STATE OF THE OPERATING ENVIRONMENT

DONE BY : RISK & ECONOMIC RESEARCH DEPARTMENT

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1. Political Landscape

1.1: International relations

- **The EU has resumed development cooperation with Zimbabwe**, following revocation of Article 96 of the Cotonou Agreement on the 1st November 2014, under which the EU had suspended direct aid to the Government of Zimbabwe (GoZ). In 2014, the country was allocated a **USD270 million grant to cover period 2015-19**. This is the first direct assistance to the Government by the EU bloc since 2002.
- However, the **US – OFAC targeted sanctions have remained unchanged** since they were promulgated in 2001. The US sanctions were recently extended by a further 12 months in March 2015.
- Relations with the **East (China, Russia, Malaysia) have remained strong**. Chinese investors have partnered with the Zimbabwe Government to undertake the Kariba **Hydroelectricity expansion (USD566 million).** Governments of Zimbabwe & China also signed an MOU under which Chinese investors promised to scout and undertake various **infrastructural projects worth up to USD4 billion**.

1. Political Landscape

1.1: International relations …… (cont'd)

- **Russia** has also partnered the Government to set up a **USD3 billion platinum mining joint venture**.

- **South African investors** (e.g. Group Five and Development Bank of SA) have already started to do **infrastructure works in Zimbabwe** (widening and rehabilitation of road networks). In April 2015, the Governments of Zimbabwe and South Africa signed some Memorandum of Understanding to explore business opportunities. South African Investors are estimated to have invested USD 1.7 billion between 2003 – 2013.
- Various business delegations mainly from the European Union have been engaging with the Government of Zimbabwe.

Significance: the successful reengagement with the international community is a welcome development as the country seeks to unlock external capital (mainly FDI flows).

1. Political Landscape (cont'd)

1.2: Indigenisation & Economic Empowerment

- Govt has clarified that the **51:49 shareholding** thresholds will be strictly targeted **only in resource based sectors, e.g. mining**.
- In other sectors, a more **flexible approach** will be pursued, with a view to **fostering foreign investment** in the country.
- Recently Government indicated that qualifying foreign entities would be required to **negotiate their indigenisation plans with the specific sector ministries**.

Significance: it is our opinion that specific line ministries have a better understanding of the circumstances obtaining in their sectors of responsibility and are thus better placed to approve indigenisation plans in their sectors. However, amending the law to reflect this clarified stance will significantly improve business confidence.

1. Political Landscape (cont'd)

1.3: Currency Management, Business Competitiveness

- The Government has maintained that the **multi-currency system will remain in place** until the macroeconomic environment has stabilized to support a new local currency.
- The Reserve Bank of Zimbabwe is also working on a **de-monetization exercise of the ZWD balances** which should be concluded by end of June 2015. USD 20 million has been earmarked for this process.
- However, the use of a relatively stronger currency i.e. the USD has rendered most companies **highly uncompetitive compared to international and regional competitors**.

1. Political Landscape (cont’d)

1.3: Currency Management and Business Competitiveness …….cont’d

- In an effort to address the competitiveness issues, the Government is promoting dialogue among employers, employees, banks, Government institutions and other stakeholders to seek ways of promoting economic viability.
- The proposed measures include price & salary freeze and the reduction of finance costs to sustainable levels.
- According Government reports, a total of 3200 employees in the manufacturing sector (25k), mining (5k) and banking sector (2k) were trenched in 2014 alone.

Significance: it is our opinion that as the Government pursue the objective of restoring competitiveness to do it with extreme caution as some of the proposed measures might be viewed by some investors as a price control mechanism.

2. State of the Economy

2.1 Real Sector

- GDP which grew at an average of 8%/year during the 2009-2012 period, **significantly slowed down to around 3-4% during 2013-2014.**
- IMF has recently revised its 2015 GDP growth forecast from 3.2% to 2.8%. Below are the key challenges highlighted by the IMF that are affecting the economy:
  - **Weak international commodity prices** *(gold, platinum, chrome, cotton). Mining exports contribute up to 55% of the country's total exports.*
  - **Relative strengthening of the US dollar** (anchor currency) against currencies of major trading partners, which adversely impacted *export competitiveness*
  - **High import dependency**, which has contributed to de-industrialisation and the *drain of money* from the economy.
  - **Foreign Direct Investment (FDI) inflows slowed down** from an annual average of USD400 million during 2009-12 to about USD250 million by 2014.
  - **Erratic weather patterns & constrained resources** – resulting in depressed agricultural yields and quality.

2. State of the Economy

2.1 Real Sector…….cont'd

- According to the Africa Development Bank reports, industrial competitiveness in Zimbabwe is difficult to address due to the relatively high cost of doing business in Zimbabwe compared to regional counterparties as evidenced by:

    i. **Borrowing costs** (avg 28% in 2013) are twice or three times levels in the region

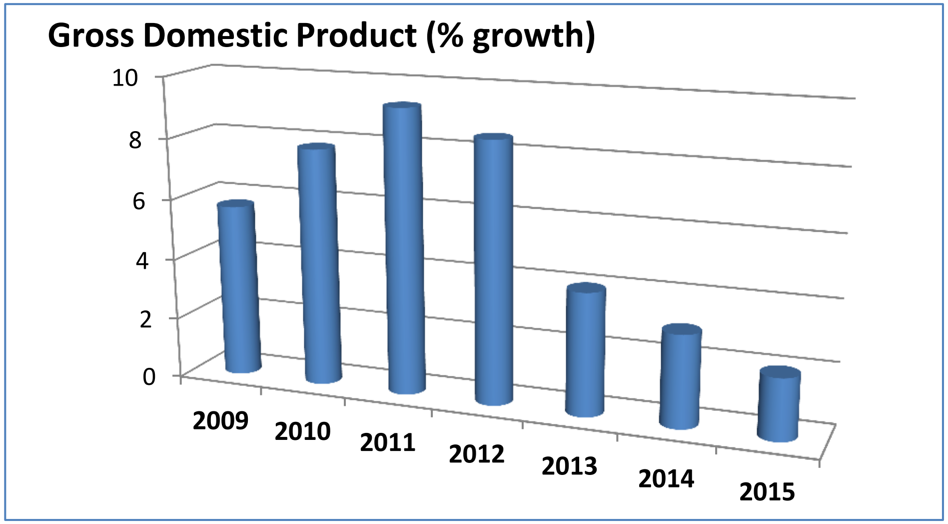
    ii. Average cost of **commercial electricity** in Botswana, Mozambique, South Africa and Zambia is 8.3 Usc | KWh which is 57% of what Zim businesses pay (14.6 USc)

    iii. **Import taxes** for industrial inputs are generally twice as high in Zimbabwe.

    iv. High labour costs and obsolete/ inefficient production infrastructure.

- Significant investment opportunities are abundant in infrastructure rehabilitation, development and expansion. These may take the form of Private Public Partnerships joint ventures and strategic partnerships.

2. State of the Economy…cont'd



Mining: Selected Mineral Production

	Jan – Feb 2014	Jan – Feb 2015	% change
Gold/kg	2168	2520	16.2%
Platinum/kg	2058	2050	-0.4%
Coal/mil tonne	1.04	1.05	1.0%
Nickel/t	3.1	3.2	3.2%

Agriculture: Selected key Food and Export crops

'000 tonnes	2012	2013	2014	2015	14/15 % Change
Tobacco	144	166	216	195	-9.7%
Cotton	304	140	125	80	-36.0%
Maize	960	750	800	600	-25.0%
Soya bean	70.5	72	80	75	-6.3%

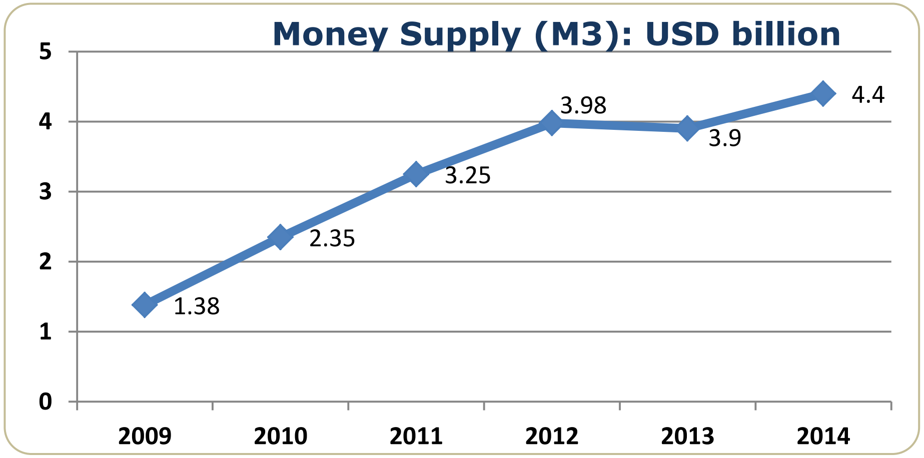
2. State of the Economy…cont’d

Monetary Sector

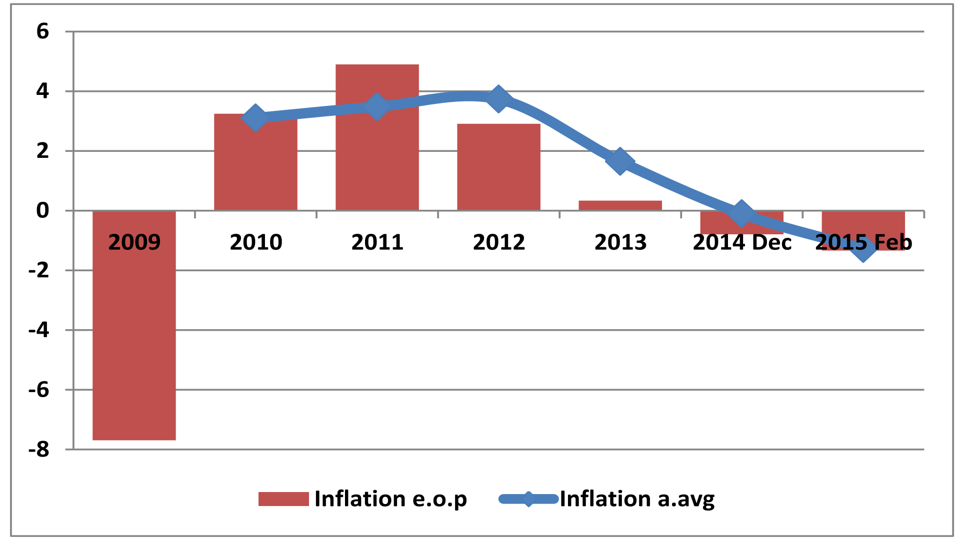
- **Inflation**: Headline inflation stood at -1.40% (Feb 2015), largely reflecting the depreciation of the SA Rand against the US dollar. Zimbabwe still needs to deal with challenges including (a) weak internal demand due to low economic performance, (b) wage cuts and labor lay-offs, (c) low investment inflows, (d) reduced credit granting capacity, and (e) reduced fiscal revenues.
- **Stagnation in Money Supply:** M3 has stagnated at around USD4 billion since 2012. The RBZ reported a decline to USD4.3 billion in January 2015 compared to levels of around USD 4.4 bn during the second half of 2014. The stagnation of M3 is attributed to the huge Balance of Payments outflows, reflecting over-dependency on imports. To address challenges of the huge import bill, Government is promoting import substitution and beneficiation of exports.
- **Non Performing Loans:** The level of Non- Performing Loans have progressively increased from 4% in December 2010 to 16% by December 2014. The Reserve Bank of Zimbabwe has created a Special Purpose Vehicle (SPV) called Zimbabwe Asset Management Company (ZAMCO) to purchase NPLs from banks and release liquidity to banks. USD80 million worth of NPLS have already been acquired.
- **Financing mechanisms for ZAMCO** - the operations of ZAMCO will be financed through the issuance of Government bonds.

2. State of the Economy…cont'd

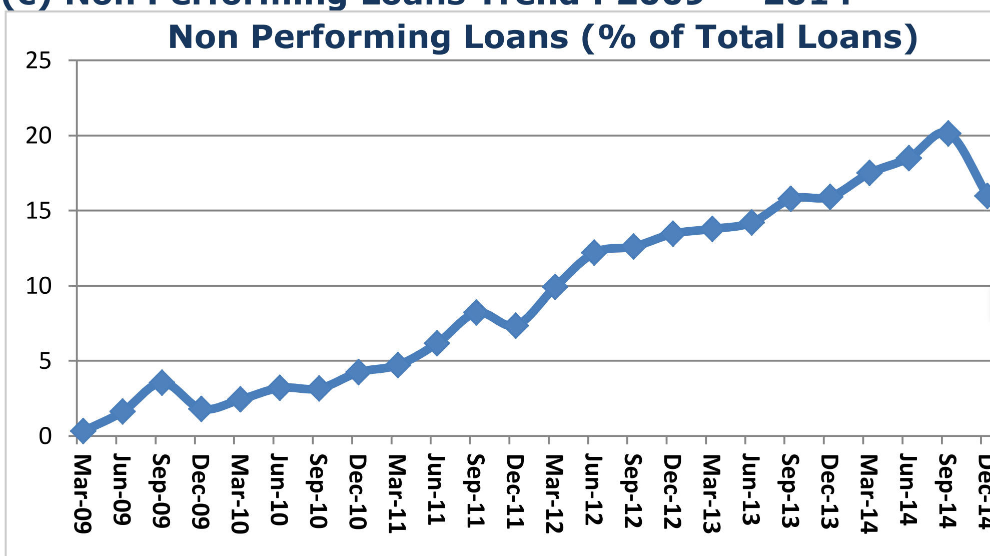
(a) M3 Money Supply (USUSD million): 2009 – 2014



(b) Inflation (%): 2009– 2014



(c) Non Performing Loans Trend : 2009 – 2014



The drop in NPL's ratio was due to the write off of Interfin and Allied Bank following the cancellation of their banking licences. Combined NPL's for the 3 banks including AfrAsia were estimated at $270 m .

2. State of the Economy…cont'd

Government (public) Sector

- **Revenues:** Cumulative to December 2014, total revenues amounted USD3.7 billion against a target of USD4.12 billion. Revenues for 2015 (maintained at USD3.7 billion).

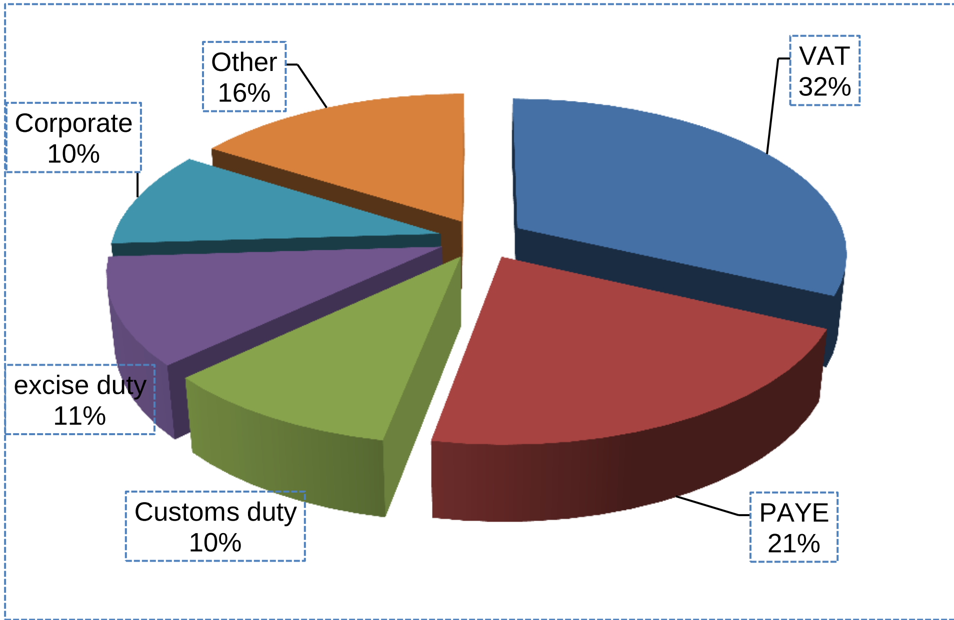
- **Expenditures:** Total expenditures amounted to USD4.1 billion against a target of USD4.12 billion. Targeted expenditures for 2015 have been reduced at USD 3.78 billion. **In a bid to contain expenditures, the Government has suspended the payment of bonuses to civil servants during 2015 and 2016.**

- **Deficit:** Government accrued a deficit of USD400 million during 2014, which was financed by treasury bills issuance, bank borrowings and accumulation of arrears. *As the borrowing requirement increases, domestic debt has risen from zero in 2009 to USD1 billion by 2015*.

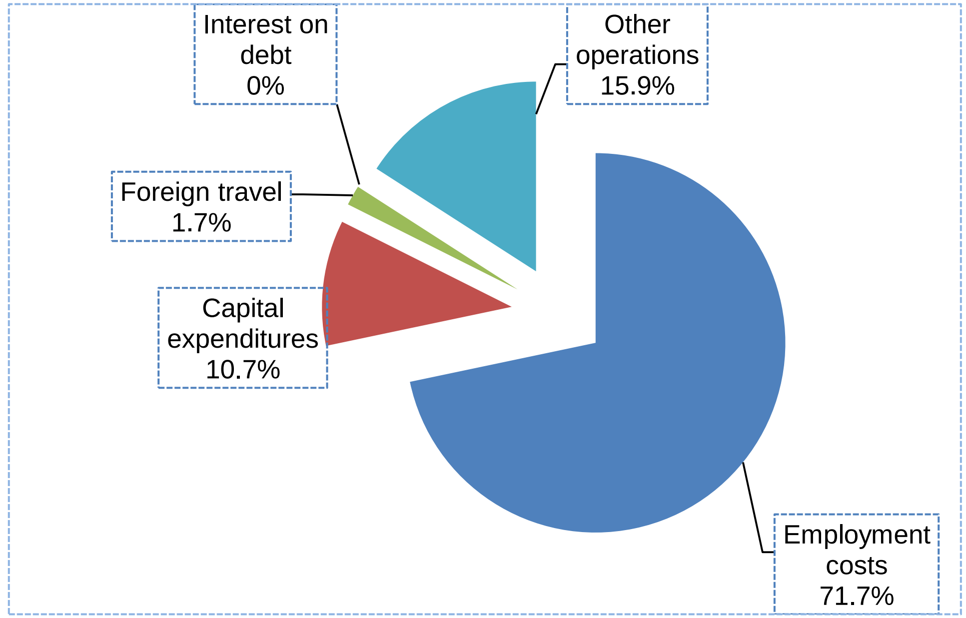
- **Average Monthly performance:** Owing to depressed economic performance, monthly revenues are averaging USD250 million to USD300 million. Capital projects and other social service delivery expenditures such as health and education are receiving reduced allocations from the fiscus. Health and education have continued to receive humanitarian assistance from donors – e.g. Global Fund, WHO, UNICEF .

2. State of the Economy…cont'd

Distribution of Revenues: 2009 - 14



Distribution of Expenditures : 2009 - 14



(c) National Govt Statistics : 2013 - 15

	2013	2014	2015
Nominal GDP (USD m)	13490	13560	13782
Revenues & Grants (USD m)	3741	3721	3700
% of GDP	27.7%	26.9%	26.5%
Expenditures & Net Lending	3987	4085	3780
% of GDP	29.6%	30.1%	27.4%
Recurrent Exp	3520	3634	3650
% of GDP	26.1%	26.8%	26.5%

2. State of the Economy…cont'd

External Sector (Balance of Payments)

- **Trade deficit:** During 2014, total exports declined by 11.4% to USD3.1 billion. During the same period imports also declined by 9.9% to USD6.4 billion. The huge trade deficit is largely responsible for the high current account deficit currently at 27.9% of GDP. This compares unfavorably with international benchmarks of under 5%.
- **Exports receipts** during the first quarter of 2015 increased by 12% to USD 868.7 million, compared to same period in 2014.
- **Weak Commodity Prices** - the prevailing weak commodity prices (especially Gold and Platinum) will have a greater impact on export generation capacity of Zimbabwe. These two minerals account for an estimated 40% of the country's total export receipts.

2. State of the Economy…cont'd

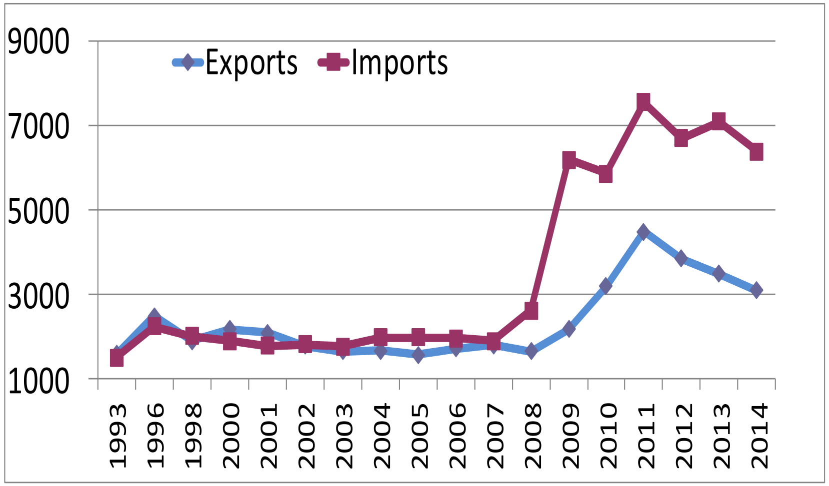
External Sector (Balance of Payments)……cont'd

- **International reserves:** The BOP position is not supported by international reserves. The country's usable reserves are estimated at USD284 million or 2 weeks import cover. This is unsustainably low compared to internationally acceptable levels of at least 3 months import cover.

- **External Debt**: Total Public external debt stands at USD6.9 billion with USD5.6 billion being payments arrears. Zimbabwe private sector owes a total USD1.9 bn (the debt is current). Key creditors to Zimbabwe include; World Bank (USD1.4 billion), Paris Club (USD4.2 billion), AfDB (USD500 million), China (USD350 million), and the IMF (USD142 million).
- The Government is currently working with the Africa Development Bank (AfDB), World Bank and IMF for technical assistance/advice on the resolution of the external debt challenge.

2. State of the Economy…cont'd

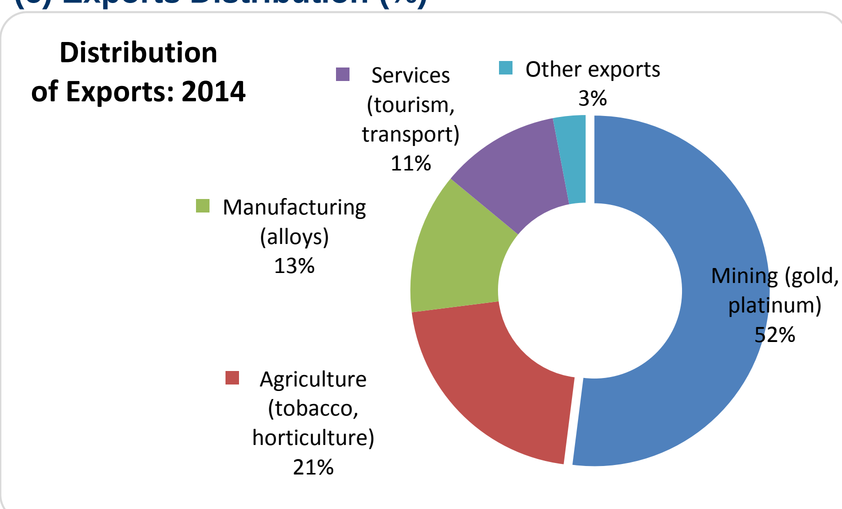
(a) Export & Import Performance: USD Millions



(b) Selected BOP Summary Items

$ Millions	2012	2013	2014	2015
Current account (excl official transfers)	-3048	-3426	-3024	-3068
FDI (Net)	+ 353	+400	+256	+262
Portfolio (Net)	+ 100	+ 96	+120	+125
Long-term Loans (Net)	+ 723	+ 1058	+1193	+1154
Short-term Loans (Net)	+ 244	+ 927	+670	+639
Overall BOP Balance	**-$-184**	**-$405**	**-$439**	**-$371**

(c) Exports Distribution (%)



(d) Imports Distribution (%)