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IMF Executive Board Concludes 2009 Article IV Consultation with Zimbabwe

On May 4, 2009 the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Zimbabwe.¹

Background

Economic and social indicators in Zimbabwe worsened significantly in 2008. Real Gross Domestic Product (GDP) is estimated to have fallen by about 14 percent in 2008 (on top of a 40 percent cumulative decline during the period of 2000–07) due to economic disruptions caused by hyperinflation and a further significant deterioration in the business climate. Poverty and unemployment have risen to catastrophic levels, with 70 percent of the population in need of food assistance and a cholera epidemic claiming more than 4,000 lives.

In 2008, quasi-fiscal activities undertaken by the Reserve Bank of Zimbabwe (RBZ) increased in the context of weak RBZ governance. They are estimated at US\$1.1 billion (36 percent of GDP) in 2008, and included election-related expenses, transfers to parastatals, subsidized directed lending, subsidized provision of equipment and fertilizers to farmers, and allocation of foreign exchange at subsidized exchange rates. Besides monetization, these activities were financed by surrender requirements on export proceeds, the retention of foreign exchange earnings of the gold and agricultural sectors in excess of mandatory surrender requirements, a

¹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Chairman of the Board summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

freeze of most foreign currency deposits, external borrowing, and purchases of foreign exchange at the parallel market exchange rates. These large operations unrelated to central banking core activities were conducted in the context of weak oversight of RBZ operations. Key governance weaknesses include lack of enforcement of the RBZ Act's accountability requirements and noncompliance with the International Financial Reporting Standards.

The central government's revenue and expenditure effectively collapsed in 2008. With economic decline and hyperinflation eroding the real value of accrued tax liabilities, budget revenue fell from almost US\$1 billion (25 percent of GDP) in 2005 to US\$133 million (4 percent of GDP) in 2008. Expenditure shrank from about US\$1.4 billion (37 percent of GDP) in 2005 to US\$258 million (8 percent of GDP) in 2008 causing an almost complete collapse in the provision of public services, including a significant reduction in electricity generation capacity, collapse of water supply, and major disruptions in railway services.

Unprecedented hyperinflation led to the disappearance of the local currency and a contraction of the financial system in 2008. Fueled by the monetization of the RBZ's quasi-fiscal operations, twelve-month CPI inflation is estimated to have peaked in September 2008 at almost 500 billion (10⁹) percent. Since October–November 2008, the local currency has virtually disappeared from circulation and dollarization has gained momentum. The banking system shrank, as reflected in deposits that declined from almost US\$1 billion at end-2005 to about US\$300 million (of which local currency-denominated deposits amounted to an equivalent of US\$6 million) at end-2008.

With the demise of the Zimbabwe dollar hyperinflation has stopped. De facto dollarization was recognized by the official transition to use of hard currencies for transactions and adoption of the rand as the reference currency in early 2009. Under this monetary system, transactions in hard currencies are authorized, payments of most taxes are mandatory in foreign exchange, trading at the Zimbabwe Stock Exchange is conducted in foreign exchange, and many foreign exchange restrictions on current account transactions are liberalized. During January–February 2009, the CPI in U.S. dollar terms experienced a decline.

The short-term macroeconomic outlook is uncertain. The government's short-term emergency recovery program and the revised 2009 budget contain a number of important macroeconomic and structural policy commitments which, if fully implemented and supported by donor assistance, could lay the foundation for a private sector-led economic recovery in a low-inflation environment. However, there are significant downside risks to the economic recovery due to potential policy reversals.

Executive Board Assessment

A decade of high inflation, severe economic decline, and rising poverty has culminated in an acute, ongoing humanitarian crisis. Directors considered that Zimbabwe is now at a critical juncture. They welcomed the efforts by the recently formed government of national unity to seize the historic opportunity to improve prospects for economic growth and poverty reduction by forging the necessary political consensus among all stakeholders for ambitious reforms.

Directors welcomed the authorities' Short-Term Emergency Recovery Program (STERP) that is based on sound principles of macroeconomic management. They underscored that following through with the STERP's commitment to establish fiscal discipline, eliminate quasi-fiscal activities, maintain a multi-currency monetary framework, and accelerate structural reforms would be essential for an economic turnaround in a low-inflation environment. However, Directors cautioned that downside risks were significant. Potential political instability and limited implementation capacity may undermine reform and stabilization efforts, weakening the prospects for mobilizing donor financial support and attracting private capital inflows.

Directors underscored the importance of establishing fiscal discipline while ensuring the delivery of essential public services. They were encouraged by the authorities' intentions to improve tax administration and review the tax regime to increase budget revenues. Directors emphasized that the budgeted wage bill needs to be maintained and spending pressures from parastatals to finance nonessential activities should be resisted to leave sufficient resources for critical social needs and infrastructure. They also called for rapid progress in strengthening the public financial management system. Given the sizable unfilled financing gap and the necessity to cover critical humanitarian expenses, Directors encouraged the authorities to intensify their efforts to establish workable budget aid delivery mechanisms in close cooperation with the donor community. Directors noted that Zimbabwe is in debt distress and large financing gaps would persist over the medium term even if policies were improved.

Given the circumstances, Directors supported the authorities' decision to anchor inflation expectations by introducing a multi-currency system with the rand as the reference currency. They also emphasized that a significant strengthening of governance and transparency, including through an independent audit, at the Reserve Bank of Zimbabwe is urgently needed to enhance the credibility and durability of recent macroeconomic policies. Directors concurred that reintroduction of the national currency should await the establishment of a credible institutional framework that would underpin central bank operations with a focus on price stability.

Directors noted that banking system issues need to be addressed to improve payment services and access to credit. They underscored that the payments system, banking supervision, and liquidity management would need to be attuned to the requirements of the multi-currency monetary framework.

Directors underscored that the revival of the economy depends critically on quickly attracting private domestic and foreign investors and improving competitiveness. It is essential that the government ensures the protection of property rights, maintains the rule of law, guards against protectionism, and pursues prudent wage and income policies. Directors emphasized that recent commendable efforts to liberalize prices and exchange restrictions for current account transactions needed to be sustained. They also stressed the importance of improving the quality and timeliness of data.

Directors observed that a track record of sound policy implementation, supported by targeted technical assistance, including related statistics, from the Fund and other international financial institutions, is a critical first step to securing donor financial support for the reconstruction of Zimbabwe's economy and regularizing its arrears to official creditors.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Zimbabwe: Selected Economic Indicators, 2007–09

	Estimated		Proj.
	2007	2008	2009
Real GDP growth (annual percent change)	-6.9	-14.1	2.8
Nominal GDP (US\$ millions)	3,553	3,180	3,498
Inflation (annual percent change)			
Consumer price inflation (annual average) 1/	10,452.6	556*10 ⁸	6.9
Consumer price inflation (end-of-period) 2/	108,844.1	489*10 ⁹	...
Central government (percent of GDP, measured in US\$)			
Revenue	5.7	4.2	25.2
Expenditure and net lending	10.8	8.1	35.7
Quasi-fiscal activity by RBZ	22.9	35.7	0.0
Primary balance (including quasi-fiscal activity)	-24.5	-35.2	-5.9
Overall balance (including quasi-fiscal activity)	-28.0	-39.6	-10.5
Money and credit (US\$ millions) 3/			
Broad money (M3)	603.1	313.9	513.0
Net foreign assets	61.0	-707.0	-650.7
Net domestic assets	542.1	1,020.9	1,163.7
Reserve money	51.7	6.8	58.1
Velocity (M3)	5.9	10.1	6.8
External trade (US\$ millions; annual percent change)			
Merchandise exports	4.8	-8.5	-8.1
Merchandise imports	-3.8	24.4	0.4
Balance of payments (US\$ millions; unless otherwise indicated)			
Merchandise exports	1,804	1,651	1,518
Merchandise imports	-2,113	-2,630	-2,641
Current account balance (excluding official transfers)	-383	-906	-666
(Percent of GDP)	-11	-28	-19
Overall balance	-647	-612	-1,090
Official reserves			
Gross official reserves (US\$ millions; end-of-period)	58.0	5.8	5.8
Gross official reserves (months of imports of goods and services)	0.3	0.2	0.2
Debt			
Total external debt (US\$ millions; end-of-period) 4/	5,285	6,027	6,719
Total external debt (percent of GDP; end-of-period) 4/	149	189	192

Sources: Zimbabwean authorities; IMF staff estimates and projections.

1/ For 2008, annual average January–September 2008.

2/ For 2008, inflation at end-September 2008.

3/ Zimbabwe dollar values converted into U.S. dollars at the UN exchange rates at end-2007 and end-2008.

4/ Including arrears and estimated interest charges on arrears.