

International Monetary Fund

African Department



Zimbabwe: Reengagement and the way forward

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



Road Map

1.

- Background (unfulfilled potential) and Recent developments

2.

- Fund engagement

3.

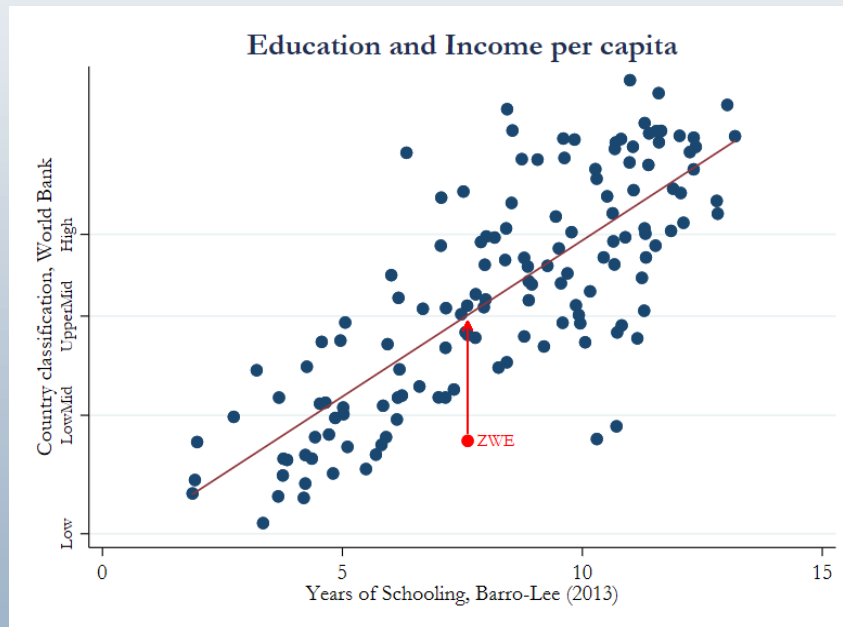
- Policy priorities



Large economic potential

High human capital

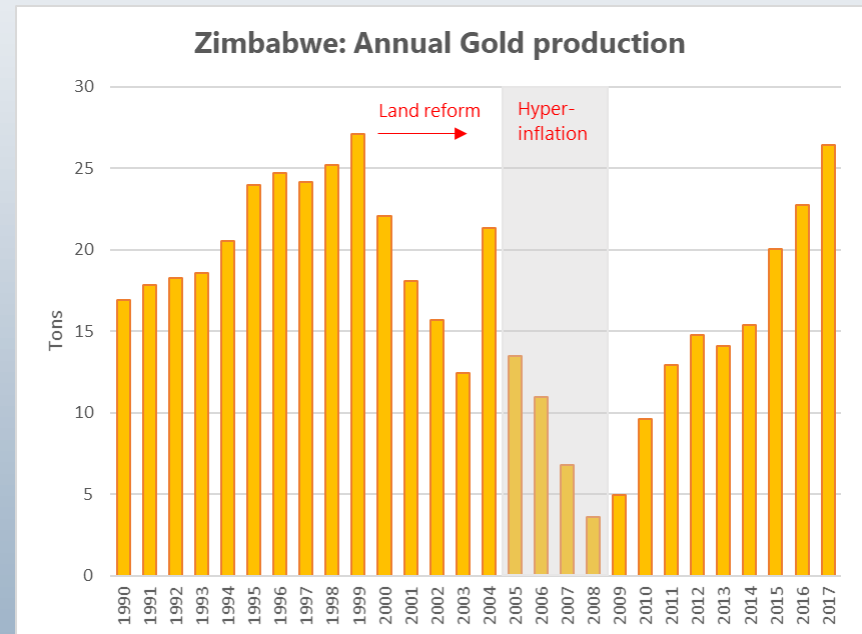
Literacy rate of 85%, in the top quintile of SSA countries



Zimbabwe's human capital stock is consistent with those observed in Upper Middle income countries

Extensive mineral wealth

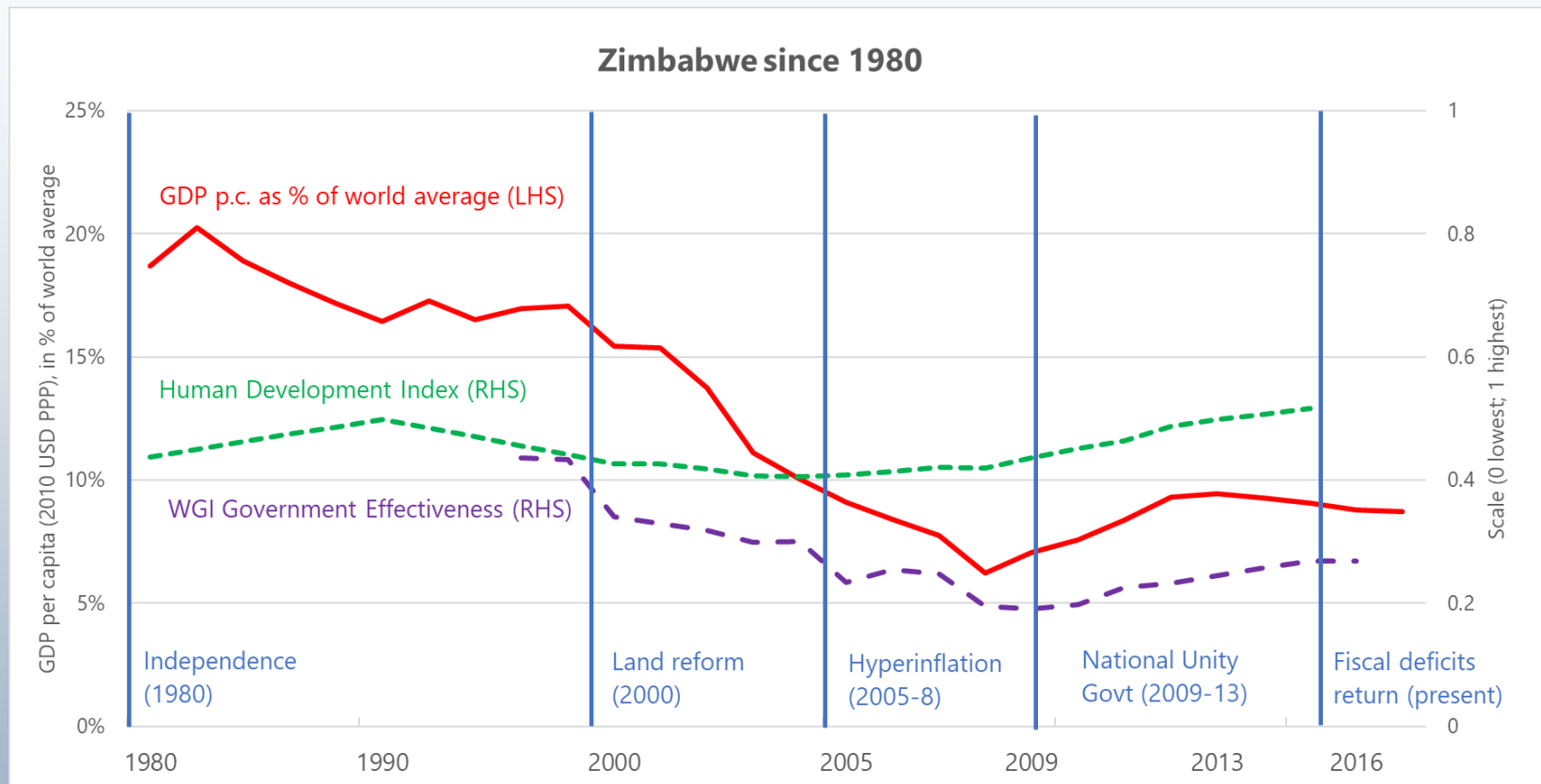
Mining sector currently generates 50% of FDI and exports



Zimbabwe has 13m tons of underground gold reserves, of which only 611 tons have been mined since 1980



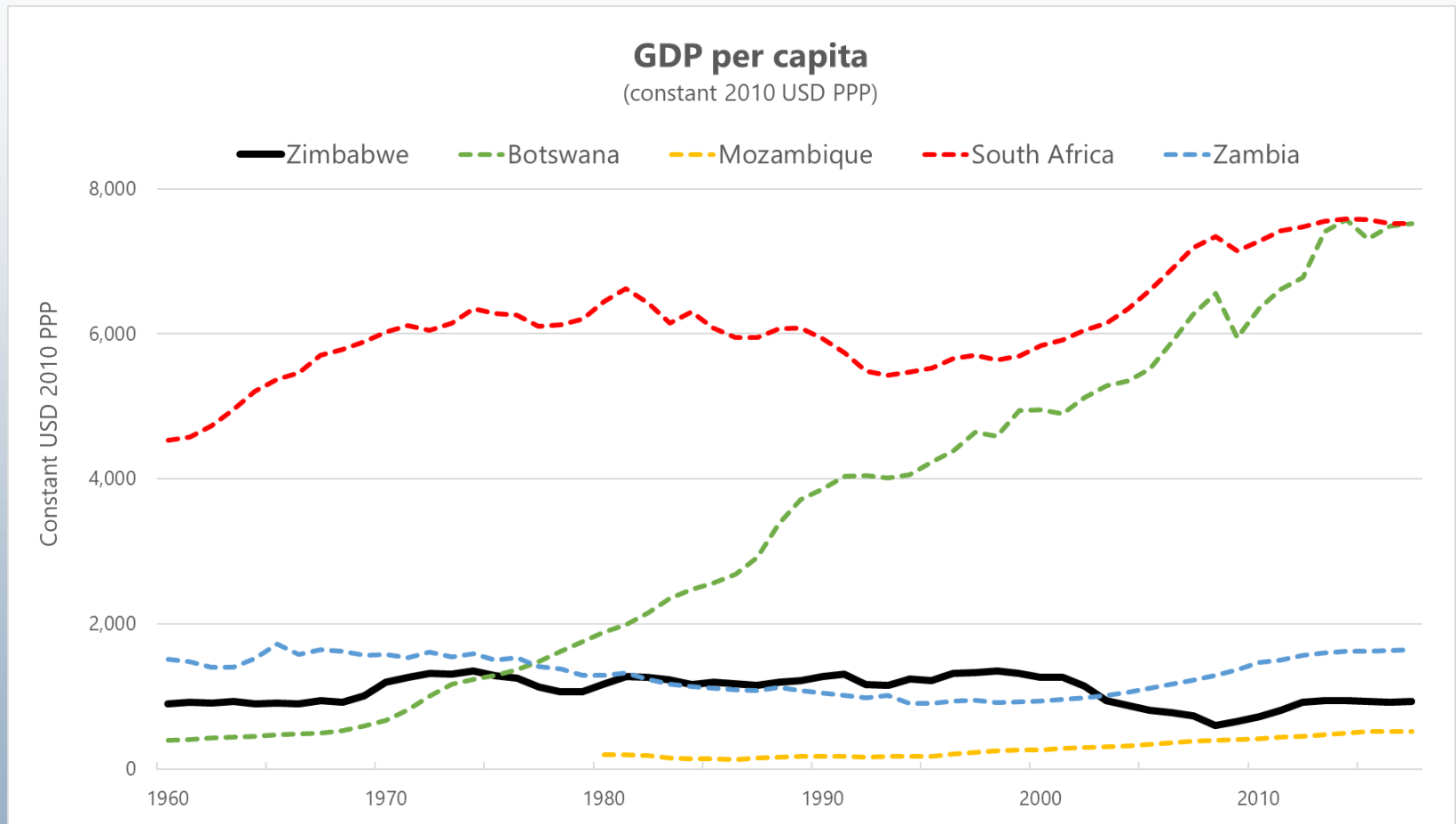
Stagnation and missed opportunities...



- Large productivity decline since 1980 (from 80% of US TFP to 20% in 2016)
- HDI decline between 1990-2005, as worsening health and life expectancy offset education gains
- Steady erosion in the quality of public services and institutional capacity since the late 1990s



While other countries in the region took off...





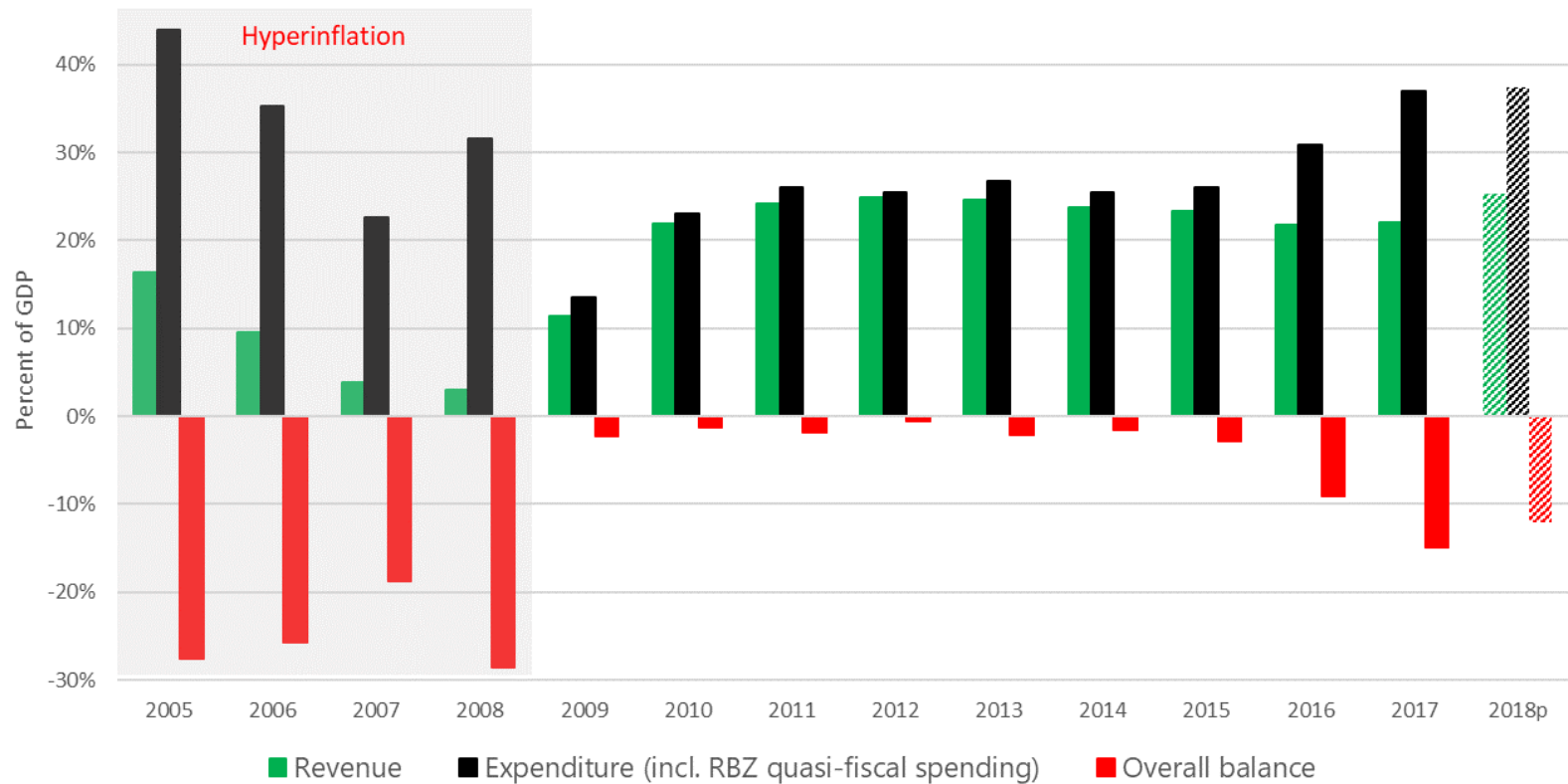
Political and economic isolation...

- Political and economic failures have taken a heavy toll:
 - ◆ Political repression
 - ◆ Human rights violations
 - ◆ ZIDERA, EU Restrictive Measures
 - ◆ Mass emigration (25% of population since 2000)
 - ◆ Poverty (21% with less than \$1.90/day)
 - ◆ Rising economic vulnerabilities
 - ◆ Limited external financing



Large deficits have returned...

Zimbabwe: Fiscal Position
(percent of GDP)





Driven by spending increases...

- Deficit driven by current expenditure increases

- ◆ Subsidies to agriculture and SOEs (+7.0)
- ◆ Goods & services (+2.1)
- ◆ Wage bill (+1.7)

- Revenue declined as the commodity cycle reversed (-2.6)

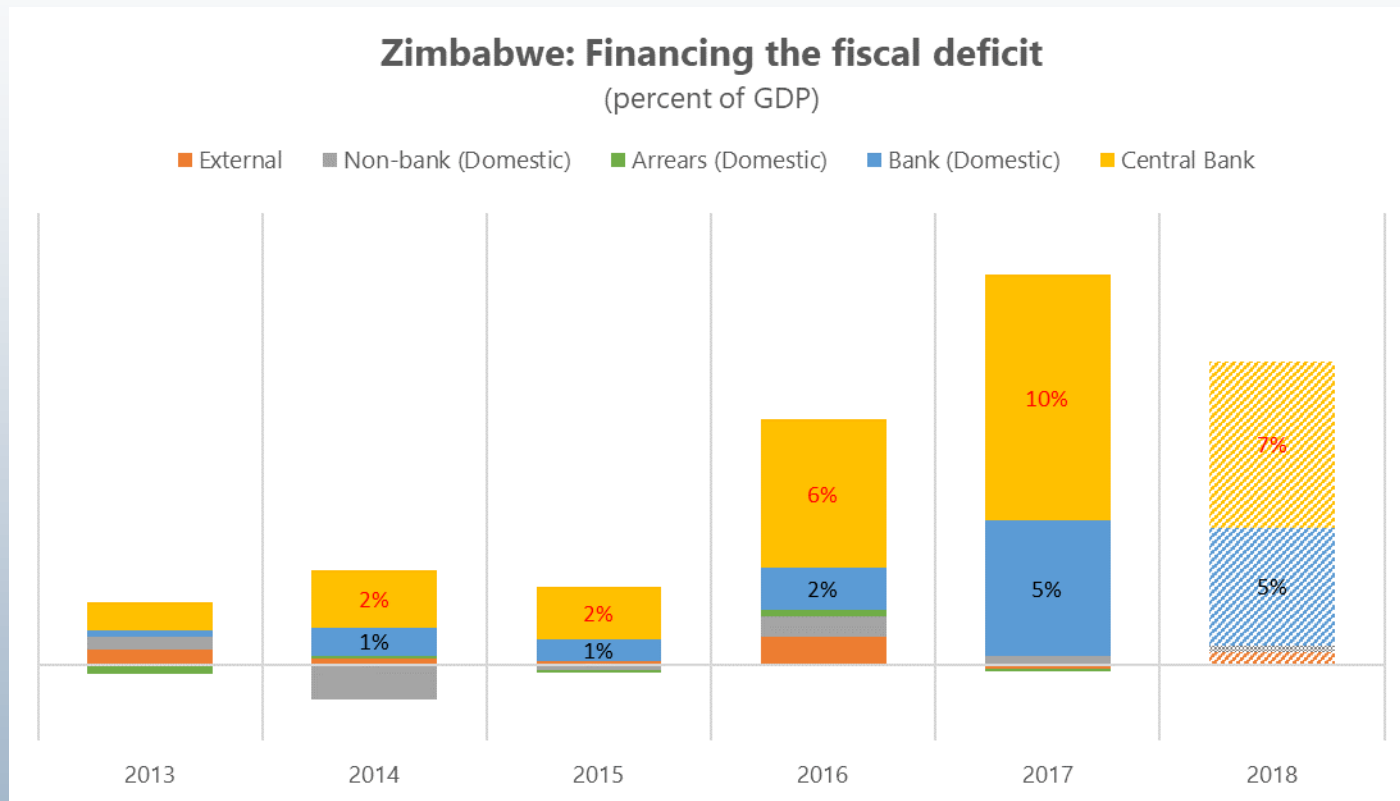
Zimbabwe: Fiscal outturn 2017 vs. 2013

(percent of GDP)

	2013	2017	Change
Revenue	24.6	22.0	-2.6
Tax	22.4	20.6	-1.8
Nontax	2.1	1.4	-0.8
Expenditure	26.5	37.2	10.7
Current	25.5	36.4	10.8
Wage bill	18.2	19.8	1.7
Subsidies	2.1	9.1	7.0
Goods and services	2.9	5.0	2.1
Transfers	2.2	1.2	-1.0
Interest	0.2	1.2	1.0
Capital	0.9	0.8	-0.1
Deficit	-1.9	-15.2	13.3



Leading to an increase in monetary financing...

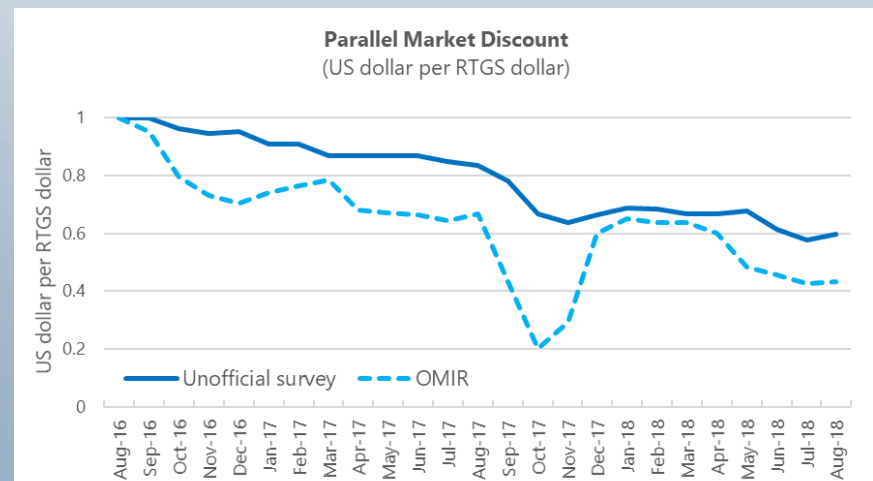
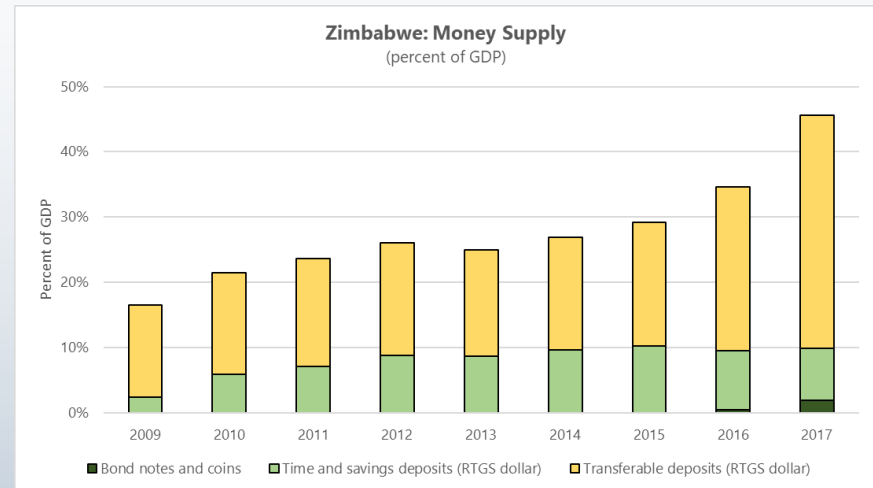


- Monetary financing takes place through RBZ overdraft, RBZ quasi-fiscal operations, and direct purchase of government bonds



The introduction of domestic quasi-currencies...

- The resumption of excessive monetary financing led to increased external outflows
- The authorities brought back the current and capital controls they had abolished in 2009
- And increased the supply of quasi-currency instruments:
 - Bond notes/coins
 - Electronic money
 - RTGS bank balances
 - Mobile payments
- With FX shortages, these instruments are discounted for USD in parallel markets at increasingly steep rates
 - Currently around 40-60%



Note: Unofficial survey of Harare money traders. The Old Mutual Implied Rate (OMIR) compares the price of Old Mutual shares listed in the Zimbabwe and London stock exchanges.



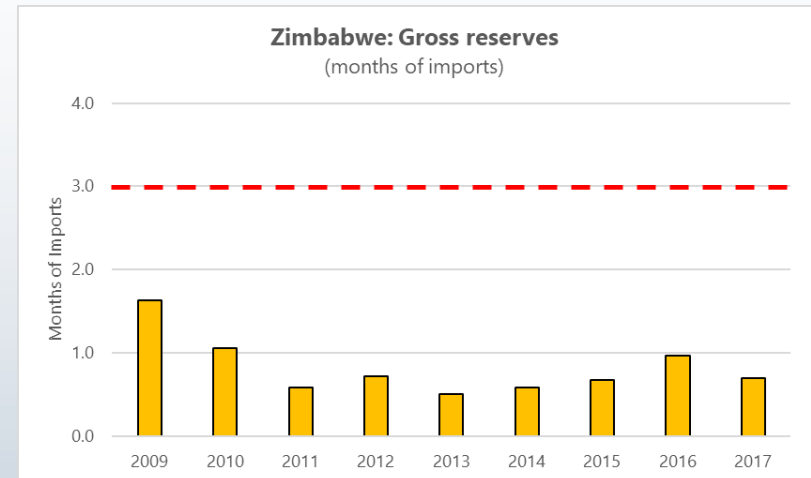
Slowing growth and financial development

- Monetary financing has slowed down growth
 - ◆ Lowered private-sector credit (“crowding out”)
 - ◆ Increased informality
 - ◆ Lowered financial inclusion
 - People queue for long hours to withdraw money over the counter (daily withdrawals are capped at \$20-\$50, and banks often run out of physical cash)
 - Restricted supply of bond notes vs. electronic money hurts poor, rural households disproportionately



The existing monetary regime is not sustainable

- Reserves have been exhausted
- Exchange controls impact production and investment
 - ◆ Access to FX is rationed via RBZ priority list
 - ◆ Corporates, households also access FX via parallel markets



Zimbabwe: Bank Balance Sheets, end-2017

Item	Foreign	Domestic	All banks
<i>(million USD)</i>			
Balances with central bank	1,373	871	2,244
Government bonds	1,014	1,965	2,979
Loans to the private sector	931	2,723	3,653
Total Assets	4,314	6,952	11,265
<i>(as a % of total assets)</i>			
Balances with central bank	32%	13%	20%
Government bonds	24%	28%	26%
Loans to the private sector	22%	39%	32%

- Pricing distortions are pervasive
 - ◆ Prices vary when paying with USD cash, bond note, mobile, ...
 - ◆ Widening discounts are not well reflected in the official CPI
- Banking sector is fragile
 - ◆ Banks hold large amounts of sovereign debt (26% of assets)
 - ◆ Foreign subsidiaries are heavily exposed to RBZ via RTGS system



Zimbabwe is in debt distress

- External arrears continue to mount
 - \$2.1 billion to IFIs
 - \$3.3 billion to bilaterals
- New external financing is limited to
 - Non-Paris Club creditors
 - Gold export-backed loans
- Domestic debt is growing rapidly:
 - Debt stock skyrocketed from \$0.4 billion (2013) to \$7 billion (2017)
- Farmer's compensation represents a large contingent liability
 - Government: \$2.4 – \$3.4 billion (only land improvements)
 - Farmers: up to \$10 billion (land improvements + land itself)

Zimbabwe: Public and Publicly Guaranteed Debt

(USD millions; as of end-2017)

	DOD	Arrears	Total	% of GDP
External Debt 1/	3,177	5,652	8,829	50%
Bilateral Creditors	1,443	3,327	4,770	27%
Paris Club	240	2,990	3,230	18%
Non Paris Club	1,203	336	1,539	9%
Multilateral Creditors	1,060	2,262	3,322	19%
World Bank	246	1,174	1,420	8%
African Development Bank	37	641	678	4%
European Investment Bank	22	287	309	2%
Afreximbank	622	67	690	4%
Others	133	93	226	1%
Commercial Creditors	674	63	737	4%
Domestic debt 2/	6,886	108	6,994	40%
Government Bonds	4,785	-	4,785	27%
RBZ loans	2,049	-	2,049	12%
Domestic Arrears	-	108	108	1%
Other	52	-	52	0%

Farmer's compensation 3/ 2.4-10 USD billion (13-57% GDP)

Source: Zimbabwean authorities and IMF staff calculations

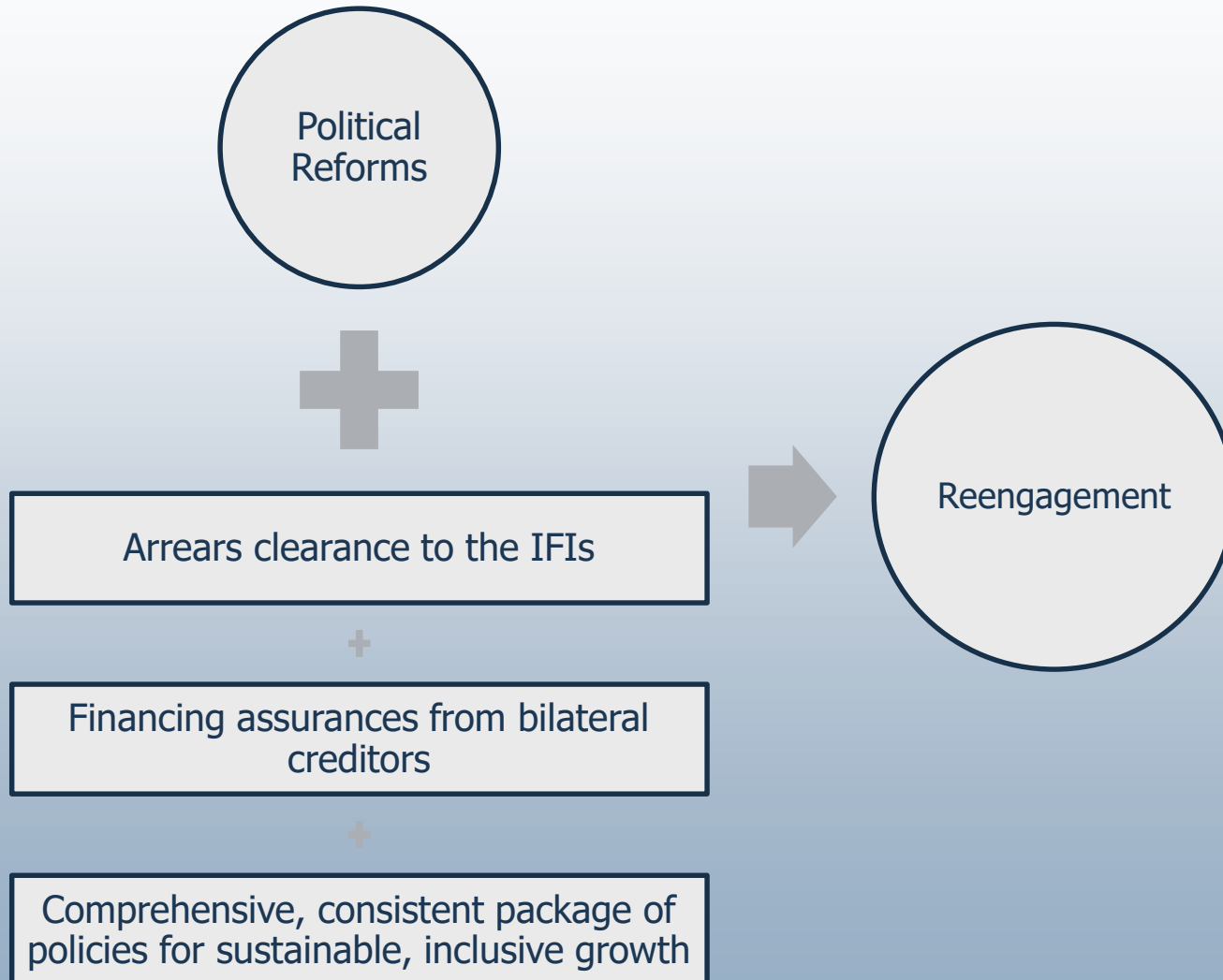
1/ External public and publicly-guaranteed debt, including RBZ and SOEs

2/ Unconsolidated domestic debt of the central government

3/ Contingent liability



Conditions for IMF financial engagement





Road Map

Road Map



Fund engagement



Policy priorities



Fund engagement

A. Continue TA and policy advice

- ◆ Article IV (past due)
- ◆ Upcoming TA
 - Monetary Policy and Financial Stability
 - Tax and Expenditure
 - AFRITAC: revenue administration, Basel III, ...

B. Consider access to Fund resources

- ◆ Zimbabwe is PRGT-eligible and is facing a BoP pressure
 - Needs US \$0.6-1.0 billion to shore up credibility of a new FX regime
 - Quota is SDR 706.8m (approx. US \$1 billion)



Fund engagement: options

Option	Pros	Cons
SMP	<ul style="list-style-type: none">• potential to control fiscal slippages while advancing structural reforms• facilitate debt restructuring	<ul style="list-style-type: none">• May have limited appeal to authorities• does not address urgent financial need
SMP + RCF	<ul style="list-style-type: none">• build credibility while providing emergency financial assistance	<ul style="list-style-type: none">• no ex-post conditionality and weak track record of authorities mean catalytic role could be minimal• available financing is small compared to needs
ECF	<ul style="list-style-type: none">• create space for fiscal and monetary adjustment• catalytic role	<ul style="list-style-type: none">• weak track record• reduced int'l support for a financial program, including at the Board



Policy priorities

● Near-term

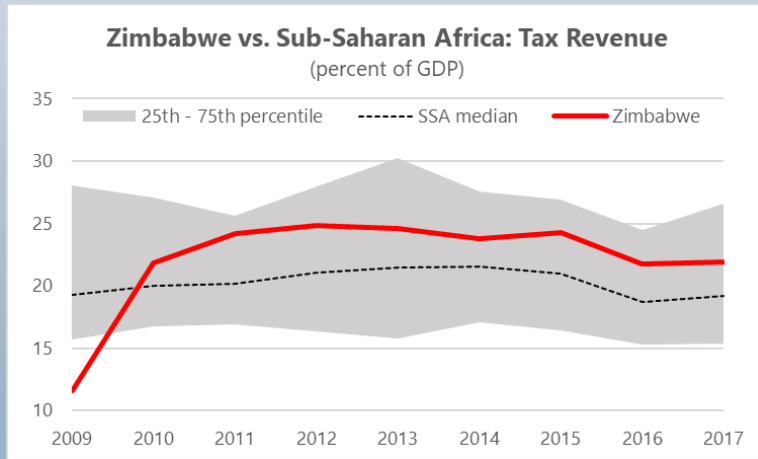
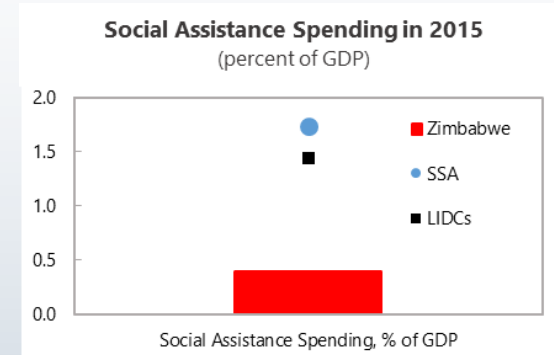
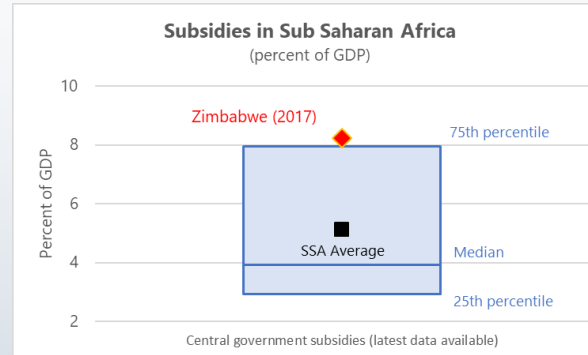
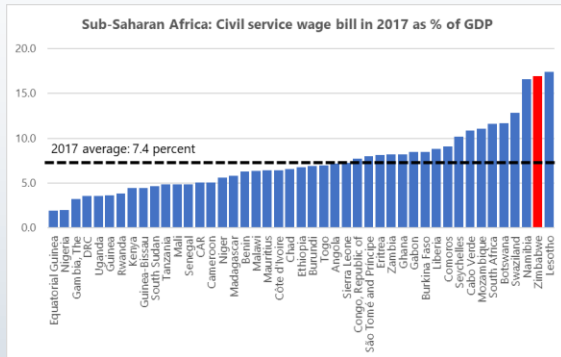
- ◆ Resolve policy uncertainty (recent bond notes issue)
- ◆ Initiate fiscal consolidation
- ◆ Limit monetary financing
- ◆ Decide on monetary policy framework
- ◆ Improve on investment laws
- ◆ Agree arrears clearance plan with IFIs
- ◆ Agree debt treatment plan with official creditors

● Medium-term

- ◆ Rebuild reserves
- ◆ Implement new monetary policy framework
- ◆ Reduce infrastructure gap
- ◆ Enhance agricultural productivity
- ◆ Adopt structural reforms for private-sector led growth
- ◆ Adopt fiscal rules to manage commodity price volatility



Fiscal consolidation: background



- Strong revenue collections by historical standards and relative to peer countries
- While government spending is too high and poorly targeted
- Fiscal consolidation should be primarily spending-based, and focused on increasing spending efficiency and equity



Fiscal consolidation: options

- Debt sustainability will depend on debt / arrears treatment
 - The required adjustment without debt relief will be onerous
- Focus on spending efficiency and equity:
 - Agricultural reform to foster private-sector led development
 - Increase social spending targeting poor, rural households
- Potential measures building on existing Fund TA

Zimbabwe: Potential Consolidation Measures (% GDP)

	Year 1	Year 4
Revenue	1.2	1.6
Tax allowances	1.0	1.0
CIT and VAT base broadening	0.2	0.6
Expenditure	3.1	7.7
Wage bill	1.8	3.7
Eliminate the 13th check	1.0	1.0
Index compensation to 2% below CPI inflation	0.3	1.0
2/1 replacement rule	0.5	1.7
Subsidies: freeze at 2018 levels	0.9	3.1
Goods & Services: freeze at 2018 levels	0.6	1.8
Social transfers: double to 2% GDP over 4 years	-0.2	-0.9
Total	4.3	9.3

Note: Estimates for tax and wage bill measures based on FAD TA (2017, 2018)



Monetary regime: issues

- Credible monetary regime is crucial for investment and financial resilience
- Success of any regime requires:
 - ◆ **Fiscal discipline**
 - ◆ RBZ independence and limited monetary financing
- Financial sector and distributional implications are important:
 - ◆ Balance sheet vulnerabilities depend on ER regime chosen



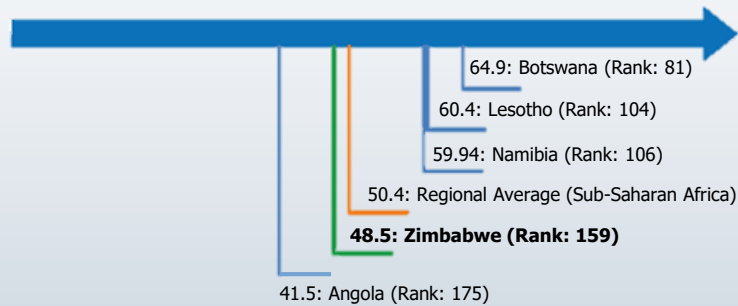
Monetary regime: options

Regime	Pros	Cons	Implementation risks
Return to full dollarization	Low inflation No currency risk	Loss of seigniorage No LOLR, independent MP	USD peg is not optimal Rebuilding reserves requires large internal devaluation
(Hard) Peg <ul style="list-style-type: none"> • Join MMA • Currency board • Crawling peg 	Clear nominal anchor (credibility) Stable inflation If pegged to Rand: <ul style="list-style-type: none"> • Minimize REER volatility • Trade integration MMA/SACU 	No independent MP No LOLR (currency board)	Choice of anchor currency Choice of optimal peg level Low reserves
(Managed) Float	Market-determined ER Independent MP	ER volatility Weak MP transmission	No track record Choice of monetary anchor



Structural reforms to unlock Zimbabwe's potential

Doing Business 2018 – Distance to Frontier



- High labor costs incentivize informality while heavy government presence distorts competition
- Structural reforms could increase GDP by nearly 8 percent over 5 years

Table – 5-year impact of structural reform packages

	GDP	Unemployment	Formal firms	Exports	Investment
Individual reforms					
Hiring cost	2.5	-2.6	1.6	1.7	5.3
Bargaining power	3.2	-3.5	0.9	1.5	7.3
Entry cost	0.7	-0.1	6.1	0.3	2.5
Reform packages and sequencing					
1. Labor, 2. Product	7.9	-7.3	3.7	3.7	11.4
1. Product, 2. Labor	0.8	-0.6	6.1	0.4	1.7
Simultaneous	6.4	-6.6	8.7	3.6	14.9

Note: Based on ongoing work with SPR using STRESS model.