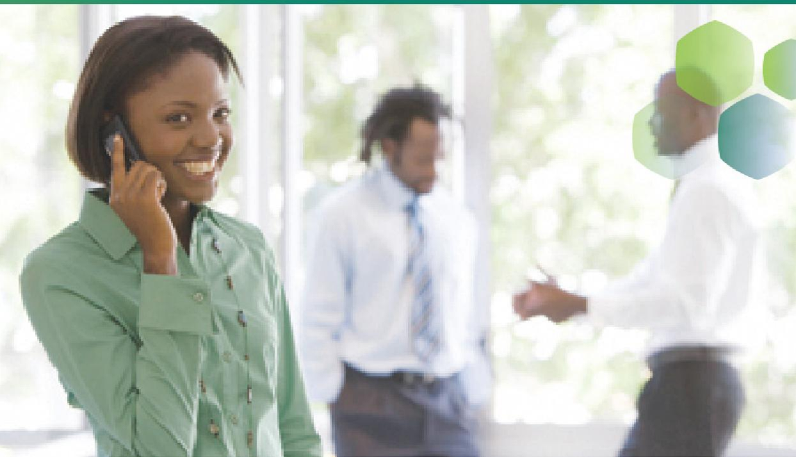
Quarterly Economic Brief

Q2' 2016



Highlights

The U.K voted in favour of leaving the European Union, sparking global market nervousness.

The World Bank revised its 2016 global economic growth forecast down from 2.9% to 2.4%.

Global Foreign Direct Investment flows gained 38% in 2015 to close at US$1.76 trillion.

The IMF expressed satisfaction with Zimbabwe's reform efforts, but warned that new funding is still far.

ZSE total market capitalization recovered 3.93% to close the quarter at usd2.919 billion.

Global| Rate hike back on the cards…

Employers in the US added 287,000 new jobs in June 2016, representing a 2,509% increase from the previous month. The jump in new jobs eased fears that the US labour market was in a slump. This notwithstanding, the unemployment rate rose to 4.9%, up from 4.7% the previous month. The rise in unemployment is technically attributable to more people seeking employment, generally regarded as a sign of confidence in the economy. Overall, the latest US jobs data is hugely positive.

Earlier in the year, there was speculation that US monetary authorities would raise interest rates as early as mid-2016 as the US economic recovery picked momentum. The disappointing May 2016 jobs data, exacerbated by the recent UK vote in favour of leaving the EU (Brexit) appeared set to defer a rate hike well into the future. While the likelihood of a near-term US interest rate hike still seems dim, the good news is that the world's largest economy is on the right track.

US$2.1 trillion equity losses in day post Brexit decision

On 23 June 2016, Britain voted 52% to 48% in favour of the country leaving the EU (Brexit). Resulting uncertainty over the accompanying implications of the 'Brexit' fuelled market risk aversion, partly because the likely global implications on international trade and investment are exceptionally difficult to quantify. As investors sought to hedge against possible losses; defensive assets such as the dollar and gold registered significant gains while risky assets registered huge losses.

The day following the Brexit vote, an estimated US$2.1 trillion was wiped off global equity markets, the biggest single day loss in history. To put the movement into context; the previous single day global equities loss was US$1.94 trillion, recorded on 29 September 2008 when the US Congress rejected a US$700 billion proposal for US financial markets during the 'global' financial crisis. The equity movements are based on the S&P Global Broad Market Index of 47 countries.

World Bank predicts 2.4% global economic growth

The World Bank revised its 2016 global economic growth forecast down from 2.9% to 2.4%. The Bank cited stubbornly low commodity prices, weak global trade and diminishing capital flows. Across countries, commodity-exporters have struggled to adapt to lower prices, therefore accounting for half the global downward revision. Overall, commodity exporters are projected to expand by a meager 0.4%, representing a 1.2% downgrade from the earlier forecast.

Going forward, risks to global economic growth center on a significant increase in private sector credit across most emerging and developing economies; fueled by low interest rates and, more recently, by rising financial needs. An upside risk to the global growth outlook centers on the fact that some commodity-importing economies have been able to sustain steady or accelerating growth. Overall, the Bank noted that risks are now more skewed to the downside.

Rise of the sandwich generation and financial informalisation

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 survey is based on 1,000 face to face interviews. The proportion of household income spent on debt repayment increased from 12% in 2015 to 16% in 2016. 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 difficulties, households are cutting costs where possible, notably targeting travel and entertainment. Another commendable remedial measure is an increase in stokvels (savings clubs) participation by households.

Global FDI gained 38% in 2015

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 small developing countries that are highly dependent on FDI.

Mozambique facing compromised credibility

The IMF suspended financial aid to Mozambique citing a 'serious breach of trust'. The 'Fund' discovered that Mozambique had not declared government guaranteed debt of more than US$1 billion. By failing to declare its full liabilities, Mozambique compromised its repayment ability by assuming new debts. The IMF sanctions are likely to attract further sanctions from international creditors. If the fallacy of composition holds, the risk extends across the entire region.

China-dependent economies face risk of lower growth

China, the world's second largest economy, registered GDP growth of 6.7% in Q2'2016 compared to the same period last year, matching the previous quarter's growth. Although growth during the quarter under review held steady, it was also the lowest since early 2009. The growth data sustains China's 'new normal' of low growth, having closed full year 2015 at 6.9%, the lowest annual growth in 25 years. Chinese authorities project 2016 growth between 6.5% and 7%.

China's GDP growth is of particular importance to the global economy, directly through commodity exporters as China consumes more 50% of world base metal output. Slowing Chinese growth implies slower demand for raw commodities, translating to lower earnings for commodity exporters. The slowing Chinese economy correlates well with projections of slower growth in Sub-Saharan Africa, which the IMF projects to end 2016 at 3%, down from previous averages of 5-7%.

BP's ESG violations cost US$61.6 billion

British Petroleum (BP) issued an estimate of the cost of the 2010 oil spill, the biggest in US history. The disaster involved an underground oil leak lasting 87 days, pouring 3.2 million barrels of oil into the Gulf of Mexico. The cost is estimated around US$61.6 billion; mostly emanating from lawsuits, environmental penalties and clean up exercises. BP's market capitalization has shed a third since its pre-disaster US$180 billion tag.

The total cost of the oil spill could well exceed US$61.6 billion factoring other economic costs; highlighting the importance of ESG considerations to business.

Dollar in bullish mode

The United Kingdom's 23 June 2016 decision to leave the European Union (Brexit) and accompanying uncertainty had far reaching consequences reaching foreign currency markets. The dollar presented a hedge from such uncertainty, registering significant gains against most trading currencies. The dollar firmed 2.03% and 6.93% against the Euro and Pound, respectively, closing the quarter ended 30 June 2016 at US$1.11 per Euro and US$1.34 per Pound.

The dollar was also supported by a high likelihood of monetary stimulus by the Bank of England and European Central Bank to offset an anticipated slowdown in post-Brexit economic output. The shock Brexit vote did not fully reverse earlier gains as the South African Rand sustained gains of 0.16% against the dollar from its opening position, to close the quarter under review at ZAR15.01. On a year to date basis, the ZAR extended its gain to 2.51%, albeit from a very low base.

Commodities is strong rebound

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

Commodity	Price	Q2'16	YTD'16
Nickel (usd/ton)	9,280.00	10.48%	7.78%
Crude Oil (usd/barrel)	50.01	26.86%	36.27%
Gold (usd/oz)	1,317.24	6.62%	23.97%
Platinum (usd/oz)	1,003.72	2.98%	15.08%
Coffee (usd/lb)	146.40	15.05%	18.21%
Maize (usd/ton)	149.30	3.48%	5.57%
Sugar (usc/lb)	21.10	34.05%	38.72%
Cotton lint (usc/lb)	66.32	15.38%	4.08%

As expected under global markets uncertainty, gold gained 8.74% as risk-averse investors sought to hedge against possible losses emanating from the Brexit vote, among other themes shaking global market confidence. The price surge in other commodities was against market expectations as weak global growth projections are generally associated with depressed demand for commodities.

Global Economic Outlook

Uncertainty clouds the global economic outlook. New risks have emerged; primarily centering on the Brexit event and the forthcoming U.S Presidential elections, both presenting noteworthy downside risks to global economic output. Inherent risks are also expected to worsen, including geo-political tensions and the threat of religious banditry. Growth concerns in major economies such as the U.S and China present further headwinds to global demand.

Revived prospects of further U.S monetary policy tightening and opposite monetary policy action by major economies such as the Euro Area and Britain present speculative support for the dollar. Generalized uncertainties and weak macro-economic themes also present safe-haven support for gold. Adverse weather also poses a noteworthy external risk. Overall, global economic output is likely to remain firmly entrenched in a low-growth equilibrium, doing just enough to avoid recession.

Zimbabwe| Reforms underway, but will they be enough?

Fiscal imbalances raise risks for private sector

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. Preliminary figures show that Q2’2016 collections missed target by 8%. 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, raising the threat of public debt crowding out private debt.

Central government funding under pressure

In January 2013, then Minister of Finance Tendai Biti reportedly disclosed that government had US$217 as its bank balance. Between then and now, government funding sources do not seem to have materially improved, suggesting not much change from the 2013 position. A shrinking revenue base and accompanying underperforming tax revenue collections against targets suggests a high likelihood of government turning to the private sector for funding, ostensibly through debt instruments.

Delayed civil service salaries (about 80% of total spending) point to an escalating fiscal problem. Treasury announced the postponement of settlement dates for June 2016 public service salaries. Payments that were meant to start around the 13th of June would be staggered from the end of June to mid-July 2016. Resultantly, public sector employees, mostly in the education and health sectors are engaged in a go-slow. Delayed public salaries are likely to have a significant bearing on aggregate demand, investment, spending and consumption decisions.

Monetary policy adjustments

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. The RBZ is therefore directly intervening in an attempt to manage the allocation of scarce foreign currency resources.

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 redistribute the proceeds to nosto-starving banks.

To encourage production and exports, the RBZ availed 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.

Matter of differing opinion

Minister of Finance Hon. Patrick Chinamasa reportedly said the announcement of plans to introduce ‘Bond notes’ by the Reserve Bank of Zimbabwe was premature. He however believes that contrary to market fears, bond notes will maintain their value. Meanwhile, Speaker of the House of Assembly, Hon. Jacob Mudenda said given the choice, he would buy gold with the US$200 million AFREXIMBANK facility backing bond notes. Contradicting assertions on fundamental policy matters suggests widening political and policy polarization.

Presidential interventions…

President Mugabe issued a Presidential statement clarifying government’s position on empowerment laws. The notably temperate Presidential statement followed 3 government official positions on the same policy since December 2015, highlighting policy fluidity and inherent fears of policy uncertainty. Minister responsible for the empowerment policy, Hon. Patrick Zhuwao reportedly admitted his earlier misinterpretation of the law and stated that the President’s interpretation is ‘perfect and final’.

Speaking during Independence Day celebrations, President Mugabe allegedly promised to align minimum public wages to the poverty datum line (PDL). The current minimum public wage is around US$300, against a PDL of US$481.65. The minimum public wage can match the PDL; either through government increasing the minimum wage by 60%, or by allowing deflation to escalate to ‘hyper-deflation’ which can drive the PDL down to the minimum wage. Limited resources and restricted monetary policy limit the possibility of both

Structural reforms underway…

Public workers are now reportedly signing 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 to US$157 to lower the public wage bill. Meanwhile, the sincerity of such ‘politically costly’ reforms is threatened by nearing elections; as ZANU-PF held a ‘million-man march,’ ostensibly supporting the status quo.

Government has reportedly embarked on an accelerated valuation exercise of agricultural land as it moves towards compensating displaced farmers. Minister of Finance Hon. Patrick Chinamasa said displaced farmers will be compensated for seized land, developments and equipment. Minister of Lands Hon. Douglas Mombeshora said the process will also involve identification of idle land for redistribution. Conclusion of the land issue is necessary for full international re-engagement.

IMF happy with reform efforts… but far from funding

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.

The IMF however made it clear that it is far from agreeing a financing program with Zimbabwe because there is need for 'a couple of things to be in place before even that consideration can take place.' This followed some 'misreporting on Zimbabwe' amid heightened expectations that Zimbabwe was close to securing an IMF funded program.

Hope from the East…

Chinese President Xi Jinping reportedly deployed a special envoy to Zimbabwe to update President Mugabe on progress regarding 'mega-deals' signed between 2014 and 2015. Under the deals, China pledged to bankroll infrastructure projects worth billions of dollars in line with Zimbabwe's economic blueprint 'ZIMASSET'. Given limited foreign funding sources and drying domestic sources, implementation of the mega-deals as an economic stimulus becomes a matter of urgency.

Post *El Nino:* army worm, locusts and quelea birds loom

The International Red Locust Control Organisation for Central and Southern Africa (IRLCOCSA) predicts that 'all migratory pests will be a great concern next year and may affect food security in Southern Africa.' The pests include red locusts, armyworm and quelea birds. The region, Zimbabwe included, is currently saddled with an *El-Nino* induced drought, which is projected to transition into *La-Nina* induced excessive rainfall by the next rainfall season. Adequate precaution is required on the part of farmers and all their associates.

Deflation persists, but inflation expectations heightened

Year on year headline inflation for June 2016 was -1.37%, up from -1.69% in the previous month. Monthly inflation closed June 2016 at 0.19%, driving year to date inflation to -0.54%, down from -0.27% at the end of the first quarter. Inflationary pressures were largely expected, following a wave of panic driven consumer hoarding as consumers feared possible shortages following the announcement of monetary policy interventions to reduce imports and a complementary quota system on consumer goods that can be sourced locally.

Money market rates buckled under weak deposit appetite

Money market interest rates remained depressed in light of a low appetite for deposits for on-lending by banks. The average 90 days interest rate quote declined from 3.32% at the beginning of the year to end the quarter under review at 2.93%, compared to 2.95% at the beginning of the quarter.

Foreign investors selling out of local equities

The ZSE industrial index recovered 3.51% during the quarter ended 30 June 2016 as highlighted in the following table.

Sector	**30 Jun'16**	**Q2'16**	**YTD'16**
Commodities	216.89	-6.21%	-25.47%
Consumer	146.16	9.79%	-8.25%
Financial	72.65	-4.11%	0.72%
Listed Property	93.14	-6.42%	-20.56%
Manufacturing	44.53	10.86%	-3.49%
Industrial	**101.04**	**3.51%**	**-12.02%**
Mining	**24.70**	**26.47%**	**4.13%**
Market Cap (usd bln)	**2.919**	**3.93%**	**-9.13%**

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

Top 3 Performers	**Price USc**	**Q2'16**	**Market Cap**
GBH	0.02	100.00%	107,318
STARAFRICA	1.00	66.67%	5,184,691
ZIMRE	1.80	40.63%	27,552,173

Bottom 3 Performers	**Price USc**	**Q2'16**	**Market Cap**
CAFCA	18.00	-55.00%	1,531,214
MEDTECH	0.02	-50.00%	559,927
INNSCOR	18.73	-37.48%	101,440,452

ZSE market capitalization firmed 3.93% during the quarter under review to close at US$2.919 billion, representing a 9.13% decline on a year to date basis. Compared to the same period of last year, ZSE market capitalisation retreated 29.7% from US$4.153 billion. Total trades retreated 45% to US$38.2 million during the quarter under review with foreign investor trades constituted 62% of total trades. Net foreign portfolio outflows for the quarter reached US$6.7 million, extending the year to date net outflows to US$21.3 million.

Economic Outlook

The macro outlook remains dire, in light of inherent monetary policy uncertainties and deteriorating fiscal conditions, exacerbated by external imbalances. This notwithstanding; prevailing conditions present a noteworthy investment opportunity from undervalued assets. Significant returns could be earned in the 'post-depression phase' from identifying high-quality assets that have had their market prices dragged down with the rest of the market. Overall, the environment prescribes a medium to long term view.