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Press Release:
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June 4, 2008

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Zambia: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

May 7, 2008

The following item is a Letter of Intent of the government of Zambia, which describes the policies that Zambia intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Zambia, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.

7th May, 2008

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, D.C.

Dear Mr. Strauss-Kahn,

The Government of the Republic of Zambia successfully completed a three year economic program with support from the International Monetary Fund under the Poverty Reduction and Growth Facility (PRGF) arrangement in September 2007. The attached Memorandum of Economic and Financial Policies (MEFP) and Technical Memorandum of Understanding (TMU) reviews recent economic progress and sets out the macroeconomic policies and structural reforms that the Government will pursue in the coming years. To support the implementation of the program, the Government requests a new three-year arrangement under the PRGF in a total amount equivalent to SDR 48.91 million (10 percent of quota). We also request that the first disbursement, in an amount equivalent to SDR 6.987 million, be made available after the approval of the PRGF arrangement by the Executive Board of the IMF.

The Government's development strategy and policies will continue to focus on achieving high rates of sustainable economic growth, founded on a stable macroeconomic environment, and reducing poverty through wealth and job creation. In this regard, the Government will continue to implement prudent fiscal and monetary policies and structural reforms to strengthen expenditure management and improve the conditions for private sector-led growth.

The Government believes that the policies set forth in the attached MEFP are adequate to achieve the objectives of its program, but it will take any further measures that may become appropriate for this purpose. The Government will consult with the IMF on the adoption of these measures and in advance of revisions to policies contained in the MEFP, in accordance with the Fund's policies on such consultation.

The Government authorizes the IMF to make the staff report for the new PRGF arrangement and this letter and attached memoranda available to the public, including placement of these documents on the IMF website, subject to the removal of market-sensitive information, following the IMF Executive Board's conclusion of the review.

Yours sincerely,

/s/
Ng'andu P. Magande, MP
MINISTER OF FINANCE AND NATIONAL PLANNING

ZAMBIA: MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

1. This memorandum reviews recent economic developments and outlines the government's policies and targets that it will pursue in 2008 and the medium-term under a new Poverty Reduction and Growth Facility (PRGF).

I. RECENT ECONOMIC DEVELOPMENTS

2. **The performance of the Zambian economy has improved markedly since the early 2000s.** This reflects strengthened macroeconomic policies and a favorable external environment. The economic expansion has been broad-based and has benefited from the revival of the mining sector in the wake of privatization and sharply higher world prices of copper. The public finances have improved significantly, especially since 2004, which, combined with a prudent monetary policy and an appreciating exchange rate, lowered inflation to single digits for the first time in three decades in 2006. Higher copper export receipts, as well as extensive debt relief through the Highly Indebted Poor Countries Initiative and Multilateral Debt Relief Initiative, have strengthened Zambia's external position, bolstering investor confidence in the economy. This contributed to a substantial real appreciation of the exchange rate and a buildup in international reserves.

3. **Poverty has been reduced but remains unacceptably high, particularly in rural areas.** The overall incidence of poverty fell from 73 percent of the population in 1998 to 64 percent in 2006, largely on account of a reduction in urban poverty to 34 percent in 2006 from 53 percent in 2004. However, in rural areas it remains at about 80 percent of the population. Progress has been made in the social sectors, such as increased gross enrolments in education, and human development, but the achievement of the Millennium Development Goals remains a challenge.

4. **The positive macroeconomic performance of recent years continued in 2007.** Real GDP grew by an estimated 6.0 percent, led by solid expansion in construction, telecommunication and public services, and annual inflation remained in the single digits at 8.9 percent. The fiscal stance was tighter than envisaged. The overall deficit (excluding grants) was 4.9 percent of GDP, or about 2.5 percentage points of GDP lower than budgeted, owing to a better-than-expected revenue performance and lower-than-planned capital expenditures. Despite the tighter fiscal stance, the rate of monetary expansion exceeded projections, particularly during the latter part of the year, because of BoZ's difficulties in sterilizing foreign exchange inflows. A reduction in the cash reserve requirement from 14 to 8 percent in October injected additional liquidity into the banking system during the last few months of the year. Export proceeds grew by 17 percent, mostly due to higher copper prices, while imports grew by more than twice as much on account of stronger imports of machinery and equipment by the mining sector. As a result, the current account deficit (excluding grants) widened sharply to an estimated 7.1 percent of GDP. Foreign direct investment in the

mining sector reached an estimated record level of about US$1 billion, about double that in 2006. Helped by strong foreign exchange inflows and tight fiscal conditions international reserves rose to 2.5 months of imports at year-end.

II. Medium Term Challenges and Policies

5. **The government's key economic objectives are to further raise growth and enhance the employment and income opportunities, especially for the poor.** The Fifth National Development Plan (FNDP) 2006–10—Zambia's Poverty Reduction Strategy Paper—sets out the policy framework for meeting these objectives. The FNDP emphasizes the need to create an environment that encourages private sector growth through macroeconomic stability, public sector efficiency and accountability, and investments in infrastructure and human resources. The main objectives of the program therefore are to (i) maintain macroeconomic stability and debt sustainability; (ii) increase fiscal space for investment in infrastructure, energy, and human resources; and (iii) diversify the economy to lessen its dependence on mining by improving the conditions for broad-based private sector-led growth.

6. **The medium-term outlook for the Zambian economy is favorable, although not without risk.** Real GDP is expected to continue to expand at 6–7 percent per year over the medium-term on the basis of continued investments in mining, a modest recovery in agriculture, and buoyant construction and telecommunication sectors. However, continued electricity shortages and a sharper-than-assumed drop in copper prices would place these projections at risk. Fiscal and monetary policies will be geared to keeping the fiscal position sustainable and lowering inflation to about 5 percent over the next two years. The public finances are projected to improve markedly in the coming years reflecting an increase in tax collections from the mining sector. The external current account deficit is projected to narrow in the medium-term, as export volume growth from additional mining capacity and a slowing of import growth, mainly linked to completion of large investment projects in the mining sector, will offset a projected decline in world market copper prices. International reserves are projected to increase to 5.5 months of imports by 2010. Annual net external support in the form of grants and concessional loans to the central government is projected to remain at around 6 percent of GDP during 2008–10. Owing to past debt relief, rising export earnings, and a conservative approach to external borrowing, Zambia's external debt is expected to remain sustainable over the long-term.

7. **The government intends to create sufficient fiscal space over the medium term to increase growth-enhancing spending, including investments in infrastructure and other FNDP projects.** While pressing for scaling up of donor inflows, the government will use other channels to expand fiscal space, including introducing a new fiscal regime for the mining sector, improving revenue administration, restraining non-priority spending, and raising the efficiency of public expenditure. For larger investment projects, particularly in the

energy sector, external borrowing on nonconcessional terms could be considered if concessional financing is not available.

8. **Fiscal revenues are projected to increase substantially over the medium term and expenditures will shift towards capital spending.** Mainly reflecting the introduction of the new fiscal regime for mining which recently came into effect, revenues are estimated to increase from 18.7 percent of GDP in 2007 to 21 percent of GDP in 2008–10. The tax estimates for the mining sector assume a decline in world copper prices in the medium-term, in line with the World Economic Outlook projections in February 2008. Reflecting the government's emphasis on investment in infrastructure, the composition of expenditure will gradually shift toward capital spending, which is projected to increase to 6¾ percent of GDP in 2010. Increased resources will also be made available to hire additional teachers and health workers in the coming years. The current stock of domestic arrears, including on pensions, will be paid in 2008 and 2009. In summary, the primary deficit of the central government (excluding mining revenues and grants) is projected at 7–8 percent of GDP in 2008–10 and net savings from accumulated mining taxes are projected at 5 percent of GDP at end-2010.

9. **The structural program complements the medium-term macroeconomic framework.** The government's structural reform agenda is articulated in a number of multiyear government programs, including the Public Expenditure Management and Financial Accountability (PEMFA) program, the Public Sector Management (PSM) program, the Financial Sector Development Plan (FSDP), and the Private Sector Development Initiative (PSDI), as well as the FNDP. The program will focus on (i) improving expenditure management and budget execution; (ii) making revenue collection more efficient and effective; (iii) strengthening monetary operations and deepening the financial sector; (iv) implementing a debt management strategy; and (v) strengthening policies in the energy sector to ensure an adequate and reliable supply of electricity in the future. The reforms in the first year are laid out in Table 2.

10. **The structural program for 2009-10 will build on the first year's reform efforts and continue to focus on measures to support high sustainable economic growth**. On public expenditure management, the implementation of a treasury single account in 2009, the continued roll-out of IFMIS, and reforms to public procurement should strengthen budget execution. Efforts will also be made to improve budget planning by increasing the government's capacity to evaluate projects and adopting lessons learned from the public expenditure tracking surveys planned for the social sectors. On financial sector reform, the agenda will focus on strengthening financial sector regulation and supervision and measures to facilitate financial sector deepening. The regulatory agencies for pension and insurance sectors will be strengthened and there is need to further harmonize financial sector legislation and improve contract enforcement and auditing and accounting practices. Reforms are also planned to increase access to financial services of the rural sector, poor households and small enterprises. Further measures may be adopted on the basis of Zambia's FSAP update

scheduled to be completed in early 2009. On electricity, the government intends to continue implementation of the strategy to address the power shortages, including raising tariffs to fully cover the cost of service, encouraging private sector participation, and reforming ZESCO to ensure a sufficient and cost effective delivery of electricity.

III. Policies for 2008

A. Fiscal policies

11. **The primary fiscal deficit, excluding grants and mining revenue, is projected to increase to 8.3 percent of GDP in 2008.** Revenues are projected to increase by 2.5 percentage points to 21.2 percent of GDP, reflecting changes to the fiscal regime for mining. Excluding mining, revenue in 2008 should rise somewhat, as losses from the reduced VAT rate and changes to the personal income tax thresholds would be offset by gains from the new export levy on copper concentrate and greater nontax revenues. Grants are expected to increase from 4.6 percent of GDP in 2007 to 5.3 percent of GDP. Expenditures are budgeted to rise from 24.6 percent of GDP in 2007 to 27.4 percent of GDP, reflecting continued hiring in education and health, clearance of domestic arrears, higher capital spending, and short-term allocations to the constitutional review process. The overall financing need would be 1.1 percent of GDP, but net domestic financing would be negative, at 0.1 percent of GDP.

12. **A new fiscal regime for the mining sector came into effect on April 1, 2008.** The new regime will ensure that the government receives a greater share of mining profits and rents, through the introduction of a windfall tax and a variable profit tax, as well as an increase in the mineral royalty. In implementing the new fiscal regime, the government will be mindful of the need to preserve Zambia's attractiveness for investment in mining. To this end, the windfall tax and the variable profit tax will not apply at the same time. When the windfall tax applies the profit tax rate will be the standard 30 percent. With international copper prices projected to decline by about 12 percent in 2008, mining revenue is estimated at 2.8 percent of GDP in 2008, about 1.4 percent of GDP higher than estimated under the old fiscal regime. In 2008, all mining revenue in excess of what would have been collected under the old regime K 722 billion will be saved in a separate government Mining Resource Account (MRA) account at the Bank of Zambia (BoZ). The MRA will be used as a stabilization fund to smoothen expenditures over time taking into account macroeconomic conditions and absorptive capacity. In 2009 and subsequent years, the net inflow to the MRA will be based on the medium-term expenditure framework (MTEF). The funds would be used to finance high priority projects identified in the FNDP. All revenues, including those channeled through the MRA, and expenditures will be fully integrated in the budget and fiscal accounts.

13. **Enhancing transparency in the mining sector is important to ensure that available public resources from the sector are realized and used effectively.** To this end, the government is working towards formally adopting the Extractive Industries Transparency Initiative (EITI) in a participatory process, in line with EITI guidelines.

14. **The ZRA has embarked on a modernization project to strengthen the effectiveness of tax administration.** This will involve the adoption of an integrated and taxpayer-segmented organizational structure. Although many preparatory activities have been completed, including the appointment of senior staff in the newly created management structure, the major elements of the project remain to be implemented. These involve, among others, the establishment of a headquarters functional structure by September 2008 (structural benchmark) and a large taxpayer office by December 2008 (structural benchmark). The headquarters structure should be focused on planning and monitoring activities, strengthening systems and methodologies, setting operational policy, and not perform any operational functions. Within the large taxpayer office, a specialized team will be created to effectively audit mining companies and administer the new fiscal regime.

15. **The government is aware of the financial difficulties of the insolvent Public Service Pension Fund (PSPF).** The PSPF is a defined-benefit scheme that was closed to new entrants in 2000. The actuarial deficit is estimated at about 10 percent of GDP. With a rising number of pensioners, the annual cash-flow deficit is projected to increase in the medium-term before falling as the scheme winds down (the deficit is estimated at ½ percent of GDP over the next few years). The long-term sustainability of the PSPF depends on the constitutional amendments that are required to redesign the defined benefit scheme. In the meantime, the budget will allocate sufficient resources to the PSPF to ensure that pension obligations are met in full.

B. Public Expenditure Management

16. **Stepped up implementation of public expenditure management reforms is critical for increasing the effectiveness and productivity of the public sector.** To this end, a proposal on the establishment of a treasury single account (TSA) system will be submitted to Cabinet by end-June 2008 (structural performance criterion) with the intention of making the TSA effective in 2009. In preparing for the TSA, the government has started to use real-time-gross-settlement in place of checks for large transactions and will continue to consolidate government accounts in commercial banks into a limited number of accounts at the BoZ, and roll-out the Integrated Financial Management and Information System (IFMIS). To harmonize treasury functions, the MoFNP will submit to Cabinet by end-June 2008 a proposal to establish a Treasury Department within the MoFNP (structural benchmark).

17. **A number of other PEMFA and PSM reforms are underway.** The first pilot sites for IFMIS are expected to be fully functional by mid-2008. To improve the quality and timeliness of reports prior to the full roll-out of IFMIS, which will take at least another two

years, enhancements to the existing Financial Management System (FMS) will be completed by end-April 2008. The enhancements include moving to a more stable database to enable budget execution reports to once again be published within 60 days of the end of each quarter. In other PEMFA components, improvements to the procurement framework to facilitate accelerated execution of capital projects will be sought by submitting to Cabinet proposed amendments to the Procurement Act by end-September 2008. Efforts to strengthen procurement planning through increased training will also be made. In regards to PSM reform, government is in the process of developing a pay policy for the public service. A draft policy is expected to be submitted to Cabinet for approval by the end of the year.

C. Monetary and Exchange Rate Policies

18. **Monetary policy will aim to reduce annual inflation to 7 percent in 2008 and 5 percent in 2009.** While volatile food prices and uncertainties about the pass-through effects of higher oil prices pose risks to the inflation outlook, monetary policy will be sufficiently firm to keep inflation on a downward trend. Reserve money is targeted to grow by 11½ percent in 2008. This will accommodate a robust expansion in credit to the private sector of about 20 percent and a buildup of international reserves to 3.2 months of imports by end-2008. Government spending financed from significant foreign exchange inflows will require that the BoZ undertake appropriate measures to contain excess liquidity. To achieve this without undue exchange rate volatility, the BoZ will adopt a program of regular foreign exchange sales for the remainder of 2008.

19. **The government is very aware that fiscal and monetary policies need to be better coordinated**. Uneven and unpredictable budget execution often cause difficulties for liquidity management. The MoFNP and the BoZ intend to establish a formal mechanism for coordination with key line ministries on liquidity management by June 2008 (structural benchmark). This would involve setting up meeting and data submission procedures, including for key line ministries' expenditure plans to the MoFNP and the BoZ.

20. **The government remains committed to a flexible exchange rate regime.** The BoZ will confine interventions in the foreign exchange market to smoothening fluctuations in the exchange rate while allowing a gradual build-up of international reserves. In this regard, the BoZ will seek to continue to improve the operation of the foreign exchange market and encourage the development of hedging instruments, in particular forward market transactions.

D. Financial Sector Development.

21. **Financial sector reforms will build on progress made under the first phase of the FSDP.** The credit reference bureau launched in 2007 has made progress in building the necessary database for its operation, and is expected to begin playing its role in providing credit information to facilitate lending by financial institutions in the period ahead. To

support the development of the financial market in Zambia, the government will seek a sovereign rating over the coming months. This would enhance the country's attractiveness as an investment destination as well as provide a benchmark to promote the development of the domestic capital market. Further, to encourage the emergence of a stable interbank money market and a benchmark short-term interest rate, the BoZ will strengthen liquidity management by restructuring its rediscount window operations by reducing the penal element in the pricing of securities and increasing the range of securities eligible for rediscounting to encourage its use by banks (June 2008 structural benchmark). To further stimulate the growth of the secondary market, the government will set up a supervisory regime for the secondary market in government securities by September 2008 (structural benchmark). This will entail the issuance of harmonized regulations to govern trading.

22. **While the banking sector remains sound, more needs to be done to strengthen supervision and ensure stability.** The BoZ is developing a framework for risk-based supervision to be implemented by December 2008 (structural benchmark). The government is committed to undertake legislative changes to strengthen the independence of BoZ.

E. Energy Sector

23. **The government is conscious of the gravity of the current shortage of electric power and the risk it poses to sustained growth.** Development of the electricity sector is vital to achieving sustained high growth and reducing poverty. In particular, greater electricity generation will be needed to support the envisaged expansion of mining, private sector growth, and the planned rural electrification program. There is a need to strengthen policies to ensure that sufficient electricity generation capacity is installed as quickly as possible to meet a rapidly growing demand. To this end, the government will develop policies with specific strategies to (i) gradually adjust electricity tariffs to reflect the cost of service; (ii) attract private investments and competition in the sector; (iii) increase the operational efficiency of ZESCO and strengthen its governance; and (iv) ensure that ZESCO has sufficient resources to implement the planned rehabilitation and new generation projects. Given the urgency, the government intends to complete this action plan no later than June 2008 (structural performance criterion). Further, as a first step to improve the financial footing of ZESCO, the government will ensure that all arrears to ZESCO from ministries, provinces, and spending agencies (MPSAs) are paid by end-December 2008. Moreover, the MoFNP will issue a circular instructing all ministries, provinces, and spending agencies (MPSAs) that (i) all utility bills for each quarter are to be paid from the quarterly budget funding and (ii) all funds released for payment of utility bills should not be reallocated by MPSAs.

24. **Implementation of the new projects to expand electricity generation will likely require borrowing on nonconcessional terms.** To this end, ZESCO is currently looking for financing to carry out three investment projects (the Kariba North Power Station Extension, the Itezhy-Tezhy Power Station, and completion of the rehabilitation project) in the amount

of $450 million. Given the importance of raising electricity supply to achieve the medium-term growth objectives, as well as limited availability of grants or concessional financing, the Government and/or ZESCO may likely need to contract new nonconcessional external borrowing for these three projects in 2008.

F. Trade, Debt, and Aid

25. **The government will continue to pursue an open trade regime.** Zambia has fully implemented the tariff phase down commitment under the Southern African Development Community (SADC) Protocol. About 85 percent of intra- merchandise trade has been liberalized, as tariffs were further reduced in January 2008. The tariff phase down is scheduled to continue during 2008–12, when Zambia is expected to eliminate its tariff on sensitive products (imports that compete with industrial and agricultural domestic products). The government is actively participating in the harmonization of trade related agendas under SADC and COMESA.

26. **The government is committed to improving public debt management.** To maintain debt sustainability, the MoFNP is finalizing Zambia's debt management strategy, which will be submitted to Cabinet by end-September 2008 (structural benchmark). The strategy will provide a clear framework for borrowing, establishing the principles that should guide the debt manager's decision regarding the currency composition, maturity, interest rates, and other risks of the debt portfolio. In addition, the government will continue to work on (i) enhancing and unifying the legal framework of public sector debt contracting and guaranteeing, (ii) strengthening the institutional capacity of IDM so that debt operations are assessed and audited, and (iii) monitoring total public sector debt, including debt to be contracted by public enterprises.

27. **The government will continue to strengthen the management of aid.** In line with the recently launched Aid Policy and Strategy, the government will develop an action plan for aid management. A database on disbursements from traditional donors and creditors has already been established and disbursements from emerging creditors, which are mainly allocated to finance projects, will be captured in the near future.

G. Economic Statistics

28. **The government is strengthening Zambia's capacity to collect and disseminate economic data.** The Central Statistics Office (CSO) is undertaking an economic census and key results are expected to be presented in the latter part of 2008. The census will provide important information about the structure of the Zambian economy and, among other things, will be used to rebase the national accounts. The CSO is testing a new, rebased CPI, which will be published starting in June 2008. Further, balance of payments statistics will be strengthened, drawing on IMF technical assistance.

IV. Program Monitoring

29. **Semi-annual disbursements under the PRGF program arrangement will be based on the observance of quantitative and structural performance criteria.** Completion of the first and second review of the arrangement will be based on the observance of quantitative and structural performance criteria through end-June 2008 and end-December 2008, respectively (Tables 1 and 2).

Table 1. Zambia: Quantitative Performance Criteria (PC) and Indicative Targets[1]
(Billions of kwacha, unless otherwise indicated)

	2007	2008		
	Dec Level	Jun Prog.	Sep Indicative	Dec Prog.
Performance criteria:				
Ceiling on the cumulative increase in net domestic assets (NDA) of the Bank of Zambia[2, 3]	-1243	-208	-512	-776
Ceiling on the cumulative increase in net domestic financing (NDF)[2]	4,638	567	534	-64
Floor on the cumulative increase in gross international reserves (GIR) of the Bank of Zambia (Millions of U.S. dollars)[2]	947	154	267	382
Ceiling on new external payment arrears[4]		0	0	0
Ceiling on contracting or guaranteeing short-term external debt by the central government, BOZ, ZESCO, ZAMTEL and Zambia Railways Limited[4]		0	0	0
Ceiling on contracting or guaranteeing medium- and long-term nonconcessional external debt by the central government, BOZ, ZESCO, ZAMTEL and Zambia Railways Limited (millions of U.S. dollars)[5]				
Electricity sector projects[6]		450	450	450
Other sectors		0	0	0
Indicative targets:				
Floor on the cumulative payment of domestic arrears of the government		297	527	669
Cumulative increase in reserve money	2500	22	155	289
Memorandum items:				
Cumulative net budget support (millions of U.S. dollars)	73.7	100.7	154.5	141.2
General budget support	135.7	115.2	200.0	200.0
Central Government debt service obligations (excluding IMF)	-62.0	-14.5	-45.5	-58.8
Cumulative revenue from mining		351	1055	1640

[1]The definitions of the items in the quantitative program are contained in the Technical Memorandum of Understanding (TMU).
[2]Adjustors, including for general budget support, are defined in the TMU.
[3]The ceiling will be adjusted for changes in the legal reserve requirements as specified in the TMU.
[4]Continuous performance criteria.
[5]Nonconcessional loans are those having a grant element of less than 35 percent.
[6]The projects are Kariba North Extension, Itezhy-tezhy, and the rehabilitation of Kafue Gorge and Kariba power stations.

Table 2. Zambia: Structural Program for 2008

Measure	Timing
Performance Criteria	
Submit to Cabinet a proposal to establish a treasury single account.	End-June 2008
Submit to Cabinet a policy for the electricity sector with specific strategies to (i) gradually adjust electricity tariffs to the cost of service; (ii) attract private investment and competition in the sector; (iii) increase the operational efficiency of ZESCO; and (iv) ensure that ZESCO has sufficient resources to implement the planned rehabilitation and new generation projects.	End-June 2008
Benchmarks	
Submit to Cabinet a proposal to establish a Treasury Department.	End-June 2008
Establish a headquarters functional structure at the Zambia Revenue Authority.	End-September 2008
Establish a single large-taxpayer office at the Zambia Revenue Authority.	End-December 2008
The Ministry of Finance and National Planning and the Bank of Zambia will establish a formal mechanism for coordination with key line ministries on liquidity management.	End-June 2008
The Bank of Zambia will restructure the operations of its rediscount window.	End-June 2008
Set up a supervisory regime for the secondary market in government securities.	End-December 2008
Introduce risk based bank supervision.	End-December 2008
Submit to Cabinet a debt management strategy.	End-September 2008

ZAMBIA: TECHNICAL MEMORANDUM OF UNDERSTANDING FOR THE 2008–10 POVERTY REDUCTION AND GROWTH FACILITY (PRGF) ARRANGEMENT

I. INTRODUCTION

1. This memorandum sets out the understandings between the Zambian authorities and the International Monetary Fund (IMF) regarding the definitions of the quantitative performance criteria and indicative targets for the program supported by the PRGF arrangement, as well as the program adjusters and the related reporting requirements.

II. QUANTITATIVE PERFORMANCE CRITERIA AND INDICATIVE TARGETS: DEFINITIONS AND DATA SOURCES

A. Net Domestic Assets (NDA) of the Bank of Zambia (BoZ)

2. Net domestic assets (NDA) of the BoZ are defined as the monthly average (based on daily data) of reserve money (as defined below) less net foreign assets of the BoZ calculated at kwacha 3,844.8 per U.S. dollar for 2008.[1] Net foreign assets of the BoZ are defined as gross international reserves (defined in paragraph 8) plus any other foreign assets, including the US$25 million blocked reserves at the former Meridien Bank (MBZ), minus foreign reserve liabilities (defined below). The kwacha values of net foreign assets are derived from the U.S. dollar values using the program exchange rate.

3. Foreign reserve liabilities are defined as short term (one year or less in original maturity) foreign currency-denominated liabilities of the BoZ to nonresidents and outstanding use of IMF credit.

B. Reserve Money

4. Reserve money (monthly average based on daily data) consists of currency issued, required reserves on kwacha deposits, required reserves on foreign currency deposits (at the program exchange rate), positive current account balances of banks with the BoZ, and deposits in the BoZ of non-central government institutions.

5. Data on reserve money, including its components, will be reported by the BoZ on weekly and end-month basis.

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[1] Unless otherwise defined, program exchange rates for 2008 between the U.S. dollar and other (non-kwacha) currencies will be equal to the end-December 2007 values. The U.S. dollar/SDR rate for program purposes is 1.576 for 2008. All other assets (e.g., gold) would be revalued at their end-December 2007 market prices for 2008.

C. Net Domestic Financing (NDF)

6. Net domestic financing (NDF) is defined as the Central Government's net borrowing from the banking and non-banking sectors (See Table 1).[2] All government-issued securities will be recorded at cost (face value less discount). NDF will be defined as:

(a) the net position of the central Government with commercial banks, including: (i) Treasury bills; (ii) government bonds; (iii) loans and advances; less (iv) support to MBZ; and (v) central government deposits (defined to include account balances under the authority of controlling officers); plus

(b) BoZ holdings of: (i) Treasury bills; (ii) government bonds; (iii) kwacha bridge loan (overdraft facility); less (iv) the government's deposits at the BoZ; and (v) the donor suspense account; plus (vi) the outstanding amount of the long-term non-transferable security issued against the government's indebtedness to BoZ as at end-2002; plus

(c) Nonbank holdings of: Treasury bills; and government bonds.

7. The data source for NDF will be the "Net Domestic Financing" Table produced by the Economics Department of the BoZ. The Table will be submitted on a weekly basis, and will be reconciled with the monthly monetary survey.

D. Gross International Reserves of the BOZ

8. Unless otherwise noted here, gross international reserves of the BoZ will be defined as reserve assets of the BoZ (see Table 2). Reserve assets are defined in the IMF BOP manual (5^{th} edition) and elaborated in the reserve template of the IMF's special data dissemination standards (SDDS). They exclude, for example, foreign assets not readily available to or controlled by the monetary authorities, and foreign currency claims on Zambian residents.

9. Gross international reserves consist of: (i) monetary gold; (ii) foreign currency in cash; (iii) unencumbered foreign-currency deposits at non-resident banks; (iv) foreign securities and deposits; and (v) SDR holdings and Zambia's reserve position with the IMF. Gross reserves exclude non-convertible currencies, any encumbered reserve assets including but not limited to reserve assets pledged, swapped or used as collateral or guarantee for third-party external liabilities, commercial bank reserve requirements on foreign currency deposits, and the US$25 million deposit in MBZ (in liquidation).

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[2] The Central Government includes all the administrations identified by the budget heads listed in the Yellow Book for 2008.

10. For the purpose of this target, as well as those for external debt and arrears, valuation will be in U.S. dollars at actual end-period exchange rates.

11. Data on gross international reserves, including its components, will be reported by the BoZ on a weekly and end-month basis.

E. External Payment Arrears

12. The performance criterion on the non-accumulation of new external payment arrears is continuous. Official external payment arrears are defined as unpaid debt service by the central Government and BoZ 30 days beyond the due date and/or the grace period. This definition excludes arrears on debt subject to rescheduling.

13. Data on arrears are compiled jointly by the Ministry of Finance and National Planning (MoFNP) and BoZ and will be reported by the MoFNP on a quarterly basis.

F. Official External Debt

14. Official medium- and long-term concessional external debt is defined as all forms of official debt with original maturity of more than one year contracted or guaranteed by the central Government, BoZ, ZESCO, ZAMTEL and Zambia Railways Limited having a grant element of no less than 35 percent. The grant element is to be calculated by using currency-specific commercial interest reference rates (CIRRs) reported by the DAC of the OECD. For maturities of less than 15 years, the grant element will be calculated based on six-month averages of CIRRs, and for maturities longer than 15 years, the grant element will be calculated based on 10-year averages. Lending from the IMF will be excluded.

15. This minimum grant element applies not only to debt as defined in Point 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85) of August 24, 2000; see Annex), but also to commitments contracted or guaranteed for which value has not been received.

16. Official external non-concessional debt is defined as the contracting or guaranteeing of external debt other than concessional debt as defined in paragraph 14, owed or guaranteed by the central Government, BoZ, ZESCO, ZAMTEL and Zambia Railways Limited.

17. The ceiling on contracting or guaranteeing of medium and long-term non-concessional external debt by the central government, BoZ, ZESCO, ZAMTEL and Zambia Railways Limited excludes: (i) non-concessional loans stemming from the rescheduling of external debt; and (ii) central government securities issued in domestic currency, placed in the domestic primary or secondary markets, and held by non-residents.

18. Official external short-term debt is defined as the contracting or guaranteeing external debt with original maturity of less than one year, and includes forward commodity sales but will exclude normal trade credit for imports.

19. The term "debt" has the meaning set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85) of August 24, 2000; see Annex).

20. Detailed data on all new external debt (concessional and non-concessional) contracted or guaranteed by the central government, BoZ, ZESCO, ZAMTEL and Zambia Railways Limited will be provided by the MoFNP on a monthly basis. Information will include (i) amounts contracted or guaranteed; (ii) currencies; and (iii) terms and conditions, including interest rate, maturity, grace period, payments per year, commissions and fees, and collaterals.

G. Domestic Arrears of Central Government

21. Domestic arrears are defined as: (i) any bill that has been received by a spending ministry from a supplier for goods and services delivered (and verified) and for which payment has not been made within 30 days after the due date of payments; (ii) wage, salary, and any other payment to government employees, including pension contributions and all forms of housing allowances, that were due to be paid in a given month but remained unpaid on the 15th of the following month; and (iii) interest or principal obligations which remain unpaid 30 days after the due date of payment.

22. Information regarding domestic arrears is to be compiled through audits of the accounts of spending Ministries and agencies, conducted by the Internal Audit division of the MoFNP**.** The audits will be completed and data submitted to IMF staff by the Secretary of the Treasury within six weeks of the end of each quarter.

III. Adjusters

23. The quantitative performance criteria specified under the program are subject to the following adjusters:

General budget support (GBS) net of debt service[3]

(i) The ceilings on NDA and NDF will be adjusted downward (upward) by the full amount of the excess (shortfall) in GBS net of debt service relative to the programmed levels specified in Table 1 of the MEFP.[4, 5]

(ii) The floors on GIR will be adjusted upward (downward) by the full amount of the excess (shortfall) in GBS net of debt service relative to the programmed levels (Table 1 of the MEFP).

(iii) The total adjustment for shortfalls will be limited to US$30 million for January-June and US$35 million for January-December 2008.

Change in reserve requirements

(iv) The ceiling on NDA will be adjusted downward/upward to reflect decreases/increases in the legal reserve requirements on deposits in commercial banks. The adjuster will be calculated as the percent change in the reserve requirement multiplied by the actual amount of required reserves (kwacha and foreign-currency denominated) at the end of the previous calendar month.

Revenue from mining

(v) The ceilings on NDA and NDF will be adjusted downward (upward) by the full amount of the excess (shortfall) in revenues from the mining sector relative to the programmed levels (Table 1 of the MEFP).

(vi) The floors on GIR will be adjusted upward (downward) by the full amount of the excess (shortfall) in revenues from the mining sector relative to the programmed levels (Table 1 of the MEFP).

(vii) The total adjustment for shortfalls will be limited to K75 billion (US$19 million) for January-June and K917 billion (US$231.7 million) for January-December 2008.

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[3] General budget support consists of grants and loans received by the central Government for financing its overall policy and budget priorities following Zambian budget procedures.

[4] For the purpose of adjusting the NDA ceiling, external disbursements will be treated as if they were received the first day of the month. The targeted NDA will be increased by the amount of the disbursement divided by the number of business days in the month multiplied by the number of business days from the beginning of the month to the day prior to the disbursement.

[5] For purpose of adjusting the NDF ceiling, the cumulative excess/shortfall will be converted to kwacha value using the program exchange rate.

IMF disbursement

(viii) The floors on GIR will be adjusted upward (downward) for any excess (shortfall) in the disbursements from the IMF (US dollar value) relative to the programmed levels.

BoZ short-term debt

(ix) The floor on GIR will be adjusted upward for any increase in BoZ short-term debt denominated in foreign currency, (see definition of short-term debt above).

ANNEX

Guidelines on Performance Criteria with Respect to Foreign Debt

Excerpt from Executive Board Decision No. 6230-(79/140), as revised on August 24, 2000

(a) For the purpose of this guideline, the term "debt" will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows:

(i) loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);

(ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and

(iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property.

(b) Under the definition of debt set out in point 9 (a) above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

Table 1. Zambia: Net Domestic Financing

	2007	2008
	End-Dec.	End-Dec. Program Base
Total domestic financing (program)		
Adjustment		
Adjusted program financing		
Excess/shortfall (- = excess)		
Total domestic financing	4,638	
Bank financing	2,002	
Commercial banks	2,087	
Treasury bills[1]	1,394	
Bonds[1]	1,070	
Loans and advances	118	
less: Support to MBZ	-8	
less: Deposits	-486	
Bank of Zambia	-85	
Treasury bills[1]	557	
Bonds[1]	189	
Kwacha bridging loan	0	
GRZ position	-1,951	
Donor suspense balance	-0.3	
GRZ long-term security IFO BoZ	1,121	
Other	0.0	
Nonbank financing	2,636	
Treasury bills[1]	1,111	
Bonds[1]	1,525	

Source: BoZ net domestic financing table.

[1]Measured at cost (face value less discount) starting from end-December 2003.

Table 2. Zambia: Gross International Reserves[1]
(In millions of U.S. dollars)

	2007 December			2008 June, December				
	12/31/2007= Base				Current		31/12/08	
	Amount	Exch rate or price	U.S. dollars	Amount	Exch rate or price	U.S. dollars	Exch rate or price	U.S. dollars
Official reserve assets[2]								
Foreign Currency Reserves								
Securities								
In U.S. dollars								
In U.K. pounds								
In Euro								
Other currencies								
Deposits[3]								
In U.S. dollars								
In U.K. pounds								
In Euro								
In South African Rand								
Other currencies								
IMF reserve position								
SDR (excludes IMF interim assistance under the HIPC Initiative)								
Monetary gold								
Other reserve assets								
Memo: Other foreign currency assets[4]								
Predetermined short-term net drains[5]								
Liabilities to IMF								
Other foreign currency loans and securities								
In U.S. dollars								
In U.K. pounds								
In other currencies								
Aggregate short and long positions in forwards, futures and swaps								
Other								
Contingent short-term net drains								
Contingent liabilities								
Securities with embedded options								
Undrawn, unconditional credit lines								
Aggregate short & long term positions of options								
Memorandum items:								
Short-term domestic currency debt indexed to the exchange rate								
Financial instruments denominated in foreign currency settled by other means								
Pledged assets								
of which: Balance of IMF interim HIPC assistance								
Securities lent and on repo								
Financial derivatives (net, marked to market)								
Derivatives w/ residual maturity > 1 year, subject to margin calls								

[1]As defined in the TMU or IMF, "Data Template on Int'l Reserves and Foreign Currency Liquidity: Operational Guidelines."
[2]Corresponds to gross international reserves for program monitoring.
[3]Excludes deposits at resident banks, unless assets held abroad by the bank are explicitly connected to the foreign exchange deposits of the BoZ and are totally and effectively controlled by BoZ and are available for balance of payment needs.
[4]Includes foreign currency deposits at resident banks.
[5]The program target for gross international reserves will be adjusted as described in the TMU.