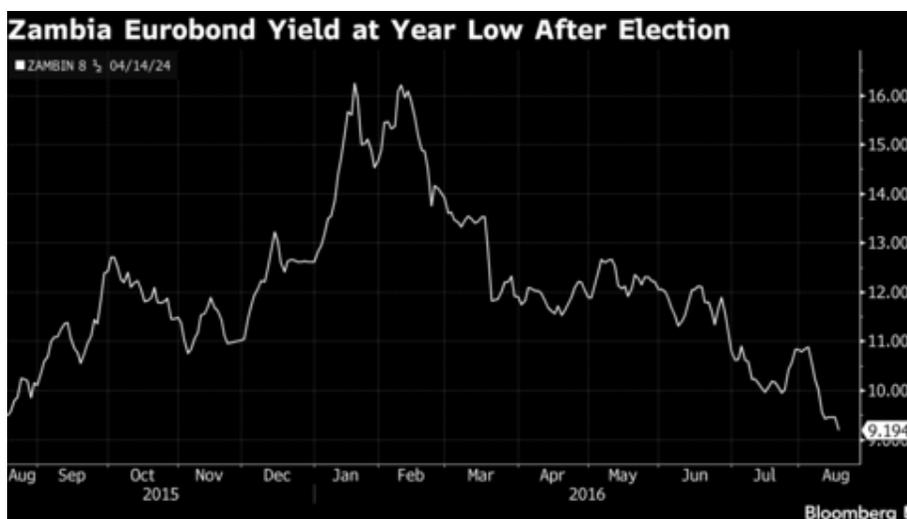


ZAMBIA RESEARCH NOTE

All systems go?

*The decision of Zambia's Electoral Commission to award a first-round victory to the incumbent Edgar Lungu has helped drive Zambian bond yields to 12-month lows. **We do not share the market consensus** that the stage is now set for an IMF deal by the end of the year.*



1) Zambia's judiciary has demonstrated considerable independence vis-à-vis the executive branch of late. This autonomy was on full display in the injunction handed down on Tuesday (August 16th)¹ by the Constitutional Court², staying Mr. Lungu's decision to remove Mutembo Nchito from his position as director of public prosecutions.

What was particularly significant about this case is the fact that, although the grounds for the DPP's dismissal were *prima facie* unassailable³, the Court ruled against the President on the basis of a procedural infraction. So, it is **by no means a given that the Court will rubber-stamp the ECZ's well-documented irregularities** – a contingency that the market does not appear to have priced in.

2) Much has been made of the IMF's June 2nd comment on Zambia that "our mutual goal is to move as quickly as possible after the elections with the hope of presenting a program to the IMF Executive Board before the end of 2016."

Out of context, the statement appears to suggest an accelerated time-line to a USD 1.2 billion extended credit facility. However, it is important to **recall the additional guidance that the Fund then provided:** "How quickly the post-election negotiations go will depend on various factors ... From our standpoint, **in particular, the government will need, the post-election government, will need to present and implement measures that can credibly be expected to reduce the Zambian fiscal deficit.**"⁴

¹ This ruling has come on the heels of the Tax Court ruling last June that overturned a decision by the Zambia Revenue Authority to close the independent newspaper *The Post*, for alleged tax delinquency.

² The very body before which the opposition UPND plans to challenge the results published by the Electoral Commission.

³ The DPP had issued a *noloprosequi* ruling on a matter in which he himself was the defendant (instead of recusing himself).

⁴ See 'Transcript of a Press Briefing with William Murray, Deputy Spokesman, Communications Department'; IMF, Jun. 2, 2016.

3) Meeting these requirements will present a much bigger challenge than is generally appreciated.

Zambia has not undergone an Article IV review since early 2015. Although the Fund has since fielded two separate missions to "discuss policy responses to the macroeconomic challenges facing the country"⁵, each ended on a very inconclusive note. As was pointedly observed at the end of the team's March 2016 visit:

*"The mission is confident that Zambia's current economic challenges can be overcome with resolute policy action ... However, delays in implementing corrective measures will only worsen the situation, increase the adjustment cost and postpone the recovery."*⁶

4) Since then, not only have the authorities failed to adopt any of the requisite measures; they appear to have doubled down on the fiscal excesses.⁷

The repeated delays in disbursing civil servant salaries and the accumulation of arrears⁸ payable to government contractors over the last five months both chime with the anecdotal evidence of significant extra-budgetary disbursements related to Mr. Lungu's re-election effort.

5) In our view, satisfying the IMF's basic precondition (see Para. 2 above), will require considerably more than simply undertaking to phase out Zambia's energy and agricultural subsidies⁹. Worse this major fiscal adjustment will need to be implemented against the backdrop of a potentially dire outlook for copper. As will be recalled, Goldman Sachs recently issued a 12-month price target of \$4,000/MT.¹⁰

In the light of the foregoing, **we have deep reservations about the Zambian 'story'**.

⁵ As the IMF mission noted in late 2015, 'In recent months, the pressures on the economy have not only reflected the impact of external shocks. Fiscal discipline has been undermined by additional spending commitments that stand in contrast to lower-than-budgeted revenues.' – See "IMF Press Release No. 15/531", Nov. 20, 2015.

⁶ See "IMF Press Release No. 16/120", Mar. 18, 2016.

⁷ 'Expenditure is running far above budget, in large part as a result of fuel subsidies and contracted emergency electricity imports that together are estimated to cost the treasury about US\$660 million a year at the current pace (equivalent to 3.2 percent of GDP); *ibid.*

⁸ Based on the precedent set in Q3&Q4/2014 (i.e. the run-up to the 2015 by-election), Zambian farmers who have begun delivering maize to the Food Reserve Authority are likely to find themselves acting as reluctant creditors to the Government – alongside other providers of goods and services.

⁹ As the presidential spokesman glibly assured an interviewer last week, 'The president has promised to move rapidly to either completely do away with subsidies or progressively reduce them.' Statement quoted in "Zambian Leader Sees Swift Subsidy Cuts in \$1.2 Billion IMF Deal"; Bloomberg, Aug. 10, 2016.

¹⁰ As reported in "Goldman warns 'Supply Storm' to engulf copper market"; Bloomberg, Aug. 4, 2016.

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