IMF Country Report No. 20/82

ZIMBABWE

March 2020

2019 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR ZIMBABWE

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2019 Article IV consultation with Zimbabwe, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on February 24, 2020, following discussions that ended on December 11, 2019, with the officials of Zimbabwe on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on February 12, 2020.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the International Development Association (IDA).
- A **Selected Issues** paper prepared by the IMF staff.
- A **Statement by the Executive Director** for Zimbabwe.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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INTERNATIONAL MONETARY FUND
COMMUNICATIONS DEPARTMENT

Press Release No. 20/72
FOR IMMEDIATE RELEASE
February 26, 2020

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2020 Article IV Consultation with Zimbabwe

On February 24, 2020, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Zimbabwe. As the Board meeting and the policy discussions with the authorities on which the staff report is based occurred before the COVID-19 became a pandemic, the staff report does not reflect the implications of this development. While highly uncertain at this stage, it is clear that COVID-19 will adversely impact the economic outlook for Zimbabwe and require additional health-related spending and international support. COVID-19 will make it even harder to balance the policies needed to restore macroeconomic stability with those to address urgent social needs.

Zimbabwe is experiencing an economic and humanitarian crisis. Macroeconomic stability remains a challenge: the economy contracted sharply in 2019, amplified by climate shocks that have crippled agriculture and electricity generation; the newly introduced ZWL$ has lost most of its value; inflation is very high; and international reserves are very low. The climate shocks have magnified the social impacts of the fiscal retrenchment, leaving more than half of the population food insecure. With another poor harvest expected, growth in 2020 is projected at near zero, with food shortages continuing.

The government that came to office following the 2018 elections adopted an agenda focused on macro stabilization and reforms. This was supported by a Staff Monitored Program from the IMF, adopted in May 2019, but is now off-track as policy implementation has been mixed. Notable reforms include a significant fiscal consolidation that has helped reduce the monetary financing of the deficit, the introduction of the new domestic currency in February 2019, the creation of an interbank FX market, and the restructuring of the command agriculture financing model to a public-private partnership with commercial banks. However,

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

uneven implementation of reforms, notably delays and missteps in FX and monetary reforms, have failed to restore confidence in the new currency.

Reengagement with the international community continues to face delays. The Zimbabwean government has yet to define the modalities and financing to clear arrears to the World Bank and other multilateral institutions, and to undertake reforms that would facilitate resolution of arrears with bilateral creditors. This continues to constrain Zimbabwe's access to external official support. As a result, the authorities face a difficult balance of pursuing tight monetary policy to reduce very high inflation and prudent fiscal policy to address the macroeconomic imbalances and build confidence in the currency, while averting a crisis. While the 2020 budget includes a significant increase in social spending, it is likely insufficient to meet the pressing social needs. Absent a scaling up of donor support, the risks of a deep humanitarian crisis are high.

Executive Board Assessment[2]

Executive Directors noted with concern that Zimbabwe is facing an economic and humanitarian crisis exacerbated by policy missteps and climate-related shocks. These would require difficult policy choices from the authorities and support from the international community. Directors urged the authorities to make a concerted effort to ensure economic and social stability through the adoption of coordinated fiscal, monetary and foreign exchange policies, alongside with efforts to address food insecurity and serious governance challenges. They emphasized the importance of reengagement with the international community to support efforts to achieve economic sustainability and address the humanitarian crisis.

Notwithstanding efforts in 2019 to tighten the fiscal stance and contain quasi-fiscal operations by the central bank, Directors noted that pervasive deficits remain and could be exacerbated by the need to respond to the humanitarian crisis. Directors called for non-essential spending cuts, including decisive reforms to agricultural support programs, to allow for social spending needs. They underscored the importance of public financial management and enhanced domestic revenue mobilization efforts.

Directors stressed that eliminating deficit monetization would not only be crucial for fiscal sustainability, but it would also serve as a precondition for the stabilization of hyper-inflation and the preservation of the external value of the currency.

Directors noted that Zimbabwe remains in debt distress, with large external arrears to official creditors, and encouraged the authorities to give impetus to reengagement efforts and debt

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

management and transparency. In particular, they cautioned against continued recourse to collateralized external borrowing on commercial terms as this may potentially complicate any future arrears clearance operation.

Directors underscored the need to establish credibility in the new currency. They encouraged the authorities to press forward with the establishment of a functional foreign exchange market and to remove distortions that could lead to rent-seeking behavior in the economy. Directors agreed that given low reserves and hyper-inflation, limited credibility, and a lack of access to traditional forms of external financing, a monetary targeting regime is appropriate to conduct monetary policy. Enhancing central bank independence and transparency, including by timely publication of monetary statistics, would be important.

Directors welcomed the progress on financial innovation, supervision and inclusiveness indicators. They noted, however, the need for continued vigilance to ensure financial stability. They encouraged the authorities to conduct asset quality reviews of the banking sector, develop a new framework for managing weak banks, and increase the effectiveness of the AML/CFT framework, including by effectively implementing FAFT standards.

Directors stressed the need to address governance and corruption challenges, entrenched vested interests, and enforcement of the rule of law to improve the business climate and support private-sector-led inclusive growth. Such efforts would be instrumental to advance reengagement efforts with the international community and mobilize the needed support. They noted with regret that the Staff-Monitored Program was off-track and underscored the importance of continued engagement between the Fund and the authorities, including through technical assistance, policy advice and other innovative ways, to help immediately stabilize the economy and address the humanitarian crisis.

Table 1. Zimbabwe: Selected Economic Indicators, 2016-20

	2016	2017	2018	2019	2020
		Act		Prel	Proj
	(annual percentage change, unless otherwise indicated)				
Output and prices					
Real GDP growth 1/	0.7	4.7	3.5	-8.3	0.8
Nominal GDP (US$ millions)	20,549	22,041	22,946	20,703	20,563
Nominal GDP (ZWL millions)	20,806	27,438	42,468	156,165	390,666
GDP deflator	3.5	26.0	49.5	300.9	148.1
CPI (annual average)	-1.6	0.9	10.6	255.3	221.1
CPI (end-of-period)	-0.9	3.4	42.1	521.1	52.0
Money and credit					
Money supply (M2)	18.8	39.0	24.0	127.5	24.4
Credit to the private sector	-3.9	5.9	9.1	174.1	56.7
Credit to the central government	51.6	74.5	59.2	62.3	27.5
	(ZWL per US$)				
Official Exchange rate					
ZWL:USD exchange rate (annual average)	1.0	1.3	2.0	8.5	...
ZWL:USD exchange rate (end-of-period)	1.0	1.3	3.5	16.8	...
	(percent of GDP)				
Central government					
Revenue and grants	16.8	14.1	12.9	13.5	12.8
Expenditure and net lending	23.9	24.0	18.6	16.9	17.8
Of which: Employment costs	15.5	12.7	9.3	4.9	4.3
Of which: Capital transfers and net lending	4.1	5.8	5.0	3.3	4.0
Overall balance	-7.1	-9.9	-5.7	-3.4	-5.0
Primary balance	-6.4	-9.0	-4.8	-3.0	-4.6
	(US$ millions, unless otherwise indicated)				
Balance of payments					
Exports of goods and services	4,060	4,734	5,304	4,634	5,038
(annual percentage change)	1.5	16.6	12.1	-12.6	8.7
Imports of goods and services	6,427	6,555	7,617	5,455	6,247
(annual percentage change)	-14.4	2.0	16.2	-28.4	17.7
Current account balance (excluding official transfers)	-718	-284	-1,229	155	-204
(percent of GDP)	-3.5	-1.3	-5.4	0.7	-1.0
Gross international reserves	310	293	87	111	109
(months of imports of goods and services)	0.6	0.5	0.1	0.2	0.2
Public debt					
Consolidated public sector debt (e.o.p.)	10,089	11,998	14,459	10,372	11,082
(percent of GDP)	49.1	54.4	63.0	50.1	53.9
Public and publicly guaranteed external debt (e.o.p.)	7,997	8,829	8,672	9,865	10,591
(percent of GDP)	38.9	40.1	37.8	47.6	51.5
Of which: Arrears	5,157	5,652	6,109	6,284	6,421
(percent of GDP)	25.1	25.6	26.6	30.4	31.2

Sources: Zimbabwean authorities; IMF staff estimates and projections.

1/ At constant 2012 prices.

INTERNATIONAL MONETARY FUND

ZIMBABWE

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION

February 12, 2020

KEY ISSUES

The Staff Report was prepared by a staff team of the IMF for the Executive Board's consideration on February 24, 2020. The staff report reflects discussions with the Zimbabwe authorities in September and December 2019 and is based on the information available as of February 12, 2020. It focuses on Zimbabwe's near- and medium-term challenges and policy priorities and was prepared before COVID-19 became a global pandemic that has resulted in unprecedented strains in global trade, commodity, and financial markets. It, therefore, does not reflect the implications of these developments and related policy priorities. The outbreak has greatly amplified uncertainty and downside risks around the outlook. Staff is closely monitoring the situation and will continue to work on assessing its impact and the related policy response in Zimbabwe and globally.

Context. Zimbabwe is experiencing an economic and humanitarian crisis. High fiscal deficits financed by RBZ money creation resulted in severe macroeconomic imbalances and market distortions. The government that came to office following the 2018 elections adopted an agenda focused on macro stabilization and reforms. This was supported by a Staff Monitored Program, adopted in May 2019, but is now off-track as policy implementation has been mixed: progress on fiscal reforms was overshadowed by costly missteps on monetary and FX market reforms. Climate shocks have crippled agriculture and electricity generation and magnified the social impacts of the fiscal retrenchment and currency reform, leaving more than half of the population food insecure. Protracted external arrears constrain access to external official support, while additional commercial borrowing has worsened the debt overhang and likely complicated discussions on debt resolution.

Outlook. With another poor harvest expected, growth in 2020 is projected at near zero, following a sharp contraction in 2019, with food shortages continuing. With no progress on clearing longstanding external arrears, the authorities face a difficult balance of pursuing tight monetary, to reduce very high inflation, and fiscal policies to address the macroeconomic imbalances and build confidence in the currency, while averting a crisis.

Risks. Pressures are mounting to increase spending on wages and for social protection to mitigate the impact of the weather shocks and high inflation. While the 2020 budget includes a significant increase in social spending, it is likely insufficient to meet the pressing needs. Absent a scaling up of donor support, the risks of a deep humanitarian crisis are high. Risks associated to the absorption of large foreign currency private debt will likely further challenge macroeconomic stabilization and debt restructuring efforts.

Policies. The near-term macroeconomic imperative is coordinated fiscal, FX, and monetary policies to stabilize the economy, while addressing food insecurity. Policies include scaling back low-priority spending to contain pressure for monetary financing of the budget; eliminating quasi-fiscal operations by the central bank; FX reforms to establish a market-determined exchange rate; and operationalizing the money targeting framework. Ensuring a minimum level of social protection will require further reprioritization of spending and engagement with the international community. Reducing governance and corruption vulnerabilities is essential for improving the business environment and ensuring sustained and inclusive growth.

Approved By
David Robinson (AFR) and Jeromin Zettelmeyer (SPR)

Discussions took place in Harare during September 5-17 and December 4-11, 2019. The missions met with H.E. President Mnangagwa, Finance Minister Ncube; Reserve Bank of Zimbabwe Governor Mangudya; other senior government officials; and representatives of the donor community and the private sector. The staff team comprised H. Leon (head), N. Hobdari, T. Lessard, F. Lima (all AFR), D. Gurara (SPR), E. Karlsdóttir (MCM), O. Akanbi (FAD). P. Imam, P. Chishawa, and B. Banda (IMF Resident Representative in Harare office and local staff) assisted the mission. D. Robinson (AFR) and W. Nakunyada (OED) participated in key policy discussions. K. Fabo and S. Ourigou (all AFR) assisted from headquarters.

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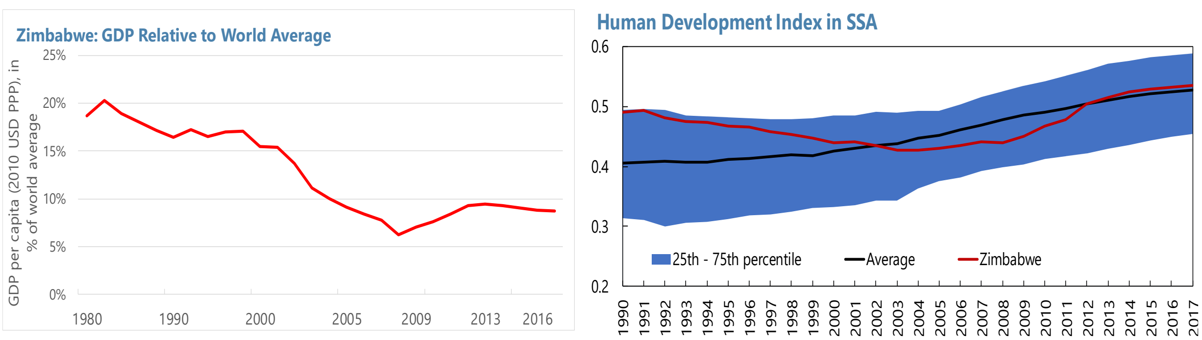
CONTEXT

1. **Economic and social outcomes have fallen behind peers in recent decades**. Economic activity has been on a trend decline since the 1980s, falling particularly sharply in the early 2000s as agricultural production collapsed and relations with the international community deteriorated. Subsequently, high fiscal deficits financed by money printing from the Reserve Bank of Zimbabwe (RBZ) led to hyperinflation and the demise of the (original) Zimbabwe dollar. A period of fiscal restraint, anchored on a strict cash budgeting framework, and robust growth followed full dollarization in late 2008. But large deficits returned in 2016, financed by the RBZ. Income per capita has declined from roughly 20 percent of the global average in the early 1980s to less than 10 percent today. Since independence, human development indicators have barely changed, while most countries in Sub-Saharan Africa made steady and significant improvements (Text Figure 1).

Text Figure 1. Zimbabwe: Growth and Development, 1980–2017



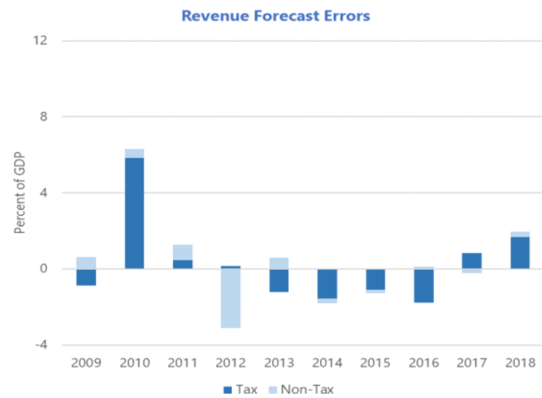
Sources: Zimbabwean authorities and IMF staff estimates. United Nations Development Program.

2. **The resumption of large fiscal deficits financed by issuing quasi-currency instruments that were not convertible created substantial economic distortions, ultimately forcing the authorities to abandon the dollarized system and adopt a new domestic currency in early 2019.** During 2016-18, off-budget quasi-fiscal activities, unbudgeted agricultural programs, and wage bill overruns proliferated, with budget outcomes significantly worse than approved budgets. While revenue forecasts continued to be mostly achieved, actual and budgeted expenditure deviated on average by about 45 percent (Text Figure 2).[1] Strict FX and deposit withdrawal controls were introduced to ration the excess demand for FX at the official 1:1 rate of US$ per RTGS for deposits at banks. The situation became increasingly untenable, with the parallel market premium reaching about 300 percent in early-2019, and in February 20, 2019 the authorities introduced a new domestic currency (the "RTGS dollar" that was later renamed Zimbabwean dollar or ZWL$) and announced the creation of an interbank FX trading market.

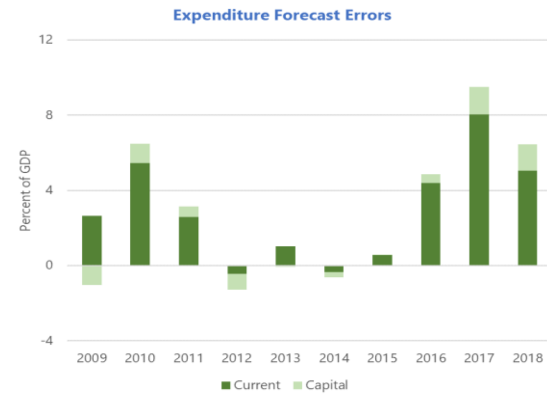
[1] By comparison, the average deviation in SSA countries was 1.5 percent, with a standard deviation of 14.5 percent, as calculated from data available in PEFA reports.

Text Figure 2. Zimbabwe: Accuracy of Budget Forecasts, 2009–18

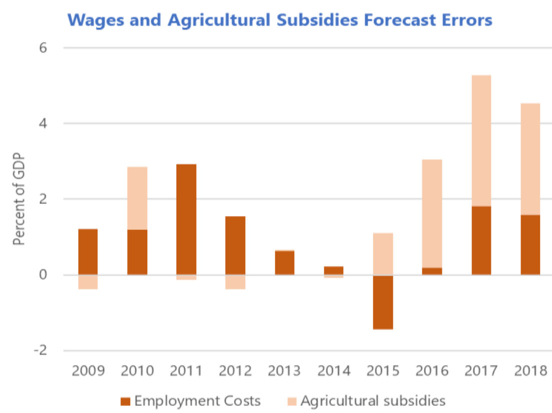
While revenue targets were mostly achieved…



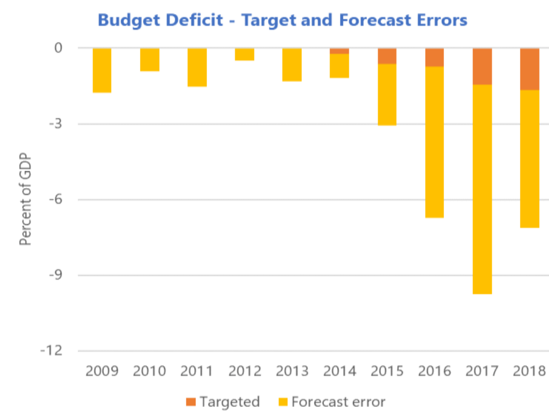
Expenditure targets were largely missed in recent years…



Due to overspending on wages and agriculture subsidies…



Resulting in deficits being systematically under-projected.



Sources: Zimbabwean authorities and IMF staff estimates.

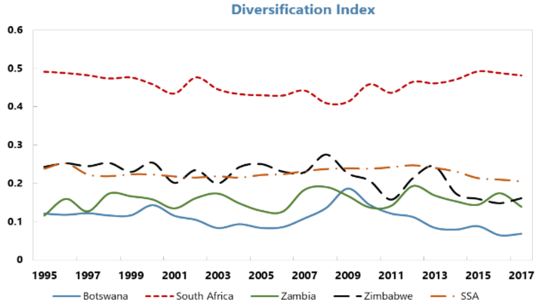
3. Policy uncertainty and missteps have limited the development of the economy—export diversification has not occurred and FDI remains well below peers (Text Figure 3). During 2009–18, gold, platinum, and tobacco accounted for about 60 percent of total export earnings. Further, about 66 percent of Zimbabwe's exports were to South Africa. Annual FDI was 1.6 percent of GDP during 2004–2017, compared to the SSA average of 2.6 percent and well below similarly endowed peers—Zambia attracted 6 percent of GDP during 2004–2017. Weak institutions, policy inconsistencies, and fiscal indiscipline have eroded investors' confidence.[2]

4. International reengagement has not advanced. Political reforms have advanced much slower than expected. The authorities have signed into law the Maintenance of Order and Peace Act (MOPA), advanced legislation on Access to Information and Protection of Privacy Act (AIPPA), and are preparing to bring to parliament by mid-2020 an Omnibus Bill aimed at accelerating electoral reforms and aligning all national laws with the 2013 Constitution. There is also concern that

[2] Gwenhamo, Farayi. "Foreign Direct Investment in Zimbabwe: The Role of Institutional and Macroeconomic Factors." *South African Journal of Economics* 79, no. 3 (2011): 211–23.

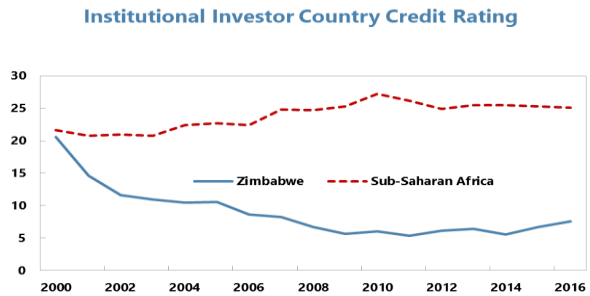
continued external commercial borrowing at market rates will further complicate the finding of a mutually agreeable resolution to Zimbabwe's debt overhang with its external creditors. A debt reconciliation with creditors, supported by transparency on the terms of all borrowings (including recent collateralized borrowing against future gold and platinum export receipts), is a necessary first step in advancing discussions. Given Zimbabwe's large external arrears, and ineligibility for traditional debt relief mechanisms (e.g. HIPC/MDRI), there is a need to develop, and reach consensus on, affordable solutions to Zimbabwe's debt overhang.

Text Figure 3. Zimbabwe: Diversification and Credit Ratings, 1995–2016



Note: Diversification index closer to 1 indicates greater diversification.

Source: Staff computations based on UNCTAD STAT



Note: Countries are rated on a scale of zero to 100, with 100 representing the least likelihood of default.

Source: Staff computations based on Institutional Investor Database

Notes: The above non-IMF indicators provide qualitative information about the indicators listed in these figures, and the accuracy of the indices can be biased by experts' views (instead of facts). They do not represent the IMF's assessment on any of these indicators.

5. **Implementation of past IMF policy advice has been mixed**. The government that came into office after the July 2018 elections adopted in October 2018 a Transitional Stabilisation Programme (TSP) with a focus on macroeconomic stabilization during 2018-20, institutional reforms to support economic growth and human development, and governance reforms to tackle corruption and strengthen the rule of law. Many of the reforms contained in the TSP are in line with past Fund policy advice: strengthening fiscal management, improving the financial stability framework, developing a transparent and better-functioning FX market, and supporting governance reform. As summarized in Annex I and discussed below, the authorities have achieved a significant fiscal adjustment. However, reserve money growth has remained high and the monetary and FX market reforms have not advanced sufficiently. The authorities have also approved reforms for key SOEs, aimed at making them more accountable, transparent, and viable, but other structural reforms have lagged, including on improving the business climate and clarifying agriculture land rights.

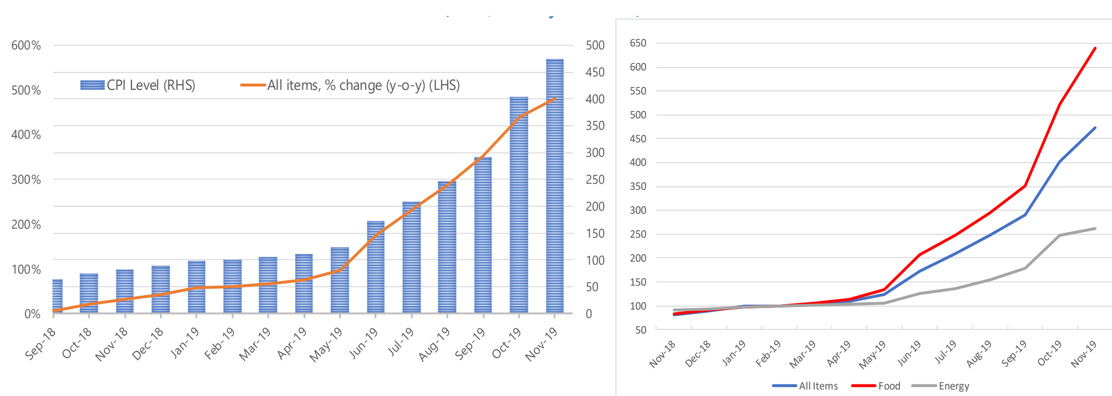
RECENT ECONOMIC DEVELOPMENTS

6. **The government's ambitious reform program has resulted in significant adjustment costs, amplified by two large climate shocks.** A substantial fiscal consolidation and the reintroduction of a national currency has created transition costs for a fragile state with limited capacity and negligible access to external concessional financing. The social impact has been

exacerbated by Cyclone Idai[3] and the devestating impact of the ongoing drought that has severely affected agriculture as well as electricity production leading to widespread load-shedding. WFP estimates (in December 2019) that about 8 million people (approximately 60 percent of the population) are food insecure. Donors continue to provide significant humanitarian support, but as of January 2020 only US$240 million, or roughly half of the US$468 million requested under the UN Flash Appeal for Zimbabwe, has been committed.

7. The economy contracted in 2019 and inflation has spiked sharply, increasing poverty. Favorable rains, mining, public sector wage increases, and fiscal support to the agricultural sector helped push real GDP growth to 3.5 percent in 2018. Nevertheless, growth was not sustainable, with agricultural gains fueled by unsustainable government subsidies and little investment for productivity growth. Highlighting Zimbabwe's vulnerability to climate change and environmental shocks, output is estimated to have contracted by over 8 percent in 2019 as the adverse impact of a severe drought on agriculture and electricity generation compounded the contractionary effects of fiscal consolidation.[4] With the overwhelming majority of Zimbabwe's agriculture being rain-fed, and its electricity generation largely dependent on the rain collected at the Kariba dam, the country has little resilience to droughts and other environmental shocks. Inflation remained in low single digits through September 2018, but has jumped sharply since to 521 percent at end-2019 (Text Figure 4), reflecting the sharp exchange rate depreciation from the monetary overhang of past monetary financing of deficits and continued quasi-fiscal activities by the RBZ during 2019, as well as the removal of subsidies on fuel and electricity. Rising inflation is adversely affecting the poor, especially the higher price of maize, with prices for fuel and electricity also having a negative impact. Economic hardship is also eroding human capital, with education and health indicators deteriorating.

Text Figure 4. Zimbabwe: Consumer Price Index by Category, 2018–19 (Index, February 2019 = 100)



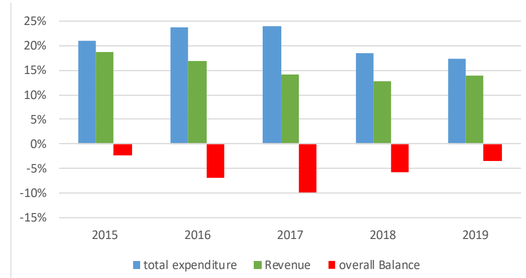
Sources: Zimbabwean authorities and IMF staff estimates.

[3] Cyclone Idai hit Zimbabwe in March 2019 causing damage estimated at about US$1.2 billion (6 percent of GDP).

[4] See Selected Issues Paper for additional discussion.

8. Given tight financing constraints, the fiscal stance has been tightened significantly under the current administration to contain monetary financing of the deficit and help stabilize the economy (Text Figure 5). In 2019, revenues were driven by higher inflation but also supported by the new financial intermediation tax and the increase in fuel excises. The government has contained spending well below the supplementary budget allocations, with lower than budgeted infrastructure spending and transfers to provinces, as well as containment of the wage bill. Although quasi-fiscal operations by the RBZ continued during 2019 (see below), the cash deficit of the central government, is estimated to have declined to 3.5 percent of GDP, compared to 4 percent targeted in the budget and 7.5 percent in 2018.

Text Figure 5. Zimbabwe: Revenue, Expenditure, and Deficit, 2015–19
(percent of GDP)

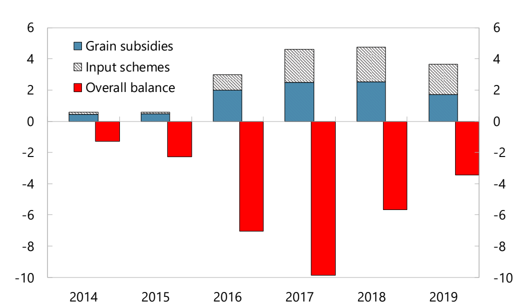


Sources: Zimbabwean authorities.

- **Real public sector wages have fallen drastically** (Text Figure 6). The government's real wage bill increased from 42 to 85 percent of tax revenue between 2010 and 2016, driven by higher compensation. Recent reforms have reduced the government wage bill to the SSA average. With employment growth contained, the adjustment has taken place entirely on the compensation side. Despite several nominal adjustments since January 2018, high inflation has eroded public sector real compensation by more than 80 percent, from about US$5,000 per year in 2016 to less than US$1,000 in 2019. As a result, the wage bill as a share of revenue has declined sharply from 90 percent in 2017 to 72 percent in 2018, and is estimated to have reached 37 percent in 2019, close to the 25th percentile across Sub-Saharan Africa countries and in line with the authorities' medium-term target of 35 percent of tax revenue.

- **Agriculture spending has remained high despite the changes in 2019 to the financing of the agriculture input schemes.** In response to a significant drought in 2015 agriculture spending has spiked (to nearly 5 percent of GDP in 2018), reflecting an increase in grain subsidies and the introduction of Command Agriculture intended to ensure food security (Text Figure 7). However, the effectiveness of the multiple agricultural schemes has been very low, as governance challenges, poor targeting, and structural barriers to agricultural growth potential hold the sector back (see Selected Issues Paper (SIP)). Starting with the 2019/20 agriculture season, the financing of inputs under the command agriculture program has been transferred to the banking system. However, risks to the budget remain high as the government provided a full guarantee against credit default.

Text Figure 7. Zimbabwe: Agriculture Spending, 2014–19
(in percent of GDP)



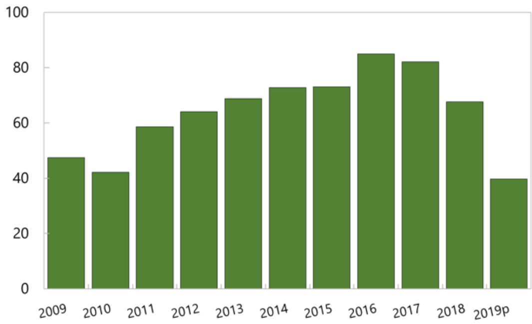
Sources: Zimbabwean authorities.

Text Figure 6. Zimbabwe: Government Wage Bill 2009–19

The last decade saw a large expansion of government wage bill…

Zimbabwe: Public Wage Bill

(Wage bill to tax revenue ratio)

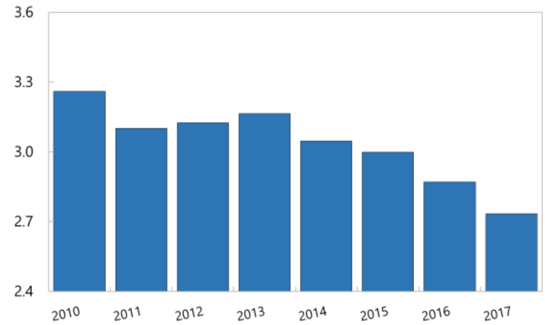


Sources: Zimbabwean authorities, and IMF staff calculations and projections.

although public employment remained on a downward path.

Zimbabwe: Public Employment

(Employment to working age population ratio)

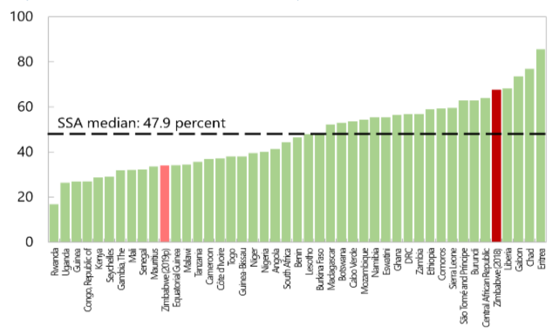


Sources: Zimbabwean authorities, and IMF staff calculations.

Recent reforms brought the government wage bill back to a sustainable position…

Sub-Saharan Africa: Government Wage Bill

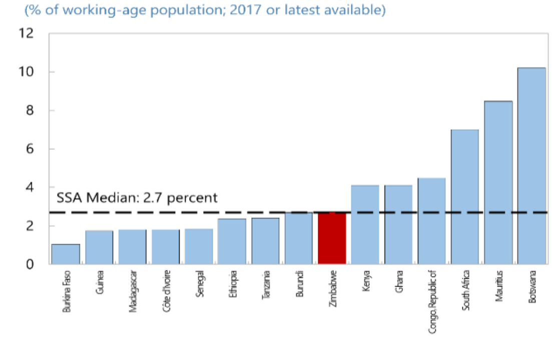
(% of tax revenue; 2018 or latest available)



while public employment remains in line with peer countries.

Sub-Saharan Africa: Public Employment

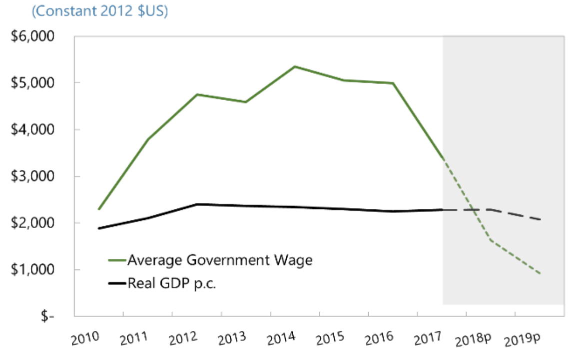
(% of working-age population; 2017 or latest available)



The large disparity between public and private sector compensation has been reduced…

Zimbabwe: Government Wages and GDP per capita

(Constant 2012 $US)

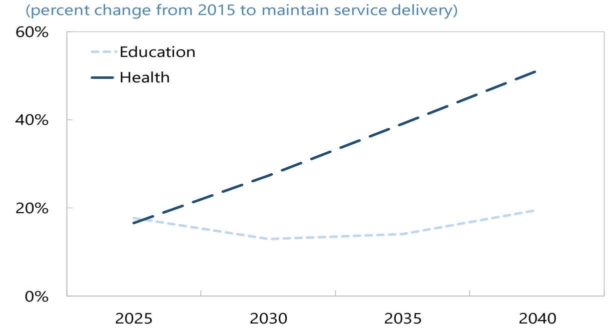


Sources: Zimbabwean authorities, and IMF staff calculations. Government wages exclude uniformed forces.

Which will help accommodate pressures from future demographic trends.

Zimbabwe: Public Employment Growth Projections

(percent change from 2015 to maintain service delivery)

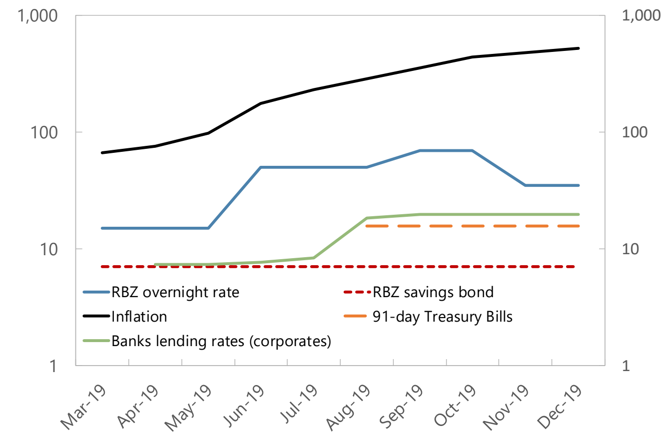


Sources: Zimbabwean authorities, UN, and IMF staff projections.

Sources: Zimbabwean authorities and IMF staff estimates

9. Reserve money rose sharply in the second half of 2019 owing to the resumption of quasi-fiscal operations by the RBZ. While reserve money remained broadly stable during the first half of 2019, it nearly tripled during the second half of the year, estimated to have reached ZWL$9 billion at year end compared to ZWL$3.3 billion as of end-June. This reflects the resumption of quasi fiscal operations by the RBZ that were not sterilized, including: the discounting in July 2019 of a 0.8 percent of GDP USD Treasury Bill held by a domestic firm; provision of FX to fuel importers at below market rates to contain the increase of the retail fuel price (discontinued since October); and the introduction in September of an export incentive for gold purchases financed by reserve money expansion of about ZWL$400 million/month. Reserve money has also been very volatile, as the new quantitative monetary targeting framework that the RBZ announced at the time of the currency reform has not been operationalized, effectively leaving the market without a credible nominal anchor. Domestic interest rates remain well below inflation (Text Figure 8).

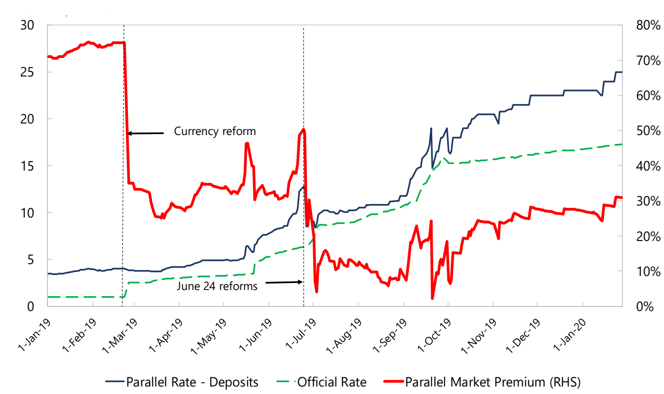
Text Figure 8. Zimbabwe: Domestic Interest Rates
(in percent, log scale)



Sources: Zimbabwean authorities.

10. Distortions in the FX market remain significant. After a brief period of relative stability around mid-2019, the parallel exchange rate depreciated sharply following the massive expansion of reserve money. At end-January 2020, the parallel exchange rate was around 25 ZWL$/US$, compared to 10-11 during July and 3.5 when the new currency was introduced in February. The parallel market premium has also increased and is now over 30 percent, from about 10 percent before the reserve money shock in mid-2019 (Text Figure 9). The higher premium reflects additional restrictions placed by RBZ, specifically on trading margins for authorized FX dealers, policy uncertainty, and a lack of publicly available statistics to guide market expectations.

Text Figure 9. Zimbabwe: Official and Parallel Market Exchange Rates,
(ZWL$ per US$)

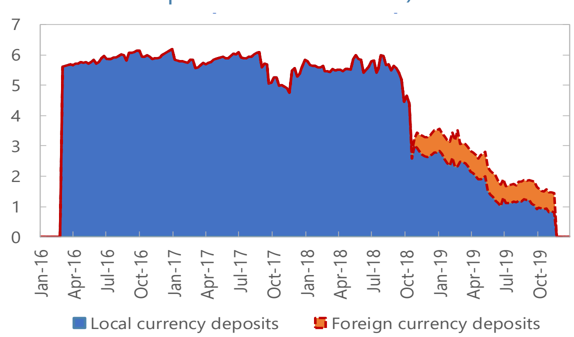


Sources: Zimbabwean authorities and IMF staff estimates.

11. The capacity of the banking sector to support growth has been significantly reduced. Conversion of banks' assets and liabilities to ZWL$ at an exchange rate of 1:1 to the US$ in February 2019 caused a sharp shrinkage in banking sector assets (from 58 percent of GDP at end-2018 to 24 percent at end-September 2019) and bank deposits converted into US$ (from 6 to 1.6 billion over the same period) (Text Figure 10). This negatively affects banks' ability to maintain credit lines with foreign banks, to meet corporates' needs for working capital, and to fund the government. Private sector credit as a share of GDP has contracted for 5 consecutive years (Text Figure 11).

Text Figure 10. Zimbabwe: Bank Deposits, 2016–19

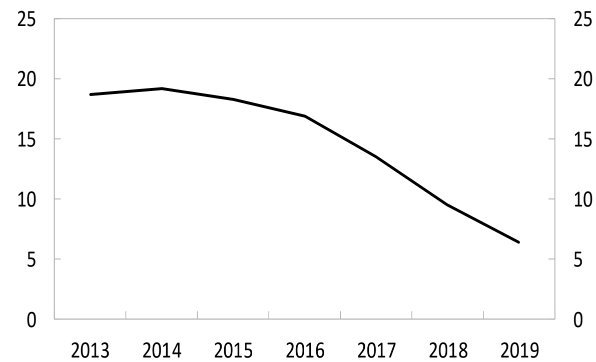
(in US$ billion; ZWL$ deposits converted at parallel market rate)



Sources: Zimbabwean authorities.

Text Figure 11. Zimbabwe: Commercial Bank Credit to the Private Sector, 2013–19

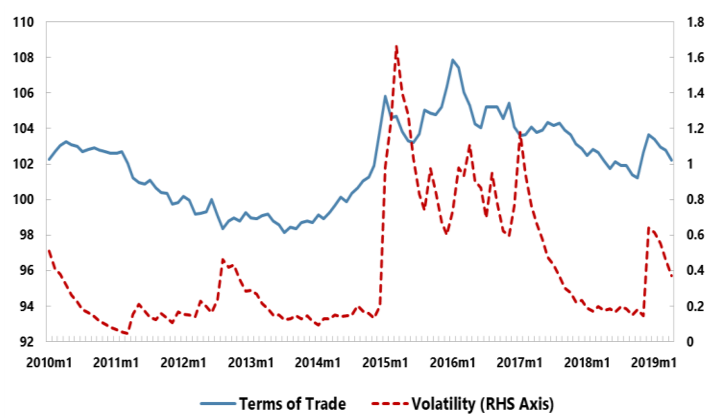
(in percent of GDP)



Sources: Zimbabwean authorities.

12. The current account recorded a small surplus in the first half of 2019, but reserves remain at critically low levels. The surplus of US$148 million (vs a US$1.2 billion deficit in 2018), reflects import compression from higher fuel prices, FX shortages, and a sharp decline in real disposable income. Terms of trade have also been declining since 2016 (Text Figure 12), from falling tobacco prices and rising oil prices. International reserves have fallen to about one week of imports.

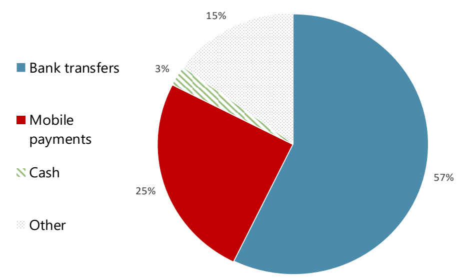
Text Figure 12. Zimbabwe: Terms of Trade, 2010–19



Sources: IMF Research Department and staff estimates.

13. Cash shortage in conjunction with Zimbabwean entrepreneurship has turned mobile payments into the preferred vehicle for payments. Electronic transfers are not subject to restrictions and Zimbabwe has achieved one of the highest usage levels of innovative payment products (mobile payments, cards, etc.) in the region. This has spurred a significant increase in financial inclusion of underserved communities (unbanked population). The value of mobile payments during 2019H1, for example, accounted for 25 percent of the consolidated transaction activities, compared to just 3 percent for cash (Text Figure 13).

Text Figure 13. Zimbabwe: Financial Transactional Activities, 2016–19
(in US$ billion; ZWL$ deposits converted at parallel market rate)



Sources: Reserve Bank of Zimbabwe.

14. The financial supervisory and stability framework is being strengthened. The RBZ has finalized its review of banks' first recovery planning and developed a methodology for designation of domestic systemically important banks. Since June 2019, the Credit Registry receives daily credit data from all banking institutions, providing support for financial sector credit risk management. A Collateral Registry for movable assets is expected to become operational in 2020 and facilitate SME and individual's access to credit. RBZ has drafted plans for migration to the Basel III regulatory framework. In addition, with IMF technical assistance, it is preparing changes to the legal framework for bank supervision and the financial safety net in line with international standards and best practice.

15. The SMP for Zimbabwe that was approved by IMF management in May 2019 is off track. Performance against quantitative program targets was satisfactory through end-June, but the SMP went off track afterwards, with most end-September 2019 performance criteria missed owing to the large quasi-fiscal operations by the RBZ discussed above (Table 7). Performance against the SMP's structural benchmarks has been largely satisfactory (Table 8). The SMP is due to expire at end-March 2020.

MACROECONOMIC OUTLOOK AND RISKS

16. The outlook for 2020 is for near-zero growth and gradual disinflation (Text Table 1 and Tables 1-4). For 2020, the economy is expected to remain basically flat as agriculture fails to rebound from the previous drought year, electricity generation endures another year of low rainfall, and fiscal adjustment continues. With grain stocks already depleted, a weak agriculture harvest would put additional pressures on the balance of payments for food imports. Over the medium-term, continued external arrears and the consequent lack of access to external finance continue to constrain investment, and real growth, but eventually reduced fiscal deficits and a more flexible exchange rate regime allow the economy to achieve some growth (the baseline assumes that the identified fiscal gaps in 2020-23 are closed through fiscal measures and/or additional external financing). Without a resolution of Zimbabwe's unsustainable external debt, the economy will not be able to grow at or near potential and there is little chance of the country reaching its targets under the sustainable development goals (SDGs). Inflation is expected to decline but nonetheless remain relatively high through mid-2020, as exchange rate depreciation pass-through runs its course, but could fall in the latter part of 2020 if the RBZ successfully contains money growth.

Text Table 1. Zimbabwe: Macroeconomic Framework, 2017–23

	2017	2018	2019	2020	2021	2022	2023
Real GDP growth (%)	4.7	3.5	-8.3	0.8	2.5	2.5	2.2
Inflation (%, average)	0.9	10.6	255.3	221.1	3.7	3.0	3.0
Inflation (%, eop)	3.4	42.1	521.1	52.0	3.0	3.0	3.0
Overall Fiscal balance (% GDP)	-9.9	-5.7	-3.4	-5.0	-2.3	-2.1	-2.1
Consolidated public sector debt (% GDP)	54.4	44.2	50.1	53.9	56.0	55.9	55.7
Public and publicy-guaranteed external debt (% GDP)	40.1	37.8	47.6	51.5	52.7	52.1	51.5
Current account (% GDP)	-1.3	-5.4	0.7	-1.0	-1.4	-1.3	-2.3
FDI (% GDP)	1.4	1.6	0.6	1.1	0.7	1.6	1.9
Reserves (months of imports)	0.5	0.1	0.2	0.2	0.2	0.2	0.2

Sources: Zimbabwean authorities; IMF staff estimates and projections.

17. **There is a risk of a social backlash as the adverse exogenous shocks and stabilization policies needed to promote macro stability affect vulnerable sections of the population.** The fiscal retrenchment and currency reform, followed by the sharp depreciation, exacerbated the disastrous effects of the climate shocks by cutting real wages, wiping out domestic savings, increasing poverty in both rural and urban areas, and generating fiscal drag on activity. Risks for another drought in 2020 are also high, which would weigh on the economy's recovery and exacerbate food shortages and BOP pressures. If no additional donor support materializes in the first half of 2020, pressures for large central bank financing of the budget will increase further. A return to excessive money printing would result in further depreciation, high inflation, and further erosion in the confidence of the new currency (Annex II).

Authorities' Views

18. **The authorities broadly share staff's assessment of risks on the macroeconomic outlook.** However, they believe that risks on 2020 real GDP growth are on the upside, reflecting a more optimistic view of prospects in agriculture, tourism, mining, and a boost in investment from a prompt rebound in confidence. While acknowledging the social impacts from the sharp fiscal adjustment, the authorities believe that this is necessary to stabilize the economy and expressed a strong commitment to continue stabilization policies and structural reforms to pave the way for strong and inclusive growth over the medium term.

POLICY DISCUSSIONS

19. **The authorities' economic policies over the medium term are guided by Vision 2030, which aims at making Zimbabwe an upper middle-income country by creating a thriving and open economy, with sound macroeconomic policies anchored on fiscal discipline, and a**

business-friendly environment that attracts foreign and domestic investment. To achieve these objectives, in the near term the authorities have committed to restore macroeconomic stability, combat corruption, address poverty, improving debt management, and pursue re-engagement with the international community, consistent with the strategy outlined in the TSP.

A. Fiscal Restraint to Restore Macro Economic Stability

20. The 2020 budget approved by Parliament in December is anchored on zero RBZ financing, but is based on very ambitious revenue and financing assumptions and needs to integrate additional expenditures (e.g. gold incentives scheme and maize meal subsidies).

- Total ***spending*** allocated in the budget is ZWL$63.6 billion However, that does not include the cost of the incentive for gold purchases that were in place as of January 2020 (ZWL$400 million a month) and revamped maize subsidies that were introduced recently. Based on policies existing at January 2020 regarding gold incentives and maize subsidies, staff estimates additional spending of ZWL$6 billion will be needed in 2020.[5]
- Latest projections of ***revenue*** and ***financing*** fall short of what is needed to support the full spending envelope of ZWL$69.6 billion. IMF staff project revenue of ZWL$49.9 billion, compared to ZWL$58.6 billion in the approved budget – the difference reflects updated inflation forecasts and the commitment by the RBZ to a disinflationary monetary policy. Similarly, the lower inflation level, as well as developments in the banking sector, suggest lower available net domestic financing for the 2020 budget.
- Staff estimates a **fiscal financing gap** of about ZWL$14.9 billion in 2020 (about 3.8 percent of GDP or ¼ of spending in the 2020 budget). The financing gap, while large, may understate the magnitude of measures necessary as it does not include additional funding to close the humanitarian funding gap (see ¶21). Discussions focused on fiscal measures to close the identified gap, since the alternative of resorting to RBZ money creation to fully close it would nearly triple reserve money and further stoke hyperinflation pressures. Following recent tax policy changes (the 2 percent tax on financial transactions,[6] excise tax reform, as well as fuel and electricity price increases), there are no obvious tax policy reforms that could generate significant revenue and be politically feasible during this humanitarian crisis and economic contraction. While discussions were inconclusive, staff urged the authorities to contain spending on inefficient subsidies and transfers while bolstering more effective social transfers (e.g. harmonized cash transfer), and making a concerted effort to prioritize capital expenditure in case financing does not materialize. Staff also encouraged the authorities to undertake

[5] The authorities have recently communicated to staff that they have decided to terminate gold incentives and replace them with a credit support scheme funded by the government. The impact on the budget of this policy change and its timing is unclear at this stage, but could potentially reduce the additional spending.

[6] The authorities introduced a 2 percent financial transactions tax in October 2018 as part of their efforts to bring the fiscal deficit under control and help stabilize the economy. While such taxes can generate significant revenue quickly, they also have potential adverse effects, especially regressivity and cascading. To mitigate these effects, the transactions below ZWL$100 are excluded from the tax in Zimbabwe, as are the payment of salaries and taxes.

coordinated outreach to external and domestic stakeholders to maximize the chances for financing the deficit.

21. Staff supports an upward nominal salary adjustment in 2020, although a further reallocation of spending towards social protection is needed. The budgeted increase in wages for 2020 (approximately 50 percent relative to their level at end-2019) provides for a preservation of real wages (relative to 2019) for public sector employees, following the drastic cuts they have experienced since 2017. The budget also includes a significant increase in social spending to ZWL$6.2 billion (about US$286 million or 1½ percent of GDP), compared to ZWL$750 million (about US$75 million) in 2019. However, the needs for social spending are much higher, with preliminary estimates suggesting a gap of about US$545 million (Text Table 2).

Text Table 2. Zimbabwe: Minimum Required Social Spending and Funding Gap in 2020

In Millions	Budget Estimates		Estimated Needs		Funding Gap	
	ZW$	US$ [1]	ZW$	US$	ZW$	US$
Harmonised Cash Transfer [2]	500	20	7,482	295	6,982	275
Basic Education Assistance Module [3]	450	18	2,276	90	1,826	72
Health Assistance [4]	2,144	84.4	5,542	218	3,398	134
School Feeding Programme [5]	1,030	41	2,762	109	1,732	68
Public works	0	0	381	15	381	15
Drought Mitigation	1,020	40	1,410	56	390	15
Teaching and learning materials	650	26	1,237	49	587	23
Others [6]	1,451	57	-	-	-1,451	-57
Total	**7,245**	**285**	**21,089**	**830**	**13,844**	**545**

Source: Zimbabwean authorities, World Bank, and IMF Staffs Estimates.

[1] Converted to USD at official exchange rate of ZW$25.4 to US$1.

[2] Based on monthly US$20 per household covering 1.01 million households.

[3] Required intervention to cover tuition fees for vulnerables children.

[4] Minimum intervention to cover public health, primary healthcare and hospital care.

[5] Minimum intervention covering about 2.72 million children at US$40 per child yearly. Derived based on the required intervention to cover tuition fees for vulnerable children.

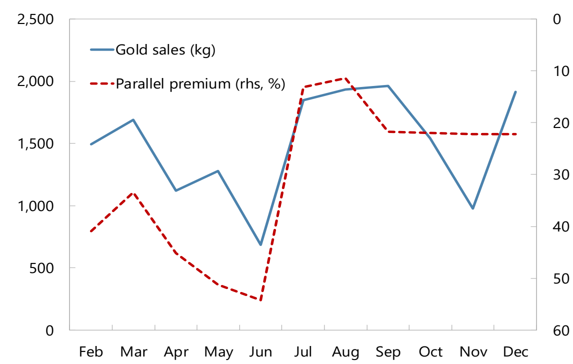
[6] Includes a number of social support programs (such as special needs education and sanitary wares, and support for elderly, disabled and children in difficult circumstances) and the price subsidy for maize meal.

22. Zimbabwe's social protection programs are generally effective in targeting the poor, but their coverage is low, posing a significant challenge to responding to the current crisis. Critical challenges to the performance of these programs have been inadequate funding (spending on social assistance has been less than 1 percent of GDP in recent years and declining as a share of GDP) and implementation performance. The coverage of these programs is mostly in rural areas, leaving exposed the significant number of people that are food poor in urban areas.

23. Additional funding is needed to support humanitarian needs. Even with the increased budget allocations for social assistance and existing commitments from development partners (estimated to increase by US$70 million relative to 2019),[7] preliminary estimates suggest minimum additional financing needs of about US$300 million for the first half of the year (covering through the 2020 agriculture season).

24. Staff urged the authorities to increase fiscal transparency and eliminate quasi-fiscal activities by the RBZ. While previous subsidies on electricity and fuel (via FX allocation at preferential rates) have been eliminated, the gold incentive introduced in September 2019 is a quasi-fiscal activity aimed at encouraging gold sales by small producers to Fidelity Printers and reducing sale in the grey market to neighboring countries.[8] Staff urged the authorities to remove the gold incentive (which would have an annual cost of about 1 percent of GDP) and to incentivize gold sales to Fidelity Printers via FX market liberalization reforms so as to reduce the parallel market premium (see below), given the strong (negative) correlation between the premium and gold sales by small producers (who account for over 60 percent of total gold supplies in Zimbabwe) (Text Figure 14). As noted in ¶20, the authorities have decided to terminate the gold incentive, although the timing and the fiscal impact of the reform is unclear at this stage. Staff also stressed that this and any similar subsidies should be included in the budget to improve transparency about their fiscal cost and should not take place via FX allocation at below-market rates.

Text Figure 14. Zimbabwe: Parallel Market Premium and Gold Sales from Small Producers
(February-December 2019)



Sources: Zimbabwean authorities.

25. Staff urged the authorities to minimize the assumption of private losses related to the currency reform. The authorities are considering assuming certain losses related to the currency reform, including from large net open foreign positions of banks, a backlog of unrepatriated dividends, and private debts owed by nonfinancial corporates. The amounts involved are very large (at least US$1.9 billion; nearly 10 percent of GDP and half of exports) and staff raised several concerns related to the process including the unclear method of compensation, lack of Parliamentary oversight, potential litigation risk, and the macroeconomic impact of this decision given a weak external position and non-existent FX reserves. Staff also cautioned the authorities to

[7] These interventions span across water supply and sanitation, health, education, humanitarian and basic social services that do not largely follow public sector social protection classifications.

[8] Fidelity Printers is a wholly-owned subsidiary of the RBZ with monopsony power over all purchases of gold production in Zimbabwe. Fidelity compensates miners through a combination of ZWL$ and US$, and the gold purchased is sold by Fidelity in Johannesburg where the proceeds are used to clear collateralized debt obligations (and the residual is returned to the RBZ in US$).

explore how this would affect the prospects of future normalization of Zimbabwe's external arrears with official creditors.

26. Reforms are needed in public debt management regarding pricing, predictability, and transparency of issuance of government securities. Strengthening the domestic currency debt market would support de-dollarization and establish a local currency yield curve over the medium term. Since government securities comprise a large share of banks' asset base, staff recommends that the RBZ uses these securities as collateral for monetary operations. This will facilitate the introduction of market-rate determined repo instruments (see SIP), enhance marketability of government securities, and help mitigate fragmentation of issuance, and hence improve pricing.

Authorities' Views

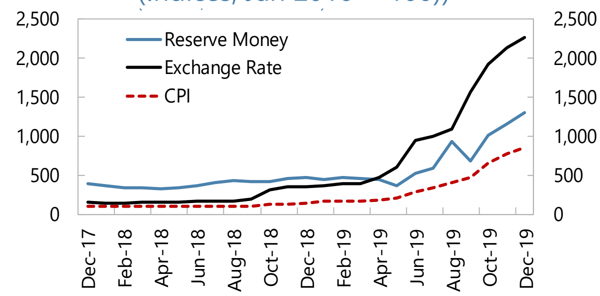
27. The authorities' twin fiscal anchors are a public debt level under 60 percent of GDP and an overall fiscal deficit under 3 percent of GDP, consistent with SADC commitments. They noted the significant progress that has been made since the new Government came into office in September 2018 in addressing the twin (fiscal and BOP) deficits, and expressed commitment for continued fiscal prudence to ensure a stable macro-economic environment. Based on revenue collection in recent months, the authorities believe that the annual revenue target of ZWL$58.6 billion approved by Parliament can be achieved. In any event, they expressed their commitment to delay execution of some allocations in the 2020 budget until there is greater clarity on revenue outcomes and the availability of domestic financing, while protecting social spending. The authorities noted that any non-concessional borrowing will be limited to critical food imports and essential infrastructure projects. On the losses related to the currency reform, the authorities agree on the objective to limit the overall amount assumed by the government, but emphasized that failing to honor obligations of foreign investors and creditors would harm Zimbabwe's reputation and undermine access to critical goods and services. They confirmed that the debt assumption for such losses will be approved by Parliament through a Debt Assumption Act.

B. Monetary and Exchange Rate Policies

28. Reserve money targeting (RMT) is the best feasible anchor at this time for the new currency (see SIP). The very low level of international reserves and the poor track record on inflation make other traditional nominal anchors for monetary policy—such as a fixed exchange rate regime or inflation targeting—not viable in the near term. Experience has shown that money-based stabilizations in countries with high inflation have—when consistently applied and supported by fiscal policy—quickly reduced inflation, given the close correlation between money growth and inflation. To that end, targeting a moderate increase in reserve money in 2020 would help anchor movements in broad money growth, exchange rate and inflation, given their correlation with reserve money growth (Text Figure 15).

Text Figure 15. Zimbabwe: Reserve Money, Exchange Rate, and Inflation Trends

(Indices, Jan 2016 = 100))



Sources: Zimbabwean authorities.

29. Operationalizing the RMT regime requires the introduction of short-term, market-rate-determined repo instruments to allow the RBZ to conduct open market operations. Although the RBZ has announced the adoption of an RMT framework, it currently lacks the instruments to fully implement such a framework—the only instrument at its disposal is the savings bond that is offered weekly to banks at a fixed interest rate. At 7 percent, well below prevailing inflation, the take up by banks in recent months has been minimal despite a high level of excess reserves (about ZWL$ 7 billion or 2 percent of GDP at end-December 2019). While market-determined interest rates will be higher than is currently the case for the savings bond, and possibly volatile initially, higher rates would boost demand for the new domestic currency, put upward pressure on the exchange rate, and help establish credibility of the new currency. In addition, the RBZ should stop direct lending to its subsidiaries (e.g., Fidelity Printers and Homelink).

30. Once structurally-low inflation levels have been reached, the authorities could consider alternative monetary frameworks. RMT relies on relationships between inflation and the growth in narrow and broad monetary aggregates, which typically become unstable at low levels of inflation. At that stage monetary policy needs to be more finely calibrated, and a price-based framework relying on interest rate signals, as opposed to the quantity-based RMT, may become more effective in stabilizing and finetuning inflation. Therefore, at a later time, it would be expected that reserve money would be replaced by a policy interest rate as the operational target.

31. Continued liberalization of FX controls is key to moving towards a market-clearing rate in the FX market. Staff urges the authorities to: develop a schedule for the removal of FX allocation via the priority list; allow exporters to sell more of the surrender amount (from 50 percent currently) in the interbank market while removing restrictions set on the rate at which banks can transact in the market; and eliminate as soon as possible all restrictions on current account transactions. Measures to de-dollarize the economy further are also essential, including promoting incentives for the holding of local currency over FX—in particular, requiring that all of government's domestic transactions be carried out in ZWL$.

32. Enhanced disclosure by the RBZ will be indispensable for the success of the stabilization program. Minutes of the meetings of the recently established Monetary Policy Committee are already being published in a timely manner. However, monetary statistics and central bank balance sheet data are provided with long lags. Staff proposed that, at a minimum, the daily RBZ balance sheet be published on the RBZ website, with a short (e.g., one-week) lag from the reference date, and that full monetary statistics be published no later than 4 weeks after the end of the month.

33. Certain exchange measures maintained by the authorities give rise to several exchange restrictions and multiple currency practices (MCPs).[9] These measures include: (i) prioritization of FX sales; and (ii) the RBZ's application of the prior date's interbank rate when allocating FX to finance certain imports and when purchasing FX from exporters subject to surrender requirement. Each of these measures gives rise to both an exchange restriction and a multiple currency practice. In addition, some capital account measures in the past few years that aimed to prevent further reserve losses constitute capital flow management measures (CFMs) under the Fund's Institutional View (IV) on capital flows (Box 1); staff encouraged the authorities to relax these measures as soon as economic conditions permit.

Box 1. Capital Flow Management Measures

The following capital account measures put in place by the Zimbabwean authorities constitute CFMs under the Fund's IV on capital flows:

- Capital account transfers started to be subject to approval (2016): outflow CFM.
- Cash withdrawal and related measures were tightened (2016): all outflow CFMs.
    - Cash exports limit was lowered (tightened) to $1000 from $5000, which was slighted eased to $2000 (2017).
    - Limits on credit card use, cash withdrawal, and bond withdrawal were introduced.
- Surrender requirement for FX was introduced in 2016 and further tightened during 2018-19: outflow CFM.
- Since 2016, limits on foreign investments and on external borrowing have been generally eased (though repayment for external borrowing, other than for productive activities, were restricted): easing of inflow CFMs.

[9] For more details see the Informational Annex.

Authorities' Views

34. The RBZ and the newly established Monetary Policy Committee expressed determination to establish monthly reserve money targets consistent with low inflation and to introduce instruments and processes for achieving these targets at market-determined rates. The authorities also agree on the need to liberalize the FX market, but noted a preference for a gradualist approach to help contain inflation, since Zimbabwe needs to import many critical products (such as fuel and essential food imports, as well as raw materials and machinery for production to export or to substitute imports of essential finished goods), and they viewed their current exchange control measures as necessary to direct needed FX to finance such imports. The RBZ plans to target a moderate (10-15 percent) increase in reserve money in 2020 and make any lending to its subsidiaries consistent with the overall reserve money targets. The authorities expressed concern that high interest rates would increase the cost of servicing public debt and negatively affect credit to the private sector, and thus intend to continue limiting the amount of fiscal financing in the domestic market. The authorities are not requesting Fund approval of the exchange restrictions and MCPs and indicated to staff that they plan to gradually relax them considering developments in the economic environment, and depending on the potential impact of the relaxation steps on FX conditions and market confidence.

C. Financial Sector Policies

35. Supported by administrative measures and government's commitment to compensate banks for FX losses, the banking sector has shown resilience (Figure 5). Exchange controls and deposit withdrawal restrictions have provided the banking sector with stable low-cost funding and the ability to keep lending rates relatively low on existing customer loans. Loan performance has improved helped by the sale of nonperforming loans to the Zimbabwe Asset Management Corporation (ZAMCO) during 2015-2018 and declining debt payments in real terms in 2019; the strength of capital is supported by the government's commitment, following currency conversion, to assume large losses related to banks Net Open FX Positions (NOP) (Box 2) and revaluation of real assets. Reported liquidity is ample but consists largely of illiquid long-term government bonds that could generate large valuation losses if discounted or sold. Therefore, reported prudential ratios overstate banks' ability to provide credit and meet deposit withdrawals in the absence of deposit withdrawal restrictions.

36. Staff emphasized the urgency of implementing financial sector reforms. The RBZ's recent measures to support bank credit to the productive sectors raises government contingent liabilities. These include a liquidity facility that was introduced in September 2019 at preferential rates and against collateral in corporate loans with a minimum maturity of 12 months. Staff noted that the collateralization of corporate loans transfers credit risk to the RBZ, raises government contingent liabilities and reduces banks' incentives for effective credit risk management. Staff emphasized that priority should be given to ensuring that banks have healthy balance sheets, allowing better transmission of market confidence and improved intermediation. Staff discussed:

- ***Legal and regulatory framework***. Ongoing legal reforms should be finalized, including to strengthen the prompt corrective actions and bank resolution regimes. Secondary legislation and prudential standards should be updated to ensure that primary legislation can be effectively implemented.
- ***Strengthening banking supervision***. More resources should be dedicated to core banking supervision systems and processes, focusing on DSIBs and problem institutions. On DSIBs, the RBZ should conduct immediately a thematic on-site credit review to assess the adequacy of loan classification and provisioning, large exposures, lending to related parties and credit risk policies and practices. To support systemic risk analysis and financial sector policy formulation, efforts are needed to improve supervisory data and reconcile with the monetary survey.
- ***Asset quality reviews (AQR)***. The RBZ should consider conducting an AQR to gauge banks' capital position, following an assessment of the impact of the new currency. To ensure credibility, the AQR should include participation by international reputable experts and the scope include banks loan books, real assets, NOPs and risk stemming from sovereign exposure.
- ***Resolution and contingency planning***. The RBZ should develop its resolution planning alongside the steps already taken on recovery planning; and prepare contingency plans, should capital shortfalls be detected in the AQR.
- ***The national payment system***. To catch up with the rapidly growing electronic payments, the legal and supervisory framework for payment and settlement systems should be brought in line with international standards. Forums with public authorities and private stakeholders could help facilitate further development of the system.
- ***AML/CFT.*** Substantial progress in improving the effectiveness of AML supervision, transparency of beneficial ownership information, and targeted financial sanctions will support Zimbabwe's exit from the FATF list and help mitigate pressures on correspondent banking relationships.

Authorities' Views

37. The authorities noted their commitment to addressing gaps in the financial sector supervision and financial stability frameworks consistent with the findings and recommendations of the Financial Sector Stability Review conducted by the Fund in November 2018. To that end, they plan to upgrade the legal framework to align banking supervision and the financial safety net with international best practice, reorganize the offsite and onsite supervisory functions, and strengthen the risk assessment framework with TA from the Fund. Currently they are drafting amendments to the banking law and deposit protection corporation act—including the triggers for bank resolution, improvements to the bank liquidation regime, clarifying the hierarchy of claims, and elaborating on the role of the courts in bank resolution—to bring legislation in line with international best practice.

Box 2. Zimbabwe: Banks' Net Open FX Positions

Following the currency reform of February 2019, negative NOPs arose in banks (up to 45 percent of sector capital) because banks assets and liabilities were only partially redenominated from US$ in ZWL$.[1] Losses accumulated as the ZWL$ depreciated against hard currencies and sector solvency was threatened.

- Mandatory currency redenomination from US$ into ZWL$ applied only to bank assets and liabilities that were subject to Zimbabwean legislation — assets kept abroad or registered with the RBZ as "off-shore" customer loans, and liabilities contracted according to foreign legislation were excluded. Among these were liabilities that banks had acquired from the government in exchange for T-bills that were subject to currency redenomination.[2]
- Deposits of FX earners were by law exempt from currency conversion.[3] Banks had been instructed by the RBZ to ringfence such deposits in "Nostro Foreign Currency Accounts (FCA)" in October 2018, which included "free funds" (diaspora remittances and international organizations' remittances), portfolio investment flows, loan proceeds, and export retention proceeds. To shore up confidence in the Nostro-FCA, the RBZ announced that it would establish a "Nostro Stabilisation Guarantee Facility" (NSGF) of US$500 million to ensure that the FX would be available when required by the account holders.[4]

To safeguard financial stability, the authorities announced in February 2019 that they would compensate banks for FX losses related to the NOPs at the time of currency conversion. However, the size and form for compensation is yet to be determined and Financial Soundness Indicators (Table 5) reflect banks' own expectations.

[1] Staff estimate.

[2] The liabilities originate from RBZ borrowing abroad to fund fuel imports but were transferred to the government under the Debt Assumption Act of 2015.

[3] Statutory Instrument 33 of 2019.

[4] RBZ Monetary Policy Statement of October 2018.

D. Structural Policies: Promoting Inclusive Growth and Improving Governance

38. The external position of Zimbabwe in 2019 was broadly consistent with medium-term fundamentals and desirable policies. The current account (CA) gap is assessed at -0.5 percent, translating into a two percent real effective exchange rate (REER) gap. The sharp depreciation of Zimbabwe dollar in 2019, over and above the concurrent sharp rise in inflation, has helped reduce the large REER observed in 2018 (Annex III).

39. Weak business environment undermines the potential competitiveness benefit from the recent exchange rate depreciation. Zimbabwe's global competitiveness has been declining since 2015 and is below the sub-Saharan African average.[10] Zimbabwe ranks 124th (out of 137) in the Global Competitiveness Index (GCI), with political instability, foreign currency regulations, inefficient

[10] Measured by the World Economic Forum Global Competitiveness Index.

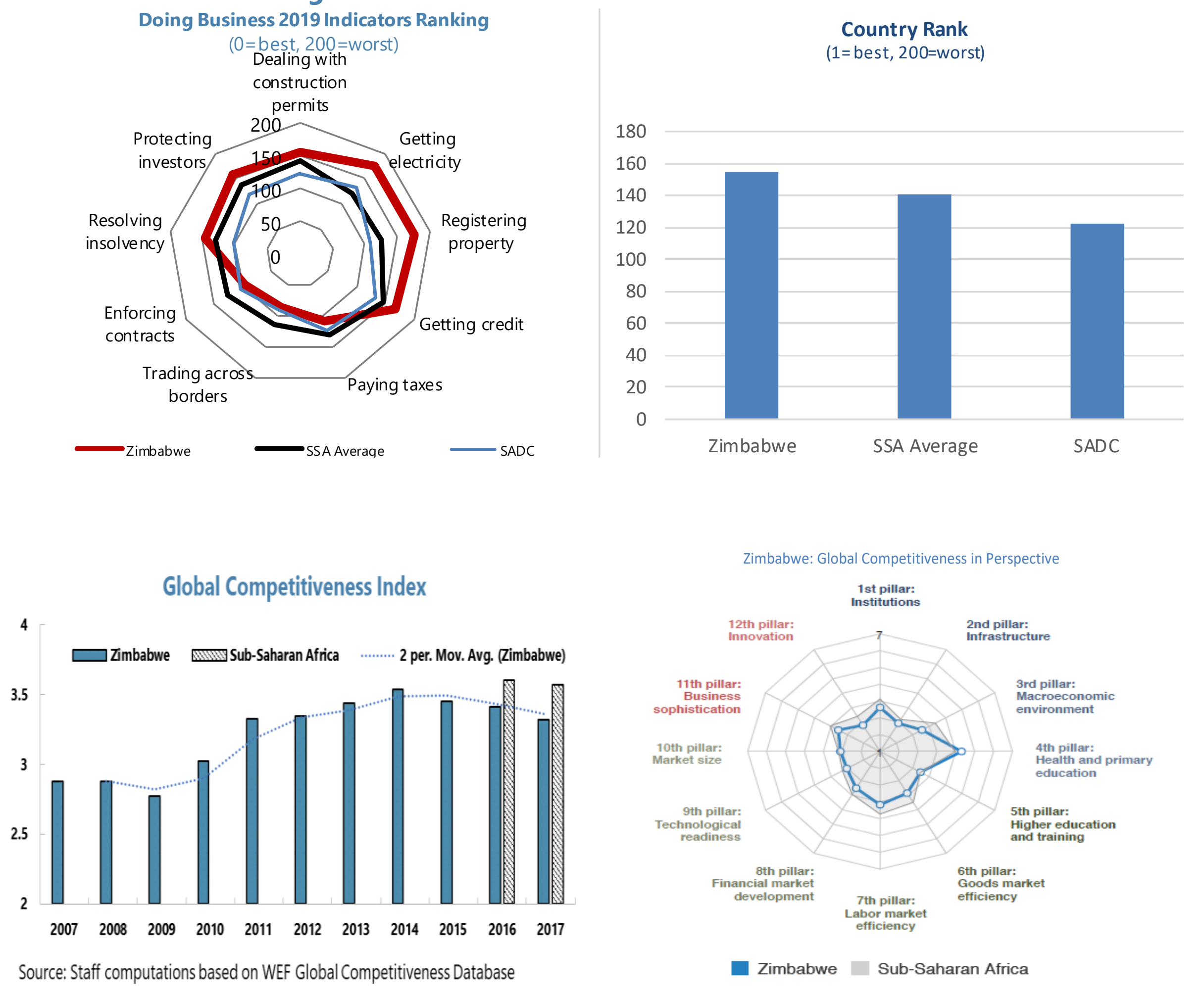
government bureaucracy, and corruption underscoring the negative perception of stakeholders (Text Figure 16). The authorities have made some progress on structural reforms: indigenization policy has been relaxed, investment-promoting institutions merged into a single Zimbabwe Investment and Development Agency, and SOE reforms are underway to improve service delivery and reduce their financial burden on the budget. However, the business climate remains challenging, with electricity shortages and inability to use agricultural land as collateral proving obstacles to private sector growth.

40. Structural reforms in the agricultural sector are key to boost Zimbabwe's medium-term growth and reduce poverty (see SIP). Agriculture is a key driver of the economy—it has the highest employment and, outside extractive industries, contributes most to GDP. Over the last two decades, agricultural productivity has declined significantly, moving Zimbabwe from having one of the most productive agricultural sectors to one of the least in sub-Saharan Africa. Dilapidated irrigation infrastructure, lack of skills development for new farmers, land rights uncertainty, and a challenging regulatory framework are the main causes of this secular decline. Recent government support to the sector, in the form of price and input subsidies, have not sustainably improved agricultural productivity as they have not addressed the root causes of problems afflicting the sector. Staff stressed that a reorientation and rationalization of fiscal agricultural support programs, along with legal and policy reforms to address the above structural weaknesses, could invigorate the sector and help restore Zimbabwe as an agricultural exporter.

41. The authorities are taking steps to address governance vulnerabilities but much more needs to be done. Zimbabwe scores well below the regional average on governance, transparency and corruption indicators (Text Figure 17). Accordingly, as discussed above, the TSP identified the strengthening of governance and tackling of corruption among the key reform priorities. The authorities have worked closely with IMF staff since mid-2019 to conduct the diagnostic assessment of Zimbabwe's governance vulnerabilities. IMF staff, in collaboration with World Bank staff, helped the authorities conduct an assessment of Zimbabwe's governance vulnerabilities in many areas, including public financial management, revenue administration, oversight of state-owned enterprises, the extractive industries, public procurement, RBZ operations, financial sector oversight, the rule of law, and AML/CFT (Annex IV).[11] Based on this assistance from IMF staff, the authorities are committed to publish in the next few months their final assessment of governance vulnerabilities and their high-level anti-corruption plan which will feed into a comprehensive anti-corruption strategy for Zimbabwe.

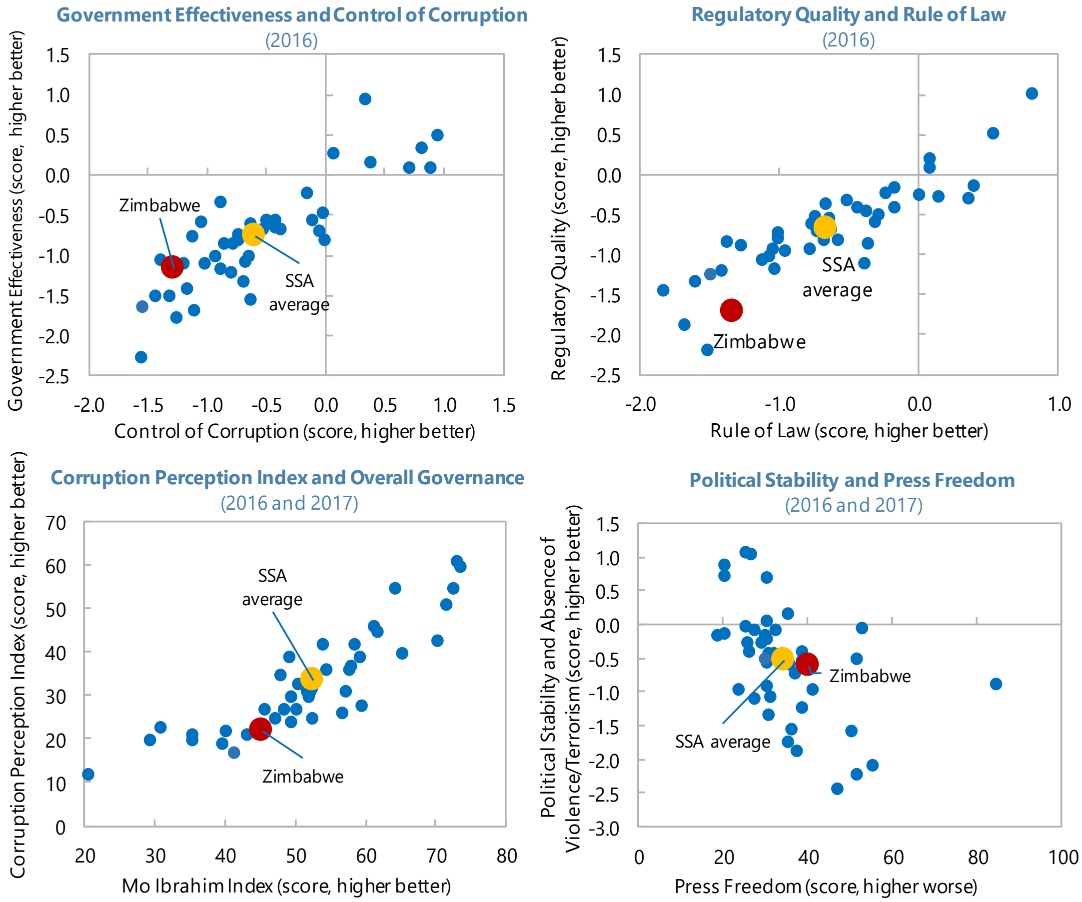
[11] IMF staff's assistance to the authorities in conducting the diagnostic assessment was provided in the context of the SMP. IMF staff's report on governance was shared with the authorities in January 2020 (IMF, Technical Report on Governance, Zimbabwe: Governance and Anti-Corruption Assessment, January 2020), and Annex IV summarizes the assessment as described in this report.

Text Figure 16. Zimbabwe: Business Environment Indicators



Notes: The above non-IMF indicators provide qualitative information about the indicators listed in these figures, and the accuracy of the indices can be biased by experts' views (instead of facts). They do not represent the IMF's assessment on any of these indicators.

Text Figure 17. Zimbabwe: Governance and Development Indicators Across Sub-Saharan Africa



Sources: Worldwide Governance Indicators; Transparency International; Mo Ibrahim Foundation; Doing Business Database; United Nations Development Programme; and Reporters Without Borders.

Notes: The above non-IMF indicators provide qualitative information about the indicators listed in these figures, and the accuracy of the indices can be biased by experts' views (instead of facts). They do not represent the IMF's assessment on any of these indicators.

Authorities' Views

42. The authorities agreed on the need to deepen structural and institutional reforms. Consistent with the TSP, their focus is on reforms that would support private sector activity, including by reallocating spending towards infrastructure rehabilitation; accelerating public enterprise reforms to improve their service delivery; continuing ease of doing business reforms especially to reduce constraints for starting a business, acquiring construction permits, and registering property; and implementing the ambitious governance reform program to combat corruption. The authorities also note that with international credibility and reengagement an essential aspect of achieving the Vision 2030 goals.

OTHER ISSUES

43. Zimbabwe remains in debt distress (see attached DSA), with long standing external arrears to IFIs, official, and commercial creditors. Domestic debt has grown in recent years due to large fiscal deficits and negligible access to external finance, but the recent currency conversion and high inflation have significantly eroded its real value. In the event that the Government assumes the liabilities from losses associated with the currency reform, then external debt situation would worsen further. Staff emphasized that this and continued recourse to collateralized external borrowing on commercial terms may potentially complicate any future arrears clearance operation for Zimbabwe. Restoring debt sustainability will require fiscal prudence across the public sector, as well as support for a debt arrangement by creditors.

44. Zimbabwe has large capacity development needs and has benefitted significantly from TA provided by the Fund and other stakeholders (Annex V). Following the clearance of arrears in 2016, the IMF has provided much technical assistance to Zimbabwe. The focus of Fund TA will continue to be on areas that expand revenue mobilization, improve expenditure controls/efficiency, support monetary and exchange market operations, and address governance concerns. The World Bank is providing support on the design of the social safety net and agriculture subsidies, as well as PFM and SOE reforms, among others.

STAFF APPRAISAL

45. The administration that took office in September 2018 has embarked on economic reforms aimed at addressing Zimbabwe's large macroeconomic imbalances and reducing distortions. Notable steps include a significant fiscal consolidation that has helped reduce, although not entirely eliminate, the monetary financing of the deficit; the introduction of the new domestic currency in February 2019 and the creation of an interbank FX market; the establishment of a new monetary policy committee at the RBZ with outside members, which has broadened the consultative process in setting monetary policy and increased the transparency of RBZ operations through regular publication of the minutes of its deliberations; and the restructuring of the command agriculture financing model to a public-private partnership with commercial banks.

46. Progress has not been balanced, implemented smoothly, or without cost, and has been severely hampered by climatic shocks. Uneven implementation, notably delays and missteps in FX and monetary reforms, have failed to restore confidence in the new currency despite the sharp tightening in fiscal policy. Continued rapid money growth for quasi-fiscal operations has resulted in a significant exchange rate depreciation and very high inflation. Together with a deep economic contraction from weather shocks and unavoidable fiscal adjustment, this has contributed to a sharp decline in living standards with more than half of the population now expected to be food insecure in 2019–20.

47. The near-term macroeconomic imperative is simultaneous and coordinated fiscal, FX, and monetary policies to stabilize the exchange rate and inflation, but this has to be achieved while addressing food insecurity.

- **Fiscal policy.** Approved spending in the 2020 budget exceeds realistic revenue mobilization and commercial bank financing. Delivering on the authorities' commitment of no RBZ financing of the budget will require identifying measures to scale-back spending, such as eliminating export gold incentives and containing low-priority current and capital spending. In addition, it will be important to contain the fiscal implications of any assumption of losses related to the currency reform, to: limit such assumptions using transparent criteria; require that any such debt takeover be approved by the MOFED, and eventually Parliament, consistent with the provisions in the Constitution and Public Debt Management Act; and use long-dated government securities for any assumption of such liabilities to limit the impact on liquidity and FX market in the near term. Continued recourse to collateralized external borrowing on commercial terms may potentially complicate any future arrears clearance operation for Zimbabwe and should be avoided.

- **FX reforms**. More determined implementation of currency reform is needed if a market is to be created. Continued liberalization of FX controls—such as removal of FX allocation via the priority list, allowing exporters to sell more of the surrender amount, and eliminating restrictions set on the rate at which banks can transact in the market—is key. Measures to de-dollarize the economy, including to increase incentives to hold local currency over FX—especially requiring that all of government's domestic transactions be carried out in ZWL$—are also essential. Staff welcomes the discontinuation of the practice of providing FX at a preferential rate, and urges the authorities that any subsidies for specific goods should not be done through preferential FX rates and be included transparently in the budget.

- **Monetary policy**. Reserve money targeting is the most appropriate anchor at this time for the new currency, given the paucity of international reserves and lack of credibility on inflation management. With rapid growth in money supply driving the sharp exchange rate depreciation and high inflation, stabilizing macroeconomic conditions will require the RBZ to achieve moderate reserve money growth. The introduction of short-term instruments to allow the RBZ to conduct open market operations would facilitate the operationalization of the reserve money targeting framework. In addition, the RBZ should stop direct lending to its subsidiaries.

- **Social protection**. The impact of the cyclone and prolonged drought, on top of the high inflation and exchange rate depreciation depleting the income and savings of many, has produced a humanitarian crisis. The budget has significantly increased the allocations for social spending, but even with the assistance pledged by the international community, these fall short of projected needs. Closing the gap to ensure a minimum level of social protection will require further reprioritization of budgetary resources and further engagement with the international community.

48. Staff urges the authorities to eliminate the exchange restrictions and MCPs described in paragraph 34. Staff does not support the policies that have given rise to these exchange restrictions and MCPs. Although the authorities have indicated that they plan to gradually relax them, there is presently no timetable to do so. Staff urges the authorities to articulate an exit strategy for their removal as economic conditions permit, to allow an improved functioning of the foreign exchange market.

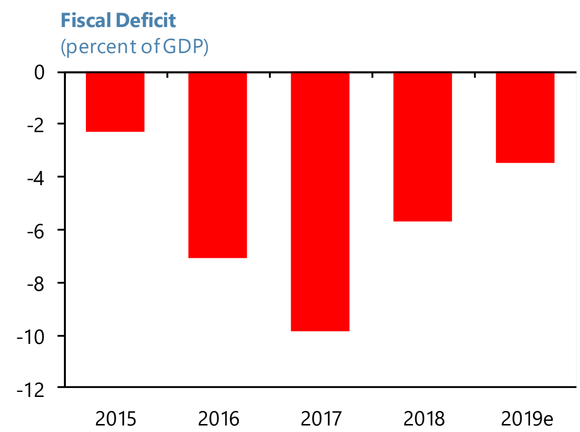
49. Given financial sector risks and vulnerabilities, steps to support financial sector stability are a priority. Key steps include close monitoring of weakly capitalized banks with elevated levels of NPLs and to that end, the RBZ should initiate a review of banks' asset quality and develop a strategy to address capital shortfalls. The RBZ should urgently allocate resources to update and operationalize its framework for managing weak banks, including their exit; strengthen legal and regulatory requirements to support bank supervision and enhance crisis preparedness; and advance efforts to increase the effectiveness of the AML/CFT framework to support the exit from the FATF list.

50. Structural reforms should focus on addressing governance vulnerabilities and improving the business environment to boost medium-term growth and reduce poverty. Combating corruption and improving governance will contribute to reducing the cost of doing business. Steadfast implementation of the recently adopted action plan aimed at addressing governance vulnerabilities will be a critical signal of the authorities' commitment in this regard. Agricultural reforms, key for medium-term growth and poverty reduction, should be continued, especially by improving improve irrigation infrastructure, expanding skills development for new farmers, facilitating the leasing of farms to productive farmers, and making the 99-year leases truly bankable so as to be used as collateral to secure needed financing.

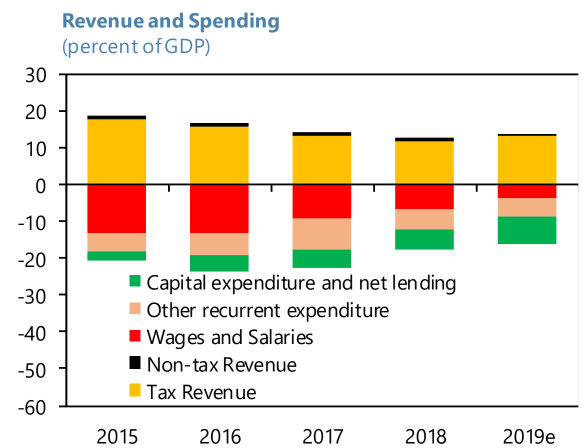
51. Staff recommends that the next Article IV consultation with Zimbabwe be held on the standard 12-month consultation cycle.

Figure 1. Zimbabwe: Fiscal Developments

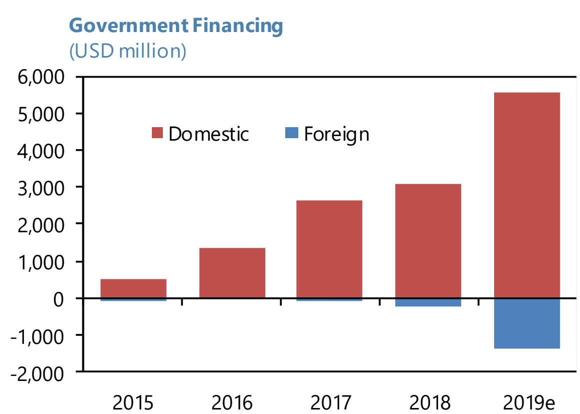
Significant fiscal adjustment after the July 2018 elections…



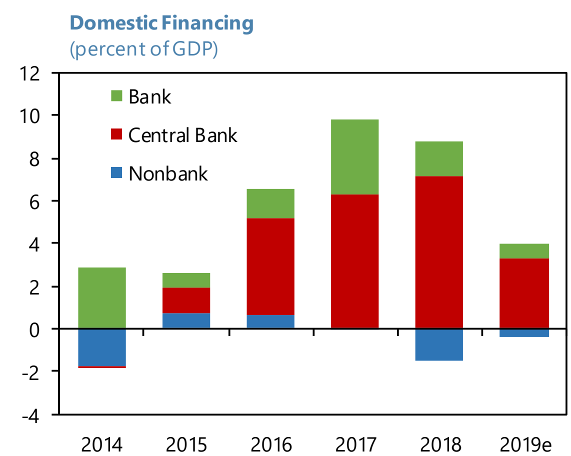
…reflecting revenue measures and expenditure cuts especially on wages …



…reducing government financing needs…



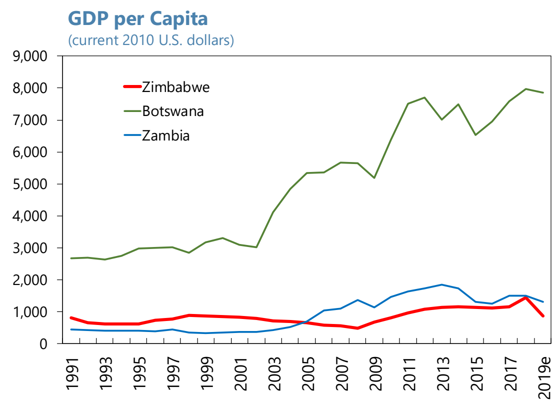
…especially from the Central Bank.



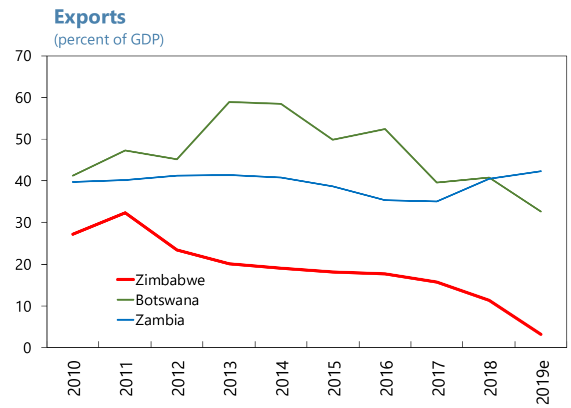
Sources: Zimbabwean authorities and IMF staff calculations

Figure 2. Zimbabwe: Evolution of Selected Economic and Social Indicators

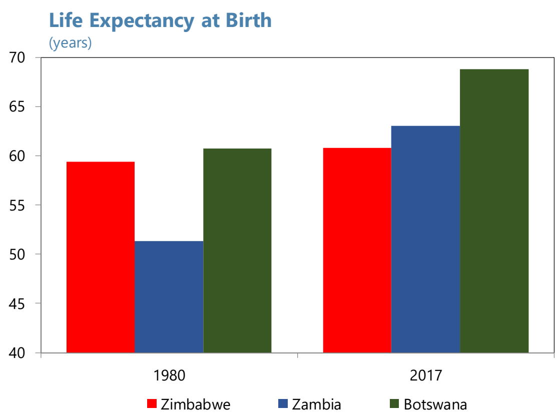
GDP per capita has remained stagnant since the 1990s.



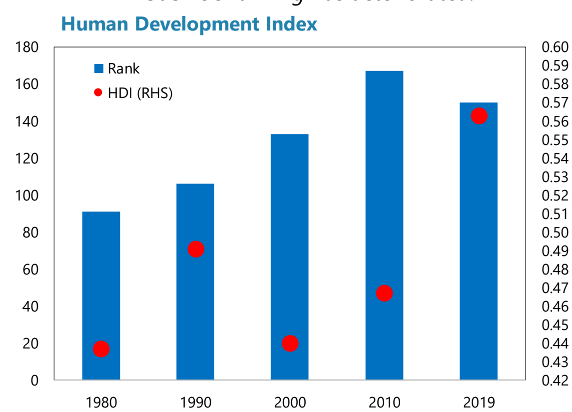
Export performance has been weak.



Life expectancy is below that in neighboring countries.



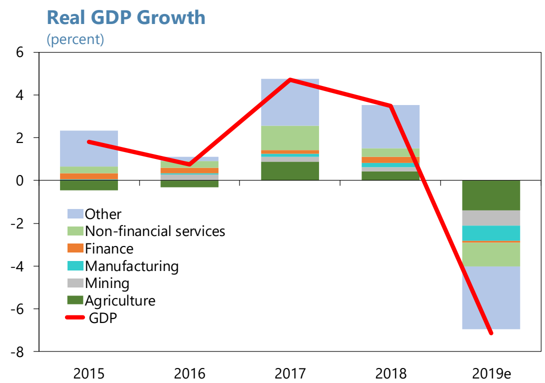
Notwithstanding the improvement in human development, Zimbabwe's ranking has deteriorated.



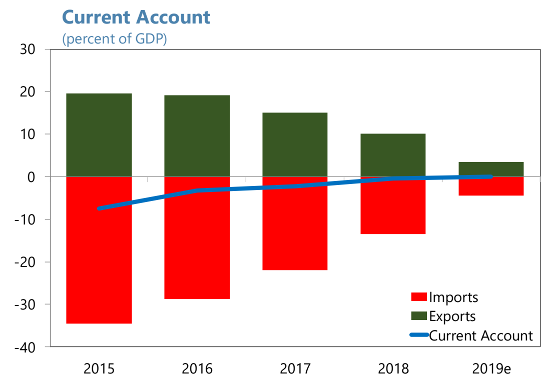
Sources: Zimbabwean authorities, International Energy Agency, and IMF staff calculations.

Figure 3. Zimbabwe: Recent Macroeconomic Developments

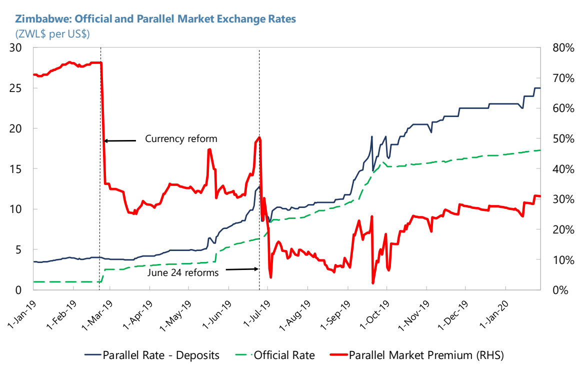
Growth contracted sharply in 2019 due to a severe drought and unavoidable fiscal consolidation



The current account deficit has shrunk due to limited external financing.



The parallel market exchange has been very volatile recently…



Sources: Zimbabwean authorities and IMF staff calculations.

…reflecting policy uncertainty amid a very low level of international reserves.

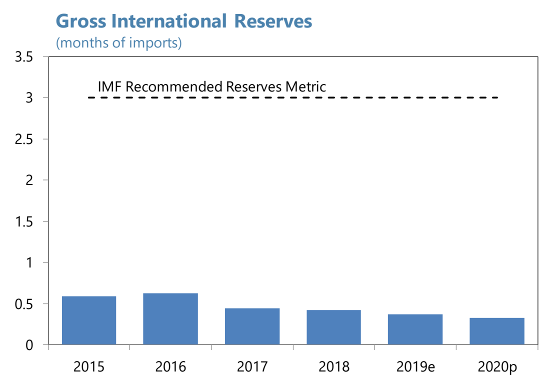
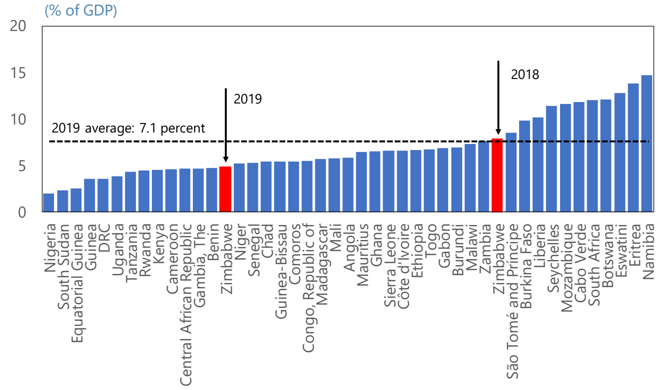


Figure 4. Zimbabwe: Government Revenue and Spending in Zimbabwe Relative to Peers

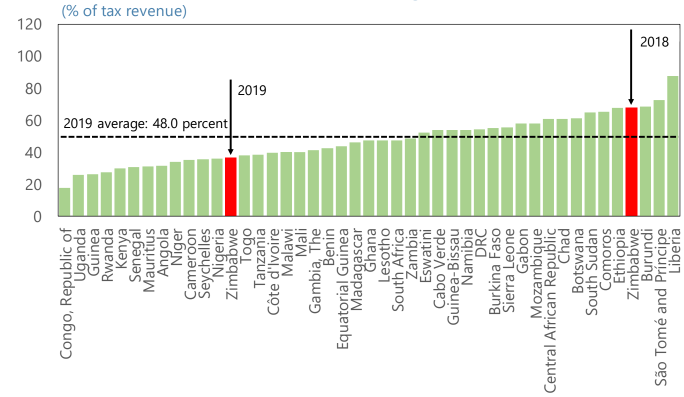
Zimbabwe's wage bill was until 2018 among the highest among peers both relative to GDP…

Sub-Saharan Africa: Civil service wage bill in 2019
(% of GDP)



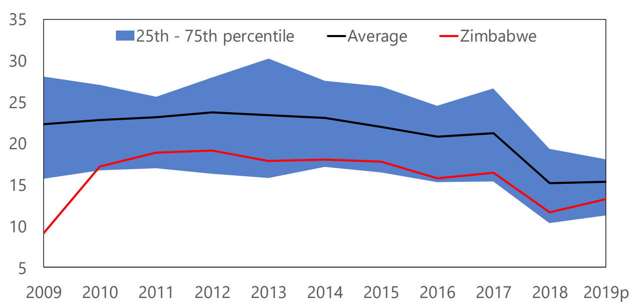
…and as a share of revenue, but has since declined well below SSA average…

Sub-Saharan Africa: Civil service wage bill in 2019
(% of tax revenue)



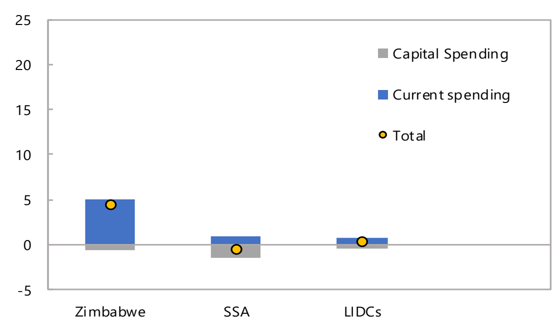
…whereas revenue is below SSA average.

Revenue: Zimbabwe and SSA
(in percent of GDP)



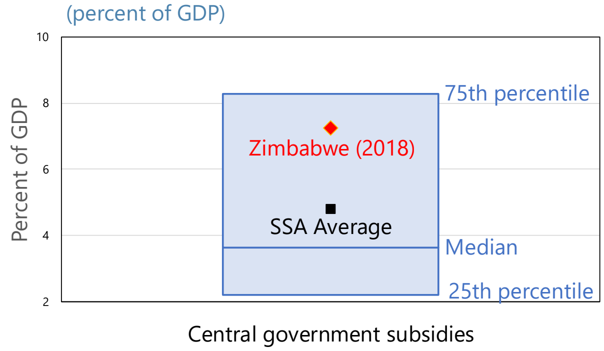
Higher government spending in the last decade reflects an increase in current expenditure…

Change in Central Government Expenditure
(in percent of GDP, 2010-2017)



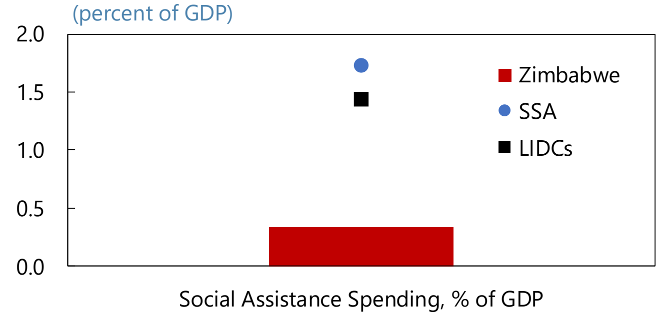
…which mostly go towards subsidies to agriculture and SOEs…

Subsidies in Sub Saharan Africa
(percent of GDP)



…whereas social spending is below the peers.

Social Assistance Spending in 2015
(percent of GDP)

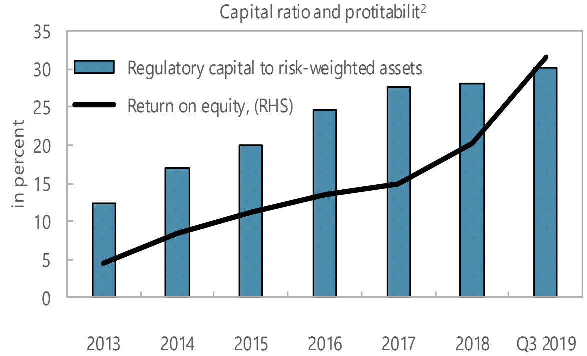


Sources: Zimbabwean authorities and IMF staff calculations.

Figure 5. Zimbabwe: Financial Soundness Indicators[1]

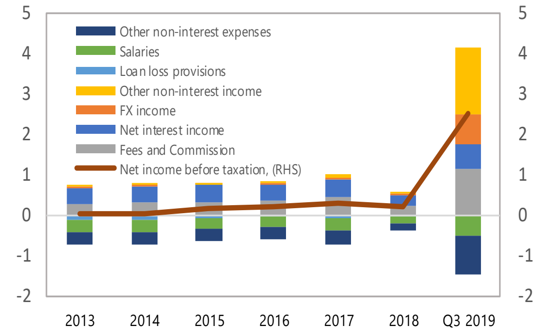
Banks reported high profitability and increasing capital ratios in the first half of 2019 ...

Capital ratio and protitabilit²



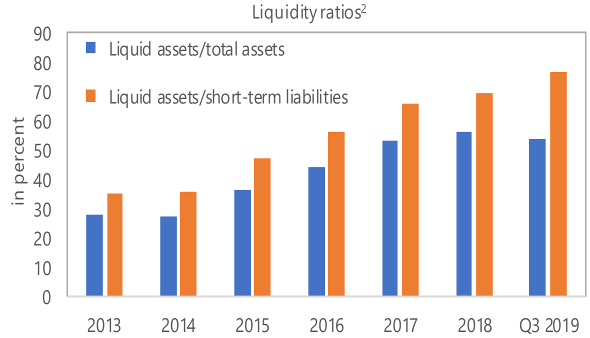
... with profits mostly from FX income and non-interest income

Income and expenses³, in billions of ZWL$



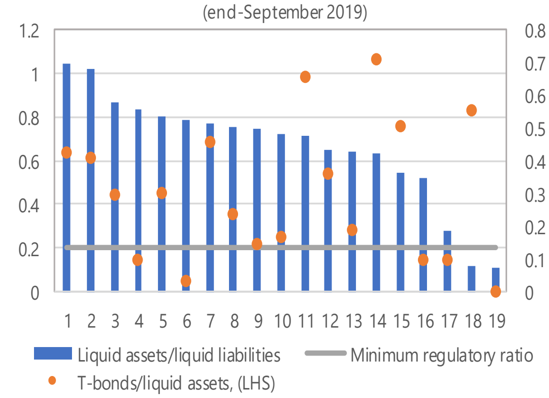
Commercial banks' liquidity is reported amble at 76 percent of short-term liabilities, reflecting falling intermediation.

Liquidity ratios²



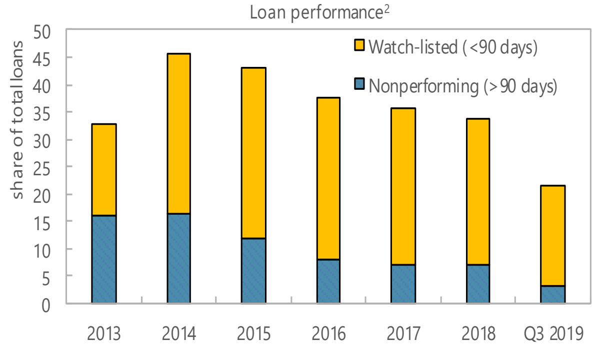
Liquidity differs across banks and consists largely of illiquid long-term government securities in several banks.

Liquidity in the 19 banks³
(end-September 2019)



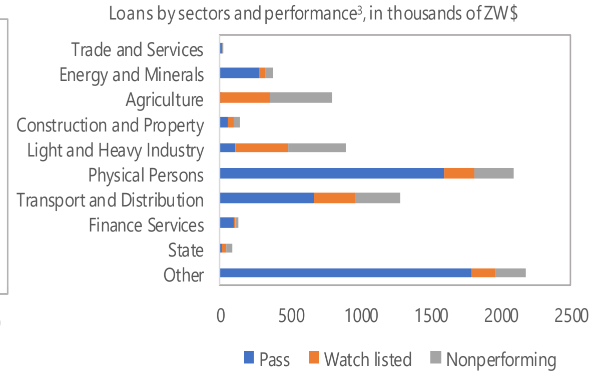
While commercial banks report improving loan performance, past due loans remain high at 22 percent of total loans.

Loan performance²



Loan performance varies widely across economic sectors, with 99 percent of loans to agriculture classified as past due.

Loans by sectors and performance³, in thousands of ZW$



Source: RBZ, staff calculations.

[1] Reported data for September 2019 reflects banks´ expectations about the size and form of government compensation for FX losses, both of which was undetermined at the time.

[2] Commercial banks (13).

[3] Commercial banks (13), building societies (5) and savings bank (1).

Table 1. Zimbabwe: Selected Economic Indicators, 2016–23

	2016	2017	2018	2019	2020	2021	2022	2023
		Act		Prel		Proj		
	(annual percentage change, unless otherwise indicated)							
Output and prices								
Real GDP growth 1/	0.7	4.7	3.5	-8.3	0.8	2.5	2.5	2.2
Nominal GDP (US$ millions)	20,549	22,041	22,946	20,703	20,563	21,339	22,607	23,588
Nominal GDP (ZWL millions)	20,806	27,438	42,468	156,165	390,666	442,791	476,139	504,257
GDP deflator	3.5	26.0	49.5	300.9	148.1	10.5	4.9	3.7
CPI (annual average)	-1.6	0.9	10.6	255.3	221.1	3.7	3.0	3.0
CPI (end-of-period)	-0.9	3.4	42.1	521.1	52.0	3.0	3.0	3.0
Money and credit								
Money supply (M2)	18.8	39.0	24.0	127.5	24.4	...	...	...
Credit to the private sector	-3.9	5.9	9.1	174.1	56.7	...	...	...
Credit to the central government	51.6	74.5	59.2	62.3	27.5	...	...	...
	(ZWL$ per US$)							
Official Exchange rate								
ZWL:USD exchange rate (annual average)	1.0	1.3	2.0	8.5				
ZWL:USD exchange rate (end-of-period)	1.0	1.3	3.5	16.8				
	(percent of GDP)							
Central government								
Revenue and grants	16.8	14.1	12.9	13.5	12.8	12.7	12.6	12.7
Expenditure and net lending	23.9	24.0	18.6	16.9	17.8	15.0	14.7	14.8
Of which: Employment costs	15.5	12.7	9.3	4.9	4.3	4.3	4.5	4.9
Of which: Capital transfers and net lending	4.1	5.8	5.0	3.3	4.0	3.5	3.2	2.8
Overall balance	-7.1	-9.9	-5.7	-3.4	-5.0	-2.3	-2.1	-2.1
Primary balance	-6.4	-9.0	-4.8	-3.0	-4.6	-1.5	-1.4	-1.4
	(US$ millions, unless otherwise indicated)							
Balance of payments								
Exports of goods and services	4,060	4,734	5,304	4,634	5,038	5,215	5,447	5,772
(annual percentage change)	1.5	16.6	12.1	-12.6	8.7	3.5	4.5	6.0
Imports of goods and services	6,427	6,555	7,617	5,455	6,417	6,511	6,730	7,359
(annual percentage change)	-14.4	2.0	16.2	-28.4	17.7	1.5	3.4	9.3
Current account balance (excluding official transfers)	-718	-284	-1,229	155	-204	-302	-302	-538
(percent of GDP)	-3.5	-1.3	-5.4	0.7	-1.0	-1.4	-1.3	-2.3
Gross international reserves	310	293	87	111	109	109	109	109
(months of imports of goods and services)	0.6	0.5	0.1	0.2	0.2	0.2	0.2	0.2
Public debt								
Consolidated public sector debt (e.o.p.)	10,089	11,998	14,459	10,372	11,082	11,950	12,639	13,144
(percent of GDP)	49.1	54.4	44.2	50.1	53.9	56.0	55.9	55.7
Public and publicly guaranteed external debt (e.o.p.)	7,997	8,829	8,672	9,865	10,591	11,238	11,786	12,151
(percent of GDP)	38.9	40.1	37.8	47.6	51.5	52.7	52.1	51.5
Of which: Arrears	5,157	5,652	6,109	6,284	6,421	6,559	6,698	6,837
(percent of GDP)	25.1	25.6	26.6	30.4	31.2	30.7	29.6	29.0

Sources: Zimbabwean authorities; IMF staff estimates and projections.

1/ At constant 2012 prices.

Table 2. Zimbabwe: Balance of Payments, 2016–20

	2016	2017	2018	2019	2020
		Act.		Est.	Proj.
	(US$ millions, unless otherwise indicated)				
Current Account	-718	-284	-1,229	148	7
Balance on goods	-1,500	-1,147	-1,787	-486	-620
Exports of goods	3,663	4,315	4,804	4,138	4,569
Imports of goods	5,163	5,462	6,591	4,624	5,189
Balance on services	-867	-674	-526	-342	-345
Primary income (net)	-178	-161	-311	-339	-340
Secondary income (net)	1,827	1,697	1,396	1,314	1,311
of which: Workers' Remittances	1,103	1,013	898	839	839
Capital Account	242	278	309	53	54
Financial Account	-906	-994	-703	375	200
Direct investment	-343	-306	-358	-118	-223
Portfolio investment	80	101	-55	-7	69
Financial derivatives and employee stock options	0	0	0	0	0
Other investment	-643	-789	-291	500	354
Currency and Deposit (net)	22	144	137	556	93
Loans (net)	-559	-685	-293	22	-167
Assets	-62	41	140	192	49
Liabilities	581	830	430	534	260
Central bank	534	499	87	-9	0
General government	18	83	158	-7	167
Other sectors (NFCs, HH, NPISHs))	29	248	186	550	93
Errors and Omissions	522	1,362	104	23	…
Overall Balance	-92	-374	-320	-175	-139
Financing	92	374	320	152	139
Accumulation of external arrears	78	357	114	175	137
Reserve accumulation (minus = increase)	14	18	206	-24	2
Unidentified financing	…	…	…	…	0
Percent of GDP	…	…	…	…	0.0
Memorandum:					
Reserve assets	310	293	87	111	109
Months of import cover	*0.6*	*0.5*	*0.1*	*0.2*	*0.2*
	(percent of GDP)				
Current account	-3.5	-1.3	-5.4	0.7	0.0
Exports of goods and services	19.8	21.5	23.1	22.4	24.5
Imports of goods and services	31.3	29.7	33.2	26.4	29.2
	(annual percentage change)				
Exports of goods and services	1.5	16.6	12.1	-12.8	9.8
Imports of goods and services	-14.4	2.0	16.2	-28.4	10.9
Terms of Trade	1.2	0.9	0.9	-0.3	-1.4

Sources: Zimbabwean authorities; IMF staff estimates and projections.

Table 3a. Zimbabwe: Central Government Operations, 2016–23
(millions of ZWL$)

	2016	2017	2018	2019	2020	2020	2021	2022	2023
		Act.		Proj	Budget		Proj.		
Revenue and grants	**3,502**	**3,870**	**5,491**	**21,042**	**58,640**	**49,908**	**56,109**	**60,024**	**64,020**
Tax revenue	3,237	3,628	5,000	20,641	56,458	48,923	52,169	55,184	58,895
Personal income tax	736	729	856	3,000	7,200	7,214	8540	9551	10115
Corporate income tax	338	485	802	2,458	6,012	4,974	4385	4514	5312
Other direct taxes	187	203	261	891	3,364	3,075	3244	3341	3441
Customs	273	295	433	1,793	3,655	3,945	4063	4185	4311
Excise	642	676	909	3,928	11,509	7,738	7970	8209	8456
VAT	963	1,075	1,363	5,609	15,831	14,601	15,806	16,608	17,588
Other indirect taxes	98	165	377	2,962	8,886	7,376	8161	8776	9672
Non-tax revenue and Grants	265	242	491	401	2,182	985	3,940	4,840	5,126
Expenditure and net lending	**4,970**	**6,573**	**7,895**	**26,403**	**63,640**	**69,601**	**66,303**	**70,086**	**74,571**
Current expenditure	4,004	4,831	5,220	13,456	38,850	38,709	47,737	51,394	55,983
Employment costs	3,231	3,495	3,935	7,700	17,751	16,740	19,096	21,635	24,513
Wages & salaries (excl. grants & transfers)	2,753	2,978	3,382	6,618	15,257	14,388	16,412	18,595	21,068
Pensions	478	517	553	1,082	2,494	2,352	2,683	3,040	3,444
Interest payments	127	233	368	669	704	1,574	3,708	3,198	3,340
Foreign	20	68	43	424	200	1,047	1,406	1,319	1,321
Domestic	107	165	325	245	504	527	2,302	1,879	2,019
Goods & services	370	887	703	3,559	11,234	11,234	15,498	16,415	17,384
Current transfers	276	216	214	1,528	9,161	9,161	9,436	10,146	10,746
Capital expenditure and net lending	966	1,742	2,675	12,947	24,790	30,892	18,566	18,691	18,588
Capital transfers[1]	754	1,193	1,735	9,503	…	15,448	15,448	15,081	14,024
Other capital expenditure	105	145	542	2,532	…	15,242	2,916	3,408	4,362
Net lending	107	404	398	912	…	202	202	202	202
Overall balance (commitment basis)	**-1,468**	**-2,703**	**-2,403**	**-5,360**	**-5,000**	**-19,693**	**-10,194**	**-10,062**	**-10,551**
Primary balance (commitment basis)[2]	-1,341	-2,471	-2,035	-4,691	-4,296	-18,119	-6,487	-6,864	-7,210
Overall balance (cash basis)	**-1,421**	**-2,760**	**-2,371**	**-5,360**	**-5,000**	**-20,704**	**-10,194**	**-10,062**	**-10,551**
Primary balance (cash basis)[2]	-1,301	-2,527	-1,959	-4,691	-4,296	-18,119	-6,487	-6,864	-7,210
Unidentified Financing and Fiscal Measures	…	…	…	…		**14,912**	**4,695**	**4,461**	**4,613**
Financing	**1,401**	**2,631**	**3,186**	**5,364**	**5,000**	**4,781**	**5,499**	**5,601**	**5,938**
Domestic financing (net)	1,354	2,658	3,082	5,566	8,170	4,851	5,662	5,921	6,317
RBZ	950	1,727	3,038	5,178	0	0	0	0	0
Bank	274	953	677	1,106 #	4,550	4,600	5,562	5,821	6,217
Non-bank	130	-22	-633	-655	3,620	400	100	100	100
Foreign financing (net)	0	-73	-231	-1379	-3170	-3463	-4805	-4478	-4553
Disbursements	210	145	4	92	0	307	353	143	84
Amortization	210	218	234	1,471	-3,170	3,770	5,158	4,621	4,637
of which: Paid	210	116	13	294	-3,170	377	516	462	464
Change in arrears	46	46	335	1,177	0	3,393	4,642	4,159	4,174
Domestic	40	-56	76	0	…	0	0	0	0
Foreign	7	102	259	1,177	…	3,393	4,642	4,159	4,174
Interest	7	0	37	0	…	0	0	0	0
Principal[3]	0	102	222	1,177	…	3,393	4,642	4,159	4,174
Errors and omissions [4]	-67	-72	783	…	…	…	…		

Sources: Zimbabwean authorities; and IMF staff estimates and projections.

[1] Capital transfers include spending related to off-budget agricultural support programs and RBZ quasi-fiscal activitieswhich could be classified as current expenditures.

[2] The difference between the fiscal balance on a commitment and cash basis is the change in domestic and foreign interest arrears.

[3] Accumulated arrears on foreign debt do not include valuation adjustment. The stock of arrears could differ from that in the balance of payments table.

[4] A negative (positive) number means that Financing is lower (higher) than the Overall Balance on commitment basis.

Table 3b. Zimbabwe: Central Government Operations, 2016–23

(in percent of GDP)

	2016	2017	2018	2019	2020	2020	2021	2022	2023
		Act.		Est.	Budget		Proj.		
Revenue and grants	**16.8**	**14.1**	**12.9**	**13.5**	**15.0**	**12.8**	**12.7**	**12.6**	**12.7**
Tax revenue	15.6	13.2	11.8	13.2	14.5	12.5	11.8	11.6	11.7
Personal income tax	3.5	2.7	2.0	1.9	1.8	1.8	1.9	2.0	2.0
Corporate income tax	1.6	1.8	1.9	1.6	1.5	1.3	1.0	0.9	1.1
Other direct taxes	0.9	0.7	0.6	0.6	0.9	0.8	0.7	0.7	0.7
Customs	1.3	1.1	1.0	1.1	0.9	1.0	0.9	0.9	0.9
Excise	3.1	2.5	2.1	2.5	2.9	2.0	1.8	1.7	1.7
VAT	4.6	3.9	3.2	3.6	4.1	3.7	3.6	3.5	3.5
Other indirect taxes	0.5	0.6	0.9	1.9	2.3	1.9	1.8	1.8	1.9
Non-tax revenue and Grants	1.3	0.9	1.2	0.3	0.6	0.3	0.9	1.0	1.0
Total expenditure & net lending	**23.9**	**24.0**	**18.6**	**16.9**	**16.3**	**17.8**	**15.0**	**14.7**	**14.8**
Current expenditure	19.2	17.6	12.3	8.6	9.9	9.9	10.8	10.8	11.1
Employment costs	15.5	12.7	9.3	4.9	4.5	4.3	4.3	4.5	4.9
Wages & salaries (incl. grants & transfers)	13.2	10.9	8.0	4.2	3.9	3.7	3.7	3.9	4.2
Pensions	2.3	1.9	1.3	0.7	0.6	0.6	0.6	0.6	0.7
Interest payments	0.6	0.8	0.9	0.4	0.2	0.4	0.8	0.7	0.7
Foreign	0.1	0.2	0.1	0.3	0.1	0.3	0.3	0.3	0.3
Domestic	0.5	0.6	0.8	0.2	0.1	0.1	0.5	0.4	0.4
Goods & services	1.8	3.2	1.7	2.3	2.9	2.9	3.5	3.4	3.4
Current transfers	1.3	0.8	0.5	1.0	2.3	2.3	2.1	2.1	2.1
Capital expenditure and net lending	4.6	6.3	6.3	8.3	6.3	7.9	4.2	3.9	3.7
Capital transfers[1]	3.6	4.3	4.1	6.1	...	4.0	3.5	3.2	2.8
Other capital expenditure	0.5	0.5	1.3	1.6	...	3.9	0.7	0.7	0.9
Net lending	0.5	1.5	0.9	0.6	...	0.1	0.0	0.0	0.0
Overall balance (commitment basis)	**-7.1**	**-9.9**	**-5.7**	**-3.4**	**-1.3**	**-5.0**	**-2.3**	**-2.1**	**-2.1**
Primary balance (commitment basis)[2]	-6.4	-9.0	-4.8	-3.0	-1.1	-4.6	-1.5	-1.4	-1.4
Overall balance (cash basis)	**-6.8**	**-10.1**	**-5.6**	**-3.4**	**-1.3**	**-5.3**	**-2.3**	**-2.1**	**-2.1**
Primary balance (cash basis)[2]	-6.3	-9.2	-4.6	-3.0	-1.1	-4.6	-1.5	-1.4	-1.4
Unidentified Financing and Fiscal Measures	...	...	...	...	**0.0**	**3.8**	**1.1**	**0.9**	**0.9**
Financing	**6.7**	**9.6**	**7.5**	**3.4**	**1.3**	**1.2**	**1.2**	**1.2**	**1.2**
Domestic financing (net)	6.5	9.7	7.3	3.6	2.1	1.2	1.3	1.2	1.3
RBZ	4.6	6.3	7.2	3.3	0.0	0.0	0.0	0.0	0.0
Bank	1.3	3.5	1.6	0.7	1.2	1.2	1.3	1.2	1.2
Non-bank	0.6	-0.1	-1.5	-0.4	0.9	0.1	0.0	0.0	0.0
Foreign financing (net)	0.0	-0.3	-0.5	-0.9	-0.8	-0.9	-1.1	-0.9	-0.9
Disbursements	1.0	0.5	0.0	0.1	0.0	0.1	0.1	0.0	0.0
Amortization	1.0	0.8	0.6	0.9	-0.8	1.0	1.2	1.0	0.9
Of which: Paid	1.0	0.4	0.0	0.2	-0.8	0.1	0.1	0.1	0.1
Change in arrears	0.2	0.2	0.8	0.8	0.0	0.9	1.0	0.9	0.8
Domestic	0.2	-0.2	0.2	0.0	...	0.0	0.0	0.0	0.0
Foreign	0.0	0.4	0.6	0.8	...	0.9	1.0	0.9	0.8
Interest	0.0	0.0	0.1	0.0	...	0.0	0.0	0.0	0.0
Principal[3]	0.0	0.4	0.5	0.8	...	0.9	1.0	0.9	0.8
Errors and omissions [4]	-0.3	-0.3	1.8	...	...	...	...	...	...
Memo: Nominal GDP (LCU, millions)	20,806	27,438	42,468	156,165	390,666	390,666	442,791	476,139	504,257

Sources: Zimbabwean authorities; and IMF staff estimates and projections.

[1] Capital transfers include spending related to off-budget agricultural support programs and RBZ quasi-fiscal activitieswhich could be classified as current expenditures.

[2] The difference between the fiscal balance on a commitment and cash basis is the change in domestic and foreign interest arrears.

[3] Accumulated arrears on foreign debt do not include valuation adjustment. The stock of arrears could differ from that in the balance of payments table.

[4] A negative (positive) number means that Financing is lower (higher) than the Overall Balance on commitment basis.

Table 4. Zimbabwe: Monetary Survey, 2016–20

(Millions of ZWL$; unless otherwise indicated)[1]

	2016	2017	2018	2019	2020
		Act.		Est.	Proj.
Reserve Bank of Zimbabwe (RBZ)					
Net foreign assets	-574	-1,126	-1,758	-50,741	-66,576
Net domestic assets	2,047	3,794	5,016	60,141	77,386
Net credit to financial corporations	-149	-406	-2,246	-4,684	-3,274
Claims on central government	2,338	3,986	7,025	14,182	14,182
of which: Government securities	566	1,479	2,062	9,872	9,872
of which: Loans (incl. overdraft)	1,771	2,507	4,962	4,311	4,311
Other items, net[2]	-142	214	237	50,642	66,478
Monetary base	1,473	2,668	3,258	9,400	10,810
Banks					
Net foreign assets	18	-201	-119	10,448	12,815
Net domestic assets	5,549	7,649	9,610	21,724	34,166
Claims on the RBZ	1,643	2,605	3,970	8,167	9,401
Net credit to central government	1,379	2,332	3,009	4,052	8,500
Credit to other public sector	121	215	285	313	793
Credit to private sector	3,497	3,694	4,037	11,038	17,355
Other items, net[2]	-1,091	-1,196	-1,692	-1,846	-1,884
Deposits	5,567	7,448	9,491	32,172	46,980
of which: FX deposits	0	0	343	11,216	20,483
Monetary survey					
Net foreign assets	-556	-1,328	-1,877	-40,292	-53,762
Net domestic assets	6,194	9,145	11,887	75,571	104,000
Net credit to central government	3,598	6,277	9,992	16,213	20,661
Credit to other public sector	288	637	775	3,389	3,870
Credit to private sector	3,514	3,719	4,059	11,125	17,442
Other Items, net[2]	-1,205	-1,490	-2,939	44,843	62,027
Broad money (M3)	5,638	7,817	10,010	33,309	48,269
Money (M2)[3]	5,575	7,749	9,608	21,858	27,190
Currency	70	332	502	1,011	1,162
Memorandum items		*(Annual percentage change)*			
Credit to private sector	-3.9	5.9	9.1	174.1	56.8
Net credit to central government	51.6	74.5	59.2	62.3	27.4
Monetary base	161.5	81.2	22.1	188.5	15.0
M2[3]	18.8	39.0	24.0	127.5	24.4
Nominal GDP growth	4.2	31.9	54.8	267.7	152.4
			(Percent of GDP)		
Credit to private sector	16.9	13.6	9.6	7.1	4.4
Monetary base	7.1	9.7	7.7	6.0	2.7
M2[3]	26.8	28.2	22.6	14.0	6.9

Sources: Zimbabwean authorities; and IMF staff estimates and projections.

[1] Parity between the ZWL$ and the USD$ is assumed before 2019.

[2] Includes valuation adjustment from currency reform.

[3] Excludes FX deposits.

Table 5. Zimbabwe: Financial Soundness Indicators

Financial Soundness Indicators	Dec-2014	Dec-2015	Dec-2016	Dec-2017	Dec-2018	Sep-2019[1]
Capital Adequacy						
Regulatory capital to risk-weighted assets	16.9	19.9	24.5	27.6	28.1	30.1
Percentage of banks greater or equal to 10 percent	85.7	100.0	100.0	100.0	100.0	100.0
Percentage of banks below 10 and above 6 percent minimum	7.1	0.0	0.0	0.0	0.0	0.0
Percentage of banks below 6 percent minimum	7.1	0.0	0.0	0.0	0.0	0.0
Capital to assets	10.4	11.3	13.4	12.3	11.4	8.8
Asset Quality						
Foreign exchange loans to total loans	1.4	3.0	0.1	0.5	0.4	1.2
Past-due loans to gross loans[2]	45.8	43.2	37.5	35.6	34.8	21.7
Nonperforming loans (past due > 90 days)[3]	16.3	12.0	7.9	7.1	7.2	3.2
Watch-listed loans (past due < 90 days)[4]	29.4	31.2	29.6	28.6	26.4	18.5
Provisions as percent of past-due loans	15.5	13.2	14.1	14.7	24.3	20.6
Earnings and Profitability						
Net profit (before tax and extraordinary items)/net income	129.9	149.9	120.4	121.3	117.9	106.0
Return on assets	0.8	1.8	2.5	2.6	3.9	6.2
Return on equity	4.6	9.0	13.4	15.5	24.7	44.3
Expenses/income	93.0	81.8	73.5	70.7	65.2	35.5
Liquidity						
Liquid assets/total assets	27.3	36.1	44.1	52.9	56.4	54.0
Liquid assets/short-term liabilities	35.6	46.8	55.9	65.5	69.1	0.0
Loans/deposits	76.5	84.7	69.8	49.2	43.9	39.7
Liquid assets/total deposits	48.6	64.3	72.9	77.1	83.0	100.8
Foreign exchange liabilities/total liabilities	4.3	2.1	3.1	2.0	2.9	16.2
Excess Reserves to Broad Money	9.5	11.8	17.2	16.2	23.2	16.5

Source: Reserve Bank of Zimbabwe.

[1] Based on commercial banks only. The Sep-2019 prudential ratios reflect banks' own expectation regarding government the size of compensation for FX losses.

[2] Past due loans are defined as the aggregate of special mention, substandard, doubtful, and loss loans.

[3] Non-perfoming loans are defined as the aggregate of substandard, doubtful, and loss loans.

[4] Watch-listed loans are the same as special mention loans.

Table 6. Zimbabwe: SMP Quantitative Targets[1]

(in units as indicated)

	Dec.	End-June 2019			End-September 2019		
	Actual	Prog.	Prel.	Status	Prog.	Prel.	Status
1. Floor on the primary budget balance of the central government (ZWL$ million) [2]	...	-1,203	38	met	-1,604	-2,502 [3]	not met
2. Floor on protected social spending (ZWL$ million) [2]	...	225	268	met	500	561	met
3. Floor on the stock of net official international reserves (in US$ million) [4]	56	-1,267	186	met	-1,267	66	met
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) [5,6]	...	0	108	not met	0	108	not met
5. Ceiling on changes in net domestic assets of the RBZ (ZWL$ million) [7]	...	300	-240	met	350	1,057	not met
6. Ceiling on credit to the nonfinancial public sector from the RBZ (ZWL$ million) [8]	...	0	-191	met	0	1,572	not met

[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.

[3] Although in nominal terms the primary deficit target for end-September was missed, this reflects the higher inflation (as a share of GDP the deficit was below the SMP target).

[4] The SMP targeted an unchanged level of NIR relative to end-December stock (US$56 million), but the numbers erroneously reflected NFA (US$-1,267 million). This has been corrected for the end-September and end-December 2019 targets.

[5] Cumulative from April 30, 2019.

[6] Reflects augmentation of loans for infrastructure projects (energy, water and telecommunication) originally signed between 2012 and 2015 but not disbursed.

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

Table 7. Zimbabwe. SMP Structural Benchmarks

Benchmark	Objective	Completion Date	Comments
Cabinet to approve a revised 2019 budget consistent with a deficit of RTGS$2.8 billion (Country Report No. 19/144, MEFP ¶9 and ¶10)	Restore macroeconomic stability	Prior Action	**Done**
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 (Country Report No. 19/144, MEFP ¶13)	Improve PFM, budget execution, and fiscal discipline	Prior Action	**Done**
Issue an instruction to disallow, with immediate effect, any future acquisitions of non-performing loans by ZAMCO (Country Report No. 19/144, MEFP ¶16)	Improve governance, PFM, and budget monitoring/execution	Prior Action	**Done**
Adopt regulations implementing the Public Financial Management (PFM) Act., including to ensure all expenditure commitments are recorded in IFMIS (Country Report No. 19/144, MEFP ¶13)	Improve governance, PFM, and budget monitoring/execution	June 2019	**Done –** Gazetted on the 14th of June 2019 (SI 135 of 2019)
Complete a comprehensive stock-take of domestic expenditure arrears across the central government as of end-2018 (Country Report No. 19/144, MEFP ¶17)	Improve PFM, budget execution, and fiscal discipline	September 2019	**Done –** The report has been produced
Complete a review of agricultural support programs and develop an action plan based on its findings (Country Report No. 19/144, MEFP ¶10)	Improve targeting and efficiency of agricultural support programs	September 2019	**Done** – Smart Agriculture introduced in 2020 National Budget. Financing for Agriculture will be from the private sector with Government providing guarantees
Extend the coverage of IFMIS to 37 Districts by establishing 31 additional kiosks (Country Report No. 19/144, MEFP ¶13)	Improve governance, PFM, and budget monitoring/execution	September 2019	**Done**
Submit to Parliament draft amendments to the Banking Law to address gaps identified by the FSSR (Country Report No. 19/144, MEFP ¶22)	Maintain financial stability	December 2019	After the Financial Sector Stability Review (FSSR) Mission, the Reserve Bank requested for Technical Assistance (TA). The proposed TA has not yet commenced, and this will influence the recommendations to the Banking Law amendments.
Complete with assistance from the IMF and publish the report of a diagnostic assessment of Zimbabwe's governance vulnerabilities (Country Report No. 19/144, MEFP ¶24)	Strengthen governance and combat corruption	December 2019	The authorities have agreed to publish shortly their own assessment of governance vulnerabilities, which will feed into a comprehensive anti-corruption strategy.

Annex I. Progress Against IMF Recommendations

Policies	2017 Article IV Recommendations	Actions since 2017 Article IV Consultations
Fiscal Policy	Fiscal consolidation to achieve fiscal surplus over the medium term	Fiscal deficits in 2017 and 2018 were much higher than targeted under the budget. Significant fiscal consolidation in 2019.
	Contain wage bill	Significant progress despite high inflation that has made containing the wage bill very challenging.
	Streamline the civil service	No action taken. Authorities agreed with staff assessment, but disagreed with policy recommendations.
	Eliminate the agricultural command program	Financing of inputs under the program has been transferred to the banking system. Risks to the budget remain high as the government provided full guarantee against credit default.
	Implement PFM Reforms	Authorities adopted regulations to implement the Public Financial Management Act, gazetted on the 14th of June 2019.
Monetary and Financial Polices	Refrain from monetary financing	Although direct financing of the central government deficit has stopped, large quasi-fiscal activities by the RBZ have continued.
	Lift the interest rate cap	All caps on interest rate have been removed following the June 2019 increase in overnight interest rate from 15 to 50 percent.
	Strengthen AML/CFT framework	Steps taken since the 2016 ESAAMLG assessment were insufficient to prevent a grey listing of Zimbabwe by the FATF in October 2019.
Structural Polices	Improve governance	A comprehensive governance assessment was undertaken by Fund staff, and the authorities will adopt shortly an anti-corruption strategy.
	Improve the management of SOEs	The government has approved a reform framework for 43 SOEs and parastatals, aimed at making them fully accountable, transparent, and economically viable. In addition, the government is targeting 5 key SOEs for privatization/divestiture and is preparing turnaround strategies for at least 20 SOEs with technical assistance from various development partners.
	Provide clarity to land rights	The first phase of the National Agricultural Land Audit was undertaken in 2018. The second phase is planned for 2020.
	Improve business climate	The indigenization policy has been relaxed, investment-promoting institutions merged into a single Zimbabwe Investment and Development Agency, and a policy has been established to collapse multiple licensing requirements into single omnibus licenses in the tourism and transportation sectors.

Annex II. Risk Assessment Matrix[1]

Source of Risks	Likelihood/ Time Horizon	Expected Impact on Economy	Policy Response
		Potential Domestic Shocks	
Delay in fiscal consolidation	**High/Short to Medium Term**	**High.** Absent expenditure rationalization or continued quasi-fiscal activities by the RBZ, the financing needs would continue to remain high. Given limited external financing, resorting to large monetary financing would lead to continued depreciation, threatening price and financial sector stability.	Create the domestic political consensus to contain current spending, improve revenue collection, and increase spending efficiency. Reduce the footprint of the government in the economy by leveraging the private sector.
Stalled reengagement from delays in political and economic reforms	**Medium/Short to Medium Term**	**High.** A failure to advance political and economic reforms and garner the support of the international community would maintain the status quo, exacerbating the economic imbalances and further worsening policy confidence.	Advance political and economic reforms to gain support of international community and pave the way for arrears' clearance. This would unlock financing from IFIs and help restore access to international financial markets.
Worsened drought conditions	**Medium/Short to Medium Term**	**High.** Most of the agricultural sector is rainfed and highly susceptible to rainfall, and hydropower provides much of electricity generation.	Create fiscal space for grain imports and social spending to support the most vulnerable parts of the population.
		Potential External Shocks	
Weaker-than-expected global growth, and/or rising protectionism	**Medium/Short to Medium Term**	**High**. Zimbabwe would be impacted mainly through the trade channel, especially from South Africa. Financing and remittances would also suffer, increasing BOP pressures.	Advance structural reforms to improve productivity and competitiveness, and re-engage with the international community to gain access to financial support.
Sharp rise in risk premia	**High/Short term**	**High**. In addition to adverse effects from the trade channel, tighter global financial conditions could hit Zimbabwe's competitiveness through an appreciation of the U.S. dollar, and raise the cost of Zimbabwe's external borrowing.	Renew efforts to implement structural reforms to improve the business climate and reduce the cost of doing business, to increase productivity and strengthen competitiveness.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term (ST)" and "medium term (MT)" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.

Annex III. External Sector Assessment[1]

Overall Assessment: *The external position of Zimbabwe in 2019 was broadly consistent with the medium-term fundamentals and desirable policies. The current account (CA) gap is assessed at -0.5 percent, translating into a two percent real effective exchange rate (REER) gap. The sharp depreciation of Zimbabwe dollar in 2019, over and above the concurrent sharp rise in inflation, has helped reduce the large REER gap observed in 2018.*

A. Current Account and Real Effective Exchange Rate

1. **The current account registered a small surplus in 2019, on account of a sharp import compression driven by foreign exchange constraints and possibly the expenditure switching effects of the currency reform.** Although exports have declined by 12.8 percent mainly because of drought, energy shortages, and exchange rate issues, the sharp fall in imports (28.4 percent) and stable remittance inflows have contributed to the positive current account balance.

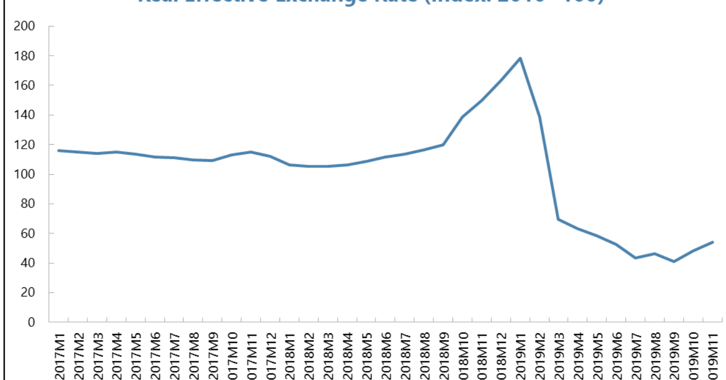
Balance of Payments, 2017-2019
Percent of GDP

	2017	2018	2019
Current Account	-1.3	-5.4	0.7
Trade balance on goods and services	-8.3	-10.1	-3.9
Exports of goods and services	21.5	23.1	22.0
Imports of goods and services	29.7	33.2	25.9
Income	7.0	4.7	4.6
Primary Income	-0.7	-1.4	-1.6
Secondary Income	7.7	6.1	6.3
Capital Account	1.3	1.3	0.3
Financial Account	4.5	3.1	-1.8

Source: Authorities and Fund staff calculations.

2. **The Real Effective Exchange Rate (REER) depreciated by about 70 percent at end-2019 relative to end-2018.** The depreciation reflects the sharp devaluation of the domestic currency following the currency reform in February 2019 and the subsequent depreciation of the currency. Although domestic prices accelerated sharply by about 500 percent at end-2019, the domestic currency depreciated by much more (losing more than 4/5 of its value during 2019)—leading to a significant REER depreciation.

Real Effective Exchange Rate (Index: 2010=100)



[1] The external balance sheet is not covered here for lack of IIP data.

B. External Sustainability Assessment

3. The external position is broadly consistent with the fundamentals and desirable policies. The EBA-lite current account model suggests a current account gap of -0.5 percent of GDP, implying a 2 percent REER gap. The REER model suggests a slight undervaluation, about 3 percent, on account of a fifteen-fold depreciation of the domestic currency while prices increased by five-fold by end-2019. However, multiple breaks in the historical real effective exchange rate data series could distort the results of the REER index model.

Summary Table: Current Account Balance Approach

CA-Actual	0.7%
Cyclical Contributions (from model)	1.0%
Cyclically Adjusted CA	-0.3%
CA-Norm	0.6%
Cyclically Adjusted CA Norm	-0.5%
Multilaterally Consistent Cyclically Adjusted CA Norm	0.2%
CA-Gap	-0.5%
of/which Policy Gap	-2.4%
Elasticity	-0.31
REER Gap	2.0%
CA-Fitted	-1.7%
Residual	2.4%
Natural Disasters and Conflicts	0.2%

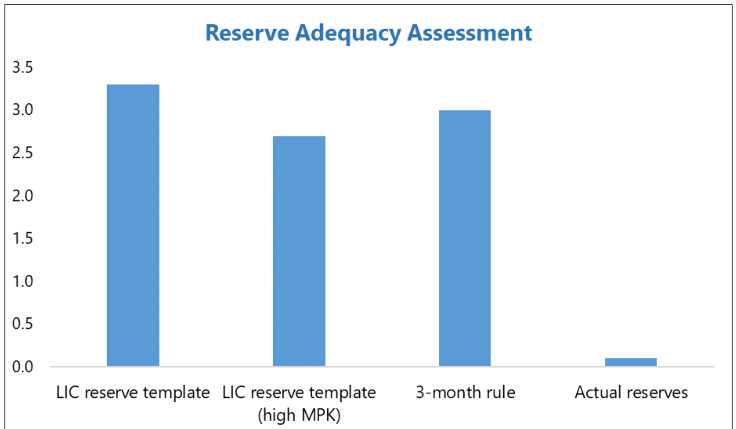
Source: IMF staff estimates.

4. The CA adjustment has been achieved through significant import compression that cannot be sustained over the medium term. As the country is faced with a foreign exchange crunch with little prospects for external financial flows over the medium term, import compressions could persist as export receipts are earmarked for servicing massive foreign debt obligations, leading to significant economic contraction.

C. Capital Flows and International reserves

5. The financial account turned to a net lending position on the back of huge repayments for offshore facilities. Non-debt creating inflows, notably FDI, were subdued as uncertainties regarding political and economic reforms are lingering. Private capital flows in the forms of loans are also depressed on account of high perceived country risk premium.

6. Reserves have fallen below what could be considered adequate because of weak capital inflows. Gross international reserves stood at US$ 109 million by end-2019, covering about a week of imports. Zimbabwe's foreign reserves are much lower than both the rule-of-thumb (3-month rule) and the model-based benchmark—the IMF template for assessing reserve adequacy in low income countries suggests 2.7 to 3.3 months[2] equivalent of imports as the adequate level for Zimbabwe.



Source: Fund staff estimates

Policy implications

7. Accelerating the ongoing foreign exchange market, monetary market, and structural reforms are essential to boost investors' confidence and attract private capital flows. The interbank FX market should be allowed to play its role of price discovery for private investors to price the exchange rate risks. A functioning interbank FX market and stabilizing inflation through restrictive fiscal and monetary policies are important for restoring and maintaining market confidence. Fiscal policy has been significantly tightened in 2019 but it has to be in tandem with tight monetary policy in order to bring inflation down. In addition, structural reforms including strengthening the property rights regime and improving the business climate could help unlock private capital flows.

[2] The low end of the estimate assumes high cost of holding reserves (marginal productivity of capital) as Zimbabwe is struggling to finance essential imports.

Annex IV. Governance and Corruption Challenges

1. Addressing Zimbabwe's governance and corruption vulnerabilities will resolve huge economic challenges and have a large positive impact on medium- to long-term inclusive growth. Several international indicators show Zimbabwe's scores on governance, transparency and corruption perception to be well below the regional average. The consensus across different sectors (public, private, civil society and the international community) is that the country's serious governance weaknesses have proliferated corruption, thus dampening prospects for the sustained long-term growth of fiscal revenue and output.

2. The government has embarked on reforms to restore trust and enhanced governance. It established a high-level working group of relevant department and agencies, chaired by the Ministry of Finance and Economic Development (MoFED) and the Office of the President and Cabinet (OPC), and requested the IMF staff's assistance to conduct a diagnostic assessment of Zimbabwe's governance and corruption challenges.[1] In line with the IMF's revised policy on governance,[2] the diagnostic assessment focuses on macro-critical issues related to governance and corruption in Zimbabwe. Based on this assistance from IMF staff, the government is planning to publish its final assessment of governance vulnerabilities by the first quarter of 2020 which will feed into a comprehensive anti-corruption strategy.

3. The Zimbabwe authorities correctly recognize the importance of governance reform and addressing corruption but faces serious challenges in tackling it. The Transitional Stabilisation Programme (TSP) adopted in October 2018, is focused on macroeconomic stabilization, but also lays out important social and political reforms to empower citizens, tackle corruption, and strengthen the rule of law. Several new laws have been put in place as well as institutional reforms to strengthen the judiciary and revamp the Anti-Corruption Commission. These reform initiatives are taking place amid severe economic conditions and resource constraints. They face serious challenges due to generally poor enforcement of laws and regulations and deep mistrust between the government, the business sector and civil society.

4. In assisting the authorities to assess governance vulnerabilities in Zimbabwe, IMF staff focuses on the six areas covered by the Fund's 2018 Framework. These areas are: fiscal governance, the financial sector, central bank governance and operations, market regulation, the rule of law, and the AML-CFT framework. In addition, IMF staff also helped assess Zimbabwe's overall anti-corruption framework.

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[1] IMF, Technical Report on Governance, *Zimbabwe: Governance and Anti-Corruption Assessment*, January 2020.

[2] IMF, *Review of the 1997 Guidance Note on Governance—A Proposed Framework for Enhanced Fund Engagement.* April 2018.

A. Fiscal Management

Public Financial Management

5. In Zimbabwe, subsidies are extensively used in many sectors and areas. These include agriculture, electricity, fuel and other import subsidies via Foreign Exchange (FX) allocation at preferential rates, as well as subsidies to gold and platinum exporters. Subsidies included in the budget are recorded as capital expenditures and cover subsidized grain imports and agricultural support programs.

6. The Command Agriculture Program that was introduced in 2016 has created governance vulnerabilities due to lack of clarity, transparency and accountability in its design and implementation. The program included two schemes: (i) the input scheme (Special Maize Production Program), which provided inputs, irrigation, and mechanized equipment to farmers through designated suppliers; and (ii) the price subsidy scheme for grain purchases (especially of maize) through the Grain Marketing Board (GMB) at an administered price backed by law. Governance issues related to the input scheme included lack of strict criteria for eligibility, low take-up of the subsidies provided, and no transparent selection criteria for designated input suppliers. The price subsidy scheme also gave rise to corruption vulnerabilities (i.e., round-tripping). These vulnerabilities arose when the GMB purchases maize from farmers at the official higher price and sells it to millers and other customers at a subsidized lower price. As discussed in the staff report (¶8), starting with the 2019/20 agriculture season, the financing of inputs under the command agriculture program has been transferred to the banking system. However, risks to the budget remain high as the government provided a full guarantee against credit default and it is too early to assess the impact on addressing governance challenges stated above.

7. Debt management is weak and debt statistics are not systematically compiled and published. Even though the Public Debt Management Office has been working on the publication of a debt bulletin, currently no debt data are disseminated on the Ministry of Finance's (MoFED) web site, except for the limited data included in the annual budget documentation. No public debt report has been submitted to the Parliament despite the provisions of the Constitution and the legislation on public debt.

8. There is lack of full utilization of the expenditure controls available in Zimbabwe's automated financial management information system (PFMS). Many transactions occur outside the PFMS despite provisions of the PFMA and related Treasury Instructions. Procuring goods and services outside the PFMS is possible and no penalties are applied to ministries, departments and agencies (MDAs) who take this approach. Given this, expenditure arrears have started accumulating due to weak expenditure controls and the worsened fiscal conditions. The authorities have been working with the World Bank on a stocktaking exercise. In the meantime, MDAs pay some of these arrears without having transparent criteria to prioritize the payments, thus creating a governance vulnerability.

9. The government is not complying with some legal requirements in respect of public financial management and fiscal reporting. Preparing accurate, comprehensive and timely fiscal reports is crucial for transparency and accountability and to avoid governance vulnerabilities. The government currently publishes the budget execution reports and monthly consolidated financial statements but there is limited or no regularly published information on extrabudgetary funds or state-owned enterprises (SOEs). There has been slow progress in improving fiscal reporting in budget execution, fiscal statistics and government financial statements, though the authorities have improved compliance with international standards for statistical reports (the IMF's *Government Finance Statistics Manual*, 2014).

10. The systems of internal control and internal audit are weak in Zimbabwe, creating many opportunities for financial irregularities and corruption. Internal audit functions have been established in all line ministries which receive appropriations from the Central Government by votes. Implementation by the government of the recommendations of the Auditor General's Office (the supreme audit institution in Zimbabwe) on fiscal reporting and internal control covering the period 2014-2017 has been very limited. In some cases, the MoFED and line ministries have not complied with legal requirements.

Revenue Administration

11. Zimbabwe Revenue Authority (ZIMRA), has in place many of the elements of an integrity strategy, but more can be done. Good practice is evident in ZIMRA's integrity processes—both procedurally and operationally. But governance gaps created by inefficiencies in processes have negatively impacted perceptions of the tax system. It is critical that reforms underway continue to address governance gaps already identified on taxpayer compliance and additional high-risk governance vulnerabilities.

12. ZIMRA's governance framework is set out in its enabling legislation (the Revenue Authority Act). The Act states that ZIMRA will act as "an agent of the state in assessing, collecting and enforcing payment of all revenues." Its further states that ZIMRA will be "controlled and managed by the board" but is silent on the specific role of the board. The ZIMRA governance framework under the Revenue Act assigns some far-reaching roles and responsibilities to the board that weaken government oversight. The law, for example, enables the board to control and manage ZIMRA operations with potential access to taxpayer information without secrecy constraints. The law gives the board powers normally provided to a Minister and Commissioner General. In addition, the Minister must consult the Board before making regulations related to contraventions and penalties, e.g., for non-filing.

13. The existence and lack of coordination among multiple (up to 26) government agencies at the 18 border posts in Zimbabwe promotes disorder and fraudulent transactions. Drawing on the experience of neighboring countries such as Zambia, a coordinated border management law would reduce governance vulnerabilities by clearly defining the role and responsibility of ZIMRA and other government agencies operating at the border.

State-Owned Enterprises (SOEs) and Extractive Industries

14. The management of SOEs remains challenging and raises governance concerns. The challenges relate to weak governance and failure to implement announced government policies. Despite reforms launched in the 2011 budget and the following budgets, the SOE sector continues to operate with losses and increasing liabilities. The government has outlined a comprehensive program to reform state enterprises and parastatals. The program aims to strengthen the governance of state enterprises and improve their financial performance and service delivery. Also, the government has earmarked 43 enterprises for privatization, liquidation, or merger. Currently, several milestones have been achieved, notably the approval of the Public Entities Corporate Governance (PECG) Act in November 2018, and the establishment of a Corporate Governance Unit under the OPC.

15. Other serious governance challenges, however, still need to be addressed:

- The nominations of the members of SOEs' boards do not yet comply with the PECG Act and its regulations.
- The principles of good governance require the publishing of annual financial statements by SOEs, but this is not yet a standard practice, and information is both limited and untimely.
- The public finance law requires public entities to submit quarterly and annual reports to MoFED, but many SOEs have not observed this requirement.
- Lack of clarity in the inter-ministerial arrangements for managing the privatization of 25 SOEs announced in November 2018 creates risks of rent-seeking opportunities.

16. There are substantial governance vulnerabilities in the mining sector which includes both private companies and SOEs.[3] These vulnerabilities include lack of scrutiny of agreements with investors (including fiscal concessions), undue discretion in the award of mining licenses, inefficient or conflicted SOE performance, lack of monitoring of production leading to theft and/or smuggling of minerals, and inefficient allocation/spending of natural resource revenues. Several investment incentive regimes are available to investors and SOEs are also entering into agreements with investors. These contracts can include fiscal terms, but little information is publicly disclosed on what has been agreed with investors. Several SOEs (Minerals Marketing Corporation of Zimbabwe—MMCZ, Zimbabwe Consolidated Diamond Company—ZCDC and Fidelity Printing and Refining—FPR, which is an RBZ subsidiary) play a prominent role in the mining industry and have been afforded exclusive rights to undertake essential market functions, powers that create substantial governance vulnerabilities.

[3] The IMF's assessment of the extractive industries was also limited by challenges in convening meetings with some entities and persons and in receiving certain key data.

B. Reserve Bank Governance and Financial Sector Oversight

17. The RBZ's mandate is convoluted and weak by international standards. As a pre-condition for robust decision making, the RBZ Act should distinguish clearly between the Bank's objectives, functions and powers, which is not yet the case. The Act currently blurs the distinction between objectives and functions. This weakness is exacerbated by an overly complex and non-transparent monetary system. While a recent Regulation defines the ZWL$ as sole legal tender, the concept of legal tender remains unclear and there have been cases where payments due after the introduction of the ZWL$ have been allowed in the old currency and exchange rates.

18. The framework for the RBZ's lending operations to the banking sector is not transparent. These lending operations cover both standard monetary policy operations and Emergency Liquidity Assistance (ELA). As noted in the IMF's Financial Sector Stability Review (FSSR) conducted in 2018, monetary policy and ELA operations should be clearly differentiated. Although the RBZ has addressed the differentiation, it has not communicated this in a transparent way.

19. The RBZ conducts quasi-fiscal operations that fall outside of typical central bank activities. Some of these operations are carried out through the RBZ's subsidiaries—for example, financial support to gold miners via the FPR. Another significant example was the RBZ's preferential exchange rates for fuel imports (discontinued since October 2019), which provided fuel subsidies estimated to have amounted to over US$ 300 million in 2019. All gold mined in Zimbabwe must be sold to the FPR. While the RBZ has introduced incentives aimed at enhancing gold deliveries to FPR, it also needs to ensure that its subsidiary follows the requirements of the Gold Trade Act to purchase gold only from authorized persons.

20. The RBZ's broad discretion in applying the foreign exchange regulations reveals further governance vulnerabilities. The allocation criteria are opaque and open to mismanagement (e.g., the allocation of foreign exchange to priority imports). Another risk relates to the RBZ directive for authorized dealers to transfer legacy debt to the RBZ. The legal basis for this RBZ decision is unclear.

21. The RBZ's decision-making framework is not in line with leading international practices and should be strengthened to mitigate the above-mentioned vulnerabilities. While the Board exercises supervision over the executive management of the RBZ, there is a concentration of power at the executive level. In addition, the composition of the Audit and Oversight Committee (AOC), which is typically charged with close oversight of financial matters, is not in line with leading practices with respect to the independence and experience of the members.

22. The rules on conflicts of interest have major weaknesses. While the RBZ Act does contain a provision on disclosure of information in the Codes of Conduct for managerial and non-managerial staff, the latter do not apply to the Governor, Deputy Governors, and Board members. This also applies to the Zimbabwe Asset Management Company (ZAMCO)—the RBZ subsidiary managing non-performing loans—which does not have specific provisions that describe its powers and governance.

23. **The RBZ does not have full autonomy from the government in relation to its policies, decision-making, and operations.** The RBZ Act contains an extensive list of provisions which allow for direct undue political influence over the Bank's policies and operations. Stronger safeguards are needed to insulate the Bank from political interference in respect of the appointment and dismissal of the Governor, the Deputy Governor(s), other Board members and MPC members. Leading practices require a double veto procedure (i.e., the involvement of two separate bodies to ensure a transparent and objective procedure) for appointments and dismissals.

24. **The RBZ framework for financial sector oversight creates governance vulnerabilities.** A weak legal framework does not allow the supervisory authority to adequately perform its responsibilities. The significant role of the MOFED with respect to bank supervision undermines the supervisory authority's (RBZ) operational independence and creates governance vulnerabilities. Contrary to leading practices, the Banking Act contains many instances where the MOFED is involved in the final decision-making, grants approval on certain applications, or has the authority to reverse the supervisory authority actions.

C. Rule of Law

25. **Corruption vulnerabilities may arise in the administration of land resources.** Sources of vulnerability include: (i) lack of clarity in the criteria for administering land resources (i.e., ambiguous conditions for granting land use permits and leases, for granting permission to sublease or to use land in joint investment venture, and for government retaking of the land); (ii) lack of transparency in the decision-making process; and (iii) lack of proper control over this process (i.e., role of an independent and capable agency and judiciary to safeguard against potential abuses). These weaknesses create an opportunity for arbitrary decisions, and together with the lack of transparency and proper control, the risk of official abuse could significantly increase.

26. **The government is undertaking further reforms to enhance the judiciary's capacity and efficiency**. The relative efficiency of the judiciary in Zimbabwe appears to have improved significantly in recent years, mainly due to a performance management system for judges and magistrates which was launched by the Judicial Service Commission in 2014.

D. AML/CFT

27. **Corruption and the laundering of its proceeds present a significant threat in Zimbabwe.** The authorities are working to address the AML/CFT deficiencies identified in the recent

FATF listing and the 2016 ESAAMLG report. Legislative amendments have addressed some weaknesses in the AML framework, including an obligation on financial institutions to identify and verify their customers' beneficial owners. Further efforts to enhance the effectiveness of the AML/CFT framework (including capacities for conducting financial investigations and public access to beneficial ownership information) will help detect and deter corruption. Effective implementation of risk-based AML/CFT supervision can also contribute to ensuring financial institutions' compliance with fit and proper controls, enhanced customer due diligence obligations for politically exposed persons, and dynamic suspicious transaction reporting. A robust online asset declaration system for politically exposed persons should also be introduced.

E. Recommendations

28. Despite a fairly adequate legal framework, enforcement of anti-corruption has so far been relatively ineffectual and there is also a perception that the authorities' fight against corruption is selective and highly politicized. Several factors may have contributed to these problems. First, there is no top-down overall anti-corruption strategy and framework for implementation across the entire public administration. Second, information and data in many critical areas (e.g., fiscal information in mining contracts or central bank financial statements) is kept secret or not transparent. Third, there is no formal system or protocol to address the conflicts of interest that inevitably arise when the government is both regulator and involved in the business. Fourth, appointments to boards of public entities are not based on clear, publicly-disclosed criteria and are not transparent. Finally, enforcement agencies are not well coordinated and fall behind in enforcing existing law.

29. The IMF staff's report includes a set of recommendations for dealing with the governance vulnerabilities identified in the report. Listed below are some of the main high-level measures identified in the report that require action immediately or in the short term. Implementing the actions identified in this report will require political leadership at the highest level, and a dedicated central secretariat, as well as broad-based support from civil society and other groups. In each of the areas identified the ministries or agencies concerned will need to undertake further work to develop project plans, and to identify benchmarks and performance indicators that can be monitored. Budgets will need to be allocated for implementing new laws and procedures together with communication plans, action plans, change management strategies, and timeframes. Progress reports should be published on a regular basis. Development partners may be asked to provide technical support and where appropriate financing to support the reforms.

Anti-Corruption Framework

- Develop an anti-corruption strategy consistent with international good practice principles.
- Enact whistleblower legislation and protection in line with international good practice.
- Introduce an asset declaration regime.

- Enhance transparency and formalize clear procedural guidance on the government's anti-corruption strategy and policies, and strengthen the capacity of enforcement agencies and their coordination.

Public Financial Management

- Conduct a comprehensive review of the Command Agriculture Program by the Auditor General or an external audit firm, taking account of the need to protect vulnerable citizens.
- Tighten the enforcement of legal provisions on the submission of public debt reports.
- Accelerate the roll-out of the PFMS to local governments and extrabudgetary units.
- Enforce the constitutional and legal requirements in respect of financial reports and internal controls.
- Enforce sanctions on MDAs and/or officials who fail to submit fiscal reports.
- Introduce data dissemination dates and follow those dates for publishing regular and timely fiscal information.
- Publish public procurement plans, introduce e-procurement, and establish an online procurement database.

Revenue Administration (ZIMRA)

- Continue important ongoing reforms to increase taxpayer compliance through improved IT systems, dispute resolution procedures, compliance risk management, and taxpayer support services.
- Clearly specify the role of the board to include oversight of administrative functions and reporting, while removing the management of operations by the board;
- Prohibit the disclosure of taxpayer information to board members and issue a specific tax secrecy requirement for Board members should they receive such information;
- Remove the authority of the board to appoint Commissioners and staff, but allow vetting of candidates for board membership by a sub-committee of the board; and
- Remove the involvement of the Board in policy matters considered by the Minister of Finance.
- Enact new legislation to coordinate the management of border controls and reduce fraud.

SOEs and Extractive Industries

- Increase capacity for enforcing the provisions and regulations of the PECG Act and publish data on appointments to the boards of SOEs.

- Build capacity in MoFED to provide effective oversight of the financial performance of SOEs, and issue instructions based on the PFMA requiring SOEs to submit quarterly and annual financial statements.

- Prepare and enact a law on the privatization process, and issue clear criteria and guidance on the role and responsibilities of the MoFED, line ministries and other agencies in managing the process.

- Publish all resource contracts with investors including those signed by SOEs, as a first step towards implementation of the Extractive Industries Transparency Initiative (EITI).

Reserve Bank

- Amend the RBZ Act to distinguish clearly between the Bank's objectives, functions and powers and simplify the current wording on legal tender.

- Remove the extensive list of provisions, including on prudential supervision, which allow for undue political influence over the RBZ's operations.

- Prohibit in law and discontinue RBZ's quasi-fiscal operations, with measures to mitigate potentially adverse social impacts, and operationalize the RBZ's financial stability mandate.

- Consolidate the RBZ's subsidiaries in its financial statements and clarify ZAMCO's powers, including fit and proper rules and strict conflict of interest requirements for its board of directors.

- Verify the basis and feasibility for the transfer of legacy debt (noting approval by the MoFED and the Parliament) and engage an external audit firm to certify the process of validating the legacy debt.

Rule of Law

- Develop clear criteria for granting and cancelling land permits and leases, and for authorizing different forms of land use (e.g., sublease or investment partnership), and publish these criteria.

- Publish decisions related to land use.

- Establish an independent agency to handle complaints relating to land administration.

AML/CFT

- Develop and implement a risk-based approach to AML/CFT supervision, focusing on compliance with fit and proper controls, customer due diligence requirements for politically exposed persons and suspicious transaction reporting.

Annex V. Capacity Development Strategy for 2020

The Zimbabwean authorities are closely engaged with Fund staff on economic policy formulation and implementation, including through an SMP. They see technical assistance from the IMF as important for supporting their economic and financial policies under the program. As such, the Fund's capacity development program for Zimbabwe, including related technical assistance delivery, is a key component of the SMP and Fund's surveillance priorities for Zimbabwe.

Overall Assessment of Capacity Development

1. The provision of Fund TA to Zimbabwe started recently. Following Zimbabwe's payment of its arrears to the PRGT, the Fund's Executive Board removed, effective November 14, 2016, all remedial measures including limitations on the provision of Fund TA. In the beginning, the bulk of Fund TA to Zimbabwe focused on public financial management (PFM), revenue administration, and macroeconomic statistics (BOP, GDP, and CPI). Recently, there has also been extensive TA on national accounts, price, balance of payments, and public sector debt statistics. A Financial Sector Financial Stability Review (FSSR) was conducted in November 2018, from which the authorities and staff have tentatively agreed a TA Road Map to support the authorities´ efforts to address key gaps and vulnerabilities. The TA will also play a complementary role in helping the authorities meet some obligations under the SMP and any potential subsequent programs.

2. The recent track record on implementing TA recommendations has been mixed. In part this reflects the need for legislative changes in many of the targeted areas, which have often faced delays given the significant political uncertainty in the run up to the presidential and parliamentary elections of July 2018.

Forward-Looking Priorities

3. Zimbabwe faces vast capacity development needs given the multiplicity and severity of the economic issues it faces following an extended period of international isolation. The Fund's TA remains crucial, as Zimbabwe transitions toward a functioning economy and seeks to restore macroeconomic stability. Given the brain drain that the civil service experienced during the hyperinflationary era, and the resulting near complete erosion of systems, particularly in debt management, statistics and PFM, TA has been, and will be, a critical element on the path to normalizing relations with the international community.

4. The focus of the TA in the near term will be on areas that facilitate fiscal consolidation, support the transition to a new monetary policy framework, and protect financial sector stability. To that end, targeted areas include PFM reforms aimed at strengthening expenditure management, budget preparation and execution, and fiscal reporting; further developing the debt management framework; reviewing the design of the tax system; enhancing tax and customs administrations; strengthening the financial stability framework and assessing banks' asset quality once the macroeconomic situation has stabilized; and providing financial modelling and forecasting training for supervisors.

5. TA priorities include:

Priorities	Objectives
PFM	Strengthen budgeting, reporting, fiscal forecasting, cash management, and fiscal oversight.
Revenue policy and administration	Broaden the tax base, mostly by reducing tax incentives (which reduce collections and make the economy less efficient). Modernize revenue administration to improve its efficiency and effectiveness by addressing taxpayer segmentation and strengthening audit and risk management capacity.
Debt management	Strengthen government's debt management capacity for achieving fiscal sustainability and effective budgeting.
Monetary policy framework	Support the authorities in designing and operationalizing a monetary policy framework to deliver macroeconomic stability. Reduce the distortions from exchange controls.
Financial supervision and crisis management	Legal reforms to strengthen bank supervision and resolution, and payment system oversight. Update, adopt, and operationalize the 2014 draft Crisis Management Plan. Review banks' quality once the macro economic situation has stabilized.
Macroeconomic statistics	Enhance macroeconomic analysis, budget preparation, and policy design.

INTERNATIONAL MONETARY FUND

ZIMBABWE

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

February 12, 2020

Prepared By | The IMF's African Department (in collaboration with other Departments)

CONTENTS

FUND RELATIONS

(As of December 31, 2019)

I. Membership Status: Joined: September 29, 1980; Article VIII

II. General Resources Account:	**SDR Million**	**%Quota**
Quota	706.80	100.00
IMF's Holdings of Currency (Holdings Rate)	706.47	99.95
Reserve Tranche Position	0.33	0.05

III. SDR Department:	**SDR Million**	**%Allocation**
Net cumulative allocation	338.58	100.00
Holdings	2.35	0.69

IV. Outstanding Purchases and Loans: None

V. Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-By	Aug 02, 1999	Oct 01, 2000	141.36	24.74
Stand-By	Jun 01, 1998	Jun 30, 1999	130.65	39.20
EFF	Sep 11, 1992	Sep 10, 1995	114.60	86.90

VI. Overdue Obligations and Projected Payments to Fund [1/]

(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2020	2021	2022	2023	2024
Principal					
Charges/Interest	2.52	2.49	2.49	2.49	2.49
Total	2.52	2.49	2.49	2.49	2.49

[1/] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

VII. Implementation of HIPC Initiative: Not Applicable

VIII. Implementation of Multilateral Debt Relief Initiative (MDRI): Not Applicable

IX. Implementation of Catastrophe Containment and Relief (CCR): Not Applicable

Lifting of Remedial Measures following clearance of arrears to the PRGT:

On October 20, 2016, Zimbabwe fully settled its overdue financial obligations to the Poverty Reduction and Growth Trust (PRGT) using its SDR holdings. Zimbabwe had been in continuous arrears to the PRGT since February 2001. As of the day of repayment, Zimbabwe's arrears to the PRGT amounted to SDR 78.3 million, which comprised overdue PRGT principal of SDR 61.7 million, and total interest obligations of SDR 16.6 million (covering overdue interest and interest accrued through October 20, 2016 on overdue principal and interest amounts). The repayment of SDR 78.3 million has been applied towards the PRGT's Reserve Account.

Effective November 14, 2016, the Executive Board of the International Monetary Fund (IMF) approved the removal of the remedial measures applied to Zimbabwe. These measures had been in place because of Zimbabwe's overdue financial obligations to the Poverty Reduction and Growth Trust (PRGT). These remedial measures related to: (i) the declaration of noncooperation with the IMF (see Press Release No. 02/28); (ii) the suspension of technical assistance (which had already been partially lifted, see Press Release No. 09/152 and Press Release No. 12/405); and (iii) the removal of Zimbabwe from the list of PRGT-eligible countries (see Press Release No. 01/40).

Zimbabwe is now current on all its financial obligations to the IMF. Its eligibility to the PRGT has also been restored.

Exchange Arrangement

On February 20, 2019, Zimbabwe introduced a new domestic currency—named the Real Time Gross Settlement (RTGS) dollar—and adopted a de jure floating exchange rate arrangement, previously a "no separate legal tender" arrangement. The RBZ denominated legally, through Statutory Instrument (SI) 33 of 2019, the existing RTGS balances, bond notes and coins in circulation as RTGS dollars making them part of the multi-currency system in Zimbabwe. An inter-bank foreign exchange market was established to formalize the trading of RTGS dollar balances and bond notes with the United States Dollars and other currencies on a willing seller-willing buyer basis through banks and bureau de changes. This decision to establish a flexible exchange rate market was taken in consultation with Government and business taking into consideration the distortions in the market caused by multi-pricing. The RTGS dollar was renamed as the Zimbabwean dollar (ZWL$) in June 2019. The de facto exchange rate arrangement was reclassified to floating from other managed, effective February 20, 2019.

Facing severe imbalance of payment and US dollar liquidity pressures, the authorities continue to maintain a series of measures to limit current and capital account transactions. These measures have given rise to several exchange restrictions and multiple currency practices (MCPs), inconsistent with Article VIII, Section 2(a) and Section 3, in particular:

a. Under the official guidance issued by the Reserve Bank of Zimbabwe (RBZ), commercial banks are required to prioritize their foreign exchange (FX) sale to finance specific categories of international transactions which constitutes an exchange restriction as it limits the availability of FX for payments and transfers for current international transactions, in particular in the non-priority or low priority categories. Further, the prioritization also results in an MCP as it channels some of the non-priority or low-priority transactions to the bureau market which has an exchange rate of more than 2 percent in excess of that in the interbank market.

b. The RBZ also allocates FX to finance certain necessity imports, and purchases repatriated FX proceeds that exporters are required to sell (surrender) to the RBZ, at the prior business date's interbank rate. These allocation and purchase transactions at the prior business date's interbank rate constitute an MCP as this rate has recently deviated and may continue to deviate by more than 2 percent from the prevailing FX rate for other FX transactions taking place on the same date. The FX allocation here also gives rise to an exchange restriction as it limits the availability of FX for payments and transfers for other current international transactions not eligible to receive such allocation.

c. Zimbabwe has also a longstanding exchange restriction subject to IMF jurisdiction arising from unsettled balances under an inoperative bilateral payment agreement with Malaysia.

Article IV Consultations

Zimbabwe is on the standard 12–month consultation cycle. The Executive Board discussed the staff report for the 2017 Article IV consultation on July 5, 2017.

JOINT WORLD BANK—IMF WORK PROGRAM, 2020-21

Title	Products	Delivery Date
Bank work program in next 12 months	**Technical Assistance** • SOE Reform • Doing Business and Investment Policy • Mineral Sector Reform • Climate Change • Energy Sector • Transport Sector • Health and Nutrition Sector • Education Sector • Social Protection and Safety Nets • Land Policy and Administration • Transport Sector • Poverty Monitoring and Analysis	Ongoing, all
IMF work program in next 12 months	**Technical assistance** • Establishing a money targeting framework • Public financial management • Revenue administration • Public debt management • Financial supervision and regulation • National account statistics	Ongoing, all
Bank provides to Fund	• Updates on policy reform work: impact of drought and other climatic shocks, assessment of social assistance needs and ways to improve targeting of vulnerable groups, improving the business climate • Timing, scope, and conclusions of Bank's missions • Update on arrears clearance	Ongoing, all
Fund provides to Bank	• Updates on medium-term macroeconomic framework • Updates on program discussions • Updates on policy reform work: PFM, tax and financial sector reforms • Timing, scope, and conclusions of missions	Ongoing, all
Joint products in next 12 months	• DSA for 2021 Article IV	Q1 2021

STATISTICAL ISSUES

As of December 31, 2019

I. Assessment of Data Adequacy for Surveillance
General: Data provision has some shortcomings but is broadly adequate for surveillance. Despite the resource constraints, ZIMSTAT usually produces sufficient data to users and largely complies with international standards, but the reintroduction of the Zimbabwe dollar has caused some inevitable delays in the publication of national account statistics that the authorities, with external support, have an action plan to remedy.
National Accounts: ZIMSTAT has made progress in following the 2008 *System of National Accounts (SNA)* guidelines. The scope of national accounts statistics is being expanded, including through the compilation of quarterly national accounts. Staff resources remain insufficient to achieve these objectives. ZIMSTAT is under a heavy workload as it works, with the assistance of IMF TA, to redenominate and rebase its national accounts statistics. Redenominating national accounts from the US dollar back to the reintroduced Zimbabwe dollar, and rebasing to a more recent year will require extensive resources and additional data, particularly for 2019 outturns that will be essential as the first year of ZWL$-based transaction data. Zimbabwe is also making important strides in improving the timeliness of its data, and is expanding its available data to include more real time indicators. Currently it is working on quarterly GDP statistics. In this regard, the Zimbabwe Revenue Authority has agreed to share tax data which is a basis for quarterly (and annual) national accounts compilation. The authorities are undertaking the Poverty, Income, Consumption and Expenditure Survey (PICES) 2017. The survey will provide data on income distribution, consumption level, private consumption, and living conditions of the population, CPI weights, production account of agriculture and poverty mapping.
Price Statistics: ZIMSTAT are generally of good quality and a recent IMF TA mission reaffirmed the methodology and sampling techniques, while nevertheless noting the challenges of developing price statistics in a multi-currency and high inflation environment. In 2019, ZIMSTAT rebased their CPI (Feb/2019 = 100) and reweighted the basket.
Government Finance Statistics: The Ministry of Finance and Economic Development (MoFED) collects data on revenue, expenditure, and financing for the budgetary central government (BCG). These are published on a monthly basis on its website in the consolidated financial statements and budget outturns, along with the Treasury quarterly Bulleting. The MoFD regularly reports annual Government Finance Statistics (GFS) consistent with the Government Finance Statistics Manual (GFSM) 2014 to the IMF's Statistics Department (STA). However, data dissemination is limited to transactions and does not include expenditure by Classification of Functions of Government (COFOG) or stock positions in financial assets and liabilities. While data for the BCG have improved, efforts are required to improve the timeliness, frequency, and coverage of GFS.

Monetary and Financial Statistics (MFS): The RBZ began reporting MFS to the Fund using the Standardized Report Forms (SRFs) in late 2015. With technical assistance from STA, the data were approved for publication in *International Financial Statistics (IFS)* in May 2018. Consultations are ongoing with STA on classifications of certain line items, particularly the distinction between national currency and foreign currency denominated assets and liabilities following the end of the multi-currency regime. Zimbabwe does not currently compile data for Other Financial Corporations (OFCs), which are a significant part of the country's financial system. The RBZ reports data on several indicators of the Financial Access Survey (FAS) including the two indicators (commercial bank branches per 100,000 adults and ATMs per 100,000 adults) adopted by the UN to monitor Target 8.10 of the Sustainable Development Goals (SDGs).
Financial sector surveillance: Zimbabwe does not currently report Financial Soundness Indicators (FSIs) to the Fund for dissemination on the Fund's external website. The RBZ is advanced in the compilation of the FSIs but needs to finalize the action plan related to the submission of the FSI data and metadata to the IMF for external dissemination.
External Sector Statistics: The RBZ migrated from the *Balance of Payments Manual*, fourth edition, (*BPM4*) to the *Balance of Payments and International Investment Position*, sixth edition, (*BPM6*) in December 2016 and has since submitted only balance of payments data to STA in accordance to *BPM6*. The RBZ does not report International Investment Position (IIP), coordinated direct investment survey (CDIS) and coordinated portfolio investment survey data (CPIS) data to the IMF. the RBZ does not report quarterly external sector data (QEDS) to the Work Bank debt database. In the data reported, there remain gaps particularly on the financial accounts, especially reinvested earnings and trade credit. The RBZ is receiving technical assistance (TA) from the IMF and the UK's Department for International Development (DFID)'s Enhanced Data Dissemination Initiative 2 (EDDI-2), Project Module 1 aimed at strengthening compilation of external sector statistics (ESS). The most recent ESS TA assisted the authorities on approaches to increase the response rate to the quarterly Foreign Private Capital survey for direct investment data and in developing a preliminary database on IIP.
International Investment Position (IIP): The RBZ has made progress on the compilation of IIP with the assistance of the IMF under EEDI-2. There is however missing stock data on FDI and portfolio investments which will be obtained from the planned Foreign Private Sector Survey.
II. Data Standards and Quality
Zimbabwe participates in the Enhanced General Data Dissemination System (e-GDDS) from November 2002. The e-GDDS metadata on the IMF DSBB site were last updated in May 2013. No data ROSC is available.
III. Reporting to STA
Zimbabwe is reporting its MFS, external sector statistics (mainly BOP), and currency composition of foreign reserves to STA. However, Zimbabwe does not report national accounts and price statistics to STA for

dissemination in the *IFS* and the *BOP Statistics Yearbook*. Zimbabwe reports GFS data that are included in the GFS yearbook, but no sub-annual data are reported for dissemination in the IFS.

Table 1. Zimbabwe: Common Indicators Required for Surveillance

	Date of latest observation	Date received	Frequency of data[1]	Frequency of reporting[1]	Frequency of publication[1]
Exchange rates[2]	Jan. 30, 2020	Jan. 31, 2020	D	D	D
International reserve assets and reserve liabilities of the monetary authorities[3]	Dec. 2019	Jan. 2020	W	W	M
Reserve/base money	Nov. 2019	Jan. 2020	M	M	M
Broad money	Nov. 2019	Jan. 2020	M	M	M
Central bank balance sheet	Nov 2019	Jan. 2020	M	M	M
Consolidated balance sheet of the banking system	Nov. 2019	Jan. 2020	M	M	NA
Interest rates[4]	Dec. 2019	Jan. 2020	M	M	M
Consumer price index	Dec. 2019	Jan. 2020	M	M	M
Revenue, expenditure, balance and composition of financing[5]— General government[6]	NA	NA	NA	NA	NA
Revenue, expenditure, balance and composition of financing[5]—Central government	Nov. 2019	Jan. 2020	M	M	M
Stocks of central government and central government-guaranteed debt[7]	Sep. 2019	Dec. 2019	Q	I	A
External current account balance	Q3 2019	Dec. 2019	A	I	I
External capital and financial account	Q3 2019	Dec. 2019	Q	I	I
Exports and imports of goods	Q3 2019	Dec. 2019	M	I	I
GDP/GNP	2018	Jun. 2019	A	A	A
Gross external debt	Sep. 2019	Dec. 2019	A	I	I
International investment position[8]	NA	NA	NA	NA	NA

[1] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).
[2] The Zimbabwe dollar is no longer traded against foreign currencies on the exchange market.
[3] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.
[4] Both market-based and officially-determined, including discounts rates, money market rates, rates on treasury bills, notes and bonds.
[5] Foreign, domestic bank, and domestic nonbank financing.
[6] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[7] Including currency and maturity composition.
[8] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

Note: This table reflects data submission as of January 31, 2020.

ZIMBABWE

February 12, 2020

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION—DEBT SUSTAINABILITY ANALYSIS

Approved by
David Robinson and Jeromin Zettelmeyer (IMF) and Marcello Estevão (IDA)

The Debt Sustainability Analysis (DSA) has been prepared jointly by the staff of the International Monetary Fund (IMF) and International Development Association (IDA), in consultation with the authorities, using the debt sustainability framework for low-income countries approved by the Boards of both institutions.

Risk of external debt distress	In debt distress
Overall risk of debt distress	In debt distress
Granularity in the risk rating	Unsustainable
Application of judgement	No

Zimbabwe is classified as "in debt distress", with unsustainable public and publicly guaranteed (PPG) external and total debt and large external arrears.[1] *External and total public debt breach the thresholds in both the baseline and shock scenarios. Moreover, Zimbabwe has large and longstanding external arrears to IFIs, official, and commercial creditors. Domestic debt has grown in recent years due to large fiscal deficits and negligible access to external finance, but the recent currency conversion and high inflation have significantly eroded its real value. Restoring debt sustainability requires the sustained implementation of a significant fiscal consolidation, cessation of quasi-fiscal activities that lead to debt increases, as well as reaching agreement with creditors on a comprehensive treatment of Zimbabwe's external debt and arrears. The authorities broadly concurred with the staff's assessment contained in the DSA, and were confident that the envisaged reengagement with the international community will help restore debt sustainability.*

[1] Zimbabwe's Composite Indicator (CI) index is calculated at 1.8 based on the October 2019 WEO and the 2018 CPIA data, indicating that the county's debt-carrying capacity is 'weak', which is the same classification as under the previous DSA.

BACKGROUND ON DEBT

1. **Zimbabwe's public debt has increased since the last published DSA (2017) as unsustainable fiscal deficits and quasi-fiscal activities of the RBZ increased domestic and external debt, including through further arrears accumulation.**[2] With negligible access to external financing, these deficits were financed domestically through the banking system and, until recently, the Reserve Bank of Zimbabwe (RBZ), as well as arrears. Domestic debt, which was negligible 5 years ago, reached ZWL$ 6.98 billion by end-2018. However, its value, in real terms[3] and as a percentage of GDP, has fallen drastically since the introduction of the Zimbabwe dollar and the redenomination of domestic debt into the new currency in 2019. External debt is dominated by official creditors—both bilateral and multilateral—with the bulk of the debt in arrears. Text Table 1 outlines the debts of Zimbabwe under various categories, e.g. debt outstanding and disbursed (DoD) vs accumulated arrears, for 2018. In 2019, the authorities effectively secured several additional external loans, with some constituting almost-concessional borrowing[4] for critical infrastructure projects, but also expensive commercial loans that are securitized by future

Text Table 1. Zimbabwe: Public and Publicly Guaranteed Debt

(USD millions; as of end-2018)

	DOD	Arrears	Total	% of GDP*
(USD millions; as of end-2018)				
External Debt[1]	**2,563**	**6,109**	**8,672**	**38%**
Bilateral Creditors	1,519	3,687	5,206	23%
Paris Club	210	3,258	3,469	15%
Non Paris Club	1,309	428	1,737	8%
Multilateral Creditors	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%
Commercial Creditors	145	63	208	1%
(ZWL$ millions; as of end-2018)				
Domestic debt[2]	**6,875**	**108**	**6,984**	**16%**
Government Bonds	4,785	-	4,785	11%
RBZ loans	2,049	-	2,049	5%
Domestic Arrears	-	108	108	0%
Other	42	-	42	0%
Farmer's compensation[3]	**2.4-10 USD billion (10-45% GDP)**			

Source: Zimbabwean authorities and IMF staff calculations.

*Percentage of estimated nominal 2018 GDP, which is still subject to potential major revision

1/ External public and publicly-guaranteed debt, including RBZ and SOEs.

2/ Note: Domestic debt is unconsolidated domestic debt of the central government, which differs from the DSA that takes a broader perimeter of debt coverage for the analysis.

3/ Contingent liability.

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[2] In this DSA, external debt is defined on a residency basis.

[3] Inflation spiked to 521 percent (y-o-y) in December 2019.

[4] Staff estimates a grant element of approximately 30 percent, which is below the 35 percent requirement for it to be considered officially concessional.

mineral exports. These commercial loans mainly reflect borrowings to introduce and defend the new ZWL$ and facilitate the importation of essential goods (fuel, maize, pharmaceuticals)

2. **Public debt coverage includes external and domestic obligations of the central government, central bank, and some state-owned enterprises (SOEs), but coverage of the SOE sector remains incomplete** (Text Table 2). The authorities are improving the monitoring of SOEs balance sheets, incomes, and debt levels. In 2019, led by the State Enterprises Restructuring Agency (SERA), which is based in the Office of the President and Cabinet and the Ministry of Finance, the Government of Zimbabwe adopted a policy for a broad overhaul of the SOE sector, including privatizations, mergers, and requiring a standardized set of reporting from all SOEs to the Ministry of Finance and Accountant General. While domestic arrears of the central government to non-governmental entities are small (ZWL 108 million, 0.8 percent of GDP), this does not reflect all domestic non-governmental arrears (e.g., it excludes accounts payable) and more importantly, significant cross-debts within the public sector. Many of these arrears are between public sector units, in particular the state electricity generator and revenue agency. IMF TA provided in Q1/2019 recommended that the authorities revive a tracking system of 'from whom-to-whom' in order to get a database that would facilitate clearing intra-government cross public sector institution arrears. Also, given the high degree of indebtedness between public sector entities, including RBZ lending to central government, it would be beneficial for the authorities to update the Public Debt Management Act (PDMA) to clarify the appropriate reporting of public sector gross debt in terms of consolidation.

Text Table 2. Zimbabwe: Coverage of Public Sector Debt

	Subsectors of the public sector	Check box
1	Central government	X
2	State and local government	
3	Other elements in the general government	
4	o/w: Social security fund	
5	o/w: Extra budgetary funds (EBFs)	
6	Guarantees (to other entities in the public and private sector, including to SOEs)	X
7	Central bank (borrowed on behalf of the government)	X
8	Non-guaranteed SOE debt	X

BACKGROUND ON MACRO FORECASTS AND STRESS TESTS

3. **Zimbabwe's current debt-carrying capacity is classified as 'weak' according to the methodology employed in the revised DSF Framework (2017).** The country's Composite Indicator (CI)[5] index is 1.80 based on the October 2019 WEO and World Bank's latest (2018) CPIA. The relevant indicative debt thresholds for this category are shown in the weak column of Text Table 3, and the

[5] To capture the various factors affecting a country's debt carrying capacity, the DSF uses a composite indicator (CI). The CI captures the impact of the several factors through a weighted average of the World Bank's CPIA score, the country's real GDP growth, remittances, international reserves, and world growth.

benchmark of the PV of total public debt for countries with weak debt carrying capacity is 35 percent.

Text Table 3. Zimbabwe: Debt Carrying Capacity and Relevant Indicative Thresholds

EXTERNAL debt burden thresholds	Weak	Medium	Strong
PV of debt in % of			
Exports	140	180	240
GDP	30	40	55
Debt service in % of			
Exports	10	15	21
Revenue	14	18	23

TOTAL public debt benchmark	Weak	Medium	Strong
PV of total public debt in percent of GDP	35	55	70

A. The Baseline Scenario and Realism Tools

4. **Establishing a definitive picture of Zimbabwe's outlook for debt sustainability is challenging given the considerable uncertainty surrounding the estimates of key macroeconomic statistics**. The re-adoption of the Zimbabwe dollar has removed an important distortion in the economy, but additional time is needed for markets to settle, inflation (and interest rates) to normalize, and the country's statistical agency (ZIMSTAT) to recompile national accounts statistics in the new currency. ZIMSTAT is making good progress on the work of rebasing and redenominating its national accounts statistics so that once completed it will have a complete and consistent set of historical national accounts statistics. However, for the exercise to be completed and avoid large revisions to the data, additional time is needed to collect, analyze, and integrate 2019 data (e.g. the new base year GDP).[6] The IMF and World Bank are providing extensive TA to support ZIMSTAT's endeavor. In the interim, staff and the authorities continue to collaborate on a set of mutually agreed national accounts statistics that are sufficient to conduct a DSA, but an external debt reconciliation exercise and an official time series for national accounts should be considered prerequisites for clarifying debt sustainability and forming the basis for any further engagement with creditors.

5. **The economy contracted sharply in 2019 and the outlook for 2020 is for near-zero growth and gradual disinflation.** Negative growth in 2019 reflects declines in agriculture and electricity generation from the drought, and the impact of electricity shortages on other sectors. For 2020, the economy is expected to remain basically flat as agriculture and electricity generation endure another year of drought. With grain stocks already depleted, a poor coming agriculture harvest would put additional pressures on the balance of payments for imports. Inflation is expected to remain high through mid-2020, with the pass-through from the exchange rate depreciation in 2019H2 running its course, and fall thereafter as the RBZ contains money growth.

[6] 2019 GDP will also be the first full year of estimation where the Zimbabwe dollar is used to collect the data, hence it will be an important benchmark for many of the assumptions made to convert 2018 national accounts statistics from USD to ZWL.

6. **Over the medium term, investment and growth will be constrained by a continuation of protracted external arrears and the consequent lack of access to external finance.** Nevertheless, sustainable fiscal deficits and a more flexible exchange rate regime allow the economy to achieve some growth. The lack of external financing also constricts the size of the current account deficits, which in the current DSA is forecasted to be smaller than in the previous one.

7. **The baseline assumes that the authorities have also exhausted their ability to contract non-traditional commercial external debt** (Text Table 4), which the RBZ has done repeatedly since the last DSA by collateralizing future sales of commodity exports, primarily gold. Staff has reiterated concerns that continued external borrowing on commercial terms would likely worsen debt sustainability and complicate finding a consensus on arrears clearance and debt relief. For the purposes of this DSA the standard assumption that the financing gap in the forecast period is filled by domestic debt issuances has been held, which results in a higher forecast level of public debt than if the gap was filled through a combination of revenue mobilization, expenditure rationalization, and grant support.

Text Table 4: Macroeconomic Framework, 2017-23

	2017	2018	2019	2020	2021	2022	2023
Real GDP growth (%)	4.7	3.5	-8.3	0.8	2.5	2.5	2.2
Inflation (%, average)	0.9	10.6	255.3	221.1	3.7	3.0	3.0
Inflation (%, eop)	3.4	42.1	521.1	52.0	3.0	3.0	3.0
Overall Fiscal balance (% GDP)	-9.6	-7.5	0.0	-5.0	-1.0	-4.0	-2.9
Consolidated public sector debt (% GDP)	54.4	63.0	50.1	53.9	56.1	56.0	55.9
Public and publicy-guaranteed external debt (% GDP)	40.1	37.8	47.6	51.5	52.7	52.1	51.5
Current account (% GDP)	-1.3	-5.4	0.7	-1.0	-1.4	-1.3	-2.3
FDI (% GDP)	1.4	1.6	0.6	1.1	0.7	1.6	1.9
Reserves (months of imports)	0.5	0.1	0.2	0.2	0.2	0.2	0.2

Sources: Zimbabwean authorities; IMF staff estimates and projections.

8. **The current DSA includes commitments by the RBZ to fully compensate some stakeholders for losses relating to currency reform, through the issuance of FX-dominated domestic debt securities in 2020.** Following currency conversion, the RBZ announced that it would compensate stakeholders for losses, estimated then at US$1.2 billion. The legal channels for assuming and the method for compensating (e.g. the tenor of the debt instrument) these 'legacy debts' remain unclear. With indications that the debt to be assumed could reach US$2 billion, the difference has been included in the customized shock discussed below along with the contingent compensation to displaced farmers. Staff expressed concern that assuming these debts would significantly deteriorate the Government's balance sheet, worsen Zimbabwe's debt distress, and affect the prospects for future normalization of Zimbabwe's external arrears.

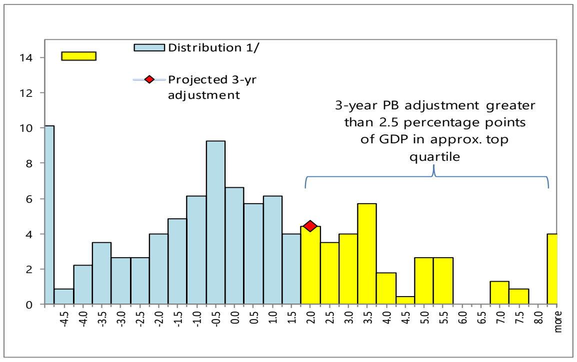
9. **Risks to the baseline scenario are multi-dimensional.** The change in the currency regime, while unavoidable, is also unparalleled and presents numerous challenges that are difficult to anticipate, including high and volatile levels of inflation, exchange rate, and interest rates. The fiscal adjustment, without external and RBZ financing is substantial, raising risks of austerity fatigue and a loss of social support for fiscal consolidation. Together, the sharp spike in inflation, the impact of

drought and cyclone, and large losses by bank depositors following the currency reform have reduced significantly purchasing power and living standards, disproportionately affecting the most vulnerable in society. Risks to 2020 are to the downside as rainfall is well below average (similar to last year's drought levels), and distortions in the mining sector continue to adversely affect production. Upside risks over the long term include a successful resolution of Zimbabwe's arrears that could be followed by a normalization of financial relationships and a superior growth-investment and poverty reduction path. Normalization of its external financial relationships is a necessity if Zimbabwe is to achieve the Sustainable Development Goals (SDGs).

10. **The realism and forecast error tools highlight the more pessimistic baseline that operates under the assumptions of no progress on international re-engagement (or arrears clearance), a debt overhang, limited external support, and lower investment.** The large implied fiscal multiplier in the baseline arises as the model does not capture adequately the effects of idiosyncratic shocks in 2019, particularly drought and the cyclone, and measurement challenges relating to high inflation and a large parallel market premium.

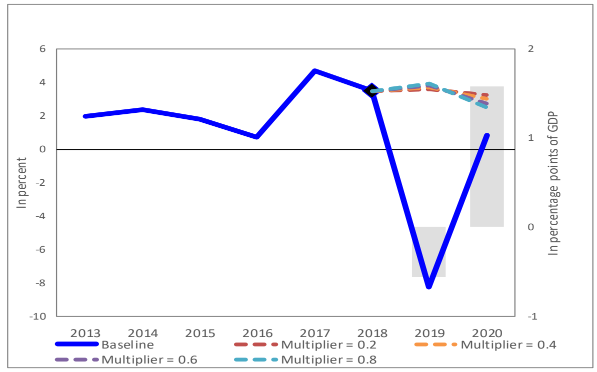
Figure 1. Zimbabwe: DSA Realism and Forecast Error tools

3-Year Adjustment in Primary Balance
(Percentage points of GDP)



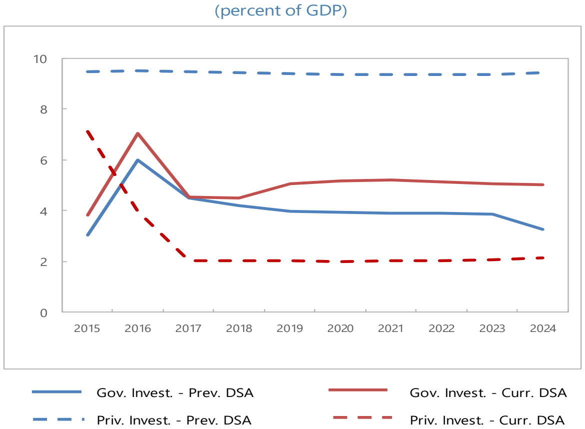
1/ Data cover Fund-supported programs for LICs (excluding emergency financing) approved since 1990. The size of 3-year adjustment from program inception is found on the horizontal axis; the percent of sample is found on the vertical axis.

Fiscal Adjustment and Possible Growth Paths 1/

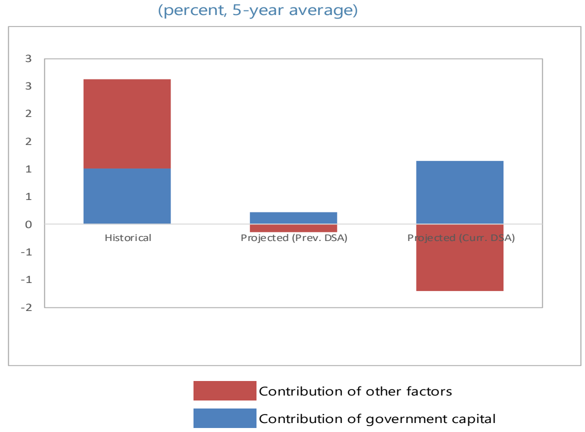


1/ Bars refer to annual projected fiscal adjustment (right-hand side scale) and lines show possible real GDP growth paths under different fiscal multipliers (left-hand side scale).

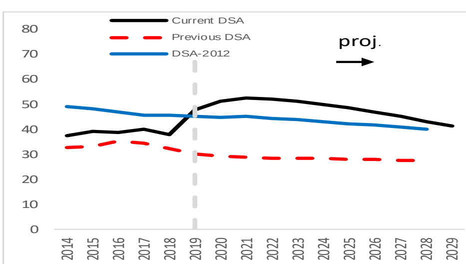
Public and Private Investment Rates
(percent of GDP)



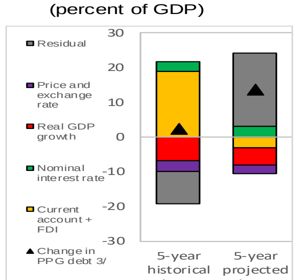
Contribution to Real GDP growth
(percent, 5-year average)



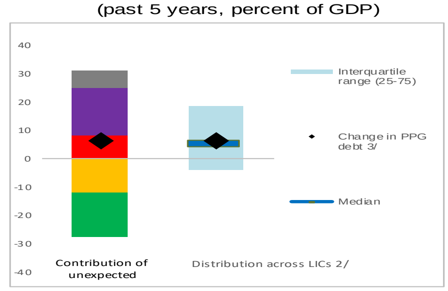
Gross Nominal PPG External Debt
(in percent of GDP; DSA vintages)



Debt-creating flows
(percent of GDP)

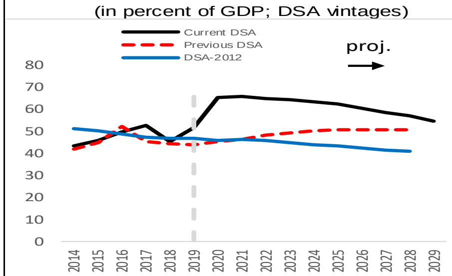


Unexpected Changes in Debt 1/
(past 5 years, percent of GDP)

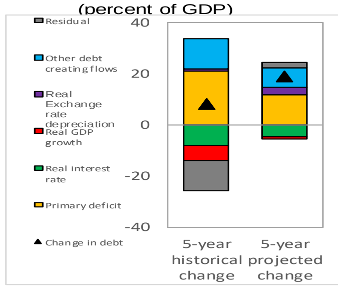


Public debt

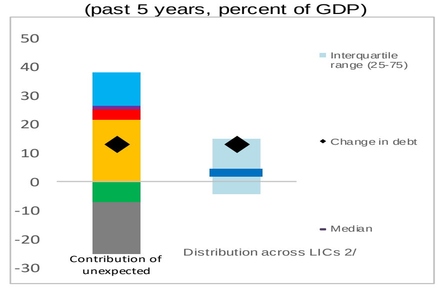
Gross Nominal Public Debt
(in percent of GDP; DSA vintages)



Debt-creating flows
(percent of GDP)



Unexpected Changes in Debt 1/
(past 5 years, percent of GDP)



1/ Difference between anticipated and actual contributions on debt ratios.
2/ Distribution across LICs for which LIC DSAs were produced.
3/ Given the relatively low private external debt for average low-income countries, a ppt change in PPG external debt should be largely explained by the drivers of the external debt dynamics equation.

11. **Zimbabwe has protracted arrears on external debt, which has cut off access to official financing.** The authorities have expressed a renewed commitment to reengagement with the international community, beginning with the clearance of arrears at the World Bank, African Development Bank, and European Investment Bank. With the authorities unable to finance arrears clearance, the timing and scope of repayment is still uncertain, and the results of this DSA could change significantly depending on the modalities and timing of arrears clearance. Technically, arrears can be cleared using a (commercial or concessional) loan, grants, or internal resources of the IFIs (facilitated via a bridge loan). There is currently no consensus on an agreed path forward as there is a multiplicity of views from the international community on how to restore debt sustainability and what would be the requisite actions for a comprehensive treatment of Zimbabwe's debt. The most practical starting point would be a comprehensive debt reconciliation exercise and a creditor agreement on clearing arrears at the IFIs. Given Zimbabwe's large external arrears there is a need to develop, and reach broad consensus on, affordable solutions to Zimbabwe's arrears.

B. Determination of Scenario Stress Tests

12. **The standard contingent liability stress test is calibrated to account for debt coverage weaknesses** (Text Table 5). To reflect the incomplete coverage of SOE debt, the default shock of 2 percent of GDP is modified to 5 percent. Potential liabilities from the domestic banking system, including those related to recent RBZ measures to support domestic credit, are captured by the standard 5 percent of GDP financial market shock. Given that the latest World Bank estimate of the public private partnership (PPP) capital stock is less than 3 percent, no PPP shock is applied. Finally, a further 10 percent shock is added to reflect the elevated risk of additional private sector bailouts.

Text Table 5: Calibration of the Standard Contingent Liability Shock

1	**The country's coverage of public debt**	The central government, central bank, government-guaranteed debt, non-guaranteed SOE debt			
		Default		**Used for the analysis**	**Reasons for deviations from the default settings**
2	Other elements of the general government not captured in 1.	0	percent of GDP	10.0	risks of additional private sector bailout are high
3	SoE's debt (guaranteed and not guaranteed by the government) 1/	2	percent of GDP	5.0	history of bailouts for SOEs in financial distress
4	PPP	35	percent of PPP stock	0.0	PPP not a risk factor in Zimbabwe
5	Financial market (the default value of 5 percent of GDP is the minimum value)	5	percent of GDP	5.0	In addition to 'legacy' debts discussed and shocked elsewhere
	Total (2+3+4+5) (in percent of GDP)			20.0	

13. **However, the main risk to Zimbabwe's debt stems from additional contingent liabilities relating to a compensation agreement for displaced farmers and additional fiscal costs from RBZ debt assumption and quasi-fiscal activities, for which staff have prepared a customized scenario (**Text Table 6)**.** The authorities have a large contingent liability to previous farmers in Zimbabwe who had their assets expropriated during the land reform process. For purely illustrative purposes, staff has simulated the effects of an agreement on farmers compensation and additional costs related to the absorption of 'legacy debts' (including relating to the currency reform) on the country's debt dynamics. The scenario assumes: (i) an agreement is reached with the new debt crystalizing in 2020; (ii) valuation is in the middle-ranges of ongoing discussions between the authorities and claimants (e.g. US$6.25 billion in total; and (iii) the financing of the debt will be on

commercial-like terms (e.g. 5 percent interest, 1 year grace, 10 year maturity). The result is a jump in the PV of debt in 2020 of approximately 30 percent of GDP, further aggravating the debt overhang.

Text Table 6: Contingent Liability Shock
Farmers Compensation and Legacy Debts Absorption 2018-2029[1/]
(In percent of GDP)

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
			shock year									
Public Sector Debt	45.3	51.8	101.6	99.6	98.3	97.2	95.7	94.1	91.7	89.3	87.0	83.8
of which: foreign-currency denominated	37.8	47.6	64.4	65.9	65.9	65.1	63.8	62.8	61.2	59.4	57.5	55.6
PV of public debt-to-GDP ratio 2/	43.7	49.0	98.1	95.6	94.2	93.2	91.8	90.4	88.3	86.1	84.0	81.0

1/Sources: Country authorities; and staff estimates and projections.
2/ The magnitude of shocks used for the commodity price shock stress test are based on the commodity prices outlook prepared by the IMF research department.

DEBT SUSTAINABILITY AND RISK RATING

A. External Debt Sustainability Analysis

14. **Zimbabwe's public and publicly-guaranteed external debt burden indicators are high, and the external debt overhang is massive.** Under the baseline scenario, external public and publicly-guaranteed (PPG) debt indicators breach the policy-relevant thresholds over the relevant forecast period under the baseline and the stress tests (Figure 2). The PV of external debt-to-GDP ratio is above the 30 percent threshold for the entire projection horizon under the baseline and the stress tests; a similar result holds for the PV of debt-to-exports with a threshold of 140 percent and the debt service-to-revenue ratio. The stress tests with the most severe impacts are the combination shock (for the PV of external debt-to-GDP), the exports shock (for the PV of external debt-to-exports and debt service-to-exports) and the commodity price shock (for debt service to revenue).

15. **Risks to external debt are heightened further by the lack of foreign exchange and the weak external position.** The increase in the stock of external debt has been modest not because of a lower financing need but owing to Zimbabwe's almost non-existent access to financing. Weak export competitiveness, the withdrawal of foreign investment, and FX precautionary hoarding have further hampered the country's debt service capability.

16. **These results suggest that absent stronger growth, monetary policy normalization, access to concessional financing, and some form of debt relief, Zimbabwe has little chance of escaping its debt trap**. While the authorities have announced their intention to redouble efforts to find an agreeable debt restructuring plan with Zimbabwe's external creditors, beginning with the clearance of arrears at the IFIs, the timelines and modalities of such a process remain undetermined.

17. **These outturns, together with the existence of substantial external arrears, support the determination that Zimbabwe is in external debt distress**.

B. Public Sector Debt Sustainability Analysis

18. **Driven by government's rising spending—especially quasi-fiscal activities of the RBZ to support agriculture and other activities—the stock of domestic debt increased since the last DSA, but the recent very high inflation has radically reduced its real value.** Domestic debt has fallen in real terms because of currency conversion and the lack of ability of banks to absorb new sovereign debts. Previous recapitalization and debt assumptions of the SOEs, subsidies to agriculture, and expansion in RBZ obligations have pushed public debt to well beyond the indicative threshold of 35 percent of GDP (PV terms) under both the baseline and the stress tests. Even with fiscal consolidation, the amount of public debt will carry a heavy burden on the Government of Zimbabwe.

19. **Domestic debt obligations, external arrears, and large contingent liabilities support the assessment that the Zimbabwean government is in debt distress**.

RESTORING DEBT SUSTAINABILITY

20. **Restoring debt sustainability will require a combination of fiscal adjustment and a comprehensive debt restructuring plan with appropriate burden sharing**. Text Table 7 shows the distance between relevant fragility ratios to threshold values for determining that a country has a 'weak debt-carrying capacity'. These estimates become even larger if considering possible over-estimation of GDP or compensation to the farmers whose assets were expropriated.

21. **Zimbabwe also currently carries a sizeable domestic debt load, a legacy from financing previous years' deficits almost entirely from domestic sources.** Text Table 7 also provides the difference between Zimbabwe's end-2018 public debt stock and the applicable threshold given the CI assessment.

Text Table 7. Zimbabwe: End-2019 Projected Debt and DSA Thresholds

Indicator	(1) Applicable LIC-DSA Thresholds: Weak	(2) Zim. end-2019	Distance above applicable DSF threshold (2) - (1)
PV of debt in % of			
Exports	140	201	61
GDP	30	45	15
Debt service in % of			
Exports	10	12	2
Revenue	14	33	19
Public Debt Benchmark	38	51	13

CONCLUSION

22. **Zimbabwe is in debt distress.** The external debt burden is excessive and the country is incuring arrears. While the real value of domestic debt has fallen significantly given the high inflation, contingent liabilities (related to a compensation agreement for displaced farmers and additional

fiscal costs from debt assumptions for losses following the currency conversion) could sharply increase domestic debt, further aggravating the debt overhang.

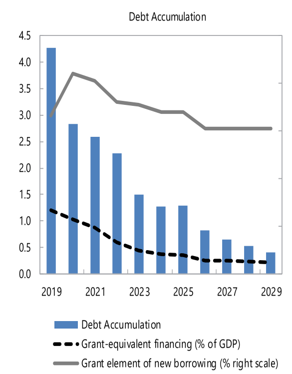
23. **Steady implementation of the reform strategy outlined in the TSP is critical for Zimbabwe to emerge from its current difficulties.** Prudent fiscal and monetary polices are necessary, as are bold structural reforms to restore growth and attract investment. Furthermore, external support and debt relief from the international community must be part of the strategy. Supported by a robust reform program, the envisaged reengagement process could bear fruit and restore growth and sustainability.

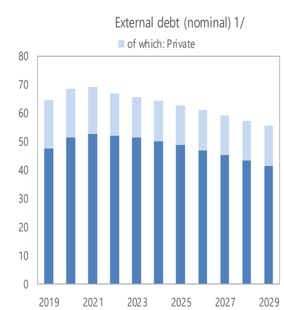
Table 1. Zimbabwe: External Debt Sustainability Framework, Baseline Scenario, 2016–39

(In percent of GDP, unless otherwise indicated)

	Actual			Projections								Average 8/	
	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029	2039	Historical	Projections
External debt (nominal) 1/	56.1	55.8	53.0	64.5	68.5	69.1	66.7	65.6	64.2	55.5	39.4	53.3	63.1
of which: public and publicly guaranteed (PPG)	38.9	40.1	37.8	47.6	51.5	52.7	52.1	51.5	50.1	41.5	25.4	41.5	48.3
Change in external debt	-1.0	-0.2	-2.8	11.5	4.0	0.7	-2.4	-1.1	-1.5	-1.9	-1.4		
Identified net debt-creating flows	0.5	-3.4	2.3	-1.3	-0.6	-1.4	-1.4	-0.2	-0.2	-0.4	1.0	2.6	-0.7
Non-interest current account deficit	2.8	0.7	5.0	-1.2	0.4	0.7	0.6	1.6	1.5	1.2	1.5	8.6	0.9
Deficit in balance of goods and services	11.5	8.3	10.1	4.0	5.7	6.1	5.7	6.7	6.4	6.1	6.1	19.3	5.9
Exports	19.8	21.5	23.1	22.4	24.5	24.4	24.1	24.5	24.6	24.6	24.6		
Imports	31.3	29.7	33.2	26.3	30.2	30.5	29.8	31.2	31.0	30.7	30.7		
Net current transfers (negative = inflow)	-9.5	-8.7	-8.4	-9.2	-9.1	-8.7	-8.1	-7.6	-7.2	-6.3	0.0	-11.0	-7.5
of which: official	-3.7	-3.2	-3.1	-3.4	-3.6	-3.5	-3.4	-3.4	-3.3	-3.0	0.0		
Other current account flows (negative = net inflow)	0.8	1.2	3.3	4.1	3.8	3.3	3.1	2.4	2.3	1.5	-4.6	0.3	2.5
Net FDI (negative = inflow)	-1.3	-0.9	-0.9	-1.0	-1.1	-1.1	-1.1	-1.1	-1.1	-1.1	0.0	-1.6	-1.1
Endogenous debt dynamics 2/	-1.0	-3.2	-1.8	0.9	0.0	-1.0	-0.9	-0.6	-0.6	-0.6	-0.5		
Contribution from nominal interest rate	0.7	0.6	0.4	0.4	0.5	0.7	0.7	0.7	0.7	0.6	0.3		
Contribution from real GDP growth	-0.4	-2.5	-1.9	0.5	-0.5	-1.7	-1.6	-1.4	-1.3	-1.2	-0.8		
Contribution from price and exchange rate changes	-1.2	-1.3	-0.3	...	...	...	...	...	...	...	...		
Residual 3/	-1.5	3.2	-5.1	12.8	4.6	2.0	-1.0	-0.9	-1.2	-1.4	-2.4	-3.8	0.9
of which: exceptional financing	-0.7	-0.6	-0.6	-0.7	-0.7	-0.7	-0.5	-0.5	-0.5	-0.4	0.0		
Sustainability indicators													
PV of PPG external debt-to-GDP ratio	...	...	36.2	44.9	48.0	48.8	48.2	47.6	46.4	38.9	24.3		
PV of PPG external debt-to-exports ratio	...	...	156.7	200.6	196.1	199.7	200.1	194.7	188.7	158.3	98.8		
PPG debt service-to-exports ratio	48.6	41.4	12.4	12.2	10.3	10.4	9.0	9.1	8.7	8.3	5.9		
PPG debt service-to-revenue ratio	59.2	63.5	33.0	22.9	22.3	23.8	20.5	20.9	20.5	19.5	13.9		
Gross external financing need (Million of U.S. dollars)	2388.5	2037.1	3190.2	1699.0	1950.5	2026.6	1871.9	1736.2	1574.2	1430.2	1299.3		
Key macroeconomic assumptions													
Real GDP growth (in percent)	0.7	4.7	3.5	-8.3	0.8	2.5	2.5	2.2	2.2	2.2	2.2	11.5	1.2
GDP deflator in US dollar terms (change in percent)	2.2	2.4	0.6	-1.6	-1.5	1.2	3.3	2.1	3.2	3.0	3.0	5.5	2.0
Effective interest rate (percent) 4/	1.2	1.1	0.7	0.7	0.8	1.0	1.1	1.1	1.1	1.1	0.9	1.3	1.0
Growth of exports of G&S (US dollar terms, in percent)	1.5	16.6	12.1	-12.6	8.7	3.5	4.5	6.0	6.0	5.2	5.2	14.1	3.9
Growth of imports of G&S (US dollar terms, in percent)	-14.4	2.0	16.2	-28.4	14.0	4.7	3.4	9.3	4.9	5.2	5.2	12.1	3.0
Grant element of new public sector borrowing (in percent)	...	...	...	16.6	21.0	20.3	18.0	17.7	17.0	15.3	15.3	...	17.1
Government revenues (excluding grants, in percent of GDP)	16.2	14.0	8.7	11.9	11.3	10.7	10.6	10.7	10.4	10.4	10.4	16.6	10.7
Aid flows (in Million of US dollars) 5/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Grant-equivalent financing (in percent of GDP) 6/	...	...	...	1.2	1.0	0.9	0.6	0.4	0.4	0.2	0.1	...	0.5
Grant-equivalent financing (in percent of external financing) 6/	...	...	...	16.6	21.0	20.3	18.0	17.7	17.0	15.3	15.3	...	17.1
Nominal GDP (Million of US dollars)	20,549	22,041	22,946	20,703	20,563	21,339	22,607	23,588	24,876	32,183	53,556		
Nominal dollar GDP growth	2.9	7.3	4.1	-9.8	-0.7	3.8	5.9	4.3	5.5	5.2	5.2	18.5	3.2
Memorandum items:													
PV of external debt 7/	...	...	51.5	61.8	65.0	65.3	62.8	61.8	60.5	52.9	38.3		
In percent of exports	...	...	222.6	275.9	265.4	267.1	260.6	252.5	245.9	215.3	155.5		
Total external debt service-to-exports ratio	51.2	43.9	42.5	46.5	41.3	40.3	36.3	28.2	24.2	17.4	3.8		
PV of PPG external debt (in Million of US dollars)			8313.2	9294.7	9880.1	10411.9	10899.7	11239.4	11541.3	12532.9	13013.1		
(PVt-PVt-1)/GDPt-1 (in percent)				4.3	2.8	2.6	2.3	1.5	1.3	0.4	0.0		
Non-interest current account deficit that stabilizes debt ratio	3.8	0.9	7.8	-12.6	-3.5	0.1	3.0	2.6	2.9	3.1	2.9		

Definition of external/domestic debt	Residency-based
Is there a material difference between the two criteria?	Yes





Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as [r - g - ρ(1+g) + Ɛα (1+r)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, ρ = growth rate of GDP deflator in U.S. dollar terms, Ɛ=nominal appreciation of the local currency, and α= share of local currency-denominated external debt in total external debt.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

4/ Current-year interest payments divided by previous period debt stock.

5/ Defined as grants, concessional loans, and debt relief.

6/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

7/ Assumes that PV of private sector debt is equivalent to its face value.

8/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

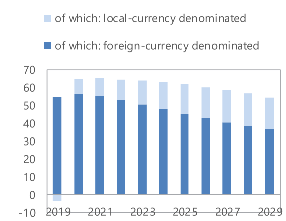
Table 2. Zimbabwe: Public Sector Debt Sustainability Framework, Baseline Scenario, 2016–39

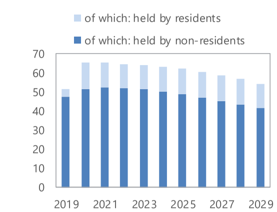
(In percent of GDP, unless otherwise indicated)

	Actual			Projections								Average 6/	
	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029	2039	Historical	Projections
Public sector debt 1/	49.7	52.5	45.3	51.8	65.3	65.6	64.6	64.3	63.2	54.4	33.5	46.1	60.7
of which: external debt	38.9	40.1	37.8	47.6	51.5	52.7	52.1	51.5	50.1	41.5	25.4	41.5	48.3
Change in public sector debt	3.8	2.8	-7.2	6.5	13.5	0.3	-1.0	-0.3	-1.1	-2.5	-1.8		
Identified debt-creating flows	8.4	9.1	-2.4	6.3	12.3	-0.1	-1.2	-0.4	-1.1	-2.4	-1.5	-0.5	0.7
Primary deficit	6.0	9.1	4.0	4.6	3.0	2.0	1.2	0.9	0.8	-1.0	-0.8	2.3	1.1
Revenue and grants	16.2	14.0	8.7	11.9	11.3	10.7	10.6	10.7	10.4	10.4	10.4	16.6	10.7
of which: grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Primary (noninterest) expenditure	22.3	23.2	12.7	16.5	14.3	12.7	11.7	11.6	11.3	9.4	9.6	18.9	11.8
Automatic debt dynamics	-0.6	-4.0	-8.2	1.1	2.5	-2.3	-2.5	-1.4	-2.0	-1.4	-0.7		
Contribution from interest rate/growth differential	-0.2	-3.8	-8.9	-0.5	0.6	-2.7	-1.8	-1.3	-1.4	-1.0	-0.5		
of which: contribution from average real interest rate	0.2	-1.6	-7.1	-4.6	1.0	-1.1	-0.2	0.1	0.0	0.2	0.3		
of which: contribution from real GDP growth	-0.3	-2.2	-1.8	4.1	-0.4	-1.6	-1.6	-1.4	-1.4	-1.2	-0.7		
Contribution from real exchange rate depreciation	-0.4	-0.2	0.7	...	...	...	...	...	...	...	...		
Other identified debt-creating flows	3.0	3.9	1.8	0.6	6.8	0.1	0.1	0.1	0.1	0.1	0.0	1.2	0.7
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Recognition of contingent liabilities (e.g., bank recapitalization)	2.2	0.6	0.7	0.0	6.7	0.0	0.0	0.0	0.0	0.0	0.0		
Debt relief (HIPC and other)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Other debt creating or reducing flow (please specify)	0.9	3.3	1.1	0.6	0.1	0.1	0.1	0.1	0.1	0.1	0.0		
Residual	-4.6	-6.3	-4.8	1.8	3.2	0.9	-0.5	0.0	-0.6	-0.5	-0.5	-1.0	0.2
Sustainability indicators													
PV of public debt-to-GDP ratio 2/	...	...	43.7	49.0	61.8	61.8	60.7	60.4	59.5	51.9	32.4		
PV of public debt-to-revenue and grants ratio	...	...	502.4	411.0	547.0	579.7	572.5	566.3	570.1	496.7	310.2		
Debt service-to-revenue and grants ratio 3/	34.2	36.2	62.5	34.8	23.8	100.5	70.8	71.6	75.0	78.4	34.7		
Gross financing need 4/	14.6	18.2	11.2	9.3	12.5	12.9	8.8	8.6	8.7	7.2	2.8		
Key macroeconomic and fiscal assumptions													
Real GDP growth (in percent)	0.7	4.7	3.5	-8.3	0.8	2.5	2.5	2.2	2.2	2.2	2.2	11.5	1.2
Average nominal interest rate on external debt (in percent)	1.6	1.5	1.0	0.8	1.0	1.2	1.3	1.4	1.3	1.3	1.2	1.6	1.2
Average real interest rate on domestic debt (in percent)	-1.0	-13.9	-54.7	-64.6	-48.4	-7.8	2.1	3.4	2.3	2.5	3.2	-8.2	-9.2
Real exchange rate depreciation (in percent, + indicates depreciation)	-1.1	-0.5	1.8	...	...	...	...	...	...	...	...	-1.1	...
Inflation rate (GDP deflator, in percent)	7.3	22.3	120.7	204.9	148.1	16.4	4.9	3.7	4.8	4.5	4.5	20.0	36.9
Growth of real primary spending (deflated by GDP deflator, in percent)	11.0	8.9	-43.2	19.0	-12.7	-8.9	-5.1	0.8	-0.8	-6.6	2.3	65.0	-1.3
Primary deficit that stabilizes the debt-to-GDP ratio 5/	2.2	6.4	11.2	-1.9	-10.6	1.7	2.2	1.2	1.9	1.5	0.9	6.6	0.3
PV of contingent liabilities (not included in public sector debt)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		

Definition of external/domestic debt	**Residency-based**
Is there a material difference between the two criteria?	**Yes**

Public sector debt 1/





Sources: Country authorities; and staff estimates and projections.

1/ Coverage of debt: The central government, central bank, government-guaranteed debt, non-guaranteed SOE debt . Definition of external debt is Residency-based.

2/ The underlying PV of external debt-to-GDP ratio under the public DSA differs from the external DSA with the size of differences depending on exchange rates projections.

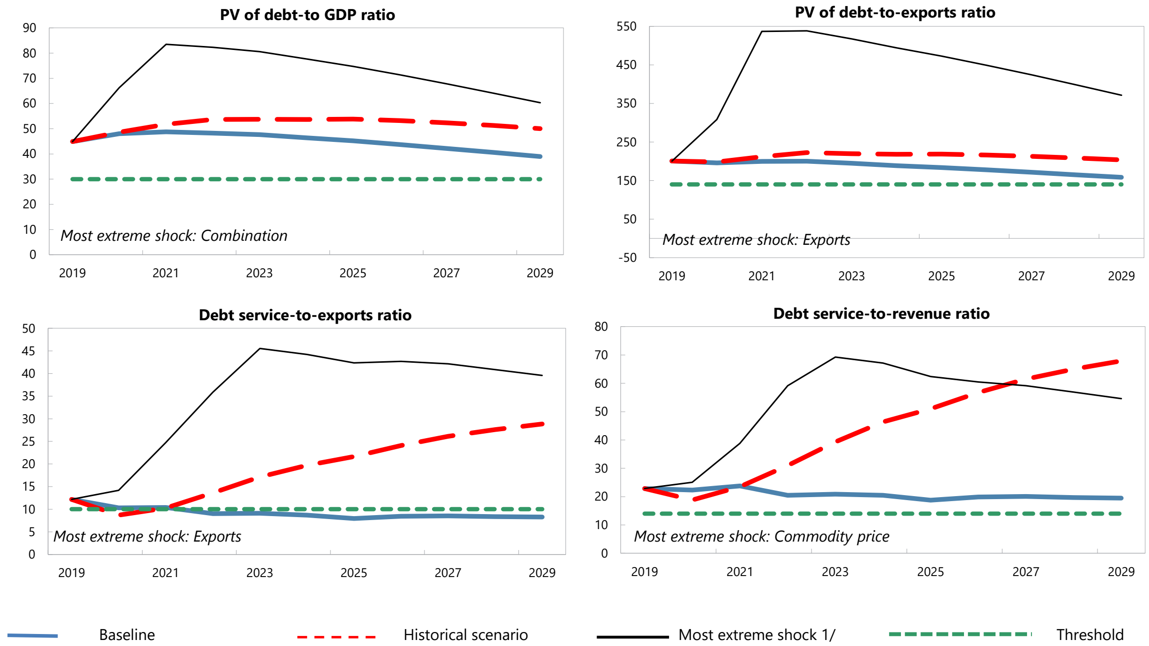
3/ Debt service is defined as the sum of interest and amortization of medium and long-term, and short-term debt.

4/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period and other debt creating/reducing flows.

5/ Defined as a primary deficit minus a change in the public debt-to-GDP ratio ((-): a primary surplus), which would stabilizes the debt ratio only in the year in question.

6/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

Figure 2. Zimbabwe: Indicators of Public and Publicly Guaranteed External Debt under Alternative Scenarios, 2019–29[1/,2/]



Customization of Default Settings	Size	Interactions
Tailored Stress		
Combined CL	Yes	
Natural disaster	n.a.	n.a.
Commodity price	No	No
Market financing	n.a.	n.a.

Note: "Yes" indicates any change to the size or interactions of the default settings for the stress tests. "n.a." indicates that the stress test does not apply.

Borrowing assumptions on additional financing needs resulting from the stress tests*	Default	User defined
Shares of marginal debt		
External PPG MLT debt	100%	
Terms of marginal debt		
Avg. nominal interest rate on new borrowing in USD	6.0%	9.0%
USD Discount rate	5.0%	5.0%
Avg. maturity (incl. grace period)	10	10
Avg. grace period	1	1

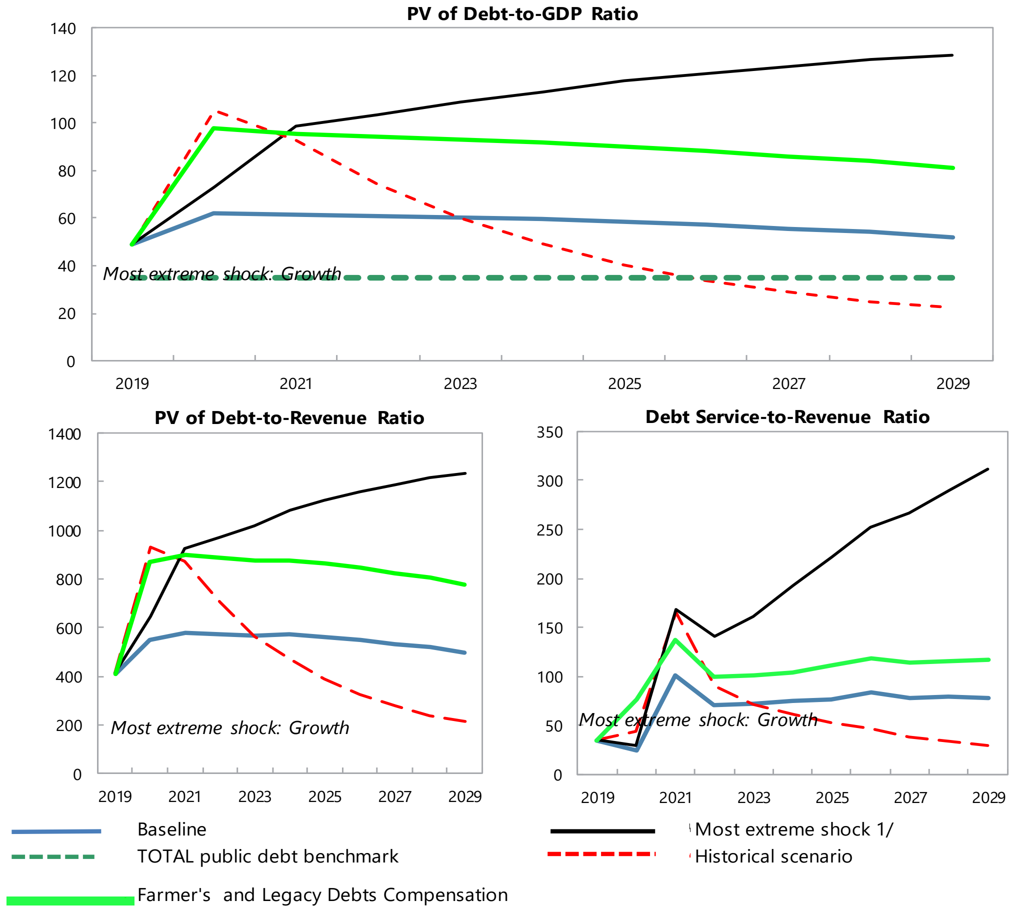
* Note: All the additional financing needs generated by the shocks under the stress tests are assumed to be covered by PPG external MLT debt in the external DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2029. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

2/ The magnitude of shocks used for the commodity price shock stress test are based on the commodity prices outlook prepared by the IMF research department.

Figure 3. Zimbabwe: Indicators of Public External Debt under Alternative Scenarios, 2018–28



Borrowing assumptions on additional financing needs resulting from the stress tests*	Default	User defined
Shares of marginal debt		
External PPG medium and long-term	33%	5%
Domestic medium and long-term	57%	80%
Domestic short-term	9%	15%
Terms of marginal debt		
External MLT debt		
Avg. nominal interest rate on new borrowing in USD	6.0%	9.0%
Avg. maturity (incl. grace period)	10	10
Avg. grace period	1	1
Domestic MLT debt		
Avg. real interest rate on new borrowing	-29.9%	1.0%
Avg. maturity (incl. grace period)	4	4
Avg. grace period	0	0
Domestic short-term debt		
Avg. real interest rate	-32.4%	1.0%

* Note: The public DSA allows for domestic financing to cover the additional financing needs generated by the shocks under the stress tests in the public DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2029. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

Table 3. Zimbabwe: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2019-29

(In percent)

	Projections 1/										
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
PV of debt-to GDP ratio											
Baseline	**45**	**48**	**49**	**48**	**48**	**46**	**45**	**44**	**42**	**41**	**39**
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2029 2/	**45**	**49**	**52**	**54**	**54**	**54**	**54**	**53**	**52**	**51**	**50**
B. Bound Tests											
B1. Real GDP growth	**45**	**62**	**81**	**80**	**79**	**77**	**75**	**72**	**70**	**67**	**65**
B2. Primary balance	**45**	**48**	**49**	**49**	**48**	**47**	**46**	**44**	**43**	**41**	**40**
B3. Exports	**45**	**57**	**73**	**72**	**71**	**68**	**65**	**62**	**58**	**55**	**51**
B4. Other flows 3/	**45**	**51**	**54**	**53**	**53**	**51**	**49**	**47**	**45**	**43**	**41**
B5. Depreciation	**45**	**48**	**48**	**48**	**47**	**46**	**45**	**43**	**42**	**40**	**39**
B6. Combination of B1-B5	**45**	**66**	**83**	**82**	**81**	**78**	**75**	**71**	**68**	**64**	**60**
C. Tailored Tests											
C1. Combined contingent liabilities	**45**	**49**	**50**	**50**	**50**	**49**	**48**	**47**	**45**	**44**	**42**
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	**45**	**61**	**74**	**73**	**71**	**68**	**65**	**61**	**57**	**53**	**49**
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	30	30	30	30	30	30	30	30	30	30	30
PV of debt-to-exports ratio											
Baseline	**201**	**196**	**200**	**200**	**195**	**189**	**184**	**178**	**171**	**165**	**158**
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2029 2/	**201**	**198**	**212**	**223**	**220**	**218**	**219**	**216**	**213**	**209**	**203**
B. Bound Tests											
B1. Real GDP growth	**201**	**196**	**200**	**200**	**195**	**189**	**184**	**178**	**171**	**165**	**158**
B2. Primary balance	**201**	**197**	**201**	**202**	**197**	**191**	**186**	**181**	**174**	**168**	**161**
B3. Exports	**201**	**308**	**537**	**539**	**518**	**494**	**473**	**449**	**424**	**398**	**371**
B4. Other flows 3/	**201**	**207**	**222**	**222**	**215**	**207**	**201**	**193**	**185**	**176**	**167**
B5. Depreciation	**201**	**196**	**200**	**200**	**195**	**189**	**184**	**178**	**171**	**165**	**158**
B6. Combination of B1-B5	**201**	**257**	**248**	**336**	**324**	**311**	**299**	**286**	**271**	**257**	**241**
C. Tailored Tests											
C1. Combined contingent liabilities	**201**	**200**	**205**	**207**	**203**	**198**	**194**	**189**	**184**	**179**	**173**
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	**201**	**506**	**523**	**460**	**389**	**332**	**287**	**271**	**254**	**236**	**218**
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	140	140	140	140	140	140	140	140	140	140	140
Debt service-to-exports ratio											
Baseline	**12**	**10**	**10**	9	9	9	8	8	9	8	8
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2029 2/	**12**	9	**10**	**14**	**17**	**20**	**22**	**24**	**26**	**28**	**29**
B. Bound Tests											
B1. Real GDP growth	**12**	**10**	**10**	9	9	9	8	8	9	8	8
B2. Primary balance	**12**	**10**	**10**	9	9	9	8	9	9	9	9
B3. Exports	**12**	**14**	**25**	**36**	**46**	**44**	**42**	**43**	**42**	**41**	**40**
B4. Other flows 3/	**12**	**10**	**11**	**12**	**13**	**13**	**12**	**12**	**12**	**12**	**12**
B5. Depreciation	**12**	**10**	**10**	**20**	**23**	**23**	**21**	**22**	**22**	**21**	**20**
B6. Combination of B1-B5	**12**	**12**	**17**	**21**	**24**	**24**	**22**	**23**	**23**	**22**	**21**
C. Tailored Tests											
C1. Combined contingent liabilities	**12**	**10**	**11**	10	10	9	9	9	10	9	9
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	**12**	**21**	**26**	**35**	**37**	**32**	**28**	**28**	**27**	**26**	**25**
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	10	10	10	10	10	10	10	10	10	10	10
Debt service-to-revenue ratio											
Baseline	**23**	**22**	**24**	**20**	**21**	**20**	**19**	**20**	**20**	**20**	**19**
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2029 2/	**23**	**19**	**24**	**31**	**39**	**46**	**51**	**57**	**61**	**65**	**68**
B. Bound Tests											
B1. Real GDP growth	**23**	**29**	**39**	**34**	**35**	**34**	**31**	**33**	**33**	**33**	**32**
B2. Primary balance	**23**	**22**	**24**	**21**	**22**	**21**	**20**	**21**	**21**	**21**	**21**
B3. Exports	**23**	**23**	**32**	**45**	**58**	**58**	**56**	**56**	**55**	**54**	**52**
B4. Other flows 3/	**23**	**22**	**26**	**27**	**30**	**30**	**28**	**29**	**29**	**28**	**27**
B5. Depreciation	**23**	**22**	**39**	**48**	**56**	**56**	**53**	**54**	**53**	**52**	**50**
B6. Combination of B1-B5	**23**	**27**	**40**	**50**	**57**	**57**	**54**	**55**	**54**	**53**	**51**
C. Tailored Tests											
C1. Combined contingent liabilities	**23**	**22**	**25**	**22**	**22**	**22**	**21**	**22**	**22**	**22**	**22**
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	**23**	**25**	**39**	**59**	**69**	**67**	**62**	**60**	**59**	**57**	**55**
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	14	14	14	14	14	14	14	14	14	14	14

Sources: Country authorities; and staff estimates and projections.
1/ A bold value indicates a breach of the threshold.
2/ Variables include real GDP growth, GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
3/ Includes official and private transfers and FDI.

Table 4. Zimbabwe: Sensitivity Analysis for Key Indicators of Public Debt, 2019-2029
(In percent)

						Projections 1/					
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	202
						PV of Debt-to-GDP Ratio					
Baseline	**49**	**62**	**62**	**61**	**60**	**60**	**59**	**57**	**56**	**54**	**5**
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2029 2/	**49**	**105**	**93**	**74**	**60**	**49**	**41**	34	29	25	2
Farmer's and Legacy Debts Compensation	**49**	**98**	**96**	**94**	**93**	**92**	**90**	**88**	**86**	**84**	**8**
B. Bound Tests											
B1. Real GDP growth	**49**	**73**	**99**	**103**	**109**	**113**	**118**	**121**	**124**	**127**	**12**
B2. Primary balance	**49**	**61**	**65**	**64**	**64**	**63**	**62**	**61**	**59**	**58**	**5**
B3. Exports	**49**	**69**	**81**	**79**	**78**	**76**	**74**	**70**	**67**	**64**	**6**
B4. Other flows 3/	**49**	**64**	**67**	**66**	**65**	**64**	**63**	**61**	**59**	**57**	**5**
B5. Depreciation	**49**	19	**54**	**49**	**45**	**40**	**36**	31	26	21	1
B6. Combination of B1-B5	**49**	**59**	**63**	**62**	**62**	**61**	**60**	**58**	**57**	**55**	**5**
C. Tailored Tests											
C1. Combined contingent liabilities	**49**	**78**	**78**	**77**	**77**	**76**	**75**	**74**	**72**	**70**	**6**
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.
C3. Commodity price	**49**	**65**	**44**	33	29	28	31	**36**	**41**	**46**	**5**
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.
TOTAL public debt benchmark	35	35	35	35	35	35	35	35	35	35	3
						PV of Debt-to-Revenue Ratio					
Baseline	411	547	580	572	566	570	562	548	533	519	49
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2029 2/	411	933	873	703	564	470	388	325	277	240	21
Farmer's and Legacy Debts Compensation	35	77	138	99	101	105	111	118	114	116	11
B. Bound Tests											
B1. Real GDP growth	411	648	927	975	1,021	1,085	1,127	1,157	1,186	1,216	1,23
B2. Primary balance	411	542	606	602	597	603	596	581	566	552	52
B3. Exports	411	607	757	750	732	727	704	675	645	614	57
B4. Other flows 3/	411	570	630	622	613	614	601	583	564	545	51
B5. Depreciation	411	171	504	463	422	386	343	294	247	202	15
B6. Combination of B1-B5	411	519	592	580	576	581	574	559	544	528	50
C. Tailored Tests											
C1. Combined contingent liabilities	411	691	732	727	720	728	720	705	689	674	65
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a
C3. Commodity price	411	643	466	353	297	287	303	344	394	442	47
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a
						Debt Service-to-Revenue Ratio					
Baseline	35	24	101	71	72	75	77	84	78	79	7
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2029 2/	35	45	165	90	72	61	52	47	38	34	3
Farmer's and Legacy Debts Compensation	35	77	138	99	101	105	111	118	114	116	11
B. Bound Tests											
B1. Real GDP growth	35	29	168	141	162	193	221	253	266	290	31
B2. Primary balance	35	24	114	93	94	102	104	109	103	104	10
B3. Exports	35	24	106	92	105	108	110	116	109	109	10
B4. Other flows 3/	35	24	103	78	81	84	86	93	87	87	8
B5. Depreciation	35	35	36	25	26	27	27	30	28	28	2
B6. Combination of B1-B5	35	23	106	75	76	79	82	89	82	83	8
C. Tailored Tests											
C1. Combined contingent liabilities	35	24	182	138	144	162	153	157	151	152	14
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a
C3. Commodity price	35	28	66	38	46	57	72	100	123	147	17
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a

Sources: Country authorities; and staff estimates and projections.
1/ A bold value indicates a breach of the benchmark.
2/ Variables include real GDP growth, GDP deflator and primary deficit in percent of GDP.
3/ Includes official and private transfers and FDI.

INTERNATIONAL MONETARY FUND

ZIMBABWE

SELECTED ISSUES

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Approved By
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Prepared by a team led by Gene Leon and with individual chapters authored by Niko Hobdari, Trevor Lessard, and Frederico Lima

CONTENTS

ELUSIVE QUEST FOR MACRO STABILITY IN ZIMBABWE[1]

In February 2019, Zimbabwe introduced an interbank market FX where domestic quasi-currency instruments (bank deposits and bond notes) could be traded against the U.S. dollar at rates other than parity. This reform aimed to remove the significant distortions caused by a large and growing parallel market premium for the conversion of these domestic instruments into foreign currency. In June, the new Zimbabwean dollar was introduced as the sole legal tender, effectively ending the multi-currency regime that had been in place since 2009. The new regime was to be supported by prudent fiscal policy and discontinuation of monetary financing. However, quasi-fiscal operations by the central bank continued throughout 2019. In addition, the money targeting framework that the authorities announced in February has not yet been introduced. The rapid money growth and lack of a nominal anchor have resulted in rapid exchange rate depreciation and very high inflation. Looking ahead, stabilizing the economy will require fiscal restraint and a more moderate growth of monetary aggregates. This should be supported by institutional reforms at the Reserve Bank of Zimbabwe (RBZ) and the introduction of short-term monetary instruments to better manage market liquidity conditions.

A. A Brief Monetary History of Zimbabwe

1. The monetary regime of Southern Rhodesia, the predecessor of what today is Zimbabwe, was tied to the pound sterling. After an initial period when the pound sterling had sole legal tender, the Southern Rhodesian pound was introduced in 1940, and pegged to the sterling in a currency board arrangement. This currency was then replaced by the pound of Rhodesia and Nyasaland starting in April 1956, which remained pegged to the sterling.

2. With the breakup of the Federation of Rhodesia and Nyasaland, a new Rhodesian pound was introduced in November 1964, replacing the old currency at par. The Rhodesian pound was officially pegged to gold, but de facto remained pegged to the pound sterling (Ilzetski et al., 2017). A new Rhodesian dollar was introduced in February 1970 shortly before the Republic of Rhodesia was declared. This currency replaced the Rhodesian pound at a 2:1 rate, while establishing a decimal system. The de facto peg to the pound sterling remained in place until August 1970, when the new currency was pegged to the South Africa rand instead.

3. Upon Zimbabwe's independence in 1980, the currency was renamed the Zimbabwe dollar. Officially, it was pegged to a basket of currencies, but in practice the monetary authorities targeted the US dollar (Ilzetski et al., 2017). The Zimbabwe dollar was initially above par versus the US dollar, but depreciated sharply during the 1990s and the early 2000s in the context of declining and volatile output growth, policy instability, and monetary financing of public sector deficits. As drought and the fast-track land reform program deepened the economic decline, monetary financing accelerated in the mid-2000s, eventually leading to triple-digit monthly inflation rates

[1] Prepared by Niko Hobdari and Frederico Lima (both AFR).

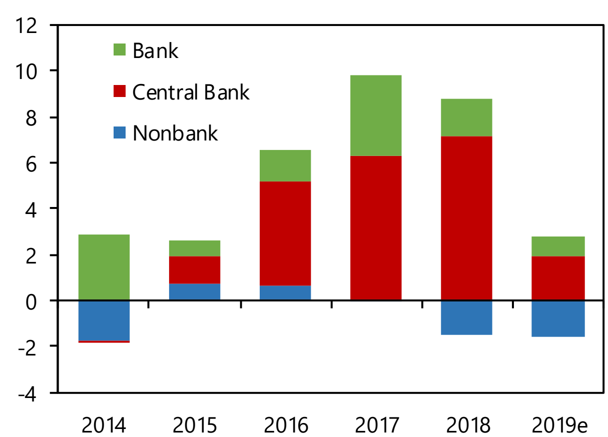
starting in early 2007, and culminating in prices doubling almost every day by November 2008 – one of the largest hyperinflations ever recorded (Hanke and Krus, 2013).

4. The hyperinflation ended in early 2009, when Zimbabwe abandoned its domestic currency and fully dollarized. As inflation spiraled out of control, the population dropped the Zimbabwean dollar and opted to conduct transactions only in foreign currency or through barter. In early 2009, the authorities officially recognized several foreign currencies as legal tender, including the US dollar, the UK pound sterling, the Euro, the Botswana pula, the South Africa rand, and the Chinese renminbi. Surrender requirements of foreign currency were formally abolished in March 2009, thus liberalizing the capital account.

5. The first few years after full dollarization were marked by economic recovery, low inflation and reengagement with the international community. Real GDP growth averaged 25 percent per year between 2009 and 2012, partially offsetting the contraction during much of the 2000s, and prices stabilized, helped by the fiscal discipline imposed by cash budgeting and a favorable external environment. However, a decline in commodity prices starting in 2013 and a steady devaluation of the rand versus the US dollar put pressure on Zimbabwe's terms-of-trade. This was compounded by erratic weather, including a severe drought during the 2015-16 season, and a return of fiscal profligacy which saw the fiscal deficit balloon starting in 2016.

6. After 2014, the authorities resumed monetary financing, supported by the creation of domestic quasi-currency instruments. Monetary financing was implemented via an RBZ overdraft and central bank purchasing of government bonds (Text Figure 1). The substantial increase in RBZ claims on the government, nominally equivalent to the US dollar but not supported by actual US dollar assets, was matched by an equal increase in system liabilities, and in particular bank deposits. Despite formally denominated in US dollars, these deposits began trading domestically at a discount versus the US dollar, and become known popularly as RTGS dollars.[2] Amid strict capital controls and deposit withdrawal restrictions, a parallel market developed to trade RTGS dollars for foreign exchange. Electronic RTGS dollars were also complemented by physical quasi-currencies, first with the introduction of bond coins in 2014, and later of bond notes in November 2016.

Text Figure 1. Zimbabwe: Domestic Financing, 2014–19
(in percent of GDP)

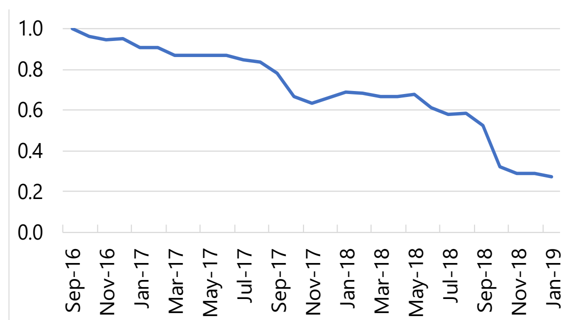


Sources: Zimbabwean authorities and IMF staff estimates.

[2] Real-Time Gross Settlement (RTGS) is a payment clearance system, used in Zimbabwe. The name came into use to separate domestic transactions from US dollar transactions between Zimbabwean and non-resident entities.

7. The growing parallel market premium for domestic quasi-currencies created severe economic distortions. Monetary financing, which peaked at 7.1 percent of GDP in 2018, led to a gradual depreciation of the RTGS dollar in the parallel market. This depreciation accelerated around multiple confidence crises, especially the one associated with the political transition in November 2017 that led to the ouster of President Mugabe, and another one in October 2018 when the authorities announced the formal separation of RTGS$ from nostro foreign currency accounts (FCAs). Having started at parity, by February 2019 these quasi-currencies were trading in the parallel market at 3.5 to 1 against the US dollar, implying a *de facto* nearly 80 percent loss in RTGS-denominated assets (Text Figure 2).
Depreciation resulted in rising inflation—which had increased from slightly negative in 2015 to nearly 60 percent in February 2019—and also significant distortions as the country was still *de jure* dollarized. For example, retail fuel prices were set administratively in US dollars, but paid by most in RTGS dollars, so that the real cost of fuel significantly declined, leading to increased smuggling to neighboring countries and a large fiscal cost. Similarly, tax liabilities and wages were often computed in US dollars, but paid in RTGS dollars, leading to a sharp decline in revenue and purchasing power.

Text Figure 2. Zimbabwe: Parallel Market Discount, 2016–19
(1 US$ per ZWL$)



Sources: Zimbabwean authorities and IMF staff estimates.

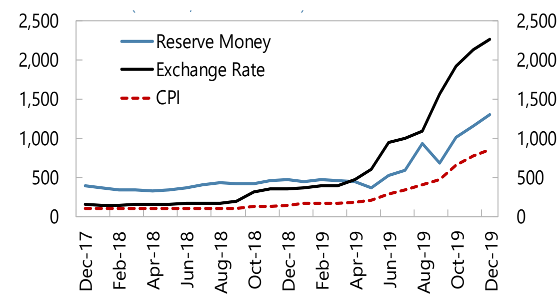
8. In February 2019, the authorities introduced a new domestic currency and an interbank foreign exchange market where it could be traded against the U.S. dollar.[3] The new domestic currency was originally named the Real Time Gross Settlement (RTGS) dollar and adopted a de jure floating exchange rate arrangement, previously a "no separate legal tender" arrangement. The RBZ denominated legally, through Statutory Instrument (SI) 33 of 2019, the existing RTGS dollar balances, bond notes and coins in circulation as RTGS dollars making them part of the multi-currency system in Zimbabwe. An inter-bank foreign exchange market was established to formalize the trading of RTGS dollar balances and bond notes with the United States Dollars and other currencies on a willing seller-willing buyer basis through banks and bureau de changes. The RTGS dollar was renamed as the Zimbabwean dollar (ZWL$) in June 2019.The reform was to be supported by prudent fiscal policy, with the 2019 budget anchored on no central financing of the deficit. The RBZ also announced it would adopt a reserve money targeting framework with base money as the nominal anchor, although it did not publicly disclose the specific base money targets and gave few details about the liquidity management framework it would use.

[3] See RBZ's Monetary Policy Statement of February 2019.

B. Developments Since the Introduction of the New Currency

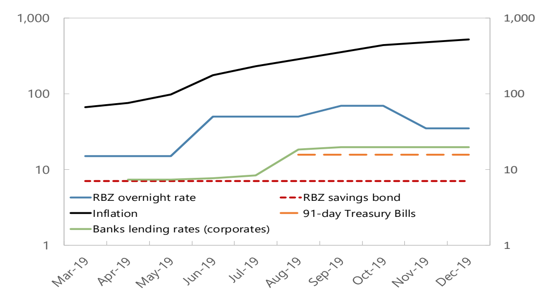
9. Rapid exchange rate depreciation and accelerating inflation continued through 2019. As of end-January 2020, the parallel exchange rate was around 25 ZWL$ per US$, compared to 3.5 less than one year before when the new currency was introduced. Inflation has also spiked sharply, reaching 521 percent in December 2019. These trends reflect a rapid increase in reserve money, which nearly tripled during the second half of 2019 as the RBZ resumed quasi-fiscal operations (Text Figure 3). These include the discounting in July 2019 of a 1½ percent of GDP USD Treasury Bill held by a domestic firm; provision of FX to fuel importers at subsidized rates to contain the increase of the retail fuel price (discontinued since October); and the introduction of an export incentive for gold purchases in September. Reserve money has also been very volatile, as the new quantitative monetary targeting framework that the RBZ announced at the time of the currency reform has not been operationalized, effectively leaving the economy without a credible nominal anchor. Domestic interest rates remain well below inflation, implying deeply negative real interest rates (Text Figure 4).

Text Figure 3. Zimbabwe: Reserve Money, Exchange Rate, and Inflation Trends
(Indices, Jan 2016 = 100))



Sources: Zimbabwean authorities.

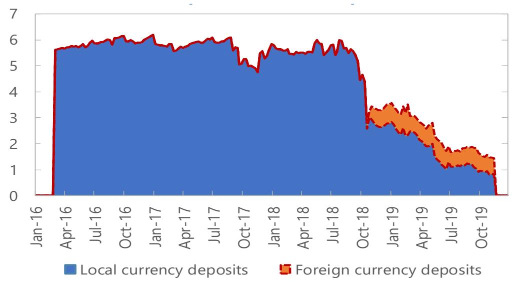
Text Figure 4. Zimbabwe: Domestic Interest Rates
(in percent, log scale)



Sources: Zimbabwean authorities

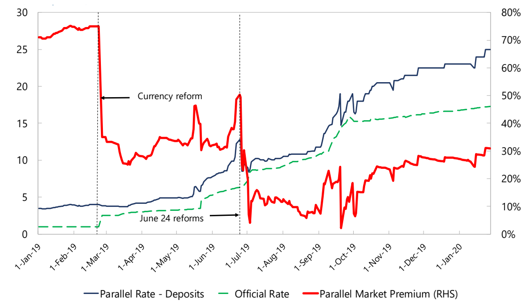
10. Real money balances have declined sharply and distortions in the FX market remain significant. Depreciation and the conversion of banks' assets and liabilities to ZWL$ at an exchange rate of 1:1 to the US$ in February 2019 caused bank deposits converted in US$ to shrink sharply, from about 6 billion in mid-2018 to 1½ billion at end-2019 (Text Figure 5). Concerned about exchange rate volatility, the authorities placed constraints on the FX market, including informal guidance and formal restrictions (e.g., mid-point determination and announcement) from the beginning, which have prevented real two-way trades and open price discovery in the FX market. The parallel market premium has declined significantly after the currency reform, dropping from about 70 percent prior to the reform to about 10 percent in mid-2019, although it has since increased again since then and exceeded 30 percent as of end-2019 (Text Figure 6). This higher premium reflects additional restrictions placed by the RBZ on trading margins in the interbank FX market. While volumes traded in the interbank market have been rising, sales appear to be almost exclusively from official sources or forced by administrative requirements.

Text Figure 5. Zimbabwe: Bank Deposits, 2016–19
(in US$ billion; ZWL$ deposits converted at parallel market rate)



Sources: Zimbabwean authorities.

Text Figure 6. Zimbabwe: Official and Parallel Market Exchange Rates
(ZWL$ per US$)



Sources: Zimbabwean authorities and IMF staff estimates.

11. **In September 2019 the government established a new Monetary Policy Committee (MPC) at the RBZ.** The MPC is tasked with setting monetary policy in Zimbabwe, with the majority of its members (six of the nine) selected from the private sector and academia, and also comprising the RBZ governor and its two deputy governors. The objective for the new MPC was to broaden the consultative process in setting monetary policy and increase the transparency of RBZ operations. The MPC has started to have monthly meetings with minutes of the meetings made public within a short timeframe,[4] and it has been instrumental in developing a Reuters System for Foreign Exchange Trading following extensive stakeholder consultation that is expected to become operational shortly. The MPC has publicly committed to adopting a prudent monetary policy to bring inflation under control, and has requested technical assistance to operationalize the money targeting framework.

C. What is the Appropriate Monetary Policy Framework for Zimbabwe?

12. **Fiscal sustainability and central bank independence are preconditions for the success of any monetary policy framework.** International experience has shown that, more than the choice of the monetary framework, the key for low and stable inflation is having sound and sustainable fiscal policy. By containing debt build-up or the need for monetary financing of the deficit, this minimizes fiscal dominance and facilitates the central bank's job in pursuing price stability and actively engaging public support for this task (Mishkin 2000).

13. **Once these conditions are in place, there are three main policy frameworks that provide a nominal anchor for monetary policy.** These include: monetary targeting; exchange rate pegs (such as full dollarization, a currency board, and a fixed exchange rate regime); and inflation targeting. All three monetary frameworks have their strengths and weaknesses (Text Table 1), and no one framework is best for all countries or at all times. In practice, most countries have followed discretionary frameworks mixing and matching monetary and exchange rate measures as they try

[4] https://www.rbz.co.zw/index.php/publications-notices/notices/press-release.

and meet multiple objectives, with inflation targeting gaining ground especially in developed and emerging market economies.

Text Table 1. Zimbabwe: Pros and Cons of Different Monetary Policy Frameworks

Regime	Pros	Cons	Common issues
Monetary Targeting	• Flexibility in setting inflation target • Ability to deal with transitory output fluctuations	• Does not work well in a low inflation environment (unstable money-inflation relationship)	• **Fiscal discipline** is required under any regime • **Central Bank independence** under inflation and monetary targeting (limit monetary financing of fiscal deficits, and give RBZ instrument independence) • **Central Bank transparency** (public availability of monetary data and central bank balance sheets)
Hard pegs (dollarization, currency union, currency board, fixed exchange rate)	• Easily understood by public • No FX volatility • Low inflation • Little/no currency risk (if credible) • Low interest rates (if credible)	• No independent monetary policy • Limited/No lender of last resort (currency board and dollarization) • Loss of seigniorage (dollarization) • Needs higher level of international reserves than alternatives	
Inflation Targeting	• Flexibility in setting inflation target • Ability to respond to real domestic and external shocks • Central bank accountability	• Weak transmission if interbank market is underdeveloped • FX and inflation volatility (especially at start)	

14. Exchange rate pegs and inflation targeting are not viable for Zimbabwe as monetary policy frameworks at the current juncture.

- ***Exchange rate peg*.** Such a regime has the advantage of providing a clear nominal anchor for monetary policy, and of anchoring public expectations for inflation. At the same time, a peg requires a significant level of reserves by the central bank to implement. The reserve adequacy metric (ARA) used by the IMF for low-income countries experiencing credit constraints (IMF, 2016) suggest that Zimbabwe's reserves should be about 5 months of imports under a fixed exchange rate regime. This is higher than under the traditional rules

Text Table 2. Zimbabwe: Reserve Metrics

	Millions of US$	Months of imports
IMF ARA metric		
Full dollarization	3,023	6.0
Fixed	2,519	5.0
Managed float	857	1.7
Currency board		
100 percent of monetary base[1]	464	0.9
100 percent of M2[1]	4,257	8.4
Traditional approaches		
3-month of imports	1,512	3.0
20 percent of M2[1]	851	1.7
Current reserves	**103**	**0.2**

Sources: Zimbabwean authorities and IMF staff estimates.

[1]As of end-2014 (before introduction of FX and deposit controls.)

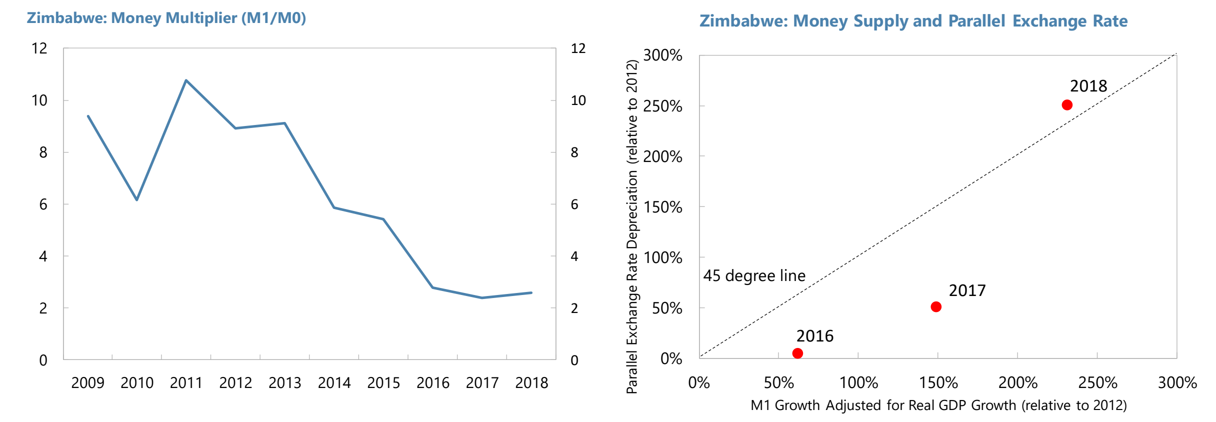
of thumb – 3 months of imports or 20 percent of M2 (Text Table 2). The reserve requirement for a currency board would be between 1-8 months of imports (depending on the monetary aggregate used, i.e., monetary base or M2), whereas reverting to a dollarized system would require about 6 months of imports. Given Zimbabwe's poor inflation track record, these reserve metrics are likely to define a lower bound, and a higher level of reserves is likely to be needed under each regime. With Zimbabwe's international reserves currently below one week of imports and no prospect for a material increase soon, an exchange rate peg is thus not feasible in the near term.

- ***Inflation targeting.*** There are several requirements for an inflation targeting regime to serve as an effective monetary policy framework (Mishkin, 2004). These include a prudent fiscal policy and fiscal sustainability to minimize fiscal dominance, a sound and stable financial system with a functioning interbank market to facilitate the monetary policy transmission mechanism, and a strong track record of delivering low inflation. Zimbabwe does not currently meet any of these conditions, which suggests that inflation targeting is not feasible either for Zimbabwe in the near term.

15. Monetary targeting is the most appropriate monetary policy regime for Zimbabwe for now. As summarized in Text Table 1 above, such a framework gives the authorities flexibility in setting the inflation target, as well as the ability to deal with transitory output fluctuations. Monetary targeting is based on a theoretical and observed long-run correlation between broad money aggregates and nominal output, and similarly between broad money and base money. Based on this, quantitative targeting postulates that controlling base money will ultimately have an impact on price stability. This theoretical framework assumes stable links between base money (the operational target) and broad money (the intermediate target) through a stable money multiplier, and a predictable relationship between broad money and prices, for a given rate of real growth.

16. In countries with high inflation (as is the case in Zimbabwe), experience has shown that money-based stabilizations have quickly brought inflation under control. For example, Peru undertook a money-based stabilization program in the early 1990s, using base money as the main intermediate target for monetary policy. This arrangement brought hyperinflation quickly to an end (Mishkin and Savastano, 2000). Other successful stabilization programs had a similar approach: tightening monetary policy early and sharply, and not easing it until stability had clearly been restored (Berg, et al 2003), with tight monetary policy aimed at reducing overshooting of the exchange rate and subsequent high inflation. In the case of Zimbabwe, rapid base money growth in recent years was the driver of the increase in broad monetary aggregates, with the money multiplier remaining broadly stable during 2016-18. The growth in broad money had, in turn, been a key contributor to the rise in the parallel market premium (Text Figure 7). Thus, moderating the increase in base money under the recently announced money targeting framework, with support from responsible fiscal policies, can stabilize the exchange rate and inflation.

Text Figure 7. Zimbabwe: Money Growth, Exchange Rate, and Money Multiplier



Sources: Reserve Bank of Zimbabwe and IMF staff estimates

17. Discretion will be needed in implementing the monetary targeting framework. While money targets can provide a clear nominal anchor for inflation, their implementation in practice is complicated due to fluctuations in money demand and unstable relations between base money and broader monetary aggregates. Thus, meeting money targets does not necessarily imply an adequate monetary policy stance. In addition, practice has shown that even if money targets are met, in many cases the exchange rate and interest rates displayed large swings. In turn, exchange rate fluctuations risk feeding into expectations and being validated by balance sheet effects and wage-price setting dynamics (Berg et al 2003). For these reasons, monetary targets in both emerging market and advanced countries suggest have usually been implemented quite flexibly. The monetary targets were missed about half of the time in Germany during the 1970s and 1980s, for example, while being quite successful in producing low inflation (Mishkin 2000). Peru's money-based stabilization of the 1990s also was not a "clean" monetary targeting framework, with the central bank using base money growth as only one of the elements guiding its decisions on instruments settings in the context of a strategy that can be described as one of discretionary monetary policy with an increasing focus on price stability (Mishkin and Savastano, 2000). These examples suggest that while monetary targets can play a useful role as a nominal anchor, the authorities should implement the framework flexibly considering other high frequency indicators—such as expected inflation, economic activity, wage growth, and exchange rate developments—when assessing the appropriateness of the stance of macroeconomic policies.

18. Once structurally-low inflation levels have been reached, the Zimbabwean authorities could consider alternative monetary frameworks. As discussed above, the monetary targeting framework relies on relationships between inflation and the growth in narrow and broad monetary aggregates. While such a relationship tends to be strong in a high inflationary environment, it typically becomes unstable at low levels of inflation. At that stage monetary policy needs to be more finely calibrated, and a price-based framework relying on interest rate signals, as opposed to the quantity-based monetary targeting, may become more effective in stabilizing and finetuning inflation. Therefore, at a later time, it would be expected that reserve money would be replaced by a policy interest rate as the operational target.

D. How to Operationalize the Monetary Targeting Framework in Zimbabwe

19. The operational target under monetary targeting is base money. As the growth of broad money cannot be directly influenced by the central bank, an operational target is needed. Base money, which comprises the central bank liabilities that support the expansion of broad money and credit, is typically defined as the sum of currency in circulation and banks' reserves at the central bank and is an operational target that can be directly influenced by the central bank.[5]

20. Monetary targeting frameworks rely on daily operations and constant monitoring. Because velocity of money (defined as nominal GDP divided by broad money) and the money multiplier (defined as broad money divided by base money) may not be stable, projections should be updated regularly to incorporate new information and accommodate changes in the underlying economic relationships. Base money targets will need to be adjusted accordingly, albeit at a lower frequency—quarterly or semi-annually—to strike a balance between the incorporation of new information and the need to anchor expectations through sticking to a pre-announced path for money.

21. A monetary targeting framework is implemented by conducting open market operations (OMOs) such that base money is in line with the target. Zimbabwean banks currently have a substantial stock of excess reserves—as of end-2019, banks held about ZWL$7 billion in excess reserves relative to a monetary base of about ZWL$9 billion. In such an environment of surplus liquidity, the RBZ may need to absorb reserves in sufficient quantity to contain growth in broad money (and consequently inflationary pressures). To encourage participation by banks, RBZ should allow true price discovery through OMOs and in government debt markets. However, this is expected to lead not just to more interest rate volatility, but also significant rises in the level of interest rates to bring them into line with expected inflation/depreciation. This would allow for an eventual re-start in the private credit markets (some credit at high rates is better than no credit at all for borrowers who do not benefit from official favors). Developing the capacity to understand and forecast known, large elements of money demand that can be volatile—notably fiscal operations—will be key to mitigate exchange rate and interest rate volatility.

22. OMOs should be limited to depository institutions and initially have short (e.g., seven-day) maturities. The counterparties to OMOs should be limited to institutions subject to reserve requirements (depository institutions), as these are the conduits of monetary growth. Initially, it is recommended that OMOs be focused on short maturities (e.g., up to seven days), given the need to adjust liquidity conditions at a high frequency and the desirability of avoiding locking in high interest rates given their potential volatility. Liquidity absorbing OMOs could be carried out through repurchase agreement ("repo") transactions using T-bills. With a sufficient stock of T-bills, the RBZ could use them as collateral in liquidity absorbing operations, which has several advantages, such as: (i) improving the ability of banks to undertake secondary market transactions with T-bills, as well as improve interbank liquidity; (ii) the RBZ would not compete directly with the MoF in the issuance of

[5] See Monetary and Financial Statistics Manual and Compilation Guide (https://www.imf.org/~/media/Files/Data/Guides/mfsmcg_merged-web-pdf.ashx).

short-term securities while at the same time providing liquidity to the government bond market; (iii) T-bills can be used as collateral if a bank needs to borrow from standing facilities; and (iv) usage of a single instrument in both monetary policy operations as well as government borrowing additionally allows for the efficient use of existing settlement infrastructure.

23. A daily calculation of the monetary base as well as current and expected liquidity conditions is required to calibrate OMOs. In pursuit of the monetary base target, the RBZ should make a daily evaluation of the current liquidity conditions, as well as a forecast of autonomous factors[6] covering the period of outstanding OMOs. This evaluation should be based on the previous day's RBZ balance sheet, outstanding OMOs, and standing facilities usage, as well as a short-term forecast of factors affecting liquidity conditions. In order to accommodate unexpected fluctuations in liquidity conditions, the reserve money target may be set as a monthly average. Day-to-day deviations from the target are considered in the average and influence the size of future operations in order to achieve the targeted average by the end of the month.

24. Adjusting reserve requirements on bank deposits can complement OMOs in affecting market liquidity conditions. With Zimbabwean banks having significant excess reserves, the effectiveness of a monetary targeting framework could be challenging. This is because money deposit growth through credit creation is not constrained, as banks may utilize excess reserves to fulfil the resulting increase in reserve requirements. The establishment in October 2018 of a reserve requirement of 5 percent of all corporate and retail domestic currency deposits has reduced somewhat the size of the liquidity surplus. However, since excess reserves remain significant, a temporary increase in the reserve requirement ratio to absorb additional excess liquidity and increase the demand for base money could be considered. The risk of affecting banks desired working balances with a higher reserve requirement and of excessive interest rate volatility can be mitigated by allowing averaging of required reserves.

25. Longer-term OMOs could be considered once interest rates have stabilized. In order to reduce the size of the daily OMOs, a one-month liquidity absorbing operation, with a fixed size, could be conducted once the interest rates in daily OMOs become more stable and banks develop confidence in their ability to anticipate interest rates over this period. Such longer-term operations should be conducted at variable rates at a pre-set amount with the central bank acting as a rate taker. The size of these operations should ideally not be larger than half of the outstanding OMOs. As longer-dated instruments are considered, coordination with the MoF to avoid overlaps in issuance timetables will be needed.

26. The effectiveness of the monetary targeting framework will also depend on jointly implementing reforms in FX and debt markets. The interbank FX market remains dominated by the RBZ, with surrender requirements, strict exchange controls, tight margin limits and moral suasion affecting price discovery and creating a large parallel market premium. These inefficiencies lower the total amount of FX available in the interbank market and create rent-seeking behavior,

[6] Autonomous factors include (i) net foreign exchange reserves; (ii) net claims on government; (iii) net other items; and (iv) currency in circulation.

where some connected firms have access to FX and others do not. Similarly, existing attempts to cap interest rates on government bonds or RBZ savings bonds limit private-sector interest in holding government debt and encourage demand for foreign assets, fueling depreciation pressures and exacerbating foreign exchange imbalances. While there may be scope for managing the transition, prices in the FX, money, and public debt markets should ultimately be determined in a framework that ensures a consistent outcome.

27. Communication and transparency on monetary conditions is critical for establishing the credibility of the monetary targeting framework. By communicating publicly and regularly on the reserve money targets and day-to-day levels, the RBZ can demonstrate its success in achieving its goals. The ability of the financial system and the wider public to observe these developments at a high frequency should help anchor expectations of future monetary developments. The RBZ should publish a weekly balance sheet on its website as well as daily information on the current month's monetary base target, the previous day's monetary base, and the rate and volume of OMOs and standing facilities. Additionally, the RBZ should ensure that the website contains all the rules and regulations pertaining to its monetary policy and exchange rate policy.

E. Conclusion

28. Stabilizing the economy requires fiscal discipline and a moderation of base money growth. The monetary targeting framework announced by the authorities can deliver a stable exchange rate and low inflation. However, as international experience indicates, more than the choice of the monetary framework the key for macro stability is having sound and sustainable fiscal policy, encompassing all relevant public sector operations. In particular, this requires containing quasi-fiscal operations of the RBZ consistent with a moderate increase in base money.

29. Operationalizing the monetary targeting framework requires setting reserve money targets and introducing open market operations to steer reserve money towards established targets. Nevertheless, discretion will be needed in implementing the monetary targeting framework. While monetary targets play a useful role as a nominal anchor, the Zimbabwean authorities should implement the framework flexibly taking into account other high frequency indicators—such as expected inflation, economic activity, wage growth, and exchange rate developments—when assessing the appropriateness of the stance of monetary policy. Clear communication on the performance against the monetary targets and their link with the ultimate objective of price stability is essential, and should be accompanied by regular and timely publication of RBZ balance sheets, to ensure transparency and help anchor expectations of future monetary and inflation developments.

30. The authorities are encouraged to liberalize the FX market further. The introduction of the new Zimbabwean dollar and an interbank FX market has significantly reduced distortions. Due to the existence of capital controls, a spread between the parallel market and the interbank market rates will persist. However, at nearly 30 percent, the premium remains too high and the authorities are encouraged to gradually relax the margin limits on trading in the interbank FX market, and gradually eliminating surrender requirements and exchange controls so that the exchange rate is determined freely as a function of supply and demand. Consistently delivering on the commitment for moderate base money growth, effective communication, and timely dissemination of monetary statistics as discussed above will help reduce exchange rate volatility.

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UNLOCKING ZIMBABWE'S AGRICULTURAL POTENTIAL[1]

The agricultural sector is a major component of total value added in Zimbabwe, the largest employer, and the country's second largest source of exports earnings. This Selected Issues Paper (SIP) describes the evolution of agricultural production in Zimbabwe since independence in 1980, focusing on the steady decline in agricultural productivity over the last two decades and the growing gap between Zimbabwe's agricultural output and its potential. Using cross-country analysis, we identify the key drivers and bottlenecks of agricultural productivity in Zimbabwe, including structural, regulatory, and financial barriers to sustainable growth. We then examine the role of government support and subsidy programs for agriculture, including the large fiscal costs associated with these subsidies. Finally, we identify fiscally sustainable reforms to improve agricultural as a vehicle for inclusive growth in Zimbabwe.

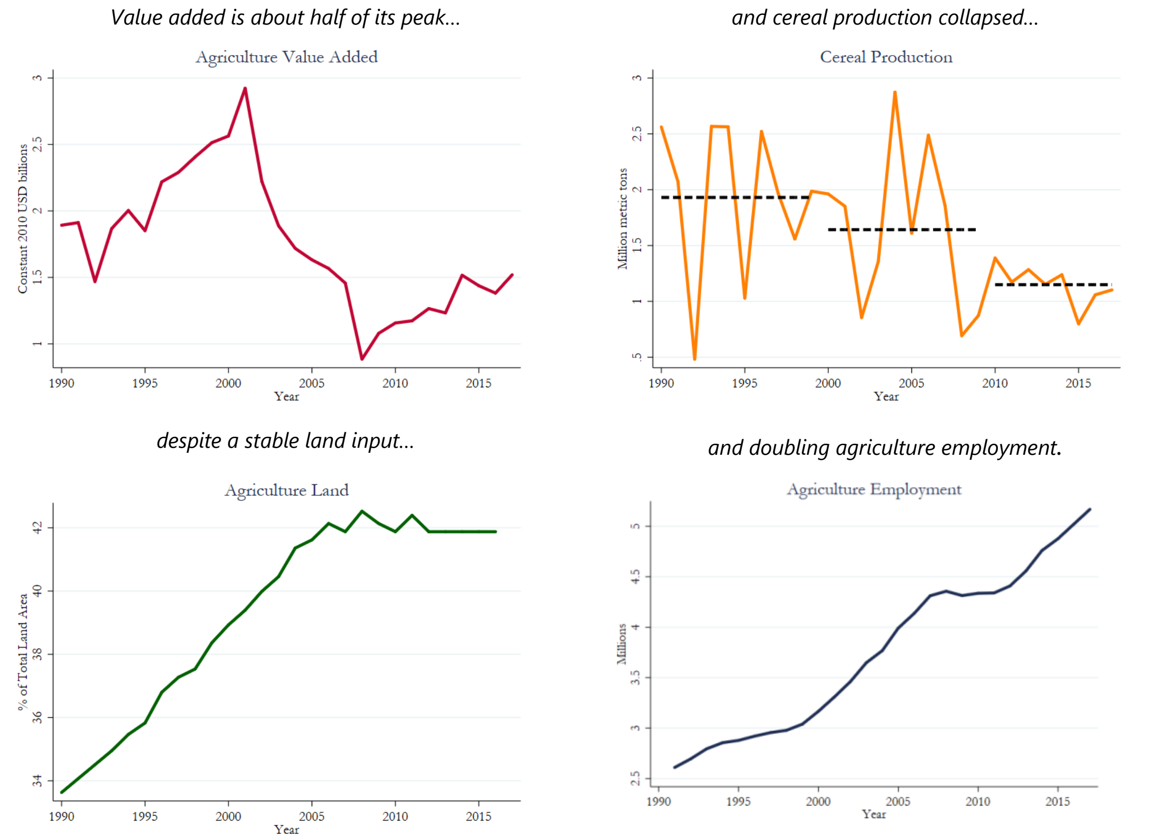
A. The Evolution of Agricultural Production in Zimbabwe Since Independence

1. **Agriculture plays a critical employment and production role in Zimbabwe.** The agricultural sector represents about 10 percent of aggregate value added, and while this is down from 20 percent just a few decades ago, the sector remains of fundamental importance to the economy. About two-thirds of working Zimbabweans are employed in agriculture, and agricultural exports represent about 30 percent of the US dollar value of exports, second only to mining. Moreover, agriculture plays a critical role in food security and poverty reduction in the country. For example, the drought of 2018-2019, which continues into 2020, has led to a rapid rise in the number of Zimbabweans who are food insecure, which currently stands at 8 million people (about 60 percent of the population)

2. **Adjusted for inflation, agricultural value-added remains below what it was in the 1990s, and roughly 50 percent below its peak.** Agricultural value-added reached its peak in 2000, after nearly 20 years of sustained growth, but has fallen precipitously since then. This decline occurred despite a secular increase in inputs, as agricultural land in production has been stable and employment in the sector essentially doubled (Figure 1). While most agricultural products experienced a trend decline during this period, the reduction was most pronounced in non-irrigated crops such as cereals.

[1]Prepared by Frederico Lima and Trevor Lessard (both AFR).

Text Figure 1. Zimbabwe: Agriculture Production and Inputs, 1990–17



Note: FAO, ILO and IMF staff calculations. Value added figures include agriculture, forestry and fishing, and are expressed in constant 2010 US dollars.

3. Independence gave voice to the preference of many Zimbabweans to redistribute land in a more egalitarian manner. At the time of independence, the ownership of land was heavily skewed, with a minority of white Zimbabweans (approximately 2 percent of the population) owning 40 percent of the country's farmland, which produced 40 percent of the country's GDP and was responsible for 60 percent of its export earnings. These inequalities created pressures for the Government to redistribute land to poorer black Zimbabweans, as well as to provide settlements for war veterans.

4. While land reform lasted several decades, and underwent several distinct stages (Table 1), it was only during the last phase that agricultural output and productivity were severely affected (Figure 1). The Fast-Track Land Reform Program (FTLRP), represented a marked departure from previous land reform phases, in particular by abandoning the process of 'willing buyer-willing seller' that had been followed until then. The FTLRP was also saddled with a more radical political environment, which resulted in a shift from technical to politically-driven land allocations and the drying up of donor support for land reform.

Table 1: Phases of Zimbabwe's Land Reform

Date	Land Reform Initiative	Description
1980-1992	'Willing Buyer, Willing Seller'	• The Lancaster Agreement of 1980 marked an initial effort to redistribute land more equitably, but contained provisions protecting white farmers from compulsory land acquisition for 10 years. • Progress in land transfer under this policy was slower than anticipated, but orderly and largely market-based land transfers sales. • By 1989, the number of commercial farms had decreased from 6,000 to 4,300 and the share of land from 42 to 30 percent. • It is estimated that more than 80 percent of the beneficiaries of land transfer fell in the category of those with the greatest need.
1992-2000	National Land Policy of 1992 Land Reform and Resettlement Program (LRRP)	• Government passes the Land Acquisition Act. (1992), which allows for compulsory acquisition of land with limited compensation and limited rights of appeal to the courts. • British Government decides to stop its program of helping to finance land acquisition/compensation. • Government of Zimbabwe announces it will take no action to remove war veterans (or other communities) who have occupied white-owned land.
2000s	Fast Track Land Reform Process (FTLRP)	• Constitutional amendment 16 includes a clause that states the responsibility for compensating evicted farmers is the UK's, while a separate clause removed the requirement for 'fair and adequate' compensation, and another amended the law to prohibit judicial challenges to questions surrounding the fairness of compensation. • Government of Zimbabwe revises the Land Acquisition Act, stating that in the absence of a fund set up by the UK for compensation of evicted farmers, the Government of Zimbabwe would pay for only improvements on the land but not the land itself. • Process created two new classes of models of farming, A1 and A2 shareholders. A1 module was primarily for smallholder, family plots, while A2 module was primarily for medium-to-large farms that were primarily commercial. • Introduction of land leases of between 25-99 years. • By 2008, significantly more land had been redistributed by FTLRP, 6.8 million hectares, than all previous schemes combined, 3.7 million hectares.

5. The trend-decline in value added for the agricultural sector is partially attributable to declining production volumes and a hollowing out of the value chain. As an example, cereal production fell from an annual production of 1.9 million tons in the 1990s, to 1.6 million in the 2000s, and closer to 1.1 million since 2010. While some grains experienced increases, such as sorghum and millet, this was mostly due to changing incentives for crop selection as farm size decreased, access to credit evaporated, and farmer skills declined. Cash crops, such as tobacco, experienced a similar sharp decline. Declining agricultural production and macroeconomic instability proceeded to affect agribusiness as well, leading to the closure and scaling back of many firms.

6. Fundamentally, the driving force for the collapse in agriculture was the steep decline in productivity since 2000. The decline in agricultural productivity affected the sector as a whole, but unevenly. Productivity, measured as output per hectare of land, declined for both staple crops (e.g. maize), but also essential export earning cash crops such as tobacco (Figure 2). In both maize and tobacco, Zimbabwe moved from being above the average of its peers to significantly underperforming (Table 2). A bright spot is the rebound in tobacco productivity since 2010, which is attributable specific developments in the sector, including the start of contract farming in the mid-2000s, and which provides insights on how to reform the agricultural sector as a whole to restore growth.

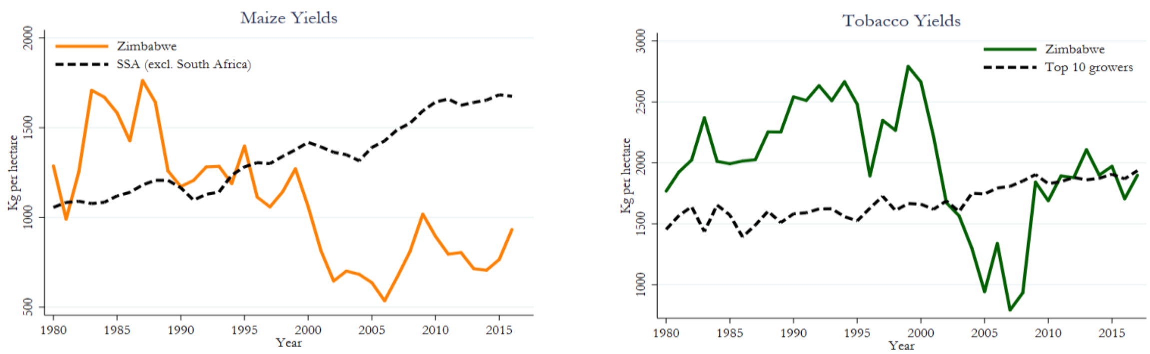
Text Table 1. Agriculture and Productivity – Zimbabwe versus Peers
(kgs per hectare)

Maize				Tobacco			
Country	1980s	2010s	% change	Country	1980s	2010s	% change
Top SADC Producers				*Top World Producers*			
South Africa	1,922	4,653	142%	China	1,796	2,167	21%
Tanzania	1,336	1,438	8%	USA	2,313	2,375	3%
Malawi	1,154	2,000	73%	India	1,142	1,688	48%
Zambia	1,907	2,666	40%	Brazil	1,390	2,018	45%
Mozambique	419	1,004	140%	Indonesia	555	874	57%
Angola	398	935	135%	Zambia	1,037	1,683	62%
Zimbabwe	1,471	830	-44%	**Zimbabwe**	2,064	1,881	-9%

Source: FAO, Zimbabwe authorities, and IMF staff calculations. Peer countries are ranked by their production shares in the 1980s.

Text Figure 2. Zimbabwe: Agriculture Productivity, 1980–2017

Maize yields halved since the 1980s… …while tobacco yields have partly recovered.



Sources: Zimbabwean authorities, TIMB, FAO, and IMF staff estimates.

Note: Maize yields are presented as a 3-year moving average

7. Starting in 2015, the Government of Zimbabwe started to place additional emphasis on the importance of agriculture, especially through its fiscal and quasi-fiscal activities under Command Agriculture. This commitment to agriculture is bolstered by the medium-term Transition and Stabilization Plan (TSP) and the Vision 2030 long-term development strategy, which aim to transform Zimbabwe into a middle-class economy. For these goals to be met, agriculture will have to improve its productivity and increase volumes in order to provide a reasonable income for Zimbabwe's many farmers. However, recent interventions have focused primarily on income support and other subsidies rather than financing long-term productivity enhancing investments (Section C). At the same time policy uncertainty, FX shortages, land rights and transfer issues, environmental shocks, and macroeconomic instability have choked off (external and domestic) private investment in the sector.

B. Determinants of Low Agricultural Productivity in Zimbabwe

8. Zimbabwe has enormous untapped agricultural potential and agriculture (and agribusiness) are essential ingredients in any sustainable development model for the country. The abundance of fertile land, an educated labor force, good weather, and access to large export markets are highlighted as strengths of the sector that can be built upon to build a dynamic agriculture/agribusiness sector. Unfortunately, weak infrastructure, market distortions, structural barriers and policy mistakes have presented formidable headwinds to improving productivity in the sector.

9. Economies of scale are limited by unsecure property rights and difficulty in accessing financing.

i. Reforms to the land tenure system eventually led to the extinguishing of most private property rights through socially differentiated forms of land tenure provided to the A1 and A2 land beneficiaries. The latter get 99-year lease contracts providing land use rights to individual landholders. The A1 beneficiaries, on the other hand, receive statutory permits to occupy and use land in perpetuity as a family land right. Nevertheless, due to governance challenges, rent seeking, and political headwinds it is not uncommon for holders of A1 and A1 claims to not be able to access their land for several years (and sometimes never). Moreover, the security of these property claims in uncertain, as they can be revoked through ministerial authority, and owners are in general not able to transfer land titles, an essential aspect of using land as collateral for access to finance.

ii. The uncertainty surrounding the 99-year leases, the influx of new farmers without strong farming experience, and government interventions in the market have made it difficult for the sector to access credit. About 21 per cent of the beneficiaries reported encountering problems with access to credit because they did not have adequate land tenure documents and the majority of these were A2 landholders.

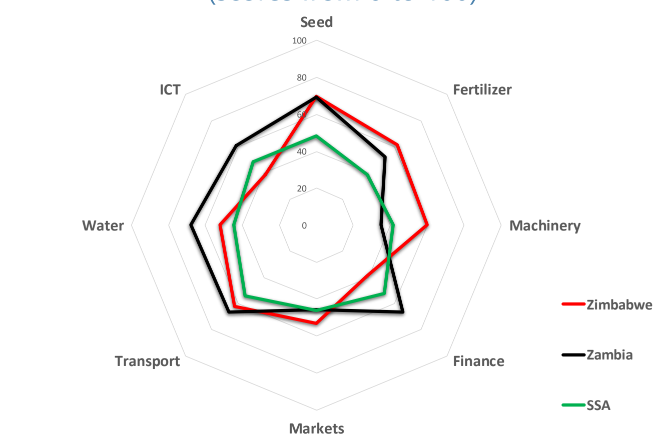
iii. While average farm size in the aggregate does not indicate a barrier to economies of scale, with A1 allocations around 5-10 hectares and A2 averaging 100 hectares, caution should be taken in using these figures. For example, there are challenges in estimating farm size, because of widespread use of land by those with unsecured property rights, as well as insufficient data on subdivided plots. More importantly, the dividing of seized farm land into plots under the FTLRP was conducted with a focus on social and political outcomes, rather than profitability, and consequently many of the plots were no longer economically viable as a standalone entity.

10. While notionally access to credit for Zimbabwe seems relatively robust for the agricultural sector, the reality is that most of the credit is short-term creditor for fertilizer and seed that is backed by a government guarantee. Private lenders, despite default rates in excess of 90 percent in recent years, have thus been able to receive a risk-free return on these 'agricultural' loans. However, through a combination of interest rate caps, risk perceptions, and unclear property rights, access to medium-term capital for investment (or land acquisition) is basically non-existent through private domestic channels. **The Enabling the Business of Agriculture (EBA) survey highlights some of the fundamental barriers to a dynamic agricultural sector** (Figure 3). The 2017 report is a project by the World Bank to assess the regulatory framework in agriculture and agribusiness. Higher scores represent better laws and regulations in each EBA topic. The 2017 report covers 62 countries and 12 topics. The report focuses on the quality of laws and regulations, and not how they are implemented in practice. In the case of Zimbabwe, we see that Zimbabwe scores similar or better than the average SSA country and a close peer country (Zambia) across several topics, such as fertilizer, machinery, market access, transportation and seed. However, it scores poorly in water, ICT and especially finance. While it scores similar to its peers in terms of seed availability and better than average for fertilizer it is important that these two achievements were reached in 2017 by unsustainably high fiscal outlays under Command Agriculture to subsidize these two inputs. Consistent with other information, one dimension where Zimbabwe scores particularly low is that property rights, credit registry and availability of collateral for accessing finance.

11. **The Enabling the Business of Agriculture (EBA) survey highlights some of the fundamental barriers to a dynamic agricultural sector** (Figure 3). The 2017 report is a project by the World Bank to assess the regulatory framework in agriculture and agribusiness. Higher scores represent better laws and regulations in each EBA topic. The 2017 report covers 62 countries and 12 topics. The report focuses on the quality of laws and regulations, and not how they are implemented in practice. In the case of Zimbabwe, we see that Zimbabwe scores similar or better than the average SSA country and a close peer country (Zambia) across several topics, such as fertilizer, machinery, market access, transportation and seed. However, it scores poorly in water, ICT and especially finance. While it scores similar to its peers in terms of seed availability and better than average for fertilizer it is important that these two achievements were reached in 2017 by unsustainably high fiscal outlays under Command Agriculture to subsidize these two inputs. Consistent with other information, one dimension where Zimbabwe scores particularly low is that property rights, credit registry and availability of collateral for accessing finance.

Text Figure 3. Zimbabwe: Agriculture Regulatory Framework, 2017

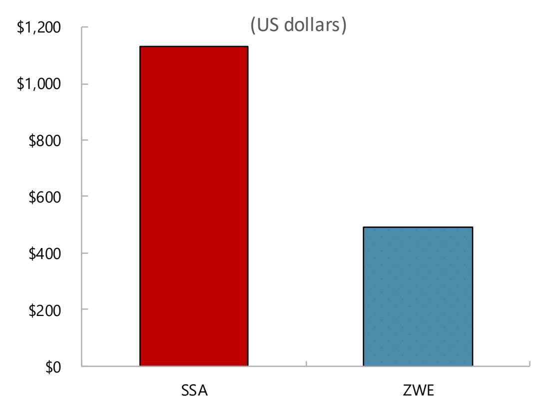
(scores from 0 to 100)



Sources: World Bank Enabling the Business of Agriculture, 2017. .

12. **Infrastructure remains a weak point across the economy, affecting the productivity of all sectors.** The combination of low public investment with a growing population has led Zimbabwe to fall below the regional average, with Zimbabwe's per capita public capital stock now approximately half the average for sub-Saharan Africa (Text Figure 4.) For agriculture, the fundamental infrastructure barriers are a lack of irrigated land, with only 1 percent of agricultural land equipped for irrigation, and a deficient transportation network (roads, rail, airports) to get agricultural products to market. More recently, electricity shortages that decrease the effectiveness of irrigation equipment and the damage caused by Cyclone Idai to transport infrastructure have only exacerbated these challenges.

Text Figure 4. Zimbabwe: Public Capital Stock per Capita, 2017



Sources: IMF FAD Database, and staff estimates.

13. **The ineffectiveness of fertilizer to meaningfully increase output despite relatively high use is consistent with the literature on fertilizer input schemes.** Generally, the literature shows lower maize response to fertilizer on smallholder-managed plots, for reasons that correlate strongly

with Zimbabwe's situation. First, crop yields response to fertilizer tend to be lower and less predictable when farmers rely on rainfed irrigation. The need to couple irrigation with fertilizer will become even more critical over the coming decades as rainfall becomes more erratic due to climate change. Second, there tend to be strong learning-by-doing effects in the use of fertilizer, with younger and less experienced farmers averaging lower yields for the same amount of fertilizer per hectare. For Zimbabwe, with a generation of new farmers, this could have a large aggregate decrease on the effectiveness of fertilizer. Finally, diversion and re-selling of fertilizer, while difficult to quantify, is undoubtedly also partly responsible for the low effectiveness of fertilizer. Anecdotal evidence suggests that the 100 percent government guarantee for agricultural input loans has led some unscrupulous recipients to take those loans, sell the inputs and default on the loans. Consequently, the real amount of fertilizer being used maybe less than estimated figures (Figure 5).

C. Impact of Government Support Programs on Agriculture

14. Recognizing the importance of agriculture as an engine of growth for Zimbabwe, the Government has devoted significant support to the sector under the umbrella program 'Command Agriculture'. Starting during the 2016/2017 season, a set of initiatives were introduced, and subsequently scaled up, which entailed the significant mobilization of public (fiscal and quasi-fiscal) and private (with a government guarantee) financial flows into the agricultural sector. These initiatives had four components:

i. *The Presidential Input Scheme (PIS)*. In place since 2011, the PIS is a social safety net where the government distributes agricultural inputs – seeds and fertilizer – to small-scale and impoverished rural farmers to support grain and soya bean production. The PIS was scaled up significantly, from US$42 million in 2016 to US$263 million in 2018. Data constraints limit the ability of a full evaluation of the effectiveness and targeting of the PIS, but anecdotal evidence indicates governance, cost, and distribution challenges.

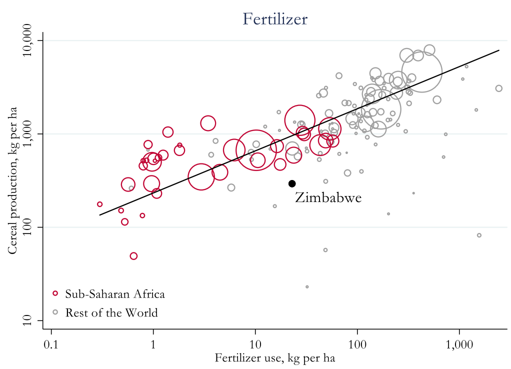
ii. *The Special Maize Program*. This backbone of Command Agriculture has increased production, but at a significant cost. Under the scheme, the Government of Zimbabwe, via a full 100 percent guarantee of the loan, encourages private companies (banks, fertilizer importers, etc.) to extend inputs to farmers on credit. The contract stipulates that the farmer commits to producing a minimum of 5 tons per hectare and would pay back the credit via delivery of the grains to the Grain Marketing Board (GMB).

iii. *The Tobacco and Cotton Input Funds*. Next to gold, tobacco is the most import export for Zimbabwe and in 2017 a revolving fund for tobacco support was established via an RBZ quasi-fiscal activity; the fund has had to be recapitalized since its establishment. A similar input support scheme was put in place for cotton, with public support to the fund in 2016 and again in 2017.

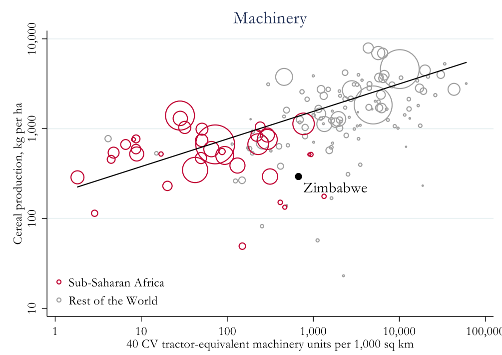
iv. *Price Subsidies for both inputs and outputs.* To incentivize sale to the GMB, the purchase price offered to farmers is set well above import parity and production costs. At the same time, the GMB sells this grain at a steep discount compared to import parity prices in an attempt to avoid price increases for final consumers. The result were income gains for producers and consumers of grain, but at the cost of large losses at the GMB that needed to be covered by fiscal transfers.

Figure 1. Zimbabwe: Determinants of Agriculture Productivity

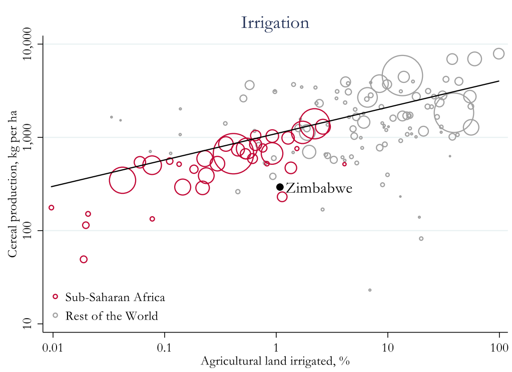
Cereal yields are disappointing even though fertilizer use is relatively high…



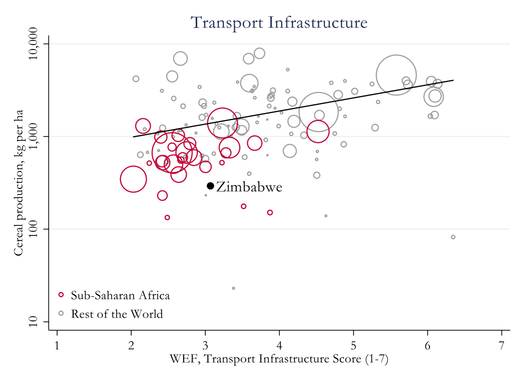
…and available machinery per hectare is above many other countries in SSA.



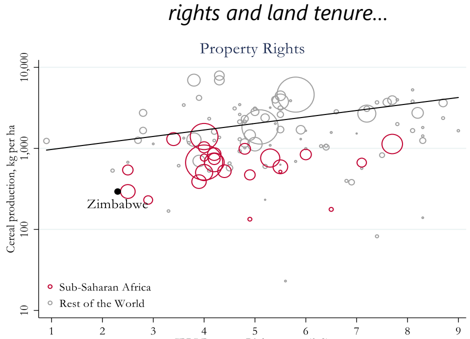
Only about 1% of agricultural land is equipped for irrigation…



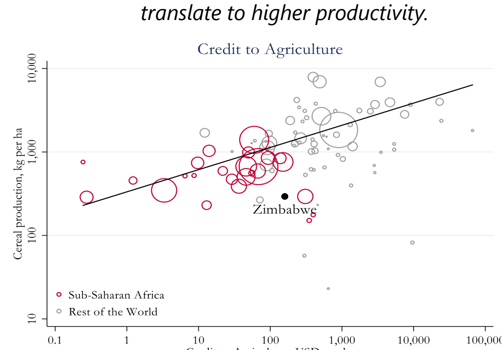
…while the coverage and quality of transport infrastructure are lagging.



Zimbabwe scores poorly on protection of physical property rights and land tenure…



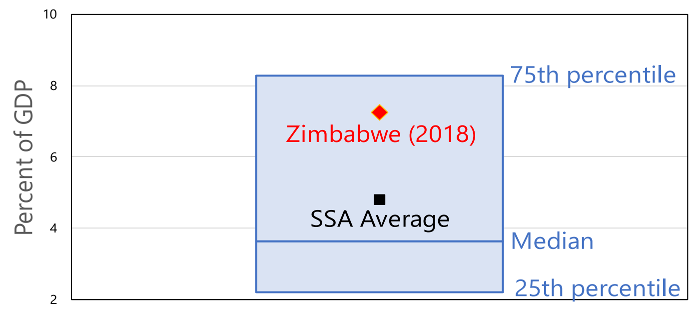
…and although credit to agriculture is high, it does not translate to higher productivity.



Note: FAO, ILO and IMF staff calculations.

15. Zimbabwe has a long history of central government subsidies, which are large relative to other sub-Saharan countries (Figure 6). While historically these subsidies have been to SOEs and to facilitate private sector bailouts, in recent years they have increasingly been directed towards increasing the incomes of farmers, and to a larger extent, agribusinesses.

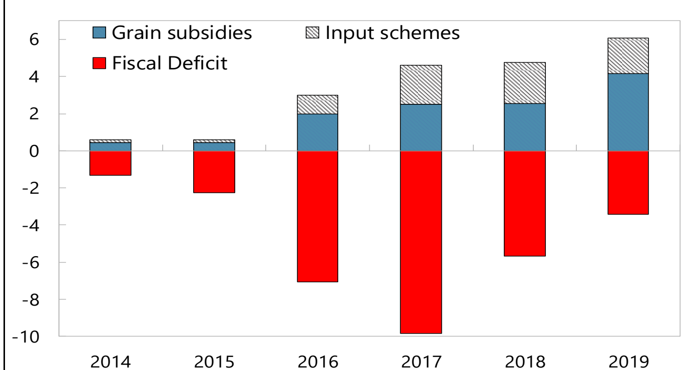
Text Figure 5. Zimbabwe: Subsidies in Sub-Saharan Africa
(in percent of GDP, average of 2009-2018)



Sources: Zimbabwean authorities., and IMF staff estimates. .

16. The fiscal costs of Command Agriculture have been dramatic and a principal contributor to the unsustainable deficits in recent years (Figure 7). The cost of grain subsidies and input schemes escalated substantially in 2016 with the start of Command Agriculture. Overall, nearly 20 percent of GDP worth of fiscal and quasi-fiscal expenditures were spent on agriculture between 2015- 2018, and preliminary indications are for the 2019-2020 crop season to also incur significant fiscal costs. Although large, these fiscal costs understate the true costs to the economy as they omit: costly subsidies for fuel imports via RBZ quasi-fiscal activities and the full cost of repayment of defaulted farmer loans, and the destabilizing macroeconomic consequences of RBZ money creation to finance unexpected, off-budget, agricultural expenses.

Text Figure 6. Zimbabwe: Agriculture Spending and Central Government Deficit
(in percent of GDP)



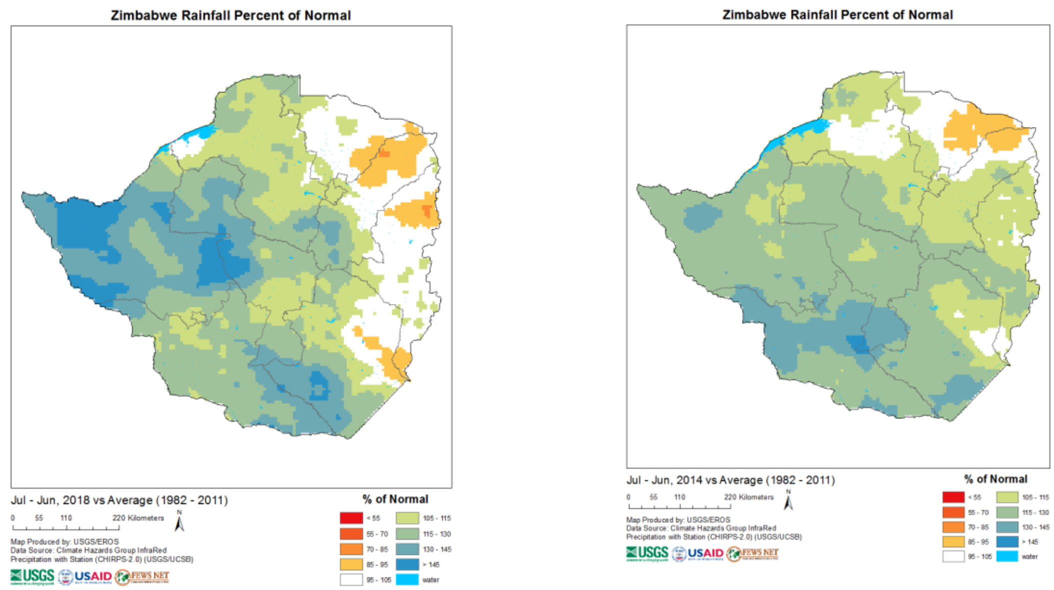
Sources: Zimbabwean authorities.

17. Despite their large fiscal cost, government programs have had limited impact on agricultural output and no discernable impact on productivity. Comparing three-year averages before and after the Command Agriculture program was started shows little to no change in maize output or yield per hectare. Fluctuations are almost entirely attributable to rain variance, highlighting the need for increased irrigation to improve agricultural output and climate resistance. Figure 8 provides an illustrative and compelling example of the negligible effect of government intervention in recent years by comparing 2014 with 2018. While in 2014 there was very little government intervention, 2018 saw public support reaching more than 4 percent of GDP. Despite reasonably similar weather conditions, government support translated into only a small increase in yields, with maize output increasing by just 15 percent (from approximately 1,500 tons to 1,700 tons). Under this scenario, the marginal cost of an extra ton of maize produced with the support of Command Agriculture was US$2900, nearly nine times the cost of importing the maize and selling it at prevailing subsidized rates.

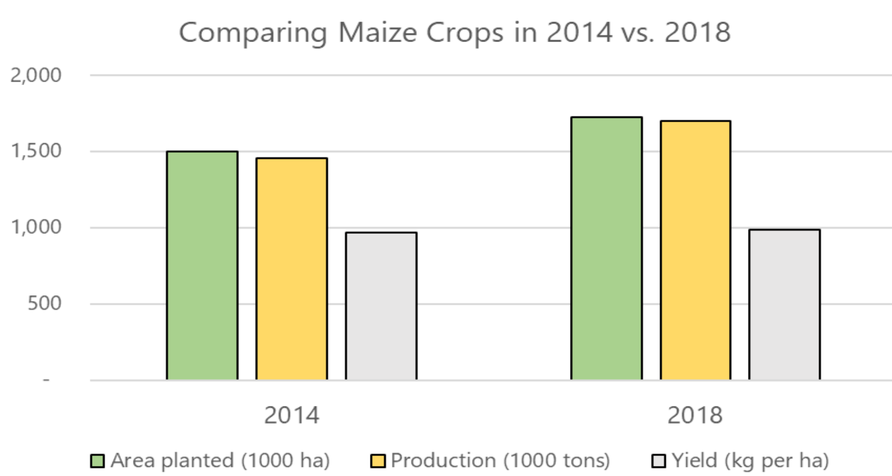
Figure 2. Impact of Government Spending in Agriculture

2018 was a good weather year, with above average rainfall across most regions, including Mashonaland West and Central.

2014 was also a good weather year, with similar rainfall performance across the same regions



Although government spent about 4 percent of GDP on agriculture subsidies in 2018, the impact on production was only 15 percent, and the impact on maize yields was negligible



Sources: Zimbabwean authorities, USGS, USAID, FEWS.NET and IMF staff calculations.

D. Policy Recommendations to Improve Sustainable Growth in Agriculture

18. Improving public spending on agriculture can enhance productivity, improve volumes, catalyze growth, and strengthen the sector's resilience to climate change. In the case of Zimbabwe, the fundamental policy prescription is to shift spending away from income support, input subsidies and price controls and towards skills development, R&D, and infrastructure spending; in essence, moving fiscal resources away from the provision of private goods to the provision of public goods. A new agricultural plan must also respect fiscal constraints and bring public support for agriculture to a sustainable level.

19. In this regard, consideration should be given to following policy reforms:

- *Reduce the guarantee on loans from 100 percent to avoid moral hazard and consistently high default rates.* If the government wishes to continue to subsidize access to finance for farmers consideration should be given to providing only a partial guarantee that ensures fair risk sharing across stakeholders and is subject to a cap to avoid fiscal shocks. Alternatively, the government could commit to paying a portion of the interest bill so that farmers receive concessional financial support. Moreover, penalties and consequences for farmer loan defaults need to be established and enforced.

- *Remove the inefficient and untargeted price subsidy for maize and replace it with an expanded social safety net.* While the Government has made much progress in reducing prices subsidies, the recently announced subsidy for maize millers goes in the wrong direction. This uncapped, untargeted subsidy is expected to cost at, prevailing prices, ZWL 1.2 billion in 2020, but could likely rise depending on the future inflation path.

- *Catalyze resources from the private sector and donors through joint partnerships for the funding of growth-enhancing investments.* There remains strong interest among the official and private sector to invest in agriculture given its potential for lucrative exports. Carefully designed joint-partnerships with appropriate burden-sharing can help alleviate critical bottlenecks in electricity generation, storage and transportation, market access, and skills development that would permanently increase the productivity of the sector.

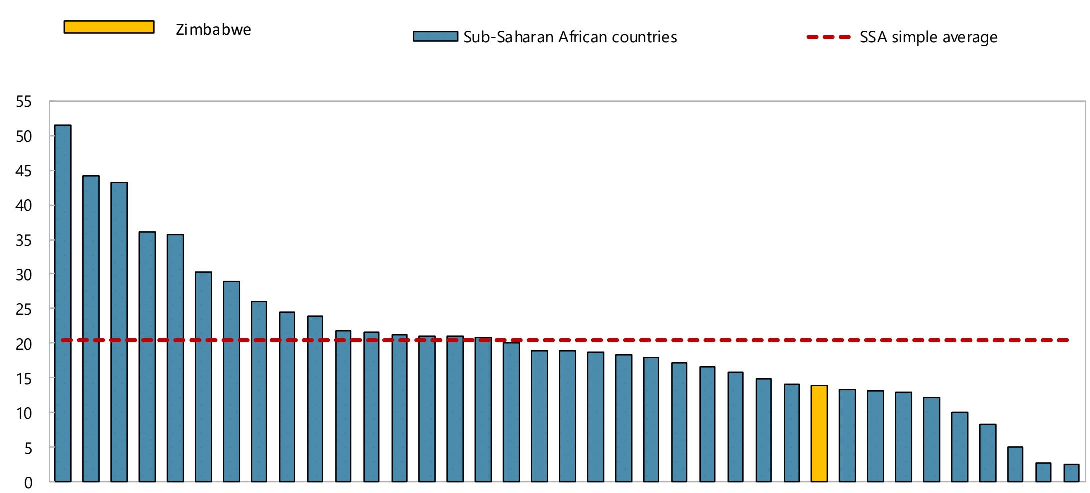
- *Reduce the distortionary effects of price controls*. Not only are there fiscal consequences to fixed prices, but large deviations in the fixed price and import parity have at times led to the large-scale diversion of agricultural output. While consideration needs to be given to the security of livelihood of small farmers, it is less clear why medium-to-large scale commercial farmers should not be required to respond to market forces. Increased tailoring of income support to small farmers, potential through insurance-based instruments (e.g. crop insurance) and improved social safety nets (e.g. cash transfers), would result in improved outcomes and lower and more predictable fiscal outlays.

- *Improve and increase the use of contract farming*. Contract farming has seen notable success in Zimbabwe with tobacco, where yields have increased as financial constraints were removed and a market for the sale of the agricultural product was created. To promote the use of contract farming in other crops, efforts should be made to improve and simplify the legal structure for contract farming and encourage small and communal farmers to form cooperatives that could facilitate contract farming at the appropriate scale.

20. It is also imperative to improve the regulatory environment and legal clarity of land titles. It is essential to improve the land tenure security of individuals, particularly A1 and A2 farmers. An immediate improvement would be to standardize and de-politicize the leasing of agricultural land. Moreover, to unlock foreign investment, and remove a significant perceived risk to the sector, a formal agreement for compensation of previous farmers who had their land expropriated is indispensable.

21. It is worth noting that many of the barriers to sustainable growth in agriculture are not unique to the sector, but affect the entire economy. Macroeconomic stability, reliable electricity supply, and a functional transportation network are as essential to agriculture as the rest of the economy. If Zimbabwe is going to reach its stated goals under the TSP, Vision 2030, and the Sustainable Development Goas (SDGs), it is going to require an increase and reprioritization of fiscal spending (Figure 9). While the additional spending needs for Zimbabwe are less than the average for sub-Saharan Africa, they remain substantial. Securing these resources will require concerted efforts to mobilize domestic revenues, a commitment to macroeconomic stability, and a normalization of its financial relationships with the external community.

Text Figure 7. Zimbabwe: Additional Spending to Meet the SDGs in 2030
(percentage points of GDP)



Sources: Zimbabwean authorities, and IMF staff estimates.

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Statement by Mr. Mahlinza, Executive Director for Zimbabwe and Mr. Nakunyada, Advisor to the Executive Director

February 24, 2020

Introduction

1. Our Zimbabwean authorities appreciate the constructive Fund engagement during the recent Article IV consultations. They broadly share staff's assessment of key policy challenges and priorities.

2. Macroeconomic conditions in Zimbabwe have continued to deteriorate over the past year, exacerbated by the twin shocks of the severe drought and tropical cyclones experienced in 2019. As a result, economic activity has contracted, and social indicators have deteriorated, with an estimated 8.5 million people (more than half the population) expected to be food insecure in 2020. Meanwhile, subdued exports and limited access to affordable offshore credit lines have compounded the foreign exchange situation, with persistent pressures on the exchange rate and inflation. Against this background, the new government, which assumed power in September 2018, launched Vision 2030 to guide medium term policies aimed to create a competitive and open economy. Consistent with the overarching Vision, they adopted the short-term Transitional Stabilization Program (TSP 2018-2020), to address structural rigidities, restore macroeconomic stability, and accelerate growth.

3. To support the TSP, the authorities requested a Staff Monitored Program (SMP) which was approved in May 2019. The SMP largely focused on establishing a track record of coherent policies to restore macroeconomic stability and facilitate reengagement with the international community. Despite implementation challenges with the SMP, the authorities remain committed to continued reforms supported by a new SMP, which is currently under negotiation.

Recent Economic Developments

4. Economic growth declined from 3.5 percent in 2018 to an estimated -8.3 percent in 2019 due to adverse weather conditions which undermined agricultural production and hydro-power supply with downstream effects on manufacturing and mining activity. Concurrently, persistent foreign exchange shortages constrained critical imports required to support productive sectors. Looking ahead, the authorities are optimistic that economic activity will rebound faster, subject to the moderation of weather-related shocks, as well as improved prospects in mining and tourism. Meanwhile, inflation has increased significantly from 42 percent in December 2018 to an estimated 521 percent by end 2019, amplified by the depreciation of the exchange rate, broad money supply growth, and the recent removal of fuel and electricity subsidies.

5. On the external front, the current account balance is projected to improve from -4.5 percent of GDP in 2018 to -2.5 percent of GDP in 2019 underpinned by a faster decline in imports and growth in remittance inflows. That said, reserve buffers remain below 1 month of import cover, reflecting the cumulative effects of persistent external imbalances over the years.

Fiscal Policy and Debt Management

6. Since September 2018, the authorities have pursued strict cash budgeting practices, realizing a large fiscal adjustment in 2019. Sustained fiscal consolidation achieved through a combination of revenue enhancing and expenditure containment measures, delivered cash surpluses for the greater part of 2019. At the same time, domestic revenue performance remained impressive on the back of several tax administration measures adopted by the Zimbabwe Revenue Authority (ZIMRA). Other measures being implemented by ZIMRA include an enhanced compliance program focusing on improvements in data matching and integrity, upgrading ICT systems, and strengthening controls. Additional efforts to recover tax arrears and simplify and modernize business processes, are also expected to improve tax compliance, plug leakages, and generate efficiency gains.

7. On the expenditure front, the authorities' frontloaded fiscal adjustment program has largely focused on containing the public wage bill through restrained wage adjustments. As a result, savings were generated from a 5 percent pay cut in the salaries of senior government officials, rationalization of the civil service, and the limiting of the civil servants 13th cheque to the basic salary. The authorities also introduced biometric verification of civil servants, which is expected to help further contain the wage bill. They also halted expenditure overruns to rein-in the budget deficit and scaled back central bank borrowing.

8. To further curtail expenditures, the authorities successfully re-set the agricultural financing model in 2019, away from direct government budget allocations, towards lending by private banks. Under the new arrangement, banks are lending to farmers in line with their normal due diligence and creditor scrutiny to minimize NPLs. Further, in the last quarter of 2019, subsidies on fuel and electricity were removed. The authorities are also reviewing the maize meal subsidy for better targeting and prudent management. Furthermore, they have terminated the gold export incentive scheme and replaced it with the Gold Fund, established by the Treasury. This will enhance transparency and minimize the effects of the gold incentives on reserve money and inflation, as the Gold Fund has been established at a much lower cost.

9. To address the worsening debt dynamics, the authorities are also considering non-debt creating sources of finance for major capital projects. At the same time, government has reduced central bank borrowing from the 20 percent statutory limit to 5 percent of the previous year's revenue, with advances only confined to smoothening short-term cashflow mismatches. Going forward, the resumption of the Treasury Bill (TB) auction system is

expected to promote competitive bidding and market pricing of government securities and the eventual reduction of the interest burden.

10. The authorities view the settlement of exchange losses stemming from the currency conversion implemented in February 2019, as essential to retain the private sector's access to critical off-shore facilities. In this respect, they plan to compensate banks' net operating positions to enhance financial stability. Already, the central bank has completed verification of the external obligations and plans to firm up on repayment modalities. Nevertheless, the authorities concur with staff that the obligations to be assumed by government, remain subject to resource availability and Parliamentary approval.

Monetary and Financial Sector Policies

11. To anchor inflation expectations and stabilize the exchange rate, the authorities concur that adoption of reserve money targeting (RMT) would be critical. In this regard, the new Monetary Policy Committee is planning to establish monthly reserve money targets consistent with low inflation. Concurrently, the Reserve Bank of Zimbabwe (RBZ) is planning to operationalize the RMT framework through deployment of open market operations tools including Treasury Bills, Savings Bonds, Corporate Bonds, and reserve requirements to support active liquidity management. Consistent with Fund advice, the authorities introduced the interbank market for foreign exchange in February 2019 which allows for the greater role of market forces. They also launched the Reuters Electronic Trading Platform (RETP) to enhance the efficiency of the interbank market. The RETP is expected to promote realistic price discovery and help remove distortions while the market determined exchange rate is expected to help eliminate the need for the gold export incentive.

12. The banking sector remains generally stable with sustained earnings performance, fairly liquid positions, and reasonably good asset quality. In light of emerging vulnerabilities faced by banks, the authorities recently directed banks to increase their minimum capital requirements. In addition, the RBZ is developing guidance on the implementation of the Basel III capital and liquidity framework to support ongoing measures to enhance the stability and resilience of the financial system. Relatedly, the central bank is in the process of operationalizing the macro-prudential policy framework to improve identification of financial vulnerabilities.

13. The authorities have also advanced work to implement recommendations of the 2019 Financial Sector Stability Review (FSSR). In this regard, they have made steady progress in strengthening off-site examinations, capacitating the financial stability unit of the RBZ, and revamping the supervisory toolkit. Further, the authorities are currently reviewing the regulatory and supervisory framework to strengthen consolidated supervision, cross-border cooperation, and crisis management.

14. Satisfactory progress has been made in improving the coverage and usage of the web-based Credit Registry. In parallel, work is advancing to establish a collateral registry for

movable assets, which is expected to promote access to credit including by SMEs. The RBZ has also directed banks to appropriately review their risk management systems to mitigate financial stability risks stemming from adverse climate events. The authorities are also pressing ahead with the implementation of the National Financial Inclusion Strategy (NFIS) which was launched in 2016. Under the NFIS, efforts are being made to promote product diversification, innovation and human centered design of financial services and delivery channels, financial literacy, consumer protection, micro-insurance, and support for SMEs. As a result, access to financial services has more than doubled between 2016 and 2019, underpinned by increased access by women, the youth, and SMEs, as well as the opening of low-cost accounts.

Structural Reforms

15. The authorities are making determined efforts to implement comprehensive structural reforms to promote private sector development and improve the business environment. In this vein, they are advancing work to identify, evaluate, and determine appropriate restructuring models that are suitable for various state-owned enterprises (SOEs). Already, work has commenced to restructure the Grain Marketing Board, re-bundle the power utility company (ZESA), and review government's shareholding in the telephone and mobile phone SOEs. Further, government has earmarked 43 out of 107 enterprises for privatization, liquidation, or merger. At the same time, the Public Entities Corporate Governance (PECG) Act was approved in November 2018, while the Corporate Governance Unit was established in the President's office.

16. The authorities are at an advanced stage to establish the Zimbabwe Investment Development Authority (ZIDA) which is expected to integrate the various investment-supporting institutions into a one-stop investment shop. In addition, work is advancing to review about 40 pieces of legislation aimed to improve the business climate and enhance the country's investment appeal. On AML/CFT, the authorities are currently addressing deficiencies identified in the 2016 Mutual Evaluation Report, to safeguard the integrity of the financial system.

17. The authorities are planning to develop a roadmap for the implementation of recommendations of the recent Governance and Vulnerabilities Assessment conducted jointly by the IMF and the World Bank. Meanwhile, progress has been made on governance reforms targeting improvements in individual and media freedoms. In this context, the Public Order and Security Act (POSA) has been repealed and replaced with the Maintenance of Peace and Order Act (MOPA). On the other hand, work to review the Access to Information and Privacy Protection Act (AIPPA) has advanced. Furthermore, the Zimbabwe Anti-Corruption Commission (ZACC) has been reconfigured and capacitated to intensify the fight against corruption.

18. The authorities attach great importance to ensuring adequate social spending to cushion vulnerable households and creating fiscal space for growth-enhancing public investment. External support, however, remains essential to complement government's efforts to strengthen social safety nets and mitigate the pain of adjustment on vulnerable households. The compression of real wages over the recent past, extreme poverty levels, and the adverse impact of weather shocks, underline the need for stronger social safety nets to avert the humanitarian crisis. Although government has increased budgetary allocations for social assistance, the remaining financing requirements are significant, thereby, underlining the need for donor support to avoid further impoverishment of vulnerable segments of the population. This is particularly important given that the drought conditions are expected to persist into 2020.

Conclusion

19. The authorities acknowledge the pressures exerted by high money supply growth on inflation and the exchange rate in the past year. Going forward, they are determined to rein-in monetary expansion while pursuing further fiscal consolidation. At the same time, they remain committed to reforms under a Fund supported SMP, which remains a critical step towards amicable resolution of the country's debt arrears and re-engagement with the international community. They are determined to implement corrective measures including through sustained fiscal consolidation and supportive monetary and structural reforms. They however, require support from the international community to sustain reforms, alleviate poverty, and ensure food security. That said, the authorities remain optimistic that the Fund can help explore more innovative ways to assist them overcome attendant challenges. They look forward to continued Fund engagement and technical support to sustain the reform momentum.