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ZAMBIA RESEARCH NOTE [REV]

The Makings of a Perfect Storm

As we have periodically noted in amused bewilderment, the "forgiving" climate of recent years[1] has delayed Zambia's date with reality since early 2015. Witness the success of Friday's Kw 1.65 billion bond auction[2], less than a week after the IMF's withering statement!

But the day of reckoning draws closer by the day - and the related adjustment promises to be anything but orderly*, for several reasons.*

1) In the first place, **the entire executive branch is now engaged in an orgy of procurement scams** reminiscent of the frenzy that marked the 2009-14 term of Mozambique's President Guebuza (who, like Lungu, was bent on a prohibited third mandate).

The name of the game, now as then, is for the incumbent to **accumulate the cash required to coopt** Constitutional Court judges[3] and targeted members of opposition parties, while securing the loyalty of the ruling PF's barons by encouraging/accommodating their corrupt self-enrichment schemes.

2) The point was underscored in **the infamous "*Ubomba mwibala*" speech delivered by President Lungu himself a fortnight ago**, during a PF fund-raiser in Kitwe, in which he advised the faithful that *"You are free to 'eat' but don't finish everything"*[4]. Veteran Africa hands will recognize the **ominous echoes of Mobutu**'s cynical, 1976 exhortation, *"Debrouillez-vous"*[5].

3) Below, in no particular order, are some of the latest additions to the informal log one has been keeping of **the fiscally destructive schemes Mr. Lungu and his friends have come up with**.

- **Road projects:** Last Weds., the newly reshuffled Cabinet approved **USD 200 million** worth of contracts **for "rehabilitating, upgrading and constructing selected roads"**[6] in the capital and **a further USD 197 million for road works** in the Copperbelt region[7].
- **Clandestine sale of prime Lusaka real-estate:** After months of strenuous denial, there is now concrete evidence that the **Administration has secretly sold a 304-acre parcel of land**[8] belonging to the Natural Resource Development College **to Chinese contractor AVIC International**[9].

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[1] Aided and abetted by the staggering incompetence of the ratings agencies. As will have been noted, S&P's managed to replicate Moody's blunder, and parrot the Government's line about a narrowing fiscal decicit. It has since emerged that this er, provisional estimate does not even include a figure for capital expenditure!

[2] Incidentally, one detail obscured by the aggregate oversubscription statistic of 2.03x is the fact that the Kw 500 million offered in 10 and 15 yr paper – favoured by the usual offshore suspects – attracted total bids of Kw 1.89 billion

[3] The anecdotal evidence suggests that the going rate, in connection with the challenge to the results of the Aug. 2016 election, was USD 500,000.

[4] Literally, "*Ubomba mwibala alya mwibala, tabatila kulya nembuto kumo.*" – as reported and translated by The Mast, Feb. 12, 2018.

[5] The open invitation to unpaid public servants to "help themselves" shifted the institutionalized plunder of state resources into overdrive and set the stage for the financial and administrative collapse of the Republic of Zaire .

[6] The planned disbursements are of course 'peanuts' compared to the USD 1.2 billion Lusaka-Ndola road - a 350 km. project - announced three months ago. As will be recalled, the Roads Development Authority (RDA), a specialized agency that reports to the Office of the President, has been the Patriotic Front's cash-cow, *ab initio*.

[7] In her maiden public address earlier the same day, the incoming finance minister, had pledged that, '*Government will continue to enhance domestic revenue mobilization and expenditure restraint to attain a 3% of GDP fiscal deficit by the end of the medium term. Key to expenditure restraint is to concentrate on completing ongoing projects as outlined in the ESGP.*' See "*Statement on the Economy and on Government Reforms*", *Feb. 21, 2018.*

[8] As can be seen, the sale is artfully disguised as a swap - of the priceless NDRC plot for a piece a land in a rural area of Central province.

[9] AVIC are one of the Lungu administration's preferred contractors, having been selected, inter alia, to execute much of the pending road-work in the capital as well as the construction of four new toll plazas.

- **Contract to upgrade the Lusiwasi Hydro Power Station:** Rejecting the recommendation of his energy and finance ministers, **Lungu has** directed the state power authority ZESCO to award **the USD 50 million project to Sino Hydro**, a 'preferred' contractor

- **Supply of uniforms to the armed forces**[10]**:** A **USD 62 million procurement contract** has been awarded to BHB[11] **without public tender**, even though a Kenyan supplier had reportedly quoted a cost of USD 14 million.

So, rather than the repeatedly promised fiscal consolidation, **the stage has been set for an even more dramatic overshoot** than originally forecast. This profligacy will financed by a **further accumulation of payment arrears** and the contracting of **additional, 'off-balance-sheet' debt**.

4) How long it will take before the rubber meets the road in Zambia is impossible to tell. However, it is worth monitoring **two specific indicators of the growing macroeconomic imbalance**.

- ⇨ During a meeting of senior finance ministry officials with their new Minister on Feb. 20th, *"Treasury secretary Fredson Yamba assured the Minister that plans were underway to dismantle domestic arrears and timely pay public service workers."*[12] This was an obvious red flag[13], though one apparently unnoticed by the ratings agencies.

- ⇨ Figures available to the IMF indicate that **reserves stand at a critical ly low USD 1.7 billion**[14]. This is equivalent to a mere 2.3 months' import cover and leaves Zambia **highly vulnerable to a run on the Kwacha**, in the event of the slightest shock.

5) Meanwhile, the results of the pending harvest[15] also warrant attention. As in 2016, the acute drought conditions recorded across much of Southern and East Africa all but guarantee that **this year's harvest will show a significant shortfall in white maize, the regional staple**. With its strategic grain reserve of 500,000 MT and a projected harvest of at least 1.2 million MT, Zambia is more than self-sufficient.

However, this local supply will attract **strong demand from neighbouring countries** already projecting acute deficits. This **will drive Zambian grain prices higher and, with it, the inflation rate**[16] that has been reassuringly quiescent for more than a year. With international liquidity perilously low, **this will bring pressure to bear on the Kwacha**, at a time when the central bank is trying to spur growth through monetary accommodation.

6) In other words, **we could ǿŜƚ be looking at the makings of a perfect storm**. At the time of writing, one is still trying to devise a cost-efficient trade to express this view. Stay tuned …

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[10] Zambia's armed forces have a total strength of 16,500.

[11] The company is registered to one Stanislaus Mubanga, a well-known PF financier of dubious repute.

[12] As quoted in *"Let's pay our workers on time – Mwanakatwe"*, Ministry of Finance post, Feb. 20, 2018.

[13] Moreover, the mantra of "dismantling arrears" has been repeated ad nauseam since Mr. Mutati's maiden budget presentation in 2016 – with no actual follow-through.

[14] I.e. down from the USD 2.1 billion that BoZ governor helpfully provided last week, as the end-2017 level.

[15] The crop is harvested in March-April, and marketed between May and November.

[16] Millie-meal, a flour milled from white maize, is the single largest item in the *Foods* component that makes up 55% of the CPI basket.