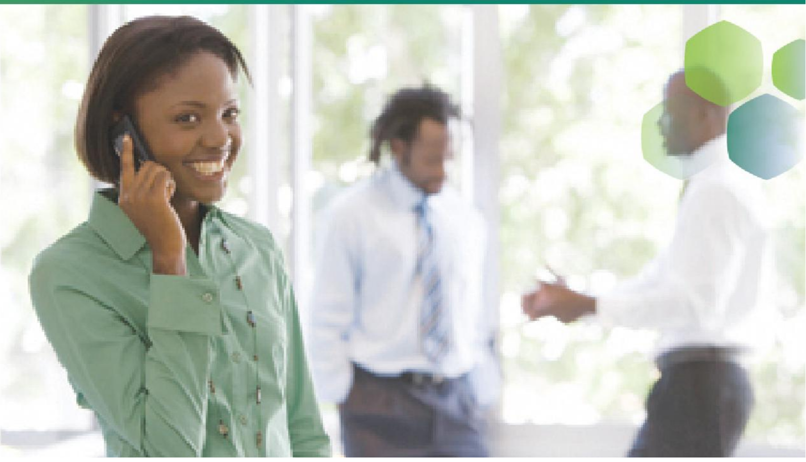
Quarterly Economic Brief

Q1' 2017



Highlights

The World Bank unveiled a US$57 billion financing package for sub-Saharan Africa.

S&P downgraded South Africa's credit rating from investment to speculative grade.

RBZ Amendment Act regularizing issuance of bond notes signed into law.

ZSE total market capitalization retreated 6.06% to close the quarter at usd3.959 billion.

Global | US Fed tightening monetary policy

The US Federal Reserve instituted its third interest rate increase since the 2008 financial crash and the second in three months. The Fed increased the base rate by 0.25% to 1% and signaled towards two more hikes in 2017. The rate hikes are generally construed as a show of confidence in the U.S economy's growth trajectory, vindicated by improving labour and consumer demand statistics.

Rising interest rates in the United States imply higher debt service costs in the United States, particularly on holders of rate-adjustable liabilities. Higher interest rates are likely to increase US$ demand in light of increased funds inflows in to United States in search of higher yields; presenting support for the dollar. A stronger dollar would make dollar-denominated assets more costly in alternative currency terms.

Brexit (the process) has begun…

On 28 March 2017, Theresa May, the British Prime Minister, signed a letter formally giving notice that the United Kingdom intends to leave the European Union. The unprecedented action triggers a long set of talks about the terms of Britain's exit. Uncertainties on the likely overall outcome of the negotiations and their implications for the United Kingdom and global economies continue to affect global markets.

No time to be left behind…

The World Bank unveiled a record US$57 billion financing package for Sub-Saharan African (SSA) countries over three years. The bulk of the financing - US$45 billion - comes from the International Development Association (the World Bank's fund for the poorest countries.) The funding is targeted at programs in education, basic health, clean water and sanitation, agriculture, infrastructure, business climate and institutional reform.

The new fund tries to address hindrances preventing SSA from reaching its full development potential. In the words of World Bank President Jim Yong Kim, "This represents an unprecedented opportunity to change the development trajectory of the countries in the region." Though it remains unclear how the US$57 billion pot will be split across SSA's 49 countries; it is vital that each country tries to get a share of the cake to avoid slacking further behind regional peers.

IMF notes of a high 'potential for disappointment'

The 2017 World Economic Outlook update by the IMF (The Fund) estimated 2016 world GDP growth at 3.1%. The Fund projects growth of 3.4% in 2017 and 3.6% in 2018. Growth in 2017 and 2018 is supported by projections of a strong economic rebound in the United States, backed by expansionary fiscal policy and less than earlier anticipated post-Brexit economic aftershocks.

The Fund noted that global economic prospects hinge considerably on United States (world's largest economy) macroeconomic policy, which remains vulnerable under the new administration. The Fund noted that risks to global economic growth are two-sided, but skewed to the downside, especially over the medium term outlook.

On the constancy of growth forecasts, the Fund reiterated downside risks, warning that "…the potential for disappointment is high, as underscored by repeated growth markdowns in recent years." Overall, significant uncertainty clouds the outlook.

Wide growth disparity across regions

The United Nations believes developing countries will continue to be the main drivers of global growth, accounting for about 60% of world GDP in the three year period 2016-18. East and South Asia regions are viewed as the most dynamic, premised on strong domestic demand and supportive macroeconomic policy reforms. Meanwhile, growth in developed economies is expected to remain depressed under weak investment growth and policy uncertainty.

The United Nations warned that GDP growth in the least developed counties (LDCs) is likely to remain well below the Sustainable Development Goals target of at least 7%. If the current growth trajectory persists and assuming no improvement in income distribution; the United Nations warns that nearly 35% of the LDC population could remain in extreme poverty by the year 2030.

New global inflation dynamics…

A trend of extremely low inflation has persistently concerned policymakers, particularly in developed economies and some parts of Asia. Extremely low inflation could adversely impact on economic output as businesses face a weaker earnings outlook against unchanged debt service obligations (a debt-deflation spiral).

The first quarter of 2017 saw a reversal in global inflation dynamics on the back of intensified inflation pressures. In 2016 the Organization of Petroleum Exporting Countries (OPEC) resolved to cut global supplies starting in 2017, fueling speculative demand. In February 2017 Germany's inflation closed at 2.2%; the highest since August 2012. Similarly, inflation in the United States reached a five-year high of 2.5% in January 2017. Global inflationary pressures mitigate debt-deflation concerns in developed economies, but the implications for poor net importing countries could be damaging on fiscal and trade balances.

Spillover risks from S.A's credit dowgrade

S&P credit rating agency downgraded South Africa's credit rating from investment to speculative grade. Among other factors, the agency cited 'poor mid-term growth prospects and a deteriorating investor climate. The downgrade was largely expected following several warnings from rating agencies and an increasingly fragile political environment.

South Africa's net capital inflows are likely to be significantly compromised on increased risk premia attached to the outlook. Consequently, the country's borrowing costs are likely also to increase. Going forward, the South Africa Rand (ZAR) is likely to face downward pressure against the US$ on the back of lower portfolio investment inflows (lower demand).

A weak ZAR outlook threatens regional funds flows, particularly capital and remittance flows from South Africa into the rest of the region as ZAR holders need to send more on a purchasing power parity basis. The dilution of ZAR fund flows into the region is likely to be most adverse on countries with strong currencies, particularly US$ based economies.

The ZAR shed 0.2% against the dollar in March 2017 in line with South Africa's increasingly fragile political-economic dynamics. The March 2017 ZAR decline reduced ZAR strength from earlier gains in the quarter under review to 4.8% at ZAR12.97 per dollar.

Commodity price movements largely positive

International commodity price movements were predominantly positive during the quarter ended 31 March 2017. As highlighted in the following table

Commodity	**Price**	**Q1'17**	**FY'16**
Nickel (usd/ton)	9,930.00	-1.05%	16.55%
Crude Oil (usd/barrel)	52.61	-7.98%	55.78%
Gold (usd/oz)	1,242.09	7.10%	9.15%
Platinum (usd/oz)	945.45	4.28%	3.95%
Coffee (usd/lb)	138.90	2.55%	9.37%
Maize (usd/ton)	141.13	2.72%	-2.85%
Sugar (usc/lb)	16.74	-14.11%	28.14%
Cotton lint (usc/lb)	76.35	7.50%	11.46%

Declines were registered in the prices of nickel, oil and sugar during the quarter ended 31 March 2017. Commodity price movements during the quarter under review suggest a correction, as declines were confined to commodities that registered aggressive gains in the past year.

Global Economic Outlook

Global macroeconomic themes are likely to remain hinged on U.S macroeconomic policy. A tighter U.S monetary policy outlook presents a case for a strong dollar outlook. The new U.S administration is likely to offset monetary tightening with fiscal expansion – maintaining support for U.S economic output. Both monetary and fiscal policy shifts support U.S based asset holdings in light of prospects of higher yields on interest bearing investments and brighter fundamentals for U.S equities.

Capital flows to the U.S in search of higher investment returns present significant support for the dollar. Further dollar appreciation is likely to be fueled by deteriorating policy prudence in many developing countries. Small exporting countries with strong currencies are likely to intensify external and/or internal devaluation and de-dollarization (in the case of dollarized economies) in order to maintain global competitiveness.

Zimbabwe | Uncertainty reigns

Policy increasingly populist skewed…

Political undercurrents intensified ahead of the impending 2018 general elections. Opposition parties under the National Electoral Reform Agenda (NERA) maintained pressure for electoral reforms ahead of elections, threatening street protests if their demands are not met. Among other demands, NERA is calling for government to allow the Southern African Development Community and the United Nations to monitor elections in 2018, among other reforms.

Some urban councils raised concern at residents accruing large debts on utility bills. Councils fear that residents might be deliberately defaulting on bill payments; ostensibly in anticipation of a '2013-style' debt write-off. In the run-up to 2013 elections, government wrote-off utility bill debts dating back to 2009. Overall, the risk of business-inhibiting populist policies is inflated as elections draw near.

Heard that song before…

Minister of Industry and Commerce, Hon. Mike Bimha reportedly urged local authorities to stop granting operating licenses to foreign businesses in sectors reserved for locals under Zimbabwe's empowerment laws. Sectors covered under the 'reserved pool' include advertising, agriculture, transport, retail and distribution. Foreign investors have often cited the contentious and often 'misunderstood' law as a major hindrance to foreign investment inflows.

Landmark ruling 'to cap abuse of public office'

In a landmark ruling, the High Court ruled that former State Security Minister Didymus Mutasa can be sued for the abduction of a human rights activist in 2008. By implying public officials can be sued in their personal capacities, the ruling might mitigate abuse of public office, corrupt and irregular tendencies.

Nothing temporary about bond notes

President Mugabe signed the Reserve Bank of Zimbabwe Amendment Act into law, regularising the issuance of 'Bond notes,' which have been circulating on a temporary legislation since November 2016. The new law makes the issuance of bond notes un-contestable on the basis of their legality. An estimated $117 million in bond notes had been issued by mid-March 2017, against a maximum AFREXIMBANK backed ceiling of $200 million.

The ability to maintain bond notes issuance within the prescribed ceiling will present a litmus test of authorities' commitment to monetary policy discipline, more so in light of pressing funding needs.

Limited room to maneuver…

Zimbabwe's budget imbalances persisted, with the 2016 budget deficit closing at $1.4 billion. Expenditure closed at $4.92 billion of which recurrent spending accounted for 80%. Employment costs accounted for 66% of total government spend, translating to 92% of total revenue. The budget deficit was partly financed via government debt, raising the need for new revenue sources and/or cost containment.

New tax measures were implemented during the month under review, with transport operators, informal cross borders traders and hairdressers facing new taxes. Traffic offence fines were also increased by 50% to 100% with government presumably seeking to expand its revenue base.

2017 Monetary Policy highlights…

Reserve Bank of Zimbabwe Governor Dr. John Mangudya presented the 2017 Monetary Policy Statement on 15 February 2017. All things normal, monetary policy should influence interest rates, exchange rates and inflation through the manipulation of money supply. The prevailing multi-currency regime presents a major hindrance to monetary policy efficacy.

The 2017 monetary policy statement was expectedly focused on bank supervision. Policy measures include a 12% lending interest rate ceiling for banks and an upward review of deposit interest rates. The Central Bank is also committed to maintaining parity between local 'bond notes' and the United States Dollar. The export incentive paid out in bond notes could also be extended to the tourism sectors.

The ceiling on interest rates against pressure to increase deposit rates could depress bank earnings. The interventionist approach to interest rates is likely to compromise the effectiveness of local interest rates as a key economic gauge of money supply, inflation and credit risk. The Central Bank's commitment to parity between bond notes and dollars could present a key macro-policy bellwether.

Tobacco marketing season in strong start…

Tobacco deliveries in the 2017 marketing season to 31 March 2017 reached 15.5 million kgs, representing growth of 38% from the same period last year. Farmers have earned $40.2 million from the deliveries, a 47% increase from the corresponding period last year. The 2017 seasonal outturn is expected to outperform last season's 205 million kgs. Tobacco remains a key forex earner for the country.

Wide forecast variances on the outlook

The World Bank predicts Zimbabwe's economy to grow by 3.8% in 2017. The World Bank prediction is conspicuously above the IMF's -2.5% predicted contraction. In line with many independent analysts, the World Bank acknowledged that risks remain tilted to the downside; citing drought and political uncertainty. The wide forecast variance underlines environment uncertainty. Policy and general uncertainty dis-incentivizes gross investment growth, compromising economic recovery prospects.

Two sides to the 'good rains'

Treasury revised its 2017 GDP growth projection from 1.7% to 3.7%. The upward revision was attributed to above normal rains and an accompanying better than earlier anticipated agriculture outturn. Preliminary estimates suggest the seasonal maize outturn could be around 3 million tons, partly attributed to government's special (command) agriculture initiative. Last season's maize outturn closed at 513,000 tons. Zimbabwe's annual maize requirement is around 2.8 million tons.

On the flip side, President Mugabe reportedly declared floods that ravaged the southern parts of Zimbabwe in February 2017 a 'State of disaster.' Roads and other infrastructure were extensively damaged by the floods, leading to considerable downtime. Mines across the country also experienced flooding, disrupting output. Police reported that about 132 people lost their lives to drowning in the first two months of 2017. The true cost/benefit of the 'above normal' rains is yet to be quantified.

Persistent, though narrowing, external deficits

Zimbabwe's 2016 trade deficit was US$2.38 billion, down from US$3.29 billion in 2015. Exports firmed 4.8% to US$2.83 billion while imports shed 13% to US$5.21 billion in 2016. Government had set a target of US$3.36 billion for exports in 2016, while the National Trade Policy (2012) had envisioned exports to grow from US$4.3 billion in 2011 to US$7 billion in 2016. Persistent trade and overall balance of payment (BOP) deficits point to continued cash shortages under the prevailing foreign currency regime.

Uncomfortably familiar territory…

Year on year inflation entered positive territory for the first time in more than 3 years, closing February 2017 at 0.06%, up from -0.65% in the previous month. Month on month inflation surged from 0.23% to 0.61%, driving year to date inflation to 0.84%.

Inflationary pressures have been sustained by supply side constraints in light of import restrictions, exacerbated by reports of speculative multi-pricing tendencies. A relatively softer ZAR outlook against the dollar presents some mitigating relief against imported inflation in the near term outlook. This notwithstanding; the outlook remains inflationary.

ZSE losing steam…

The ZSE industrial index retreated 3.85% in the quarter ended 31 March 2017. The market showed signs of fatigue from a strong rally in 2016. The following table summarizes ZSE return for the quarter under review.

Sector	**31 Mar'17**	**Q1'17**	**FY'16**
Commodities	371.81	4.56%	22.18%
Consumer	194.69	-7.28%	31.81%
Financial	97.67	2.48%	32.13%
Listed Property	109.50	-7.96%	1.47%
Manufacturing	67.77	13.59%	29.30%
Industrial	**138.96**	**-3.85%**	**25.84%**
Mining	**58.56**	**0.09%**	**146.67%**
Market Cap ($ bln)	**3.959**	**-6.06%**	**31.20%**

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

Top 3 Performers	**Price USc**	**Q1' 2017**	**Market Cap**
ZBH	11.00	143.36%	19,270,971
FALGOLD	1.00	66.67%	1,111,651
FIRST MUTUAL	6.86	63.33%	26,081,772

Bottom 3 Performers	**Price USc**	**Q1' 2017**	**Market Cap**
ECONET	16.05	-46.50%	264,690,521
BINDURA	3.00	-25.00%	37,189,698
DAWN	1.25	-21.88%	30,714,651

Foreign investors registered net sales of $17.5 million compared to net sales of $14.8 million in the same period last year. Foreigners contributed 52% of total ZSE trades during the quarter under review. Total and daily average value of ZSE trades declined by 39.7% and 41.7% to $44 million and $0.7 million, respectively, during the quarter under review.

Economic Outlook

The near-term outlook remains uninspiring. Prolonged low growth conditions and simmering inflationary pressures point to a scenario of stagflation. Increasing political undertones raise the risk of outcomes more adverse than the baseline.