



BANK *Of* ZAMBIA

**BI-ANNUAL SURVEY OF BUSINESS
OPINIONS AND EXPECTATIONS
REPORT**

Disclaimer:

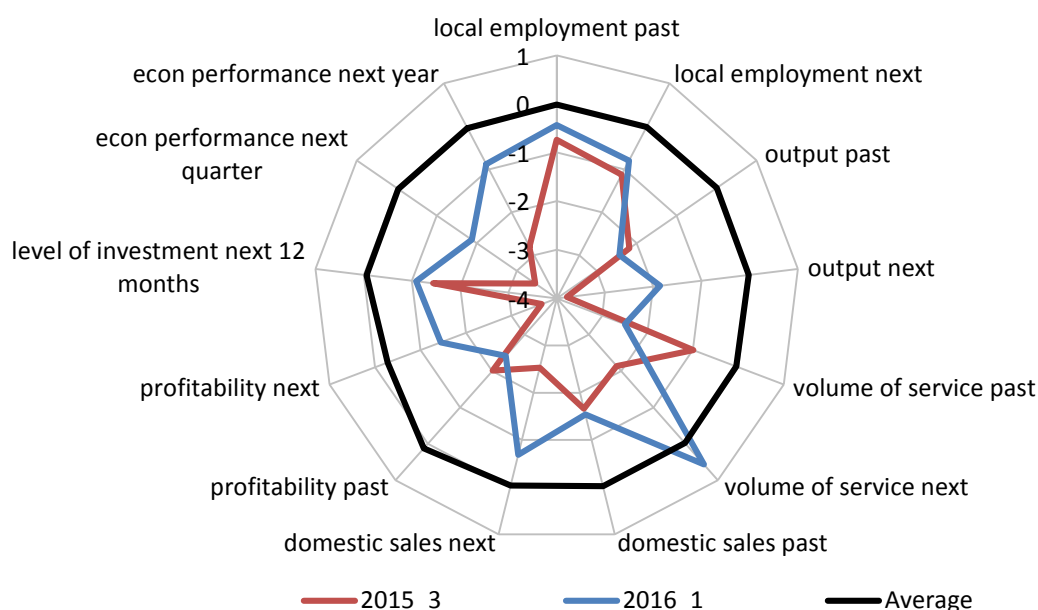
The opinions and expectations presented herein are of the respondents and not of the Bank of Zambia.

MAY 2016

Executive Summary¹

Responses collected during the Survey of Business Opinions and Expectations undertaken during the first quarter of 2016 revealed that economic activity remained subdued. This was mainly due to the unpredictable business environment, impact of electricity load shedding, poor rainfall patterns, upward adjustment in electricity tariffs, low export receipts, low demand, high cost of credit and exchange rate volatility. This, notwithstanding, economic performance was expected to improve slightly in the next quarter, reflecting an anticipated pick up in activity related to the post-harvest agriculture output coupled with the upcoming peak tourism season. Despite the seasonal impact of these activities, economic performance over the next twelve months was expected to remain below the historical average growth. The survey opinions and expectations also indicated that monetary policy continued to be tight, on account of tight credit and liquidity conditions as well as the high interest rates. Inflation, though slowing down, was expected to remain higher than the historical average, owing mainly to past high prices, the pass-through of the exchange rate depreciation and increased production costs.

Overall Survey Response Patterns*



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

¹ This Report presents findings of the Survey of Business Opinions and Expectations conducted during the first quarter of 2016. The results are based on responses from 483 firms covering manufacturing, merchants, services, tourism, agriculture and construction sectors, thus representing a response rate of 69.0%.

Introduction

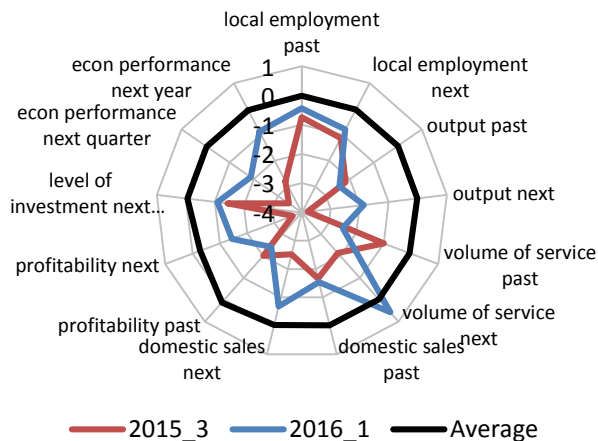
This Business Opinions and Expectations Survey Report is divided into four sections. The first section presents the response patterns related to economic performance during the first quarter 2016 and expectations for the next quarter, while section II presents opinions and expectations on input costs, wages and selling prices. Section III provides perceptions on monetary policy for the next period and section IV provides the general conclusion.

I Opinions and Expectations of Economic Activity

Economic Activity DETERIORATED

The business opinion survey results for the first quarter of 2016 revealed that economic activity declined². Although expectations indicated an improvement in output, volume of services, domestic sales and profitability during the next quarter (see Chart 1), economic performance would generally remain below the historical average growth over the next twelve months.

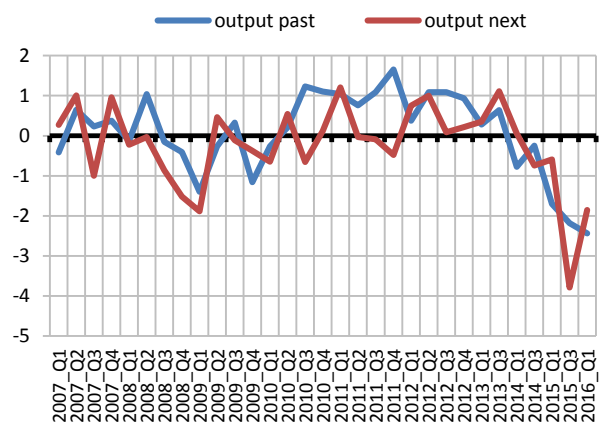
Chart 1: Opinions & expectations of economic activity*



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

Output: During the quarter under review, overall output fell, with a net balance of -36% compared to -32.9% in the third quarter of 2015. This was mainly on account of power shortages attributed to electricity load shedding, upward adjustment of electricity tariffs, increased cost of raw materials resulting from the depreciation of the Kwacha against major currencies, poor rainfall patterns and high cost of credit. An increase in output is anticipated during the next period, mainly owing to post-harvest agricultural production. Nonetheless, the general level of output will remain below the historical average (see Chart 2).

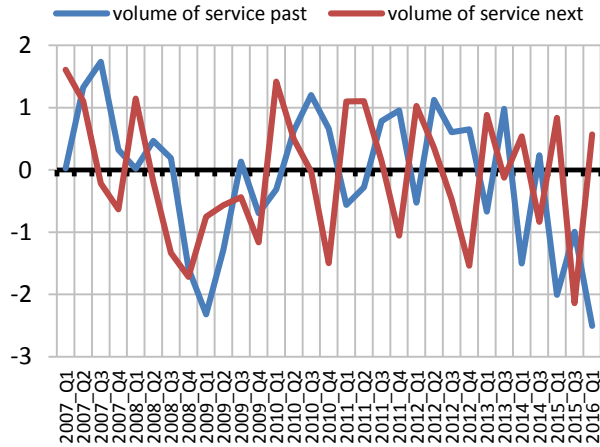
Chart 2: Opinion on Output



Volume of Service: The volume of services declined during the first quarter of 2016, as reported by the tourism and service sectors, with a net balance of -47.4% against -21.3% in the third quarter. This was due to low demand attributed to the economic downturn and reduced tourism activity during the rainy season. In addition, the exchange rate depreciation and the on-going power rationing impacted negatively on the cost of providing services. However, the volume of services is expected to improve in the second quarter of 2016 (see Chart 3), largely on account of the upcoming holidays and the peak tourism season.

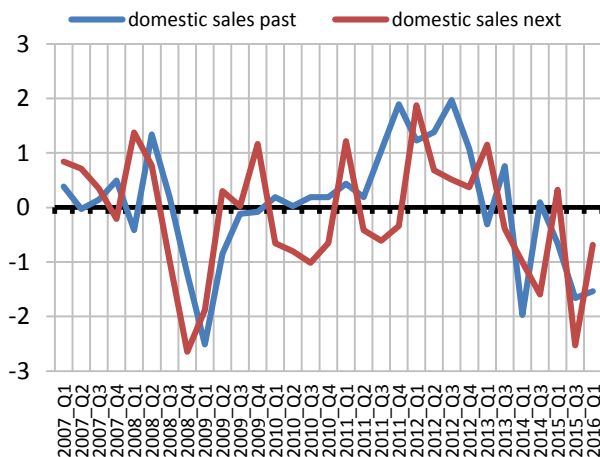
² see Appendix for the methodology

Chart 3: Volume of Service



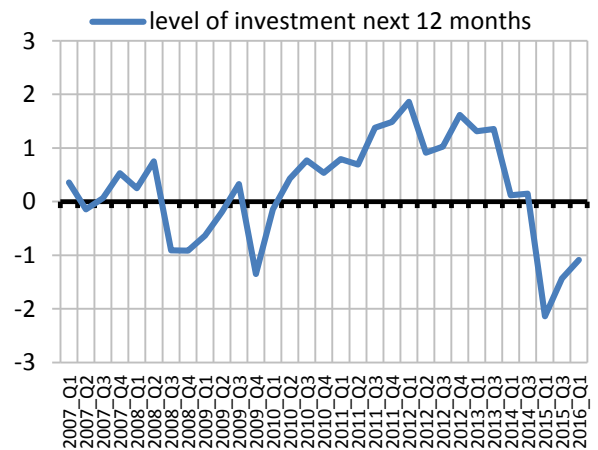
Domestic Sales: Domestic sales continued to be weak during the first quarter, though showing a marginal improvement, with a net balance of -28.2% compared with -30.3% in the third quarter of 2015. This was particularly attributed to merchant sales and discounts. Reduced demand, low production resulting from high input costs and reduced farming activities contributed largely to the low domestic sales. Expectations, however, showed a slight improvement for domestic sales in the second quarter of 2016, mainly due to activities related to the agriculture harvest period and peak tourism season. This notwithstanding, domestic sales would still remain weaker than the historical average (see Chart 4).

Chart 4: Domestic Sales



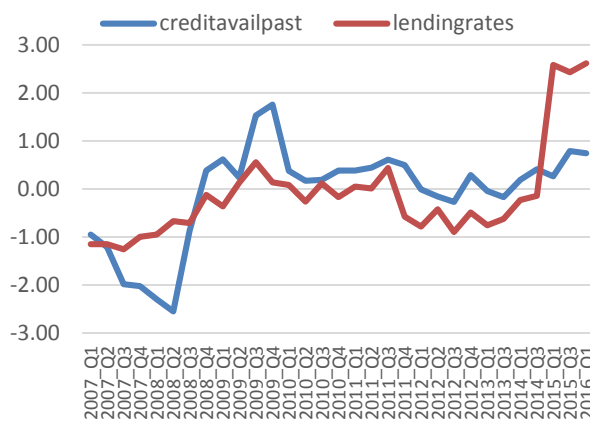
Investment: During the first quarter 2016, investment spending continued to be largely driven by firms' retained earnings reflecting tight credit conditions and higher interest rates charged by banks. Over the coming 12 months, investment spending is expected to be weaker than the historical average (see Chart 5). This is largely attributed to the unpredictable business environment, exchange rate volatility, lack of re-investment income due to reduced profitability and increased cost of doing business emanating from power shortages.

Chart 5: Investment plans in next 12 months



Credit: Credit conditions remained tight during the first quarter as revealed by the survey, with a net balance of 68.7% compared to 69.1% in the third quarter of 2015 (see Chart 6). The tight credit conditions were attributed to tight monetary policy, high interest rates, as well as perceived high default risk. Accordingly, 67.1% of the surveyed firms utilised retained earnings for investment finance and 75.9% utilised retained earnings for working capital.

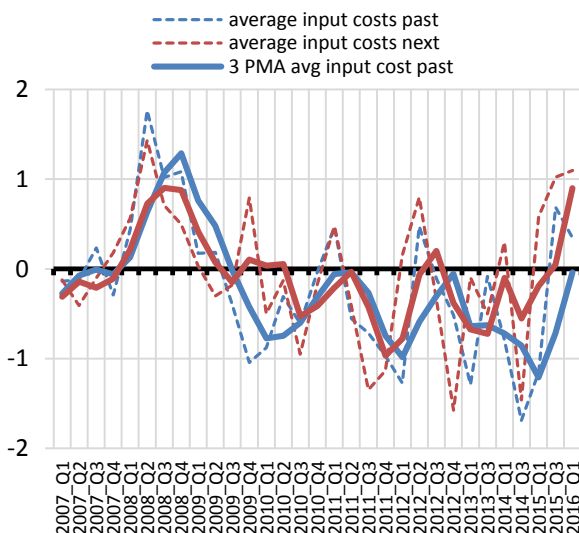
Chart 6: Credit conditions and lending rates



II Evolution of Costs, Wages and Prices

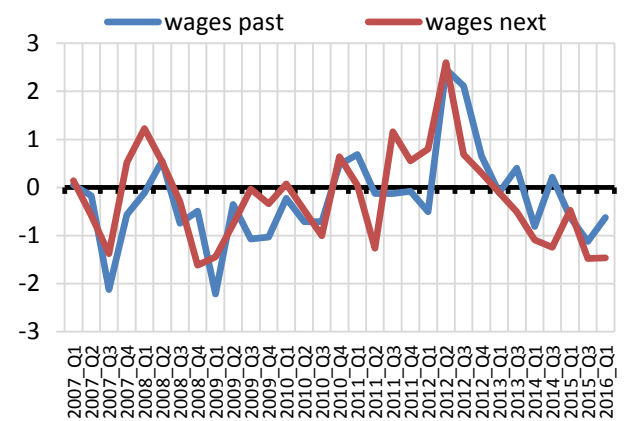
Input Costs: Average input costs continued to rise during the first quarter of 2016, with a net balance of 36.2% compared with 39.5% during the third quarter of 2015. This was largely attributed to the exchange rate depreciation, increased electricity tariffs, increased cost of raw materials as well as costs associated with mitigating the impact of electricity shortages. Respondents expect input costs to increase further in the next period and remain higher than the historical average (see Chart 7).

Chart 7: Evolution of average input costs



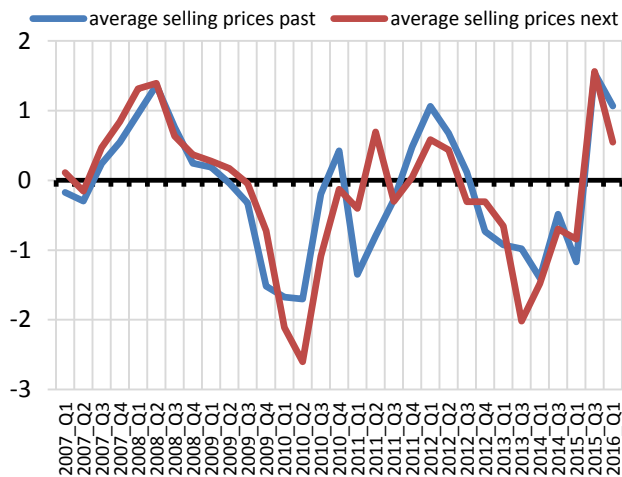
Wages: Wages increased in the first quarter of 2016, with a net balance of 12.2% against 8.6% in the third quarter of 2015. The business community expects wages to decline in the next quarter largely due to the anticipated weaker economic activity, reduced profitability and lower number of working hours owing to power rationing (see Chart 8).

Chart 8: Evolution of wages



Selling Prices: Average selling prices reduced slightly, but continued to be higher than the historical average during the first quarter of 2016, with a net balance of 21.4% against 30.3% in the third quarter of 2015. This was largely attributed to higher input and production costs, profit motives and the pass-through of exchange rate depreciations. The average selling prices were expected to further decline in the second quarter of 2016, largely due to Merchant sales to clear stocks and improved supply of agricultural products. Nonetheless, selling prices would still remain higher than the historical average (see Chart 9).

Chart 9: Evolution of average selling prices



III Perceptions and Expectations on Monetary Policy

Inflation: In the second quarter of 2016, inflation is expected to slow down driven by an improvement in the supply of fresh food following the agricultural harvest period. However, past high prices, the pass-through of the exchange rate depreciation and high production cost are likely to moderate this impact, hence inflation, though slowing down, will remain higher than the historical average (see Chart 10).

Chart 10: Inflation expectations for the next quarter

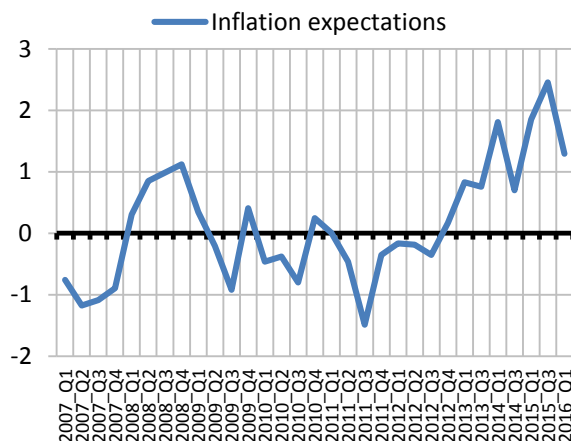
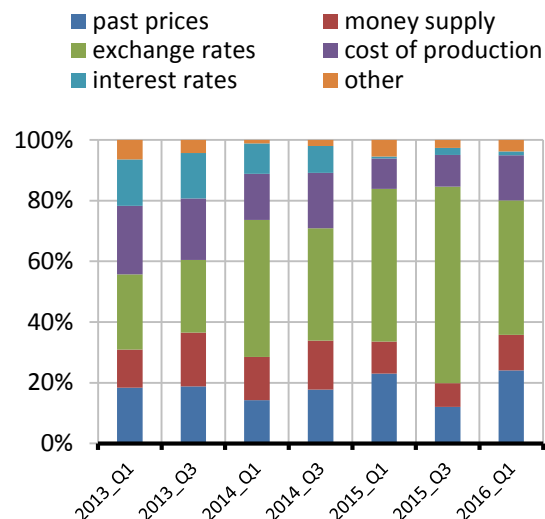
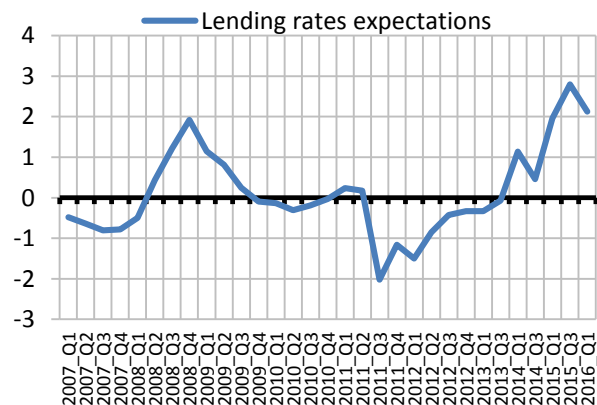


Chart 11: Inflation expectations less driven by exchange rate and more by past prices



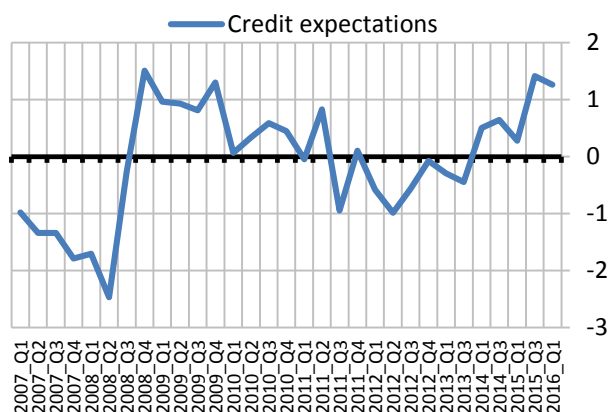
Interest Rates: Interest rates are expected to remain high and above the historical average during the second quarter of 2016 (see Chart 12). This is attributed to the high BOZ policy rate and removal of interest rates caps, high inflation, expected increase in Government borrowing on account of elections, expected high default risk and low liquidity levels in the economy.

Chart 12: Interest rate expectations next quarter



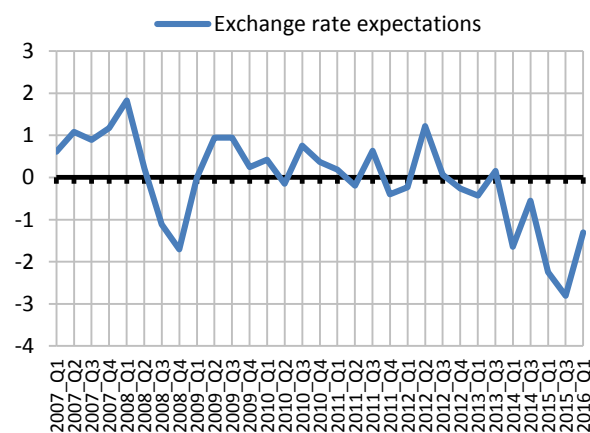
Credit: Credit conditions expectations for the second quarter of 2016 remained tight and above the historical average (see Chart 13), on account of tight monetary policy, high collateral requirements and high interest rates.

Chart 13: Credit expectations for the next quarter



Exchange rate: The Kwacha exchange rate depreciation against the US dollar is expected to slow down in the second quarter of 2016, mainly due to tight monetary policy. This notwithstanding, the Kwacha exchange rate against the US dollar will remain weaker than the historical average (see Chart 14).

Chart 14: Exchange rate expectations next quarter



IV Conclusion

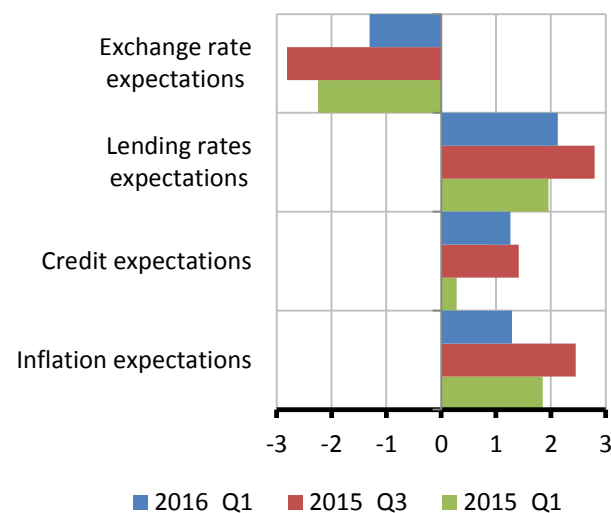
According to the Business Opinion Survey conducted in March 2016, economic performance was subdued in the first quarter of 2016. Although economic activity was expected to improve in the next quarter, on account of the upcoming agriculture harvest and peak tourism season, economic growth would still remain below the historical average over the next 12 months.

The major factors explaining the poor growth prospects include unpredictable business environment, electricity load shedding, poor rainfall patterns, upward adjustment of electricity tariffs, low export receipts, reduced profitability, high cost of credit, exchange rate volatility and lower investment spending.

Monetary policy is perceived and expected to remain tight, as reflected in high interest rates and tight credit conditions. The tight monetary policy stance is expected to moderate the pace of the Kwacha exchange rate depreciation in the next quarter, though it will still remain weaker than the historical average.

Respondents expect inflation to slow down in the next quarter mainly on account of improved food supply and merchant sales to clear goods. However, prices remain higher than the historical average owing mainly to past high prices, the pass-through of the exchange rate depreciation, impact of power shortages and higher production costs.

Chart 15: Expectations indicated tighter conditions with lower inflation expectations



Appendix I: Background on the BSBOE

Business surveys are useful indicators of current and future economic activity and assist in the formulation of decisions today that impact on future economic activity. The Bi-Annual Survey of Business Opinion and Expectations (BSBOE) undertaken by the Bank of Zambia is designed as a supplementary tool to provide information on the business community's opinion and expectations about the current and future direction of the economy for macroeconomic analysis. Business opinions and expectations provide a guide to likely developments because of the powerful role expectations play in shaping economic behavior.

This Report is based on the results of the BSBOE conducted in March – April 2016. Out of the 700 questionnaires targeted for distribution, 483 firms responded, representing a response rate of 69.0%.

Survey Methodology

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

The Survey covers the Copperbelt (Luanshya, Ndola, Kitwe and Chingola), Southern (Mazabuka, Choma, Kalomo and Livingstone), Central (Chisamba, Kabwe and Mukushi Farming Block), Eastern (Petauke, Chipata and Mfuwe), North-Western (Kasempa and Solwezi), Northern (Kasama, Mbala and Mpulungu), Muchinga (Mpika, Chinsali, Isoka and Nakonde), Luapula (Samfya and Mansa) and Lusaka (Lusaka City).

Data analysis is done using the Net Balance Statistic (N) where qualitative responses are converted into quantitative measures using the following equation:

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

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

The Net Balance Statistic method has the advantage of detecting the directional changes in performance/expectations of respondents in such surveys. The method indicates the predominance of either an improvement or deterioration in a variable. A positive net percentage indicates that more respondents reported/expected an increase/improvement/tightening and a negative net percentage means a decrease/deterioration/loosening, depending on the variable under consideration. This method has been used widely in the analysis of survey data.