OPERATING ENVIRONMENT – FEBRUARY 2021 FLASH REPORT

Dear Esteemed Client,

In our bid to keep you well informed regarding key factors that affect your investments, please find below some brief highlights for the month of February:

OPERATING HIGHLIGHTS

- During the month, the **kwacha** remained on the back foot closing at ZMW 21.75. The shortage of US dollars coupled with deteriorating fiscal dynamics resulted in the local unit depreciating by 1.68% in February. On a Year to Date (YTD) basis the currency had a movement of -2.82%.
  - **Market liquidity** decreased to an average of ZMW 1.49 billion from ZMW 1.98 billion while the average **interbank rate** increased to 8.46% from 8.33%.

- Annual **inflation** accelerated for the sixth consecutive month to 22.2% from 21.5% in January. As seen in the previous month, consumer prices were driven upward as a result of price movements in food items such as meats, oils and vegetables. Food inflation quickened to 27.3% from 25.6% while non-food inflation decreased for the third successive month to 16.2% from 16.7%.

- **Copper prices** on the London Metal Exchange (LME) opened at USD7,877/tonne and closed at USD9,172.50/tonne translating to a monthly appreciation of 16.45% and YTD movement of 18.48%. During the month, the price of the red metal hit 10-year highs as a result of low inventories, a bright outlook on demand and optimism about global economic recovery.

- February recorded a total of five price movements on CEC (12.61%), REIZ (10.26%), Zambeef (0.91%), Zanaco (19.15%) and StanChart (-0.73%). The **LuSE All Share Index** closed the month at 3,983.90 points, representing a monthly gain of 2.03% and YTD position of 1.83% The **LuSE Free Float Index** closed the month at 2,283.97 points, representing a monthly gain of 2.56% and YTD position of 2.55%. Speaking to the trading activity, the total number of trades registered on the LuSE was 449 up from 188 while the total turnover was ZMW 14,551,309 from ZMW 4,173,795 in the previous month.

- **Global equities** as measured by the MSCI World Index had a USD monthly gain of 2.45% (YTD 1.37%). In kwacha terms the index gained 4.18% (YTD 4.23%). The drop in infections and rapid vaccination rollouts from major economies such as the US and UK, continued to drive global markets higher in February.

- The **T-bill auctions** were held on the 11th and 25th of February:

Period (Days)	Amount Offered	Amount Bid	Amount Allocated	Yield Rate (%)	Prev Yield (%)	Change (%)
91	100.00	413.09	413.09	14.03	14.03	-
182	220.00	132.50	132.39	16.03	16.03	-
273	330.00	313.30	313.30	20.00	20.00	-
364	650.00	1,433.76	1,433.76	25.75	25.75	-
Total	**1,300.00**	**2,292.65**	**2,292.54**			

The first auction saw subscription and allocation rates of 151.16% while the second auction had a subscription rate of 176.36% and allocation rate of 176.35%, relative to the amount offered. At cost the first auction sold 121.01% while the second sold 148.85%. Overall, as seen in the previous auctions, majority of investor interest was on the 364-day T-bill. Furthermore, while both auctions saw a significant increase in participation, there were no yield movements recorded during the month. **March auctions**: 11th and 25th

- The **Government bond auction** held on 19th February had the following results:

Period (Years)	Amount Offered	Amount Bid	Amount Allocated	Range of Accepted Bids	Range of Rejected Bids	Yield Rate (%)	Prev Yield (%)	Change (%)
2	185.00	528.97	528.97	31.00%-32.00%	None	32.00	32.00	-
3	320.00	72.24	72.24	32.00% - 32.70%	None	32.70	32.70	-
5	410.00	80.86	80.86	30.00% - 34.50%	None	34.50	34.50	-
7	135.00	0.519	0.52	30.10% - 30.10%	None	30.10	30.10	-
10	360.00	961.460	11.46	34.50% - 34.50%	37.00% - 38.00%	34.50	34.50	-
15	90.00	19.97	19.97	33.70-34.00%	None	34.00	33.70	0.30
Total	**1,500.00**	**1,664.02**	**714.02**					

The auction had a subscription rate of 110.93% and allocation rate of 47.60%, relative to the amount offered. Yield movements were recorded on the 15-year tenor which went up by 0.3 percentage points. Bids ranging between 37.00% and 38.00% were rejected on the 10-year bonds. At cost, the auction sold 30.22%. **Next auction:** 19th March 2021

LOOKING AHEAD

- While there are expectations for an imminent exit from the pandemic thanks to the rapid vaccination rollouts, virus mutations such as the Brazilian and South African variant could still potentially slow down the return to normalcy. Government and central bank support appears to have carried economies through the worst of the Covid-19 crisis, having issued trillions of dollars of debt to provide support to affected businesses and households. However, this comes at a price. The Institute for International Finance estimates that in 2020 global government debt increased by US$ 8.4 trillion and non-financial corporate debt increased by US$ 6.0 trillion. Borrowing on such a large scale might have been expected to put upward pressure on interest rates however, due to the extraordinary interventions of the central banks, it will most likely result in an extended period of low interest rates and continued asset purchases by central banks. Moreover, with central banks maintaining a loose monetary policy stance, inflation risks may possibly materialize in mid-2021.
- Locally, Zambia became the second country in the world, following Mozambique, to tighten its monetary policy by raising the benchmark interest rate to 8.5% from 8%. The decision was a delicate act of balancing between fighting the escalating inflation and supporting economic growth. With inflation projected to remain above the central bank's 6-8% target for the next two years, the decision shows the central banks determination to tackle inflation and support the local currency.
- From a macroeconomic standpoint, the February Purchasing Managers Index (PMI) came in at 47.1 from 47.7 signalling a contraction in the Zambian private sector for 2 consecutive years. The private sector showed some signs of improvement in Q4 2020 having recorded gains for two successive months as a result of the opening of businesses in September, increased liquidity and lower interest rates. In Q1 2021, despite the slightly improved economic conditions, companies continue to face operational challenges. The cost of production remains high on the back of the depreciating kwacha. The gains recorded in the previous quarter are likely to reverse following the contractionary monetary policy stance taken by the central bank as well as Covid-19 related challenges. Moreover, as interest rates are expected to trend upward and money market liquidity is likely to tighten, the outlook for local business activity remains bleak.

We shall endeavor to keep you abreast of key events as and when they occur, to ensure you are able to make more informed decisions as we aim to fulfil the fund objectives

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