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THIRD REVIEW UNDER THE STAFF-MONITORED PROGRAM AND SUCCESSOR STAFF-MONITORED PROGRAM—STAFF REPORT; AND PRESS RELEASE

In the context of the third review under the Staff-Monitored Program and Successor Staff-Monitored Program, the following documents have been released and are included in this package.

- The **Staff Report** prepared by a staff team for the Executive Board's information following discussions that ended on October 1, 2014, 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 November 4, 2014.
- A **Press Release**

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Zimbabwe*
Memorandum of Economic and Financial Policies by the authorities of Zimbabwe*
Technical Memorandum of Understanding*

*Also included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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November 4, 2014

THIRD REVIEW UNDER THE STAFF-MONITORED PROGRAM AND SUCCESSOR STAFF-MONITORED PROGRAM

EXECUTIVE SUMMARY

Outlook. Zimbabwe's economy is at a crossroads. The post-hyperinflation rebound has ended and the outlook is for sluggish growth in 2015. Sustained growth and poverty reduction will require comprehensive reforms over the medium term. Following the slowdown in reform implementation in the post-election period, new momentum for policy reform is building up. This presents a window of opportunity for a deeper engagement and a potential path toward normalizing relations with the international community.

Performance under the SMP. The SMP that expired in June 2014 provided an important anchor for macroeconomic policies. Zimbabwe succeeded in keeping macroeconomic conditions relatively stable, despite difficult political and economic circumstances. The authorities' renewed commitment to the policies under the program was key to meeting all targets and benchmarks for the third review.

Successor SMP. The main objective of the new program is to strengthen the country's external position, as a prerequisite for arrears clearance, resumption of debt service, and restored access to external financing. To that end, the authorities will strive to consolidate the fiscal position, accumulate international reserves, and mobilize international support for resolving the country's external debt situation. They will also aim to restore confidence in the financial sector, as well as improve public debt and financial management. Finally, the authorities plan to make progress in a number of key structural reform areas in order to enhance the business climate, boost productivity and competitiveness, and build confidence.

Risks. The most salient domestic risks stem from possible policy slippages that may undermine support for the authorities' strategy to normalize relations with creditors. The lack of progress on reforms would further worsen the external position, set back the country's capacity to repay, and ultimately hurt the chances for economic recovery. Even in the absence of policy slippages, adverse political developments may complicate the authorities' efforts to garner broad support for their strategy. The benefits to economic prospects from a successful implementation of the program and resumed relations with creditors would outweigh the downside risks that, if materialized, would maintain the current status quo.

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Discussions took place in Harare from September 17 to October 1, 2014. The staff team comprised Mr. Fanizza (head), Mr. Beddies (resident representative), Ms. Morgan, Mr. Slavov (all AFR), Ms. Mendez (FIN), and Mr. Cipollone (SPR). Ms. Teferra (OED) joined the discussions during the mission.

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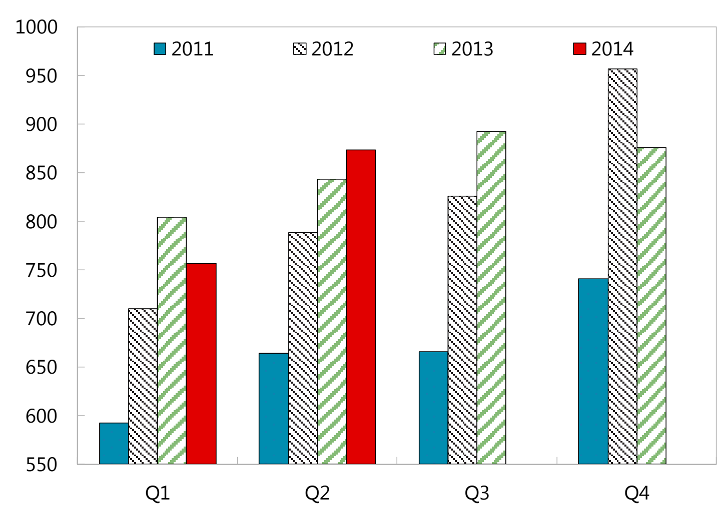
RECENT DEVELOPMENTS AND PROGRAM PERFORMANCE

1. **Zimbabwe's economy is at a crossroads.** The SMP that expired at the end of June 2014 provided an important anchor during a difficult election year. Following the slowdown in reform implementation in the post-election period, new momentum is building up, with the Zimbabwean authorities displaying renewed interest in policy reforms, as well as a commitment to start tackling the country's economic problems. This presents a window of opportunity for a deeper engagement and a potential path toward normalizing relations with the international community.

2. **Growth and inflation have both decelerated (Figure 1, Table 1).** Following a post-hyperinflation rebound, economic growth dropped in 2013 and it is likely to further decline to about 3 percent in 2014, amid widespread company closures, rising unemployment, and contracting activity in both mining and manufacturing. Bumper harvests in tobacco and maize are unlikely to offset the weakness elsewhere in the economy. Inflation will hover close to zero in 2014 because of the continued impact of the recent South African rand depreciation and weak domestic demand.

3. **The external position is expected to improve in 2014, mainly as a result of fiscal tightening, but remains precarious (Figure 2, Table 2).** International reserves are on the rise, but at half a month of import cover are clearly inadequate. We project the deficit on the current account at 22 percent of GDP in 2014, down by almost 4 percentage points from 2013. Private long- and short-term capital inflows are likely to continue to finance the bulk of the deficit, with FDI likely to increase somewhat because of the recent relaxation of capital controls. The accumulation of arrears will continue to reflect only interest and penalties on old unpaid obligations.

Text Figure 1. Zimbabwe: Quarterly Tax Revenues, 2011–2014



Source: Ministry of Finance and Economic Development.

4. **The fiscal position came under pressure in early 2014 (Figure 3, Table 3).** Tax revenues under-performed in Q4 of 2013 and Q1 of 2014, as the economy weakened (Text Figure 1). In addition, while the 2014 budget provided for an 8 percent increase to the overall wage bill, following the conclusion of public sector wage negotiations in January 2014, the projection for 2014 wage bill growth rose to 14 percent. The larger increase resulted from the new government's determination to honor its election commitments.

Text Table 1. Zimbabwe: Central Government Operations, June 2014

(cash basis; in millions of U.S. dollars)

	Budget (1)	Program (2)	Outturn (3)	Difference (3)-(2)
	Jan-June 2014			
Total revenue & grants	**1,848**	**1,735**	**1,803**	**67**
Tax revenue	1,738	1,553	1,630	77
Personal income tax	346	382	430	48
Corporate income tax	190	171	172	1
Other direct taxes	131	120	127	7
Customs	195	154	139	-15
Excise	261	228	241	13
VAT	558	437	451	14
Other indirect taxes	58	60	69	9
Non-tax revenue	110	182	173	-9
Of which: Additional mineral revenues	37	25	0	-25
Total expenditure & net lending	**1,742**	**1,797**	**1,772**	**-24**
Current expenditure	1,618	1,662	1,651	-11
Employment costs	1,197	1,259	1,266	7
Wages and social security payments	972	1,021	1,028	7
Pensions	225	239	238	0
Interest payments	18	18	18	0
Goods & services	130	119	97	-22
Grants & transfers	273	266	270	4
Of which: Employment costs	213	220	220	0
Capital expenditure and net lending	123	134	121	-13
Capital expenditure	90	117	108	-9
Net lending	33	18	13	-4
Overall balance	**106**	**-62**	**30**	**92**
Primary balance	**124**	**-43**	**48**	**92**

Source: Ministry of Finance and Economic Development.

5. **To address these fiscal headwinds, the authorities implemented a package of revenue and expenditure measures in Q2 of 2014.[1]** As a result, the authorities comfortably met their fiscal targets for the first half of the year. Revenues performed well, thanks to a strong Q2 (Text Table 1). Tax revenues benefited from ZIMRA's determined push to improve tax compliance and from a

[1] As originally announced (see EBS/14/139), the revenue measures in the package included targeted tax compliance operations, higher non-tax revenues (mostly from redirecting surplus resources in several extra-budgetary funds), and additional customs revenue from selective increases in duties and a determined effort to address identified leakages. Expenditure measures included re-prioritizing non-personnel, non-interest expenditures, while ring-fencing high-value social spending. The authorities were successful in executing the expenditure side of the package. On the revenue side, while tax compliance operations and extra-budgetary funds yielded the expected additional revenues, customs measures were postponed until the second half of 2014.

bumper tobacco crop which was auctioned in the second quarter. Under non-tax revenues, the absence of diamond dividends was offset by unforeseen license fees. The authorities also managed to contain non-interest, non-personnel expenditures.

6. **The banking sector has not yet fully recovered from the boom and bust that followed the end of hyperinflation (Figures 4-5).** Deposit growth has slowed significantly, although the good tobacco season translated into a temporary pick-up in the first half of 2014. The growth rate of credit has remained well below that of nominal GDP. Non-performing loans (NPLs) are now at 18.5 percent of total loans, up from 16 percent at the end of 2013, mainly because of sluggish economic activity. The distribution of liquidity in the system has been highly skewed, with no functioning interbank market. On the positive side, provisioning levels for NPLs have improved, but this has dented profitability. The system is highly segmented and strong banks do not appear to be exposed to banks that suffer from high NPLs (Text Table 2).

Text Table 2. Zimbabwe: Selected Financial Sector Indicators, June 2014

	Share of Assets	Share of Deposits	Loans/ Deposits	Liquidity Ratio	NPLs/ Total Loans	Capital Adequacy Ratio 1/	ROA	ROE
Commercial banks	82.9	82.1	93.9	35.1	18.7	9.1	0.1	0.8
Top five	52.4	52.3	93.1	43.5	10.7	7.1	1.2	2.3
Top domestic bank	24.1	23.1	103.0	32.3	6.6	14.2	0.7	0.8
Top foreign-owned banks	28.2	30.9	73.6	48.0	14.2	4.7	1.7	1.4
Merchant banks	1.2	1.7	93.4	1.1	97.2	-8.3	-9.8	-1.0
Building societies	14.5	14.2	94.1	40.8	7.9	31.8	3.3	2.1
Post Office Bank	1.4	2.0	57.2	75.9	15.6	11.2	0.8	-0.1
Total banking sector	100.0	100.0	100.2	38.2	18.5	12.3	-0.1	1.1
of which: Troubled banks 2/	8.2	7.9	122.8	8.4	76.4	-5.0	-7.1	-3.9

1/ The minimum capital adequacy ratio was increased from 10 percent to 12 percent effective August 1, 2012.

2/ Includes four commercial banks (of which one is under curatorship) and one merchant bank.

Source: Reserve Bank of Zimbabwe.

7. **All program targets for the June 2014 test date were met,** as the authorities' renewed commitment to policy reforms resulted in improved program implementation (Table 1, MEFP). Following the package of revenue and expenditure measures, the primary cash balance recorded a surplus of US$48 million (about 0.3 percent of GDP), against a target for a primary deficit of 0.3 percent of GDP. While containing expenditures, the authorities succeeded in protecting priority social spending and met their end-June target. The stock of domestic arrears was significantly lower than envisaged under the program. The authorities met the floors on payments to the PRGT and on net international reserves. No new non-concessional external debt was incurred in the first half of 2014, before the SMP expired at the end of June.

8. **The authorities also made progress on their structural reform agenda (Table 2, MEFP):**

- Cabinet approved the principles for amendments to the Mines and Minerals Act in July 2014. The corresponding bill has been drafted and reviewed, and should be submitted to the Cabinet Committee on Legislation by end-2014. Once enacted, the bill will modernize the legislation and make it consistent with international best practices, in line with the authorities' commitment to reform the mining sector.

- Cabinet approved the principles for the Public Debt Management Bill in June 2014. The bill will be submitted to Cabinet for approval by December 2014 (structural benchmark for the first review of the successor SMP), and then submitted to Parliament by March 2015. When enacted, the new bill will provide the Ministry of Finance and Economic Development (MoFED) with a stronger and more effective mandate to plan, negotiate, and monitor external borrowing operations. It will also bolster the institutional role of the Debt Management Office at MoFED. Combined with Fund technical assistance, the new bill should strengthen the quality of public debt management in Zimbabwe.

- Cabinet approved the principles for amendments to the Banking Act in June 2014. The amendments are expected to be submitted to Parliament by end-March 2015 (structural benchmark for the second review of the successor SMP). The authorities and staff agree that, once enacted, these amendments will improve corporate governance in the banking sector, strengthen the Troubled Bank Resolution Framework, enhance consumer protection, improve regulatory coordination, and facilitate the licensing and regulation of credit reference bureaus.

OUTLOOK AND THE SUCCESSOR STAFF-MONITORED PROGRAMME

9. **The outlook is for sluggish growth in 2015 (Figure 6).** Sustained growth and poverty reduction will require comprehensive reforms over the medium term. The successor SMP aims to lay the foundations for such reforms. The main objective of the program is to strengthen the country's external position, as a prerequisite for arrears clearance, resumption of debt service, and restored access to external financing. To that end, the authorities will strive to consolidate the fiscal position, accumulate international reserves, and mobilize international support for resolving the country's external debt situation. They will also aim at restoring confidence in the financial sector, as well as improving public debt and financial management. Finally, the authorities plan to make progress in a number of key structural reforms in order to enhance the business climate, boost productivity and competitiveness, and build confidence (¶6, MEFP).

A. Restoring Fiscal Sustainability and Advancing Fiscal Reform

10. **The authorities believe that further fiscal consolidation will be critical to bringing public finances back on a sustainable footing.** The authorities' fiscal policy for the remainder of 2014 and for 2015 will be anchored on moving the central government's primary balance from a small deficit in 2014 to a near balance in 2015 on a cash basis, while protecting priority social spending and gradually reducing the stock of domestic arrears (¶5 and 7, MEFP). In the medium term, the authorities will target a primary fiscal surplus of between 1.5 and 2 percent of GDP, in order to re-build international reserves and restore their debt service capacity. While the burden of fiscal adjustment so far has fallen on revenues and non-interest, non-personnel expenditures, the authorities will make an effort to tackle the large public sector wage bill, by maintaining the ongoing

hiring freeze, indexing wages to inflation, and streamlining the civil service.[2,3] To mobilize additional revenues, they have already raised excise duties on fuel and certain customs duties.

11. **The authorities remain committed to their agenda for improving diamond revenue transparency and reforming the diamond sector:**

- The authorities are seeking to overcome legal and institutional obstacles, so that the retroactive withholding of the special 15 percent diamond dividend can start in Q4 of 2014, after a delay.[4]
- The authorities are also on track with their plans to amend the Mines and Minerals Act by end-2014 and the Precious Stones Trade Act by end-2015.
- They are reviewing the fiscal regime for the mining sector in order to encourage new investment and ensure that Zimbabwe maximizes the benefits from its mineral resources (structural benchmark for the second review).
- In addition, they are reviewing the structure of the diamond sector, with a view to streamlining the number of companies operating in the sector to not more than three.
- The audited financial accounts of the Zimbabwe Mining Development Corporation (ZMDC) will be published annually, as required by law.
- An inter-agency task force is meeting on a regular basis to forecast and monitor diamond-related revenue collections. The task force has developed a monthly reporting template for diamond companies that should enhance the accuracy of revenue projections and flag possible revenue shortfalls (¶8, MEFP).

12. **The authorities are reviewing their revenue administration framework, with Fund technical assistance.** Reform efforts will focus on customs administration, where compliance has emerged as a recurrent sore point in recent years and revenue collections under-performed in the first half of 2014 (Text Table 1). The authorities' reforms aim to mobilize additional revenue and also make the system simpler and fairer by closing the gaps in tax administration and streamlining procedures, in line with the recommendations of recent Fund TA (¶9, MEFP).

13. **Further fiscal consolidation will require substantial rebalancing of the current expenditure mix.** The authorities are committed to reducing the public sector wage bill relative to revenues and expenditures in the medium term, while preserving the real value of salaries in the civil

2 The projected increase in the 2015 public sector wage bill is 2.9 percent, lower than the growth rate of nominal GDP, and resulting mostly from wage drift.

3 On a cash basis, 2015 spending on goods and services is projected to increase to 2.4 percent of GDP in 2015 from 2 percent in 2014, while capital spending is projected to decline to 2.1 percent of GDP in 2015 from 2.5 percent in 2014. On a commitment basis, the numbers for 2015 are significantly lower, as they assume a substantial effort to reduce domestic arrears in 2015.

4 The special diamond dividend is projected to yield US$31 million (0.2 percent of GDP) in 2014, and US$80 million (0.5 percent of GDP) in 2015.

service. They have cautioned that substantial political economy difficulties call for a more gradual approach on this issue. They are committed to granting only one salary adjustment in 2015, as they did in 2013 and 2014. In addition, they will maintain the ongoing hiring freeze, while allowing some limited flexibility in filling critical vacancies. Furthermore, the Civil Service Commission (CSC) is currently undertaking a restructuring exercise aimed at aligning ministries' staffing with their mandates, and also at identifying redundancies. Moreover, the CSC is modernizing and decentralizing the Salary Service Bureau in order to improve its grip on the wage bill. The CSC's Human Resource Management Information System is now up and running. It will be rolled out to five line ministries in 2014, and to all others in 2015. Over the medium term, the authorities intend to pursue comprehensive civil service reform (¶10-11, MEFP).

14. **The authorities remain committed to reducing domestic arrears over time.** They have been successful in containing the consumption of services by the public sector, with monthly bills so far in 2014 about 5 percent lower than last year. While these measures represent clear progress, they also need to be combined with realistic provisions in the 2015 budget, and beyond, in order to reduce the recurrence of domestic arrears (¶12-13, MEFP).

15. **Addressing the governance and accountability issues that have emerged in the last few months within the country's state-owned enterprises and local authorities constitutes an urgent priority.** Toward that end, the authorities plan to review the Public Finance Management Act in order to strengthen MoFED's financial oversight of state-owned enterprises (SOEs) and local authorities (structural benchmark for the second review). They also intend to review the Procurement Act in order to tighten the public procurement framework and make it more efficient at delivering value for money (structural benchmark for the third review). With Fund technical assistance, the authorities plan to develop a comprehensive public financial management (PFM) reform strategy and action plan (¶14-16, MEFP).

B. Rebuilding Confidence in the Financial System

16. **The authorities' overriding objective is to restore confidence and bring stability to the financial sector.** The authorities are taking steps to recapitalize the Reserve Bank of Zimbabwe (RBZ), to allow it to focus on its core functions. Following the central government's decision to assume RBZ's non-core debt (arising from quasi-fiscal activities), medium-term debt securities are being issued to banks and non-bank institutions against validated debts.[5] The government's treasury accounts were successfully transferred from a commercial bank to the RBZ in early-July 2014, thus restoring the RBZ's function as banker to the government. Following the recapitalization of the RBZ and the return of stability to the financial system, the authorities intend to consider possible options for establishing a lender-of-last-resort facility for solvent banks over the medium term, with Fund technical assistance based on the experiences of other dollarized economies (¶17, MEFP). The authorities agree with staff that establishing such a facility may be difficult, particularly in light of the tight fiscal position.

[5] Total non-core domestic and external liabilities are estimated at US$1.35 billion. As of end-September 2014, some US$261 million of securities have been issued to clear validated debt.

17. **The RBZ has committed to intensifying the monitoring of troubled banks, with a particular focus on loan provisioning practices and risk management.** The number of troubled banks has been reduced from seven to four through closures, mergers, and voluntary surrenders of licenses. The RBZ has been proactive in ensuring the efficient resolution of these banks. Shareholders and boards of troubled banks have been directed to finalize their turnaround plans by end-2014 or face supervisory intervention. In addition, amendments to the Banking Act will strengthen RBZ's powers to effectively deal with troubled banks.

18. **The RBZ plans to tackle the deteriorating quality of assets in the banking system (¶18, MEFP).** Given the impact of high level of NPLs on financial stability and economic growth, the RBZ will develop a framework to address the problem, with Fund technical assistance. The Zimbabwe Asset Management Corporation (ZAMCO), a special-purpose vehicle (SPV), has been established to acquire, restructure, and dispose of the NPLs while minimizing the impact on the budget. The authorities plan to develop the key features required to underpin a successful asset purchase strategy for ZAMCO. Specifically, by end-December 2014, they plan to develop a mandate for ZAMCO detailing its overarching objectives, the assets eligible for purchase, a timeline for assets to be transferred, the role of public guarantees (if any), the ownership structure, and a sunset clause specifying when ZAMCO's operations will be closed down (structural benchmark for the first review). In addition, by end-March 2015, the authorities plan to design the operational framework for ZAMCO, specifying an appropriate legal and governance structure, an asset valuation and pricing strategy, and a feasible and sustainable funding strategy. (Structural benchmark for the second review). The authorities have requested Fund technical assistance to develop a strategy and operational guidelines for ZAMCO. The design of ZAMCO's governance structure, funding mechanism, transfer pricing, and lifespan will be critical in minimizing moral hazard and fiscal costs.

19. **ZAMCO is only one element of the strategy to effectively address the NPL problem**. To this purpose, the authorities plan to develop, with the help of Fund TA, measures to strengthen banking supervision, to ensure banks are adequately capitalized, to strengthen the legal framework regarding insolvency and foreclosure regimes, and to address any tax or other disincentives to loan write-offs and asset sales.

20. **ZAMCO's operations will be complemented by the establishment of a central credit registry system to address informational asymmetries in the sector (¶19-20, MEFP).** The necessary amendments to the Reserve Bank of Zimbabwe Act have been approved by Cabinet and will be submitted to Parliament in the first half of 2015 (structural benchmark for the second review). In the meantime, the RBZ has enhanced stress testing frameworks, and enforced regulations for writing off NPLs. In addition, the authorities are working on the establishment of limits on insider loans.

21. **The minimum capital requirements have been revised to promote flexibility in the financial sector, with both large and small institutions that are strong and profitable.** The revision, which is in line with the Banking Act, will result in three tiers of banks, each with a

recapitalization plans for December 2020, with interim targets, are to be submitted to the RBZ by end-December 2014 (¶23, MEFP).

C. Resolving External Arrears and Restoring External Sustainability

22. **The outlook for Zimbabwe's external position has not changed since the recent Article IV consultation (see EBS/14/139).** The external position remains precarious: with low international reserves, a large current account deficit, and an overvalued real exchange rate. The authorities are taking the initial steps to address these imbalances. Fiscal consolidation is expected to result in higher international reserves and a lower current account deficit. Strengthening the external position will require a determined effort over the life of the successor SMP and beyond. The authorities remain committed to the multicurrency system over the medium term, which leaves relative price adjustments and productivity growth as the only available levers for macroeconomic adjustment.

23. **The authorities continue to borrow on terms that are as concessional as possible.** In August 2014, they contracted one new external loan from China Eximbank. The loan amounts to US$219 million and finances an upgrade of telecom infrastructure. The authorities managed to negotiate a grant element of 27 percent, short of the 35 percent standard concessionality requirement, but still substantial. Despite the fact that this new loan was contracted during the gap period between the two SMPs, the authorities have agreed that it will count toward the US$400 million ceiling for non-concessional financing for 2014 (Table 3, MEFP).

24. **The authorities remain committed to seeking primarily grants and concessional financing for critical development projects with high economic returns.** The authorities also reaffirmed their commitment to use non-concessional financing only if concessional resources are unavailable, to finance critical infrastructure projects in power, water and sanitation, and transportation and telecommunications. The authorities are currently negotiating several new loans with external creditors to upgrade essential infrastructure. Before signing any new non-concessional loans, the authorities have agreed to seek a project viability assessment from the African Development Bank (AfDB), the World Bank, or the Development Bank of South Africa. They have also committed to consulting with Fund staff at an early stage of the negotiations, in order to seek a comprehensive assessment of the financial terms and conditions, and to prevent a breach of the program ceiling on new non-concessional external debt (¶27, MEFP).

25. **Zimbabwe will remain in debt distress in the absence of comprehensive debt relief.**[7] The authorities intend to approach multilateral creditors to agree on a plan that could eventually

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lending, leasing, and hire purchases. Tier II banks (small commercial banks, building societies, and merchant banks) will be restricted to core banking activities only, and are required to have minimum core capital of US$25 million by 2020. For Tier III banks (deposit-taking microfinance institutions), the minimum core capital requirement increases from US$5 million to US$7.5 million by 2020. Banks can migrate to a higher tier, provided they meet the necessary capital requirements and have in place risk management systems commensurate with the nature and scope of the activities of the higher tier.

[7] The recent external debt reconciliation and assessment clearly indicated that Zimbabwe does not currently qualify for debt relief under the HIPC Initiative.

lead to clearing outstanding arrears. This would serve as a prerequisite for seeking rescheduling of bilateral official debt by the Paris Club, possibly including debt relief. The authorities made it clear that they would focus on seeking traditional debt relief from the Paris Club, and have started to explore ad hoc debt relief options with creditors. They have asked multilateral creditors and stakeholders to propose feasible ad hoc options. The authorities have also reiterated their commitment to refrain from drawing down their remaining SDR holdings during the duration of this successor SMP (¶24-25, MEFP).

26. **The authorities have committed to continue regular payments to multilateral creditors, including the IMF, the AfDB, and the World Bank.** They will continue to make regular payments of at least US$ 150,000 per month to the PRGT (Table 3, MEFP), and are committed to increasing these payments as their capacity to repay improves. The authorities have acknowledged that increasing payments to the World Bank and other IFIs is a prerequisite for normalizing relations with these creditors. To this end, they intend to increase these payments as the country's external position strengthens. Moreover, to the extent possible, they plan to raise payments to the levels required by these organizations' policies, by the end of the program period. They will also start making payments to the European Investment Bank. The authorities plan to avoid selective debt servicing to bilateral external creditors, as doing so would make it more difficult to reach agreement on a debt workout in the future, but they will continue making payments to those creditors providing positive net financing (¶24-25, MEFP).

D. Unlocking Potential for Sustained Growth and Poverty Reduction

27. **Since their enactment in 2009, the Indigenization and Economic Empowerment Laws have had an adverse effect on much-needed investment and capital flows.** In the authorities' view, these laws seek to ensure that partnerships between Zimbabweans and foreign investors are mutually beneficial. In practice, compliance with the laws has been achieved via what has been widely perceived to be a subjective and discretionary process, with substantial uncertainty shrouding implementation. Because of the negative perceptions associated with the current indigenization and empowerment framework, the authorities plan to broaden and streamline the ways through which companies can comply (¶29, MEFP).[8] Publishing the changes in the official Government Gazette by March 2015 (structural benchmark for the second review) will provide clarity and predictability to investors and will facilitate their transparent and even-handed implementation.

28. **Under ZIM ASSET, Zimbabwe's medium-term development blueprint, the authorities are committed to job creation and equal opportunities for all Zimbabweans.** Zimbabwe's labor laws date back to 1985 and urgently need to be upgraded. Zimbabwe ranks 137 out of 144 countries for labor market efficiency in the World Economic Forum's 2014–15 Global Competitiveness Report. In consultation with various stakeholders, the authorities are developing the principles which will guide labor market reform, with a view toward modernizing legislation and making it consistent with international standards and ILO conventions (¶30, MEFP). Building

[8] Compliance will be achieved via listing on the Zimbabwe Stock Exchange, implementing programs which empower local communities, investing in designated sectors of the economy, participating in joint ventures, entering into contract farming and land use agreements, and participating in Build-Own-Operate-Transfer (BOOT) projects.

consensus around the need to make the labor market more flexible, dynamic, and efficient will also help the authorities tackle Zimbabwe's large public sector wage bill.

PROGRAM RISKS

29. **On the downside, the most salient risk stems from possible policy slippages that may undermine support for the authorities' strategy to normalize relations with creditors.** Under this scenario, the current status quo would persist, but the lack of progress on reforms would further worsen the external position, set back the country's capacity to repay, and ultimately hurt the chances for economic recovery. In addition, even in the absence of policy slippages, adverse political developments may complicate the authorities' efforts to garner broad support for their strategy.

30. **On the upside, progress in policy implementation could succeed in building support towards normalizing relations with creditors, and eventually lead to resumed access to financial support from both multilateral and bilateral creditors.** In turn, this could help the authorities address the country's deep-seated economic distortions and improve Zimbabwe's economic prospects.

31. **Other substantial risks to the successor SMP stem from global commodity price shocks and gaps in policy implementation capacity.** While Zimbabwe faces these risks with practically no buffers, the successor SMP's main objective is to rebuild these buffers and strengthen the country's resilience to shocks. The authorities have committed to taking additional policy measures to ensure the attainment of the program objectives, if these risks were to materialize (LOI). Capacity gaps will continue to be tackled through Fund technical assistance.

PROGRAM DESIGN AND MONITORING

32. **The SMP will cover a 15-month period, October 2014 through December 2015, and will be monitored based on quantitative targets and structural benchmarks (Tables 3 and 4, MEFP).** The 15-month program horizon will ensure continuity with the old SMP. The structural benchmarks focus on strengthening debt and public financial management, restoring confidence in the financial system, as well as improving tax policy and the investment climate. The SMP will be monitored based on performance through end-December 2014, end-June 2015, and end-December 2015. The authorities have established two monitoring committees comprised of officials from the main institutions responsible for macroeconomic policy. A policymakers' monitoring committee will meet monthly and be coordinated by the Office of the President and Cabinet. A technical monitoring committee will meet every week (¶33, MEFP).

STAFF APPRAISAL

33. **Achievements:** Zimbabwe has succeeded in keeping macroeconomic conditions relatively stable, despite difficult political and economic circumstances. In particular, the precarious external position improved somewhat, with higher international reserves and a projected lower current account deficit in 2014. In addition, steps to strengthen the financial sector and increase diamond

revenues have started laying the foundation for private-sector led growth. Institutional capacity has improved. The SMP that expired in June 2014 provided an anchor for macroeconomic policies. The authorities' renewed commitment to the policies under the program was key to meeting all the quantitative targets and structural benchmarks for the third review.

34. **Challenges:** Economic recovery remains elusive. Economic activity continues to decelerate despite the recent bumper crop. The country's precarious external position and debt distress have triggered a severe credit crunch that has hurt investment. The recent depreciation of the South African rand has exacerbated competiveness issues and highlighted the need for deep economic reforms to reverse the adverse economic trends. It has now become clear that Zimbabwe cannot address its development objectives of higher growth, lower unemployment, and better living conditions for its population without restoring access to finance from multilateral and bilateral creditors.

35. **Creditor relations:** Staff welcomes the authorities' decision to start discussions with multilateral creditors to address Zimbabwe's outstanding arrears, before exploring the possibility of rescheduling bilateral official debt through traditional mechanisms. This decision constitutes an important step toward normalizing relations with the international financial community. To this end, Zimbabwe needs to improve its capacity to repay and to show that it can implement policies that could justify a financial arrangement with the Fund by implementing its reform program.

36. **Fiscal Policy.** Bringing the primary fiscal accounts into balance in 2015 constitutes the lynchpin of the authorities' adjustment efforts. This objective should contribute to strengthening the external position and improving Zimbabwe's capacity to repay. Moreover, running a balanced primary budget will provide a strong and immediate signal that the country is living within its means. Planned future surpluses could provide the basis for higher repayments. However, to achieve their fiscal objective the authorities should keep public wage increases in line with inflation and limit new hiring only to essential positions that cannot be filled through redeployment. It is encouraging that the authorities have already started a civil service restructuring exercise and plan a comprehensive civil service reform. Other fiscal reforms, such as enhancing PFM, strengthening the oversight of SOEs, and improving procurement will not only help fiscal consolidation, but will also increase accountability and efficiency in the use of public resources. In light of the country's difficult economic conditions, all effort should be made to protect and possibly increase social spending.

37. **Financial Sector:** A well functioning financial system is essential to improving the country's growth prospects. Restoring confidence in the system requires a strong regulator. Thus, the authorities' decision to move ahead with the recapitalization of the RBZ is welcome. The most pressing priorities are dealing effectively with NPLs and minimizing systemic risks coming from troubled banks through monitoring closely, ringfencing, or closing them. It is encouraging that the RBZ has sought technical assistance from MCM to develop a strategy for cleaning banks' balance sheets with limited recourse to the budget, and that the amendments to the central bank act would enhance RBZ's powers to take the necessary actions to manage risks. The authorities should consider the possible establishment of a lender of last resort facility only after recapitalizing the RBZ, addressing NPLs, and resolving troubled banks. Moreover, this facility should not entail the use of public resources.

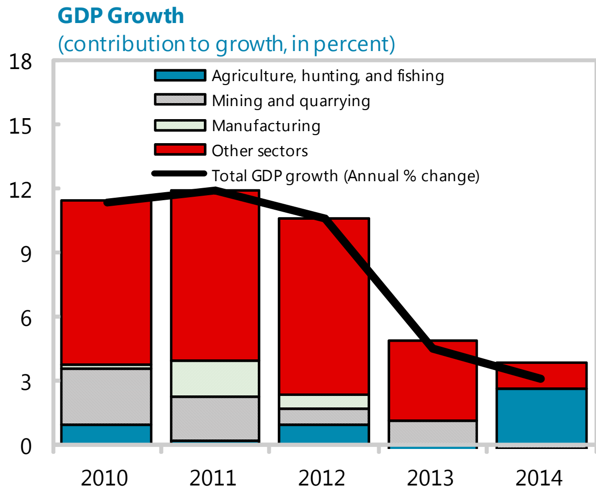
38. **Business Climate:** The authorities' decision to clarify the Indigenization and Empowerment Laws will lower uncertainty about the regulatory framework and contribute to a more business-friendly environment. This step would go a long way toward allaying perceptions about the security of investments and property rights, providing legal transparency and predictability, and reassuring markets that investing in Zimbabwe is safe. Staff welcomes the authorities' plan to reform the labor market in order to make it more flexible, and to link compensation to productivity.

39. **Balance of Risks:** The benefits to economic prospects from a successful implementation of the program and resumed relations with creditors would outweigh the downside risks that, if materialized, would maintain the current status quo.

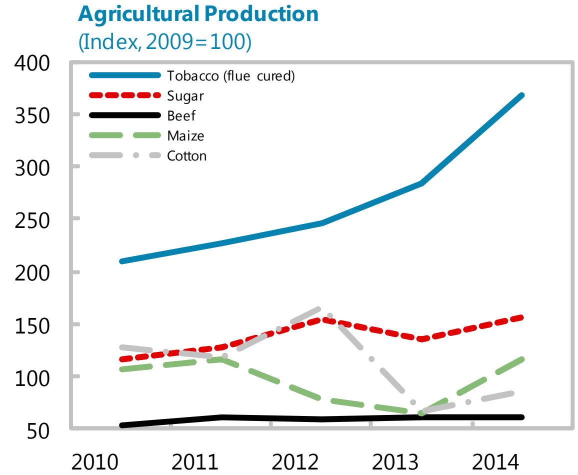
40. **External Loans and Re-payments to the IFIs:** Staff welcomes the authorities' intention to continue to seek financing through grants or loans that are as concessional as possible, and to limit contracting non-concessional loans within the ceilings set under the program. It is critical for Zimbabwe to keep repayments to the PRGT at their current level, while exploring the possibility of gradually increasing repayments to the other IFIs as the country raises its capacity to repay, toward the levels comparable with those required by IFI policies. Staff welcomes the authorities' commitment to increase payments to the PRGT, as their capacity to repay improves.

Figure 1. Zimbabwe: Recent Economic Performance

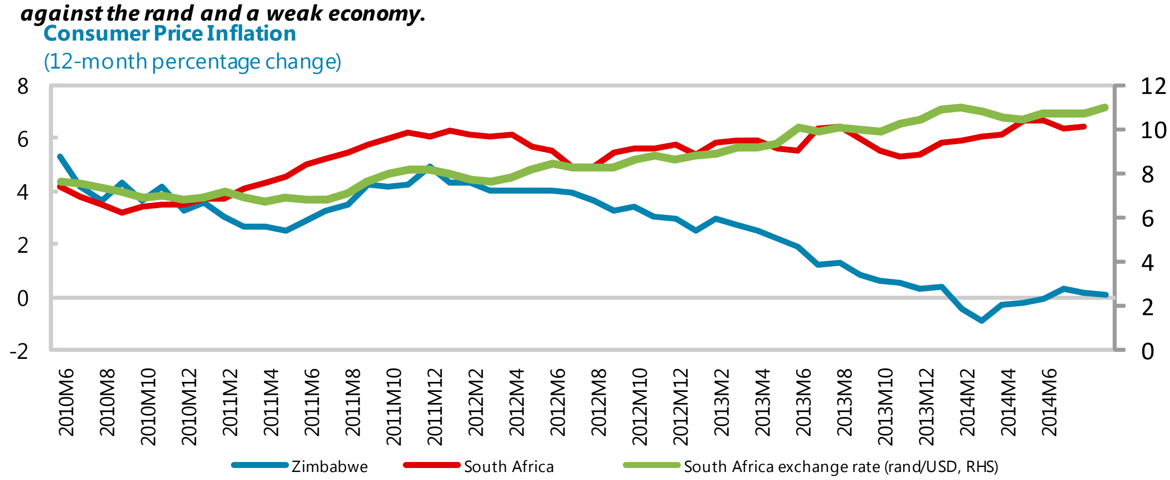
Growth decelerated in 2013-14, due to policy uncertainty and weakness in manufacturing.



A good rain season contributed to a stronger harvest in 2014.



Inflation has been very low and briefly dipped into negative territory recently, driven by appreciation against the rand and a weak economy.

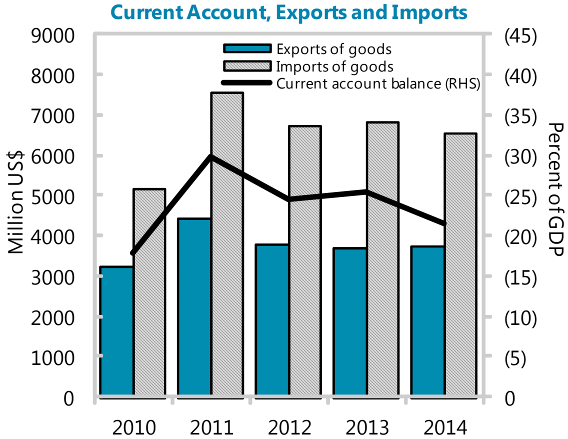


Sources: Zimbabwean authorities and IMF staff estimates.

Figure 2. Zimbabwe: External Sector Performance

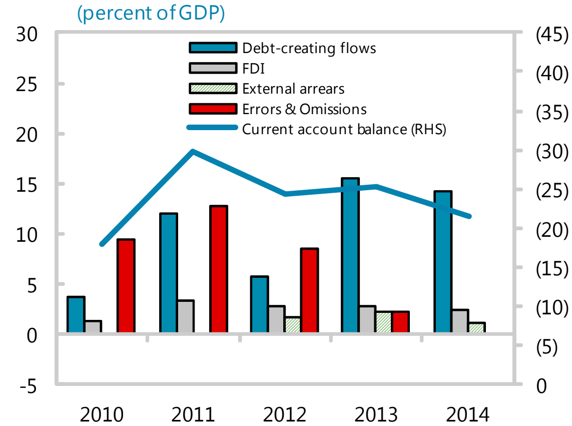
The current account deficit remained high in 2013-14, mainly due to lower-than-expected mining exports.

Current Account, Exports and Imports



External financing has come to rely more on short-term private sector debt and large flows remain unregistered. [1/]

Current Account and Financing
(percent of GDP)

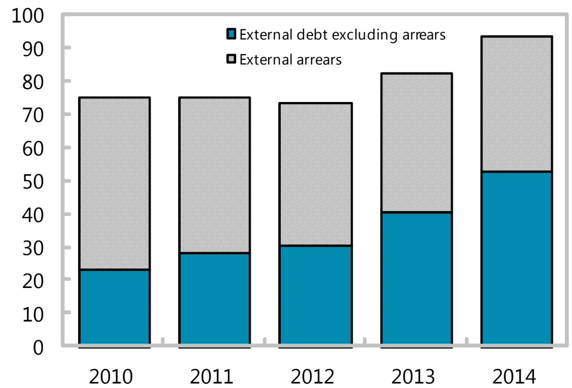


International reserves have stabilized at very low levels…

Gross International Reserves

…and the total external debt remains unsustainably high.

External Debt [2/]
(percent of GDP)

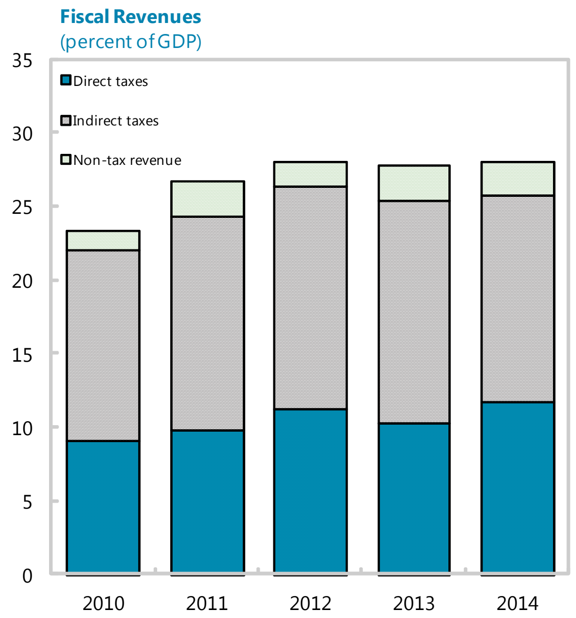


Sources: Zimbabwean authorities and IMF staff estimates.

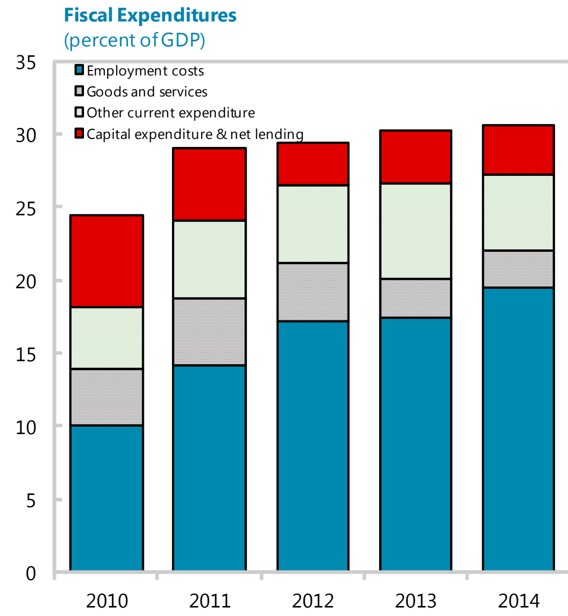
1/ These unregistered flows are likely related to unregistered remittances and exports, which would lower the current account deficit.
2/ Total external debt stocks include arrears and are estimates, except for the 2011-2013 public and publicly guaranteed debt stock which is based on preliminary results from the authorities' external debt reconciliation exercise initiated in 2013.

Figure 3. Zimbabwe: Recent Budgetary Performance

While tax revenues stagnated in 2013-14…



…employment costs have continued to grow rapidly, crowding out capital and social expenditures.

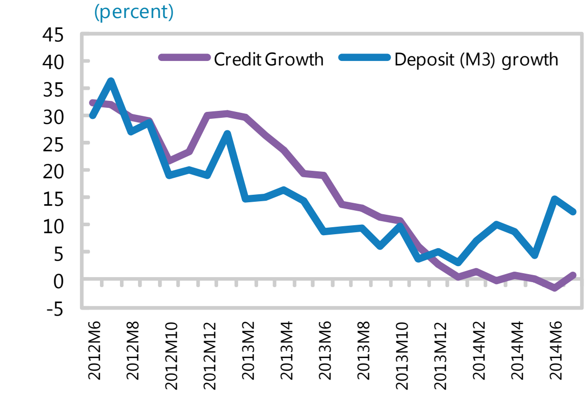


Sources: Zimbabwean authorities and IMF staff estimates.

Figure 4. Zimbabwe: Banking System Indicators

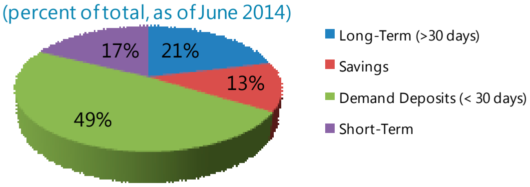
Deposits growth picked up 2014, while credit growth continued to decline.

Loans and Deposits
(percent)

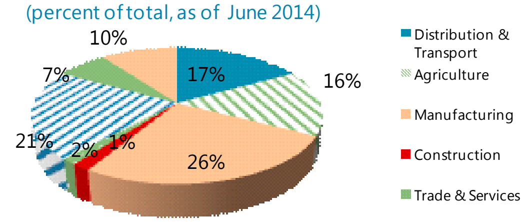


Deposits remain predominantly short-term and credit largely funds consumption.

Composition of Banking Sector Deposits
(percent of total, as of June 2014)

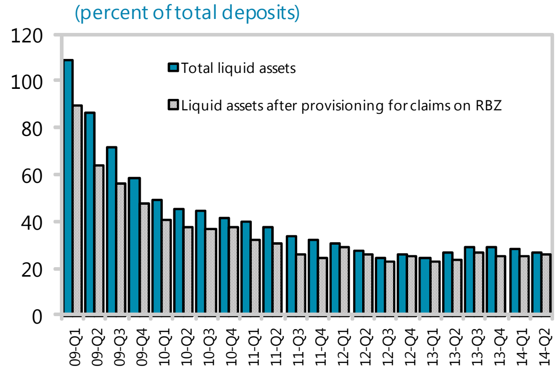


Composition of Private Sector Credit
(percent of total, as of June 2014)



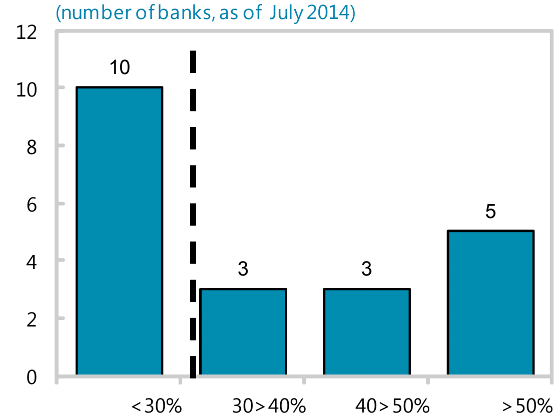
Liquidity risks remain...

Liquid Assets
(percent of total deposits)



...as 10 out of 21 operating financial institutions face tight liquidity.

Distribution of Liquidity Ratios 1/2/
(number of banks, as of July 2014)

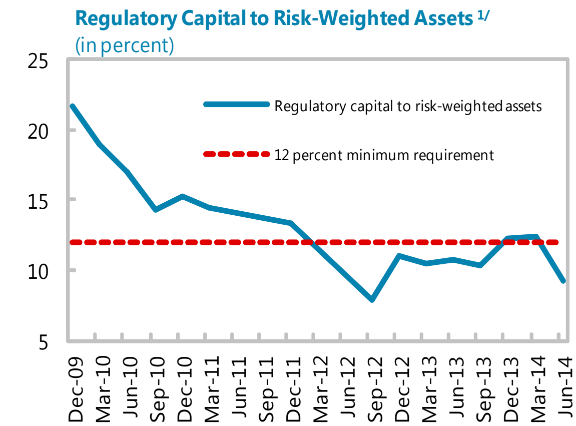


Sources: Zimbabwean authorities and IMF staff estimates.

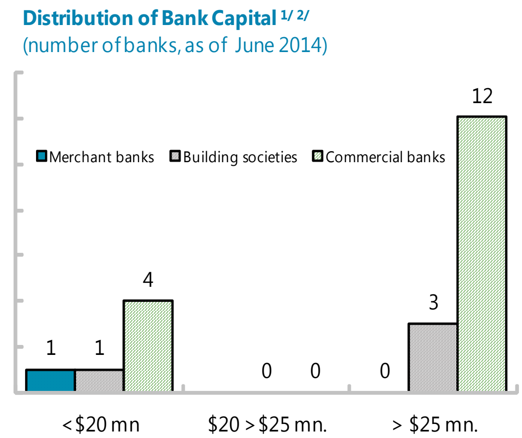
1/ The ratio of liquid assets to short-term liabilities. Liquid assets are defined as cash, claims on nonresident banks, interbank claims, and clearing balances at the RBZ. Illiquid claims on the RBZ are excluded. Short-term liabilities comprise all deposits, interbank liabilities, and liabilities to nonresidents. The prudential liquidity ratio was increased from 25% in March 2012 to 30% in June 2012.
2/ Excludes Interfin Bank which is under curatorship.

Figure 5. Zimbabwe: Banking System Performance and Soundness

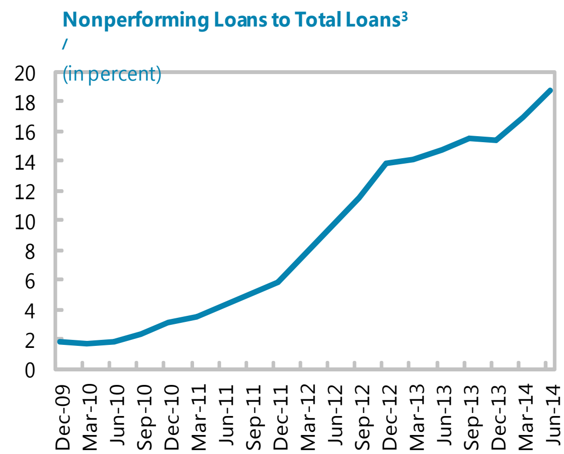
Banking system capital remains very low…



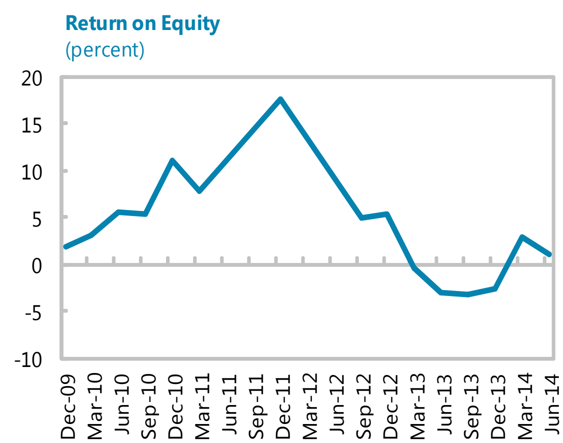
…due to a number of insolvent small banks.



Assets quality has deteriorated, with high and rising levels of NPLs…



…and this, together with the economic slowdown, has impacted bank profitability.



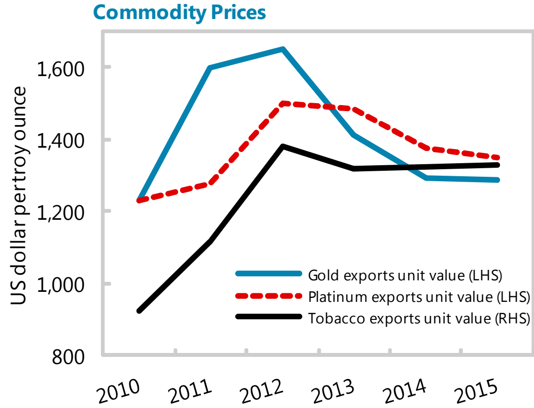
Source: Reserve Bank of Zimbabwe.

1/ Illiquid claims on the RBZ count toward capital. The minimum capital ratio was increased from 10 percent to 12 percent in August 2012.
2/ Excludes the Post Office Saving Bank. As of December 2013, minimum capital requirements are $25 million for commercial banks and merchant banks, and $20 million for building societies.
3/ Nonperforming loans of commercial banks

Figure 6. Zimbabwe: Program Scenario

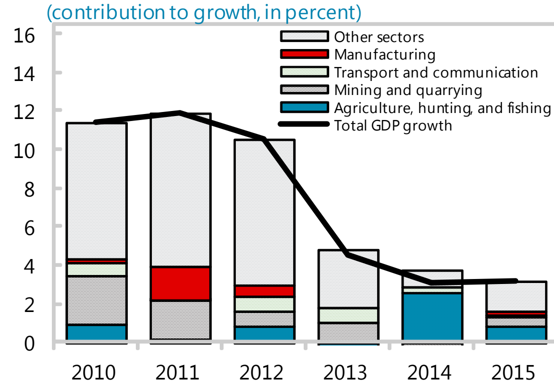
The prices of Zimbabwe's main exports are expected to stabilize at comfortable levels...

Commodity Prices



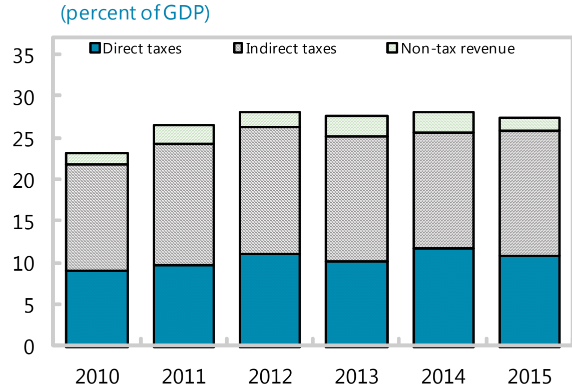
...but growth in 2015 is projected to be weak, led by services, mining, and agriculture.

GDP Growth
(contribution to growth, in percent)



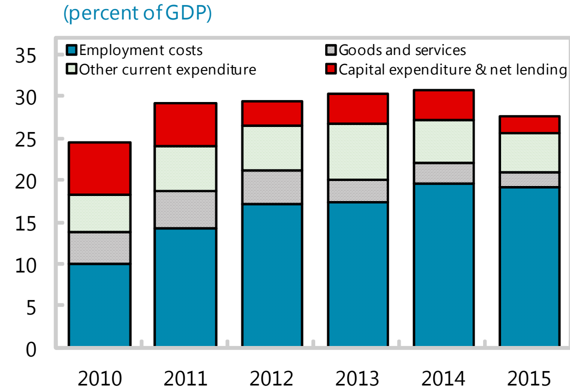
As fiscal revenues are projected to stabilize just under 30 percent of GDP...

Fiscal Revenues
(percent of GDP)



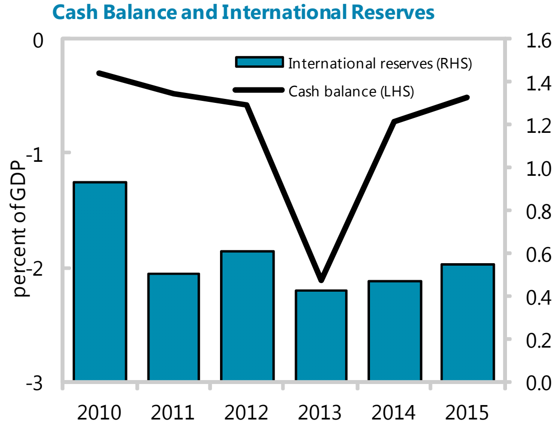
...employment costs need to be contained, to make space for high-priority capital and social spending.

Fiscal Expenditures
(percent of GDP)



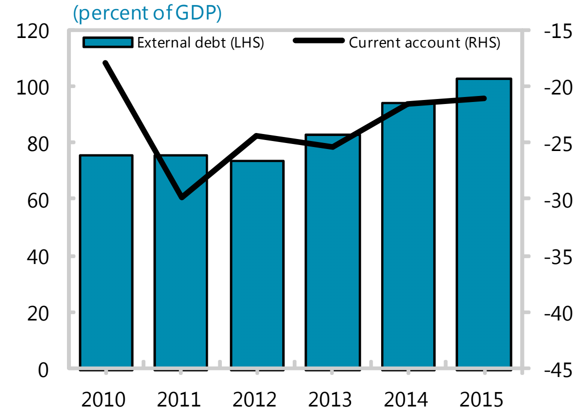
An improved fiscal position will allow for the re-building of external reserves...

Cash Balance and International Reserves



...but the large current account deficit will persist and total external debt will remain unsustainable. 1/

External Debt and Current Account
(percent of GDP)



Sources: Zimbabwean authorities and IMF staff estimates.

1/ Total external debt stocks include arrears and are estimates, except for the 2011-2013 public and publicly guaranteed debt stock which is based on preliminary results from the authorities' external debt reconciliation exercise initiated in 2013.

Table 1. Zimbabwe: Selected Economic Indicators, 2011–15

Population (millions):	13.1 (2013)	Per capita GDP:	US$ 1028 (2013)
Quota (current, SDR millions, % of total):	353.4 (0.15%)	Literacy rate (%):	96 (2011)
Main products and exports:	Tobacco, gold, platinum, diamonds		
Key export markets:	South Africa, Mozambique, United Arab Emirates		

	Actual		Projected		
	2011	2012	2013	2014	2015
Real GDP growth (annual percentage change) 1/	11.9	10.6	4.5	3.1	3.2
Nominal GDP (US$ millions)	10,956	12,472	13,490	14,012	14,585
GDP deflator (annual percentage change)	3.7	3.0	3.5	0.8	0.9
Inflation (annual percentage change)					
Consumer price inflation (annual average) 2/	3.5	3.7	1.6	0.0	0.4
Consumer price inflation (end-of-period)	4.9	2.9	0.3	0.4	0.0
Central government (percent of GDP)					
Revenue and grants	26.7	28.0	27.7	28.0	27.4
Expenditure and net lending	29.0	29.3	30.2	30.6	27.6
Of which: cash expenditure and net lending	27.1	28.6	29.8	28.8	27.9
Of which: employment costs (incl. grants & transfers)	16.7	20.1	20.5	22.9	22.6
Overall balance (commitment basis)	-2.4	-1.3	-2.4	-2.6	-0.2
Overall balance (cash basis)	-0.5	-0.6	-2.1	-0.7	-0.5
Primary balance (cash basis)	-0.2	-0.4	-1.9	-0.4	0.0
Money and credit (US$ millions)					
Broad money (M3)	3,100	3,694	3,888	4,215	4,544
Net foreign assets	-290	-435	-809	-565	-517
Net domestic assets	3,390	4,129	4,697	4,779	5,061
Domestic credit (net)	2,754	3,559	3,993	4,106	4,274
Of which: credit to the private sector	2,711	3,524	3,618	3,499	3,635
Reserve money	186	273	272	450	486
Velocity (M3)	3.5	3.4	3.5	3.3	3.2
Balance of payments (US$ millions; unless otherwise indicated)					
Merchandise exports	4,421	3,808	3,694	3,728	3,990
Value growth (annual percentage change)	36.1	-13.9	-3.0	0.9	7.0
Merchandise imports	-7,562	-6,710	-6,809	-6,538	-6,725
Value growth (annual percentage change)	46.5	-11.3	1.5	-4.0	2.9
Current account balance (excluding official transfers)	-3,269	-3,048	-3,426	-3,024	-3,068
(percent of GDP)	-29.8	-24.4	-25.4	-21.6	-21.0
Overall balance 3/	148	-186	-405	-439	-371
Gross international reserves (US$ millions)	366	398	284	304	365
(months of imports of goods and services)	0.5	0.6	0.4	0.5	0.5
Net international reserves (US$ millions)	220	259	149	172	232
Debt (end-of-period)					
Public and publicly guaranteed external debt (US$ millions, e.o.p.) 4/5/	6,268	6,709	7,014	7,249	7,518
Percent of GDP	57.2	53.8	52.0	51.7	51.5
Of which: Arrears	5,101	5,313	5,607	5,761	5,908
Percent of GDP	46.6	42.6	41.6	41.1	40.5

Sources: Zimbabwean authorities; IMF staff estimates and projections.
1/ At constant 2009 prices.
2/ For 2014, the authorities project average inflation of 0.8 percent.
3/ Includes errors and omissions through 2012.
4/ Includes arrears.
5/ Debt stocks are estimates, except for the 2011-13 debt stock which are based on preliminary results of the authorities' external debt reconciliation exercise initiated in 2013.

Table 2. Zimbabwe: Balance of Payments, 2011–15

(Millions of U.S. dollars; unless otherwise indicated)

	Actual			Projected	
	2011	2012	2013	2014	2015
Current account (excluding official transfers)	-3,269	-3,048	-3,426	-3,024	-3,068
Trade balance	-3,141	-2,902	-3,115	-2,810	-2,736
Exports, f.o.b.	4,421	3,808	3,694	3,728	3,990
Imports, f.o.b.	-7,562	-6,710	-6,809	-6,538	-6,725
Food	-513	-731	-658	-551	-542
Nonfood	-7,050	-5,980	-6,151	-5,986	-6,183
Nonfactor services (net)	-759	-866	-929	-937	-977
Investment income (net)	-906	-959	-1,018	-1,058	-1,138
Interest	-96	121	-85	10	2
Receipts	168	294	179	197	217
Payments	-265	-173	-265	-187	-215
Other	-810	-1,080	-932	-1,068	-1,140
Private transfers (including transfers to NGOs)	1,538	1,679	1,635	1,781	1,783
Remittances	570	646	764	891	940
Capital account (including official transfers)	2,024	1,811	2,723	2,585	2,697
Official transfers	346	738	251	256	262
Direct investment	360	351	373	346	457
Portfolio investment	10	99	114	120	125
Long-term capital	684	81	1,058	1,193	1,154
Government[1]	-154	-116	43	188	235
Receipts	0	20	199	265	290
Payments	-154	-136	-156	-77	-55
Public enterprises	29	11	0	0	0
Private sector	809	187	1,015	1,005	918
Short-term capital	625	543	927	670	639
Private sector (loans mediated outside DMBs)	539	365	663	781	628
Change in NFA of DMBs	85	178	264	-111	11
Change in assets	47	2	-62	-53	-39
Change in liabilities	39	176	326	-58	50
Errors and omissions[2]	1,392	1,051	297	0	0
Overall balance	148	-186	-405	-439	-371
Financing	-148	186	405	439	371
Central bank (net)	54	-27	111	-126	-60
Assets	69	-34	109	-21	-60
Change in gross official reserves	86	-32	114	-20	-60
Monetary authorities operations (non-reserve)	-17	-2	-4	-1	0
Liabilities	-16	7	1	-105	0
Change in arrears (– denotes decrease)	0	212	294	154	147
Debt relief/rescheduling; adjustment for debt reconciliation[3]	201	0	0	0	0
Unidentified financing[2]	0	0	0	411	284
Memorandum items:					
Current account balance (percent of GDP)	-29.8	-24.4	-25.4	-21.6	-21.0
Gross international reserves (US$ millions, e.o.p.)	366	398	284	304	365
Months of imports of goods and services	0.5	0.6	0.4	0.5	0.5
SDR holdings (US$ millions, e.o.p.)[4]	252	143	143	142	143
Total external debt (US$ millions, e.o.p.)[3,5]	8,231	9,134	11,117	13,137	14,953
Percent of GDP[3]	75	73	82	94	103
PPG external debt (US$ millions, e.o.p.)[5]	6,268	6,709	7,014	7,249	7,518
Percent of GDP	57	54	52	52	52
Of which: Arrears	5,101	5,313	5,607	5,761	5,908
Percent of GDP	47	43	42	41	41
Other external debt (US$ millions, e.o.p.)[3,5]	1,964	2,425	4,103	5,889	7,435
Percent of GDP	18	19	30	42	51
Nominal GDP (US$ millions)	10,956	12,472	13,490	14,012	14,585
Percentage change	16.0	13.8	8.2	3.9	4.1
Exports of goods and services	4,694	4,076	3,972	4,011	4,283
Percentage change	35.2	-13.2	-2.6	1.0	6.8
Imports of goods and services	-8,594	-7,844	-8,015	-7,759	-7,996
Percentage change	47.9	-8.7	2.2	-3.2	3.1

Sources: Zimbabwean authorities; IMF staff estimates and projections.

[1] May not match data for government external financing in the fiscal table because this line is on an accrual basis.
[2] Large errors and omissions (past data) and unidentified financing (future projections) are likely generated by under-recording of exports, remittances, and FDI.
[3] Debt stocks are estimates, except for the 2011 debt stock which is based on preliminary results of the authorities' external debt reconciliation exercise concluded in January 2013.
[4] Excludes amounts in SDR escrow account.
[5] Includes arrears.

Table 3a. Zimbabwe: Central Government Operations, 2011–15

(Millions of U.S. dollars)

	Actual			Program	Projected	
	2011	2012	2013	2014	2014	2015
Total revenue & on-budget grants	**2,921**	**3,496**	**3,741**	**4,014**	**3,928**	**3,990**
Tax revenue	2,660	3,279	3,414	3,636	3,608	3,763
Personal income tax	588	661	744	803	929	835
Corporate income tax	296	445	404	405	417	448
Other direct taxes	188	287	227	284	288	295
Customs	333	354	361	558	347	390
Excise	307	394	510	535	536	590
VAT	912	1086	1068	939	968	1051
Other indirect taxes	36	52	98	112	122	154
Non-tax revenue	261	217	327	378	320	227
Of which: Licensing fees	0	40	158	11	11	10
Of which: Diamond dividends	151	44	18	82	31	80
Budget grants	0	0	0	0	0	0
Total expenditure & net lending	**3,181**	**3,657**	**4,069**	**4,306**	**4,290**	**4,021**
Of which: Cash expenditure	2,974	3,568	4,027	4,092	4,030	4,065
Current expenditure	2,629	3,302	3,586	3,791	3,805	3,735
Employment costs	1,544	2,134	2,344	2,696	2,728	2,798
Wages & salaries	1,269	1,732	1,926	2,218	2,251	2,320
Pensions	275	402	418	478	477	478
Interest payments	113	116	120	149	147	187
Foreign	113	114	114	121	121	129
Of which: Paid	34	18	17	16	15	14
Domestic	0	3	6	28	26	59
Of which: Paid	0	3	6	28	26	59
Goods & services	504	505	359	368	350	240
Grants & transfers	468	548	763	579	580	510
Of which: Employment costs	290	370	423	461	480	504
Of which: Referendum costs	0	0	46	0	0	0
Of which: Election costs	0	0	132	0	0	0
Capital expenditure and net lending	551	355	483	515	484	286
Overall balance (commitment basis)	**-260**	**-161**	**-328**	**-292**	**-361**	**-31**
Primary balance (commitment basis) 1/	-147	-45	-208	-144	-214	157
Overall balance (cash basis)	**-53**	**-72**	**-286**	**-78**	**-102**	**-75**
Primary balance (cash basis) 1/	-19	-51	-262	-35	-60	-2
Financing	**260**	**162**	**316**	**292**	**361**	**30**
Domestic financing (net)	-25	13	270	145	178	178
Bank	4	49	198	112	175	219
Non-bank	-30	-36	72	33	3	-41
Foreign financing (net)	-48	8	-254	-246	-255	-228
Disbursements	78	0	72	18	8	10
Amortization due	127	101	326	234	234	178
Of which: Paid	0	49	68	54	54	54
Movement in Zimbabwe's SDR holdings (net)	0	109	0	-30	-30	-60
Other	0	0	0	0	0	0
Change in arrears	333	141	300	393	439	80
Domestic	128	-6	-55	109	154	-159
Arrears accumulation	128	116	123	132	177	0
Arrears clearance	0	-122	-178	-23	-23	-159
Foreign	205	147	355	284	285	239
Interest	79	96	97	105	106	115
Principal	127	51	258	180	179	124
Statistical discrepancy / Financing gap	**0**	**0**	**-12**	**0**	**0**	**0**

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

1/ The difference between the primary balance on a commitment and cash basis is the change in domestic arrears.

Table 3b. Zimbabwe: Central Government Operations, 2011–15

(Percent of GDP)

	Actual			Program	Projected	
	2011	2012	2013	2014	2014	2015
Total revenue & on-budget grants	**26.7**	**28.0**	**27.7**	**28.6**	**28.0**	**27.4**
Tax revenue	24.3	26.3	25.3	25.9	25.7	25.8
Personal income tax	5.4	5.3	5.5	5.7	6.6	5.7
Corporate income tax	2.7	3.6	3.0	2.9	3.0	3.1
Other direct taxes	1.7	2.3	1.7	2.0	2.1	2.0
Customs	3.0	2.8	2.7	4.0	2.5	2.7
Excise	2.8	3.2	3.8	3.8	3.8	4.0
VAT	8.3	8.7	7.9	6.7	6.9	7.2
Other indirect taxes	0.3	0.4	0.7	0.8	0.9	1.1
Non-tax revenue	2.4	1.7	2.4	2.7	2.3	1.6
Of which: Diamond dividends	1.4	0.3	0.1	0.6	0.2	0.5
Budget grants	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure & net lending	**29.0**	**29.3**	**30.2**	**30.7**	**30.6**	**27.6**
Of which: Cash expenditure	27.1	28.6	29.8	29.2	28.8	27.9
Current expenditure	24.0	26.5	26.6	27.1	27.2	25.6
Employment costs	14.1	17.1	17.4	19.2	19.5	19.2
Wages & salaries	11.6	13.9	14.3	15.8	16.1	15.9
Pensions	2.5	3.2	3.1	3.4	3.4	3.3
Interest payments	1.0	0.9	0.9	1.1	1.1	1.3
Foreign	1.0	0.9	0.8	0.9	0.9	0.9
Of which: Paid	0.3	0.1	0.1	0.1	0.1	0.1
Domestic	0.0	0.0	0.0	0.2	0.2	0.4
Of which: Paid	0.0	0.0	0.0	0.2	0.2	0.4
Goods & services	4.6	4.0	2.7	2.6	2.5	1.6
Grants & transfers	4.3	4.4	5.7	4.1	4.1	3.5
Of which: Employment costs	2.6	3.0	3.1	3.3	3.4	3.5
Of which: Referendum costs	0.0	0.0	0.3	0.0	0.0	0.0
Of which: Election costs	0.0	0.0	1.0	0.0	0.0	0.0
Capital expenditure and net lending	5.0	2.8	3.6	3.7	3.5	2.0
Overall balance (commitment basis)	**-2.4**	**-1.3**	**-2.4**	**-2.1**	**-2.6**	**-0.2**
Primary balance (commitment basis) 1/	-1.3	-0.4	-1.5	-1.0	-1.5	1.1
Overall balance (cash basis)	-0.5	-0.6	-2.1	-0.6	-0.7	-0.5
Primary balance (cash basis) 1/	-0.2	-0.4	-1.9	-0.2	-0.4	0.0
Financing	**2.4**	**1.3**	**2.3**	**2.1**	**2.6**	**0.2**
Domestic financing (net)	-0.2	0.1	2.0	1.0	1.3	1.2
Bank	0.0	0.4	1.5	0.8	1.2	1.5
Non-bank	-0.3	-0.3	0.5	0.2	0.0	-0.3
Foreign financing (net)	-0.4	0.1	-1.9	-1.8	-1.8	-1.6
Disbursements	0.7	0.0	0.5	0.1	0.1	0.1
Amortization due	1.2	0.8	2.4	1.7	1.7	1.2
Of which: Paid	0.0	0.4	0.5	0.4	0.4	0.4
Movement in Zimbabwe's SDR holdings (net)	0.0	0.9	0.0	-0.2	-0.2	-0.4
Other	0.0	0.0	0.0	0.0	0.0	0.0
Change in arrears	3.0	1.1	2.2	2.8	3.1	0.5
Domestic	1.2	0.0	-0.4	0.8	1.1	-1.1
Arrears accumulation	1.2	0.9	0.9	0.9	1.3	0.0
Arrears clearance	0.0	-1.0	-1.3	-0.2	-0.2	-1.1
Foreign	1.9	1.2	2.6	2.0	2.0	1.6
Interest	0.7	0.8	0.7	0.7	0.8	0.8
Principal	1.2	0.4	1.9	1.3	1.3	0.8
Statistical discrepancy / Financing gap	**0.0**	**0.0**	**-0.1**	**0.0**	**0.0**	**0.0**

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

1/ The difference between the primary balance on a commitment and cash basis is the change in domestic arrears.

Table 4. Zimbabwe: Monetary Survey, 2011–15

(Millions of U.S. dollars; unless otherwise indicated)

	Actual			Projected	
	Dec. 2011	Dec. 2012	Dec. 2013	Dec. 2014	Dec. 2015
Monetary authorities					
Net foreign assets	**-734**	**-700**	**-810**	**-677**	**-618**
Claims on non-residents	516	550	441	461	521
Gross international reserves	366	398	284	304	365
Of which: Other reserve assets	114	255	141	162	226
Liabilities to non-residents	-1,250	-1,250	-1,251	-1,138	-1,139
Short-term foreign liabilities	-662	-658	-655	-546	-545
Short-term official reserves liabilities	-146	-138	-135	-133	-133
Of which: Liabilities to IMF	-134	-127	-126	-121	-120
Other foreign liabilities	-588	-592	-596	-593	-595
Net domestic assets	**919**	**973**	**1,082**	**1,127**	**1,103**
Net domestic claims	-1	-8	2	-32	-82
Claims on other depository corporations	0	0	0	0	0
Net claims on central government	-2	-11	-1	-35	-85
Claims on other sectors	1	4	3	3	3
Claims on other financial corporations	0	0	0	0	0
Claims on state and local government	0	0	0	0	0
Claims on public non-financial corporations	0	0	0	0	0
Claims on private sector	1	4	3	3	3
Other items (net)	921	980	1,080	1,159	1,185
Monetary base	**186**	**273**	**272**	**450**	**486**
Statutory reserves	83	0	0	0	0
Banks' current/RTGS accounts	102	273	272	450	485
Deposit money banks and other banking institutions					
Net foreign assets	**443**	**266**	**1**	**112**	**101**
Foreign assets	644	642	704	757	795
Foreign liabilities	-200	-376	-702	-644	-694
Net domestic assets	**2,657**	**3,428**	**3,886**	**4,102**	**4,443**
Net domestic claims	3,105	3,892	4,397	4,615	4,869
Claims on RBZ	349	325	406	478	513
Currency	0	0	0	0	0
Deposits	349	325	406	478	513
Net claims on central government	0	-5	315	580	660
Claims on other sectors	2,755	3,572	3,676	3,557	3,696
Claims on public non-financial corporations	45	52	61	62	64
Claims on private sector	2,710	3,520	3,615	3,495	3,632
Other items (net)	-448	-463	-510	-513	-426
Liabilities to RBZ	**0**	**0**	**0**	**0**	**0**
Deposits included in broad money	**3,100**	**3,694**	**3,888**	**4,215**	**4,544**
Monetary Survey					
Net foreign assets	**-290**	**-435**	**-809**	**-565**	**-517**
Net domestic assets	**3,390**	**4,129**	**4,697**	**4,779**	**5,061**
Domestic claims	2,754	3,559	3,993	4,106	4,274
Net claims on central government	-2	-17	314	545	575
Claims on other sectors	2,756	3,575	3,679	3,561	3,699
Claims on public non-financial corporations	45	52	61	62	64
Claims on private sector	2,711	3,524	3,618	3,499	3,635
Other items (net)	636	570	704	674	786
Broad money liabilities (M3)	**3,100**	**3,694**	**3,888**	**4,215**	**4,544**
Deposits	3,100	3,694	3,888	4,215	4,544
		(annual percentage change)			
Monetary Base	-27	47	0	66	8
Broad Money (M3)	33	19	5	8	8
Currency	...	...	...	...	...
Deposits	33	19	5	8	8
Private Sector Credit	63	30	3	-3	4
Memorandum Items:					
Loan-to-deposit ratio (in percent)	87	95	93	83	80
Reserves-to-deposit ratio (in percent)	6	7	7	11	11
Money multiplier (M3/monetary base)	17	14	14	9	9
Velocity (GDP/M3)	3.5	3.4	3.5	3.3	3.2

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

LETTER OF INTENT

November 3, 2014

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington, DC 20431

Dear Ms. Lagarde:

The first and second reviews of our Staff-Monitored Programme (SMP) were approved by Fund Management in June 2014. The SMP is Zimbabwe's first programme engagement with IMF staff in more than a decade. The SMP played a pivotal role in setting the stage for a more stable macroeconomic environment and for rebalancing gradually the economy toward fostering private sector-led growth. Following delays in the initial implementation of the programme, which were related to the fact that 2013 was an election year, we succeeded in bringing the programme back on track. Moreover, we have taken steps to strengthen the financial sector, and have made progress in increasing diamond revenue transparency. As a result, we have met all quantitative targets and structural benchmarks for the third review. We are grateful to the IMF for its continued support of our economic reform programme and its significant technical assistance.

The Government has also stepped up its efforts to reach out to a broader set of stakeholders. In September 2014, we held a workshop with development partners, private sector representatives and NGOs to prioritise projects and programmes under our economic blueprint for the next five years, the *Zimbabwe Agenda for Sustainable Socio-Economic Transformation (ZIM ASSET) October 2013 to December 2018*. ZIM ASSET aims to achieve sustainable development and social equity, propelled by the careful exploitation of the country's abundant human and natural resources.

As part of ZIM ASSET, we also intend to accelerate our re-engagement on debt resolution with all our creditors, including the international financial institutions (IFIs). We also plan to host a Second International Debt Resolution Forum sometime in November 2014, with a view to building consensus on the process for resolving Zimbabwe's debt challenge. Zimbabwe urgently requires a substantial amount of inflows of fresh capital to help the economy to recover.

Against this background, we hereby request completion of the third review and continued Fund-staff support under a successor 15-month SMP. The new SMP (October 2014–December 2015) will provide a coherent macroeconomic framework that will support our efforts to maintain macroeconomic stability, promote inclusive growth, address weaknesses in the financial sector, improve the external position and lay the foundation to build our capacity to repay our outstanding debt. We consider that a successor SMP will be instrumental in building on the achievements already made and tackling the economic challenges Zimbabwe faces. It will also, in our view, be an important step on the path toward normalizing relations with our creditors and the Fund's financial support.

The attached Memorandum of Economic and Financial Policies (MEFP) outlines our macroeconomic objectives for 2014-15 and provides specific measures to achieve them. We are committed to the objectives of our programme recognizing that completion of reviews under the SMP is subject to observance of quantitative targets and structural benchmarks. The Government believes that the policies set out in the attached MEFP are adequate to achieve the objectives of the SMP, but stands ready to take additional measures. Furthermore, the Government of Zimbabwe will consult with the IMF staff in advance of any revisions to the policies contained in the MEFP, in accordance with the IMF's policies on such consultations, at the initiative of the Government or the IMF staff.

In line with our commitment to transparency in government operations, which we believe is essential for good governance, we consent to the publication of all SMP-related documents on the IMF's web site.

/s/
Patrick A. Chinamasa
Minister of Finance & Economic Development
Government of Zimbabwe

/s/
John P. Mangudya
Governor
Reserve Bank of Zimbabwe

Attachment I. MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES (MEFP) FOR 2014–15

INTRODUCTION

1. This Memorandum sets out the economic and financial policies for 2014–15 of the Government of Zimbabwe, which aim at rebalancing the policy mix toward a stable macroeconomic environment conducive to private sector-led growth. In particular, our programme is geared toward improving the country's external position to restore eventually its viability, strengthening its fiscal position, while protecting infrastructure and social outlays, enhancing financial sector stability, and addressing governance issues in the economy. These policies form the basis for a new 15-month Staff-Monitored Programme (SMP).

BACKGROUND AND OUTLOOK

2. The constitutional referendum in March 2013 was followed by the July 2013 harmonised and peaceful elections. The new Cabinet was appointed in September 2013 and is a more cohesive body than its predecessor, with a two thirds majority in parliament. We believe that this cohesiveness has already translated into strengthened policy formulation and implementation. This will enhance our ability to vigorously pursue our reform agenda.

3. The macroeconomic situation remains precarious:

- Growth has slowed down significantly, because of inadequate financial flows which have exacerbated the liquidity crunch that has weakened economic activity, despite a very favourable agricultural season.

- The external position remains a challenge with low levels of international reserves, a very large current account deficit, and growing external arrears.

- Inflation continues to be low, reflecting weak domestic demand, tight liquidity conditions and the appreciation of the US dollar against the South African rand, the currency of our main trading partner.

- The fiscal position faced strong headwinds in early 2014, because of the conclusion of salary negotiations that resulted in salary increases in excess of budgeted amounts. To address the fiscal pressures and get back on track, we implemented a package of revenue, expenditure, and financing measures in Q2 of 2014. We succeeded in meeting our fiscal targets for the first half of 2014, while at the same time honouring (and, in fact, exceeding) our commitments to protect social spending and to reduce the stock of domestic arrears.

4. Over the medium term, we are committed to implementing sound macroeconomic and structural policies. These policies will allow us to maintain macroeconomic stability, fully harness

Zimbabwe's growth potential, tackle fiscal challenges, restore confidence in the financial sector, improve the external position, and enhance the role of the private sector in the economy.

POLICIES FOR 2014–15

5. A gradual return to a stable macroeconomic position is the cornerstone of our SMP. In particular:

- We expect real GDP growth to remain below potential in 2014, reflecting among other factors, continuing low business and investment confidence, scarce liquidity, and subdued international prices for our major exports. However, we expect that the timely and full implementation of ZIM ASSET could accelerate growth substantially over the medium term.
- Inflation is projected to remain close to zero by end-2014 and in 2015.
- The current account deficit remains a concern, primarily owing to lower mining exports.
- Further fiscal consolidation will be critical to bring public finances back on a sound footing. We recognize that this will require substantial rebalancing of the current expenditure mix. In the medium term, we will target a primary fiscal surplus of between 1.5 and 2 percent of GDP, in order to re-build buffers and restore our capacity to service our debt.
- We will continue to carefully monitor external borrowing with a view to limiting additional pressures on an already precarious debt situation.

6. The main objectives for the 2014-15 economic programme are to:

- Consolidate the fiscal position;
- Improve the external position;
- Restore confidence in the financial sector;
- Mobilise international support for resolving the country's external debt situation; and
- Make progress in key structural reform areas in order to enhance the business climate, boost productivity and competitiveness, and build confidence.

A. Fiscal policy

7. Fiscal policy will aim to move central government balances from a deficit position to close to balance or a small surplus in 2015. This will help to rebuild our international reserves. So far the burden of fiscal adjustment has fallen on revenue, non-wage recurrent outlays and capital expenditures. We intend to make an effort to tackle the large wage bill as outlined in paragraphs 10 and 11 below. We will continue to protect high-value and high-impact social spending.

8. ZIM ASSET will be propelled by the judicious and sustainable exploitation of the country's abundant natural resources. That is why we remain committed to our ambitious plans to improve diamond revenue transparency and reform the diamond sector:

- The Finance Act gazetted in April 2014 gave legal effect to the tax measures pronounced in the 2014 Budget Statement, including the withholding by the Mineral Marketing Corporation of Zimbabwe (MMCZ) and the Zimbabwe Mining Development Corporation (ZMDC) of a special dividend equal to 15 percent of the gross proceeds of diamond sales for direct payment to the Treasury. The enforcement and collection of this special dividend started in October 2014, following consultations with the various stakeholders.

- In July 2014 Cabinet approved the principles for amendments to the Mines and Minerals Act. The corresponding bill has been drafted and reviewed, and should be submitted to the Cabinet Committee on Legislation by end-2014. Once these amendments are adopted by Parliament, the amendments of the Precious Stones Trade Act will become our priority for 2015.

- With technical support from the World Bank and consultants, we are in the process of reviewing the fiscal regime for the mining sector to ensure that Zimbabwe maximizes the benefits from its mineral resources, while at the same time encouraging investment in the sector. As part of our consultative process, we held a workshop in June 2014 with key stakeholders. The consultants' reports are expected in October 2014, and their recommendations will determine the appropriate legal framework for implementing the new fiscal regime for the mining sector.

- We are undertaking a review of the structure of the diamond sector, with a view to streamlining the number of companies operating in the sector to not more than three. This will be accomplished through mergers and dissolutions of the current seven companies wholly or jointly owned by the Government, through ZMDC.

- The 2012 audited financial accounts of the ZMDC were posted on the website of the Ministry of Mining and Mining Development (MoMMD) in May 2014. Going forward, we intend to publish these annually, as required by law. In particular, the 2013 audited financial accounts of the ZMDC will be published by the end of 2014.

- Finally, we have constituted a joint task force composed of technical staff from MoFED, MoMMD, and the Zimbabwe Revenue Authority (ZIMRA) to forecast and monitor diamond-related revenue flows. The task force is meeting on a regular basis, and has developed a reporting template that companies complete every month.

9. With Fund technical assistance, we are reviewing our revenue administration framework, with the goal of mobilizing additional revenue and also making the system simpler and fairer, particularly in customs where compliance has emerged as a serious problem in the last few years.

10. We recognize that further fiscal consolidation will require substantial rebalancing of the current expenditure mix. The public sector wage bill, in particular, is on an unsustainable trajectory and is competing for resources with projects under ZIM ASSET. Therefore, we remain committed to our objective of keeping the wage bill on a downward trend, relative to Government revenues and expenditures in the medium term, while preserving the real value of salaries in the civil service. Like we did in 2013 and 2014, we commit to granting only one salary adjustment in 2015. In addition, we will maintain the hiring freeze in Government which started in July 2012, while allowing some limited flexibility in filling critical vacancies that cannot be filled through internal mobility.

11. In addition, the Civil Service Commission (CSC) is currently undertaking a restructuring exercise which will be completed in time to inform the 2015 budget process. The exercise aims to align ministries' staffing with their mandates, and to also identify any duplications and redundancies. The CSC is also modernizing and decentralizing the Salary Service Bureau (SSB), an exercise that will involve placing a payroll assistant in every district, and will be completed by end-2015. This will improve the SSB's grip on the wage bill and put it in a better position to flush out any irregularities. The CSC's Human Resource Management Information System (HRMIS) is now up and running. As a pilot project, it will be rolled out to five line ministries in 2014, and to all others in 2015. Over the medium term, the Government of Zimbabwe intends to pursue comprehensive civil service reforms.

12. We remain committed to reducing domestic arrears over time. We plan to clear the remaining stock of pre-2013 domestic arrears by end-2014.

13. We have implemented a raft of measures to contain the consumption of services by the public sector. These measures have been successful in curbing 2014 monthly bills by an average of around 5 percent, relative to 2013, and by more for vehicle rentals and landline telephones. These measures combined with realistic provisions in the 2015 Budget and beyond could reduce the recurrence of domestic arrears.

14. To address governance issues and increase accountability in state-owned enterprises (SOEs) and local authorities, we will review the Public Finance Management (PFM) Act by mid-2015 in order to strengthen Treasury's financial oversight of SOEs and local authorities. The proposed amendments will include:

- Requiring state enterprises and local authorities to submit their corporate and financial plans to Treasury not later than three months before the beginning of each fiscal year;
- Mandating Treasury to review the budgets of public entities to ensure that deployment of resources is consistent with priorities, mandates, and service delivery objectives;
- Empowering the Minister of Finance and Economic Development to direct SOEs Boards to amend their corporate plans where necessary to align them with ZIM ASSET, to ensure these entities are refocused to contribute significantly to national development;
- Requiring SOEs and local authorities to submit quarterly financial statements and performance reports not later than thirty days after the end of the respective quarter; and
- Strengthening the enforcement arrangements to effectively deal with cases of non-compliance.

15. A transparent and efficient public procurement system is critical to strengthening governance and accountability, achieving value for money, and improving service delivery by public institutions. The current public procurement framework has resulted in delays in procurement processes, cost escalation, and inability to hold non-performing contractors to account. It is, therefore, necessary that the Procurement Act be reviewed to tighten the public procurement framework and make it more efficient and transparent. This will entail:

- Decentralizing procurement to procuring entities to improve timeliness by allowing managers the latitude to make procurement decisions within set frameworks;
- Giving the State Procurement Board a regulatory and monitoring role to ensure procuring entities operate within the agreed parameters;
- Enhancing the integrity, transparency, and accountability of the public procurement system through linking procurement planning to budget formulation; and
- Providing for a review mechanism to facilitate verification of bidders' capacity, as well as mandatory progress and contract completion reports, coupled with publication of major contract awards and naming and shaming of non-performing contractors.

16. To address existing weaknesses in the area of public financial management (PFM), we plan to develop a comprehensive PFM reform strategy and action plan by mid-2015, with Fund technical assistance.

B. Restoring confidence in the financial sector

17. The Government of Zimbabwe reaffirms its commitment to strengthening financial sector stability, and we have been implementing a number of measures toward this end. Recognizing the critical role a strong central bank plays in restoring financial stability and boosting confidence, we are taking the necessary steps to recapitalize the Reserve Bank of Zimbabwe (RBZ) to better allow it to focus on its core central banking functions as banker to the Government and regulator of financial institutions:

- The Reserve Bank of Zimbabwe Debt Assumption Bill which will provide the legal framework for assumption of the RBZ non-core debt by the Government is currently being debated in Parliament. The validation and reconciliation of the debt is ongoing, and medium-term securities have been issued to banks and other institutions and suppliers against validated debts.
- Recapitalization of the RBZ will be a necessary precondition for reestablishing a lender-of-last-resort (LOLR) facility for solvent banks. The Government is considering issuing long-term debt instruments to capitalize the RBZ. Following the recapitalization of the RBZ, we will consider possible options for establishing a LOLR facility for solvent banks over the medium term, with Fund technical assistance based on the experiences of other "dollarized" economies. The transfer of the exchequer accounts from one of the commercial banks to the RBZ in early-July 2014 was completed successfully.

18. The RBZ has been working closely with key stakeholders in pursuing measures to address the problem of rising non-performing loans (NPLs). The Cabinet has approved the establishment of a special purpose vehicle—the Zimbabwe Asset Management Corporation (Pvt) Limited (ZAMCO)—to acquire and resolve NPLs from banks on commercial terms. This is one element of a broader strategy to address the NPLs problem. ZAMCO will clean up and strengthen the banks' balance sheets and provide them with liquidity to fund productive activities and help spur economic growth. Over the next few months, with Fund technical assistance, we will develop the key features required to underpin a successful asset purchase strategy for ZAMCO that minimizes fiscal risks. Specifically, by end-December 2014, we will develop a specific mandate for ZAMCO detailing overarching objectives, assets eligible for purchase, timeline for asset to be transferred, the role of public guarantees (if any), ownership structure, and a sunset clause specifying when ZAMCO operations will be closed down. By the end of March 2015, we will (i) design an appropriate legal and governance structure ensuring that ZAMCO can operate independently of political and commercial interests, and has powers enabling a maximization of value of the acquired assets; (ii) develop an appropriate asset valuation and pricing strategy, that ensures assets are purchased from banks at fair value; and (iii) identify a feasible and sustainable funding strategy, ideally relying on a combination of long-term domestic bonds and externally-sourced financing. We will endeavor to minimize the impact on the budget. ZAMCO's Board will be appointed by end of December 2014. We have requested Fund technical assistance to develop the strategy and operational guidelines for ZAMCO.

19. To address the information asymmetry gap in the financial sector which has contributed to over indebtedness and resulted in some multi-banked clients defaulting in several banks, the RBZ is working on establishing a central credit registry system, with assistance from the World Bank. The system will be comprised of private credit reference bureaus (CRBs), and a credit registry within the RBZ that will serve as a databank for licensed CRBs. The credit reference system will complement the work of ZAMCO, and help enhance financial stability by promoting more robust risk management practices, reducing credit risk, increasing the supply of credit to fuel growth-related activities, and helping to promote lower interest rates.

20. Amendments to the Reserve Bank Act, which will empower the Reserve Bank to establish a credit registry, have been approved by Cabinet and will soon be submitted to Parliament.

21. In addition, amendments to the Banking Act have also been approved by Cabinet. These include strengthening the problem bank resolution framework, corporate governance, risk management and compliance, help reduce systemic risks, and the licensing and regulation of private credit reference bureaux. We plan to submit the amendments to the Banking Act to Parliament by the end of March 2015. Banking supervision will remain vigilant in monitoring weak banks, focusing on loan provisioning practices and risk management. In addition, we will be proactive to ensure orderly resolution of troubled banks. The shareholders and boards of these weak banks have been directed to finalize their turnaround plans by end-December 2014 or face supervisory intervention. In addition, amendments to the Banking Act will empower the RBZ to effectively deal with these banks.

22. The Afreximbank-guaranteed interbank liquidity facility will be operational by end-2014. The facility will augment the current bilateral inter-market trade between banks, and help unlock the interbank market by providing securities (Aftrades) to banks with excess liquidity to secure funding for banks requiring liquidity.

23. Well-capitalized banks are critical for absorbing shocks, allowing for effective financial intermediation, and ensuring financial stability. However, the current operational environment has imposed numerous challenges on banks' ability to grow organically or raise capital from investors. The RBZ has therefore revised the minimum capital requirements to promote strategic groups based on current banking classes, and in line with the Banking Act. The groups will be segmented into three Tiers with different capital thresholds and activities. Banks are required to submit Board approved recapitalization plans with interim targets by end-2014, based on their chosen strategic groups. We expect this strategic segmentation to allow for the operation of smaller, profitable banks with strong governance and risk management systems that can play meaningful roles in the economy.

C. Addressing Zimbabwe's substantial debt burden

24. In the absence of a comprehensive debt resolution strategy, Zimbabwe is expected to remain in debt distress. We are therefore, strongly determined to redouble our efforts and move forward toward an arrears clearance strategy with a view to normalizing relations with our creditors. To this end, we are stepping up our reengagement with all creditors, with a view to garnering sufficient support to resolve our debt with bilateral creditors under the umbrella of the Paris Club. Recently, we have successfully completed the debt reconciliation process, initiated in 2012, with both official creditors in the Paris Club and with multilateral creditors. We have made regular payments to the International Monetary Fund (IMF), African Development Bank (AfDB) and the World Bank, and we will soon start making regular payments to the European Investment Bank (EIB). We remain committed to increasing these payments as our payment capacity improves.

25. During the period of this successor SMP, we will continue to treat current SDR holdings as our core international reserves, and we target an increase in our international reserves. We will avoid selective debt servicing to some creditors as this would complicate reaching an agreement with creditors on a debt resolution strategy. We will continue to make repayments to all creditors that are providing us with positive net new financing.

26. In August 2014, the Government of Zimbabwe contracted a new external loan with Export-Import Bank of China for telecommunication network expansion. The financial terms of the loan are very favourable under the circumstance, with a grant element of close to 30 percent. The total amount of the loan is well below the target in the SMP. The loan is key to improving the telecommunication system, which is important for economic development and poverty reduction.

27. As reiterated in our 2014 Mid-Year Fiscal Policy Review Statement, we will continue to refrain from borrowing on non-concessional terms. We will contract or guarantee non-concessional loans only if grants and concessional financing are not available, subject to the limits proposed in Table 1, and only for critical infrastructure projects — power generation, water and sanitation, transportation and telecommunication. Moreover, before signing any non-concessional loan agreement, we will seek project viability assessments from at least one of the following institutions: the AfDB, the World Bank, and the Development Bank of South Africa, to ensure that the identified projects have high economic and social impact. We will also consult, at an early stage of the negotiations, with Fund staff, and we will provide them with all related information and documents regarding non-concessional external borrowing, government guaranteed debt and borrowing by SOEs. Finally, we would strongly encourage international organizations, such as the AfDB, EIB and IFC, to resume operations aimed at providing political credit risk insurance and access to sustainable long-term financing to the private sector.

28. The Public Debt Management Bill will be submitted to Cabinet for approval by December 2014, and then submitted to Parliament by March 2015. Passage of this into law will statutorily establish the debt management office within the MoFED, and outline the legal and institutional framework that guides debt management operations.

D. Other Structural Reforms

29. The Indigenisation and Economic Empowerment Laws seek to encourage mutually beneficial partnerships between Zimbabwean and foreign investors. In fact, these laws have been perceived as an obstacle to foreign investment. Policy clarity and consistency would significantly improve Zimbabwe's business climate and attract much-needed capital flows. To that end, we have streamlined the ways by which compliance can be achieved. The Minister of Youth, Indigenisation and Economic Empowerment will, therefore, be communicating the necessary clarification by way of a Notice in the Government Gazette in terms of Section 5 (4) of the Regulations (2010) by March 2015. This should help allay misperceptions on the security of investments and property rights, provide legal transparency and predictability, and reassure markets of our open invitation to investors to come and invest in Zimbabwe.

30. Job creation and equal opportunities for all Zimbabweans remain the over-arching goal of ZIM ASSET. In this regard, it will be very important for us to invigorate our domestic industry and improve Zimbabwe's competitiveness, which currently ranks low amongst regional partners. Our Labour Relations Act dates back to 1985, and even though several amendments have been introduced, the global economy in which we operate justifies a closer look at the legislation to improve the business climate, while preserving fairness to employers and employees. We are reviewing our labour laws, in consultation with stakeholders, with a view to modernize it, consistent with international standards and conventions. Consultations on the Principles for the reform are at an advanced stage. The reform is expected to improve labour productivity and facilitate economic growth in line with ZIM ASSET.

31. To encourage foreign investments, we have lifted a number of exchange control restrictions to allow foreign investors to participate in the primary and secondary bond markets and the stock exchange.

PROGRAMME MONITORING

32. The SMP will be monitored through quantitative targets and structural benchmarks. The quantitative targets are set out in Table 1 and the structural benchmarks in Table 2. The review of the SMP will be conducted semi-annually, and end-December 2014, end-June 2015, and end-December 2015 will be test dates for the quantitative targets. The agreement between Zimbabwe and IMF staff regarding the technical definitions of quantitative targets and structural measures described in this Memorandum, as well as reporting requirements, are further specified in the attached Technical Memorandum of Understanding (TMU, Appendix II).

33. The Government of Zimbabwe remains committed to ensuring that the programme remains on track, given its importance as one of the key steps towards a Fund-supported financial programme and hence the importance of establishing a good track record of implementing sound economic policies. To this end, we will continue to monitor the programme at both the technical and political levels. At the political level, the monitoring is coordinated by the Office of the President and Cabinet through monthly meetings. The technical monitoring committee, comprised of officials from the Ministry of Finance and Economic Development, the Reserve Bank of Zimbabwe, the Zimbabwe National Statistics Agency, and the Zimbabwe Revenue Authority, meets weekly.

Table 1. Zimbabwe: Quantitative Targets

(In millions of U.S. dollars, unless otherwise indicated)

	2013[1]									2014[1]			
	March	June[2]			Sept.		Dec.[2]			March	June[2]		
	Act.	Prog.	Act.	Status	Prog.	Act.	Prog.	Act.	Status	Act.	Prog.	Act.	Status
1. Floor on primary budget balance of the central government[3,4,5,6,7]	-46	18			80		-47			52	-43	48	Met
Adjusted floor		169	-3	Not met	170	-25	-53	-262	Not met				
2. Continuous ceiling on new domestic payment arrears[8]	n.a.	0	n.a.	Not met	0	n.a.							
3. Floor on protected social spending	18	51	58	Met	93	98	144	100	Not met	5	25	27	Met
4. Floor on stock of usable international reserves	143	149	143	Not met	169	143	143	143	Met	143	143	143	Met
5. Floor on payments to the PRGT	0.45	0.90	1.05	Met	1.35	1.50	1.80	1.80	Met	0.60	0.90	0.90	Met
6. Continuous ceiling on the stock of new non-concessional external debt contracted or guaranteed by the general government with original maturity of one year or more	0	330	29	Not Met[9]	330	29	350	348	Met	0	400	0	Met
7. Ceiling on total stock of arrears to domestic service providers, agricultural input suppliers, and on capital certificates			171			75	117	158	Not met	200	301	242	Met
Memorandum Items:													
Broad Money (stock)	3,646	4,043	3,689		4,226	3,757	3,828	3,888		4,014	3,900	4,236	
Reserve Money (stock)	227	232	337		243	276	283	272		311	276	278	
Disbursements on medical equipment and supplies loan	0	90	30		90	30	72	72		0	0	0	
Unbudgeted costs related to the referendum and elections	18	148	47		148	153	153	153					
Unbudgeted revenues from telecom licence fees	0	50	40		50	85	91	85					

1 Value of cumulative flows for the calendar year, unless otherwise indicated.

2 Program performance will be monitored based on the quantitative targets for June and December 2013 and for June 2014.

3 To be adjusted downwards in any quarter and subsequent quarters by the full amount of any new borrowing disbursed and utilized by central government for priority infrastructure projects.

4 To be adjusted downwards in any quarter and subsequent quarters by the full amount of any domestic debt issuance by central government ring-fenced for clearance of domestic payment arrears.

5 To be adjusted upwards (downwards) in Q2 and Q3 of 2013 by the full amount of any shortfall (excess) in unbudgeted costs related to the constitutional referendum and national elections and incurred by central government, relative to programme

6 To be adjusted downwards (upwards) in any quarter and subsequent quarters in 2013 by the full amount of any shortfall (excess) in unbudgeted revenues from telecom licence fees received by central government, relative to programme assumptions.

7 To be adjusted downwards in Q1 of 2013 by the value of the medical equipment and supplies project loan if the loan were disbursed in that quarter. To be adjusted upwards in Q2 and Q3 of 2013 by the shortfall in the cumulative disbursement on the loan effected through these quarters, relative to programme assumptions. To be adjusted downwards (upwards) in Q4 of 2013 and all 4 quarters of 2014 by the full amount of any excess (shortfall) in the cumulative disbursement on the loan for the calendar year effected through each date, relative to programme assumptions.

8 For the second and third SMP reviews, the continuous ceiling on new domestic payment arrears is replaced with a ceiling on the total stock of arrears to domestic service providers, agricultural input suppliers, and on capital certificates.

9 A US$ 319 million non-concessional loan was signed with the Export-Import Bank of China in November, thus breaching the continuous US$ 330 million ceiling.

10 Indicative targets are part of the authorities' reform agenda .

Table 2. Zimbabwe: Structural Benchmarks for 3rd SMP Review

Benchmarks	Macroeconomic Rationale	Review	Status
Tax Policy			
1. Submit to Cabinet amendments to the Mines and Minerals Act.	Increase transparency and accountability.	3rd	Met
Public Financial Management			
2. Cabinet approval of the principles for a Public Debt Management Bill.	Enhance public debt management.	3rd	Met
Financial Sector			
3. Cabinet approval of the principles for the amendments to the Banking Act.	Reduce financial sector vulnerability.	3rd	Met

Table 3. Zimbabwe: Quantitative Targets

(In millions of U.S. dollars, unless otherwise indicated

	2014[1]	2015[1]			
	Dec.[2]	March	June[2]	Sept.	Dec.[2]
	Proposed	Proposed	Proposed	Proposed	Proposed
1. Floor on primary budget balance of the central government	-60	-10	28	54	-2
2. Floor on protected social spending	60	15	35	57	72
3. Floor on stock of net international reserves	172	177	194	213	232
4. Floor on payments to the PRGT	1.80	0.45	0.90	1.35	1.80
5. Continuous ceiling on the stock of new non-concessional external debt contracted or guaranteed by the general government with original maturity of one year or more	400	400	400	400	400
Memorandum Items:					
1. Ceiling on total stock of arrears to domestic service providers, agricultural input suppliers, and on capital certificates	312	304	250	194	153

[1] Value of cumulative flows for the calendar year, unless otherwise indicated.

[2] Program performance will be monitored based on the quantitative targets for December 2014, June 2015, and December 2015.

Table 4. Zimbabwe: Structural Benchmarks 2014-2015		
Benchmarks[9]	**Macroeconomic Rationale**	**Review**
Tax Policy		
1. Submit to Cabinet a report with MoFED's recommendations on reforms to the fiscal regime for the mining sector.	Enhance tax administration and improve revenue collection	2nd
Debt Management		
2. Approval of the Public Debt Management Bill by Cabinet.	Enhance public debt management	1st
Public Financial Management		
3. Submit to Cabinet amendments to the Public Finance Management Act to strengthen Treasury's financial oversight of SOEs and local authorities.	Enhance public expenditure and financial management	2nd
4. Submit to Cabinet amendments to the Procurement Act to tighten the public procurement framework and make it more efficient and transparent.	Strengthen governance and accountability	3rd[10]
Financial Sector		
5. Approval of the mandate, strategy, and specific objectives of ZAMCO by the RBZ Executive Committee/Board.	Address the problem of NPLs and strengthen banks' balance sheet	1st
6. Develop the operational framework for ZAMCO, specifying: • an appropriate legal and governance structure, including necessary powers; • an asset valuation and transfer pricing strategy; and • a feasible and sustainable funding strategy.	Address the problem of NPLs and strengthen banks' balance sheet	2nd
7. Submit to Parliament the amendments to the Reserve Bank of Zimbabwe Act.	Strengthen legal and regulatory framework and reduce financial sector vulnerability	2nd
8. Submit to Parliament the amendments to the Banking Act.	Strengthen legal and regulatory framework and reduce financial sector vulnerability	2nd
Investment Climate		
9. Publish in the Government Gazette, the necessary clarification on the indigenisation and economic empowerment policies.	Increase transparency and boost investor confidence	2nd

[9] Each structural benchmark is to be completed by the earlier of: (i) the time of the relevant review; or (ii) end-December 2015, the end of the SMP.

[10] Additional structural benchmarks for the third review will be included at the time of the first review.

Attachment II. TECHNICAL MEMORANDUM OF UNDERSTANDING

INTRODUCTION

1. This memorandum sets forth the understandings between the Government of Zimbabwe and the IMF staff regarding the definitions of the quantitative targets, the structural benchmarks, the applicable adjusters, and the respective reporting requirements for the Staff-Monitored Programme (SMP). The quantitative targets and structural benchmarks are reported in Tables 1 and 3 of the Government's Letter of Intent (LOI).

DEFINITIONS

2. **Central government** represents a single institutional unit consolidating all the accounts whose total revenues and expenditures are authorized through the Blue Book (including line ministries, the Parliament of Zimbabwe, the Auditor General's Office, and Vote of Credit). The definition excludes public entities with autonomous legal personae whose own budgets are not included in the central government budget.

3. **The general government** comprises the central government, the Reserve Bank of Zimbabwe (RBZ), extra-budgetary funds, social security, and local governments.

4. **The public sector** comprises the general government and all state-owned enterprises.

5. **Non-interest expenditures** are measured on a cash basis. Non-interest expenditures include current expenditures (wages and salaries, pensions, goods and services, grants and transfers), capital expenditures, and net lending. Net lending comprises loans granted by the central government, except in the case of on-lending of externally borrowed funds, which is included as a negative domestic financing item ("below the line"). All expenditures and net lending financed with loans to be serviced by the central government fall within the programme's definition of expenditures and net lending, even if the cash did not transit through the treasury. Non-interest expenditures will be measured from the budget execution data.

6. **Domestic arrears** are defined as overdue domestic payment obligations of the central government, whether verified or not, to domestic service providers, agricultural input suppliers, and on capital certificates. Payments for goods and services are in arrears if they have not been made within 90 days after invoice receipt from service providers; and after the invoice date for contractors executing capital projects for the government. Arrears will be monitored using the monthly Fiscal

Monitor. Domestic service providers are defined to comprise the Central Mechanical Equipment Department (CMED), NetOne, TelOne, ZESA Holdings, ZINWA (water authority), and the local authorities.

QUANTITATIVE TARGETS

A. Floor on the Primary Budget Balance of the Central Government

7. **The primary budget balance of the central government** is measured on a cash basis and is defined as revenues and grants minus non-interest expenditures. The central government primary balance will be measured from above the line using budget execution data.

B. Floor on Protected Social Spending

8. **Protected social spending** is measured on a cash basis and comprises central government spending in the following areas:

- **education** (recurrent spending on teaching and learning materials, on student stipend support from the National Education and Training Fund; and capital spending on upgrading of schools and other facilities);
- **health** (recurrent spending on government hospitals and health centres, on grant-aided institutions such as Parirenyatwa Hospital, mission hospitals, and local authorities, on maternal and child health, on results-based financing, on preventive health programmes, on procurement of ARVs and TB drugs; and capital spending on revitalization of health institutions, on medical equipment, and on procurement of ambulances and service vehicles);
- **social protection** (recurrent spending on the Basic Education Assistance Module (BEAM), on the harmonized cash transfer, on health assistance, on rehabilitation of disabled persons, on government social protection institutions; and capital spending on refurbishment of rehabilitation centres);
- **water and sanitation** (capital spending on water and sewer infrastructure for local authorities, on water supply infrastructure for small towns and growth points, and on water and sanitation for rural areas);
- **agriculture** (recurrent spending on animal diseases and risk management, and capital spending on irrigation rehabilitation and development and on input support for disadvantaged households); and
- **other** (capital spending on construction and rehabilitation of rural roads).

C. Floor on the Stock of Net Official International Reserves

9. **Net official international reserves (NIR)** are defined as the difference between the RBZ's liquid, convertible gross official foreign reserve assets and its short-term official foreign reserve liabilities. For the purpose of the programme, SDR-denominated accounts will be valued at the programme exchange rate of US$ 1.52 per SDR.

- **Gross official reserve assets** of the RBZ are defined as the sum of: (i) Zimbabwe's SDR holdings (excluding SDRs allocated under the Fourth Amendment of the IMF's Articles of agreement and placed in escrow account at the IMF (SDR 66.4 million); (ii) refined gold: (iii) balances with foreign banks; (iii) foreign treasury bills, securities and investments, and foreign currency held by the Reserve Bank of Zimbabwe; and (iv) Zimbabwe's reserve position in the Fund. Pledged or otherwise encumbered assets, including but not limited to, assets used as collateral or as guarantee for third-party external liabilities are excluded from official reserve assets.
- **Short-term official reserve liabilities** of the RBZ are defined as: (i) outstanding credit from the IMF; (ii) and short-term foreign currency liabilities to non-residents with maturity of up to and including one year. Official foreign liabilities used to calculate the NIR do not include long-term liabilities such as SDR allocations.

D. Ceiling on the Amount of New Non-concessional External Debt Contracted or Guaranteed by the General Government with Original Maturity of One Year or More

10. **Contracting or guaranteeing of new external debt by the general government** applies to debt to non-residents with original maturity of one year or more. For the purposes of the programme, the definition of "debt" is set forth in point No. 9 of the "Guidelines on Performance Criteria with Respect to External Debt" (see Decision No. 6230-(79/140) as revised on August 31, 2009 (Decision No. 14416-(09/91)), attached in Annex I). This quantitative target will be assessed on a continuous basis for the prevailing calendar year.

11. Debt is defined as concessional if, at the time of its contracting, the ratio between the present value (PV) and the face value of debt is less than 65 percent (equivalent to a grant element of at least 35 percent). The PV of debt at the time of its contracting is calculated by discounting the future stream of payments of debt service due on this debt. The discount rate used for this purpose is 5 percent.

12. New non-concessional debt will be contracted or guaranteed only as financing for viable priority infrastructure projects that have been assessed in consultation with a reputable and

independent financial institution, such as the African Development Bank, the Development Bank of Southern Africa, or the World Bank, prior to the signing of the loan agreement and project documents.

E. Adjusters

13. **The quantitative target on the primary budget balance of the central government specified under the programme is subject to the following adjusters:**

- The floor on the cumulative primary budget balance in any quarter and subsequent quarters will be adjusted downwards by the full amount of any new borrowing disbursed and utilized by central government for priority infrastructure projects.
- The floor on the cumulative primary budget balance in any quarter and subsequent quarters will be adjusted downwards by the full amount of any domestic debt issued by central government ring-fenced for clearance of domestic payment arrears.

DATA REPORTING

14. To facilitate the monitoring of programme implementation, the Government of Zimbabwe will prepare and forward to the Fund staff electronically information in accordance with the agreed reporting framework contained in Table 1.

Table 1. Zimbabwe: Data Reporting for Programme Monitoring

Data Description	Reporting Institution	Reporting Frequency	Submission Lag
Monetary and Financial Sector			
NIR, NFA, monetary control programme	RBZ	Weekly	1 week
Broad money survey	RBZ	Monthly	2 months
RTGS transactions	RBZ	Monthly	1 month
Prudential liquid asset ratios	RBZ	Monthly	1 month
Cash flow of the RBZ	RBZ	Monthly	1 month
Balance sheets and income statements for financial institutions	RBZ	Quarterly	2 months
Financial soundness indicators (aggregate and by bank)	RBZ	Quarterly	2 months
Lending activity of banks (by sector)	RBZ	Quarterly	2 months
Commercial bank interest rates	RBZ	Monthly	1 month
External Sector			
RBZ purchases and sales of foreign currency	RBZ	Monthly	1 month
Balance of payments (incl. revised outturn for previous quarters)	RBZ/ZIMSTAT	Quarterly	3 months
Import and export data, for aggregated sectors	RBZ/ZIMSTAT	Monthly	1 month
Net international reserves (incl. reserve assets/liabilities by currency)	RBZ	Monthly	1 week
Foreign exchange flow data (by type of flow)	RBZ	Monthly	1 month
Diamond production, exports, and prices	RBZ	Quarterly	1 month
RBZ Monthly Economic Review	RBZ	Monthly	6 weeks
Quarterly report on macroeconomic developments	MoFED	Quarterly	1 month
External debt stock, disbursements, amortization, interest, other fees and charges, and repayment (by creditor and currency); detailed terms and conditions of all new contracted and government-guaranteed external borrowing (concessional and non-concessional); and committed undisbursed balances (by creditor)	MoFED	Monthly	1 month

Table 1. Zimbabwe: Data Reporting for Programme Monitoring (concluded)

Data Description	Reporting Institution	Reporting Frequency	Submission Lag
Fiscal Sector			
Central government operations – revenue, expenditure, and financing	MoFED	Monthly	1 month
Detailed data on the execution of the recurrent budget (by economic and administrative classification and by line ministry)	MoFED	Monthly	1 month
Total stock of arrears to domestic service providers, agricultural input suppliers, and on capital certificates at end-month	MoFED	Monthly	1 month
Stock of domestic debt, disbursements, amortization, interest, and other fees and charges; face value, maturity, interest rate, and payments schedule for new domestic loans and securities	MoFED	Monthly	1 month
Employment data for each ministry	MoFED	Monthly	1 month
Detailed data on resource revenue (by type)	MoFED	Quarterly	1 month
Detailed data on the budget execution of protected social spending (as defined in this document)	MoFED	Quarterly	1 month
Details of disbursed external budget support and project grants and loans	MoFED	Quarterly	1 month
Real Sector			
Consumer Price Index	ZIMSTAT	Monthly	1 month
Fuel price indices, including Petrol, Diesel, and Paraffin	ZIMSTAT	Monthly	1 month
Producer Price Index; Building Materials Price Index; Poverty Datum Lines; and Civil Engineering Materials Index	ZIMSTAT	Quarterly	6 weeks
Agricultural production data (volume/value of major products)	ZIMSTAT	Semi-annually	6 months
Mining production data (volume/value by minerals), excluding production from sand and stone quarries	ZIMSTAT	Quarterly	6 weeks
National Accounts (breakdowns of production and expenditure side in real and nominal terms)	ZIMSTAT	Annually	8 months
Quarterly Digest of Statistics	ZIMSTAT	Quarterly	3 months
Structural Benchmarks			
Update on the status of implementation of the structural benchmarks specified in Table 3 of the LOI	MoFED/RBZ	Quarterly	3 weeks

GUIDELINES ON EXTERNAL DEBT

Excerpt from Executive Board Decision No. 6230-(79/140) as revised on August 31, 2009 (Decision No. 14416-(09/91)):

- For the purpose of this guideline, the term "debt" will be understood to mean a current, i.e., not contingent liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows:

  (i) loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);

  (ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until sometime after the date on which the goods are delivered or services are provided; and

  (iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lesser retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property.

- Under the definition of debt set out in this paragraph, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

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Zimbabwe – IMF Management Completes Third Review of Staff-Monitored Program and Approves a Successor SMP

On October 29, 2014, the Management of the International Monetary Fund (IMF) completed the third review under the Staff-Monitored Program (SMP)[1] with Zimbabwe and approved a successor SMP covering the period October 2014 – December 2015.

The SMP that expired in June 2014 provided an important anchor for Zimbabwe's macroeconomic policies under difficult political and economic circumstances. The authorities' renewed commitment to the policies under the program was key to meeting all the quantitative targets and structural benchmarks for the third review.

Zimbabwe's economy is at a crossroads. The economic situation remains difficult. The post-hyperinflation rebound has ended. Gross Domestic Product (GDP) growth decelerated from 10½ percent in 2012 to 4½ percent in 2013, due to adverse weather conditions, weak demand for key exports, and election-year uncertainty. The outlook in 2014 is for continued low growth of 3 percent. Annual inflation dipped below zero recently, but stood at 0.1 percent in September 2014. The external position is precarious, with low international reserves, a large current account deficit, an overvalued real exchange rate, and growing external arrears. Credit and deposit growth have slowed down sharply, liquidity conditions are tight, and the banking system remains weak. Fiscal pressures arose in early 2014 due to higher-than-budgeted wage increases and revenue shortfalls as the economy weakened. However, the implementation of a package of revenue and expenditure measures enabled the authorities to comfortably meet their fiscal targets for the first half of 2014.

Sustaining higher growth and poverty reduction will require comprehensive reforms over the medium term. The successor SMP aims at laying the foundations for such reforms. The main

[1] An SMP is an informal agreement between country authorities and Fund staff to monitor the implementation of the authorities' economic program. SMPs do not entail financial assistance or endorsement by the IMF Executive Board.

objective of the new program is to strengthen the country's external position, as a prerequisite for arrears clearance, resumption of debt service, and restored access to external financing. To that end, the authorities will strive to consolidate the fiscal position, eliminating the primary budget deficit by end-2015. They will also aim to accumulate international reserves and seek to mobilize international support for resolving the country's external debt situation. The authorities intend to restore confidence in the financial sector, as well as improve public debt and financial management. Finally, the authorities plan to make progress in a number of key structural reform areas in order to enhance the business climate, boost productivity and competitiveness, and build confidence. Successful implementation of these reforms will demonstrate that the country can implement the policies that could justify a Fund-financed program.

Key risks to the new program stem from global commodity price shocks, domestic policy slippages, gaps in policy implementation capacity, and lagging progress in resolving external arrears. While Zimbabwe faces these risks with practically no buffers, the successor SMP aims to rebuild these buffers and strengthen the country's resilience to shocks.

Strong macroeconomic policies and debt relief, in the context of a comprehensive arrears clearance strategy supported by development partners, will be essential to address Zimbabwe's developmental needs. A successful implementation of the SMP would be an important stepping stone toward Zimbabwe's normalizing relations with the international community. IMF staff welcomes the authorities' decision to start discussions with multilateral creditors to address Zimbabwe's outstanding arrears, and exploring the possibility of debt rescheduling.

IMF staff will remain engaged with the authorities to monitor progress in the implementation of their economic program, and will continue providing targeted technical assistance in order to support Zimbabwe's capacity-building efforts and its adjustment and reform program.