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Zambia—Fourth Review Under the Three-Year Arrangement Under the Extended Credit Facility, Requests for Waiver of Nonobservance of Performance Criteria and Modification of Performance Criteria, and Financing Assurances Review

The following documents have been released and are included in this package:

- The staff report, prepared by a staff team of the IMF, following discussions that ended on March 2, 2010, with the officials of Zambia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on June 10, 2010. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A supplement to the staff report.

- A press release on the Executive Board discussion.

- A statement by the Executive Director for Zambia.

The document(s) listed below will be separately released.

- Letter of Intent sent to the IMF by the authorities of Zambia*
- Memorandum of Economic and Financial Policies*
- Technical Memorandum of Understanding*

*Also included in staff report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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ZAMBIA

Fourth Review Under the Three-Year Arrangement Under the Extended Credit Facility, Requests for Waiver of Nonobservance of Performance Criteria and Modification of Performance Criteria, and Financing Assurances Review

Prepared by the African Department
(In consultation with other departments)

Approved by Seán Nolan and Dhaneshwar Ghura

June 10, 2010

Discussions: February 18–March 3, 2010 in Lusaka and April 22–24, 2010 in Washington, D.C. The staff team consisted of George Tsibouris (head), Nils Maehle, Alfredo Baldini, Perry Perone (Resident Representative) (all AFR), Ding Ding, Joong Beom Shin (both FAD), and Kazuko Shirono (SPR). The mission met with the Minister of Finance and National Planning, Dr. Musokotwane; the Governor of the Bank of Zambia, Dr. Fundanga; other senior officials; and representatives of the business community, civil society, and Zambia's development partners.

IMF relations: Zambia joined the Fund on September 23, 1965, and has accepted the obligations of Article VIII, Sections 2, 3, and 4. The third review under the Extended Credit Facility (ECF) arrangement and the 2009 Article IV consultation with Zambia were concluded in December 2009. Zambia's current three-year ECF arrangement was approved in June 2008.

Exchange rate regime: Zambia maintains a free-floating exchange rate regime.

In the attached letter of intent (LoI) and Memorandum of Economic and Financial Policies (MEFP), the authorities review program implementation and outline their policies for the rest of 2010 and over the medium term.

Contents Page

EXECUTIVE SUMMARY

Zambia's strong performance continues under the Extended Credit Facility (ECF) supported program and staff recommends completion of the fourth review.

- *All but one of the end-December 2009 quantitative performance criteria were met, and structural reforms are progressing.*

- *Aggregate output has held up well despite a sharp decline in copper prices in late 2008-early 2009*. GDP growth exceeded 6 percent in 2009, inflation declined to single digits by end-2009 and has declined further since, and the current account deficit has narrowed. The overall budget position in 2009 was broadly as targeted.

- *In the aftermath of exchange rate and copper price fluctuations, the financial sector's recovery has been slow*. Nonperforming loans have been increasing but there has been a recent improvement in banks' return on assets and equity. Banks have been increasing their capital and have ample liquidity. Tighter lending standards have led to a decline in credit to the private sector, and the resulting liquidity has led to a sharp drop in interest rates on government securities.

- *The economic outlook is positive.* Copper prices have strengthened, international reserves are higher than they have been in almost four decades, debt is moderate, and growth should remain strong. Credit to the private sector should gradually pick up, as broad-based economic activity gains strength.

- *The main risks include possible adverse developments in world copper and oil prices, and in aid inflows*.

The main macroeconomic policy challenge going forward is to increase growth further by creating fiscal space for expenditures that would enhance economic diversification and reduce Zambia's dependence on copper exports.

- *The 2010 budget focuses on harnessing domestically generated resources to support investment in infrastructure and human capital*. Current expenditures are to be curtailed, and domestic revenues are expected to recover somewhat. The overall fiscal stance remains appropriate and staff recommended channeling any additional fiscal revenues towards social and capital spending.

- *The authorities are committed to achieving full cost-recovery pricing of electricity by 2011.* Fuel prices have been increased to cost recovery levels.

- *Monetary policy appropriately targets a further reduction in underlying inflation*. Excess reserves should drain as private sector credit picks up.

I. Background and Program Performance

A. Weathering the Global Crisis: Strong Growth and Positive Outlook

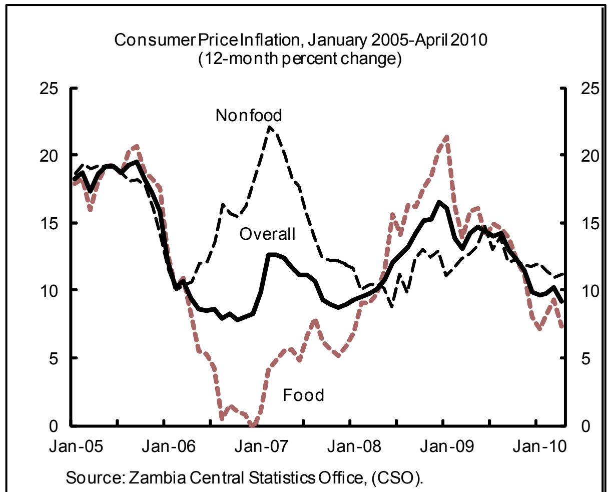
1. **The economy has been holding up well, despite a sharp decline in copper prices in late 2008 that has been largely reversed.**[1]

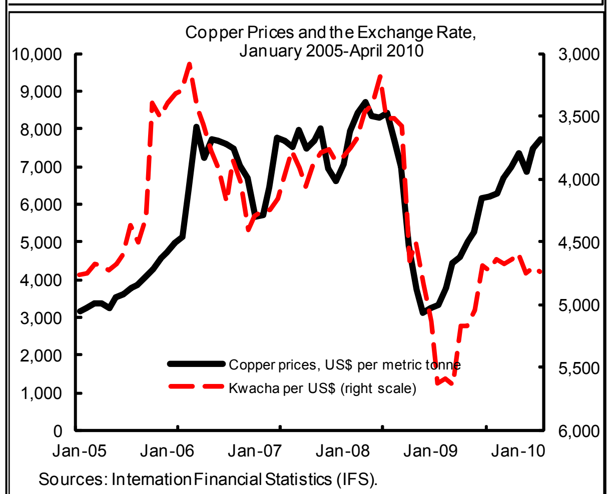
- **GDP growth** was more than 6 percent in 2009, boosted by the coming on-stream of a new copper mine, a bumper harvest, and strong construction activity.

- **Inflation declined to single digits by end-2009,** and has declined further in the first five months of 2010 despite a 15 percent domestic fuel price increase in January 2010.

- **The current account deficit has narrowed**, helped by a recovery of copper prices and import compression following a sharp depreciation of the kwacha in late 2008-early 2009 (Figure1).[2]

- **Tax revenues slowed in 2009** (Figure 2), primarily owing to import compression. The 2009 fiscal outturn was largely as anticipated at the time of the third ECF review. To protect domestically financed capital spending, domestic borrowing was increased by 0.4 percentage points.





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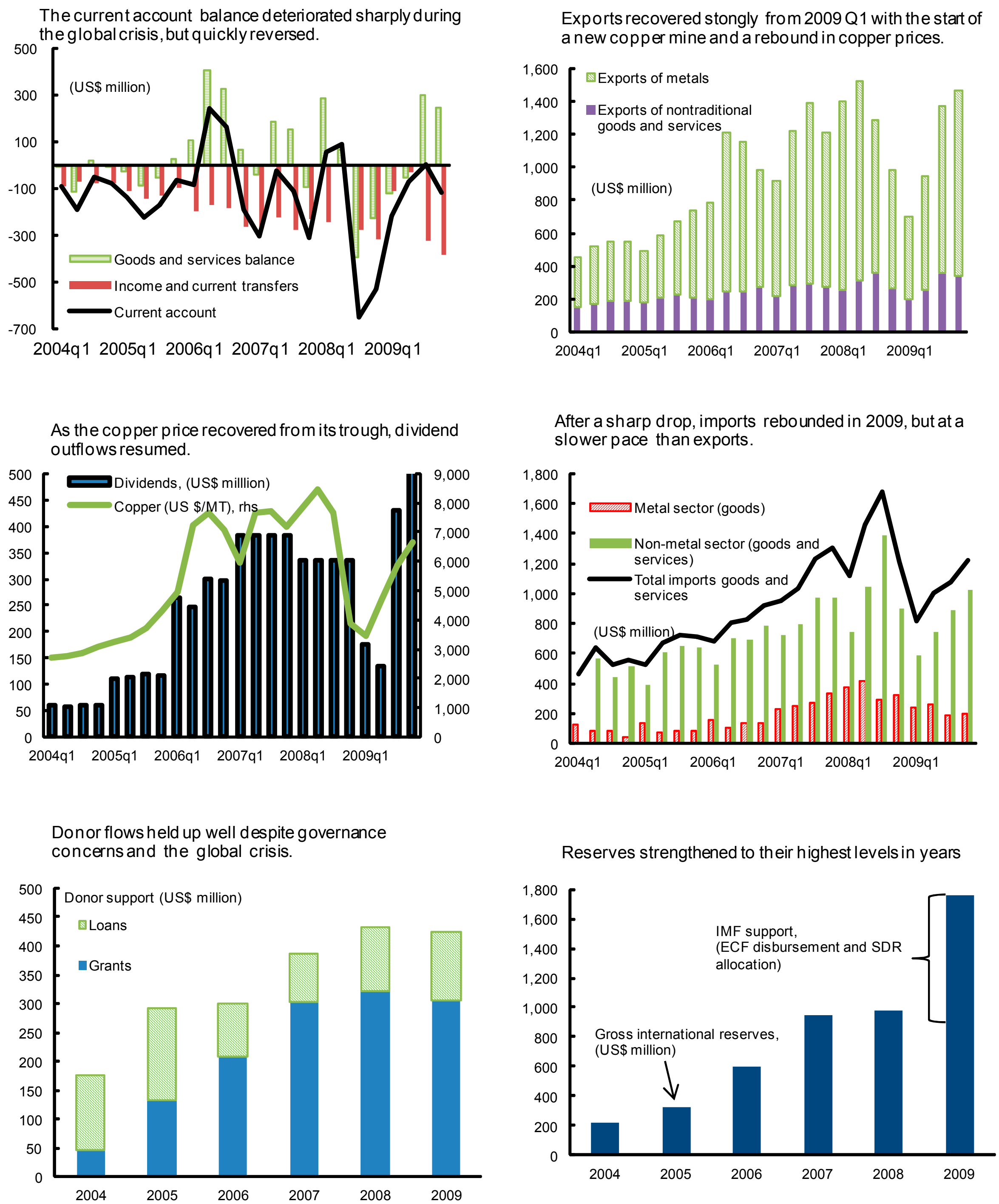
[1] Copper prices declined by 60 percent between July 2008 and January 2009, but have recovered since.

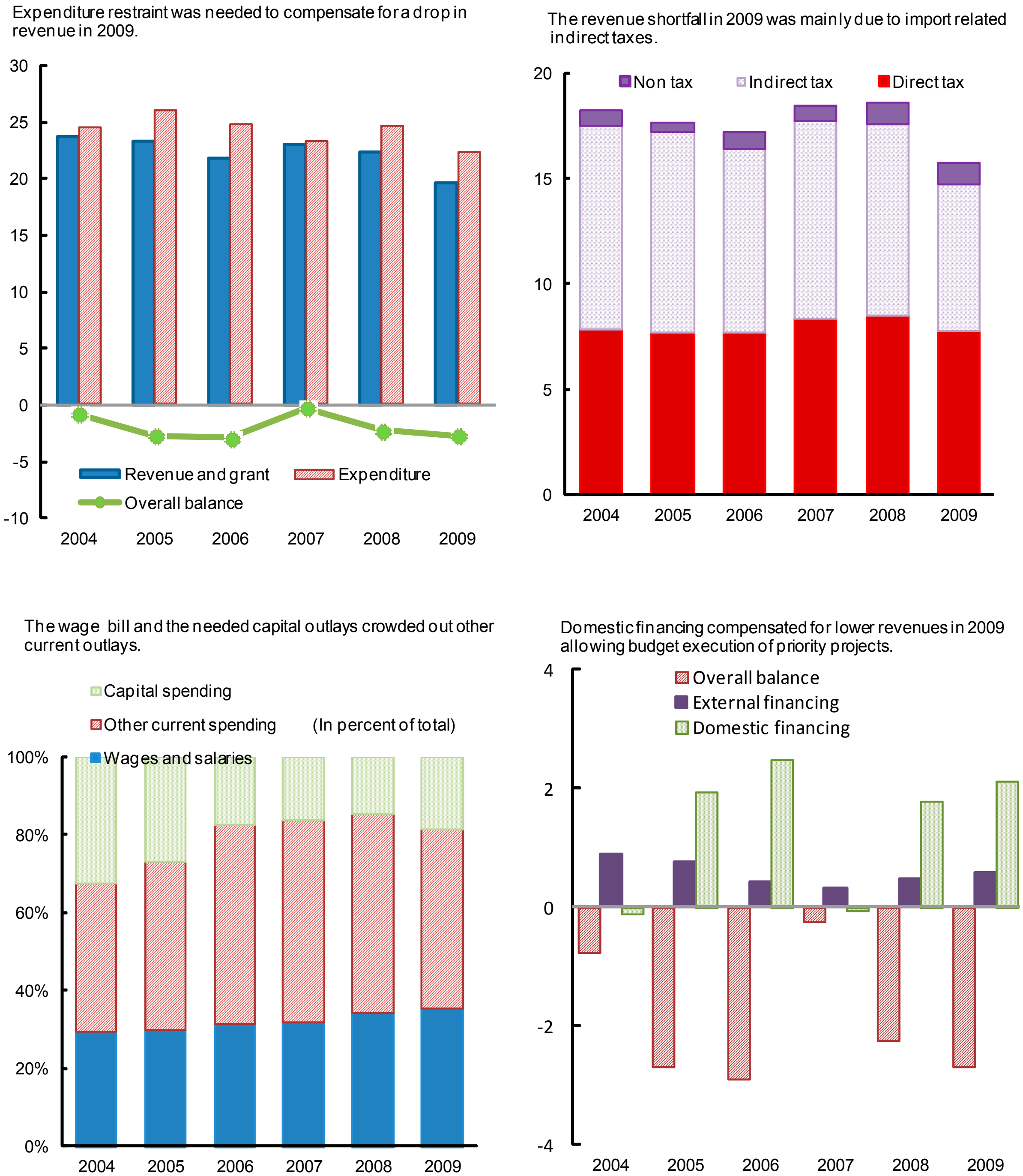
[2] The nominal exchange rate depreciated by 42 percent between end-June 2008 and end-March 2009. It has since appreciated by 11 percent through June 1, 2010.

Figure 1. Zambia: Balance of Payments Developments, 2004-09



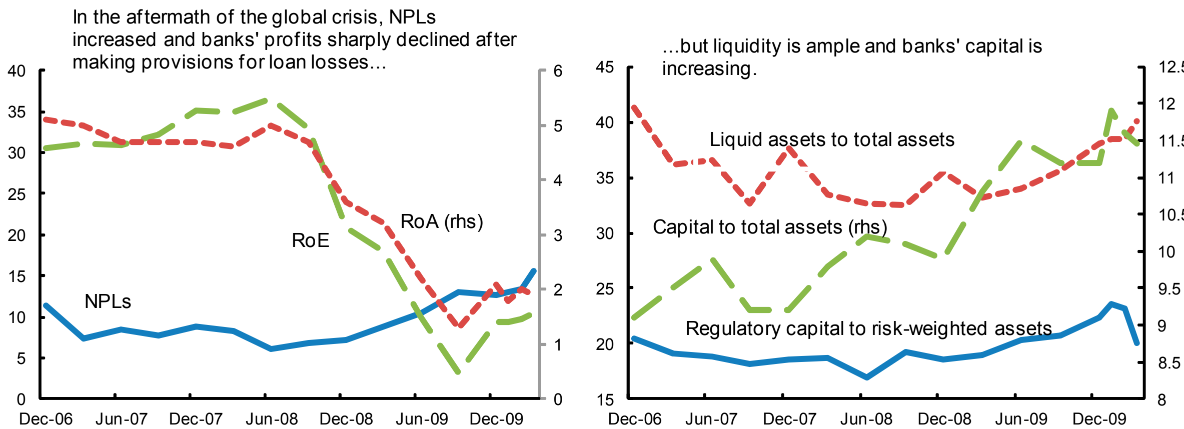
Sources: Zambian authorities and Fund staff estimates.

Figure 2. Zambia: Fiscal Developments, 2004-2009
(Percent of GDP)



Sources: Zambian authorities and Fund staff estimates.

- **In the aftermath of exchange rate and copper price fluctuations, the financial sector's recovery has been slow**. Nonperforming loans have been increasing (primarily in the agricultural and household sectors), but there has been a recent improvement in banks' return on assets and equity. Banks have been increasing their capital and have ample liquidity.

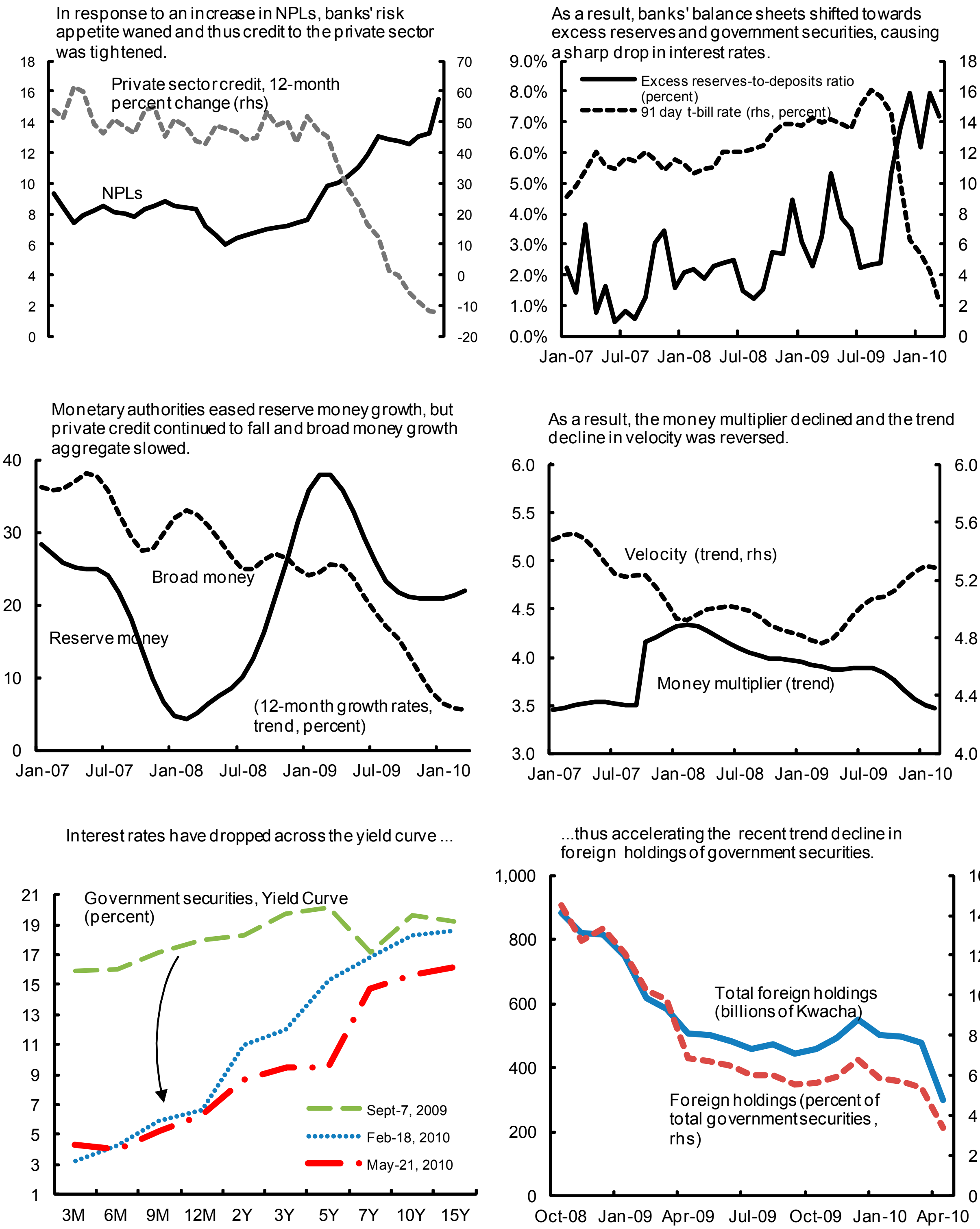


Source: Bank of Zambia

- **Tighter lending standards and lower credit demand** led to a marked slowdown in credit to the private sector and in broad money growth (Figure 3). As a result, although commercial bank lending rates are high, interest rates on government securities have dropped across the yield curve and are now negative in real terms.

2. **The economic outlook is positive.** Growth in 2010 is projected at around 6 percent and underlying inflation is targeted to moderate to 8 percent by end-2010. However, recent and ongoing adjustments of domestic petroleum prices and electricity tariffs towards cost recovery levels may cause a temporary increase in headline inflation, while a favorable maize harvest will help. Credit to the private sector should pick up as broad-based economic activity gains strength. Zambia's gross international reserves (GIR) are higher than they have been in almost four decades, thanks in part to the SDR allocations. Gross international reserves are expected to stay at about four months of prospective imports over the medium term. The main risks to the outlook include possible adverse developments in world copper and oil prices and in aid inflows.

Figure 3. Zambia: Monetary and Credit Developments, January 2007- March 2010



Sources: Bank of Zambia and Fund staff estimates.

B. Program Performance

3. **All but one of the end-December 2009 quantitative performance criteria were met and structural reforms are progressing.**[3]

- The end-December 2009 nonconcessional debt ceiling was not observed. On December 23, 2009, the government signed a US$46 million non-electricity related loan contract with a grant element of 27 percent (the program threshold is 35 percent). In addition, the government also signed two other nonconcessional loans on May 26, 2009 (amounting to US$37 million or 0.3 percent of GDP), with a grant element of 28 percent. All three of these loans give rise to nonobservance of the PC since the debt ceiling applies on a cumulative basis from January 1, 2009. The authorities explained to staff that they used an outdated concessionality calculator, which led them to believe at the time of signature that the loans would be concessional. The authorities request a waiver for the nonobservance of the PC on the basis of ongoing reforms to strengthen debt management, including in terms of assessing, recording, and providing timely external debt data, and related operational procedures.

- At the time of the third review, the end-June 2009 nonconcessional debt ceiling was reported to the Board as met (Country Report No. 10/17). In light of the two nonconcessional loans of May 2009 discussed above, it turns out that the ceiling was not in fact met. However, there is no case of misreporting since, prior to the third review, the authorities reported the two loans to staff and provided the underlying data on their terms, which would have allowed staff to determine that the loans were not concessional. Having correctly reported the underlying data and staff not having raised any issue of nonobservance, the member was entitled to believe that it had met all the conditions for requesting the disbursement.

- The payment of domestic arrears at end-December 2009 was less than the indicative program floor because the validation of claims took longer than expected.

- The indicative targets for net domestic financing and gross international reserves at end-March 2010 were missed in part because of accelerated execution of the 2010 spending program and some delays in donor disbursements.

- The structural benchmark for end-March 2010 on the supervisory regime for the government securities market was met. The authorities expect to meet most of the end-June 2010 benchmarks, but the planning and budgeting act cannot be submitted to parliament until the constitutional reform process has been completed. The authorities propose that this benchmark be reset for end-December 2010.

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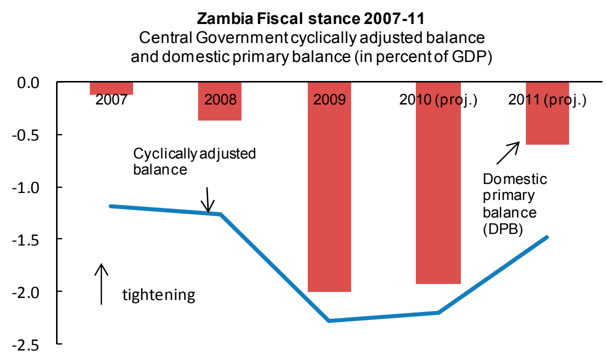
[3] See Tables 1 and 3 of the attached Memorandum of Economic and Financial Policies.

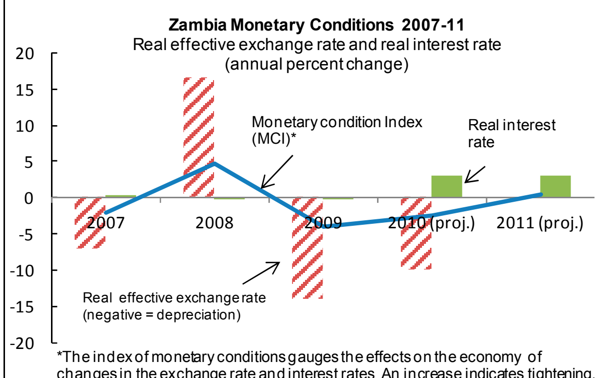
II. Policy Discussions

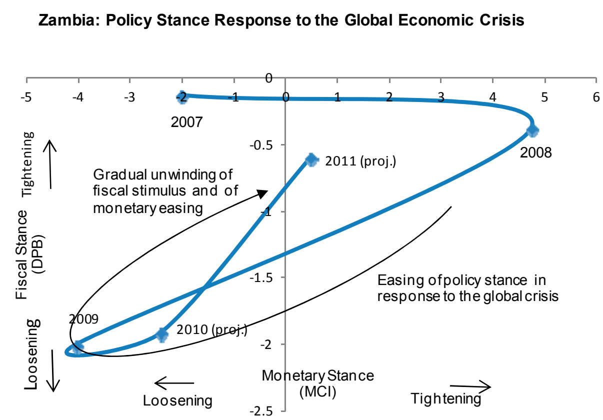
4. **The key macroeconomic policy challenge going forward is to increase growth further and create fiscal space for spending that would enhance economic diversification and reduce Zambia's dependence on copper exports, in support of its aspiration to become a prosperous middle-income country by 2030**. Economic diversification will help increase Zambia's resilience to shocks and sustain high growth and poverty reduction.[4] Prudent macroeconomic policies and significant structural reforms associated with the HIPC/MDRI process sparked the economic turnaround seen in the last decade: external and domestic debt have been brought down to moderate levels and, following the 2009 SDR allocations and augmentation of access under the ECF arrangement, international reserves have increased significantly. Moreover, as the world economy emerges from recession, prospects for the Zambian economy are improving and the need for fiscal and monetary stimulus is receding (Box 1).

Box 1. Macroeconomic Policy Stance in Zambia in Response to the Global Crisis

With global uncertainties spilling over into Zambia through the copper price, the authorities eased the policy stance (both fiscal and monetary) in 2009. The unwinding of this stimulus will accelerate during 2010–11, as global economic prospects firm up.







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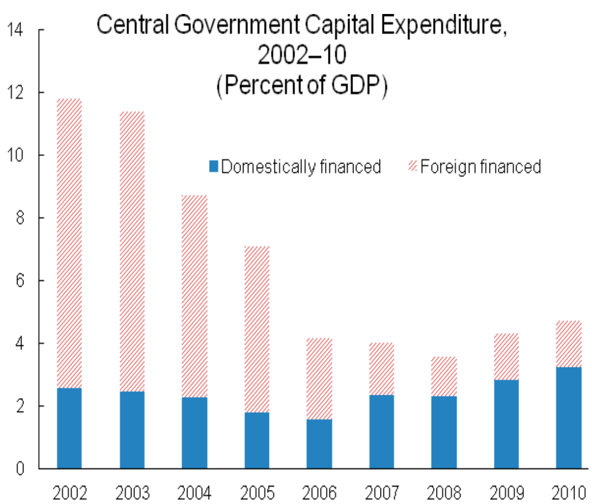
4 The authorities' mid-term review of their five-year poverty reduction strategy provides a comprehensive assessment of accomplishments and challenges to date. While progress has been made towards several MDGs and in terms of urban poverty reduction, the ongoing challenge is to tackle rural poverty and service delivery.

5. **Against this background, policy discussions focused on:**

- Creating fiscal space for infrastructure public spending within a budget envelope consistent with lowering inflation further and maintaining debt sustainability;
- The pricing of fuel and electricity; and
- Anchoring inflation expectations and reducing interest rate spreads.

A. Fiscal Policy: Creating Space for Increased Social and Capital Spending

6. **Government capital spending is low compared to neighboring countries.** It has declined markedly since 2002, because of a sharp decline in project support, partly offset by an increase in domestically financed capital spending. Steadily declining domestic revenues (as a share of GDP), which were significantly below the target set by the Fifth National Development Plan, constrained government efforts to increase domestically financed capital expenditures.



Source: IMF staff estimates and projections.

Government Gross Capital Formation
Selected Countries
(Percent of GDP)

	Average 2000-08	2009
Zambia	7.8	3.9
Neigboring countries		
Uganda	5.3	6.9
Tanzania	7.0	10.4
South Africa	2.8	4.0
Malawi	8.8	5.4
Mozambique	11.2	15.2
Namibia	5.9	10.6
High growth Asia		
China	16.1	18.6
India	7.0	12.6
Malaysia	11.6	10.9
Vietnam	9.9	10.0

Source: International Financial Statistics (IFS)

7. **The fiscal program for 2010 focuses on harnessing domestically generated resources to support investment in infrastructure and human capital** (MEFP ¶13).[5] Current expenditures will be curtailed and domestic revenues are expected to recover to 16.3 percent of GDP, based on tax administration gains, the introduction of some tax measures, and a one-off payment of tax arrears from mining companies. The program provides for almost 2 percent of GDP of domestic bank and non-bank financing. Staff stressed that,

Zambia: Fiscal Operations of the Central Government
(Percent of GDP)

	Average 2002-08	2009 Prel.	2010 Prog.
Revenue	18.0	15.7	16.3
Grants	5.6	4.0	3.4
Current expenditures	18.7	18.1	17.3
Capital expenditure	7.2	4.3	4.6
Domestically financed	2.2	2.8	3.1
Foreign financed	5.1	1.5	1.5
Overall balance (cash basis)	-2.2	-2.7	-2.5
Financing	2.2	2.7	2.5
External financing (net)	1.2	0.6	0.6
Domestic financing (net)	1.0	2.1	1.9
Memorandum items:			
Mining taxes	1.1	1.0	1.2

Sources: Zambian authorities; and IMF staff estimates and projections.

[5] The 2010 budget was approved in December 2009.

consistent with the government strategy, any additional revenues above what is currently projected for 2010 should be channeled toward social and capital spending.

8. **Staff stressed the need for enhanced revenue mobilization, including from the mining sector, to provide space for increased priority spending** (MEFP ¶14)**.** The authorities are progressing with a comprehensive tax policy and administration review, drawing on past and ongoing technical assistance, and have begun discussions with the mining companies to resolve legacy issues related to the development agreements and adherence to the current tax regime. Mining contributes little to government revenues, in part because of favorable tax concessions granted at the time of privatization. In pursuing a larger tax take from the mining sector, the authorities emphasized the importance of avoiding undue instability in tax policies.

9. **Providing room for increased capital and social spending would also require measures to contain current spending, including on the wage bill, and improve overall spending efficiency** (MEFP ¶15). The wage bill currently takes up over 50 percent of domestically generated resources. Difficult wage negotiations limited progress on the wage level front in 2010, and the wage bill remains unchanged as a share of GDP in 2010 relative to the budgeted amount for 2009. To make inroads in the period ahead, the authorities have approved a performance-based pay policy and are expected to undertake a civil service right-sizing exercise and to extend payroll management and control to all ministries in 2010. The authorities are also taking steps to improve overall spending efficiency and public financial management more broadly, with the introduction of a planning and budgeting act, the rollout of the treasury single account, and the government's Integrated Financial Management and Information System.

10. **The government is responding to governance concerns regarding the use of donor funds** (MEFP ¶30). The misappropriation of donor funds at the Ministry of Health in mid-2009 led to an extensive dialogue between the government and the donor community. An agreed set of measures, to strengthen relevant systems, is being undertaken. The auditor general's report on the 2006–09 audit of the Road Development Agency (sent recently to the national assembly) details a range of discrepancies from expected protocols. The government has already dissolved the boards of the Road Development Agency and the National Road Fund Agency, and discussions are underway on how best to address the issues raised in the Auditor General's report.

B. Energy Sector Reforms: Tapping the Potential and Protecting the Budget

11. **With peak-load shortages becoming an issue, an expansion of Zambia's electricity supply, drawing on its substantial hydropower potential, is important** (MEFP ¶26)**.** Tapping this potential requires investments in electricity generation and distribution that are beyond the financial capacity of the government.[6] The government's strategy centers on establishing public-private partnerships (PPP)[7] and on improving the operational efficiency of the state-owned

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[6] The program provides for non-concessional borrowing to finance the government's share of these projects.

[7] The PPP Act was approved in August 2009.

electricity utility ZESCO. Raising electricity tariffs to cost-recovery levels is critical for attracting private sector investment and minimizing quasi-fiscal burdens.

12. **The government is implementing a multi-year tariff framework aimed at raising tariffs to full cost-recovery levels by 2011** (MEFP ¶25). Authorization is expected for a second tariff adjustment by the electricity regulator by June 2010.[8] ZESCO is also making progress towards improving its efficiency and meeting the key performance indicators agreed to with the regulator, although performance is still lagging in several areas.

13. **The government has reinstated cost-recovery pricing of petroleum products** (MEFP ¶27)**.** Fuel prices were kept constant between December 2008 and January 2010, at which point a partial adjustment was made. A second fuel price increase on May 10, 2010, brought domestic petroleum prices in line with current supply costs, and prices going forward will be adjusted automatically at the time of arrival of each shipment to ensure that domestic prices continue to fully cover supply costs.

C. Monetary and Exchange Rate Policies: Anchoring Inflation and Reducing Interest Rate Spreads

14. **The authorities are gearing monetary policy toward reducing underlying inflation further to 8 percent by end-2010** (MEFP ¶16)**.** In this regard, staff and the authorities agreed to maintain the broad parameters of the indicative monetary program agreed during the third ECF review, as inflation has been declining more rapidly than anticipated and there are no signs of overheating. The recent drop in interest rates on government securities was mainly caused by excess liquidity stemming from tighter credit standards. Excess reserves should drain, and interest rates on government securities should gradually return to positive territory, as credit to the private sector picks up on the back of a more broad based recovery in economic activity. Staff recommended, however, that the Bank of Zambia stand ready to tighten monetary policy if credit and broad money growth picks up faster than anticipated.

15. **The Bank of Zambia is considering an eventual shift to using interest rates as the main instrument to anchor inflation expectations** (MEFP ¶17)**.** Exchange rate volatility, large terms-of-trade shocks, emerging portfolio flows, thin financial markets, and significant supply shocks complicate policy formulation and the design of the monetary policy framework. Granted that monetary targeting has served Zambia well, staff agreed that an increased emphasis on interest rates was appropriate. An eventual shift to formal interest targeting could improve monetary policy signaling and transmission, but would likely have limited direct impact on interest rate spreads.

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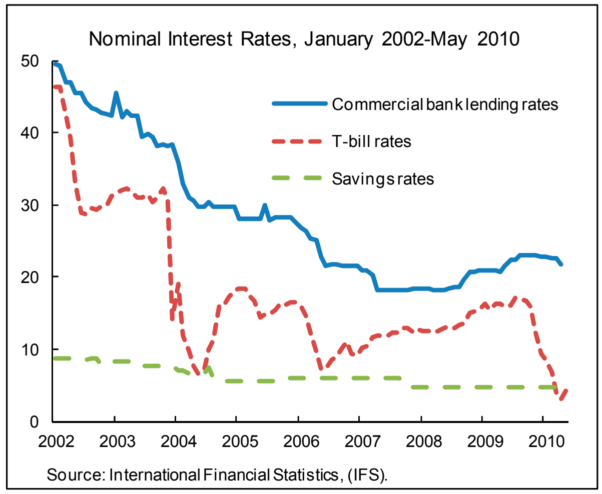
[8] ZESCO has applied to the electricity regulator for a tariff increase of 36 percent in April 2010, which would raise tariffs from 52 to 70 percent of production costs.



16. **The authorities are concerned about high lending rates and related spreads.** While nominal lending rates have declined somewhat over the past decade, structural factors, as in other parts of Sub-Saharan Africa, have kept lending spreads high. Lowering spreads will require measures to reduce operational costs and lending risks, increase competition, lower inflation further, and better anchor inflation expectations. Continued restraint on government domestic borrowing is important in this regard.

17. **The authorities are still considering whether to go ahead with the planned domestic debt redemption operation,[9] but may focus on longer-term maturities, given the recent decline in the shorter-term government securities rates**. In doing so, they would aim to redeem domestic debt held by the private sector, with the resulting liquidity injection offset by foreign exchange sales.

18. **Exchange rate fluctuations have closely mirrored movements in the terms of trade.** There is no clear evidence of any misalignment of the exchange rate (Box 2). Dampening exchange rate swings would require diversifying Zambia's export base, improving information flows to the market, including on the effect of changes in copper prices on the balance of payment, and increasing the depth and liquidity of the market.

19. **The authorities continue to make efforts to settle arrears to external private creditors stemming from the past imposition of exchange controls**. Settlement terms similar to those provided by the Paris Club were offered to commercial creditors with outstanding arrears. The authorities are continuing to verify outstanding claims to private entities and individuals. The exchange restrictions evidenced by the accumulation of these external payments arrears are subject to Fund approval under Article VIII.

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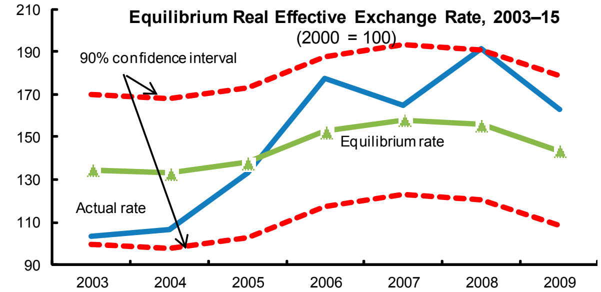
[9] See Country Report No. 10/17, paragraph 7, page 9.

Box 2. Zambia: Exchange Rate Assessment

The real effective exchange rate (REER) has exhibited large swings in recent years, largely reflecting terms of trade movements driven by world market copper prices. Portfolio flows have also contributed to these swings.

Updated estimates suggest that the real effective exchange rate remains close to its estimated equilibrium level, with no clear evidence of misalignment, but data limitations and structural changes in the Zambian economy limit the robustness of such estimates. The balance of payments position does not appear to give rise to disruptive exchange rate movements. The nominal exchange rate reflects market conditions, and the current structure of the capital and financial accounts poses no clear risk to external stability.

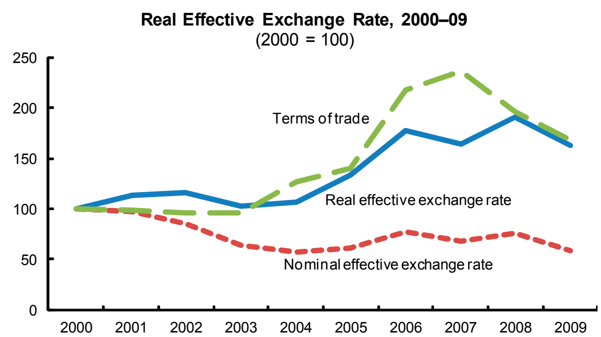


Source: IMF staff estimates and projections.

Exchange Rate Assessment Results [1]

Approach	Current account/GDP		REER
	Norm	Underlying	Gap
External sustainability	-7.2	-4.7	-12.5
Macroeconomic balance	-4.8	-4.7	-0.8
Equilibrium real exchange rate	NA	NA	15.3

[1] Based on IMF CGER methodology and extension by Francis Vitek (IMF 2009, unpublished).



Sources: Information Notice System (INS) and IMF staff estimates.

III. Program Monitoring and Modification of Performance Criteria

20. **Program monitoring will continue on a semiannual basis.** It is proposed that the quantitative performance criteria be modified for end-June 2010 (¶21 below) and be set for end-December 2010. Indicative targets have been set for September 2010 (MEFP Table 2). In the structural area, reviews will be based on an assessment of progress under the authorities' reform program, in particular in the areas of public financial management (PFM), as well as in the financial and electricity sectors, in order to achieve the macroeconomic objectives described in Table 4 of the MEFP.

21. **The authorities' request, with staff support, that the June 2010 performance criteria be modified** (MEFP Table 2). While proposing to make the end-2010 GIR target more ambitious, the authorities request a lowering of the floor on GIR at June 2010 by US$31 million to reflect expected delays in donor flows. Also, while proposing to lower the

end-2010 ceiling on the net domestic assets of BoZ, they request increasing the June 2010 ceiling by kwacha 116 billion to better reflect seasonal factors. Moreover, while maintaining the end-2010 target, the authorities request an increase of the ceiling on net domestic financing by kwacha 90 billion at end-June 2010 to facilitate early clearance of outstanding fuel subsidy bills. Finally, the authorities request adding selected Road Sector Investment Program (ROADSIP) projects to the list of projects that could be financed under the non-zero non-concessional borrowing ceiling set at the time of the third ECF review.[10] Despite some recent governance issues in the sector, road maintenance and construction are widely viewed as being critical components of the government's strategy for enhancing growth and economic diversification.

IV. Staff Appraisal

22. **Economic performance has been strong.** All but one quantitative performance criteria were met at end-2009 and structural reforms are progressing. Growth was high; inflation moderated; the current account deficit narrowed; international reserves strengthened, thanks in part to the SDR allocations and ECF augmentation; and the economic outlook is positive.

23. **The key macroeconomic policy challenge going forward is to create fiscal space for spending to enhance economic diversification and reduce Zambia's dependence on copper exports**. This will require mobilizing more revenues, including from mining; containing current spending, including on the wage bill; and improving overall spending efficiency.

24. **The moderate tightening of the policy stance for 2010 is appropriate**. Growth should remain strong, debt is moderate, and there is no sign of overheating. The 2010 fiscal program rightly focuses on harnessing domestically generated resources to support investment in infrastructure and human capital, and any additional fiscal resources above what is projected for 2010 should be geared toward social and capital spending, assuming no capacity bottlenecks. Monetary policy appropriately targets a further reduction in underlying inflation. Excess reserves should drain, and real interest rates on government securities should gradually return to positive territory, as credit to the private sector picks up. The BoZ should stand ready to tighten its monetary policy stance if broad money growth picks up faster than assumed, however.

25. **Money targeting has served Zambia well.** It has helped provide the right policy response to the ongoing credit tightening associated with the aftermath of the global financial crisis. Increased emphasis on interest rates, including when communicating changes in the policy stance, is however warranted.

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[10] The various phases of the ROADSIP reflect regular discussions between the government and relevant donors.

26. **Addressing Zambia's investment needs in the electricity sector requires continued adjustment of tariffs towards full cost-recovery levels.** Zambia has substantial hydropower potential, but realizing it would require higher prices for electricity to encourage private sector participation in large investments in electricity generation and distribution.

27. **The return to full cost-recovery pricing of petroleum products and reinstatement of the automatic fuel pricing mechanism is welcome.** It will help safeguard budgetary resources so they can be channeled to higher-priority use.

28. **Staff recommends the completion of the fourth ECF review and the financing assurances review, and supports the request for a waiver of the missed performance criterion on nonconcessional borrowing.** The waiver request is justified by ongoing reforms to strengthen debt management, including in terms of assessing, recording, and providing timely external debt data, and related operational procedures. Based on the strength of their policies, staff also supports the authorities' request for modification of end-June 2010 performance criteria.

Table 1. Zambia: Selected Economic Indicators

	2008	2009		2010		2011	2012
		Prog.	Est.	Prog.	Rev. prog.	Proj.	Proj.
		CR No. 10/17		CR No. 10/17			
	(Percent changes; unless otherwise indicated)						
National account and prices							
GDP growth at constant prices	5.7	5.3	6.3	5.5	5.8	6.0	6.3
GDP deflator	12.9	12.4	12.3	10.7	9.8	8.3	7.4
GDP at market prices (Billions of kwacha)	55,079	65,196	65,754	76,191	76,385	87,756	100,145
Consumer prices							
Consumer prices (average)	12.4	13.7	13.4	10.0	8.2	7.5	6.5
Consumer prices (end of period)	16.6	12.0	9.9	8.0	8.0	7.0	6.0
External sector							
Terms of trade (deterioration -)	-17.1	-15.4	-14.4	7.4	14.1	4.9	-7.6
Average exchange rate (kwacha per U.S. dollar)	3,746	…	5,046	…	…	…	…
(percentage change; depreciation -)	6.4	…	-34.7	…	…	…	…
Real effective exchange rate (depreciation -)[1]	16.2	…	-14.7	…	…	…	…
Money and credit (end of period, unless otherwise specified)[2]							
Domestic credit to the private sector	50.4	14.3	-5.6	20.1	15.5	15.5	…
Reserve money (monthly average of daily data)	…	19.0	13.2	19.0	21.9	13.7	…
Reserve money (end of month)	34.3	19.0	19.3	19.0	9.7	13.7	…
Broad Money (M3)	23.2	19.0	7.7	19.0	16.0	18.0	…
	(Percent of GDP; unless otherwise indicated)						
National accounts							
Gross investment	19.4	22.1	22.1	22.5	22.5	22.8	24.2
Government	3.6	4.2	4.3	4.0	4.7	4.7	5.9
Private	15.9	17.9	17.8	18.5	17.8	18.1	18.3
National savings	13.9	20.3	20.8	20.0	20.4	20.0	20.8
Gross foreign savings	5.6	1.8	1.3	2.5	2.1	2.8	3.4
Central government budget							
Revenue	18.6	15.7	15.7	15.9	16.3	17.1	17.9
Tax	17.5	15.0	14.7	14.9	15.4	16.6	17.4
Nontax	1.0	0.7	1.0	0.9	0.9	0.5	0.5
Grants	3.8	4.5	4.0	2.9	3.4	2.6	2.2
Total expenditure	23.8	22.8	22.8	21.2	22.3	21.4	21.7
Current expenditures	19.1	18.0	18.1	16.9	17.3	16.6	15.9
Of which: Wages and salaries	8.1	8.2	8.0	7.9	8.2	7.7	7.1
Capital expenditure	3.6	4.2	4.3	4.0	4.6	4.7	5.9
Domestic arrears payments	1.1	0.5	0.4	0.4	0.4	0.1	0.0
Overall balance[3]	-2.2	-2.6	-2.7	-2.4	-2.5	-1.7	-1.6
Excluding grants	-6.0	-7.1	-6.7	-5.3	-5.9	-4.3	-3.8
Financing	2.2	2.6	3.2	2.4	2.5	1.7	1.6
External financing (net)	0.5	0.3	0.6	0.5	0.6	0.5	0.5
Domestic (net)	1.8	2.2	2.1	2.0	1.9	1.2	1.1
External sector							
Current account balance	-7.1	-4.1	-3.1	-3.8	-3.5	-3.9	-4.3
(excluding grants)	-9.3	-6.3	-5.4	-5.5	-5.2	-5.4	-5.7
Gross international reserves (months of current imports)[4]	2.1	4.5	5.1	4.1	4.3	4.3	4.4
Gross international reserves (months of prospective imports)[4]	2.8	3.9	3.9	3.9	3.7	3.9	4.1
Public debt							
Total central government debt (end-period)	26.7	26.4	26.4	27.6	26.4	26.8	26.9
External	11.2	11.9	11.9	14.2	13.4	14.5	15.0
Domestic	15.5	14.5	14.6	13.4	13.0	12.4	11.8

Sources: Zambian authorities; and IMF staff estimates and projections.

[1]Excludes Zimbabwe.

[2] 2010-11 revised program projections are based on a standardized report form (SRF) which accords with the concepts and definitions of the Monetary and Financial Statistics Manual (MFSM). 2008-2009 data are based on pre-SRF monetary survey.

[3]Including discrepancy between the above-the-line balance and below-the-line financing.

[4]Imports in current and prospective year (one year forward). Includes the new SDR allocation of SDR 401 million in 2009.

Table 2. Zambia: Fiscal Operations of the Central Government

(Billions of kwacha)

	2008	2009		2010		2011	2012
		CR No. 10/17		CR No. 10/17			
		Prog.	Prel.	Prog.	Rev. Prog.	Proj.	Proj.
Revenue and grants	12,290	13,174	12,926	14,343	15,065	17,267	20,182
Revenue	10,221	10,226	10,315	12,107	12,486	15,009	17,945
Tax	9,653	9,757	9,661	11,385	11,764	14,562	17,433
Income taxes	4,678	5,024	5,073	5,730	6,109	7,414	8,934
Value-added tax	2,201	2,496	2,475	2,940	2,940	3,796	4,504
Excise taxes	1,424	1,082	1,024	1,397	1,397	1,711	2,047
Customs duties	1,351	1,155	1,089	1,318	1,318	1,641	1,948
Nontax	567	469	654	722	722	447	512
Grants	2,069	2,948	2,611	2,236	2,579	2,258	2,237
Budget support	642	990	879	790	1,088	907	907
Project grants	1,427	1,958	1,732	1,446	1,491	1,351	1,331
Expenditures	13,098	14,841	15,010	16,178	17,005	18,759	21,772
Current expenditures	10,539	11,760	11,924	12,874	13,229	14,564	15,894
Wages and salaries	4,465	5,317	5,274	6,019	6,281	6,735	7,157
Goods and services	2,808	3,147	3,188	3,793	3,581	3,957	4,704
Interest payments	950	1,017	1,033	1,246	1,151	1,270	1,290
Other	2,315	2,279	2,429	1,815	2,215	2,602	2,743
Capital expenditure	1,966	2,729	2,808	3,035	3,507	4,128	5,878
Of which: domestically financed	1,271	1,810	1,842	1,882	2,393	3,291	5,031
Domestic arrears payments	593	352	278	269	269	67	0
Discrepancy (-overfinancing)[1]	-427	0	311	0	0	0	0
Overall balance							
Including grants	-1,236	-1,667	-1,772	-1,835	-1,939	-1,492	-1,590
Excluding grants	-3,304	-4,615	-4,383	-4,071	-4,519	-3,750	-3,828
Financing	1,236	1,667	1,772	1,835	1,939	1,492	1,590
External financing (net)	257	224	385	348	452	411	495
Of which: budget support	113	108	159	156	279	162	168
Domestic financing (net)	979	1,443	1,387	1,487	1,487	1,081	1,096
Bank financing	1,189	1,393	1,546	1,187	1,187	781	546
Of which: BoZ onlending of IMF PRGF	0	423	628	0	0	0	0
Nonbank financing	-210	50	-159	300	300	300	550
Memorandum items:							
Overall balance, excl. budget grants and mining taxes	-2,654	-3,282	-3,287	-3,173	-3,955	-3,835	-4,538
Primary balance	-285	-650	-739	-588	-788	-222	-301
Primary balance, excluding mining taxes	-1,062	-1,275	-1,375	-1,136	-1,715	-1,658	-2,342
Mining taxes	776	625	636	548	927	1,436	2,041
External budget support	755	1,099	1,038	946	1,367	1,069	1,075
Stock of domestic arrears	249	269	336	185	67	0	0
Stock of domestic government securities	8,517	9,458	9,586	10,215	9,961	10,839	11,840

Sources: Zambian authorities; and IMF staff estimates and projections.

[1]Discrepancy largely reflects changes in the carryover of budgetary releases.

Table 3. Zambia: Fiscal Operations of the Central Government

(Percent of GDP)

	2008	2009		2010		2011	2012
		CR No. 10/17		CR No. 10/17			
		Prog.	Prel.	Prog.	Rev. Prog.	Proj.	Proj.
Revenue and grants	22.3	20.2	19.7	18.8	19.7	19.7	20.2
Revenue	18.6	15.7	15.7	15.9	16.3	17.1	17.9
Tax	17.5	15.0	14.7	14.9	15.4	16.6	17.4
Income taxes	8.5	7.7	7.7	7.5	8.0	8.4	8.9
Value-added tax	4.0	3.8	3.8	3.9	3.8	4.3	4.5
Excise taxes	2.6	1.7	1.6	1.8	1.8	1.9	2.0
Customs duties	2.5	1.8	1.7	1.7	1.7	1.9	1.9
Nontax	1.0	0.7	1.0	0.9	0.9	0.5	0.5
Grants	3.8	4.5	4.0	2.9	3.4	2.6	2.2
Budget support	1.2	1.5	1.3	1.0	1.4	1.0	0.9
Project grants	2.6	3.0	2.6	1.9	2.0	1.5	1.3
Expenditures	23.8	22.8	22.8	21.2	22.3	21.4	21.7
Current expenditures	19.1	18.0	18.1	16.9	17.3	16.6	15.9
Wages and salaries	8.1	8.2	8.0	7.9	8.2	7.7	7.1
Goods and services	5.1	4.8	4.8	5.0	4.7	4.5	4.7
Interest payments	1.7	1.6	1.6	1.6	1.5	1.4	1.3
Other	4.2	3.5	3.7	2.4	2.9	3.0	2.7
Capital expenditure	3.6	4.2	4.3	4.0	4.6	4.7	5.9
Of which: domestically financed	2.3	2.8	2.8	2.5	3.1	3.8	5.0
Domestic arrears payments	1.1	0.5	0.4	0.4	0.4	0.1	0.0
Discrepancy (-overfinancing)[1]	-0.8	0.0	0.5	0.0	0.0	0.0	0.0
Overall balance (cash basis)							
Including grants	-2.2	-2.6	-2.7	-2.4	-2.5	-1.7	-1.6
Excluding grants	-6.0	-7.1	-6.7	-5.3	-5.9	-4.3	-3.8
Financing	2.2	2.6	2.7	2.4	2.5	1.7	1.6
External financing (net)	0.5	0.3	0.6	0.5	0.6	0.5	0.5
Of which: budget support	0.2	0.2	0.2	0.2	0.4	0.2	0.2
Domestic financing (net)	1.8	2.2	2.1	2.0	1.9	1.2	1.1
Bank financing	2.2	2.1	2.4	1.6	1.6	0.9	0.5
Nonbank financing	-0.4	0.1	-0.2	0.4	0.4	0.3	0.5
Memorandum items:							
Overall balance, excl. budget grants and mining taxes	-4.8	-5.0	-5.0	-4.2	-5.2	-4.4	-4.5
Primary balance	-0.5	-1.0	-1.1	-0.8	-1.0	-0.3	-0.3
Primary balance, excluding mining taxes	-1.9	-2.0	-2.1	-1.5	-2.2	-1.9	-2.3
Mining taxes	1.4	1.0	1.0	0.7	1.2	1.6	2.0
External budget support	1.4	1.7	1.6	1.2	1.8	1.2	1.1
Stock of domestic arrears	0.5	0.4	0.5	0.2	0.1	0.0	0.0
Stock of domestic government securities	15.5	14.5	14.6	13.4	13.0	12.4	11.8
Nominal GDP (in billions of kwacha)	55,079	65,196	65,754	76,191	76,385	87,756	100,145

Sources: Zambian authorities; and IMF staff estimates and projections.

[1]Discrepancy largely reflects changes in the carryover of budgetary releases.

Table 4. Zambia: Monetary Accounts[1]

(Billions of kwacha, unless otherwise indicated)

	2008	2009	2009	2009	2010	2011
	Monetary Survey (pre-SRF)			Revised Monetary Survey (SRF)[2]		
		CR No. 10/17	Prel.	Prel.	Prog.	Proj.
Monetary Survey						
Net foreign assets	4,985	4,500	5,178	5,178	5,200	6,748
Asset	7,750	11,346	11,814	11,814	12,267	14,174
Liabilities	-2,765	-6,846	-6,636	-6,636	-7,067	-7,426
Net domestic assets	7,830	11,045	8,619	8,619	10,804	12,137
Domestic Claims	10,332	13,110	11,711	11,711	14,099	16,270
Net Claims on Central Government	1,886	3,751	3,698	3,698	4,885	5,667
Claims on Central Government	4,572	7,184	7,820	7,820	10,330	11,982
Liabilities to Central Government	-2,686	-3,433	-4,122	-4,122	-5,444	-6,315
Claims on Other Sectors	8,446	9,392	8,013	8,013	9,214	10,604
Claims on Other Financial Corporations	92	0	58	58	58	58
Claims on State and Local Government	4	0	0	5	5	5
Claims on Public Non-financial Corporations	147	160	208	208	208	208
Claims on Private Sector	8,204	9,232	7,741	7,741	8,943	10,332
Other Items net	-2,502	-3,230	-3,092	-3,092	-3,295	-4,133
Broad Money (M3)	12,815	15,545	13,797	13,797	16,004	18,885
Quasi money (M2)	8,542	9,894	8,818	8,818	10,229	12,070
Foreign exchange deposits	4,273	5,203	4,979	4,979	5,775	6,815
Monetary Authorities						
Net foreign assets	4,181	3,600	3,996	3,996	4,207	5,661
Asset	5,211	8,744	9,010	9,010	9,596	11,436
Liabilities	-1,030	-5,145	-5,013	-5,013	-5,389	-5,775
Of which: IMF liabilities	-462	-5,145	-1,600	-1,600	-1,864	-2,085
Net Domestic Assets	-782	221	58	58	241	-603
Net Domestic Claims	752	665	914	914	1,288	1,522
Claims on Other Depository Corporations	12	1,197	11	11	11	11
Net Claims on Central Government	703	995	861	861	1,217	1,451
Claims on Central Government	2,054	3,390	3,563	3,563	5,037	6,007
Liabilities to Central Government	-1,351	-2,395	-2,702	-2,702	-3,820	-4,555
Claims on Private Sector	37	60	43	43	60	60
Other Items (Net)	-1,534	-1,158	-856	-856	-1,047	-2,125
Reserve money	3,399	3,821	4,054	4,054	4,448	5,057
Currency outside banks and cash in vaults	1,932	2,299	1,999	1,999	2,193	2,494
Other depository corporation reserves	1,467	2,299	1,999	2,055	2,956	3,361
	(12-month percentage change: unless otherwise specified)					
Reserve money (end-of-month)	34.3	19.0	19.3	19.3	9.7	13.7
Broad Money (M3)	23.2	19.0	7.7	7.7	16.0	18.0
Credit to the private sector	50.4	14.3	-5.6	-5.6	15.5	15.5
Velocity (Nominal GDP/M3)	4.3	4.2	4.8	4.8	4.8	4.6
Money multiplier (M3/reserve money)	3.8	4.1	3.4	3.4	3.6	3.7
Credit to the private sector (percent of GDP)	14.9	14.2	11.8	11.8	11.7	11.8
Gross foreign exchange reserves of the Bank of Zambia (millions of U.S. dollars)	976	1,740	1,758	1,758	1,849	2,378
Exchange rate (kwacha per U.S. dollar, end period)	4,832	…	4,641	4,641	…	…

Sources: Zambian authorities; and IMF staff estimates and projections.

[1]End of period.

[2] From end-2009 and onward, authorities data are based on a standardized report form (SRF) which accords with the concepts and definitions of the IMF 2001 Monetary and Financial Statistics Manual (MFSM).

Table 5. Zambia: Balance of Payments[1]

(Millions of U.S. dollars, unless otherwise indicated)

	2007	2008	2009 Prel.	2010 Proj.	2011 Proj.	2012 Proj.
Current account	-754	-1,049	-404	-560	-689	-844
Trade balance	899	404	906	1,054	1,012	695
Exports, f.o.b.	4,510	4,959	4,319	5,462	6,210	6,328
Of which: copper	3,407	3,684	3,179	4,308	4,912	4,845
Imports, f.o.b	-3,611	-4,554	-3,413	-4,408	-5,198	-5,633
Of which: oil	-493	-816	-536	-626	-716	-787
Services (net)	-640	-615	-465	-647	-749	-825
Income (net)	-1,545	-1,399	-1,361	-1,433	-1,452	-1,219
Of which: interest on public debt	-13	-20	-12	-13.6	-15	-22
Current transfers (net)	530	560	516	466	500	505
Budget support grants	147	171	198	187	183	176
Sector-wide approach grants	156	150	106	84	83	84
Private transfers	228	239	212	194	235	245
Capital and financial account	1,065	1,046	1,005	654	986	1,136
Capital account	223	230	237	230	189	175
Project grants	223	230	237	230	189	175
External debt cancellation	0	0	0	0	0	0
Financial account	843	816	768	424	797	961
Foreign direct and portfolio investments	1,366	933	620	739	833	899
Other investments	-523	-116	148	-315	-36	62
Medium and long-term	-523	-116	148	-315	-36	62
Public sector (net)	34	67	77	115	133	146
Disbursements	83	111	119	166	228	233
Of which: budget support	0	32	33	59	33	33
Amortization due	-49	-43	-43	-51	-96	-86
Monetary authority[2]	0	0	627	0	0	0
Commercial banks (net)	-67	143	-63	-51	11	-3
Other sectors	-490	-327	-493	-380	-179	-81
Short-term	0	0	0	0	0	0
Errors and omissions	0	16	-61	0	0	0
Overall balance	310	13	540	94	297	292
Financing						
Central bank net reserves (- increase)	-310	-13	-540	-94	-297	-292
Of which: Gross reserve change	-352	-29	-782	-150	-319	-280
Of which: Use of Fund resources	42	16	242	56	22	-12
Exceptional financing	0	0	0	0	0	0
Financing gap	0	0	0	0	0	0
Memorandum items:						
Current account (percent of GDP)	-2.5	-7.1	-3.1	-3.5	-3.9	-4.3
Current account, excluding grants (percent of GDP)	-9.2	-9.3	-5.4	-5.2	-5.4	-5.7
Change in copper export volume (percent)	-0.2	2.0	16.0	8.4	5.9	6.2
Copper export price (U.S. dollars per tonne)	7,132	6,275	4,716	6,011	6,473	6,011
Total official grants (percent of GDP)	4.6	3.7	4.2	3.1	2.6	2.2
Gross international reserves[3]	947	976	1,758	1,849	2,378	2,820
In months of current imports	2.5	2.1	5.1	4.3	4.3	4.4
In months of prospective imports	2.1	2.8	3.9	3.7	3.9	4.1
GDP (millions of U.S. dollars)	11,542	14,705	13,031	16,072	17,673	19,469

Sources: Zambian authorities; and IMF staff estimates and projections.

[1]Disbursements and imports related to possible future hydropower projects are not included.

[2]SDR allocation, long term liability.

[3]Reserves are evaluated at market exchange rates.

Table 6. Zambia: Financial Soundness Indicators

(Percent, unless otherwise indicated)

	2006	2007	2008	2009	2010 Mar
Capital adequacy					
Regulatory capital to risk-weighted assets	20.4	18.6	18.6	22.3	20.0
Tier 1 regulatory capital to risk-weighted assets	18.0	15.9	15.7	18.9	23.3
Capital to total assets	9.1	9.2	9.9	11.2	11.5
Asset quality					
Past due advances (NPL) to total advances	11.3	8.8	7.2	12.6	15.5
Loan loss provisions to nonperforming loans	83.3	73.2	104.6	86.6	75.0
Bad debt provisions to advances	6.8	6.4	6.1	10.9	11.6
Loan concentration					
Households	16.1	15.5	30.1	30.9	32.2
Government and parastatals	6.2	9.1	1.9	3.1	2.2
Agriculture	23.9	18.4	16.0	19.0	20.0
Mining	4.4	4.1	5.0	4.0	4.0
Manufacturing	14	11.0	11.0	12.0	11.0
Construction	2.4	3.7	4.0	3.0	3.0
Services	9.8	13.3	9.0	8.0	6.0
Others	23.2	25.0	23.0	20.0	21.6
Earnings and profitability					
Return on average assets	5.1	4.7	3.6	2.1	1.9
Return on equity	30.6	35.1	20.8	9.4	10.5
Gross interest income to total gross income	60.2	63.1	66.6	65.1	69.0
Gross noninterest income to total gross income	39.8	36.9	33.4	34.9	31.0
Net interest margin	12.8	11.5	10.4	10.7	10.7
Liquidity					
Liquid assets to total assets	41.3	37.6	35.5	38.0	40.1
Liquid assets to total deposits	49.6	46	49.9	52.6	55.8
Advances to deposits ratio	49	57.4	66.3	60.1	56.8
Exposure to foreign currency					
Foreign currency loans to total gross loans	34.0	32.5	42.1	36.4	34.7
Foreign currency liabilities to total liabilities	61.2	27.1	35.8	38.0	36.9
Net open position in foreign exchange to capital	9.4	7.1	6.9	2.5	6.7

Source: Bank of Zambia.

Table 7. Zambia: Indicators of Capacity to Repay the Fund

	2010	2011	2012	2013	2014	2015	2016
Fund obligations based on existing credit							
(in millions of SDRs)							
Principal	0.6	3.3	7.7	11.7	23.1	43.4	40.7
Charges and interest	0.2	0.2	0.7	0.7	0.7	0.6	0.5
Fund obligations based on existing and prospective credit							
(in millions of SDRs)							
Principal	0.6	3.3	7.7	11.7	23.1	45.3	49.9
Charges and interest	0.2	0.2	0.9	0.8	0.8	0.7	0.6
Total obligations based on existing and prospective credit							
In millions of SDRs	0.7	3.5	8.6	12.5	23.9	46.0	50.5
In millions of US$	1.2	5.5	13.6	20.0	38.0	73.2	80.4
In percent of exports of goods and services	0.0	0.1	0.2	0.3	0.5	0.9	0.9
In percent of debt service[1]	1.8	4.8	11.3	15.3	24.0	36.0	42.5
In percent of GDP	0.0	0.0	0.1	0.1	0.2	0.3	0.3
In percent of Gross International Reserves	0.1	0.2	0.5	0.6	1.0	1.7	1.8
In percent of quota	0.1	0.7	1.7	2.6	4.9	9.4	10.3
Outstanding Fund credit							
In millions of SDRs	256.2	271.3	263.6	251.9	228.8	183.5	133.6
In millions of US$	408.2	431.9	419.9	401.3	364.2	292.1	212.7
In percent of exports of goods and services	7.1	6.6	6.3	5.8	4.9	3.6	2.4
In percent of debt service[1]	624.3	372.4	349.3	307.3	230.1	143.7	112.5
In percent of GDP	2.5	2.4	2.2	1.9	1.6	1.1	0.8
In percent of Gross International Reserves	22.1	18.2	14.9	12.4	9.9	6.7	4.6
In percent of quota	52.4	55.5	53.9	51.5	46.8	37.5	27.3
Net use of Fund credit (in millions of SDRs)	36.2	15.1	-7.7	-11.7	-23.1	-45.3	-49.9
Disbursements	36.8	18.4	0.0	0.0	0.0	0.0	0.0
Repayments	-0.6	-3.3	-7.7	-11.7	-23.1	-45.3	-49.9
Memorandum items:							
Exports of goods and services (in millions of US$)	5,756	6,533	6,683	6,893	7,421	8,209	8,968
Debt service (in millions of US$)[1]	65	116	120	131	158	203	189
Nominal GDP (in millions of US$)	16,072	17,673	19,469	21,362	23,481	25,770	28,238
Gross International Reserves (in millions of US$)	1,849	2,378	2,820	3,230	3,683	4,354	4,584
Quota (millions of SDRs)	489	489	489	489	489	489	489

Sources: IMF staff estimates and projections.

[1]Total central government debt service; it includes IMF repayments.

Table 8. Zambia: Schedule of Disbursements Under the ECF Arrangement[1]

Availability	Current Millions of SDRs	Current Percent of quota	Conditions for Disbursement
June 4, 2008	6.987	1.429	Board approval of the three-year ECF arrangement
November 30, 2008[2]	6.987	1.429	Board completion of the first review based on observance of performance criteria for June 30, 2008
May 1, 2009[2]	99.923	20.430	Board completion of the first and second review based on observance of performance criteria for June 30 and December 31, 2008
November 30, 2009	51.013	10.430	Board completion of the third review based on observance of performance criteria for June 30, 2009
June 30, 2010	18.395	3.761	Board completion of the fourth review based on observance of performance criteria for December 31, 2009
November 30, 2010	18.395	3.761	Board completion of the fifth review based on observance of performance criteria for June 30, 2010
May 15, 2011	18.395	3.761	Board completion of the sixth review based on observance of performance criteria for December 31, 2010
Total disbursements	**220.095**	**45.0**	

Source: IMF staff estimates.

[1]Original ECF disbursements of SDR 48.91 million (10 percent of quota) during 2008–11; and augmentation of SDR 171.2 million (35 percent of quota) during 2009–11; in total, SDR 220.1 million (45 percent of quota) during 2008–11.

[2]Disbursement made available upon completion of the first and second reviews on May 1, 2009.

LETTER OF INTENT

June 10, 2010

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, D.C. 20431
USA

Dear Mr. Strauss-Kahn,

The attached Memorandum of Economic and Financial Policies (MEFP) reviews recent economic developments and progress in implementing the Government of the Republic of Zambia's macroeconomic and structural program under the country's three-year Extended Credit Facility (ECF), approved by the IMF Executive Board on June 4, 2008. It also sets out macroeconomic policies and structural reforms that the government will pursue for the remainder of 2010 and over the medium term.

The Government requests that the fifth disbursement be made available upon completion of the fourth review by the Executive Board of the IMF. All but one of the performance criteria for the fourth review under the ECF arrangement were met. Unfortunately, the use of an outdated concessionality calculator caused the end-December 2009 non-concessional debt ceiling to be breached, for which a waiver is requested. In December 2009 a non-electricity related loan contract was signed that was believed to be concessional. However, corrected calculations now show that the grant element (at 27 percent) was less than the program threshold of 35 percent. The December 2009 ceiling was also missed by the contracting of two loans in late-May 2009. Further, it is now understood that the contracting of these two loans means that the end-June 2009 performance criterion on non-concessional borrowing that was assessed as met at the 3rd review under the ECF arrangement was not, in fact, met. At the time, however, the Government reported to IMF staff the contracting of the May 2009 loans as well as relevant data on their terms and were under the impression that there was no issue of nonobservance. Accordingly, the associated disbursement was requested.

Structural reforms are progressing well. The structural benchmark for end-March 2010 on the supervisory regime for the government securities market was met and most of the end-June 2010 benchmarks are on track, but the planning and budgeting act cannot be submitted to parliament before the constitutional reform process has been completed. Thus, it is requested that this benchmark be rescheduled for end-December 2010.

The Government believes that by adhering to the policies and measures set forth in the attached MEFP, it is well placed to achieve the objectives of the program. The economic program for 2010 has been updated to take into account recent developments, and modifications to the end-June 2010 performance are being requested. It is also requested that three road projects are added to the list of projects that can be financed under the non-zero non-concessional borrowing ceiling set at the time of the third ECF review. The Government is firmly committed to the objectives of the program, and will promptly take any additional measures necessary for their achievement. The Government remains committed to regular consultations with the IMF—at our own initiative or whenever the Managing Director of the IMF requests such a consultation—on the adoption of these measures and in advance of revisions to the policies contained in the MEFP, in accordance with the Fund's policies on such consultation.

The Government will provide the Fund with such information as the Fund may request in connection with the progress made in implementing the economic and financial policies and achieving the objectives of the program. Data reporting provisions have been strengthened in the Technical Memorandum of Understanding accordingly.

The Government authorizes the IMF to publish this letter, the attached Memorandum of Economic and Financial Policies, and the related Staff Report, including placement of these documents on the IMF website subject to the removal of market-sensitive information, following the IMF Executive Board's conclusion of the review.

Yours sincerely,

/s/

Dr. Situmbeko Musokotwane
Minister of Finance and National Planning

Attachments:
- Memorandum of Economic and Financial Policies
- Technical Memorandum of Understanding for the 2010–11 Extended Credit Facility (ECF) Arrangement

ATTACHMENT I. MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

1. This memorandum reviews recent economic developments and outlines policies and targets that the government of the Republic of Zambia will pursue for the remainder of the year 2010 and over the medium-term under the Extended Credit Facility (ECF) arrangement.

2. The ECF supports the implementation of the Fifth National Development Plan 2006–10 (FNDP). The FNDP underscores the need to create an environment conducive to private sector growth through sustained macroeconomic stability, public sector efficiency and accountability, and investments in infrastructure and the social sectors. Consistent with these principles and objectives, the program will continue to focus on: (i) maintaining macroeconomic stability and debt sustainability, while increasing fiscal space for investment in infrastructure, energy, and human resources; and (ii) diversifying the economy to lessen dependence on mining by improving the conditions for private sector-led growth.

I. RECENT ECONOMIC DEVELOPMENTS

3. **Growth in the Zambian economy was higher than projected earlier**. Initial estimates by the Zambian Central Statistical Office indicate that real GDP growth in 2009 was 6.3 percent, largely as a result of historically high growth in mining and agriculture and strong construction activity. A rebound in copper prices during the second half of the year, combined with the commencement of production at a large new copper mine, contributed to growth in the mining sector. The 2009 agricultural harvest was the highest recorded in ten years. Despite this strong performance, the tourism and tertiary sectors were negatively affected by the global economic crisis. Gross international reserves rose by US$782 million in 2009 to reach US$1.8 billion at end-2009 (equivalent to 5.1 months of contemporaneous imports or 3.9 months of prospective imports). This was on account of higher than expected copper revenues, an augmentation under the ECF of US$256 million, and the one-off SDR allocations of US$627 million. The Kwacha depreciated sharply in late 2008 and early 2009, before recovering strongly from March 2009 onwards. Inflation fell to 9.9 percent in December 2009, thus meeting the inflation target for the year.

4. **Despite a shortfall in tax collections and in inflows from cooperating partners, the fiscal program was broadly on track.** Preliminary estimates indicate that the shortfall in total revenues and grants relative to earlier projections was 0.3 percent of GDP, and 0.5 percent of GDP relative to budgeted estimates. Import-related tax collections declined compared to 2008 and fell below the program target by 0.2 percent of GDP, largely due to a decline in imports. The overall fiscal deficit of 2.5 percent of GDP remained in line with the program target.

5. **The global financial and economic crisis and the commodity price shocks of 2008 have provided an important stress test for Zambia's monetary policy framework.** These shocks increased inflation beyond single digits and created a more volatile exchange rate.

However, an appropriate monetary stance, combined with a flexible exchange rate regime provided the Bank of Zambia (BoZ) with the flexibility to intervene in the foreign exchange market. This helped address excess volatility and enabled the Zambian economy to adjust to the external shocks, particularly the decline in copper prices. This has helped in preserving a viable external sector over the medium term.

6. **Monetary developments in 2009 were influenced by a sharp drop in domestic credit to the private sector.** As a result, broad money growth slowed down substantially to 8.2 percent, 10.8 percent less than projected, in the 12 months to December 2009. Average reserve money in December 2009 was below target by kwacha 171 billion. Credit to the private sector contracted by 3.9 percent in 2009 driven mainly by a sharp decline in consumer loans and in domestic lending to the mining sector, compared to a programmed expansion of 14.3 percent, as financial institutions tightened lending standards amidst declining credit quality. This decline in the quality of credit was evidenced by an increase in non-performing loans in the banking system from 7.2 percent in 2008 to 12.6 percent at end-2009.

7. **The balance of payments position improved during the year following the recovery in copper prices.** The overall balance of payments surplus rose to 4.1 percent of GDP (equivalent to US$540 million) in 2009 compared to 0.1 percent of GDP (US$13 million) in 2008. This significant improvement in the overall balance was mainly on account of a large narrowing in the current account balance to –3.1 percent of GDP from –7.1 percent in 2008, together with the SDR allocation of US$627 million. The current account deficit declined substantially partly due to the sharply compressed imports. As a result, the international reserve position improved significantly, reaching 5.1 months of contemporaneous imports in 2009 or 3.9 months of prospective imports.

8. **The authorities' mid-term review of the Fifth National Development Plan found that significant strides have been made in poverty reduction efforts, but progress remains mixed.** The Millennium Development Goals in reducing hunger, maternal and child mortality, preventing the spread of HIV/AIDS and malaria, and providing universal primary education are on-track. However, the water, sanitation, and environmental sustainability goals are unlikely to be met without substantial effort. With strong annual average real GDP growth over the FNDP period, per capita income grew to US$980 in 2009, placing Zambia in lower middle-income status. While there has been significant progress in urban poverty reduction, the challenge for the government remains to tackle rural poverty and service delivery. Consultations with stakeholders on the draft of the Sixth National Development Plan (2011–15) are underway.

9. **The program was essentially on track at end-2009, and all but one of the quantitative performance criteria were met; one indicative target on domestic arrears clearance was missed.** The target relating to the ceiling on contracting of non-concessional debt was not met: the government signed two loans with China EXIM Bank for storage sheds

and the completion of a government complex building in late-May 2009 (equivalent to US$37 million) and a US$46 million loan agreement with China EXIM Bank for procurement of container scanning equipment in late December 2009. At the time these loans were signed, information available to the authorities indicated a computed grant element of 35 percent, thereby meeting the program threshold. Re-calculations using corrected information on the commercial interest reference rates provided to the authorities by the IMF staff at the time of discussions for the fourth review, however, indicate that the computed grant element is lower, at 28 and 27 percent respectively. In addition, payment of domestic arrears was less than the indicative program floor. This was as a result of the audit and verification process taking longer than expected. On the structural front, in order to enhance the efficiency of monetary policy, an overnight lending facility was introduced on December 1, 2009. This facility is expected to lower volatility of short-term interest rates as well as ease structural rigidities relating to market segmentation in the financial sector. The establishment of a supervisory regime for the secondary market in government securities was launched on March 26, 2010.

II. Medium-Term Macroeconomic Framework

10. **Economic growth is expected to remain strong over the medium term, in line with previous projections.** As agricultural output reverts to trend levels, real GDP growth is expected to fall marginally to 5.8 percent in 2010 before rising to 6 percent thereafter. Growth in 2010 will be driven by a recovery in the tertiary sector and by continued investment in the mining and construction sectors. Mines that had been closed down as a result of the crisis have reopened, and a rebound in tourism activity is expected in connection with the 2010 Football World Cup in South Africa. Downside risks, however, still remain amidst uncertainties about a full-fledged global recovery in 2010 and rising oil prices. Growth over the medium term is premised on the realization of policy initiatives and structural reforms aimed at economic diversification and enhanced competitiveness. Additionally, growth will be boosted by anticipated new investments in mining and electricity generation.

11. **A key government goal in the medium-term is to increase capital expenditure, particularly on infrastructure and social spending.** Stagnating revenues as a percentage of GDP, however, pose a significant challenge towards the attainment of this goal. The government is committed to addressing potential weaknesses in tax administration and policy, and is taking remedial measures to reduce current spending to provide room for capital expenditures. The measures will include rationalization on the purchase of goods and services and reduction in the number of foreign trips and holding of workshops.

12. **Earlier projections on increasing foreign direct investment (FDI) flows have been maintained.** A number of large investments in the mining and energy sector are expected over the medium-term, as indicated by pledges recorded at the Zambia Development Agency. Import-intensive infrastructure projects, particularly in the energy

sector, will require government equity participation, although the private sector is expected to play the lead role in the development of these projects.

III. Policies For 2010

A. Fiscal Policy

13. **Fiscal policy in 2010 remains geared towards the containment of current expenditures in favor of higher capital expenditures.** Domestic revenues are expected to rise to 16.3 percent of GDP, premised on tax administration gains and the introduction of some tax measures, such as the increase in the excise tax on diesel from 7 to 10 percent. Current expenditures will be reduced by 0.9 percentage points of GDP relative to 2009, in order to create fiscal space for capital spending which is expected to increase to 4.6 percent of GDP. The overall fiscal deficit is expected to rise remain at 2.5 percent of GDP and domestic financing is expected to remain as programmed at 1.9 percent of GDP. This fiscal framework is consistent with the inflation target and provides adequate room for the expansion of private sector credit.

14. **Improving the performance of revenues will be a key area of focus in the medium term.** While the contribution to GDP by sectors such as mining has increased dramatically over the last decade, this has not been matched by commensurate contributions to domestic revenues. In addition, the revenue burden continues to be borne by personal income taxpayers, while corporate and import taxes and VAT continue to underperform. The government remains on track to undertake a comprehensive review of tax policy and administration this year (structural benchmark for end-September 2010), and will draw on past technical assistance and the ongoing technical assistance on VAT. In the mining area, the government has commenced discussions with the mining sector aimed at resolving legacy issues related to the development agreements as well as the adherence to the current tax regime. In this context, the government intends to draw on lessons stemming from the ongoing audit of selected mining companies. The Government will continue to draw on the expertise of the IMF and other relevant development partners on the ramifications stemming from these discussions for the fiscal regime of the mining sector.

15. **Progress is being made towards reducing the high proportion of the public service wage bill relative to domestic revenues.** During the first half of 2009, the government undertook a review of pay policy and the recommendations of this review have now been approved by Cabinet (structural benchmark for end-June 2010). Implementation is expected to begin in 2010 through the establishment of a secretariat that will supervise the process of pay reform. The Cabinet Office has begun the process of undertaking a job evaluation exercise, which will determine the right-sizing requirements over the medium-term. In addition, progress continues to be made in rolling out the payroll management and establishment control (PMEC), to all remaining ministries and spending agencies during 2010.

B. Monetary and Exchange Rate Policies

16. **The government and Bank of Zambia will aim to bring down inflation further to 8 percent by the end of 2010.** Broad money is projected to expand in line with nominal GDP and the money multiplier to increase gradually towards past levels, as increased private sector credit drains excess liquidity. This should result in short term interest rates returning to positive real levels and in a flattening of the yield curve. Consistent with this, reserve money is targeted to grow by 9.7 percent from end-December 2009 to end-December 2010.

17. **The current reserve money-based program will remain in place, while at the same time progress is being made towards the use of interest rates as the main instrument to anchor inflationary expectations.** The Bank of Zambia is actively working on tackling the necessary preconditions and is in the process of developing draft operational guidelines to ensure a smooth eventual migration. The Bank will draw on technical assistance by the IMF to ensure the adoption of international best practices.

18. **The government will continue to maintain a flexible exchange rate regime**. Interventions in the foreign exchange market by the Bank of Zambia will be limited to the smoothing of excessive fluctuations, while allowing for a gradual buildup of international reserves.

19. **The government will continue examining the possibility of redeeming domestic debt securities financed through a drawdown on reserves.** This drawdown is initially expected to be in the amount of up to US$100 million. It is expected that this portfolio swap, focusing on longer-term more expensive instruments, will lead to a lower debt service burden and create room for more private sector borrowing in domestic markets.

C. Structural Policies

Public financial management

20. **Improving public financial management continues to remain a priority in 2010.** As a result of a constitutional amendment, the 2010 budget was presented and approved in advance of the fiscal year, allowing for implementation over the full financial year. The introduction of a planning and budgeting act in 2010 (that was structural benchmark for end-June 2010), however, is likely to be delayed as a result of the national constitutional reform process. While a draft of the act has been prepared, certain provisions pertaining to the budgeting process during and after a national election can only be finalized after the constitutional reform process is complete. As a result, the submission to parliament is likely to be delayed, and is expected to be completed by end-December 2010.

21. **The government's Integrated Financial Management and Information System (IFMIS) commenced pilot operations in January 2010.** The first pilot site, the Ministry of Finance and National Planning, has commenced use of all of the technology modules under

IFMIS. Additional ministries, provinces and spending agencies (MPSAs) are expected to launch operations over the course of 2010. A full rollout of IFMIS remains on track for end-2011.

22. **Trial runs of the Treasury Single Account (TSA) have commenced in 2010 at the Ministry of Finance and National Planning. The payment of salaries from the TSA has already commenced, with 54 MPSAs participating.** Implementation of the TSA will go hand-in-hand with the rollout of IFMIS over the course of the year. The government remains on track towards the rollout of the TSA at six MPSAs in 2010 (structural benchmark for end-December 2010).

Financial sector development

23. **The government remains on-track to implement the second phase of the Financial Sector Development Plan (FSDP II).** The FSDP II will focus on improving access to credit, thereby deepening financial markets, and reducing the high cost of borrowing.

24. **The Bank of Zambia is on course to revise its lender of last resort policy by end-June 2010 to align it with accepted international standards and ensure its effectiveness and relevance.** In the mean time, BoZ is enhancing its own stress testing capacity with a view of having an operational stress testing capability up and running by end-September 2010. Progress is also being made towards the development of a financial sector contingency plan to address the impact of a system-wide crisis in the financial sector and the broader economy (structural benchmark for end-June 2010).

Energy

25. **The government remains strongly committed to addressing constraints in electricity generation.** A multi-year tariff framework was announced to raise electricity tariffs to cost-recovery levels by 2011. A first adjustment of 35 percent was implemented in April 2009 and an indicative increase of 26 percent was announced for 2010. ZESCO, the public utility, has formally applied to the Energy Regulation Board (ERB) for a 36 percent tariff increase. After statutory public consultations, the ERB will announce the exact percentage of the next increase. The government is committed to meeting the related structural benchmark for end-June 2010. We also intend to modify the regulatory process to allow for implementation of phased multi stage tariff adjustments, as a way to streamline the process.

26. **Progress continues to be made in the development of electricity generation projects across the country.** Work will continue on the Kariba North Bank extension project in 2010, which will add 360 MW of additional capacity by 2013. Part of this work was financed by contracting US$315.6 million in nonconcessional financing in 2009. In addition, the government will continue, in 2010, with preparatory work for eventual

development of the 600 MW Kafue Gorge Lower (KGL) and the 120 MW Itezhi-tezhi projects, which are likely to be completed by 2017. Both of these projects will also require contraction of non-concessional financing, while remaining consistent with the nonconcessional debt ceiling under the program. Financial negotiations for the KGL project are expected to commence in 2010.

27. **The government has reinstated full cost recovery pricing of petroleum products.** Fuel prices were kept constant between December 2008 and January 2010, at which point a partial adjustment towards cost recovery was made. An average fuel price increase of 11.2 percent on May 11, 2010 has brought domestic petroleum prices fully in line with supply costs, and going forward the ERB will ensure that prices adjust automatically at the time of arrival of each shipment to ensure that domestic prices fully cover the supply costs The fact that prices were below cost in 2009 and the first part of 2010 resulted in an unbudgeted subsidy of US$90 million that will be covered by additional revenues and by savings elsewhere in current spending in the 2010 fiscal year.

Debt and aid management

28. **Improved public debt management remains a priority for the Government**. A medium-term debt strategy has been developed for Zambia with assistance from the IMF and World Bank. Progress is also being made to restructure debt management operations of government, with a view to improve risk management, ensure that financial obligations are honored, and minimize the cost of financing the budget.

29. **There is a growing demand for resources to finance large infrastructure projects of high economic return in Zambia.** Given the constraints of limited concessional financing, and in order to attract private sector investment, there is likely to be need for government equity participation in infrastructure projects. In addition to energy projects already outlined, the government will also undertake the development of a number of roads in 2010. These projects have been identified through the Road Sector Investment Program (ROADSIP I and draft ROADSIP II), which was developed after wide consultation with stakeholders, and will play a strategic role in the development of the Zambian economy. The government is likely to contract some non-concessional financing, consistent with the nonconcessional debt ceiling under the program, to facilitate the development of the most important of these projects in 2010.

30. **Aid management will remain a medium-term priority for the government**. The government and cooperating partners successfully concluded discussions on the underlying values of the Poverty Reduction Budget Support (PRBS) process, which was initiated in 2009 after concerns were raised over governance issues. Work has now commenced towards the development of a new Joint Assistance Strategy for Zambia, and a new memorandum of understanding for PRBS. Progress also continues towards improved aid data management between the government and cooperating partners. These measures will improve dialogue

and effectiveness of aid delivery in Zambia. The government remains committed to improving governance, and stands ready to deal swiftly with any mismanagement of public financial resources.

31. **Recent use of incorrect reference interest rates in assessing the concessionality of external debt highlights the need to strengthen debt management capacity.** As a result, the government intends to strengthen the process of assessing, recording, and providing timely external debt data, and related operational procedures and the document tracking system. The government will share information with IMF staff prior to contracting any potentially nonconcessional loans.

IV. Program Monitoring

32. **The government is committed to enhancing further the consultation process and information sharing with the IMF.** As an important step, a high level monitoring committee has been established comprising among others, the Secretary to the Treasury and the BoZ Deputy Governor for operations, and the IMF resident representative. This committee will meet often and with regularity.

33. **Semi-annual disbursements under the ECF arrangement will be based on the observance of quantitative performance criteria.** Completion of the sixth review under the arrangement will be based on the observance of quantitative performance criteria through end-December 2010 (Tables 1 and 2). The sixth review is expected to be completed by end-May 2011.

MEFP Table 1. Zambia: Quantitative Performance Criteria (PC) and Indicative Targets, 2009[1]
(Billions of kwacha, unless otherwise indicated)

		2008	2009								
	Dec	Dec	June			September			December		
	Prog.	Level	Prog.	Act.	Status	Indicative	Prel.	Status	Prog.	Prel.	Status
Performance criteria:											
Ceiling on the cumulative increase in net domestic assets (NDA) of the Bank of Zambia[2,3]	-776	-1,449	397	1134	Met	642	1176	Met	1670	1226	Met
Adjusted ceiling	83		578						1585		
Ceiling on the cumulative increase in net domestic financing (NDF)[2]	-64	5,291	447	35	Met	844	750	Met	1,443	1387	Met
Adjusted ceiling	795		628						1,560		
Floor on the cumulative increase in gross international reserves (GIR) of the Bank of Zambia (Millions of U.S. dollars)[2,4]	382	976	44	16	Met	29	684	Met	714	782	Met
Adjusted floor	158		14						737		
Ceiling on new external payment arrears[5]	0	0	0	0	Met	0	0	Met	0	0	Met
Ceiling on short-term external debt and on contracting or guaranteeing of nonconcessional debt by central government, BoZ, and ZESCO, ZAMTEL, and Zambia Railways Limited (millions of U.S. dollars)[5,6]		0	0	0	Met	0	0	Met	0	0	Met
Ceiling on medium- and long-term external debt and on contracting or guaranteeing of nonconcessional debt by central government, BoZ, and ZESCO, ZAMTEL, and Zambia Railways Limited (millions of U.S. dollars)[6]											
Electricity projects	450	0	400	0	Met	400	0	Met	400	316	Met
Other sectors	0	0	0	37	Not Met	0	37	Not Met	0	82	Not Met
Indicative targets:											
Floor on the cumulative payment of domestic arrears	669		161	199	Met	264	205	Not Met	352	278	Not Met
Ceiling on cumulative increase in reserve money	289	3,211	-60	26	Not Met	112	55	Met	610	438	Met
Memorandum items:											
Cumulative net budget support (millions of U.S. dollars)	141.2	142	110	72		126	73		160	178	
General budget support	200.0	203	110	91		201	113		212	231	
Central Government debt service obligations (excl. IMF)	-58.8	-61	0	-19		-75	-39		-52	-54	
Domestically financed capital expenditure		1271	- -	- -		- -	- -		1810	1842	
Program exchange rate (Kwacha per U.S. dollar)		4,832.3	4,832.3	5,074.9		4,832.3	4,654.0		4,832.3	4641	

Sources:

[1] The definitions of the items in the quantitative program are contained in the Technical Memorandum of Understanding (TMU)
[2] Adjustors, including for general budget support, are defined in the TMU.
[3] The ceiling will be adjusted for changes in the legal reserve requirements as specified in the TMU.
[4] Reserves are calculated at program exchange rates.
[5] Continuous performance criteria.
[6] Nonconcessional loans are those having a grant element of less than 35 percent.

MEFP Table 1. Zambia: Quantitative Performance Criteria (PC) and Indicative Targets, 2010[1]

(Billions of kwacha, unless otherwise indicated)

	2009	2010					
		March 31			Jun 30	Sep 30	Dec 31
	Prel.	Indicative CR No. 10/17	Act.	Status	Rev. Prog.	Indicative	Prog.
		(Cumulative from January 1st, 2010)					
Performance criteria:							
Ceiling on the cumulative increase in net domestic assets (NDA) of the Bank of Zambia[2,3]	58	405	80	Met	390	33	183
Adjusted ceiling		410					
Ceiling on the cumulative increase in net domestic financing (NDF)[2]	6,677	321	447	Not Met	825	1,386	1,487
Adjusted ceiling		151					
Floor on the cumulative increase in gross international reserves (GIR) of the Bank of Zambia (Millions of U.S. dollars)[2,4]	1,758	-2	-22	Not Met	40	126	150
Adjusted floor		-7					
Ceiling on new external payment arrears[5]	0	0	…		0	0	0
Ceiling on short-term external debt and on contracting or guaranteeing of nonconcessional debt by central government, BoZ, and ZESCO, ZAMTEL, and Zambia Railways Limited (millions of U.S. dollars)[5,6]	…	0	…		0	0	0
Ceiling on medium- and long-term external debt and on contracting or guaranteeing of nonconcessional debt by central government, BoZ, and ZESCO, ZAMTEL, and Zambia Railways Limited (millions of U.S. dollars)[5,6]							
Electricity[7] and road projects[8]		600	50		600	600	600
Other sectors		0	…		0	0	0
Indicative targets (cumulative):							
Floor on payment of domestic arrears of the government	278	59	…		153	157	269
Increase in reserve money (end of period)	4,054	239	-61	Met	223	264	394
Floor on social spending by the government of Zambia	…	930	…		1,875	2,838	3,938
Memorandum items:							
Cumulative budget support net of Central Government debt service (U.S. dollars)		61	98		204	235	223
General budget support (Fiscal accounts)[9]		78	108		235	288	288
Cumulative BoP support net of Central Government debt service (U.S. dollars)		61	56		162	193	182
General BoP support		78	66		193	246	246
Central Government debt service obligations (excl. IMF)	…	-17	-11		-31	-52	-64
Program exchange rate (Kwacha per U.S. dollar)	4,832	4,622	4,690		4,641	4,641	4,641

Sources:

[1] The definitions of the items in the quantitative program are contained in the Technical Memorandum of Understanding (TMU)

[2] Adjustors, including for general budget support, are defined in the TMU.

[3] The ceiling will be adjusted for changes in the legal reserve requirements as specified in the TMU.

[4] Reserves are calculated at program exchange rates.

[5] Continuous performance criteria.

[6] Nonconcessional loans are those having a grant element of less than 35 percent.

[7] The electricity projects are: Kariba North bank extension, Itezhi-Tehzi power station, Kafue Gorge Lower;

[8] The road projects are: Mutanda-Chavuma Road, Choma-Chitongo-Namwala Road, Kasama-Luwingu Road.

[9] Includes US$ 41.8 mn of budget support from the EU (V-flex) received from the Bank of Zambia on December 31, 2009 (BOP recording) and disbursed to GRZ government in January 2010.

Table 3 MEFP. Zambia: Structural Benchmarks for 2009

Measure	Timing	Macro Rationale	Status
Prepare a comprehensive strategy for phased implementation of the establishment of the treasury single account system.	End-June 2009	Strengthen public expenditure management and budget execution, including improving cash flow management and forecasts.	Met
Set up a supervisory regime for the secondary market in government securities.	End-June 2009	Financial sector deepening which is vital to achieving the growth objectives of the program.	Reset to end-March 2010; Met on March 26, 2010.
Raise the average electricity tariff in 2009 and publicly announce indicative tariffs for 2010-11consistent with the policy to reach cost-reflective levels by 2011.	End-June 2009	To ensure an efficient and sustainable power supply. Solving the current problems in the energy sector is essential to achieving the growth objectives of the program.	Met
Approval by Cabinet of all necessary amendments to the Public Finance Management Act specifying the general principles of the treasury single account system.	End-September 2009	Strengthen public expenditure management and budget execution, including improving cash flow management and forecasts.	Met
Bank of Zambia will introduce a new standing overnight lending facility.	End-September 2009	Strengthen liquidity management, reduce volatillity in the money market, and enhance the effectiveness of monetary policy.	Met with delay (December 1, 2009)

Source: Zambian authorities and IMF staff estimates.

Table 4 MEFP Zambia: Structural Benchmarks for 2010

Measure	Timing	Macro Rationale	Status
Approval by Cabinet of the pay policy reform	End-June 2010	Strengthen payroll management, and increase productivity of the public sector.	Met
Establish a Lender-of-Last Resort Framework and draft legislation and procedures for a financial sector contingency plan in the event of a crisis.	End-June 2010	Strengthen the Central Bank's crisis preparedness.	
Submit to parliament the Planning and Budgeting Act.	End-June 2010	Strengthen public expenditure management and budget execution, including improving cash flow management and forecasts.	Reset to end-December 2010
Raise the average electricity tariff in 2010 and publicly announce indicative tariffs for 2011 consistent with the policy to reach cost-reflective levels by 2011.	End-June 2010	To ensure an efficient and sustainable power supply. Solving the current problems in the energy sector is essential to achieving the	
Prepare a review of tax administration and policy	End-September 2010	Strenghten revenue performance	
Adoption of Treasury Single Account by six ministries, provinces, and spending agencies.	End-December 2010	Strengthen public expenditure management and budget execution, including improving cash flow management and forecasts.	

Source: Zambian authorities and IMF staff estimates.

ATTACHMENT II. TECHNICAL MEMORANDUM OF UNDERSTANDING FOR THE 2010–11 EXTENDED CREDIT FACILITY (ECF) ARRANGEMENT

I. INTRODUCTION

1. This memorandum sets out the understandings between the Zambian authorities and the International Monetary Fund (IMF) regarding the definitions of the quantitative performance criteria and indicative targets for the program supported by the ECF arrangement, as well as the program adjusters and the related reporting requirements.

II. QUANTITATIVE PERFORMANCE CRITERIA AND INDICATIVE TARGETS: DEFINITIONS AND DATA SOURCES

A. Net Domestic Assets (NDA) of the Bank of Zambia (BoZ)

2. Net domestic assets (NDA) of the BoZ are defined as the monthly average (based on daily data) of reserve money (as defined below) less the monthly average of net foreign assets of the BoZ calculated at kwacha 4,640.6 per U.S. dollar for 2010.[1] Net foreign assets of the BoZ are defined as gross international reserves (defined in paragraph 9) plus any other foreign assets, minus foreign liabilities (defined in paragraph 3).[2] The kwacha values of net foreign assets are derived from the U.S. dollar values using the program exchange rate.

3. Foreign liabilities are defined as short term (one year or less in original maturity) liabilities of the BoZ to nonresidents, plus any outstanding use of IMF credit, plus the stock of SDRs allocations to Zambia, and plus any other medium and long term foreign liabilities of BoZ.

4. Daily data on NDA, including all its components and calculation, will be reported by the BoZ weekly in electronic format and shall be consistent with the Standard Reporting Format (SRF) for monetary accounts.

B. Reserve Money

5. Reserve money (monthly average based on daily data) is defined as currency in circulation, plus required reserves on kwacha deposits, plus required reserves on foreign currency deposits (at the program exchange rate), plus any positive current account balance of Other depository corporations (ODC) with the BoZ, and plus deposits in the BoZ of sectors other than central government.

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[1] Unless otherwise defined, program exchange rates for 2010 between the U.S. dollar and other (non-kwacha) currencies will be equal to their end-December 2009 values. For the 2010 program, the U.S. dollar/SDR rate is 1.567; the U.S. dollar/GBP rate is 1.624, the U.S. dollar/euro rate is 1.459, and the U.S. dollar/South Africa Rand is 0.133. All other assets (e.g. gold) would be revalued at their end-December 2009 market prices for 2010.

[2] Other foreign assets include encumbered reserves and any other foreign assets of BoZ.

6. Daily data on reserve money, including its components, will be reported by the BoZ weekly in electronic format and shall be consistent with the SRF for monetary accounts.

C. Net Domestic Financing (NDF)

7. Net domestic financing (NDF) is defined as the Budgetary Central Government's net borrowing from the banking and non-banking sectors.[3] All government-issued securities will be recorded at cost (face value less discount). NDF will comprise:

(a) the net position of the central Government with commercial banks, including: (i) Treasury bills; (ii) government bonds; (iii) loans and advances; less (iv) support to Meridien Bank of Zambia (MBZ); and (v) central government deposits (defined to include account balances under the authority of controlling officers); plus

(b) BoZ holdings of: (i) Treasury bills; (ii) government bonds; (iii) kwacha bridge loan (overdraft facility); less (iv) the government's deposits at the BoZ; and (v) the donor suspense account; plus (vi) the outstanding amount of the long-term non-transferable security (10-Year Mega Bond) issued against the government's indebtedness to BoZ as at end-2002; plus

(c) Nonbank holdings of: Treasury bills; and government bonds.

8. The data source for NDF will be the "Net Domestic Financing" Table produced by the Economics Department of the BoZ. The Table will be submitted on a weekly basis in electronic format, and end-month outturns will be fully reconciled with the monthly monetary survey.

D. Gross International Reserves of the BOZ

9. Unless otherwise noted here, gross international reserves of the BoZ will be defined as reserve assets of the BoZ (See Table 2). Reserve assets are defined in the IMF BOP manual (5th edition) and elaborated in the reserve template of the IMF's special data dissemination standards (SDDS). They exclude, for example, foreign assets not readily available to or controlled by the monetary authorities, and foreign currency claims on Zambian residents.

10. Gross international reserves consist of: (i) monetary gold; (ii) foreign currency; (iii) unencumbered foreign-currency deposits at non-resident banks; (iv) foreign securities and deposits; and (v) SDR holdings and Zambia's reserve position with the IMF. Gross reserves exclude non-convertible currencies, any encumbered reserve assets including but not limited to reserve assets pledged, swapped or used as collateral or guarantee for third-party external

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[3] The Budgetary Central Government includes all the units identified by the budget heads listed in the Yellow Book for 2010 and listed in Table 1.

liabilities, other depository corporation reserve requirements on foreign currency deposits, and the US$25 million deposit in MBZ (in liquidation).

11. For the purpose of this target valuation will be in U.S. dollars at program exchange rates.

12. Daily data on gross international reserves, including its components, will be reported by the BoZ weekly.

E. External Payment Arrears

13. The performance criterion on the non-accumulation of new external payment arrears is continuous. Official external payment arrears are defined as unpaid debt service by the central Government and BoZ 30 days beyond the due date and/or the grace period. This definition excludes arrears on debt subject to rescheduling.

14. Data on arrears, at program exchange rates, are compiled jointly by the Ministry of Finance and National Planning (MoFNP) and BoZ and will be reported by the MoFNP on a quarterly basis.

F. Official External Debt

15. Official medium- and long-term concessional external debt is defined as all forms of official debt with original maturity of more than one year contracted or guaranteed by the central Government, BoZ, ZESCO, ZAMTEL, and Zambia Railways Limited with nonresidents having a grant element of no less than 35 percent, since the beginning of the calendar year. The grant element is the difference between the present value (PV) of debt and its nominal value, and is expressed as a percentage of the nominal value of the debt. The PV of debt at the time of its contracting is calculated by discounting the future stream of payments of debt service due on this debt.[4] The discount rates used for this purpose are the currency-specific commercial interest reference rates (CIRRs) published by the Organization for Economic Cooperation and Development (OECD).[5] For debt with a maturity of at least 15 years, the ten-year-average CIRR will be used to calculate the PV of debt and, hence, its grant element. For debt with a maturity of less than 15 years, the six-month average CIRR will be used. To both the ten-year and six-month averages, the same margins for differing repayment periods as those used by the OECD need to be added (0.75 percent for repayment periods of less than 15 years, 1 percent for 15 to 19 years, 1.15 percent for 20 to 29 years, and 1.25 percent for 30 years or more). Lending from the IMF will be excluded.

[4] The calculation of concessionality will take into account all aspects of the loan agreement, including maturity, grace period, payment schedule, upfront commissions, and management fees.

[5] Available at http://www.oecd.org/dataoecd/21/52/39085945.xls. Where the CIRR is not available, the SDR rate shall be used.

16. This minimum grant element applies not only to debt as defined in Point 9 of the Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements (Decision No. 6230-(79/140), as subsequently amended, including by Executive Board Decision No. 14416-(09/91), effective December 1, 2009, but also to commitments contracted or guaranteed for which value has not been received.

17. Official external non-concessional debt is defined as the contracting or guaranteeing of debt with nonresidents other than concessional debt as defined in paragraph 15, owed or guaranteed by the central Government, BoZ, ZESCO, ZAMTEL, and Zambia Railways Limited.

18. The ceiling on contracting or guaranteeing of medium and long-term non-concessional external debt by the central government, BoZ, ZESCO, ZAMTEL, and Zambia Railways Limited excludes: (i) non-concessional loans stemming from the rescheduling of external debt; and (ii) central government securities issued in domestic currency, placed in the domestic primary or secondary markets, and held by non-residents.

19. Official external short-term debt is defined as the contracting or guaranteeing of debt with nonresidents with original maturity of one year or less, and includes forward commodity sales but will exclude normal trade credit for imports, incurred since the beginning of the calendar year. The term "debt" has the meaning set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to External Debt (Decision No. 6230-(79/140), as subsequently amended, including by Executive Board Decision No. 14416-(09/91), effective December 1, 2009.

20. Detailed data on all new external debt (concessional and non-concessional) contracted or guaranteed by the central government, BoZ, ZESCO, ZAMTEL, and Zambia Railways Limited will be provided by the MoFNP on a monthly basis. Information will include (i) amounts contracted or guaranteed; (ii) currencies; and (iii) terms and conditions, including interest rate, maturity, grace period, payments per year, commissions and fees, and collaterals.

G. Domestic Arrears of Central Government

21. Domestic arrears are defined as: (i) any bill that has been received by a spending ministry from a supplier for goods and services delivered (and verified) and for which payment has not been made within 30 days after the due date of payments; (ii) wage, salary and any other payment to government employees, including pension contributions and all forms of housing allowances, that were due to be paid in a given month but remained unpaid on the 15th of the following month; and (iii) interest or principal obligations which remain unpaid 30 days after the due date of payment.

22. Information regarding domestic arrears will be compiled through audits of the accounts of spending Ministries and agencies, conducted by the Internal Audit division of the MoFNP**.** The audits will be completed and data submitted to IMF staff by the Secretary of the Treasury within six weeks of the end of each quarter.

H. Floor on Social Spending

23. Social spending is defined as central government domestically financed expenditure on health and education as listed in the 2010 Yellow Book under the functional classification. The corresponding indicative target sets the minimum spending on these sectors combined.

III. Adjusters

24. The quantitative performance criteria specified under the program are subject to the following adjusters:

General budget support (GBS) net of debt service[6]

(i) The ceilings on NDA and NDF will be adjusted downward (upward) by the full amount of the excess (shortfall) in GBS net of debt service relative to the programmed levels specified in Table 1 of the MEFP.[7,8]

(a) The total adjustment for shortfalls will be limited to US$40 million for January-June 2010 and US$60 million for January-December 2010.

(ii) The floors on GIR will be adjusted upward (downward) by the full amount of the excess (shortfall) in GBS net of debt service relative to the programmed levels (Table 1 of the MEFP).

Change in reserve requirements

(iv) The ceiling on NDA will be adjusted downward/upward to reflect decreases/increases in the legal reserve requirements on deposits in commercial banks. The adjuster will be calculated as the percent change in the reserve requirement multiplied by the actual amount of required reserves (kwacha and foreign-currency denominated) at the end of the previous calendar month.

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[6] General budget support consists of grants and loans received by the central government for financing its overall policy and budget priorities following Zambian budget procedures.

[7] For the purpose of adjusting the NDA ceiling, external disbursements will be treated as if they were received the first day of the month. The targeted NDA will be increased by the amount of the disbursement divided by the number of business days in the month multiplied by the number of business days from the beginning of the month to the day prior to the disbursement.

[8] For purpose of adjusting the NDF ceiling, the cumulative excess/shortfall will be converted to kwacha value using the program exchange rate.

IMF disbursement

(v) The floors on GIR will be adjusted upward (downward) for any excess (shortfall) in the disbursements from the IMF (US dollar value at the program exchange rate) relative to the programmed levels.

BoZ short-term debt

(vi) The floor on GIR will be adjusted upward for any increase in the US dollar value at the program exchange rate of BoZ short-term debt, (see definition of short-term debt above).

IV Reporting Requirement

25. To facilitate monitoring of the program, the information listed in Table 2 below will be reported to the IMF within the timeframe indicated. These data, and any other information needed for monitoring of adherence to program targets, will be provided electronically by email to AFRZMB@IMF.ORG.

Table 1. Administrative units comprising the Budgetary Central Government

Office of the President	Ministry of Finance and National Planning
Office of the Vice President	Ministry of Labour and Social Security
National Assembly	Ministry of Community Development and Social Services
Gender in Development Division	Ministry of Health
Electoral Commission	Ministry of Communications and Transport
Public Service Commission - Office of the President	Ministry of Works and Supply
Office of the Auditor General	Ministry of Science, Technology and Vocational Training
Cabinet Office - Office of the President	Ministry of Tourism, Environment and Natural Resources
Teaching Service Commission - Office of the President	Ministry of Sport, Youth and Child Development
Police and Prisons Service Commission	Ministry of Defence
Zambia Police - Ministry of Home Affairs	Zambia Security Intelligence Services - Office of the President
Commission for Investigations - Office of the President	Ministry of Education
Ministry of Energy and Water Development	Ministry of Lands
Ministry of Mines and Mineral Development	Anti-Corruption Commission
Ministry of Home Affairs	Ministry of Livestock, and Fisheries Development
Ministry of Foreign Affairs	Ministry of Agriculture and Cooperatives
Judiciary	Office of the President - Lusaka Province
Loans and Investments - Local Government and Housing	Office of the President - Copperbelt Province
Loans and Investments	Office of the President - Central Province
Ministry of Information and Broadcasting Services	Office of the President - Northern Province
Public Service Management Division	Office of the President - Western Province
Ministry of Local Government and Housing	Office of the President - Eastern Province
Ministry of Justice	Office of the President - Luapula Province
Ministry of Commerce, Trade and Industry	Office of the President - North-Western Province
Human Rights Commission	Office of the President - Southern Province

Table 2: Reporting Requirements

Data description	Data Freq.	Reporting Agency	Reporting Freq.	Date	Mode
Monetary and financial sector					
Reserve money and its components (NDA and NFA) at current and program exchange rate	D	BoZ	W	T5	E
Excess reserves	D	BoZ	M	T5	E
Overnight interbank rates	D	BoZ	W	T5	E
Treasury bill and BoZ bill auction results	W	BoZ	W	T5	E
Interest rates	M	BoZ	M	T15	E
Holdings of government and BoZ securities by maturity and type of investors (local commercial banks, nonbanks, and foreigners)	M	BoZ	M	T15	E
Monetary survey (and the BoZ, and Other Depository Corporations surveys)	M	BoZ	M	T15	E
Commercial bank lending. Credit to the economy by sector and type of institution	M	BoZ	M	T15	E
Financial soundness indicators by banks	M	BoZ	M	T15	E
External sector					
Exchange rates	D	BoZ	W	T5	E
Gross international reserves, and foreign exchange purchases and sales	D	BoZ	W	T5	E
Copper prices	D	BoZ/CSO	W	T5	E
BoZ foreign exchange cash flow	M	BoZ	M	T10	E
Import and export data	M	CSO	M	T15	E
Balance of payments	Q	BoZ	Q	T30	E
Copper production and exports (quantities, prices and US dollar value)	M	MoF	M	T15	E
Foreign direct investment (actuals and pledges)	M	MoF/ZDA	M	T15	E
Fiscal					
Net Domestic Financing	D	BoZ	W	T5	E
Fiscal table including revenue, expenditure, and financing.	M	MOF	M	T30	E
Real sector					
Consumer price index and monthly statistical bulletin	M	CSO	M	T15	E
National accounts	A	CSO	BA	Mar. 15; Sep. 15	E
Program monitoring					
Report on IMF program performance	Q	MOF	Q	T15	E
Stock of domestic and external payment arrears	Q	AuG	Q	T15	E
Central government domestic borrowing	Q	BoZ	M	T15	E
New external loans contracted or guaranteed by the central government BoZ, ZESCO, ZAMTEL, and Zambia Railways Limited or any other agency on their behalf[1]	Q	MOF	Q	T30	E

D-Daily, W-Weekly, M-Monthly, Q-Quarterly, BA-Bi-annual A-Annual; Tx: x days after the date of the last observation; E-email, H-Hard copy

1 Detailed information on the amounts, currencies, terms, conditions, and purpose (to finance electricity and road projects listed on the quantitative performance criteria table, or other purposes).

ANNEX I. ZAMBIA: RELATIONS WITH THE FUND

(As of May 31, 2010)

I. **Membership Status:** Joined: September 23, 1965; Article VIII

II. **General Resources Account:**	**SDR Million**	**Percent Quota**
Quota	489.10	100.0
Fund holdings of currency	489.10	100.0
Reserve position in Fund	0.02	0.0

III. **SDR Department:**	**SDR Million**	**Percent Allocation**
Net cumulative allocation	469.14	100.0
Holdings	406.65	86.68

IV. **Outstanding Purchases and Loans:**	**SDR Million**	**Percent Quota**
ECF arrangements	219.93	44.97

V. **Latest Financial Arrangements:**

Type	**Approval Date**	**Expiration Date**	**Amount Approved (SDR Million)**	**Amount Drawn (SDR Million)**
ECF [19]	06/04/2008	06/03/2011	220.10	164.91
ECF [1]	06/16/2004	09/30/2007	220.10	220.10
ECF [1]	03/25/1999	03/28/2003	278.90	237.52

VI. **Projected Payments to the Fund**
(SDR million; based on existing use of resources and present holdings of SDRs)

	Forthcoming				
	2010	2011	2012	2013	2014
Principal	0.55	3.30	7.70	11.70	23.09
Charges/interest	0.10	0.16	0.69	0.67	0.64
Total	0.65	3.46	8.40	12.37	23.73

[19] Formerly PRGF.

VII. Implementation of HIPC Initiative

	Enhanced Framework
Commitment of HIPC assistance	
Decision point date	Dec. 2000
Assistance committed (1999 NPV terms)[20]	
by all creditors (US$ million)	2,499.20
Of which: Fund assistance (US$ million)	602.00
(SDR equivalent in million)	468.80
Completion point date	April 2005
Disbursement of IMF assistance (SDR million)	
Assistance disbursed to Zambia	468.80
Interim assistance	351.60
Completion point balance	117.20
Additional disbursements of interest income[21]	39.47
Total disbursements	508.27

VIII. Implementation of MDRI Assistance

I.	Total debt relief (SDR million)[22]	402.59
	Of which: MDRI	398.47
	HIPC	4.12
II.	Debt relief by facility (SDR million)	

Delivery Date	GRA	PRGT	Total
January 2006	N/A	402.59	402.59

[20] Net present value (NPV) terms at the decision point under the enhanced framework.

[21] Under the enhanced framework, an additional disbursement is made at the completion point corresponding to interest income earned on the amount committed at the decision point but not disbursed during the interim period.

[22] The Multilateral Debt Relief Initiative (MDRI) provides 100 percent debt relief to eligible member countries that are qualified for assistance. The debt relief covers all debt owed to the Fund as of end-2004 that is outstanding at the time the member qualifies for the relief.

IX. Safeguards Assessment

An update of the previous safeguards assessment, completed on January 13, 2009, of the Bank of Zambia (BoZ) is currently underway in conjunction with the augmentation under the ECF arrangement approved in June 2009. The previous safeguards assessment found that aspects of the BoZ safeguards framework have been strengthened since the previous assessment, completed in 2004. Specifically, the BoZ implemented IFRS in 2005 and strengthened foreign reserves management and oversight in 2008. Weak statutory independence, protracted external audit completion, and incomplete publication of audited information remain safeguards concerns. The assessment recommended specific measures to address these issues, the implementation of which are being monitored under the program.

X. Exchange Rate Arrangement

The currency of Zambia is the kwacha. The exchange rate arrangement is a “float”, with the kwacha exchange rate determined in the interbank market. The buying rate of the Bank of Zambia (BoZ) is a simple average of the primary dealers’ low bid rates and the BoZ’s selling rate is the simple average of the primary dealers’ high offer rates. On April 19, 2002, Zambia accepted the obligations of Article VIII, Section 2, 3, and 4 of the Articles of Agreement. However, the Fund urged the authorities to eliminate the exchange restriction evidenced by the accumulation of external payments arrears, which is subject to Fund approval under Article VIII, as soon as possible.

XI. Article IV Consultations

Zambia is on the standard 24-month Article IV consultation cycle, subject to the provisions of the decision on consultation cycles approved on July 15, 2002. The Executive Board concluded the last Article IV consultation on December 14, 2009.

XII. FSAP Participation and ROSC

Zambia has participated in the financial sector assessment program (FSAP); an FSAP mission from the Fund and the World Bank conducted a comprehensive external assessment of the financial system April 30-May 15 and July 15–26, 2002. A mission from the Fund and the World Bank conducted a follow up FSAP in November 2008.

The fiscal transparency module of a Report on Observance of Standards and Codes (ROSC) assessing compliance with the IMF’s Code of Good Practices on Fiscal Transparency—Declaration of Principles was issued to the Executive Board on October 31, 2001. A ROSC-data module was issued to the Executive Board on January 18, 2005.

XIII. Technical Assistance (since 2003)

Resident advisors

Department	**Dates**	**Position**
FAD	2002–03	Advisor on public expenditure management

Technical assistance missions

Department	**Dates**	**Purpose**
MFD	January and May 2003	Development of foreign exchange interbank market, monetary operations, and reform of the financial system
	September 2003	Monetary operations, reform of the financial system, government securities market, and payments system
	April–October 2004	Resolution of nonbank financial institutions (three missions)
	April–May 2005	Liquidity management operations
	March 2006	Liquidity management, monetary and exchange rate policies
MCM	March 2009	Contingency planning and lender of last resort
	September 2007	Institutional arrangements and operation of the foreign exchange market.
	September 2007	Foreign exchange market
	November 2007	Risk-based supervision
	July 2008	Bank Restructuring
	July 2009	Debt Management Strategy
STA	June 2004	Data ROSC
	April–May 2005	Monetary Statistics (GDDS)
	May 2005	Government Finance Statistics (GDDS)
	February 2006	Real Sector (GDDS)
	July 2006	Real Sector (GDDS)
	April 2008	Monetary and Financial Statistics
	January 2009	Consumer Price Index
	April 2010	Government Finance Statistics

FAD	July–August 2005	Regulations for the Public Finance Act
	November 2005	Fiscal regime for copper mining
	July 2006	Revenue administration
	August 2006	Follow up on fiscal arrangements for the mining sector
	October 2006	Review of tax policy
	June 2008	Tax administration
	November 2008	Tax administration
	January 2009	Tax administration
	April 2009	Public Financial Management
	November 2009	Tax Administration
	February 2010	Tax administration
LEG	August 2004–February 2005	Assistance on amending legislation on nonbank financial institutions
	May 2005	Strengthening the regulatory framework for nonbank financial institutions

XIV. **Resident Representative**

A Fund Resident Representative first took up the position in Lusaka in June 1990. Mr. Perry Perone has been the Resident Representative since December 2009.

ANNEX II. ZAMBIA: JOINT WORLD BANK-FUND WORK PROGRAM, 2010–11

Title	Products	Expected delivery date
World Bank work program in next 12 months	1. Political Economy of Mining	July 2010
	2. Fertilizer Support Program – Public Expenditure Tracking Study	May 2010
	3. Public Expenditure Review	May 2010
	4. Jobs, Prosperity and Competitiveness Study	June 2010
	5. Institutional Review of the Transport Sector	August 2010
	6. Country Health Strategy Report	June 2010
	7. Capacity Building for Public Expenditure Tracking for HIV-AIDS	June 2011
	8. Review of Oversight Institutions	June 2010
	9. Zambia Business Survey	June 2010
	10. Improved Access to ACT – Malaria	August 2010
IMF work program in next 12 months	1. Fourth PRGF review	June 2010
	2. Fifth PRGF review	December 2010
	3. Technical assistance: public financial management	June 2010 (and follow up)
	4. Technical assistance: tax policy	July 2010 (and follow up)
	5. Sixth PRGF review	May 2011
Fund request to Bank	1. Public Expenditure Review.	May 2010
	2. Review the Fertilizer Support Program (FSP). With significant increase in budget allocation, there is an urgent need to assess the FSP's poverty targeting goals.	December 2009
Bank request to Fund	1. Medium-term macroeconomic framework	
	2. Real exchange rate study	September 2010
Joint products in next 12 months	1. DSA	September 2010

ANNEX III. ZAMBIA: STATISTICAL ISSUES

As of June 2, 2010

I. Assessment of Data Adequacy for Surveillance
General: Data provision has some shortcomings, but is broadly adequate for surveillance. Issues with source data and compilation affect most datasets, but are particularly problematic in the national accounts, balance of payments, and consumer prices.
National Accounts: There is a high degree of uncertainty attached to estimates of the level and growth rate of real GDP, as 1994 is the latest benchmark year for value-added ratios to estimate GDP under the production approach. For many important industry areas, such as wholesale and retail trade, construction, business services and many other service industries, (consisting mainly of small-scale private service providers) there are no appropriate indicators. Data on total production and intermediate consumption of establishments are not available. On the expenditure side, there are no reliable indicators of household consumption and private final consumption expenditure is derived as a residual. Source data for estimating gross fixed capital formation and changes in stocks are incomplete. The situation largely reflects resource constraints and organizational weakness within the CSO that have affected its ability to produce economic statistics on a timely basis.
Price statistics: The CPI broadly adheres to international methodological standards. The classification system used for compilation closely follows the Classification of Individual Consumption by Purpose. However, the measurement of inflation is also subject to a high degree of uncertainty since the weights for Zambia's CPI are derived from the Household Budget Survey (HBS) of 1993/94 and thus are out-of-date. STA is providing technical assistance in this area.
Government finance statistics: Data provision is broadly adequate for surveillance purposes. The transactional coverage of these data is however limited to government operations and transactions in nonfinancial assets. Data on transactions in financial assets and liabilities are still unavailable. The authorities report monthly budget data to AFR for operational use in a timely manner, but the data are often subject to substantial revisions, and data on extra-budgetary institutions and local governments are not available. STA is providing technical assistance in this area.
Monetary statistics: Data provision is broadly adequate for surveillance purposes. As a result of implementation of a 2005 monetary and financial statistics mission, there has been a noticeable improvement in the quality of monetary accounts compiled and reported in accordance with the standardized report forms (SRFs) for the BoZ and other depository corporations (ODCs). However, the implementation of some recommendations pertaining to the ODCs accounts still has some way to go and in some instances the pace of

implementation could have been accelerated.	
Balance of payments statistics: Little progress had been made since the assessment by the 2004 Data ROSC mission. Data sources remain poor (some items are estimated without reference to current source data) and compilation methods are inadequate. Resources available for balance of payments compilation have been increased, but are still inadequate, while coordination between the BoZ and CSO had improved. As a result, significant gaps in data remain in many areas including reinvested earnings, trade in services, and the financial account (including export proceeds held abroad by mining and nontraditional exporters). While the source data are generally adequate in terms of timeliness, they fall short in terms of coverage. As a result the shortcomings in source data coverage, indirect estimation methods are used, some of which have remained unchanged for many years and are out of date. Source data on private sector foreign assets and liabilities are insufficient to compile an International Investment Position statement.	
External and domestic debt statistics: Data provision is broadly adequate for surveillance purposes. Recent efforts, facilitated by technical assistance, have led to an improvement in the consolidation of the debt databases, both in terms of external and domestic debt. Further work is underway in these areas.	
II. Data Standards and Quality	
Zambia has participated in the General Data Dissemination System (GDDS) since November 2002.	A Data ROSC Assessment was published in February 2005.

Zambia: Table of Common Indicators Required for Surveillance
As of June 2, 2010

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of publication[7]	Memo Items: Data Quality – Methodological soundness[8]	Memo Items: Data Quality – Accuracy and reliability[9]
Exchange Rates	May 19, 2010	May 21, 2010	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	May 19, 2010	May 21, 2010	W	W	M		
Reserve/Base Money	May 19, 2010	May 21, 2010	W	W	F	LO, LO, LO, LO	LO, O, O, O, O
Broad Money	Mar. 2010	May 4, 2010	M	M	M		
Central Bank Balance Sheet	Mar. 2010	May 4, 2010	M	M	M		
Consolidated Balance Sheet of the Banking System	Mar. 2010	May 4, 2010	M	M	M		
Interest Rates[2]	Mar. 2010	May 21, 2010	W	W	F		
Consumer Price Index	May, 2010	May 27, 2010	M	M	M	O, LO, O, LO	LNO, LO, LO, LNO, LO
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	NA					LO, LNO, LNO, LO	LNO, LO, O, O, LNO
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	April, 2010	May 24, 2010	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Q4, 2009	Feb. 17, 2010	M	M	A		
External Current Account Balance	2009	Feb. 17, 2010	A	A	A	LO, LNO, LNO, O	LNO, O, LNO, LO, LNO
Exports and Imports of Goods and Services	2009	Feb. 17, 2010	A	A	A		
GDP/GNP	2009	Feb. 17, 2010	A	A	A	LO, LO, LO, LO	LNO, LO, LNO, LNO, LNO
Gross External Debt	Q4, 2009	Feb. 17, 2010	Q	I	I		
International Investment Position[6]	NA	NA					

1 Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
2 Both market-based and officially determined, including discounts rates, money market rates, rates on treasury bills, notes and bonds.
3 Foreign, domestic bank, and domestic nonbank financing.
4 The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
5 Including currency and maturity composition.
6 Includes external gross financial asset and liability positions vis-à-vis nonresidents.
7 Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); or Not Available (NA).
8 Reflects the assessment provided in the data ROSC, published February 1, 2005, and based on the findings of the mission that took place during May 18-June 3, 2004 for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning (respectively) concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).
9 Same as footnote 8, except referring to international standards concerning (respectively) source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.

INTERNATIONAL MONETARY FUND EXTERNAL RELATIONS DEPARTMENT

Press Release No.10/260
FOR IMMEDIATE RELEASE
June 25, 2010

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Fourth Review Under ECF Arrangement for Zambia and Approves US$27.1 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed its fourth review of Zambia's economic performance under the Extended Credit Facility (ECF) arrangement. Completion of the review allows Zambia to draw an amount equivalent to SDR 18.395 million (US$27.1 million) immediately, bringing total disbursements under the arrangement to the equivalent of SDR 183.305 million (US$270.5 million). In completing the review, the Executive Board granted a waiver of non-observance of the performance criterion concerning the non-concessional debt ceiling at end-December 2009.

The ECF (formerly Poverty Reduction and Growth Facility) arrangement for Zambia was originally approved in June 2008 (see Press Release No. 08/134) and augmented in May 2009 by SDR171.185 million (about US$252.6 million) to an amount equivalent to SDR 220.095 million (about US$324.7 million) (see Press Release No. 09/147). Zambia has been a member of the Fund since September 1965.

Following the Executive Board's discussion of Zambia, Mr. Naoyuki Shinohara, Deputy Managing Director and Acting Chair, issued the following statement:

"The Zambian economy has performed well in the aftermath of a sharp decline in copper prices in late 2008-early 2009, thanks to prudent macroeconomic policies and structural reforms. Growth is high; inflation has moderated; the current account deficit has narrowed; international reserves have strengthened, thanks in part to the SDR allocations and ECF augmentation; and the economic outlook is positive. The financial sector's recovery has, however, been slow.

"The moderate tightening of the policy stance in 2010 is appropriate. As the world economy emerges from recession, prospects for the Zambian economy are improving and the need for fiscal and monetary stimulus is receding. Excess reserves should drain, and real interest rates on government securities should gradually return to positive territory, as credit to the private sector picks up. The Bank of Zambia should stand ready to tighten its monetary policy stance if broad money growth picks up faster than assumed.

"The key macroeconomic policy challenge is to create fiscal space for spending to enhance economic diversification and reduce Zambia's dependence on a narrow export base. This will require mobilizing more revenues, including from mining; containing current spending, including on the wage bill; and improving overall spending efficiency. The 2010 fiscal program rightly focuses on harnessing domestically generated resources.

"The return to full cost-recovery pricing of petroleum products and the reinstatement of the automatic fuel pricing mechanism is welcome. It will help safeguard budgetary resources so they can be channeled to higher-priority use.

"Addressing Zambia's investment needs in the electricity sector requires cost-recovery tariffs to encourage private sector participation in electricity generation and distribution projects."

Statement by Samuel Itam
Executive Director for Zambia

June 25, 2010

Introduction

1. My Zambian authorities thank the Fund for the support of the country's economic program under the ECF and the provision of technical assistance in several key areas. The program is based on the Fifth National Development Plan whose main thrust is to enhance economic growth. In line with the national vision, the country strives to revert to middle-income status by 2030. In this respect, the authorities' objectives for 2010 and the medium-term are to consolidate economic recovery and accelerate growth by maintaining the economic diversification program and attracting private sector investment.

Economic performance

2. Economic growth of 6.3 percent in 2009 was higher than earlier projected as a result of supportive macroeconomic policies, a rebound in copper prices, and a bumper agriculture harvest. For the medium-term, economic growth is expected to remain strong, propelled by a recovery in the tertiary sector and continued investment in mining and construction. Per capita income stood at US$980 in 2009, placing the country in the lower middle-income status. While progress has been recorded in reducing urban poverty and attaining some MDGs, reducing rural poverty remains a key challenge.

3. Broad money growth slowed in 2009 due to a sharp drop in domestic credit to the private sector as a result of lower credit demand and tightened lending standards. Despite the adverse impact of the financial crisis on the banking system globally, the banking sector in Zambia remained adequately capitalized. However, there was a decline in the quality of loan performance, as reflected by the increase in nonperforming loans, largely in the agriculture sector because of borrowing in unhedged U.S. dollars and in households because of job losses.

4. The overall balance of payments surplus strengthened significantly in 2009, as the external current account deficit narrowed sharply. This development, together with the SDR allocation, raised the level of the international reserves appreciably to the equivalent of about 5 months of current imports. The country's external debt, at about 12 percent of GDP at end-2009, is within sustainable limits and in line with the authorities' debt policy objective.

Program performance

5. Program performance remains strong in 2009. All but two of the end-December quantitative performance criteria and indicative targets were met. A technical error led to the breach of the ceiling on contracting of nonconcessional debt; and payment of domestic arrears

was less than the indicative target because completion of the verification process took longer than expected. Also, we would like to note that the introduction of overnight lending facility was met with a delay because the consultation process with key stakeholders took longer than originally planned; and the establishment of a supervisory regime for the secondary market in government securities, re-set to end-March 2010, has been met. Despite lower-than-expected revenue and donor inflows, the fiscal program remained broadly on-track.

6. The zero ceiling on nonconcessional debt was met at end-December 2008 and end-June 2009. During the 4th review (February/March 2010), staff re-classified three projects under the Chinese loan (storage sheds, completion of government complex building (both signed on May 26, 2009), and procurement of intrusive scanners equipment (signed on December 23, 2009)) as nonconcessional on account of using SDR rate instead of commercial interest reference rate (CIRR) resulting in grant elements of 28 percent and 27 percent, respectively, compared to the program undertaking of 35 percent.

7. In addition to what has been reported in the letter of intent and the MEFP, the background to the three projects is that they were part of a loan pledge made in 2007 by China to Zambia to finance various projects. The terms of the loan are the same for all the projects. Despite Zambia not having been on a program supported by the Fund then, the authorities recognized the need for the loan to meet the concessionality threshold. Using available information at the time, including the 2007/08 CIRR, the loan was considered concessional with the requisite grant element. Staff was informed accordingly about the loan and the projects being financed. As indicated earlier, the staff determined during the February/March 2010 mission that the grant elements in these loans were insufficient to meet the concessionality criterion when the stipulated SDR discount rate is used. Accordingly, the authorities are requesting a waiver for the breach of the non-concessional debt ceiling at end-December 2009.

Fiscal policy

8. Fiscal policy is geared towards curtailing current expenditures, in favor of higher capital spending, and improving revenue performance. Already, progress is being made in addressing the public service wage bill—recommendations following a review of the pay policy were approved by Cabinet in November 2009 and their implementation has commenced. Revenue enhancing measures include the comprehensive review of the tax policy and administration. The overall fiscal deficit will remain at around 2.5 percent of GDP in 2010 and decline in subsequent years.

Monetary policy and financial sector

9. The objective of monetary policy is to maintain single digits inflation and financial stability. The authorities recognize that the current framework based on monetary aggregates has provided little room for monetary policy to counter adverse cyclical conditions using interest rates. In the proposed framework, interest rates will be the main instrument to anchor

inflation expectations. We believe that the proposed framework will have direct positive impact on interest rate spreads. In order to enhance financial sector stability and preparedness to deal with problems of systemic nature, the authorities are revising the lender of last resort policy to ensure its effectiveness and relevance, and working on a financial sector contingency plan.

Debt management capacity

10. Improved public debt management remains a priority for the authorities. In this regard, a medium-term debt management strategy has been developed with the assistance of the IMF and World Bank. Progress is being made in restructuring debt management operations aimed at improving risk management, honoring financial obligations in a timely manner, and minimizing the cost of financing the budget.

Other structural reforms

11. Several reforms are being undertaken to strengthen operations in the public service. Following the approval of the review of pay policy, the process of undertaking a job evaluation exercise to determine the right-sizing requirements in the public sector over the medium-term has started. Also, the roll-out of the payroll management and establishment control to the remaining ministries and agencies continues. Second, the roll-out of the Integrated Financial Management and Information System and Treasury Single Account is on-track. Third, to improve the project planning capacity, management systems are being strengthened and project evaluation and monitoring capacity is being established in all agencies.

12. A number of reforms to promote diversification and competitiveness have been undertaken, including review of licensing procedures; introduction of a legal framework for Public-Private Partnership; a program for cost recovery in pricing electricity; and return to full cost recovery in pricing of petroleum products. Most recently, the government divested 75 percent of government equity in the Telecommunications Corporation, and intends to divest the remaining 25 percent through public listing in the Lusaka Stock Exchange, in order to improve the quality of service and reduce costs.