)

Over the fourth quarter of 2018, most respondents expect inflation to increase above the historical average (see Chart 16). Inflationary pressures are expected to rise mainly on account of the upward adjustment in fuel prices which would lead to higher transport costs, pass through of the Kwacha exchange rate depreciation against major foreign currencies as well as high production costs

Q: Which is the main factor explaining your expectations of inflation?

Most respondents indicated that the main driver of inflationary expectations for the fourth quarter of 2018 would be the exchange rate, as reported by 32.3% of the firms compared to 26.8% for the third quarter 2018. This would be followed by past prices at 25.7% (25.2%) and cost of production 22.6% (24.8%) (see Chart 17).

Chart 17: Inflationary expectations mainly driven by the exchange rate and cost of production

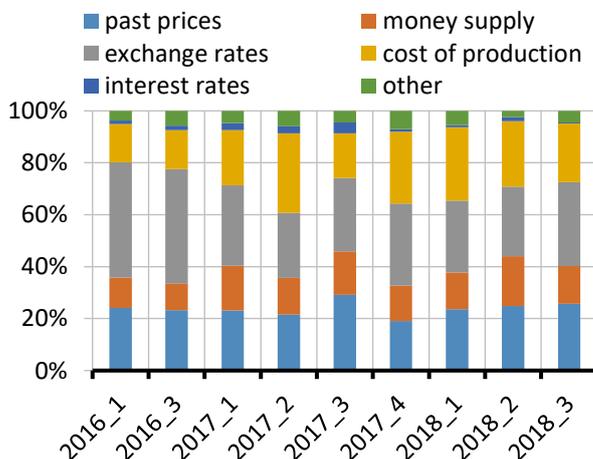
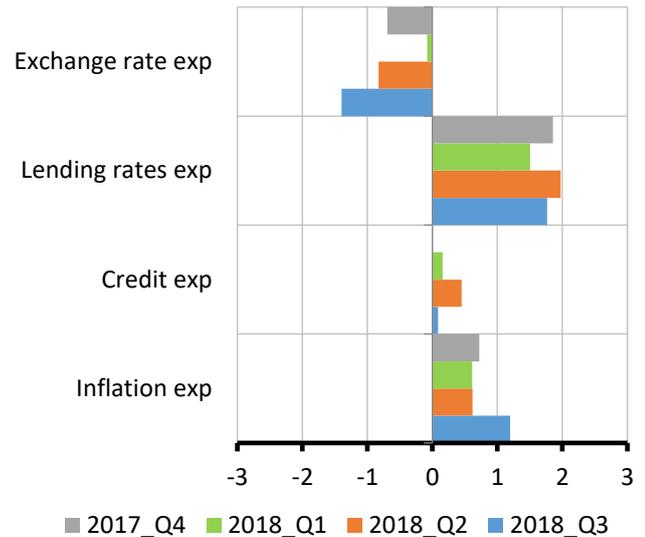


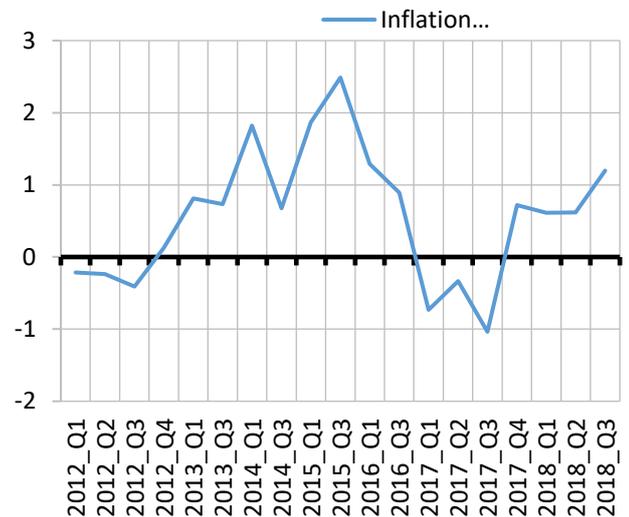
Chart 15: Expectations for rising inflation, weaker Kwacha, tight credit conditions and high lending rates



Notes:

- Exchange rate = appreciation, strong (+) /depreciate, weak (-)
- Lending rates = increase, high (+)/decrease, low (-)
- Credit conditions = tight (+)/ loose (-)
- Inflation expectations = increase, high (+)/decrease, low (-)

Chart 16: Inflationary expectations above historical average in Q4 2018

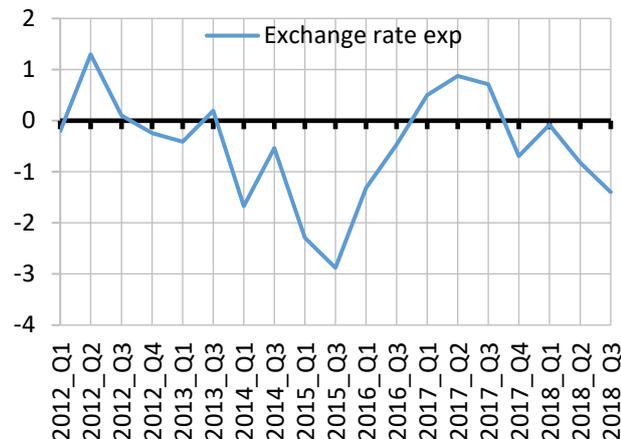


Q: How do you expect the performance of the Zambian Kwacha against the US Dollar to be at the end of the next quarter?

(Net balance, -50.9%; Q2 2018, -36.0%)

Most respondents expect the Zambian Kwacha to depreciate against the US Dollar in the fourth quarter of 2018 (see Chart 18). The reasons provided for this expectation include: higher demand for imports during the festive period, low FDI inflows, high foreign debt service, suspension of some donor inflows, reduction in foreign reserves, low export earnings as well as declining investor confidence

Chart 18: Exchange rate expectations next quarter

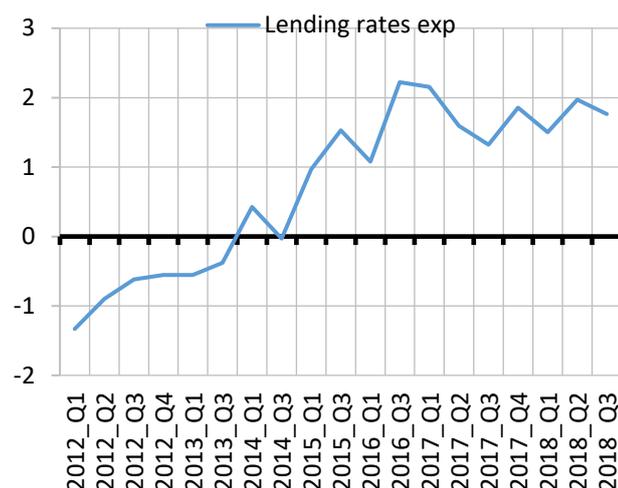


Q: Over the next quarter, what do you expect to happen to commercial banks' lending interest rates?

(Net balance, 69.8%; Q2 2018, 76.2%)

Majority of the respondents expect commercial banks' lending rates to remain high during the fourth quarter of 2018, with only a slight decline when compared to the previous quarter (see Chart 19). The lending rates remain high due to tight liquidity, and high Government domestic borrowing.

Chart 19: Interest rate expectations next quarter

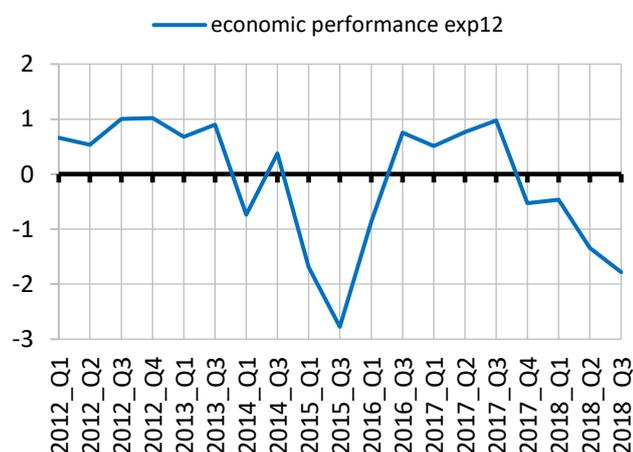


Q: What is your expectation of the performance of the Zambian economy in the next 12 months?

(Net balance, -16.1%; Q2 2018, -6.6%)

Most respondents expect a deterioration in economic activity over the next 12 months (see Chart 20). The main reasons provided for the weak economic performance include; reduced government support to the agriculture sector, poor fiscal management, high Government debt, excessive taxes, rising cost of living, lack of demand, declining investor confidence, the Kwacha exchange rate depreciation against the US Dollar, as well as low copper prices. In addition, lack of diversification and the poor work culture are likely to negatively affect the general performance of the economy

Chart 20: Economic performance in next 12 months



IV CONCLUSION

The Quarterly Survey of Business Opinions and Expectations conducted during September – October 2018, showed a general weakening in economic performance for the third quarter 2018 when compared to the second quarter 2018 and third quarter 2017. The subdued economic environment was largely attributed to liquidity constraints, high cost of doing business, depreciation of the Kwacha against the US Dollar, inadequate consumer demand, unfavourable competition from cheap Chinese goods, high cost of raw materials and the upward adjustment in the minimum wage.

The outlook for the fourth quarter of 2018 indicated that most of the monitored indicators would continue to deteriorate. This notwithstanding, an increase in domestic sales and new orders was anticipated premised on the seasonal rise in demand associated with the festive period.

Over the next 12 months, economic performance is expected to remain fragile. Most respondents anticipate a generally challenging economic environment due to inadequate support to the agriculture sector, poor fiscal policy management, high government debt, excessive taxes, lack of consumer demand, Kwacha exchange rate volatility and the withdrawal of support from donor countries.

Appendix I: Background on the QSBOEs

This Report is based on the results of the QSBOEs conducted from September – October 2018. Out of the 280 questionnaires distributed, 253 firms responded, representing a response rate of 90.4%.

Survey Methodology

Data collection for the Quarterly Survey of Business Opinions and Expectations is done by means of a questionnaire which is designed to capture information on economic performance, sources of finance and operational constraints for the current quarter as well as expectations for the following quarter and the following 12 months. The questionnaire is administered to a sample of respondents in manufacturing, trading, tourism and services, construction and agriculture sectors. The sectors covered were selected on the basis of their contribution to GDP.

The Survey covers the Copperbelt towns of Luanshya, Ndola, Kitwe and Chingola, Southern (Mazabuka, Choma, Kalomo and Livingstone), Central (Chisamba, Kabwe and Mkushi Farming Block), Eastern (Petauke, Chipata and Mfuwe), North-Western (Kasempa and Solwezi), Northern (Kasama, Mbala and Mpulungu), Muchinga (Mpika, Chinsali, Isoka and Nakonde), Luapula (Samfya and Mansa) and Lusaka (Lusaka and Kafue). Data analysis is done using the Net Balance Statistic (N) where qualitative responses are converted into quantitative measures using the following equation:

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

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

The Net Balance Statistic method has the advantage of detecting the directional changes in performance/expectations of respondents in such surveys. The method indicates the predominance

of either an improvement or deterioration in a variable. A positive net percentage indicates that more respondents reported/ expected an increase/ improvement/ tightening and a negative net percentage means a decrease/ deterioration/ loosening, depending on the variable under consideration. This method has been used widely in the analysis of survey data.