



BANK Of ZAMBIA

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

Second Quarter 2017, Vol 1.2

Disclaimer:

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

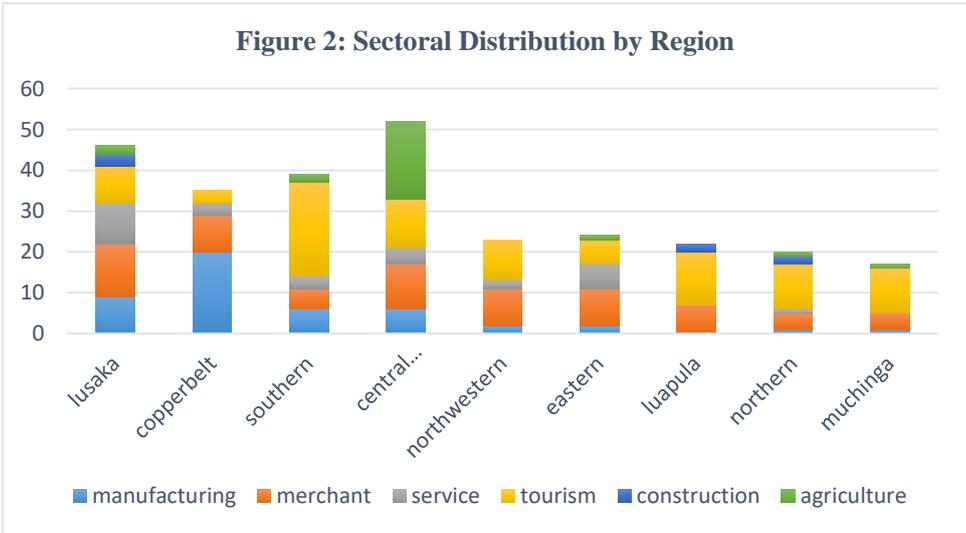
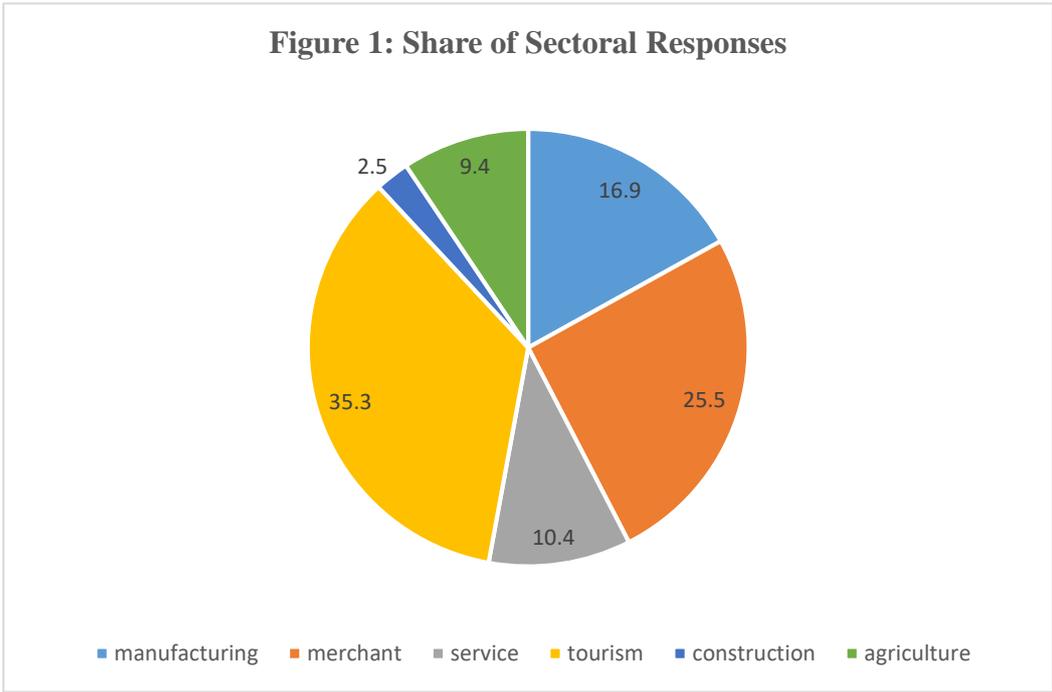
AUGUST 2017

PREFACE

Business surveys provide useful indicators of current and future economic activity and assist in the formulation of decisions today that impact on future economic performance.

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 for macroeconomic analysis. Business opinions and expectations provide a guide to likely developments because of the dominant role expectations play in shaping economic behavior.

This Report is based on the results of the QSBOE conducted from May - June 2017. Out of the 313 questionnaires distributed, 278 firms responded, representing a response rate of 88.8%.



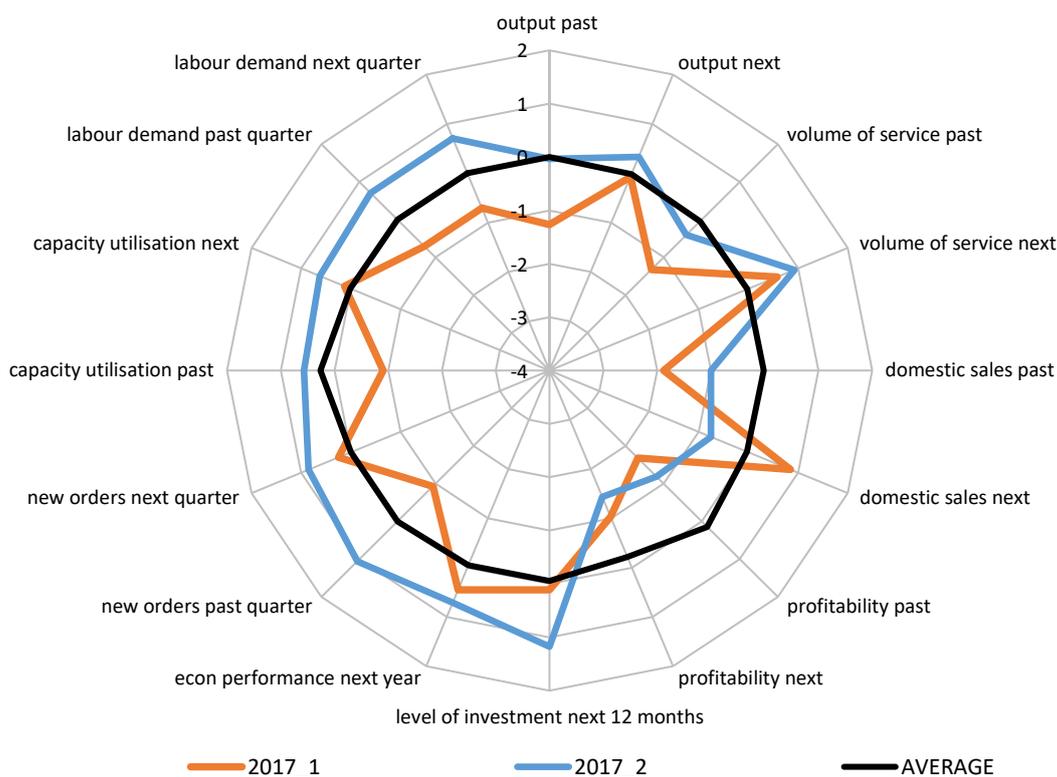
Executive Summary¹

According to the Business Opinions and Expectations Survey, economic activity improved during the second quarter of 2017, with most variables above historical averages. Higher output and capacity utilisation were reported by most businesses, mainly on account of increased maize and soya beans production on the back of a good rainy season, and increased investment in the manufacturing sector. Accordingly, domestic sales increased. An improvement in the volume of tourism services was also recorded, owing to the start of the tourism season and lower charges following the appreciation of the exchange rate. In addition, the easing of monetary policy contributed to an improvement in the volume of banking services.

Outlook for the third quarter indicated higher output and capacity utilisation on account of the bumper harvest in the current agricultural season. Moreover, most respondents were of the view that labour demand and volume of service would increase due to the peak tourism season. Domestic sales would remain lower than the historical average. Profitability is expected to be lower than the previous quarter on account of lower domestic sales and higher average input costs, related mainly to the upward adjustment in electricity tariffs.

Inflationary pressures are therefore anticipated to rise during the third quarter, mainly attributed to higher electricity tariffs. Further, loose credit conditions are expected following the easing in monetary policy in May 2017. The Kwacha exchange rate against the US Dollar is expected to strengthen, largely on account of higher global copper prices, increased mining output and exports.

Overall Survey Response Patterns*



¹ This Report presents findings of the Quarterly Survey of Business Opinions and Expectations conducted during the second quarter of 2017. Previously this Survey was conducted bi-annually. The results are based on responses from 278 firms covering manufacturing, merchants, tourism and services, agriculture and construction sectors, thus representing a response rate of 88.8%.

**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*

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 second quarter of 2017 and expectations for the third quarter, while section II presents opinions and expectations on input costs, wages and selling prices, among other variables. Section III provides perceptions on monetary policy for the third quarter and section IV provides the general conclusion.

I. Opinions and Expectations of Economic Activity

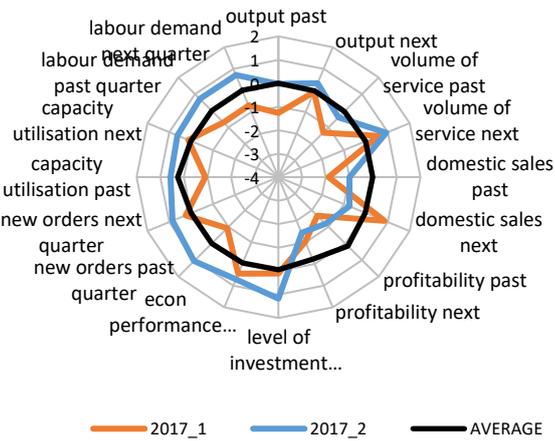
Economic Activity improved...

The overall response pattern from the survey for the second quarter of 2017, showed a general improvement in economic activity, with capacity utilisation, labour demand, output and new orders positioned above the historical average (see Chart 1). However, despite an improvement, volume of service, domestic sales and profitability remained below the historical average.

Over the third quarter, capacity utilization, labour demand, output, volume of service and new orders are expected to improve.

Overall economic performance is expected to improve in the next 12 months,.

Chart 1: Business Opinions & Expectations 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.*

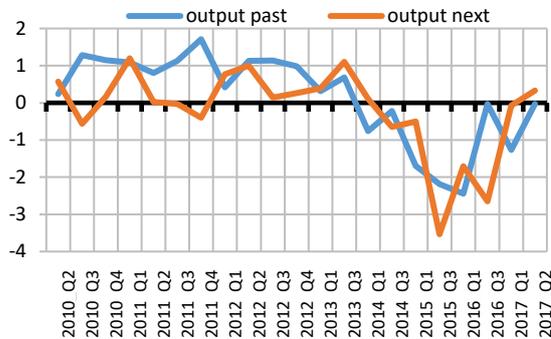
Output improved in Q2 2017...
(net balance -2.9%, Q1 2017 -20.0%)

Overall output improved during the second quarter of 2017, mainly due to increases in maize and soya beans production, following a favourable rainy season as well as an increase in investment in the manufacturing sector (see Chart 2).

Respondents were expectant that output, especially in the manufacturing sector, would improve during the third quarter of 2017 mainly supported by the bumper harvest recorded in the current agricultural season.

In the second quarter, domestic sales improved in both manufacturing and agriculture sectors, although below the historical average. This was mainly on account of increased agricultural production in the 2016/2017 agricultural season.

Chart 2: Opinion on Output

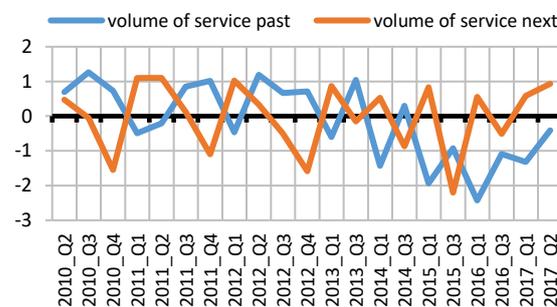


Volume of Service improved...
(net balance -12.3%, Q1 2017 -28.2%)

The volume of service improved during the second quarter, albeit below the historical average. This was mainly attributed to reduced charges in the tourism sector on account of the appreciation of the Kwacha exchange rate and easing of monetary policy in the banking sector (see Chart 3).

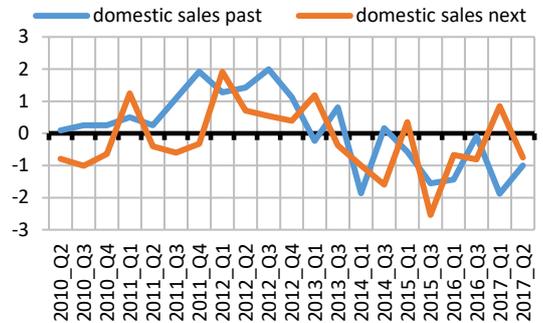
Most respondents anticipate an improvement in the volume of service during the third quarter, largely on account of the peak tourism season.

Chart 3: Volume of Service



Domestic Sales improved...
(net balance -20.9%, Q1 2017 -35.6%)

Chart 4: Domestic Sales



In the third quarter, however, domestic sales are expected to decline owing mainly to the seasonal reduction in agricultural marketing activities (see Chart 4).

Labour demand increased...
(net balance 3.8%, Q1 2017 -4.4%)

Labour demand increased during the second quarter, owing to new investments and increased capacity utilization, particularly in the manufacturing sector.

In the third quarter, it is anticipated that demand for labour will increase, with a net balance of 11.5% compared to 7.9% projected for the second quarter. This is largely on account of the peak tourism season.

Retained earnings remained main source of financing...

Firms' retained earnings remained the main source of investment finance and working capital in the second quarter, as 70.3% and 73.6% of respondents indicated compared with 66.7% and 70.9%, respectively, in the first quarter. Commercial bank borrowing remained the second largest source of investment finance and working capital, as

17.8% (18.2%, Q1) and 12.4% (15.9%, Q1) of respondents indicated.

Chart 5A: Sources of Investment Finance

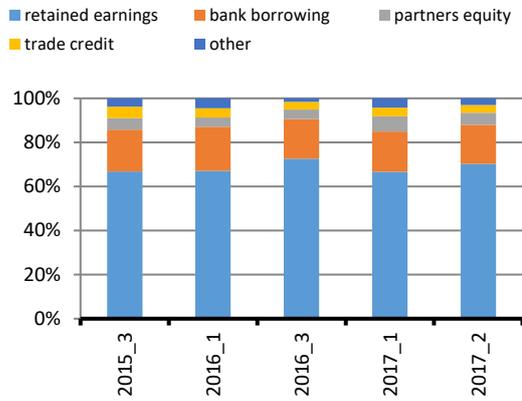
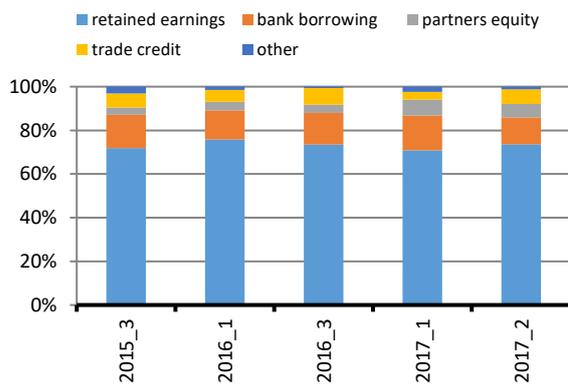


Chart 5B: Sources of Working Capital



Investment to continue rising in the medium term...

(net balance 29.4%, Q1 2017 20.2%)

Investment spending is expected to increase over the next 12 months (see Chart 6) in order to increase production and expand customer base, as well as to replace obsolete plant and machinery.

Chart 6: Investment plans in next 12 months

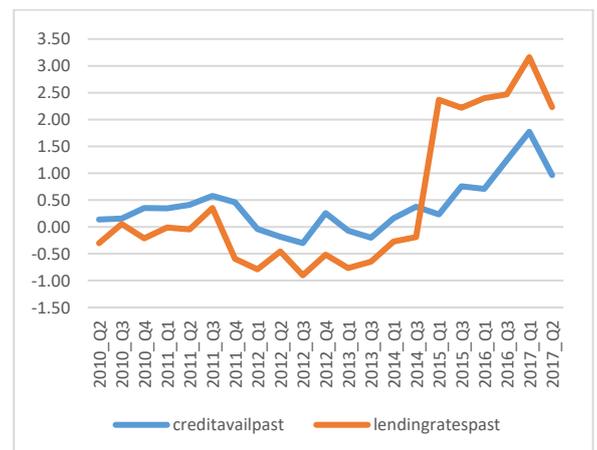


Credit conditions loosened

(net balance 55.8%, Q1 2017 73.2%)

Following the reduction in the BoZ policy rate and easing in monetary policy in May 2017, respondents expect credit conditions to loosen in the third quarter (see Chart 7).

Chart 7: Credit conditions and lending rates



II Evolution of Costs, Wages and Prices

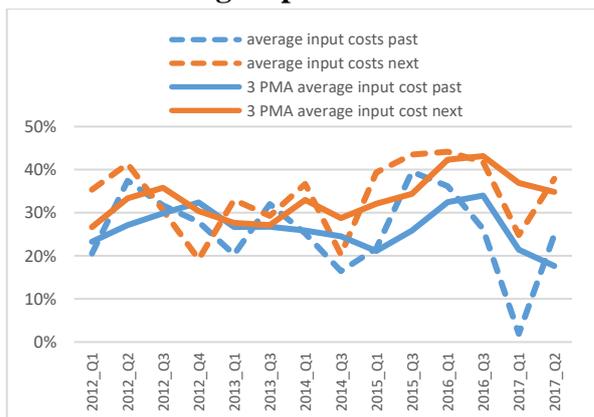
Input Costs higher....

(net balance 24.8%, Q1 2017 1.9%)

During the quarter under review, average input costs increased, as indicated by most respondents (see Chart 8). The upward adjustment in electricity tariffs, increase in council rates and the introduction of skills development levy (effective 1 January 2017) were cited as the major factors explaining the rise in input costs.

In the third quarter, it is anticipated that higher electricity tariffs will have an impact on the cost of raw materials, thereby increasing average input costs, as reflected in the net balance of 37.8% (24.8%).

Chart 8: Average input costs



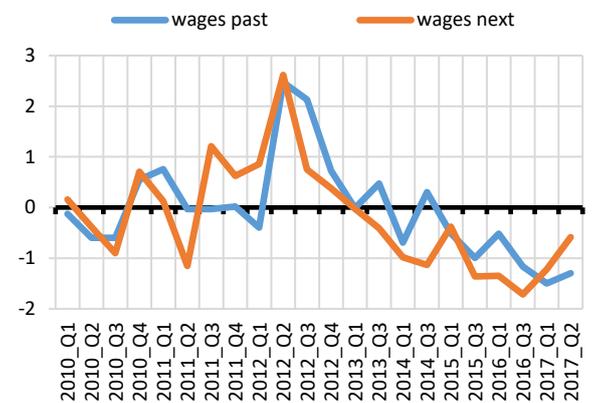
Wages increased...

(net balance 6.3%, Q1 2017 4.8%)

Wages increased during the second quarter, as shown by the balance of responses. This was mainly attributed to staff recruitments, business expansion and annual collective agreements.

In the third quarter, wages are expected to rise (see Chart 9), owing to annual upward adjustment of salaries and a rise in the number of employees due to seasonal factors. This was evidenced by a net balance of 19.5% compared with 13.8% in the first quarter of 2017.

Chart 9: Evolution of wages



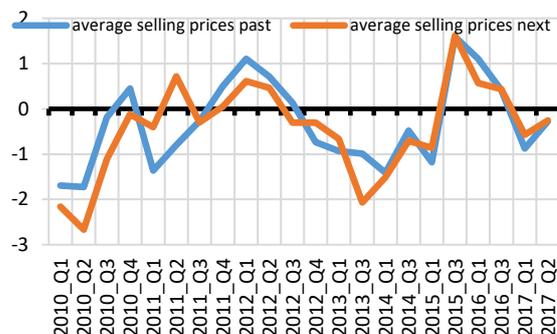
Selling Prices increased...

(net balance -4.1%, Q1 2017 -15.1%)

The number of respondents indicating a rise in selling prices increased, as reflected in the net balance (see Chart 10). This was mainly attributed to increased input costs, especially electricity tariffs, as well as the recently introduced tourism levy (effective 1st March 2017).

In the third quarter, most respondents expect a rise in selling prices, as evidenced by the net balance of 4.5% compared to -1.5% in the first quarter of 2017. This is due to the anticipated increase in input costs as electricity tariffs are scheduled for further revision in September 2017.

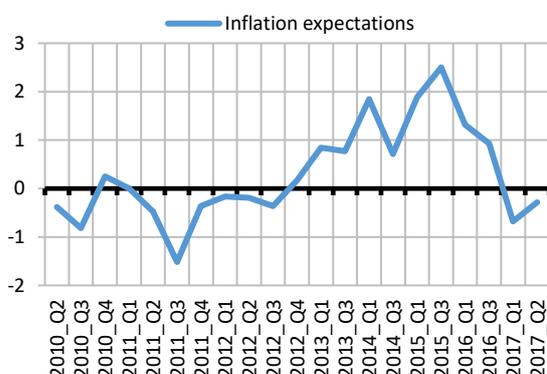
Chart 10: Evolution of average selling prices



additional increase in electricity tariffs by 25% in September 2017.

III Expectations on Monetary Policy for Second quarter

Inflationary pressures to increase
(net balance 27.2 %, Q1 2017 18.5%)

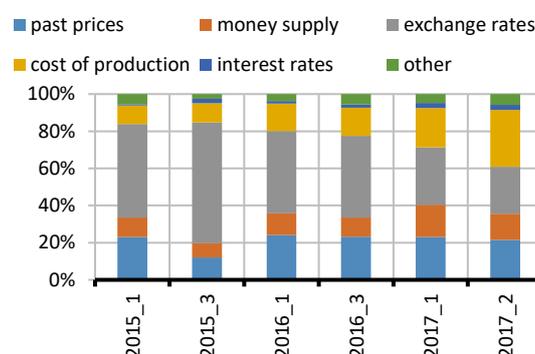


Inflationary pressures in the third quarter are expected to emanate from the pass through effects of the upward adjustment in electricity tariffs in May 2017 and the anticipated increase in September 2017 (see Charts 11 & 12).

Cost of production was indicated as the main driver of inflationary expectations for the third quarter by 30.6% (21.2%, Q2) of respondents, followed by the exchange rate at 25.1% (31.0%, Q2); past prices, 21.6% (23.1%, Q2) by; money supply, 14.1% (17.3%, Q2); and other factors, 5.9% (4.7%, Q2) while interest remained at 2.7%.

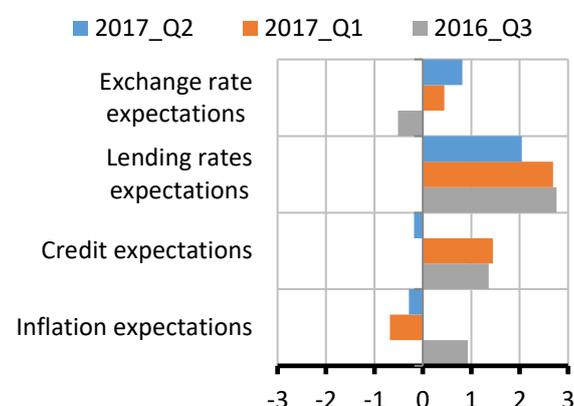
Over the next 12 months, inflationary pressures are expected on account of the likely removal of subsidies, if a programme is agreed with the IMF, and the proposed

Chart 11: Inflation expectations mainly driven by cost of production and exchange rates and less by interest rates.



Respondents expect an appreciation in the exchange rate, lower lending rates, loose credit conditions and higher inflation (see Chart 12).

Chart 12: Expectations of higher inflation, stronger exchange rate, and loose credit with lower interest rates



Notes:

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

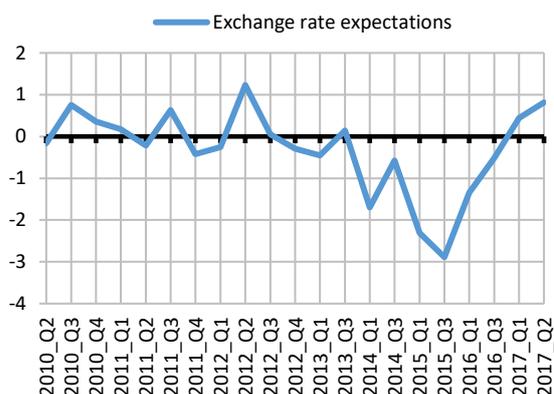
- Inflation expectations = increase, high (+)/decrease, low (-)

Kwacha Exchange rate against US dollar to strengthen further

(net balance 8.6%, Q1 2017 -1.2%)

Based on prospects of higher global copper prices, increased mining activities and increased export earnings, the Kwacha exchange rate against the US dollar is expected to appreciate in the third quarter (see Chart 13). In addition, possible maize exports are expected to contribute to a stronger exchange rate of the Kwacha against the dollar.

Chart 13: Exchange rate expectations next quarter



Interest Rates to decline.....

(net balance 64.6%, Q1 2017 81.7%)

Commercial banks’ lending rates are expected to decline in the third quarter, although they would remain above the historical average (see Chart 12). The decline is attributed to the easing in monetary policy, particularly the reduction in the BoZ policy rate.

Chart 14: Interest rate expectations next quarter



IV Conclusion

During the second quarter of 2017, the Business Opinions and Expectations Survey revealed an improvement in economic performance, as most variables were above historical averages.

Output increased, as evidenced by the rise in agricultural output. Further, capacity utilisation in the manufacturing sector went up, leading to a rise in labour demand and domestic sales. A higher volume of services in the tourism sector was reported mainly on account of the start of the tourism season and lower charges following the appreciation of the exchange rate. In the banking sectors, the reduction in the BoZ policy rate in May 2017 contributed to an improvement in the volume of services. Subsequently, profitability increased.

Businesses anticipate an improvement in economic activity during the third quarter, mainly premised on the bumper harvest in the agriculture sector.

Merchants expect an increase in labour demand due to an anticipated growth in business activity, as the agricultural marketing season progresses. In the tourism sector, the volume of service is expected to increase due to increased tourism activities during the peak season.

With regard to monetary policy, a rise in inflation is expected following the scheduled upward adjustment in electricity tariffs in September 2017 and the anticipated loosening in credit conditions, mainly attributed to the reduction in the BoZ policy

rate. Accordingly, commercial banks' lending rates are expected to decline. The Kwacha exchange rate against the US Dollar is expected to appreciate on account of rising copper prices on the international market as well as an anticipated rise in mining output and mineral exports.

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:

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

Appendix I: Background on the QSBOE

This Report is based on the results of the QSBOE conducted from May - June 2017. Out of the 313 questionnaires distributed, 278 firms responded, representing a response rate of 88.8%.

Of the 278 respondents, 35.3% were from tourism, merchants (25.5%), manufacturing (16.9%), services (10.4%), agriculture (9.4%) and construction (2.5%).

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, 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

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.