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

Investor Note

Mid-Term Monetary Policy Statement February 2017

04 August 2017

Executive Summary

The Mid Term Monetary Policy Statement was presented under the theme, **Produce and Create.** The policy statement generally looked at the supply side funding initiatives measures that the central bank put in place to propel the economy which include but are not: the export finance facility, business linkages fund, tourism support facility, cross border facility, gold support facility, women empowerment fund, youth empowerment fund, fund for people with disabilities and the horticulture support facility. The statement also focused on ways of enhancing foreign exchange inflows as well as efficient utilization together with retaining the same. It was also highlighted that the mismatch between demand and supply of foreign exchange has caused premiums between local dollars and foreign exchange ranging between 5%-25. The first half of the year 2017 witnessed a turnaround of the national economy at a time when inflation, underpinned by an expansionary fiscal policy stance, crept out of deflation in February 2017 after two and a half years of a prolonged episode of negative inflation to reach 0.31% in June 2017. The economy is thus expected to grow by 3.7% in 2017 largely driven by agriculture, mining and tourism. Below are some of the highlights of the Midterm Monetary Policy Statement:

Monetary Policy Statement Highlights:

Financial sector stability

- **Aftrades** as Lender of Last Resort**-**The Afreximbank Trade Debt-Backed Securities (Aftrades) facility of US$200million has been a game changer in revitalising banking sector stability in Zimbabwe. Total trades under this facility amounted to US$981 million from the effective date of the facility on 13 February 2015 to 30 June 2017.
- **Multi-Currency System-**The multi-currency system which was adopted by Government in 2009 is here to stay up until the economic fundamentals for the return of the local currency have been attained.
- **ZAMCO-**The Zimbabwe Asset Management Corporation (ZAMCO) has lived to the Bank's expectation to reduce the non-performing loans (NPLs) in the banking sector

from 20.45% in 2014 to 7.98% as at 30 June 2017 through the acquisition, management and restructuring of NPLs. The reduction in NPLs is gravitating towards the Bank's desired benchmark of between 5 - 7.5%. ZAMCO has significantly stabilised the banking sector after acquiring NPLs of $568.3 million from all banks as at 30 June 2017.

- **Credit Registry System-**The uploading of bank loan records to the registry is almost complete following successful implementation of the Credit Registry. As at 30 June 2017, banking institutions had submitted 361,154 or 97.06% of banking sector loans. Inquiries made by the subscribers have continued to increase since access to the Credit Registry began in May 2017. From 5 May 2017 the cumulative inquiries increased from 43 to 15 649 in 30 June 2017. - *Our view is that this initiative will reduce the NPLs in the economy thereby fostering the much need growth and development.*
- **Collateral Registry**-The passage of the Movable Property Security Interests Bill through Parliament and Senate during the first half of 2017 was a significant milestone towards the enhancement of the credit infrastructure pillar for financial inclusion.- *Our view is that the collateral registry system will assist in reducing the credit default risk in the entire banking system.*
- **Basel II/III**-Banking institutions have significantly aligned their risk systems and capital strategies with the Basel II capital framework. Embracing the Basel II capital framework as a minimum guide is necessary to improve the quality, consistency and transparency of capital, and reduce procyclicality, as well as enhance liquidity management. Going forward, the Bank shall continue to engage banking institutions and provide guidance as well as training on Basel II/III implementation.- *Implementation of Basel III will align our banking sector to the international standards which will enhance the risk systems of the entire banking sector*.
- **International Financial Reporting Standard 9** -January 2016 Monetary Policy Statement regarding the adoption and implementation of IFRS 9, banking institutions have continued to enhance their systems towards effective compliance with the Standard, whose effective date is 1 January 2018. To ensure effective and smooth implementation of the standard, collaborative efforts between the Reserve Bank, banking institutions, Public Accountants & Auditors Board, Institute of Chartered Accountants Zimbabwe, and accounting firms have gathered momentum. – *Our view is that adoption of the IFRS 9 will also align the country's financial system to developments taking place in the globe.*

Foreign Exchange Management

- Total foreign currency receipts for the country amounted to USD2.96 billion during the period January to June 2017 In line with the current foreign exchange management framework, USD2.1 billion was utilised for various foreign payments through banks. The balance of USD887 million (30%) was received and administered by the Reserve Bank through the Foreign Exchange Management System.- *It is our view that the US$2.1 billion that was managed through the foreign exchange management system is a significant figure since it accounts for about 80% of the foreign receipts generated during the period under review. This arguers well with strategy of allocative efficiency which the country greatly needs in times of limited resources like the prevailing ones.*
- **Export incentive scheme**-Since inception of the scheme, cumulative foreign currency receipts amounted to US$4.9 billion, 4% 16 higher than the same period prior to the introduction of the export incentive scheme. This indicates a positive impact that EIS has had on foreign currency receipts, particularly from exports that went up by 14%- *Although the EIS seems to be achieving the desired goals our view is that a supply side solution is necessary at this point in time rather than a monetary solution*.
- **Financial Inclusion strategy** (FIS)- In addition, an Educational Loan facility which will be administered through six participating institutions has been put in place. The facility is targeted at the 125,000 students at the 21 universities in Zimbabwe- *Our view is that the measure will go a long way in developing the country's human capital*.
- **Export Credit Guarantee**-The extension of credit insurance and guarantee facilities by the Export Credit Guarantee Corporation (ECGC) has significantly contributed to financial inclusion and the promotion of exports by SME- *This measure will bolster the country's export receipts*

Financial Sector Developments

- The performance of the banking sector was satisfactory over the half year to 30 June 2017. Total assets were $9.65 billion, while capitalisation and profitability indicators reflect improved performance.
- The aggregate core capital increased by 1.81% from US$1.22 billion as at 31 March 2017 to US$1.24 billion as at 30 June 2017, on the back of improved earnings

performance. The capital adequacy and tier 1 ratios of 26.89% and 24.02% as at 30 June 2017, respectively, were above the required minima- *Adequate capitalisation by all banks reduces systemic risk that may emanate as a result of failure of one bank.*

- The net profit for the half year ended 30 June 2017 amounted to $100.59 million, representing an increase of 47.99%, from $67.97 million reported in corresponding period in 2016. Eighteen (18) out of nineteen (19) operating banking institutions recorded profits during the period ended 30 June 2017.
- The average prudential liquidity ratio for the banking sector of 66.87% as at 30 June 2017, was above the regulatory requirement of 30%. The high average prudential liquidity ratio is largely reflective of the cautious lending approach adopted by banking institutions especially under the context of foreign exchange shortages.
- Banks reduced lending rates as at 30 June 2017, the average maximum effective lending rate was 11.94% compared to 15.7 % as at the end of December 2016.- *The reduction of lending rates is critical for the development of the economy since it results in cheaper cost of borrowing which in turn results in a decline in the average cost of production in the economy.*
- **Microfinance Institutions**- The microfinance sector registered an increase in total assets (6.13%) and total loans (4.34%) to $291.89 million and $215.24 million, respectively, during the quarter ended 31 March 2017.
- The top 20 microfinance institutions account for 84.91% of total sector loans. The number of active accounts in the sector were 257,498 as at 31 March 2017, down from 290,552 as at 31 December 2016.
- Deposit-taking MFIs' total assets grew by 57.85% over the year, from $53.50 million as at 31 March 2016 to $84.45 million as at 31 March 2017, while total loans increased by 9.75% from $44.62 million as at 31 March 2016 to $48.97 million as at 31 March 2017.
- While the microfinance sector continues to face high credit risk, the portfolio quality for the entire industry, as measured by the Portfolio at Risk (PaR>30 days) ratio, has improved since December 2012 from a peak of 25.20%, to 7.52% as at 31 March 2017, against international best practice of 5%.
- Cognisant of the catalytic role that microfinance institutions play in poverty reduction and financial inclusion, the Reserve Bank issued Circular No. 02/2017 to all microfinance institutions requiring them to align their lending rates to ensure that the effective lending rate, inclusive of all administrative costs, does not exceed 10% per month.

Money and Capital Markets Development

Monetary Developments

- Annual broad money supply amounted to $6 200.3 million in May 2017, representing an annual growth rate of 23.24% from the US$5 031.3 million recorded in May 2016. Broad money, however, continued to be dominated by deposits that are short-term in nature.- *The short term nature of the deposits is detrimental to the performance of the economy since critical sectors like mining & agriculture generally require long term loans. We can therefore tentatively conclude that the growth in the money supply was not quality growth.*
- Domestic credit recorded an annual increase of 21.10%, from $6 978.7 million in May 2016 to $8 451.4 million in May 2017. The growth was largely due to a 38.67% annual expansion in net credit to Government- *Increased government borrowing is detrimental to the development of the economy since it naturally inhibits or slows down capital projects as the government will be servicing the debts. It also increases the country's risk premium.*
- **Money Market Liquidity**- During the first half of 2017, monthly RTGS account balances averaged US$1 421.9 million, compared to US$768.9 million over the same period in 2016
- **Treasury Bills-** The stock of treasury bills and bonds as at 30 June 2017 amounted to $2.5 billion. The bulk of these TBs were issued for expunging the Banks's legacy debt under the Reserve Bank Debt Assumption Act. t is evident from this utilisation analysis that TBs have substantially been developmental in nature and productive in as far as the final beneficiaries of the TBs were private sector firms that were owed by Government for various services rendered. Such payments assisted the firms to resuscitate their business operations.
- Tenor of government securities- Around 73% of the total outstanding Government domestic debt instruments mature beyond 365 days, leaving a balance of 27%, which matures within 365 days
- **Bond Market**- The first debt listing on the Zimbabwe Stock Exchange (ZSE) in 20 years was undertaken by Getbucks in April 2017, after Securities Exchange Commission (SECZ) approved the listing of debt securities on the ZSE in June 2016. Listing of securities promotes the standardization and flow of information through disclosure requirements, which in turn enhances the price discovery process and improves transparency in prices.

- **Zimbabwe Stock Exchange (ZSE)**- Bullish sentiments were experienced on the local bourse during the first half of 2017. The mainstream industrial index gained 35.6% to 195.97 points, whilst the resources index put on 19.3% to 69.79 points as at 30 June 2017. Total market capitalization increased by 42.1% to US$5.70 billion as at 30 June 2017, in line with the increase in both the industrial and mining counters - *Our view is that the stock market gained as a result of developments that were taking place in the informal currencies market where the local dollars were traded at a discount to the foreign exchange.*

Policy Measures

The following policy measures are expected to address investor confidence, efficient allocation of foreign exchange, stabilisation of the country's nostro position, export competitiveness, stabilisation of the financial sector and the promotion of a savings culture and efficient circulation of money.

- **Establishment of a Portfolio Fund-** The Central Bank has noticed that repatriation of foreign exchange for securities related transactions is taking a long time to be processed by banks despite such transactions being on the first category of the priority list for the allocation of foreign exchange. In order to address this challenge, the Bank is establishing a Zimbabwe Portfolio Investment Fund ('the Fund") to facilitate the efficient repatriation of portfolio related funds to foreign investors invested specifically on the Zimbabwe Stock Exchange (ZSE).

  (i) The Fund shall initially focus on the collection and repatriation of foreign funds related to portfolio equity purchases and sales, with the scope of the Fund to include the repatriation of dividends at a later date. Such dividends would then be serviced on a pro-rata basis.

  (ii) Opening of a dedicated Portfolio Investment Fund at two designated commercial banks for the receipt of all portfolio investment proceeds into Zimbabwe and the repatriation of foreign investors' proceeds from the ZSE. The Bank shall place an initial seed capital of US$5 million in this Fund to kick-start the repatriation mechanism and improve investor confidence.

  (iii) The Bank shall have an oversight role for monitoring purposes and to maintain integrity and transparency in the functioning of the Fund.

  Our view, is that although the initiative will assist in improving investor sentiment the initial seed capital of US$5 million is on the low side given the volume of transactions carried out by foreigners on the ZSE.

- **Nostro Stabilisation Facility-**RBZ has negotiated for an enhanced nostro stabilisation facility of US$600million from Afreximbank to manage the cyclical nature of Zimbabwe's foreign exchange receipts. This facility shall be available for drawdown after the closure of the tobacco selling season by the end of August 2017. Together with the efficient foreign exchange measure in (3) below, this nostro stabilization facility shall ensure that the revival of firms is strengthened and that critical imports of fuel and electricity are assured.- *Our view is that although US$600 million is relatively low compared to the country's annual imports this measure will g enhance international payments for Zimbabwe (this is one of the main challenges facing the country at the moment). The country managed to partially solve the local trading through introduction of Bond Notes however the key challenge has been the foreign trading (which it now appears to be solving)*
- **Efficient Utilisation of Foreign Exchange-** In order to ensure that the nostro stabilisation facility is supported by a continuous stream of export receipts, and by so doing, improve the efficient utilisation of foreign exchange and bring equity in the foreign exchange market, foreign exchange receipts from platinum and chrome shall be treated in the same manner as gold, diamonds, tobacco and cotton. This policy measure, which is with immediate effect, is consistent with best practice in other jurisdictions that include Angola and Nigeria where fuel foreign exchange receipts are managed by the central banks, just like what diamonds are to the Bank of Botswana and copper to the Bank of Zambia.- *Although this measure may increase the allocative efficiency of foreign exchange the players (ie various miners) need to be involved in the process in a manner which will not leave the players short changed otherwise the revenues collected from the miners may dwindle as players protest the move by the Central Bank.*
- **Standby Facility to Support Export Competitiveness-** Like other countries the Central Bank subscribes to this philosophy of "Export, Subsidise or Die" strategy in noting that foreign exchange is a critical factor of production especially under the context where foreign exchange is also a domestic currency in Zimbabwe within the multi-currency system. The Bank found it imperative to extend and enhance the export incentive scheme by US$300 million under a standby liquidity support from Afreximbank. The Standby Liquidity Support, which is separate from the Nostro Stabilisation Facility, shall be used to back the bond notes that are going to be issued to monetise this subsidy scheme. As like under the US$200 million facility, the Bank will release the bond notes into the market on a drip-feed basis.

- **Aftrades as Lender of Last Resort-** Following the maturity and full settlement of the US$200 million initial African Export-Import Bank Trade Backed Securities (Aftrades) on 13 February 2017 and the positive impact it had on the interbank market, the Bank has renewed the facility at an enhanced level of US$400 million for another two years to mature in 2019- *Our guided view is that this facility will continue to offer a cushion to the banking sector thereby enhancing stability of the banking sector.*
- **Export of Cash-** The carrying of foreign currency cash on person per exit from Zimbabwe has been reviewed to an equivalent of US$2000 per individual per exit. Amounts in excess of this amount require prior authorisation from Exchange Control through normal banking channels
- **Addressing the Inefficient Circulation of Money-** The current stock of money in circulation in Zimbabwe is made up of bond coins ($25 million), bond notes ($175 million) and multi-currencies dominated by the U.S. dollar at approximately $800 million, to give a total of around $1 billion. This quantity of money in the economy is quite sufficient to support the usable bank balances, as measured by the RTGS balances, currently sitting at around $1.6 billion within the banking system. The amount of money in circulation is around 62.5% of RTGS balances and/or 15.5% of the total deposits as measured by M2 of around $6.2billion. For all intents and purposes, and in line with international best practice, the money in circulation in the Zimbabwean economy is sufficient to support money supply as measured by M0, M1 or M2. What therefore makes the situation in Zimbabwe unique is that money in the economy is not circulating efficiently within the formal economy. Its confined to the informal sector and/or the parallel markets.

- **Savings Bonds-** To encourage individuals, families, households, small and medium enterprises, schools, universities, public and private institutions, corporates, churches and investors in general, to start saving and to nurture a culture of saving and building national wealth the Bank has developed a savings bond which offers simplicity and guaranteed returns with minimum investment from as little as $100 with no commission, agency or service fees- *Our view is that the savings bond will help in creating a saving culture which is necessary in any functional economy. We believe objective of enhancing savings will be met because the returns are lucrative: 7% compared to Money Market rates which have a return of 4%-5% per annum.*

- **Transformation of the Status of IDC-** Sustainable development in the next 15 years starting 2015 to 2030, following the adoption of the Sustainable Development Agenda in the form of the 17 Sustainable Development Goals (SDGs) to which

Zimbabwe is a signatory, is being largely underpinned by innovative domestic financing, through Central Banks and Development Finance Institutions (DFIs), the world over. In Zimbabwe, while we have the Infrastructure Development Bank of Zimbabwe (IDBZ) and Agribank, both falling under RBZ supervision as DFIs, supporting infrastructure and agriculture development, respectively, there is an apparent vacuum of a similar institution operating to support industrial development. However, a relook at the mandate of the Industrial Development Corporation of Zimbabwe (IDC), shows that it was created as a DFI for industrial development, even though it has largely not operated as such, but has to a large extent become a player and competitor in the private sector space.- *This noble move will be successful if it gets complementary development from various sectors like agriculture and mining since most of the countries industries depended on input from those sectors.*

- **Reduction of Licence Fees for Authorised Dealers with Limited Authority-** The Bank recognises Diaspora remittances as a key and reliable source of liquidity for the country and continues to find ways to improve the remittances market. In an effort to enhance the ease of doing business and increase competition in the remittances market, the licence fees for Authorised Dealers with Limited Authority (ADLAs) have been reviewed downward with effect from 1st August 2017. The new fees are shown below:

	Old Fees ($)		**New Fees ($)**	
	Initial	**Renewal**	**Initial**	**Renewal**
Head office	1000	800	500	250
Branch	400	200	200	100
Rural Branch	200	100	50	50

The reduction in the fees will have an impact of lowering the entry costs into the industry thereby allowing more players to enter the industry. The increased number of players will give people in the diaspora a wider network for which they can use to transfer money back to Zimbabwe.

- **Efficient and Effective Management of Foreign Exchange-** In order to ensure the efficient and effective utilisation of foreign exchange, Authorised Dealers are being reminded to continue to exercise financial discipline and integrity in the allocation of foreign exchange among competing demands. In this regard, Authorised Dealers should prioritise the importation of raw materials and other inputs, critical for increasing local production and exports, a key component for the revival of the national economy

- **Diaspora Remittances Incentive (DRIS)-** The Diaspora Remittances Incentive (DRIS) has attracted international remittances to flow through formal channels, but informal remittances are still high. The remittances market also has a high appetite for cash as the majority of recipients are not banked. In order to enhance financial inclusion for remittances recipients, the Bank shall increase the DRIS for remittances received through banking or wallet accounts from 3% to 10%, with effect from August 2017. The incentive for Money Transfer Agencies and remittances received as cash shall remain at 2% and 3%, respectively.

Conclusion

The major conclusion to be derived from this Monetary Policy Statement is the need to change the cash shortages narrative to foreign exchange shortages. Basically the theme of the MPS was on the enhancement of foreign exchange inflows as well as efficient to utilisation of the foreign exchange. Although the measures highlighted in the MPS are noble they need to be complemented with robust supply side measures in the various sectors of the economy like the mining sector and the agriculture sector.

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