

Zambia: Challenges 2010-2011 and Beyond

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Overview

- Recent Events
- Broader Challenges
- Budget and Prospects for 2011
- Summary and conclusion

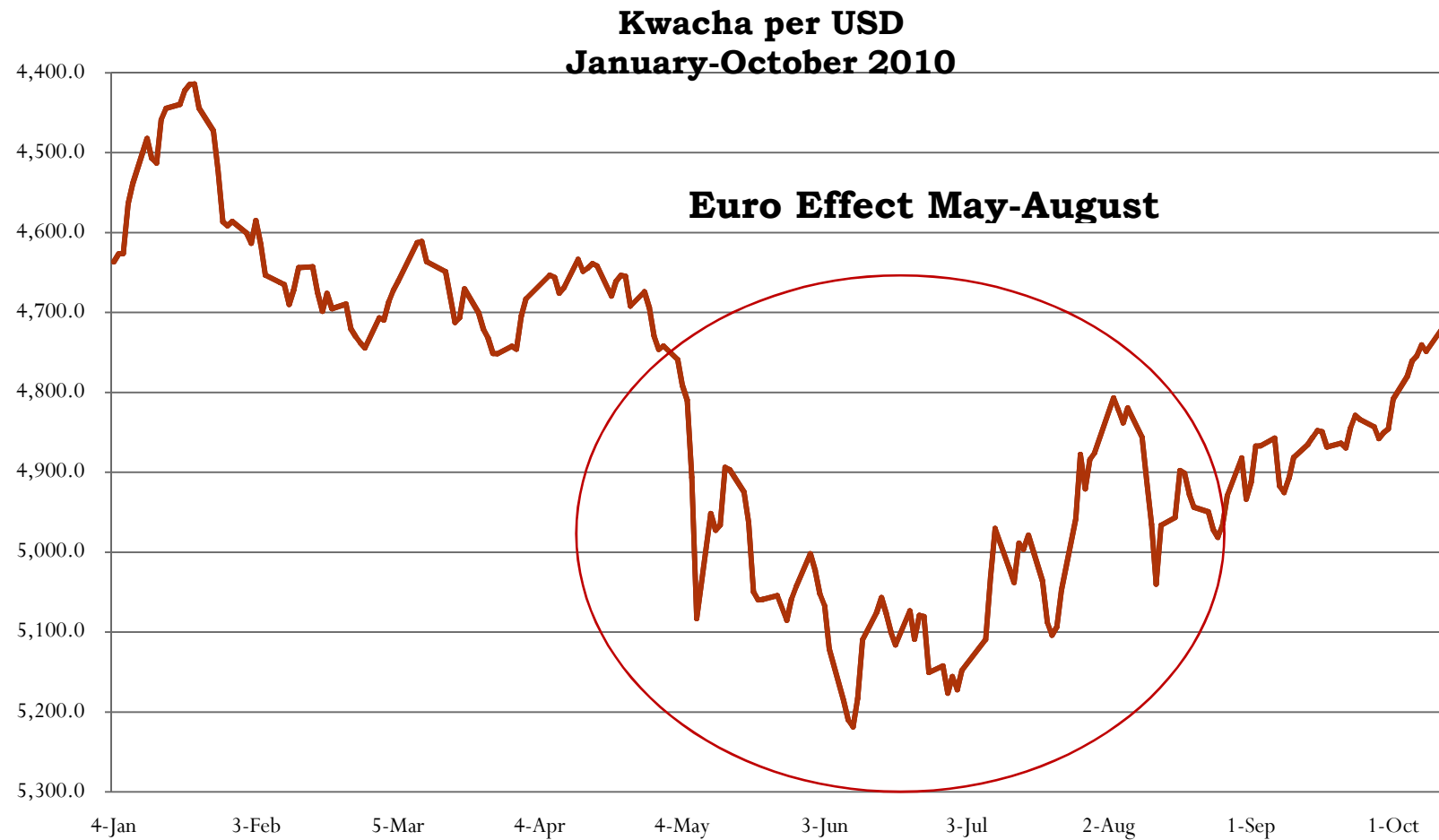
Recent Events

- External Factors
 - Slow Recovery in World Economy
 - Euro Zone Crisis
- Domestic Factors
 - Record Maize Crop
 - Elections
- Historical Perspective
 - Improvement in all macroeconomic variables
- Regional Comparison
 - Higher Growth than most other SSA Countries

Recovery of World Economy?

- Recovery in advanced economies is expected to be sluggish
 - households and financial institutions seeking to repair balance sheets
 - credit growth constrained
 - persistent demand and employment uncertainty
- Recovery in emerging markets expected to rebound more quickly
- Potential effects on demand for Zambian Exports and thus economic growth

Euro Zone Crisis—Risk Aversion



Domestic Factors

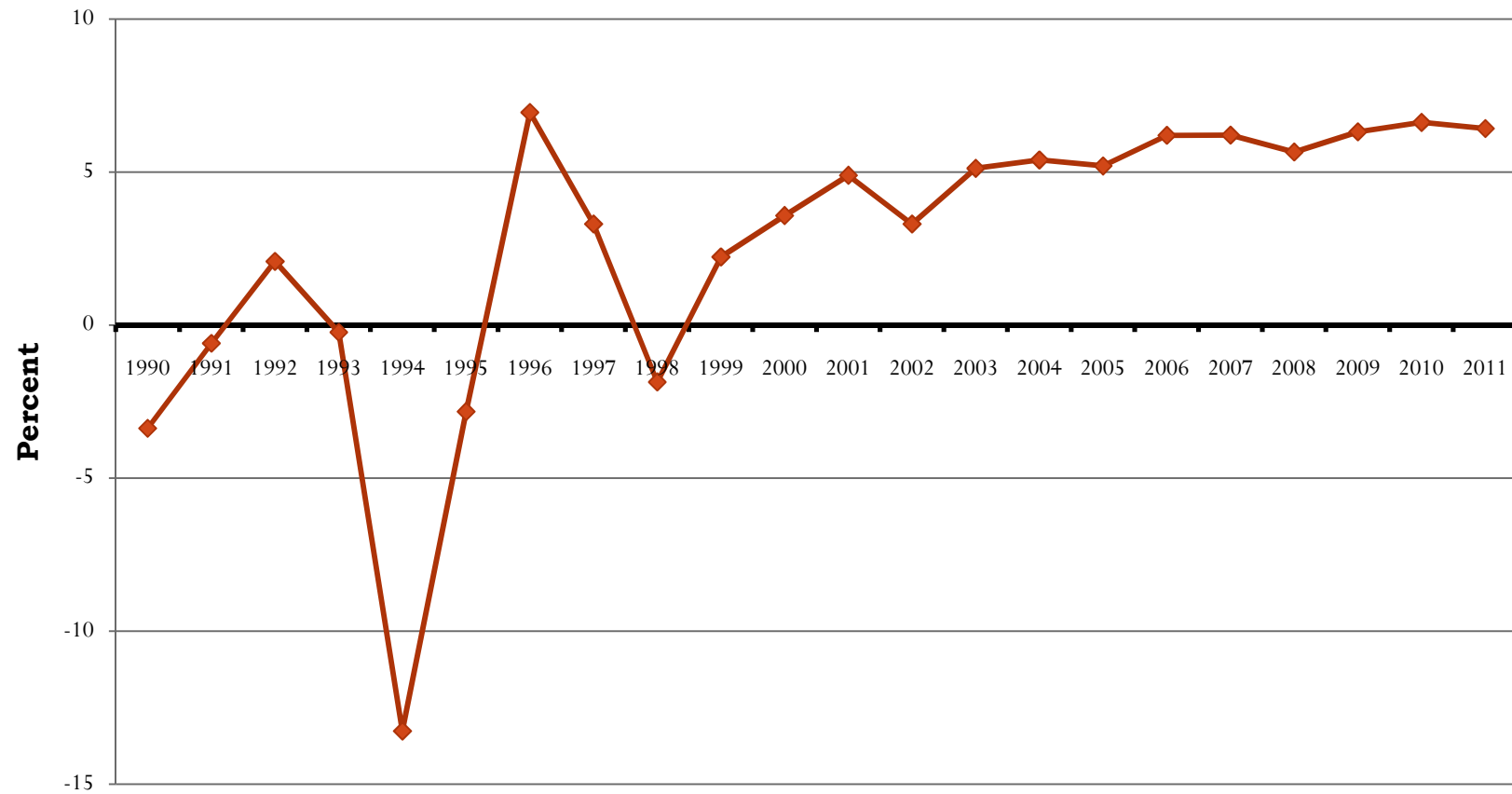
- Record Maize Harvest--Financing Need
 - Maize pricing—Floor well above market price
 - Decision to purchase the entire surplus rather than what is sufficient for food security
 - No well-developed export channels
- Elections--Political budget cycle
 - Potential to Overspend
 - Potential for Short-Term Policy Perspective

Historical Context

- Increased Economic Growth
- Inflation Down
- Current Account Deficit Financeable
- Government Debt Manageable
- Reserves Up

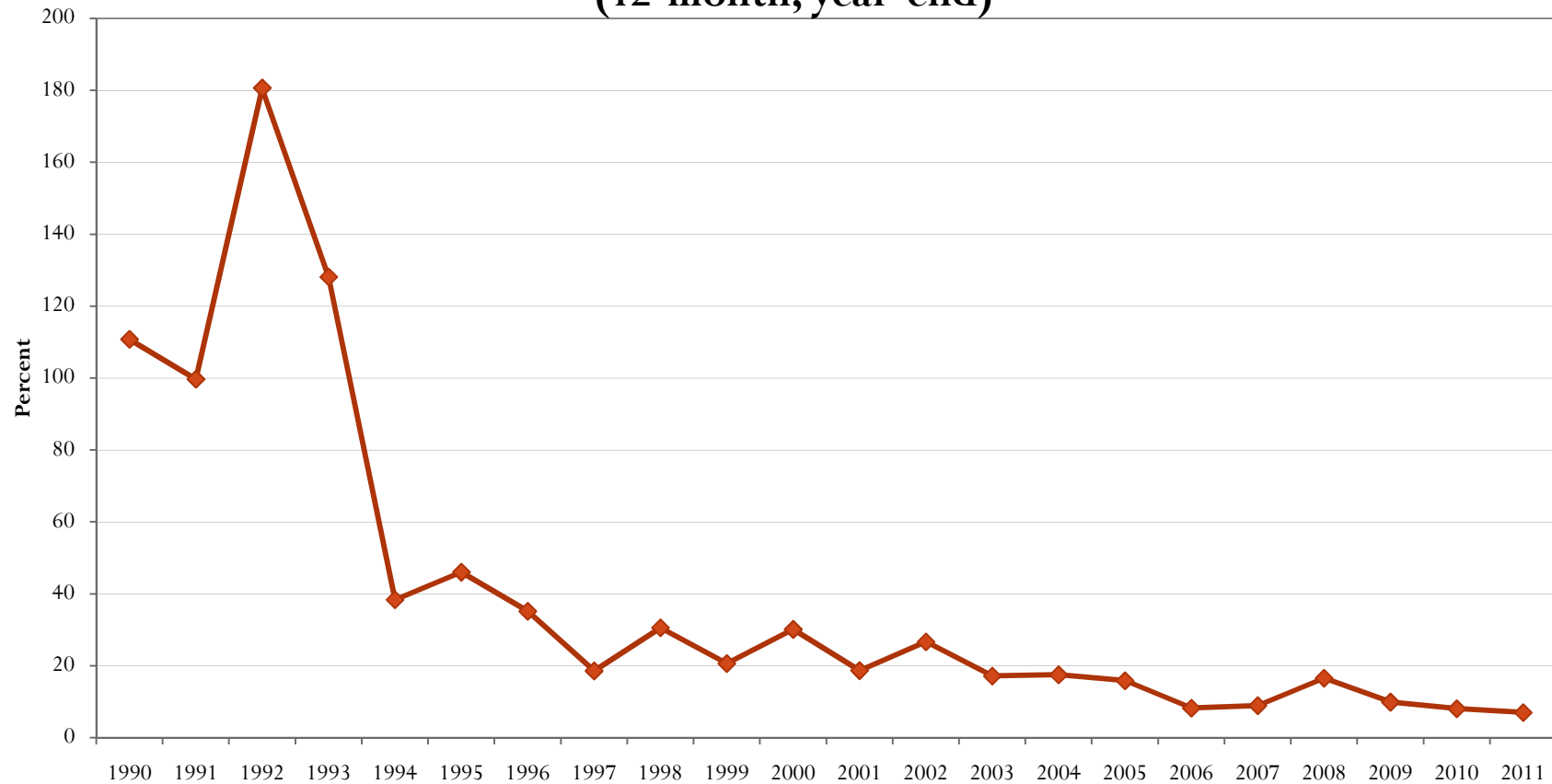
Sustained Real Economic Growth

Real GDP Growth-1990-2011



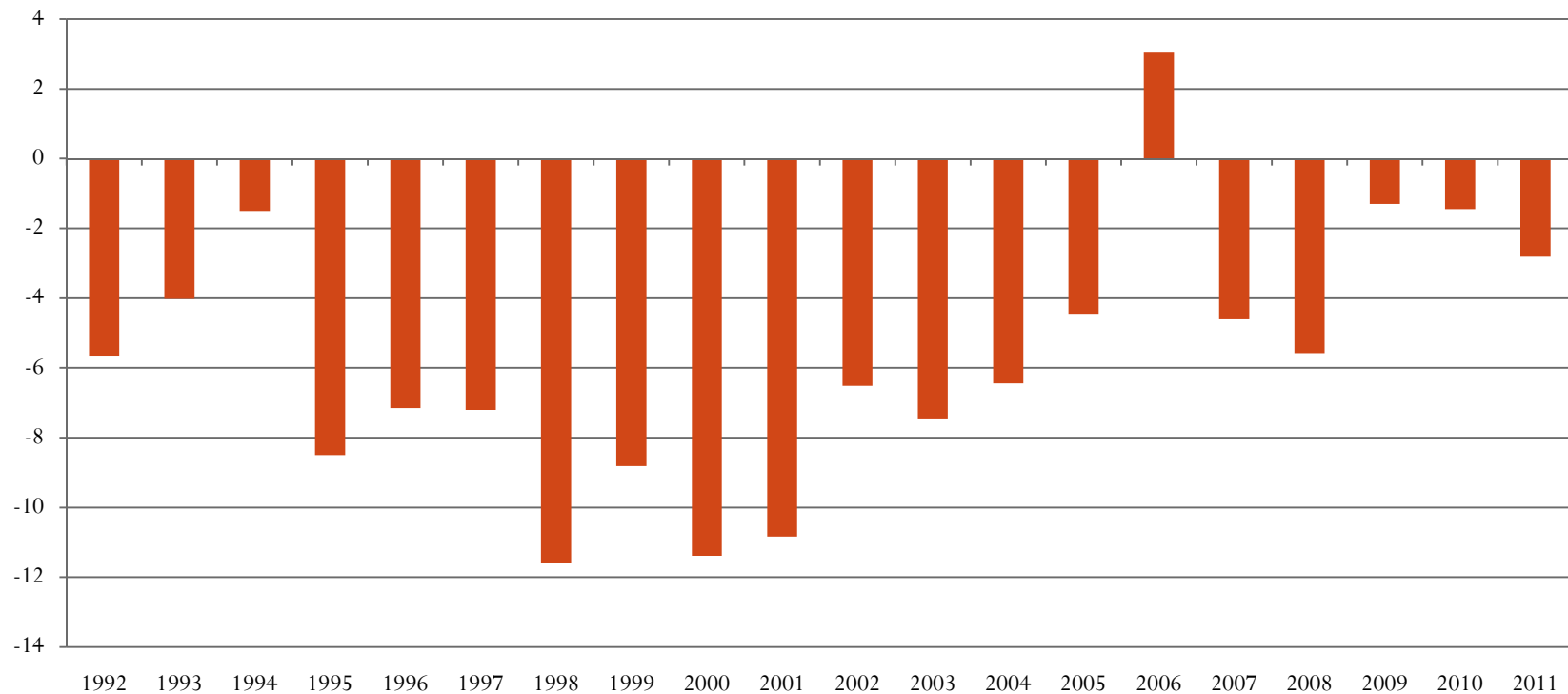
Inflation Under Control

**Inflation, 1990-2011
(12-month, year-end)**



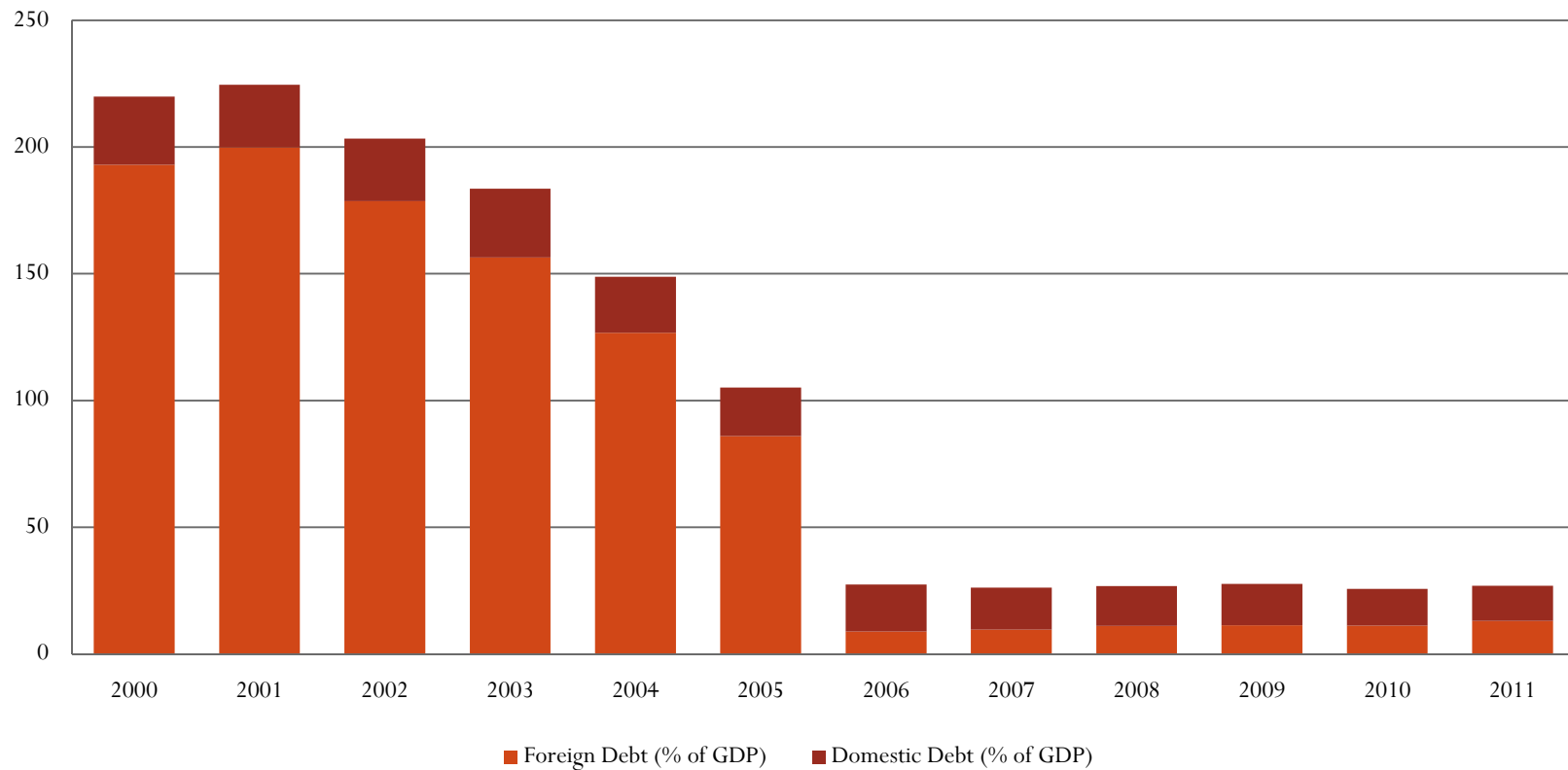
Current Account Deficit Reduced

Current Account Balance, Incl. Grants, 1992-2011
(Percent of GDP)

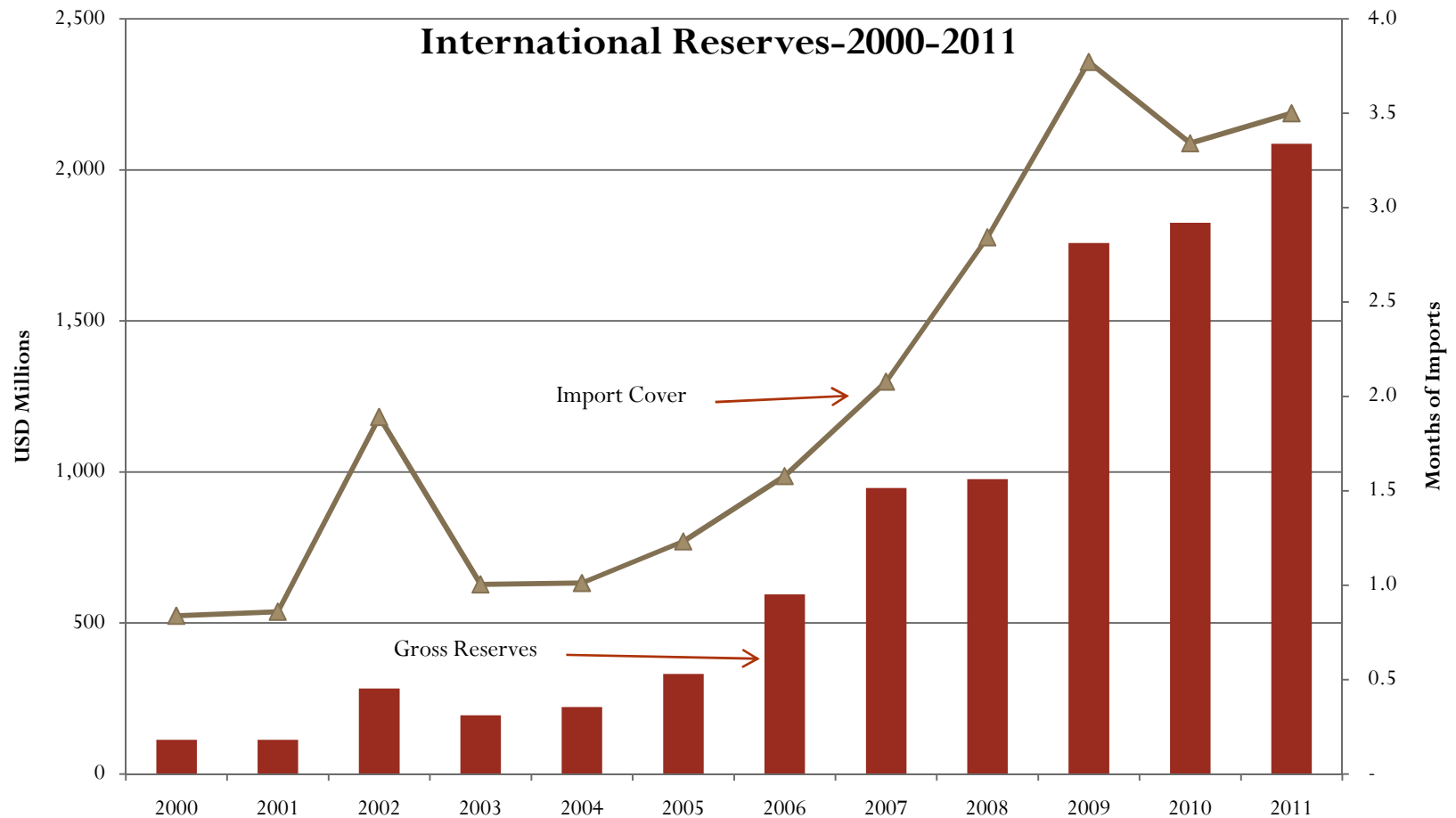


Government Debt Manageable

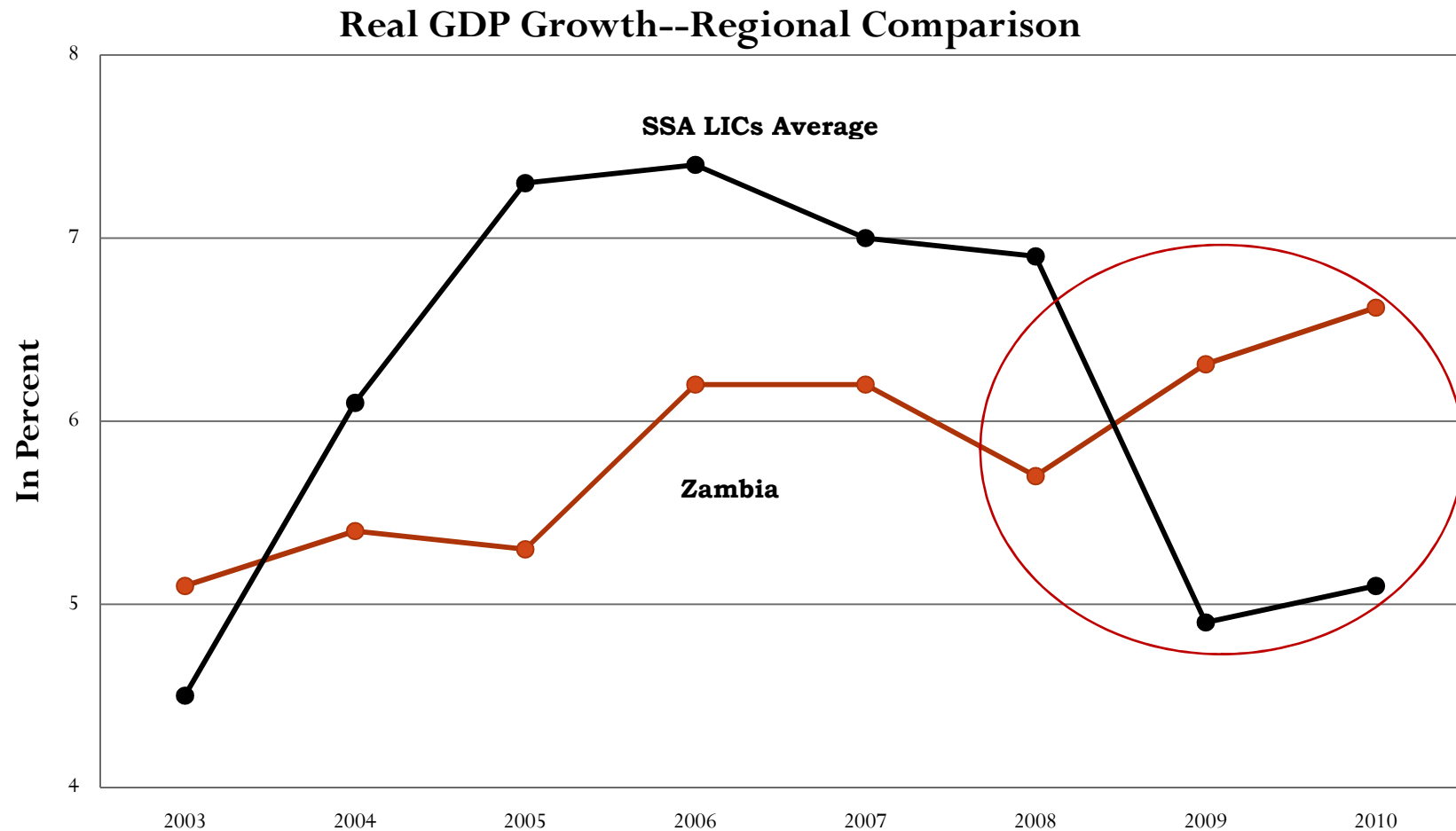
Government Debt-2000-2011
(Percent of GDP)



Strong Reserve Position



Good Policies = Buffers Against External Shocks



Reasons for Improved Macroeconomic Performance

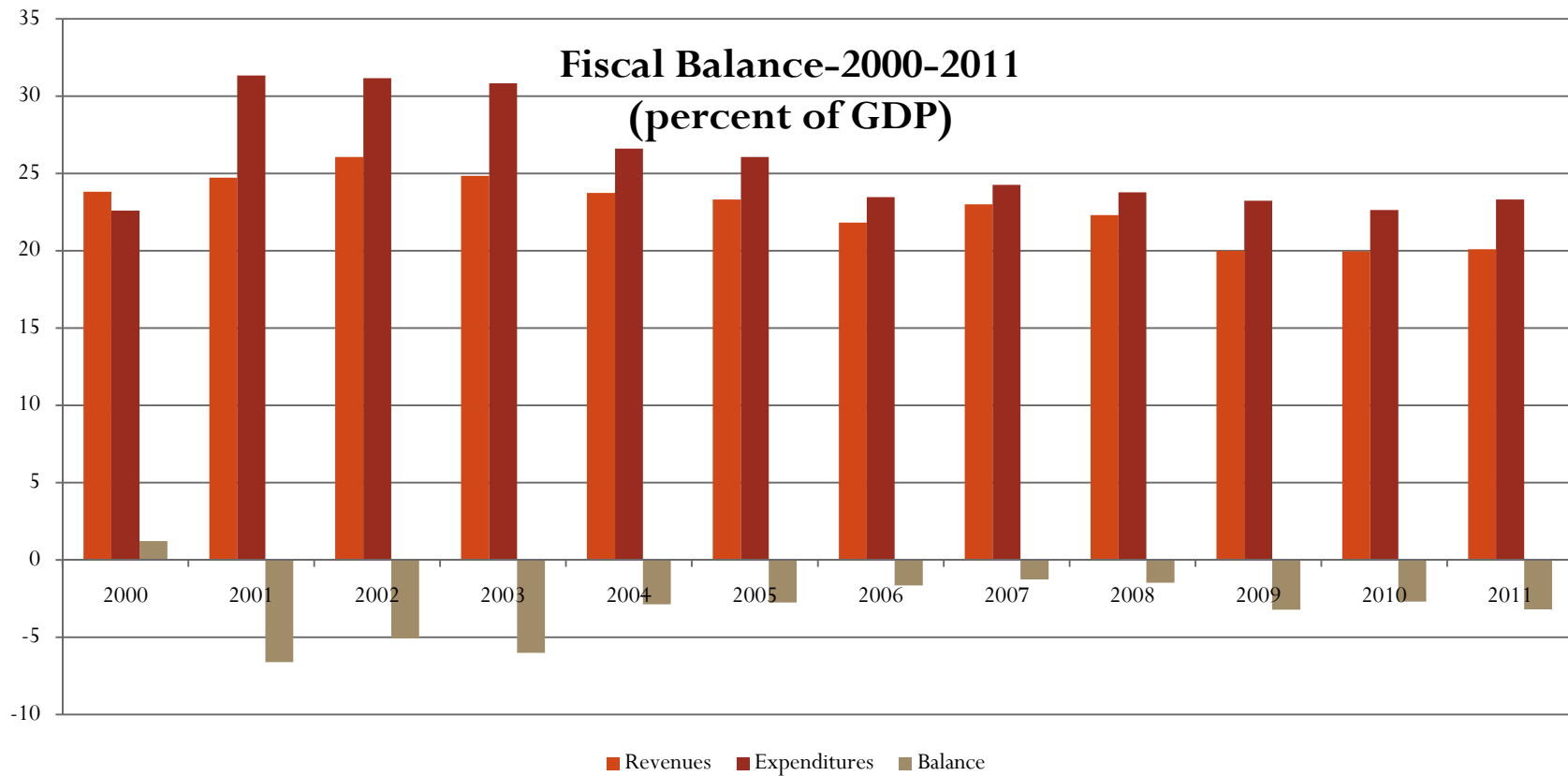
- Recovery of Copper market
- Support from international community, particularly debt relief
- Structural reforms: Privatization, lowering of trade barriers, floating of the exchange rate, etc.
- Prudent macroeconomic policies

Prudent Macroeconomic Policies

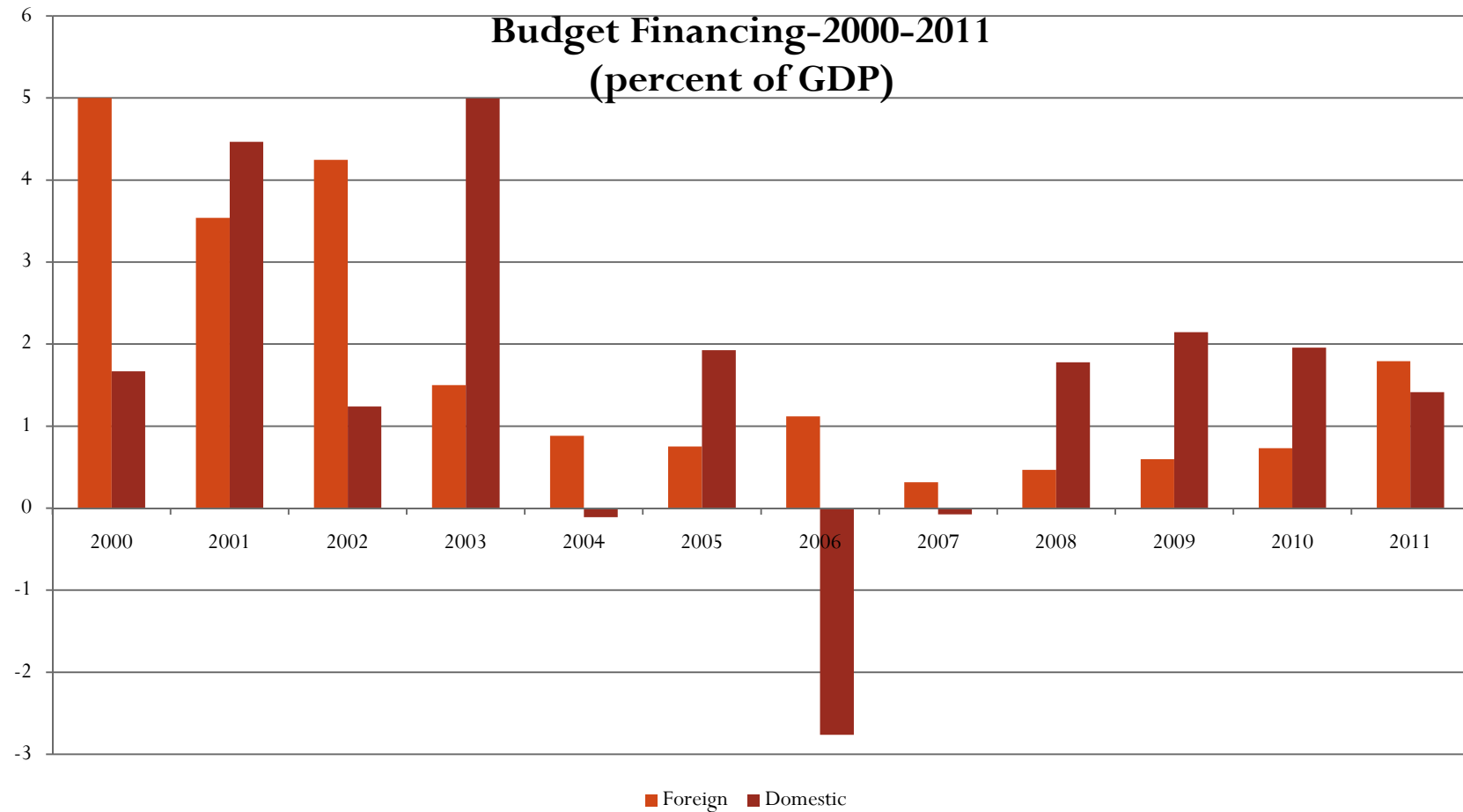
Low fiscal deficits lead to:

- Reduced borrowing, both foreign and domestic
- Bank of Zambia being able to focus on its monetary policy objectives rather than monetization of deficits
- Build-up of buffers against external shocks

Manageable Deficits



Reduced Borrowing



Medium-Term Challenges

- Create fiscal space for development expenditures which create conditions for high growth
- Maintain stable macroeconomic conditions

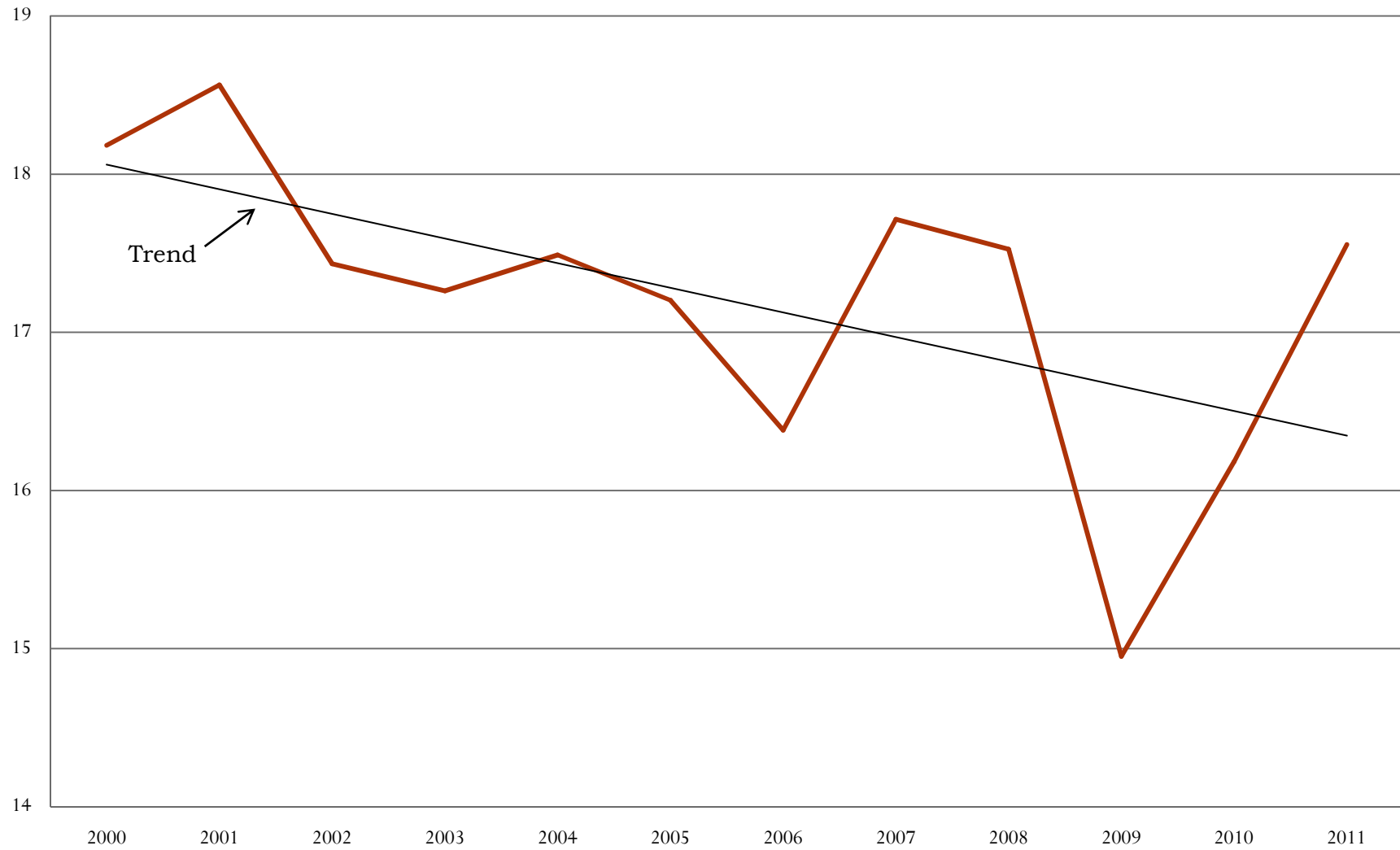
Create Fiscal Space

- Improve revenue performance
- Make expenditures more efficient

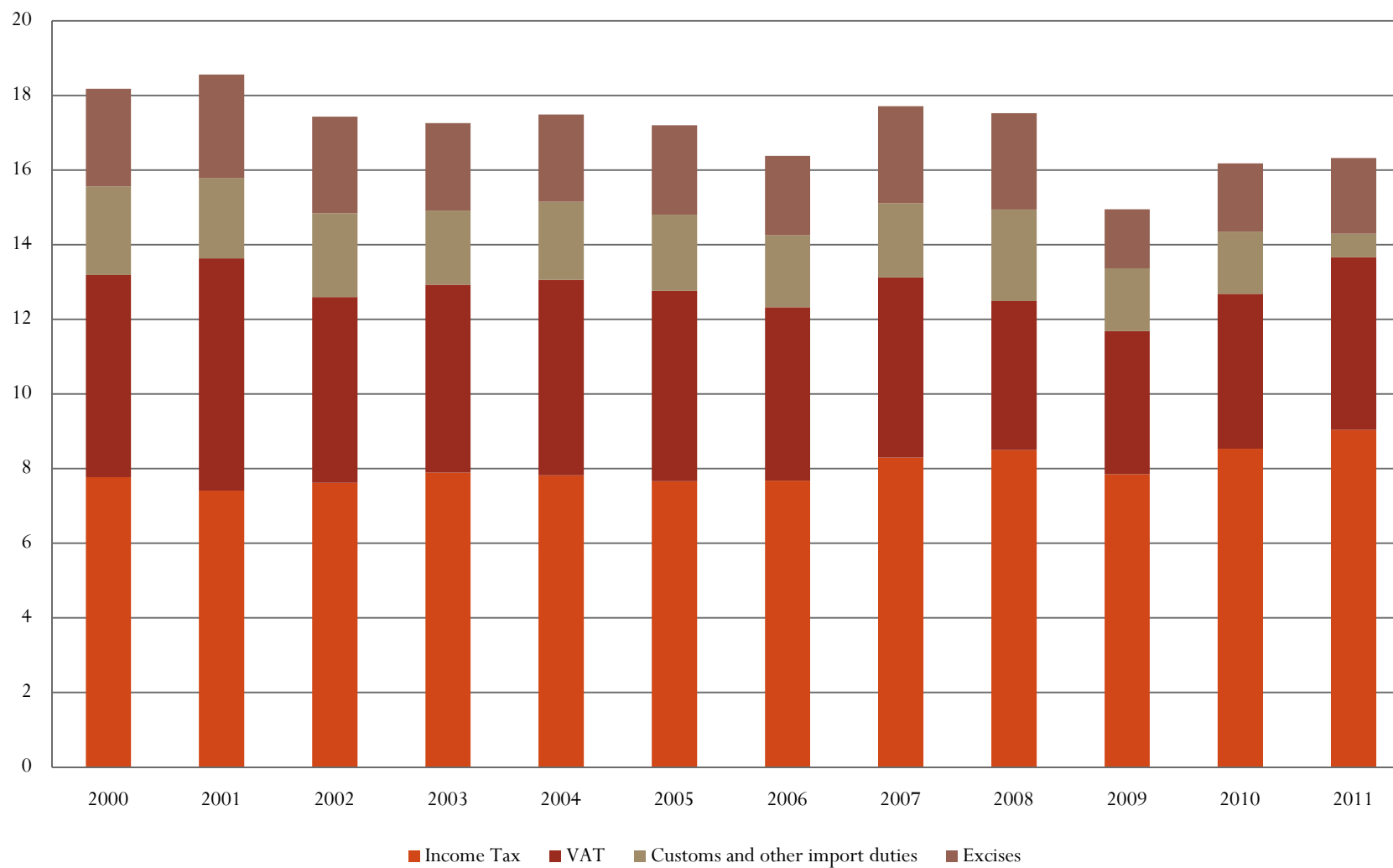
Improving Revenue Performance

- Revenue Trends
 - Tax Revenues trending down (but expected to pick up in 2010-2011)
 - Income tax doing reasonably well
 - Trade related taxes, VAT, excises, and, duties have declined
 - Mining sector contribution very small compared to contribution to GDP (although expected improvement in 2010-2011)
 - Donor Aid Trending Down

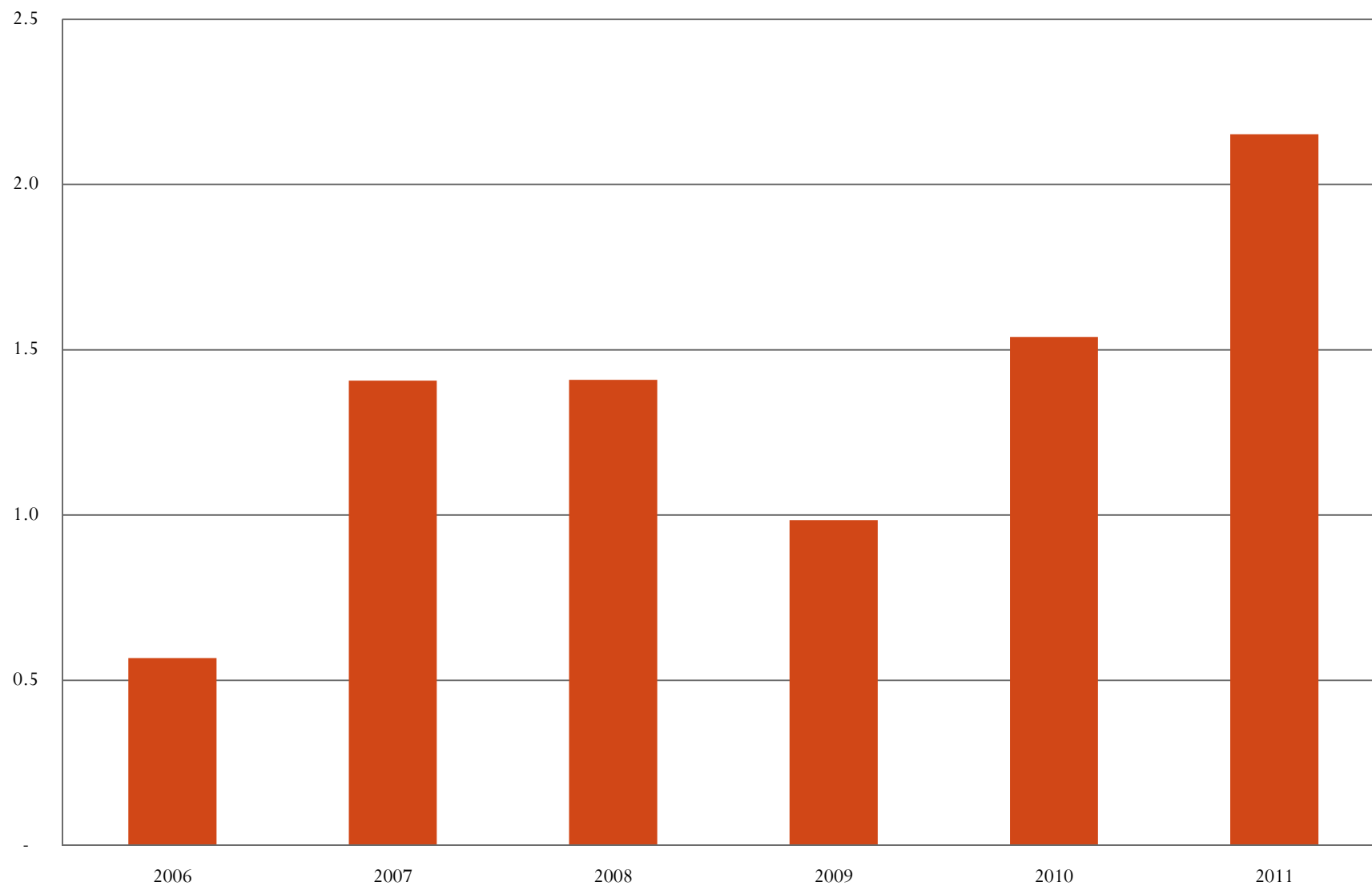
Tax Revenue-2000-2011 (Percent of GDP)



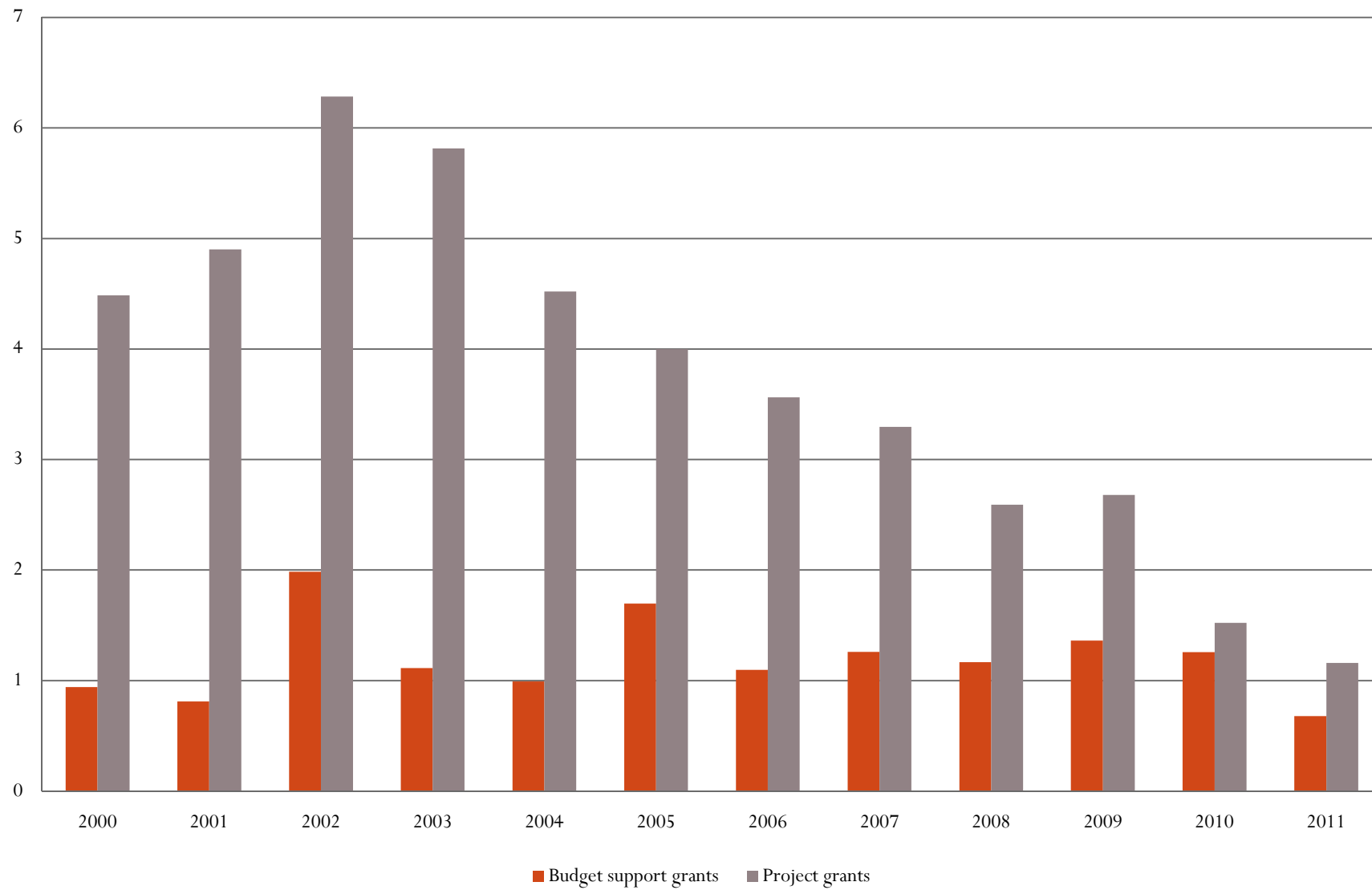
Tax Revenue Components-2000-2011 (Percent of GDP)



Mining Income Tax Revenue-2006-2011 (Percent of GDP)



Donor Support-2000-2011 (Percent of GDP)



Policies to Improve Revenues

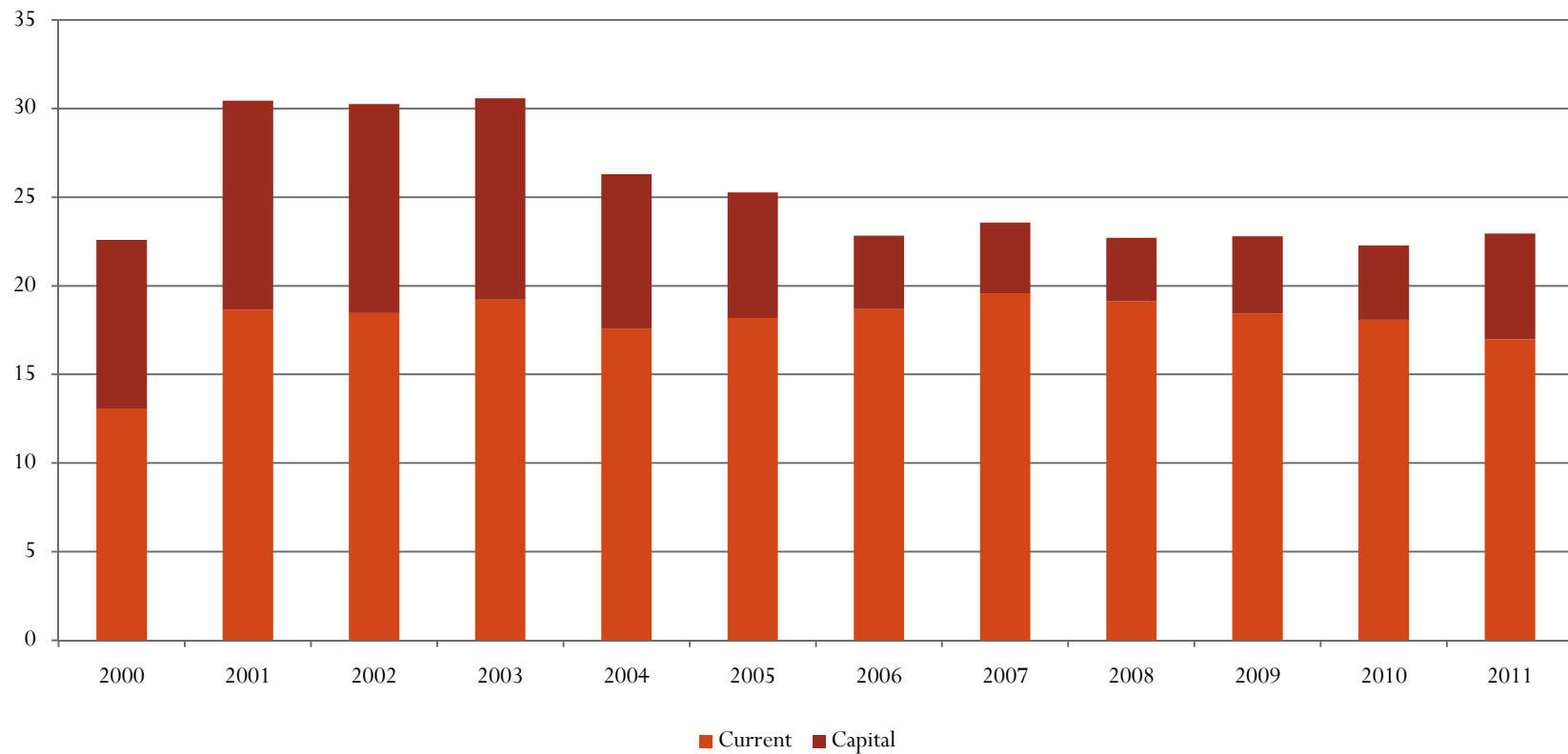
- Strengthen Tax Administration
- Review Tax Policy
- Regularize Relations with the Mining Sector

Making Expenditures More Efficient

- Expenditure Trends
 - Overall spending has been on a declining trend, particularly capital spending
 - Salaries and benefits account for the largest share of current spending and are increasing
 - Spending on interest has declined

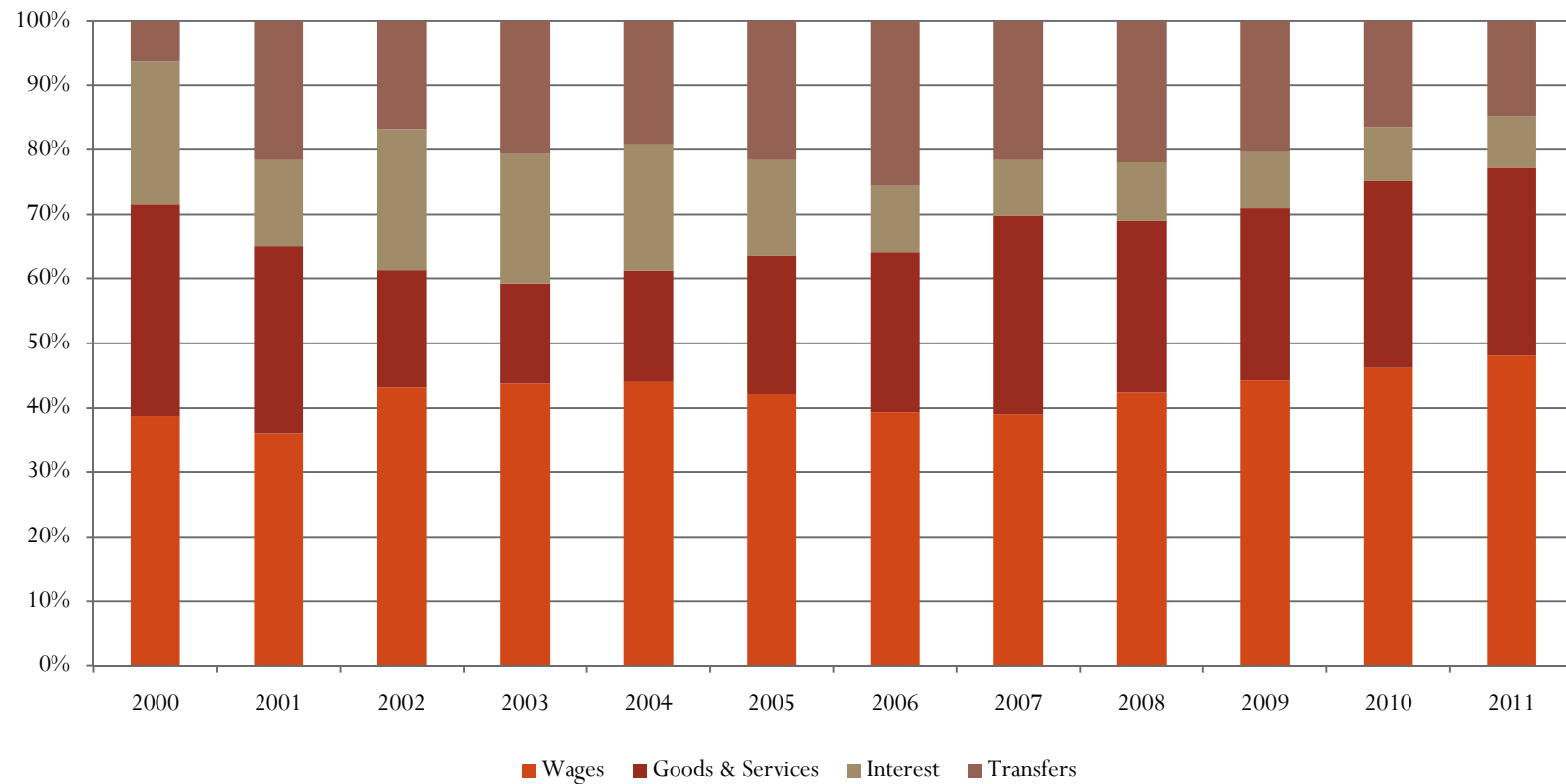
Expenditure Declining

Expenditures-2000-2011
(percent of GDP)



Wages Dominate Expenditures...

Current Expenditures-2000-2011
(percent of total)



... and are increasing in relation to GDP



Expenditure Policies

- Implement modern public financial management system
 - Effective Liquidity Control
 - Increased Transparency / Accountability
- Control Wage Bill (public sector reform)
- Review Food Reserve Policy

Maintain Stable Macroeconomics

- **Maintain prudent fiscal position** such that domestic and external debt are managed from the point of view of sustainability
- **Focus Monetary Policy on inflation** while maintaining conditions conducive to growth
- **Structural Issues in Financial Sector**
 - Negative real interest rates
 - Relatively low growth of credit to the private sector
 - High interest rate spreads

Prospects for 2011

- Ambitious Budget
 - Increase in tax revenues—*Measures to Support?*
 - But even more increase in expenditures (both wages and capital expenditures)—*Economically Viable Projects?*
 - Overall deficit to increase—*Room to borrow more?*
- General Macroeconomics
 - Inflation expected to fall compared to 2010
 - Strong Real GDP Growth
- Risk Factors
 - Uncertainty about Cooperating Partner disbursements
 - Potential resurgence in inflationary pressures

Conclusions

- To reduce poverty high growth rates must be sustained
- This requires massive public investments in infrastructure and human capital
- Given the secular decline in external aid, GRZ will have to finance this from domestic resources
- This will require increasing revenues and making expenditures more efficient