# STATE OF THE OPERATING ENVIRONMENT – HALF YEAR ASSESSMENT

JULY 2015

# 1. State of the World Economy

## (a) TOP SIX EMERGING RISKS FOR THE GLOBAL ECONOMY

| RISK | POTENTIAL GLOBAL IMPACT | IMPACT ON ZIMBABWE |
|---|---|---|
| **United States**<br>• Exit from quantitative easing resulting in financial markets correction.<br>• Uptick in USD yield curves | • Potential capital flight ( mainly portfolio investments) in Emerging Markets (EM) and particularly those with huge current account deficits e.g. South Africa & Brazil. Currencies for EM's are likely to further depreciate.<br>• Mature markets would be affected by the upward pressure on the yield curves and adverse wealth effects on equities markets.<br>• Slow down on economic growth for the US economy and economies of other major US trading partners. | • **Limited capital inflows** - A rise in US interest rates will result in significant Capital outflows ( mostly portfolio investments) from emerging markets including Zimbabwe.<br><br>• **Export uncompetitiveness -** increased investment flows into the US economy will further strengthen the USD and thus hurting export competitiveness of Zimbabwe. |
| **China**<br>• Slower GDP growth,<br><br>• Crash of the Chinese equity market.<br><br>• Slow down in business and infrastructure development. | • Slower Chinese growth would have a significant impact on emerging markets producing commodities used in Chinese investments.<br>• However, the effect on mature markets is minimal as the effects are partly offset by terms of trade gains. | • **Slow down in commodity demand and weak prices -** China is the biggest consumer of commodities coming out of Africa including Zimbabwe.<br>• **Scaling down of external investments** – slow down in the Chinese economy will also impact its investments in emerging markets including Zimbabwe. |

# 1. State of the World Economy

## (a) TOP SIX EMERGING RISKS FOR THE GLOBAL ECONOMY

| POTENTIAL RISK | POTENTIAL GLOBAL IMPACT | IMPACT ON ZIMBABWE |
|---|---|---|
| **Emerging Markets**<br>• Intensification of country-specific problems in a period of high global risk aversion and limited market liquidity.<br>• Further loss of confidence in EM's due to country specific challenges resulting in exit of institutional investors. | • Pressures on external financing to a broader group of countries would reduce external demand and slow global growth.<br>• Stress would be more of a regional than systemic impact e.g. challenges in Ukraine are mainly likely to be felt in Russia. | • Low business confidence in EM result in FDI slowdown. Currently Zimbabwe is highly dependent on foreign funding for investment and growth. |
| **Euro Area**<br>• Economic stagnation and entrenched disinflation | • Lower external demand and global growth, spillover effects on financial markets.<br>• A rise in global risk aversion, with negative impact on financial sector bond and equity returns. | • International commodity prices are likely to remain lower as the Euro area is a major consumer and producer of commodities. |
| **Ukraine & Greece**<br>• Crisis escalation | • Russia would be hit by disruptions of gas exports and capital outflows.<br>• Direct spillovers through trade and financial linkages maybe limited, but there would be substantial adverse spillovers on sustainability of the Euro area ( potential financial turmoil in the Euro area) | • The proposed investments by the Russians in Zimbabwe might be delayed as the Russian Government might seek to limit/control capital outflows in an effort to control the current crisis |

# 2. State of the Economy

## 2.1 Real Sector

- Both the World Bank (WB) and the International Monetary Fund (IMF) have significantly revised downwards their 2015 GDP growth forecasts to under 2% from previous estimates of around 3%. Below are the key challenges highlighted by both the IMF & the WB, that are affecting the economy:
  - **Poor agricultural season –** *affecting major crops such as cereals, tobacco and oil seeds. Maize shortage is estimated at over one million metric tonnes. Cash required for food imports represent a drain from the already strained Treasury.*
  - **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.
  - **Relatively low Foreign Direct Investment (FDI)- inflows have been averaging** USD400 million during 2009-14 compared to regional averages of over USD 1.5 billion.

# 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)

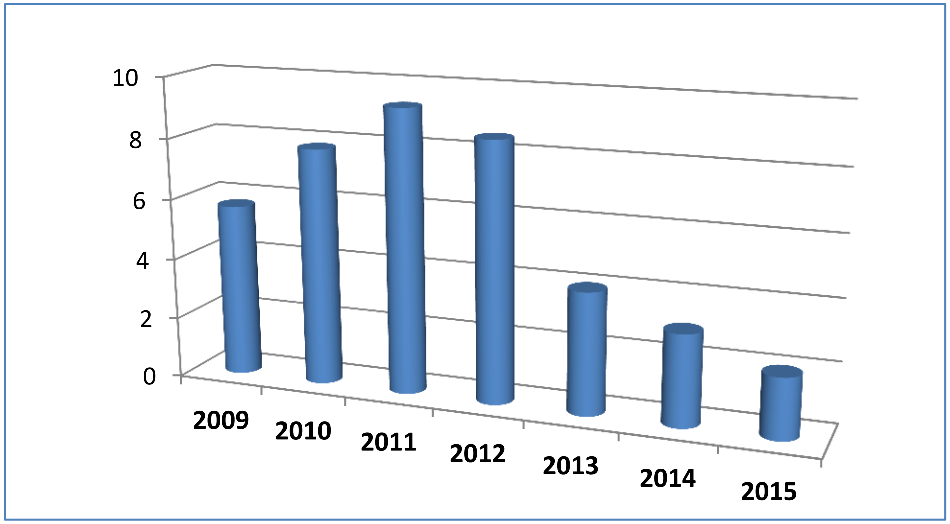
  iii. **Import taxes** for industrial inputs are generally twice as high in Zimbabwe.

  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

### Fig 1: Gross Domestic Product (%)




**Source:** *MoF, IMF, 2015*

### Table 1: Agriculture Output (000 MT)

| | 2014 | 2015 ( est) | % Change |
|---|---|---|---|
| **Maize** | 1460 | 750 | -48.6% |
| **Tobacco** | 216 | 185 | -14.4% |
| **Soybean** | 84.7 | 58 | -31.5% |
| **Cotton** | 114 | 68 | -40.4% |
| **Groundnuts** | 88.9 | 135 | 51.9% |
| **Citrus** | 216 | 180 | -16.7% |

**Source:** *Ministry of Agriculture, 2015*

### Table 2: Key Commodities Price Trend

| | Qtr. 4 - 2014 | Qtr. 1 - 2015 | Qtr. 2 - 2015 | May 2015 | Jun 2015 |
|---|---|---|---|---|---|
| **Gold (USD/oz)** | **1201.1** | **1217.1** | **1192.7** | **1198.6** | **1181.5** |
| *Y-o-Y changes* | -5.7% | -5.9% | -7.4% | -7.0% | -7.6% |
| **Nickel (USD/ton)** | **19897.9** | **18370** | **15580** | **15803** | **15064** |
| *Y-o-Y changes* | 13.6% | -2.1% | -29.6% | -30.5% | -31.2% |
| **Platinum ( USD/oz)** | **1228** | **1193** | **1127** | **1140** | **1089** |
| Y – o – Y change | -6.9% | -18.5% | -22.1% | -20.4% | -23.5% |
| **Crude Oil ( USD/bl)** | **74.5** | **51.7** | **60.4** | **62.5** | **61.3** |
| Y – o – Y change | -24.9% | -50.7% | -44.0% | -42.0% | -43.4% |
| **Coal ( USD/ton)** | **62.9** | **61.2** | **59.0** | **60.4** | **58.7** |
| Y – o – Y change | -23.3% | -20.6% | -18.9% | -18.0% | -17.9% |

**Source:** *World Bank, IMF*

# 2. State of the Economy…cont'd

**Monetary Sector**

- **Inflation**: Headline inflation stood at -2.70% (Feb 2015), largely reflecting the depreciation of the SA Rand against the US dollar and the depressed demand of goods and services. More companies are having to resort to lowering prices as a way of stimulating demand. In the outlook period inflation is likely to remain in the negative due to the prevailing challenges in the operating environment.
- **Stagnation in Money Supply:** Total market deposits slightly increased to USD 4.48 billion during the first half of 2015 up from USD 4.43 billion during the last quarter of 2014. The net increase of around USD 50 million growth in 2015 is significantly lower than increases of an average of USD 300-500 million attained over the same period over the past 3 years mainly spurred by tobacco inflows. The negotiated deals from China and Russia are not expected to significantly result in increased money supply as the nature of their investments is mainly capital in nature (that is if they are to materialise).
- **Non Performing Loans:** The level of Non- Performing Loans has 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. To date, USD80 million worth of NPLS have already been acquired.

# 2. State of the Economy…cont'd

**Monetary Sector**

- **Stock Market:** Turnover on the Zimbabwe Stock Exchange for the first half of 2015 declined by 32 percent to $136.7 million compared to a turnover of $ 200 million attained over the same period in 2015. The subdued performance is  attributed to weakening stock prices and low business confidence.
- Foreign investors continue to dominate the market. Seed Co recorded the single largest decline in trades during the first six months of the year, with turnover  declining by 86% to $6 million from $44 million in 2014, CBZ Holdings turnover , declined by 70% to $2,8 million, Delta Corporation ( 40% decline to $39,4 million) and Econet Wireless, (34% decline to $33,1 million).

- **Interest Rates and Bank Charges:** There has a gradual decline in weighted lending rates levels. The decline is a result of both regulatory & customer pressures as well as competition for good credit among banks.
- The Government has reiterated that it does favour moral suasion as  compared to legislation of interest rates as the later will affect business confidence.

# 2. State of the Economy…cont'd

**Table 3: Monetary Sector Variables**

| | December 2014 | March 2015 | June 2015 |
|---|---|---|---|
| **INFLATION** | | | |
| Annual | -0.80% | -1.20% | -2.81% |
| Monthly | -0.09% | -0.03% | -0.139% |
| **MONEY SUPPLY** | | | |
| M3($ million) ** May 2015 | 4403 | 4370 | 4488** |
| M3 (annual growth) | 11.97% | 6.8% | 3.75%** |
| Loan/Deposit Ratio ( Total loans/M3) | 99.4% | 98.0% | 107% |
| Government Borrowings ($ million) | *515* | *537* | *950.6* |
| Non Performing Loans Ratio | 15.92% | 15.19% | 15.2% |
| **STOCK MARKET** | | | |
| Industrial Index | 162.8 | 158.68 | 144.45* |
| Mining Index | 71.7 | 43.93 | 39.72* |
| Market Cap ( $ mil) | 4619 | 4328 | 3781 |
| **INTEREST RATES** | | | |
| Average Lending Rates to Corporates | 9.8% | 9.7% | 8.9% |
| Average Lending Rates to Individuals | 14.3% | 14.0% | 13.0% |
| Nominal Lending Rates | 6 -35% | 6-35% | 5 – 31% |
| Deposit Rates ( Savings) | 0.15 – 8% | 0.15 – 12% | 0.15% - 8% |
| Deposits Rates ( 3 months fixed) | 1 – 20% | 1 – 17% | 1 – 17% |

# 2. State of the Economy…cont'd

**Government (public) Sector**

- **Revenues:** Zimra net revenue collections during the first quarter of 2015 were 5.5% below a budget of USD 850 million. The subdued revenue performance reflected depressed economic activity. Government expenditures are likely to remain unsustainably high, due to the slow progress of the proposed fiscal reforms.
- In the outlook period Government revenues are likely to remain depressed mainly due to the increased informalisation of the economy and the depressed economic performance. Monthly revenue collections could potentially decline from the current monthly averages of around USD 300 million. Health and education sectors are expected to continue to receive the bulk of humanitarian assistance from donors – e.g. Global Fund, WHO, UNICEF.

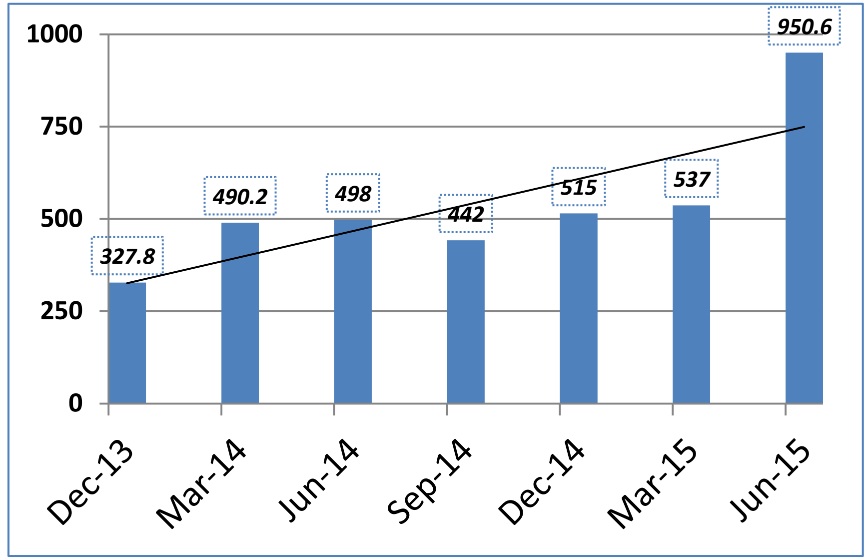
- **Expenditures:** Government expenditures are expected to remain high mainly due to the slow implementation of the proposed fiscal reforms to contain the unsustainable wage bill. Additional pressures also include the planned importation of grain to supplement local production.
- **Deficit:** Government borrowings are growing rapidly thus indicating the growing expenditure pressures.

# 2. State of the Economy…cont'd

(a) 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%** |

(b) Government Domestic Borrowings ( USD mil) : 2013 - 15



# 2. State of the Economy...cont'd

## External Sector (Balance of Payments)

- **Trade deficit:** The trade deficit, which is estimated at over USD 1.8 billion during the first half of 2015, is projected to worsen in the outlook to December 2015. The deterioration is due to the following issues:
  - **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.
  - **Poor agricultural season** – the country is expected to import over one million metric tonnes of maize at an estimated cost of over USD 320 million. Tobacco output and prices have also been depressed.
  - **Loss of export competitiveness –** a stronger USD is hurting export competitiveness of local exporters. According to the IMF, the USD in Zimbabwe is overvalued by over 20%. This is resulting in many companies closing down and hence the overreliance on cheaper imports.

# 2. State of the Economy...cont'd

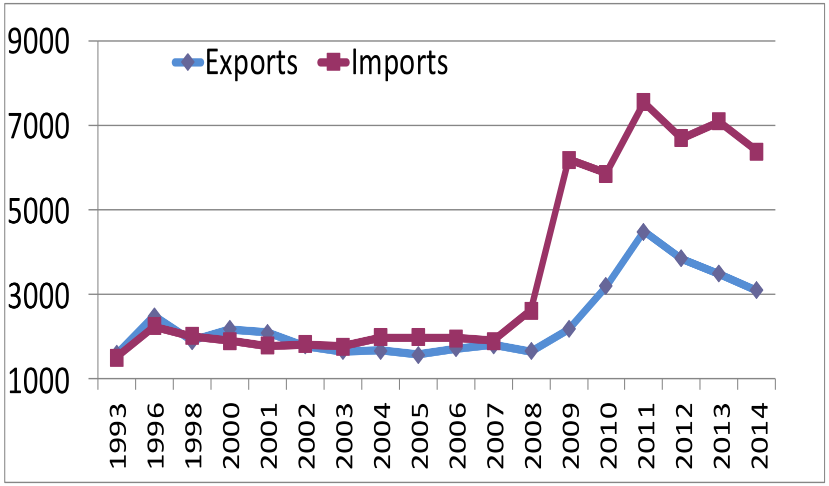
**External Sector (Balance of Payments)......cont'd**

- **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. The Zimbabwean 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) External Debt Distribution: USD million

| | 2013 | 2014 |
|---|---|---|
| **Long Term Debt** | | |
| • Public Sector | 6368 | 6183 |
| • Private Sector | 1002 | 2261 |
| • Monetary Authorities | 12.5 | 12.5 |
| **Short Term Debt** | | |
| • Private Sector | 950 | 1807 |
| • Reserve Bank | 614 | 587 |
| **Total External Debt** | **8934** | **10838** |