COUNTRY RISK CATEGORY

7

OF 7

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Zambia

COUNTRY ANALYST

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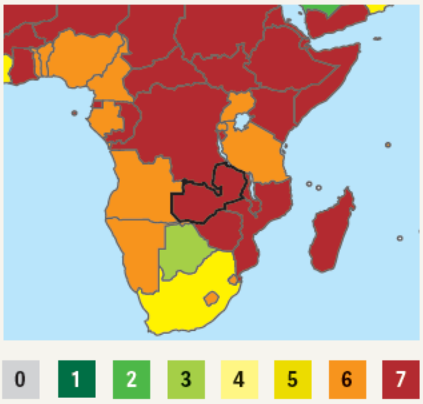
Basic facts (2022)

Population: 20 million

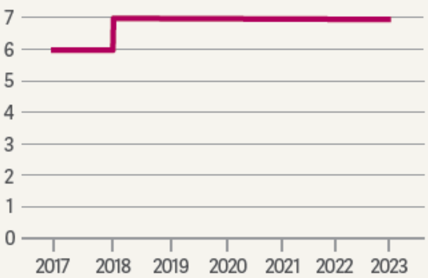
GDP, nominal: USD 28,5 billion

GDP/capita: USD 1 424



The country risk categories are arranged on a scale from 0 to 7. The lower the figure, the better the country's creditworthiness

Country classification history



Source: EKN

Strengths

+ Abundant copper resources.
+ Relatively politically stable, although the trend is negative.

Weaknesses

- The economy is vulnerable to weather, climate change, and changes in raw material prices.
- Weak public finances and weak debt management
- Difficult business environment

Continued high dependence on the copper industry

Zambia's economy revolves around the copper industry, which accounts for approximately 70 per cent of export revenues. Privatisation of the mining industry during the 1990s led to increased productivity which, together with high copper prices, contributed to strong economic growth averaging close to six per cent per year in the early 2000s. Falling copper prices in 2015, combined with falling demand from China (the country's main trading partner), caused a marked decline in export earnings. Around the same time, the country was entering an energy crisis, caused by neglected infrastructure and droughts. As a result, growth has slowed down, government finances have drastically deteriorated, and external liquidity has declined. Between the years 2015 and 2021, the Zambian kwacha has lost nearly 70 per cent of its value against the USD, which is a major contributor to the country's increased debt relative to GDP. Given Zambia's large agricultural sector and dependence on hydropower for the generation of electricity, Zambia is exposed to significant risk from climate change. Low-income levels and relatively weak institutions mean limited ability to prevent the risk of increasing droughts, fires and storms. The mismanagement of the economy and the poor management of public debt over the past five years are signs of weak institutional capacity. Hakainde Hichilema has been the new president since autumn 2021, and hopes are high that the country will return to being one of the more politically and economically well-run countries in sub-Saharan Africa. So far, Hichilema has made a positive impression in politics and the economy.

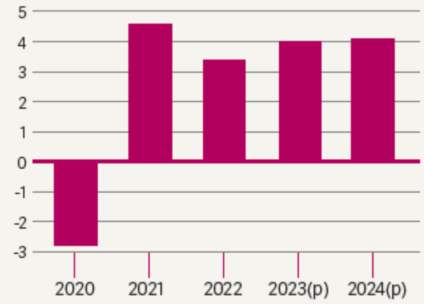
Bilateral debt settlement

The Zambian economy continues to develop in a positive direction. The growth rate is expected to accelerate to an average of just over four per cent per year in 2023-2025, mainly driven by the important mining industry. Copper makes up more than 70 per cent of Zambia's exports. The forecast for the next three years is for international copper prices of over USD 9,000 per tonne, which will support growth. Inflation appears to have peaked at just over 20 per cent in 2020 and is expected to continue to fall below eight per cent in 2023-2025, despite higher energy prices and a weaker Kwacha. The Zambian Kwacha fell at a rapid pace in the autumn of 2022/spring of 2023 in connection with falling copper prices but strengthened again thanks to the bilateral debt settlement (see below). Rising current account surpluses and emergency loans mean that international reserves will continue to recover in 2023-2025 from a critical level. At the start of the Covid crisis, there were only USD 1.2 billion in international reserves. In the coming years, the reserve is expected to rise to between USD 3–5 billion, equivalent to three to five months of import coverage. As such, the hard currency liquidity of banks and corporates is expected to improve in the coming years.

On 31 August 2022, Zambia signed a USD 1.3 billion agreement with the IMF, which was an important first step towards public debt sustainability. The government has so far stayed the course and initiated reforms in the energy sector, where fuel subsidies have been abolished and electricity tariffs increased.

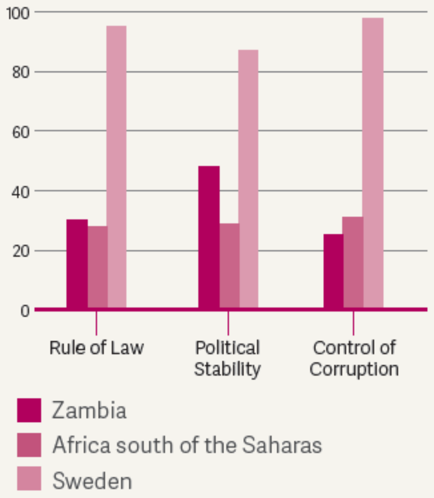
Zambia

Real GDP growth (constant prices, % per annum)



Source: IMF WEO, Macrobond

Business environment



Ranking from 0 (worst) to 100 (best)

Source: The World Bank, Macrobond

Swedish export to Zambia

	MSEK
2022	91
2021	109
2020	231
2019	358
2018	655

Source: SCB

EKN:s exposure

	MSEK
Guarantees	1 342
Offers	255

At the end of June 2023, a debt settlement was reached with bilateral creditors after nearly 2.5 years of negotiations, opening the way for an additional USD 188 million in financing from the IMF. The settlement covers USD 6.3 billion in bilateral loans, where repayment terms are extended by an average of 12 years (end date for payment in 2043) and interest rates are reduced to a minimum of one per cent. The agreement means that the present value of the loans will be reduced by up to 40 per cent, which will create a breathing space and room for reform. As a result, Zambia's high cost of public debt will be significantly reduced, although the government had hoped for an even more comprehensive settlement. Before the renegotiation, interest expenses and amortisation amounted to approximately 30 per cent of public revenue. The agreement does not entail any debt cancellation, which is why public debt as a share of GDP will remain high in the coming years. When Zambia started the debt renegotiation, public debt amounted to more than 100 per cent of GDP, which is a high level even for country risk category 7. The government is still in default on Eurobonds and there is still no agreement with the country's private creditors regarding the remaining part of the external debt. The debt to private creditors is just over USD 6 billion, of which about half is in Eurobonds. Zambia's ability to repay creditors is subject to reasonably favourable developments in the exchange rate and international copper prices. In principle, all of Zambia's government debt is foreign and is therefore sensitive to exchange rate fluctuations. Under a clause in the debt agreement, the interest rate can be adjusted upwards, and maturities adjusted downwards if Zambia's debt management capacity is assessed as medium (currently low) after the 38-month long IMF programme. In such a scenario, Zambia is likely to be able to repay the debt early.

The debt deal, together with the IMF agreement, is a big feather in the cap of Hichilema, who has campaigned on reforming the economy. The new political leadership appears to be better placed than the previous one to manage public finances and appears to continue to have the support of the people to implement reforms, including the controversial energy sector reforms. This suggests a turnaround in government finances in the long run. However, in view of the persistently high level of public debt and the extent of fiscal problems, the turnaround is likely to be witnessed first in the private sector of the economy. The growth in recent years is a sign that such a turnaround has already begun. If the positive developments continue, an easing of the policy stance on banking and corporate risks may be considered in the coming year. As far as sovereign risk is concerned, any easing of the policy is likely to be several years in the future. EKN confirms country risk category 7 for Zambia.

Business environment

On paper, the business and regulatory environment in Zambia is relatively good. However, the economic crisis has meant a deterioration, not least for mining companies that have been hit by increased taxes and fees in order to increase revenues to the weak public purse. Zambia is ranked 117th out of 179 countries in Transparency International's Corruption Perceptions Index. For transactions that result in a claim, the assessment is that legal proceedings in a court would be very protracted and complex.

With President Hichilema, there is potential for improvement in the business environment. President Hichilema, who has a background in the private sector, has promised a crackdown on corruption, better conditions for businesses and a return to a more democratic Zambia. Since taking office in August 2021, the President has initiated criminal proceedings against senior public servants and government ministers accused of corruption. Zambia's foreign policy has become more assertive, with a clear focus on economic diplomacy and improved relations with the West. The corporate tax rate has been reduced from 35% to 30%, and a tax deduction on payments to the State for mining operations has been reintroduced in an effort to avoid double taxation. The expectation is that the new administration will work towards more predictability and better conditions for companies, especially in the mining sector.

EKN:s policy

EKN does not currently cover any sovereign risks and other public risks include requirements for a letter of credit guarantee or bank guarantee. As regards bank risks, a letter of credit is required as the payment instrument and in addition, a higher premium is charged for longer risk periods. Companies are required to have their own hard currency earnings or have access to external support they can rely upon. Increased premium rates apply for long risk periods, for those companies that meet the requirements.

EKN:s commitment and experience

Most of EKN's transaction flow in Zambia concerns private buyers in the country's mining industry. However, the outstanding guarantee commitment mainly consists of a guarantee for a transmission project with the Treasury as guarantor. With this guarantee, Zambia is one of the largest guarantee exposures in sub-Saharan Africa. A handful of transactions are made each year.

Generally, the experience with the issuance of guarantees in Zambia has been positive. The exception is the transmission project, where EKN has had delays and claims paid in 2020-2023. So far, however, all claims have been recovered, which means that there are currently no arrears. Delays continue to be reported, but are settled after 2-3 months. However, in the event of a debt renegotiation, the transaction will most likely be covered, so further claims payments are likely in the coming years. Current claims relate to older transactions from the period 2009-2017, mostly on buyers in the mining sector.

Zambia has had nine Paris Club agreements since 1983 and received debt cancellations in the early 2000s through the HIPC (Heavily Indebted Poor Countries) initiative. The agreement currently being negotiated within the Common Framework is therefore the tenth such agreement.