



BANK *Of* ZAMBIA

**QUARTERLY SURVEY OF BUSINESS
OPINIONS AND EXPECTATIONS
REPORT**

Fourth Quarter 2017, Vol 1.4

Disclaimer:

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

JANUARY 2018

PREFACE

The Quarterly Survey of Business Opinions and Expectations (QSBOE) undertaken by the Bank of Zambia is designed as a supplementary tool to provide information on the business community’s opinions and expectations about the current and future direction of the economy.

The business opinions and expectations survey provides useful indicators of current and future economic activity and assist in the formulation of decisions today that impact on future economic performance. The survey provides a guide to likely future developments because of the dominant role expectations play in shaping economic behaviour.

This Report is based on the results of the QSBOE conducted from November - December 2017. A total of 281 questionnaires were distributed, out of which 261 firms responded. This represented a response rate of 92.9%. The sectoral response shares and distribution are indicated in Figures 1 and 2 below.

Figure 1: Response Rates by Sector (%)

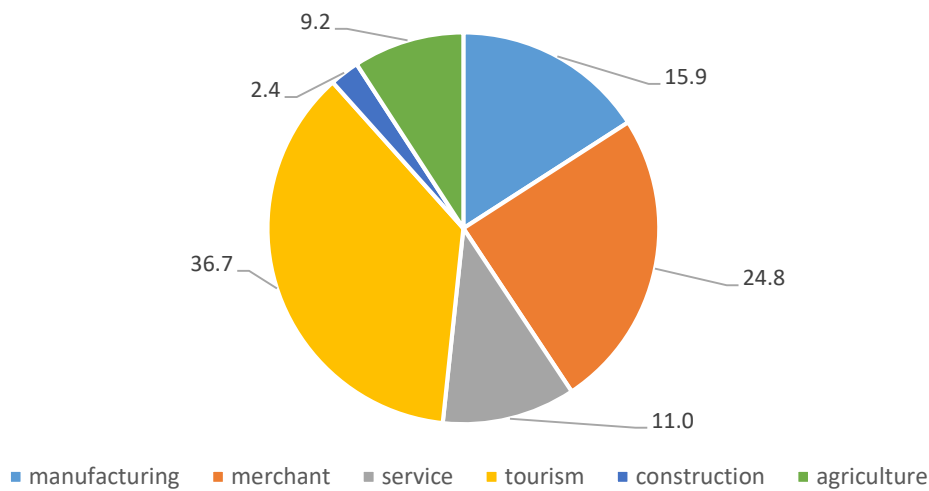
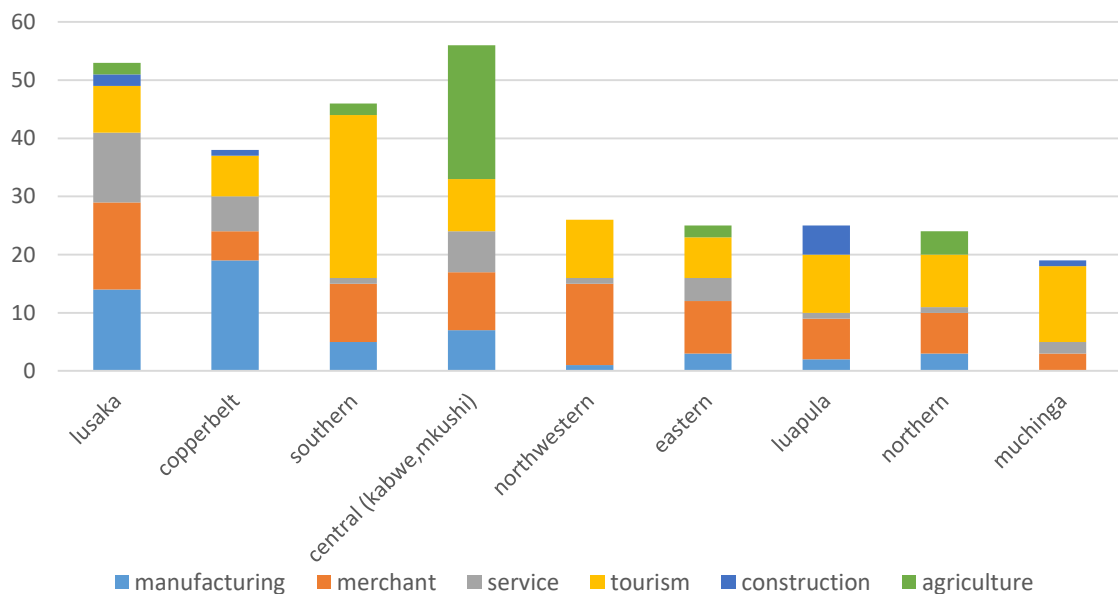


Figure 2: Sectoral distribution by region



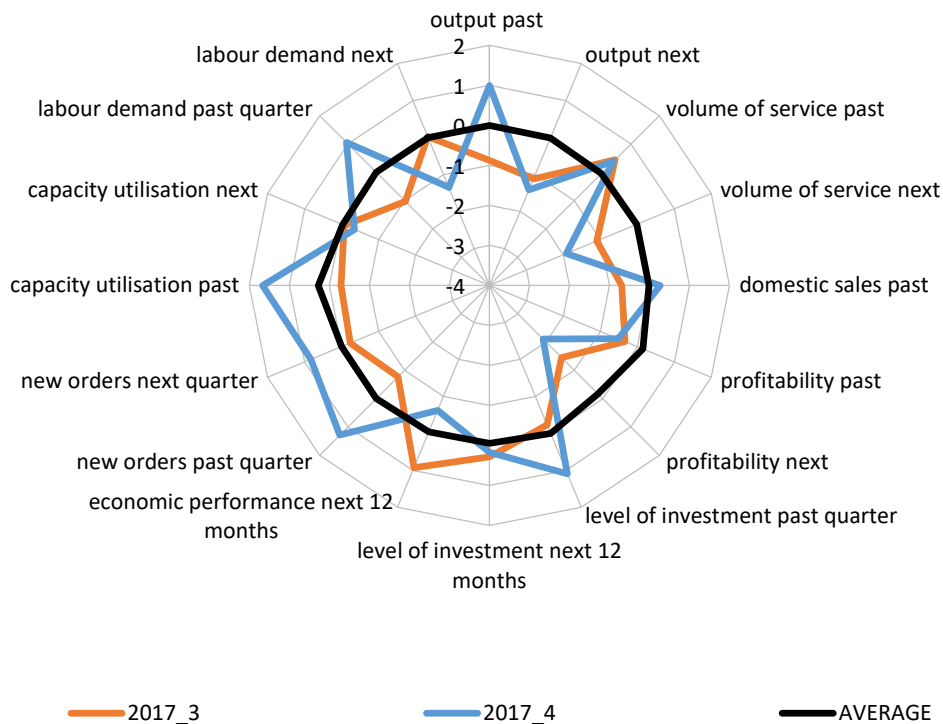
Executive Summary¹

The Quarterly Survey of Business Opinions and Expectations for the fourth quarter of 2017 showed that economic activity improved in the fourth quarter compared to the third quarter. Capacity utilisation, the level of investment, output, new orders, labour demand and domestic sales were above their average historical performance, mainly driven by the festive period, when consumer demand typically increases. Nonetheless, profitability remained relatively unchanged due to an increase in average input and wage costs.

The outlook for the first quarter of 2018, indicated a decline in the performance of most indicators. Capacity utilisation, output, volume of service, and labour demand were all expected to be below the previous quarter and the historical average. Respondents anticipated a reduction in output and labour demand in the agriculture and tourism sectors due to low maize prices and seasonal factors, as well as a decline in manufacturing orders. Further, domestic sales and profitability were expected to fall owing to reduced demand after the festive period. Inflationary pressures were expected to rise, largely driven by the pass through from the anticipated Kwacha exchange rate depreciation against the US dollar and the higher costs of production.

Expectations for the next twelve months indicated that investment spending would slow down relative to the previous quarter, but remain above the historical average. This prospect was mainly attributed to higher copper prices and the associated output which continued to provide positive sentiment. However, the poor distribution of agricultural inputs, credit constraints, high cost of doing business, high tax burden, stiff competition as well as low confidence levels in Government policies would negatively affect local businesses, hence economic activity was expected to decline (see Figure 3).

Figure 3: 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 Quarterly Survey of Business Opinions and Expectations conducted during the fourth quarter of 2017. The results are based on responses from 261 firms of the 281 questionnaires distributed, covering manufacturing, merchants, tourism and services, agriculture and construction sectors, thus representing a response rate of 92.9%.

Introduction

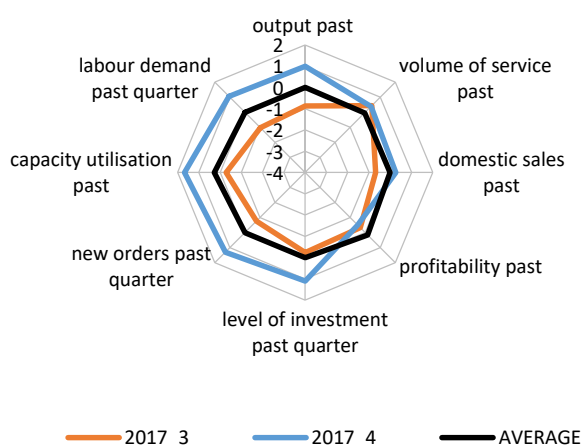
This Business Opinions and Expectations Survey Report is divided into four sections. The first section presents the response patterns related to economic performance during the fourth quarter of 2017 and expectations for the first quarter of 2018, while section II presents opinions and expectations on input costs, wages and selling prices, among other variables. Section III provides first quarter 2018 perceptions on variables that influence monetary policy, while section IV provides the general conclusion.

I. Opinions and Expectations of Economic Activity

Economic Activity improves in Q4 2017

The overall response pattern from the survey for the fourth quarter of 2017, showed that economic activity improved in comparison to the third quarter. Capacity utilization, the level of investment, output, volume of service, new orders, labour demand and domestic sales, all performed above their historical averages (see Chart 1). This was largely driven by high consumer demand during the festive period.

Chart 1: Business Opinions Response Patterns

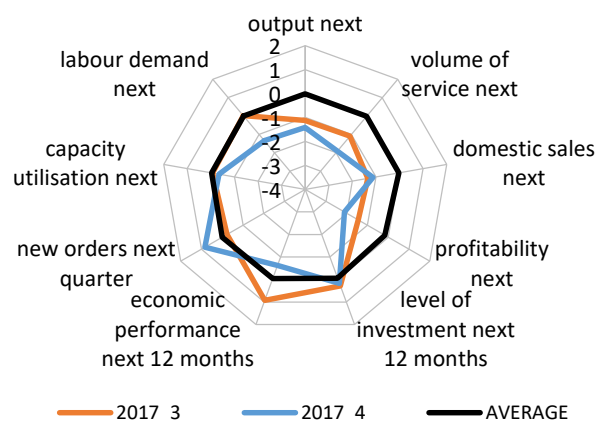


In contrast, expectations for the first quarter of 2018, indicated weaker economic performance. Output, the volume of service, capacity utilisation, labour demand, domestic sales and

profitability, were anticipated to fall below historical levels due to seasonal factors affecting the agriculture, tourism, construction and manufacturing sectors, coupled with subdued demand after the festive season.

Further, most respondents expect economic activity to decline over the next twelve months owing mainly to the high cost of doing business, credit constraints, stiff competition from cheaper imports and low confidence in Government economic and tax policies.

Chart 2: Business Expectations Response Patterns



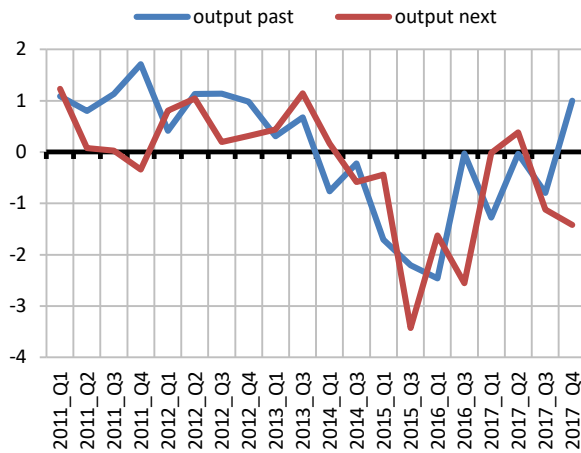
Output rises in Q4 2017

(net balance 11.5%; Q3 2017, -14.5%)

Output increased during the fourth quarter of 2017 and was above the historical average mainly on account of the rise in the number of orders and improved supply of raw materials in the manufacturing sector to support the high demand during the festive period (see Chart 3).

However, expectations for the first quarter of 2018, indicated a decline in output attributed to seasonal factors affecting the agriculture and tourism sectors. Furthermore, plant maintenance and less orders after the festive season are expected to reduce manufacturing output.

Chart 3: Opinion on Output

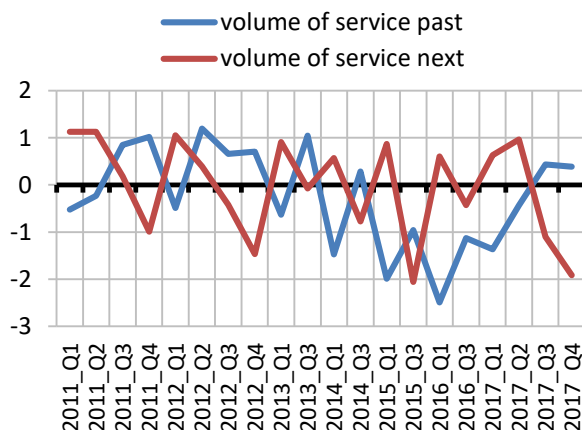


Volume of service slows down
(net balance 1.6%; Q3 2017, 2.6%)

During the fourth quarter, the volume of service remained above the historical average, although it slowed down slightly when compared to the previous quarter. This was mainly attributed to improved efficiency in the banking sector due to digital payment solutions and easing liquidity conditions. However, the tourism sector experienced low demand due to the rainy season hence some lodges closed down for industrial break.

The volume of service is expected to decline and fall below the historical average in the first quarter of 2018. This is mainly on account of reduced tourism and construction activities during the rainy season (off-peak), limited conference gatherings as well as cancelled bookings due to the cholera outbreak (see Chart 4).

Chart 4: Volume of Service

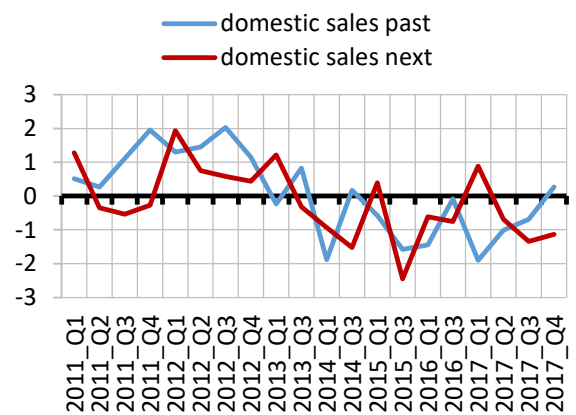


Domestic sales improve
(net balance 0.0%; Q3 2017, -16.9%)

Domestic sales rose to historical average levels during the fourth quarter of 2017. This was mainly explained by higher demand associated with the festive period and retail sales/discounts offered by most merchant outlets (see Chart 5).

However, during the first quarter of 2018, domestic sales are expected to remain below the historical average due to the slowdown in economic activity and subdued demand.

Chart 5: Domestic Sales

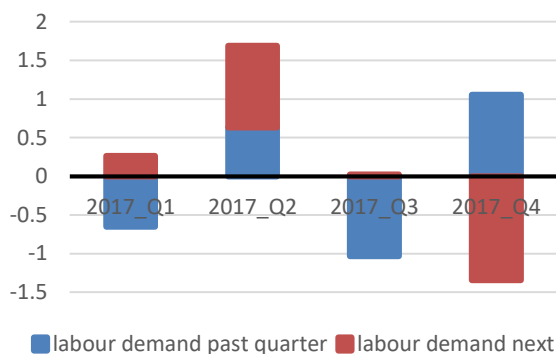


Labour demand increases
(net balance 6.5%; Q3 2017 -6.8%)

Demand for labour increased during the fourth quarter 2017, as a result of expansion in business activity in manufacturing and merchant sectors, following higher demand during the festive season.

Labour demand is, however, expected to decline in the first quarter of 2018, mainly due to reduced activities in the manufacturing, tourism and merchant sectors (see Chart 6).

Chart 6: Labour Demand



Retained earnings remain main source of financing

Retained earnings continued to be the main source of investment finance and working capital in the fourth quarter 2017, at 67.9% (72.3%) and 76.1% (72.4%), respectively. This was followed by Bank borrowing at 16.7% (14.8%) and 9.8% (13.1%), respectively (see Charts 7A and 7B).

Chart 7A: Sources of Investment Finance

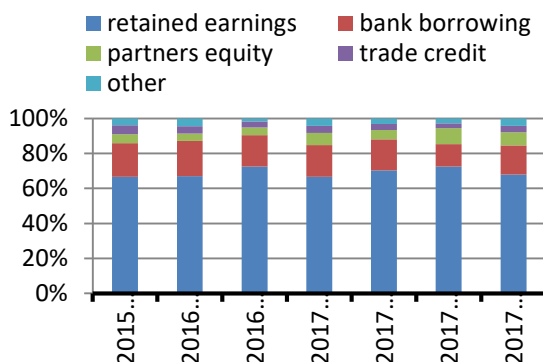
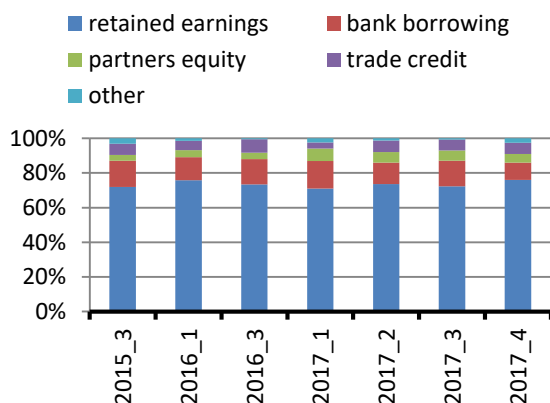


Chart 7B: Sources of Working Capital

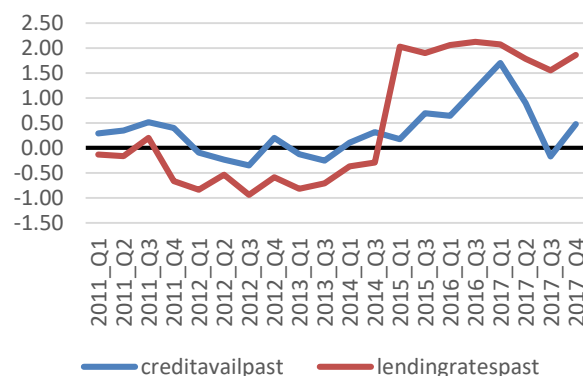


Credit conditions tighten

(net balance 67.2%; Q3 2017, 61.7%)

During the fourth quarter of 2017, most respondents observed tighter credit conditions compared to the previous quarter. They felt that the prevailing interest rates were still high despite the reduction in the Bank of Zambia policy rate in November 2017 (see Chart 8).

Chart 8: Credit conditions and lending rates



II Evolution of Costs, Wages and Prices

Average input costs increase

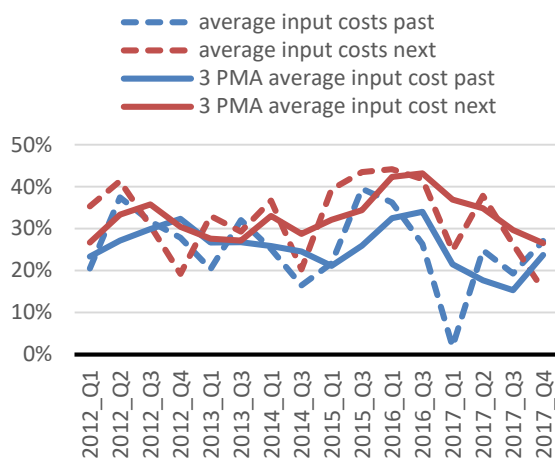
(net balance 27.1%; Q3 2017, 19.3%)

Average input costs increased, and were above the historical average during the fourth quarter of 2017. This was mainly attributed to the pass through of the Kwacha exchange rate depreciation against the US Dollar as the manufacturing and merchant sectors depend on imported inputs/commodities coupled with rising transportation costs following the fuel price increase and the introduction of toll fees. Further, the higher electricity tariffs and land rates also contributed to the increase in average input costs (see Chart 9).

Expectations for the first quarter of 2018, however indicated that average input costs would slow down, but remain above the historical average. Respondents hoped that improvements in liquidity and e-commerce

in the banking sector and raising the scale of production in manufacturing sector would help reduce input costs.

Chart 9: Average input costs



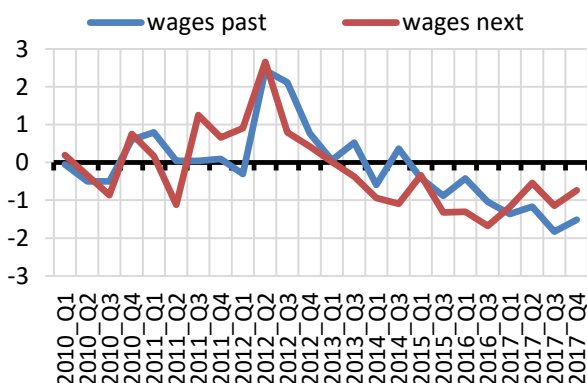
Wages increase

(net balance 3.6%; Q3 2017, 1.1%)

Although the wage bill increased during the fourth quarter 2017, when compared to the previous quarter, it remained below the historical average. The increase in the wage bill was mainly attributed to Christmas bonuses, annual increments and hiring of more labour to increase the scale of production in the manufacturing sector, as well as overtime pay during the festive period in the merchants' sector.

The wage bill is expected to remain below the historical average, during the first quarter of 2018, largely due to lower economic activity (see Chart 10).

Chart 10: Evolution of wages

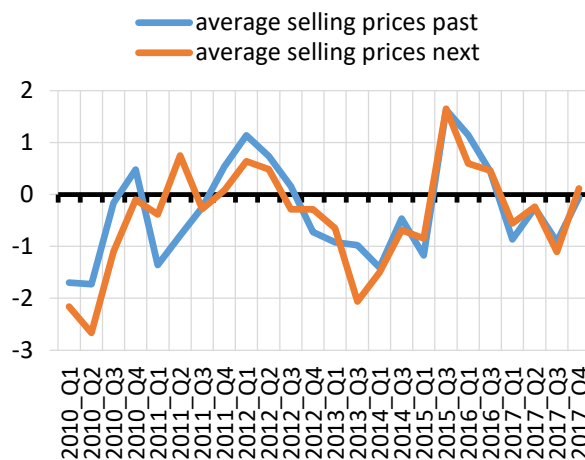


Selling prices increase

(net balance -0.4%; Q3 2017, -15.9%)

Average selling prices rose during the fourth quarter of 2017, but remained relatively unchanged when compared to the previous quarter. The trend is expected to continue during the first quarter of 2018, on account of high costs of production and effects of the exchange rate depreciation in the manufacturing and merchants' sectors (see Chart 11).

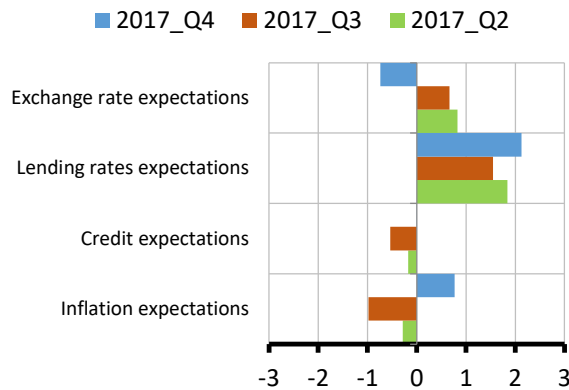
Chart 11: Evolution of average selling prices



III Expectations on Monetary Policy for First Quarter 2018

Most respondents' expectations for the first quarter of 2018 indicated higher inflation, a weak exchange rate, higher lending rates and tightening credit conditions (see Chart 12).

Chart 12: Expectations of higher inflation, weak exchange rate, tightening credit conditions with higher lending rates



Notes:

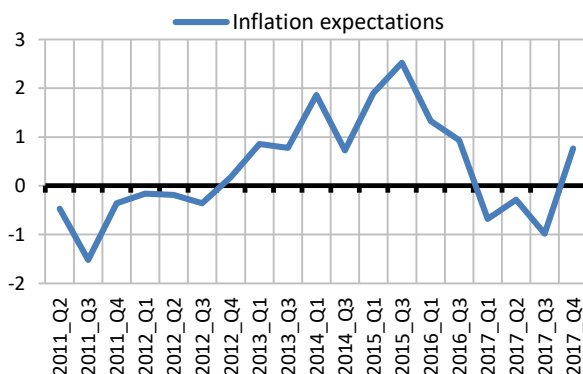
- Exchange rate = appreciation, strong (+)/depreciate, weak (-)
- Lending rates = increase, high (+)/decrease, low (-)
- Credit conditions = tight (+)/loose (-)
- Inflation expectations = increase, high (+)/decrease, low (-)

Inflationary pressures to increase

(net balance 50.2%; Q3 2017, 11.4 %)

During the first quarter of 2018, inflationary pressures are expected to rise above historical levels on account of the pass-through from the anticipated weaker Kwacha exchange rate against the Us dollar and higher production costs (see Chart 13).

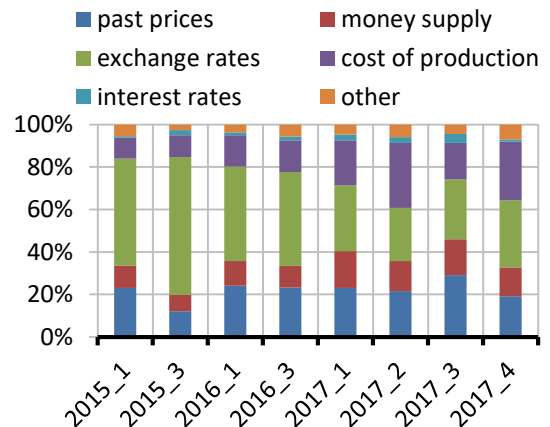
Chart 13: Inflationary expectations next quarter



Inflationary expectations drivers

The main drivers of inflationary expectations continued to be the exchange rate as indicated by 31.7% of respondents compared to 28.3% in the previous quarter; followed by the cost of production at 27.6% (17.2%) (see Chart 14).

Chart 14: Inflation expectations mainly driven by exchange rates and cost of production

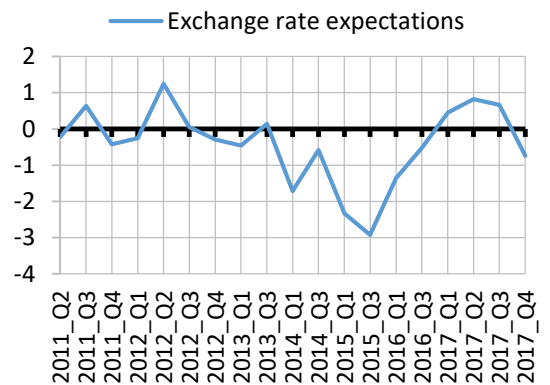


Kwacha Exchange rate to weaken

(net balance -32.5%, Q3 2017 4.8%)

Most respondents anticipated a depreciation in the Kwacha exchange rate to the US dollar during the first quarter of 2018. This was largely on account of Government’s failure to agree on a programme with the IMF, as well as huge VAT refunds and the easing in monetary policy (see Chart 15).

Chart 15: Exchange rate expectations next quarter



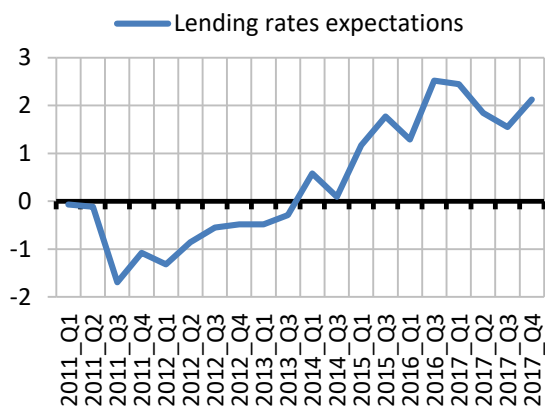
Interest rates to remain high

(net balance 72.5%, Q3 2017 56.5%)

Most respondents expected commercial banks’ lending rates to remain high in the first quarter of 2018. This was attributed

to increased Government borrowing and continued high default risk (see Chart 16).

Chart 16: Interest rate expectations next quarter

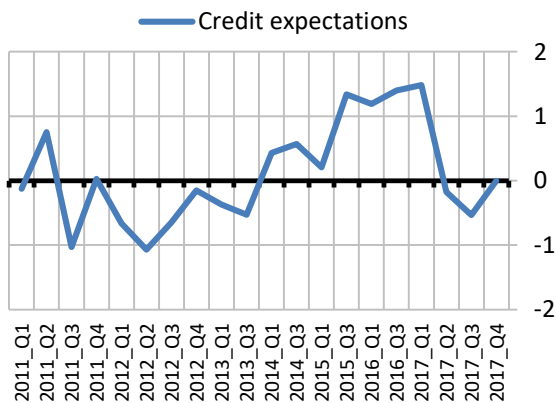


Credit conditions to tighten

(net balance 57.4%; Q3 2017, 51.6%)

Credit conditions were expected to tighten during the first quarter of 2018, mainly due to stringent collateral requirements and high default risk (see Chart 17).

Chart 17: Credit conditions expectations next quarter

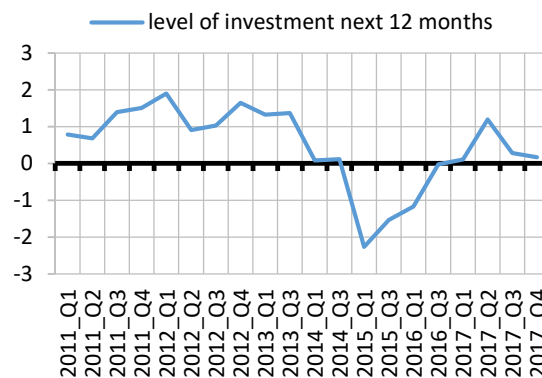


Investment spending to decrease in next 12 months

(net balance 20.7%; Q3 2017, 21.7%)

Over the next 12 months, investment spending is expected to marginally slow down to average historical levels, owing largely to the anticipated high cost of doing business, credit constraints, stiff competition and low confidence in Government economic and tax policies (see Chart 18).

Chart 18: Investment plans in next 12 months

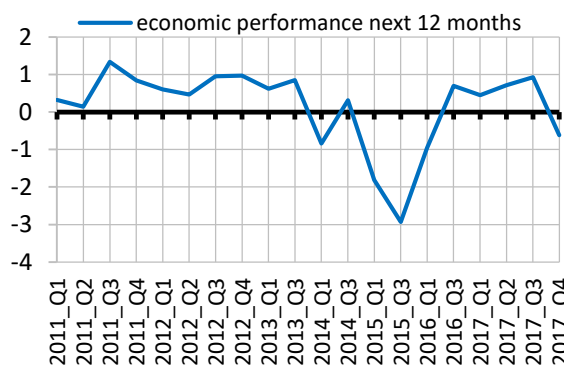


Economic Activity to slow down in next 12 months

(net balance 11.1%, Q3 2017 43.7%)

The outlook for economic performance indicated a slow down over the next twelve months. This perception was premised on poor distribution of agricultural inputs and prolonged dry spell, failure to secure an IMF bailout package, high electricity tariffs, low maize prices and high tax burden on the private sector coupled with increased Government borrowing (see Chart 19).

Chart 19: Economic performance next 12 months



IV Conclusion

The results of the Business Opinions and Expectations Survey conducted during the fourth quarter of 2017, showed an improvement in economic activity during the fourth quarter compared to the third quarter, with most indicators performing above the historical average.

However, the outlook for the first quarter 2018, indicated a decline in output, capacity utilisation, volume of service, domestic sales and profitability largely due to seasonal factors and the impact of the Cholera outbreak. Further, most respondents anticipated a rise in inflationary pressures on account of the pass through from a weaker Kwacha exchange rate against the US Dollar coupled with higher costs of production. Credit conditions would be tighter than the previous quarter and interest rates were expected to remain high, despite the reduction in the Bank of Zambia policy rate in November 2017.

Over the next 12 months, investment spending and economic performance are expected to slow down. This perception is mainly premised on lower agriculture output due to the poor distribution of inputs, prolonged dry spell and low maize price which discouraged its cultivation; high costs of production; credit constraints, and high tax burden. This notwithstanding, higher copper prices and the associated output would continue to provide positive sentiment towards the economy.

Appendix I: Background on the QSBOE

This Report is based on the results of the QSBOE conducted from November - December 2017. Out of the 281 questionnaires distributed, 261 firms responded, representing a response rate of 92.9%.

Of the 261 respondents, 36.7% were from tourism, merchants (24.8%), manufacturing (15.9%), services (11.0%), agriculture (9.2%) and construction (2.4%).

Survey Methodology

Data collection for the Quarterly 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 and operational constraints for the current quarter as well as expectations for the following quarter and the following twelve months. The questionnaire is administered to a sample of respondents in manufacturing, trading, tourism and services, construction and agriculture

sectors. The sectors covered were selected on the basis of their contribution to GDP.

The Survey covers the Copperbelt towns of Luanshya, Ndola, Kitwe and Chingola, Southern (Mazabuka, Choma, Kalomo and Livingstone), Central (Chisamba, Kabwe and Mkushi 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 and Kafue). 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.