

The Impact of the Global Economic Crisis on Zambia: Responses and recommendations: A Submission to the Economic Affairs and Labour Committee of Parliament.

Preamble

As the world reels under the challenges of the worst economic crisis in 60 years, the impact is not isolated to developed countries. In developing countries, Zambia, particularly, which has been placed in the highly exposed category, the crisis threatens to play out as a human tragedy. Tens of thousands of people are likely to be trapped in poverty leading to thousands more children dying before their fifth birthday in infant mortality.

Owing to the effects of the global economic crisis (GEC), the 2009 growth forecasts for Africa have been revised downwards, from 5.9 percent in November 2008 to 2.8 percent in February 2009. Export growth in 2009 is expected to drop by a steep 7 percent while import growth will decline by 4.7 per cent, resulting in a decline in the balance of trade for most African countries¹.

The International Monetary Fund (IMF) alleges that, the downturn in global growth, the decline in most commodity prices and tighter credit has significantly deteriorated the economic outlook for Sub-Sahara Africa. Risks are rising and it is uncertain how long the crisis will last. Therefore, policy makers must walk a tightrope between not aggravating the shock in aggregate demand on the one hand, while protecting hard-worn gains in economic fundamentals on the other. It is important that any policy response being considered must take into account the impact on the poor and seek to incorporate social safety nets.

The dangers of the crisis will obviously deepen with time. Meaning that the longer the period between the onset of the economic downturn and point of recovery, the worse the consequences and the opposite is true.

¹ See Africa Economic Report 2008

I) Origin and possible causes of the Global Economic Crisis

The crisis originated with the “bursting” of the commonly referred, “US housing bubble” which was basically high default rates on the "subprime" borrowers which set off as early as early 2005. Several years prior to the crisis, the US Government policies and competitive pressures encouraged high risk lending practices. An increase in loan incentives such as easy initial terms and a long-term trend of rising housing prices encouraged borrowers to assume difficult mortgages with hope that they would be able to quickly refinance at more favourable terms.

Unfortunately, interest rates began to rise and housing prices started to drop between 2006 and 2007 in many parts of the US making refinancing more difficult. Defaults and foreclosure² activities increased dramatically as easy initial terms expired, home prices failed to go up as anticipated, and interest rates went high. Foreclosures accelerated in the USA in late 2006 and triggered a global financial crisis through 2007 to date.

II) Impact of GEC on Monetary and Exchange rate policies

The initial impact of the crisis in Zambia was felt and recorded in the foreign exchange market which due to drastic declines in commodity prices specifically copper on the international market. The situation led to a constriction in foreign exchange earnings and negative speculations for the short and medium term. During the fourth quarter of 2008, the domestic economic outlook became weaker and foreign investors began to withdraw their money from the local market.

Withdrawals, especially by foreign portfolio investors, softened demand for Government securities particularly from the later part of 2008. Consequently, a slow performance in the external sector and a lower than expected build up of international reserves, has had a negative impact on broad money (inclusive money supply) growth. Broad money slowed down to 22.1 percent in December 2008 from 25.9 percent in December 2007. The prevailing situation has now led to a rise in interest rates on Government securities mainly due to the protracted inflationary environment.

² A foreclosure is a situation where a borrower defaults in making payment and the lender takes possession of the residence acquired using mortgage proceeds.

At end of 2008, the local currency depreciated by 27.3 percent against the US dollar to an average of K4, 882.3 per US dollar from K3, 835.7 per US dollar in December 2007³. The situation worsened at the end of first quarter 2009 as the currency was trading at an average of K 5, 680.5.

III) Impact of GEC on Fiscal Policy in Zambia

Analysing the fiscal performance for 2008, substantial losses in export earnings posed a strain on the economy's somewhat stable fiscal position which has manifested in high inflation and consequently deep currency depreciation. The further deepening of the financial crisis in the developed world has increased volatility on the local currency against other major currencies giving rise to higher lending rates.

In spite of the gradually creeping effects of the crisis, budget performance in 2008 was generally positive. Total revenues, including grants but excluding revenues from the new mining tax regime, amounted to K12, 008.2 billion against the projection of K12, 106.4 billion, representing a shortfall of 0.8 percent. The overall budget deficit for 2008, stood at 2.6 percent of GDP and was lower than the projected 3.2 percent of GDP but higher than 1.2 percent in 2007⁴.

On the downside, the Government projected to collect a total of K2, 641.0 billion from Value Added Tax (VAT). A total of K2, 210.0 billion was collected and was below the target by 16.3 percent. However, this could not be attributed to the crisis but to administrative challenges experienced in collecting tax.

IV) The Impact of the GEC on Macroeconomic Fundamentals

On the macroeconomic front, the negative impact of the GEC on the economy have been felt and recorded. In 2008, the economic report shows that the economy grew, in real terms, by 6.0 percent to K3, 777.2 billion from K3, 563.1 billion in 2007. Although this was a positive development, it was lower than the growth rate of 6.2 percent in 2007 and the end year target of 7.0 percent. This outcome was attributed to a slowdown in the secondary sector (e.g. financial institutions and communication), which outweighed the increased output in the tertiary and primary sectors (e.g. construction and manufacturing). The table below shows a trend in macroeconomic indicators from 2006 to 2009.

³ See Ministry of Finance and National Planning Economic Report 2008; February, 2009.

⁴ Ibid

Table 1.0: Selected Macroeconomic Indicators, 2006-2009

	2006	2007	2008	2009 Target
Real GDP	6.2	6.2	6.0*	5
Money Supply (annual % change)	45.1	26.3	14.9	-
Inflation (end year)	8.2	8.9	16.6	10
Lending interest rates	27.9	24.4	26.9	-
Domestic borrowing (% of GDP)	1.9	0.9	1.5	1.8
Overall Budget Deficit (% of GDP)	18.6	-0.2	-2.6	18.1
Current account deficit (% of GDP, excluding grants)	-0.6	-9.3	(9.1)*	-
Gross International Reserves (months of import cover)	2.2	2.5	2.8*	-

Source: Ministry of Finance and National Planning and 2009 National Budget Address Data

* Preliminary

Although, output as measured by real Gross Domestic Product remained strong, it can be observed from the table that macroeconomic performance was weak. Evidenced by rising inflation and interest rates, the country experienced increased volatility of the exchange rate of the Kwacha, particularly in the latter part of the year, and the widening of the current account deficit.

In spite of the effects of the crisis on commodity prices, copper and articles thereof still account for the major export products. This depicts how grossly dependent the economy is on the commodity. In a period of nine months between May 2008 and February 2009, the country experienced a sharp constriction of 40 percent in copper export earnings. Whereas K1, 109, 924 million was earned from exports of copper and articles thereof in May 2008, nearly half of these earnings were recorded in February 2009. The value of K669, 797 million was earned at the end of February 2009 representing 76.9 percent of May 2008 and 59.4 percent of February 2009 export earnings⁵.

⁵ See CSO Monthly Bulletins for specific months in reference.

V) Impact of the GEC on the Real Sector

The effects of the crisis have progressively spread beyond the financial sector to hurt the real sector. Zambia experienced a punch on the real sector towards the end of 2008 which worsened at the break of 2009. It is now well known that the mining sector is the loci of real sector collapse in Zambia. The mining industry has been hard hit putting the country in the World Bank's high exposure category. Copper prices, which rose to US\$8, 500 per ton in July 2008 slumped to slightly below US\$3, 000 per ton at the beginning of 2009. The old and deep shaft mines have been the hardest hit due to high costs of production. The sad repercussions have been massive loss of over 12, 000 jobs. Truly, thousands of people dependent on the working class have painfully lost their livelihoods and the multiplier effects are a sad thought. Unfortunately, Ministry of Labour cannot currently provide exact statistics on total job losses.

Trade performance, as a result of the above, severely shrunk. The year 2009, began with a severe trade deficit of K237.8 billion at the end of January, meaning that the country's exports were outweighed by imports causing a negative trade imbalance. Statistics further reflect a deeper cumulative trade deficit of K 401.1 billion for January and February 2009 compared to a trade surplus of K 126.1 billion at the same period in 2008⁶.

Another sector hard hit though again with inadequate statistics is tourism. The industry had recently seen its better days and was flourishing steadily for presumably for two reasons. First, the success in the mining sector and the general stable economic outlook stimulated much interest in foreign nationals to visit. Second, the country seems to have "unfortunately" benefited significantly from Zimbabwe's political and economic turmoil. Whereas in the past Zimbabwe received more tourists than Zambia, the situation changed after the year 2000 - the post land policy institutionalisation era.

Several lodges and hotels had sprung up predominately in Livingstone and Lusaka and recently in Solwezi and surrounding areas to accommodate an influx of tourists. In terms of accommodation in guest houses, lodges, and hotels, occupancy rates were nearly hitting 100 percent which perceptibly meant more jobs and more foreign exchange. Now with the credit crunch⁷ in developed countries, the sector

⁶ Ibid

⁷ A credit crunch is almost synonymous to the financial crisis – it is a situation where lenders, e.g., banks become risk averse and no longer want to lend out money in fear of bankruptcy due to high default rates. This is done by charging higher interest rates, or rejects all but safest loans only.

has recorded massive job cuts. Ministry of labour officials speculate that accommodation occupancy has possibly dropped to about 20 percent.

For decades now, tourism potential remain largely unexploited, and yet the industry has become one of the dominant sector of economic activity in Zambia and even worldwide. The Africa Economic Report for 2008 indicates that Africa as a whole attracted fewer than 4.6 per cent (or 37.3 million) of the 802 million world tourist arrivals. Only four African countries (Egypt, South Africa, Morocco and Tunisia) are listed on the top 50 worldwide destinations in terms of both arrivals and receipts.

VI) Adequacy of the current regulatory framework governing the financial and Capital markets

In the 2009 Budget Address, the Minister for Finance announced that to achieve this growth objective, the Government will promote diversification and enhance national competitiveness through structural reforms and infrastructure development. And that emphasis would be placed on agricultural development, tourism infrastructure development, and the promotion of the manufacturing sector. These aspirations have remained but broad wish list items without tangible action points.

The Bank of Zambia which has been mandated to offer financial and capital market supervision could not provide information on current regulatory frameworks they have improvised to regulate an interplay in the financial and capital market.

VII) Government strategies being considered to mitigate the impact of the crisis

The broad fiscal strategy for 2009 is increasing expenditure on infrastructure and social services, in line with the Government's objectives of encouraging diversification and enhancing competitiveness. This strategy is hoped to be achieved through robust realignment of resources, and an increase in borrowing. The Government has planned to increase domestic borrowing by 0.4 percent from 1.4 percent of GDP in 2008 to 1.8 percent of GDP in 2009.

In order to ensure macroeconomic stability, the Government has committed to reviewing the monetary and supervisory policies to take account of ongoing developments in the domestic and global financial markets.

In order to curtail inflationary effects, steady supply of food and fuel in the country has been maintained. The Bank of Zambia as an institution has been tasked to closely monitor developments in the financial sector and to respond appropriately with measures to safeguard the domestic financial system.

VIII) Conclusion

Today, several people in Zambia express the following sentiments; “this situation it is not new”, “there is not difference in the standard of living”, “we have always lived in poverty”. Yes! These statements may be true but since government had not employed proactive measures to rebound this inhumane situation, the current crisis, as can be deduced from the above analysis will put the country in an extraordinary position, probably the worst ever.

In the country’s recovery plan, aggressive endogenous solutions should be sought. Zambia is blessed with a bounty of natural resources but more so untapped human resource which are the major ingredients if properly and expertly blended to act as countercyclical factors. Looking out for stimulus packages from the agents of the crisis is not a wise initiative as it exemplifies our limited scope in rethinking sustainable development.

IX) Recommendations

The above difficult and uncertain economic outlook argues for forceful actions both on the financial and macroeconomic policy fronts to establish the conditions for a return to sustained growth. The following are our strong recommendations;

1. Government in collaboration with stakeholders should put up strategies to protect expenditure on health and education including school feeding programs to encourage parents to keep their children in school because sustainable good health and education are key factors in integral development in the long term.
2. Commercial banks and other financial institutions must be monitored vigilantly by way of regular analysis of performance reports in order to minimise vulnerabilities and mitigate risks.
3. Government should treat the issue of diversifying away from mining with utmost urgency. Well thought out suggestions on possible different areas of diversification and investment were offered during the Indaba, particularly on revamping the agriculture sector by ending chronic dependency on rain fed crops.

4. The Bank of Zambia should intervene to bring down the cost of borrowing from commercial banks, which appear to be nonresponsive to improvements in the fiscal management of our economy. If this trend remains uncontrolled, the high cost of borrowing stifles the growth of the productive sector.
5. As much as external borrowing might be important to supplement local resources for development needs, strategic boost in domestic production is the only way to sustain the strength of the local currency and propping up national reserves. Government should therefore not be complaisant by relying on dangerous loans from IFI's to replenish national reserves.
6. Government also should exhibit a very high and stronger level of political will to mitigate the crisis. To prevent unregulated or impulse external borrowing, the Zambian government should hastily put in place binding public debt sustainability by revising the debt law. This will limit the amount of debt to be borrowed at a particular time and increase scrutiny and purpose of loans being procured.
7. Reduce external debt and mobilize more domestic and external non-debt-generating resources. Since domestic resource mobilization is considered to be insufficient in low-income countries like Zambia, unusually more efforts should be dedicated in identifying and possible avenues of mobilising local resources other than depending on foreign integral distorting resources such as ODA, FDI and grants.
8. Agriculture sector being the biggest element in the transformation of Zambia, the Government, policy advisors and other stakeholders should realise the potential that the sector has of emerging the bread basket for the region. Currently, Zambia like other countries in the region has shifted from being a net exporter of food to a net importer.
9. Government should endeavour to protect vulnerable households to help them cope with the downturn by financing strategic programmes that have the capacity to create jobs, ensure social service delivery, and those that can provide safety nets for the majority of the population.
10. Institutional capacity to absorb increased spending of financial resources should be reinforce. Now is not the time to hear reports of public resources being misappropriated or stolen. Spending for vulnerable groups needs to improve by

committing adequate funds to FNDP social sector programmes to guard against worst effects on our economy.

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