June 2024

Weathering Zambia's Economic Drought

2024 Supplementary Budget Overview

1. On June 21, 2024, Dr. Situmbeko Musokotwane, the Minister of Finance and National Planning, presented a supplementary budget of K41.9 billion to Parliament. This budget adjustment comes on the heels of the initial K177.9 billion budget for 2024, which the Minister outlined with key macroeconomic goals in mind. These goals included achieving a real GDP growth of 4.8%, reducing inflation to a target range of 6-8%, maintaining international reserves at a level equivalent to 3 months of import cover, increasing domestic revenue to represent 22% of GDP, narrowing the fiscal deficit to 4.8% of GDP, and capping domestic borrowing at a maximum of 2.5% of GDP.
2. The foundation for these objectives rested on several critical assumptions. The government anticipated making substantial headway in the debt restructuring process, which would alleviate some of the fiscal pressures. There was an expectation of increased output from the mining sector, spurred by new investments and the resolution of prevailing challenges in major operations such as Mopani and Konkola Copper Mines. The agricultural sector was projected to significantly enhance its performance, capitalising on considerable market opportunities within the region. Additionally, there was a focus on bolstering the manufacturing sector through value addition, particularly targeting export markets. Lastly, the energy sector was expected to expand, providing a necessary pillar for the overall economic growth.

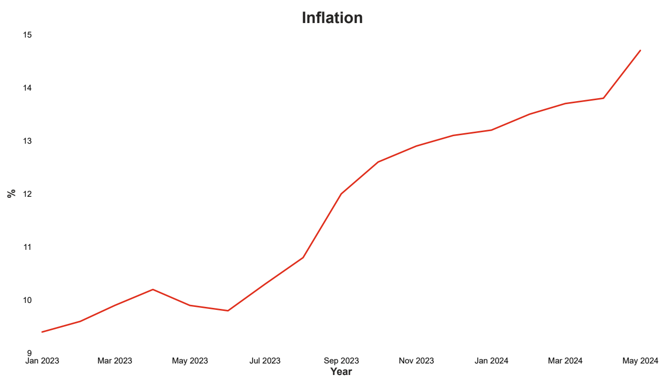
3. The supplementary budget presented by Dr. Musokotwane is a recalibration of the government's fiscal strategy in response to evolving economic conditions and the need to address unforeseen expenditures. It reflects the government's commitment to maintaining fiscal discipline while pursuing policies aimed at alleviating the impacts of the prevailing crisis.
4. The supplementary budget sets out two overarching objectives. Firstly, it empowers the Government to effectively address the urgent needs stemming from the drought. Its primary aim involves providing targeted relief to the most vulnerable population segments. This strategic reallocation of resources highlights the Government's dedication to mitigating the drought's adverse effects on affected communities. Secondly, the Government seizes the opportunity to adjust the funds required for debt servicing, reflecting the actual agreed amounts after making progress in the restructuring process. Additionally, the Government plans to settle and refinance the expensive, long-standing debt incurred from procured fuel with more favorable concessional finance.

A. Economic Impact of the Supplementary Budget

5. As we assess the economic landscape of Zambia at the midpoint of 2024, it is clear that the nation's immediate economic path has significantly deviated from its intended trajectory, necessitating a prompt reassessment of short-term economic strategies. The country has been grappling with the severe effects of an El-Nino-induced drought, which has undermined the execution of the government's economic plans. Despite the initial optimism, the ambitious targets set forth now appear increasingly out of reach.

Inflation and Price Stability

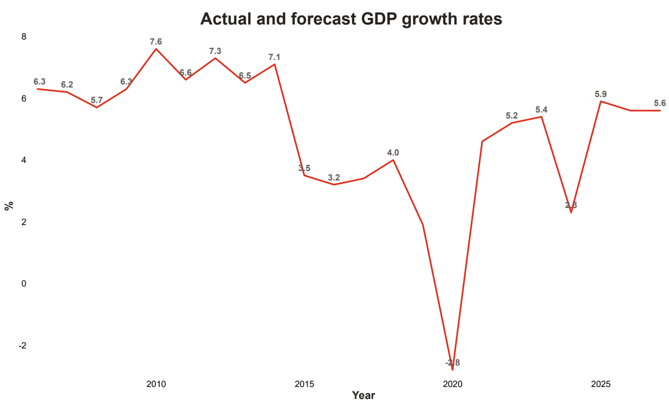
6. The inflationary trend presents a stark challenge. Initially, the aspiration to achieve single-digit inflation seemed a stretch; current data now suggests it is even less attainable. The Zambia Statistics Agency reports that average inflation in the first quarter stood at 13.5%, a rise from the previous quarter's 12.9%. More concerning is the climb to an annual inflation rate of 14.7% in May 2024, up from 13.8% in March, with escalating food prices being the primary driver.



Source: Bank of Zambia.

Economic Growth and Sectoral Performance

7. Energy sufficiency, especially, has such a pervasive impact on economic output that the 4.8% target outlined when the budget was read in September 2023 is now projected as a challenged 2.3%. That's a 52% reduction in projected economic growth. Unnervingly, agriculture is expected to decline by 19% as the general reduction in productivity, with all significant sectors expected to see lower productivity. Although unavoidable, this is not ideal given where Zambia is coming from and what the country needs to do. The predicted boost arising from significant positives such as debt restructuring milestones achieved, and considerable good news from the mining sector in the form of added investment and the resolution of issues has been overwhelmed by the negatives coming from the current disaster.



Source: Ministry of Finance and National Planning

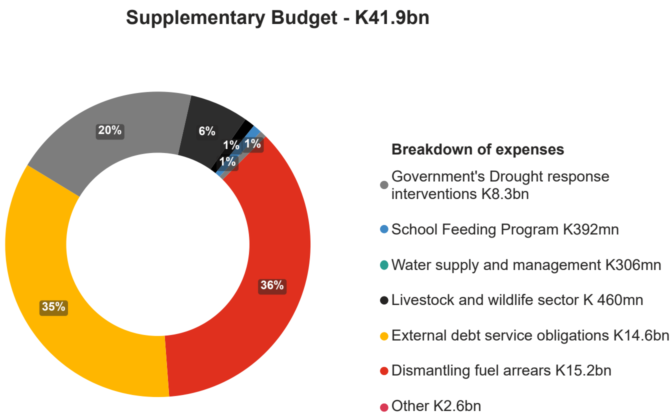
Fiscal Health and Economic Resilience

8. The fiscal objectives, including domestic revenue mobilisation, curbing domestic borrowing, and reducing the fiscal deficit, are now jeopardised by the current economic headwinds. The focus, understandably, has shifted towards addressing these immediate challenges, with an emphasis on protecting the welfare of the most vulnerable groups in society.

9. In light of these developments, it is imperative that the government's economic response is recalibrated to address the immediate needs without compromising long-term stability and growth. The resilience of Zambia's economy is being tested, and strategic adjustments are required to navigate through these turbulent times.

B. Allocation of the Supplementary Budget

10. The budgetary reallocation includes the following key measures:



C. Drought Response Measures

11. The supplementary budget outlines a series of interventions aimed at mitigating the effects of the current drought. The government has earmarked a substantial K5.2 billion for a K200 monthly cash top-up to the Social Cash Transfer programme, which will benefit 1.3 million households until June 2025. This measure is designed to provide additional support to those already identified as vulnerable.
12. Furthermore, a K400 monthly Emergency Cash Transfer has been introduced to assist 1.2 million households not covered by the existing Social Cash Transfer Programme. The specifics of the expenditure for this initiative are yet to be disclosed, but the intent is to extend support to vulnerable households through to June 2025.
13. The Cash for Work Programme, supported by donors, will engage individuals capable of work who have been affected by the drought. An initial K2 billion has been allocated, with the potential to increase to K3.8 billion, contingent on the finalisation of financing procedures.
14. In the realm of education, the government has allocated K392.2 million to a school feeding programme that will benefit children in early childhood and secondary education across 37 districts impacted by the drought. This initiative aims to ensure that school-going children receive necessary nutritional support.
15. Water supply and management have also been addressed, with K306.6 million dedicated to the maintenance and rehabilitation of dams, as well as the improvement of water infrastructure in 84 affected districts. This is a critical investment in the resilience of water systems against the backdrop of drought conditions.
16. To safeguard livestock and wildlife, K460 million has been allocated for heightened disease control measures, reflecting the government's commitment to managing the increased risk of disease outbreaks during drought periods.

D. Debt Obligations: A Fiscal Perspective

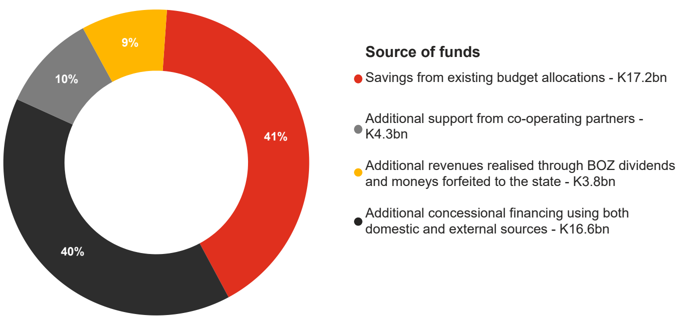
17. The supplementary budget also includes provisions for debt servicing, with K14.6 billion set aside for external debt obligations and K15.2 billion for fuel arrears. The total of K29.8 billion represents a significant financial commitment and suggests an increase from the initial budget allocations, although specific comparative figures have not been provided.
18. The K15.2 billion allocated for fuel arrears, approximately US$600 million, indicates a strategic decision to expedite the settlement of outstanding debts. This approach is aimed at avoiding substantial penalties that have continued to accrue because of delayed payments.
19. Additionally, the government has advanced US$30 million to Zesco for power imports from Mozambique, a move that is expected to alleviate some of the power shortages experienced due to the drought.
20. This is a tactical response to address the immediate energy needs arising from the drought while also managing the country's debt obligations. The focus on social support, infrastructure, and debt servicing demonstrates a multi-faceted response to the economic challenges posed by the drought. The full impact of these measures will become clearer as more detailed financial data is released and as the implementation of these initiatives progresses.

E. Funding the Supplementary Budget

21. The supplementary budget presented by Dr Situmbeko Musokotwane MP necessitates a comprehensive funding strategy to ensure its successful implementation. The proposed financial framework for the supplementary budget is anchored on a combination of internal reallocations, external support mechanisms and concessional financing.

- **Internal Reallocations:** A significant portion of the funding is expected to come from repurposing existing budget allocations, with a substantial K17.2 billion being redirected from the current budget. This reallocation demonstrates the government's commitment to fiscal discipline and its ability to adapt to changing economic circumstances by prioritising spending.

Supplementary Budget - K41.9bn



- **External Support and Revenue Streams:** Additional support has been secured from cooperating partners, amounting to K4.3 billion. This reflects continued confidence in the country's economic management and the potential for collaborative efforts to bolster financial stability. Furthermore, the state is set to benefit from dividends and forfeited funds totalling K3.8 billion, which will contribute to the supplementary budget without increasing the debt burden.
- **Concessional Financing:** To complement these sources, the government plans to obtain additional concessional financing, drawing from both domestic and international lenders, to the tune of K16.6 billion. This debt will be made available on terms that are more favourable and sustainable for the country's long-term economic health. It should be noted that US$194.5 million will be obtained from the International Monetary Fund increasing the funding support availed to Zambia.

F. Revised Budget Overview

22. Although not published, our estimate of the revised total budget for 2024 is K202.6 billion, marking a 13.88% increase from the previously announced K177.9 billion. This figure has been derived from the income and expenditure projections provided. It reflects the Government's approach of first planning expenditures then determining the income required to

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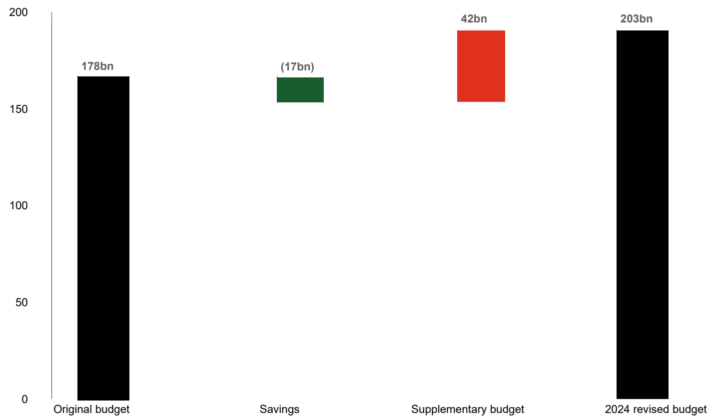
support them. The shortfall not covered by domestic resources is addressed through financing. It should be noted that the final amount will likely change once the legislative procedures are concluded.

Key Considerations for the Supplementary Budget

23. The Government faces limited options in responding to the current economic challenges. Zambia's trajectory of moving from one crisis to another hampers its recovery and growth prospects. In light of this, several critical issues warrant attention to ensure the effective implementation of the survival plan:

2024 supplementary budget
Income and Expenditure estimate
K'billion



- **Balancing Social Spending and Private Sector Support**: While social spending remains crucial, its sustainability is a matter that requires constant consideration. Support for the private sector to alleviate the impact of the drought and accelerate recovery is essential. The absence of immediate, targeted measures for the private sector suggests a need for future budgetary focus, potentially in 2025. That said, there is opportunity for the private sector to receive a boost indirectly as partners with the Government as the drought response plan is rolled out.

- **Securing private sector growth:** Ordinarily, long term economic challenges that Zambia has been facing do provide some opportunities for growth. For example, a weakening currency should stimulate exports and import substitution. However, the power crisis means that the productivity required to capitalise on the situation is harder to realise. However, the opportunity to grow sectors such as sustainable energy and agriculture are available for exploitation.
- **Achieving Projected Savings:** The anticipated savings of K17.2 billion are significant. Realising these in the face of high inflation and exchange rate volatility will be a challenge. Given the austere context in which the 2024 budget was formulated, it does seem ambitious that such significant savings will be realised, particularly within a truncated fiscal period. Let's wait and see.
- **Financing Strategy:** The Government's financing strategy leans towards concessional borrowing to address the budgetary gap. It is imperative to minimise reliance on domestic financing markets to prevent exacerbating the crowding-out effect, which could inflate borrowing costs and displace private sector financing.
- **Resilience and Growth Projections:** The macroeconomic projections suggest a return to growth in 2025. However, the potential for prolonged crisis effects or an extended drought period necessitates a contingency plan to support recovery.
- **Debt Servicing:** Zambia's resumption of external debt servicing, and settlement of outstanding petroleum debts, requires substantial foreign currency. Without an increase in foreign currency supply, this could destabilise market rates further.
- **Economic Growth Focus:** Despite the challenges, fostering economic growth is imperative to mitigate the crisis' impacts swiftly. Addressing the energy crisis, irrespective of climate-induced power shortages, is vital. This includes expediting the diversification of energy sources to enhance Zambia's resilience.

24. The revised budget reflects the Government's efforts to navigate through economic adversities with a strategic focus on recovery and growth. The considerations outlined above are integral to the successful implementation of the budget and the country's economic stability.

G. Private Sector Considerations

25. The 2024 supplementary budget is primarily focussed on Zambia's crisis response and debt obligations. What impact might the recast budget have on the private sector?
    - By increasing household spending through social and emergency cash transfers, consumer demand is expected to rise, potentially benefiting businesses in the process. This increase in demand can lead to higher production and sales thereby supporting business operations.
    - The Cash for Work Programme offers immediate employment, mitigating drought impacts while fostering skill development.
    - Investments in water infrastructure are pivotal, laying the groundwork for future agricultural and industrial productivity as more water is harvested and stored. This infrastructure can be developed with the private sector who also stand to benefit from it once it is operational.
    - Supporting livestock and wildlife ensures that the disease burden does not increase thereby ensuring sustained productivity even in the drought. This will protect those invested in the sector from undue loss.

- Prudent debt management signals fiscal responsibility, improving Zambia's creditworthiness and investor confidence. This can create a favorable investment climate, potentially lowering interest rates and improving business access to credit.
- Allocations for power imports and energy sufficiency aim to provide a reliable energy supply, a key factor for business operations. This can boost productivity and competitiveness, while also opening opportunities in alternative and renewable energy sectors.
- The government's disciplined budget funding approach underscores a commitment to macroeconomic stability, providing a predictable business climate for the private sector's long-term planning and investment.

26. In essence, the 2024 supplementary budget can provide some stimulus to the private sector through enhanced consumer spending, job creation, infrastructure development, agricultural resilience, improved investor confidence, energy sector investment, and macroeconomic stability. A question does arise as to whether more direct support for the private sector could have been provided. During the Covid-19 pandemic for example, the K10 billion Targeted Medium Term Refinancing Facility was made available to businesses and individuals by the Bank of Zambia through banks providing much needed relief and financing during the period. It has been argued that this intervention helped to keep credit risk contained. We would think that utilising some of the supplementary budget to provide such stimulus would be of value to the economy. Such a package could be targeted at, for example, providing cheaper financed energy solutions.

H. Conclusion: An Analysis of the Zambian 2024 Supplementary Budget

27. The Zambian 2024 supplementary budget strategically intervenes in the economic hardship caused by drought, prioritising the vulnerable and aiming for a resilient economy. The government's fiscal realignment focuses on social welfare to ensure social stability and long-term economic growth. It includes increased social cash transfers and emergency support to mitigate drought impacts.

28. The budget rightly prioritises sectoral support, with emergency energy and agricultural infrastructure investments. Despite resource constraints, the government maintains its commitment to restructured debt agreements, enhancing investor confidence. A balanced funding strategy, requiring fiscal discipline and careful monitoring, supports this commitment.

29. The government's response, aiding social and private sectors, is vital for recovery, with positive growth anticipated in 2025. However, vigilance and contingency planning are essential. The budget's success hinges on effective implementation and responsiveness to economic shifts, offering Zambia a chance to fortify its economy and inform future strategies.

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