PwC Zambia

Banking Industry Survey Report

Eighth Edition

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Foreword

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Zambia's banking sector has continued to demonstrate remarkable fortitude in the face of local and global challenges. At the domestic level, these challenges have included high inflation, a weakened kwacha and poor liquidity.

The findings of PwC Zambia's Eighth Annual Banking Industry Survey (June 2024) are testament to the sector's strength. The survey offers an examination of the banks' performance against a backdrop of economic flux and realignment. In presenting the results of the survey, we not only hope to illuminate the prevailing challenges within the sector but to also highlight the issues that will likely influence its future course.

This year's findings are particularly telling, as they capture the sector's navigation through a range of difficulties that span from the immediate pressures of the local economy to the ongoing complexities of regulatory compliance.

PwC's annual banking survey has established itself as a key barometer of the health of the banking industry. The survey articulates the perspectives of Zambia's banking leaders and offers invaluable insight into what influences their strategy.

Our survey response rate was very good this year, with 73% of CEOs/MDs and 87% of executive management taking the time to answer our questions. We are grateful to everyone who responded. We also acknowledge the input and support of the Bank of Zambia through its Governor, Dr Denny Kalyalya and the Bankers Association of Zambia, which is chaired by Ms Lowani Chibesakunda.

Finally, a special thank you to the PwC team, who continue to work diligently to deliver this publication each year.

1. Introduction

The banking industry in Zambia has faced a complex array of challenges and opportunities. The Eighth Annual Banking Industry Survey (June 2024) by PwC Zambia provides an analysis of these challenges and opportunities as reported to us by the nation's banking leaders.

Our dual-questionnaire approach targeted the chief executive officers (CEOs) and managing directors (MDs) of the country's banks, as well as their executive management, providing us with a rich dataset from which to analyse the issues faced by the sector.

The survey results bring to the fore the most significant issues confronting Zambian banks. The state of the local economy was the most pressing concern by a decent margin, underscoring the importance of the relationship between banks and the economic environment in which they operate. Liquidity risk, a perennial challenge for banks, was also a big issue for the sector.

Other challenges faced by banks included cybersecurity, with the growing digitisation of banking services amplifying banks' need for robust cyber defences, increasing credit risk and non-performing loans (NPLs) due to a weak domestic economy, and heightened regulatory compliance.

The insights gleaned from the Eighth Annual Banking Industry Survey (June 2024) not only give a snapshot of the current state of the banking sector but can also guide future strategy. In presenting these findings, we invite stakeholders to engage with the data and to consider its broader implications. The survey is a call to action for strategic thinking and collaborative effort as the banking industry works towards a prosperous and stable future.

2. Survey results

2.1 Methodology

As the basis for our survey, we sent two different questionnaires to all 15 commercial banks currently operating in Zambia. These questionnaires were designed to capture the different perspectives of the banks' leadership. The first questionnaire targeted the chief executive officers (CEOs) or managing directors (MDs) and asked them to list, in order of priority, the biggest challenges their business faced. We then used the results to identify the most pressing issues. The first questionnaire also asked questions about the banks' strategic priorities while the second questionnaire, was sent to the banks' executive management, included a wider range of topics, designed to give us a broader view of the financial challenges and opportunities.

We achieved an excellent response rate, with 73% of CEOs/MDs and 87% of executive management contributing valuable insights. To distil the data, we used a weighted average analysis, which enabled us to identify the most significant issues both collectively and individually.

The analysis revealed that the top five concerns for banks, as identified by the CEOs and MDs, were:

- The state of the local economy
- Liquidity risk
- Cybersecurity threats
- Increased credit risk and NPLs
- The escalating demands of regulatory compliance

2.2 Top five issues: all banks

State of the local economy

The health of the local economy was the main concern for the banking sector, with an average score of 8.6. Marking an increase from the previous year's score of 8.3. Weak economic conditions and subdued domestic demand for goods and services continue to be sources of concern for banks. The poor performance of loans in the agricultural sector, which was adversely affected by drought, has further intensified these concerns. Despite these challenges, there is cautious optimism that policy interventions designed to diversify and stabilise the economy, could create a more conducive environment for growth.

This optimism is contingent upon the interplay of gross domestic product (GDP) growth, inflation, exchange rate fluctuations and geopolitical factors. In section three of the report, we provide further insight into this area.

Liquidity risk

Liquidity was the second most critical issue, with an average score of 7.5 – a significant increase from 5.9 in our prior year survey.This was set against a backdrop of evolving regulatory policies and debt repayments being due. The significant increase in statutory reserve ratios, which were increased by the regulator in response to rising inflation and kwacha instability, plus the transfer of government deposits held to the Bank of Zambia in early 2024 has also impacted already constrained market liquidity. Banks have responded by diversifying funding sources, optimising asset-liability management and implementing currency risk hedging strategies. The regulator has provided some relief to the sector as it has allowed for a portion of a banks' statutory reserves to be maintained in the form of government securities.

Cybersecurity

Cybersecurity, while still a top concern, moved down to third position, with an average importance score of 6.3 - a decrease from the previous year's score of 8.6, when it was the issue of most significance. The sector's growing reliance on digital channels has heightened the risk of cyberattacks. In response, banks have strengthened their cyber defences by investing in infrastructure, engaging external consultants, and enhancing customer and staff awareness programmes.

Increased credit risk and NPLs

Re-entering the list of top issues after a brief absence is increased credit risk and the rise in NPLs, which had an average score of 4.3. The industry is witnessing higher probabilities of default and expected credit losses, leading to a decline in banks' loan book value across the sector. This trend is not surprising given the economic slowdown and significant volatility and weakening in macroeconomic indicators. Exacerbating these challenges are the effects of the severe drought, constrained financing avenues, currency weakening and

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persistent inflationary pressures, which are compelling banks to bolster their provisions in the 2024 financial year.

Increased regulatory compliance

Increased regulatory compliance emerged as the fifth most critical issue, with an average score of 4.3. This new entrant reflects the impact of heightened regulatory demands stemming from cybersecurity risks, associated with the digitisation of banking processes and prevailing economic challenges which have led to liquidity constraints. The regulator's response has resulted in an increase in regulatory measures, meaning banks are having to navigate an increasingly complex regulatory environment.

Going forward, banks will need to adopt a balanced approach that ensures they manage risk, adapt quickly to new regulations, and stay focused on innovation and customer service.

Figure 1: Top five issues for banks 2021–2023

2021		2022		2023	
Cybersecurity	5.8	Cybersecurity	8.6	State of the local economy	8.6
State of the local economy	5.5	State of the local economy	8.3	Liquidity Risk	7.5
Digital transformation	4.2	USD liquidity	5.9	Cybersecurity	6.3
Impact of the proposed IMF program on the banking sector	3.6	Digital transformation	4.9	Increased credit risk and NPLs	4.3
USD liquidity	3.4	Increased Competition from non-traditional players	4.5	Increased regulatory compliance	4.2

2.3 Top five issues: five largest banks (by asset size as at 31 December 2023)

In the 2023 survey, the five largest banks in Zambia, determined by asset size, identified similar pressing issues to those of the broader banking sector, albeit with differences in the lower rankings.

The state of the local economy remained the most critical concern for the five largest banks, with a score of 10, underlining the big banks' unanimity in the greatest challenge their business faced that year. Liquidity risk, with a score of 7.2, and cyber security, which scored 5.8, also maintained their positions as the second and third most significant issues respectively, indicating that these challenges continue to be an issue for the largest banks.

The fourth and fifth most pressing issues identified by the big banks, climate change and cost containment, both of which scored 5.4, diverge from the broader banking sector. These concerns underscore growing awareness among the big banks of environmental factors and the need to manage operational costs effectively.

If we compare the results for the current and prior year, it is interesting to note that the top three issues remain the same, albeit with a different order and scores. The state of the local economy was the most pressing issue in both years, with a score of 9.2 in the prior year and 10 in the current year. Cyber security and liquidity risk swapped rankings in the current year, with cyber security falling from the second to the third most pressing issue in the current year, and liquidity risk rising from third to second place.

The fourth and fifth most pressing issues in current year are different to those in the prior year, with climate change and cost containment replacing digital transformation and increased competition from non-traditional players.

Figure 2: Top five issues: five largest banks

2021		2022		2023	
Digital transformation	7.0	State of the local economy	9.2	State of the local economy	10.0
Cybersecurity	7.0	Cybersecurity	8.5	Liquidity risk	7.2
State of the local economy	5.5	USD liquidity	6.7	Cybersecurity	5.8
USD liquidity	4.3	Digital transformation	5.2	Climate change	5.4
High credit risk and NPLs	4.2	Increased Competition from non-traditional players	4.0	Cost containment	5.4

Figure 3: Top five issues – rest of the banks

2021		2022		2023	
State of the local economy	6.9	Cybersecurity	8.7	Liquidity Risk	7.7
Cybersecurity	6.4	State of the local economy	7.8	State of the local economy	7.6
Impact of Covid-19	4.8	USD liquidity	5.4	Cybersecurity	6.7
Impact of proposed IMF program	4.5	Increased Competition from non-traditional players	4.9	Increased credit risk and NPLs	6.0
USD liquidity	3.5	Inequity of regulation and Digital Financial Services	4.9	Managing interest rate risk	4.6

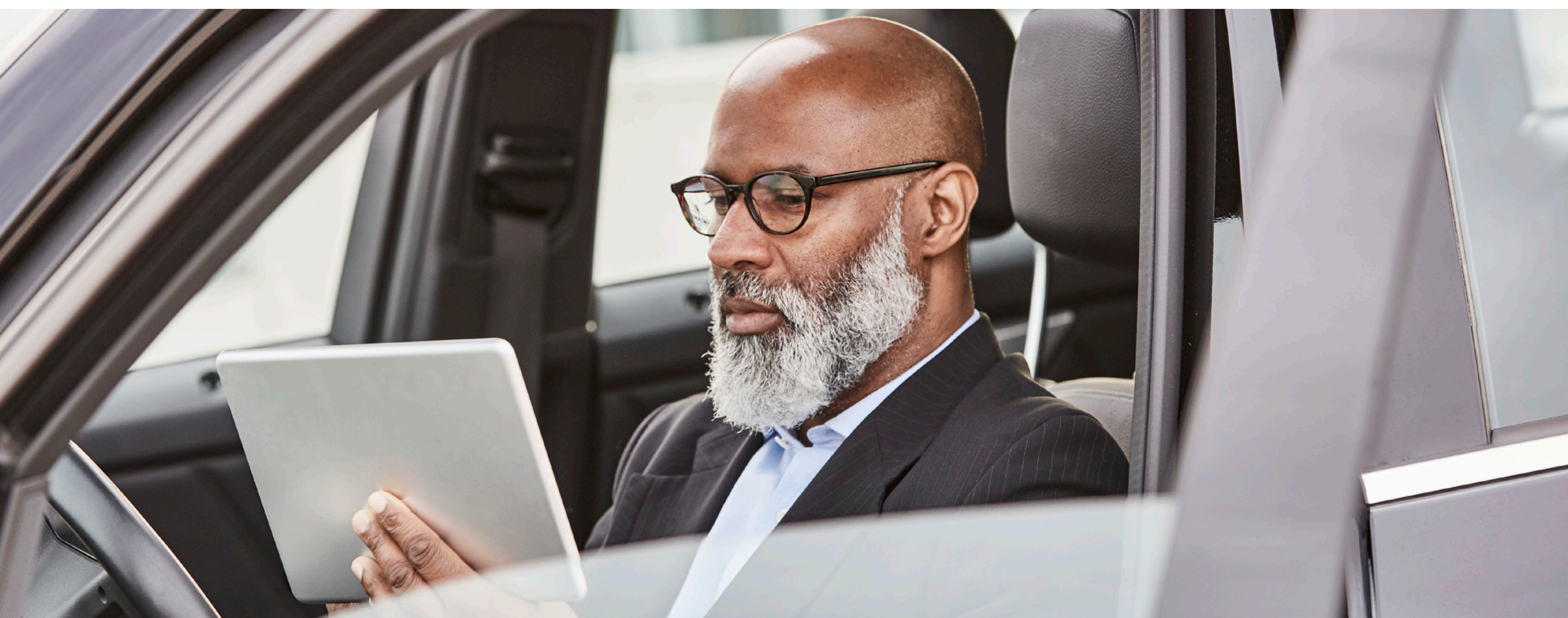
2.4 Top five issues: rest of the banks

Although the rest of the banks shared several concerns with the five largest banks, they also highlighted a slightly different set of challenges. Liquidity risk was the biggest issue faced by the rest of the banks, with a score of 7.7, reflecting the issue's increased prominence, and the challenges faced by these banks in managing liquidity amid market volatility and constraints in the supply of USD.

The state of the local economy and Cyber security remained critical issues, scoring 7.6 and 6.7, respectively. These scores echo the broader sector's concerns and highlight the impact of subdued economic activity, exacerbated by the severe drought and the ongoing energy crisis.

This year's survey also brought to light issues that did not feature among the top issues in the prior year. These include increased credit risk and NPLs, as well as managing interest rate risk, which scored 6.0 and 4.6 respectively. These concerns overtook growing competition from non-traditional players and the challenges of regulatory inequity, and digital financial services, both of which were more prominent in the previous year's survey.

The findings from both the largest banks and the rest of the banks provide a comprehensive view of the challenges facing Zambia's banking sector, highlighting the need for banks to focus on economic, operational and risk management if they are to navigate the ever-evolving financial landscape.



3. State of the local economy: a foremost concern for Zambian banks

The state of the local economy emerged as the preeminent concern for Zambian banks, with its weighted average score rising from 8.3 to 8.6. This heightened concern reflects the intricate interplay between the banking sector and the broader economic environment in which it operates. The state of the local economy continues to be an area of focus for the industry in the current year.

Economic performance and projections

Information obtained from the World Bank and the Ministry of Finance and National Planning, as depicted in Figure 4, shows that the global economy is expected to maintain a steady growth rate of 2.6% in 2024, largely influenced by central banks exercising prudence in monetary policy adjustments amid ongoing inflationary pressures and geopolitical tensions. These global factors, coupled with commodity price volatility, are likely to influence inflation trajectories.

Sub-Saharan Africa's economic outlook

The economic pulse of Sub-Saharan Africa is expected to strengthen in 2024, propelled by increasing domestic demand. Nonetheless, the spectre of a protracted drought, political instability and conflict loom as potential impediments to economic activity and investment, which are critical to poverty alleviation efforts in the region. Resource-rich economies are poised for a rebound following a period of languid growth in 2023, with metal prices forecast to recover.

Looking ahead to 2025 and 2026, a marginal uptick in GDP growth is projected, spurred by burgeoning trade and investment. Sub-Saharan Africa is forecasted to experience an increase in regional GDP growth to 3.5%, up from 3%. However, the early part of 2024 brought about a severe drought, adversely impacting Madagascar, Malawi, Zambia, and Zimbabwe, which could temper regional economic prospects.[1]

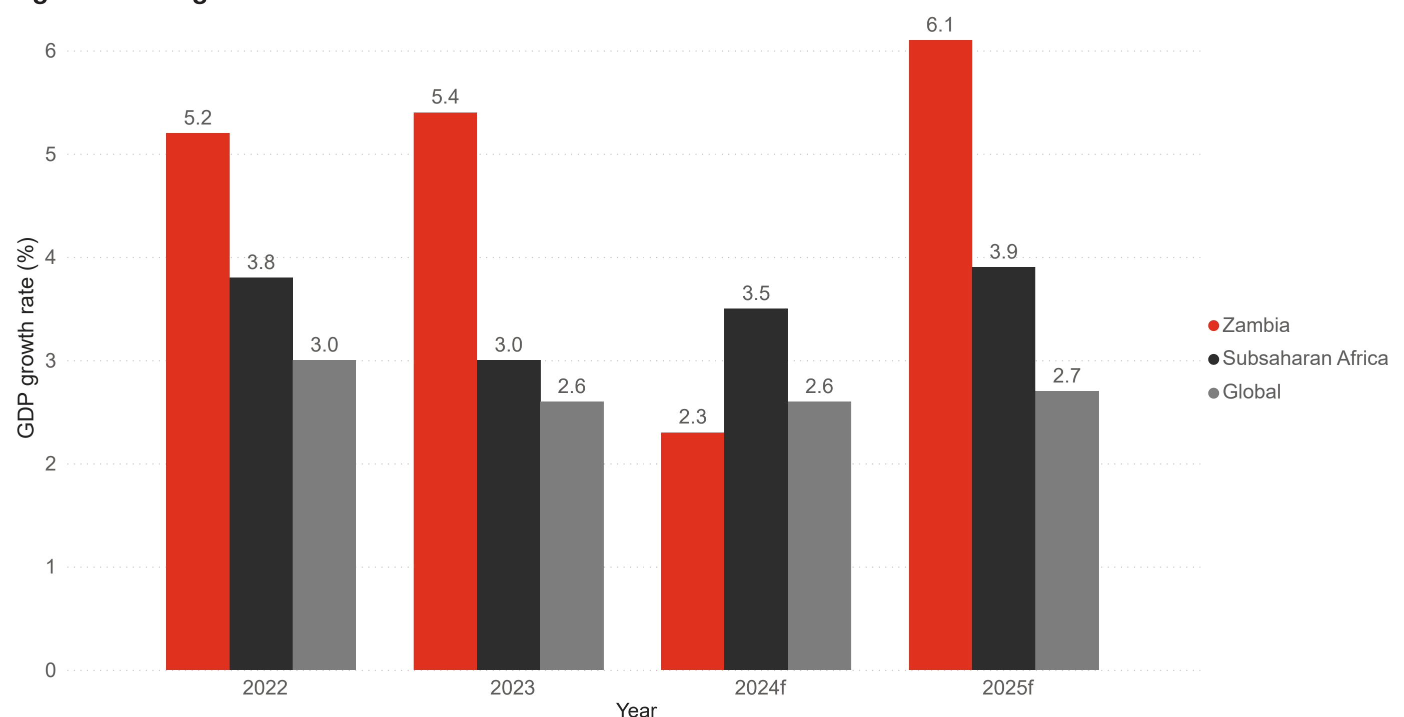
Zambia's economic landscape

Zambia itself recorded GDP growth of 5.4% in 2023, a modest increase from 5.2% in the preceding year. This growth was primarily driven by the robust performance of the information and communication technology (ICT) and construction sectors. Conversely, the agriculture, forestry and fishing industries, along with mining and quarrying, experienced contractions.

The initial forecasts for the domestic economy were optimistic, predicting growth over 6%, although this was contingent upon the resurgence of the mining sector as it overcomes operational challenges. The ICT and construction sectors were also anticipated to contribute positively to this growth trajectory. However, the depreciation of the kwacha in 2024 has exerted inflationary pressures, escalating the cost of living.

In light of this year's drought, the Monetary Policy Presentation in May 2024 revised the domestic GDP growth forecast downward from 4.2% to 2.3%, with the agriculture and energy sectors bearing the brunt of the drought's impact. This revision underscores the susceptibility of the Zambian economy to climate-related risks and the consequential effects on banking sector performance.

Figure 4: GDP growth rate



Source: World Bank and Ministry of Finance and National Planning

[1] Page 95 https://openknowledge.worldbank.org/server/api/core/bitstreams/aa9feaf4-0331-467d-9f46-10b9a1aef5a9/content

Private business conditions

In our examination of the business landscape, we scrutinised the Bank of Zambia's Quarterly Survey of Business Opinions and Expectations. This survey provides a lens through which we can gauge the business community's sentiment towards the macroeconomic policies implemented by the regulator.

The findings from the 2023 survey show that private sector performance was sluggish during the year, with growth only materialising in the second quarter. This isolated growth spurt was attributed to the buoyancy of the agricultural marketing season and a strengthening Zambian kwacha, which benefited from the restructuring of Zambia's official multilateral debt and the resulting positive market sentiments. Conversely, the remaining quarters were characterised by a contraction in growth, primarily due to diminished demand, local currency depreciation and escalating input costs. Consequently, businesses reported a downturn in output, domestic sales, new orders and capacity utilisation.

As we transition into the latter part of 2024, slow economic activity continues to impede private sector growth as businesses grapple with persistent inflationary pressures, a depreciating currency and restricted access to credit facilities. However, there is a glimmer of hope on the horizon. Prospects for growth are cautiously optimistic, underpinned by the potential resurgence of the mining industry and interventions designed to counteract the adverse effects of climate change.

Considering these insights, it is imperative that stakeholders navigate these challenges with strategic foresight. The resilience of the private sector will be tested and its ability to adapt will be crucial in overcoming the economic headwinds faced.[2]

Insights from the Stanbic Purchasers Managers Index

The Stanbic Purchasers Managers Index (PMI) serves as a barometer for Zambia's business climate, providing monthly snapshots that help businesses understand the economic trends in the country. The index, which ranges from zero to 100, offers a clear demarcation of the business environment: a reading above 50 indicates a favourable landscape for business activities, while a figure below 50 suggests challenging conditions.

In 2023, the Stanbic PMI presented a pattern of volatility, with the index starting and ending the year below the critical 50 threshold. Despite this, the overall picture for the year was more optimistic, with seven months registering readings above 50, while the other five months recorded readings below 50.

The depreciation of the Zambian kwacha exerted significant pressure on businesses during 2023, particularly those in the manufacturing, services, and wholesale and retail industries. This currency weakness, coupled with other economic issues such as poor agricultural output and low ore grades in the mining sector, contributed to the contraction in business activities during the months where the PMI recorded readings below 50.

However, it is also important to acknowledge the sectors that demonstrated resilience and growth during the year. Notably, the agricultural and construction sectors showed signs of expansion and progress. These sectors were instrumental in driving the PMI readings above 50 during the seven months of favourable business conditions, underscoring their role as pillars of the Zambian economy.

In 2024, the business environment has been challenging, with the PMI falling below 50 for the first seven months of the year. These poor business conditions have been attributed to this year's drought and the impact of load shedding, which has increased the cost burden for companies and hindered new business. The PMI dropped to its lowest level in March, falling to 47.3 for the first time since December 2023. This was due largely to reduced money in circulation and kwacha weakening.

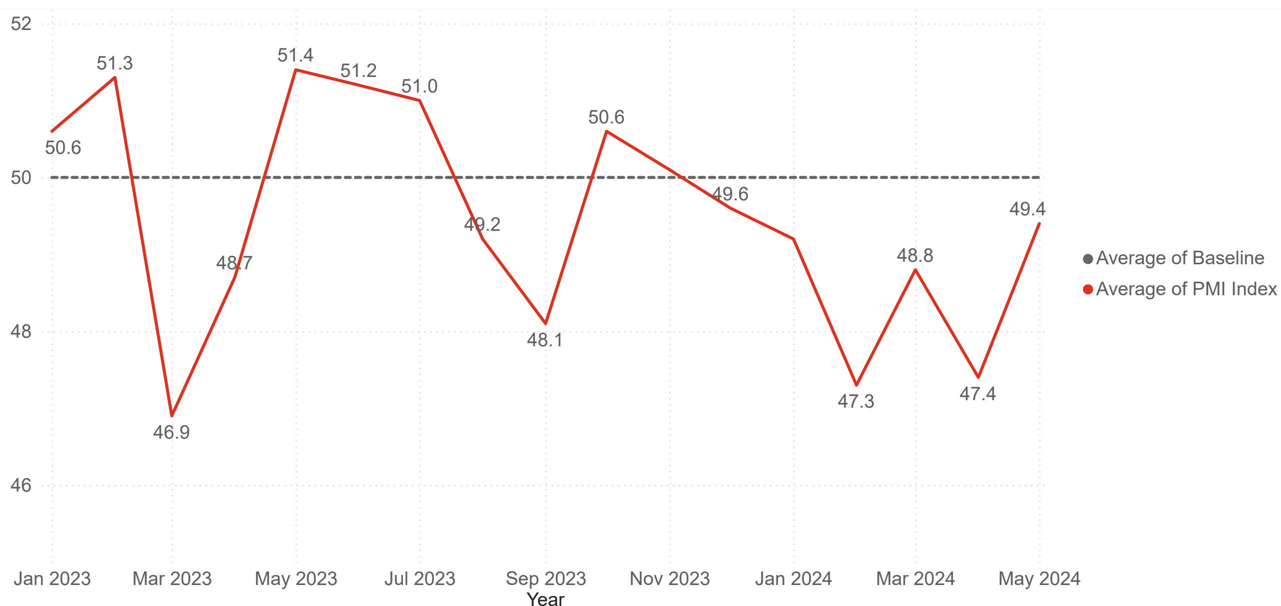
More recently, the Stanbic PMI has increased marginally, rising from 47.9 in June to 49.4 in July, although this still indicates an overall decline in business activity. Input costs have increased, while output has fallen significantly due to a decrease in new orders on account of the weakening local currency and power outages affecting business operations.

The fluctuations seen in the Stanbic PMI in 2023 and 2024 underscore the fragility of the economy. Stakeholders therefore need to consider these insights when forming strategies and making decisions. As we delve deeper into the survey findings, we will explore the implications of the confluence of these economic factors on the banking sector and how financial institutions are positioning themselves to navigate the challenges and opportunities that lie ahead.

"The findings from the 2023 survey show that private sector performance was sluggish during the year....

[2] https://www.boz.zm/QSBOEReport2024Q1.pdf

Figure 5: Purchasing Managers' Index



Source: Stanbic Bank Zambia

Monetary policy adjustments in response to inflationary pressures

In response to this constantly changing economic landscape, Bank of Zambia's Monetary Policy Committee (MPC) adopted an active approach to adjusting the Monetary Policy Rate (MPR) during 2023. This contrasted with the previous year, when the MPR remained static at 9% throughout the year. The adjustments made to the MPR in 2023 were informed by forward-looking projections, which indicated that without intervention inflationary pressures would pose a significant threat to the country's macroeconomic stability.

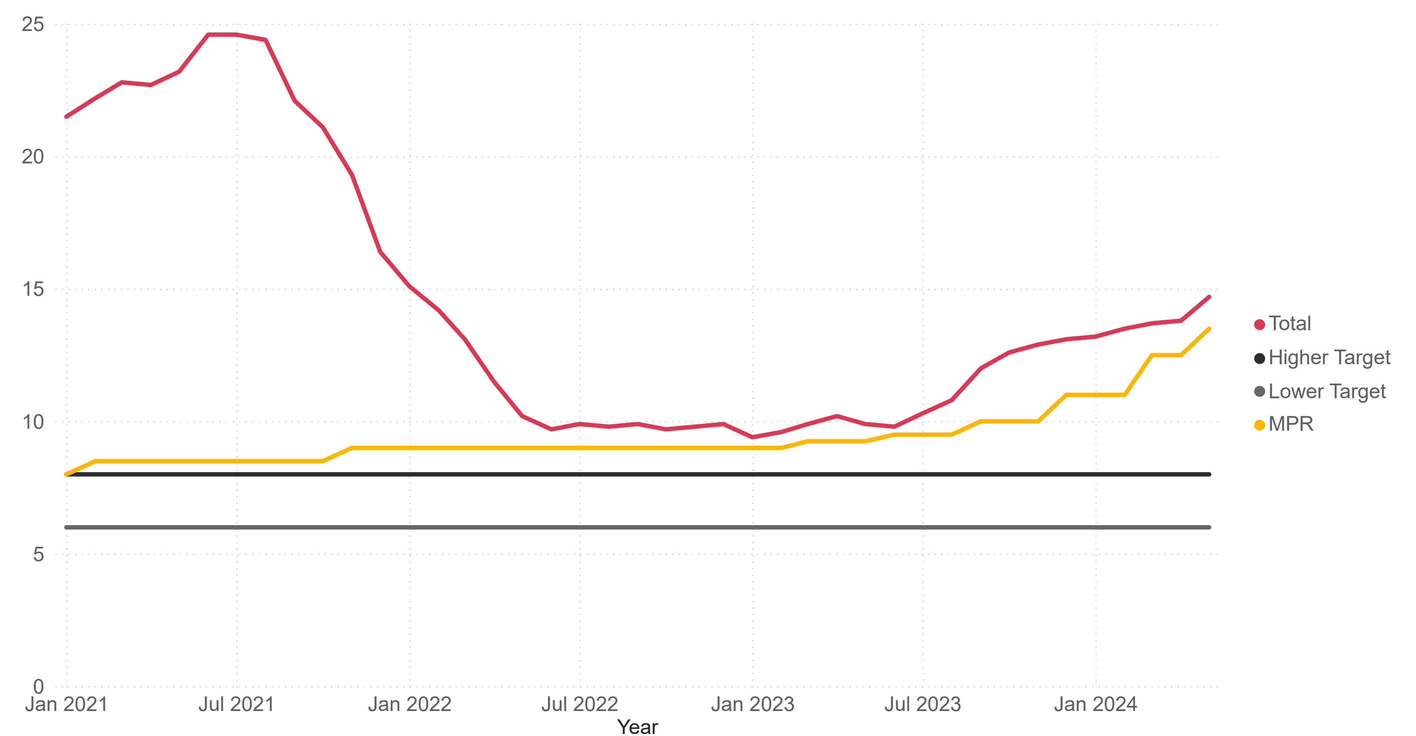
The MPC's response to the threat of inflation was a series of incremental rate hikes throughout the year. The MPR was increased to 9.5% in the first quarter of 2023, followed by a further rise to 10% in the second quarter.

This upward trajectory continued in the second half of the year, with the MPR rising to 11% in the third quarter and 12.5% in the final quarter. These rate rises were designed to counteract inflationary pressures, largely triggered by the continued depreciation of the kwacha and the impact of unfavourable weather conditions on food prices. Inflationary pressures have continued into 2024 and, in May this year, the Bank of Zambia increased the policy rate by another 100 basis points to 13.5%.

Looking ahead to 2025 and 2026, inflationary pressures are expected to ease due to a recovery in economic output and a projected decline in global food prices. The MPC remains attentive to the evolving economic conditions and is prepared to adjust the policy framework as necessary to support sustained economic growth and keep inflation within the target range.

Figure 6: Inflation, MPR and target band

Source: PwC analysis



Exchange rate and statutory reserve ratio

The kwacha lost 17.5% of its value against the US dollar in the final quarter of 2023, averaging K24.75 during the quarter. As of 13 February 2024, the exchange rate had depreciated by a further 4.6%, with increasing demand for a limited supply of foreign exchange exerting pressure on the exchange rate. These pressures continued to impact the kwacha during the second quarter of this year, with the kwacha falling a further 10.2% to K27.37 by 10 May 2024.

In response to the on-going challenges in the foreign currency market, the statutory reserve ratio was increased by 900 basis points from 17% in November 2023 to 26% on 5 February 2024. Zambia continues to experience an imbalance in the foreign exchange market due largely to sustained demand for a limited supply of foreign currency. This demand for forex is being fuelled by the energy, manufacturing, wholesale and retail sectors, which rely on foreign exchange for imports and operations.

Interest rate dynamics and monetary policy adjustments

The banking sector experienced generally favourable credit conditions in 2023, underpinned by a sustained period of ample liquidity. This environment facilitated a degree of flexibility and responsiveness within the sector, allowing for the accommodation of credit demands.

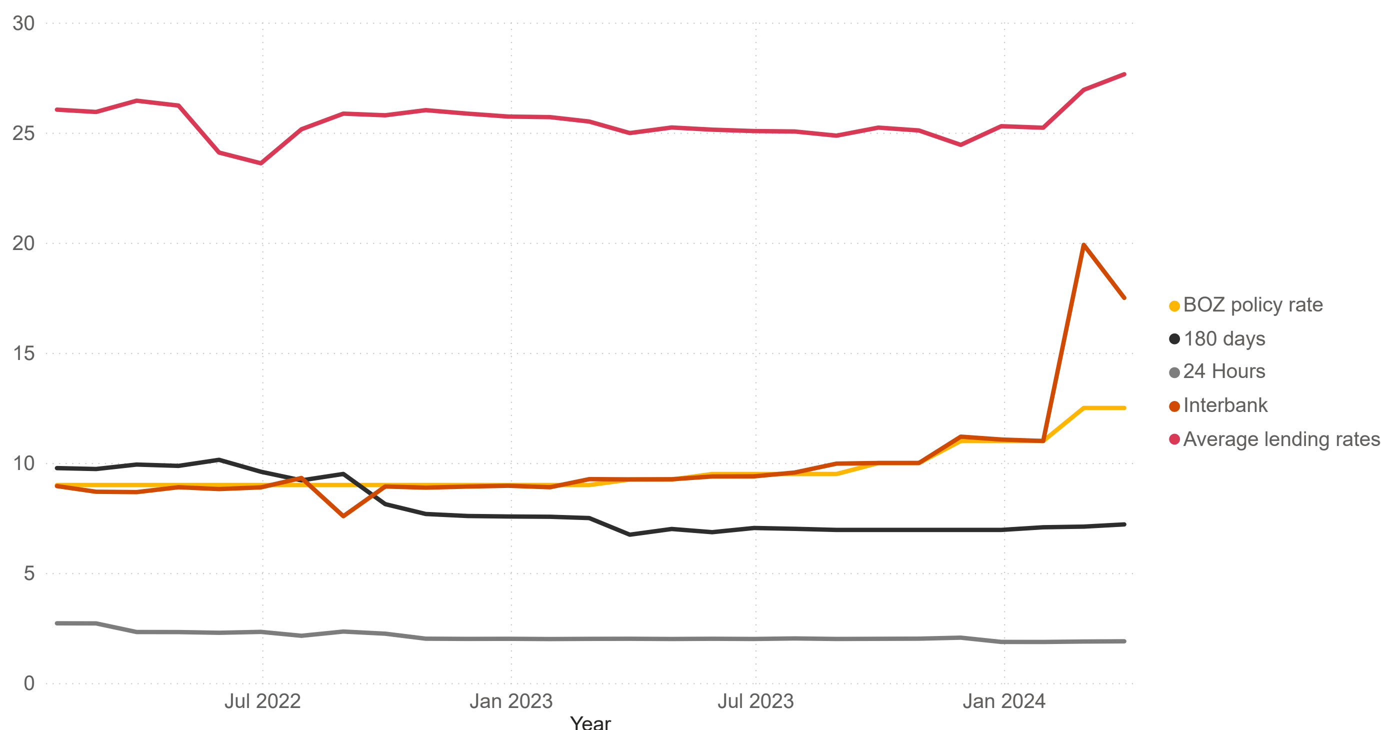
As noted above, in response to inflationary pressures, Bank of Zambia implemented a further tightening of its monetary policy stance by increasing the MPR and SRR. Naturally, these interventions, including the transfer of GRZ deposits to consolidated account, resulted in liquidity constraints which inturn exerted upward pressure on interest rates.

Looking at Q1 2024, initial observations suggest a tightening of credit conditions across various parts of the economy, including households, small and medium enterprises, and large corporations. This tightening is indicative of a continued and deliberate monetary policy stance aimed at addressing the persistent rise in inflation, which is being driven by the ongoing depreciation of the kwacha. The banking sector is thus poised to navigate a landscape of more stringent monetary conditions, with implications for lending practices and overall financial stability.[3]

[3] https://www.boz.zm/CreditConditionsSurveyReportQ12024Final150524.pdf

Figure 7: Interest rates

Source: Bank of Zambia



Debt restructuring

On 25 March 2024, the Zambian Government announced a pivotal agreement with the Steering Committee concerning the restructuring of government bonds maturing in 2022, 2024 and 2027.[4] A summary of the agreement is provided below.[5]

The government has received assurances that the terms align with the Official Creditor Committee's assessment for comparable treatment and adhere to the International Monetary Fund (IMF) programme requirements. These terms include:

- Financial terms: the agreement necessitates substantial concessions from bondholders to facilitate debt relief for the government. Bondholders are set to relinquish claims of approximately US$840 million and provide cash flow relief totalling around US$2.5 billion over the duration of the IMF programme. The weighted average maturity is projected at 15 years for the base case scenario and eight years for the upside case.
- Non-financial terms: the agreement incorporates non-financial conditions, such as clauses that oblige the government to ensure no other creditors receive more favourable restructuring terms on a net present value basis. Additionally, a loss reinstatement clause will activate if Zambia defaults during the current agreement. The government has also committed to ongoing information delivery requirements, as stipulated by the IMF programme.

Consensus has been reached, as the implementation proceeded via an exchange offer or consent solicitation. The transaction was finalised between the committee and the government, and the new bonds were issued at ratings higher than default. This is because the execution of the transaction involved the introduction of a consent fee of 1.5% of the original face value amount of the bonds (US$3 billion).

Restructuring of Eurobonds

The agreement assumes two treatment cases, the upside case and the base case, while two bonds, Bond A and Bond B, make up the financial structure as shown in the schedule below. The "observation period" of the trigger mechanism will run from January 2026 to December 2028. If the country reaches better economic standing, the upside case is activated when the country attains any or all of the following criteria:

- Zambia's composite indicator, which measures a country's debt carrying capacity, meets or exceeds a score of 2.69 for two consecutive semi-annual reviews. With this, Zambia's debt carrying ability will be upgraded to medium-term.
- The three-year rolling average of USD exports and USD equivalent of fiscal revenues (excluding grants) exceeds the IMF projections as laid out in the second review of the IMF's Extended Credit Facility released in 2023.

[4] Steering committee-own or control approximately 16% of outstanding bonds while all other members of the committee currently own or control more than 33% of outstanding bonds.

[5] London Stock Exchange
https://www.londonstockexchange.com/news-article/32BT/statement-re-restructuring-of-eurobonds/16393988

Figure 8: Bond repayment schedule

Aspect	Before restructuring	After restructuring
Number of bonds	3	2
The total value of the bonds	US$3.89 billion	US$3.05 billion
Minimum term to maturity of the shortest dated bond from 2024 (years)	Past due or defaulted	9
Maximum term to maturity of longest-dated bond outstanding from 2024 (years) – Base case	3	29
The maximum term to maturity of most extended dated bond outstanding from 2024 (years) – Upside case	3	11
The lowest interest rate of any of the bonds outstanding – Base case	5.375%	0.5%
Highest interest rate of any of the bonds – Base case	8.97%	7.5%
Highest interest rate of any of the bonds – Upside case	8.97%	7.5%
Principal cashflows – Base case		
Principal cash outflows before IMF ECF expires (2025) – Base case	US$1.75 billion	US$0.498 billion
Principal cash outflows between 2026 and 2035 – Base case	US$1.25 billion	US$1.205 billion
Principal cash outflows after 2035 – Base case	0	US$1.35 billion
Principal cashflows – Upside case		
Principal cash outflows before IMF ECF expires (2025) – Upside case	**US$1.75 billion**	**US$0.498 billion**
Principal cash outflows between 2026 and 2035 – Base case	**US$1.25 billion**	**US$1.816 billion**
Principal cash outflows after 2035 – Upside case	0	0

On 26 June 2024, the IMF board approved Zambia's performance as satisfactory in the third review under the 38-months Extended Credit Facility as all but one criterion was sufficient to unlock the US$0.569 billion disbursement. This outcome brings the total disbursements so far to US$1.1 billion.

Despite a challenging local and global environment, programme performance has been satisfactory. By the end of 2023, all but one of the indicative targets and all the quantitative performance criteria targets had been reached. Authorities have made progress in terms of the structural reform agenda, by meeting continuous and end-December 2023 structural benchmarks, as well as (all but one) end-March 2024 structural benchmarks on time.[7]

Strategic imperatives for economic resilience

In the quest to steer the economy towards a stable and growth-oriented trajectory, industry leaders have underscored the need to adopt a multifaceted approach. The insights gathered from this survey reveal that chief executives and managing directors of commercial banks place significant emphasis on diversifying the economy to attain foreign exchange rate stability. This entails a strategic shift to expand export markets beyond the traditional sectors of mining, agriculture and manufacturing. There is a consensus on the potential of service exports to contribute to a more robust and varied revenue stream, thereby fostering greater economic resilience.

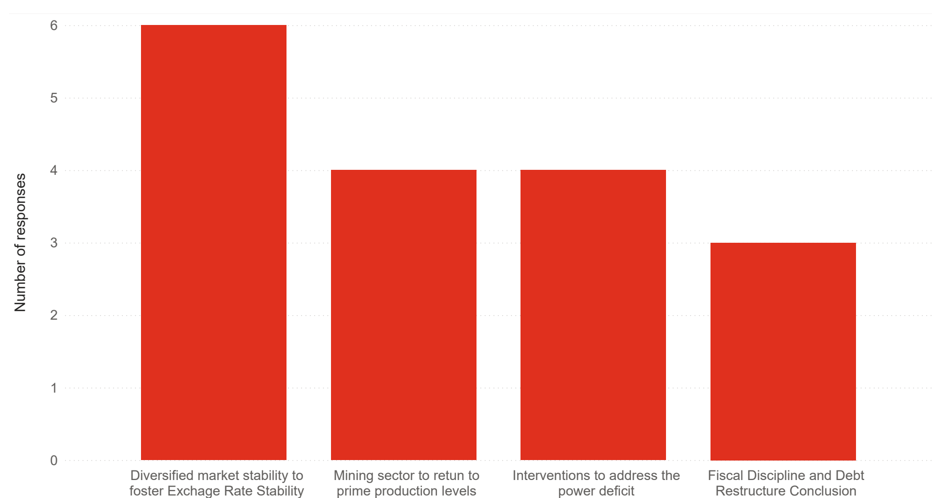
[7] https://www.imf.org/en/News/Articles/2024/06/26/pr-24242-zambia-imf-completes-3rd-review-under-ecf-and-approves-augmentation

Addressing the persistent power deficit remains a critical concern, particularly given the challenges faced since the onset of 2024 due to diminished water levels at the Kariba Dam, Zambia's principal hydroelectric facility. The situation has exerted pressure across all sectors of the economy, underscoring the urgency for sustainable and self-sufficient energy solutions. The banking sector recognises the importance of such interventions in ensuring uninterrupted business operations and supporting economic growth.

The mining sector, a cornerstone of the Zambian economy, is poised for a resurgence following the reopening of key mines such as Mopani Copper Mines and Konkola Copper Mines. Stakeholders are optimistic that the revitalisation of these mines will boost the sector's ailing performance. The anticipated resurgence of copper production is expected to catalyse a significant upturn in output, thereby enhancing economic growth prospects.

Lastly, it is important that government exerts fiscal discipline and finalises the country's debt restructuring programme. Successfully navigating the country out of default status is a pivotal step towards reinvigorating investor confidence and attracting foreign direct investment, and unlocking access to finance for businesses. Government needs to finalise agreements with the rest of the commercial creditors which own more than 33% of outstanding bonds and dismantle domestic debt arrears to lift the country out of default status. Banking sector leaders recognise that this is crucial to repair the economy and lay foundations for sustainable growth and development going forward.

Figure 9: Priorities in repairing and growing the economy



Source: PwC analysis

4. Regulatory landscape

Banks ranked increased regulatory compliance as a significant concern, with the issue rising to fifth position with a score of 3.9. A notable increase from its previous ranking of tenth with a score of 2.9. This elevation in priority reflects the sector's response to an evolving regulatory landscape.

Regulatory requirements

The following are some of the recent regulatory compliance updates for banks:

1. Reserve requirement

The statutory reserve ratio (SRR) moved significantly from 17% to 26% in February 2024. As a result of this there was a net withdrawal of K8.1 billion from banks. This move impacted and constrained liquidity.[9]

2. Cybersecurity guidelines

There has been an increase in regulatory compliance due to cybersecurity risks associated with the growing digitisation of banking institutions. The Cyber and Information Risk Management Guidelines provide minimum standards and controls for managing cyber risks. These guidelines offer guidance on governance, strategies, policies and procedures, including collaboration and information sharing on cyber risks within the sector.

The guidelines are issued on an "apply and explain" basis, with the expectation that larger and more complex entities will fully comply. Entities unable to fully apply all the guidelines must demonstrate how they manage the cyber and information risks they face in pursuit of their business objectives.

Additionally, regulated entities are required to conduct annual cyber and information security maturity assessments to determine their level of maturity. The methodology and tools used for the self-assessment, along with the results, must be submitted to Bank of Zambia. The first self-assessment reports on cyber and information security maturity were required to be submitted by 30 September 2023.[8]

8 https://www.boz.zm/monetary-policy-instruments.htm
9 https://www.boz.zm/MPC_Media_Presentation_Q1_2024.pdf

3. Mandatory e-invoicing by the Zambia Revenue Authority

Following the announcements made in the 2024 national budget address by the Minister of Finance and National Planning, the Hon, Situmbeko Musokotwane, taxpayers will be required to use the smart invoice system to record all transactions. The implementation will start with a pilot phase before a full rollout.

As a result of the enactment of the Value Added Tax (Amendment) Act No. 27 of 2023 and the gazetting of The Value Added Tax (Electronic Invoicing System) Regulations, Statutory Instrument No. 58 of 2023, all VAT-registered taxpayers will be required to issue electronic invoices using the smart invoice system starting from 1 July 2024.

The smart invoice system is an electronic invoicing solution implemented by the ZRA. It allows taxpayers to create, customise and manage invoices electronically.

The ZRA Smart Invoicing system can have several significant impacts on the banking sector:

- Enhanced compliance and reporting: banks can benefit from improved compliance and reporting standards. The real-time transmission of invoice data to the ZRA ensures that all transactions are accurately recorded and reported, reducing the risk of non-compliance.
- Streamlined financial processes: the automation of invoicing processes reduces the need for manual data entry, minimising errors and speeding up transaction processing. This can lead to more efficient financial operations for banks.
- Improved cash flow management: with real-time tracking of invoices and payments, banks can offer better cash flow management solutions to businesses. This helps businesses manage their finances more effectively, which in turn can lead to more stable banking relationships.
- Reduced fraud risk: the use of digital signatures and encryption in smart invoicing systems helps reduce the risk of invoice fraud. This enhances the security of financial transactions, benefiting both banks and their customers.
- Integration with banking services: smart invoicing systems can be integrated with banking services, allowing for seamless transactions and better financial management. For example, businesses can automate payment reminders and reconcile invoices with bank statements.
- Data analytics and insights: banks can leverage the data generated from smart invoicing to offer personalised financial products and services. This data can provide insights into customer behaviour and financial health, enabling banks to tailor their offerings more effectively.

Overall, the ZRA smart invoicing system can streamline financial processes, enhance security and provide valuable data insights, benefiting both banks and their customers.[11]

4. Export proceeds trading framework

Bank of Zambia's Export Proceeds Tracking Framework Directives, 2023, which came into effect on 1 January 2024, establish regulations to monitor export proceeds and ensure compliance with financial and legal obligations. These directives apply to banks, financial institutions, and exporters of goods and services. The framework requires exporters to complete and submit the form CE20 with a Unique Consignment Reference (UCR) to ZRA and open accounts with Zambian financial institutions. Export earnings must be reflected in these accounts within 90 days. Commercials banks and financial institutions that receive export proceeds are required to submit returns of all money and remittances to Bank of Zambia. Bank of Zambia then reconciles, follows up on discrepancies and is authorized to inspect and enforce compliance, with penalties for violations including fines, imprisonment, and revocation of tax clearance certificates. Additionally, these directives mandate the use of electronic systems for tracking and impose anti-money laundering obligations.

With continued updates and introduction of new regulations, banks have seen an increase in costs in order to comply with these requirements both from operations and cost of funding. The Bank of Zambia in June 2024 has introduced some relief on SRR with banks allowed to invest 40% in the form of government securities.

[10] https://www.boz.zm/CBCIRCULARNO.16OF2023BANKOFZAMBIACYBERANDINFORMATIONRISKMANAGEMENT-GUIDELINES.pdf
[11] https://www.zra.org.zm/wp-content/uploads/2024/08/Smart-Invoice-FAQs.pdf

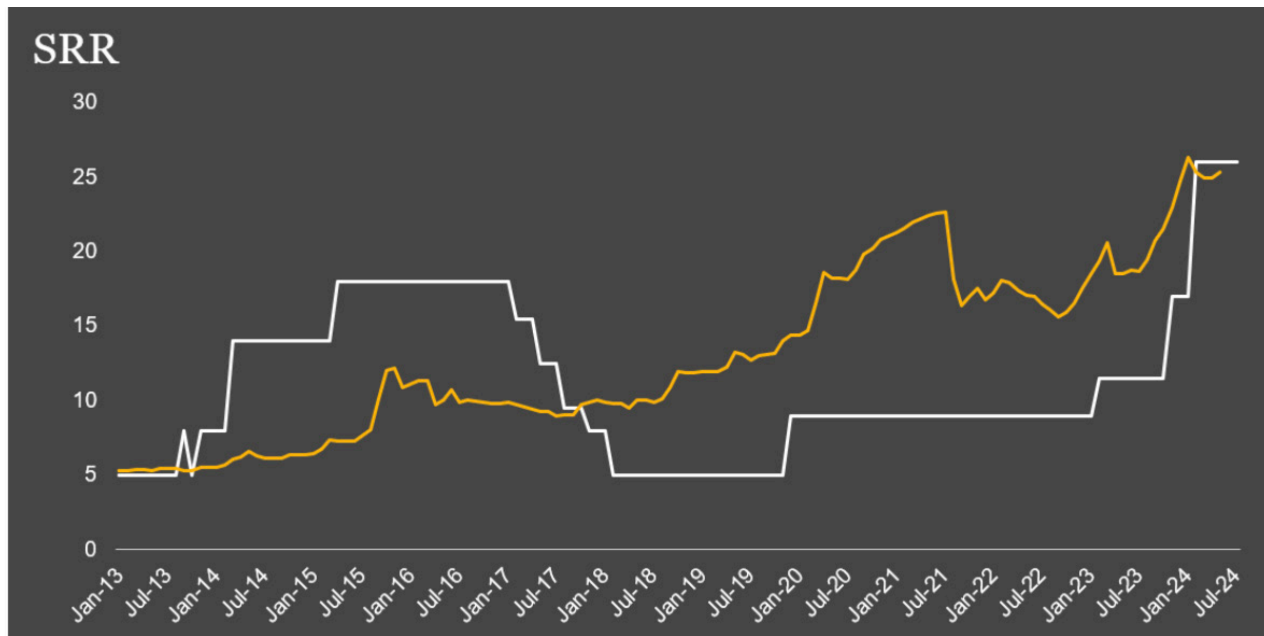
5. Banking sector liquidity challenges

On account of the combination of factors, this year, concerns have widened to encompass both local and foreign currency liquidity.

Local currency liquidity

The final quarter of 2023 witnessed a marked depreciation of the Zambian kwacha against the US dollar, culminating in a 17.5% decline to an average exchange rate of K24.75. This downward pressure on the kwacha persisted into 2024, with a further depreciation of 4.6 percent by mid-February. In response to these pressures, the statutory reserve ratio underwent a significant adjustment, increasing by 900 basis points to 26.0 percent for both local and foreign currency as of early February 2024, up from 17.0 percent in the preceding November 2023.

Figure 10: SRR and Interest movement



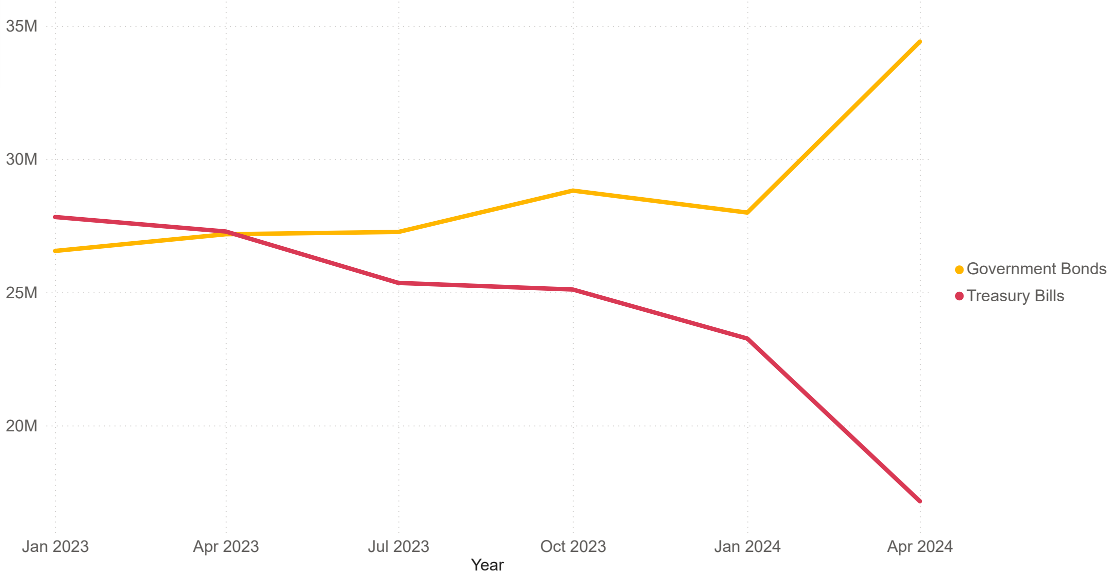
To alleviate market volatility and ensure the availability of essential imports, Bank of Zambia intervened with a substantial injection of US$215.5 million, which further increased to US$369 million by the end of the first quarter of 2024.

Concurrently, a government directive mandated the repatriation of government deposits from commercial bank accounts to the central bank's mopping account, which, alongside the augmented statutory reserve requirement, significantly constrained the liquidity of local currency within the banking sector. This resulted in the repatriation of approximately K3.4 billion from January 2024 to July 2024.

The repercussions of these liquidity constraints are multifaceted. Banks have pivoted towards reduced investments in government securities to maintain liquidity. This shift has also led to a strategic unwinding of balance sheets, as banks allow investments to mature without renewal. The broader economic implications include a dampening effect on economic growth, with domestic credit expansion decelerating to 10.5% in March 2024, down from 18.1% at the close of the previous year. This slowdown is attributable to diminished lending to both the government and private sector, with the latter also impacted by stringent liquidity conditions in the money market. The liquidity constraint has also resulted in increased external funding by banks to support their short-term liquidity needs. There has been an increase in lending rates; specifically, overnight lending rates have increased from an average of 11% at the end of Q4 2023 to an average of 17% by the end of Q1 2024.This has resulted in a decrease in the net interest margins across the sector.

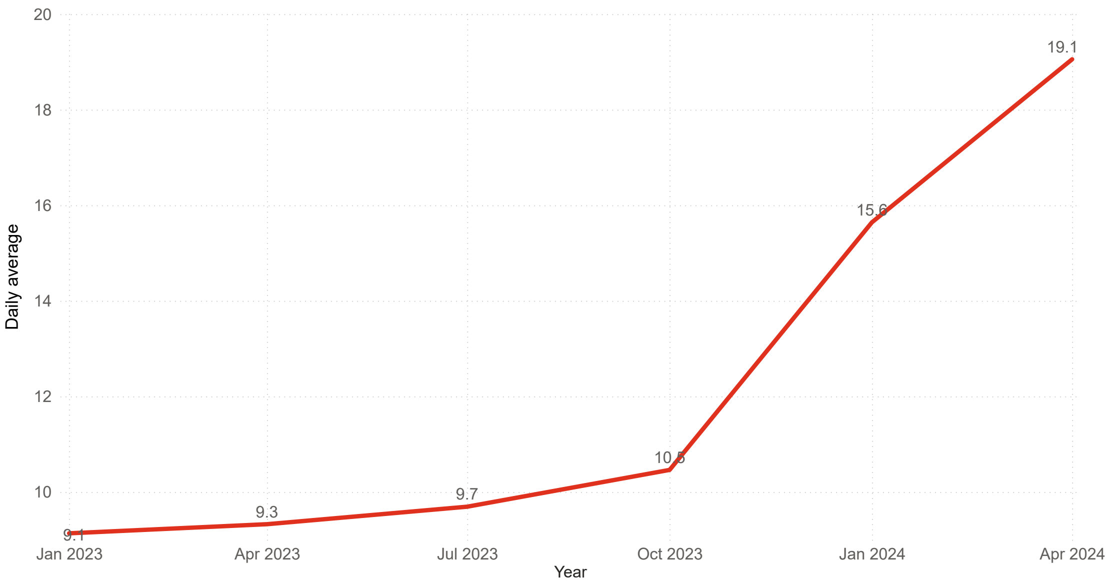
It should be noted that the regulator issued a directive to allow 40% of the statutory reserve allocation to be made up of government securities. This has allowed a portion of the reserve to earn interest and provide much needed relief.

Figure 15: Investment in government securities



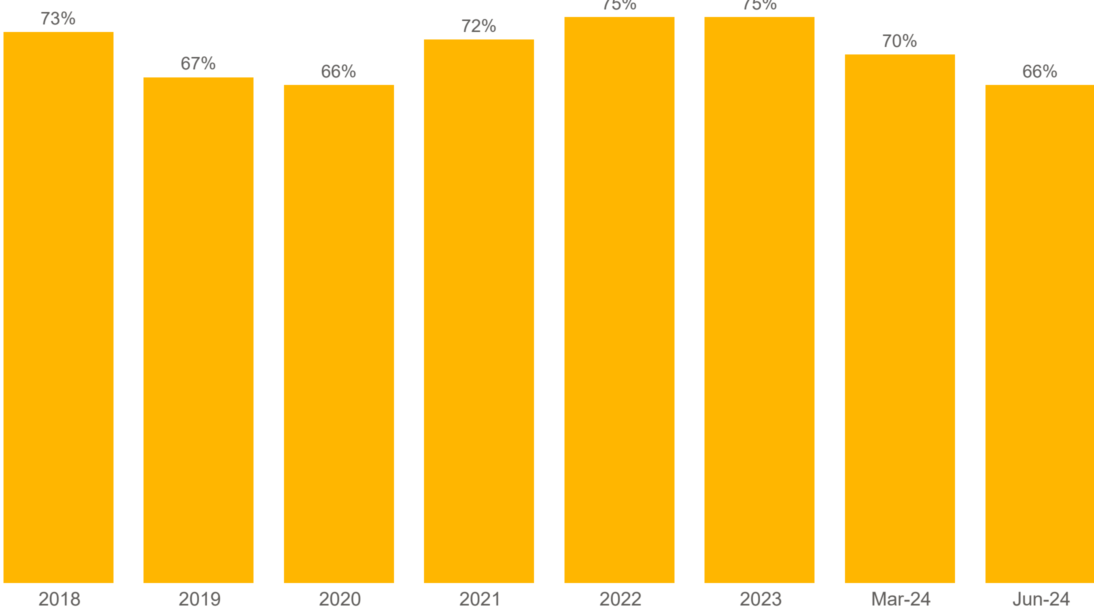
Source: Bank of Zambia

Figure 16: Overnight lending rates daily average by year and quarter



Source: Bank of Zambia

Figure 17: Net interest margin



Source: PwC analysis

USD liquidity

In Q1 2024, merchandise exports declined by 2.5%, largely driven by a decrease in copper and non-traditional export earnings. Copper, Zambia's main export, experienced a drop in earnings despite higher market prices due to reduced export volumes. Non-traditional exports also suffered, primarily due to the adverse effects of drought on agricultural production and energy generation.

The contraction in export earnings has precipitated a foreign currency deficit, particularly affecting banks with limited international affiliations and a significant local-to-foreign currency deposit ratio. Although the kwacha's depreciation against the dollar moderated in the first quarter of 2024, renewed pressure led to a further depreciation of 10.2% by mid-May. The kwacha appreciated by 7.8% from 10-14 May due to improved foreign exchange supply and positive market reactions to advancements in external debt restructuring.

The shortfall in USD liquidity poses a significant challenge for banks, hindering their ability to fulfil customer transactions in USD and to service their own foreign currency-denominated liabilities. This situation underscores the need for improvements in the local economy and robust liquidity management strategies within the banking sector to navigate the complexities of currency fluctuations and regulatory changes.

6. Technology and cybersecurity

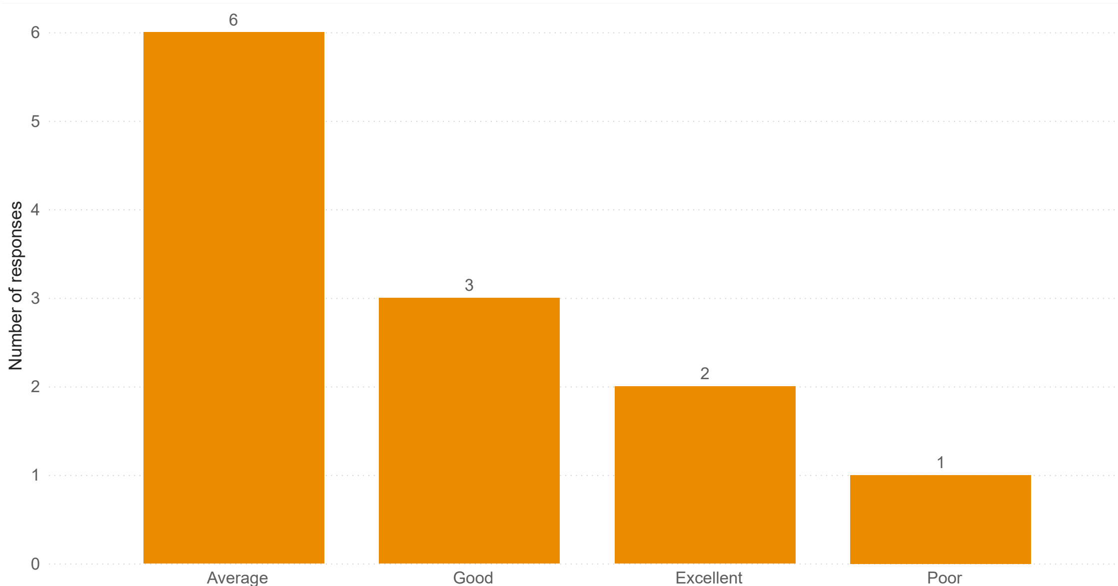
Cybersecurity in the Zambian banking sector

Cybersecurity continues to be a critical concern for banks, who rated the subject as the third most pressing issue, albeit down from the top issue in the prior year. While the change in ranking may suggest that banks are becoming more adept at implementing robust cybersecurity measures and thereby reducing the perceived immediacy of the threat. It is more probable, however, that other matters have become more pressing in the period under consideration.

The *Putting Security at the Epicentre of Innovation* report, published by PwC South Africa in 2024, provides a broader African context to cybersecurity, revealing that 30% of African respondents acknowledge significant gaps in their cybersecurity capabilities. The report draws attention to the increasing prevalence of high-value breaches, particularly those targeting cloud infrastructure. It also points to the advent of generative AI as a double-edged sword, offering both innovative defensive capabilities and novel attack vectors.

Our survey indicates that regulatory support in cybersecurity is perceived as moderate, with half of the participating banks rating it as average. This feedback underscores the need for regulators to improve their support mechanisms and refine the regulatory framework to more effectively address the evolving cyber threat landscape. Regulatory bodies might consider engaging key stakeholders, such as the Ministry of Technology and Science, as well as the regulated institutions in the development and implementation of incident management policies and procedures that would help improve the cyber response and recovery.

Figure 17: Support from regulators on cyber-related matters

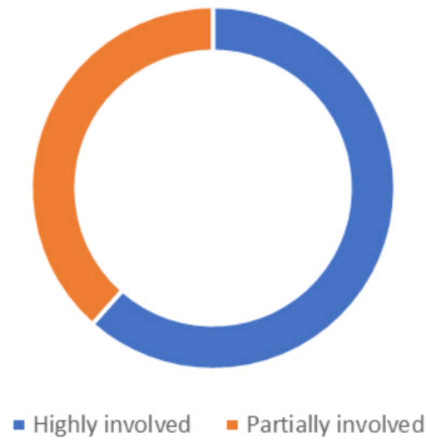


Source: PwC Zambia Analysis

Board engagement in cybersecurity

The involvement of Zambian bank boards in cybersecurity decision-making is significant, with 69% of banks reporting high levels of board engagement. This trend is encouraging, as it highlights the increasing recognition of cybersecurity as a strategic governance issue that requires board-level oversight. Conversely, two of the top five banks indicated that they do not perceive their board's involvement in cybersecurity decision-making.

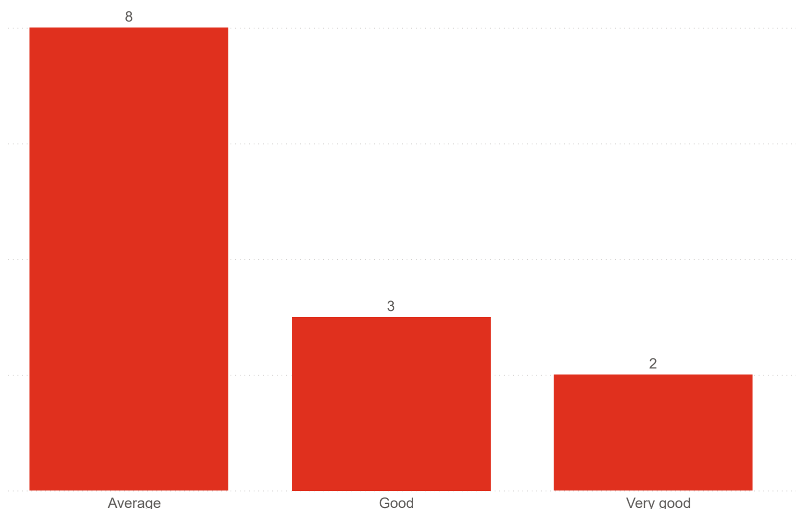
Figure 17: Boards Involvement on Cybersecurity Decision Making



Cybersecurity talent in Zambia

The availability of skilled cybersecurity professionals in Zambia remains a significant concern for the banking sector. Most banks rate the current level of available expertise as average, with only 15% considering it to be very good. On November 14, 2023, the Zambia Information and Communications Technologies Authority (ZICTA) published a National Cyber Risk Assessment report, which highlighted that the banking and finance sector, as well as the energy and information & communication sectors in Zambia, are highly exposed to malware, phishing, and insider attacks. However, the statistics regarding the scarcity of skilled cybersecurity resources capable of addressing these threats are alarming. There is an urgent need for banks to invest in the development and upskilling of their cybersecurity workforce to strengthen their defences against cyber threats. Additionally, banks may consider outsourcing expertise from organizations that specialize in cybersecurity services.

Figure 19: Availability of skilled cyber resources in Zambia



Source: PwC analysis

[12] https://www.boz.zm/MPC_Media_Presentation_Q1_2024.pdf
[13] https://www.boz.zm/Governors_Media_Presentation_May_2024.pdf
[14] https://www.boz.zm/May_2024_Monetary_Policy_Report.pdf
[15] https://www.boz.zm/Governors_Media_Presentation_May_2024.pdf

Cybersecurity awareness programmes

Cybersecurity awareness programmes in Zambian banks have shown encouraging results, with most institutions reporting positive outcomes. According to the findings, 62% of the banks indicated that their cybersecurity awareness programmes are effective, while 38% reported that their programmes are very effective.

It would have been insightful to understand how the banks are measuring the effectiveness of their cybersecurity awareness programmes. This information could have provided valuable insights into the specific metrics and methods used to assess the impact of these initiatives.

Nonetheless, it is imperative that banks continue to refine and enhance their cybersecurity awareness programmes to maintain vigilance and resilience against evolving cyber threats. The Bank of Zambia's Cyber and Information Risk Management guidelines of May 2023 also emphasize the importance of all regulated entities undergoing an annual cybersecurity maturity level assessment. This exercise will help ascertain the maturity of the bank's cybersecurity controls and identify areas for improvement.

By continually evaluating and strengthening their cybersecurity awareness programmes, Zambian banks can ensure that their employees are well-equipped to identify, mitigate, and respond to cyber threats, ultimately enhancing the overall security posture of the banking sector.

Technology and the future of banking

While banks continue to transform their operations to meet changing customer needs, a partnership has emerged with mobile network operators. In the current year, MNOs are considered the second most competitive threat after other incumbent banks.

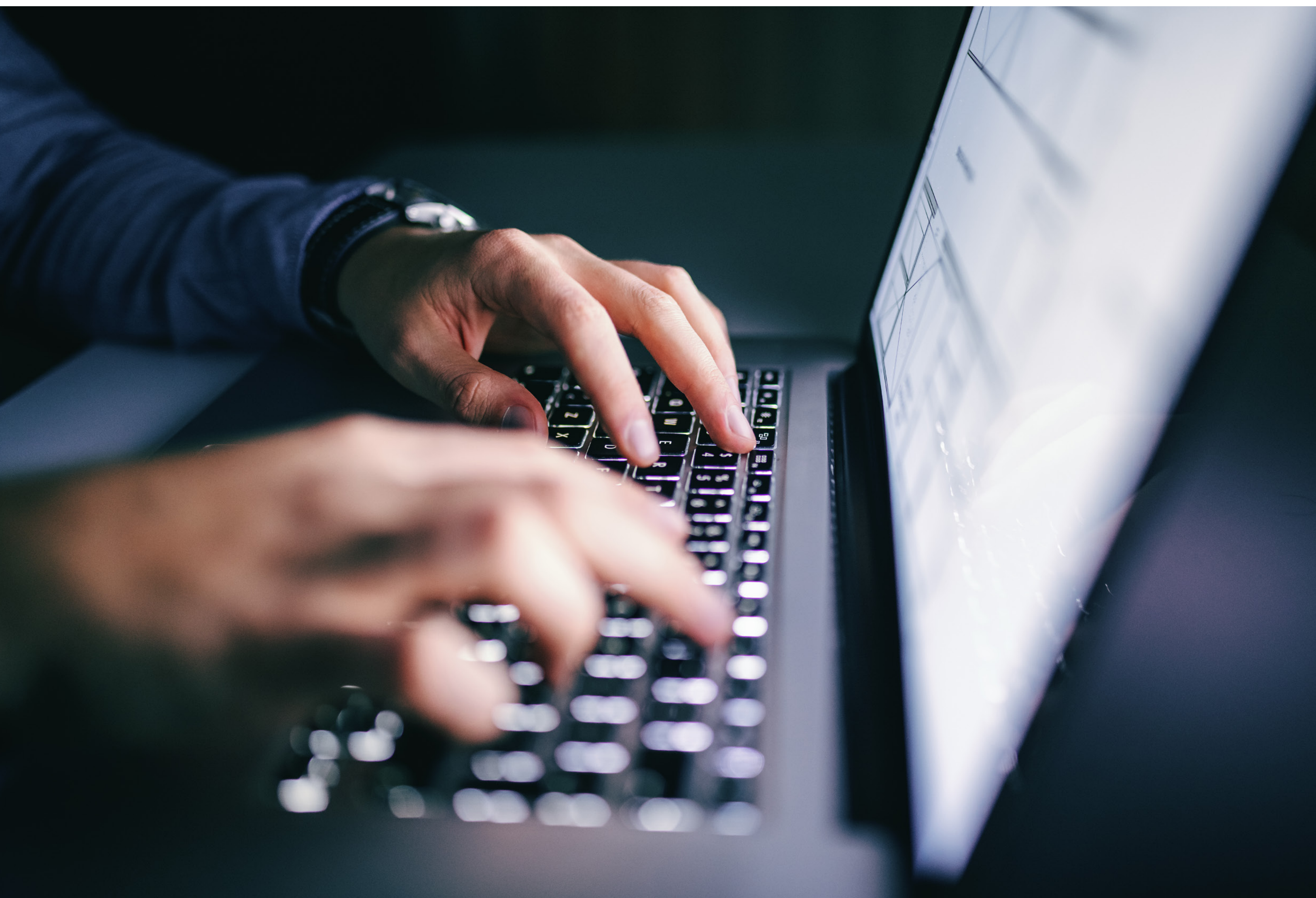
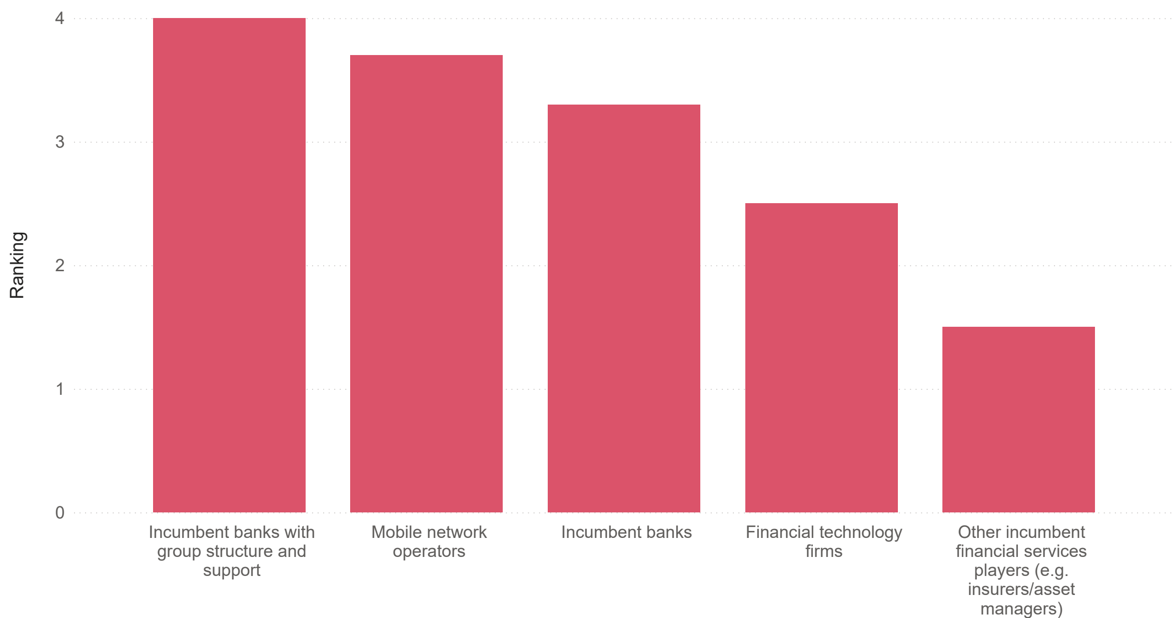


Figure 20: Competitive threats

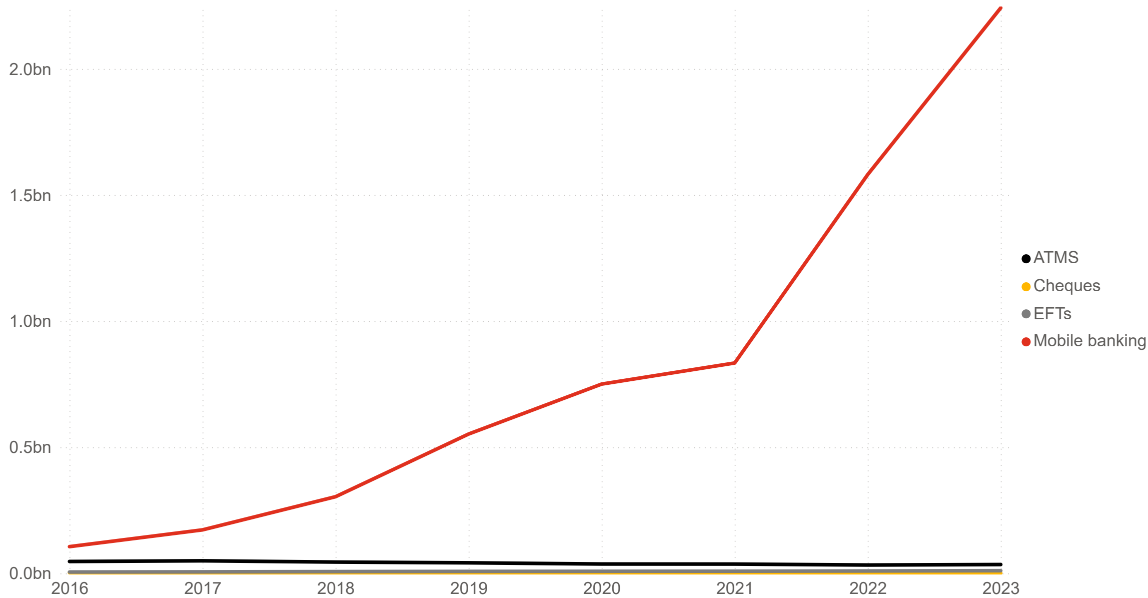


Source: PwC analysis

Market Trends

Technological advancements and the proliferation of mobile phone usage have precipitated a marked transition from traditional retail banking towards mobile banking. The 2023 National Payments Systems Annual Report by Bank of Zambia underscores this shift, documenting a surge in mobile payment volumes to over two billion in 2023 a stark contrast to the less than 500 million recorded in 2016. This growth trajectory is not mirrored in the use of ATMs, cheques and electronic funds transfer which have remained relatively static.

Figure 21: Retail Volumes

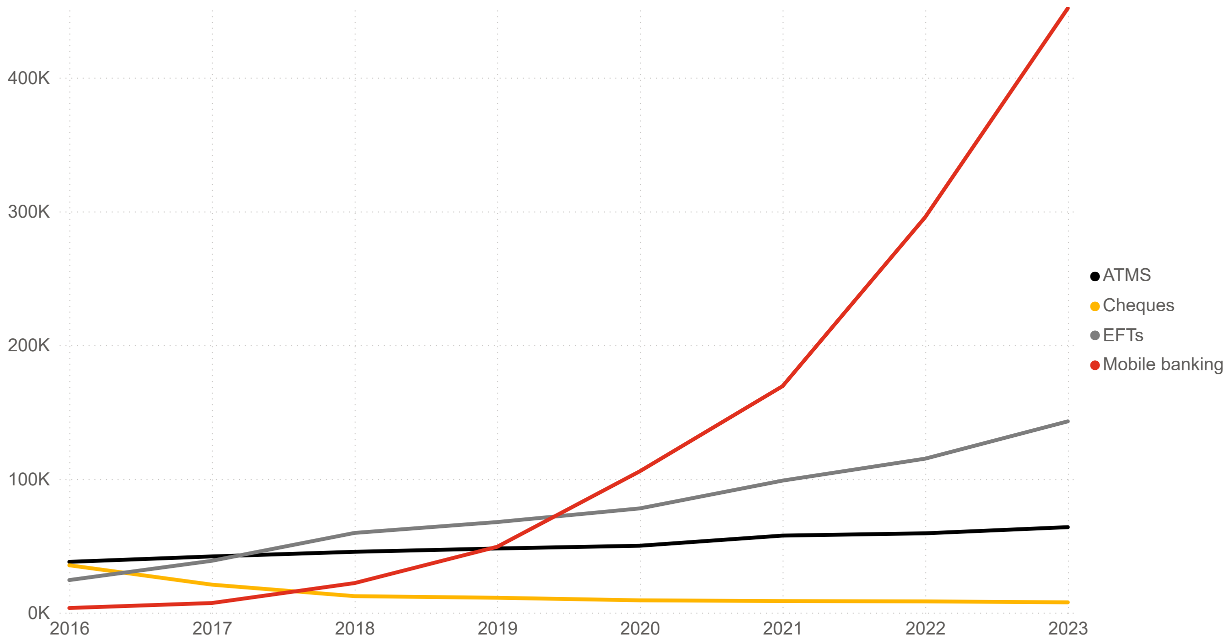


Source: 2023 National Payment Systems Annual Report

Transaction Analysis

The trend is further corroborated by the value of transactions, with mobile payments experiencing a significant uptick, particularly during the Covid-19 pandemic. The year 2020 witnessed mobile payments peak at over K105 billion, a dramatic rise from the previous year's figure of less than K50 billion. This represented the largest annual increase within an eight-year span, with the value of transactions continuing to ascend to K452 billion in 2023.

Figure 22: Retail values



Source: 2023 National Payment Systems Annual Report

Mobile Payment Breakdown

An analysis of the over two billion mobile payments in 2023 reveals that 60% were peer-to-peer wallet transactions, 22% were merchant purchases, 8% airtime purchases, 6% utility payments and the remaining 4% Bank2Wallet to E-Wallet account transfers.

Generative artificial intelligence

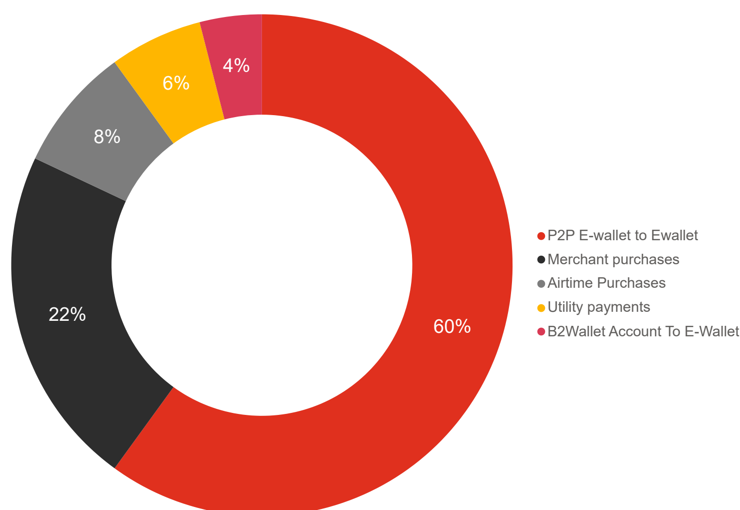
Generative artificial intelligence (GenAI) represents a transformative force in the Zambian banking sector, offering significant potential for maintaining a competitive edge and enhancing operational efficiencies. GenAI is a form of advanced technology that leverages machine learning models to generate new content, such as text, images, and other forms of data, based on input patterns. It is rapidly becoming a crucial tool in various industries, including banking, where it can optimize processes, improve customer service, and drive innovation.

Our survey indicates a moderate engagement with GenAI technologies among Zambian banks, with a current utilisation rate of 62%. While three of the top five banks indicated that they use GenAI for software development, behaviour analysis, notes taking and cyber threat monitoring, two of the top five banks indicated that GenAI is still under consideration some indicating that it is going through trial. This adoption level suggests a more cautious approach to integrating GenAI than initially expected. While over half of the banks have started using GenAI, the pace of adoption remains measured, reflecting a tentative approach to fully committing to this new technology.

Banks are encouraged to explore further the potential benefits of GenAI to enhance productivity and operational efficiency. The power of GenAI lies not just in its technological capabilities but also in its ability to reshape workforce and operational paradigms. As emphasized in PwC South Africa's 2023 report, "AI Catalysing a Workforce Revolution, Now!", the digital era demands a strategic approach to workforce development. This means cultivating a workforce that is adaptable, innovative, and equipped with the skills necessary to excel in an increasingly automated environment. For banks to fully leverage GenAI, they must understand the dynamic between automation and human talent.

In conclusion, although the current adoption of GenAI in Zambian banks is moderate, there is a clear need for banks to accelerate its integration. By doing so, banks can unlock new opportunities for innovation, drive greater productivity, and position themselves as leaders in the evolving landscape of banking.

Figure 23: Mobile transactions



Source: 2023 National Payment Systems Annual Report

7. Emerging risks

This section delves into the key emerging risks identified by respondents, their implications for the operational aspects of banking, and the strategic considerations banks must adopt in response.

7.1 Climate change and financial stability

The spectre of climate change looms large, presenting a suite of emerging risks with the potential to profoundly disrupt the global economy and the financial sector. A study by the London School of Economics, called Climate Value at Risk of global financial assets, estimates the value of global financial assets at risk due to climate change to be in the region of US$2.5 trillion, with the most extreme scenarios predicting losses upwards of US$24 trillion[15]. The current drought in Zambia exemplifies the tangible economic consequences of climate change, with the capacity to significantly erode the value of financial assets. These risks transcend environmental concerns, posing multifaceted financial and operational challenges for banks.

Implications for banks

Banks are inherently susceptible to a diverse range of risks, and the diverse impacts of climate change are set to exacerbate this. We categorise these into physical and transitional risks, which include traditional credit and market risks familiar to the banking sector.

7.1.1. Physical risks

Physical risks encompass the immediate and enduring effects of environmental shifts, such as increased incidence of wildfires, floods, droughts and other extreme weather events. These events can directly diminish the value of financial assets and their productive capacity, leading to reduced returns on capital. Physical risks have a direct bearing on credit risk, as the devaluation of collateral, uncertainties surrounding business continuity and loss of income-generating assets all contribute to the deterioration of counterparty credit quality. Catastrophic environmental events can also increase banks' insurance costs and make it difficult for them to insure collateral assets, while heightening banks' exposure to market risks through shocks and liquidity crises.

7.1.2. Transition risks

As the world becomes more aware of climate change and the transition to a low-carbon economy gains momentum, transition risks start to manifest. Banks must navigate the fallout from shifting company strategies and the launch of carbon-neutral goods and services, which have an impact on consumer behaviour and, consequently, financial institutions. As these transitions occur, banks may struggle with the weight of adaptation costs, whilst disruptive business models pose a competitive threat to traditional credit portfolios. Moreover, increased volatility in the performance of different asset classes, induced by evolving climate risks and changing regulatory frameworks, further amplifies banks' exposure to market risks.

In conclusion, the banking industry in Zambia must remain vigilant and responsive to these emerging risks. Strategic foresight and adaptability will be crucial in mitigating the impacts and seizing opportunities that arise from the evolving economic and environmental landscape.

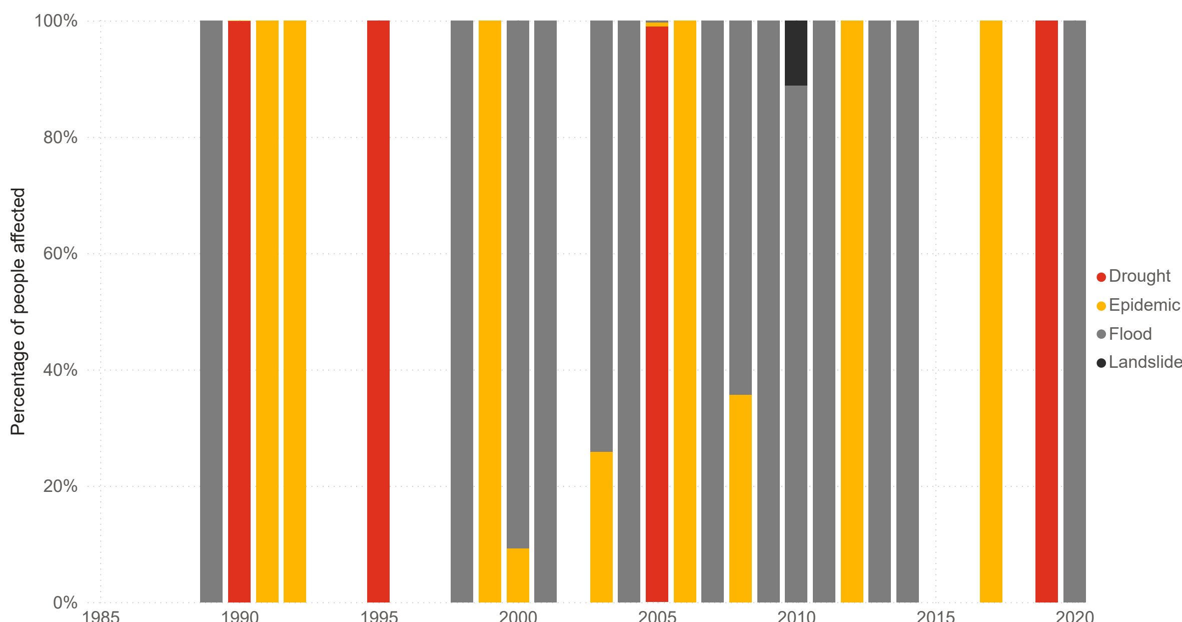
[15] https://eprints.lse.ac.uk/66226/

What should banks think about?

Climate risk management and the banking sector

Banks have an opportunity to channel financing into projects that are targeted towards climate mitigation and adaptation, with the latter being a bigger priority for Africa. According to the World Bank Group's climate change knowledge portal, historically Zambia has been inundated with seasonal flash floods, extreme temperatures and droughts, with increased severity and frequency in recent decades. Inadequate infrastructure paired with the fact that a large proportion of the population is rural and poor, makes Zambia highly vulnerable to natural catastrophes, especially floods.

Figure 24: Key natural statistics for 1980-2020



The Zambia central bank strategy 2024 – 2027

Bank of Zambia has expressed its intention to implement the climate risk guidelines soon as part of its Financial Stability Focus Area 2.[16] The strategic initiatives under this focus area aim to:

- Strengthen the resilience of the financial system by adopting and entrenching Environmental, Social and Governance (ESG) issues and practices within the central bank and in the financial sector.
- Improve data collection, management and application.
- Strengthen cybersecurity resilience and fraud mitigation in the financial sector.

Network for greening the financial system (NGFS)

The NGFS, launched at the Paris One Planet Summit on 12 December 2017, is a group of central banks and supervisors which, on a voluntary basis, are willing to share best practices and contribute to the development of environment and climate risk management in the financial sector. The NGFS, which brings together 141 central banks and supervisors and 21 observers, also aims to mobilise mainstream finance to support the transition toward a sustainable economy.

The NGFS's guide on climate-related disclosure for central banks provides information for central banks that are in the process of, or considering, disclosing their climate related exposures. Organised around four thematic areas adapted from the Taskforce for Climate Related Disclosures recommendations (governance, strategy, risk management, and metrics and targets), the guide introduces a distinction between "baseline" and "building block" disclosure recommendations.

[16] https://eprints.lse.ac.uk/66226/

Why these guidelines?

The guidelines would propose a prudent approach to managing the risks that arise from the link between climate-related and environmental financial risks and financial stability with a view to enhancing the resilience of the banking sector.

Figure 25: What do these guidelines expect financial institutions to do?

Source: PwC Survey Response Analysis

Key next steps towards climate risk reporting and climate finance

The IFRS Sustainability Disclosure Standards, which are now mandatory for certain entities in Zambia, and the NGFS, provide guidance on climate-related risk disclosures for banks. Banks can adopt best practices for climate risks and non-financial metrics disclosure and unlock new business opportunities.

Here are recommended next steps for banks:

Climate stress testing	Assess financial institutions' ability to withstand climate-related risks through rigorous scenario analysis and stress tests.
Green taxonomy and standards	Establish clear definitions and criteria to identify and evaluate climate-friendly investments, ensuring consistency and transparency in the market.
Disclosure and transparency	Require companies to publicly disclose their carbon footprint, climate risks, and mitigation strategies to enable informed decision-making by investors.
Incentives and subsidies	Offer financial incentives such as tax credits and subsidies to encourage investment in renewable energy, energy efficiency and other sustainable projects.
Capacity building and education	Provide training and educational programmes to enhance the understanding and management of climate-related risks and opportunities among financial stakeholders.
International collaboration	Facilitate cooperation among regulators and policymakers globally to harmonise climate finance regulations and standards and promote cross-border investment.
Innovation and research	Support research and development of innovative financial instruments and mechanisms that mobilise capital for climate-resilient and low-carbon investments.

7.2 Capital adequacy and climate risk mitigation

Capital adequacy should be a major concern for banks, particularly in the context of climate-related financial risks. In the short to medium term, the adequacy of economic capital should be a priority if banks are to withstand the tangible changes in credit and market risks that accompany climate change.

Zambian banks are urged to scrutinise their economic capital levels to ensure they are commensurate with these burgeoning risks. Economic capital acts as a safety net for unforeseen losses within a predetermined duration, usually one year specified at a given confidence level. It provides a forward-looking, probabilistic risk measure that links capital to the unique risks and risk appetite of an entity, independent of its assets.

The formulation and implementation of a robust economic capital framework can significantly boost management's foresight in navigating impending adversities. The global financial crisis of 2008 made clear how inadequate traditional, non-risk-adjusted performance metrics—like return on equity or assets—are not capturing the changing risk profile of banks. The crisis brought to light the need for banks to reorient their capital management methods towards economic profitability, economic capital and risk-adjusted returns in light of impending climate risks and market volatility.

Furthermore, scenario analysis and stress testing are becoming essential tools for assessing vulnerability and the financial impact of climate change, underscoring the significance of efficient risk management.

7.3 Credit risk modelling and forward-looking information

The imperative for banks to refine their credit risk modelling to underscore the need to address identified gaps and enhance the precision of expected credit loss provisioning. The incorporation of forward-looking information into credit risk models is fraught with challenges, particularly in establishing statistically meaningful relationships between default rates and macroeconomic factors. The resulting models frequently have low goodness-of-fit metrics, raising doubts about their effectiveness.

The lack of strong correlations is attributed to a variety issues, including insufficient portfolio segmentation, which ideally should cluster exposures with comparable credit characteristics, and dependence on a limited range of macroeconomic variables that may not correspond with the bank's business and risk profile.

Banks employ various methodologies to incorporate forward-looking information, from simple linear regression to more complex machine learning techniques. Regardless of the chosen method, it is imperative for banks to consider an extensive array of historical and forecast information that resonates with their credit risk profile.

Furthermore, banks must ensure proper segmentation of their exposure portfolios, grouping financial assets by the commonality of credit risk drivers, while maintaining data adequacy.

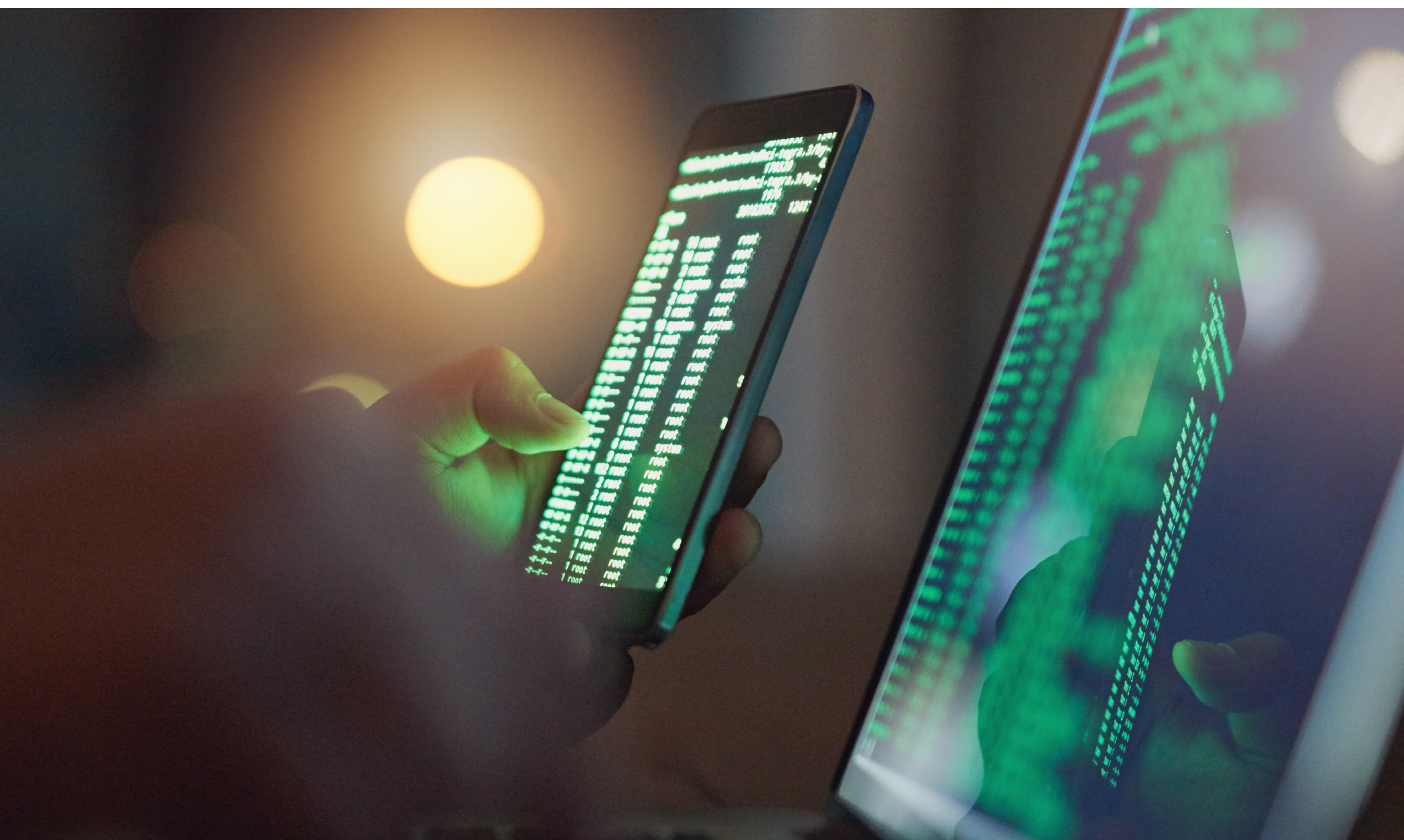
Model governance and control processes

Banks also need to pay consideration to the governance of credit risk models. It is necessary to pay attention to the shortcomings in model governance and internal control processes that have been found, including insufficient model validation and back testing and a lack of understanding of models created by outside parties.

Due to the widespread use of models that are produced outside of the bank, institutions must ensure that the data, assumptions, and scenarios used are specific to their risk profiles. Furthermore, it's critical that the credit department of the bank fully comprehends the essential elements of these models.

Zambian banks are at a juncture where strategic enhancement of capital adequacy, credit risk modelling, and model governance is not just advisable but imperative for sustained resilience and competitiveness in a rapidly evolving financial landscape marked by climate change and economic uncertainty. to more complex machine learning techniques. Regardless of the chosen method, it is imperative for banks to consider an extensive array of historical and forecast information that resonates with their credit risk profile.

Furthermore, banks must ensure proper segmentation of their exposure portfolios, grouping financial assets by the commonality of credit risk drivers, while maintaining data adequacy.



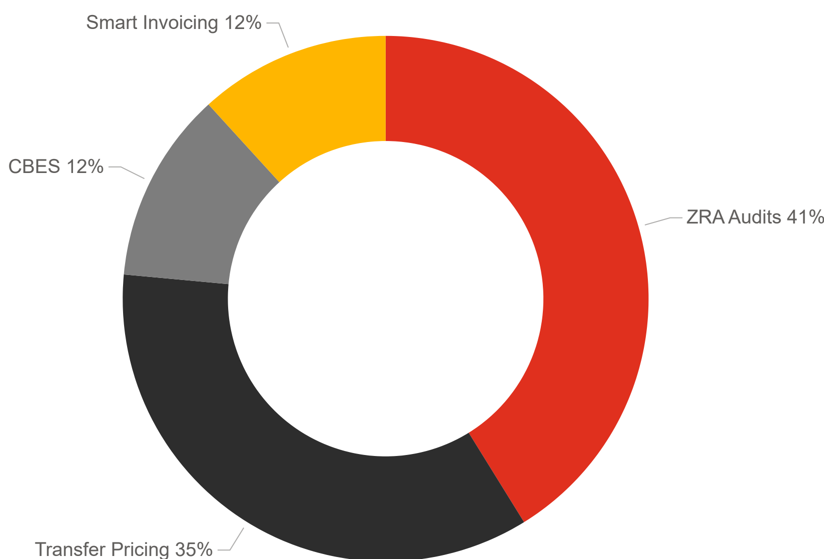
8. Taxation, the tax environment and banks

Taxation plays a pivotal role in shaping a bank's operational landscape, impacting both taxes borne by banks and those collected on behalf of the government. The financial implications of these taxes are significant, necessitating additional resources and capabilities to ensure effective collection. It is, therefore, imperative for banks to develop a comprehensive strategy to manage their tax obligations. Failing to do so can introduce risks into the bank's ecosystem, potentially resulting in financial setbacks and damage to reputation.

Given these factors, we conducted a survey among banks to explore contemporary challenges in tax compliance and their potential impacts.

We have summarised the responses below:

Figure 26: Banks' tax issues



Source: PwC Survey Response Analysis

Transfer pricing concerns in the Zambian banking sector

Transfer pricing has emerged as a point of contention within the Zambian banking sector, with 46% of the surveyed banks acknowledging it as a pressing issue. This represents a modest uptick from the figures reported in prior years. The complexity inherent in the operational structures of banking groups, which often encompass centralised financial functions and specialised platforms, has led to heightened regulatory examination of their transactions, both within the country and across borders.

The practice of transfer pricing within financial institutions is governed by a multitude of critical considerations. These include the nature and scope of the services provided, prevailing market conditions, comprehensive risk assessments and thorough comparability analysis. The dynamic nature of financial services, such as interbank lending and foreign exchange dealings, coupled with market-driven variables like interest rates and liquidity levels, are pivotal in shaping the pricing strategies adopted by banks. It is important that these issues are documented meticulously to establish arm's length pricing that aligns with regulatory expectations.

In recent times, the Zambia Revenue Authority (ZRA) has amplified its efforts to scrutinise transfer pricing, mirroring a global shift towards more rigorous enforcement. The regulatory framework in Zambia, as delineated under Section 97A of the Income Tax Act and further refined by the amendments introduced in 2018, mandates detailed documentation that adheres to the guidelines set forth by the Organisation for Economic Cooperation and Development (OECD). In anticipation of this increased oversight, banks have been engaging more intensively with their in-house group tax specialists and external consultants. The objective is to ensure that their documentation is exhaustive and that they remain in full compliance with both Zambian and international transfer pricing regulations.

This proactive stance is indispensable if banks are to navigate the complexities of the regulatory landscape effectively. By doing so, they can manage the heightened scrutiny with confidence and uphold the stringent standards of transfer pricing practices on a global scale.

Tax audits instigated by ZRA

The Zambian banking sector has experienced a notable intensification in tax audits by the ZRA over the past year. This trend has emerged as a significant concern for the industry, with more than half of the banks reporting tax audits as a critical tax issue - an increase from 40% in the previous year.

This heightened scrutiny by the ZRA has put considerable pressure on banks' operational capacities. The escalation in both the frequency and depth of these audits has meant banks have had to divert substantial internal resources to manage the audit processes effectively. The disruption to normal business activities has been palpable, compelling banks to allocate significant manpower and time to address the audit requirements.

In response to these challenges, banks have taken measures to fortify their tax compliance frameworks. A strategic enhancement of internal processes has been a notable development as banks strive to mitigate the impact of these rigorous audits. Furthermore, there has been a concerted effort to foster a more collaborative environment with the ZRA. By engaging in open dialogue and building constructive relationships, banks aim to streamline the audit process and reduce the associated operational strain.

Additionally, banks have increasingly sought the expertise of consulting firms to navigate the complexities of tax audits. This approach has provided them with a dual advantage: access to specialised knowledge and an external perspective on best practices in tax compliance.

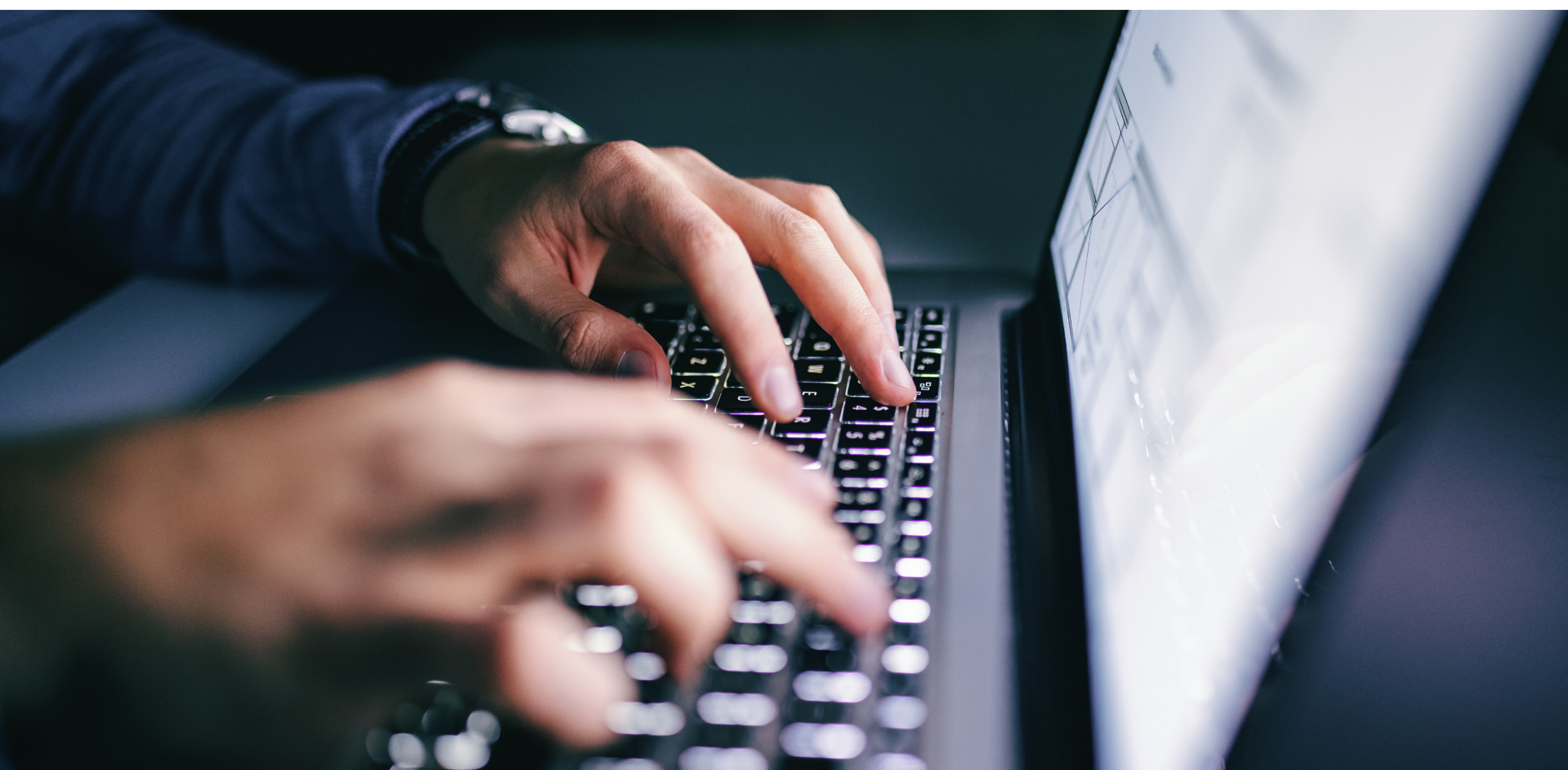
The findings of this survey underscore the evolving dynamics within the Zambian banking sector, particularly in relation to tax administration. As banks continue to adapt to these changes, the insights gleaned from this report will be instrumental in shaping their strategic imperatives and ensuring resilience in the face of regulatory challenges.

Cross-border electronic services

The enactment of Value Added Tax (VAT) on cross border electronic services in Zambia, which commenced on 1 January 2024, represents a pivotal alteration in the country's taxation framework. This legislative change compels international digital service providers to undertake VAT registration within Zambia and mandates the imposition of VAT on services rendered to consumers within the country. This development requires banks to meticulously monitor and declare VAT on all electronic services procured from overseas suppliers. This requirement is not without its challenges as it often demands significant enhancements to existing financial infrastructures to ensure adherence to the new compliance landscape. According to our survey, approximately 23% of the participating banks identified this as a salient issue.

The financial ramifications of this policy are substantial. The imposition of VAT on foreign electronic services increases the total expenditure on these services for the banking sector. Banks are thus confronted with a strategic decision: to either internalise these additional costs, potentially diminishing their profitability margins, or to transfer them onto their clientele, which could lead to an escalation in the cost of banking services for consumers.

In anticipation of these hurdles, banks have been engaging with tax advisory services to demystify the intricacies associated with the new VAT obligations. These collaborations aim to facilitate the necessary system enhancements and ensure that banks remain compliant with the updated tax regulations. The steps taken by the banking sector underscore its commitment to maintaining operational excellence and fiscal responsibility in the face of evolving tax policies.



Smart invoicing

In the wake of the 2024 National Budget announcement by the Minister of Finance and National Planning, the Zambian banking sector is on the cusp of a significant transformation. The mandate for taxpayers to adopt smart invoicing is a pivotal development, one that the ZRA initiated in 2023 to improve tax compliance and refine the mechanisms of tax administration. This measure is a cornerstone in the government's agenda to modernise the country's tax infrastructure and enhance operational efficiency.

The introduction of smart invoicing requires the use of sophisticated electronic systems that enable real-time reporting and meticulous tracking of transactions. The overarching goal is to curtail tax evasion, elevate the precision of tax reporting, and simplify the compliance process for enterprises. The banking industry in particular has felt the impact of this transition as it necessitates considerable investment in new technologies to ensure that invoicing procedures are in strict adherence to the stipulations set forth by the ZRA.

The advantages of transitioning to smart invoicing are manifold. From the perspective of the ZRA, it ensures a more robust surveillance of financial transactions and improves the authority's capacity to identify and thwart fraudulent activities. For the corporate sector, it heralds a more efficient, transparent and simplified approach to managing invoicing and tax-related obligations.

The initiative undertaken by the ZRA is a commendable step towards refining Zambia's tax administration. It is a move that promises to foster enhanced efficiency, transparency and adherence to tax regulations. In response to the smart invoicing directive, banks have embarked on a series of strategic actions and are undertaking developmental enhancements to their systems, ensuring seamless integration with the ZRA's framework. These initiatives are a testament to the banks' unwavering commitment to regulatory compliance and their readiness to embrace the new smart invoicing paradigm.

Enhancing bank and ZRA synergy

The results of our survey strongly indicate that there are several areas where the synergy between banks and the ZRA can be significantly improved. Our findings indicate that while banks are reasonably content with the current level of support and guidance from the ZRA on tax-related matters, there is a scope for enhancement. The measures outlined below are instrumental in refining the interactions and addressing the persistent challenges, underscoring the need for more efficacious engagement and support to streamline tax administration and compliance processes.

Strengthened stakeholder engagement and feedback mechanisms

A measure that has been proposed is the intensification of engagement with stakeholders, particularly through the Bankers Association of Zambia (BAZ). This would entail a more consultative approach prior to the enactment of new tax regulations. Such a strategy would ensure that the banking sector's concerns are integrated at the inception stage, leading to the formulation of regulations that are not only pragmatic but also grounded in the operational realities of the banks.

Targeted training and educational initiatives

To ensure that banks remain abreast of tax obligations and are adept at navigating the complexities of tax compliance, a series of regular training sessions and specialised workshops is recommended. These initiatives should be designed to address the nuanced aspects of tax requirements, with a particular emphasis on enhancing banks' comprehension of tax laws, especially those pertaining to cross-border electronic services. The expansion of taxpayer education workshops is also deemed critical in this context.

Swift e-solution of legacy tax audits

Another area of focus is the expedited resolution of outstanding legacy tax audits. By prioritising the conclusion of these audits, banks would be relieved of the administrative burden associated with them. This would enable banks to channel their resources and attention towards ensuring adherence to current compliance requirements.

9. Sustainability and banking: sustainable finance and sustainability reporting

9.1. Sustainability strategy

In an era where sustainability has become a cornerstone of corporate strategy, the banking sector is no exception. The need for sustainable finance and robust ESG reporting is driven by a confluence of factors. These include the escalating demands of investors for sustainable investment opportunities, the need for climate resilience and the implementation of stringent regulatory measures aimed at fostering a low-carbon economy.

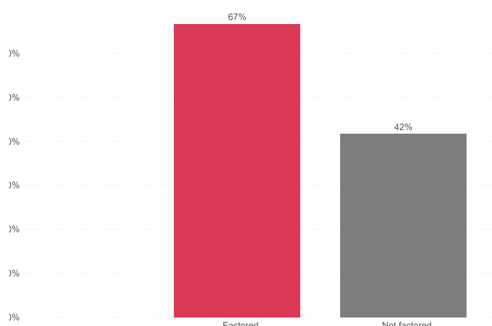
The ascendancy of ESG

The influence of ESG on business models is undeniable and is set to reshape the banking industry profoundly. Banks are poised to encounter a wealth of opportunities as they navigate the transition towards sustainability, which will require substantial investment. However, this shift also presents considerable risks to existing business models. ESG risks can involve anything from how a business responds to climate change to how it supports ethical labour standards to how it handles concerns about data management and privacy. The integration of ESG considerations into banking operations is increasingly recognised as essential, not only from an ethical standpoint but also for regulatory compliance and financial performance. Banks that prioritise ESG are often viewed as more resilient and less risky, which in turn attracts investors who are mindful of the long-term sustainability of their portfolios.

Strategic responses to ESG imperatives

Our analysis reveals that the majority of banks have adapted their strategies to incorporate ESG principles. According to PwC's 27th Annual Global CEO Survey, nearly one-third of CEOs acknowledge the potential of climate change to reshape their value creation processes within the next few years. Moreover, CEOs are putting their sustainability commitments into action, with most CEOs reporting advancements in energy efficiency and the innovation of eco-friendly products and services.

Figure 27: Factored changes to strategy



Source: PwC Survey Response Analysis

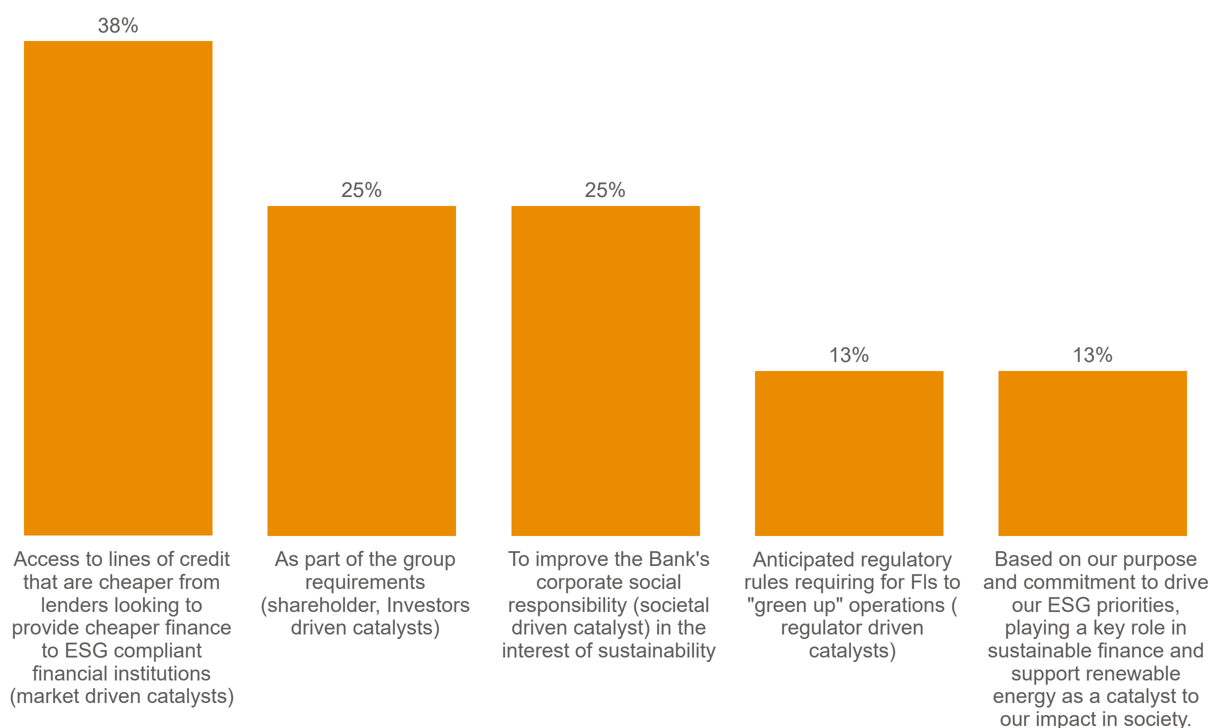
Economic outlook and ESG investments

PwC's 27th Annual Global CEO Survey highlights a cautious outlook on global economic growth, with a substantial proportion of executives bracing for a downturn. Despite this, the banking sector recognises the unique opportunities that lie ahead. There is a growing trend among banks to leverage their position to drive value through sustainable financing initiatives and substantial infrastructure investments, particularly in support of Africa's burgeoning economic and demographic growth.

Drivers of ESG integration

The primary motivation for banks to integrate ESG factors is the prospect of accessing more favourable credit lines from lenders incentivised to support ESG-compliant institutions. This market-driven catalyst is complemented by shareholder and investor expectations, as well as the need to enhance corporate social responsibility. Anticipated regulatory requirements and a commitment to sustainable finance are also significant factors influencing banks' ESG strategies.

Figure 28: Main diver to factor changes to strategy



Source: PwC Survey Response Analysis

9.2. Sustainability reporting and regulatory developments

The evolution towards a sustainable economy requires financial institutions to address both financial and non-financial risks. Sustainability reporting in Zambia is in its nascent stages, with a minority of companies, including those in the banking sector, disclosing sustainability information.

Sustainability reporting in the banking sector

The landscape of corporate reporting is undergoing a significant transformation, with sustainability reporting at the forefront of this change. The need for transparent disclosure is not solely driven by regulatory bodies but also by a growing chorus of stakeholders, including investors, customers and employees, who demand comprehensive insights into an organisation's sustainability practices. This shift reflects a broader recognition of the critical role that environmental and social governance plays in the long-term viability and ethical standing of businesses.

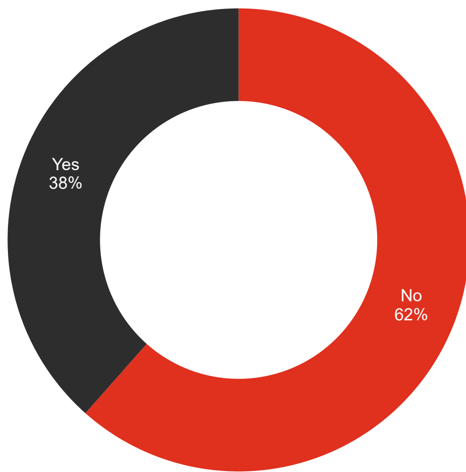
The recent release of sustainability reporting standards by the International Sustainability Standards Board (ISSB) marks a pivotal moment in the harmonisation of global sustainability disclosure practices. The ISSB's inaugural standards, IFRS S1 and IFRS S2, aim to provide a consistent and robust framework for reporting sustainability-related financial information and climate-related disclosures, respectively. These standards are designed to enhance the comparability and reliability of data, enabling stakeholders to make more informed decisions.

The IFRS S1 standard mandates entities to disclose material sustainability-related risks and opportunities that affect their value chain, while IFRS S2 focuses on the specificities of climate-related risks and opportunities. The standards draw upon the established principles of the Task Force on Climate-Related Financial Disclosures (TCFD), encompassing governance, strategy, risk management, and metrics and targets. This alignment with the TCFD framework facilitates a smoother transition for entities already familiar with its requirements.

In Zambia, the adoption of these standards has been endorsed by the Zambia Institute of Chartered Accountants, mandating all publicly accountable entities to integrate IFRS S1 and S2 into their reporting practices. This adoption extends to entities preparing for public trading or those already listed on public markets, with the exclusion of private markets, small public securities markets and entities without public accountability. The implementation timeline is set, with entities expected to apply the integrated reporting framework and the sustainability standards for reporting periods commencing on 1 January 2026.

Our survey reveals a nascent adoption rate among Zambian banks, with only 38% indicating that they have embraced the new disclosure standards. This suggests a considerable gap in preparedness within the sector, highlighting an urgent need for banks to accelerate their sustainability reporting capabilities to meet the upcoming regulatory requirements and stakeholder expectations.

Figure 29: Adoption of inaugural ISSB disclosure standards



Source: PwC Survey Response Analysis

and the sustainability standards for reporting periods commencing on 1 January 2026.

Our survey reveals a nascent adoption rate among Zambian banks, with only 38% indicating that they have embraced the new disclosure standards. This suggests a considerable gap in preparedness within the sector, highlighting an urgent need for banks to accelerate their sustainability reporting capabilities to meet the upcoming regulatory requirements and stakeholder expectations.

The significance of sustainability reporting cannot be overstated. It is a critical tool for businesses to communicate their commitment to sustainable practices, manage risks and seize opportunities in a rapidly evolving economic landscape. As the banking sector grapples with the challenges of the local economy, liquidity risks, cybersecurity threats, return on equity targets and increased regulatory compliance, the integration of robust sustainability reporting practices will be instrumental in demonstrating resilience and strategic foresight.

In conclusion, the adoption of the ISSB's sustainability reporting standards represents a strategic imperative for banks. It is an opportunity to lead by example in the stewardship of environmental and social resources, to build trust with stakeholders and to secure a competitive advantage in the marketplace. As the reporting landscape evolves, banks that actively enhance their reporting capabilities will be well-positioned to navigate the complexities of the modern business environment and to thrive in the long term.

Green financing initiatives in Zambia

Zambia is actively pursuing its commitment to green growth, with the government's National Green Growth Strategy serving as a blueprint for a sustainable economic and environmental future. Regulatory initiatives, such as The Securities (Green Bonds) Guidelines, 2019 and The Banking and Financial Services (Green Loans) Guidelines, 2023 are instrumental in promoting green investments and integrating eco-friendly practices within the financial sector.

The issuance of the Banking and Financial Services (Green Loans) Guidelines by the Bank of Zambia marks a significant step towards fostering environmentally-conscious lending practices. Concurrently, the registration of the CEC's green bond is indicative of the momentum building around sustainable finance in Zambia. Banks are increasingly incorporating ESG into their risk management frameworks, reflecting a broader commitment to responsible financing.

In conclusion, the banking sector in Zambia is at a pivotal juncture, with sustainable finance and ESG reporting emerging as key determinants of future success. The industry's response to these important issues will not only shape its own trajectory but also contribute to the broader goal of achieving a sustainable and resilient economy.

9.3. Sustainable finance in Zambia

Sustainable finance: a strategic imperative for Africa

The African continent has witnessed a surge in sustainable finance, with a special focus on climate finance, in response to the region's vulnerability to climate-induced adversities such as drought, floods and extreme temperature fluctuations. Although Zambia is in the nascent stages of formalising its climate commitments, there are valuable insights to be gleaned from the initiatives of its African counterparts.

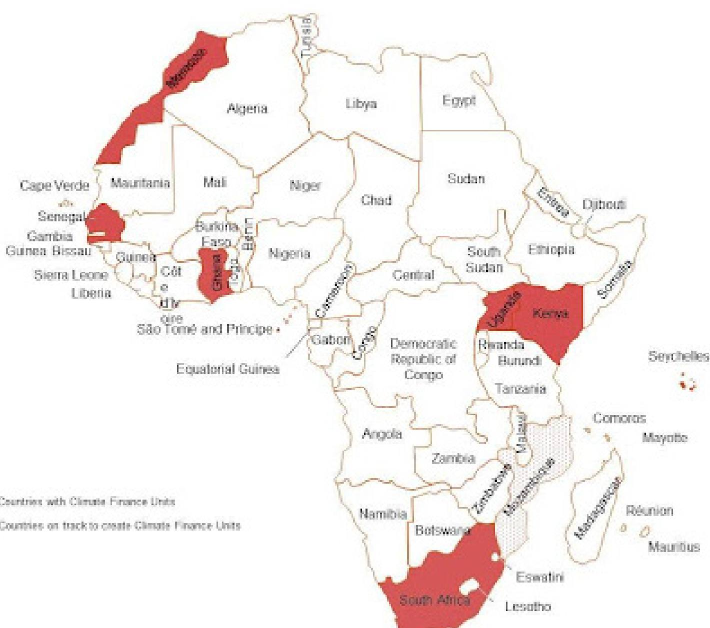
Establishment of climate finance units

A significant development has been the establishment of Climate Finance Units (CFUs) within Ministries of Finance. These units serve as a nexus for both public and private sectors in the mobilisation of capital for climate-related projects. The inception of CFUs in countries like Uganda, and the anticipated launch in Mozambique and Ghana, is indicative of the heightened focus by national governments on climate finance. This trend is likely to precipitate a mix of incentives and regulatory measures for the banking sector aimed at ensuring compliance with emerging environmental standards.

Green and blue bonds: financing the future

The issuance of green and blue bonds is gaining traction as governments across Africa seek to harness these instruments for funding environmentally sustainable projects. The success of blended finance solutions, which balance the return expectations of institutional investors with the concessional rate aspirations of public issuers, has encouraged repeat issuances in the green and blue bond markets. However, vigilance is necessary to maintain the integrity of these terms, and stakeholders are exploring more efficient verification and compliance methodologies that do not compromise the transactions' environmental objectives.

Figure 30: Map of African countries with CFUs



[18] Map of African Countries with CFUs

Zambia's own foray into this arena was marked by the Copperbelt Energy Corporation's (CEC) issuance of a green bond through its subsidiary, CEC Renewables. This US$200 million bond, listed on the Lusaka Securities Exchange, was directed towards funding renewable energy projects and was met with robust demand, as evidenced by the swift subscription of its initial tranche. This milestone not only reflects the strong market appetite for sustainable investment options but also sets the stage for further evolution of Zambia's capital markets.

Cultivating a pipeline of investible projects

Addressing the perennial challenge of immature project pipelines, development partners and international agencies are stepping up their efforts to prepare bankable projects. These projects are now being evaluated on their financial viability and sponsor creditworthiness, rather than solely on detailed engineering feasibility. Reports from leading financial institutions like the World Bank and the African Development Bank indicate a tenfold increase in the number of bankable projects over the past three years, with a notable rise in projects reaching financial close.

The ascendancy of sustainable finance in Africa heralds a transformative era for Zambia's banking sector. The establishment of climate finance units and the advent of green bond issuances are emblematic of a deepening commitment to environmental stewardship. By drawing lessons from regional experiences and capitalising on international support to forge a robust pipeline of investible projects, Zambian banks have an opportunity to both further national development objectives and carve out a strategic position in the burgeoning domain of sustainable finance. This alignment with global trends will enable the banking sector to drive innovation and build resilience, thereby playing a pivotal role in the continent's sustainable development narrative.

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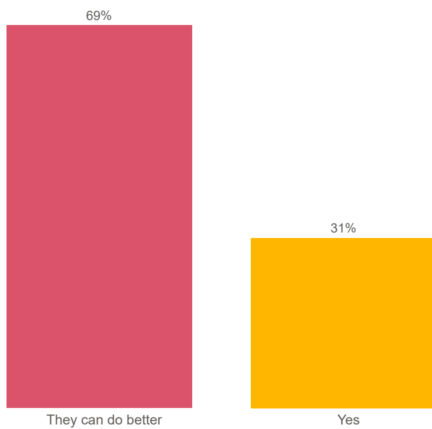
https://african.business/2024/01/finance-services/zambias-debut-green-bond-attracts-54m-in-first-raise

Regulatory support for sustainable finance in Zambia

Figure 31: Are the regulators doing enough to support sustainable finance in Zambia?



Source: PwC Survey Response Analysis

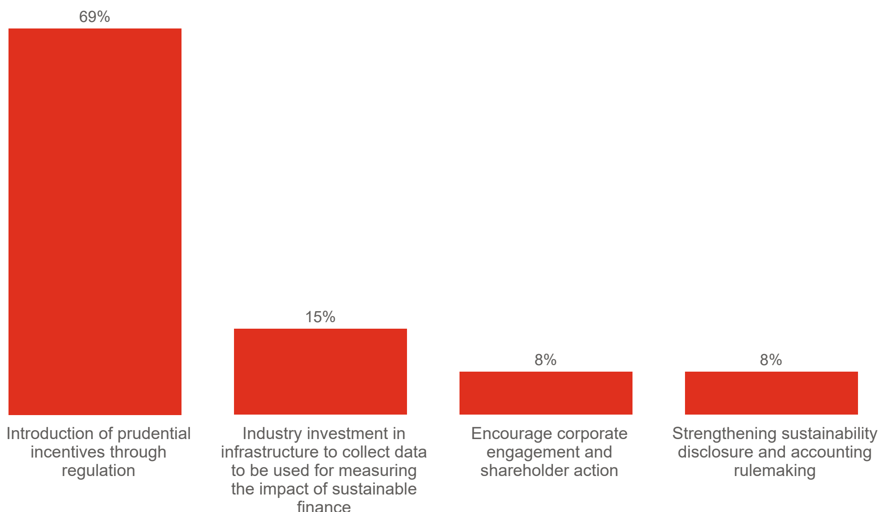
The feedback from industry leaders suggests that there is room for improvement in regulatory support for sustainable finance in Zambia. The PwC 2024 African Business Agenda - Sustainability focus underscores the pivotal role of regulators in fostering an environment conducive to ESG investing. By crafting a legal framework that holds businesses accountable for their environmental and societal impact and provides investors with the necessary information for informed decision-making, regulators can significantly boost ESG investment. With 81% of businesses acknowledging that government regulations have shaped their value creation, delivery and capture over the past five years, it is evident that regulatory adaptation to societal shifts, including climate risks, is imminent.

In anticipation of these changes, companies must devise strategies that align with regulatory evolution. Only through such forward-thinking approaches can businesses fully leverage the potential of sustainability and drive meaningful societal impact amidst an era of disruption, volatility and change.

Promoting sustainable finance in Zambia

In our dialogue with the banking sector, we sought to identify the measures deemed most effective in promoting sustainable finance in Zambia. A significant 69% of respondents advocated for the introduction of prudential incentives through regulation as the most impactful measure. This echoes the findings from our previous banking survey, reaffirming its position as the leading recommendation from industry stakeholders. Conversely, investment in infrastructure for data collection to measure the impact of sustainable finance garnered support from a modest 15% of respondents. Prudential regulation is essential in maintaining the safety and soundness of financial institutions, ensuring public confidence in their ability to meet financial commitments with integrity.

Figure 32: Measures to promote sustainable finance in Zambia



Source: PwC Survey Response Analysis

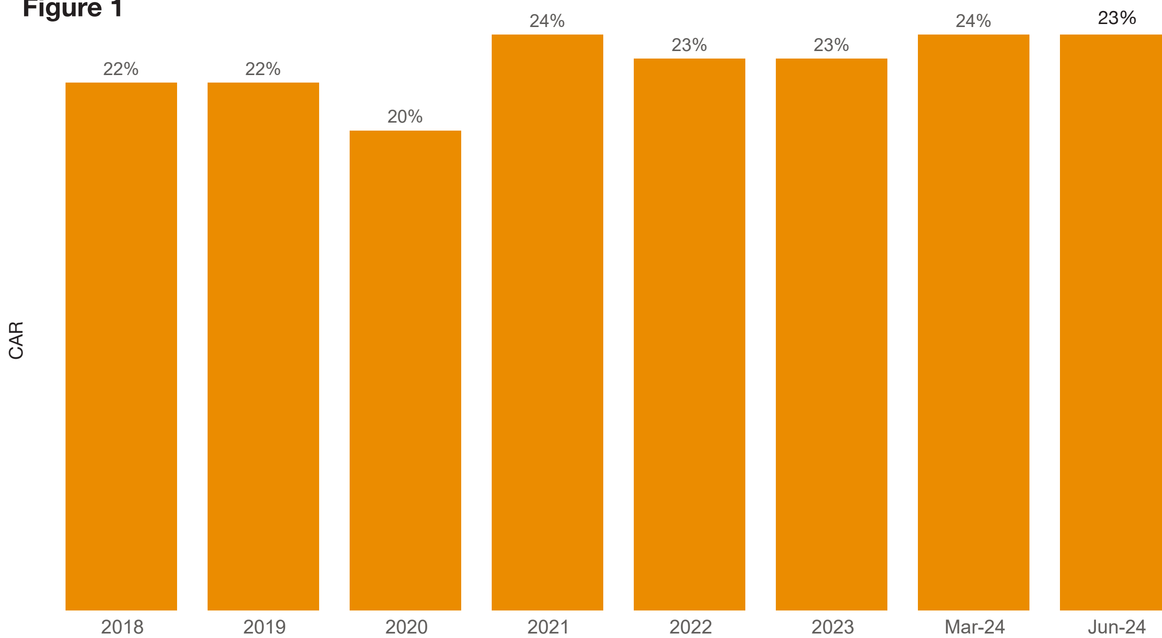
The banking sector's insights reveal a clear consensus on the need for regulatory enhancements and strategic initiatives to advance sustainable finance in Zambia. As we forge ahead, it is essential that the industry and regulators collaborate to establish a robust framework that not only supports sustainable finance but also aligns with the broader objectives of economic resilience and environmental stewardship.

10. Banking sector performance and analysis

10.1 Capital adequacy ratio

Banking sector

Figure 1



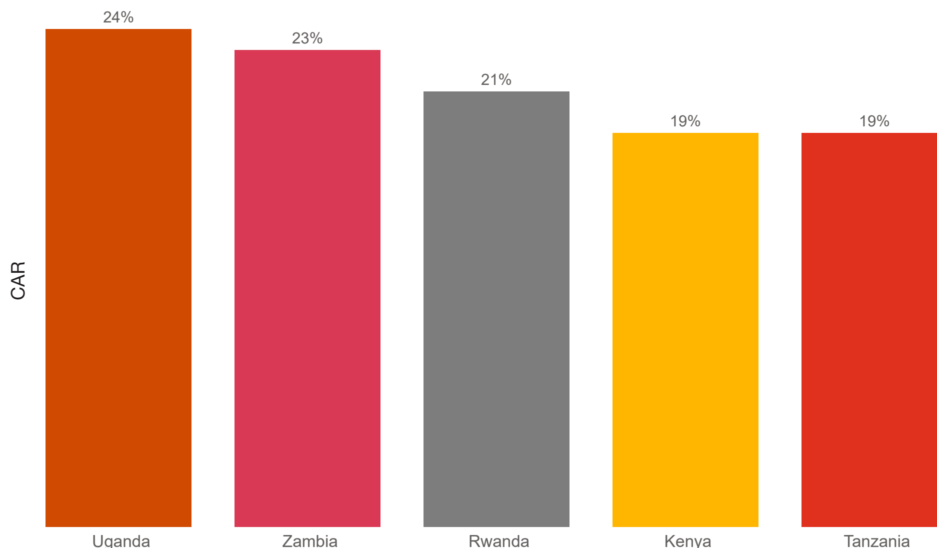
Source: PwC analysis

The banking sector's resilience is often gauged by its capital adequacy ratio (CAR), a critical measure of financial stability and an indicator of the sector's ability to withstand economic shocks. In 2023, the sector witnessed an increase in its CAR, rising from 22.5% in the previous year to 23.3%. This upward trend continued into the first half of 2024, with the ratio reaching 24%, primarily due to an uptick in retained earnings. It is important to note that the industry's average CAR comfortably surpasses the Bank of Zambia's regulatory minimum of 10%, underscoring the sector's robust capitalisation.

In comparison to the regional landscape, the analysis reveals a varied picture. Uganda leads with a CAR of 24%, a reflection of its banks' enhanced net after-tax profits and an augmentation in permanent shareholders' equity. Zambia follows closely with a CAR of 23% as of December 2023 and then Rwanda with 21%. Both Kenya and Tanzania share a CAR of 19%. However, it is pertinent to mention that the regional CAR figures are based on data available as of 30 June 2023 and thus may not fairly reflect the most recent status.

Regional analysis

Figure 2

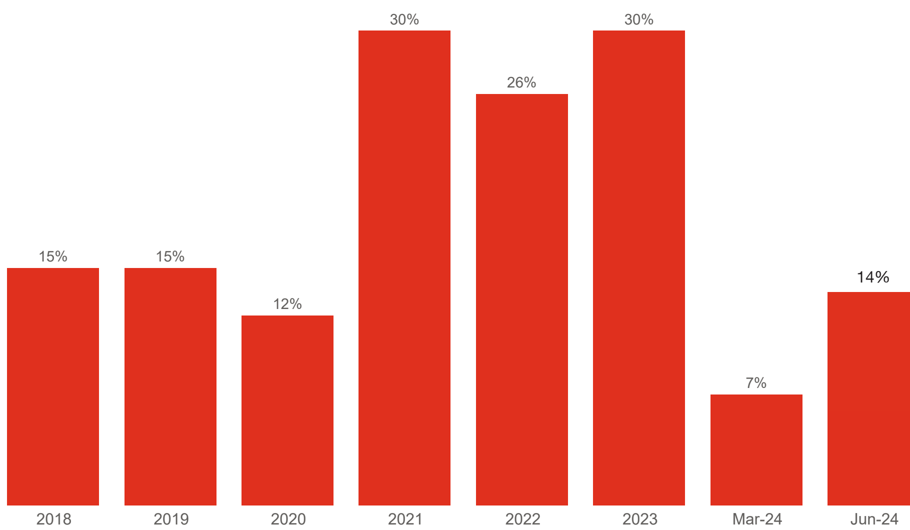


Source: PwC analysis

10.2 Return on equity

Banking sector

Figure 3



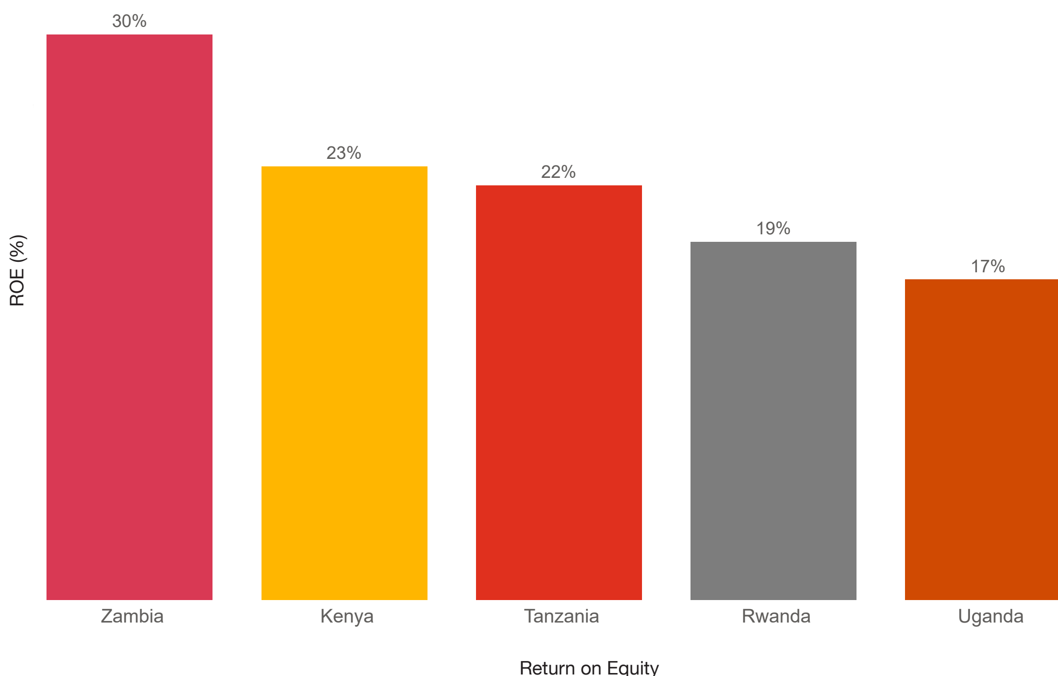
Source: PwC analysis

Another key performance metric is Return on Equity (ROE), which provides insight into the profitability and efficiency with which shareholder equity is employed. The Zambian banking sector's ROE experienced a significant increase to 30% in 2023, up from 26% in the preceding year, and well above the Bank of Zambia's benchmark of 20%. However, the first half of 2024 saw a reduction in ROE to 14%.

In comparison with its regional counterparts, Zambia's banking industry achieved the highest ROE at 30%. This is indicative of the strong earnings recorded during the year. Kenya's banking sector followed with a ROE of 23%, while Tanzania and Rwanda posted figures of 22% and 19% respectively. Uganda, with a ROE of 17%, recorded the lowest among the selected countries.

Regional comparison

Figure 4

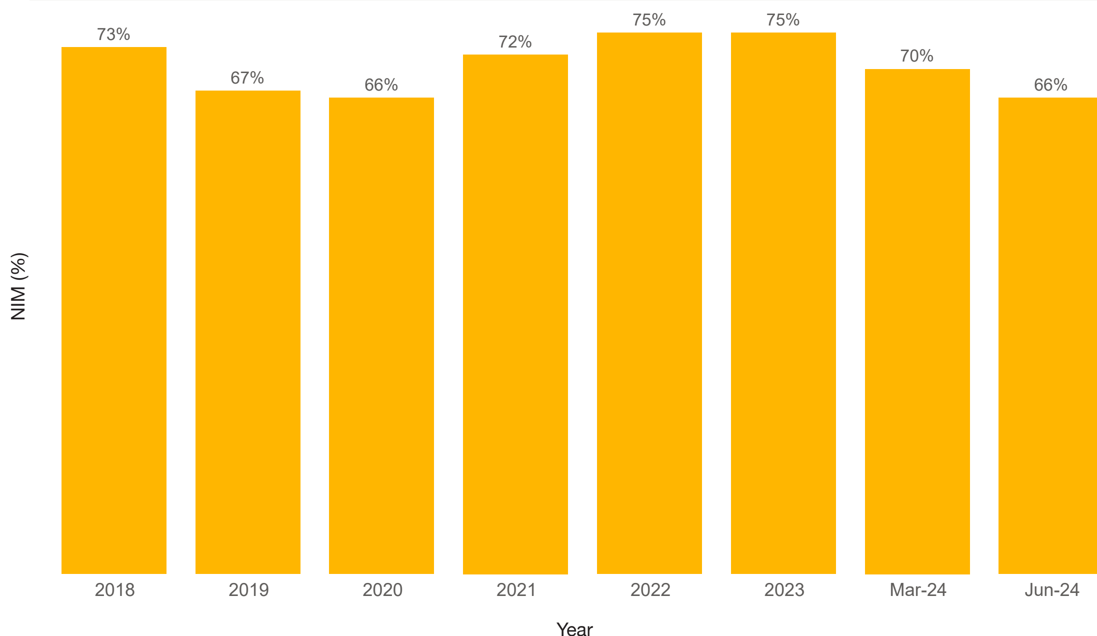


Source: PwC analysis

10.3 Net interest margin dynamics

Banking sector

Figure 5



Source: PwC analysis

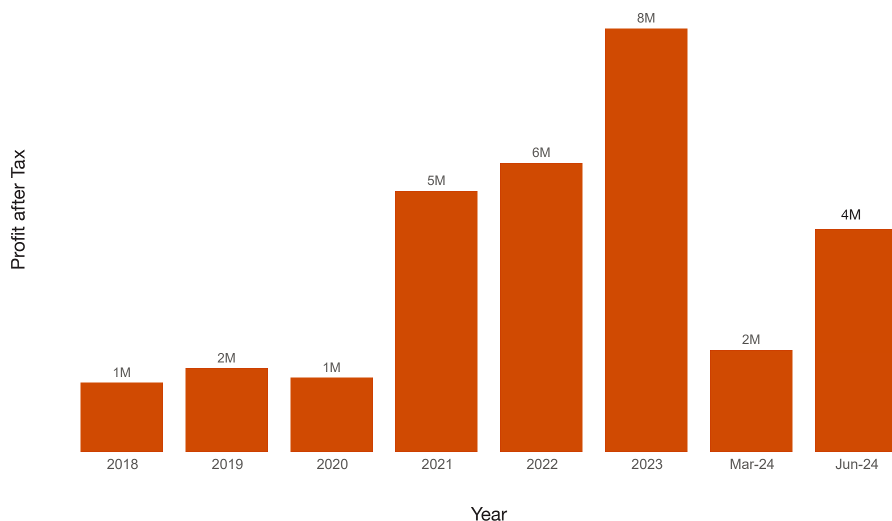
In Zambia's banking sector, the net interest margin (NIM) serves as a critical barometer for financial health and profitability. Our analysis shows that in 2023, the industry's NIM remained largely unchanged at 75%. This stability is attributable to a confluence of factors, including a marked decrease in interest earned from government securities counterbalanced by an uptick in interest accrued from loans and advances.

The consistency of the NIM, particularly among the five largest banks, is noteworthy. These institutions have collectively maintained a NIM of 83%, mirroring the figures reported in the preceding year. This uniformity suggests a strategic alignment in the management of assets and liabilities, reflecting a cautious yet optimistic outlook in the face of economic headwinds.

10.4 Year on Year Profit after Tax

Banking sector

Figure 6



Source: PwC analysis

The profitability of banks has been on an upward trajectory. Figure 6 shows a substantial year-on-year growth in profits for commercial banks. Specifically, there has been a 46% increase from K5.6 billion in 2022 to K8.3 billion in 2023. This remarkable growth in profitability underscores the sector's resilience and adaptability in the face of challenges. The increase in profits can be attributed to increase in net interest income and a reduction in impairment charges.

In the first half of 2024, banks reported a Profit After Tax of K4 billion compared to K3.9 billion in the same period in 2023. If this run-rate is maintained the profitability trend is likely to continue if current conditions persist.

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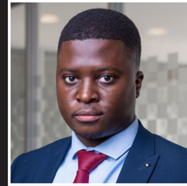

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