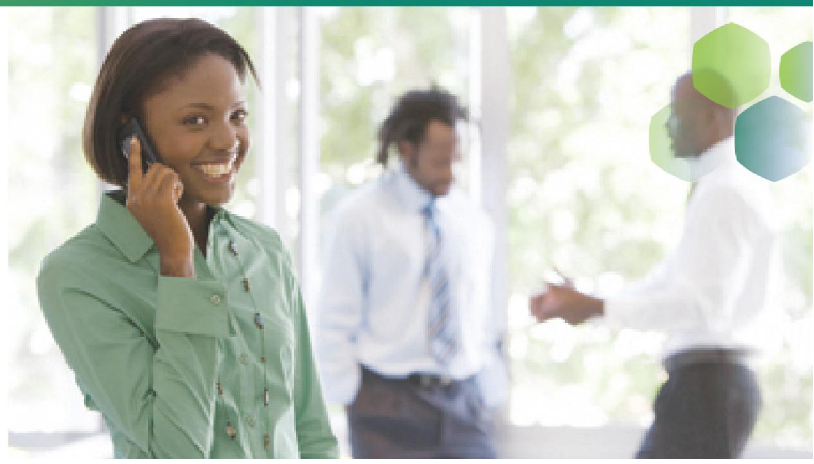
Annual Economic & Investment Report 2016



Highlights

Investors are losing patience with underperforming 'BRICS' bloc.

Britain set to leave the European Union following shock referendum vote.

Global equities registered gains of 8.48% in 2016, up from losses of 1.84% in the previous year.

Zimbabwe introduced a monetary export-incentive funded by a surrogate currency (bond notes).

GDP growth decelerated from 1.1% to 0.6% in 2016, weighed down by a depressed agriculture outturn.

ZSE market capitalization firmed 31.2% to $4.214 billion in the year ended 31 December 2016.

Annual Brief| Q1'2016

BRICS mantra 'at risk'...

Leading emerging countries, Brazil, Russia, India, China and South Africa (BRICS) struggled to justify predictions that they would underpin the future of global economic growth. Investor confidence in the BRICS had been premised on the emerging economic powerhouses holding approximately 25% of the world's total land mass and housing more than 40% of the world's population. The BRICS concept and acronym was coined by Goldman Sachs Asset Management in 2001, as the new investment frontier.

Of the 5 BRICS countries, only India has sustained a stable growth path while China registered its lowest GDP growth rate in 25 years at 6.9% in 2015. In November 2015, Goldman Sachs closed its BRIC investment fund, declaring that it did not expect 'significant asset growth in the foreseeable future,' as asset values in the fund had retreated 88% from a 2010 peak. Incessant structural weakness in the BRICS also weighed on the overall BRICS outlook.

Annual Brief| Q2'2016

US$2.1 trillion equity loss in the day post Brexit poll

On 23 June 2016, Britain voted 52% to 48% in favour of the country leaving the EU (Brexit). The likely implications on international trade and investment flows were exceptionally difficult to quantify, leading to investors taking up defensive positions. Safe haven assets such as the dollar and gold registered significant gains while risky assets registered huge losses. An estimated US$2.1 trillion was wiped off global equity markets the day following the Brexit vote, the biggest single day loss in history.

Rise of the sandwich generation

The 2016 Old Mutual Savings & Investment Monitor revealed that two thirds of South African households consider their financial stress levels as overwhelming or high. The share of income spent on debt repayment increased from 12% in 2015 to 16%. Fewer homeowners are paying lump sums into their bonds, instead sticking to the minimum payment thereby maximizing future interest owed.

The report noted that dependency on children for financial assistance during retirement is at its highest level, correlating with an increasing 'sandwich generation' – people supporting their children as well as their parents. In response to mounting financial constraints, the report noted an increase in stokvels (savings clubs) participation.

Annual Brief| Q3'2016

The curious case of Ireland…

The European Commission ruled that Apple Inc. received unfair tax benefits from Ireland. Resultantly, Apple was ordered to pay Ireland US$14.5 billion in back taxes, plus interest. In a strange twist of events, Ireland declined the offer, opting instead to challenge the ruling.

The Commission's ruling followed a three year investigation, which concluded that the country 'substantially and artificially' lowered the tax paid by Apple since 1991. The Commission ruled that EU 'state aid rules' make it illegal to selectively offer tax benefits. Apple subsequently paid an effective tax rate ranging from 1% to 0.005% between 1991 and 2014, against the country's prescribed corporate tax rate of 12.5%. Ireland's 'flexibility' on tax policies is attractive to multinational investors, leading to job creation and other cascading benefits.

Annual Brief | Q4'2016

US Presidential election 'shock' result

The United States 2016 Presidential election race was won by radical republican Donald Trump - a situation described by Oxford Economics as 'The single largest risk to the global economy.' The assertion was based on a client survey raising concerns of an unusually elevated degree of policy and geo-political uncertainty. President Trump promised radical 'America-first' policy reforms that pose a threat to international trade, migration and capital flows. He was inaugurated on 20 January 2017.

Financial markets reacted sharply to the shock election result, with investors selling out of risky assets in 'post-Brexit' proportions. By the end of the quarter under review, markets had rebounded as investors warmed up to the prospects of medium to long term positive effects of anticipated expansionary fiscal policy under the new regime. A generalized uncertainty is sustained by the fact that it is not unprecedented for a campaign trail to soften its stance by the time policies are implemented.

2016 Investment Summary |

Tech and services sectors prop FDI flows

The 2016 World Investment Report by the United Nations reported that global Foreign Direct Investment (FDI) flows gained 38% to close 2015 at US$1.76 trillion, the highest level in the post global financial crisis era. FDI growth was boosted by 'Mega-deals' involving tech and services firms in advanced economies such as the US$68 billion merger between Actavis Plc and Allergan Plc and the US$17 billion acquisition of Sigma-Aldich Corp. by Merck KGaA.

Depressed commodity prices and slowing global aggregate demand weighed on FDI inflows to emerging markets, ostensibly supporting the notion of FDI becoming more services and innovation sector inclined. Global economic fragilities and generally depressed demand conditions are expected to result in a 10-15% decline in 2016 global FDI flows. Projections of lower FDI flows make the need for business-enabling reforms critical for developing countries that are highly dependent on FDI.

Commodity price movements were largely positive

Commodity price movements during the year ended 31 December 2016 were predominantly bullish as highlighted in the following table.

	Dec-16	MVT'16	MVT'15
Nickel ($/ton)	10,035.00	-5.43%	-42.04%
Crude Oil ($/barrel)	57.17	-3.53%	-34.80%
Gold ($/oz)	1,159.75	3.24%	-11.23%
Platinum ($/oz)	906.67	8.92%	-27.84%
Coffee ($/lb)	135.45	10.93%	-24.78%
Maize ($/ton)	137.39	2.65%	-11.47%
Sugar (USc/lb)	19.49	4.16%	3.47%

Nickel and oil prices went against the general positive trend, extending earlier losses. Oil prices were depressed by speculation of increased volumes after U.S oil production surged in response to anticipated oil price support in line with an Organization of Petroleum Exporting Countries (OPEC) resolution to cap supply in 2017. Higher than earlier estimated Chinese stocks of nickel weighed on prices amid concerns of a likely market glut.

Global equities closed the year strong

Investor risk appetite returned during the year under review, with the global MSCI All Country Index registering returns of 8.48%, up from losses of 1.84% in the previous year as highlighted in the table below.

	MSCI Global	MSCI Developed	MSCI Developing
2016	8.48%	8.15%	8.96%
2015	-1.84%	-0.32%	-1.68%
2014	4.71%	5.80%	4.36%
2013	23.44%	27.37%	24.17%
2012	16.80%	16.54%	17.04%
2011	-6.86%	-5.02%	-7.43%
2010	13.21%	12.34%	14.87%
2009	35.41%	30.79%	37.18%
2008	-41.85%	-40.33%	-42.01%

Emerging markets outperformed advanced markets in 2016 in light of weak macro-economic themes and concerns of possible policy shocks arising from the Brexit and United States poll outcomes.

Global Outlook | Growth remains at risk

Inherent global policy and geopolitical vulnerabilities threaten economic output. A weak global demand outlook is likely to cascade to depressed commodity export earnings for commodity exporters. External risks for Sub-Saharan Africa's regional economic output include macro-policies in advanced economies, particularly the United States and the threat of adverse weather conditions.

Average manufacturing sector capacity utilization (measure of industrial output against installed capacity) increased from 34.3% in 2015 to 47.7% in 2016, with some manufacturing companies reportedly operating at full capacity. Growth capacity utilization was largely attributed to protectionist policies advanced by government.

Bond notes and coin were introduced to the market as a surrogate currency on 28 November 2016. The new notes are issued to banks to fund incentives of up to 5% for forex earners. By year-end a total of $72.9 million worth of bond notes had been issued. Issuance of the notes is backed by a US$200 million AFREXIMBANK facility and the notes are pegged at par with the US$.

Civil activist groups coordinated anti-government protests via social media platforms. In July 2016, the groups coordinated arguably the largest mass stay-away in decades, citing delayed public wages and declining economic conditions. Government responded by settling wages a day earlier than announced, effectively ending the participation of public workers in the protests. Further calls for mass action were significantly undersubscribed.

Deflation persisted, ending the year at -0.93%, compared to -2.47% in the previous year. Inflationary pressures were experienced in the final quarter of the year, registering positive monthly inflation in all three consecutive months. The inflationary pressures were attributed to seasonal consumption trends as well as speculative pricing fueled by a generalized fear of ‘bond notes.’

Empowerment law misinterpretations and alleged misrepresentations were lifted in April 2016 following a Presidential statement clarifying government’s position on the contentious law. The statement presented a noticeably temperate tone, accommodating empowerment credits. Minister responsible for empowerment, Hon. Zhuwawo reportedly admitted misinterpretation of the law and said the President’s version is ‘perfect and final.’

Foreign Direct Investment (FDI) inflows closed 2016 at $254.7 million, down 36% from $399.2 million in 2015. The data from the Central Bank also showed that portfolio investment flows closed on a net negative position of $26 million, significantly down from positive net inflows of $122.8 million in the previous year. Quarter on quarter, FDI inflows averaged $79.8 million in the first three quarters of 2016 and then slid to $55.1 million in the final quarter.

Portfolio investment outflows also peaked in Q4’2016, ostensibly due to investor nervousness arising from monetary policy uncertainty.

Gross Domestic Product (GDP) as a proxy of overall economic output closed 2016 at 0.6%, according to Treasury estimates. GDP had closed at 1.1% in the previous year, signifying a downward trend in economic activity. The economic underperformance in 2016 was primarily attributed to a weak agriculture outturn following one of the worst regional droughts in years. Treasury anticipates a growth rebound in 2017 premised on a normal to above normal rainfall outlook.

Hoarding of consumer goods characterized the market amid fears of looming shortages. The fear was occasionally triggered by reports of restricted imports in light of generalized foreign currency shortages. Inadvertently, hoarding tendencies fueled occasional shortages, particularly for fuel.

International Monetary Fund (IMF) arrears amounting to US$107.9 million were fully settled by Zimbabwe on the 20th of October 2016. The funds were transferred from Zimbabwe’s approximately US$110 million Special Drawing Rights reserve balance held by the IMF. Zimbabwe can now access approximately US$91 million from the IMF which had been held in escrow pending clearance of arrears. The IMF reiterated that settlement of arrears does not automatically provide Zimbabwe with access to IMF funding.

Judicial Services Commission interviews to select a new Chief Justice were stopped following a constitutional court appeal citing irregularities in the process. Consequently, government published a bill seeking to extend the President’s power to appoint the Chief Justice. The bill faced resistance amid concerns of compromised judicial independence.

Kariba Dam wall rehabilitation is scheduled to commence in 2017. Rehabilitation costs are estimated at $294 million being sourced from partners such as the World Bank and AfDB. Kariba’s 185 cubic km capacity makes it the world’s largest man-made lake, with huge economic benefits.

Lima plan; Zimbabwe’s US$1.8 billion external arrears clearance program, moved a gear up following full settlement of arrears to the IMF. Authorities revised the plan from a simultaneous to a sequential based approach. As such, government is negotiating repayment of the US$610 million to the AfDB and US$1.1 billion to the World Bank.

Standard Chartered Bank Plc expressed its desire to assist in settling part of AfDB arrears, on condition of British government approval and implementation of reforms by the Zimbabwean government. United States based Lazard Capital is reportedly arranging a syndicated loan for the repayment of half of the World Bank arrears. Afreximbank is reportedly also participating in the funding arrangement.

Mid-year 2016 fiscal policy highlights included a US$623 million budget deficit, primarily financed by debt. Minister of Finance Hon. Chinamasa acknowledged that government's debt burden was increasingly unsustainable. Resultantly Hon. Chinamasa announced bold austerity measures such as public service salary cuts ranging from 5% to 20% coupled with 25,000 job cuts by December 2017 and a two-year bonus suspension. The austerity measures were nullified a week later by government.

National maize output for the 2015/16 season was estimated around 445,600 tons, representing a 40% decline from 742,000 tons in the previous season. The estimate was produced by the Zimbabwe Vulnerability Assessment Committee. Some independent assessors reportedly put the seasonal estimate as low as 250,000 tons citing adverse drought conditions. Zimbabwe's annual maize requirement is around 1.8 million tons.

Over 2,658 agricultural extension workers and about 91,000 farmers were reportedly trained under government's $520 million 'command' maize import substitution program. The audacious program aims to address grain shortages by producing two million tons of maize from 400,000 hectares annually starting in the 2016/17 season. Participating farmers receive privileges such as inputs, debt restructuring and lower power tariffs in exchange for at least 5 tons grains per hectare planted.

President Mugabe was endorsed as ZANU-PF's 2018 presidential election candidate at the party's annual national conference. The youth league recommended that President Mugabe be appointed life-President and that government acquires all remaining white-owned farms. The women's league called for a women's quota in the party's 'three-man' Presidium.

Questions over the President's alleged infirmity sustained environment uncertainty. MDC-T Parliamentarian Hon. Maridadi accused Parliament of failing or deliberately frustrating his proposed impeachment motion against President Mugabe. The motion papers were reportedly filed in June 2016, alleging State capture by the First Lady and accusing the President of 'failure to rein corruption'. The matter was taken to the Constitutional Court.

Rains associated with *La Nina* effects across the Southern African region caused extensive damage since they commenced towards the end of 2016. The *La Nina* conditions followed *El Nino* conditions that caused the worst droughts in decades. The economic costs of the adverse weather conditions are yet to be quantified, but seasonal agriculture was considerably affected with Treasury estimating a 4.2% contraction in 2016.

Shrinking aggregate demand was cited for declining tax collections. Total tax collections for Q4'16 closed at $893.89 million, representing growth of 4% from the previous quarter. This notwithstanding, Q4'16 collections were 4% below target. Cumulative collections for 2016 closed at $3.462 billion, 4% below target and about 10% lower than in 2015. Taking tax collections as proxy for overall economic activity, shrinkage typify the unpleasant reality of an underperforming economy.

Total exports gained 4.8% to US$2.83 billion in 2016 while imports declined by 13% to US$5.21 billion. Resultantly, Zimbabwe's trade deficit narrowed from US$3.29 billion in 2015 to US$2.38 billion in 2016. Government had reportedly set a target of US$3.36 billion for exports in 2016, while the National Trade Policy (2012) had projected exports to grow from US$4.3 billion in 2011 to US$7 billion in 2016.

Underperforming balance of payments inflows, captured by weak current and capital account balances fueled cash shortages under the prevailing multi-currency framework. Bank queues resurfaced and the RBZ responded by reducing maximum withdrawal limits to US$1000 per day. Most banks could hardly meet the maximum withdrawal threshold due to scarce cash holdings. Most banks also reported pilling external payment backlogs on the back of limited Nostro account balances.

Vendors clashed with police as they resisted attempts by urban councils to move them out of central business districts. Vending constitutes considerable supplementary income for many households on the back of an increasingly informalized economy. The International Labour Organization (ILO) estimated Zimbabwe's unemployment rate at 5.4% in 2014. The statistic suggests high levels of informal employment.

Weak global rankings continued to dent Zimbabwe's near-term sustainable recovery prospects. Zimbabwe slipped four places down to 161 out of 190 comparable economies on the World Bank's Ease of Doing Business global rankings. The World Economic Forum ranked Zimbabwe 126 out of 138 on the global competitiveness rankings, one place down from the previous year. Transparency International ranked Zimbabwe at 154/176 on the corruption perceptions index.

Xi Jinping, President of the Peoples Republic of China, reiterated his country's commitment to full implementation of major deals signed between Zimbabwe and China in 2015. Of the 12 projects signed, the Kariba South Hydro power expansion project and the new Parliament building projects are underway. Implementation modalities of the other projects are yet to be finalized.

Yearly sales of brand new vehicles declined by 6.6% to 3,393 units in 2016, compared to 3,633 in the previous year. Toyota registered growth in sales of 8% to 728 units, translating to market share of 21.5%. Nissan sales declined 10.7% to 626 vehicles, while Volkswagen experienced a 250% increase to 56 vehicles, albeit from a very low base. Meanwhile, used vehicle imports through Beitbridge border post gained 0.25% to 24,573 in 2016, despite prohibitive import tariffs imposed to aid local manufacturers.

Zimbabwe Stock Market (ZSE) returns closed the year 2016 bullish, with the ZSE industrial index closing 25.8% firmer. ZSE performance was against a depressed aggregate earnings outlook under generalized environment uncertainty. Foreign investors registering net sales of $80 million, up from only $0.8 million in 2015. The inverse relationship between foreign investor interest and ZSE returns adds credence to the notion that local investors were shifting portfolios to real assets.

Zimbabwe | Annual Statistical Tables

GDP growth deceleration persisted, while inflation remained negative under depressed aggregate demand conditions as shown in the table below.

	Real GDP $ m	Real GDP Growth	Inflation year-end
2016	12,398	0.56%	-0.93%
2015	12,329	1.08%	-2.47%
2014	12,197	3.85%	-0.80%
2013	11,745	4.48%	0.30%
2012	11,241	10.56%	2.90%
2011	10,167	11.91%	4.90%
2010	9,085	11.38%	3.20%
2009	8,157	5.40%	-7.70%

The threat of adverse spillover effects is high in the foreseeable outlook. The baseline outlook without policy reforms points to stagflation - stagnating growth and inflationary pressures. The worst case suggests contraction and 'excessive' inflation.

The budget deficit widened from $123 million in 2015 to $1.1 billion in 2016 as highlighted below.

	National Revenue $'m	National Spending $m	Budget Deficit $m
2016	3,530	4,590	-1,060
2015	3,737	3,860	-123
2014	3,769	3,911	-142
2013	3,741	3,987	-246
2012	3,495	3,505	-10
2011	2,921	2,898	23
2010	2,339	2,143	196
2009	933	898	35

Continued central government budget deficits raise the risk of unorthodox funding measures.

Zimbabwe's trade deficit narrowed in 2016, albeit primarily due to shrinking imports caused by import restrictions, shortages of foreign currency, and generally depressed aggregate demand.

	Total Exports $m	Total Imports $m	Trade Deficit $m
2016	2,830	5,210	-2,380
2015	2,700	5,887	-3,187
2014	3,487	7,471	-3,984
2013	3,507	7,704	-4,197
2012	4,355	7,456	-3,101
2011	4,771	8,491	-3,720
2010	3,541	5,834	-2,293

Restricted imports without compensatory growth in local output could fuel shortages and inflation.

Aggregated electronic transactions reached $61.7 billion in 2016, up from $1.67 billion in 2009.

	TOTAL $b	RTGS $b	Mobile $b	POS $b	ATM $b	Other $b
2016	61.72	48.11	5.82	2.9	2.28	2.61
2015	56.85	44.87	4.65	1.72	3.85	1.76
2014	53.53	43.83	3.63	1.53	3.19	1.35
2013	49.23	41.8	2.09	1.45	2.38	1.51
2009	6.88	6.82	0.00	0.01	0.02	0.03

Market-wide cash shortages have incentivized e-payments as an alternative payment method.

The local bourse registered a noteworthy 31.2% gain in market capitalization, albeit on thin trades in 2016.

	Total Trades ($)	Market Cap ($)	Trades/Mkt Cap (%)
2016	194 mln	4,214 mln	4.60%
2015	229 mln	3,211 mln	7.13%
2014	455 mln	4,736 mln	9.61%
2013	485 mln	5,611 mln	8.64%
2012	448 mln	4,245 mln	10.55%
2011	478 mln	3,954 mln	12.09%
2010	392 mln	4,208 mln	9.32%

Market liquidity slid from 7.13% to a post dollarization low of 4.6%. Foreign investors remained net sellers.

Zimbabwe Outlook | Uncertainty persists...

The foreseeable outlook remains dire, clouded by persistent macro-economic and policy fragilities. Underperformance is likely to persist in the absence of a material policy review. Overall, the environment still dictates safety over return.