

## Investigating the impact of kwacha depreciation (Against the us dollar) on Zambian businesses, employment and income

Ezra Malemuna, Marvin Kabubi

Information and Communications University, School of Business, Zambia Research Development Centre (ZRDC) Lusaka, Zambia

### Abstract

The basic aim of this research is to investigate the impact of kwacha depreciation (against the US dollar) on Zambian businesses, employment, and income. The research was based on primary data, and this research was conducted on different individuals within territory of Copperbelt region, Ndola, Zambia. Data were collected through questionnaire consisting of several questions; the sample consisted of 100 employees of different respondents.

The Correlation analysis test was applied through Excel to find out the results of research. Results indicate on how the Kwacha depreciation has affected the businesses, employment, and income in a negative way. So the findings of research proved that as long as we depend on the success of other countries, the economy of Zambia shall forever be a fragile economy. The Zambian economy shall forever be unstable. Zambia's economy shall continue to depend on the success of big economies such as China as long as it does not develop its local industry. This was done to investigate the different relationships between and the impact of the variables on each other. Based on the results of this research it has been recommended that Zambia can only succeed with its own grown economy. As it is often said, you can only succeed with your own hands and not borrowed hands. Zambia has been reporting the significant economy growth, but this growth has not benefited or cannot be seen by a common man on the street. So there is need for Zambia to come up with a major policy shift that would see many local industries supported.

**Keywords:** Kwacha Depreciation, Employment, Businesses, Income

### 1. Introduction

Kwacha depreciation has been the hot subject in current economic scenario in Zambia. We are experiencing a tough time with kwacha depreciation every day. Current economic context created anxious moments to various industrial sectors in Zambia. On 13th March, 2015 the value of Zambian Kwacha stood at 7.4824 according to Barclays Bank FOREX rates. The experts in the field perceived the situation in different manners. Some considered it as highly depressed and threatening environment; some others considered it as an opportunity in disguise. There are various positive and negative impacts which are being predicted by experts in the fields. Kwacha depreciation, no doubt it will affect upper and lower sectors of the economy. This spectacular decline of kwacha value will loss Zambia's confidence in its growth prospect too. The history of Kwacha - dollar exchange rates has many periods of kwacha volatility and devaluation linked to chaotic economic conditions. The current phase of significant depreciation in kwacha vis-à-vis dollar has become the focus of discussion on various platforms. Daily we are confronted with news items relating to the „dipping kwacha“, „slumping kwacha“, „plunging kwacha“, „spiraling kwacha“ and many other phrases pulled out from the journalistic panache for dramatizing.

Currency depreciation is the loss of price of a country's currency with respect to one or more foreign currencies. The exchange value of a country's currency is linked with its economic conditions and policies. Changes in exchange rates can wreak havoc on economies, businesses and individuals. Thus any fluctuations in currency value attract interest of economists, policymakers and general public.

One kwacha of 1965 is not the same as one kwacha today, not only in terms of appearance but in terms of purchasing power as well. From 1964-1965 until somewhere 1980, Zambia had an exchange rate regime with the kwacha pegged to the pound sterling.

As per the basic laws of economics if the demand for USD in Zambia exceeds its supply then it's worth will go up and that of the ZMW will come down in that respect. It may be that importers are the major entities who are in need of the dollar for making their payments. Likelihood there could be that the Foreign Institutional Investors are re-treating their investments in the country and taking them elsewhere.

This can create a shortfall in supply of the dollar in Zambia. This state of affairs can only be addressed by exporters who can bring in dollars in the system. If by some means the FIIs can be wooed back, then this imbalance can also be addressed to a certain extent. Zambia needs serious structural & economic policies reform in order to bring the stability in exchange rate.

### 1.2 Statement of the Problem

In the early 1980's the Zambia economy faced a severe economic crisis, stemming from poor governance, overspending and other external factors like oil crisis including the slumping of Zambia's major exporter, Copper at the London Metal Exchange Market. As a result, the Zambia Kwacha suffered from very high inflation throughout the 1990's and parts of 2000's, which rose up to 108% in 1987-88 (Burnside, 2007) <sup>[9]</sup>.

During this period of hyperinflation rates, the prices of both goods and services short up making the currency lose its value

very fast so much that people had to start carrying a lot of cash to buy a small commodity. Therefore, the credibility of the kwacha was lost. The combination of the loss in the credibility and the loss of its value, the kwacha experienced an accelerated depreciation against major currencies. Despite the interference on the foreign exchange market by Bank of Zambia, the kwacha never recovered. It is at this point that some few remaining investors and other business people disposed-off the kwacha to keep their cash in a more stable currency like US dollar (BOZ, 2015) <sup>[15]</sup>.

Therefore, the researcher found it critical to carry out an independent evaluation of some of the effects of the kwacha depreciation on businesses, employment, and income. In other words, the paper will investigate how the depreciation of kwacha has impacted the economy in the following ways: Businesses, Employment, and Income. It has to be noted that the research will only concentrate on finding out as to whether the Kwacha depreciation has impacted the economy positively or negatively.

### 1.3 Significance of the study

The focus of this study is the identification and empirical analysis of the process that determines the movement and level of the Kwacha with regard to the currencies of Zambia's major trading partners. Exchange rate instability seems closely associated with capital account fluctuations and moderated by the level of foreign exchange holdings of the Bank of Zambia. This study analyses the impact of kwacha depreciation on Zambian Businesses, Employment, and Income.

Due to volatility and non-performance of the Government on the economic change measure, the Foreign Investment Institutions are in a problem whether to spend in Zambia or not. The equity market becomes unpredictable. In this situation they are seriously thinking of supplementing their investment from Zambian market. This will again decrease in supply and increase in demand of dollars results in the deteriorating of the Kwacha against the dollar.

The researcher believes that the research work might be cardinal to many researchers and policy makers who might be interested in further research in currency depreciation category. The researcher has the hope that it can contribute knowledge and also serve as a literature review for further study and complement other research work made on similar field or topic.

### 1.4 Study Site

Participants of this research paper were the employees of different organizations, Business men and women, and those whose income is paid in dollars. Target population was the employees of different organizations in Ndola, on the Copperbelt part of Zambia.

### 1.5 Literature Review

#### 1.5.1 Global Perspective

The global Forex market is by far the largest financial market with its daily trading volume of over \$5 trillion - far exceeding that of other markets including equities, bonds and commodities. Despite such enormous trading volumes, currencies stay off the front pages most of the time. However, there are times when currencies move in dramatic fashion; during such times, the reverberations of these moves can be

literally felt around the world. We list below a few such examples:

#### The Asian crisis of 1997-98

A prime example of the havoc that can be wreaked on an economy by adverse currency moves, the Asian crisis began with the devaluation of the Thai baht in July 1997. The devaluation occurred after the baht came under intense speculative attack, forcing Thailand's central bank to abandon its peg to the U.S. dollar and float the currency. This triggered a financial collapse that spread like wildfire to the neighboring economies of Indonesia, Malaysia, South Korea and Hong Kong. The currency contagion led to a severe contraction in these economies as bankruptcies soared and stock markets plunged (Owen, 2005) <sup>[11]</sup>.

#### China's undervalued Yuan

China held its Yuan steady for a decade from 1994 to 2004, enabling its export juggernaut to gather tremendous momentum from an undervalued currency. This prompted a growing chorus of complaints from the U.S. and other nations that China was artificially suppressing the value of its currency to boost exports. China has since allowed the Yuan to appreciate at a modest pace, from over 8 to the dollar in 2005 to just over 6 in 2013 (Burnside, 2007)<sup>[9]</sup>.

*Japanese yen's gyrations from 2008 to mid-2013* The Japanese yen has been one of the most volatile currencies in the five years to mid-2013. As the global credit intensified from August 2008, the yen which had been a favored currency for carry trades because of Japan's near-zero interest rate policy began appreciating sharply as panicked investors bought the currency in droves to repay yen denominated loans. As a result, the yen appreciated by more than 25% against the U.S. dollar in the five months to January 2009. In 2013, Prime Minister Abe's monetary stimulus and fiscal stimulus plans nicknamed "Abenomics" – led to a 16% plunge in the yen within the first five months of the year (Singh, 2010) <sup>[14]</sup>.

#### Euro fears (2010-12)

Concerns that the deeply indebted nations of Greece, Portugal, Spain and Italy would be eventually forced out of the European Union, causing it to disintegrate, led the euro to plunge 20% in seven months, from a level of 1.51 in December 2009 to about 1.19 in June 2010. A respite that led the currency retracing all its losses over the next year proved to be temporary, as a resurgence of EU break-up fears again led to a 19% slump in the euro from May 2011 to July 2012 (Dagar, 2008)<sup>[12]</sup>.

#### 1.5.2 Regional Perspective

The proximate cause of Zimbabwe's hyperinflation was the Government literally printing money to support its spending. Upon achieving independence in 1980, Zimbabwe (formerly Rhodesia) was a fairly prosperous and productive sub-Saharan nation. However, due to disastrously implemented economic policies, including a land redistribution program that put land confiscated from white settlers into the hands of inexperienced black farmers, as well as a general decline into lawlessness and violence, the nation suffered dramatic declines in agricultural and industrial production. With less production, incomes and taxes declined precipitously (Mbululu, 2013) <sup>[6]</sup>.

**Persistent very high inflation**

The currency (Zimbabwe dollar) was heavily depreciated and this caused severe economic problems. In 2008, the annual inflation rate was 11.2 million percentage points, practically costing more to print the money than the money is worth. For e.g.: at one point of time a loaf of bread, cost between Z\$7,000 and Z\$10,000. The effect of currency under valuation is such that they had to print money with denominations in trillions.

**Severe Unemployment**

Over 80% of the population was unemployed

**Life expectancy dropped**

Life expectancy of people dropped and it has one of the lowest life expectancy in the world and a large proportion of the people were depending upon food aid.

**Severe food crisis**

Millions of Zimbabweans had experienced a huge scarcity of food and most of them were surviving on just one meal a day and this is worsened by the droughts of mid 2000s.

**Wide spread of diseases and mortality rate**

HIV/Aids and malaria cases were common adding further problems to the economy.

**Population Displacement**

Hundreds of thousands of people were uprooted at the height of the crisis, either fleeing to neighboring countries or displaced within Zimbabwe.

**1.5.3 Zambian Perspective****The Exchange Rate in Zambia**

In countries with developed financial sectors stock-flow balances determine nominal exchange rates. The stock of foreign currencies assets and the adjustment of those stocks overwhelm trade flows in the short run (Economist, 2014) <sup>[7]</sup>. Though Zambia has a financial sector relatively developed by regional comparison and substantial short term capital flow for the size of the economy, rarely are asset transactions so large as to overwhelm the impact of trade flows.

Strong demand of US currency from importers and banks, continuous capital outflows, widening current account deficit and dollar strength against other currencies overseas amid expectation that the federal reserve will soon taper its bond buying program has put pressure on the kwacha. Whether the currency would find its stable level or will continue to slide further remains a tricky question (bloomberg, 2014) <sup>[11]</sup>.

There have also been important domestic factors impacting on the exchange rate. The supply of foreign exchange by the mining sector has fallen relative to demand, and this cannot be purely explained by the reduction in domestic production because we have seen higher mining sector exports in 2014 (Kalyalya, 2015) <sup>[5]</sup>.

**The Mystery of the Swiss**

Official foreign exchange flows report that Switzerland is the largest importer of Zambian copper (Central Statistics Office, Monthly Bulletins). Inspection of Swiss statistics neither show that the country imports nor exports copper. The answer to this apparent mystery is that Switzerland serves as the site for the buying and selling of copper contracts without any physical trade in copper ore or copper in any stage of processing. Not even the Bank of Zambia has the information to determine the full implications of this contract trading on copper prices and export revenues as reported to the government of Zambia. Cross country experience shows that the problem of

misrepresentation of production, exports and foreign exchange flows characterizes metal production in many countries, developed and underdeveloped. Though country characteristics affect the degree of misrepresentation, the problem is systemic in the global metals sector (BOZ, 2015) <sup>[4]</sup>.

**1.5.4 Previous and Comparative studies**

The currency depreciation will benefit the export oriented sectors such as Mining sector, Farming, power. That is, a weak kwacha will make Zambian produce more competitive in global markets which will be fruitful for Zambia's exports. The depreciating kwacha will bring delight to the exporters as goods exported abroad will fetch dollars which in return will translate into more kwacha. A sharply declining kwacha triggers inflation, broaden the current account deficit, hits investor sentiment and creates burden for the organization with high exposure to foreign debt (Mbululu, 2013) <sup>[6]</sup>.

The Zambian economy has persistently recorded sustained gross domestic product (GDP) in the last ten years, with favorable macroeconomic environment attracting significant amounts of foreign direct investments especially in the mining sector of the economy. Similarly, due to the debt write-off, it meant that the country had some fiscal space and, therefore, ample scope to affect the distributional effects of income in the economy in a positive manner. Zambia has also graduated to become a lower middle-income country in recent years.

(Melvin, 2003) <sup>[2]</sup> Investigated the dynamic association between exchange rate regimes, capital flows and currency crises in emerging economies. The study draws on lessons learned during the 1990s, and deals with some of the most important policy controversies that emerged after the Mexican, East Asian, Russian and Brazilian crises. He concludes that under the appropriate conditions and policies, floating exchange rates can be effective and efficient.

(James, 2012) <sup>[8]</sup> Discusses the failure of liberalized policies in Argentina. He says that Argentina has failed in maintaining the liberalized policies about capital flows and a firm currency. Argentina had anti-inflation program based on freezing the exchange rate in the early 1990s. This means that the money supply within the country and the supply of credit to firms are tied directly to international reserves. So if the country gets capital inflows, the supply of money and credit increases, leading to a substantial increase in domestic prices.

(Mirchandani, 2013) <sup>[10]</sup> Studied the impact of economic growth on real exchange rate. He found that there is no systematic connection between economic growth and real exchange rate. (Prusty, 2008) <sup>[13]</sup> Found in their study that little access to international capital is available for the weaker and less developed countries, so low rate of inflation and higher level of durability is associated with fixed exchange rate regime in those countries. However, they found no robust relationship between economic performance and exchange rate regime in the developing economies. They also found that advanced economies may experience durable and slightly higher level of growth rate without higher level of inflation in flexible exchange rate regime.

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goods exported abroad will fetch dollars which in return will translate into more kwacha. A sharply declining kwacha triggers inflation, broaden the current account deficit, hits investor sentiment and creates burden for the organization with high exposure to foreign debt (Economist, 2014) [7].

**2. Research Methodology**

The nature of this research can be categorized as positivism. In this type of research a theory is developed, data is collected which either supports or contests the theory, necessary revision is done and the theory is tested again. Positivism is when the researcher adopts the position of a philosopher, works with available data and the observable reality. Positivism is the best suitable research approach because in this research the reality is observed and described from an objective viewpoint without interfering with the variables being studied. The researcher relied on the respondent to provide truthful data. Research objectivity is achieved through a strict methodology, where the data ensures that there is a distance between the subjectivity of the researcher and the objectivity of the reality which is studied.

**2.1 Research Design**

A descriptive and quantitative research approach was deemed appropriate to gather the primary data and attend to the research questions. Descriptive research determines and reports the way things are. This choice was made because this research involves investigating possible relationships among two or more variables and collecting data to test hypotheses. The variables are measured once through a survey where the opinions of the respondents will be illustrated.

**2.2 Target Population**

Participants of this research paper were the employees of different organizations, Business men and women, and those whose income is paid in dollars. Target population was the

employees of different organizations in Ndola, on the Copperbelt part of Zambia.

**2.3 Sample Size**

The Sample size of research was 100 respondents from which we collected data.

**2.4 Sampling Procedure**

Random sampling design to select sample from population was used. The researcher visited all these organizations and first of all, informed the respondents that all their information will keep confidential and then got the feedback directly from the respondents.

**2.5 Data Collection Instruments**

The measuring instrument for data collection from the employees is in the form of questionnaires which consists of close-ended questions. The questionnaires were preferred because they were convenient to most respondents as they responded to the questions at their own suitable time and the interview provided the best means of getting detailed data for the study from individuals.

**2.6 Data Analysis Techniques**

The data was collected and edited for incompleteness and inconsistency to ensure correctness of the information given by the respondents. Variables were coded in Microsoft excel was used for data entry and analysis.

**3. Findings and Discussion**

In order to establish the impact of Kwacha depreciation on Zambian businesses, employment, and income, respondents were asked to give their views of the matter and below is the table showing respondent’s views.

**Table 1:** Results for respondents showing the impact of kwacha depreciation in percentile.

		Strongly Disagree	Disagree	Not Sure	Agree	Strongly Agree	Total
<b>BUSINESS</b>	<i>Cost of doing business</i>				24%	76%	100%
	<i>Cost of Machinery</i>				41%	59%	100%
	<i>Reduced Profits</i>		12%	7%	25%	56%	100%
	<i>Fuel Increase</i>				32%	68%	100%
	<i>Cost of Borrowing</i>		8%	4%	32%	56%	100%
					Yes	No	
<b>EMPLOYMENT</b>	<i>Salary Increase</i>				35%	65%	100%
	<i>Corporate Attire</i>	8%		29%	49%	14%	100%
	<i>Employee Benefits</i>	8%	16%	24%	36%	16%	100%
	<i>Medical Costs</i>	8%	9%	25%	39%	19%	100%
				Yes	No		
<b>INCOME</b>	<i>Income Decrease</i>				72%	28%	100%
	<i>Borrowing Funds</i>				41%	59%	100%
	<i>Increase In Savings</i>					100%	100%
	<i>Increased Interest Rates</i>	10%	6%	11%	41%	32%	100%
	<i>Increased Expenditure</i>		10%	3%	29%	58%	100%
	<i>Economic Downturn</i>				33%	67%	100%

Source: Field Data (2015)

### 3.1 Analyses

- While 99% of people surveyed are aware of kwacha depreciation and out of these more than 90% of people have started feeling the pinch of currency depreciation. The cost of doing business of 24% of the respondents agree and 76% strongly agree that it has increased, while the expense of has been increased and people have said that their daily expense has been increased. As for those in business, profits have been reduced due to currency depreciation whereas 12% disagree to that fact, 7% are not sure, 25% do agree, and 56% strongly agree to that fact.
- Around 41% of respondents have agreed that they have to pay more amount for their machinery and equipment for use in businesses, while around 59% of people are strongly affected by higher machinery cost, this is simply because of depreciation of kwacha now they have to pay more to the manufacturers. Respondents have agreed to the fact that high inflation is kicking in because of currency depreciation and many have agreed to this fact, since due to currency depreciation prices of raw material to make goods are increasing due to which manufacturers are transferring their cost to end consumers.
- Because of increased value of dollar crude oil import is getting costlier day by day for oil marketing companies due to which petroleum price is increasing here and this fact is agreed by 32% of people while 68% of respondents have strongly supported this fact.
- 32% of respondents have agreed to the fact that they now have to pay higher interests, while around 56% of people have strongly agreed to this fact, while 8% of respondents are neutral about it, increased EMIs are because of increased lending rates by commercial banks due to liquidity tightening measures taken by Bank of Zambia.
- Around 49% of respondents have agreed that they have to pay more amounts for their corporate attire while around 14% of people are strongly affected by higher corporate attire cost; this is simply because of depreciation of kwacha now they have to pay more to foreign manufacturers.
- 8% of the respondents have strongly disagreed that their employee benefits have not been affected in any way due to depreciation, 16% disagree, 24% are not sure about it, 36% agree that they have been affected and, 16% have strongly agreed to the fact that their benefits will be affected severely.
- Out of the total number of respondents, 8% have strongly disagreed that the medical costs have increased, 9% disagree, 25% are not sure about it, 39% agree that they have been affected and, 19% have strongly agreed to the fact that they are affected by the kwacha depreciation.
- Because of kwacha depreciation, economic growth of our country will be affected and will take a downturn, this fact has been agreed by 33% of respondents while 67% have strongly agreed to this, this is because of costlier imports and slow consumption story in the country industrial production has been decreased.
- Because of currency depreciation there would be an increase in expenditure; this fact has been agreed by 29% while 58% have strongly supported this statement, since

earnings of companies have been reduced so the expenditure rate has increased.

- Because of currency depreciation there is an observation that income has decreased; this fact has been agreed by 72% while 28% have disagreed. This can be attributed to the fact that most of the commodities have increased in prices and income has not been adjusted in any way, but still the same.

### 4. Conclusion and Recommendations

Depreciation of kwacha has affected everyone in the economy including the common man. We can conclude that kwacha is positively correlated to GDP & export growth. Hence we should focus more on increasing the export by correcting economic fundamentals. Immediate economic reforms should be taken in order to gain the confidence of foreign investor. A stable currency regime required for a stable growth economy cannot be achieved unless the structural issues are addressed to advance productivity and keep a stable inflation environment, resulting in a more stable fiscal deficit and external sector which put Zambia on a sustainable growth path with stable Fiscal deficit, current account deficit, inflation and growth.

Kwacha has depreciated significantly against the US Dollar, marking a new risk for Zambian economy. The outlook for kwacha has undergone a sweeping change in the last few months. Till 2011, the general feeling was that kwacha would either appreciate or maintain status quo and the continuing plunge in.

The compound effect of slowdown in FII inflows, the trade deficit and weakening growth have catalyzed the abysmal drop in kwacha value in the second half of 2015. The key to maintaining a stable exchange rate is controlling inflation through macro-economic measures and managing CAD through policy reforms.

The momentum is still bearish and analysts are calling kwacha undervalued at current level. They are not shying from predicting ZMW 20 per dollar in the near future. The wide-ranging perception is that until the global macroeconomic environment stabilizes, the kwacha will continue to slither.

Here are the lessons we can learn from the depreciation of kwacha;

The first lesson is that as long as we depend on the success of other countries, the economy of Zambia shall forever be a fragile economy. The Zambian economy shall forever be unstable. Zambia's economy shall continue to depend on the success of big economies such as China as long as it does not develop its local industry.

Second lesson is that Leadership is key in the stability of the economy. Speculation by major financial market operators is another crucial factor that has influenced depreciation of the kwacha. Many currency traders are in the forefront buying bulk dollars with a view to sell it at later stage hoping to make more profit. This is why leadership is key. The directive by President Lungu that Bank of Zambia and Ministry of Finance should continuously inform him about currency depreciation is the right way to go.

Thirdly, Zambia can only succeed with its own grown economy. As it is often said, you can only succeed with your own hands and not borrowed hands. Zambia has been reporting the significant economy growth, but this growth has not benefited or cannot be seen by a common man on the

street. So there is need for Zambia to come up with a major policy shift that would see many local industries are supported.

Lastly, overtrading is bad. As a nation, there is too much over trading. Zambia has reached a point where the economy is living beyond their means. So the advice from Bank of Zambia that we should reduce our expenditure should be supported. There is need for Zambia to work within its means.

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