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

Investor Note

Mid-Term Fiscal Policy Review- July 2017

1.0. Overall Economic Activity

- In 2016, the economy registered modest growth of 0.7% against an initial Budget target of 2.7%. This performance was against an El-Nino induced drought, which caused the agriculture sector to grow by a negative 3.7% and electricity and water growth to fall by 19% thereby having negative implications on other sectors of the economy.

1.1. The Command Agriculture Programme

- Under the Command Agriculture Programme, a total of 1 875 297 hectares were put under maize during the 2016/17 farming season, with the results of the National Second Crop Survey indicating maize output of 2.2 million tons, as well as small grains yields of 0.5 million tons.
- Going into the 2017/18 agricultural season Government is replicating the Special Maize Production Programme by extending it to other crops, such as wheat and soya beans, as well as the livestock sector with the themes 'Command' maize, 'Command' wheat, 'Command' livestock, 'Command' fisheries and 'Command' wildlife at a total cost of $334 million.
- This will be complemented by the Presidential Input Scheme costing $153.1 million to cater for about 1.8 million rural vulnerable households.
- Accordingly, with respect to the 2017/18 grain intake, Government entered into an understanding with the Grain Millers Association under which Millers shall buy up to 800 000 tons of grain from the GMB for production of mealie meal and related products.
- Taking into account the regional import market which millers can take advantage of, Government agreed that for grain off-take from the GMB, the millers pay a price aligned to the import parity.

1.2. Mining

- In 2016, Mining contribution to GDP increased to 8.7% from 7.9% in 2015.
- Mineral exports amounted to $2.2 billion, from $2.1 billion recorded in 2015, with major contributors being gold and Platinum Group of Metals (PGMs). The impact on gold output came from an increase in the production contribution from small scale miners to 42.6%, from 36.7% in 2015.
- In 2017, the mining sector is expected to grow by 5.1%, driven mainly by output in gold, platinum, chrome, coal and nickel.

1.3. Manufacturing

- Weighted average capacity utilisation improved from 34.3% to 47.4% in 2016 in sub-sectors such as foodstuffs, textiles and ginning, clothing and footwear, non-metallic mineral products and metals and metal products due to SI 64 of 2016, domestic financial system export incentive arrangements by the Reserve Bank, as well as supportive duty rebates on imported capital equipment.
- The sector is, therefore, estimated to have grown by 0.3% in 2016 compared to 0.2% recorded in 2015.
- In 2017, activity in the sector is expected to improve on account of strong agricultural performance and related value chains, continued implementation of SI 64 of 2016, the use of plastic money and the ongoing doing business reforms to reduce cost structures.

1.4. Outlook for 2017

- The economy is expected to register growth of 3.7% in 2017, underpinned by strong performance in agriculture of 21.3%; mining, 5.1%; and electricity and water, 2.5%.

2.0. Fiscal Revenue Performance and Expenditure outturn

- Revenue collected for 2016 stood at US$3.5 billion against an estimated $3.85 billion reflecting an overall revenue shortfall of US$347.8 million.
- Tax revenue performance during the first half of the year 2017 was 1.4% above Budget estimates and by year end, revenues are expected to rebound to US$3.7 billion, in line with the National Budget projections supported by activities such as fiscalisation, ongoing formalization of SMEs, and the implementation of the Electronic Cargo Tracking System among others.
- Budget expenditures for 2016 amounted to US$4.902 billion, against planned expenditures of US$4 billion resulting in expenditure overruns of US$902.2 million. Employment costs constituted 65% of budgeted expenditures and 91.7% of collected revenues.
- Regarding attacking the high cost of employment costs, the Public Service Wage Bill rationalisation measures approved by Cabinet in November 2015 were implemented by Government, effective 1 January 2016. This measure resulted in reducing the Costs bill, from a monthly level of around U$262 million in 2015 to around US$252 million in 2016.
- In addressing the growing fiscal deficit, Cabinet directed, at its 18th Meeting of 13 June 2017, that Government Ministries and Departments immediately adopt expenditure cost-cutting measures which will assist in restoring the fiscal deficit to sustainable levels. These measures include standardization of fuel allowances, review of cellphone and travel allowances and use of government allowances.
- In addition, the Cabinet has called on line Ministries, Departments, as well as Independent Commissions to urgently proffer costed expenditure cost cutting measures that assist in reducing the current fiscal imbalances and improving value for money.

- Revenues of $3.5 billion against expenditures of $4.9 billion in 2016 left public finances with a borrowing requirement of $1.4 billion to finance issues related to drought, water and power projects among other things. Drought mitigation related to grain importation accounted for, US$371.2 million; agriculture recovery support initiative, US$160 million; and other capital related programmes, US$121.3 million.

2.1. Treasury Bills

- Of the US$2.1 billion worth of Treasury bills and bonds issued in 2016, only US$356.3 million was used to finance the Budget deficit, whilst US$1.7 billion was to honor outstanding legacy debt (government debt, RBZ debt assumption, capitilisation of government related institutions and ZAMCO).
- The Budget deficit was financed through Treasury bills of US$346.3 million, average maturity of 160 days, and Treasury bonds, US$10 million, with average tenure of 3 years.
- Government has been honoring its obligations on maturing Treasury bills, as demonstrated by a total of US$1.1 billion that has so far been repaid timeously.

2.2. Public Debt

- Zimbabwe's total debt, as at end December 2016, is estimated at US$11.3 billion, of which public and publicly guaranteed external debt stood at US$7.3 billion, and domestic debt being US$4 billion.
- Pursuant to the Arrears Clearance Strategy agreed with creditors in Lima on 20 October 2016, Zimbabwe settled its overdue obligations to the IMF amounting to US$107.9 million.
- However for any future consideration of new financing from the IMF, Zimbabwe would be required to comply with other applicable IMF policies, which includes; resolving arrears to other multilateral creditors under the paripassu rule such as African Development Bank ($642 million), the World Bank ($1.4 billion), European Investment Bank ($294 million) as well as bilateral official creditors; and implementing strong fiscal adjustment and structural reforms to restore fiscal and debt sustainability and foster private sector development.

2.3. Public Finance Management Reforms

The following are some of the Acts that are a work in progress or have been implemented with regards to reforms of public finance management.

- **Review of Public Finance Management Act**; Government is reviewing the Public Finance Management Act to align it with the Constitution and further improve on effectiveness of public resource use and accountability arrangements.

- **Public Entities Corporate Governance Bill**; In order to promote sound corporate governance, ethical leadership, professionalism and enhanced accountability in public sector institutions. The draft Bill has been approved by Cabinet and will soon be tabled before Parliament.
- **Public Procurement**; The Public Procurement and Disposal of Public Assets Bill that seeks to transform the State Procurement Board into a regulatory authority, and transfer the responsibility of awarding tenders to procuring individual entities has been passed by Parliament and now awaits Presidential assent.
- **Public Finance Management Regulations**- In order to provide guidance on, and fully operationalize provisions of the Public Finance Management Act, the Public Finance Management Regulations have been developed. The two documents are expected to be finalized by the end of October 2017.
- **Draft Remuneration Framework for Boards and Executive Management at public entities**; A freeze on review of remuneration and benefits is in place with effect from 1 January 2017, pending finalisation of the proposed Remuneration Framework.

3.0. Special Economic Zones (SPEs)

- In an endeavor to attract foreign direct investment, the Special Economic Zones Act was promulgated in the last quarter of 2016, paving way for the implementation of the first stage of three prioritized projects namely; Sunway City in Harare; Bulawayo Industrial Hub and the Vic Falls tourism Corridor stretching from Victoria Falls–Hwange National Park–Binga–Kariba to Mana Pools and the Victoria Falls Financial Hub. Other places include Diamond Cutting and Polishing in Mutare.
- These SPEs have incentives that include;
  - i. Exemption from Corporate Income Tax for the first 5 years of operation. Thereafter, a corporate tax rate of 15% applies.
  - ii. Special Initial allowance on capital equipment to be allowed at the rate of 50% of cost from year one and 25% in the subsequent two year.
  - iii. Specialized expatriate staff will be taxed at a flat rate of 15%.
  - iv. Exemption from Non-residents tax on Fees on services that are not locally available.
  - v. Exemption from Non-residents tax on Royalties.
  - vi. Exemption from Non-residents tax on Dividends.
  - vii. Customs Duty on Capital Equipment Capital equipment for SPEs will be imported duty free.
  - viii. Customs Duty on Raw Materials Inputs which include raw materials and intermediate products imported for use by companies set up in the SPEs will be imported duty free. The duty exemption will, however, not apply where such raw materials are produced locally.

4.0. Banking sector

- Total banking sector deposits during 2016 increased by 15.8% to end the year at US$6.5 billion. Further growth was witnessed during the first quarter of 2017, to US$6.6 billion.
- Deposits rates for savings, 30 day deposits and 90 day deposits were 3.2%, 6.9% and 7.21% in January 2016, respectively and by June 2017 they were standing at 3.85%, 4.4% and 4.5% respectively.
- Commercial bank weighted lending rates for corporate clients opened the year higher at 7.28% in January 2016 and stood at 7.05 % by June 2017.
- Similarly, lending rates for individuals have been on a downward trend from 12.08% at the beginning of 2016 to 9.01% by the end of the first half of 2017.
- Banking sector loans and advances have declined from $3.7 billion on December 2016 to $3.59 billion by March 2017. The decline is largely attributable to prudential and cautious lending by banks as well as acquisition of non-performing loans by ZAMCO.
- The Credit Registry, which was established at the Reserve Bank in terms of the Banking Act, went live at the beginning of January 2017. 443. As at 31 March 2017, the Reserve Bank had captured 60% of the total banking sector loan records in the Credit Registry, comprising both individuals and corporates.

5.0. Balance of Payments

- Total exports of goods increased to $3.7 billion in 2016, from $3.6 billion recorded in 2015, driven mainly by gold and tobacco exports.
- Mineral exports stood at $2.2 billion with the largest contribution coming from gold. Strong production performance, coupled with firming international prices, for the platinum group of metals, diamonds and nickel, are expected to push mineral exports to $2.3 billion in 2017.
- Exports of the economy's agriculture products in 2016 grew by 4.8% from US$1 billion in 2015 to US$1.1 billion with tobacco contributing $933 million.
- Total imports dropped by 15%, from US$6.1 billion in 2015 to US$5.2 billion in 2016,
- In 2017, total exports are projected to reach US$3.9 billion, on account of strong performance in tobacco, PGMs and nickel among others, while imports are expected to increase to US$5.4 billion on account of a surge in the imports of intermediate goods required in the productive sectors.

6.0. Our View

- The budget review once again reaffirmed the unsustainable high levels of government expenditure especially towards employment related costs which consumed about 92% of collected government revenues and 65% of total expenditures of $4.9 billion. A budget overrun of about $900 million nullifies efforts of implemented cost cutting measures such as the Wage Bill rationalization measures that are said to have led to savings of about $10million monthly in

2016. The wage bill also remained way too high despite these implemented measures. Much more needs to be done in order to leave room for capital expenditures.

- No light was shed on the FDI receipts for the year of 2016, but it is common knowledge that foreign investment has been dwindling over the years. To further worsen matters is the fact that the country appears to be very far from receiving any financing from the IMF despite the clearance of our arrears with the institution in 2016. The conditions precedent to receiving such financing such as first clearing arrears to other International Financing Institutions (IFIs) which amount to about $2.3 billion are way too strenuous given the present status of the fiscus, the budget overruns and the upcoming elections. No further mention was made regarding how the country has proceeded with the game plan to clear those arrears according to the Lima Agreement in 2015.
- It remains to be seen if the various Bills regarding public finance management will be effective. A good start will be on taking visible action towards addressing the Auditor General's reports on gross misuse of public resources and unaccounted expenditures in State Owned Enterprises.
- Continued support of the Command agriculture programme is very important for boosting economic growth but it is also paramount that the continued success is supported by high recoveries from the funds that are lent out to farmers under the programme so that it eventually becomes self-financing. As such, in this regard it is critical that the government addresses the inefficiencies that farmers are encountering at the Grain Marketing Board in selling their grain inorder to ensure sustainability of the programme.
- It is also encouraging to note that millers will be allowed to buy grain from the GMB at prices that are aligned to import parities and not at the price of $390 per tonne that the government is paying for grain from farmers. Such a price would have eventually translated to high prices for consumers.
- In 2016 alone the government issued Treasury Bills worth $2.1 billion, most of which were taken by banking institutions leading to a boost in their short term profitability levels. The IMF and the World Bank have however warned that continued issuance of this paper will threaten the viability of the banking sector, crowd out the private sector and possibly worsen the current cash crisis and lead to high inflation. The pressure of funding from the upcoming elections that is coming at a time when the government is already strained from high recurrent expenditures is likely to see further issuances of these TBs. These TBs together with the government's overdraft facility with the RBZ are increasing money supply that is not backed by real cash. With low prospects of getting FDI, the country is likely to see a worsening of the cash crisis unless strong structural reforms on the fiscus are implemented together with an enabling economic and political environment that can attract investors.
- The Tokwe Mukosi dam was finally completed in 2016 and is now the largest dam in the country with a capacity to irrigate more than 25 000 hectares and to generate 15 MW of electricity. This vast irrigation potential will be of much benefit to companies like Hippo Valley Estates which have in prior years suffered from lower production due to irrigation challenge

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