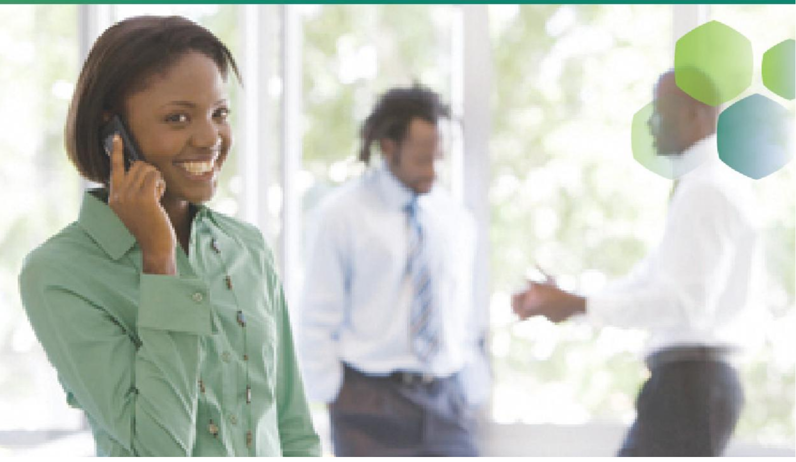
Quarterly Economic Brief

Q3' 2016



Highlights

The IMF warned of compromised global debt sustainability and cut its 2016 global growth forecast.

S&P credit rating agency downgraded Nigeria further into junk territory.

Commodity prices responded positively to a relatively weak US dollar.

Zimbabwe's H1'16 budget deficit was US$623 million and authorities confirmed 'bond notes' are coming.

ZSE total market capitalization retreated 2.14% to close the quarter at usd2.856 billion.

Global | IMF warns of looming global debt crisis

The International Monetary Fud (IMF) warned that global debt levels are high and rising in unsustainable proportions. The IMF estimates global debt at an all-time high of US$152 trillion, translating to 225% of global GDP. The private sector is responsible for two thirds of the total debt stock. The IMF critically warned that when private sector debt is on an unsustainable path, early intervention by authorities is important to avert financial crises and recessions. The risks associated with ballooning debt centre on prevailing low growth – making it difficult to reduce debt.

Advanced markets weighing on global growth

The IMF predicts global economic growth of 3.1% in 2016. The latest forecast signals a slight slowdown from the 3.2% registered last year as well as a climb-down from an earlier prediction of 3.2%. The fund cites weakness in advanced economies, which are expected to grow by a timid 1.6% in 2016, against a more robust 4.2% in emerging markets. A key factor weighing on advanced markets is the June 2016 vote by UK citizens to leave the EU (Brexit) and slower than anticipated growth in the US - presenting cascading risks to smaller emerging economies.

Japan advancing expansionary policies

In response to prevailing global uncertainties, hinging on the Brexit vote and an uncertain US political outlook, Japan unveiled an economic stimulus package worth around US$266 billion. Japan admitted that global fragilities present notable risks to Japan, the world's third largest economy. Anxious investors have been buying huge quantities of the Japanese Yen as a safe haven instrument. The stronger Yen has however compromised Japan's export competitiveness.

Japan's stimulus package includes increased government spending through increased wages, introduction of needs-based scholarships and reduced time to earn pensions. There will also be funds channeled towards infrastructure projects. On the monetary front, the Central Bank of Japan sees further scope to expand its negative interest rate policy in order to push banks to increase lending. The current policy rate is at -0.1%, implying banks pay the Central Bank interest for depositing funds.

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, concluding that Ireland 'substantially and artificially' lowered the tax the company had to pay since 1991. The Commission ruled that EU 'state aid rules' make it illegal to offer tax benefits to selected companies. The selective treatment could have allowed Apple to pay 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.

Increased uncertainty for South Africa and Nigeria

Inflated political vulnerabilities and falling revenues (from weak commodity prices) create considerable uncertainties for Africa's biggest economies, South Africa and Nigeria.

South Africa's August 2016 local elections produced hung municipalities in most districts. The ruling ANC had an outright victory in only one of the country's six largest cities. The party lost control of the largest city and economic hub, Johannesburg, as well as the administrative capital Pretoria and financial hub Cape Town. Investment markets responded positively to the election outcome, on the assumption that the Johannesburg outcome could be a microcosm of what could happen in the 2018 general elections.

Credit rating agency S&P downgraded Nigeria's credit rating further down into junk territory from B+ to B (5 levels below investment grade). The downgrade is premised on a contraction in oil price as oil revenue account for 70% of the country's revenues, a restrictive foreign currency regime and generalized political unease. The Nigerian economy is projected to contract in 2016, for the first time in 21 years.

Cost (and benefit) of reforms…

Zambia told the IMF it was ready to gradually cut subsidies worth US$1 billion as part of an economic recovery plan that would lead to a financial package. Zambia currently spends around US$600 million annually on fuel and electricity subsidies. The country also plans to increase funding for social welfare projects. A dip in copper prices has adversely affected the country's revenues, raising the urgency of an IMF funded structural reform program.

Tanzania secured an estimated US$1.6 billion in loans and grants from the World Bank. The funds are meant to address power shortages, rebuilding railways and developing the agriculture sector. Tanzania has been on an aggressive economic rebuilding excise since 2015 under a new government led by President John Magufuli. Structural reforms in Tanzania are built around top-down spending reforms (cuts) and fiscal discipline.

Global equities on the rebound

The MSCI all country world index registered growth of 4.79% during the quarter ended 30 September 2016, reversing earlier losses as the year to date return closed at 4.78%. Gains were primarily driven by emerging market equities, with the 'golden dragon' index of Chinese large and mid-cap stocks registering growth of 11.92% during the quarter under review, against gains of 4.89% and 3.60% for European and American equities, respectively.

Dollar under pressure…

The U.S. Fed left interest rates unchanged, maintaining a low interest rate policy. Low interest rates make dollars readily available and less valuable against other currencies on a supply and demand basis. The dollar shed 0.9% and 8.5% against the Euro and South Africa Rand (ZAR), respectively, during the quarter ended 30 September 2016. On a year to date basis, the dollar extended its decline to 2.7% and 10.8%, against the Euro and ZAR, respectively.

Commodities capitalize on weak dollar

International commodity prices were largely bullish during the quarter ended 30 September 2016 as highlighted in the following table.

Commodity	Price	Q3'16	YTD'16
Nickel (usd/ton)	10,525.00	13.4%	22.24%
Crude Oil (usd/barrel)	48.77	-2.5%	32.89%
Gold (usd/oz)	1,325.40	0.6%	24.74%
Platinum (usd/oz)	1,035.65	3.2%	18.74%
Coffee (usd/lb)	150.20	2.6%	21.28%
Maize (usd/ton)	128.73	-13.8%	-8.97%
Sugar (usc/lb)	23.42	11.0%	53.98%
Cotton lint (usc/lb)	67.70	2.1%	6.25%

Commodity prices responded bullishly to a weak dollar. International trade is primarily conducted in dollar terms, such that a weak dollar makes commodities on the international market relatively more affordable in alternative currency terms.

Maize and oil prices bucked the general trend, retreating 13.8% and 2.5%, respectively during the quarter under review. A higher than earlier anticipated maize output in the United States (world's largest maize producer) weighed on global prices. An agreement by members of the Organization of Petroleum Exporting Countries (OPEC) to reduce production, did not present sufficient support for oil prices on the back of depressed global demand.

Global Economic Outlook

Fragilities in the world's largest economies present a noteworthy risk of persistent global economic underperformance. Spillover risks centre on global trade and investment flows, more so in light of accompanying exchange rate fluctuations and compromised effective demand for commodities. A weak dollar outlook is likely to present some respite to net importing emerging economies, particularly those relying heavily on food imports. The arising fiscal space should be channeled towards social safety nets to mitigate simmering social misery.

2016 growth forecast downgraded to 1.2%

Presenting the 2016 mid-year fiscal policy statement, Minister of Finance Hon. Patrick Chinamasa revised the 2016 GDP growth projection from 2.7% to 1.2%. Treasury projects the mining sector to expand by 13.2% against a 4.2% contraction in the agriculture sector. Hon. Chinamasa acknowledged that the economy is facing strong headwinds; as such the 1.2% growth forecast has been generally viewed as too generous. This notwithstanding, the significant downward revision could be symbolic enough to capture prevailing difficulties.

H1'2016 budget deficit reached US$623 million

National revenues for the first half of 2016 closed at US$1.692 billion, of which taxes amounted to 92% of revenue. The full year revenue forecast was revised downwards by 4% from US$3.85 billion to US$3.7 billion in light of a shrinking revenue base. Spending during the half year closed US$308 million above plan at US$2.3 billion, leading to a budget deficit of US$623 million. The full year deficit is expected to close the year above US$1 billion. Employment costs (including 2015 bonuses of US$162 million) constituted 97% of total revenues in the first half.

The budget deficit has been primarily financed through government debt instruments. Hon. Chinamasa acknowledged the debt route is becoming increasingly unsustainable, highlighting that, 'lack of capacity to service debt has seen roll-over, posing risks to debt instrument holders.' To remedy the situation, Hon. Chinamasa prescribed austerity measures including public service salary cuts of 5% to 20%; 25,000 job cuts by December 2017 and suspension of bonuses for two years. The austere proposals were nullified a week later by government. The rejection of cost containment proposals against an apparent deficit considerably inflates the risk of a fiscal crisis - failure to settle critical public obligation.

US$1.8 billion trade deficit in first eight months

Zimbabwe's trade deficit for the year to August 2016 reached US$1.821 billion, 15% higher than in the previous month. Exports and imports over the period closed at US$1.508 billion and US$3.329 billion, respectively. Of the total exports, gold and tobacco contributed about 28% and 17%, respectively. Major imports were diesel, petrol and maize, accounting for roughly 16%, 9% and 8% of total imports, respectively. The nature of major imports makes it arguably difficult to address the trade deficit through import restrictions. Consequently, a sustainable solution could be through advancing exports. Persistent external payment deficits threaten market liquidity.

Use of plastic money increases

RBZ Governor Dr. Mangudya said measures to ease cash shortages have been impressive to date. He cited a 33% increase in weekly gold exports to US$16 million since the announcement of export incentives in May 2016. He also said the market has caught-on to use of plastic money, but there is need for more measures; ostensibly referring to 'bond notes.' In a joint statement with the ZSE, the RBZ assured investors that stocks would continue to be priced in US Dollars post the introduction of bond notes.

Multi-currency regime here to stay…

Presenting the 2016 mid-year monetary policy statement, Reserve Bank of Zimbabwe Governor Dr. John Mangudya reiterated that the multi-currency regime is here to stay. Dr. Mangudya also disclosed that export incentives will start being paid out by the end of October 2016, funded by 'bond notes.' To date, export incentives worth US$56 million have been accumulated and they are expected to close the year at US$75 million at current export rates. Export incentives are also being extended to private money transfers, effective 1 October 2016.

Dr Mangudya also clarified that bond notes (trading at par with the US$) will be used and treated the same as bond coins. Issuance (expected to commence in early November 2016) will be self-administered, based on export earnings; up to a ceiling of US$200 million. Bond notes are not a new currency, but zero-coupon, tax exempt debt instruments. To address market concerns regarding possible arbitrage opportunities, bond notes will be issued in transactionary small denominations of $2 and $5 only. This notwithstanding; the market remains skeptical of the new notes.

US$516 million command agriculture system for maize

In an attempt to address grain shortages and an accompanying grain import bill; government unveiled a command agriculture system with capacity to produce 2 million tons of maize annually, against a national requirement of about 1.8 million tons. Participating farmers will receive privileges such as inputs at concessionary rates, uninterrupted power supply and debt restructuring, in exchange for at least 5 tons from each of the 400,000 ha covered under the scheme.

That government plans to close the maize output gap through an import substitution strategy is commendable. This notwithstanding; a few concerns arise. Under command systems, government dictates what to produce, by whom, for whom and at how much. Such influence tends to breed inefficient resource allocation. The target yield of 5 tons per ha implies a 525% increase from the current national average of 0.8 tons. Such growth might require extensive supporting resources, possibly not covered in the preliminary US$516 million budget.

Net FDI inflows down 16% in 2015 at US$399 million

The UN reported that FDI inflows to Zimbabwe closed 2015 at US$421 million, 23% lower than the US$545 million registered in the previous year. Zimbabwe's net FDI inflows in 2015 retreated 16% to US$399 million as outflows declined by 69% to US$22 million. Africa's top 3 FDI recipients were Angola (US$8.7 billion), Egypt (US$6.9 billion) and Mozambique (US$3.7 billion). Outside market size and resource base; relative FDI inflows mirror policy competitiveness.

Stability rocked by mass (urban) protests

In July 2016, Zimbabweans across most urban areas embarked on a mass stay-away, shutting down all business activity in one of the biggest mass actions in nearly a decade. The stay-away was primarily centered on government's failure to settle public wages on time. Isolated pockets of social-media-coordinated civil disaffection also mushroomed, occasionally turning violent with protestors citing general economic difficulties and corruption.

Government seemingly responded by settling July 2016 public wages a day earlier than previously announced; effectively ending public sector participation in the protests. Further calls for mass action were relatively undersubscribed for. The EU delegation in Harare raised concern over violence and alleged human rights abuses in the aftermath of the protests. By the end of the quarter under review, the protests had lost momentum, sustaining a 'business as usual' atmosphere.

Depressed aggregate demand sustaining deflation

Consumer inflation for August 2016 was -1.43%, up from -1.60% in the previous month. On a month on month basis, inflation firmed from -1.19% to -0.13%. Year to date inflation reached -0.82% on the back of depressed aggregate demand. The foreseeable outlook presents a high likelihood of continued consumer deflation in the absence of expansionary macro-economic policy to spur aggregate demand.

Depressed on-lending weighing down deposit returns

Money market interest rates remained depressed in light of weak deposit demand associated with compromised borrower quality and inherent policy uncertainties. Average interest quotes were largely unchanged across investment horizons. The average 90 days interest rate quote closed the quarter under review unchanged at 2.95%, down from 3.69% at the beginning of the year.

Foreign investors remained net sellers on the ZSE

ZSE market capitalization shed 2.14% to US$2.856 billion during the quarter ended 30 September 2016. The ZSE industrial index retreated 2.06% over the same period as highlighted in the following table.

Sector	30 Sept'16	Q3'16	YTD'16
Commodities	233.99	7.88%	-19.60%
Consumer	138.17	-5.47%	-13.26%
Financial	78.83	8.51%	9.29%
Listed Property	91.72	-1.53%	-21.77%
Manufacturing	39.09	-12.21%	-15.28%
Industrial	**98.96**	**-2.06%**	**-13.84%**
Mining	**26.61**	**7.73%**	**12.18%**
Market Cap ($ bln)	**2.856**	**-2.14%**	**-11.08%**

The following table shows the top and bottom 3 performing stocks during the quarter under review.

Top 3 Performers	Price USc	Q3' 2016	Market Cap
BARCLAYS	2.00	33.33%	43,062,804
INNSCOR	23.05	33.24%	124,837,288
PADENGA	11.40	31.64%	61,741,653

Bottom 3 Performers	Price USc	Q3' 2016	Market Cap
AXIA	3.60	-52.00%	19,497,364
PPC	40.00	-38.65%	6,081,728
NTS	1.15	-32.35%	2,919,533

Foreign investors registered net portfolio outflows of US$14.8 million, up from US$6.7 million in the previous quarter. The cumulative position since the beginning of the year closed September 2016 at a negative US$36.1 million, compared to net inflows of US$3.9 million over the corresponding period last year.

Economic Outlook

Risks remain skewed to the downside in the foreseeable outlook. Macro-economic policy prescriptions to address internal and external deficits seem inadequate, inflating risks associated with domestic monetary policy. Consequently, the foreseeable outlook presents noteworthy safe haven support for real assets. Inherent environment uncertainties prescribe caution over performance.