

Global Financial Crisis Discussion Series

Paper 22: Zambia Phase 2

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Acronyms

BoP	Balance of Payments
BoZ	Bank of Zambia
CSO	Central Statistical Office
DRC	Democratic Republic of Congo
EU	European Union
FDI	Foreign Direct Investment
FNDP	Fifth National Development Plan
Fob	Free on Board
GDP	Gross Domestic Product
GIR	Gross International Reserves
HIPC	Heavily Indebted Poor Countries Initiative
IMF	International Monetary Fund
JASZ	Joint Assistance Strategy for Zambia
LuSE	Lusaka Stock Exchange
MoFNP	Ministry of Finance and National Planning
NAPSA	National Pensions Scheme Authority
NGO	Non-Governmental Organisation
NPL	Non-Performing Loan
NTE	Non-Traditional Export
ODA	Official Development Assistance
ROA	Return on Assets
ROE	Return on Equity
SDR	Special Drawing Rights
Sida	Swedish Agency for International Development Cooperation
UK	United Kingdom
UN	United Nations
UNCTAD	UN Conference on Trade and Development
US	United States
VAT	Value Added Tax
ZDA	Zambia Development Agency
ZRA	Zambia Revenue Authority

Abstract

This paper monitors the effects of the global financial crisis in Zambia. It traces the impact of the crisis through its effects on four main transmission paths, namely: private capital flows, trade, remittances and official development assistance (ODA). The study finds that, although the effects of the crisis have continued to be felt in Zambia, the situation eased somewhat during the second and third quarter of 2009, in line with global trends. ODA and remittances have not been affected by the crisis. Moreover, the country's current account balance and overall balance of payments position moved from a deficit during the first quarter to a surplus during the second and third quarters of 2009. The overall effects of the crisis are generally easing and the country is expected to grow at pre-crisis levels.

1. Introduction

The current global financial crisis emerged during 2008. The adverse impacts of the crisis and of the subsequent recession on Zambia were first observed during the third quarter of that year, manifested as an external shock to the economy. Studies carried out in early 2009 aimed to explore the impact of the crisis and recession in 10 developing countries, among them Zambia (Ndulo et al., 2009). In the Zambian case, taking trade, official development assistance (ODA), remittances and private capital flows as the main transmission mechanisms, the study observed that the crisis had its primary effects in the trade sector, producing macroeconomic imbalances in the economy resulting in rising interest rates, depreciation of the kwacha against the major currencies, inflation and falling stock market prices. In addition, most exporters, principally mines, tourist enterprises and non-traditional export producers, scaled down investment and production, and some units were closed, resulting in massive job losses in the mining sector. On the whole, the crisis threatened the country's growth prospects, risking a reversal of the gains made during the preceding eight years (ibid).

Although the global recession of 2009 is said to be easing in most industrialised countries, no system exists in Zambia to monitor the impact on the economy and its response to the crisis. This paper builds on earlier work assessing the impact of the crisis in Zambia. The objective of the study was to provide a systematic overview of what has happened and is happening in the economy as a result of the global crisis and recession. Monitoring has been carried out of crisis impacts on the key transmission mechanisms: trade, private capital flows, remittances and ODA, although detailed analysis of the crisis impact is hampered by a lack of timely availability of high quality data on the Zambian economy. This is especially the case with regard to data on the national accounts, poverty and employment, which are available only annually. This unavailability of high quality data is a significant obstacle to good policymaking.

The paper is structured as follows. Following this introduction, Section 2 looks at the key transmission mechanisms of the crisis into the domestic economy. Section 3 looks at the growth and development effects of the crisis and Section 4 discusses the policy response. We conclude the paper in Section 5.

2. Effects of the global financial crisis: Key transmission mechanisms

2.1 Financial flows

The Zambian financial sector is dominated by commercial banks and non-banking financial institutions. The dynamic sub-sectors are the banking sector and the stock market.

2.1.1 Domestic banking system

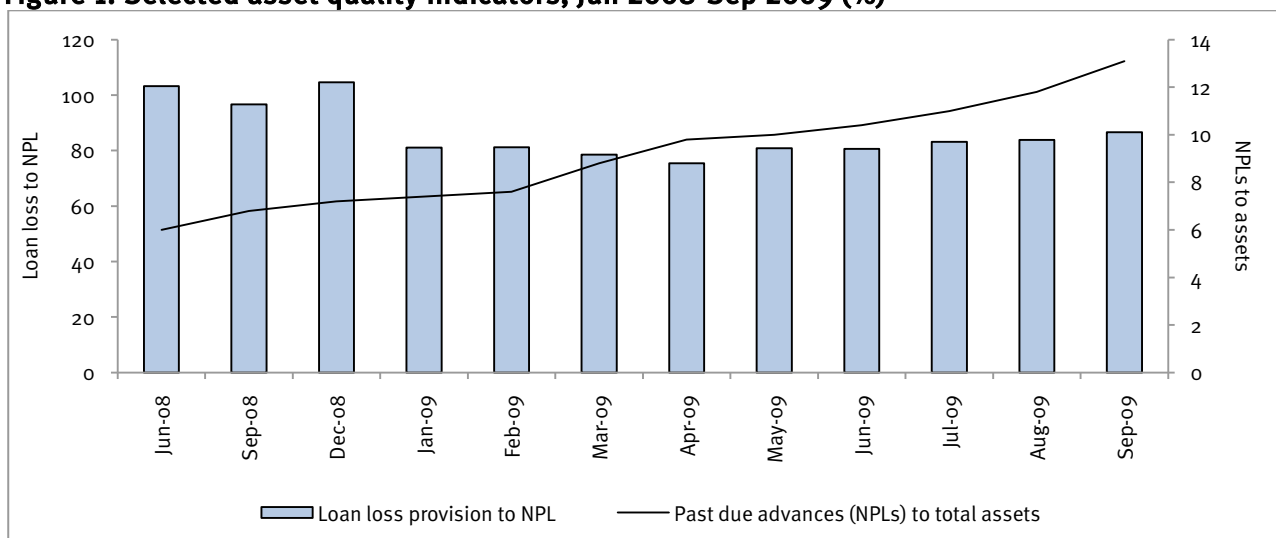
The banking sector is dominated by subsidiaries of foreign banks, which have increased in number during the past few years. During the third quarter of 2008, there were nine foreign-owned and four domestically owned banks. Two banks are joint ventures between the state and foreign owners. Between January and November 2009, three new subsidiaries of foreign banks invested in Zambia. Parent foreign banks come from the UK, the US, South Africa, Zimbabwe, China and Nigeria. Subsidiaries of foreign banks from the UK and South Africa dominate the market share of the banking sector in terms of assets, loans and deposits. Foreign banks account for over three-quarters of the sector's total assets (Ndulo et al, 2009).

The banking sector was largely unaffected by the first-round effects of the financial crisis, which were transmitted mainly through trade, because of its limited integration into the international financial market. At a time when copper and other commodity prices were collapsing, the performance of the banking sector remained satisfactory, even up to the last quarter of 2008. However, during the first three quarters of 2009, the banks were adversely affected by the secondary effects of the crisis, through their linkage to other sectors of the economy, such as tourism, mining and agriculture, which had been affected by the crisis during 2008. The state of the financial sector during 2009 can be seen in the behaviour of non-performing loans (NPLs), asset quality and capital adequacy ratios in the banking sector.

The secondary effects of the crisis on the banking sector have occurred mainly through the increase in NPLs, mainly as a consequence of the retail loans that banks extended to households during the growth period, most of which had workers in mining and its supporting industries. Prior to the crisis, most banks in Zambia had made standing agreements with the mines whereby they were to extend retail loans to mine workers. The mines would in turn undertake to deduct loan repayments from the salaries of the workers. As a result of the crisis, a large number of mine workers lost their jobs, which meant that they could no longer service their loans with the banks. These loans became non-performing, resulting in losses to the banks. Some banks had also a heavy concentration in retail loans going to farmers based on production and the expected selling price of their produce. Falling prices on the world market in commodities such as soya beans, cotton and cut flowers meant that farmers could not realise the expected revenue, so could not repay their loans as agreed with the banks. These loans also became non-performing. This put a strain on the credit market in the financial sector.

Figure 1 below shows the ratio of NPLs to total assets and loan loss provision to NPLs during 2008 and 2009. This demonstrates that asset quality indicators and overall asset quality of the banking sector deteriorated in 2009. The ratio of NPLs to total assets increased in the first three quarters, from around 7% in the first quarter to about 13% in the third quarter. Meanwhile, the loan loss provision to NPL ratio declined during the period, from 100% in December 2008 to 80% in January 2009. It further decreased to about 78% in April 2009 before increasing to around 85% in September 2009.

Figure 1: Selected asset quality indicators, Jun 2008-Sep 2009 (%)

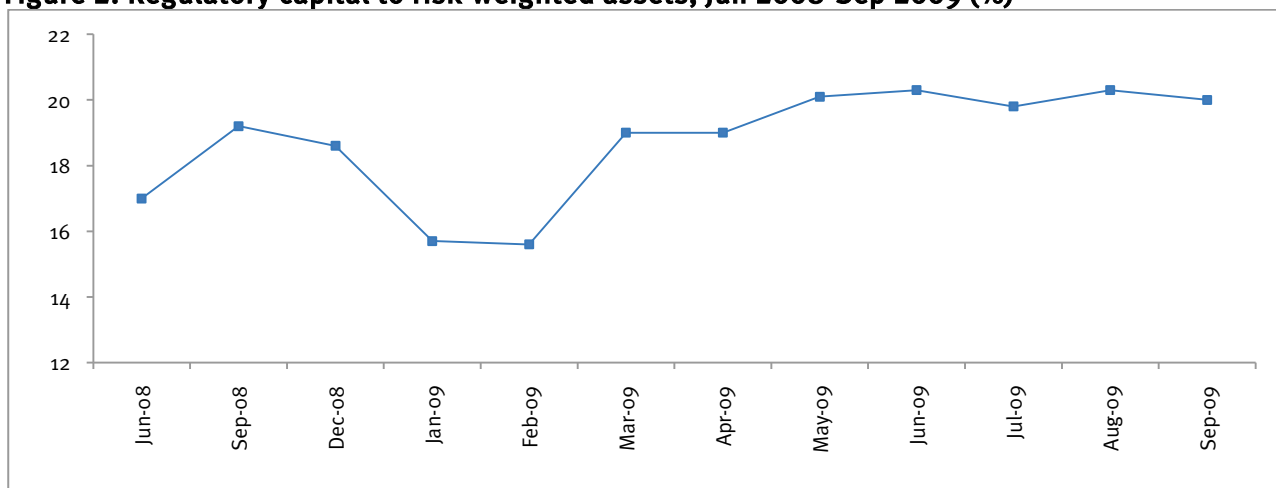


Source: Constructed from BoZ database.

However, some banks had limited exposure to NPLs, and their profits did not fall. To protect themselves, these banks reacted by curtailing interbank lending to banks whose profits had declined. This situation manifested itself during the first quarter of 2009, with banks becoming suspicious of each other as a result of heightened risk levels. This resulted in the financial sector becoming illiquid and therefore a further tightening of the credit market.²

While the capital adequacy ratio improved, return on equity (ROE) and return on assets (ROA) worsened during 2009. We show the ratio of regulatory capital to risk-weighted assets in Figure 2 and ROE and ROA in Figure 3. The capital adequacy ratio increased continuously during 2009, from 15.7% in January to 20% in September, indicating that the soundness of the banking system as a whole improved slightly, despite a dip between September 2008 and February 2009 (Figure 2). The dip of 15.7% was well above the 10% benchmark value for the capital adequately ratio.

Figure 2: Regulatory capital to risk-weighted assets, Jun 2008-Sep 2009 (%)

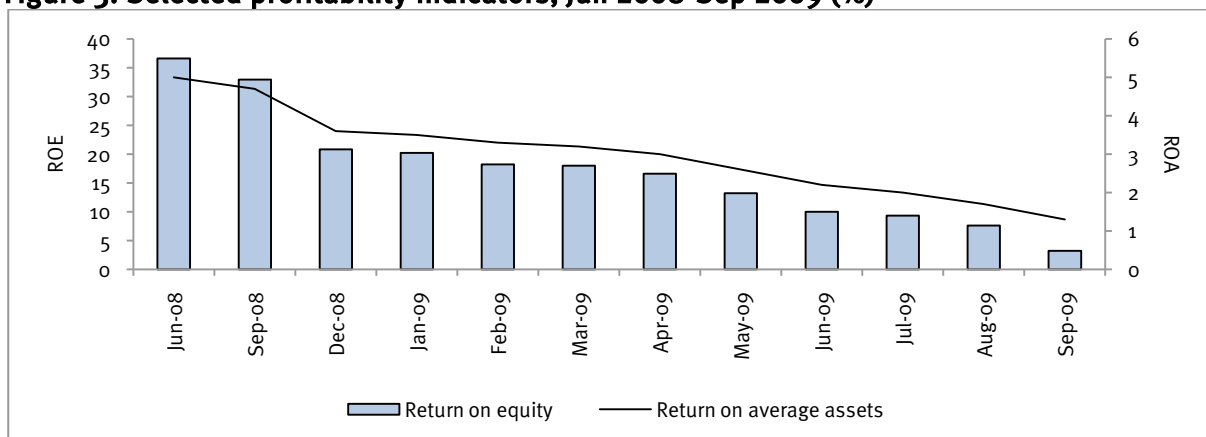


Source: Constructed from BoZ database.

Figure 3 shows that ROE declined significantly in the third and fourth quarter of 2008 and continued to fall thereafter, from 24% in January 2009 to 20% in September 2009. During the same period, ROA declined from 4% to 1.4%. This deterioration is partly explained by the increase in NPLs. The secondary effects of the global financial crisis during 2009 adversely affected all of the above financial soundness indicators in the banking sector, going on to reduce average profitability of the banking system.

² Information from interviews with commercial banks.

Figure 3: Selected profitability indicators, Jun 2008-Sep 2009 (%)



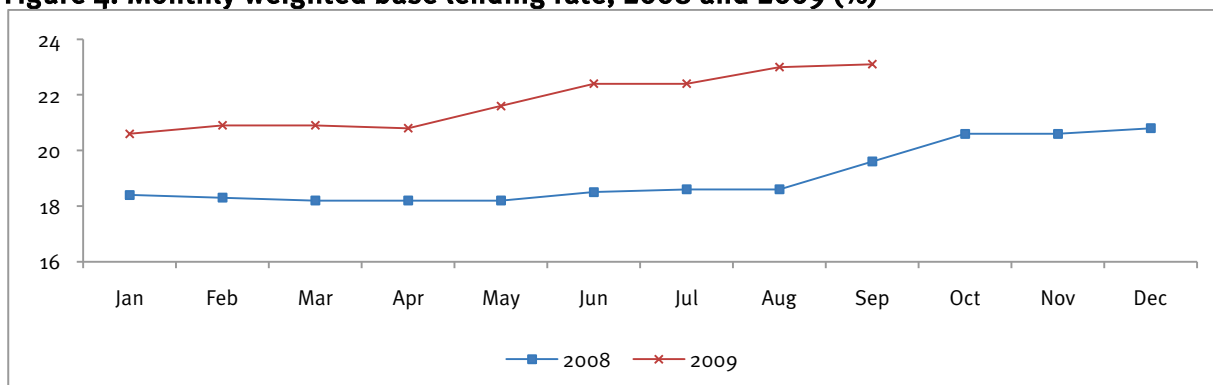
Source: Constructed from BoZ database.

As well as banks, non-banking financial institutions have also experienced reduced profits. However, asset quality and the liquidity position of the sub-sector have been rated overall as fair. The majority of the institutions were adequately capitalised: only two leasing finance companies, one building society and one credit and savings institution had below the required capital base (Fundanga, 2009a). It could be argued that financial conditions and performance have continued to be largely satisfactory, despite deterioration during 2009 (ibid). This can be attributed to the relatively underdeveloped nature of the sector (Ndulo et al., 2009) and close regulatory oversight by the central bank.

2.1.2 Credit crunch

The main contagion effects of the crisis on the banking system have been manifested by the credit crunch in the banking sector. Over the years, credit markets in Zambia have improved. This can be seen in the continuous decline in the weighted base lending rate. The rate dropped by 8.5 percentage points, from 27% in 2006 to 18.5% in June 2008. This scenario was interrupted by the impact of the global financial crisis on credit markets, first felt during the third quarter of 2008 and continuing during 2009. Credit markets therefore continued to be tight during 2009. Despite resurgence in growth prospects as a result of recovery in copper prices and increased competition in the banking sector, the weighted base lending rate has remained high and continued to increase in 2009 compared with 2008. Figure 4 shows that the rate increased from 20.9% in January to 23.1% by September 2009. This has been driven by the increase in inflation, inefficiencies in the banking sector and under-subscription to government bonds. Moreover, interviews with bank managers revealed that banks have reduced their lending to sectors perceived to be risky, such as medium and small-scale enterprises, agriculture, manufacturing and households. The withdrawal of foreign investors from the treasury bills market put additional pressure on the government to increase deposit rates on treasury bills and most likely led to the increase in lending rates.

Figure 4: Monthly weighted base lending rate, 2008 and 2009 (%)



Source: Constructed from BoZ database.

2.1.3 Pensions

It is interesting to look at pension funds because the sector has large investible financial resources and is an active participant in the stock market. The evidence gathered indicates that pension funds have been impacted by the secondary effects of the crisis but that the effects have been different from one scheme to another. In terms of impact on number of claims, there has in general not been any increase as a result of job losses in affected sectors, because statutory regulations allow pension contributors to claim benefits only after reaching the retirement age of 55 years. This means that all those who have lost their jobs have not been able to place a claim with their pension schemes. In terms of exposure to toxic assets abroad, some schemes, particularly state-owned ones, have not had exposure, having not invested abroad. However, all schemes have been affected by falling share prices on the Lusaka Stock Exchange (LuSE), which has diluted the book value of their equity investments.

It is instructive to look at the case of the major statutory pension fund, the National Pensions Scheme Authority (NAPSA). The impact of the global crisis on the fund has been minimal: there have been no effects on claims and the fund is insulated from the global financial system because it has no offshore investments. Nevertheless, in 2008 it lost potential pension contributions from the mines which, on account of the global financial crisis, renegotiated earlier agreements with the government to enter the scheme in 2008. Furthermore, many contributors working for mine suppliers lost their jobs. This is likely to have negatively impacted their contributions to the fund. The fund also lost returns on investments in the stock market as the share price fell, translating into a book value loss. However, this has not adversely affected its long-term investment in the market.

2.1.4 Private capital flows

Foreign portfolio investment

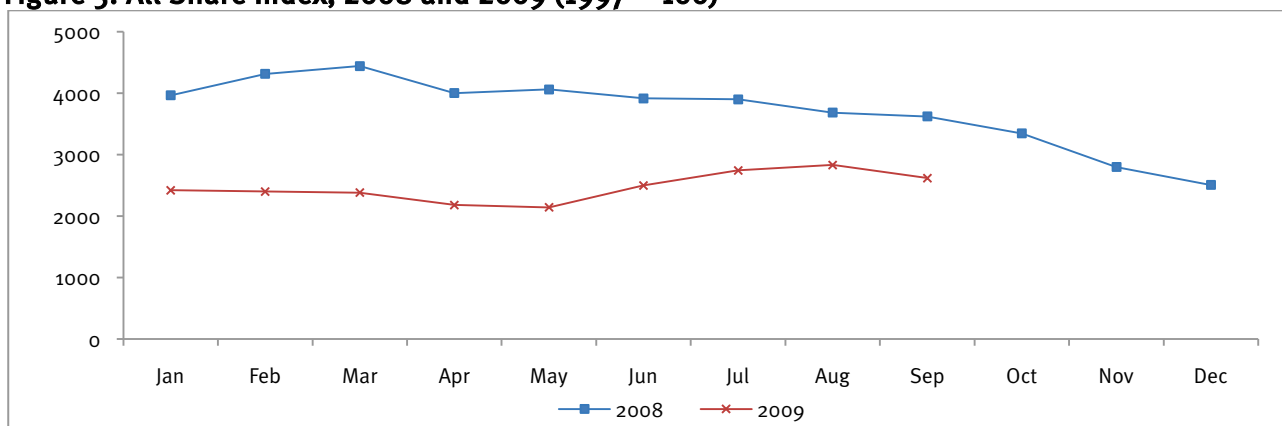
In this section, we look at foreign portfolio investment into Zambia. To capture this, we consider the stock market, the bonds market and international bank lending.

Stock market

There are signs that the stock market has been picking up hesitantly since the second quarter of 2009. The All Share Index is exhibiting a trend whereby its value improves in growth times, as is slowly happening in 2009, and reverses in stagnant times, as was clearly demonstrated in 2008. It appears, then, that the stock market is gradually recovering from the major shock in 2008. Here, we look at the All Share Index, market capitalisation and market turnover as indicators of stock market performance.

Overall stock market activity continued to be slow during the first quarter of 2009. The All Share Index continued to deteriorate in the first quarter of the year. However, there were signs of recovery during the second quarter: the index rose from 2143.4 at the end of the first quarter to 2615.81 at the end of August 2009. However, it remains below the all time high of 4440.46 recorded in March 2008. Figure 5 shows the behaviour of the All Share Index during 2008 and 2009. The index is expected to continue increasing, given the recent upsurge in copper prices and the confidence gathering in the economy.

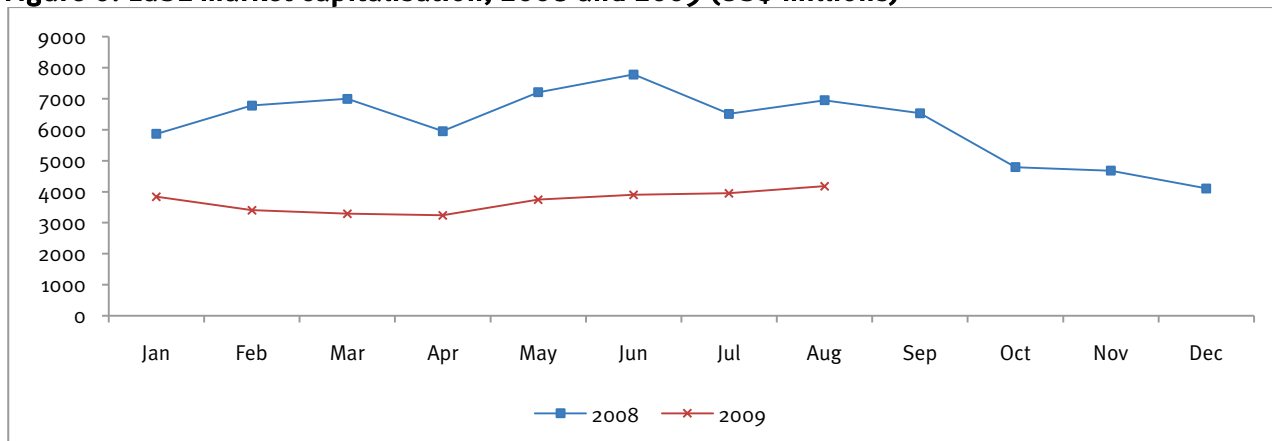
Figure 5: All Share Index, 2008 and 2009 (1997 = 100)



Source: Constructed from LuSE database: www.luse.co.zm.

The behaviour of market capitalisation during 2008 and 2009 is shown in Figure 6. Stock market capitalisation continued to deteriorate during the first quarter of 2009 at an average of 5% per month. It rebounded to an average growth rate of 2% per month between April and August 2009. In absolute terms, market capitalisation increased from \$3240 million in April to \$4177 million in August 2009. This could be attributed to improved investor confidence in the economy. However, this level remains far below the stock market’s all-time high performance of \$7778.95 million in June 2008. There were no new listings to boost the stock market during 2009. This could have been because the deterioration in share prices deterred private firms from listing, but could also have owed to the completion of the government programme of listing formerly state-owned enterprises on the stock market. Since there were no new listings, the increase in market capitalisation can be attributed to the recovery of share prices on the market.

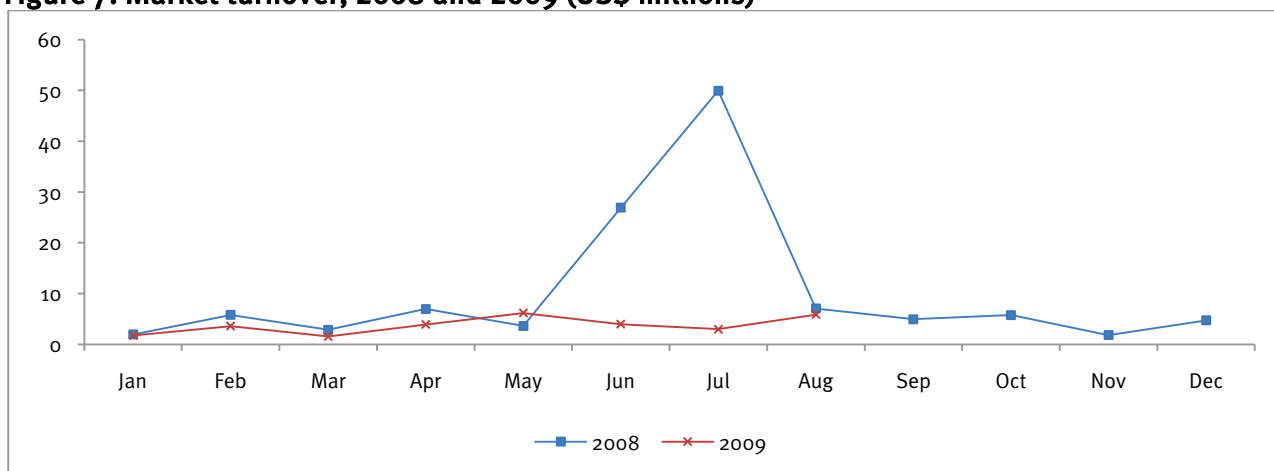
Figure 6: LuSE market capitalisation, 2008 and 2009 (US\$ millions)



Source: Constructed from LuSE database: www.luse.co.zm.

Monthly market turnover in 2008 and 2009 is shown in Figure 7. Market turnover remained fairly stable during 2009 compared with 2008. By August 2009, turnover was at \$5.84 million, and this is expected to continue gradually to increase during the fourth quarter of 2009 as a result of the increasing investor confidence in the market.

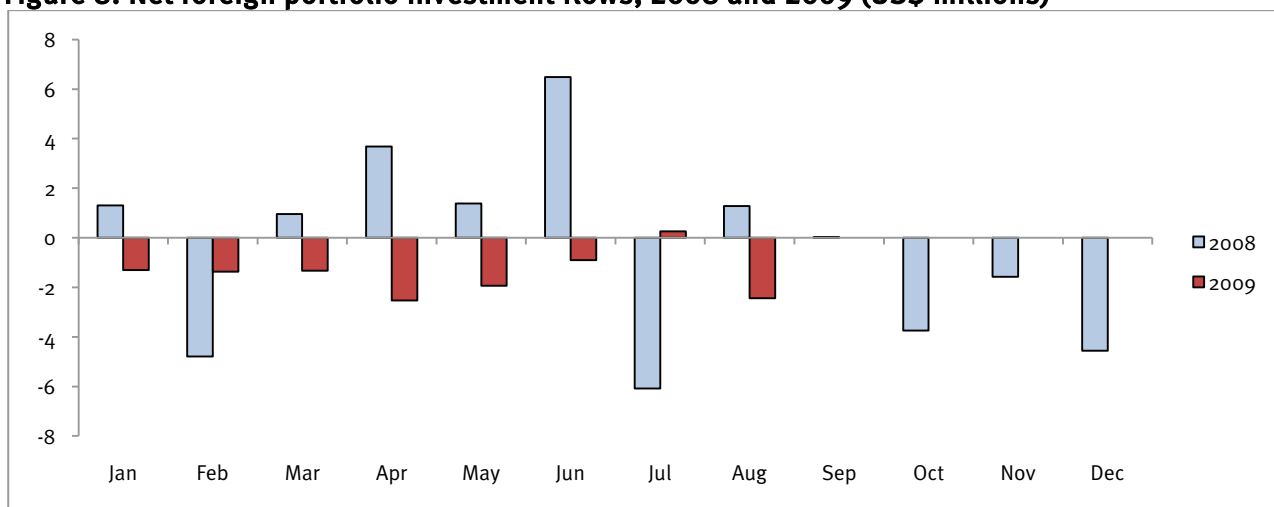
Figure 7: Market turnover, 2008 and 2009 (US\$ millions)



Source: Constructed from LuSE database: www.luse.co.zm.

Portfolio investment in equities and government securities has been shown to have been adversely affected by the global financial crisis and the resultant fall in copper prices during 2008 (Ndulo et al., 2009). A hesitant recovery seems to have occurred with the improvement in copper prices. The net position is still negative, although it has improved compared with the last quarter of 2008. This could be explained by increased investor confidence in the market as a result of high copper prices and the surging economic recovery. Figure 8 shows net portfolio flows on LuSE during 2008 and 2009.

Figure 8: Net foreign portfolio investment flows, 2008 and 2009 (US\$ millions)

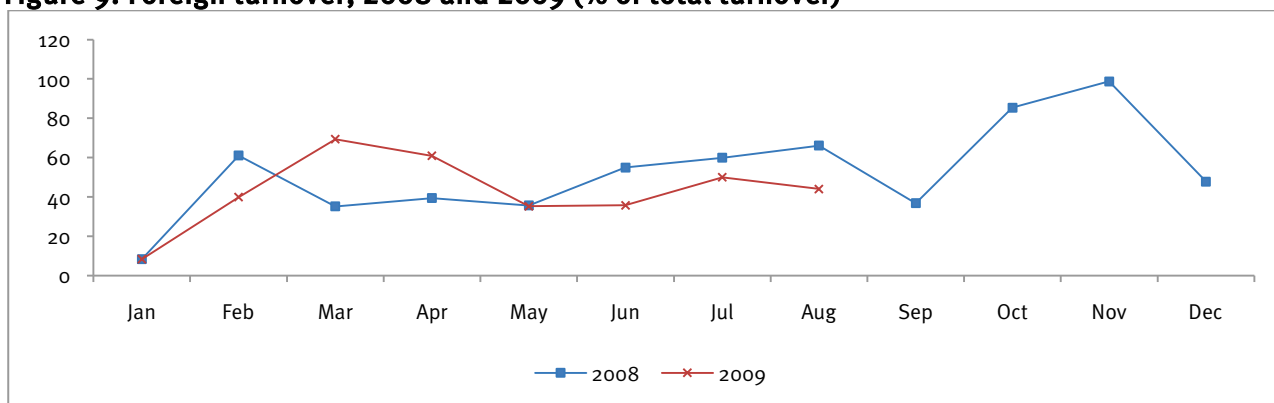


Source: Constructed from LuSE database: www.luse.co.zm.

Despite negative net outflows, there is still strong foreign participation on the stock market, as Figure 9 shows. Foreign participation increased during the first quarter of 2009, to above the level at the end of the first quarter of 2008. However, this participation dropped during the second quarter of 2009. Since then, it has been below the levels of 2008.

Nevertheless, confidence in the stock market can be demonstrated by the recent rights offer for Zambia Sugar plc, which was very successful. Zambia Sugar issued a rights offer in August 2009 of over 6 million shares. The principal objective was to raise capital and reduce the company's indebtedness. There was 100% subscription, and diverse companies participated in the offer, including Zambian and offshore institutional investors.

Figure 9: Foreign turnover, 2008 and 2009 (% of total turnover)

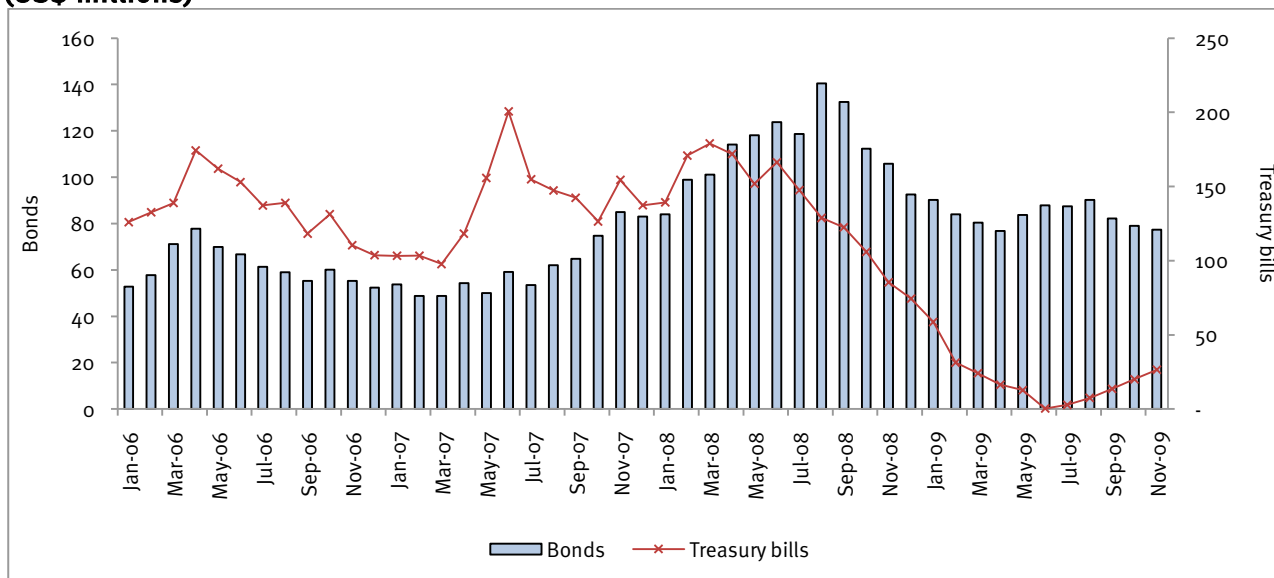


Source: Constructed from LuSE database: www.luse.co.zm.

Bond markets

The risk aversion to the kwacha by foreign investors as a result of the global crisis led to reduced foreign holdings of government securities. Investors' total holding of government securities dropped from a peak of \$296.36 million in June 2008 to \$166 million in December 2008. The level of foreign subscription dropped further, from \$145 million in January to \$85 million in June 2009. It increased slightly to \$105 million in November 2009. This is shown in Figure 10. Most investors could not roll over their funds at maturity. Combined with the non-renewal of funds at maturity, demand for government securities declined. This resulted in under-subscription in the midst of unchanged supply. As a result, treasury bill yield rates went up.

Figure 10: Foreign participation in government bonds and treasury bills, Jan 2006-Nov 2009 (US\$ millions)



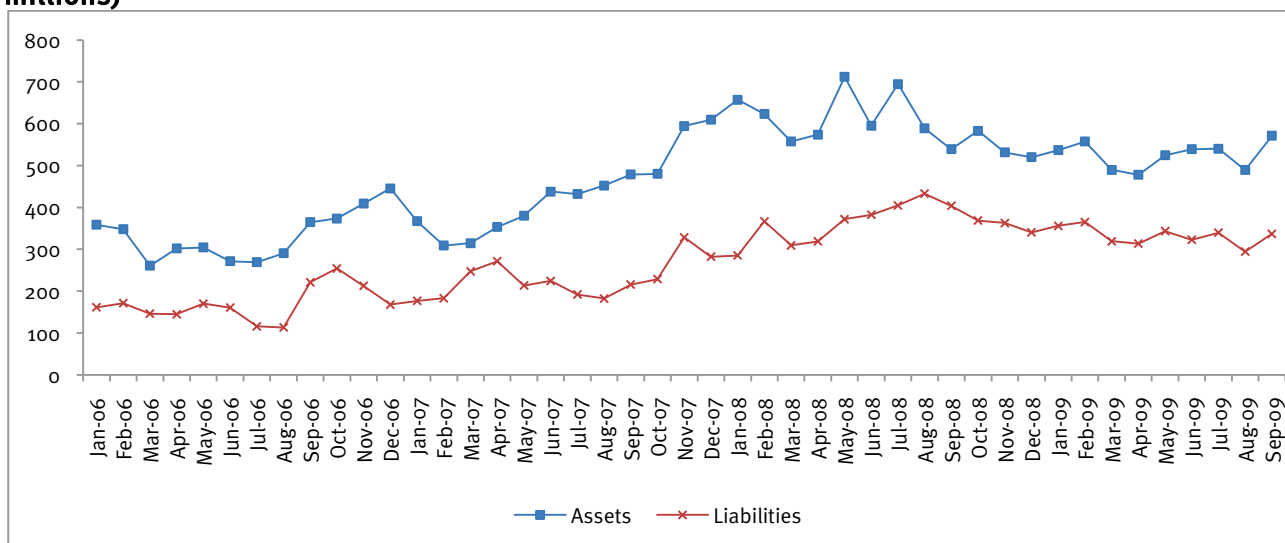
Source: Constructed from BoZ database.

International bank lending

The banking sector in Zambia is dominated by subsidiaries of foreign banks, mainly from the UK and South Africa. These have a large role to play in international bank lending. As it is difficult to get information on international bank lending, we use commercial banks' foreign assets and liabilities positions to generate the picture, using foreign assets as a proxy for international lending. Figure 11 shows that foreign assets increased steadily during 2006 and 2007, reaching a peak of over \$700 million in May 2008. Thereafter, they dropped rapidly, to under \$500 million in August 2009. The amount of assets increased rapidly between January 2008 and July 2009, mainly because some subsidiaries of foreign banks provided loans to parent banks that were faced with liquidity problems.

To avoid contagion, the Bank of Zambia (BoZ) restricted short-term foreign bank lending by commercial banks: banks were not allowed to give loans of less than one year to foreign borrowers. This is shown in Figure 11 by the decline in foreign assets during 2009.

Figure 11: Trends in commercial banks' foreign assets and liabilities, Jan 2006-Sep 2009 (US\$ millions)

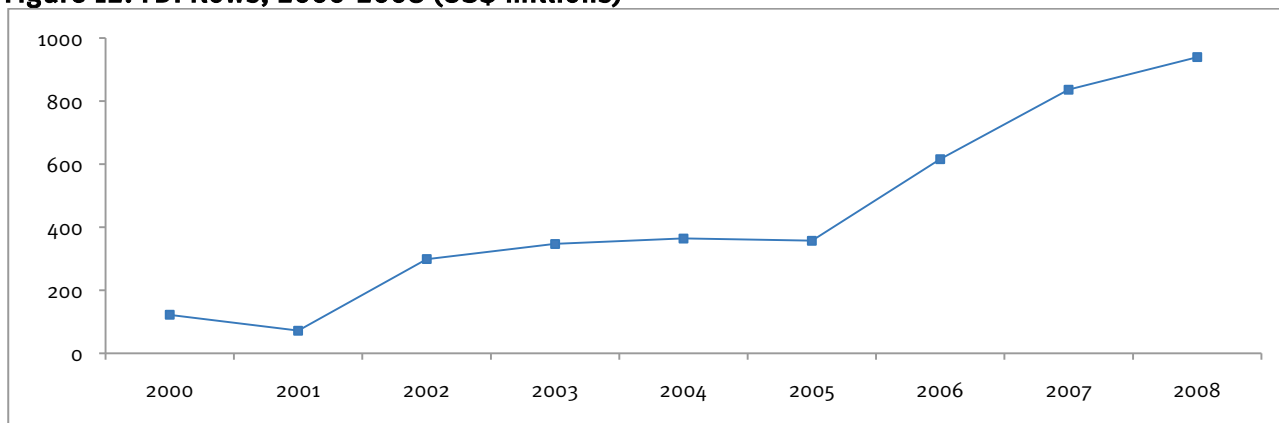


Source: Constructed from BoZ database.

Foreign direct investment

There has been an increase in FDI inflows in Zambia during the past eight years (Figure 12), from \$121.7 million in 2000 to \$939 in 2008. The increase over this period is attributed to the huge investment in the mining sector as a result of the privatisation of the mines and favourable concessions and mining tax regimes (Ndulo et al., 2009). Among the main sources of FDI are China, India, South Africa and Canada.

Figure 12: FDI flows, 2000-2008 (US\$ millions)



Source: Ndulo et al. (2009); UNCTAD (2009).

Despite the global recession, Zambia continued to experience a substantial inflow of FDI during the first three quarters of 2009, although at a much lower level than in 2008. Using investment pledges received by the Zambia Development Agency (ZDA) as a proxy, most of the FDI inflows were directed to the mining, energy and manufacturing sectors in 2008. However, there seems to have been a change during 2009. Most pledges are concentrated in manufacturing, real estates and services. Investments in energy and agriculture are driven mostly by Chinese interests in generating bio-fuels for their home market. Pledged investments in the first, second and third quarters of 2009 are shown in Table 1. The total pledged investment by the third quarter of 2009 was \$1.241 million. This is about the same as the annual pledged investment in 2008 of \$1250 million (Ndulo et al., 2009).

Table 1: Investment pledges, 2009 (US\$ millions)

	Q1	Q2	Q3	Total	% of total FDI pledges
Agriculture	1.8	7.6	16.7	26.1	2
Manufacturing	33.2	9.9	363.6	406.7	33
Mining	14.3	50.0	60.8	125.1	10
Education and health	1.30	27.29	36.30	64.9	5
Real estate	6.1	198.6	106.0	310.7	25
Tourism	15.7	73.2	9.0	97.9	8
Services	60.16	120.07	30.10	210.3	17
Total	132.6	486.7	622.5	1241.8	100

Source: ZDA database.

2.2 Trade

The external sector has improved its performance during the past few years. Merchandise exports increased more than six-fold, from \$746 million in 2000 to \$5089 million in 2008. This huge increase was driven by increased production and exports of copper, stimulated by an increase in investments as a result of the sector's privatisation and increased prices on the international market. Copper prices peaked at \$8714 per tonne in April 2008, from \$1560 in 2002. Non-traditional exports (NTEs) such as sugar, cotton, tobacco, electrical cables and fresh flowers also increased significantly, from \$248 million in 2000 to over \$881 million in 2008. Rapid growth in copper exports reduced the proportion of NTEs in total exports from 33% in 2000 to 17% in 2009. Copper has retained its position as the largest source of foreign exchange. Table 2 shows percentage share of export of NTEs in 2006-2008.

Most copper, and its associated products, is destined for China and for European countries such as the UK and Switzerland (some as entrepôt). The main markets for NTEs have tended to be within the region, including South Africa, Democratic Republic of Congo (DRC), Malawi and Zimbabwe.

Meanwhile, value of imports also increased between 2000 and 2008, from \$978 million in 2000 to \$4554.3 million in 2008. Most imports are sourced from the European Union (EU) and regional markets.

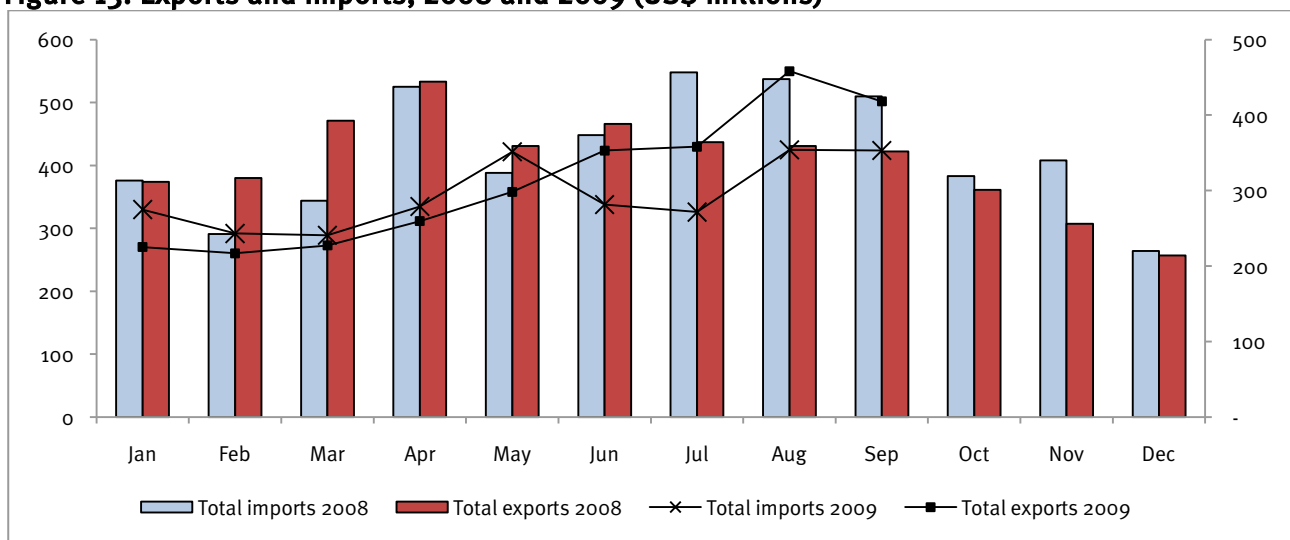
Table 2: Share of NTEs in total exports, 2006-2008 (%)

	2006	2007	2008
Copper wire	23.1	23.6	17.6
Cane sugar	7.2	9	6.5
Burley tobacco	9.3	7.6	8
Cotton lint	8.2	4.5	3.8
Electrical cables	13.7	18.2	5.9
Fresh flowers	4.6	4.6	2.6
Cotton yarn	2.5	1.5	0.8
Fresh fruits and vegetables	3.3	3	2.9
Gemstones	2.4	3.5	3.5
Other	23.6	35.5	51.2
Total	100	100	100

Sources: CSO (2009); ZDA (2009).

The trade sector was one of the main channels through which the crisis was transmitted in Zambia during 2008, through impacts on the country's exports and imports. By the third quarter of 2008, Zambia's exports and imports had declined and the trade deficit had widened. Trends in both exports and imports for 2008 and 2009 are demonstrated in Figures 13 and 14. The deficits continued up to the end of the first quarter of 2009. During the second quarter of 2009, the trade balance improved, and in May 2009 the country recorded its first surplus since July 2008.

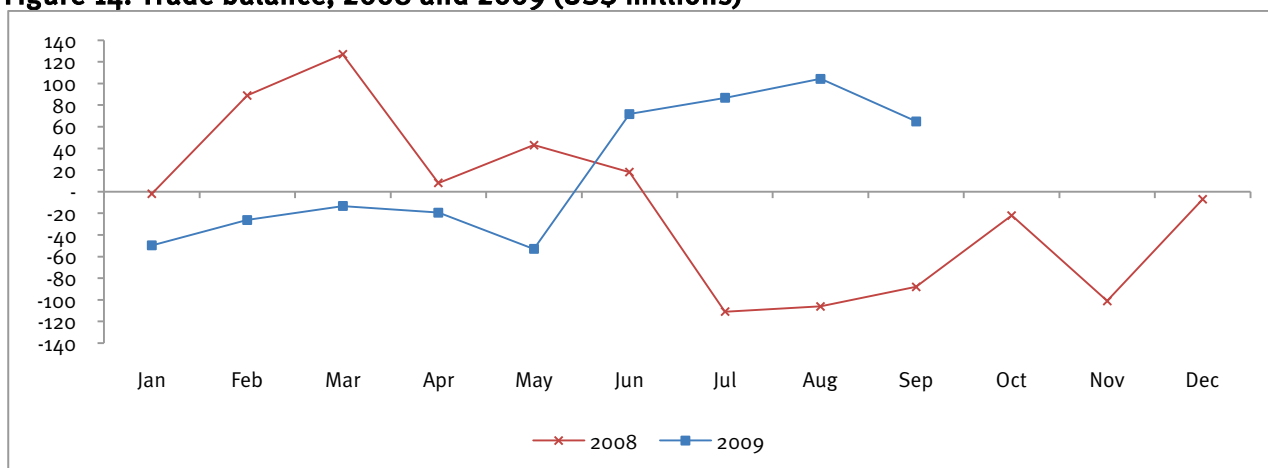
Figure 13: Exports and imports, 2008 and 2009 (US\$ millions)



Sources: Constructed from BoZ and CSO databases.

The improvement in the trade balance in the second and third quarters of 2009 was driven by the improved prices of copper and other commodities in international markets. The trade balance stood at a surplus of \$64.8 million in September 2009.

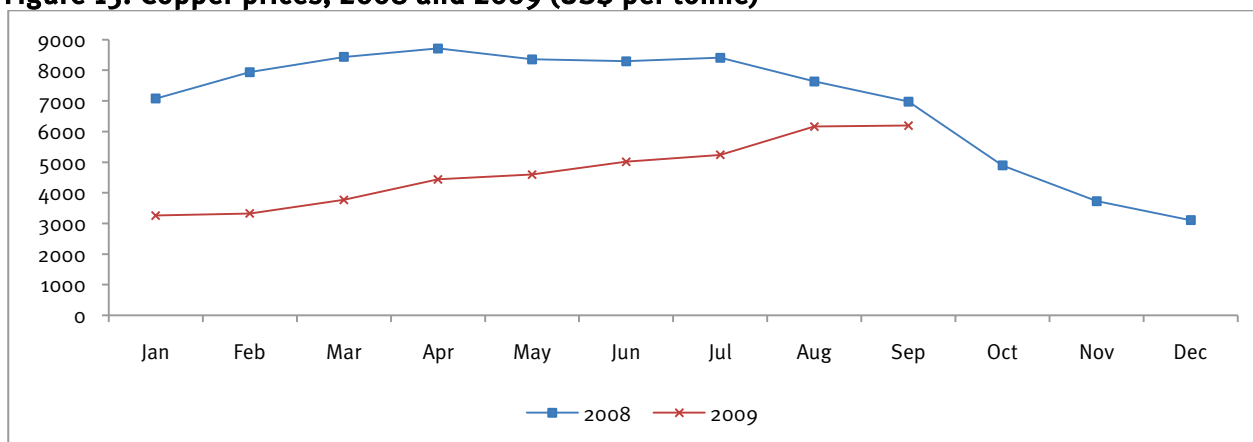
Figure 14: Trade balance, 2008 and 2009 (US\$ millions)



Source: Constructed from CSO data base

This positive phenomenon, as pointed out earlier, can be explained by the increased price of copper during 2009. The price of copper almost doubled, from \$3221 per metric tonne in January to \$6196 per in September 2009 (Figure 15). This has been one factor in increased investment, which has triggered an increase in copper production and the reopening of mines that were put under care and maintenance when the crisis was at its peak in 2008.

Figure 15: Copper prices, 2008 and 2009 (US\$ per tonne)



Source: World Bank Monthly Commodity Prices (Pink Sheets).

The export sector continues to be dominated by copper and other base metals. With increased copper prices, the urge to diversify the export base has been blunted. The proportion of NTEs in total exports declined from 22% during the first quarter of 2009 to 18% in the third quarter of 2009. Table 3 shows that, overall, NTEs are not growing significantly *relative* to copper exports (at least over 2009Q1-Q3). This may indicate a problem in the diversification process. Despite the depreciation of the kwacha, there has been very little impact on the competitiveness of the NTE sector. This can be attributed to infrastructural constraints such as in transport, telecommunications and financial services. The main NTEs are copper wire, cane sugar, burley tobacco, cotton lint, electrical cables, fruits and vegetables and electricity.

Table 3: Non-traditional and metal exports, 2008 and 2009 (US\$ millions)

	2008				2009		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Export (fob)	1318.6	1441.8	1206.7	910	684.6	873.2	1272.2
Metals	1147.2	1216.2	925.6	712	543.5	675.1	1003.5
NTEs	171.4	225.6	281.1	198.1	141	198.1	268.7
NTE % of total exports	13	15.6	23.3	23	22	19	18

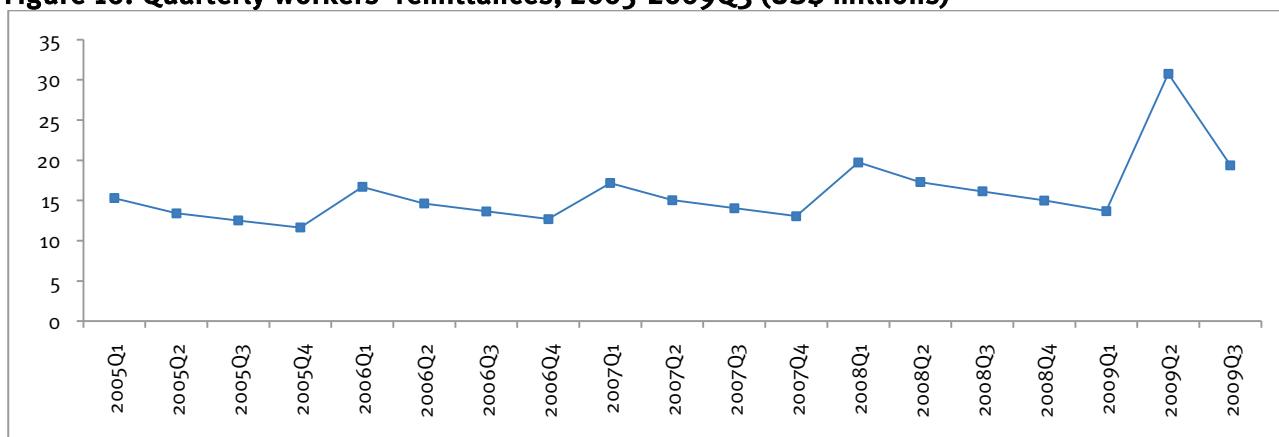
Sources: Constructed from BoZ and CSO databases.

2.3 Remittances

Remittances have displayed an insignificant but growing trend during the past few years. Figure 16 shows inflows of worker remittances for the period 2005-2009. It demonstrates that quarterly inflows oscillated between \$10 million and \$20 million between 2005 and the second quarter of 2009. Most of these remittances in Zambia are used for building houses and for social functions such as school fees, family support, weddings and funeral. The level of remittances is generally lower because Zambia has a small diaspora compared with countries like Ghana, Nigeria and Kenya.

The data suggest that the global financial crisis had no major impact on flows of remittances in 2009. This may owe to the small size of the population and the skills type of Zambians in the diaspora. Most are skilled workers whose jobs and income levels may not have been affected adversely by the crisis. However, total remittances received during the first three quarters of 2009 outstripped the total amount received during the same period in 2008.

Figure 16: Quarterly workers' remittances, 2005-2009Q3 (US\$ millions)



Source: Constructed from BoZ database.

2.4 Official development assistance

The flow of ODA into Zambia is managed under the Joint Assistance Strategy for Zambia (JASZ) framework. Current ODA commitments and arrangements were agreed within the context of the Fifth National Development Plan (FNDP). The framework spells out ODA flow modalities and government obligations.

ODA flows are shown in Table 4. ODA increased from \$300 million in 2003 to \$553 million in 2008. The increase between 2005 and 2007 can be attributed to the cancellation of Zambia's debt by bilateral and multilateral donors after attainment of the Heavily Indebted Poor Countries (HIPC) Initiative completion point. Moreover, the country has continued to receive a substantial amount of resources through project support, mainly for health, education and other social sectors. The main donors in Zambia are the UK, the US, Japan, Sweden, Denmark and the EU.

Table 4: ODA, 2003-2008 (US\$ millions)*

	2003	2004	2005	2006	2007	2008
Budget support	48.28	54.07	121.64	118.22	145.39	171.70
Project	251.95	246.23	287.19	384.01	380.21	381.84
Total grants	300.23	300.29	408.83	502.24	525.61	553.54

Note: * = This captures ODA flows that are channelled and reported through government systems.

Source: Constructed from IMF fiscal tables database.

Generally, ODA flows have not been affected by the global financial crisis. Donor pledges towards both the 2009 and the 2010 national budgets have largely not been revised. However, some major bilateral donors have either suspended or delayed their disbursement of budget support on account of the country's failure to meet the governance triggers as stipulated in the JASZ (Sweden suspended and the Netherlands delayed). Major bilateral donors to the health sector did not disburse committed funds on time because of a lack of accountability by the government at the Ministry of Health during 2009.

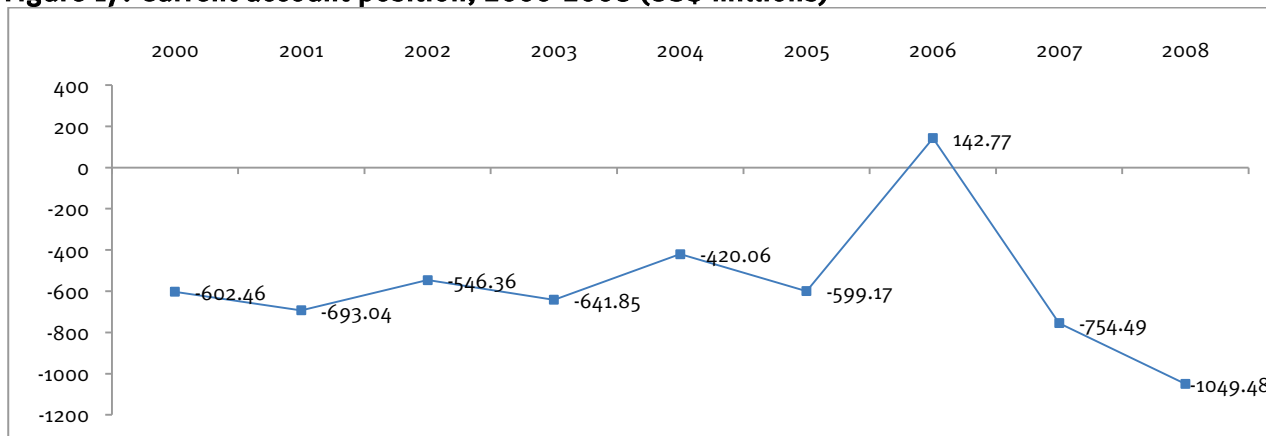
The suspension of ODA, in addition to the reduced fiscal revenues collected by the government during 2009, has led to a huge budgetary deficit, estimated to stand at more than \$200 million by the end of 2009.³ In addition, the pressure on government revenue, as a result of the global crisis, has meant that there has not been sufficient counterpart funding to support donor-funded projects.

³ Pledged ODA is part of the government budget. Thus, the suspension increased the budget deficit. As a percentage of GDP, the deficit was modest by international and Zambian historical standards.

2.5 Balance of payments effects

The country's balance of payments (BoP) position has generally been negative. This is shown in Figure 17 for the period 2000-2008. During this period, the country experienced current account deficits, except for in the year 2006, when a surplus of \$143 million was recorded.

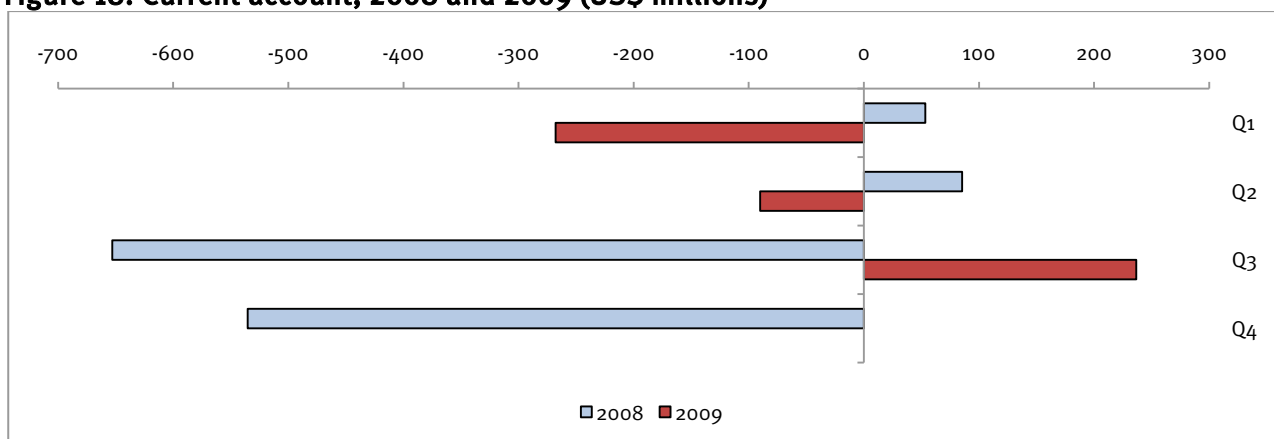
Figure 17: Current account position, 2000-2008 (US\$ millions)



Source: Constructed from BoZ database.

The global economic crisis has put pressure on the country's external accounts. The external situation deteriorated during the third and fourth quarters of 2008, although the rate of deterioration reduced during the first and second quarters of 2009. Thus, as a result of the effects of the crisis, the BoP current account moved from a surplus of \$85 million during the second quarter of 2008 to a deficit of \$260 million during the first quarter of 2009. It narrowed down to \$90.1 million during the second quarter and moved into surplus during the third quarter of 2009. This is exhibited in Figure 18.

Figure 18: Current account, 2008 and 2009 (US\$ millions)



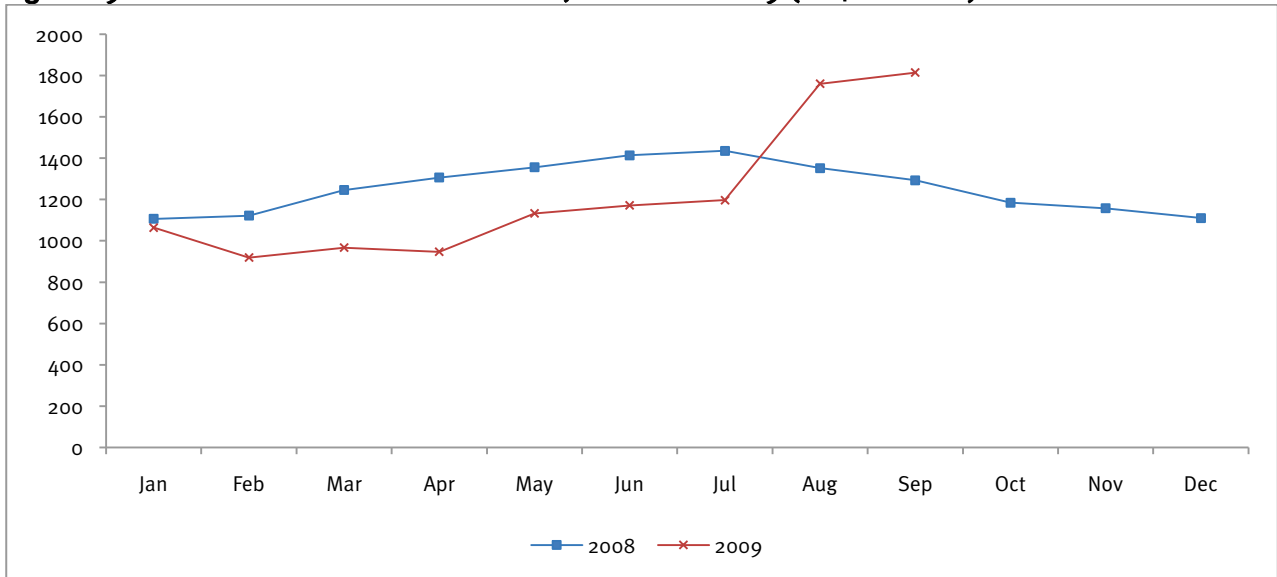
Source: Constructed from BoZ database.

In line with the BoP current account, the overall BOP position generally deteriorated during the third and fourth quarters of 2008. This resulted in the overall BoP deficit of \$147.7 million during the first quarter of 2009. The deterioration in the overall BoP position forced the BoZ to draw down on its reserves. These declined from \$1064.32 million in January to \$946 million in March 2009.

However, the overall BoP position improved tremendously during the second and third quarters of 2009. There was an overall BoP surplus in the second quarter of 2009, increasing from \$24.9 million in that quarter to \$645.5 million during the third quarter of 2009. There was an accumulation of gross international reserves (GIR) because of improved copper prices. These levels are shown in Figure 19. The rapid accumulation of reserves can also be explained by the disbursement of \$162.2 million by the International Monetary Fund (IMF) in May 2009. In addition, there was a disbursement of a Special

Drawing Rights (SDR) allocation worth \$627.3 million during the third quarter of 2009 as part of the global IMF response to the crisis in the anticipation that the crisis would persist in the near future, and following a decision by the G-20.

Figure 19: Trends in international reserves, 2008 and 2009 (US\$ millions)



Source: Constructed from BoZ database.

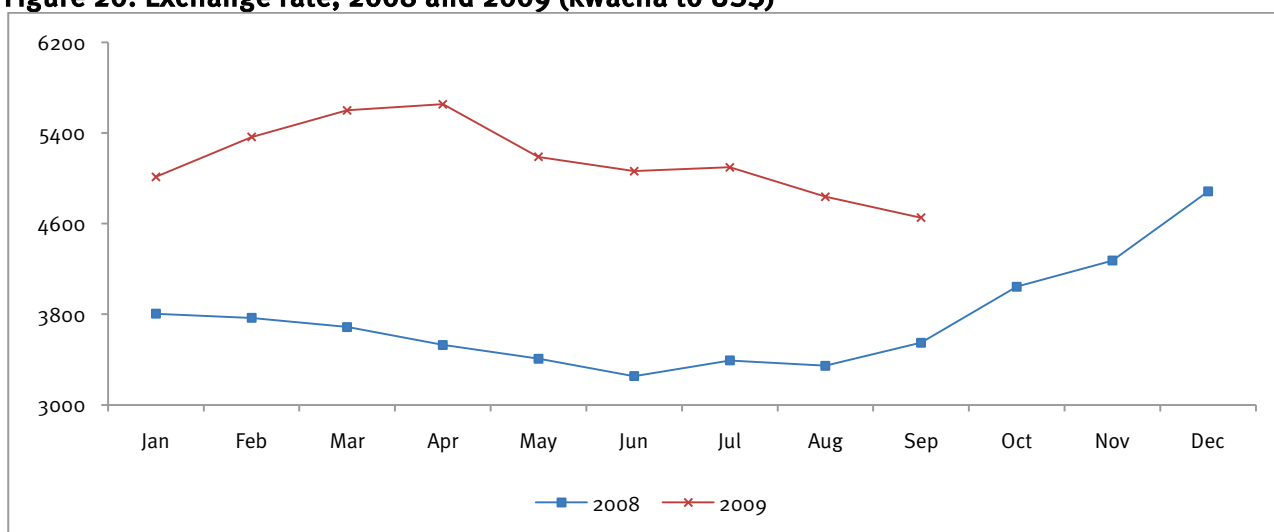
3. Growth and development effects

3.1 Inflation and exchange rate

3.1.1 Exchange rate

There is a strong correlation between the exchange rate and copper prices, as highlighted in our previous report (Ndulo et al., 2009). The two are positively correlated. Figure 20 shows the behaviour of the exchange rate during 2008 and 2009. Between October 2008 and April 2009, the kwacha depreciated continuously, from K4044 per US dollar to K5660 per US dollar. This represents a monthly average of 5% and 40% depreciation during the period. Thereafter, it changed course and started to appreciate. It has continuously appreciated since May 2009.

Figure 20: Exchange rate, 2008 and 2009 (kwacha to US\$)



Source: Constructed from BoZ database.

The kwacha depreciated broadly because of the change in the economic fundamentals governing the exchange rate. The collapse in copper prices and the consequent sharp reduction in copper revenues, persistent uncertainty about global economic prospects and their impact on the domestic economy and volatile expectations resulted in intense pressure in the foreign exchange market (IMF, 2009). For instance, as a result of risk aversion to the kwacha by investors in the treasury bills and equity portfolio, most of them could not roll over their investments at maturity, while others withdrew their investments. This put pressure on the foreign exchange market, resulting in the depreciation of the kwacha. The BoZ responded to exchange rate market pressures by intervening in the market. It provided, when necessary, foreign exchange to the market from the reserves it had built up in recent years. Consequently, the amount of gross international reserves dipped from \$1345.04 million in July 2008 to \$946.9 million in March 2009. Net sales during the second and third quarters of 2009 amounted to \$56 million (Fundanga, 2009a).

Pressure on the exchange rate was exerted also by the emergence during the crisis of offshore borrowing of the kwacha by foreign banks through domestic subsidiaries. In response to this, the BoZ moved in early 2009 to restrict commercial bank lending to long term.

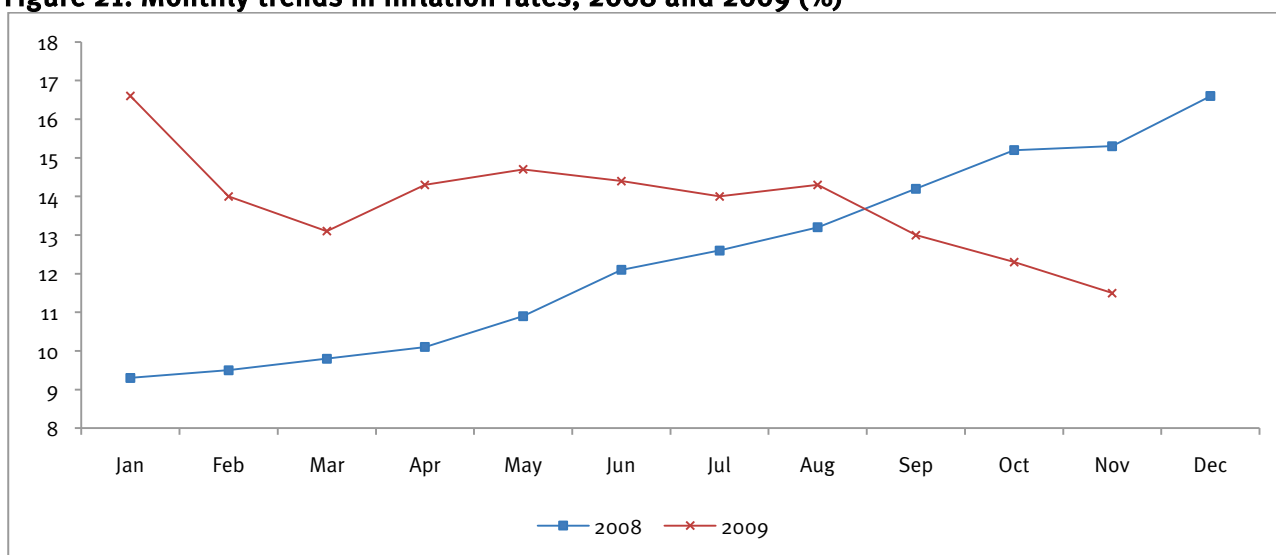
The kwacha appreciated continuously from May to September 2009 on account of the easing out of the effects of the global financial crisis. The main drivers were the increase in copper prices and production, the inflow of BoP support from the IMF, central bank participation in the foreign exchange market, stronger positive sentiments in the economy and a reduction in domestic demand for foreign

exchange. The kwacha appreciated by a period average of 20%, falling from K5600/US\$ in April to about K4654/US\$ in September 2009 (Fundanga, 2009a).

3.1.2 Inflation rate

The crisis posed a serious threat with regard to the inflation rate, which increased continuously during 2008. This was pushed by increased food and energy prices earlier in the year and the pass-through effects of the currency depreciation later in the year. However, this seems to be easing, as the exchange rate appreciation reduced the pass-through effects of the exchange rate to domestic inflation during 2009. These seem to be greater under a depreciation than under an appreciation. Figure 21 shows the behaviour of the inflation rate during 2008 and 2009. It shows that overall inflation declined sharply from 16% in January to 13.3% in March 2009. It bounced back to 14.7% in May 2009. Since then the trend has been downwards, standing at 12.3% in October 2009. The decline has been driven mainly by the fall in both food and non-food prices.

Figure 21: Monthly trends in inflation rates, 2008 and 2009 (%)

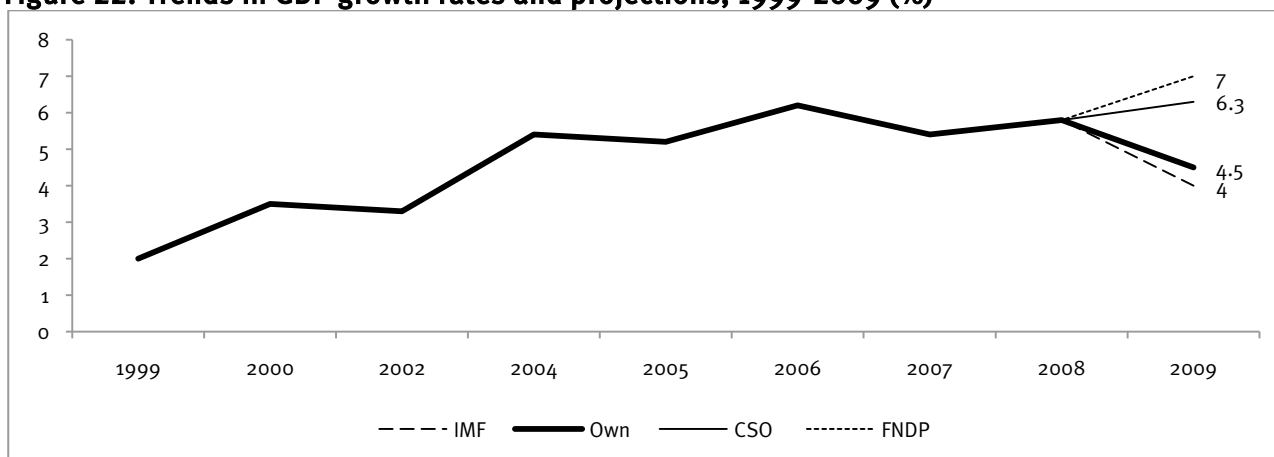


Source: Constructed from BoZ database.

3.2 National-level growth and employment

The country's growth process has been adversely affected by the global financial crisis, with the economy failing to achieve the targeted growth rate. The various scenarios in the growth rates are depicted in Figure 22. The growth rate slowed down in 2009 compared with the projected growth rates of 7% per annum for the FNDP and 5% for the 2009 budget. The economy is expected to grow by 4.3% during 2009. This is close to the growth rate we projected in our previous report (Ndulo et al., 2009): we predicted a growth rate of 4.5% for 2009 and 5% for 2010. There are indications that the growth rate of 4.5% could be surpassed in the fourth quarter of 2009 if copper prices continue to increase.

Figure 22: Trends in GDP growth rates and projections, 1999-2009 (%)



Source: Constructed from BoZ, CSO and IMF data.

This could increase to 6.3% during 2009, as projected by the Central Statistical Office (CSO). This growth is being driven by increased output in the construction, mining and agriculture sectors (CSO, 2009). However, the growth process continues to be severely constrained by energy bottlenecks, an inefficient and unprofessional civil service, infrastructural problems and a lack of institutional reforms. There has been no effort to tackle these major constraints, even though the global financial crisis has given the country the opportunity to do so.

However, the deceleration in the growth rate as a result of the global crisis has been modest in Zambia compared with most sub-Saharan African countries. Before the crisis set in, Zambia was growing at about the same rate as the average in sub-Saharan Africa. This was 6.2% (average 6.9%) during 2007, reduced to 6% (5.5%) in 2008. The crisis has further reduced the expected growth rate in 2009 to 4.3% for Zambia and 1.1% for sub-Saharan African countries (IMF, 2009). Thus, Zambia has fared better than most. The economy seems to have built up some resilience to the 2008 external shock. This can be attributed partly to the non-existence of strong macroeconomic imbalances in the economy at the start of the crisis in 2008. Since the initiation of economic reforms in 1992, there has been improved macroeconomic performance. The cumulative effects of the improved economic environment and sheer luck arising from improved external conditions partially explain the less-than-anticipated effects of the crisis on Zambia. Copper prices increased to well above \$6000 per metric tonne during 2009 and have since been over \$7000 before falling back.

The major impact of the crisis in 2009 was seen in the loss of jobs. The mining sector was the first to be affected, followed by mining support industries like construction and mine suppliers, export-oriented agricultural activities and other mining-related activities. It is estimated that more than 8500 jobs were lost between July 2008 and April 2009, mainly because some mines closed down while others scaled down their investments (Ndulo et al., 2009) However, at least 1500 jobs have been regained (MoFNP, 2009b). In addition, some jobs in secondary industries like tourism and agriculture have been recovered as a result of the surging recovery. It is expected that more jobs will be created during 2009 by the opening of the new mines and the restarting of new capital projects that lapsed when the copper price collapsed in 2008.

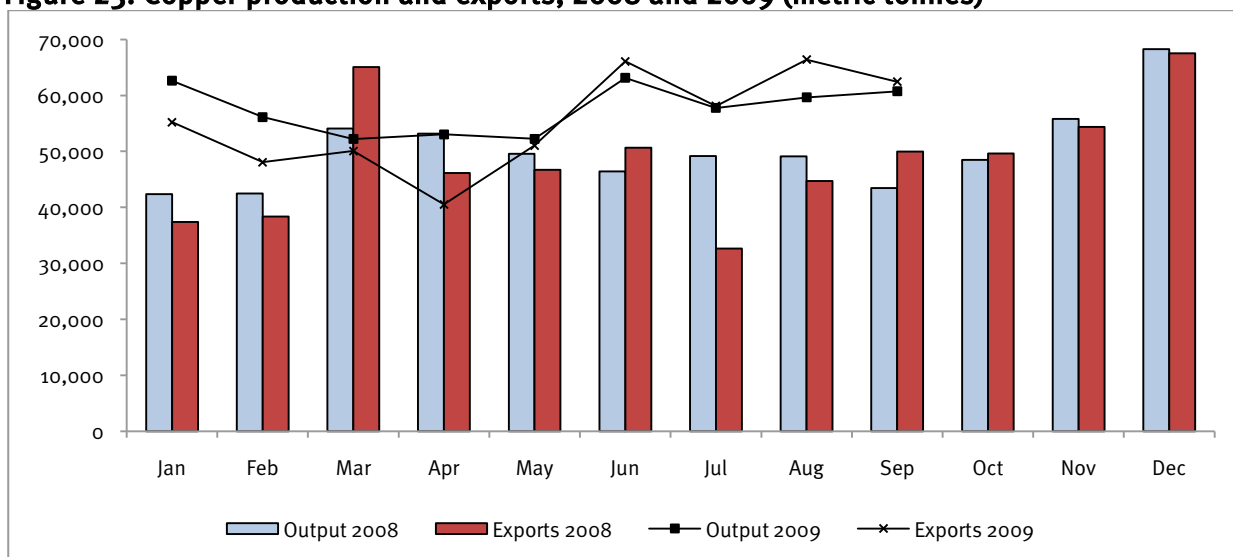
3.3 Sectoral-level effects

3.3.1 Mining

The recovery of copper prices, the main traditional export, during the second quarter of 2009 has been the major driver of the surging recovery in Zambia. Figure 23 shows that production and export of copper declined during the first quarter of 2009, with output outstripping exports. However, this changed during the second quarter, as more copper was exported compared with production levels. Both output and exports were higher than what obtained during the same period in 2008. Despite the

crisis, copper is still the main source of foreign exchange for the country, accounting for about 82% of total foreign exchange earnings. The increased output could be explained by the increased copper prices (although the link from prices to investment and production can occur with a long time lag), the reopening of closed mines and the opening of the Lumwana copper mine. Since most of the mines borrow from outside, they leverage the borrowing to the domestic financial system. With the global financial crisis, some investors could not access loans in foreign banks. Consequently, the mines cut investment and reduced on new projects. Because of the recovery of copper prices, the sector was affected only temporarily by the crisis. The mines that were closed, such as Luanshya, have been opened; others, such as Albindon, are being reopened by new investors.

Figure 23: Copper production and exports, 2008 and 2009 (metric tonnes)



Source: Constructed from BoZ database.

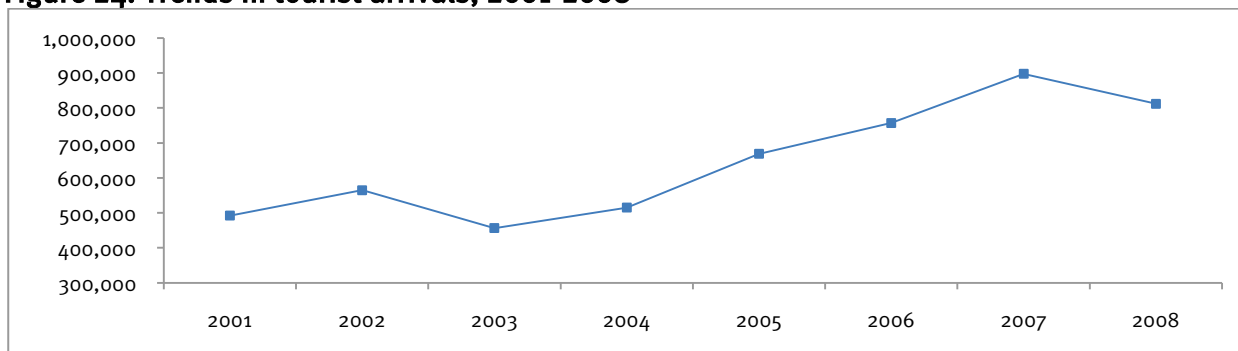
3.3.2 Manufacturing

The manufacturing sector has been adversely affected because of the rise in the cost of imported inputs, caused by the depreciation of the kwacha. The impact is especially severe given the high import dependence of production in the sector. Furthermore, reduced external prices for export commodities are severely affecting export-oriented manufacturing units. The sector grew by 1.8% in 2008, on account of the improved performance of almost all sub-sectors, including cement production and processed foods. However, it is expected to decline by 1.0 % in 2009.

3.3.3 Tourism

The tourism sector has been growing continuously since 2003. Total tourists arrivals in 2003 were estimated at 456,271. This almost doubled to a peak of 897,413 in 2007 and thereafter dropped by 10% to 811,775 in 2008. This is exhibited in Figure 24.

Figure 24: Trends in tourist arrivals, 2001-2008



Source: Ministry of Tourism, Environment and Natural Resources database.

The increase in tourist arrivals can be attributed mainly to increased investment in the sector and the improved investment climate in the country. As a result of the crisis, the sector performed badly. Most tourist units recorded a drop in business and occupancy rates. This was most severe during the fourth quarter of 2008 and the first quarter of 2009. However, there are signs that the sector is slowly recovering and that demand is picking up. Using international arrivals as a proxy for demand for tourism, it is evident that the sector is showing signs of recovery. It is estimated that 88,066 tourists arrived during the first quarter of 2009. This improved in the third quarter of 2009 to 102,918 international arrivals. This can be compared with arrivals of 193,651 and 210,487 in the first and third quarters of 2008, respectively (an increase of 8.69% and 16%, respectively).

3.3.4 Agriculture

Agriculture is a major sector for the growth process and poverty reduction (see Ndulo et al., 2009). However, it generates a limited number of export products, so was relatively insulated from the direct impact of the global financial crisis during 2008. Agricultural units producing exportable products, such as soya beans and cotton, were adversely affected by the lower export prices. However, much of the agricultural output in the country is for local production and is rain fed. The sector performed fairly well and is expected to grow by 5.2% during 2009 because of good rainfall in the 2008/09 season. It is expected that the sector will produce 1.9 million tonnes of maize in 2009 compared with 1.5 million tonnes in 2008. The sector is still faced with major infrastructural and marketing problems and, because of its undiversified nature, is unlikely to be a cushion for external shocks.

3.4 Fiscal effects

The main contributing factors to the growth experienced by the country over the past decade can be seen as improved macroeconomic management, a conducive external environment (such as high copper prices), increased FDI inflows and the 2006 debt relief. One aspect of better macroeconomic management is improvement in fiscal revenues, but this is more because of improved economic performance stimulated partially by high copper prices and less because of a reform of the tax structure. The government has failed to come up with a tax structure that captures more revenue from the mines. For example, the mines in the 1970s contributed about 40% to total revenue. In Chile in 2006, the copper sector contributed 30% of taxes and 20% of total revenue to the government (Bova, 2009).

Because of a poor fiscal mining tax regime, management of the fiscal balance has been a major challenge during the crisis. The effects of the crisis were compounded by the fact that overall tax revenue has been declining relative to gross domestic product (GDP) over the years. Government revenues excluding grants averaged around 18% at pre-crisis levels between 2005 and 2007. This dropped to 15.6% in 2009 and is likely to remain at that level during 2010. This compares unfavourably to the sub-Saharan African average of 24.7% between 2006 and 2008 (IMF, 2009) although Zambia can also be compared with other comparator groups in sub-Saharan Africa which have an average closer to the Zambian average. This dismal performance on government revenue has been compounded by upward pressure on current spending, especially on public service salaries and benefits, and the contraction of project aid from donors (Arnasson, 2009).

Tax revenues during the first three quarters of 2009 were much lower than during the same period in 2008. The global financial crisis seems to have had an impact on the ability of the government to generate revenue. The mines have continued to contribute little revenue, and the contribution of corporate income tax and tariff revenues has declined. The economic crisis affected tariff revenues severely during 2009. The depreciation of the kwacha during the year led to a reduction in imports and a consequent reduction in tariff revenues. Table 5 shows the contribution of various taxes to total revenue during the first three quarters of 2009. Personal income tax has been the most important and stable source of government revenue, contributing an average of 32.7% of total revenue during 2009. Tariff revenues averaged about 8% of total revenue during 2009.

Table 5: Government revenue by source, 2009

	Q1		Q2		Q3	
	K.b	%	K.b	%	K.b	%
Company tax	300	14	336	16	267	11
Pay as you earn	715	34	654	31	817	33
Mineral royalty tax	43	2	51	2	75	3
Excise tax	231	11	263	12	272	11
Customs duties	254	12	264	12	267	11
VAT (domestic + imports)	531	25	562	26	734	30
Other	18.5	1	5	0	7	0

Source: Constructed from ZRA database.

In response to reduced revenues, the government has had to cut current and capital spending on sectors not considered to be a priority. Most likely to be affected are recurrent departmental charges, spending on infrastructural projects and the social sector. This will obviously affect the growth process.

Furthermore, the global crisis has forced the government to rely more on tax revenue from personal income tax. This is the only source of tax revenue that has increased relative to GDP. However, this introduces major rigidities into the tax system. Meanwhile, the crisis has reinforced the declining trend in non-mining corporate income tax, indirect business taxes and tariff revenues in contributing to total revenues. Mineral royalty revenue has continued to contribute insignificant amounts, accounting for an average of 3% of total revenue during the first three quarters of 2009. This trend is likely to continue unless the government comes up with major reforms in the fiscal regime for the mining sector.

One consequence of the current fiscal regime for the mining sector is that the government is unable to generate sufficient revenues to meet its current and capital expenditures, despite the very high copper prices prevailing on the world copper market. Capital expenditure, which is necessary for growth, suffers in several ways. First, the government has inadequate resources to finance capital expenditure. Second, resources from external grants and government borrowing are used to support current expenditures. Much of the current expenditure is in respect of constitutional and statutory obligations and the public service bill. This is a situation that the government can correct, and policymakers need to take decisive action on this. The global crisis generated an opportunity for this action to take place, but this has been missed, so the country continues to use external resources and government borrowing to finance consumption. The necessary action includes institutional and structural reform (see Ndulo et al., 2009).

The crisis has made the government concentrate on raising revenues to the prevailing levels of about 19% of GDP. The government has not come up with any measures to increase revenue levels to the sub-Saharan African level of 24.7% of GDP (government revenues excluding grants). The bad performance of corporate income tax has come about because key sectors such as mining, tourism and manufacturing have performed badly during the crisis. Accordingly, revenues from these sectors have plummeted. Further, reduced imports have resulted in reduced collection of trade taxes. According to the BoZ (2009),

‘Tax revenues were significantly below projections, largely reflecting lower trade taxes and donor inflows. Notwithstanding this, Government has recorded a lower budget deficit than programmed, mainly achieved through a substantial compression of expenditures. This will have adverse effects on the implementation of various social and infrastructural programmes envisaged in the 2009 budget. However, in terms of macroeconomic stability the government has managed the situation very well. Total domestic financing has remained under control during the first half of the year. Preliminary data indicate that the Government recorded a budget deficit of K751.7 billion during the first half of 2009, 4.4% lower than the programmed deficit of K786.6 billion. The lower deficit was made possible mainly through expenditure reductions, as revenue performance was less than satisfactory.’

It may be observed that the current upsurge in copper prices during 2009 has put into question the government’s hasty decision to remove the windfall tax. This has led to a heavy loss of potential

revenue for the government from the mines which could have been used to finance growth and poverty reduction process. At the current level of copper prices, the mines would be paying substantial windfall taxes to the government.

3.5 Poverty and distributional effects

As we pointed out in our earlier report (Ndulo et al., 2009), despite increased growth in the pre-crisis period, poverty remains a major concern in Zambia. The situation did not improve during 2009. The slowdown in the growth rate and accompanying fiscal effects reduced government expenditure on the social sectors and poverty reduction programmes. In addition, the commitment and allocation of resources to social protection sectors by the government and the activities of non-governmental organisations (NGOs) involved in poverty reduction programmes relying on external funding have been affected by the crisis.

There are several issues with regard to poverty reduction. First, the estimated GDP growth rate of 4.3% is far below the threshold rate of 7% required to impact on poverty reduction under the FNDP. Second, economy-wide structural and institutional reform can create additional resources for poverty reduction at current growth rates. Furthermore, the high levels of unemployment in the country are continuing to worsen the urban and peri-urban poverty situation. The whole situation is exacerbated by the lack of effective social protection in the country. Just before the crisis, the government started to devise a social protection system for the country. The global financial crisis has stalled this, and it has lost its initial momentum as the government has not been able to generate sufficient revenue and some in government have been opposed to it.

However, it should be noted that the crisis is more likely to affect urban and peri-urban populations than rural households. This is because rural households depend more on agriculture for their livelihoods, with little connection to global markets. Favourable agricultural output during the 2009 farming season is likely to cushion them from the impact of the crisis. Rural households will be affected mainly through reduced government spending on social services such as education and health.

4. Policy responses

4.1 Macroeconomic policies to manage the impact of the crisis

When the crisis broke out in 2008, the government committed itself to maintaining macroeconomic stability. It pursued a limited expansionary fiscal policy that would restrict the budget deficit to no more than 3% of GDP. The expansionary stimuli were targeted at government spending on infrastructure, health and education. The government managed to maintain the budget limits as anticipated. However, there was pressure on the budget both from reduced domestic revenues as a result of the global crisis and from reduced donor support to the budget as a result of governance issues in 2009. Therefore, the government ring-fenced expenditures in education and health while at the same time scaling down expenditures on sectors it considered to be non-priority. The government also increased its borrowing in 2009 to 3% of GDP from the planned 1.9%.

The government has continued to pursue a prudent and tight monetary policy with the aim of reducing the inflation rate to below 10% and maintaining overall macroeconomic stability as a precondition to contain the crisis. The inflation rate fell substantially during 2009. The 2009 target of 12% end period inflation is likely to be achieved, considering that it has so far fallen from 16.6% in December 2008 to 13.3% in October 2009. The government expects to reduce the rate of inflation to 8% by the end of 2010.

The government stuck to its flexible market-determined exchange rate policy during 2009. However, the BoZ has from time to time intervened in the market to smooth fluctuations in the exchange rate so as to maintain stability, but also as a result of public pressure. The current policy is necessary for macroeconomic stability and as an incentive for the diversification of the economy, which has to be supported by key structural and institutional policies.

It should be observed that, when Zambia started feeling the impact of the crisis in the trade sector and the mines were affected adversely, policymakers panicked and reversed major policy decisions to improve the fiscal mining regime that were beneficial to the development of the country, against the advice of the IMF.⁴ This could be explained partly by a lack of institutional arrangements for dialogue between the mines and the government (National Assembly of Zambia, 2009; Ndulo et al., 2009). A case in point is the government's removal of the windfall tax in early 2009 as a response to the crisis, done without full appreciation of the likely duration of the crisis. The government reversed the tax and introduced some tax measures favourable to the mines despite the fact that mining taxation was already clearly very favourable. This had the effect of depriving the country of potential revenue from the mines. It will now be very difficult for the government to reintroduce the windfall tax.

4.2 Social policies to respond to the impact of the crisis

Government policy on poverty reduction seems to lie in the protection of key social expenditures in education and health during the crisis. This is necessary for development and for the long-term reduction of poverty. However, it is unlikely to resolve extreme poverty, which is likely to worsen during the crisis. With abject poverty in Zambia estimated at 37% of the population, there is a need for a well-designed social protection policy. Right now, apart from government activities in the social sector, NGOs are playing an important role in social protection. However, some of them that depend on external funding for their programmes have not been spared by the global crisis. Interviews with directors of NGOs revealed that they have taken a cautious approach to the expansion of their activities, as they are not guaranteed increased funding. Others observed that some of their funders

⁴⁴ www.minesandcommunities.org/article.php?a=9054.

have decided to scale down their activities and in some cases have not been able to renew their partnerships with local NGOs on account of funding uncertainties.

4.3 Economy-wide and structural policies for getting the country out of the crisis

It should be emphasised again that Zambia has fared relatively well in the face of the crisis compared with most countries in sub-Saharan Africa, because of macroeconomic stability, higher copper prices and sheer luck that the crisis seems to be short term and ending.

The government has made several policy announcements in response to the impact of the crisis. It also organised a broad-based consultative meeting with various stakeholders in early 2009 on how it should respond to the crisis. The meeting came up with a number of recommendations on the reform of the country and on how to address the crisis, most of them hinging on the need to diversify the economy as a response to the crisis. However, these recommendations have remained at draft stage, with no efforts being made to implement them.

In addition, in response to the closures of the mines, the government has facilitated the reopening of some mines that were closed by undertaking to liquidate debts left by former mine owners. Although none of these mines has started operations as of yet, this effort has resulted in the re-engagement of some workers who had lost their jobs.

Apart from the above measures, as we have pointed out, there are no discernible policies designed by the government to get out of the crisis. The government has focused on macroeconomic stability as a necessary condition to help resolve the crisis. There have been no growth-enhancing structural and institutional reforms and austerity measures that could save on public resources and remove the chronic waste in the management of public resources. There has been no evidence of any drive to diversify the economy. There has been no effort to introduce governance reforms in the mining sector. The public sector is inefficient and unprofessional, without the rules and regulations that can make it able to facilitate an effective development process to address issues of growth and poverty. Only reform in these areas will prepare the country for future crises.

4.4 Multilateral and bilateral donor response to the crisis

Most bilateral donors have not scaled up or revised their budgetary commitments in response to the crisis. Some donors have withheld aid on account of governance problems in the public service. Meanwhile, the IMF reacted to the crisis by authorising the provision of a one-time allocation of SDRs as BoP support to supplement foreign exchange reserves. The total amount of \$628 million was provided to the government by the third quarter of 2009, increasing the country's GIR. The overall BoP surplus stood at \$645.5 million during the third quarter of 2009. In November 2009, Zambia received €30 million for the 2009 fiscal year from the EU's Vulnerability FLEX instrument, which was set up to assist countries that experience revenue shortfalls arising from the global financial crisis.

5. Conclusions

The overall effect of the global financial crisis during the first and second quarters of 2009 in Zambia was highly mixed. While some of the macroeconomic fundamentals are showing signs of improvement, the government fiscal position has continued to deteriorate. It is observed that growth prospects in Zambia have been made more uncertain by the crisis. However, CSO data for the third quarter of 2009 project that the economy will grow at 6.3%, which is higher than the 4% anticipated by the government.

The crisis has shown that Zambia's economic performance and growth prospects depend largely on the international environment. Its recovery from the effects of the crisis in the short term depend mainly on ongoing global economic stimuli initiatives, which have contributed in part to increasing copper prices and rejuvenating the mining industry.

It has not been the implementation of major economy-wide structural and institutional policies that has enabled any recovery. If this were to happen, the country could achieve growth rates much higher than 7%. This would then enable Zambia to make an impact on extreme poverty and begin to resolve its major growth issues. As the global recession recedes, the country has lost an opportunity to generate major policies that can support and enhance the growth process. On the whole, though, the impact of the crisis on the Zambian economy has been less than was earlier anticipated.

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Annex 1: Selected macroeconomic indicators

Table A1.1: Selected macroeconomic indicators, 2000-2008

	2000	2001	2002	2003	2004	2005	2006	2007	2008
GDP at market prices (US\$m)	3239	3640	3776	4318	5448	7269	10,817	11,121	14,795
Real GDP growth rate (%)	3.5	4.9	3.3	5.1	5.4	5.2	6.2	5.4	6
GDP per capita (US\$)	314.5	346.7	349.6	389	490.8	654.9	917.4	917.6	1,181.20
Composition of GDP (%)									
Agriculture	17.5	16	15.2	15.2	15	14.2	13.7	12.9	12.2
Mining	6.4	7	7.9	7.7	8.4	8.6	8.7	8.5	8.4
Manufacturing	10.5	10.4	10.7	10.9	10.9	10.6	10.6	10.2	10.1
Services	59.8	60.2	60.9	61.5	61.7	62.9	63.9	65.5	66.3
Inflation rate (%)	30.1	18.8	26.7	17.2	17.5	15.9	8.2	8.9	12.5
Average exchange rate (K/US\$1)	3111	3608	4307	4743	4772	4464	3578	4003	3753.50
Weighted base lending rate	46.7	45.9	43.1	40.4	29.8	28.1	23.1	18.1	18.9
Domestic fiscal deficit (% of GDP)	-2.1	-2.4	-4.1	-5.1	-2.9	-0.9	4.3	-2.1	-2.6
Gross capital formation (% of GDP)	16.0	17.6	20.7	24.3	28.4	23.2	24.5	21.8	23
Gross domestic saving (% of GDP)	17.3	17.7	18.7	18.2	17.0	23.3	25.4	23.3	25
Current account balance (US\$m)	-602	-693	-546	-642	-420	-599	143	-754	-1,049
Current account deficit (% of GDP)	-18	-20.8	-17.3	-14.8	-11.4	-9.1	1.1	-2.4	-9.1
Gross International reserves (US\$ m)	268.34	116.5	464.8	272.2	269.5	425.7	438.95	1080.2	1109
Tourists arrivals		491,995	564,896	456,271	515,000	668,862	756,860	897,413	811,775

Sources: BoZ and CSO databases.

Annex 2: Financial flows indicators

Table A2.1: Financial variables, 2008 and 2009

	Jan-o8	Feb-o8	Mar-o8	Apr-o8	May-o8	Jun-o8	Jul-o8	Aug-o8	Sep-o8	Oct-o8	Nov-o8	Dec-o8
Overall inflation rate (%)	9.3	9.5	9.8	10.1	10.9	12.1	12.6	13.2	14.2	15.2	15.3	16.6
Weighted base lending rate (%)	18.4	18.3	18.2	18.2	18.2	18.5	18.6	18.6	19.6	20.6	20.6	20.8
Exchange rate (US\$/K)	3805	3768	3688	3529	3408	3254	3392	3346	3549	4044	4273	4884
All Share Index	3964.85	4312.93	4440.46	4000.16	4062.00	3915.40	3900.59	3683.56	3620.70	3345.05	2797.40	2505.80
LuSE foreign investor total turnover (US\$m)	1.94	5.79	2.87	6.96	3.62	26.89	49.93	7.04	4.93	5.77	1.81	4.72
LuSE foreign investor inflows (US\$m)	1.62	0.5	1.91	5.32	2.5	16.69	21.92	4.16	2.48	1.01	0.12	0.08
LuSE foreign investor outflows (US\$m)	0.32	5.29	0.96	1.64	1.12	10.2	28.01	2.88	2.45	4.76	1.69	4.64
Net portfolio capital flow (US\$m)	1.30	-4.79	0.95	3.68	1.38	6.49	-6.09	1.28	0.03	-3.75	-1.57	-4.56
Market capitalisation (US\$m)	5866	6778	6995	5951	7204	7779	6510	6947	6532	4790	4678	4106
Gross international reserves (US\$m)	1106.71	1121.89	1245.73	1306.06	1355.79	1413.39	1435.05	1351.65	1292.78	1184.64	1157.34	1109.99
	Jan-09	Feb-09	Mar-09	Apr-09	May-09	Jun-09	Jul-09	Aug-09	Sep-09	Oct-09	Nov-09	Dec-09
Overall inflation rate (%)	16.0	14.0	13.1	14.3	14.7	14.4	14.0	14.3	13.0	12.3		
Weighted base lending rate (%)	20.6	20.9	20.9	20.8	21.6	22.4	22.4	23.0	23.1	22.4	23.0	23.1
Exchange rate (US\$/K)	5012	5622	5599	5654	5189	5064	5096	4837	4653			
All Share Index	2420.15	3282.00	2182.57	2143.37	2498.32	2744.57	2833.47	2618.57				
LuSE foreign investor total turnover (US\$m)	1.39	2.71	1.37	1.37	3.34	3.88	2.53	2.60				
LuSE foreign investor inflows (US\$m)	0.05	0.07	0.02	0.40	0.97	0.81	0.87	0.08				
LuSE foreign investor outflows (US\$m)	1.35	2.04	1.35	2.93	2.91	1.72	0.61	2.52				
Net portfolio capital flow (US\$m)	-1.30	1.36	-1.37	-1.33	-2.53	-1.94	-0.91	0.26	-2.44			
Market capitalisation (US\$m)	3837	3405	3289	3240	3744	3902	3951	4177				
Gross international reserves (US\$m)	1064.32	919.07	967.02	946.89	1132.80	1171.17	1196.80	1759.66	1813.94			

Source: BoZ, CSO and LuSE data.

Table A2.2: Financial soundness, Jun 2008-Sep 2009 (%)

	Jun-o8	Sep-o8	Dec-o8	Jan-09	Feb-09	Mar-09	Apr-09	May-09	Jun-09	Jul-09	Aug-09	Sep-09
Regulatory capital to risk-weighted assets (capital adequacy)	17	19.2	18.6	15.7	15.6	19.0	19.0	20.1	20.3	19.8	20.3	20.0
Past due advances (NPL) to total assets	6	6.8	7.2	7.4	7.6	8.8	9.8	10.0	10.4	11.0	11.8	13.1
Loan loss provision to NPL	103.2	96.7	104.6	81	81	79	75	81	81	83	84	87
ROA	5	4.7	3.6	4	3	3	3	3	2	2	2	1
ROE	36.6	32.9	20.8	20	18	18	17	13	10	9	8	3

Source: BoZ data.

Table A2.3: Bonds and treasury bills, foreign holdings, 2006-2009

	Jan-06	Feb-06	Mar-06	Apr-06	May-06	Jun-06	Jul-06	Aug-06	Sep-06	Oct-06	Nov-06	Dec-06
Bonds (k.b)	180.76	191.63	234.44	239.91	239.91	237.98	231.26	231.26	231.26	231.34	222.40	231.06
Treasury bills (k.b)	431.22	439.77	457.39	537.74	555.63	545.89	517.47	544.43	494.43	505.67	443.96	456.96
Bonds (US\$m)	52.82	57.79	71.15	77.79	69.90	66.68	61.33	59.03	55.29	60.07	55.29	52.43
Treasury bills (US\$m)	126.00	132.62	138.82	174.37	161.90	152.95	137.24	138.96	118.22	131.29	110.37	103.70
	Jan-07	Feb-07	Mar-07	Apr-07	May-07	Jun-07	Jul-07	Aug-07	Sep-07	Oct-07	Nov-07	Dec-07
Bonds (k.b)	231.06	207.36	207.36	225.36	199.36	199.36	209.46	251.30	251.30	283.30	319.40	319.40
Treasury bills (k.b)	443.47	439.41	415.08	491.15	620.32	675.97	605.78	597.46	552.46	479.59	579.99	528.15
Bonds (US\$m)	53.82	48.78	48.82	54.26	50.05	59.14	53.51	61.99	64.81	74.69	85.02	83.07
Treasury bills (US\$m)	103.30	103.37	97.72	118.26	155.74	200.53	154.77	147.38	142.47	126.44	154.38	137.37
	Jan-08	Feb-08	Mar-08	Apr-08	May-08	Jun-08	Jul-08	Aug-08	Sep-08	Oct-08	Nov-08	Dec-08
Bonds (k.b)	319.40	372.70	372.70	402.70	402.70	402.70	402.70	469.90	469.90	454.40	452.40	452.40
Treasury bills (k.b)	529.87	643.81	660.23	606.35	517.30	541.48	500.50	431.20	434.60	428.50	365.20	363.50
Bonds (US\$m)	83.94	98.91	101.06	114.11	118.16	123.76	118.72	140.44	132.40	112.36	105.87	92.63
Treasury bills (US\$m)	139.26	170.86	179.02	171.82	151.79	166.40	147.55	128.87	122.46	105.96	85.47	74.43
	Jan-09	Feb-09	Mar-09	Apr-09	May-09	Jun-09	Jul-09	Aug-09	Sep-09	Oct-09	Nov-09	Dec-09
Bonds (k.b)	452.40	450.40	450.40	434.40	434.40	444.70	445.70	436.70	382.20	366.40	363.09	
Treasury bills (k.b)	294.20	167.60	134.80	92.80	65.90	1.50	14.22	36.22	63.20	93.20	124.34	
Bonds (US\$m)	90.26	83.97	80.44	76.84	83.71	87.82	87.46	90.27	82.14	78.97	77.32	
Treasury bills (US\$m)	58.70	31.25	24.07	16.41	12.70	0.30	2.79	7.49	13.58	20.09	26.48	

Source: BoZ data.

Table A2.4: Remittances, 2005-2009 (US\$ millions)

	2005Q1	2005Q2	2005Q3	2005Q4	2006Q1	2006Q2	2006Q3	2006Q4
Workers' remittances	-3.6	-6.0	-5.6	-8.8	-6.1	-8.7	-8.2	-12.0
Receipts from Zambians abroad	15.3	13.4	12.5	11.6	16.7	14.6	13.7	12.7
Payments	-18.9	-19.4	-18.1	-20.5	-22.8	-23.4	-21.9	-24.7
	2007Q1	2007Q2	2007Q3	2007Q4	2008Q1	2008Q2	2008Q3	2008Q4
Workers' remittances	-6.4	-9.1	-8.6	-12.5	-7.4	-10.5	-9.9	-14.3
Receipts from Zambians abroad	17.2	15.0	14.0	13.1	19.7	17.3	16.1	15.0
Payments	-23.6	-24.2	-22.6	-25.5	-27.1	-27.8	-26.0	-29.3
	2009Q1	2009Q2						
Workers' remittances	-48.3	13.0						
Receipts from Zambians abroad	13.7	30.8						
Payments	-62.0	-17.8						

Source: BoZ data.

Table A2.5: International banking, 2003-2009 (kwacha millions)

						Dec-03
Foreign assets (banks)						1,093,173.38
Foreign liabilities (banks)						(114,687.36)
	Jan-04	Feb-04	Mar-04	Apr-04	May-04	Jun-04
Foreign assets (banks)	1,202,754.34	1,204,999.74	1,127,170.04	1,127,853.44	1,125,370.04	1,338,408.44
Foreign liabilities (banks)	(151,206.36)	(192,811.16)	(164,344.36)	(200,757.36)	(243,232.36)	(242,000.16)
	Jul-04	Aug-04	Sep-04	Oct-04	Nov-05	Dec-04
Foreign assets (banks)	1,322,010.74	1,268,538.24	1,244,458.34	1,312,344.84	1,196,701.04	1,593,801.04
Foreign liabilities (banks)	(212,908.66)	(225,118.96)	(215,345.36)	(238,502.71)	(388,813.56)	(186,819.26)
	Jan-05	Feb-05	Mar-05	Apr-05	May-05	Jun-05
Foreign assets (banks)	1,558,088.99	1,330,077.04	1,229,973.04	1,299,637.49	1,288,351.20	1,211,268.04
Foreign liabilities (banks)	(157,598.36)	(186,444.36)	(229,346.36)	(344,455.36)	(270,510.36)	(455,476.36)
	Jul-05	Aug-05	Sep-05	Oct-05	Nov-05	Dec-05
Foreign assets (banks)	1,254,696.02	1,147,422.04	1,095,406.04	1,291,902.83	1,196,701.04	1,205,252.04
Foreign liabilities (banks)	(450,126.01)	(473,768.36)	(451,009.36)	(443,974.96)	(388,813.56)	(463,870.85)
	Jan-06	Feb-06	Mar-06	Apr-06	May-06	Jun-06
Foreign assets (banks)	1,206,642.04	1,144,526.04	995,876.04	834,836.44	965,134.04	941,797.04
Foreign liabilities (banks)	(542,187.36)	(562,956.06)	(480,671.36)	(463,749.35)	(541,017.89)	(557,888.36)
	Jul-06	Aug-06	Sep-06	Oct-06	Nov-06	Dec-06
Foreign assets (banks)	954,266.83	1,128,590.34	1,476,801.04	1,433,128.04	1,629,944.49	1,838,533.04
Foreign liabilities (banks)	(411,148.36)	(438,955.36)	(895,120.36)	(974,941.36)	(847,809.36)	(692,540.36)
	Jan-07	Feb-07	Mar-07	Apr-07	May-07	Jun-07
Foreign assets (banks)	1,548,910.04	1,313,927.04	1,340,078.54	1,469,796.97	1,524,899.04	1,699,377.04
Foreign liabilities (banks)	(745,378.36)	(778,985.36)	(1,052,792.36)	(1,129,187.86)	(857,032.36)	(872,241.36)
	Jul-07	Aug-07	Sep-07	Oct-07	Nov-07	Dec-07
Foreign assets (banks)	1,652,021.04	1,815,814.04	1,895,962.04	1,839,452.54	2,239,352.04	2,339,236.04
Foreign liabilities (banks)	(734,382.36)	(732,706.36)	(853,408.36)	(876,287.86)	(1,237,744.36)	(1,082,954.36)
	Jan-08	Feb-08	Mar-08	Apr-08	May-08	Jun-08
Foreign assets (banks)	2,492,340.04	2,341,038.04	2,044,926.04	2,020,038.04	2,419,585.04	1,935,110.04
Foreign liabilities (banks)	(1,082,067.36)	(1,376,928.36)	(1,135,249.36)	(1,122,457.36)	(1,265,099.36)	(1,242,924.36)
	Jul-08	Aug-08	Sep-08	Oct-08	Nov-08	Dec-08
Foreign assets (banks)	2,358,284.04	2,033,770.04	1,909,122.31	2,358,755.63	2,262,070.69	2,539,168.75
Foreign liabilities (banks)	(1,374,480.36)	(1,394,621.36)	(1,531,543.36)	(1,491,326.60)	(1,544,604.16)	(1,660,831.36)
	Jan-09	Feb-09	Mar-09	Apr-09	May-09	Jun-09
Foreign assets (banks)	2,693,889.55	3,013,831.02	2,658,141.29	2,704,571.40	2,720,558.99	2,734,374.43
Foreign liabilities (banks)	(1,785,650.20)	(1,975,311.55)	(1,750,724.07)	(1,775,623.78)	(1,781,745.41)	(1,637,765.23)
	Jul-09	Aug-09	Sep-09	Oct-09	Nov-09	Dec-09
Foreign assets (banks)	2,774,740.50	2,365,886.63	2,659,814.04	2,881,290.04		
Foreign liabilities (banks)	(1,742,762.23)	(1,421,882.71)	(1,568,812.36)	(1,647,009.36)		

Source: BoZ data.

Table A2.6: FDI inflows, 2000-2008 (US\$ millions)

	2000	2001	2002	2003	2004	2005	2006	2007	2008
FDI inflows	122	72	298	347	364	357	616	1324	939

Source: UNCTAD (2009).

Table A2.7: Investment pledges, 2000-2009 (US\$ millions)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009*
Agriculture	8.17	25.97	11.50	37.12	32.03	30.26	57.12	9.29	65.88	9.44
Construction	9.95	4.78	13.07	10.15	2.80	5.43	109.79	23.56	19.55	9.44
Health		0.34	0.56			0.07	1.05	1.28	32.78	22.30
Financial institutions	0.34			0.11				1.00	33.95	38.00
Manufacturing	29.33	28.54	7.09	31.38	44.67	114.28	415.60	534.53	717.28	43.08
Mining	2.32	14.66	6.80	0.66	14.45	62.40	63.47	416.50		64.34
Service	8.70	29.65	41.90	3.83	15.60	17.43	6.12	41.13	51.92	14.34
Tourism	18.84	13.96	0.65	17.54	6.63	8.39	18.70	72.51	180.09	88.90
Transport	2.29			20.16	3.69	6.36	1.11	268.98	48.92	36.33
Total	79.94	117.90	81.57	120.95	119.87	244.62	672.96	1368.78	1150.37	326.17

Note: * = First three quarters.

Source: ZDA database.

Table A2.8: ODA, 2003-2009 (US\$ millions)

	2003	2004	2005	2006	2007	2008
Budget support	48.28	54.07	121.64	118.22	145.39	171.70
Projects	251.95	246.23	287.19	384.01	380.21	381.84
Total grants	300.23	300.29	408.83	502.24	525.61	553.54

Source: IMF fiscal tables database.

Annex 3: Trade indicators

Table A3.1: Selected indicators, 1999-2008 (US\$ millions)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Merchandise exports	754.70	746	884	965	1,065	1,825	2,208	3,891	4,617	5,089
Merchandise imports	870.49	977.7	1,253	1,204	1,393	2,151	2,580	3,024	4,007	5,060
Services exports	102.51	115	144	115	165	232	273	229	273	293
Services imports	281.61	335	367	375	403	448	471	587	913	929
NTEs	287.61	248.88	294.51	347.93	392.17	458.03	534.32	715.30	780.76	881.51

Source: CSO data.

Table A3.2: Monthly exports and imports, 2008-2009 (US\$ millions)

	Jan-o8	Feb-o8	Mar-o8	Apr-o8	May-o8	Jun-o8	Jul-o8	Aug-o8	Sep-o8	Oct-o8	Nov-o8	Dec-o8
Total exports (US\$m)	374	380	471	533	431	466	437	431	422	361	307	257
NTEs (US\$m)	118	103	171	219	59	109	100	106	159	126	115	96
Total imports (US\$m)	376	291	344	525	388	448	548	537	510	383	408	264
Copper output (tons)	42,369	42,450	54,103	53,142	49,569	46,424	49,175	49,089	43,470	48,477	55,795	68,275
Copper exports (tons)	37,356	38,371	65,042	46,125	46,717	50,638	32,625	44,676	49,983	49,629	54,393	67,496
	Jan-o9	Feb-o9	Mar-o9	Apr-o9	May-o9	Jun-o9	Jul-o9	Aug-o9	Sep-o9	Oct-o9	Nov-o9	Dec-o9
Total exports (US\$m)	225	217	227	260	298	353	358	458	418			
NTEs (US\$m)												
Total imports (US\$m)	275	243	241	279	351	281	272	354	353			
Copper output (tons)	62,621	56,122	52,205	53,034	52,248	63,142	57,749	59,655	60,744			
Copper exports (tons)	55,199	48,049	50,058	40,519	51,048	66,083	58,109	66,395	62,445			

Sources: BoZ and CSO databases.



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