The Zimbabwe Economy : Third Quarter 2010 Economic Indicators and Trends – John Robertson

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CONSUMER PRICE INDEX FORECAST

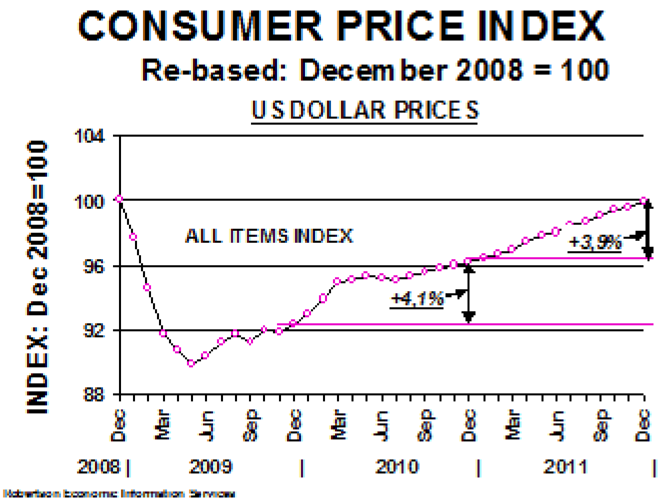
Base: Dec 2008=100	INDEX	Inflation Rate Monthly %	Inflation Rate Year-on-Year %
2010 Jan	93,0	0,7	-4,8
Feb	93,9	1,0	-0,7
Mar	95,0	1,1	3,6
Apr	95,1	0,9	4,8
May	95,3	0,7	6,1
Jun	95,2	0,1	5,3
Jul	95,1	0,2	4,2
F Aug	95,3	0,2	3,9
Sep	95,5	0,3	4,7
O Oct	95,7	0,2	4,1
Nov	95,9	0,2	4,4
R Dec	96,1	0,2	4,1
2011 Jan	96,4	0,3	3,6
E Feb	96,7	0,3	2,9
Mar	97,0	0,3	2,1
C Apr	97,5	0,5	2,5
May	97,7	0,3	2,5
A Jun	97,9	0,2	2,9
Jul	98,3	0,4	3,4
S Aug	98,6	0,3	3,5
Sep	99,0	0,4	3,7
T Oct	99,3	0,3	3,8
Nov	99,5	0,2	3,8
Dec	99,8	0,3	3,9

While the rand has remained strong against the US dollar, its fairly steady rate and the almost static business conditions in the domestic economy have made Zimbabwe's inflation a less threatening issue in recent months. Before May this year, price trends were affected by the steep falls in prices in the first half of 2009, and these caused the year-on-year gaps to become temporarily exaggerated.

The June and July figures this year have seen the figures reach levels more appropriate to Zimbabwe's use of a relatively hard currency. Possible movements in the rand exchange rate seem likely to keep the figure trending downwards in the coming year.

In the forecast shown in the adjacent table, inflation projections have been held between 0,2% and 0,5% a month, at which rates the annual figures would decline to figures below 3% during the first half of next year.

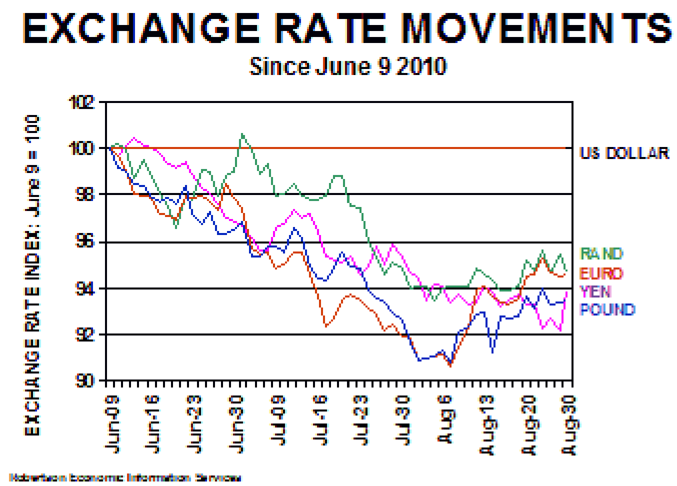
If the rates shown in the table are achieved, only by the end of 2011 is the index expected to reach its re-based starting point of December 2008=100.



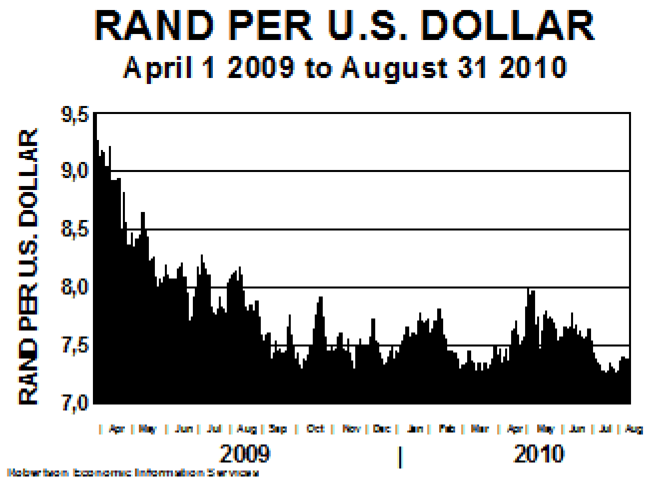
This forecast is illustrated in the graph, which also shows the steep falls in the index during the first five months after the authorities legalised the use of US dollars.

However, the forecast shown could easily be affected by uncertainties that relate mainly to local production costs. These are at risk of being driven higher by continuing pressures for higher wages. Pay awards already agreed, some back-dated, have placed many local manufacturers at a disadvantage in their efforts to compete against South African suppliers.

To ease the difficulties for some producers, duties have been increased on a range of imports, but these could also impact on Zimbabwe's inflation rate.



Recent international currency market developments, the main feature of which has been a fall in the value of the US dollar against most of the rest, have kept the rand exchange rate strong enough for it to be a source of speculation on whether it will remain strong. Based on the rates for June 9, when some speculation on the rate of US recovery moved the markets, the rand, euro, pound and yen are all seen to have appreciated by similar amounts.



Since September 2009, the rand has remained close to an average of R7,50 to the US dollar, but in the past few weeks it has moved closer to R7,30. This has become an issue of concern to employers in general and exporters in particular, specially now that the trades unions have become more militant in spite the extremely serious unemployment rate.

In the past year, the stronger rand has drawn imports into the South African market and it has made many of the country's exports less profitable to their producers. Both of these have added to existing impediments to employment growth, so the rand exchange rate has become the subject of serious political debate.

Initially, a weakening rand would reduce Zimbabwe's consumer goods import costs, but a fall of almost any percentage would also affect Zimbabwean manufacturers' efforts to recapture their home markets. However, a weakening of the rand could more than offset the duty increases. Supermarket chains and many other retailers are thought likely to continue sourcing most consumer goods from South African suppliers while the range offered by local manufacturers remains limited.

The prospects of the rand holding to that rate could be affected by the US dollar's own decline against the euro, the yen and sterling, but if interest rates rise slightly in Europe or the United States, or if South African interest rates are permitted to decline, South Africa could quickly experience an outflow of deposits that would be almost certain to weaken the rand.

Western and Japanese central bankers have remained convinced that very low interest rates are needed to encourage investment, and this has given the South African banks an opportunity to entice savings from abroad by offering more attractive rates.

However, new thinking suggests that the same low interest rates have a powerfully negative effect on spending and is this effect that is keeping the recession in place. Evidence suggests that this remains true even when savings are high and times are good, simply because savers are reluctant to dip into capital. In uncertain conditions, the best way to stimulate demand is to offer good rates of interest, as it is these payments that help underpin discretionary spending.

If interest rates rise in Europe and the rand falls, Zimbabwe will not be in a strong position to counter these changes. Many manufacturing companies are having difficulty competing with South African suppliers, so reductions in retailers' import costs could cause the failure of such manufacturers, specially if they are being forced to accept demands for higher wages.

Contract workers have already become some of the casualties, but permanent staff members' job security will soon be put at risk if their wage demands force their employers to downsize or go out of business. Bankruptcies so caused will even prevent handouts of severance packages.

Reliable statistics on consumption patterns remain scarce, but reports on rural communities suggest that many are having to be supported by aid donors and foreign NGOs. Indications suggest that remittances from Zimbabweans working abroad have trended downwards in the past year. Reduced levels of support are thought likely to become more noticeable with the return of a significant number of those who have been working, or trying to find work abroad, specially in South Africa.

However, seasonal incomes to communal and some resettlement farmers have improved as conditions affecting tobacco, cotton and cattle producers have changed for the better, assisted by contract buyer support as well as the encouragement offered by the formal marketing organisations.

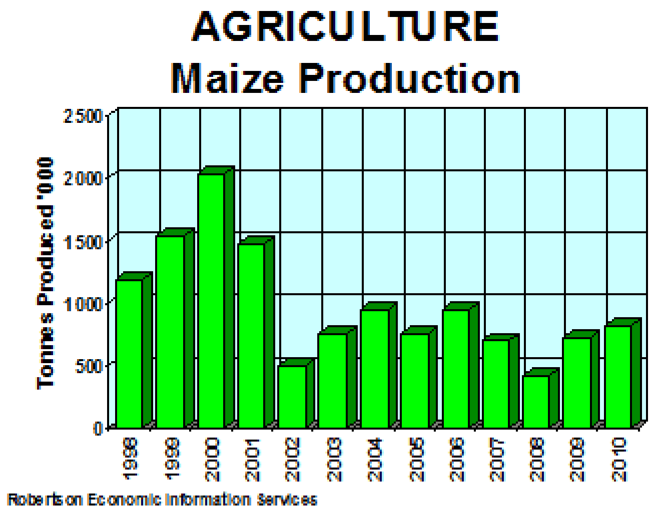
Small-scale tobacco producers have enjoyed a higher degree of success this year and the crop is now estimated at close to 120 million kilograms. Most of these growers have relied upon the tobacco auctions, on which prices started the selling season at well above US$3 per kilogram, but these tailed off to below US$2 per kg when Chinese buyers reached their purchasing targets and withdrew from the market.

By the end of August, the auction price averaged US$2,65 for the season, compared to the contract price average of US$3,06 per kg. By that date, the payouts from the auctions had exceeded US$111 million and contract growers had earned another US$233 million.

Although the costs per hectare incurred by those tobacco growers who cultivate only a few hectares are much lower than for those few who still plant 40 hectares or more, the lower average prices most of them have achieved might affect their level of commitment in the coming season.

Cotton production declined from 246 000 tonnes in 2009 to 156 000 tonnes in 2010, partly because support from contract buyers had been weakened by the evidence of side-marketing. Prices offered this year again disappointed growers and despite the passage of new legislation to prevent side-marketing, the problem appears to have become worse.

Cattle sales have increased since dollarisation. The communal farmers' former reluctance to sell more animals than was absolutely necessary has been changed by the fact that US dollars have been accepted as an equally good store of value as animals on the hoof and the sales numbers have increased, adding appreciably to rural incomes.



Maize production volumes have become somewhat politicised by claimed successes that cannot later be substantiated. Finance Minister Biti reported in his Mid-Term Fiscal Review that maize grown in 2009 amounted to 1 240 000 tonnes and this had increased to 1 330 000 tonnes this year. However, on the basis of evidence collected by the Commercial Farmers Union, the figures illustrated in this graph, 718 000 and 819 000 tonnes respectively, were the amounts produced.

Apparently the higher figures quoted by the Minister were derived from Grain Marketing Board records and reported rural area retentions. The gap is perhaps explained by the significant difference between the price offered by the GMB and the much lower price offered for maize in South Africa. This appears to have made possible imports of South African maize that have been passed off as local production and profitably on-sold to the GMB.

If this is the correct explanation, Zimbabwe remains with a serious maize deficit and total imports this year are likely to be, again, about one million tonnes. Arbitrage deals appear to have accounted for about half the gap and aid organisations might have contributed most of the balance.

Statistics on employment levels are now being collected now for the first time in four or five years and no results are yet available, but the Minister of Finance, in his Mid-Year Fiscal Review, said that PAYE collections for the period January to May 2010 came to US$126,3 million, compared to US$30,5 million for the same period in 2009.

The chaos just before and after the Zimbabwe dollar was abandoned in the first quarter of 2009 is more likely to explain this 300% increase than the Minister’s claim that “…this revenue trend indicates increase in remuneration and employment levels”. Whether marginal increases in employment have occurred has yet to be seen, but many companies are known to be making strenuous attempts to downsize their operations.

Reports indicate that, but for the costs of funding severance packages, many more people would have been retrenched.

Working from its very low base, Zimbabwe’s projected GDP growth rate, now officially put at 4,5% in 2010, is much lower than first estimated and well below the figure needed to constitute evidence of a significant recovery.

Growth prospects from 2011 are thought likely to remain low, partly because of power cuts and partly because longer-term bank finance will remain scarce and expensive. These constraints have prompted the IMF to set its forecast for 2011 at 2,2% and it suggests that, if current policies are not changed, the growth rate will fall to zero in 2012.

In the absence of the needed policy improvements, more optimistic growth figures would have to depend upon export commodity price improvements that, in turn, would depend upon an acceleration of the growth rates of countries in the industrial world.

At present, the investment inflows needed to make possible the recovery of production volume increases show little sign of materialising. This is partly because of the discouraging impact of the Indigenisation and Economic Empowerment Act, but also because the banks remain severely handicapped by liquidity shortages and because power generation constraints remain in place with no quick solution is in sight.

Investor confidence suffered a severe downturn with the publication of indigenisation regulations in February. Government’s very slight amendments since then seem unlikely to overcome the current reluctance that has caused a withdrawal of a significant number of development or expansion plans.

At present, given its power shortages, high operating costs and political uncertainties, Zimbabwe will not readily attract foreign investment funding into any project that seems likely to take some years to show a return. Local funds for such projects are not readily available because bank liquidity remains low. Substantial project registration fees and new provisions that require some registration procedures to be repeated in two years have further discouraged business promoters.

Fiscal Policy Review Sectoral Growth Rate Table				
Sector	2008 Actual	Revised 2009 Est.	Original 2010 Proj.	2010 (Revised Proj.)
Agriculture	-39.3%	14.9%	10%	18.8%
Manufacturing	-33.4%	10.2%	10%	4.5%
Mining	-17.1%	8.5%	40%	31%
Tourism	2.8 %	6.5%	10%	3.5%
Electricity, Gas and Water	-36.5%	1.9%	3.4%	-1.8%
Construction	-8.5%	2.1%	3.2%	1.5%
Finance and Insurance	-27.9%	4.5%	5.5%	2.0%
Real Estate	-36.4%	2.0%	2.2%	1.5%
Transport and Communication	5.4%	2.2%	4%	3%
Public Administration	0%	2.0%	3%	2.0%

Source: CSO, Ministry of Finance & Reserve Bank

Despite a claim frequently repeated by government that "productive sector capacity utilisation has increased from less than 10% to more than 40%" and repeated yet again by Minister Biti in his Fiscal Review, this table from the same Review shows that manufacturing output, which declined by 33,4% in 2008, grew by 10,2% in 2009 and is forecast to grow by another 4,5% in 2010.

These growth figures do not tie in with the implied growth of several hundred percent that would have resulted from the "capacity utilisation" claim. As the Minister's table shows, the reported performance of the other productive sectors also falls a long way short of this claim.

Producers of consumer goods are particularly concerned about the severe competition from South African and Far Eastern imports, and those in the food processing industries remain concerned about the volumes and quality of crops available from Zimbabwean farms.

As a result of these difficulties, job creation is slow and the unemployment numbers, now being exacerbated by the return of many Zimbabweans from South Africa, remain extremely serious. Estimates still place the unemployment figure at more than 70%.

With limited employment growth, disposable incomes are unlikely to show meaningful signs of improvement. For the existing wage earners, the heavy extended family dependency burden will continue to force most to concentrate their expenditures on basic essentials.

Although signs of modest recovery are evident, government's reluctance to accept the need to restore civil rights and property rights has prompted the IMF and other analysts to suggest that a continuation of current constraints will limit Zimbabwe's growth rate to levels well below the rates that would be within reach under more imaginative policies.

Year-End Estimates	2009	2010	2011	2012	2013	2014	2015	2016	2017
Year-on-Year Inflation	-6,7	4,2	3,9	4,5	5,0	5,0	4,5	4	4
GDP Growth %	3	4,5	2,2	0	3	3,5	4,5	4,8	5
Exchange Rate: US$ to £	1,60	1,65	1,60	1,62	1,55	1,45	1,40	1,40	1,40
Treasury Bill % 91-day	--	11,5	10,0	8,5	7,0	6,0	5,5	5,5	5,5
Minimum Lending Rate %	15,0	12,5	11,0	10,0	8,5	8,0	8,0	8,0	8,0

Assumptions : Economic

* At the GDP forecasts shown, Zimbabwe's economy will take more than ten years to recover to pre-1998 levels of activity
* Zimbabwe will not attempt to restore use of the Zimbabwe dollar before a doubling of GDP has been achieved & some reserves have been accumulated
* Export earning improvements will be delayed by political unwillingness to revise land policies, by indigenisation and slow commodity price improv
* Import volumes will remain constained by low bank liquidity & the slow recovery of foreign reserves
* Accumulation of foreign reserves will be slow, holding figures to one week's import cover for the first five years of this forecast
* External debt increases to fund critical infrastructure repairs will receive support through equity deals as well as privately funded loans

Assumptions : Political

* The Indigenisation Act and Economic Empowerment Act will be enforced with minor amendments
* Progress towards completing the preparation of the new constitution will be delayed
* Progress towards the proposed general election in 2011 will be delayed
* Land policies that accept the need for ownership rights and capital-intensive methods will begin to restore confidence by 2016

Assumptions : International

* Inflationary pressures, increasing protectionism and severe international & domestic debts will slow economic recovery of western countries
* Revised levels of involvement by Europe & the US in current war zones will impose budgetary constraints & will reduce demand for manufctured e
* Commodity prices will continue rising, but at a very slow pace during the next five years, and for longer if conflict zones become peac

Year End Estimates (click to enlarge)

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