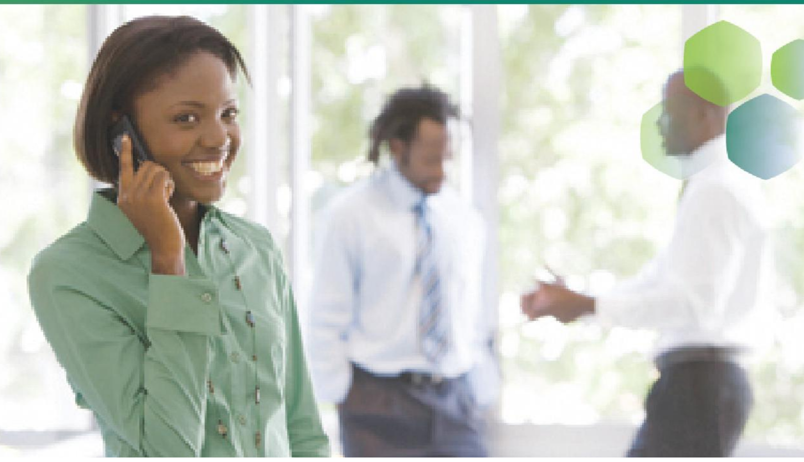
Monthly Economic Brief

May 2016



Highlights

The IMF warned of continued difficulties if bold reforms are not implemented.

The RBZ responded to market failure by prescribing measures to ease market-wide cash shortages.

Government registered a Q1'2016 budget deficit of US$160 million, against a full year target of US$150 million.

Year on year inflation closed April 2016 at -1.64%, down from -2.31% in the previous month.

Total ZSE market capitalization retreated by 1.26% to close the month under review at US$2.992 billion.

Bold reforms necessary to manage deepening difficulties - IMF

The IMF completed its Article IV consultations with Zimbabwe, concluding that 'Economic difficulties have deepened.' The IMF cited prolonged adverse weather, tight liquidity and weak international commodity prices. The IMF however, commended Zimbabwe for successfully meeting all targets under the 3rd and final IMF Staff Monitored Program (SMP), 'despite difficult conditions.' Going forward, the IMF noted that unless bold reforms are taken, the economic difficulties will continue.

The IMF Executive Board welcomed Zimbabwe's strategy for normalising relations with international financial institutions (IFIs). Resultantly the IMF urged Zimbabwe to clear arrears to IFIs 'as a first step to the process.' Arrears clearance is envisioned to provide positive signals to investors, unlocking access to foreign capital. The associated risk hinges on the negative sentiment that would arise in the unfortunate event that Zimbabwe fails to implement the ambitious strategy.

Response to market failure brings new risks…

Following persistent long withdrawal queues across most banks, delayed import payments and depressed export receipts; RBZ Governor Dr. John Mangudya presented remedial measures on the 4th of May 2016. According to Dr. Mangudya, the direct policy interventions were necessitated by market failure. Market failure is a condition whereby the forces of demand and supply fail to lead to an optimal allocation of resources. Interventions to address market failure might lead to 'government failure.'

As part of measures to mitigate market-wide cash shortages, the RBZ imposed stricter limits on daily cash withdrawals and cash that can be exported by individuals. All traders, formal and informal are also required to install functional POS machines to manage demand for cash. To manage scarce forex, the RBZ availed an import priority list for use by banks. Mineral and Tobacco exporters will sell between 50% and 100% of their export proceeds to RBZ in order for the latter to directly influence management of foreign currency earnings.

To encourage production and exports, the RBZ is offering export incentives of 2.5% and 5% on export receipts. The incentive started accumulating to exporters on 5 May 2016 and will be paid out in 'bond notes.' The bond notes will be printed in Germany, trading at par with the US$ and will be released in 4 to 5 months from May 2016. The bond notes are backed by a US$200 million facility from the AFREXIMBANK. The measure is well-meaning, but it has split market opinion along concerns of a premature return to a local currency.

Q1'16 budget deficit of US$160 million

National tax collections closed Q1'2016 at US$724.9 million, 16% below target. Compared to Q1'2015, collections were down by 10%. If the trend continues, tax collections (which contribute 94% to national revenue) could close the year around US$3.4 billion, against budgeted expenditure of US$4 billion. Outstanding tax obligations increased by 31% in Q1'2016 to US$2.6 billion. Taking tax collections as a proxy for economic activity; declining collections point to economic contraction.

National expenditure for Q1'2016 closed at US$968 million, leading to a US$160 million budget deficit. The full year budget deficit in 2015 was US$295 million and the projected deficit for 2016 is US$150 million. A budget surplus for the rest of the year is therefore necessary to pull the budget back towards a balance, otherwise the full year deficit is likely to widen considerably. In the absence of reserves, budget deficits are funded by borrowing.

Government implementing rebalancing reforms…

Public workers are now required to sign collection forms upon receiving pay slips as government moves to rid its wage bill of 'ghost workers.' The measure is part of recommendations from a 2015 public service audit. Government also plans to halve student teachers' allowances in order to reduce the public wage bill. Such unpopular reforms could be derailed by nearing elections. The ruling party held a 'million-man march in solidarity with the president', ahead of the coming elections.

Deflation persists, but inflation expectations heightened

Inflation for April 2016 closed at -1.64%, up from -2.31% in the previous month, marking the 18th consecutive month in deflation. Month on month inflation closed at -0.21%, down from -0.12% in the previous month. Year to date inflation closed at -0.48%. Market concerns regarding monetary policy stability could fuel inflation expectations, mostly from anticipated shortages and associated speculative hoarding. Monetary policy stability is crucial to manage consumer inflation expectations.

Dollar on the rebound

The USD registered notable gains against most trading currencies during the month ended 31 May 2016. Dollar support stemmed from heightened market expectation of an interest rate hike. The dollar firmed 1.8% and 9.7% against the Euro and ZAR, respectively, to close the month under review at US$1.11 per Euro and ZAR15.77 per dollar. Risks peculiar to South Africa, including economic growth underperformance and political uncertainty, made the ZAR weakness prominent relative to other currencies.

Commodities still seeking direction amid mixed themes

Commodity price movements were mixed during the month ended 31 May 2016, on the back of mixed global macro-economic themes. The following table highlights international commodity price movements during the period under review.

Commodity	Price	May'16	YTD
Nickel (usd/ton)	8,375.00	-8.47%	-2.73%
Crude Oil (usd/barrel)	49.49	2.53%	34.85%
Gold (usd/oz)	1,211.41	-5.02%	14.01%
Platinum (usd/oz)	976.30	-7.95%	11.94%
Coffee (usd/lb)	122.75	1.32%	-0.89%
Maize (usd/ton)	161.90	5.45%	14.48%
Sugar (usc/lb)	17.58	10.78%	15.58%
Cotton lint (usc/lb)	63.86	0.98%	0.22%

Hard commodities were largely negative as gold prices shed 5% during the month under review. A firming US$ and recovering investor risk appetite eroded safe-haven demand for precious metals. Oil prices registered a 2.5% gain, as market expectations of the Organisation of Petroleum Exporting Countries (OPEC) agreeing on a supply quota gained currency. Supply restrictions increase prices on a basic supply and demand basis.

Soft commodity prices closed the month distinctly firmer, led by a 10.78% gain in sugar prices. Soft commodity prices were largely supported by anticipated supply side disruptions as the prevailing *El Nino* weather conditions in the Southern hemisphere are forecast to transform to *La Nina* conditions. Whereas *El Nino* is associated with high temperatures and drought, *La Nina* is the opposite with cold temperatures and excessive rainfall. Additional supply side concerns centre on anticipated migratory pests such as red locusts and quelea birds landing in Southern Africa.

Weak macros cascading to equity returns

Local equities reversed the gains of the previous month, with the ZSE industrial index retreating 1.03% in May 2016 to extend year to date losses to 8.84%. The downturn presented a harsh reminder of underlying structural macro vulnerabilities, as validated by an uninspiring earnings reporting season.

Sector	Value	May'16	YTD
Commodities	211.27	-0.66%	-27.41%
Consumer	150.09	-0.75%	-5.78%
Financial	75.60	-3.07%	4.82%
Listed Property	95.38	-2.74%	-18.65%
Manufacturing	41.23	0.98%	-10.65%
Industrial	**104.70**	**-1.03%**	**-8.84%**
Mining	**25.54**	**26.69%**	**7.67%**
Market Cap (usd bln)	**2.992**	**-1.26%**	**-6.85%**

The following tables highlight the ZSE top and bottom 3 performing stocks for the month under review.

Top 3 Performers	Price USc	May'16	YTD
RIOZIM	16.10	46.36%	54.81%
NAMPACK	1.80	20.00%	16.13%
BINDURA	1.20	17.65%	-21.57%

Bottom 3 Performers	Price USc	May'16	YTD
BARCLAYS	2.40	-18.64%	-43.53%
STARAFRICA	0.84	-16.00%	40.00%
WILLDALE	0.18	-10.00%	-10.00%

Total turnover on the local bourse retreated 1.1% in May 2016, to close at US$13.9 million. The average daily value of trades was also down by 1.1% over the same period, closing the month at US$0.693 million. Trades by foreign investors constituted 47.5% of the total market, down from 55.2% in the previous month. Net foreign portfolio flows closed the month with an outflow of US$1.1 million, same as in the previous month. The cumulative year to date outflow reached US$16.8 million, compared to inflows of US$2.8 million last year.

Economic Outlook

The environment remains dire and the outlook uncertain. Risks are skewed to the downside in the absence of substantial policy reforms and full international re-engagement. Generalised environment uncertainty dis-incentivises sustainable investment growth under graveyard market conditions. Public expectations need to be managed carefully to avoid a self-fulfilled crisis.

Public sector reforms, if fully implemented, present potential for economic recovery. Implementation of such reforms would also support investor sentiment. The political cost of such reforms ahead of elections raises the likelihood of start-stop policy measures under the baseline scenario, suggesting 'more of the same,' in the foreseeable outlook.

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