

Cover Story

The Oil Price Slump ... Will Copper Follow?



The declining price of oil is wreaking havoc on oil-exporting countries such as Nigeria, Russia and Venezuela. These countries have one thing in common with Zambia – the dependence on one commodity for export revenues. What will happen if the price plunge extends to copper? It is time to think hard about diversification.

See full story on page 3.

News in brief

Thursday, December 18, 2014: Barrick Gold Corp to suspend Lumwana mine in Zambia amid huge royalty hike

BARRICK Gold has announced that it plans to suspend operations at Lumwana copper mine because of a mineral royalty hike introduced by the government. Parliament passed legislation that eliminates corporate income tax but increases the royalty rate on open pit mines to 20% from 6%. Barrick Gold has warned for months that this legislation, which takes effect in January 2015, would make Lumwana unsustainable. Around 4, 000 direct jobs and substantial tax revenue may be lost.

Thursday, December 18, 2014: Zambia's economic growth prospects trimmed to 5.5% - IMF

ZAMBIA'S economic growth forecast for 2014 has been trimmed to 5.5 percent due to declining copper production and the depreciation of the Kwacha in the first half of the year, said the International Monetary Fund on Thursday 19th December, 2014.

Friday, December 19, 2014: Kwacha appreciates by 1.3%

THE Zambian Kwacha posted marginal appreciation against the United States Dollar and the South African Rand. The Kwacha, which traded at K6.344/US\$ on Monday, December 15, 2014, ended the week 1.3% stronger at K6.264/US\$. The South African Rand, which started the week at K0.544/ZAR ended the week at K0.539/ZAR, which is 0.9% stronger.

INSIDE THIS ISSUE

Perspective: Come January 1, 2015, Government will commence the implementation of the 2015 Budget. We revisit some of the pronouncements made back in October

Word on the street: The recent increase of the retirement age to 65 has become an election issue with some candidates promising to reverse the order. Is it such a bad thing?

Merry Christmas

We at KSJ wish you a merry Christmas this Thursday, December 25, 2014, and a restful "boxing day". Yes, Government has declared 26th December and 2nd January 2015 public holidays!

WORD FROM THE EDITOR



Aisha Nalishebo

This publication was born out of the need to offer fresh perspectives on business and financial news happening around

us. While there are a lot of publications that talk about politics, fashion and other social events, there is hardly any magazine that exclusively looks at economic and financial aspects of domestic and international events. That is where we come in. Our aim is to publish, on a monthly basis, an economic and financial magazine to showcase invaluable contributions made by Zambian individuals to the economy and how international events affect us. Before doing that, we decided to introduce ourselves by coming up with this weekly economic and financial commentary. This serves as a build up to the monthly magazine.

In this first publication, we analyse the issues surrounding the current oil slump and how it relates to Zambia. We also tackle the controversial issue of the retirement age which has become an election issue.

As part of a regular profile on entrepreneurs making a difference in our country, our first feature is about a budding entrepreneur specialising in private equity and general investments. We also provide you with the latest market data for the week and what to expect in the week ahead.

Good to have you on board. And wishing you all a merry Christmas. God bless Zambia.

Who We Are

Katondo Street Journal (KSJ) is named after Katondo Street, a thoroughfare in the Central Business District of Lusaka.

What We Are About

At KSJ, we cover business and financial analytics in Zambia. We focus on the people, innovations and ideas behind Zambia's most dynamic and entrepreneurial companies. We also analyse business and financial data to inform decision making by business leaders.

Our tag-line "The Business Highway" provides a fast-paced route for businesses to showcase, network and grow.

Look out for the Katondo Street Journal hard copy version coming soon to a book store and supermarket near you.

KSJ's Weekly Economic & Financial Commentary is distributed to subscribers each Monday morning by e-mail and will soon be available on www.ksj.co.zm.

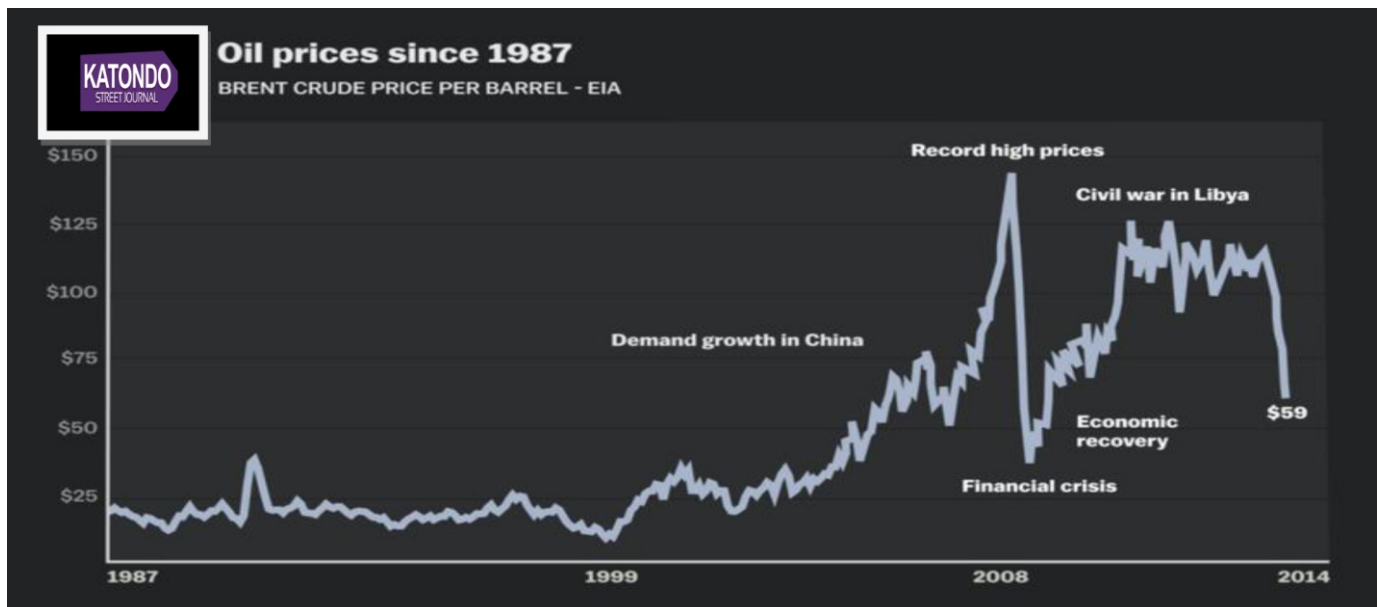
Editor-in-Chief: Aisha Nalishebo
Editor, Production & Distribution: Humphrey Zimba
Analytics: Shebo Nalishebo
Business Development: Zali Chikuba

Special Projects: Frazier Mulilo
Design: Xel Creations
Publishing: Radical Media House

*For advertising and other enquiries please email: snalishebo@gmail.com
analishebo@gmail.com*

COVER STORY

The Oil Price Slump, Will Copper Follow?



The declining price of oil has led the Energy Regulation Board to reduce the prices of petrol, diesel and kerosene, albeit marginally. While the price reductions are welcome here, it is wreaking havoc on oil-exporting countries such as Nigeria, Russia, Iran and Venezuela.

- Nigeria's finance minister presented a 2015 budget of \$23 billion to parliament on Wednesday, 17th December 2014, slashed by nearly \$3 billion from the original \$26 billion to accommodate slumping oil prices. Growth projections for 2015 have been revised from 6.35 percent to 5.5 percent. Nigeria is Africa's largest economy and oil producer. Oil finances 75 percent of Government's revenue.
- Tumbling oil prices threaten Russia's economy since sales of oil and gas are Russia's chief source of export revenue, accounting for about 45 percent of the government budget. The ruble, Russia's currency, is collapsing. This has led to a rise in inflation and an increase in interest rates to stop people from selling off the ruble. But the ruble kept declining anyway and the rate hikes

are likely to slow the country's economy down even further.

- In Venezuela, oil accounts for 96 percent of export revenue. Following the drop in the price of oil, the Venezuelan government has seen bond prices plunge, loan costs rise and market speculation of default emerge this year amid an economic slowdown.

Just six months ago, the price of oil was around \$115 per barrel. Fast-forward to mid-December and the price is just under \$60 per barrel. Just what exactly is going on with the price of oil? For much of the past decade, oil prices were high because of soaring oil consumption in countries like China and conflicts in key oil nations like Libya. Oil production couldn't keep up with demand, so prices spiked.

But beneath the surface, many of those dynamics were rapidly shifting. High prices spurred companies in the US and Canada to start drilling for new, hard-to-extract crude in North Dakota's shale formations and Alberta's oil sands. The US alone has added 4 million new barrels of crude oil per day to the global

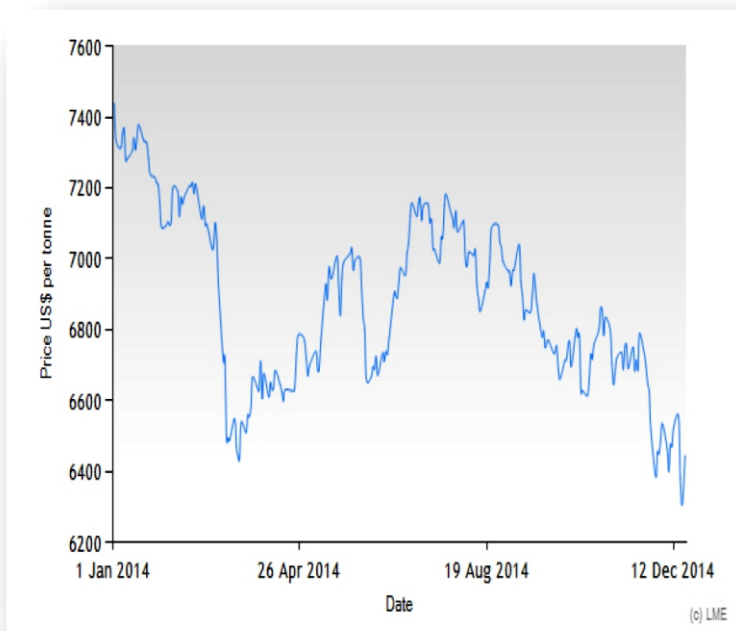
market since 2008. Global crude production is about 75 million barrels per day, so the US addition is significant. At the same time, demand for oil in places like Germany, China and the US began to slow down, thanks to weakening economies and new efficiency measures. On top of that, the conflict in Libya was slowly easing. By late 2014, world oil supply was on track to rise much higher than actual demand.

Being a non-oil producing country, a reduction in the price of crude is welcome for Zambia. However, at KSJ we see that Nigeria, Russia and Venezuela have

which accounts for about two-thirds of Zambia's exports. The chart shows the historical price graph way of repeating itself. A plunge in oil prices may also spell doom for other commodities such as copper, one thing in common with Zambia – the dependence on one commodity for export revenues. History has a of Copper from the London Metal Exchange (LME) since the beginning of the year. It shows that the price of Copper dropped to just above US\$6, 400/tonne in the first quarter of the year before it rose again to levels above US\$7,000/tonne during the third quarter of 2014. Since the beginning of December, the price has gone below the first quarter levels to around

US\$6,300/tonne. We at KSJ have not heard anyone in the mainstream media raise the alarm. If this price drop continues into 2015, Government's revenue performance is likely to be affected, even if the mining tax regime has been revised and made mineral royalties a final tax.

We have sung the diversification song for far too long without any significant increases in non-traditional exports (NTEs). NTEs have been growing over the years, albeit at a slow pace. It is time we actually reduced our dependence on copper because China, one of our chief export destinations, has begun to sneeze (the news out of China this week is that manufacturing has slowed down), and Zambia will definitely catch the cold!



WORD ON THE STREET:

The Case for Increasing the Retirement Age from 55 to 65

ACTING President Guy Scott recently signed a Statutory Instrument to increase the retirement age for civil servants from 55 to 65 years. This is part of the short- and medium-term measures to strengthen the sustainability of the pension systems in the country. The move did not go down well with the labour movement and jobless youths. This has become an election issue with a number of

candidates promising to reverse the SI.

The idea of working ten more years does not seem appealing for many people. It definitely reduces the length of time that retirees will have to enjoy the fruits of their labour, or the time they need to invest in their own private operations. It is also argued that Zambia's life expectancy is still low, so most workers may not live long enough to enjoy their retirement



package. Young people feel that their prospects of getting jobs will be diminished further when youth unemployment rates are high.

Proponents of the proposal argue that delaying the retirement benefits may save the payments for when people need them the most. The older Zambians may have run out of alternative sources of income and savings and therefore have a much greater need for social security when they are 65.

Let us do the numbers. We start with a concept called life expectancy. Life expectancy at birth compares the average number of years to be lived by a group of people born in the same year, if mortality at each age remains constant in the future. Life expectancy at birth is also a measure of overall quality of life in a country and summarises the mortality at all ages. The 2014 Human Development Report says that our life expectancy at birth is 58.1 years. Before you start thinking that you will only live three years after you retire at age 55, it is not the case. That is not the case. What this means it that a child born in 2014 is expected to live 58 years keeping everything else constant. There is a life expectancy for each particular age. According to the Central Statistical Office, a person who was 55 years old in 2010 was likely to spend 21.6 years in retirement. A person who was 65 years in 2010 was expected to live another 14.7 years. Taking your pension early means that you take it at an actuarially reduced level. In other words, taking an early retirement means the same amount of pension money accumulated during the duration of your pension plan will be spread over more years. Meaning, the yearly or monthly benefit will be reduced. As living conditions improve, we are living

longer. Therefore, we need to sort out the issue of retirement age early before the pension schemes are choked by having to make huge payouts to people who are still able to work.

According to the Labour Force Surveys, the government sector employed about 200, 000 workers in 2008. This increased to about 270, 000 workers in 2012. This means that the civil service can only take up about 14, 000 new employees annually. The 5 million youths have to compete with adults for these same jobs. The lack of prior work experience, low skills and competence gaps, and generally poor work attitudes means that the youth have a very slim chance of being hired for these 14, 000 jobs. Youths therefore have to look to the private sector other than the public sector for jobs.

Spending 10 more years on the job means that you will be able to save more and ensure that all your children have a better chance of completing their education. How many stories have you heard of school-going children unable to finish school because their father retired at age 55 and he no longer has a regular income to afford the high school fees? This parent either takes his children out of school or calls his younger brother who is still in employment to take up the responsibility of paying for his nieces/nephews' education, thereby putting a burden on his brother's already bloated family size and thereby exacerbating the poverty cycle.

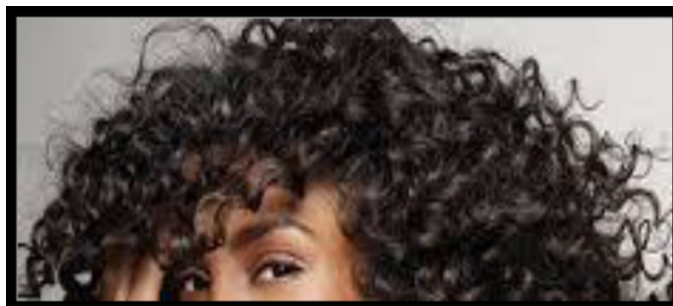
Of course, the new retirement age of 65 should not be uniform. An article by ZIPAR researchers Bernard Banda and Caesar Cheelo which appeared in the Zambia Daily Mail called for due consideration of sectoral characteristics of employment by positively discriminating between professionals with higher specialisation and workers with manually demanding occupations ("Rethinking the Retirement Age, Zambia Daily Mail, June 25, 2012). People in physically demanding jobs such as construction workers may not easily delay retirement on account of the physical demands of their jobs. Increasing retirement age may lead to lower productivity in some labour-intensive sectors. There are certainly people, especially low income populations, who are engaged in more labour-intensive types of work who tend to have

shorter life expectancies than their wealthier counterparts. It would be folly to have a construction worker, for example, retire at age 65 when they are incapable of performing tedious duties. It definitely makes sense for a lecturer to continue holding chalk for ten more years.

FACTS & STATS: Weaves are us

Thanks to our ladies, Zambia officially imported US\$1.4 million worth of wigs and weaves in 2013, according to trade statistics from the World Bank's World Integrated Trade Statistics database. The top

5 import sources for weaves and wigs are Zimbabwe, Nigeria, Kenya, China and the United States of America. Imports of wigs and weaves nominally grew by a healthy 52% between 2012 and 2013.



Imports of hair products, 2012 & 2013 (US\$)

HS tariff codes	Description	2012	2013	% change
[6703]	Human hair, wool or other animal hair prepared for use in making wigs	154,075	164,331	7%
[6704]	Wigs of human or animal hair; articles of human hair not elsewhere specified	739,057	1,192,885	61%
		893,132	1,357,216	52%

ENTREPRENEUR OF THE WEEK

Maybin Mudenda



Maybin Madiba Mudenda is a budding Zambian entrepreneur specialising in private equity and general investments. He featured in the September 2014 issue of Forbes Africa and BBC's African Dream

(<http://www.bbc.com/news/world-africa-30377047>) where he shares his tips for those seeking backing for their business ventures and suggests how governments should help.

Maybin has 10 years insurance sales and marketing experience in the insurance industry in Zambia. He served as Managing Director for Kurema Resources Zambia and Chief Investment Consultant at Genesis Global Investments in Zambia, South Africa and Botswana until 2011.

Maybin is also owner of INSIEME LIMITED which holds 50% shares in African Grey Insurance Limited, 20% shares in Genesis Finance Limited and 100% shares in a wheat farming project in Chisamba. He is also owner of Insizwe Consult Limited and has 25% shares in Burton Karya Resources Limited with the Burton Family in Zambia, 40% shares in Adjua Trading and Logistics in South Africa, a new project.

He is currently pursuing new business ventures in West Africa.

WORD PLAY



What you think it means:

Used in reference to someone who is considered very mobile; someone who moves a lot, always up and about.

What it really means:

It means absolutely nothing!



What you think it means:

Used in reference to someone who is considered naughty or mischievous

What it really means:

Consisting of members or elements of different kinds; of mixed character.

PERSPECTIVE:

PARLEY APPROVES 2015 NATIONAL BUDGET



By Robert Liebenthal
(Guest Columnist)

PARLIAMENT on Wednesday 17th December 2014 unanimously passed the K46.7 billion 2015 national budget. The 2015 budget is boring. As far as I can tell, there is only one controversial issue and that is the new mining tax regime. I will come to that, but the rest is, frankly, boring.

Which is as it should be.

Budgets should be boring. They should ideally contain no surprises, but should represent the outcome of solid planning, policy analysis, wide consultation, fine tuning of well-established policies and the next step along a well-worn path towards better delivery of public services and development of needed infrastructure. It's true that new revenue

measures are usually kept quiet before the budget, so that potential losers from the measures can't take steps to avoid the tax. So, far from being a complaint, this is a compliment. Good job, Hon. Chikwanda.

From the macroeconomic point of view - i.e. from the point of view of the impact of the budget on the

Zambian economy (and leaving aside mining tax) - the most important piece of news is that the budget deficit is decreasing to 5.5% of GDP from 6.5% last year, and that the minister is targeting it to fall further to 4.6% next year, with domestic borrowing at 2% of GDP for 2015. It is the budget deficit and the way it is financed that has the greatest short term endogenous (i.e. excluding outside shocks like fuel and food prices) impact on inflation, interest rates and indirectly the exchange rate. Domestic borrowing through Treasury bills and bonds has drained bank liquidity in the early part of the year. With the 6-month TB rate at 17%, it is not surprising that bank lending rates have remained high, though it is not the only factor. Therefore reducing domestic borrowing from the banking system is, and should remain, a high priority. Likewise, inflation, now at 8%, is slightly above target, and so the statements and the commitment to control it better are welcome.

One issue not addressed directly in the budget speech, and which is relevant here, is arrears. Much has been said about the \$600 million VAT refunds which are claimed by some mining companies, an issue which is in dispute, and about which the minister, on this occasion, only hopes for a quick solution. However, one hears reports about arrears to contractors and suppliers, an indication that the Ministry of Finance is trying to run a tight ship and contain its recourse to the banking system. If arrears are large and rising, it will make fiscal and monetary management more difficult, since the achievement of deficit reduction objectives will then require adjustments in revenue or - more likely - expenditure.

External financing of the deficit for 2015 is targeted at 2.8% of GDP. As far as I am aware, the DSA referred to in the minister's speech is not yet in the public domain, but the minister is correct in saying that Zambia's external public debt is still within acceptable limits. Indeed, one might be surprised that, within 8 years of Zambia's debt being written off by HIPC and MDRI, we would even be raising that question. But there are concerns. First, the rate at which external debt has been increasing (i.e. the size of the deficit) suggested at one point that it

was getting out of control. The large exchange rate depreciation earlier this year was, one suspects, partly a reaction to that fear. Then there are the terms on which external finance is available, notably the latest Eurobond. External debt service on the 2 Eurobonds is now, I believe, running at \$120 million per year, not a small sum.

As Marcelo Giugale of the World Bank puts it in a recent article: "Whether poor borrowers [like Zambia] can avoid a financial squeeze [when repayment is due] will depend on several factors. One is whether they will be able to issue more bonds to pay off those coming due. Another is whether they invest the money prudently, thereby enabling repayment. And it will also depend on whether countries with volatile incomes, especially those reliant on natural resources, put money aside when earnings are high."

Thus the quality of the expenditure financed by the external borrowing is crucial. And it's important to note that it's not the projects directly financed by the Eurobond that are to be considered here, it's the marginal expenditure which is made possible by the extra financing.

The minister mentions in his speech that he now plans to set up a Sovereign Wealth Fund under the IDC, funded by dividends from State-owned enterprises. It's important to point out that this is not a mechanism for setting aside funds when earnings are high, to meet debt obligations, or simply to smooth fluctuating revenues, such as countries like Botswana and Chile have done. Such a mechanism is still needed.

The target for domestic revenue is K35.1 billion, or 18.5% of GDP. It is set to increase further during the R-SNDP period. A large part of the increase is from mining, and we are told that this is because of the change in the mining tax regime, notably the increase in mineral royalties. There is no doubt that revenue from mining needed to increase, but there are some questions:

1. Will mining tax receipts actually increase? Not if mines close (as now looks likely in the case of Lumwana), and not if the mines adjust their

production to avoid the high royalties on open cast mining. (For open cast mines, the royalty rate goes up more than threefold). Were we not going to see an increase anyway from CIT as the capital allowances and loss carry-overs were fading out?

2. There has been widespread frustration with the CIT because of transfer pricing and other forms of tax evasion by some mining companies. But is this not throwing the baby out with the bathwater? And won't the two-tier royalty tax be equally difficult to administer? ZRA and other branches of government, and their international partners, can't give up on ensuring compliance, which means verifying results through tax audits and investigations. Sooner or later, a profit-based tax system will be needed. All countries exporting minerals use a mixed system.
3. What effect will the new regime have on new mine investment, especially since capital costs presumably cannot be carried forward any longer? And what effect will it have on exploration? Perhaps government has decided that it doesn't want or need new mine investment, but does this really make sense?

Little is said in the budget speech about tax administration, yet we know that tax evasion is rampant. A recent study by ZIPAR concludes potentially uncollected PAYE could be as high as 6.7% of GDP and 40.3% of total tax revenue. Similar calculations could be made for VAT and CIT. Our impression is that ZRA is trying to improve its performance and address these issues. But there is a long way to go, and it is surprising that the issue is not being flagged by the minister, and that, as noted above, there is even a sense that, on CIT for the mines, he has given up.

Last, the expenditure side. Much will be said about the wage freeze. Whether this is the right answer or not, public sector wages and salaries currently absorb more than 50% of the budget, probably more than 10% of GDP. This cannot be sustained, so something needs to happen. At the same time,

government is surely right to increase the number of extension workers, teachers and community health workers, since these are the crucial frontline services that can directly address poverty. So it is hard to see how a wage freeze can be avoided. Likewise, the small allocation to the cash transfer program, which has been shown to be effective in reducing poverty in many countries, is entirely welcome, and could indeed be larger.

Nearly K1 billion has been allocated to FRA for the strategic food reserve. But is this realistic given current policies in the maize sector? The bumper harvests of recent years, welcome though they are, have resulted in FRA being pressed to procure much more maize than 500,000 tons, the strategic reserve. This is a difficult and complex issue. Suffice it to note for this discussion that, based on past experience, there is a high probability that more resources will be needed.

Which brings me to the thorny issue of expenditure management. Parliament will now spend several weeks debating the yellow book (or whatever replaces it under the proposed reforms) vote by vote and line by line. But we know that, as for FRA, actual spending will probably diverge significantly from the approved estimates, for all sorts of reasons, some good some not so good. On some accounts, the expenditure system has all but broken down, with the MoF effectively operating a cash budget system.

Against this background, the minister tells us that the PFM reform was launched; that IFMIS is being rolled out to more sites; that the new planning and budgeting policy has been published and that OBB will be introduced. Nothing could be more laudable than making expenditure more results-oriented, but will it address the fundamental problem of the apparently broken expenditure system, with negligible predictability and hence little if any accountability? Where has it worked and where is it working? Is it true - as I have been informed - that even highly developed and sophisticated countries are struggling with it? Will it become yet another well-intentioned innovation that ends up complicating things while not addressing the basic problems with the system?

My plea would be to introduce, as part of the planning and budgeting cycle, an annual public expenditure review, that systematically scores the successes and failures, studies the causes and ensures that, year by year, there is learning from mistakes and from successes. Other countries, like South Africa, Tanzania and Uganda have used such

a system, and I don't see why it wouldn't work in Zambia.

Robert Liebenthal is a development economist and currently the Vice President of the Economic Association of Zambia.

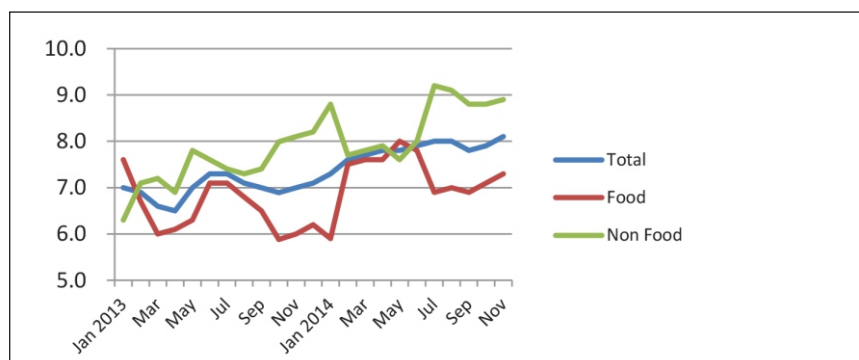
MARKET DATA

Daily Average Exchange Rates, 15-19 December, 2014

Date	US DOLLAR			South African RAND		
	Buy	Sell	Mid	Buy	Sell	Mid
19-Dec-14	6.254	6.274	6.264	0.539	0.540	0.539
18-Dec-14	6.252	6.272	6.262	0.541	0.543	0.542
17-Dec-14	6.301	6.321	6.311	0.538	0.540	0.539
16-Dec-14	6.322	6.342	6.332	0.542	0.544	0.543
15-Dec-14	6.334	6.354	6.344	0.543	0.545	0.544

Source: Bank of Zambia

Annual inflation rate: total, food and non-food; January 2013-November 2014



Source: Central Statistical Office

Lusaka Weather In The Week Ahead

	High	Low	Precipitation	Forecast
Mon Dec 22, 2014	25°	19°	16 mm	Cloudy, a couple of t-storm
Tue Dec 23, 2014	23°	18°	14 mm	Cloudy, thunderstorms; humid
Wed Dec 24, 2014	26°	19°	8 mm	Some rain and a thunderstorm
Thu Dec 25, 2014	27°	18°	18 mm	Cloudy, a couple of t-storms
Fri Dec 26, 2014	27°	18°	9 mm	Cloudy, a couple of t-storms
Sat Dec 27, 2014	26°	18°	23 mm	Cloudy, a couple of t-storms
Sun Dec 28, 2014	21°	18°	12 mm	Cloudy, a couple of t-storms

UNNOTICED

This billboard for Mapepe Cemetery is located in Chilanga. Perhaps due to its proximity to Lafarge, the CEMENT factory, Mapepe Cemetery is here referred to as 'Mapepe CEMENTRY'



THE WEEK AHEAD

- Detailed analysis of prices and inflation after the end-year inflation release from the Central Statistical Office
- 2014 Economic Review and outlook for 2015