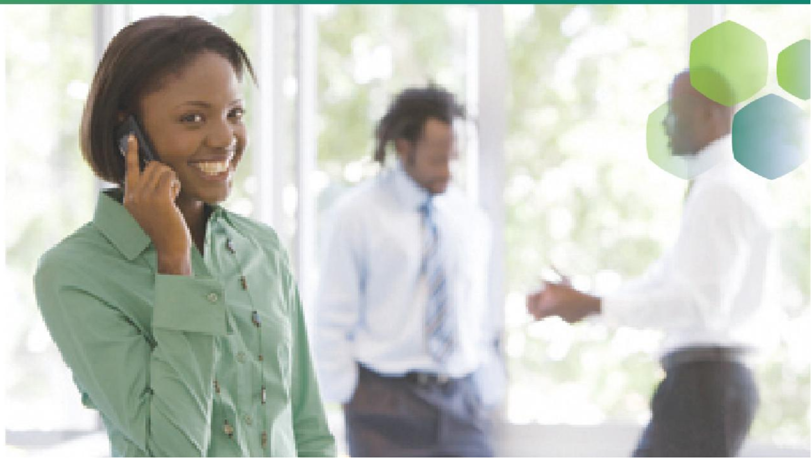
Monthly Economic Brief

October 2016



Highlights

Legal framework for bond notes was availed, making them legal tender at par with the United States Dollar.

Zimbabwe cleared its arrears with the IMF as the first step towards full re-engagement and new lending.

Cumulative tax revenues for the year to September 2016 underperformed target by 10% at US$2.4 billion.

ZSE market capitalization firmed 23.8% in October 2016, closing the month at US$3.535 billion.

Bond Notes will be legal tender…

On 31 October 2016, the Reserve Bank of Zimbabwe (RBZ) commenced 'with immediate effect' the process to issue 'bond notes' as a legal tender in Zimbabwe. The process entails public awareness of the design and security features of the new notes, followed by actual issuance of the notes 'once the RBZ has satisfied itself that the public is sufficiently conversant with the salient features of the notes.' To avoid any doubt, President Mugabe gazetted Statutory Instrument 133 of 2016 on the same day, regularising the legal tender status of bond notes – at par with United States Dollars.

The RBZ strongly warned against illicit cash dealings by the public, citing reports of cash notes being sold for a premium against bank balances. Consequently, with effect from 31 October 2016, the RBZ banned third-party bank transfers for settlement of goods or services – payments must be made from the account of the customer. Reports of premia being paid for US$ cash holdings ostensibly reflect public preferences, threatening the prescribed parity between bond and dollar notes.

Zimbabwe is now current on its IMF financial obligations

On 20 October 2016, Zimbabwe settled its US$107.9 million arrears to the International Monetary Fund (IMF). 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 acknowledged the Zimbabwe is now current on all its financial obligations with the IMF, but warned that full re-engagement and funding would be conditional upon clearance of arrears totalling US$1.7 billion to the World Bank and AfDB, coupled with structural policy reforms. There are no details on how Zimbabwe will settle the US$1.7 billion arrears, despite a commitment to do so by 31 December 2016.

Zimbabwe's ease of business ranking slipped 4 places down

According to the World Bank Ease of Business 2017 report, Zimbabwe ranks 161 against 190 comparable economies. The ranking is based on data as of June 2016 and represents a decline from a ranking of 157 last year. Rankings are based on eleven categories of doing business is various jurisdictions, covering starting a business, operations and ease of winding down. New Zealand was ranked first, followed by Singapore and Denmark. In Sub-Saharan Africa, Mauritius is the highest ranked at (49), followed by Rwanda (56) and Botswana (71).

Zimbabwe's bottom quartile ranking is despite deliberate attempts by government to improve on the annual rankings. Zimbabwe has successfully implemented reforms such as streamlining approval of building plans, making it easier to register property as well as improving access to credit. At 161 out of 190, Zimbabwe ranks as the worst-placed country in Southern Africa, despite the noteworthy reforms. Deteriorating overall rankings against reforms implies that other countries implemented more reforms compared to Zimbabwe.

National tax collections underperforming targets

National tax revenue collections (net) for Q3'16 closed at US$854.2 million. This represents a 6.9% underperformance against target and a 2.7% decline from the same period last year. Cumulative year to date collections reached US$2.4 billion, 10% below a US$2.67 billion target. The tax debt increased by 0.6% during the quarter to reach US$2.65 billion. About 77% of the debt is owed by private businesses, against 14% and 9% for Parastatals and Councils, respectively.

Shrinking tax collections signal declining economic output. This confirms the unpleasant reality of an underperforming economy. A widening tax debt typifies a depressed earnings environment, exemplified by reports of companies struggling to honour net salaries – let alone taxes on salaries.

September 2016 inflation closed at -1.33%...

Annual inflation in September 2016 was -1.3%, up from -1.4% in the previous month. Monthly inflation was -0.26%, down from -0.12% driving year to date inflation to -1.09%. Compromised household earnings threaten consumer demand in the foreseeable outlook, raising the likelihood of continued sub-zero inflation under the prevailing foreign currency regime.

Speculative demand propped the dollar

The United States Dollar registered gains against major trading currencies during the month ended 31 October 2016. The dollar closed the month under review 2.12% firmer against the Euro, to close at US$1.10 per Euro. Against the South African Rand (ZAR), the dollar closed the month 0.5% firmer to close the month under review at ZAR13.8 per dollar.

Dollar appreciation was primarily hinged on market anticipation of an interest rate hike by the United States Federal Reserve Bank in light of improving macro-economic variables. Higher interest rates imply a dearer dollar (as interest rates reflect the cost of money), fuelling speculative demand and appreciation on a demand and supply basis.

Commodity prices were largely mixed

Commodity prices were mixed during the month ended 31 October 2016, coming off a bullish run in the previous month. Year to date price movements remained predominately positive from the thick base, as highlighted in the following table.

Commodity	Price	Oct'16	YTD
Nickel (usd/ton)	10,335.00	-1.81%	20.03%
Crude Oil (usd/barrel)	49.53	1.56%	34.96%
Gold (usd/oz)	1,273.01	-3.95%	19.80%
Platinum (usd/oz)	979.08	-5.46%	12.25%
Coffee (usd/lb)	163.70	8.99%	32.18%
Maize (usd/ton)	139.36	8.26%	-1.46%
Sugar (usc/lb)	22.01	-6.02%	44.71%
Cotton lint (usc/lb)	70.64	4.34%	10.86%

Hard commodity prices, outside oil, registered declines in line with a generally depressed global economic outlook signalling weak demand, particularly from industrialised economies. Crude oil prices responded positively to a deal by the Organization of Petroleum Exporting Countries (OPEC) to curtail output - its first such agreement since 2008. Expectations of limited supply supported prices.

Soft commodity prices were largely bullish, with coffee prices gaining 8.99% in the month. Support for soft commodity prices is partly attributable to adverse weather predictions in major producing regions. Sugar prices conspicuously bucked the uptrend, registering a decline of 6.02% during the month under review. Sugar prices softened amid concerns of overheating as year to date gains had breached the 50% mark.

Money market rates remained materially unchanged

Inflated monetary policy uncertainty, compounded by generally compromised borrower quality sustained depressed activity on the local money market. The average 90 days investment interest rate quote closed the month ended 31 October 2016 unchanged at 2.95% from the previous month, down from 3.69% at the beginning of the year. The 360 days interest rate quote was also unchanged during the month at 3.67%.

Local demand spurred ZSE performance as foreigners sold out

The ZSE industrial index firmed a noteworthy 22.09% during the month under review - the highest monthly gain since May 2009. The following table summarises ZSE returns for the month ended 31 October 2016.

Sector	Value	Oct'16	YTD
Commodities	293.01	25.22%	0.68%
Consumer	175.80	27.24%	10.36%
Financial	84.53	7.24%	17.20%
Listed Property	90.75	-1.06%	-22.60%
Manufacturing	42.93	9.81%	-6.96%
Industrial	**120.82**	**22.09%**	**5.20%**
Mining	**33.76**	**26.87%**	**42.33%**
Market Cap (usd bln)	**3.535**	**23.76%**	**10.05%**

The strong ZSE performance was against declining corporate earnings, suggesting performance was driven primarily by safe-haven demand for real assets. The following tables highlight ZSE top and bottom 3 performing stocks for October 2016.

Top 3 Performers	Price USc	Oct'16	YTD
AXIA	6.00	66.67%	-20.00%
BUNDIRA	2.00	66.67%	30.72%
ZIMPAPERS	0.80	60.00%	33.33%

Bottom 3 Performers	Price USc	Oct'16	YTD
TRUWORTHS	0.50	-37.50%	-50.00%
ARISTON	0.35	-22.22%	-32.69%
DAIRIBORD	3.00	-16.67%	-53.85%

For the eleventh consecutive month, foreign investors were net sellers on the local bourse. The cumulative year to date net position closed the month at a negative US$52.9 million, compared to net inflows of US$2.7 million over the corresponding period last year. Of major concern was the magnitude, as foreign investors registered net portfolio outflows of US$16.8 million, the highest on record.

Total value of trades gained 79% to US$23.2 million while the average daily value of trades gained 87% to US$1.1 million. The inverse relationship between foreign investor interest and ZSE returns in October 2016 adds credence to the safe-haven portfolio shift notion – suggesting local investors are seeking some form of hedge from market uncertainty, particularly regarding monetary policy.

Economic Outlook

The near term outlook evokes an uneasy sense of de-javu. A general fear of bond notes, ostensibly from legacy concerns, could trigger market panic if not handled carefully. The threat of speculative behaviours and further informalisation of the economy is considerably amplified. Overall, risks for the formal economy are significantly skewed to the downside. The near-term outlook dictates cautious trading.