

International Monetary Fund

African Department

Zimbabwe: Economic outlook and the SMP

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The views expressed do not necessarily reflect the views of the IMF or the Executive Board of the IMF.





Roadmap

- ◆ Background and Recent Developments
- ◆ SMP: Objectives, Risks, and Performance
- ◆ Adverse Shocks, Policy slippage, and Social Impact



BACKGROUND AND RECENT ECONOMIC DEVELOPMENTS



Genesis of the Problem

- After a period of stability in 2010-2014, largely reflecting fiscal prudence and dollarization in the aftermath of hyperinflation, the country again finds itself in crisis.
- Several years of unsustainable fiscal deficits that were financed via central bank creation of quasi-money instruments have led to an inflation-wage-exchange rate depreciation spiral.
- Unsustainable fiscal deficits in 2017 and 2018, financed by RBZ money creation, have fueled an ever-growing parallel market for the quasi-currency (RTGS).
- Maintenance of official parity of the RTGS with the US dollar, provided opportunities for rent seeking as exchange rate distortions crushed exporters to the benefit of well-connected importers.



Key macroeconomic indicators

Zimbabwe: Key Macroeconomic Figures, 2018, 2019

	2018	2019
Real GDP growth (%)	3.5	-10.4
Inflation (% eop)	42.1	289 [*]
Overall Fiscal balance (% GDP)	-7.4	-1.0
Current account (% GDP)	-4.5	-2.6
Reserves (months of imports)	0.1	0.1

*August 2019 y-o-y CPI inflation



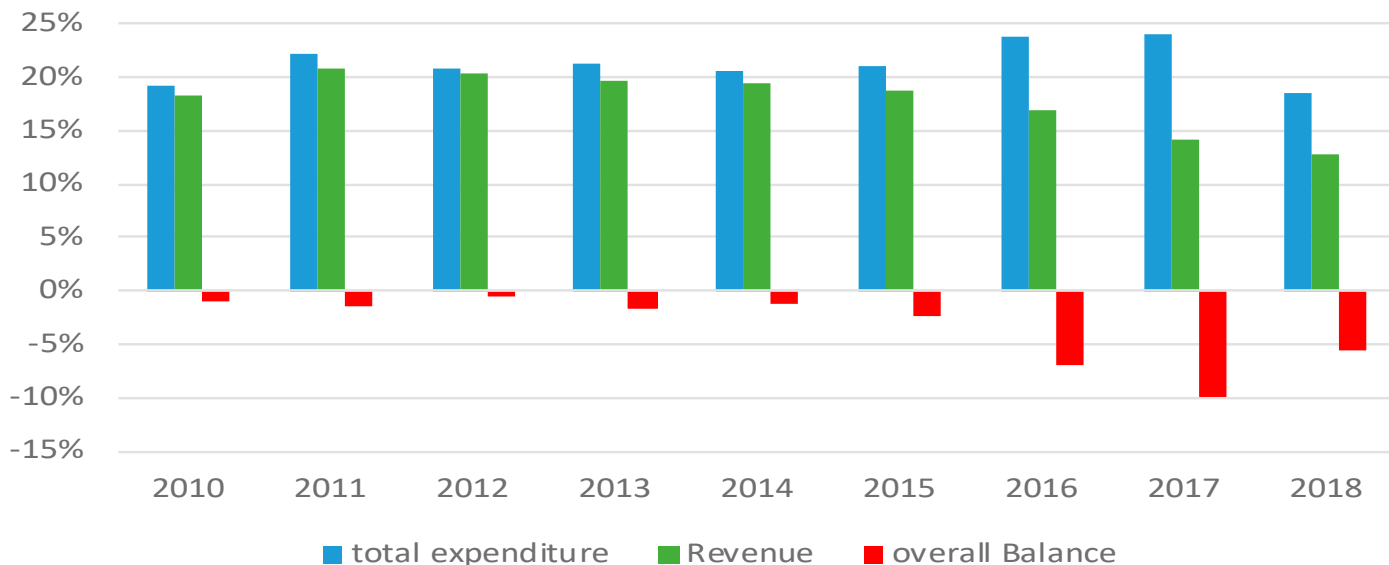
Zimbabwe: Economic outlook

- **Economic outcomes in 2019 are worse than anticipated**
GDP expected to be steeply negative due to drought, poor electricity generation, cyclone Idai and austerity
- **Twin external shocks:** have significantly impacted the macroeconomic adjustment, worsening the humanitarian crisis.
- **No external support:** Zimbabwe continues to have external arrears to IFIs and bilateral official creditors. It is effectively blocked from traditional external support to address its balance of payments crisis.
- **No domestic buffers:** The central bank has no reserves, leaving little policy ammunition to defend the new currency in a context of very weak confidence.
- **Growth projected to contract:** by at least -10.4 percent in 2019, compared to -2.1 percent under the SMP



Large deficits returned, as revenues fell and spending increased...

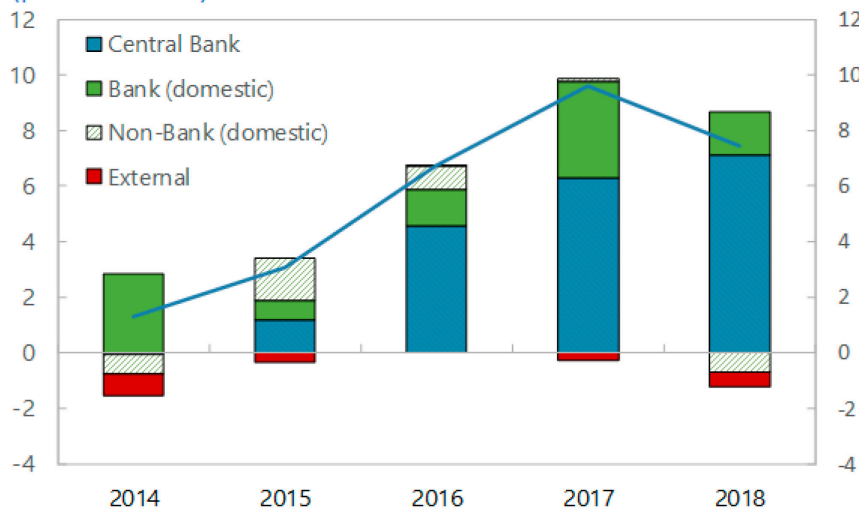
Zimbabwe: Revenue, Expenditure, and Deficit (percent of GDP)



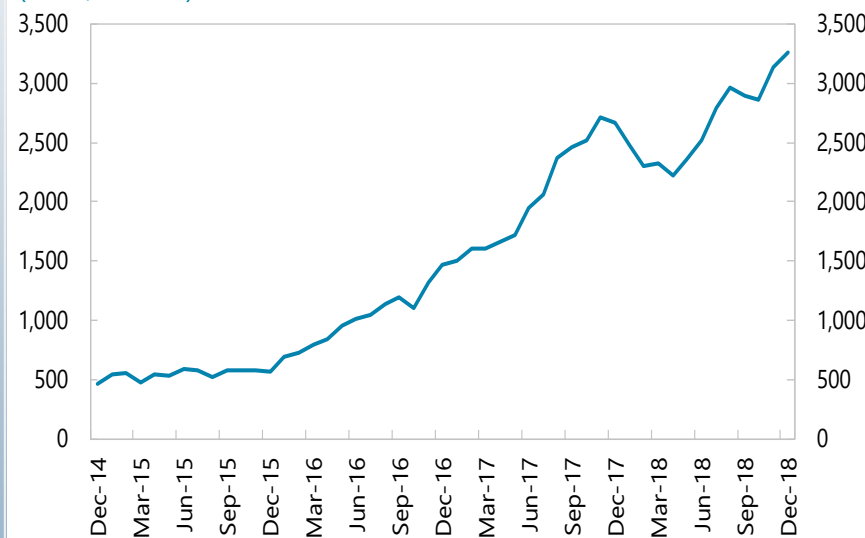


Deficits were financed domestically, mostly by money creation

Zimbabwe: Fiscal Deficit and its Financing
(percent of GDP)



Zimbabwe: Monetary Base (M0)
(ZWE\$ million)



Creating a large overhang of domestic currency formally 1:1 with US\$, but in practice not convertible



Zimbabwe remains in debt distress...

External arrears continue to mount:

- Substantial IFIs arrears, incl. \$1.3 billion to World Bank
- Bilateral arrears of \$3.7 billion

New external financing is limited to:

- Non-Paris Club creditors
- Commodity-backed loans

Zimbabwe: Public and Publicly Guaranteed Debt

	DOD	Arrears	Total	% of GDP*
<i>(USD millions; as of end-2018)</i>				
External Debt¹	2,563	6,109	8,672	38%
<i>Bilateral Creditors</i>	1,519	3,687	5,206	23%
Paris Club	210	3,258	3,469	15%
Non Paris Club	1,309	428	1,737	8%
<i>Multilateral Creditors</i>	899	2,359	3,258	14%
World Bank	219	1,270	1,489	6%
African Development Bank	35	657	692	3%
European Investment Bank	19	290	309	1%
Afreximbank	489	67	556	2%
Others	137	74	211	1%
<i>Commercial Creditors</i>	145	63	208	1%

Source: Zimbabwean authorities and IMF staff calculations.



SMP OBJECTIVES, RISKS AND PERFORMANCE



SMP (May 2019) objectives and risks...

- Objective – Address Macroeconomic Imbalances

- ◆ Fiscal Consolidation and halt RBZ lending to government
- ◆ FX liberalization to achieve a market determined exchange rate
- ◆ Governance reforms

- Risks

- ◆ No fiscal/FX buffers or access to traditional external support
- ◆ Exchange rate and interest rate volatility as price discovery takes hold
- ◆ Large social impacts from huge depreciation and burst of inflation
- ◆ Climate shocks—Cyclone Idai, Drought



Quantitative Targets

Table 1. Zimbabwe: Proposed Quantitative Targets¹

(in units as indicated)

	2018	2019		
	Dec. Actual	Jun. Prog.	Sep. Prog.	Dec. Prog.
1. Floor on the primary budget balance of the central government (RTGS\$ million) ²	...	-1,203	-1,604	-2,005
2. Floor on protected social spending (RTGS\$ million) ²	...	225	500	750
3. Floor on the stock of net official international reserves (in US\$ million)	-1,267	-1,267	-1,267	-1,267
4. Continuous ceiling on the stock of new non-concessional external debt contracted or guaranteed by the public sector with original maturity of one year or more (in US\$ million) ³	...	0	0	0
5. Ceiling on changes in net domestic assets of the RBZ (RTGS\$ million) ⁴	...	300	350	400
6. Ceiling on credit to the nonfinancial public sector from the RBZ (RTGS\$ million) ⁴	...	0	0	0

¹ Program performance will be monitored based on the quantitative targets for June, September, and December 2019.

² Value of cumulative flows since December 31 of the previous year.

for priority infrastructure projects.

³ Cumulative from April 30, 2019.

⁴ Cumulative from March 1st 2019. For the NDA target, excludes foreign exchange valuation changes.



SMP Structural Benchmarks

Table 2. Zimbabwe: SMP Structural Benchmarks

Benchmark	Objective	Completion Date
Cabinet to approve a revised 2019 budget consistent with a deficit of RTGS\$2.9 billion (¶9 and ¶10)	Restore macroeconomic stability	Prior Action
Issue instructions to ensure that no payments shall be made by the RBZ on behalf of Government without explicit and case-by-case authorization by the MoFED (¶13)	Improve PFM, budget execution, and fiscal discipline	Prior Action
Adopt regulations implementing the Public Financial Management (PFM) Act., including to ensure all expenditure commitments are recorded in IFMIS (¶13)	Improve governance, PFM, and budget monitoring/execution	June 2019
Complete a comprehensive stock-take of domestic expenditure arrears across the central government as of end-2018 (¶17)	Improve PFM, budget execution, and fiscal discipline	September 2019
Complete a review of agricultural support programs and develop an action plan based on its findings (¶10)	Improve targeting and efficiency of agricultural support programs	September 2019
Extend the coverage of IFMIS to 37 Districts by establishing 31 additional kiosks (¶13)	Improve governance, PFM, and budget monitoring/execution	September 2019
Submit to Parliament draft amendments to the Banking Law to address gaps identified by the FSSR (¶22)	Maintain financial stability	December 2019
Complete with assistance from the IMF and publish the report of a diagnostic assessment of Zimbabwe's governance vulnerabilities (¶24)	Strengthen governance and combat corruption	December 2019



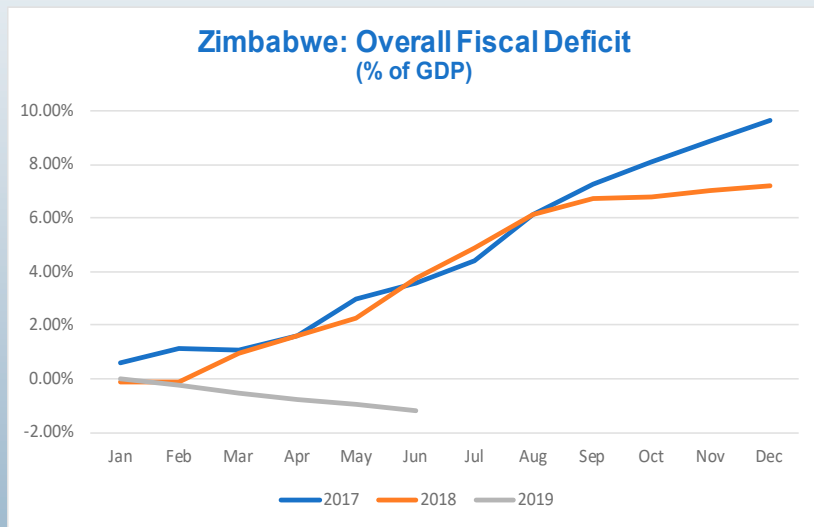
Policy implementation under the SMP

- Policy implementation under the SMP has been satisfactory to end - June, albeit with costly delays in implementing measures supporting the new domestic currency
- But economic outcomes are much worse than expected as adverse weather shocks (drought and cyclone Idai) crippled agriculture, mining, and electricity generation
- Policy slippages, poor communication and hesitancy in key steps in the currency reform, weakened confidence resulting in
 - ◆ significant increase in reserve money
 - ◆ a large exchange rate depreciation
 - ◆ inflation spike (289 percent y-o-y in August)



Performance through June was mixed

Significant fiscal adjustment since August 2018, a fiscal surplus in 2019H1



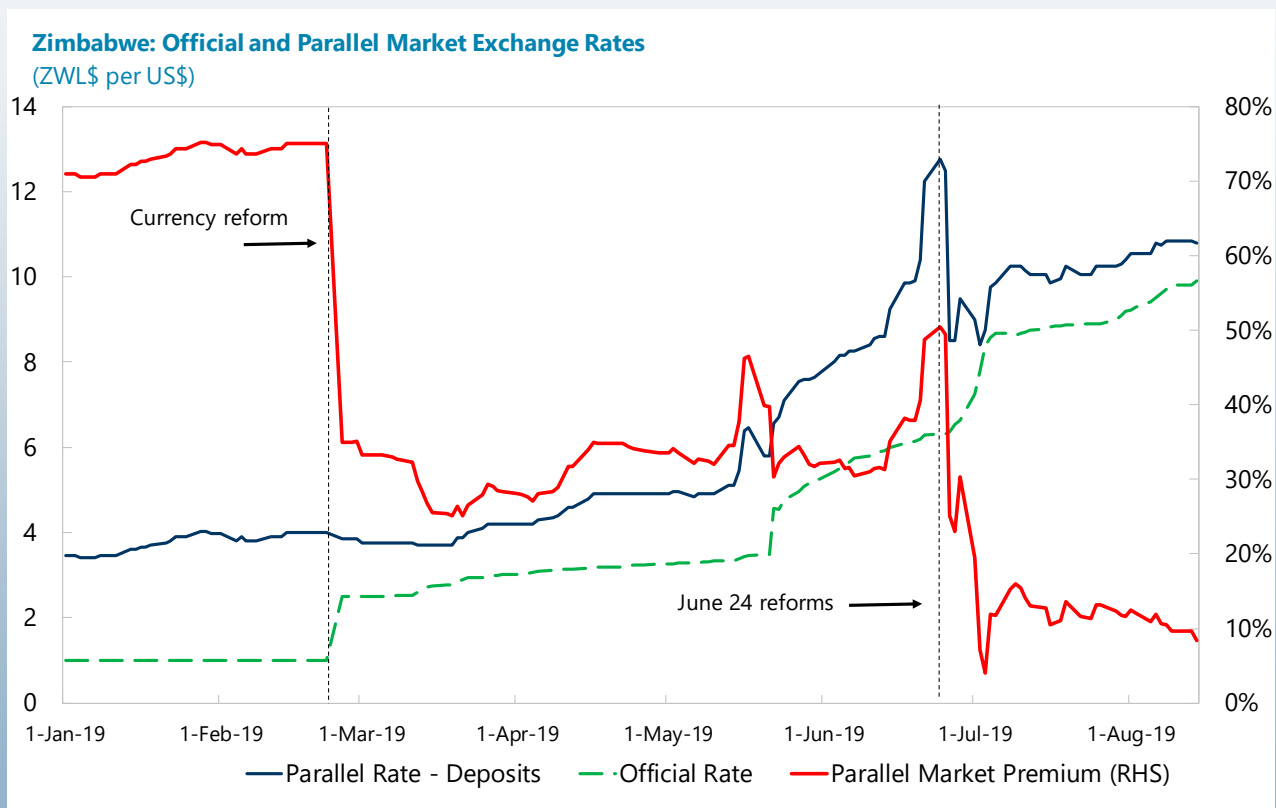
Important fiscal policy measures:

- No RBZ financing
- Contain wage increases below the rate of inflation
- Introduction of tax on financial transactions
- Improvements in revenue mobilization (fuel tax) and capacity at ZIMRA



Performance through June was mixed

A shift towards market-determined FX pricing and allocation brought, after June 24 measures, stability and narrowed the parallel market spread...

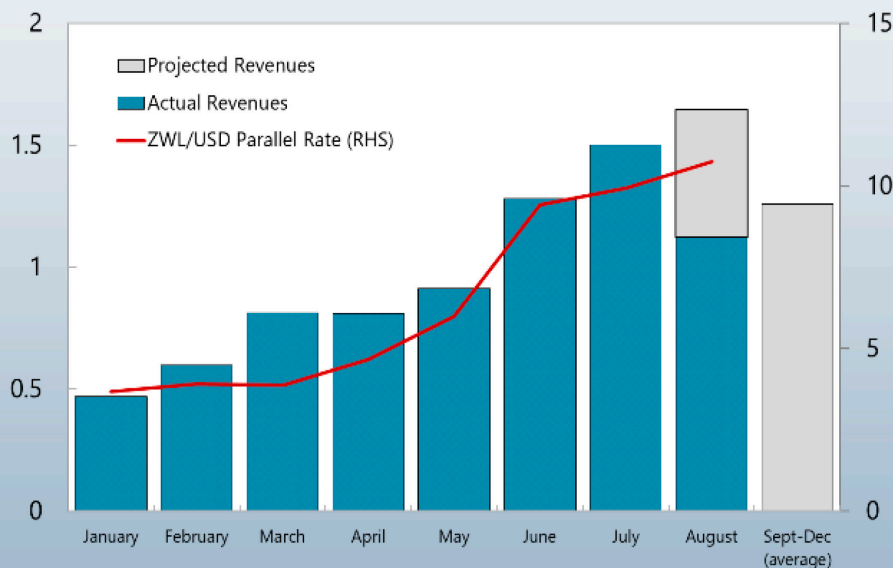




Fiscal Adjustment: Break with the past, including fiscal surplus.

Zimbabwe: Monthly tax revenue, 2019

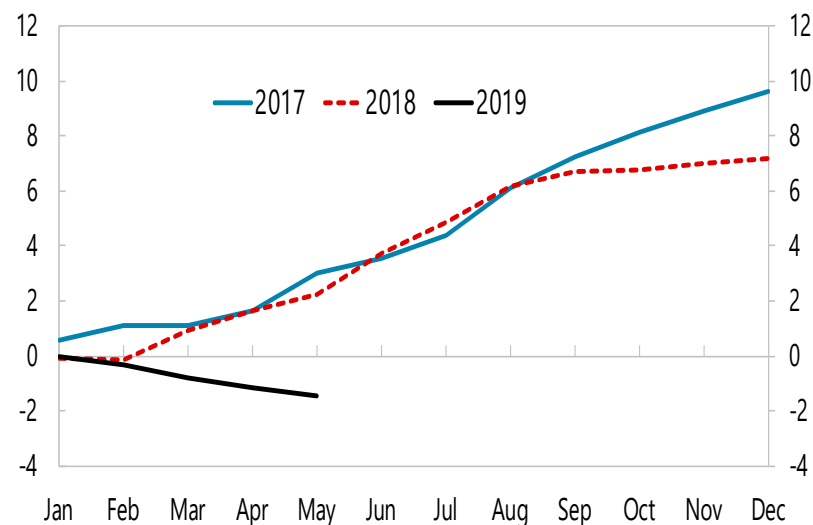
(ZWL billions; actual and projected)



Note: Tax collections were ZWL 1.1 billion as of 19th August. Staff projections for the remainder of the month.

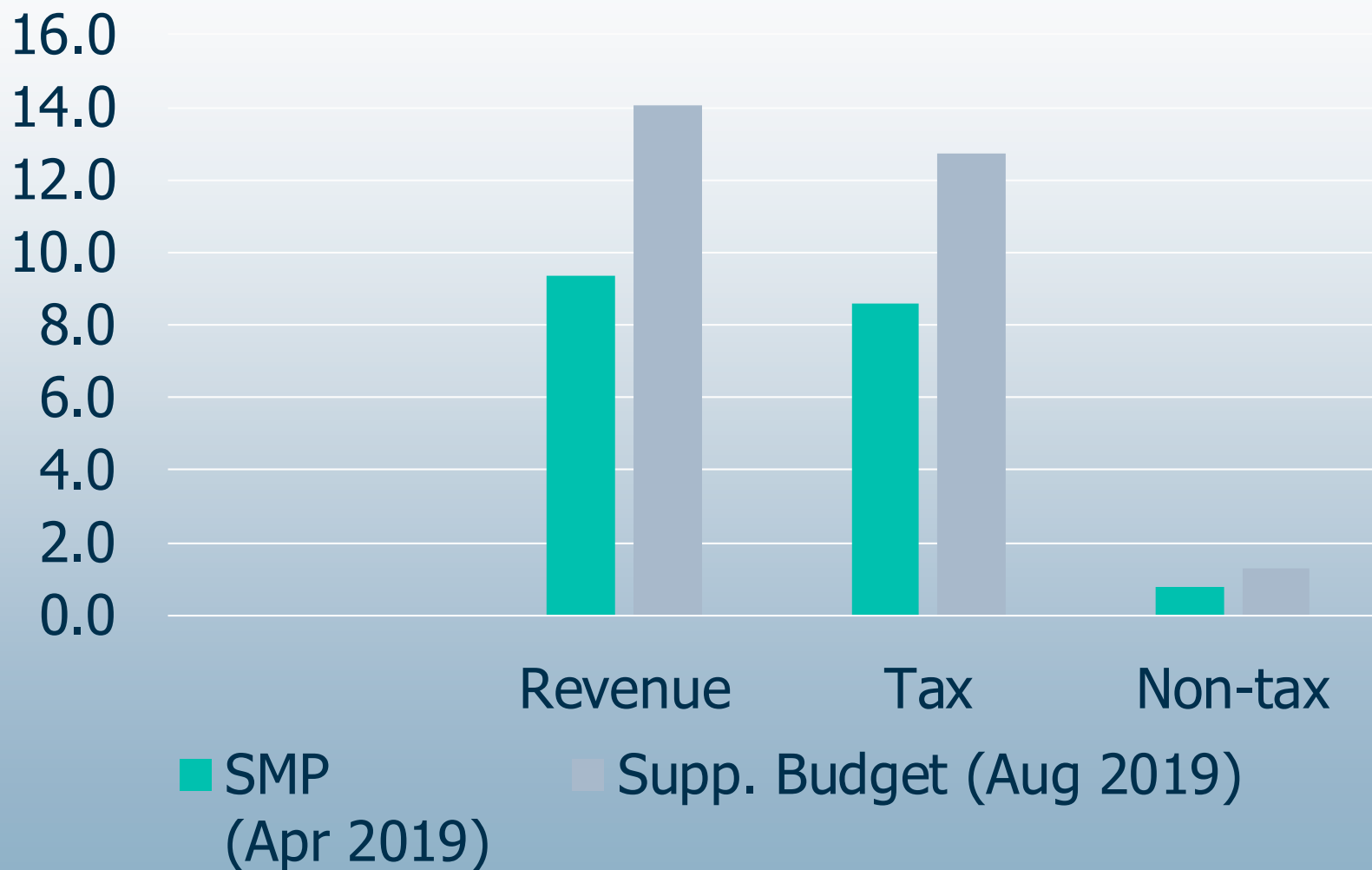
Zimbabwe: Central Government Overall Fiscal Deficit

(percent of GDP)



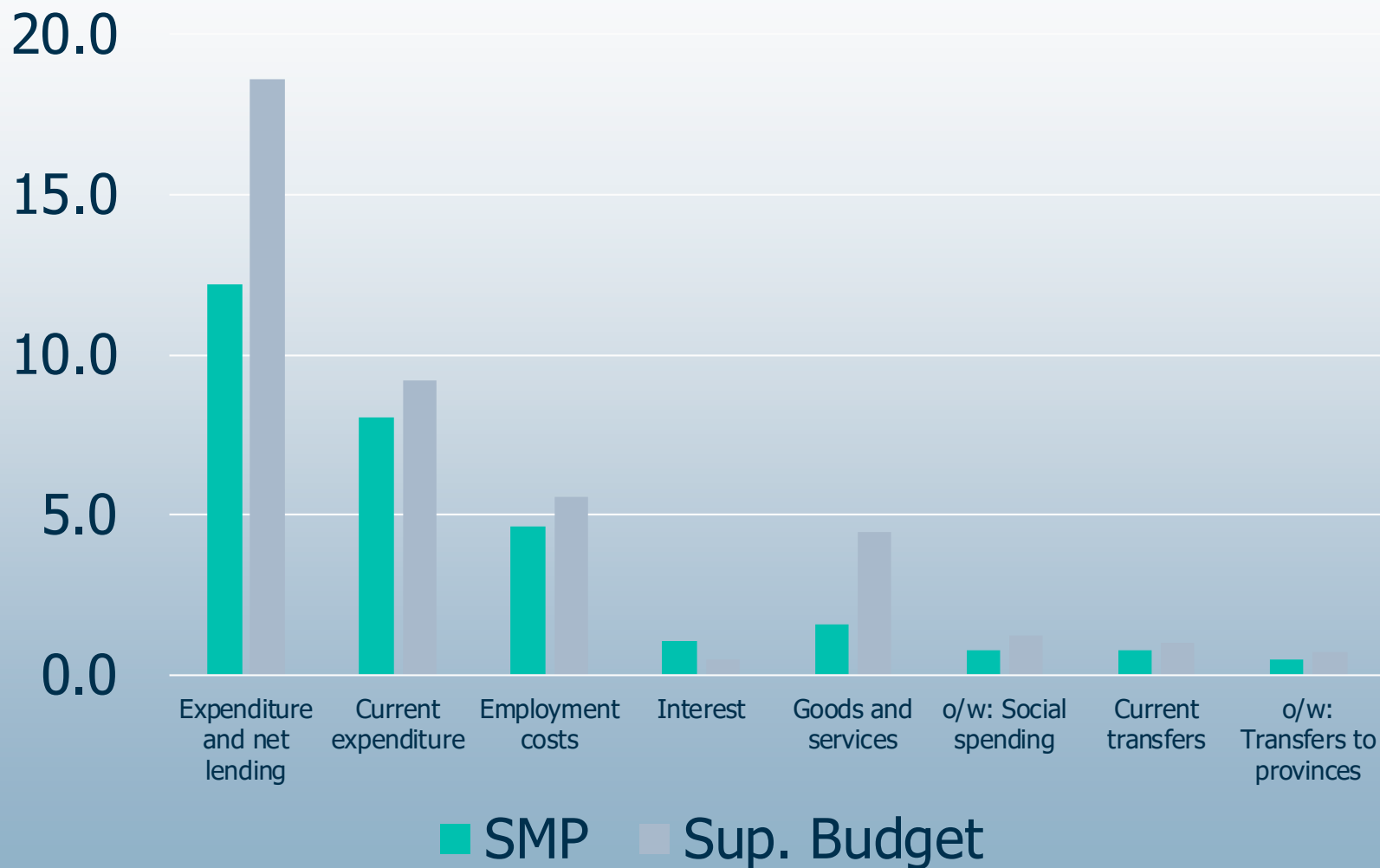


Fiscal adjustment is proceeding: SMP vs. Supplementary Budget





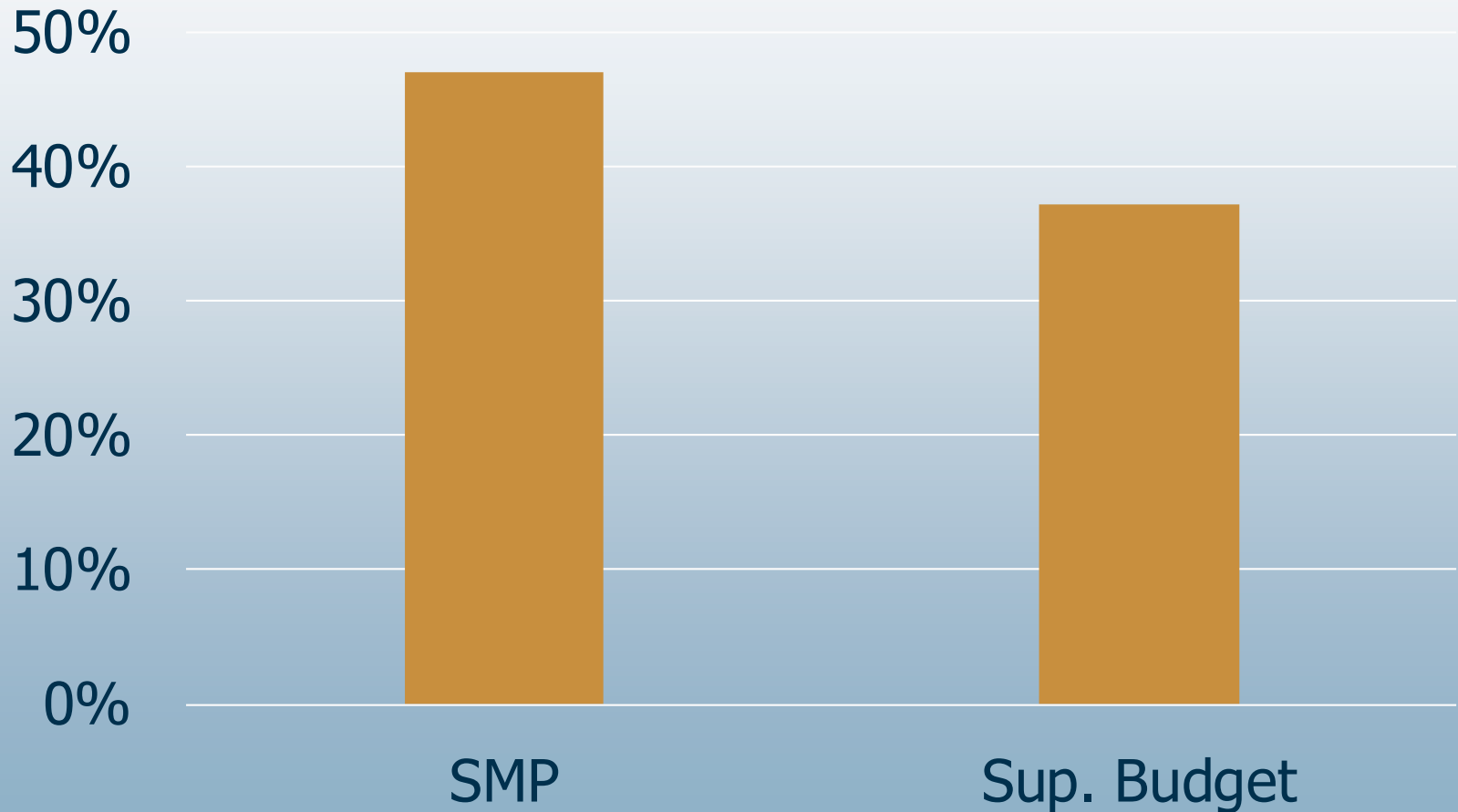
SMP vs. Supplementary Budget





SMP vs. Sup. Budget

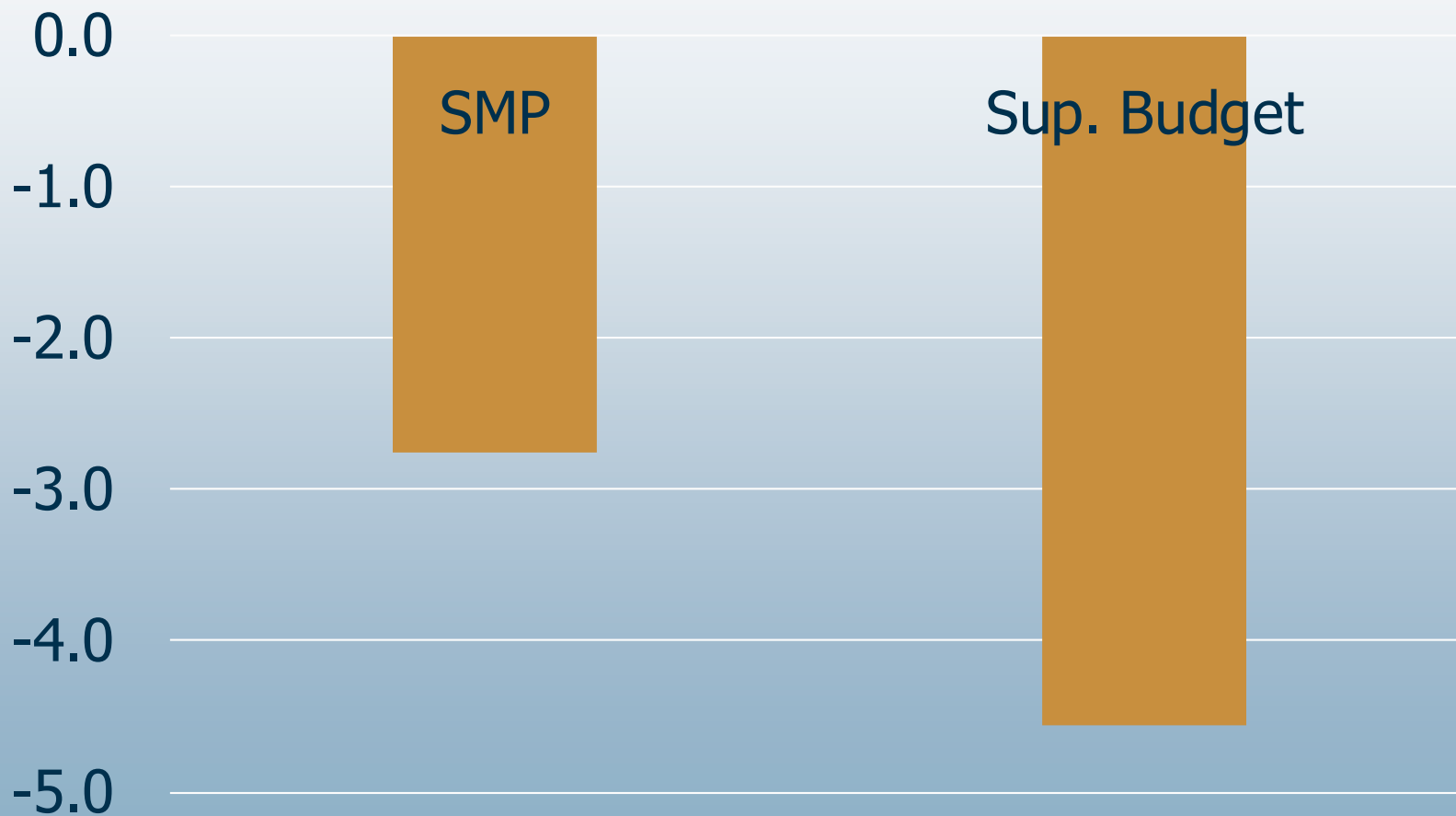
Wage bill-to-tax ratio





SMP vs. Sup. Budget

Deficit

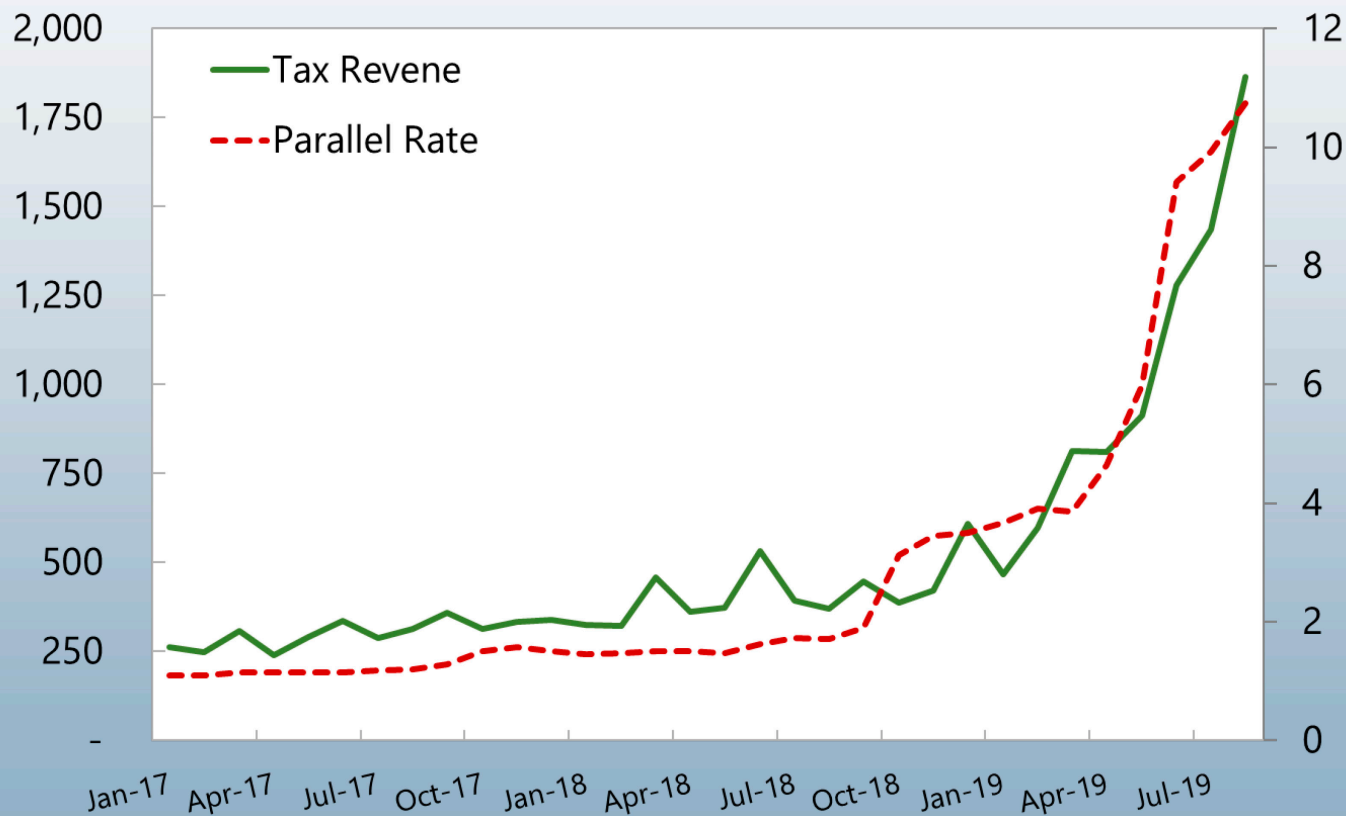




Monthly tax revenue has been rising in ZWL ...

Zimbabwe: Monthly Tax Revenue in ZWL

(ZWL millions)



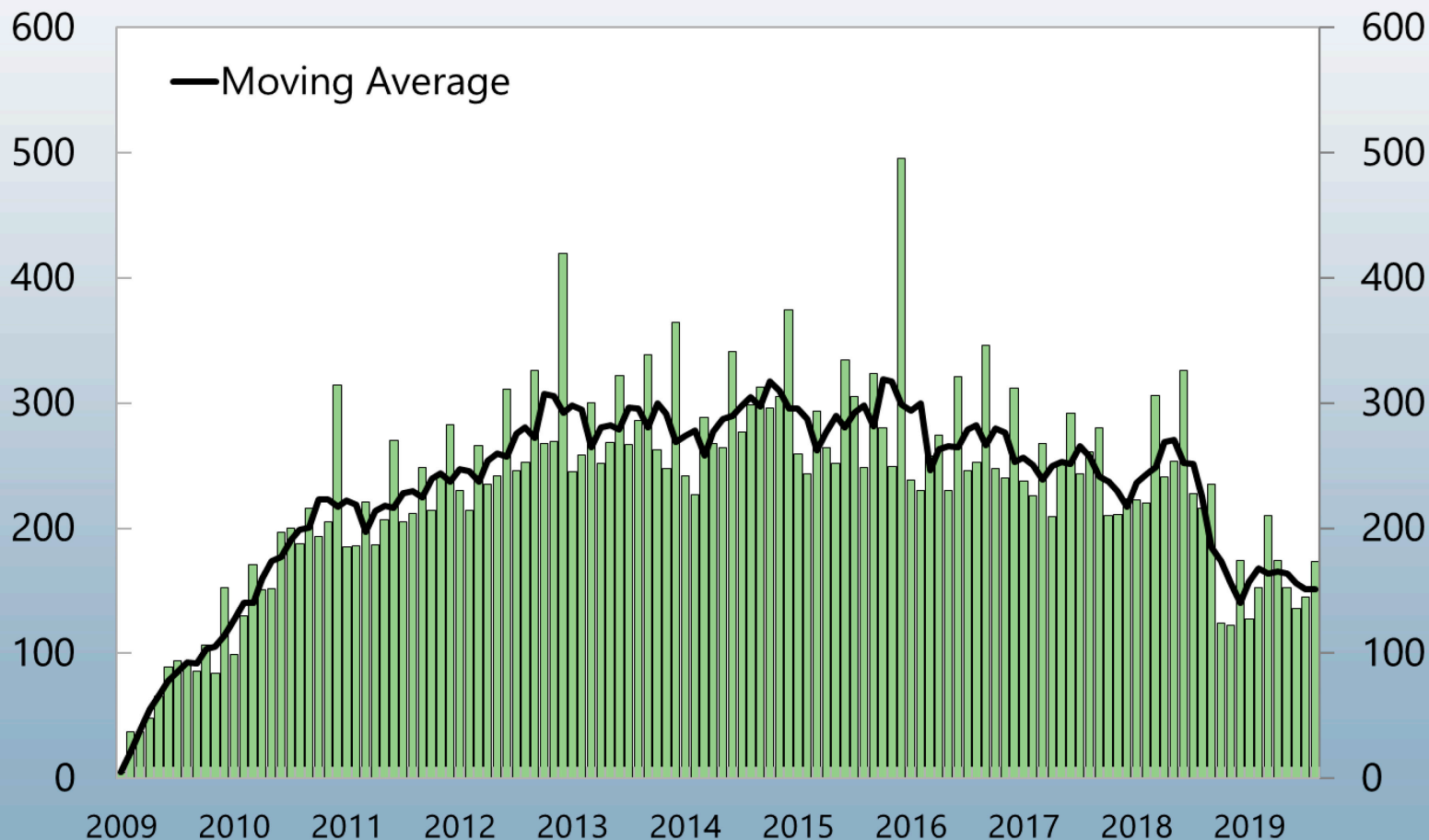
Sources: Zimbabwe authorities, and IMF staff calculations.



... but dipping in USD.

Zimbabwe: Monthly Tax Revenue in USD

(US\$ million; converted at the parallel rate)



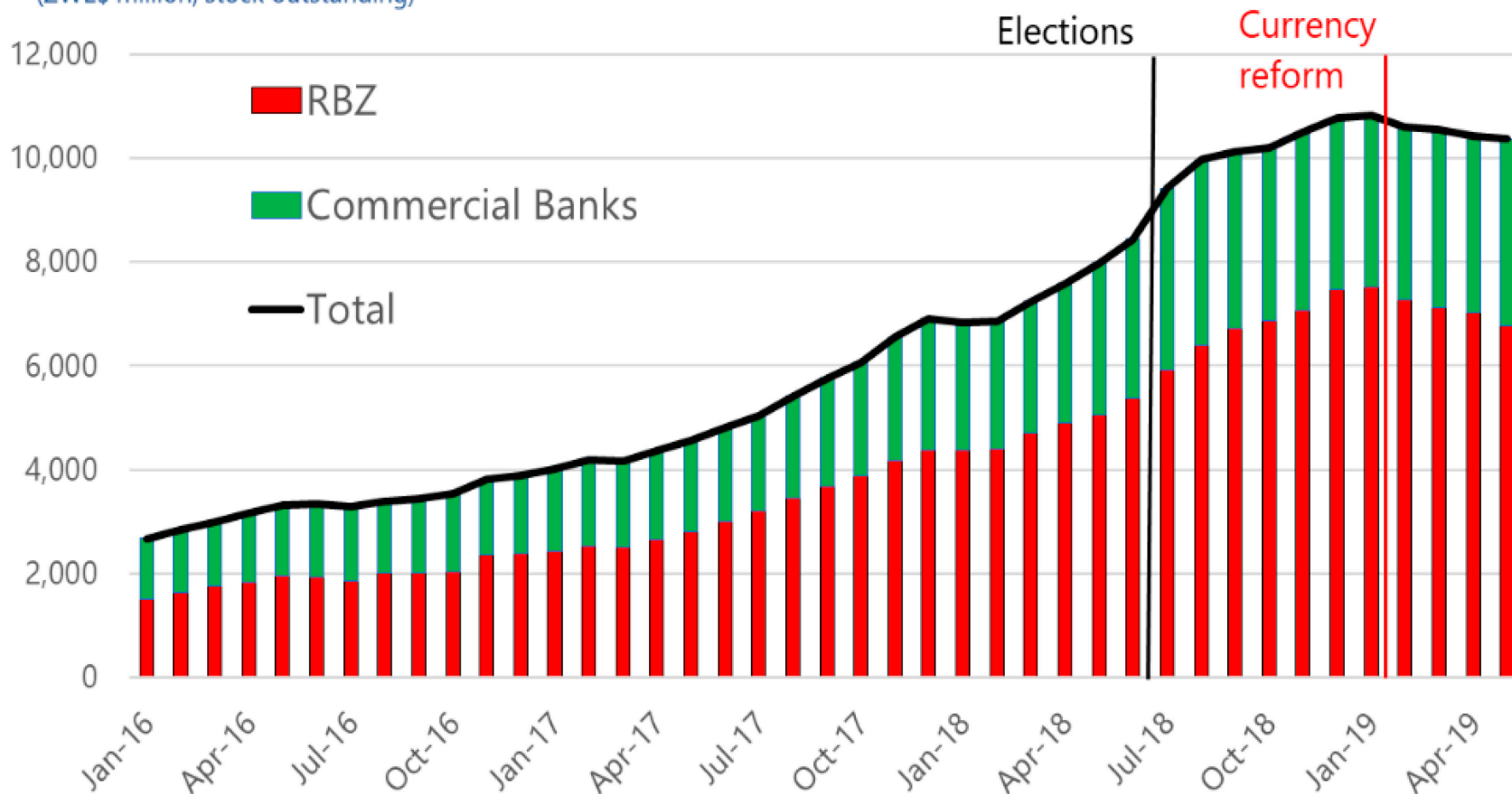
Sources: Zimbabwe authorities and IMF staff calculations.



Public domestic debt is declining.

Zimbabwe: Bank Credit to Government

(ZWE\$ million, stock outstanding)





Currency has been depreciating recently ...

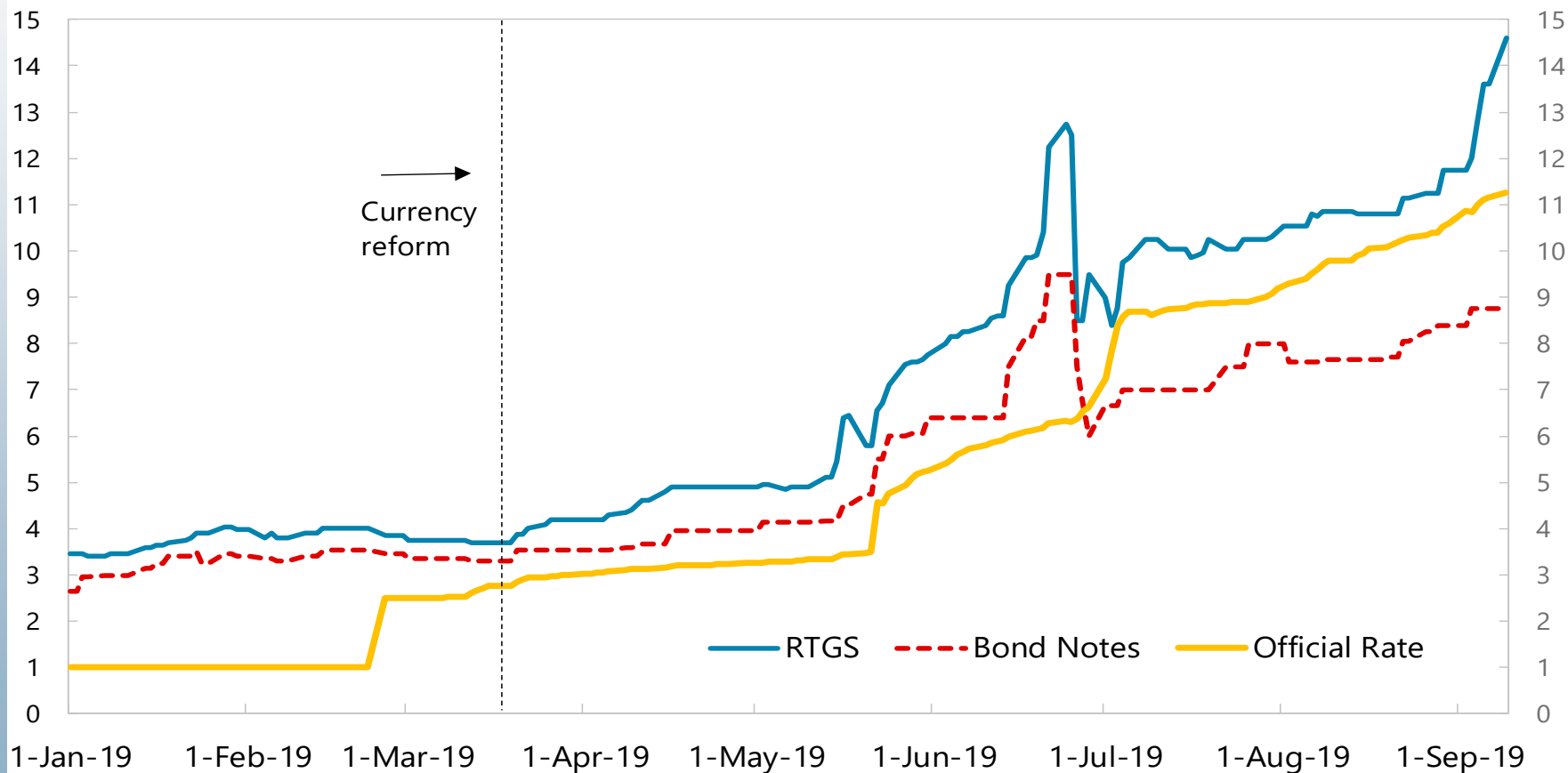
- Pressure on exchange rate escalated by weakening confidence, policy uncertainty, a continuation of FX market distortions, and a recent expansionary monetary stance
- Key challenges facing Zimbabwe are that of containing fiscal spending with non-inflationary financing and tighten monetary policy to stabilize exchange rate



Zimbabwe: Official and Parallel Market Exchange Rates

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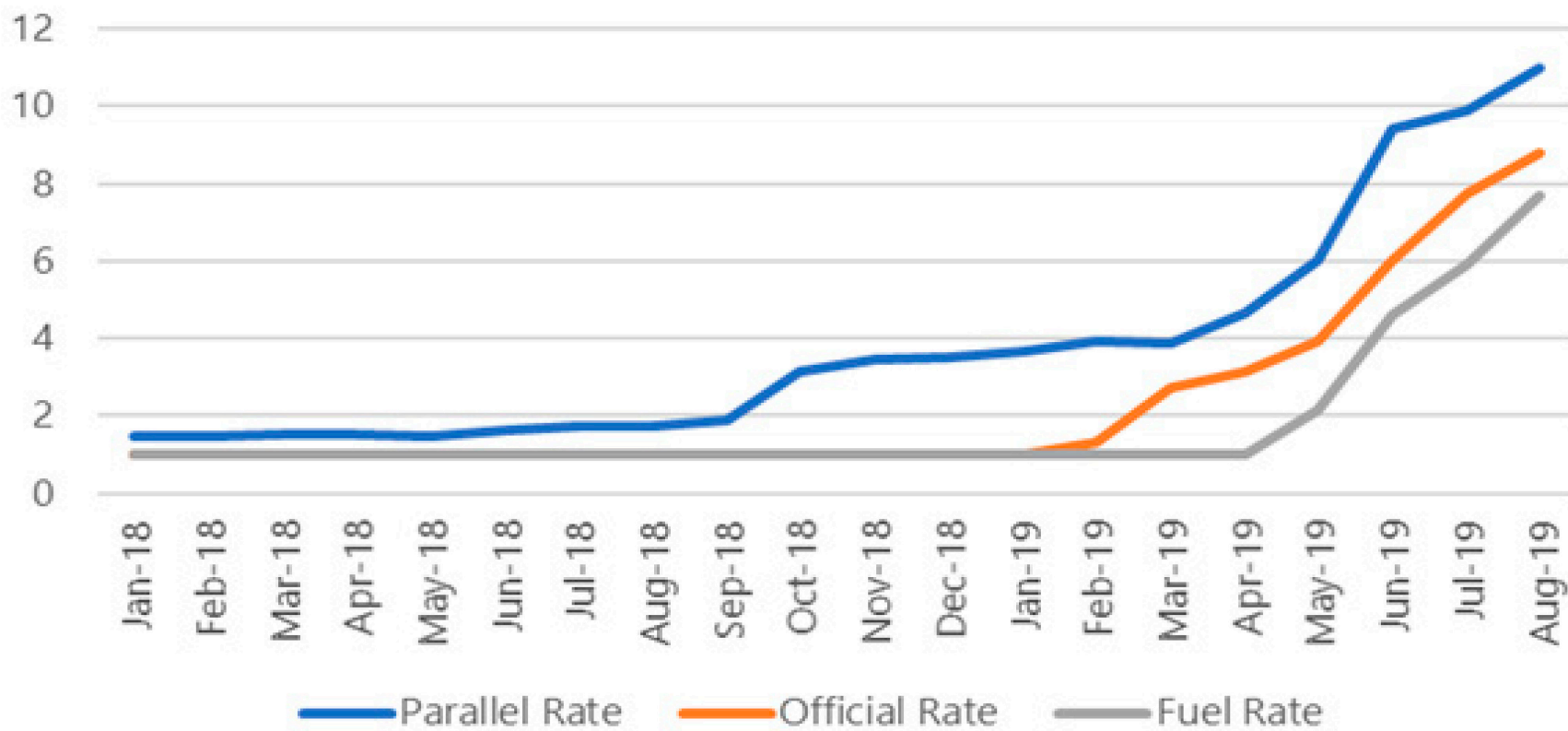
(Local currency unit per 1 US\$)





Currency has been depreciating...

Zimbabwe: Exchange Rates

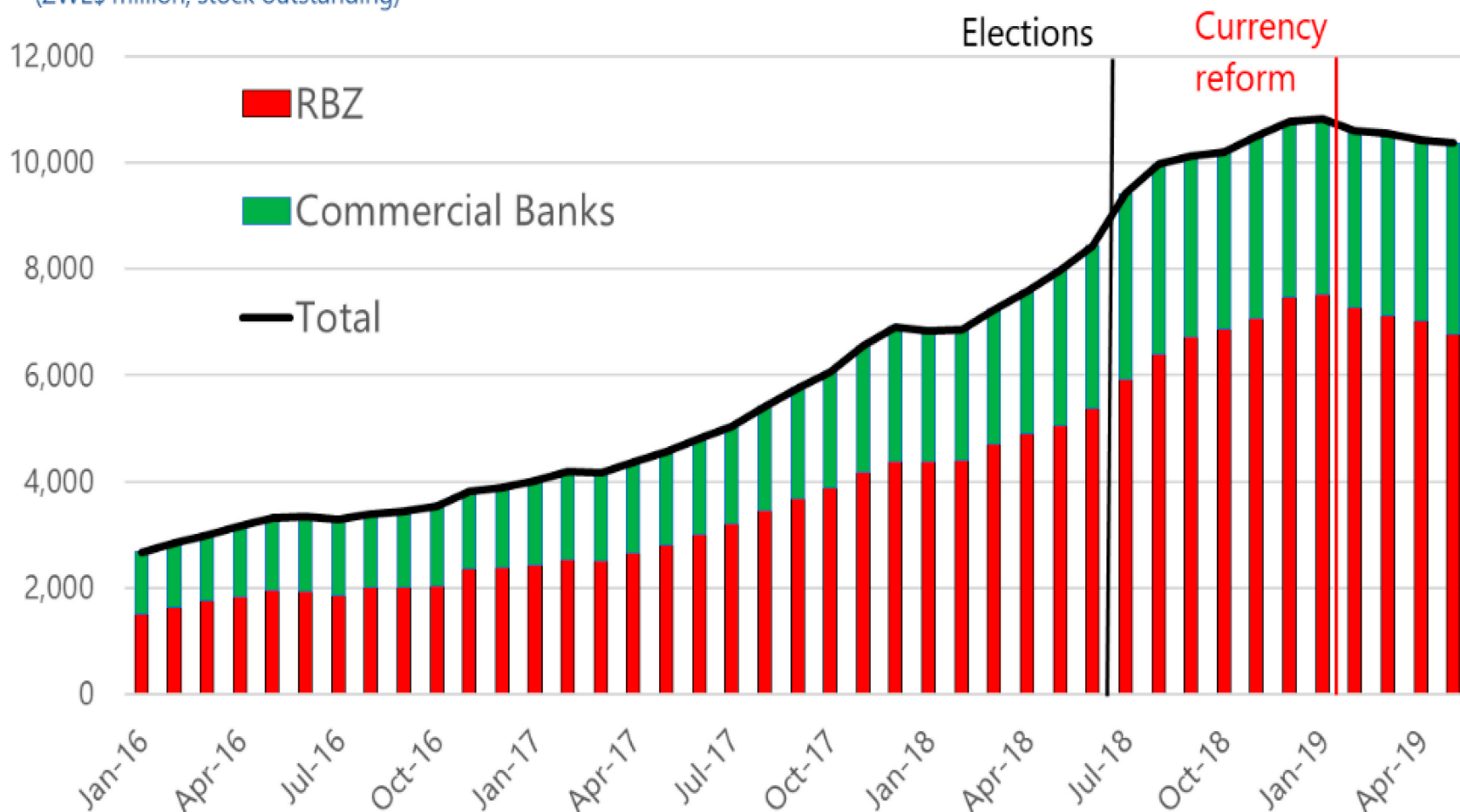




Local currency money supply was stable, but increased recently (Cont.)

Zimbabwe: Bank Credit to Government

(ZWE\$ million, stock outstanding)

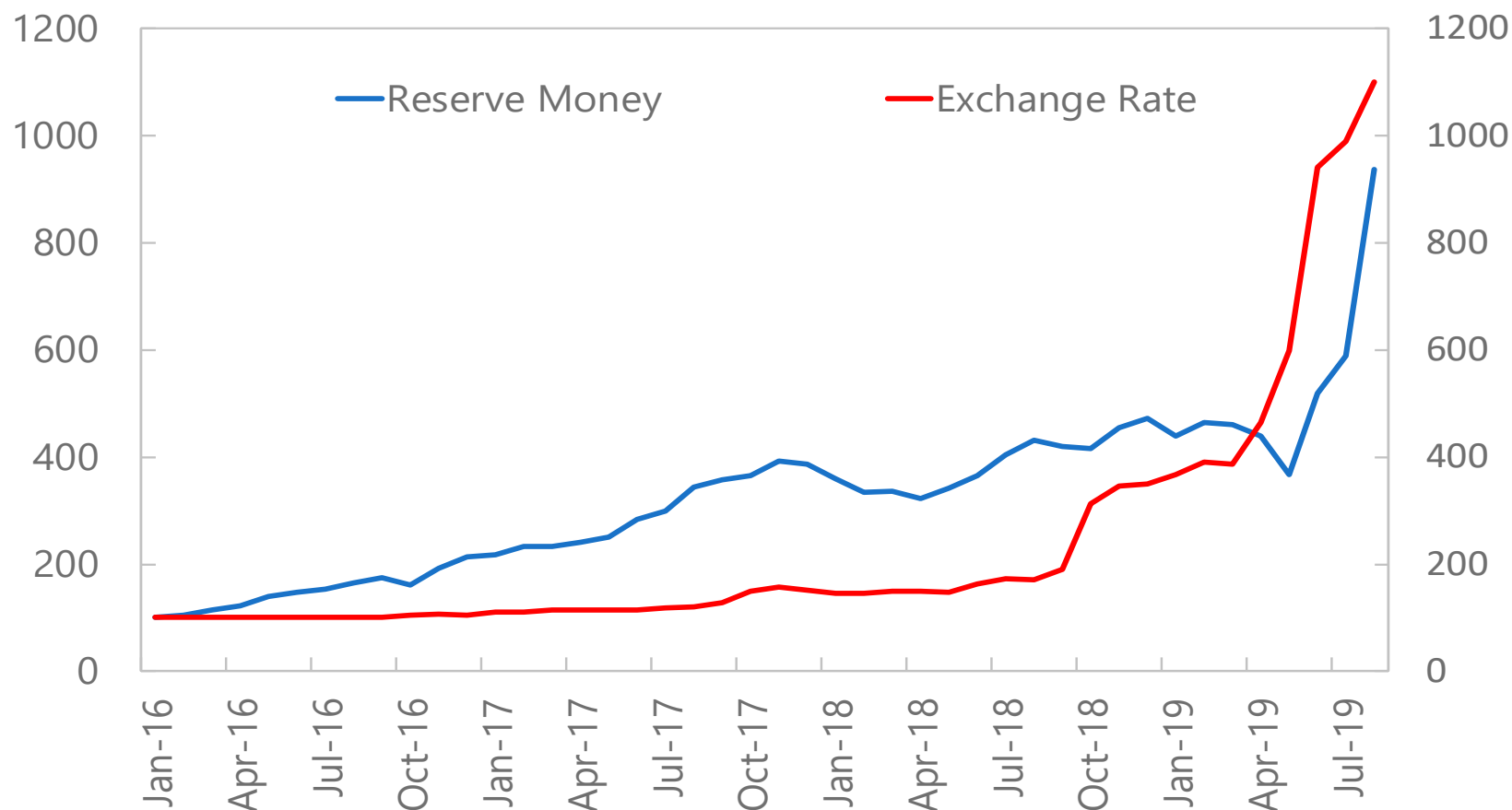




Reserve money has been increasing...

Zimbabwe: Reserve Money and Exchange Rate Trends

(Index, January 2016=100)

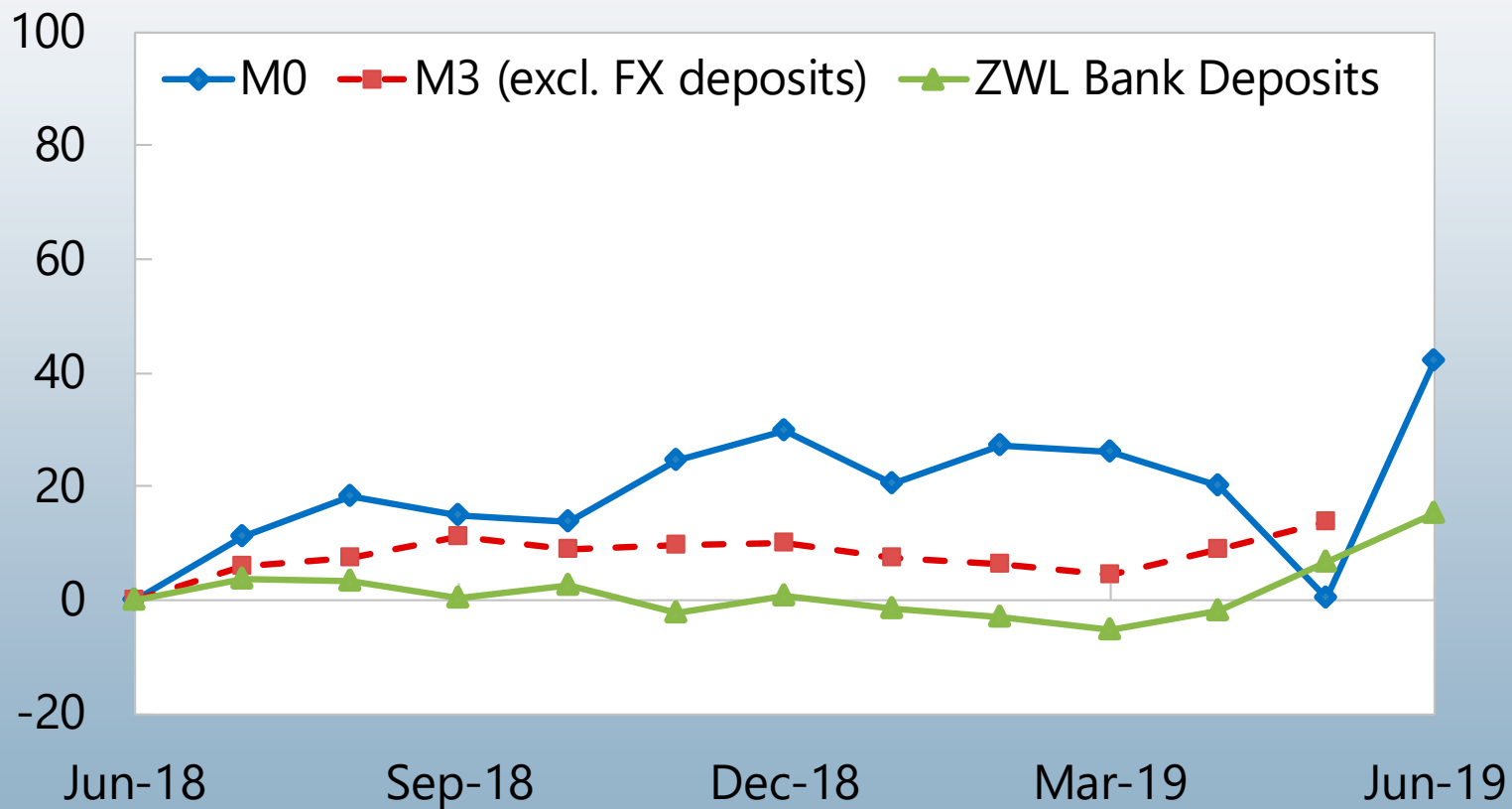


Sources: Zimbabwean authorities.



Recent Developments in Money Supply

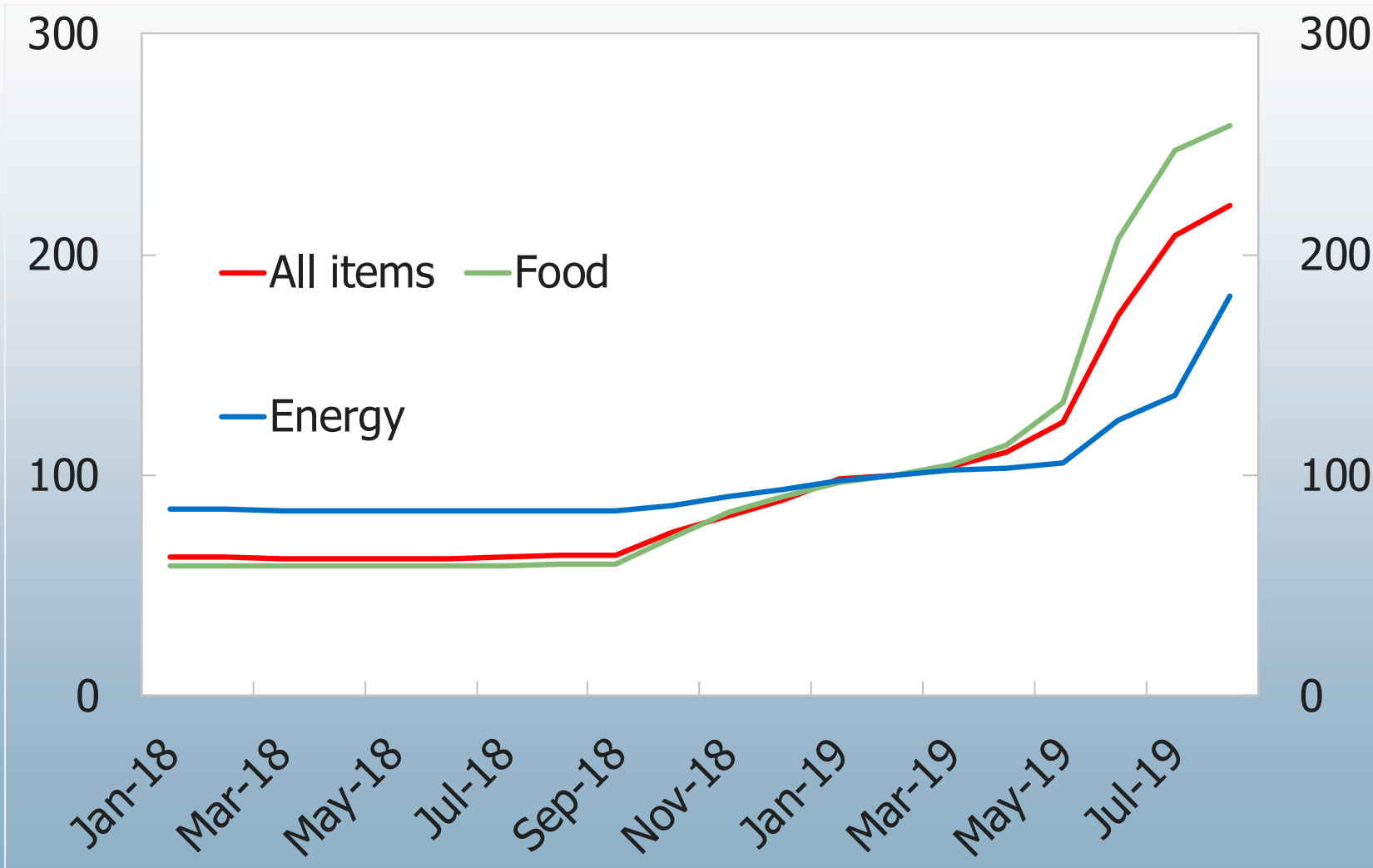
(Cumulative percent change since June 2018)



Sources: Zimbabwe authorities and IMF staff calculations.



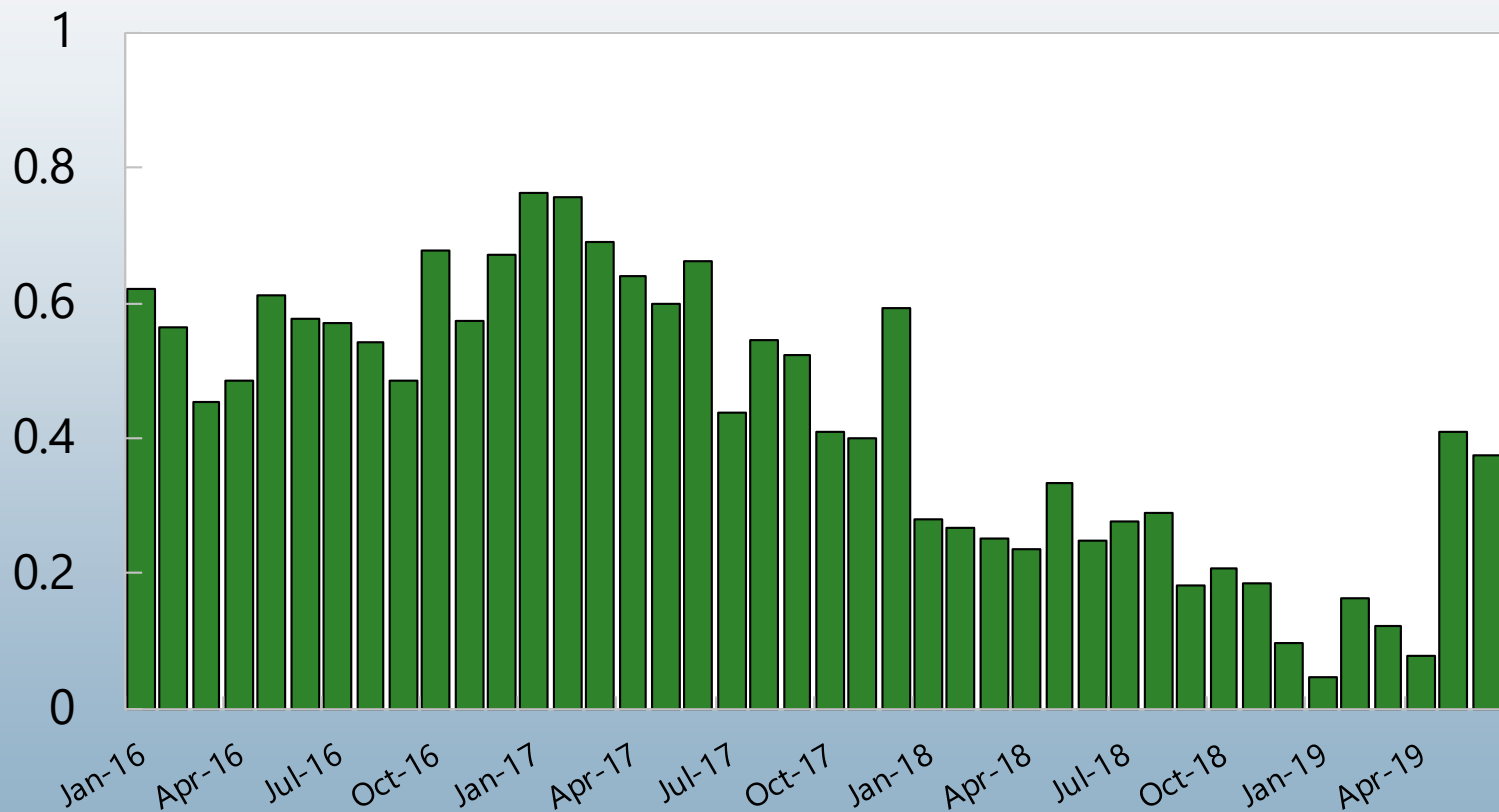
Zimbabwe: CPI





Reserves

Zimbabwe: Net International Reserves



Sources: Zimbabwe authorities and IMF staff calculations.



Progress on tackling governance concerns, but issues remain

Successful reforms have helped...

- Moving to a market-based FX allocation system critical to reduce rent-seeking market distortions
- An IMF governance diagnostic mission visited Harare Sept. 18 to Oct. 4, 2019
- Authorities committed to publish Governance Vulnerability Report by end-December, 2019

...but need to build on progress.

- Diagnostic mission emphasized need to:
 - Reform Command Agriculture
 - Strengthen debt management (in particular borrowing/issuance authority)
 - Improve public financial management
 - Address RBZ governance, improve operations, and strengthen transparency



ADVERSE SHOCKS, POLICY SLIPPAGE, AND SOCIAL IMPACT



Climate shocks have had a devastating impact

- Cyclone Idai
 - Recovery cost \$1.2 billion (6 percent of GDP)
 - US\$600 million in infrastructure damage
 - 270,000 people in need of emergency assistance
- Drought impact more severe and pervasive than anticipated
 - Agriculture forecast to decline 20 percent
 - Mining forecast to decline 15-20 percent
 - Electricity (generation and distribution), blackouts up to 18 hrs/day
 - Growth downturn expected to be severe (-10 percent)

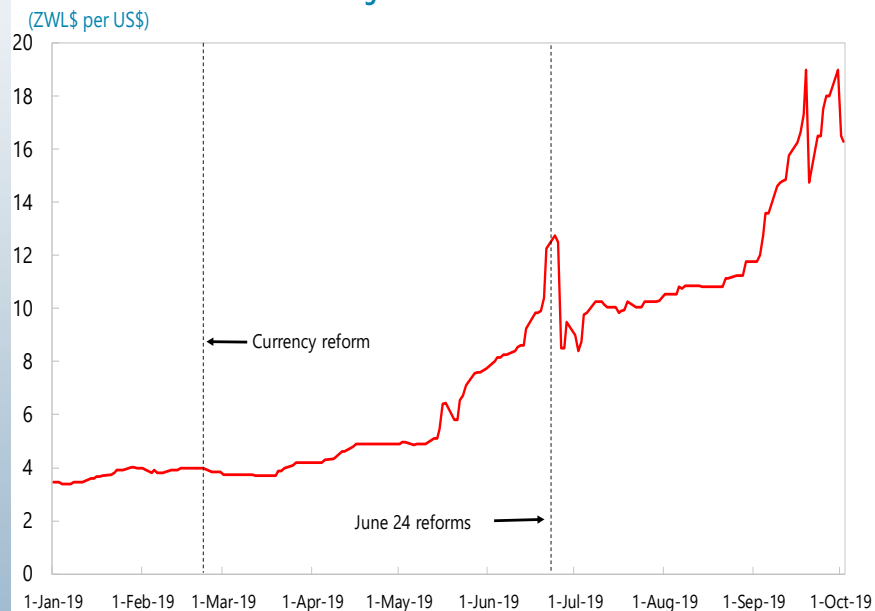


Policy slippage since June: Resumption of monetary financing, destabilizing the FX market, and depreciating ZWL

Zimbabwe: Reserve Money

	Jun-19	Jul-19	Aug-19
Stock (ZWL million)	3,576	4,057	6,450
Change (% , relative to Dec. 2018)	9.7	24.5	97.9

Zimbabwe: Parallel Market Exchange Rates





Policy mis-steps

- ❖ Substantial macro reforms undertaken—10 percent of GDP fiscal adjustment over 2 years, introduction of market-determined, convertible currency
- ❖ But macro outcomes deteriorating. A combination of policy mis-steps/hesitancy, but also large exogenous shocks with no buffers and no options to borrow to cushion the adjustment



Social impact

- Humanitarian situation requires an urgent response
- Currency conversion wiped out savings and inflation decimated purchasing power
- WFP estimates 8.5 million people (over half the population) food insecure



Negative growth shock

- Agriculture sector is expected to contract by at least 15 percent
 - ❖ drought has crippled agriculture, with maize production—cut by about a half
 - ❖ tobacco underperformed
- Mining is expected to contract by 10 percent
 - ❖ as FX shortages, pricing anomalies from the issuance of the new currency, and electricity outages affect output
- Low rainfall has curtailed hydroelectricity generation
 - ❖ Power rationed nationwide, with outages reaching 18 hours a day in Harare
 - ❖ Importation of electricity from South Africa and Mozambique has stalled due to a lack of FX/access to external financing
 - ❖ Equipment is outdated at most power stations



Lack of confidence

- a weak communication strategy
- haphazard implementation of policies,
- opaque transactions,
- distortions caused by multiple exchange rates, and a refusal to move quickly to a market determined exchange rate have exhausted all the country's external buffers
- initial hesitancy in moving to a market-determined exchange rate, has fueled inflation.
- Inflation reached 230 percent (y-o-y) in July, from 5 percent a year ago, reflecting the continued depreciation of the exchange rate
- The elongated impasse - major stakeholders remain in a 'wait and see' mode



Spending pressures...

- Demands for further public sector wage increases,
- Quasi-fiscal activities of the RBZ that will need to be absorbed by the central government, and;
- Pressure to finance agriculture could push the deficit back into an unsustainable stance (risks to budget execution)



External Sector Adjustment

Current Account

- Terms of trade have been declining since 2016 with tobacco prices falling and oil prices rising, increasing foreign exchange shortages in the face of limited foreign financial flows
- Current account turned to a surplus in 2019Q1.
- Surplus of US\$196 million so far, compared to a deficit of over US\$1 billion in 2018 reflects
 - ◆ import compression from the fuel price adjustment in January 2019 that reduced incentives for arbitrage,
 - ◆ FX shortages
 - ◆ a sharp decline in real disposable income
 - ◆ Sharp decline in investment due to weak investor confidence



External Sector Adjustment (Cont.)

- Reserves remain at critically low levels
- Export diversification is declining and Zimbabwe is vulnerable to external shocks from its dependence on a few commodity exports and on a single destination
 - ◆ During 2009-18, gold, platinum, and tobacco accounted for about 60 percent of total export earnings
 - ◆ During 2015-18, about 66 percent of the exports were to South Africa
- Foreign direct investment inflows have been low. Annual FDI was 1.6 percent of GDP during 2004- 2017, compared to the SSA average of 2.6 percent and well below its similarly endowed peers (Zambia attracted 6 percent of GDP during 2004-2017).



Worsening humanitarian crisis

- Cyclone Idai (270,000 people in need of emergency humanitarian assistance)
- Drought (8.5 million people food insecure)
- Erosion of real wages and savings
 - ❖ the introduction of the new currency and sharp acceleration in inflow implies a substantial cut in real incomes and in the real value of savings
- Erratic fuel and electricity supply
- Authorities' inability to respond to the climatic shocks
- Limited support from the international community



Corrective actions

- The IMF in September 2019 urged the authorities to undertake **urgent corrective actions** to facilitate an implementation review by mid-November 2019:



Fuel subsidies, electricity tariffs, and rationalization of agricultural expenditure

- Announce the timeline for eliminating the preferential FX rate for fuel, with a gradual monthly reduction of the subsidy starting at end-September 2019
- Increase electricity tariffs to cost recovery for all industry, mining, and high-consumption households
 - ◆ Index the new electricity tariffs to their import/generation cost, via the FX interbank rate (similar to fuel)
- Limit the fiscal deficit in the remainder of 2019 to non-RBZ financing, including through containing PIS and grain subsidy expenditures and eliminating Command Agriculture from the budget
- Include any remaining subsidies effected through public sector institutions into the central government budget starting with the 2020 budget



Monetary financing of the budget

- Reduce RBZ claims on government from their end-August level (the monthly reserve money targets for the remainder of 2019 will be set jointly between IMF staff and the authorities after agreement is reached on the fiscal targets for 2019)
- Table to Parliament an amendment to the RBZ Act to limit RBZ lending to the government to at most 5 percent of the previous year's tax revenue (currently 20 percent)



Monetary operations

- Forgo plans for direct RBZ lending to the non-financial sector and contain planned credit enhancement initiatives by the RBZ within the revised reserve money targets
- As necessary, increase the interest rate on RBZ savings bonds in line with government bond auctions. Allocate a realistic amount in the 2020 budget to repay RBZ for interest on savings bonds



Legacy debt

- Announce that requests received after August 31 will not be considered
- Share with the IMF mission the list of applications for the provision of US\$ at rate 1:1 to cover foreign liabilities and legacy debt
- Assume as debt only what is necessary to preserve financial stability, plus whatever commitments have been signed already (e.g., IATA)
- Obtain Parliamentary approval for debt takeover, following provisions in the Constitution and Public Debt Management Act



FX market

- Increase the allocation of FX surrender to the market (from 50 to at least 75 percent)
- Reduce FX allocation via the priority list (confirm phasing out of fuel and electricity and reduced allocation to other private-sector/public-sector by at least 25 percent) and articulate a plan to liberalize current account transactions



Transparency

- Publish the end-week RBZ balance sheet on the RBZ website, with no more than a one-week lag, starting with September 25 data
- Publish by mid-October the terms of reference of the Monetary Policy Council and convene by end-October an inaugural technical meeting on monetary/exchange rate policy challenges
- Share with the IMF mission hard copies of all external liability contracts undertaken by the RBZ during the past 5 years
- Consult with IMF prior to any policy measures that may impact the SMP, including on design/parameters of the 2020 budget or to accommodate any changes arising from unanticipated data outcomes
- Establish measures and enhance process to improve policy coordination across monetary and fiscal agencies, as well as implementation of safeguards to limit leakages that can be exploited from fiscal expenditure actions



Cont...

- Consult with IMF prior to any policy measures that may impact the SMP, including on design/parameters of the 2020 budget or to accommodate any changes arising from unanticipated data outcomes
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Fund relations

- The Fund continues to support Zimbabwe's capacity building in:
 - ❖ Debt management, public financial management, and government financial statistics
 - ❖ Monetary policy frameworks and operations
 - ❖ Revenue mobilization and administration
 - ❖ Financial oversight and bank supervision



Full cooperation – Reengagement

- Reengagement with the international community and restoring debt sustainability are important priorities of the Zimbabwean authorities, which the IMF supports
- These priorities require strong economic reforms that address existing imbalances, as outlined in the SMP



Conditions for IMF financial engagement

Arrears clearance to the IFIs

+

Financing assurances from bilateral creditors

+

Comprehensive, consistent package of policies for sustainable, inclusive growth



Reengagement



Conclusion

- Efforts are needed on both the economic and political front to drive Zimbabwe forward, build credibility - improve communication and policy consistency
- IMF to maintain a close and continuous dialogue on policy issues with Harare authorities, in order to restore stability



Thank you