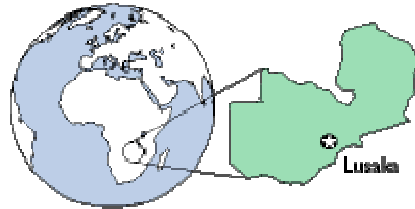


COUNTRY REVIEW

Zambia



3 September 2010

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EULER HERMES COUNTRY RISK GRADE: C

Country Risk Grades are on a scale of AA, A, BB, B, C, D
where AA is the lowest and D the highest risk.

COUNTRY PROFILE

Capital city:	Lusaka
GDP:	USD12.75bn (2009e)
Population:	12.94mn (2009e)
GDP per capita:	USD985 (2009e)
Currency:	Kwacha (ZMK)
Form of state:	Republic
Head of state:	President Rupiah Banda
Next elections:	Presidential and legislative by end-September 2011

Rupiah Banda, leader of the ruling Movement for Multi-Party Democracy (MMD), won closely-contested presidential elections at the end of October 2008. **His term runs only to 2011** as he took over from Levy Mwanawasa, who died in office in August 2008. Banda has encountered significant challenges, partly through a strengthened opposition but also as a result of divisions within the MMD. Nevertheless, **policy continuity has remained evident within a broadly democratic framework** and this has provided the donor and investor communities with comfort that the current economic strategy (broadly market- and business-friendly) will prevail. Some tensions may arise in the period prior to the presidential and legislative elections and Banda's position is not assured, although an alliance between the two largest opposition parties is currently fragile and rivals within the MMD have yet to challenge his authority to a significant degree. **We expect the elections to be close and a transfer of power, if the polls so dictate, to be relatively trouble free.**

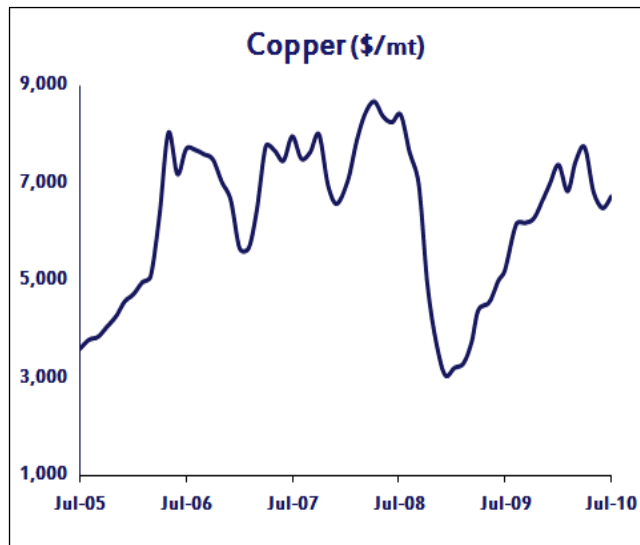
Regional and international relations are relatively good, although there are periodic concerns relating to transparency and corruption. The government will seek to appease the wider donor community because of its continuing dependence on external aid, and support is likely to remain in place. **China is an increasingly important source of loans and investment** and bilateral relations with that country will increase, partly because of Zambia's abundance of natural resources (potential hydro-electricity generation, rich arable land, limestone, gold and cobalt, as well as copper).

Zambia has made significant progress in rebuilding its economy (albeit from a low base), although it will remain dependent on aid and variable commodity prices. It is estimated that **over 65% of the population lives below the poverty line**, life expectancy is below 45 years and 42% of the population does not have access to an improved water source. In addition, refugee inflows from neighbouring Zimbabwe have exacerbated social pressures.

In April 2005, the IMF and World Bank agreed that Zambia had reached its completion point under the enhanced Heavily Indebted Poor Countries (HIPC) initiative, thereby **securing significant debt relief**. Moreover, the Fund has provided financial assistance under a series of three-year Poverty Reduction Growth Facilities (now subsumed within an Extended Credit Facility, ECF, that expires in June 2011). At that stage, the IMF is likely to extend its lending programme for a further period. As part of the agreed reforms under the Fund facilities, the **government has pledged fiscal consolidation** through reduction of non-priority expenditure and minimisation of the public sector wage bill. However, governments have found it **difficult to achieve some IMF targets, particularly in relation to public expenditure cuts and some interim Fund targets are likely to continue to be missed into 2011**. Nevertheless, in its fourth review of the ECF in July 2010, the Fund was broadly positive in relation to performance and economic outlook.

Annual real GDP growth has been robust in recent years, averaging over 5% in 2003-09, boosted by recovery in mining output, following strong investment in that sector, particularly by China. Zambia is one of Sub-Saharan Africa's largest recipients of FDI, which increased even in 2009 and could double in 2010 if pledges are fulfilled. In H1 2010, FDI inflows were in excess of USD500mn in each of the manufacturing, mining and energy sectors, compared with an overall total of USD959mn in H1 2009. Even with a global slowdown from Q4 2008 and recession in some key markets in 2009, Zambia registered relatively strong GDP growth. Rates of growth of at least 5% are needed for a lengthy period to make meaningful progress in improving basic conditions within the country and this is likely to be achievable in 2010 and 2011. **Economic indicators in H1 2010 provide evidence of continuing robustness**, with mining (10% of GDP, with a marked multiplier effect), construction and agriculture (maize output is at a twenty-year high) being key drivers. Moreover, rising copper prices will further increase investment flows in the ST. Overall, we **forecast real GDP growth of around 7.5% this year and a still-healthy 6.5% in 2011**, with an easing in the latter year reflecting moderation in mining investment.

A strategy of partial resource nationalisation through revision of mineral taxation and of contracts with international mining companies appears to have been reversed, with the **government recently stating that it is now opposed to increasing mining taxes.**



The **outlook for copper prices remains good**, even with uncertainties relating to world economic growth in 2011. This is because Asian physical demand, inventory depletion and supply constraints will continue to combine and cause market tightness. The average copper price in January-July 2010 was USD7,200/tonne (USD7,300/mt as at end-August), compared with an average for the full year in 2009 of USD5,150/mt. With some large mines in Chile and elsewhere beyond peak production and little new output coming on-stream in the next few years, prices are likely to remain firm. **Copper mining accounts for over 60% of Zambia's foreign exchange earnings and production is set to increase to 1mn tonnes by 2012 from around 700,000mt in 2009.**

Completion point of the HIPC and inclusion in the Multilateral Debt Relief Initiative granted Zambia access to **significant debt relief from all creditors** of around USD3.9bn out of a total debt of USD6.8bn. Annual debt servicing is now approximately USD150mn, compared with USD500mn in the 1990s. Accordingly, **FX reserves have been boosted** and at USD1,341mn at end-July 2010 were more than four times larger than at end-2004. While FX now provides an import cover of around the international benchmark of three months, the economy has a structural fragility (dependent on international metal prices) and will continue to be donor-dependent. **The current-account deficit is forecast to increase to around 2.5% of GDP this year**, compared with 1% in 2009, largely reflecting strong merchandise import growth and net outflows in the services and incomes accounts associated with mining investments **but will reduce to around 1% of GDP in 2011** as the investments level off and copper production increases.

The structural business environment has improved since our last assessment and now scores SBE4. Since the Suspension of Exchange Control Act of 1994, there are no official restrictions on repatriation of capital, dividends and royalties. Nevertheless, weak infrastructure limits progress, partly because poor and lengthy transport routes (Zambia is landlocked) increase costs and partly because power outages can disrupt industrial and commercial output. In addition, corruption is still quoted as a potential deterrent to doing business with the country.

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