PLATINUM SECURITIES PVT LTD

(Member of the Zimbabwe Stock Exchange)

Investor Note

Monetary Policy Statement February 2018

09 February 2018

EXECUTIVE SUMMARY

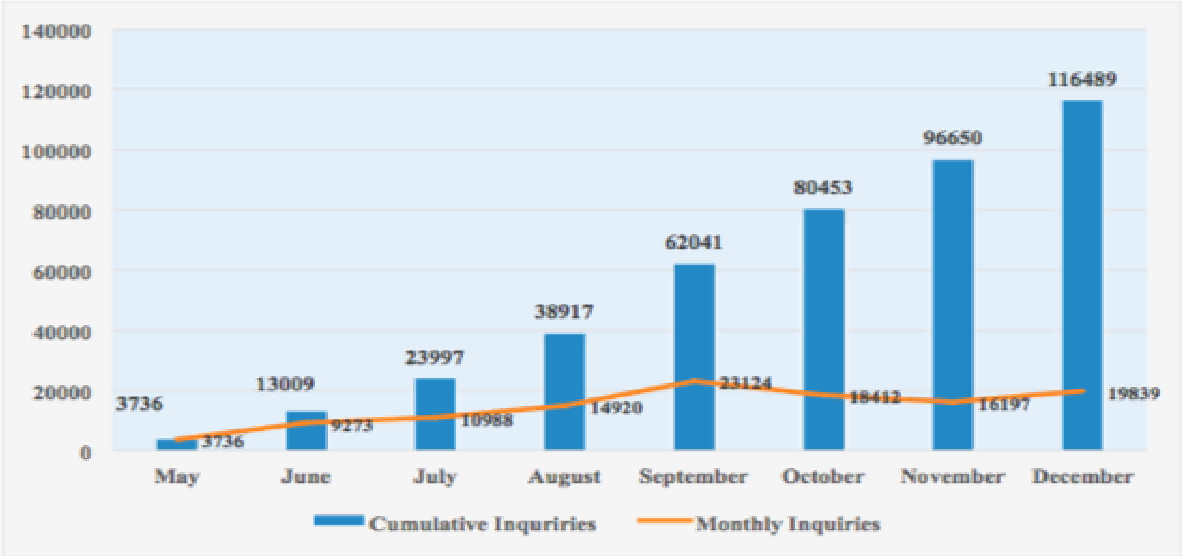
The Monetary Policy Statement was presented under the theme, **Enhancing Financial Stability To Promote Investment Confidence.** The primary focus of the policy statement is to devise ways that will gradually liberalize the currency market through enhancing nostro stabilization facilities, offering additional financial support and higher incentives to exporters, mopping up of excess liquidity in the banking system and tightening the reigns on the budget deficit. The RBZ is enhancing the nostro stabilization facilities by $400 million and it has increased export incentives to 12.5% for tobacco growers and 10% to exporters of gold, macadamia, cotton and horticulture. In addition, to increase the pool of funding available to exporters the RBZ has opened up the issuance of well secured Tobacco and Gold Production Financing Bonds to diaspora investors. The statement also indicates the success of the various export-supporting measures that led to a growth of 36% in exports in 2016 and narrowed the trade deficit from $2.2 billion in 2016 to $1.5 billion in 2017. However, the level of credit extended towards the government shows an alarming case of crowding out the private sector as it reveals that in 2017 credit to the government increased by 70% to $6.3 billion whilst credit to the private sector increased by a mere 7% to $3.7 billion. RTGS positions stood at $1.7 billion in 2017 against $954million in 2016. This RTGS position was largely driven by the increased Government borrowing through its overdraft facility with the RBZ and the issuance of Treasury Bills and Bonds, which increased from $3.2 billion in 2016 to $5.2 billion at the end of 2017. Outlined below are summary highlights of the statement, the various policy measures, our views on them and possible implications on the ZSE and the fixed income market.

1. SUMMARY OF 2017 MONETARY POLICY INTERVENTIONS

- The $1.1billion in nostro stabilisation facilities helped to stabilise the forex market and sustained funding for imports.
- The export incentive scheme significantly contributed to the growth of exports by 36% to US$3.8billion.
- The Aftrades facility alleviated liquidity shortages and it will run until 2019.
- The 7% tax-free Savings Bond was introduced which led to US$165 million being raised; it now includes a Prescribed Asset status to improve marketability.
- 96% of the one billion transactions in 2017 were through electronic and mobile banking systems. The volume of mobile transactions increased by 153% to 754.7million.

- Introducing a Credit Registry and Collateral Registry enhanced the credit infrastructure. Utilisation of the credit registry increased with cumulative access of 116 489 reports as at 31 December 2017 as shown below.

Figure 1: Cumulative Credit Registry Inquiries as at 31 Dec 2017



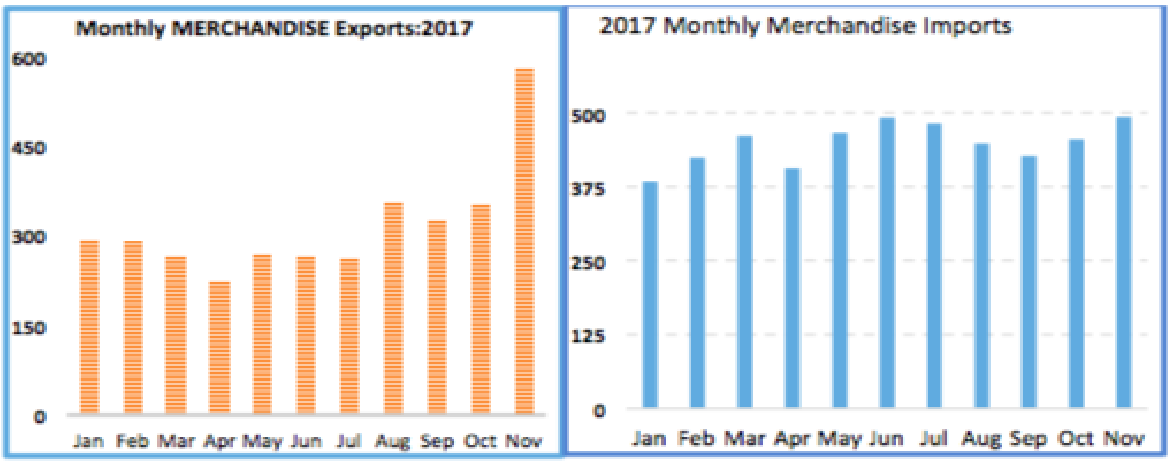
Source: 2018 Monetary Policy Statement

- Significant progress was made towards the implementation of IFRS9. All banking institutions are required to submit IFRS9 compliant financial statements as at 31 December 2017 to the bank by 31 March 2018.

2. Balance of Payments Developments

- Zimbabwe's trade deficit narrowed from $2,181.6million in 2016 to $1,456.7million in 2017.
- Exports increased by 36.8% to $3,475.9 million due to increases in exports of nickel, gold, ferrochrome and black tea.
- Imports had 4.5% increase to $4,932.6 million due to increases in importation of fuel, electricity, maize seed, machinery, fertilizers and medicines.

Figure 2: Merchandise Exports and Imports (US$m)



Source: ZIMSTAT

- There was an 11% decrease in inward remittances of $1.4 billion in 2017 from $1.6billion in 2016. $698.9 million of the inward remittances were from the diaspora.
- There was a 1.4% increase in foreign currency receipts which amounted to $5.6billion in 2017 from $5.5 billion in 2016.

Table 1: Foreign Currency Receipts (2016 and 2017)

Type of Receipt	2017 US$ millions	2016 US$ millions	% Change
Export Proceeds	3,519.70	2,994.00	17.6%
International Remittances	1,412.01	1,589.96	-11.2%
Loan Proceeds	545.49	519.49	5.0%
Income receipts	58.87	332.70	-82.3%
Foreign Investment	26.98	48.97	-44.9%
TOTAL	**5,563.05**	**5,485.12**	**1.4%**

Source: RBZ

- Foreign currency receipts increased but were outweighed by the Zimbabwe's huge import bill. Global foreign payments declined by 6% from US$5.14 billion in 2016 to $4.81 billion in 2017.
- Net foreign direct investment into the country is estimated to have declined from $343

million in 2016 to $235.4 million in 2017, while net portfolio investment inflows declined from $80 million to $41 million.

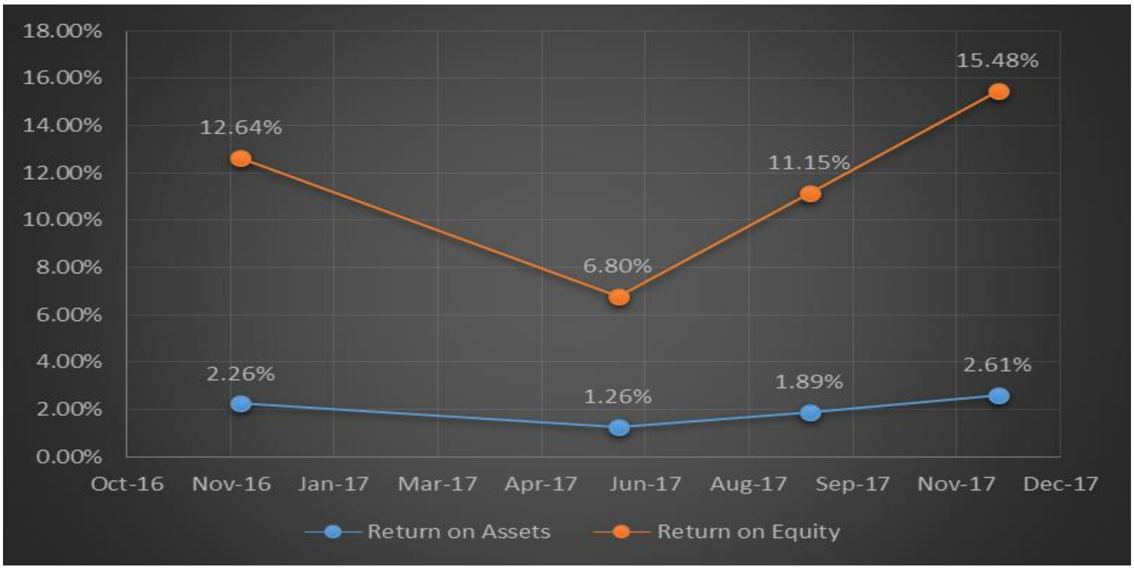
3. FINANCIAL SECTOR DEVELOPMENTS

- The financial sector had 13 commercial banks, five building societies and one savings bank as at 31 December 2017.
- Under Micro Finance Institutions (MFIs), there were 178 Credit only MFIs, 4 Deposit-taking MFIs and 2 Development Financial Institutions.

Banking Sector indicators as at 31 December 2017

- Total Assets increased from $8.73 billion in December 2016 to $11.25 billion in December 2017.
- Banking sector deposits (including interbank deposits) increased by 26.47% from $6.99 billion as at 30 June 2017 to $8.48 billion as at 31 December 2017. This was attributed from increased export receipts; expansionary impact of government expenditure and multiplier effect of new deposits.
- Loans and advances increased from $3.69 billion as at 30 June 2017 to $3.80 billion as at 31 December 2017.
- Lending to the productive sector dominated the banking sector loan portfolio at 73.64%.
- Aggregate core capital increased by 10.48% from $1.24 billion as at 30 June 2017 to $1.37 billion as at 31 December 2017, on the back of improved earnings performance.
- As at 31 December 2017 all the banks were compliant with the minimum capital requirements.
- Eighteen out of nineteen operating banking institutions recorded profits during the period ended 31 December 2017. The net profit for the period ended 31 December 2017 was up 33.91% from $181.06 recorded in prior year to $241.94 million. This is shown by the improvement in the profitability ratios shown below.

Figure 3: Trend of Return on Assets and Return on Equity Ratio



Source: 2018 Monetary Policy Statement

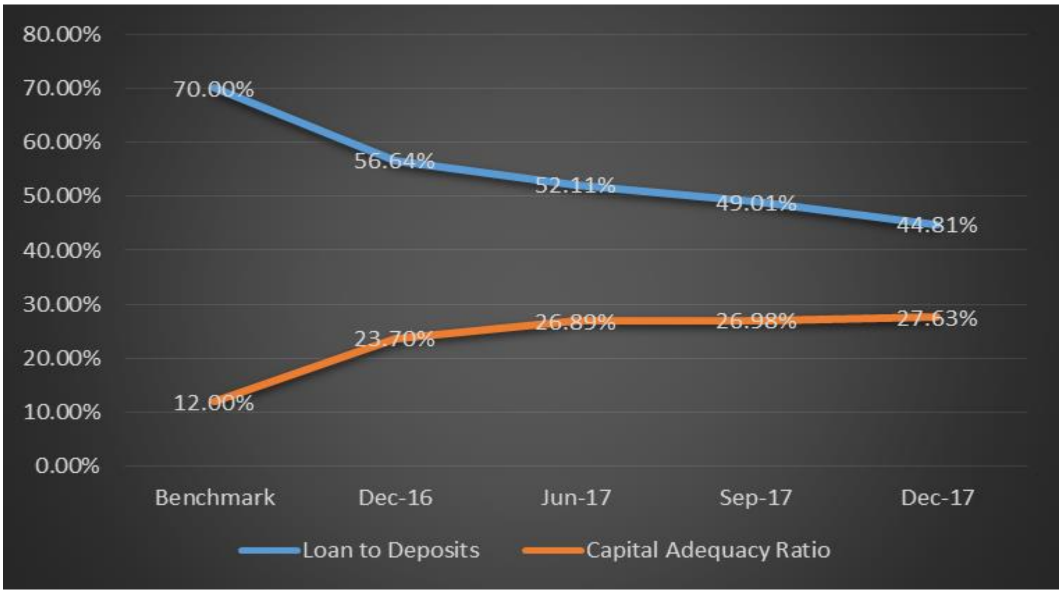
- Non-Performing Loans (NPLs) ratio was lower at 7.08% as at 31 December 2017 from 7.87% in December 2016 as banks continue to strengthen their credit risk management systems, in the aftermath of balance sheet clean up through disposals of NPLs to ZAMCO as shown in Figure 1 below.

Figure 4: Trend of Non Performing Loans December 2011 - December 2017

Source:RBZ

- ZAMCO had acquired NPLs amounting to $987 million as at 31 December 2017; assisting banks to clean up their balance sheets so that they are able to support the economy through provision of credit.

Figure 5: Trend of Loan to Deposits Ratio and Capital Adequacy Ratio



Source: 2018 Monetary Policy Statement

- The average capital adequacy ratio as at 31 December 2017 was 27.63% against the required minimum of 12%.
- The Loan to Deposit ratio has been declining at alarming levels as is shown above. It declined from 56.64% in December 2016 to 44.8% in December 2017.

Figure 6: Return on Assets and Return on Equity Ratios

Source: 2018 Monetary Policy Statement

SECTOR DEVELOPMENTS & MONETARY POLICY MEASURES

POLICY MEASURES	COMMENTS
• **Curbing of Multi-Pricing System & Refusal of Plastic Money;** The 2018 Finance Bill which has now gone through Parliament and now awaits approval by the Senate seeks to make the malpractice of multi-tier pricing and the refusal of plastic money illegal. • **Strengthening Financial Credibility;** In line with the lending powers of the Bank to Government as provided for in Section 11 1(a) of the Reserve Bank Act [Chapter 22:15], the Bank is putting in place measures to ensure that the lending limit to Government does not exceed the regulated 20% of the previous year's revenue of the State.	• As much as it is advantageous to the consumer to abolish the multi-tier pricing system and refusal of plastic money, the reality of the situation is that the delays in processing foreign payments calls for multi-tier pricing systems especially for retailers and other importers that are ranked low on the imports priority list. Indeed government intervention is needed to put some level of sanity in the pricing, but such intervention must be very minimal so as not to end up creating shortages of commodities. It is quite encouraging though that the government is now progressively addressing the root of the problem by devising various ways and means to

- **Strengthening of Liquidity Management Systems;** In order to mop up the excess RTGS funds in the banking system, the RBZ intends to issue a medium term government paper. The Bank is also assessing the possibility of reintroducing Open Market Operation (OMO) tools during the course of the year. The Bank is still on course to reintroduce an auction system for Treasury Bills and Bonds.
- **Acceptance of 99-Year Land Leases as Security by Banks; T**he Bank has agreed with banking institutions for them to accept the 99-year leases as security for accessing credit from financial institutions in line with the provisions of the leases.
- **Presidential Amnesty on Externalised Forex and Assets;** The responses have been positive from both individuals and corporates in respect of foreign currency that was externalized. The Bank is offering 7% tax-free savings bonds for funds to be repatriated under the amnesty dispensation where funds were externalised under the auspices of free funds.
- **Continuation of the Multi-Currency System;** As the fundamentals for the return of the Zimbabwean currency are still weak such as having foreign currency reserves to cover at least 3 months of imports and a sustainable budget deficit. When such fundamentals are now strong the currency reform will be predicated or tailor-made along the currency board (CB) and/or gold standard (GS) mechanisms that are stringent monetary rules.
- **Progress on the Arrears Clearance and Re-Engagement Programme;** The Government is intensifying the re-engagement process with the

promote foreign currency earning with the fundamental solution being to promote local production by seeking to attract investment into the country.

- It is critical that the RBZ ensures that the government does not exceed its borrowing threshold of 20% of the previous year revenues as the consequences of such overzealous spending has disastrous consequences on the economy. In 2017, the government projected that it reached a budget deficit of $1.7 billion which is about 9.4% of GPD. This is very high when compared to the International acceptable standards which indicate that a deficit that exceeds 4% of GDP is damaging to the economy.
- The mopping up of excess RTGS funds is essential in ensuring stability of the monetary system as this imbalance has been propelling the thriving parallel market system and causing a loss of confidence in the banking system. In addition, it shall provide an essential support to the money market rates which have been depressed due to excess liquidity in the banking system.
- The establishment of an Investment Desk to cater for Diasporans by the Reserve Bank will need to have a **24/7** presence both physically (e.g. call centres) and online for ease access by diasporans around the globe. An up-to-date online presence will act as a first port of call and give potential investors room to study the terms and conditions as well as opportunities on their own.
- The issuance of Tobacco and Gold Production Financing bond is an innovative move that will likely widen the pool of financing available for key exporters through these **Commodity**

international community to improve international relations and to resolve the external payment arrears to the remaining International Financial Institutions (IFIs) as well as bilateral creditors by following the previously agreed process for clearing external payment arrears.

- **Foreign Currency Retention Thresholds**
  This will be 100% (for a period of up to two weeks) of export receipts for exporters of all services and products except gold, diamonds, platinum, chrome and tobacco. For the exception, the retention threshold has been increased from 20% to 35%.
  This would allow exporters to fund their business operations without having to apply for foreign currency, thereby improving the ease of doing business.
- **Establishment of an Investment Desk to cater for diasporans**
  This desk will provide diasporans with direct access to information on Investment opportunities within the national economy.
- **Issuance of Diaspora Tobacco & Gold Production Financing Bonds**
  The bonds are aimed at generating foreign currency for the country, if adequately funded, and help small and start-up companies in tobacco sector access offshore funding.
- **Incentive for Diaspora Investment Accounts in Zimbabwe**
  Zimbabweans in the diaspora can open Diaspora Investment Accounts with local banks of their choice. These accounts are meant to facilitate inward Investments by Zimbabweans in the diaspora. The Reserve bank will offer 7% Diaspora Remittance Incentive over and above the interest offered by the bank.

Backed Bonds. This facility provides alternative offshore funding for producers, who are mainly into the export business.

- The further provision of Incentives to Diaspora Investment Accounts by the Reserve Bank is key to widening the net that seeks to capture more foreign currency investments into the country. The bank must ensure that inflation is kept at low levels so as to increase the attractiveness of such instruments.
- In order to further incentivise Diasporans to invest at home, local banks must also offer loan facilities where necessary to those who would be depositing reasonable amounts in their accounts.
- While the move to enhance the Nostro stabilization facility is a noble move, we are of the view that the quantum of the facility is still low compared to the demands of the Zimbabwean economy.
- We believe the move to provide investment guarantees will help in reducing the country's investments risk. However, the US$1 billion "security" is low compared to the anticipated investment inflows into the country. For instance the amount of investment required to revive the New Zim Steel Company (Ziscosteel) alone is in circa of a US$1 billion.
- On the other hand, there also appears to be an element of "concentration risk" with respect to our source of facilities as a nation. It appears we constantly borrow from one financial institution. The cost of borrowing which has not been highlighted also needs to be kept within manageable levels.
- Lastly, it is our guided view that the authorities may need to come up with

- **Payment arrangements for sale of Immovable Property and Management fees.**
  As a result of irregular execution of Zimbabwean immovable property sales, where settlement of funds is being done offshore, RBZ advised all stakeholders in property market to use local banking channels.
- Annual payment of management/technical/ consultancy fees has been capped at 3% of annual revenue.

Enhancing the Nostro Stabilisation Facilities to Support Foreign Payment

The Bank is enhancing the Nostro Stabilisation facilities by US$400 million to support international remittances and to meet the foreign exchange requirements for the importation of essential items.

Provision of Investment Guarantees to Protect Investors' Funds

- The Bank is working with the African Export-Import Bank (Afreximbank) to put in place a US$1.5 billion facility that is earmarked for the provision of guarantees (US$1 billion) to investments coming into the country and for liquidity support (US$500 million).

Provision of 7% tax-free savings bonds on non-resident transferable funds

- This compensation process is necessary to assure non resident investors of returns on their idle funds seated at banks.

Enhanced Export Incentive Scheme for Horticulture, Cotton, Macadamia and Gold

The scheme shall offer 12.5% for tobacco growers starting this year and 10% for

a framework on which investments may be guaranteed and which investments may not be guaranteed using the facility as well as the extent to which the investments may be guaranteed

- We believe the tax free savings investment bond is a very attractive stop gap measure that will assist foreign investors to cushion their disinvestments while the country works on fixing issues to do with international payments. The interest rate of 7% per annum carries of premium of about 2% when compared to other government financial instruments like "treasury bills" with average coupons converging in the region of 5%. The interest rate is also competitive regionally and internationally.
- On the other hand, the tax free savings bond may be viewed as an indication by the international community that the country is not a safe investment destination yet in thus far as repatriation of money emanating from the foreign investments is concerned.
- This incentive shall continue to provide essential additional revenues to exporters and essential growth in export production.
- However, our view is that while the Central Bank is making efforts to increase exports through incentives, a framework for making our exports competitive on the international markets should also put in place.

- By increasing support towards the major foreign currency earners the Central Bank is "feeding the goose that lays the golden egg."

horticulture, cotton, macadamia and gold producers. **Increasing tobacco and gold support facilities** • The tobacco input finance facility has been increased from the $28 million disbursed in 2017 to $70 million, while the gold support facility has been increased from $74 million (disbursed to 255 entities) in 2017 to $150 million. **Purchase of gold for value addition** • In order to enhance the gold industry's contribution to this value addition objective, priority shall be given to export oriented jewellery production, where the jewellery manufacturer shall retain 100% of the foreign currency generated from the value added component for use in their business operations. • Approved jewellery manufacturers to meet local demand shall be availed not more than 3 kgs per quarter through Fidelity Printers and Refiners under a properly monitored arrangement to guard against abuse of this facility.	• The move to allow 'selected' merchants to buy tobacco and cotton using local RTGS balances is likely to result in either: • A conversion of the local RTGS balance into nostro balances if the buyers are disciplined. • A reduction in foreign exchange receipts from the 'golden leaf and the white gold' if the participants decide to be unscrupulous. • The value addition of gold is likely to result in improved investments into the jewellery manufacturing sector while also generating foreign exchange receipts for country. The foreign currency receipts will emanate from the fact that 50% of overall gold demand globally comes from 'jewellery demand' according to The World Gold Council. • However, the authorities may need to revise their blanket figure of 3kgs per quarter to manufacturers because the demand for the yellow metal will depend on the scale of operations of the manufacturer. Those with small operations may just request the maximum gold per quarter even though they don't fully utilize it while those with bigger operations may fail to get sufficient stock for converting into jewellery.

4. FIXED INCOME MARKET IMPLICATIONS

- We believe that the efforts to mop up excess RTGS balances through a medium term government paper and open market operations shall certainly bolster money market rates. As at 30 December 2017, Savings Bonds worth $165 million had already been taken up. The presence of additional papers that offer more attractive terms could certainly be widely accepted by depositors as opposed to just keeping money in the bank at 0% interest or at the prevailing low deposit rates. This would likely reduce the funds that are currently available for lending purposes thus pushing up the demand for more deposits and hence money market rates.
- The Savings Bonds effective December 2017 now have a prescribed asset status. This should increase take up by institutional investors for compliance purposes as these

Bonds are readily available and have tenors that start from 1 year to 5 years whilst offering an attractive yield.

- The introduction of a formal auctioning system for Treasury bills and bonds shall most likely lead to a narrowing of the prevailing discount rates and allow a discernable yield curve to be developed. We believe this will assist in the pricing of riskier instruments such as corporate bonds by defining approximate risk premiums for better investment decision-making.

5. STOCK MARKET IMPLICATIONS

- Listed companies, like many other local companies have been facing the growing challenge of delays in the processing of foreign payments, a situation that has been affecting the supply of certain commodities and manufacturing activities. The continued nostro stabilization facilities such as the $400 million and the $500 million liquidity support that is expected from Afrexim are therefore critical to ensure supply of key commodities and sustainability of operations.
- The increase in the export incentive to 12.5% for tobacco growers and 10% for horticulture, cotton, macadamia and gold producers shall offer additional support to the revenues for exporters such as Riozim, Falgold, TSL and Ariston among others.
- The increased yield from the various RBZ instruments to be introduced and already existing (Savings Bonds) which average 7% should increase asset allocation towards the relatively safer assets that offer an attractive yield thus lowering allocation towards riskier assets such as the equities market.

6. CONCLUSION

In conclusion, we applaud the RBZ in reinforcing the measures highlighted in the 2018 national budget that seek to stabilise the economy and restore investor confidence in the country. In 2018, we certainly expect a continued positive growth in exports given the increase financial support to be offered to tobacco and gold producers. In addition, the Governor is widening the pool of funding to be available to these critical sectors through the Diaspora Tobacco & Gold Production Financing. We believe that this policy statement basically demonstrates the Governor’s efforts to enhance financial stability. This is evident in the continued availing of nostro facilities, increasing export incentives, using idle RTGS balances to generate forex, offering tax free interest to non-resident funds awaiting remittance, promoting the acceptability of 99 year leases, continuing with the multi-currency system and progressing with the arrears clearance programme. These are not dynamic measures that will solve the economy’s woes. However, our confidence lies in the fact that for the first time, the government is now indicating visible efforts to address the root of the country’s current economic problems through restoring investor confidence in the country.

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