

COUNTRY RISK ANALYSIS		DIN SÄKERHET I EXPORTAFFÄRER <b>ekn</b>	
<h1>Zambia</h1>			
	COUNTRY RISK CATEGORY <h2>5/7</h2> <p>The country risk categories range from 0 to 7. The lower the number the better the credit rating the country has.</p> 	EKN'S OUTSTANDING GUARANTEES TO THE COUNTRY <b>SHORT-TERM TRANSACTIONS</b> SEK 0 MILLION <b>MEDIUM AND LONG-TERM TRANSACTIONS</b> SEK 1,321 MILLION	
			DATE <b>8/12/2014</b>

## Political vacuum in the wake of president's death

Zambia has good prospects for growth, but its dependence on copper exports, with the majority exported to China, makes the country vulnerable. Its public finances have weakened since the financial crisis, but are estimated to be in the process of strengthening. President Michael Sata passed away in office in the end of October 2014. However, given that the democratic system in Zambia is sufficiently stable, no long-term or widespread turbulence is expected to emerge. The stabilisation of the public finances may however take longer than expected, since the focus is now on choosing a new president. When the country's new leadership is installed, it is expected that initiatives to increase government revenues from the mining sector will be resumed. In times of falling copper prices, it is most likely that these initiatives will be gradually implemented in an orderly fashion to avoid running the risk of scaring away foreign investors and mining companies.

### THE COUNTRY'S STRENGTHS AND WEAKNESSES

#### Strengths

- Good prospects for growth
- Moderate debt
- Relatively well-established democracy and robust institutions

#### Weaknesses

- Complete dependence on copper
- High level of poverty
- Risk of political deadlock as a result of the president's death

### EKN'S POLICY

#### Policy in brief

EKN places Zambia in country risk category 5, for both short and long-term guarantees – an assessment made in collaboration with the other OECD countries. Some form of restrictiveness applies to all buyer categories in Zambia. For public buyers such as state energy and transport companies or line ministries, EKN requires a government guarantee

from the ministry of finance. For private buyers (companies and banks), this policy means that EKN, in addition to assessing the risk on its own merits, has adopted a more restrictive approach. This means that EKN would prefer that the transaction is extremely transparent and that the debtor has sufficient buffers. Buffers can be used to address unforeseen events that are estimated to arise more frequently in Zambia than in other countries with a more stable and predictable operating environment.

#### WHAT MIGHT CAUSE A CHANGE IN THE COUNTRY POLICY?

##### **The policy may be made less restrictive in the event of**

- The government succeeding in increasing revenues from the mining industry, and these revenues being used to reduce poverty in the country
- The ongoing reform efforts leading to a better functioning financial sector
- Economic diversification to reduce the country's vulnerability to copper price changes

##### **The policy may be made more restrictive in the event of**

- Long-term, widespread political turbulence as a result of the president's death affecting the country's ability to pay
- The price of copper going down as a result of lower demand than expected from China
- The government amending tax legislation in the mining sector in such a way that it scares away foreign investors and mining companies.

#### EKN'S EXPOSURE AND EXPERIENCE

##### **One of the largest countries of exposure in the region**

The majority of EKN's transactions in Zambia are related to the country's mining industry. EKN's exposure in Zambia was low until last year, below SEK 100 million. But then EKN issued a large guarantee for a power project to link up the Zambian countryside with the main electrical grid in 2013. Zambia has thus become EKN's third-largest country of exposure in sub-Saharan Africa. EKN's experience providing guarantees in Zambia has been good thus far, except for a minor indemnification in the mining sector. Payment delays have increased in the transactions guaranteed by EKN over the past year. The delays are related to a handful of transactions in the mining sector.

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**POLITICS****Political vacuum following president's death**

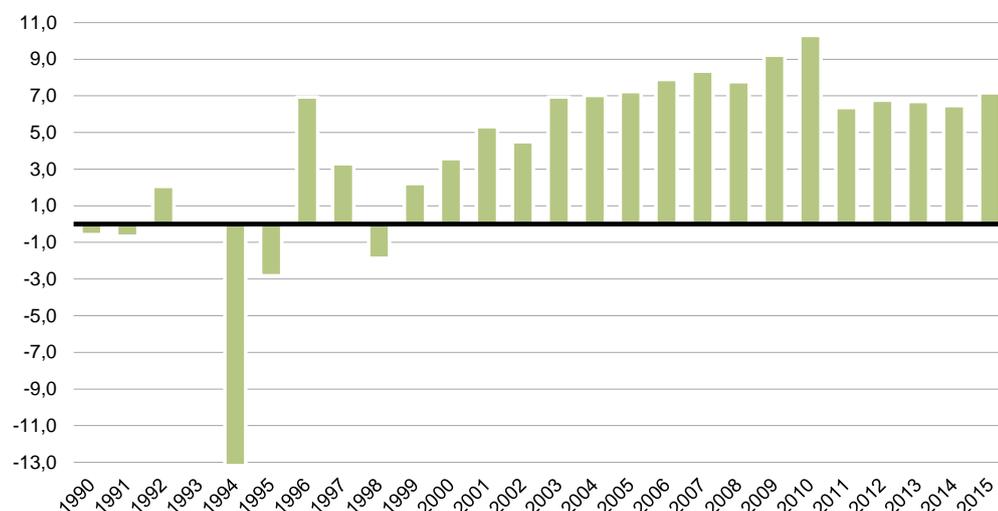
Multi-party rule was introduced in Zambia in the early 1990s and Zambia now has a more established democracy and political stability in comparison with other countries in the region. The opposition Patriotic Front (PF) party came to power in the most recent elections in 2011, and its party leader Michael Sata became the president. The PF's economic policies have been less predictable than before, although the nationalist rhetoric that carried them to power has not been put into practice to any great extent. Sata was largely absent from politics for several months due to poor health, and he passed away in October 2014. Vice President Guy Scott has temporarily taken over the presidency until new elections are held, which will be three months from the passing of Sata. There is a political vacuum until the new elections have taken place and a new president is in place, because the country's political power is concentrated in the president and his closest circles. There are internal divisions within the PF and there is no clear successor to the presidency. This can create a certain degree of political turbulence in the short term, but given that Zambia's democracy is considered sufficiently robust, no long-term or widespread turbulence is to be expected. It is highly likely that the discussions held in the summer and autumn with the IMF on a new programme will be resumed when a new president has taken office.

The next parliamentary elections will be held in 2016. Although the PF has an advantage in its access to both the government finances and the government-owned media, it is not a foregone conclusion that they will win, especially not since Sata passed away and the splits within the party have been exposed. Both of the largest opposition parties are garnering more and more support as it seems that PF is not making good on its election promises from 2011 of cutting unemployment and tackling corruption. No abrupt changes in economic policies are expected, since all parties understand the importance of not jeopardising inflows of foreign investment and development assistance.

**ECONOMY****Focus on increasing government revenues from the mining sector**

The calculation basis for Zambia's GDP was revised in the beginning of 2014, which led to the economy becoming about 25% larger than before in one fell swoop, and it is now among Africa's 10 largest. The economy is based on the copper industry, which accounts for 25% of GDP and nearly 80% of the country's export revenues. The privatisation of the mining sector in the 1990s improved productivity. Together with rapidly rising copper prices in the 2000s, this increase in productivity has generated high growth, which has averaged 6% per year since the turn of the millennium. The country's complete dependence on copper makes the economy vulnerable and makes its prospects for growth largely dependent on the copper price trend and the economic trend in China, which receives nearly half of the country's exports. Growth is being stimulated by the positive trend in the construction industry and the agricultural sector and is expected to come in at around 7% this year and next year.

## GDP GROWTH, %



GDP growth has been high since the turn of the millennium. Source: IMF, the forecast years are 2013-15

Similarly to other African raw material producers, the link between high sustainable growth and poverty reduction is weak. Nearly 90% of the workforce is in the informal sector, and youth unemployment is high. Even though the development assistance provided to Zambia has been gradually reduced, it is still equal to 7% of GDP, which is higher than several comparable countries such as Angola, Ghana and Kenya.

The public finances are considered generally sound, but have weakened in recent years as a result of the expansionary fiscal policies pursued to counter the effects of the financial crisis. The budget deficit is currently around 5% of GDP. This figure is expected to get worse, albeit at a slow rate, due to the fact that public spending will likely increase in the run-up to the parliamentary elections in 2016. The fiscal austerity that had been up for discussion may also be delayed on account of the political consequences of the passing of Sata. However, the weaknesses of the public finances are mainly on the revenue side. The mining industry, which is extensive in terms of export revenues, contributes only 6% of government revenues, and the government is attempting to implement initiatives targeting the mining industry to bring a larger portion of the revenues into the state, e.g. via higher taxation. These initiatives are expected to be gradually implemented in an orderly fashion to avoid scaring away foreign mining companies, especially in consideration of the falling copper prices.

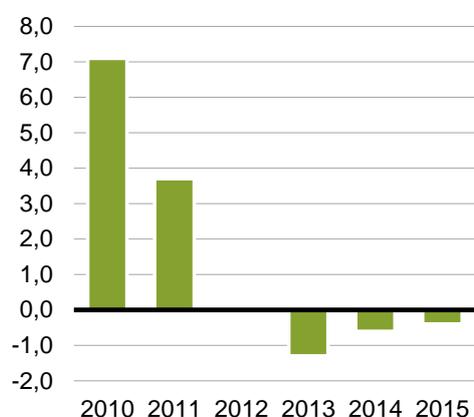
## BALANCE OF PAYMENTS AND DEBT ISSUES

As a result of Zambia's high dependence on copper exports, its external position has weakened as the copper prices have fallen. Relatively substantial import growth in relation to infrastructure investments has also contributed to this. The current account deficit is however moderate, and is falling gradually as copper production increases and the country begins exporting agricultural products to a greater extent.

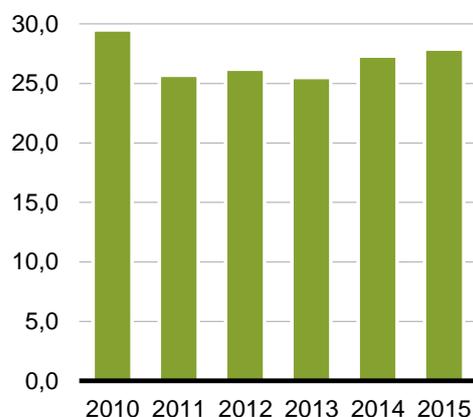
**Kommentar [DF1]:** Jag tror att det fanns lite problematik här i den svenska texten: "Budgetunderskottet ligger för närvarande på omkring fem procent av BNP. Det förväntas krympa, om än i långsam takt, till följd av att de offentliga utgifterna sannolikt kommer att öka inför parlamentsvalet 2016."

Om jag förstår rätt så är det inte att budgetunderskottet ska krympa pga av att de offentliga utgifterna ökar, utan att budgetunderskottet försämras/ökar pga av att de offentliga utgifterna ökar. Jag har bara lagt in en ganska neutral översättning för att undvika missförstånd, men annars kan vi skriva "The deficit is expected to increase" istället om det är det som ni syftar på här.

CURRENT ACCOUNT BALANCE, % OF GDP



EXTERNAL DEBT, % OF GDP



*The forecast for the current account balance is positive on account of increased agricultural exports. The external debt is moderate following debt relief. Source: IMF, the forecast years are 2013-2015*

Thanks to debt relief in the mid-2000s, Zambia's external debt has fallen and remained at a moderate level ever since. The entire national external debt consisted of development assistance loans until 2011. However, Zambia issued a ten-year government bond worth USD 750 million in 2012 to finance infrastructure investments, which generated a high level of interest from foreign investors. More than half of the government debt still consists of domestic debt, and both the domestic and external debt is long term. The risk of the country winding up in an unsustainable debt situation is estimated to be low overall.

#### CURRENCY POLICY

##### Currency depreciation slowed down

The Zambian kwacha is floating. Due to the dominance of the copper sector in the economy, the currency is sensitive to shifts in copper prices. Falling copper prices, weakened public finances and fears of amendments to the mining legislation caused the kwacha to fall by nearly 25% against the dollar in 2013. The central bank has raised the interest rate to slow down this depreciation on two occasions. The currency stabilised in 2014, and the central bank has thus been able to begin rebuilding the international reserves. The international reserves currently cover two months of imports, which is somewhat low in consideration of the country's complete dependence on copper.

## EXCHANGE RATE, KWC/USD



The Zambian currency has fallen in recent years. Source: IMF

## FINANCIAL SECTOR

### Underdeveloped financial sector, but reforms being made

The Zambian banking sector consists of around 20 banks, with the four largest playing a dominant role with around 60% of the stock of assets. The banking sector accounts for over 30% of GDP, which is slightly lower than in similar countries in the region. The country's banking legislation largely follows the fundamental principles of the Basel framework. The Zambian banking sector is rudimentary, and a large portion of the population is outside the banking system, although private lending has increased relatively significantly in recent years. The banks are generally well-capitalised, and the proportion of bad loans has fallen from 15% to just below 9% of total lending in the last five years. The government has taken measures to develop the financial sector, such as by supporting the country's credit reporting agency and supporting an increase in the number of bank offices in rural areas. The government is also planning to establish a unified system for registering collateral. The majority of the country's SMEs do not have access to loans, in part due to high interest rates. An interest rate ceiling for lending was introduced at the beginning of the year to solve this problem. However, the IMF is trying to get the authorities to instead focus on increasing competition in the banking sector and helping companies develop business plans. The authorities also raised the minimum capital requirement last year, which could lead to a certain degree of consolidation in the sector.

## BUSINESS ENVIRONMENT

### Relatively well-functioning business environment in regional context

Ever since multi-party democracy was introduced in Zambia in the early 1990s, institutional reforms have gradually been made. Zambia is above average in the region in terms of governance and institutional capacity. Zambia also does well in terms of its business environment. The country has improved four places since last year in the World Bank's Doing Business Index and is now in ninth place among the region's 47 countries, and in 111th place out of a total of 189 countries globally. Reforms have been made to the judiciary to simplify the enforcement of contracts and bankruptcy proceedings, which should make things easier for Zambian companies. The PF came to power on a relatively populist agenda, but have

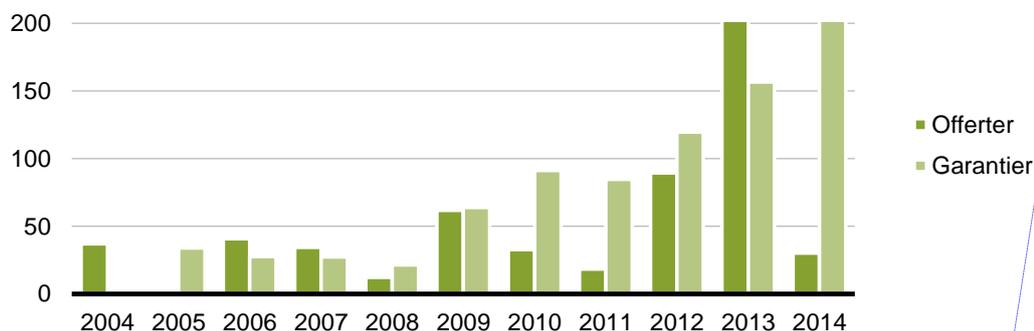
toned down these elements in their policies. Certain restrictions have however been introduced with respect to the use of hard currency in local contracts, and expanded monitoring of hard currency transactions, which puts a greater administrative burden on companies. The government has announced that it is planning to introduce regulations aiming to keep a larger portion of mining revenues in the country. There is however uncertainty concerning how these regulations will look in practice. In times of falling copper prices, it is however considered probable that the government will move forward carefully to avoid scaring away foreign investors.

#### EKN'S EXPOSURE

### Power and mining sector dominant

The majority of EKN's transactions in Zambia involve exports related to the country's mining industry. EKN's exposure in Zambia was relatively low until last year, below SEK 100 million. However, EKN issued a large guarantee in 2013 for a project in the power industry to link up parts of the Zambian countryside with the main grid. This offer has materialised in 2014 and Zambia has thus become EKN's third-largest country of exposure in sub-Saharan Africa.

EKN'S EXPOSURE, SEK MILLION



**Kommentar [DF2]:** Offers Guarantees

#### PAYMENT EXPERIENCE

### Generally good experience

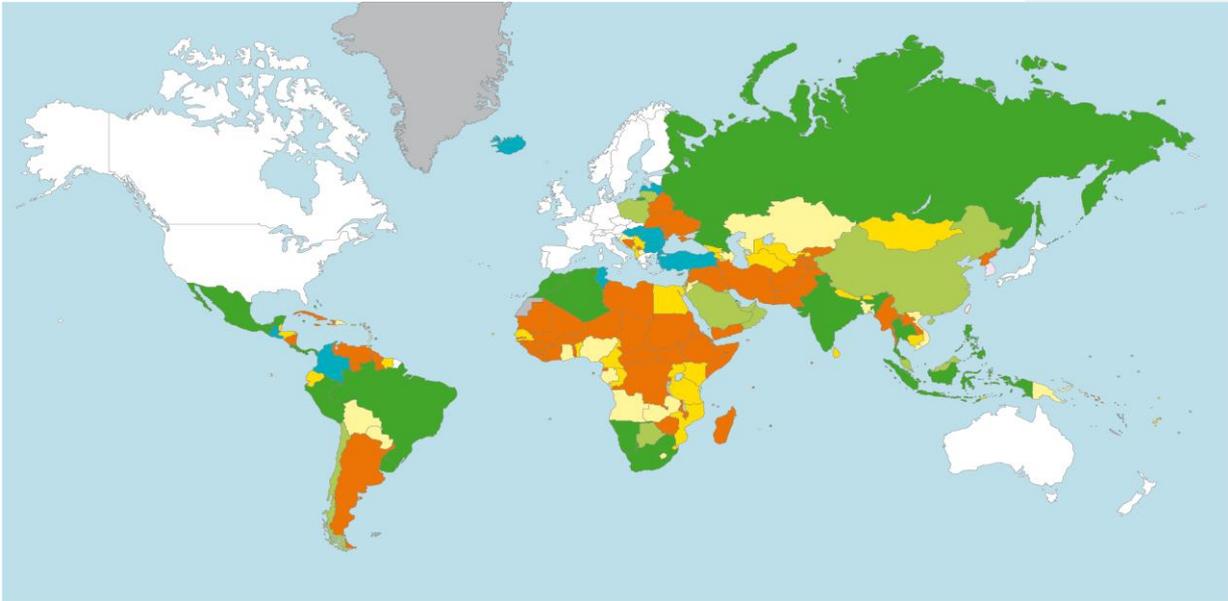
EKN's experience of providing guarantees in Zambia is generally good. Payment delays in the EKN guarantees have increased over the past year. These are commercial delays related to individual transactions in the mining sector. Thus far, EKN only has one small outstanding claim in the mining sector, and no direct experience of claim and recovery cases in Zambia.

#### COUNTRY DATA

**Area:** 752,614 km<sup>2</sup> (1.7 times Sweden)  
**Population:** 15 million (2014)  
**GDP:** USD 22 billion in 2013 (Sweden USD 552 billion in 2013)  
**GDP/capita:** USD 1,800 in 2013 (Sweden USD 40,900 in 2013)

#### CREDIT RATINGS

**Moody's:** B1(sta)/Ba2  
**S&P:** B+(neg)/B+  
**Fitch:** B(pos)/B+



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