Bad policies, half-hearted reforms sinking Zim: IMF

THE International Monetary Fund (IMF) published a report on its Article IV Consultation on Zimbabwe after a board meeting in Washington on Monday last week which pointed out that the country has derailed in its economic reforms. Business reporter Kudzai Kuwaza (KK) this week sat down with the IMF representative to Zimbabwe Patrick Imam (PI, pictured) to discuss the report, government's failed reforms and the threat of the global coronavirus scourge on Zimbabwe, among other issues:

KK: The Article IV Consultation report has just been published. Why was it not published annually, as in the past?

PI: You are correct to say that the Article IV Consultation is supposed to take place once a year with each member state. And it is true that the last one took place when (the late) president Robert Mugabe was still in power, some two-and-a-half years ago. But the delay simply reflects the rapid sequence of events of the past few years. After the last Article IV, Zimbabwe had a change in the presidency, followed by elections, followed by Staff-Monitored Programme (SMP) negotiations.

In circumstances when you have a succession of important events that require all the attention of the government, whether it is political changes or deep-seated economic reforms, the focus is rightly on tackling the very short-run challenges. The medium-term vulnerabilities, which are the focus of the Article IV, tend to be put on the backburner.

And as a result of all the events, the Article IV was overdue. Now even though short-term issues are pressing, such as the humanitarian crisis or stabilising the currency, a government should still be mindful of the medium-term challenges and vulnerabilities, which is why the Article IV consultation took place at the end of last year.

KK: What are the main messages emanating from the Article IV board meeting?

PI: The IMF board discussed the Article IV report on February 24. Several key messages stood out. First, the board noted with regret that the SMP was off track and that policy implementation under the programme was mixed. The worsening economic situation was a reflection not only of external shocks, such as the drought, but also important policy missteps.

The IMF board therefore urged improved co-ordination between monetary and fiscal policies to contain future slippages, including to help stabilise the currency and inflation. Making last year's currency reform a success is now paramount and requires monetary discipline, particularly the stopping of money printing and the implementation of monetary targeting as already announced on several occasions by the Reserve Bank of Zimbabwe (RBZ).

The humanitarian situation also topped discussions, including on how the authorities can navigate the difficult waters. Whilst the board emphasised the importance of ensuring fiscal sustainability, it also encouraged the authorities to make sure that current social protection programmes are targeted at the most vulnerable groups. This is easier said than done, of course, but given limited resources, redirecting non-essential spending, or extracting savings in the agricultural support programme, or further raising taxes will be required to avert what looks like a looming humanitarian crisis.

The IMF board also urged the authorities to prioritise governance reform, as guided by the governance vulnerabilities assessment that the authorities with the assistance of the fund embarked on in the second half of 2019.

The annex of the Article IV summarises some of these key measures. While reforms to tackle corruption have started, it is still early days and more tangible results are required, mostly to convince the population that Zimbabwe is serious about tackling this cancer.

KK: What was the outturn in 2019, and what is your projection for Zimbabwe's economy?

PI: As you know, Zimbabwe had a very rough 2019. The economic situation deteriorated sharply, reflecting past policy mistakes, the uneven implementation of reforms, and the impact of weather shocks, particularly the drought. So, our estimates for 2019 is that the economy contracted by over -8%, and inflation at year-end was 521%, which eroded the purchasing power of wages and savings. Reserves were extremely precarious as well.

For 2020, our preliminary forecast is that the economy is not expected to grow. Agriculture is again forecast to perform poorly because of the late and erratic rains and the challenging economic situation that affected inputs affordability. The credit supply to the agricultural sector was also inadequate. In fact, we may run the risk of having what is known as a "green drought".

Many parts of the country appear to be green, yet this does not translate into commensurate agricultural production, because insufficient planting took place. This is something that requires close monitoring.

Electricity generation, which affects all sectors of the economy will remain constrained and the tight fiscal position is expected to continue to constrain growth. Inflation is forecast to fall significantly from its current level, but will remain high at year-end at around 50% as the exchange rate depreciation pass-through runs its course.

This assumes, however, that the authorities can stabilise the currency and operationalise and maintain the monetary targeting framework. Gross international reserves will not change much. And, finally, the current account deficit is expected to rise, as low grain reserves and subdued agricultural output will be translated into importing more maize to meet consumption needs.

Over the medium-term, arrears and lack of foreign financing will affect investment, but efforts to contain the fiscal deficit and an improved exchange rate regime should allow the economy to recover.

KK: Given the recent outbreak of the coronavirus, what are the economic consequences?

PI: Look, regarding your question of what the economic consequences are, I would first say that, for policymakers, it is clear that the health consequences and fatalities should be a bigger concern than the immediate economic impact. But it is, of course, important for policymakers to understand the economic consequences and also to put in place the right policies.

We, at the IMF, are currently working on assessing quantitatively the potential costs to all member countries, with the results coming out soon. But based on previous outbreaks, and assuming the virus remains contained, many analysts expect a short-lived slowdown or contraction in world growth before a recovery.

In addition, the talk of monetary easing and fiscal stimulus that you have seen in recent days around the world suggests that the economic slowdown should be contained. However, this assumes that the assumptions we hold on the coronavirus are correct, which is not a given, and that the situation remains relatively contained. Otherwise the global slowdown may be much more protracted, of course.

Now if you think through the possible consequences of the coronavirus, it is likely that the indirect consequences on growth may be more consequential than the direct one. Let me give you a specific example. One consequence of the coronavirus is that workers get sick and do not go to work. The impact of this on GDP is going to be negative, but also only temporary. In addition, supply-chain disruptions would compound the temporary reduction in output.

The likely, more disruptive impact that one should fear is the change in consumer behaviour. The reality is that people are likely to adjust their behaviour and become more cautious. They will stop going to public places like restaurants or cinemas and stop travelling overseas. This impacts key sectors such as tourism and transportation. It is the concern of getting the virus and the resultant behavioural change that may be more damaging to growth than the direct impact of the coronavirus itself. The OECD (Organisation for Economic Co-operation and Development) this week already warned that GDP growth for the world could be more than halved.

KK: And do you have any forecasts for how the coronavirus will hit Zimbabwe?

PI: As I said, the IMF is currently modelling the potential impact of the coronavirus on all member countries, looking at mild and severe scenarios. But at this stage, I do not think anyone is able to even remotely quantify the impact on the economy, and the models will only be as good as the assumptions, but it is clear that the potential for another severe shock hitting the economy is there.

If we look at the three main FX (forex)-generating sectors of the economy, all are likely to be impacted by the virus, either because of the direct or indirect reasons I just mentioned. Take tourism. Even if the share of Chinese tourists is not that large for Zimbabwe, the global tourism and transportation sector is being hit. This is not Zimbabwe-specific. This applies to all tourist destinations. Now if the history of previous outbreaks is any guidance, the shock should be sharp but short, and tourism should recover quickly.

The mining sector, which accounts for about three-quarters of export earnings of Zimbabwe, is likely to be impacted by two channels. With global growth slowing, we should expect commodity prices to fall due to lower demand.

In addition, there are indications that some miners are not able to get spare parts on time due to shipping delays, and therefore have to temporarily slow down production. These supply-chain disruptions, whether because the spare parts are currently not produced because firms have shut down or because of shipping delays, would be a bottleneck to keep up mining production. So both the price generated for mining products, and quantity of minerals exported could suffer.

And, finally, the third main forex earner is tobacco. China is the main buyer of Zimbabwean tobacco. At this stage, the impact should hopefully not be very large, as the tobacco exporting takes place in the second half of the year, at a time when hopefully the coronavirus outbreak would be behind us. But should the crisis extend into the second half of the year, then volumes and prices could be impacted.

There may also be a negative impact on remittances. A slowdown in South Africa would lead the diaspora to probably send less money to Zimbabwe as well. There also offsetting factors that could will help Zimbabwe. For instance, fuel prices are expected to be lower. But on a net basis, the costs of the crisis are likely to outweigh the benefits for Zimbabwe. But the bottom line is that while the magnitude is very uncertain, the risks are clearly to the downside and Zimbabwe cannot be complacent.

KK: Fuel queues are exploding again, even though there are no fuel subsidies. Can you explain what is happening?

PI: This is a very technical question, but let me try to answer it. It is, strictly speaking, correct to say that there is no fiscal subsidy for fuels. In the 2020 budget, there is no line for fuel subsidies, and this is a good thing.

However, there is an implicit subsidy, as fuel is imported at the official rate, not the parallel rate. The subsidy is courtesy of entities that have to surrender part of their export earnings at the official rates through the retention ratios. This forex, which is not available to the market is, in turn, sold on to fuel importers at the official rate.

In an environment where the official and parallel rate are the same, this wouldn't be an issue, but when you have a gap of close to 100% between the official and unofficial rate, the result is that fuel prices are priced significantly below the international fuel price. At the official rate of 18, a litre of fuel costs about US$1, which reflects the international price. At the parallel rate of, say, 30, the litre of fuel trades at roughly US$0,6.

The result of this mispricing is on demand for fuel and this opens up huge arbitrage opportunities, with people incentivised to smuggle fuel out of the country and sell it to neighbouring countries, whilst pocketing the difference. For the arbitrage opportunities to stop, the gap between the official and parallel rate need to converge again.

KK: Why are reforms failing? The government has undertaken many reforms over the past one-and-a-half years, yet with few visible benefits to the economy or to growth. Why is that, and will further

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