



ZIMBABWE: BUSINESS OUTLOOK 2018/19

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Waiting for the Other Shoe to Drop

- ▶ Since the political change of November 2017, the country has been waiting for the other shoe – economic change – to drop.
- ▶ But so far, the much-vaunted New Dispensation has focussed on kicking the economic reform can further down the road.
- ▶ There are many promises of economic action but, as yet, no discernible movement.

PICKING DISCONTINUITIES

- ▶ Forecasting of any kind is about picking discontinuities and inflexion points.
- ▶ When does a downtrend flatten out and - perhaps - reverse?
- ▶ When and in what ways do politicians eat their words, abandoning past positions, and set out on a completely different path?

REFORM AWAITED

- ▶ Over the past year, there has been much talk of reforms to come, but when the new Finance Minister spoke of currency reform, which is essential, he was smartly put back into his box and reminded that the multi-currency status quo would remain.
- ▶ It is much easier to talk about reforms than to come forward with realistic, implementable, measures

LONG LINE OF REFORM FAILURES

- ▶ Zimbabwe has an abysmal record in this regard stretching back to ESAP in 1991.
- ▶ There have been numerous reform programmes, none of which – with the honourable exception of Tendai Biti's STERP in 2009 – was fully implemented.
- ▶ ZIMASSET is just the most recent in a long line of failures.

NO ECONOMIC EXPLANATION

- ▶ There is no economic explanation for this, because in all the reform programmes there were some sensible, sound reforms.
- ▶ But when push came to shove, two problems:
- ▶ (i) Political resistance, and
- ▶ (ii) Administrative inertia and incompetence.
- ▶ Ensured that reform was sidelined.

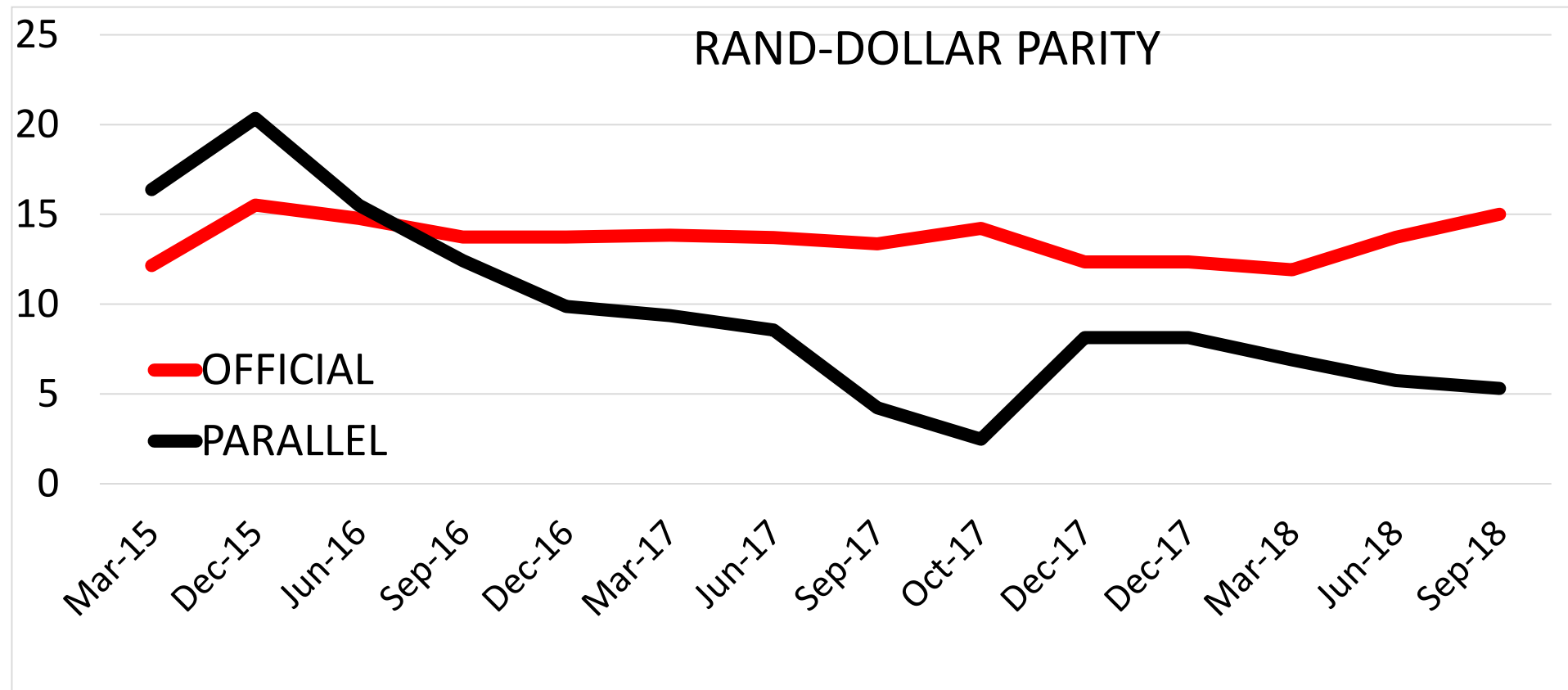
THE ECONOMY TODAY

THE SEVEN UNSUSTAINABLES

1. OVERVALUED CURRENCY

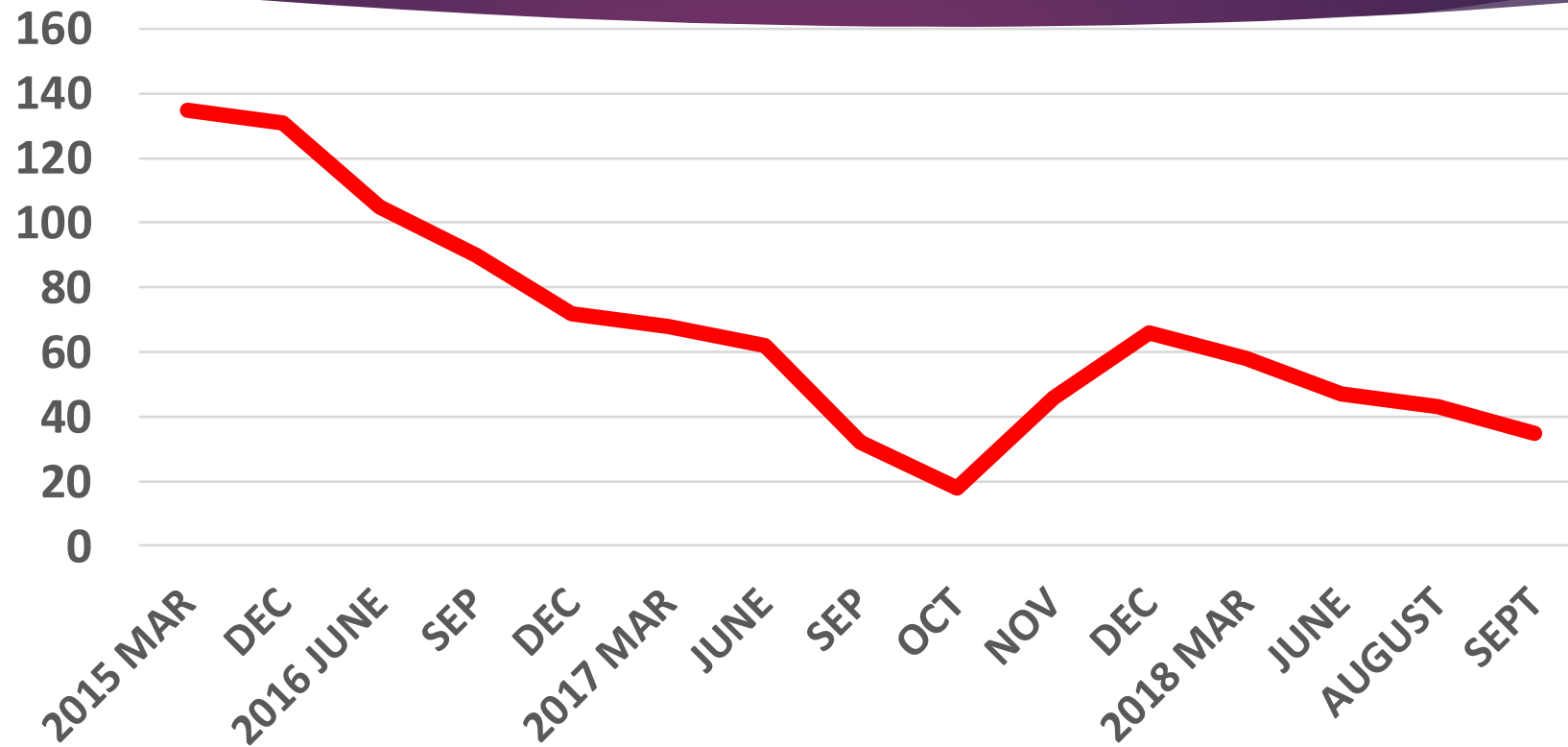
- ▶ International dollar – strongest since end 2016 and up 17% since dollarization.
- ▶ Simultaneously our main trading partner (SA)'s currency has fallen 24%.
- ▶ As a result, Zimbabwe is uncompetitive not just in the region, but also globally.

Rand-Dollar: Official & Parallel



Parallel Exchange Rate (OMIR)

US CENTS



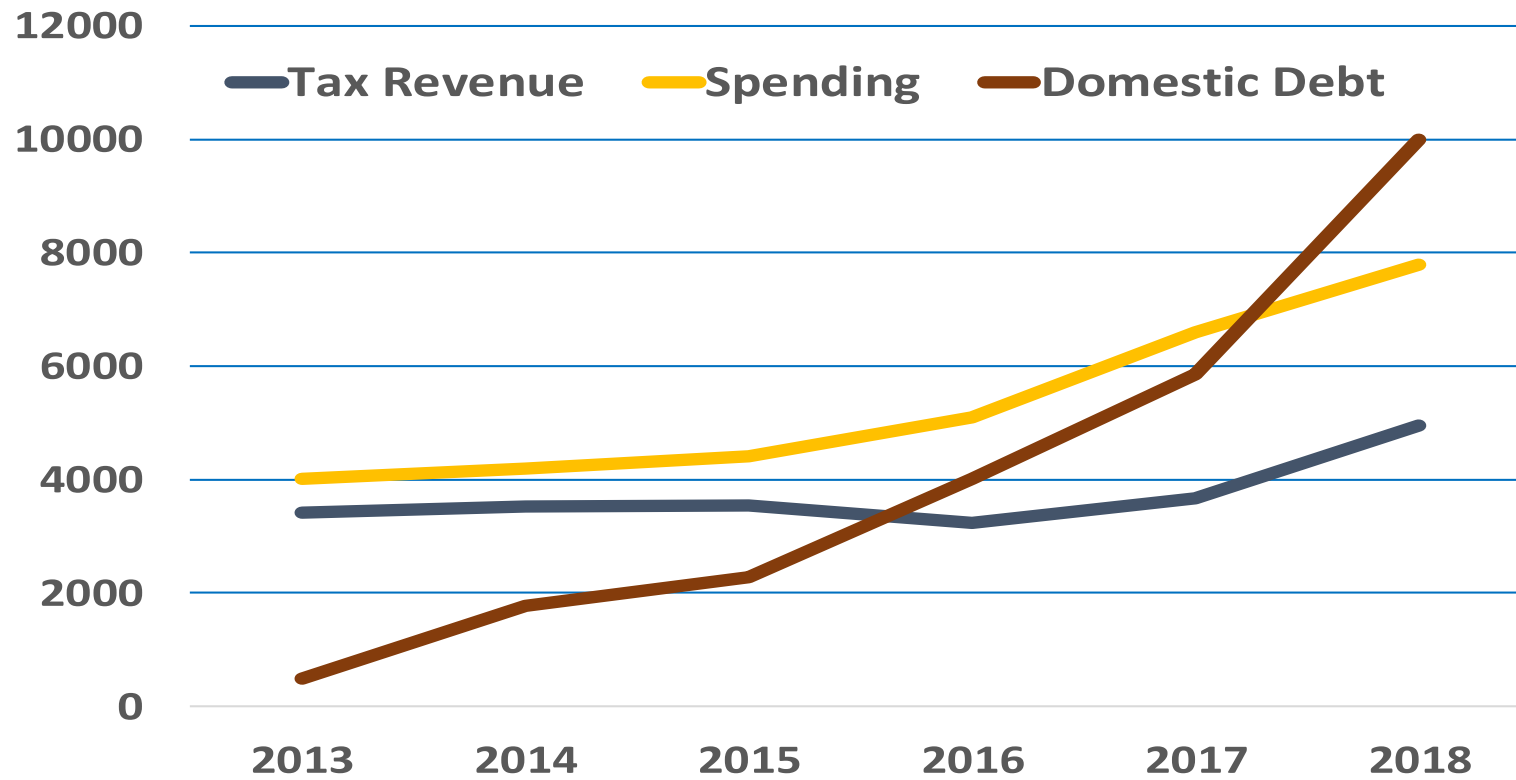
IMPACT

- ▶ Currency over-valuation results in cheap imports (up 25% so far in 2018), sluggish exports – up 14% mainly due to increased, but subsidized, tobacco and gold production.
- ▶ Helping contain inflation by keeping import prices down, but only at the official, not the parallel exchange rate.

2. BUDGET DEFICIT

- ▶ Forecast: \$3 to \$3.3 billion in 2018 – up by a third from \$2.5 billion last year.
- ▶ Despite promises to cut spending made in 2018 budget (after the coup), spending is up 57% against 14% for revenue.

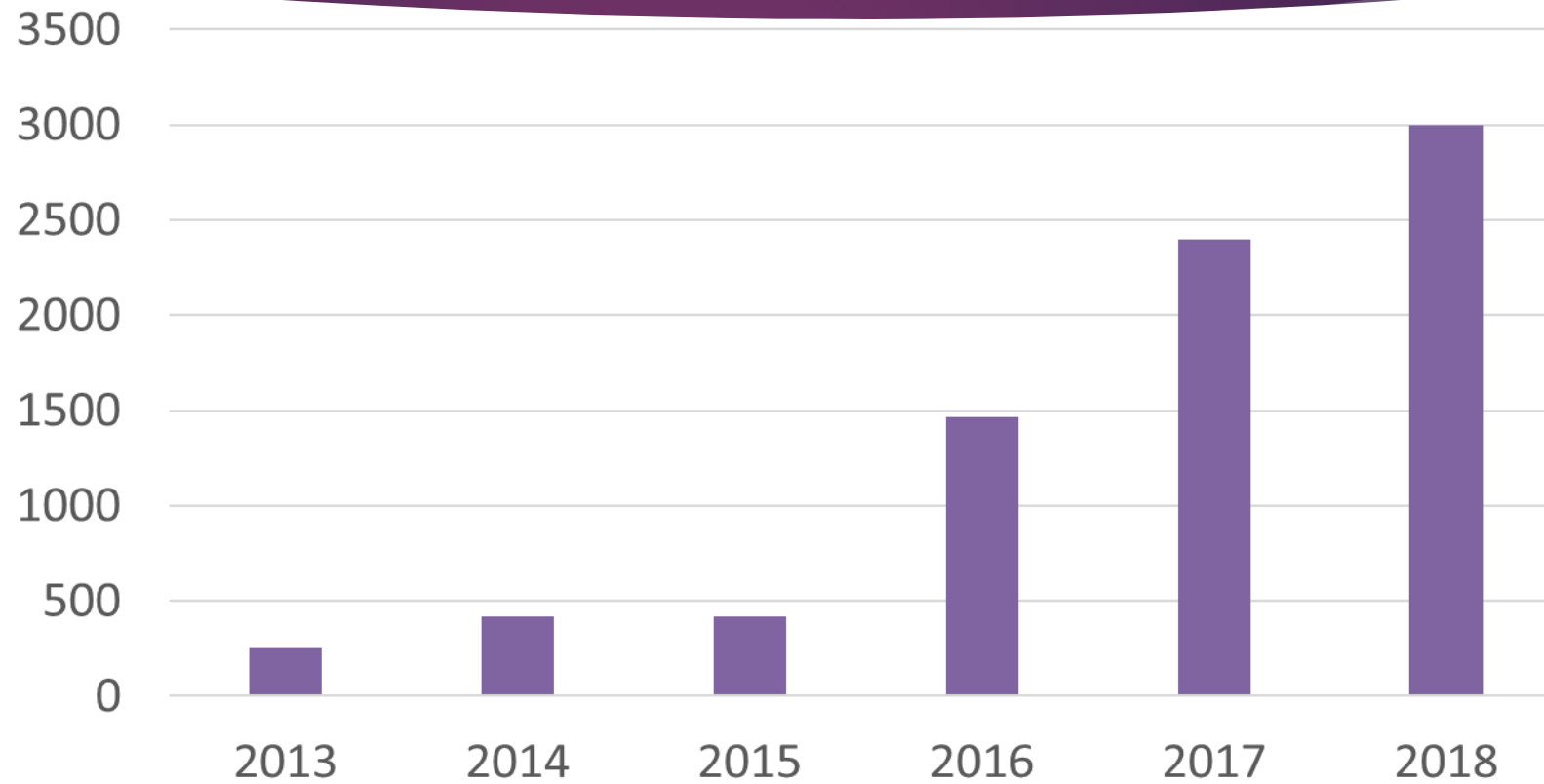
FISCAL CRISIS



WORSE TO COME IN SECOND HALF

- ▶ Deficit in the first half of the year \$1.4 billion – before the 17.5% to 22% pay rises for civil servants & security forces, which will add at least \$300 million to spending.
- ▶ Over \$1 billion of unbudgeted spending was for electorally-driven subsidy programmes (command agriculture, maize and wheat).

BUDGET DEFICIT (\$ Millions)



3. MONEY SUPPLY

- ▶ Since 2013, money supply up \$5 billion due to Government borrowing.
- ▶ BUT GDP grew much less (14%).
- ▶ When money grows far faster than production as in this case, prices rise as inflation accelerates.

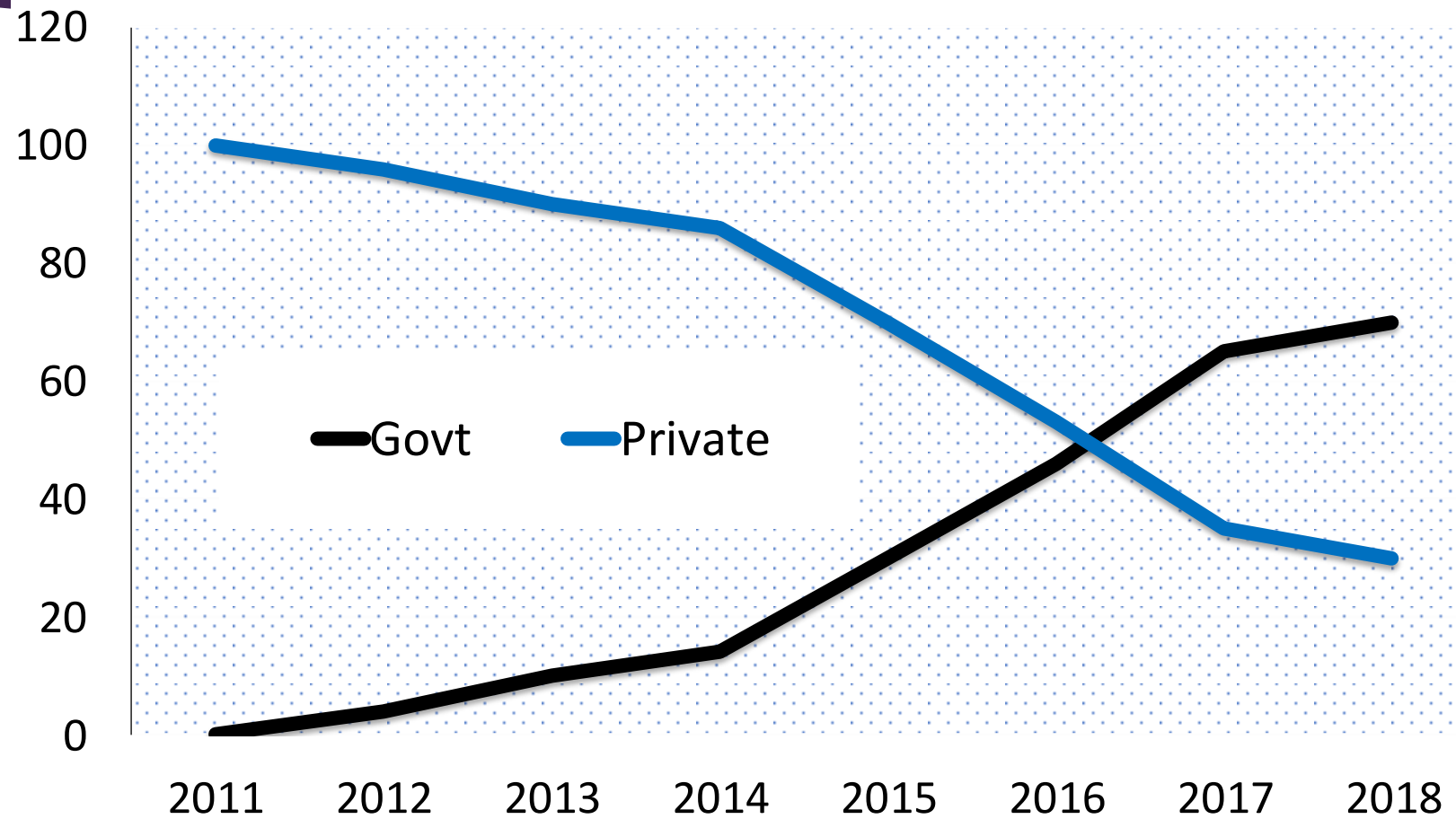
Government Borrowing drives money supply (\$ millions)

Item	2013	2018 (May)	% change
Real GDP	13 573	15 500	+ 14
Pvt Loans	3 576	3 781	+ 6
Govt Loans	2 015	8 333	+314
Money Supply	3 889	9 141	+ 135

4. GOVERNMENT BORROWING

- ▶ Since 2013 government borrowing has surged to 67% of total bank credit from just 10%, crowding out the private sector.

SHARES IN TOTAL CREDIT



5. INFLATION: DRIVERS

1. Rapid money supply growth.
2. Currency depreciation – local unit down 41% in the last year on the OMIR, though firmer than in October 2017.

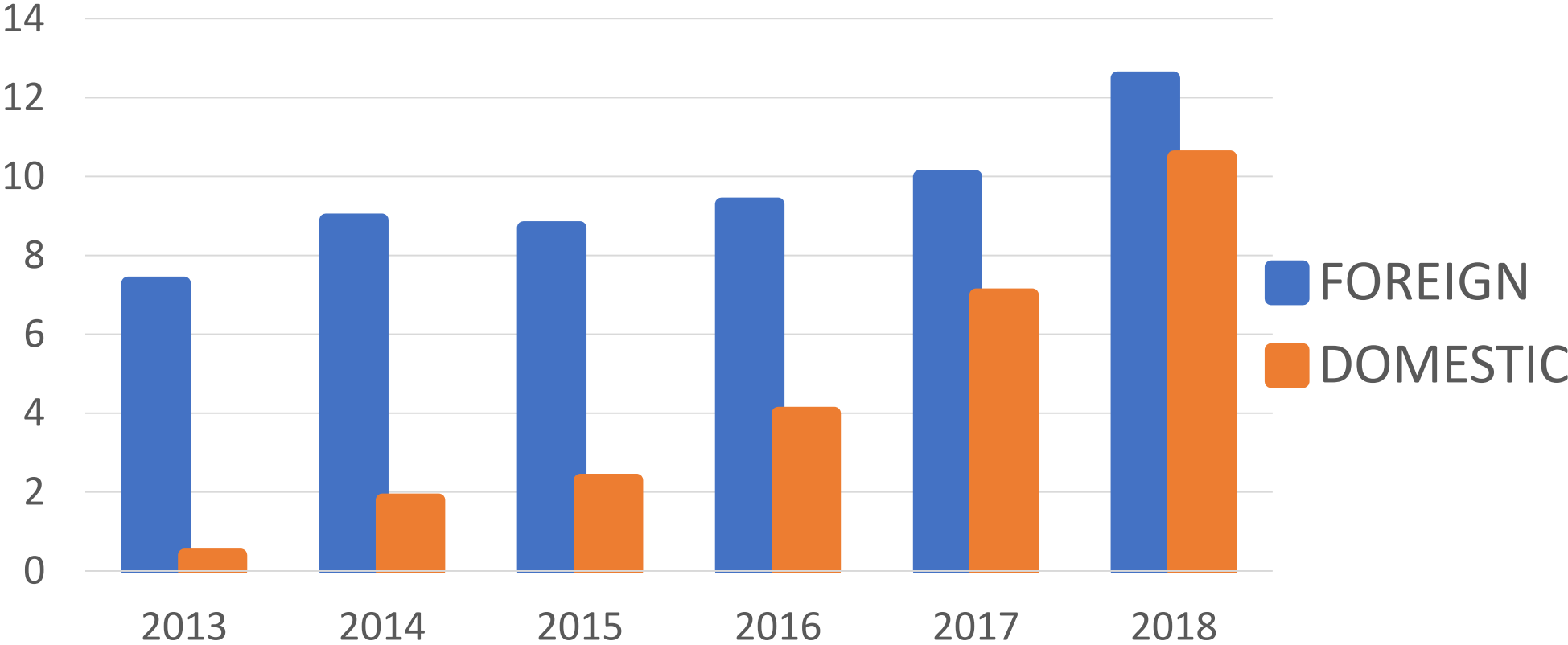
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- ▶ 3. Forex constraint forcing importers to access parallel market (expensive) money to finance supplies.
 - ▶ 4. World Oil prices up 58% from 2017 average and highest since 2014.

6. DEBT

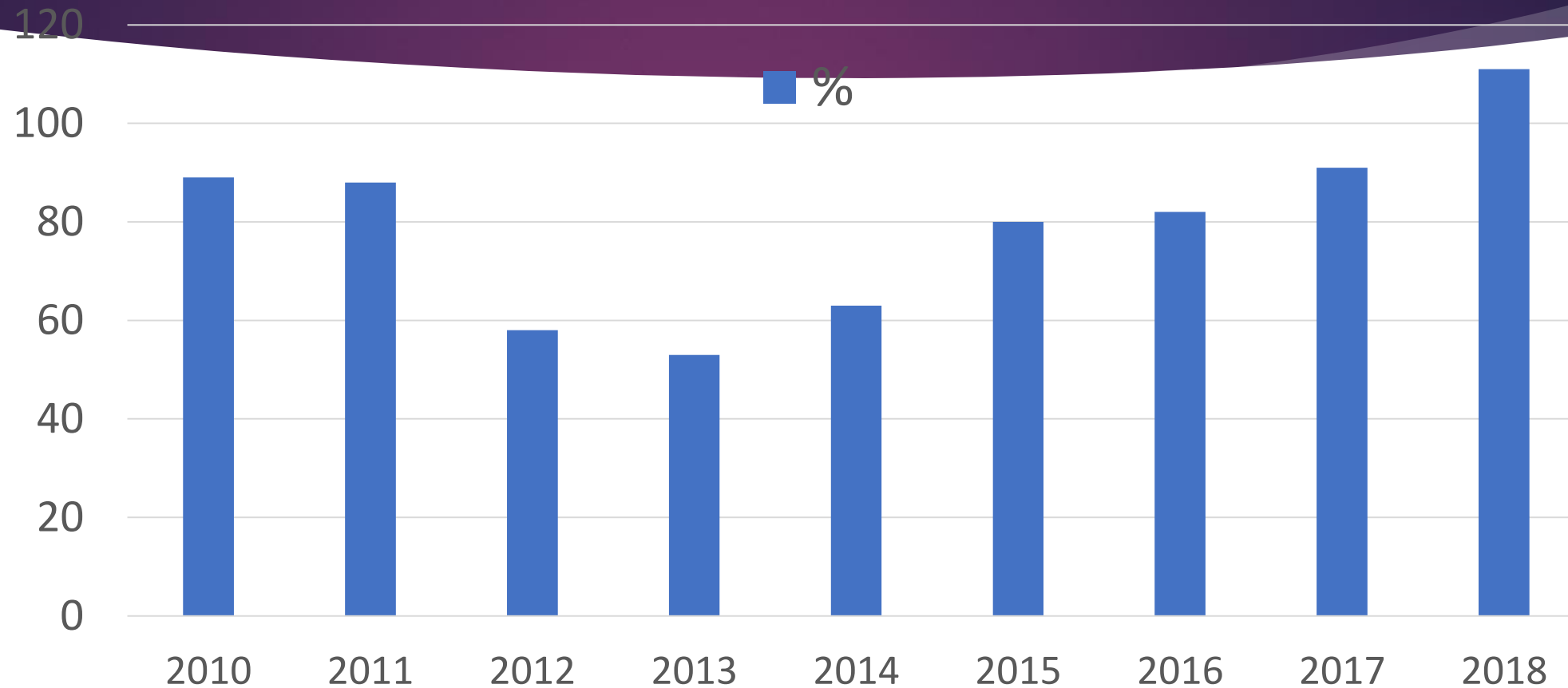
- ▶ Zimbabwe's debt – domestic and foreign – all of it in US dollars, has doubled to \$22.5 billion from \$11 billion three years ago.
- ▶ Domestic debt has grown five-fold to \$10 billion.

US DOLLAR DEBT

Dollars Billions



DEBT AS A PERCENTAGE OF GDP



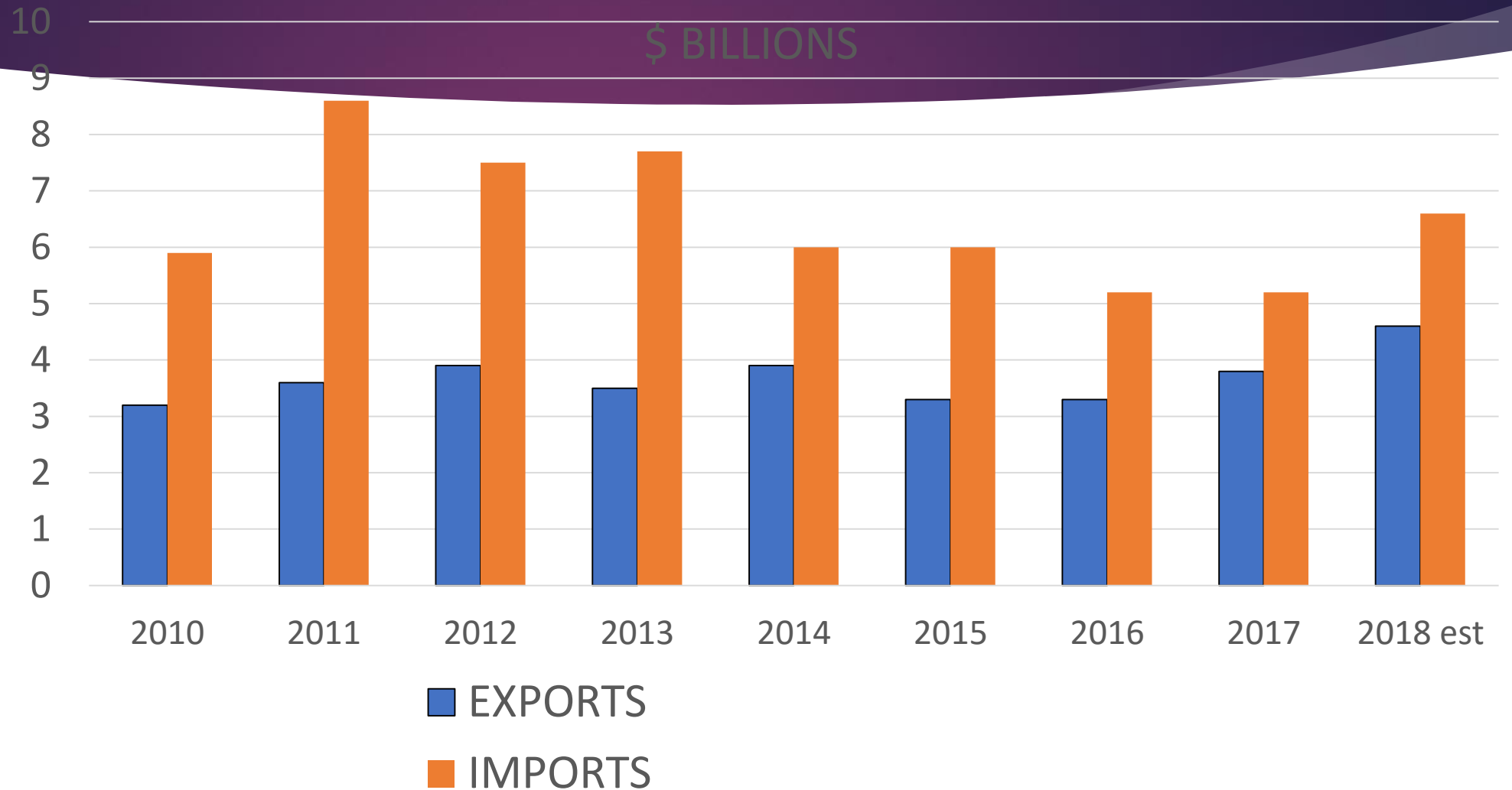
7. TRADE GAP

- ▶ Exports in 2018 are forecast to reach their highest level (\$4.6 billion) since 2014 (\$3.9 billion)
- ▶ Mainly due to gold, tobacco and other minerals like diamonds, nickel and chrome.

IMPORTS

- ▶ Imports however, are growing faster than exports and will reach \$6.6 billion – their highest since 2013.
- ▶ There will be a trade gap of \$2 billion which, after taking account of a \$500 million deficit on “invisibles”, will come close to \$2.5 billion.

FOREIGN TRADE



SOLUTIONS

PARADIGM
CHANGE

NEW PARADIGM

- ▶ Current policies – including those followed since the coup a year ago, are making matters worse, not better.
- ▶ Command economics have succeeded only in creating a parallel economy.

POLICY SINCE 2013

- ▶ Direct state intervention to mitigate and cushion the impact of hostile market conditions:
 - Currency over-valuation
 - Government over-spending
 - Credit creation to finance budget deficits

COMMAND ECONOMY

- ➔ SI 64, increased import tariffs to cushion balance-of-payments and reverse de-industrialisation
- ➔ Command Agriculture to finance farm inputs (unbudgeted)
- ➔ RBZ loan windows, export subsidies using borrowed funds – direct competition with banks

RENT SEEKING PARALLEL ECONOMY

- ▶ Financial/fiscal/currency imbalances have spawned a parallel economy.
- ▶ Not just a burgeoning informal sector but one in which firms and households generate income – not from making and selling goods – but currency trading to exploit officially-created arbitrage opportunities.

WHAT KIND OF
REFORM?

ESAP TWO?

PARADIGM SHIFT

- ▶ Reform agenda assumes a paradigm shift from a bloated and inefficient public sector
- To a free market investment- and export-led growth model.
- End to consumption-led growth fuelled by government borrowing & spending.

REFORM AGENDA (ESAP TWO)

- Currency devaluation (at least 50%)
- Abolition of subsidies
- Public sector retrenchments
- Shift in government spending from employment to social spending and to capital investment

AGENDA

- Parastatal reform and privatisation
- Reversal of tariff hikes and SI 64
- RBZ to return to traditional, normal central bank functions
- Informal inflation-targeting including positive real interest rates and tighter monetary policy

LONG-TERM GROWTH

- ▶ Reforms to lay foundation for medium-term structural change:
 - Reverse de-industrialisation
 - Revive domestic savings and investment
 - Reduce reliance on foreign funding
 - Shrink the informal economy by fostering formal job creation

RE-
ENGAGEMENT

ONLY GAME
IN TOWN

TOP OF THE AGENDA

Multi-stage process:

- ▶ Clear \$2 billion in arrears owed to multilateral lenders – World Bank, African Development Bank, etc.
- ▶ Plan is to borrow the funds privately within 6 months.

DEVALUATION

- ▶ Process likely to start at October IMF/WB meetings.
- ▶ Once that hurdle is cleared, Government will have to negotiate a programme with the IMF, similar to ESAP in 1990/1, including:
 - Deep cuts in government spending and privatisation;
 - Currency devaluation.

Political Re-Engagement

- ▶ Once negotiated with the Fund Staff, the programme must be agreed by the Executive Board, dominated by the US.
- ▶ Under Zidera, the US representative on the Board must vote against any support for Zimbabwe.

NEED US BACKING

- ▶ It may be possible to find sufficient votes to override a negative US vote.
- ▶ This is unlikely because very few US allies such as the EU, Australia, Canada, India, etc, would seek to pick a fight with Washington over a small country which does not matter to them.

POLITICAL CONDITIONALITIES

- ▶ This could mean that Zimbabwe will be forced to negotiate a political deal with the US (and other Western states) likely to include political and electoral reforms – such as Diaspora voting.

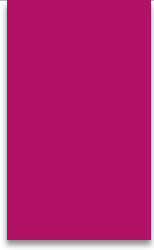
DEBT-RESTRUCTURING

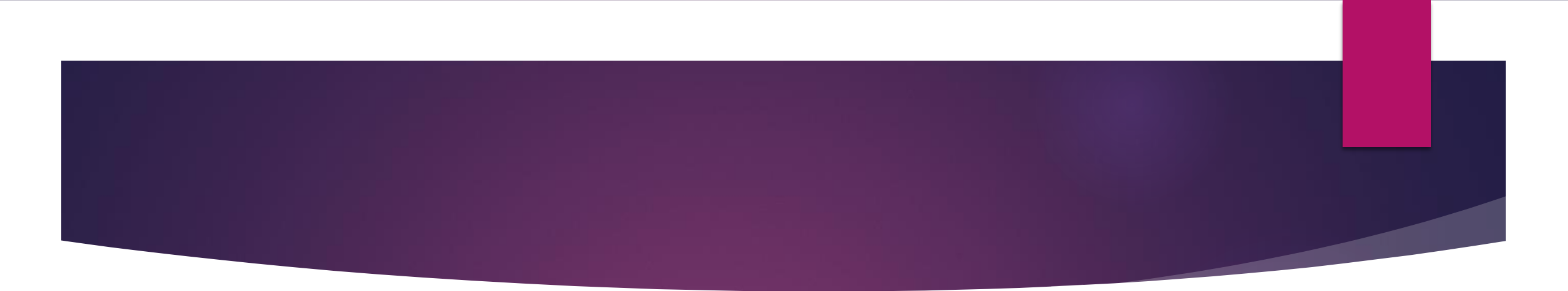
- ▶ Once an IMF programme is passed by the IMF Board, Zimbabwe would go to the Paris Club (donors) for debt restructuring and debt relief.
- ▶ Even with debt relief, the debt position – especially domestic debt which cannot be forgiven – would remain precarious.

TIMING

- ▶ All of this could take a year to put in place, meaning that Zimbabwe is unlikely to source new low-cost financing until mid-2019 at the earliest.
- ▶ This would mean more expensive commercial offshore borrowing
- ▶ The more it borrows, the more difficult the debt and IMF negotiations.

BUSINESS OUTLOOK



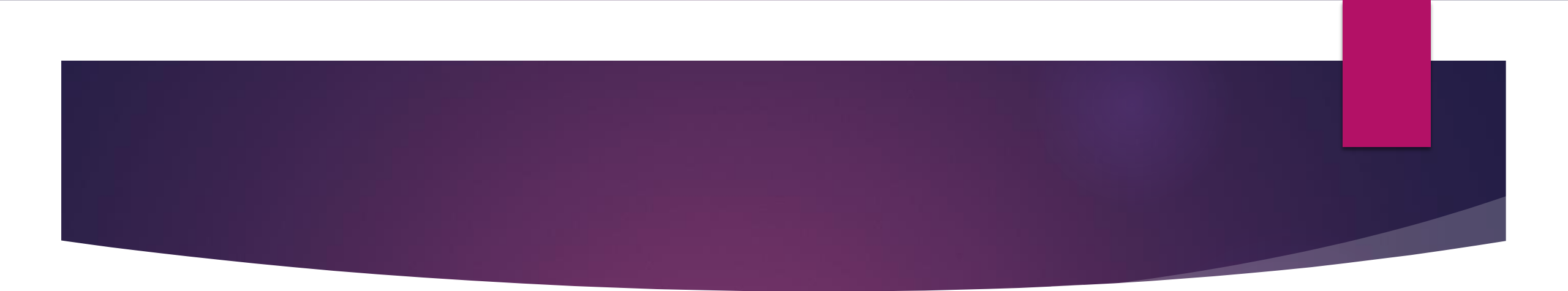
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- ▶ My forecast assumes that there will be an IMF programme of some kind that will force the authorities to implement at least some of the conditions listed earlier.
 - ▶ Start point is a major reduction in govt spending - \$2 billion (10% of GDP) over a 2 or 3 year period.

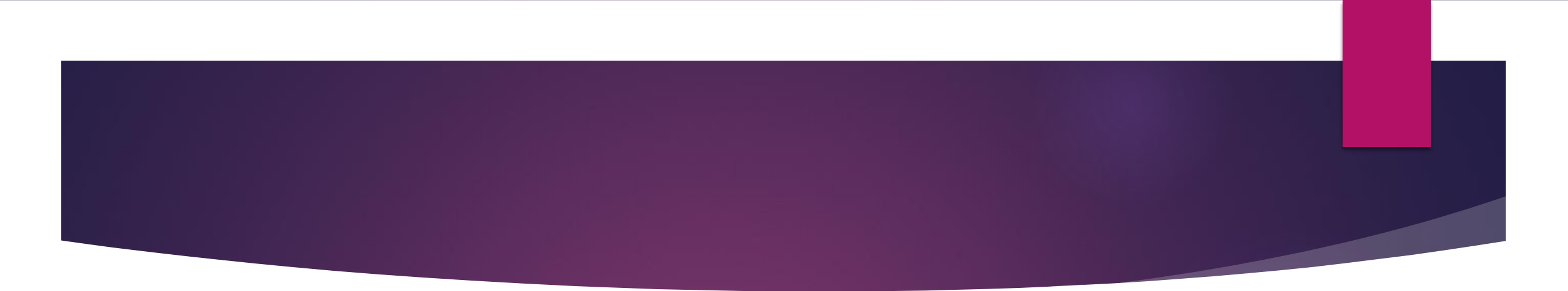
SLOWER GROWTH & HIGH INFLATION

- ▶ Since this will be accompanied by devaluation, the result will be a combination of slower growth and sharply higher inflation.
- ▶ Certainly in 2019, probably continuing into 2020

CENTRAL BANK INDEPENDENCE

- ▶ Monetary policy will have to be tightened by slowing the growth of money supply, putting an end to the RBZ's arbitrary and artificial lending windows, raising real interest rates and converting the RBV from a department in the Zanu-PF politiburo to an independent central bank.

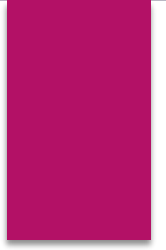
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- ▶ This is the most effective formula for putting an end to RBZ funding of public sector deficits.
 - ▶ For the immediate future government will have to stop commercial offshore borrowing and rely on official finance from donors.

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- ▶ Taken together, these measures would stabilize the economy;
 - ▶ All of them – with the exception of devaluation – would be deflationary, as a result of which growth would slow

SCENARIO

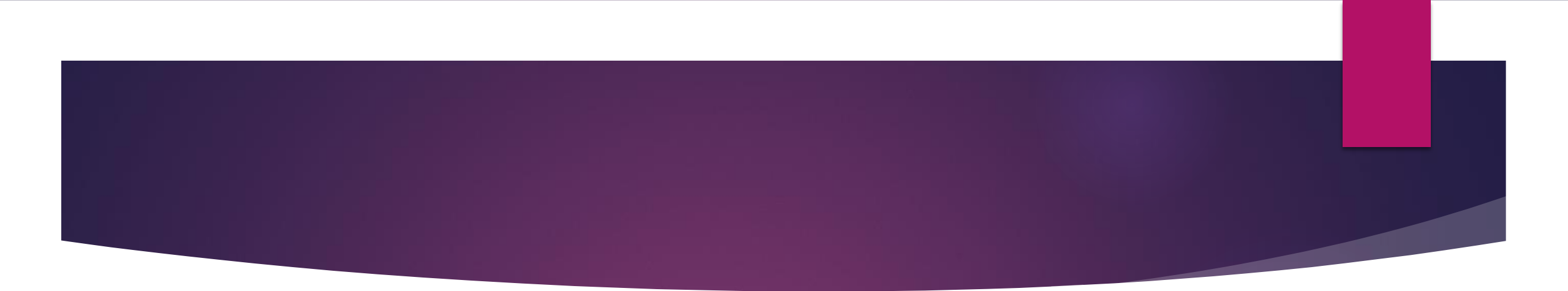
% p.a.	2018	2019	2020
GDP	4.0	3.0	4.5%
Inflation	12%	35%	20%
ER: Cents per US\$	45	30	20
Budget Deficit (% of GDP)	16.5	11	8
Debt (% of GDP)	110	100	85

Socio-political outlook



POTENTIAL BACKLASH?

- ▶ In the election campaign, the ruling party and state media created unrealistically high expectations.
- ▶ Promises that cannot and will not be kept.

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- ▶ As tough, unpopular, reforms are imposed there will be a political backlash that could force the authorities to backtrack on reforms, thereby jeopardising recovery as happened after ESAP 1.

RURAL-URBAN VOTE IMBALANCE

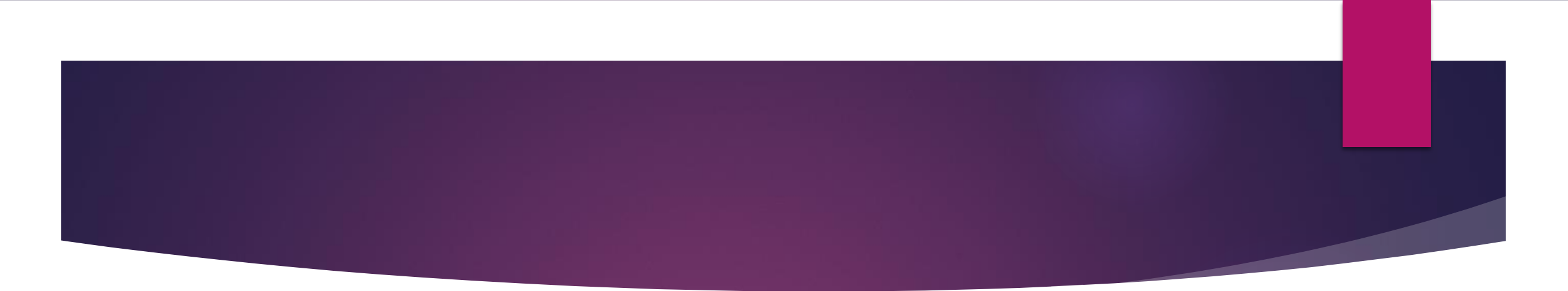
- ▶ Zanu-PF beholden to its electorate – 70% of its votes came from rural areas.
- ▶ Low income, less well educated voters, poorly informed (ZBC/ZTV), subject to official propaganda, reliant on handouts (food aid, inputs, etc.) vulnerable to widespread & intensive “soft” intimidation by traditional leaders.

UNSTABLE OVER THE MEDIUM TERM

- ▶ Imbalance between 7% margin in presidential poll and 69% of constituencies.
- ▶ Rural economy contributes less than a third of GDP yet rural voters in full political control at national level.

MODERNITY VERSUS TRADITIONALISM

- ▶ Electorate voted for continuity not change
- ▶ For rural traditionalism, not a modern open-for-business economy
- ▶ For rising levels of consumption and better living standards.

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- ▶ This unwieldy, rural-urban inequality is a recipe for instability over the medium term as unemployment worsens.
 - ▶ There is no easy solution to jobs crisis because the formal economy simply cannot and will not grow fast enough.

EMPLOYMENT

- ▶ Formal employment grows at half the rate of GDP.
- ▶ GDP growth of (say) 6% a year generates a 3% increase in employment
- ▶ At current levels this is only 45 000 jobs a year against 250 000 to 300 000 school-leavers.

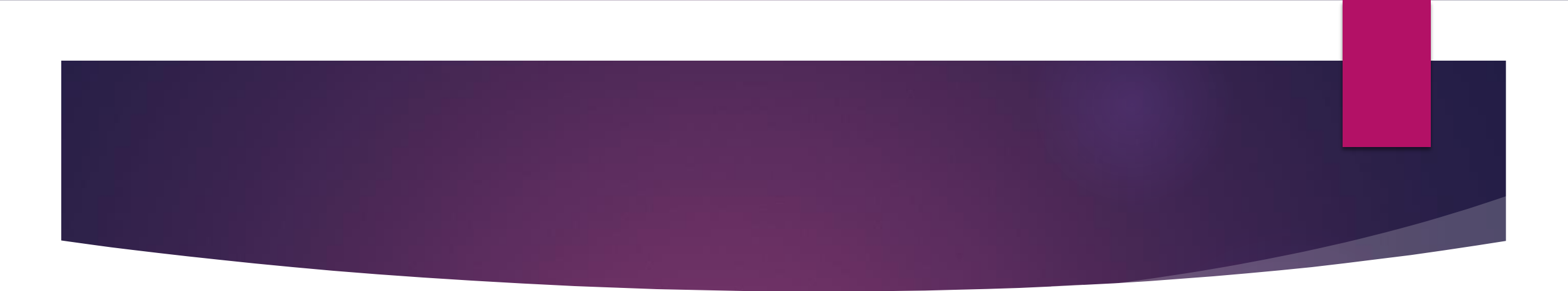
CONCLUSIONS

NO QUICK FIX

- ▶ According to the IMF, it takes 10 years for a fragile economy like Zimbabwe to overcome binding constraints – such as investment, infrastructure and skills.

FOREIGN CAPITAL NO PANACEA

- ▶ Foreign capital will not do the job
- ▶ For developing countries as a whole the average is 10% of total investment, while for fast-growth China it is 5%

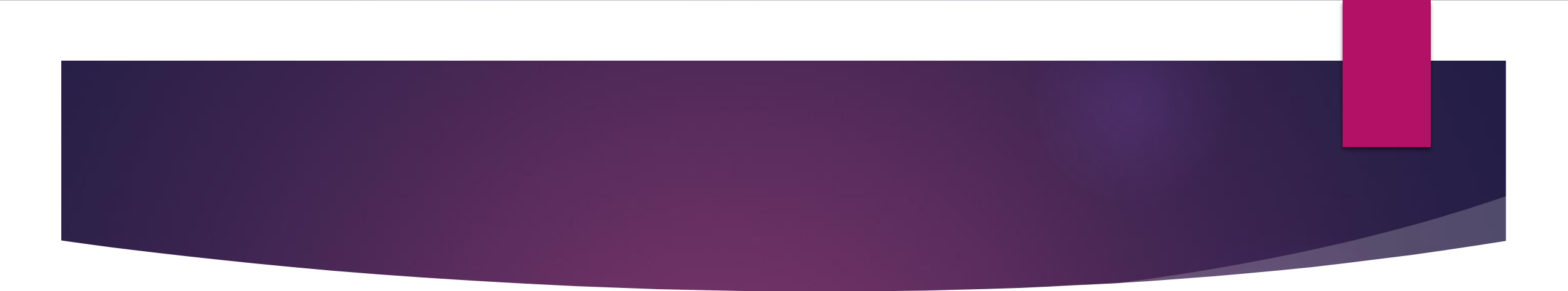
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- ▶ Domestic savings are crucial, but these are negligible in Zimbabwe as against 17% of GDP in SSA and 46% in China.

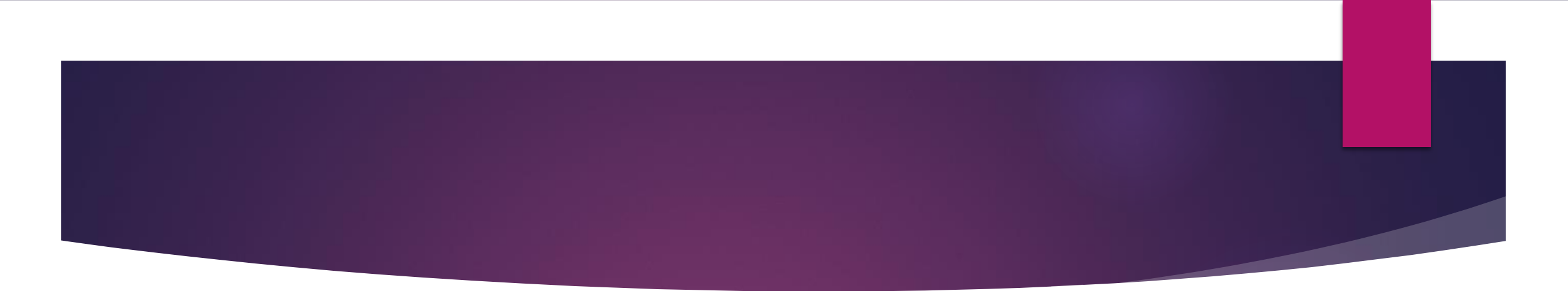
MAJOR SHIFT ESSENTIAL

- ▶ Slide suggests steep falls in expenditure shares in GDP of both private and government consumption.
- ▶ Investment must more than double while net offshore financing of all kinds declines significantly.

EXPENDITURE (% of GDP)

ITEM	NOW	REQUIRED
Private Consumption	77	65
Government Consumption	25	15
Investment	12	30
Total	14	110
Exports	25	30
Imports	39	40
Net Exports (offshore financing)	-14	-10

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- Structural shift of this nature will take a number of years to achieve.
 - But there will be fierce resistance from a population, now used to high levels of consumption spending, both private and government, partially funded by foreigners and the Diaspora.

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- ▶ It will be difficult to change this culture of the past.
 - ▶ Especially so, for a political party that relies so heavily on a traditional, rural culture for political support.