PLATINUM SECURITIES PVT LTD
(Member of the Zimbabwe Stock Exchange)

Investor Note

Mid-Term Monetary Policy Statement February 2017

20 February 2017

EXECUTIVE SUMMARY

The Mid Term Monetary Policy Statement was presented under the theme, **Stimulating Economic Growth and Bolstering Confidence.** The policy statement indicates that at surface level the banking sector appears to be more robust in terms of capitalization, deposits, profitability and a declining level of non-performing loans. The loan to deposit trend however indicates a substantial decline as banks are increasingly becoming more conservative in their lending. The policy includes amendments to the Banking Act that focus mainly on reinforcing banking sector corporate governance through reducing the tenor of directors and interlocking directorships. In addressing one of the most current critical economic risk factors, that is, the matter of depleting nostros and delays in foreign payments, the RBZ will be putting an additional $70 million nostro stabilization facility at the end of February 2017 ahead of tobacco receipts. In addition to this, foreign exchange in the nostros shall be preserved through domesticating the settlement of local card transactions on international card switches. Banks shall be required to reduce lending rates to a maximum of 12% p.a and 3% administration fees whilst interest on deposits is to be reviewed to encourage deposits. Measures of supporting small to medium enterprises (SMEs) that include gold producers and women in business through affordable loan facilities have also been highlighted.

STOCK MARKET IMPLICATIONS

I. The Amendments to the Banking Act that are meant to reinforce corporate governance systems shall certainly go some way in improving management of banks and investor confidence as it is apparent that the regulator is aware and is trying to counter the corporate governance issues that led to the failure of most banks in the past. Currently the ZSE has 5 listed banks and investor confidence in these is quite low as is indicated by the low level of trading on the counters. We however believe that the regulator still needs to do more in terms of improving independence of the board of directors for banking institutions.

II. The $70 million support for nostros at the end of February 2017 and the further measures to preserve nostro balances through local settlement of local transactions on international Visas and Mastercards will also ease the building pressure that has been affecting the payment of raw materials for both listed and unlisted companies. This is a critical concern as the country is currently on the verge of witnessing shortages of imported commodities and foodstuffs. Once this happens, it will not take too long before we have a recurrence of the 2007-8 economic crisis and high inflation. Thus it is critical for the RBZ to continue to strive to manage this situation. We do not however believe that these measures even together with tobacco and other export receipts offer a lasting situation. Government fiscal pressures are way too high, the revenue base continues to shrink, FDI levels and foreign participation keep declining (the policy statement indicates that FDI declined from $399. 2 million in 2015 to $254.7 million in 2016 whilst portfolio investment changed from a surplus of $122.8 million to a deficit of $26 million in 2016).

III. Lower lending rates should lower financial costs for most listed companies which are currently battling against declining revenues.

IV. Financial support to SMEs improves economic performance through creating employment opportunities in the country.

MONEY MARKET IMPLICATIONS

I. All other things remaining constant, we would expect that the reduction in lending rates would result in lowering of money market rates as banks would have to realign their cost of funding to reflect this decline in future interest income. In this instance however, the capping of lending rates concides with another policy instruction for banks to review their deposit rates by 31 March 2017 and submit a report to the Bank detailing their deposit profiles and proposed interest rates on deposits. This is meant to ensure that they offer rates that encourage savings. We expect this factor to counter a reduction in the prevailing interest rates and to result in a possible slight improvement in deposit rates from institutions that had rates on the lower end. We therefore do not expect a significant change either up or down in the prevailing market rates.

II. Key banking sector fundamentals of banks appear to be more robust as is seen by improvements in total deposits, capital adequacy ratio, profitability and a reduction in NPLs (due to ZAMCO intervention). We continue to be concerned however by the risk factor that can arise from bond notes given the depleting nostro balances. The measures introduced by the RBZ in addition to export receipts from tobacco are indeed expected to contain the foreign payments backlog in the short to medium term but more long term solutions are needed. We are particularly concerned about the fact that if the back log of foreign payments continues we shall eventually start seeing shortages of key commodities and food stuffs which shall certainly be the destabilizing factor of the equivalence of the bond note to the US dollar and thereafter inflation and poor returns from fixed income.

PROPERTY MARKET IMPLICATIONS

I. In 2016, building societies funded a total of 1,531 new units valued at $75.02 million. Although the bulk of the units were for the low income earners we believe the number is insignificant compared to about 2 million people who are on the national housing list.

II. The cap on lending rates is certainly expected to permeate to the mortgage market and therefore lower mortgage rates to the benefit of borrowers.

III. As a way of trying to bolster the availability of mortgage finance in the economy building societies are required to submit detailed plans by 31 March 2017, on the housing development projects and units they will be undertaking in 2017 and 2018. However, the short term liability structure of most banks (as a result of a lack of/ disintegrated savings culture) will continue to impede the availability of significant mortgage finance in the economy.

IV. In the short term we expect the residential subsector to remain a bit defensive in terms of rental yields and as the liquidity levels improve (following the introduction of Bond Notes which addressed the 'trading').

V. We also do not expect a significant uptake of "Office Buildings" due to the weak macro-economic conditions in the short to medium term.

SECTOR DEVELOPMENTS & MONETARY POLICY MEASURES

POLICY MEASURES	IMPLICATIONS
External sector and inflation • Over the period January to December 2016, merchandise exports decreased by 6.9%, from US$3,614.2 million realized in 2015 to US$3,365.8 million during the corresponding period in 2016. Similarly, merchandise imports for the period January to December 2016 at US$5,350.9 million, declined by 11.7% from US$6,062.3 million realized over the comparative period in 2015. • Remittances, which are also a major source of import financing declined by 17.9% in 2016, from US$1,917.7 million received in 2015 to US$1,574.0 million in 2016. Of the total amount received in 2016, US$779.0 million reflects remittances from the Diaspora while remittances from International Organizations (NGOs) amounted to US$795.0 million. • Foreign Direct Investment declined from$399.2 million in 2015 to $254.7 million in 2016 while portfolio investment declined from a surplus of US$122.8 million to a deficit of US$26.0 million. • Total foreign currency cash receipts for the year 2016 amounted to US$5,408.0	• Zimbabwe continues to experience a huge trade deficit due to the poor performance of exports. The decline in export and import performance is a reflection of the difficult environment in which Zimbabwe is operating in. • A combination of foreign currency management measures announced by the Bank in May 2016 and import management measures by the Ministry of Industry and Trade as well as the effect of a stronger U.S. dollar on the country's terms of trade, in part, explains the declining import bill in 2016. • Remittances from diaspora have become a significant contributor to the country's economy as the country remains a foreign direct investment leper as shown by the significant decline in FDI in 2016 and the deficit in portfolio investment. This is a clear reflection that the level of risk aversion for investors remains elevated. • The decline in diaspora remittances, FDI, a deficit in portfolio investments and the decline in the level of exports all indicate a shrinking base of the much needed foreign currency inflows. This implies that

million compared to US$6,260.3 million received during the same period in 2015, representing about 13.6% decline in liquid foreign currency supply. For the year 2016, Authorised Dealers processed foreign payments amounting to US$5,128.0 million. This represents a 29.0% decline from US$7,181.0 million for the same period in 2015. • Annual headline inflation remained in the negative territory in 2016, averaging -1.56% for the year, despite accelerating from -2.19% in January 2016 to -0.9% in December 2016. The increase in inflation was driven by both food and non-food inflation. Zimbabwe remains the only country with negative inflation in the SADC region. • Inflation is expected to move into positive territory in 2017 on the anticipated increase in international oil prices and domestic sector recovery. • The bank projects an inflation of 1% to 2% in 2017.	as much as the RBZ is coming up with ways of trying to stabilize the nostros, these ways offer a very temporary solution due to the factors mentioned above. • We believe that overall inflation to be observed in 2017 shall particularly be dependent on how far the RBZ manages the backlog of foreign payments. If we continue to see this backlog then we expect to start observing shortages of basic commodities and a higher level of inflation than anticipated.
Financial Sector Developments • The financial sector had 13 commercial banks, four building societies and four deposit taking micro finance institutions as at 31 December 2016.	**Implications** • The increase in aggregate core capital in the banking sector implies that there is enhanced confidence of the sector compared to the previous year. There is also limited chance of

- According to the governor the banking sectors remained safe & sound during the period ending December 2016. Below are some of the soundness indicators

- Total Assets increased from US$7.83 billion in December 2015 to U$8.73 billion in December 2016.

- Loans declined from US$3.87 billion in December 2015 to US$3.69 billion in December 2016.

- The distribution of credit remained largely unchanged from the first half of the year 2016 with lending to individuals, services and agriculture sectors continuing to dominate the banking sector loan portfolio. In particular, lending to individuals, services and agriculture was at 28.77%, 14.93% and 16.70% respectively.

- Net Capital Base increased from US$1.14 billion in December 2015 to US$1.34 billion in 2016

- As at 31 December 2016 all the banks were compliant with the minimum capital requirements.

- Total Deposits increased from US$5.62 billion to US$6.51 billion in December 2016.

- The commercial banking segment commanded about 82.02% of the systemic risk.
- As at 30 December 2016, all banking institutions were adequately capitalized and in compliance with prescribed minimum capital requirements
- The decline in loans and advances was largely as a result of cautious and prudent lending measures by banking institutions.
- Notwithstanding the high average prudential liquidity ratios recorded across the sector, the banking industry continued to experience underlying physical US$ cash challenges on the back of high demand for cash by the banking public. However, the Bank has been promoting the use of plastic money resulting in significant use of the same and decline in the demand for physical cash.

total banking sector deposits. • The average Prudential Liquidity Ratio was a 61.91% compared to a regulatory requirement of 30% as at 31 December 2016.	
Policy Measures to Stimulate the Economy and Bolster Confidence. • Extension of the US$200 million African Export-Import Bank (Afreximbank) Trade Debt-Backed Securities (Aftrades) facility by a further two years to expire in February 2019. • With effect from 1st April 2017, all banking institutions are required to ensure that lending interest rates should not exceed 12% per annum and that bank charges that include application fees, facility fees and administration fee, should not exceed 3%. • Reduction of cash withdrawal charges with effect from 12 December 2016 to; a maximum of $5 for RTGS, a fixed charge of $0.10 for POS transactions of up to $10, a fixed charge of $0.45 for POS transactions above $10, ATM withdrawal; 1% of transaction value and Over The Counter withdrawal at 1.25% and a maximum of $5	• The reduction of lending rates to an all-inclusive maximum of 15% per annum is very much welcome given a high costs structure faced by companies against declining revenues. This will ensure that the costs of fixed obligations are lessened especially for the already challenged productive sector. • The loan to deposit levels has however been on a steady decline. In 31 December 2016 it stood at 57% against 86% on 31 December 2015. This indicates that bank's appetite for lending has reduced substantially due to the depressed economic levels that are increasing loan defaults. Hence this lending rate will only benefit only those few companies that are still eligible for loans. • The increased nostro support of $70 million and the attempts to preserve foreign exchange in the nostros through domesticating the

monthly administration or service fee. • All banks are required, by 31 March 2017, to review interest paid on deposits and to submit a report to the Bank detailing their deposit profiles and proposed interest rates on deposits. • Preservation of foreign exchange in nostro accounts by enforcing market and institutional discipline and domesticating the settlement of local card transactions on international card switches. • Promotion of efficient circulation of bond notes within the financial market. The Bank is putting in place a redistributable measure that mitigates against skewed concentration of bond notes within the banking sector by limiting the maximum amount of bond notes that each bank should hold at any given point in time in relation to its level and type of transactions. • Preservation of the parity of the bond note to the US$. The Bank is directing financial institutions to strictly observe the policy to deposit bond notes into the US$ accounts without requesting the banking public to differentiate between bond notes and US$ cash. • Facility for bonafide cross border traders through the provision of foreign exchange and finance	settlement of local card transactions on international card switches shall certainly provide temporary relief to the pressure on the current backlog of payments before the tobacco floors open in March. Card and DSTV settlements have the second largest foreign payments after fuel. It is highly unlikely though that the tobacco receipts or other export receipts will provide a long term solution to the struggle of foreign settlements. Already key exporters such as gold miners and other manufacturers are struggling to have access to key raw materials needed for production. A more lasting solution such as a huge USD injection from International Financial Institutions is needed. This can only be achieved through conforming to IMF reforms. • The preservation of the bond-US parity is highly dependent on how the RBZ continues to manage the printing of the bond notes and also the processing of the key foreign payments such that local retailers do not start witnessing noticeable difficulties in restocking. This will certainly lead to a fast distabilisation of this parity as the bond will start trading at a discount to the dollar. • As much as an incentive to the tourism industry and cotton growers may provide much needed financial

facilities. • Comprehensive review of the farmers stop order system. • Enhancing the gold support facility for small to medium scale producers from US$20 million to US$40 million. • Foreign exchange/nostro stabilisation facility of US$70 million n to be disbursed by the end of February 2017 in order to deal with the current delays in the processing of outgoing payments for the procurement of productive imports. • Facilities to support financial inclusion such as; **I.** US$15 Million Revolving Women Empowerment Fund at an all-inclusive cost of 10%. **II.** US$10 million Business Linkages Facility an all-inclusive cost of 10% to support agriculture. **III.** Revamping the US$10 million Horticultural Facility. **IV.** Educational Support Facility for students pursing studies at the Higher Education and Tertiary Institutions. **V.** Extension of the Export Incentive Scheme to Tourism and Cotton Growers. • Fostering surveillance on combating money-laundering, tax evasion and transfer pricing.	aid, the RBZ has not made it clear how this incentive will be financed. This certainly increases a risk of over printing the $200 million bond notes in a bid to finance these incentives unless the already strained government adds on this cost to its bloated budget.

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