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ZAMBIA RESEARCH NOTE

The 2020 Budget - Dead on Arrival

Although one had anticipated that the 2019 budget would be long on creative arithmetic[1] *and short on substance,* ***Friday's submission to Parliament exceeded our worst misgivings.***

1) The document's bland theme, "*Focusing national priorities towards stimulating the domestic economy*", reflected **its near-complete divorce from the dire macro-economic situation on the ground**. Nowhere is this sense of unreality more clearly displayed than in the section on *Revenue Estimates and Financing,* which blithely announces that *"domestic financing accounts for K3.5 billion while K27.5 billion will be sourced externally."* [2]

2) Perhaps understandably, no attempt is made to explain by what miracle the government expects to **regain access to the global capital market**[3] from which it has been shut out since Jan. 2015. Nor is any attempt made to address the debt-sustainability impact of **increasing Zambia's foreign liabilities by a factor of 20%**, as proposed.

3) The document does, however, shed light on current conditions, which are shown to be even more dire than previously acknowledged. As was to be expected, given the fierce headwinds, **GDP growth has fallen to 2% - half the rate projected** in the 2019 budget[4].

4) In the most obvious knock-on effect, **domestic arrears surged by almost 30% during H1/2019** to K20.2 billion[5] – making **a complete mockery of the Government's repeated commitment**[6] to prioritize the dismantling of arrears and curtail accumulation. At this rate, the arrears stock could easily hit Kw 25 billion by year-end, equivalent to 7.64% of GDP. And yet, the **amount allocated to paying down such past-due claims is** a mere Kw 2.37 billion[7] – **less than one-tenth of the prospective stock**.

5) Given this reality, the assertion **that revenues and grants through August exceeded their target by 9.1% is simply laughable**[8]. The same goes for the budget's reassuring prediction that *"the budget deficit is estimated to close in line with the target of 6.5 percent of GDP on a cash basis."*[9]

6) The performance of the financial sector is another item on which Dr. Ngandu appears guilty of **a material misstatement**. We are asked to believe that in a pre-recessionary economy, marked by a ballooning in the Government arrears payable to bank-financed contractors, ***"The ratio of non-performing loans to total loans dropped to 9.4%*** *(at end-August 2019 from 11.0% at end-December 2018)."* [10] As if to give the lie to this preposterous assertion, the statement informs us that, **in the non-bank financial sector**[12] **the corresponding ratio stood at a dizzying 24.8%** [12].

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[1] See research note *"Enjoy the honeymoon, but ...."*, published Jul. 29, 2019

[2] Ironically, this farcical strategy almost echoes the ill-advised approach announced by Alex Chikwanda in his 2016 Budget address, delivered on Oct. 8, 2015, viz.: *"Government will, therefore, significantly limit domestic borrowing and focus on accessing external financing with lower interest rates and longer repayment periods.* (See Para. 83)".

[3] Indeed, even the task of raising Kw 3.5 billion domestically is likely to prove herculean, given recent subscription rates for Treasury bills and Government bonds of 0.79x and 0.15x respectively.

[4] The underperformance marks the fourth consecutive decline since Mr. Lungu took office.

[5] Significantly, this figure excludes amounts due in respect of VAT refunds.

[6] See, inter alia, Budget Statement for 2018, presented Sep. 28, 2018; Statement by Finance Minister on Jan 15, 2015.

[7] See Para. 105 | [8] See para. 17. Since the full-year target for revenues and grants stated in the 2019 budget was Kw 86.8 billion, the cumulative figure of Kw 42.8 billion, reported through August actually represents <u>a 26% shortfall</u> (relative to the pro-rata target of Kw 57.9 billion).

[9] See Para. 19. | [10] See para. 33.| [12] Positive correlation is the norm between the two sectors. | [12] See para. 34.

7) In view of Zambia's virtual dependence on **copper**[13], it might have been expected that the budget would at least acknowledge **the acute crisis**[14] **that has engulfed this sector** since the ill-advised hike in mining royalties introduced one year ago. Instead, the **elephant in the room** is simply ignored. The statement goes no further than to acknowledge *"a decline in copper output due to low grades of ore at some mines coupled with lower copper prices."* [15]

8) Over the years, one has repeatedly flagged the Patriotic Front's **predilection for** infrastructure spending – particularly in the area of **contract-rich road construction**, with its virtually unlimited potential for er, leakage. With unintended irony Dr. Ng'andu's statement proclaims that, *"**In the spirit of doing more with less** (sic), our strategy will be to rescope existing projects, seek alternative financing to debt contraction and increase the use of local contractors in the implementation of these projects."* [16]

Yet his budget goes on to allocate **a whopping Kw 10.55 billion to *Road infrastructure***[17] **– a 63% increase** on last year's appropriation. Evidently, old habits die hard.

9) However, the trophy for largest discretionary spending item goes to ***Power infrastructure***, with an **allocation of Kw 11.17 billion**[18] that marks **a 27-fold increase** on the 2019 appropriation of Kw 415.76 million. Just as jaw-dropping, given the energy crisis triggered by the plunging generation capacity of Zambia's hydro-dependent grid, **every project cited in this section**[19] **is a hydropower venture**.

10) Although the drought conditions that have exposed the power sector's vulnerabilities have had a **genuinely devastating impact on the Agriculture sector**[20], the budget opts for **a deafening silence** in this regard[21]. In a text-book example of management guff, we are simply informed that unspecified *"climate-smart agricultural technologies and practices … are already being disseminated in the 2019/2020 farming season"* [22].

11) Presumably this is being implemented via the ***Farmer Input Support Support Programme*** for which the total allocation is a mere Kw 1.11 billion – **an inexplicable reduction of 22%** on the appropriation for 2018. Worse still, there are g**rounds to question if any inputs are actually being delivered** to Zambia's long-suffering farmers[23].

The amount provided for maize **procurement by the Food Reserve Agency has seen an equally puzzling cut**[24]. Given the obvious need to replenish the strategic grain reserve, in the context of a region-wide shortage of the staple, **economic logic clearly argues for a higher allocation**.

[13] I.e. as a source of employment, fiscal revenue, export earnings and GDP.
[14] Predictably, mining companies have scaled back operations sharply, laying off thousands of employees, with a severe knock-on impact on mining communities across Copperbelt province. The authorities have responded by simply seizing control of one of the largest mining concerns Konkola Copper Mines, with the preposterous notion of re-selling the 80% stake misappropriated from Vedanta Ltd. to a new foreign investor.
[15] See Para. 15. | [16] See Para. 62.
[17] Equivalent to 9.95% of the budget and 3.23% of GDP.
[18] Equivalent to 10.54% of the budget and 3.41% of GDP.
[19] See Para. 54.
[20] As the Red Cross reported this week-end, *"The prolonged dry spells between January and March 2019 affected Southern and Western parts of Lusaka, and the Eastern and Central provinces. […] Thirty-eight (38) of the fifty-eight (58) districts that were in IPC phase 3 (crisis) by April have now degenerated to IPC phase 4 (emergency). A total population of 1.7 million is facing food scarcity."* Statement quoted in *"Famine getting worse in Zambia, says Red Cross"*, by Zambia Watchdog, Sept. 29, 2019.
[21] Beyond a vague allusion to *"the devastating impact of climate change* (Para 5)*"*.
[22] See Para. 42.
[23] Less than a fortnight ago, the Agri Business Association of Zambia announced plans to demonstrate in front of the National Assembly, to demand that the Government settle Kw 400 million in invoices, dating back to 2016. The police authorities, who have emerged as de facto arm of the PF government, refused to authorize the protest action.
[24] Admittedly, the reduction is only 5.7% in nominal terms, but it is worth noting that the producer price per 50 kg bag of white maize currently stands at Kw 110 - up from Kw 65 at the time that the 2018 budget was unveiled.

12) Another crisis that receives scant attention in the budget is **Zambia's crippling debt load**, now on track to end the year at above 80% of GDP. Not surprisingly, therefore, the allocation for **debt service** is the budget's largest single item, **at Kw 33.73 billion, equivalent to 10.3% of GDP**[25]. However, no guidance whatsoever is provided as to how the Government intends to tackle this load[26]. Indeed, the only **'concrete' measure presented is an allocation of Kw 660 million to the so-called sinking fund**[26](!)

13) As for the subject of **programme discussions with the Fund** - about which Dr. Ng'andu's initial press conference triggered so much excitement – the budget does not even bother to mention them. Indeed, **the initials IMF are conspicuous by their total omission from the statement**.

Despite the forest of red flags, however, **the market continues to heed the siren call of Zambia's high-yielding bonds[27].** What could possibly go wrong …?

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[25] This represents a 43% jump from last year's appropriation for this item.
[26] The section entitled *Debt Management Strategy* is embarrassingly vacuous, providing no more than a list of platitudes [i.e. *"i. Slowdown external debt contraction; ii. Postpone or cancel some pipeline loans; iii. Cease the issuance of guarantees; and, iv. Refinance existing loans."* (see Para. 93); and a vague 'undertaking' to develop a Medium-Term Debt Strategy, 2020-22 (see Para. 94).
[27] Given that Zambia has USD 3 billion in eurobond liabilities, with USD 750 million maturing in 24 months' time, this allocation of less than USD 50 million is almost laughable.
[28] The bonds closed today bid at 19.44%, 18.06% and 16.06%, in ascending order of maturity.