Bank *of* Zambia

Quarterly Survey of Business Opinions and Expectations Report

Second Quarter 2019
Vol. 2.6

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

July 2019

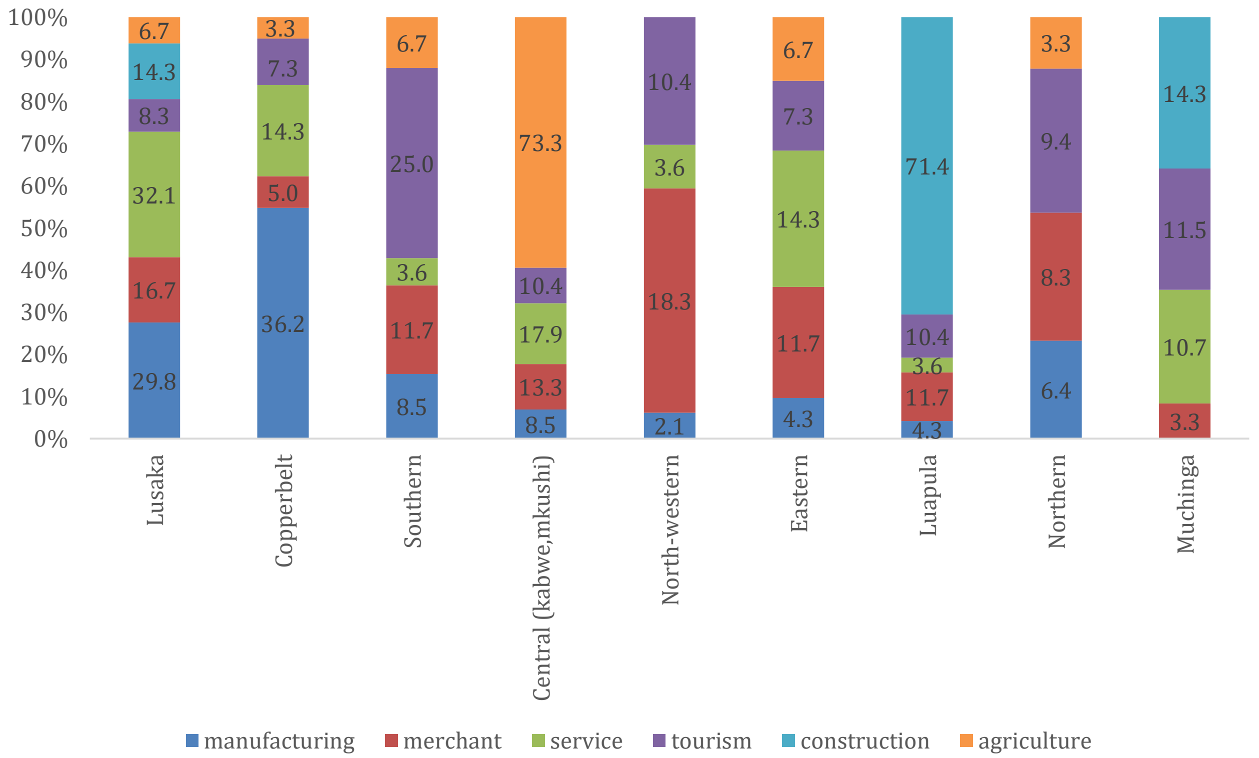
PREFACE

The Quarterly Survey of Business Opinions and Expectations (QSBOEs) provides useful indications about current and future economic activity and assists in the formulation of decisions today that impact on future economic performance. Given the dominant role expectations play in shaping economic behaviour, the Survey provides a guide to likely future developments.

This Survey 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.

This Report is based on the results of the QSBOEs conducted from May–June 2019. A total of 298 questionnaires were distributed. Of these, 254 firms responded, representing a response rate of 85.2%. Out of the 254 firms that responded, 35.8% were in the tourism industry, 22.4% were merchants, 17.5% were in manufacturing, agriculture (11.2%), services (10.4%) and construction (2.6%) (Figure 1).

Figure 1: Sectoral Distribution by Region (%)



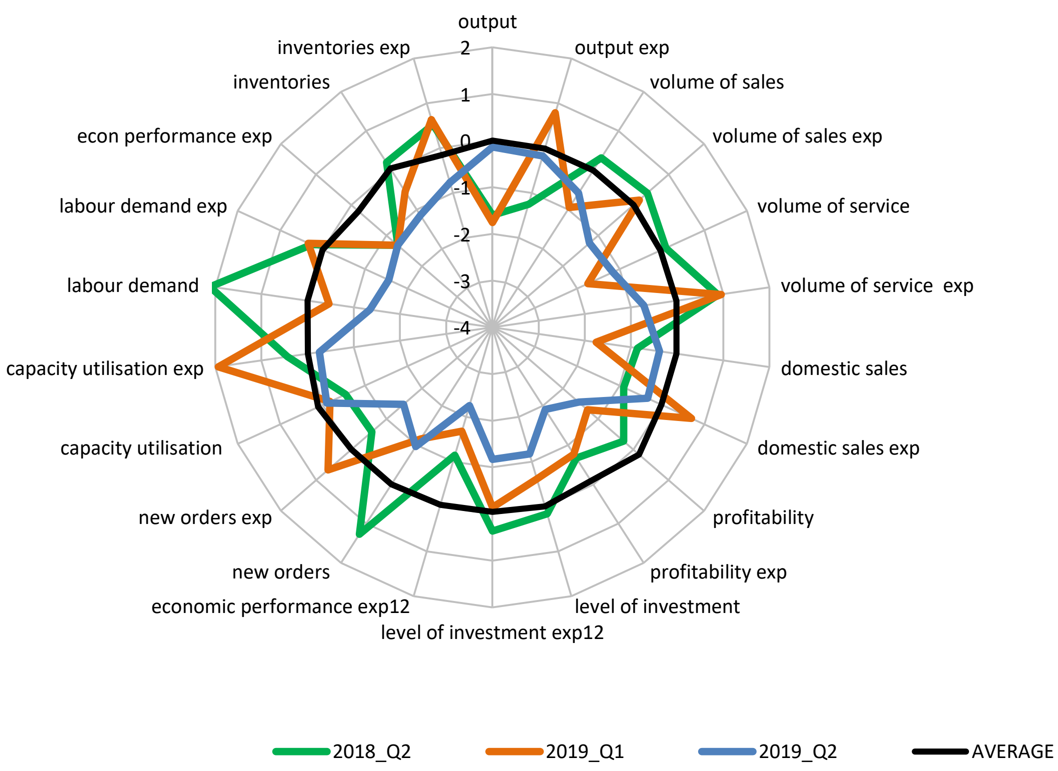
Executive Summary

Despite economic performance improving marginally in the second quarter relative to the first quarter, it remained below the long-term average (Figure 2). Accounting for the improvement in economic activity were mostly agriculture and tourism sectors. All the monitored indicators improved, mainly on account of the pickup in agriculture output and tourism activities, with the exception of level of investment, profitability and labour demand.

In the third quarter of 2019, however, economic activity is expected to deteriorate largely due to the on-going electricity load maintenance, implementation of the sales tax, and liquidity constraints in the economy. In addition, inflationary pressures are expected to continue building up largely due to the high cost of inputs associated with the expected depreciation of the Kwacha against the US dollar. The expected depreciation is premised on declining foreign exchange reserves on the back of high external debt service, low export earnings, low copper prices and negative external investors' perception of the economy. Credit conditions are also expected to tighten following the upward adjustment of the monetary policy rate in May 2019

Economic performance is anticipated to remain low over the next 12 months mainly due to the high cost of doing business attributed to the continued electricity shortages, high tax burdens, exchange rate volatility, high Government borrowing, high lending rates, and continued inflationary pressures.

Figure 2: Overall Survey Response Patterns*



**Note: The survey indicators are standardised 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.*

Introduction

This Business Opinions and Expectations Survey Report is divided into four sections. The first section presents the response patterns for economic performance during the second quarter 2019 and expectations for the third quarter 2019, as well as 12 months ahead. Section II presents opinions and expectations for the same period on input costs, wages and selling prices, among other variables. Section III provides third quarter 2019 perceptions on variables that influence monetary policy. Section IV concludes.

I. Opinions and expectations of economic activity

Economic activity improved slightly in Q2 2019, but expected to deteriorate over Q3 2019 and 12 months ahead

Although economic performance remained subdued during the second quarter 2019, most respondents reported an improvement in most economic indicators in comparison with the first quarter. This outturn is consistent with the expectations made in the first quarter of 2019. With the exception of the level of investment, profitability and labour demand, the rest of the monitored indicators improved largely on account of the commencement of the agriculture harvesting season and the tourism peak season (Chart 1).

The outlook for the third quarter of 2019 is a deterioration in economic activity owing mainly to the pass-through from the depreciation of the Kwacha, uncertainties surrounding the implementation of the sales tax, electricity shortages, and liquidity constraints (Chart 2).

Over the next 12 months, economic performance is expected to continue to deteriorate owing largely to electricity load maintenance, high tax burdens, low external investor confidence, high Government borrowing, exchange rate volatility as well as high lending and inflation rates.

Chart 1: Business Opinions Response Patterns

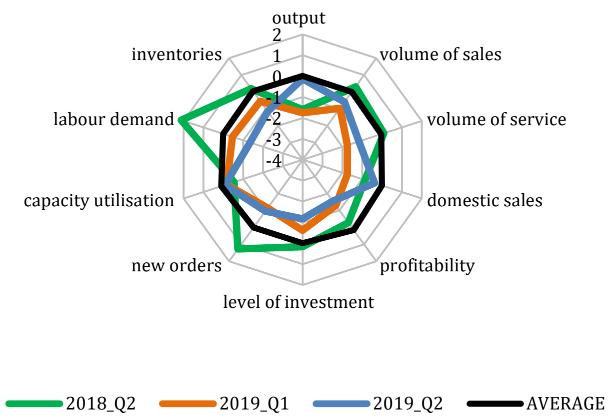
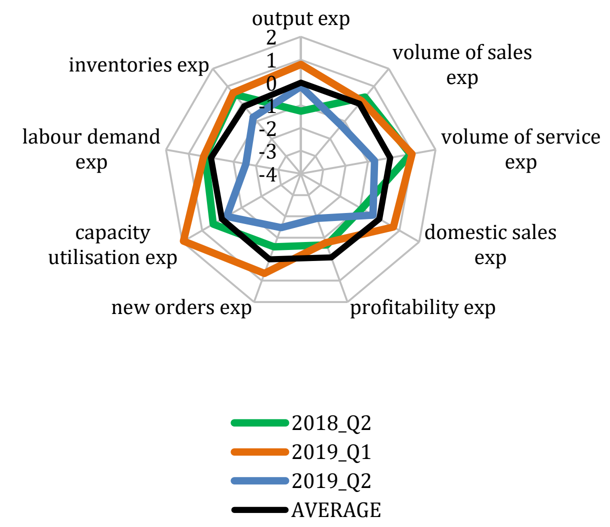


Chart 2: Business Expectations Response Patterns



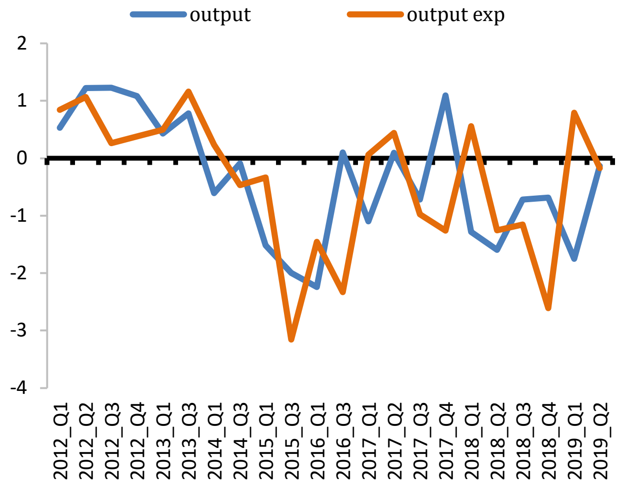
Q: What has been your firm's experience with respect to output?

(Net balance, -6.2%; Q1 2019, -29.3%)

Although output remained subdued during the second quarter of 2019, there were improvements attributed largely to the commencement of the agriculture-harvesting season, which increased the supply of raw materials in the manufacturing sector (Chart 3).

In the third quarter, output is expected to decline owing to subdued demand for local products in the manufacturing sector as well as the off-harvest season in agriculture.

Chart 3: Opinion on Output

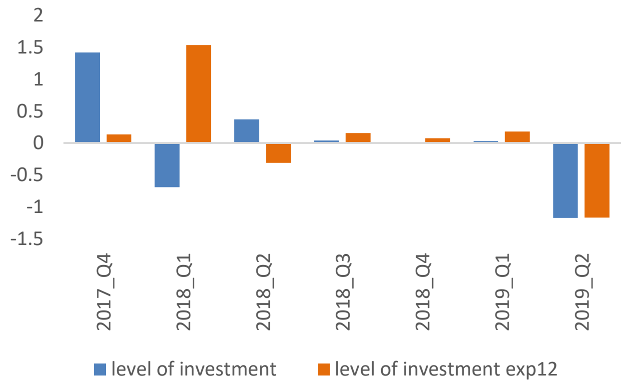


Q: How was your firm's level of investment?

(Net balance, 0.0%; Q1 2019, 3.3%)

Total investment declined[1] during the second quarter of 2019 compared with the first quarter. High cost of doing business coupled with subdued demand attributed to liquidity constraints were cited as the main factors affecting investment (Chart 4).

Chart 4: Level of investment



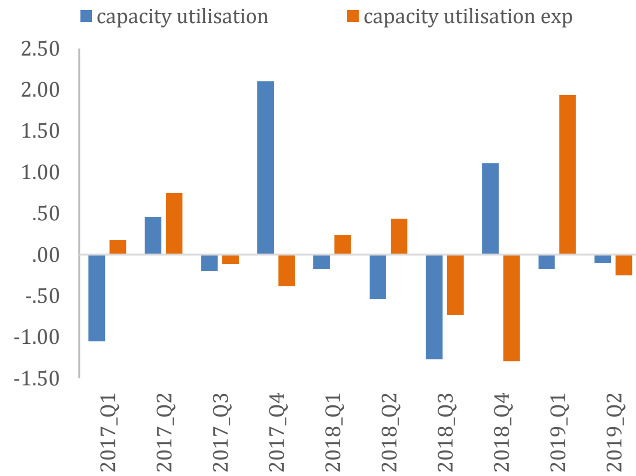
Q: What has been your firm's experience with respect to capacity utilisation?

(Net balance, -13.5%; Q1 2019, -14.3%)

Although capacity utilisation remained below the long-term average, some improvements were reported during the quarter under review, mainly driven by an increase in new orders and supply of raw materials for manufacturing during the harvesting period (Chart 5).

Capacity utilisation is expected to deteriorate in the third quarter of 2019 due to the anticipated fall in output attributed to electricity load maintenance.

Chart 5: Capacity Utilisation



1 The observed net balance is standardised in our analysis to allow for comparison over time. Accordingly, a net balance of 0.0 when standardized, given the long-term average and standard deviation, is equivalent to -1.17, as in Chart 4.

Q: What has been your firm's experience with respect to the volume of service?

(Net balance, -27.9%; Q1 2019, -38.5%)

Although the volume of service remained below the long-term average, most respondents reported an improvement during the second quarter of 2019 compared to the first quarter (Chart 6). This was mainly on account of increased tourism activities during the tourism peak season.

The volume of service is expected to decline in the third quarter of 2019 as costs are expected to increase owing to the electricity shortages, anticipated depreciation of the Kwacha, and should the sales tax be implemented.

Q: What has been your firm's experience with respect to the volume of sales?

(Net balance, -49.2%; Q1 2019, -66.1%)

The volume of sales remained below the long-term average during the second quarter of 2019, although most respondents reported an improvement (Chart 7). The improvement was mainly due to promotional sales during the Easter period in the merchant sector. An increase in incomes following the commencement of the crop-marketing season also boosted demand, which in turn contributed to the increase in the volume of sales.

Most respondents expect the volume of sales to decrease in the third quarter as prices could rise largely on account of an anticipated depreciation of the Kwacha against the US dollar, introduction of the sales tax, end of sales promotions after the Easter period and liquidity constraints.

Chart 6: Volume of Service

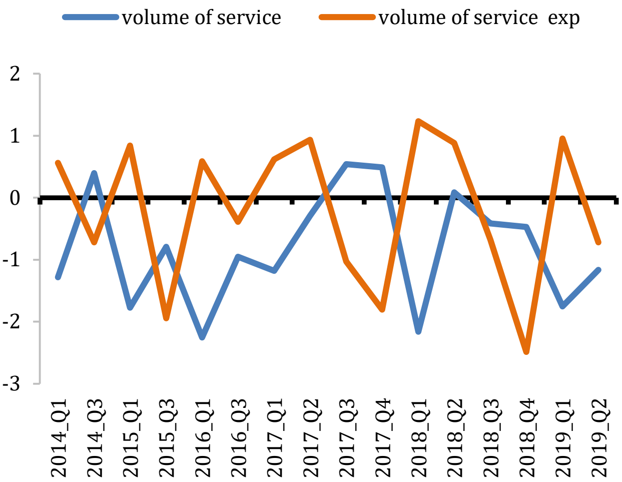
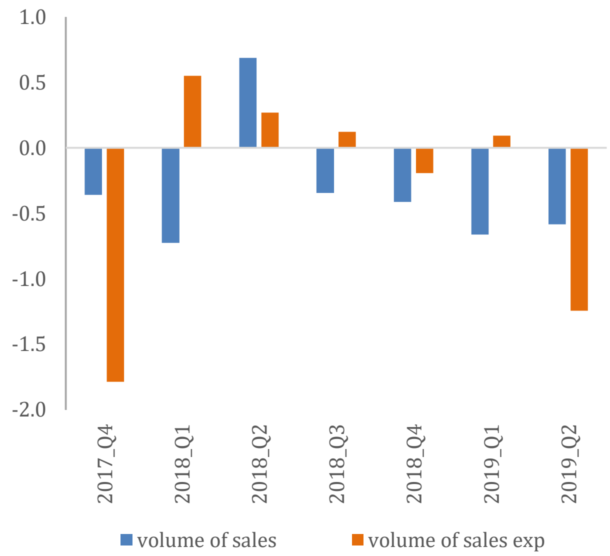


Chart 7: Volume of Sales



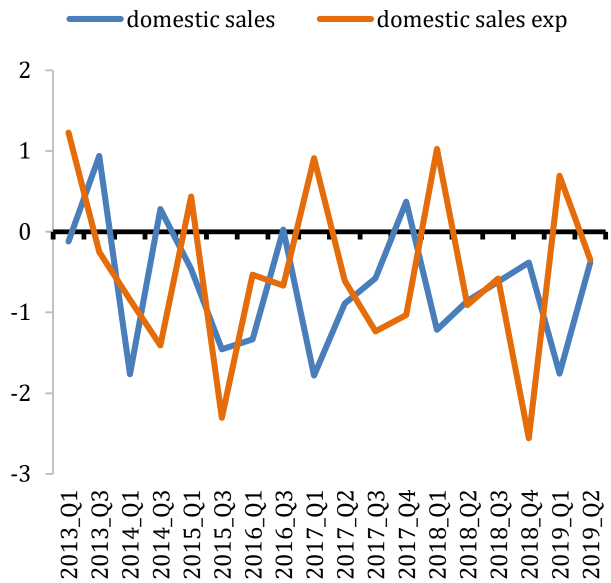
Q: What has been your firm's experience with respect to domestic sales?

(Net balance, -12.5%; Q1 2019, -35.2%)

Although domestic sales remained below the long-term average, most respondents reported an increase during the second quarter of 2019 in line with improvements in output and the volume of sales (Chart 8). The commencement of the agriculture harvest season was cited as the main factor explaining the rise in domestic sales.

In contrast, a decline in domestic sales is anticipated during the third quarter of 2019 largely on account of the effects of foot and mouth disease (FMD) for livestock farmers in the agriculture sector as well as general liquidity constraints in the economy.

Chart 8: Domestic Sales



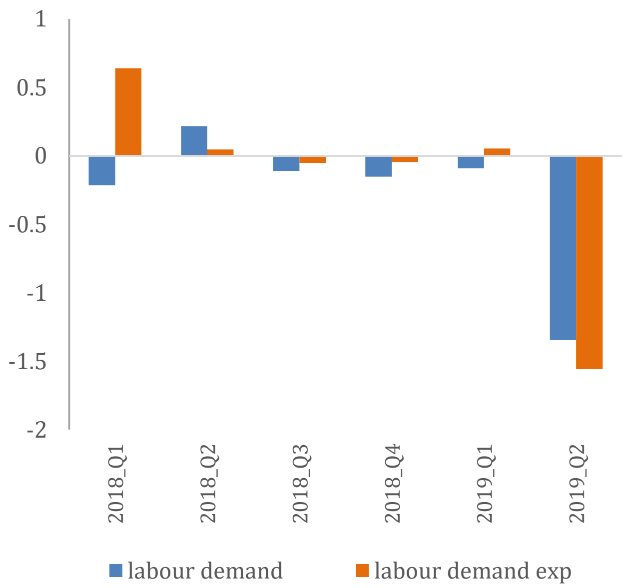
Q: How do you rate your firm's labour demand?

(Net balance, -19.8%; Q1 2019 -9.2%)

Despite the commencement of the harvest and tourism peak seasons in the agriculture and tourism sectors, respectively, labour demand significantly declined during the second quarter of 2019. This was largely due to poor crop performance owing to the dry spell experienced in the 2018/2019 agriculture season. In addition, an increase in redundancies due to the recent upward adjustment in the minimum wage coupled with liquidity constraints in the economy contributed to the fall in labour demand (Chart 9).

A further decrease in labour demand is anticipated in the third quarter of 2019 mainly due to the expected depreciation of the Kwacha against the US Dollar, a decline in manufacturing output due to electricity load maintenance and uncertainties surrounding the implementation of the sales tax.

Chart 9: Labour Demand



Q: What is your current main source of investment finance and working capital?

Retained earnings continued to be the main source of financing

Most respondents indicated that retained earnings remained the main source of investment finance and working capital, with 71.8% and 68.3% response rates compared with 68.3% and 74.1% in the previous quarter, respectively. This was followed by bank borrowing, as the main source of investment finance and working capital, at 14.9% (14.6%) and 16.7% (14.6%), respectively (Charts 10A and 10B).

Chart 10A: Sources of Investment Finance

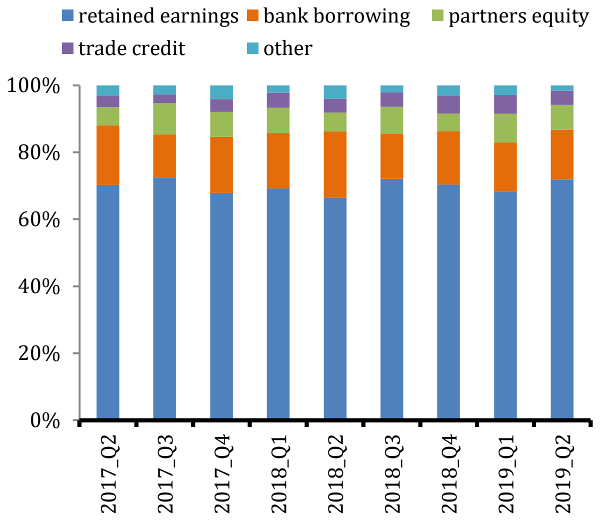
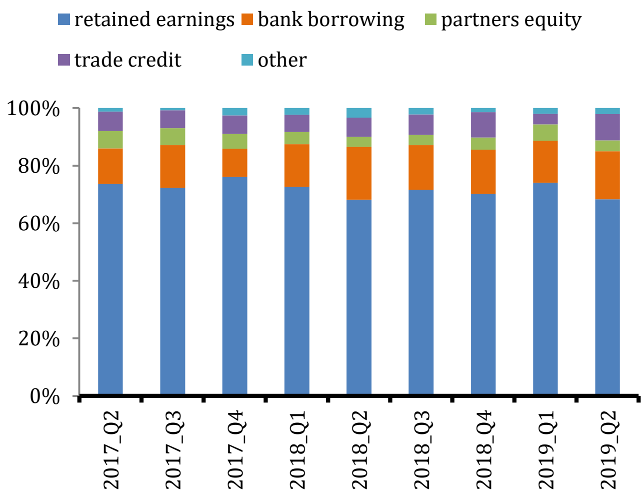


Chart 10B: Sources of Working Capital

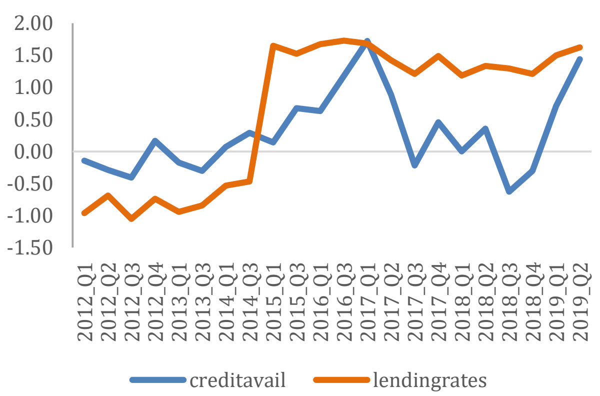


Q: What is your perception of the current availability of credit?

(Net balance, 75.4%; Q1 2019, 69.3%)

Credit conditions were reported to have tightened further during the second quarter compared to the first quarter of 2019 (Chart 11). This was largely on account of the upward adjustment in the monetary Policy Rate, tight liquidity, higher commercial banks' lending rates, and stringent collateral requirements by lending institutions.

Chart 11: Credit Availability and lending Rates



1.1.1.1

II EVOLUTION OF COSTS, WAGES AND PRICES

Q: What has been your firm's experience during the quarter under review with respect to average input costs?

(Net balance, 32.3%; Q1 2019, 36.9%)

During the second quarter of 2019, average input costs remained high, albeit lower than the levels reported in the previous quarter (Chart 12). This was largely on account of the depreciation of the Kwacha against the US dollar, rising inflationary pressures, and electricity shortages.

Average input costs are also expected to remain high in the third quarter of 2019 mainly on account of the anticipated continued depreciation of the Kwacha against the US dollar and the expected introduction of the sales tax.

Q: What has been your firm's experience with respect to the wage bill?

(Net balance, 7.5%; Q1 2019, 16.3%)

Most respondents reported a decline in the wage bill during the second quarter of 2019 (Chart 13). Largely explaining the decline were job cuts induced by higher cost of doing business owing to the rise in exchange rate and reduced demand associated with tight liquidity in the economy.

The decline in the wage bill is expected to continue in the third quarter of 2019 largely on account of an anticipated depreciation of the Kwacha against the US dollar, which would subsequently lead to increased cost of doing business. In addition, liquidity conditions are expected to remain tight, thereby constraining demand in the wholesale and retail sector. These factors are ultimately expected to result into job cuts.

Chart 12: Average input costs

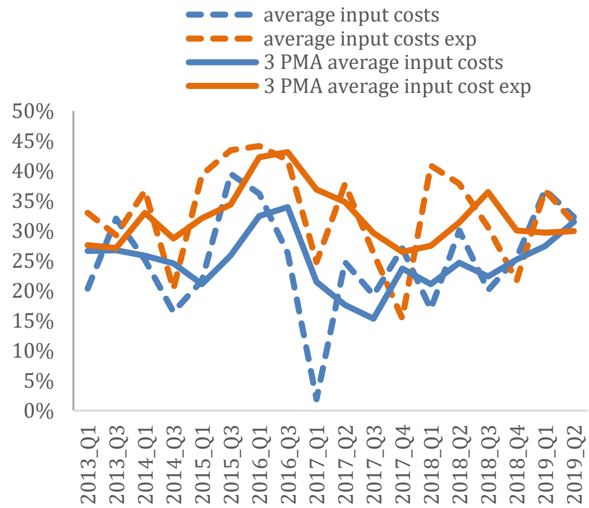
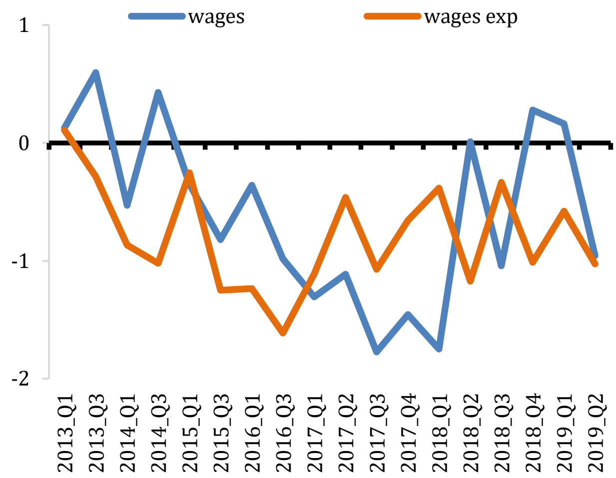


Chart 13: Evolution of wages



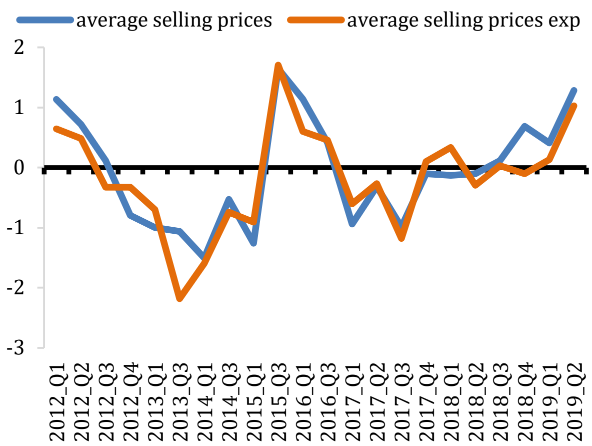
Q: What has been your firm's experience during the quarter under review with respect to average selling prices?

(Net balance, 23.9%; Q1 2019, 8.6%)

Average selling prices increased during the second quarter compared to the first quarter 2019 (Chart 14). This was mainly due to the depreciation of the Kwacha against the US dollar, the upward adjustment in the monetary Policy Rate and low supply of agricultural raw materials for milling companies.

During the third quarter, average selling prices are expected to continue to rise mainly on account of the anticipated depreciation of the Kwacha against the US dollar and the expected introduction of sales tax.

Chart 14: Evolution of average selling prices



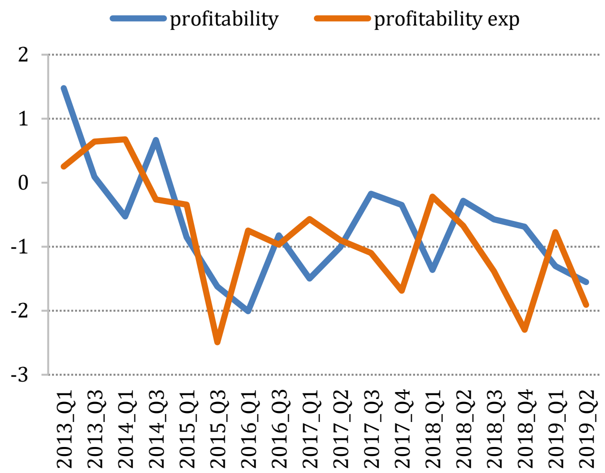
Q: What has been your firm's experience with respect to profitability?

(Net balance, -47.9%; Q1 2019, -42.7%)

Profitability continued to decline during the second quarter of 2019 (Chart 15) mainly on account of the depreciation of the Kwacha against the US dollar, high cost of inputs and depressed demand across sectors owing to tight liquidity conditions.

In the third quarter, profitability is expected to decline further mainly on account of the likely implementation of the sales tax and the anticipated rise in the Kwacha exchange rate. In addition, tight credit conditions are expected to continue, thereby depressing demand.

Chart 15: Profitability



III EXPECTATIONS OF MONETARY POLICY FOR THIRD QUARTER OF 2019

Inflationary pressures, tighter credit conditions, higher lending rates and a depreciated Kwacha exchange rate are anticipated for the third quarter of 2019 (Chart 16).

Q: What do you expect the price level to be over the next quarter?

(Net balance, 64.5%; Q1 2019, 51.1%)

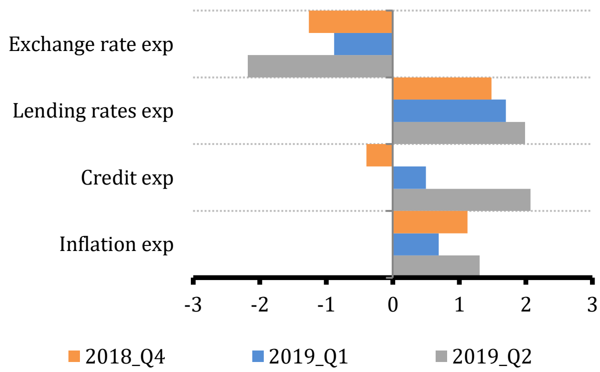
Inflationary pressures are expected to build up in the third quarter of 2019 (Chart 17). This is largely expected to be driven by the high cost of inputs attributed to the depreciation of the Kwacha, introduction of sales tax, and continued electricity load maintenance.

Over the next 12 months, inflationary pressures are expected to persist. This is mainly on account of anticipated further depreciation of the Kwacha and rising lending rates.

Q: Which is the main factor explaining your expectations of inflation?

Inflationary pressures are expected to be largely driven by the depreciation of the Kwacha, followed by past prices, and higher cost of production (Chart 18).

Chart 16: Expectations for rising inflation, weak Kwacha and high 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 (-)

Chart 17: Inflation rate expectations next quarter

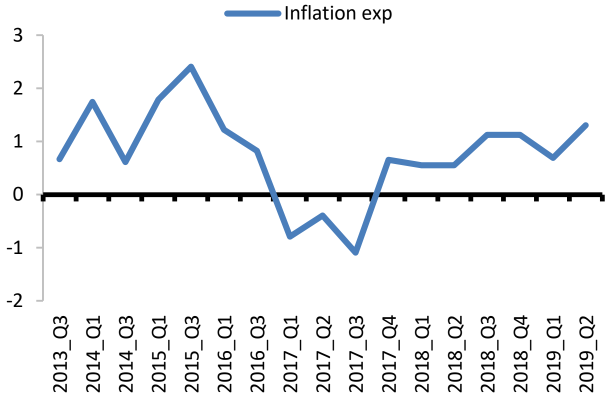
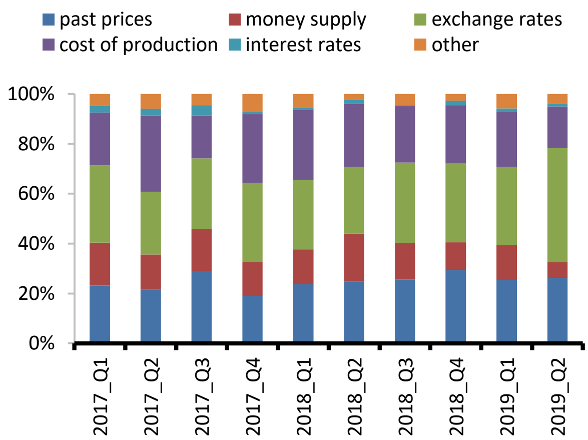


Chart 18: Inflationary expectations mainly driven by the exchange rate and cost of production



Q: How do you expect the performance of the Zambian Kwacha against the US dollar to be at the end of the next quarter?

(Net balance, -76.5%; Q1 2019, -40.8%)

Most respondents expect the Kwacha to depreciate against the US dollar in the third quarter 2019 (Chart 19). This is mainly on account of declining foreign exchange reserves attributed to high external debt service, low export earnings, low copper prices as well as negative external investors' perceptions of the economy. In addition, high import demand owing to a reduction in local manufacturing output is expected to create an upsurge in demand for foreign exchange.

Q: Over the next quarter, what do you expect credit availability to be?

(Net balance, 77.3%; Q1 2019, 62.4%)

Tighter credit conditions are anticipated by the majority of respondents during the third quarter in comparison to the second quarter of 2019 (Chart 20). This is largely attributed to the rise in interest rates following the upward adjustment in the monetary policy rate, stringent collateral requirements as well as high Government borrowing.

Q: Over the next quarter, what do you expect to happen to commercial banks' lending rates?

(Net balance, 84.4%; Q1 2019, 75.0%)

A further rise in lending rates is anticipated during the third quarter of 2019 (Chart 21). Most respondents attributed this to the upward adjustment in the Bank of Zambia Policy Rate, Depreciation of the Kwacha, rising inflationary pressures, high Government domestic borrowing and increasing non-performing loans.

Chart 19: Exchange rate expectations next quarter

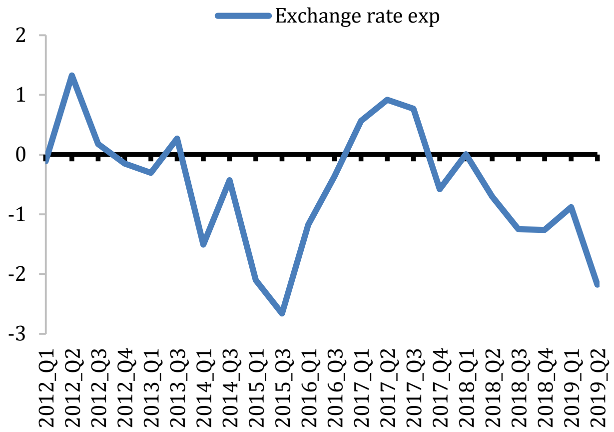


Chart 20: Credit availability expectations next quarter

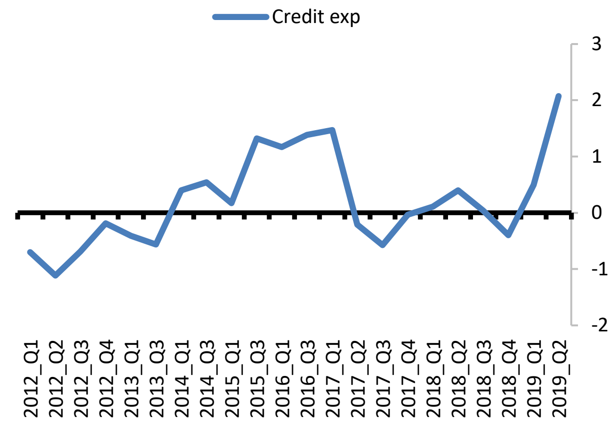
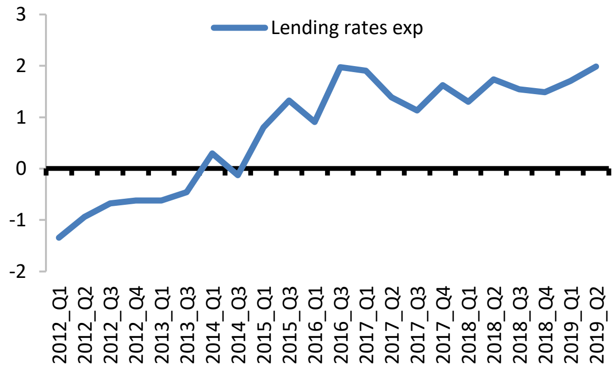


Chart 21: Interest rate expectations next quarter

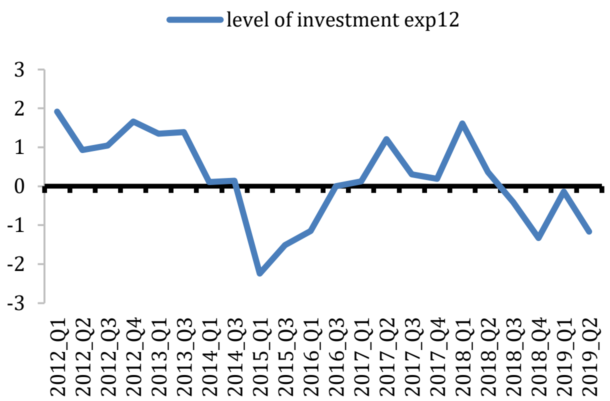


Q: Over the next 12 months, what do you expect the level of investment to be?

(Net balance, 9.1%; Q1 2019, 17.9%)

Over the next 12 months, a decline in the level of investment is anticipated mainly on account of the expected fall in demand due to tight liquidity. The change in the monetary Policy Rate coupled with the depreciation of the Kwacha against the US dollar are expected to increase the cost of doing business, thereby dampening investment in the economy (Chart 22).

Chart 22: Level of Investment in the next 12 months

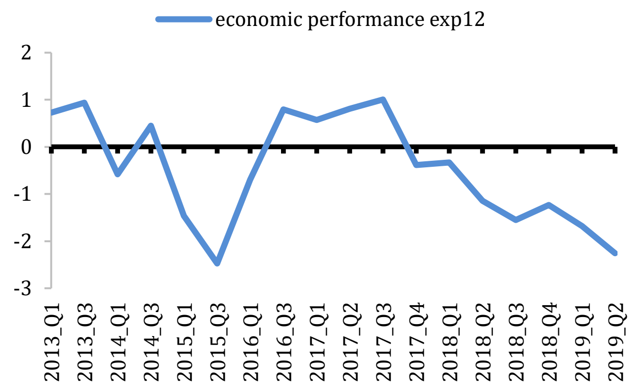


Q: What is your expectation of the performance of the economy in the next 12 months?

(Net balance, -32.6%; Q1 2019, -19.2%)

Sentiments about the performance of the economy over the next 12 months remain negative as further deterioration in economic activity is anticipated by most respondents (Chart 23). This is largely due to the high cost of doing business, attributed mainly to electricity shortages, volatility in the exchange rate, high Government borrowing and high tax burdens. In addition, high commercial banks' lending rates, rising inflationary pressures and low external investor confidence are expected to negatively impact on economic activity.

Chart 23: Economic performance in the next 12 months



IV CONCLUSION

The Survey of Business Opinion and Expectations conducted between May and June 2019 revealed a slight improvement in economic performance during the second quarter in comparison to the first quarter 2019. Although subdued, improved economic activity was noted, especially in the agriculture and tourism sectors

Looking ahead, expectations of a deterioration in economic activity in the third quarter 2019 remain elevated. This is largely associated with the high cost of doing business mainly attributed to the depreciation of the Kwacha, impending implementation of the sales tax, electricity load maintenance and liquidity constraints.

Inflationary pressures are expected to heighten mainly due to the expected introduction of sales tax, electricity load maintenance and the depreciation of the Kwacha. The anticipated depreciation of the Kwacha is on the back of declining foreign exchange reserves largely due to high external debt service and rising import demand. As a consequence of higher inflation expectations, coupled with a weaker Kwacha, the recent upward adjustment in the monetary Policy Rate and higher Government borrowing, respondents expect higher lending rates and tighter credit conditions to prevail in the third of 2019.

Over the next 12 months, it is anticipated that economic performance will continue deteriorating largely on account of electricity load maintenance, high tax burdens, low external investor confidence, high Government borrowing, exchange rate volatility as well as high lending and inflation rates.

Appendix: Survey Methodology

Data collection for the Quarterly Survey of Business Opinions 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 12 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.