EXECUTIVE BOARD MEETING

SM/20/43

February 12, 2020

To: Members of the Executive Board

From: The Secretary

Subject: **Zimbabwe—Staff Report for the 2019 Article IV Consultation**

Board Action:	Executive Directors' **consideration** (Formal)
Tentative Board Date:	**Monday, February 24, 2020**
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Questions:	Mr. Leon, AFR (ext. 36115) Mr. Hobdari, AFR (ext. 36276)
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***Unless an objection from the authorities is received prior to the conclusion of the Board's consideration, the document will be published.**

ZIMBABWE

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION

February 12, 2020

KEY ISSUES

Context. Zimbabwe is experiencing an economic and humanitarian crisis. High fiscal deficits financed by RBZ money creation resulted in severe macroeconomic imbalances and market distortions. The government that came to office following the 2018 elections adopted an agenda focused on macro stabilization and reforms. This was supported by a Staff Monitored Program, adopted in May 2019, but is now off-track as policy implementation has been mixed: progress on fiscal reforms was overshadowed by costly missteps on monetary and FX market reforms. Climate shocks have crippled agriculture and electricity generation and magnified the social impacts of the fiscal retrenchment and currency reform, leaving more than half of the population food insecure. Protracted external arrears constrain access to external official support, while additional commercial borrowing has worsened the debt overhang and likely complicated discussions on debt resolution.

Outlook. With another poor harvest expected, growth in 2020 is projected at near zero, following a sharp contraction in 2019, with food shortages continuing. With no progress on clearing longstanding external arrears, the authorities face a difficult balance of pursuing tight monetary, to reduce very high inflation, and fiscal policies to address the macroeconomic imbalances and build confidence in the currency, while averting a crisis.

Risks. Pressures are mounting to increase spending on wages and for social protection to mitigate the impact of the weather shocks and high inflation. While the 2020 budget includes a significant increase in social spending, it is likely insufficient to meet the pressing needs. Absent a scaling up of donor support, the risks of a deep humanitarian crisis are high. Risks associated to the absorption of large foreign currency private debt will likely further challenge macroeconomic stabilization and debt restructuring efforts.

Policies. The near-term macroeconomic imperative is coordinated fiscal, FX, and monetary policies to stabilize the economy, while addressing food insecurity. Policies include scaling back low-priority spending to contain pressure for monetary financing of the budget; eliminating quasi-fiscal operations by the central bank; FX reforms to establish a market-determined exchange rate; and operationalizing the money targeting framework. Ensuring a minimum level of social protection will require further reprioritization of spending and engagement with the international community. Reducing governance and corruption vulnerabilities is essential for improving the business environment and ensuring sustained and inclusive growth.

Approved By
David Robinson (AFR) and Jeromin Zettelmeyer (SPR)

Discussions took place in Harare during September 5-17 and December 4-11, 2019. The missions met with H.E. President Mnangagwa, Finance Minister Ncube; Reserve Bank of Zimbabwe Governor Mangudya; other senior government officials; and representatives of the donor community and the private sector. The staff team comprised H. Leon (head), N. Hobdari, T. Lessard, F. Lima (all AFR), D. Gurara (SPR), E. Karlsdóttir (MCM), O. Akanbi (FAD). P. Imam, P. Chishawa, and B. Banda (IMF Resident Representative in Harare office and local staff) assisted the mission. D. Robinson (AFR) and W. Nakunyada (OED) participated in key policy discussions. K. Fabo and S. Ourigou (all AFR) assisted from headquarters.

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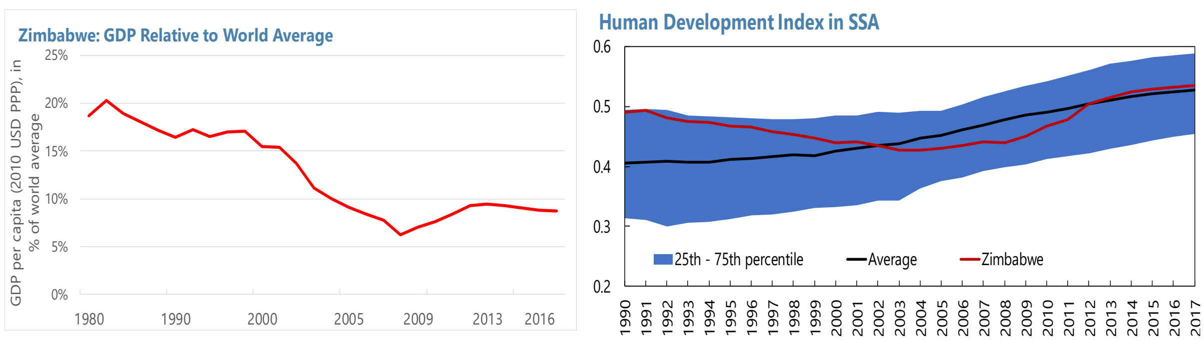
CONTEXT

1. **Economic and social outcomes have fallen behind peers in recent decades**. Economic activity has been on a trend decline since the 1980s, falling particularly sharply in the early 2000s as agricultural production collapsed and relations with the international community deteriorated. Subsequently, high fiscal deficits financed by money printing from the Reserve Bank of Zimbabwe (RBZ) led to hyperinflation and the demise of the (original) Zimbabwe dollar. A period of fiscal restraint, anchored on a strict cash budgeting framework, and robust growth followed full dollarization in late 2008. But large deficits returned in 2016, financed by the RBZ. Income per capita has declined from roughly 20 percent of the global average in the early 1980s to less than 10 percent today. Since independence, human development indicators have barely changed, while most countries in Sub-Saharan Africa made steady and significant improvements (Text Figure 1).

Text Figure 1. Zimbabwe: Growth and Development, 1980–2017

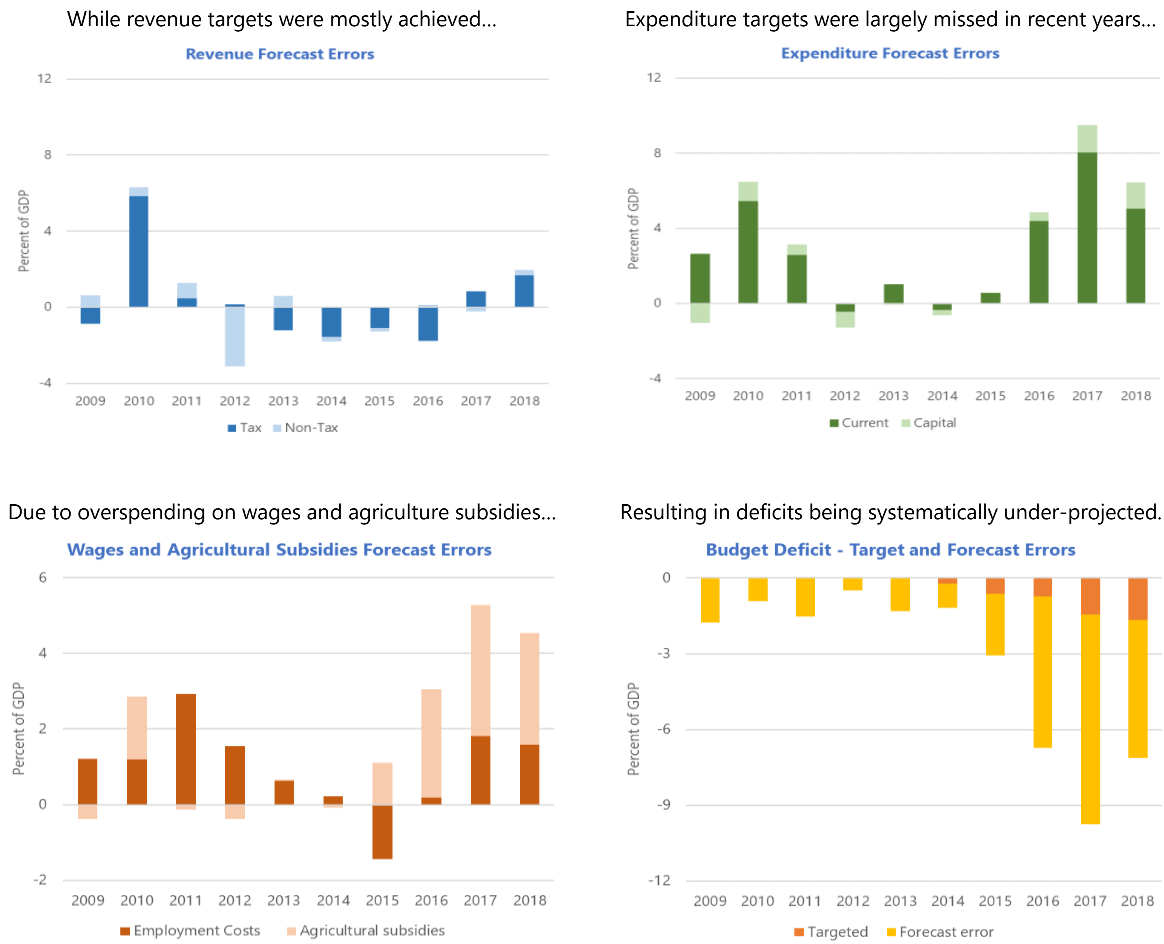


Sources: Zimbabwean authorities and IMF staff estimates. United Nations Development Program.

2. **The resumption of large fiscal deficits financed by issuing quasi-currency instruments that were not convertible created substantial economic distortions, ultimately forcing the authorities to abandon the dollarized system and adopt a new domestic currency in early 2019.** During 2016-18, off-budget quasi-fiscal activities, unbudgeted agricultural programs, and wage bill overruns proliferated, with budget outcomes significantly worse than approved budgets. While revenue forecasts continued to be mostly achieved, actual and budgeted expenditure deviated on average by about 45 percent (Text Figure 2).[1] Strict FX and deposit withdrawal controls were introduced to ration the excess demand for FX at the official 1:1 rate of US$ per RTGS for deposits at banks. The situation became increasingly untenable, with the parallel market premium reaching about 300 percent in early-2019, and in February 20, 2019 the authorities introduced a new domestic currency (the "RTGS dollar" that was later renamed Zimbabwean dollar or ZWL$) and announced the creation of an interbank FX trading market.

[1] By comparison, the average deviation in SSA countries was 1.5 percent, with a standard deviation of 14.5 percent, as calculated from data available in PEFA reports.

Text Figure 2. Zimbabwe: Accuracy of Budget Forecasts, 2009–18



Sources: Zimbabwean authorities and IMF staff estimates.

3. **Policy uncertainty and missteps have limited the development of the economy—export diversification has not occurred and FDI remains well below peers** (Text Figure 3). During 2009–18, gold, platinum, and tobacco accounted for about 60 percent of total export earnings. Further, about 66 percent of Zimbabwe's exports were to South Africa. Annual FDI was 1.6 percent of GDP during 2004–2017, compared to the SSA average of 2.6 percent and well below similarly endowed peers—Zambia attracted 6 percent of GDP during 2004–2017. Weak institutions, policy inconsistencies, and fiscal indiscipline have eroded investors' confidence.[2]

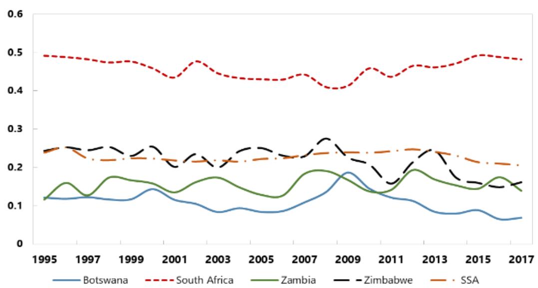
4. **International reengagement has not advanced.** Political reforms have advanced much slower than expected. The authorities have signed into law the Maintenance of Order and Peace Act (MOPA), advanced legislation on Access to Information and Protection of Privacy Act (AIPPA), and are preparing to bring to parliament by mid-2020 an Omnibus Bill aimed at accelerating electoral reforms and aligning all national laws with the 2013 Constitution. There is also concern that

[2] Gwenhamo, Farayi. "Foreign Direct Investment in Zimbabwe: The Role of Institutional and Macroeconomic Factors." *South African Journal of Economics* 79, no. 3 (2011): 211–23.

continued external commercial borrowing at market rates will further complicate the finding of a mutually agreeable resolution to Zimbabwe's debt overhang with its external creditors. A debt reconciliation with creditors, supported by transparency on the terms of all borrowings (including recent collateralized borrowing against future gold and platinum export receipts), is a necessary first step in advancing discussions. Given Zimbabwe's large external arrears, and ineligibility for traditional debt relief mechanisms (e.g. HIPC/MDRI), there is a need to develop, and reach consensus on, affordable solutions to Zimbabwe's debt overhang.

Text Figure 3. Zimbabwe: Diversification and Credit Ratings, 1995–2016

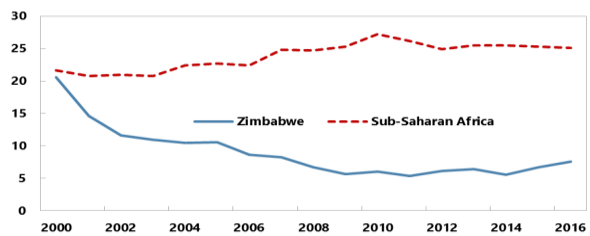
Diversification Index



Note: Diversification index closer to 1 indicates greater diversification.

Source: Staff computations based on UNCTAD STAT

Institutional Investor Country Credit Rating



Note: Countries are rated on a scale of zero to 100, with 100 representing the least likelihood of default.

Source: Staff computations based on Institutional Investor Database

Notes: The above non-IMF indicators provide qualitative information about the indicators listed in these figures, and the accuracy of the indices can be biased by experts' views (instead of facts). They do not represent the IMF's assessment on any of these indicators.

5. **Implementation of past IMF policy advice has been mixed**. The government that came into office after the July 2018 elections adopted in October 2018 a Transitional Stabilisation Programme (TSP) with a focus on macroeconomic stabilization during 2018-20, institutional reforms to support economic growth and human development, and governance reforms to tackle corruption and strengthen the rule of law. Many of the reforms contained in the TSP are in line with past Fund policy advice: strengthening fiscal management, improving the financial stability framework, developing a transparent and better-functioning FX market, and supporting governance reform. As summarized in Annex I and discussed below, the authorities have achieved a significant fiscal adjustment. However, reserve money growth has remained high and the monetary and FX market reforms have not advanced sufficiently. The authorities have also approved reforms for key SOEs, aimed at making them more accountable, transparent, and viable, but other structural reforms have lagged, including on improving the business climate and clarifying agriculture land rights.

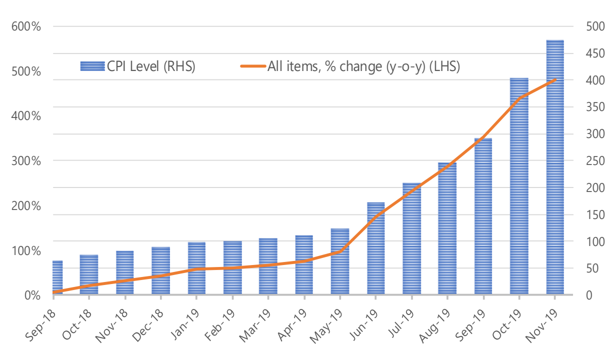
RECENT ECONOMIC DEVELOPMENTS

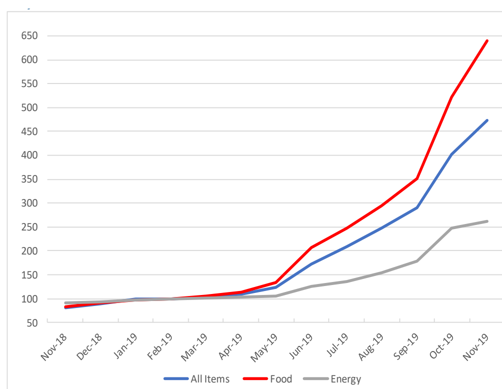
6. **The government's ambitious reform program has resulted in significant adjustment costs, amplified by two large climate shocks.** A substantial fiscal consolidation and the reintroduction of a national currency has created transition costs for a fragile state with limited capacity and negligible access to external concessional financing. The social impact has been

exacerbated by Cyclone Idai[3] and the devestating impact of the ongoing drought that has severely affected agriculture as well as electricity production leading to widespread load-shedding. WFP estimates (in December 2019) that about 8 million people (approximately 60 percent of the population) are food insecure. Donors continue to provide significant humanitarian support, but as of January 2020 only US$240 million, or roughly half of the US$468 million requested under the UN Flash Appeal for Zimbabwe, has been committed.

7. The economy contracted in 2019 and inflation has spiked sharply, increasing poverty. Favorable rains, mining, public sector wage increases, and fiscal support to the agricultural sector helped push real GDP growth to 3.5 percent in 2018. Nevertheless, growth was not sustainable, with agricultural gains fueled by unsustainable government subsidies and little investment for productivity growth. Highlighting Zimbabwe's vulnerability to climate change and environmental shocks, output is estimated to have contracted by over 8 percent in 2019 as the adverse impact of a severe drought on agriculture and electricity generation compounded the contractionary effects of fiscal consolidation.[4] With the overwhelming majority of Zimbabwe's agriculture being rain-fed, and its electricity generation largely dependent on the rain collected at the Kariba dam, the country has little resilience to droughts and other environmental shocks. Inflation remained in low single digits through September 2018, but has jumped sharply since to 521 percent at end-2019 (Text Figure 4), reflecting the sharp exchange rate depreciation from the monetary overhang of past monetary financing of deficits and continued quasi-fiscal activities by the RBZ during 2019, as well as the removal of subsidies on fuel and electricity. Rising inflation is adversely affecting the poor, especially the higher price of maize, with prices for fuel and electricity also having a negative impact. Economic hardship is also eroding human capital, with education and health indicators deteriorating.

Text Figure 4. Zimbabwe: Consumer Price Index by Category, 2018–19
(Index, February 2019 = 100)





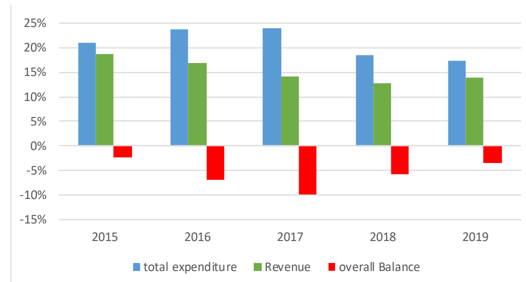
Sources: Zimbabwean authorities and IMF staff estimates.

[3] Cyclone Idai hit Zimbabwe in March 2019 causing damage estimated at about US$1.2 billion (6 percent of GDP).

[4] See Selected Issues Paper for additional discussion.

8. **Given tight financing constraints, the fiscal stance has been tightened significantly under the current administration to contain monetary financing of the deficit and help stabilize the economy** (Text Figure 5). In 2019, revenues were driven by higher inflation but also supported by the new financial intermediation tax and the increase in fuel excises. The government has contained spending well below the supplementary budget allocations, with lower than budgeted infrastructure spending and transfers to provinces, as well as containment of the wage bill. Although quasi-fiscal operations by the RBZ continued during 2019 (see below), the cash deficit of the central government, is estimated to have declined to 3.5 percent of GDP, compared to 4 percent targeted in the budget and 7.5 percent in 2018.

Text Figure 5. Zimbabwe: Revenue, Expenditure, and Deficit, 2015–19
(percent of GDP)

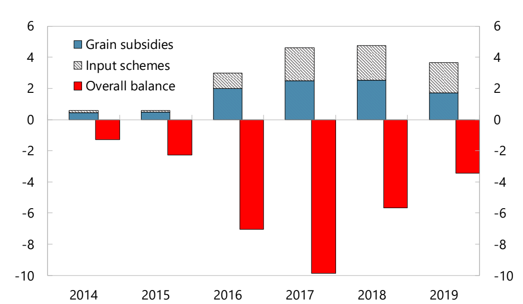


Sources: Zimbabwean authorities.

- **Real public sector wages have fallen drastically** (Text Figure 6). The government's real wage bill increased from 42 to 85 percent of tax revenue between 2010 and 2016, driven by higher compensation. Recent reforms have reduced the government wage bill to the SSA average. With employment growth contained, the adjustment has taken place entirely on the compensation side. Despite several nominal adjustments since January 2018, high inflation has eroded public sector real compensation by more than 80 percent, from about US$5,000 per year in 2016 to less than US$1,000 in 2019. As a result, the wage bill as a share of revenue has declined sharply from 90 percent in 2017 to 72 percent in 2018, and is estimated to have reached 37 percent in 2019, close to the 25th percentile across Sub-Saharan Africa countries and in line with the authorities' medium-term target of 35 percent of tax revenue.

- **Agriculture spending has remained high despite the changes in 2019 to the financing of the agriculture input schemes.** In response to a significant drought in 2015 agriculture spending has spiked (to nearly 5 percent of GDP in 2018), reflecting an increase in grain subsidies and the introduction of Command Agriculture intended to ensure food security (Text Figure 7). However, the effectiveness of the multiple agricultural schemes has been very low, as governance challenges, poor targeting, and structural barriers to agricultural growth potential hold the sector back (see Selected Issues Paper (SIP)). Starting with the 2019/20 agriculture season, the financing of inputs under the command agriculture program has been transferred to the banking system. However, risks to the budget remain high as the government provided a full guarantee against credit default.

Text Figure 7. Zimbabwe: Agriculture Spending, 2014–19
(in percent of GDP)

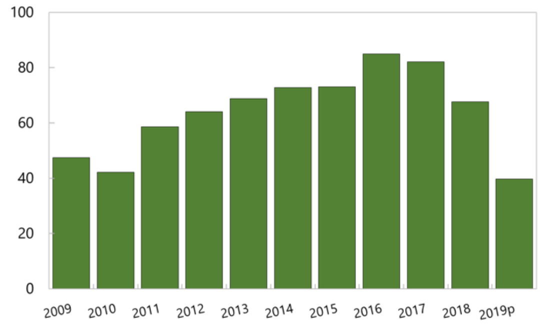


Sources: Zimbabwean authorities.

Text Figure 6. Zimbabwe: Government Wage Bill 2009–19

The last decade saw a large expansion of government wage bill…

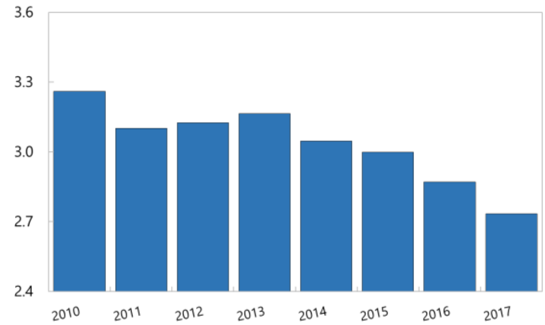
Zimbabwe: Public Wage Bill
(Wage bill to tax revenue ratio)



Sources: Zimbabwean authorities, and IMF staff calculations and projections.

although public employment remained on a downward path.

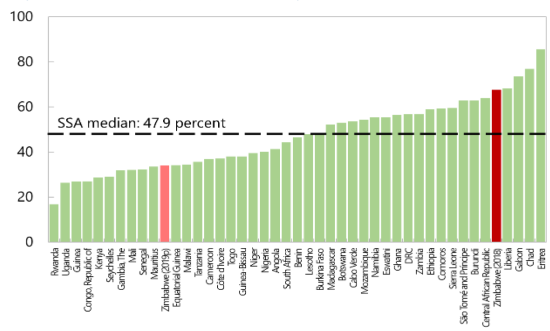
Zimbabwe: Public Employment
(Employment to working age population ratio)



Sources: Zimbabwean authorities, and IMF staff calculations.

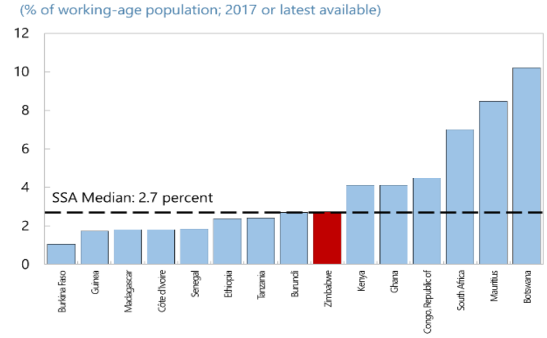
Recent reforms brought the government wage bill back to a sustainable position…

Sub-Saharan Africa: Government Wage Bill
(% of tax revenue; 2018 or latest available)



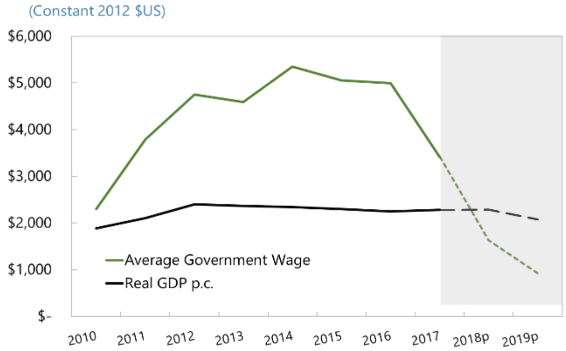
while public employment remains in line with peer countries.

Sub-Saharan Africa: Public Employment
(% of working-age population; 2017 or latest available)



The large disparity between public and private sector compensation has been reduced…

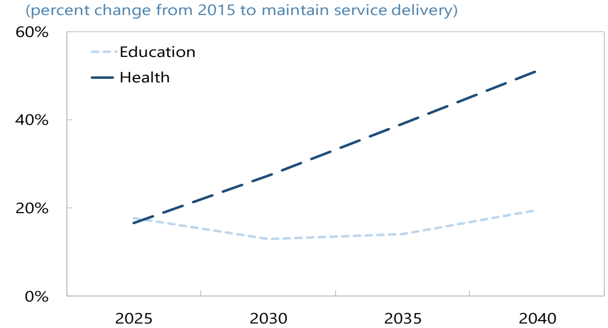
Zimbabwe: Government Wages and GDP per capita
(Constant 2012 $US)



Sources: Zimbabwean authorities, and IMF staff calculations. Government wages exclude uniformed forces.

Which will help accommodate pressures from future demographic trends.

Zimbabwe: Public Employment Growth Projections
(percent change from 2015 to maintain service delivery)



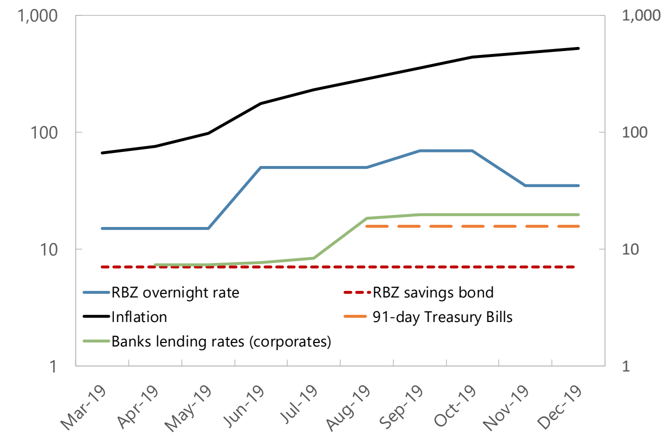
Sources: Zimbabwean authorities, UN, and IMF staff projections.

Sources: Zimbabwean authorities and IMF staff estimates

9. Reserve money rose sharply in the second half of 2019 owing to the resumption of quasi-fiscal operations by the RBZ. While reserve money remained broadly stable during the first half of 2019, it nearly tripled during the second half of the year, estimated to have reached ZWL$9 billion at year end compared to ZWL$3.3 billion as of end-June. This reflects the resumption of quasi fiscal operations by the RBZ that were not sterilized, including: the discounting in July 2019 of a 1½ percent of GDP USD Treasury Bill held by a domestic firm (Sakunda); provision of FX to fuel importers at below market rates to contain the increase of the retail fuel price (discontinued since October); and the introduction in September of an export incentive for gold purchases financed by reserve money expansion of about ZWL$400 million/month. Reserve money has also been very volatile, as the new quantitative monetary targeting framework that the RBZ announced at the time of the currency reform has not been operationalized, effectively leaving the market without a credible nominal anchor. Domestic interest rates remain well below inflation (Text Figure 8).

Text Figure 8. Zimbabwe: Domestic Interest Rates

(in percent, log scale)

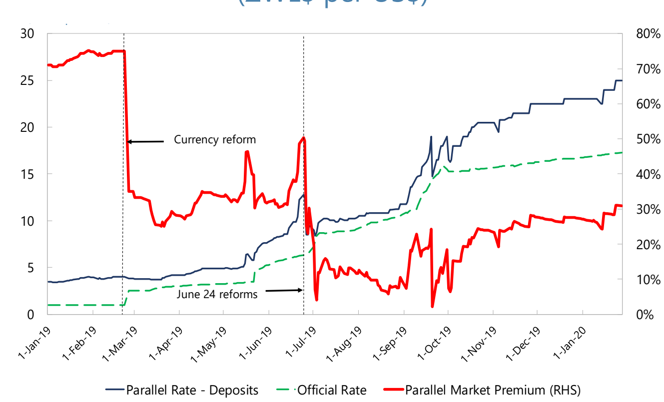


Sources: Zimbabwean authorities.

10. Distortions in the FX market remain significant. After a brief period of relative stability around mid-2019, the parallel exchange rate depreciated sharply following the massive expansion of reserve money. At end-January 2020, the parallel exchange rate was around 25 ZWL$/US$, compared to 10-11 during July and 3.5 when the new currency was introduced in February. The parallel market premium has also increased and is now over 30 percent, from about 10 percent before the reserve money shock in mid-2019 (Text Figure 9). The higher premium reflects additional restrictions placed by RBZ, specifically on trading margins for authorized FX dealers, policy uncertainty, and a lack of publicly available statistics to guide market expectations.

Text Figure 9. Zimbabwe: Official and Parallel Market Exchange Rates,

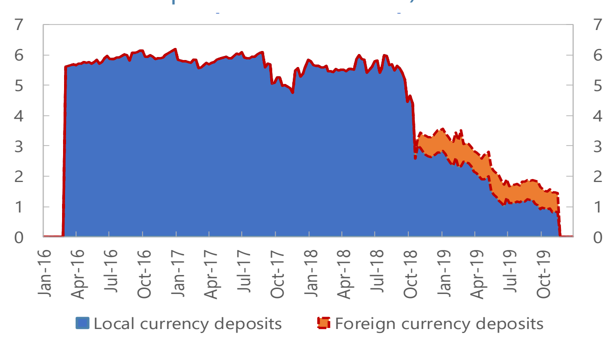
(ZWL$ per US$)



Sources: Zimbabwean authorities and IMF staff estimates.

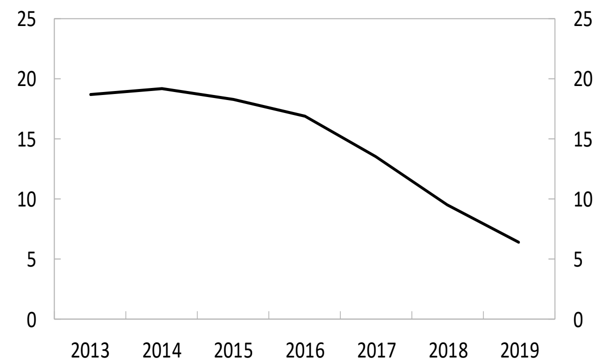
11. The capacity of the banking sector to support growth has been significantly reduced. Conversion of banks' assets and liabilities to ZWL$ at an exchange rate of 1:1 to the US$ in February 2019 caused a sharp shrinkage in banking sector assets (from 58 percent of GDP at end-2018 to 24 percent at end-September 2019) and bank deposits converted into US$ (from 6 to 1.6 billion over the same period) (Text Figure 10). This negatively affects banks' ability to maintain credit lines with foreign banks, to meet corporates' needs for working capital, and to fund the government. Private sector credit as a share of GDP has contracted for 5 consecutive years (Text Figure 11).

Text Figure 10. Zimbabwe: Bank Deposits, 2016–19
(in US$ billion; ZWL$ deposits converted at parallel market rate)



Sources: Zimbabwean authorities.

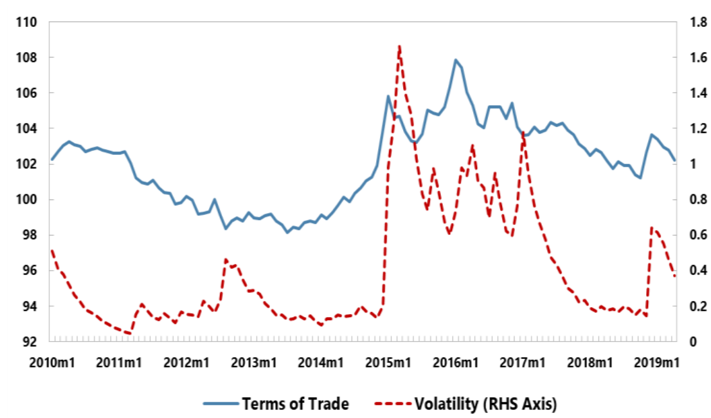
Text Figure 11. Zimbabwe: Commercial Bank Credit to the Private Sector, 2013–19
(in percent of GDP)



Sources: Zimbabwean authorities.

12. The current account recorded a small surplus in the first half of 2019, but reserves remain at critically low levels. The surplus of US$148 million (vs a US$1.2 billion deficit in 2018), reflects import compression from higher fuel prices, FX shortages, and a sharp decline in real disposable income. Terms of trade have also been declining since 2016 (Text Figure 12), from falling tobacco prices and rising oil prices. International reserves have fallen to about one week of imports.

Text Figure 12. Zimbabwe: Terms of Trade, 2010–19

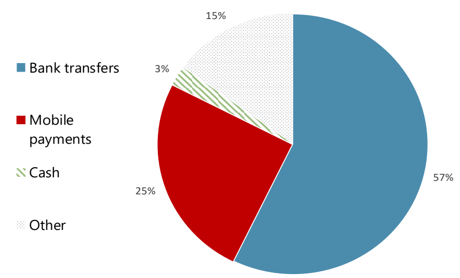


Sources: IMF Research Department and staff estimates.

13. Cash shortage in conjunction with Zimbabwean entrepreneurship has turned mobile payments into the preferred vehicle for payments. Electronic transfers are not subject to restrictions and Zimbabwe has achieved one of the highest usage levels of innovative payment products (mobile payments, cards, etc.) in the region. This has spurred a significant increase in financial inclusion of underserved communities (unbanked population). The value of mobile payments during 2019H1, for example, accounted for 25 percent of the consolidated transaction activities, compared to just 3 percent for cash (Text Figure 13).

Text Figure 13. Zimbabwe: Financial Transactional Activities, 2016–19

(in US$ billion; ZWL$ deposits converted at parallel market rate)



Sources: Reserve Bank of Zimbabwe.

14. The financial supervisory and stability framework is being strengthened. The RBZ has finalized its review of banks' first recovery planning and developed a methodology for designation of domestic systemically important banks. Since June 2019, the Credit Registry receives daily credit data from all banking institutions, providing support for financial sector credit risk management. A Collateral Registry for movable assets is expected to become operational in 2020 and facilitate SME and individual's access to credit. RBZ has drafted plans for migration to the Basel III regulatory framework. In addition, with IMF technical assistance, it is preparing changes to the legal framework for bank supervision and the financial safety net in line with international standards and best practice.

15. The SMP for Zimbabwe that was approved by IMF management in May 2019 is off track. Performance against quantitative program targets was satisfactory through end-June, but the SMP went off track afterwards, with most end-September 2019 performance criteria missed owing to the large quasi-fiscal operations by the RBZ discussed above (Table 7). Performance against the SMP's structural benchmarks has been largely satisfactory (Table 8). The SMP is due to expire at end-March 2020.

MACROECONOMIC OUTLOOK AND RISKS

16. The outlook for 2020 is for near-zero growth and gradual disinflation (Text Table 1 and Tables 1-4). For 2020, the economy is expected to remain basically flat as agriculture fails to rebound from the previous drought year, electricity generation endures another year of low rainfall, and fiscal adjustment continues. With grain stocks already depleted, a weak agriculture harvest would put additional pressures on the balance of payments for food imports. Over the medium-term, continued external arrears and the consequent lack of access to external finance continue to constrain investment, and real growth, but eventually reduced fiscal deficits and a more flexible exchange rate regime allow the economy to achieve some growth (the baseline assumes that the identified fiscal gaps in 2020-23 are closed through fiscal measures and/or additional external financing). Without a resolution of Zimbabwe's unsustainable external debt, the economy will not be able to grow at or near potential and there is little chance of the country reaching its targets under the sustainable development goals (SDGs). Inflation is expected to decline but nonetheless remain relatively high through mid-2020, as exchange rate depreciation pass-through runs its course, but could fall in the latter part of 2020 if the RBZ successfully contains money growth.

Text Table 1. Zimbabwe: Macroeconomic Framework, 2017–23

	2017	2018	2019	2020	2021	2022	2023
Real GDP growth (%)	4.7	3.5	-8.3	0.8	2.5	2.5	2.2
Inflation (%, average)	0.9	10.6	255.3	221.1	3.7	3.0	3.0
Inflation (%, eop)	3.4	42.1	521.1	52.0	3.0	3.0	3.0
Overall Fiscal balance (% GDP)	-7.1	-7.5	0.0	-5.0	-2.3	-2.1	-2.1
Consolidated public sector debt (% GDP)	54.4	44.2	50.1	53.9	56.0	55.9	55.7
Public and publicy-guaranteed external debt (% GDP)	40.1	37.8	47.6	51.5	52.7	52.1	51.5
Current account (% GDP)	-1.3	-5.4	0.7	-1.0	-1.4	-1.3	-2.3
FDI (% GDP)	1.4	1.6	0.6	1.1	0.7	1.6	1.9
Reserves (months of imports)	0.5	0.1	0.2	0.2	0.2	0.2	0.2

Sources: Zimbabwean authorities; IMF staff estimates and projections.

17. There is a risk of a social backlash as the adverse exogenous shocks and stabilization policies needed to promote macro stability affect vulnerable sections of the population. The fiscal retrenchment and currency reform, followed by the sharp depreciation, exacerbated the disastrous effects of the climate shocks by cutting real wages, wiping out domestic savings, increasing poverty in both rural and urban areas, and generating fiscal drag on activity. Risks for another drought in 2020 are also high, which would weigh on the economy's recovery and exacerbate food shortages and BOP pressures. If no additional donor support materializes in the first half of 2020, pressures for large central bank financing of the budget will increase further. A return to excessive money printing would result in further depreciation, high inflation, and further erosion in the confidence of the new currency (Annex II).

Authorities' Views

18. The authorities broadly share staff's assessment of risks on the macroeconomic outlook. However, they believe that risks on 2020 real GDP growth are on the upside, reflecting a more optimistic view of prospects in agriculture, tourism, mining, and a boost in investment from a prompt rebound in confidence. While acknowledging the social impacts from the sharp fiscal adjustment, the authorities believe that this is necessary to stabilize the economy and expressed a strong commitment to continue stabilization policies and structural reforms to pave the way for strong and inclusive growth over the medium term.

POLICY DISCUSSIONS

19. The authorities' economic policies over the medium term are guided by Vision 2030, which aims at making Zimbabwe an upper middle-income country by creating a thriving and open economy, with sound macroeconomic policies anchored on fiscal discipline, and a business-friendly environment that attracts foreign and domestic investment. To achieve these objectives, in the near term the authorities have committed to restore macroeconomic stability, combat corruption, address poverty, improving debt management, and pursue re-engagement with the international community, consistent with the strategy outlined in the TSP.

A. Fiscal Restraint to Restore Macro Economic Stability

20. The 2020 budget approved by Parliament in December is anchored on zero RBZ financing, but is based on very ambitious revenue and financing assumptions and needs to integrate additional expenditures (e.g. gold incentives scheme and maize meal subsidies).

- Total ***spending*** allocated in the budget is ZWL$63.6 billion However, that does not include the cost of the incentive for gold purchases that were in place as of January 2020 (ZWL$400 million a month) and revamped maize subsidies that were introduced recently. Based on policies existing at January 2020 regarding gold incentives and maize subsidies, staff estimates additional spending of ZWL$6 billion will be needed in 2019.[5]
- Latest projections of ***revenue*** and ***financing*** fall short of what is needed to support the full spending envelope of ZWL$69.6 billion. IMF staff project revenue of ZWL$49.9 billion, compared to ZWL$58.6 billion in the approved budget – the difference reflects updated inflation forecasts and the commitment by the RBZ to a disinflationary monetary policy. Similarly, the lower inflation level, as well as developments in the banking sector, suggest lower available net domestic financing for the 2020 budget.
- Staff estimates a **fiscal financing gap** of about ZWL$14.9 billion in 2020 (about 3.8 percent of GDP or ¼ of spending in the 2020 budget). The financing gap, while large, may understate the magnitude of measures necessary as it does not include additional funding to close the humanitarian funding gap (see ¶21). Discussions focused on fiscal measures to close the identified gap, since the alternative of resorting to RBZ money creation to fully close it would nearly triple reserve money and further stoke hyperinflation pressures. Following recent tax policy changes (the 2 percent tax on financial transactions,[6] excise tax reform, as well as fuel and

[5] The authorities have recently communicated to staff that they have decided to terminate gold incentives and replace them with a credit support scheme funded by the government. The impact on the budget of this policy change and its timing is unclear at this stage, but could potentially reduce the additional spending.

[6] The authorities introduced a 2 percent financial transactions tax in October 2018 as part of their efforts to bring the fiscal deficit under control and help stabilize the economy. While such taxes can generate significant revenue quickly, they also have potential adverse effects, especially regressivity and cascading. To mitigate these effects, the transactions below ZWL$100 are excluded from the tax in Zimbabwe, as are the payment of salaries and taxes.

electricity price increases), there are no obvious tax policy reforms that could generate significant revenue and be politically feasible during this humanitarian crisis and economic contraction. While discussions were inconclusive, staff urged the authorities to contain spending on inefficient subsidies and transfers while bolstering more effective social transfers (e.g. harmonized cash transfer), and making a concerted effort to prioritize capital expenditure in case financing does not materialize. Staff also encouraged the authorities to undertake coordinated outreach to external and domestic stakeholders to maximize the chances for financing the deficit.

21. Staff supports an upward nominal salary adjustment in 2020, although a further reallocation of spending towards social protection is needed. The budgeted increase in wages for 2020 (approximately 50 percent relative to their level at end-2019) provides for a preservation of real wages (relative to 2019) for public sector employees, following the drastic cuts they have experienced since 2017. The budget also includes a significant increase in social spending to ZWL$6.2 billion (about US$286 million or 1½ percent of GDP), compared to ZWL$750 million (about US$75 million) in 2019. However, the needs for social spending are much higher, with preliminary estimates suggesting a gap of about US$545 million (Text Table 2).

Text Table 2. Zimbabwe: Minimum Required Social Spending and Funding Gap in 2020

In Millions	Budget Estimates		Estimated Needs		Funding Gap	
	ZW$	US$ [1]	ZW$	US$	ZW$	US$
Harmonised Cash Transfer [2]	500	20	7,482	295	6,982	275
Basic Education Assistance Module [3]	450	18	2,276	90	1,826	72
Health Assistance [4]	2,144	84.4	5,542	218	3,398	134
School Feeding Programme [5]	1,030	41	2,762	109	1,732	68
Public works	0	0	381	15	381	15
Drought Mitigation	1,020	40	1,410	56	390	15
Teaching and learning materials	650	26	1,237	49	587	23
Others [6]	1,451	57	-	-	-1,451	-57
Total	**7,245**	**285**	**21,089**	**830**	**13,844**	**545**

Source: Zimbabwean authorities, World Bank, and IMF Staffs Estimates.

[1] Converted to USD at official exchange rate of ZW$25.4 to US$1.

[2] Based on monthly US$20 per household covering 1.01 million households.

[3] Required intervention to cover tuition fees for vulnerables children.

[4] Minimum intervention to cover public health, primary healthcare and hospital care.

[5] Minimum intervention covering about 2.72 million children at US$40 per child yearly. Derived based on the required intervention to cover tuition fees for vulnerable children.

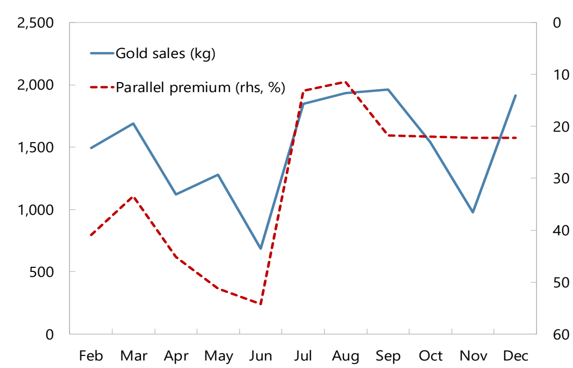
[6] Includes a number of social support programs (such as special needs education and sanitary wares, and support for elderly, disabled and children in difficult circumstances) and the price subsidy for maize meal.

22. Zimbabwe's social protection programs are generally effective in targeting the poor, but their coverage is low, posing a significant challenge to responding to the current crisis. Critical challenges to the performance of these programs have been inadequate funding (spending on social assistance has been less than 1 percent of GDP in recent years and declining as a share of GDP) and implementation performance. The coverage of these programs is mostly in rural areas, leaving exposed the significant number of people that are food poor in urban areas.

23. Additional funding is needed to support humanitarian needs. Even with the increased budget allocations for social assistance and existing commitments from development partners (estimated to increase by US$70 million relative to 2019),[7] preliminary estimates suggest minimum additional financing needs of about US$300 million for the first half of the year (covering through the 2020 agriculture season).

24. Staff urged the authorities to increase fiscal transparency and eliminate quasi-fiscal activities by the RBZ. While previous subsidies on electricity and fuel (via FX allocation at preferential rates) have been eliminated, the gold incentive introduced in September 2019 is a quasi-fiscal activity aimed at encouraging gold sales by small producers to Fidelity Printers and reducing sale in the grey market to neighboring countries.[8] Staff urged the authorities to remove the gold incentive (which would have an annual cost of about 1 percent of GDP) and to incentivize gold sales to Fidelity Printers via FX market liberalization reforms so as to reduce the parallel market premium (see below), given the strong (negative) correlation between the premium and gold sales by small producers (who account for over 60 percent of total gold supplies in Zimbabwe) (Text Figure 14). As noted in ¶20, the authorities have decided to terminate the gold incentive, although the timing and the fiscal impact of the reform is unclear at this stage. Staff also stressed that this and any similar subsidies should be included in the budget to improve transparency about their fiscal cost and should not take place via FX allocation at below-market rates.

Text Figure 14. Zimbabwe: Parallel Market Premium and Gold Sales from Small Producers
(February-December 2019)



Sources: Zimbabwean authorities.

25. Staff urged the authorities to minimize the assumption of private losses related to the currency reform. The authorities are considering assuming certain losses related to the currency

[7] These interventions span across water supply and sanitation, health, education, humanitarian and basic social services that do not largely follow public sector social protection classifications.

[8] Fidelity Printers is a wholly-owned subsidiary of the RBZ with monopsony power over all purchases of gold production in Zimbabwe. Fidelity compensates miners through a combination of ZWL$ and US$, and the gold purchased is sold by Fidelity in Johannesburg where the proceeds are used to clear collateralized debt obligations (and the residual is returned to the RBZ in US$).

reform, including from large net open foreign positions of banks, a backlog of unrepatriated dividends, and private debts owed by nonfinancial corporates. The amounts involved are very large (at least US$1.9 billion; nearly 10 percent of GDP and half of exports) and staff raised several concerns related to the process including the unclear method of compensation, lack of Parliamentary oversight, potential litigation risk, and the macroeconomic impact of this decision given a weak external position and non-existent FX reserves. Staff also cautioned the authorities to explore how this would affect the prospects of future normalization of Zimbabwe's external arrears with official creditors.

26. Reforms are needed in public debt management regarding pricing, predictability, and transparency of issuance of government securities. Strengthening the domestic currency debt market would support de-dollarization and establish a local currency yield curve over the medium term. Since government securities comprise a large share of banks' asset base, staff recommends that the RBZ uses these securities as collateral for monetary operations. This will facilitate the introduction of market-rate determined repo instruments (see SIP), enhance marketability of government securities, and help mitigate fragmentation of issuance, and hence improve pricing.

Authorities' Views

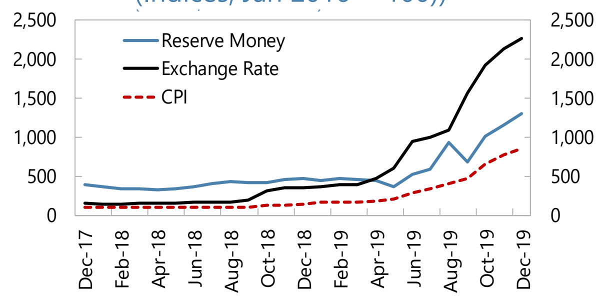
27. The authorities' twin fiscal anchors are a public debt level under 60 percent of GDP and an overall fiscal deficit under 3 percent of GDP, consistent with SADC commitments. They noted the significant progress that has been made since the new Government came into office in September 2018 in addressing the twin (fiscal and BOP) deficits, and expressed commitment for continued fiscal prudence to ensure a stable macro-economic environment. Based on revenue collection in recent months, the authorities believe that the annual revenue target of ZWL$58.6 billion approved by Parliament can be achieved. In any event, they expressed their commitment to delay execution of some allocations in the 2020 budget until there is greater clarity on revenue outcomes and the availability of domestic financing, while protecting social spending. The authorities noted that any non-concessional borrowing will be limited to critical food imports and essential infrastructure projects. On the losses related to the currency reform, the authorities agree on the objective to limit the overall amount assumed by the government, but emphasized that failing to honor obligations of foreign investors and creditors would harm Zimbabwe's reputation and undermine access to critical goods and services. They confirmed that the debt assumption for such losses will be approved by Parliament through a Debt Assumption Act.

B. Monetary and Exchange Rate Policies

28. Reserve money targeting (RMT) is the best feasible anchor at this time for the new currency (see SIP). The very low level of international reserves and the poor track record on inflation make other traditional nominal anchors for monetary policy—such as a fixed exchange rate regime or inflation targeting—not viable in the near term. Experience has shown that money-based stabilizations in countries with high inflation have—when consistently applied and supported by fiscal policy—quickly reduced inflation, given the close correlation between money growth and inflation. To that end, targeting a moderate increase in reserve money in 2020 would help anchor movements in broad money growth, exchange rate and inflation, given their correlation with reserve money growth (Text Figure 15).

Text Figure 15. Zimbabwe: Reserve Money, Exchange Rate, and Inflation Trends

(Indices, Jan 2016 = 100))



Sources: Zimbabwean authorities.

29. Operationalizing the RMT regime requires the introduction of short-term, market-rate-determined repo instruments to allow the RBZ to conduct open market operations. Although the RBZ has announced the adoption of an RMT framework, it currently lacks the instruments to fully implement such a framework—the only instrument at its disposal is the savings bond that is offered weekly to banks at a fixed interest rate. At 7 percent, well below prevailing inflation, the take up by banks in recent months has been minimal despite a high level of excess reserves (about ZWL$ 7 billion or 2 percent of GDP at end-December 2019). While market-determined interest rates will be higher than is currently the case for the savings bond, and possibly volatile initially, higher rates would boost demand for the new domestic currency, put upward pressure on the exchange rate, and help establish credibility of the new currency. In addition, the RBZ should stop direct lending to its subsidiaries (e.g., Fidelity Printers and Homelink).

30. Once structurally-low inflation levels have been reached, the authorities could consider alternative monetary frameworks. RMT relies on relationships between inflation and the growth in narrow and broad monetary aggregates, which typically become unstable at low levels of inflation. At that stage monetary policy needs to be more finely calibrated, and a price-based framework relying on interest rate signals, as opposed to the quantity-based RMT, may become more effective in stabilizing and finetuning inflation. Therefore, at a later time, it would be expected that reserve money would be replaced by a policy interest rate as the operational target.

31. Continued liberalization of FX controls is key to moving towards a market-clearing rate in the FX market. Staff urges the authorities to: develop a schedule for the removal of FX allocation via the priority list; allow exporters to sell more of the surrender amount (from 50 percent currently) in the interbank market while removing restrictions set on the rate at which banks can transact in the market; and eliminate as soon as possible all restrictions on current account transactions. Measures to de-dollarize the economy further are also essential, including promoting incentives for the holding of local currency over FX—in particular, requiring that all of government's domestic transactions be carried out in ZWL$.

32. **Enhanced disclosure by the RBZ will be indispensable for the success of the stabilization program.** Minutes of the meetings of the recently established Monetary Policy Committee are already being published in a timely manner. However, monetary statistics and central bank balance sheet data are provided with long lags. Staff proposed that, at a minimum, the daily RBZ balance sheet be published on the RBZ website, with a short (e.g., one-week) lag from the reference date, and that full monetary statistics be published no later than 4 weeks after the end of the month.

33. **Certain exchange measures maintained by the authorities give rise to several exchange restrictions and multiple currency practices (MCPs).**[9] These measures include: (i) prioritization of FX sales; and (ii) the RBZ's application of the prior date's interbank rate when allocating FX to finance certain imports and when purchasing FX from exporters subject to surrender requirement. Each of these measures gives rise to both an exchange restriction and a multiple currency practice. In addition, some capital account measures in the past few years that aimed to prevent further reserve losses constitute capital flow management measures (CFMs) under the Fund's Institutional View (IV) on capital flows (Box 1); staff encouraged the authorities to relax these measures as soon as economic conditions permit.

Box 1. Capital Flow Management Measures

The following capital account measures put in place by the Zimbabwean authorities constitute CFMs under the Fund's IV on capital flows:

- Capital account transfers started to be subject to approval (2016): outflow CFM.
- Cash withdrawal and related measures were tightened (2016): all outflow CFMs.
    - Cash exports limit was lowered (tightened) to $1000 from $5000, which was slighted eased to $2000 (2017).
    - Limits on credit card use, cash withdrawal, and bond withdrawal were introduced.
- Surrender requirement for FX was introduced in 2016 and further tightened during 2018-19: outflow CFM.
- Since 2016, limits on foreign investments and on external borrowing have been generally eased (though repayment for external borrowing, other than for productive activities, were restricted): easing of inflow CFMs.

[9] For more details see the Informational Annex.

Authorities' Views

34. The RBZ and the newly established Monetary Policy Committee expressed determination to establish monthly reserve money targets consistent with low inflation and to introduce instruments and processes for achieving these targets at market-determined rates. The authorities also agree on the need to liberalize the FX market, but noted a preference for a gradualist approach to help contain inflation, since Zimbabwe needs to import many critical products (such as fuel and essential food imports, as well as raw materials and machinery for production to export or to substitute imports of essential finished goods), and they viewed their current exchange control measures as necessary to direct needed FX to finance such imports. The RBZ plans to target a moderate
(10-15 percent) increase in reserve money in 2020 and make any lending to its subsidiaries consistent with the overall reserve money targets. The authorities expressed concern that high interest rates would increase the cost of servicing public debt and negatively affect credit to the private sector, and thus intend to continue limiting the amount of fiscal financing in the domestic market. The authorities are not requesting Fund approval of the exchange restrictions and MCPs and indicated to staff that they plan to gradually relax them considering developments in the economic environment, and depending on the potential impact of the relaxation steps on FX conditions and market confidence.

C. Financial Sector Policies

35. Supported by administrative measures and government's commitment to compensate banks for FX losses, the banking sector has shown resilience (Figure 5). Exchange controls and deposit withdrawal restrictions have provided the banking sector with stable low-cost funding and the ability to keep lending rates relatively low on existing customer loans. Loan performance has improved helped by the sale of nonperforming loans to the Zimbabwe Asset Management Corporation (ZAMCO) during 2015-2018 and declining debt payments in real terms in 2019; the strength of capital is supported by the government's commitment, following currency conversion, to assume large losses related to banks Net Open FX Positions (NOP) (Box 2) and revaluation of real assets. Reported liquidity is ample but consists largely of illiquid long-term government bonds that could generate large valuation losses if discounted or sold. Therefore, reported prudential ratios overstate banks' ability to provide credit and meet deposit withdrawals in the absence of deposit withdrawal restrictions.

36. Staff emphasized the urgency of implementing financial sector reforms. The RBZ's recent measures to support bank credit to the productive sectors raises government contingent liabilities. These include a liquidity facility that was introduced in September 2019 at preferential rates and against collateral in corporate loans with a minimum maturity of 12 months. Staff noted that the collateralization of corporate loans transfers credit risk to the RBZ, raises government contingent liabilities and reduces banks' incentives for effective credit risk management. Staff emphasized that priority should be given to ensuring that banks have healthy balance sheets, allowing better transmission of market confidence and improved intermediation. Staff discussed:

- ***Legal and regulatory framework***. Ongoing legal reforms should be finalized, including to strengthen the prompt corrective actions and bank resolution regimes. Secondary legislation and prudential standards should be updated to ensure that primary legislation can be effectively implemented.
- ***Strengthening banking supervision***. More resources should be dedicated to core banking supervision systems and processes, focusing on DSIBs and problem institutions. On DSIBs, the RBZ should conduct immediately a thematic on-site credit review to assess the adequacy of loan classification and provisioning, large exposures, lending to related parties and credit risk policies and practices. To support systemic risk analysis and financial sector policy formulation, efforts are needed to improve supervisory data and reconcile with the monetary survey.
- ***Asset quality reviews (AQR)***. The RBZ should consider conducting an AQR to gauge banks' capital position, following an assessment of the impact of the new currency. To ensure credibility, the AQR should include participation by international reputable experts and the scope include banks loan books, real assets, NOPs and risk stemming from sovereign exposure.
- ***Resolution and contingency planning***. The RBZ should develop its resolution planning alongside the steps already taken on recovery planning; and prepare contingency plans, should capital shortfalls be detected in the AQR.
- ***The national payment system***. To catch up with the rapidly growing electronic payments, the legal and supervisory framework for payment and settlement systems should be brought in line with international standards. Forums with public authorities and private stakeholders could help facilitate further development of the system.
- ***AML/CFT.*** Substantial progress in improving the effectiveness of AML supervision, transparency of beneficial ownership information, and targeted financial sanctions will support Zimbabwe's exit from the FATF list and help mitigate pressures on correspondent banking relationships.

Authorities' Views

37. The authorities noted their commitment to addressing gaps in the financial sector supervision and financial stability frameworks consistent with the findings and recommendations of the Financial Sector Stability Review conducted by the Fund in November 2018. To that end, they plan to upgrade the legal framework to align banking supervision and the financial safety net with international best practice, reorganize the offsite and onsite supervisory functions, and strengthen the risk assessment framework with TA from the Fund. Currently they are drafting amendments to the banking law and deposit protection corporation act—including the triggers for bank resolution, improvements to the bank liquidation regime, clarifying the hierarchy of claims, and elaborating on the role of the courts in bank resolution—to bring legislation in line with international best practice.

Box 2. Zimbabwe: Banks' Net Open FX Positions

Following the currency reform of February 2019, negative NOPs arose in banks (up to 45 percent of sector capital) because banks assets and liabilities were only partially redenominated from US$ in ZWL$.[1] Losses accumulated as the ZWL$ depreciated against hard currencies and sector solvency was threatened.

- Mandatory currency redenomination from US$ into ZWL$ applied only to bank assets and liabilities that were subject to Zimbabwean legislation — assets kept abroad or registered with the RBZ as "off-shore" customer loans, and liabilities contracted according to foreign legislation were excluded. Among these were liabilities that banks had acquired from the government in exchange for T-bills that were subject to currency redenomination.[2]
- Deposits of FX earners were by law exempt from currency conversion.[3] Banks had been instructed by the RBZ to ringfence such deposits in "Nostro Foreign Currency Accounts (FCA)" in October 2018, which included "free funds" (diaspora remittances and international organizations' remittances), portfolio investment flows, loan proceeds, and export retention proceeds. To shore up confidence in the Nostro-FCA, the RBZ announced that it would establish a "Nostro Stabilisation Guarantee Facility" (NSGF) of US$500 million to ensure that the FX would be available when required by the account holders.[4]

To safeguard financial stability, the authorities announced in February 2019 that they would compensate banks for FX losses related to the NOPs at the time of currency conversion. However, the size and form for compensation is yet to be determined and Financial Soundness Indicators (Table 5) reflect banks' own expectations.

[1] Staff estimate.

[2] The liabilities originate from RBZ borrowing abroad to fund fuel imports but were transferred to the government under the Debt Assumption Act of 2015.

[3] Statutory Instrument 33 of 2019.

[4] RBZ Monetary Policy Statement of October 2018.

D. Structural Policies: Promoting Inclusive Growth and Improving Governance

38. **The external position of Zimbabwe in 2019 was broadly consistent with medium-term fundamentals and desirable policies.** The current account (CA) gap is assessed at -0.5 percent, translating into a two percent real effective exchange rate (REER) gap. The sharp depreciation of Zimbabwe dollar in 2019, over and above the concurrent sharp rise in inflation, has helped reduce the large REER observed in 2018 (Annex III).

39. **Weak business environment undermines the potential competitiveness benefit from the recent exchange rate depreciation.** Zimbabwe's global competitiveness has been declining since 2015 and is below the sub-Saharan African average.[10] Zimbabwe ranks 124th (out of 137) in the Global Competitiveness Index (GCI), with political instability, foreign currency regulations, inefficient

[10] Measured by the World Economic Forum Global Competitiveness Index.

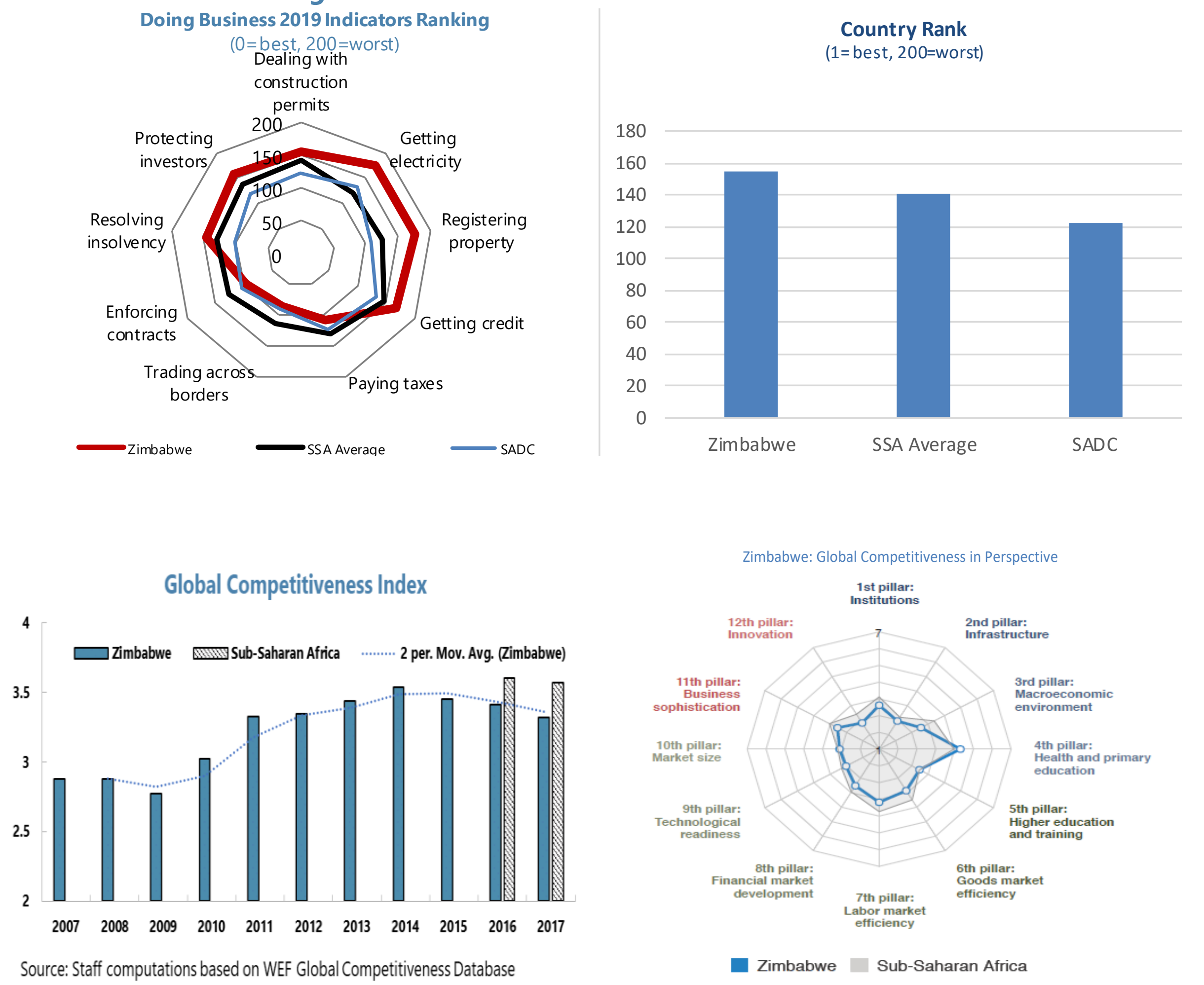
government bureaucracy, and corruption underscoring the negative perception of stakeholders (Text Figure 16). The authorities have made some progress on structural reforms: indigenization policy has been relaxed, investment-promoting institutions merged into a single Zimbabwe Investment and Development Agency, and SOE reforms are underway to improve service delivery and reduce their financial burden on the budget. However, the business climate remains challenging, with electricity shortages and inability to use agricultural land as collateral proving obstacles to private sector growth.

40. Structural reforms in the agricultural sector are key to boost Zimbabwe's medium-term growth and reduce poverty (see SIP). Agriculture is a key driver of the economy—it has the highest employment and, outside extractive industries, contributes most to GDP. Over the last two decades, agricultural productivity has declined significantly, moving Zimbabwe from having one of the most productive agricultural sectors to one of the least in sub-Saharan Africa. Dilapidated irrigation infrastructure, lack of skills development for new farmers, land rights uncertainty, and a challenging regulatory framework are the main causes of this secular decline. Recent government support to the sector, in the form of price and input subsidies, have not sustainably improved agricultural productivity as they have not addressed the root causes of problems afflicting the sector. Staff stressed that a reorientation and rationalization of fiscal agricultural support programs, along with legal and policy reforms to address the above structural weaknesses, could invigorate the sector and help restore Zimbabwe as an agricultural exporter.

41. The authorities are taking steps to address governance vulnerabilities but much more needs to be done. Zimbabwe scores well below the regional average on governance, transparency and corruption indicators (Text Figure 17). Accordingly, as discussed above, the TSP identified the strengthening of governance and tackling of corruption among the key reform priorities. The authorities have worked closely with IMF staff since mid-2019 to conduct the diagnostic assessment of Zimbabwe's governance vulnerabilities. IMF staff, in collaboration with World Bank staff, helped the authorities conduct an assessment of Zimbabwe's governance vulnerabilities in many areas, including public financial management, revenue administration, oversight of state-owned enterprises, the extractive industries, public procurement, RBZ operations, financial sector oversight, the rule of law, and AML/CFT (Annex IV).[11] Based on this assistance from IMF staff, the authorities are committed to publish in the next few months their final assessment of governance vulnerabilities and their high-level anti-corruption plan which will feed into a comprehensive anti-corruption strategy for Zimbabwe.

[11] IMF staff's assistance to the authorities in conducting the diagnostic assessment was provided in the context of the SMP. IMF staff's report on governance was shared with the authorities in January 2020 (IMF, Technical Report on Governance, Zimbabwe: Governance and Anti-Corruption Assessment, January 2020), and Annex IV summarizes the assessment as described in this report.

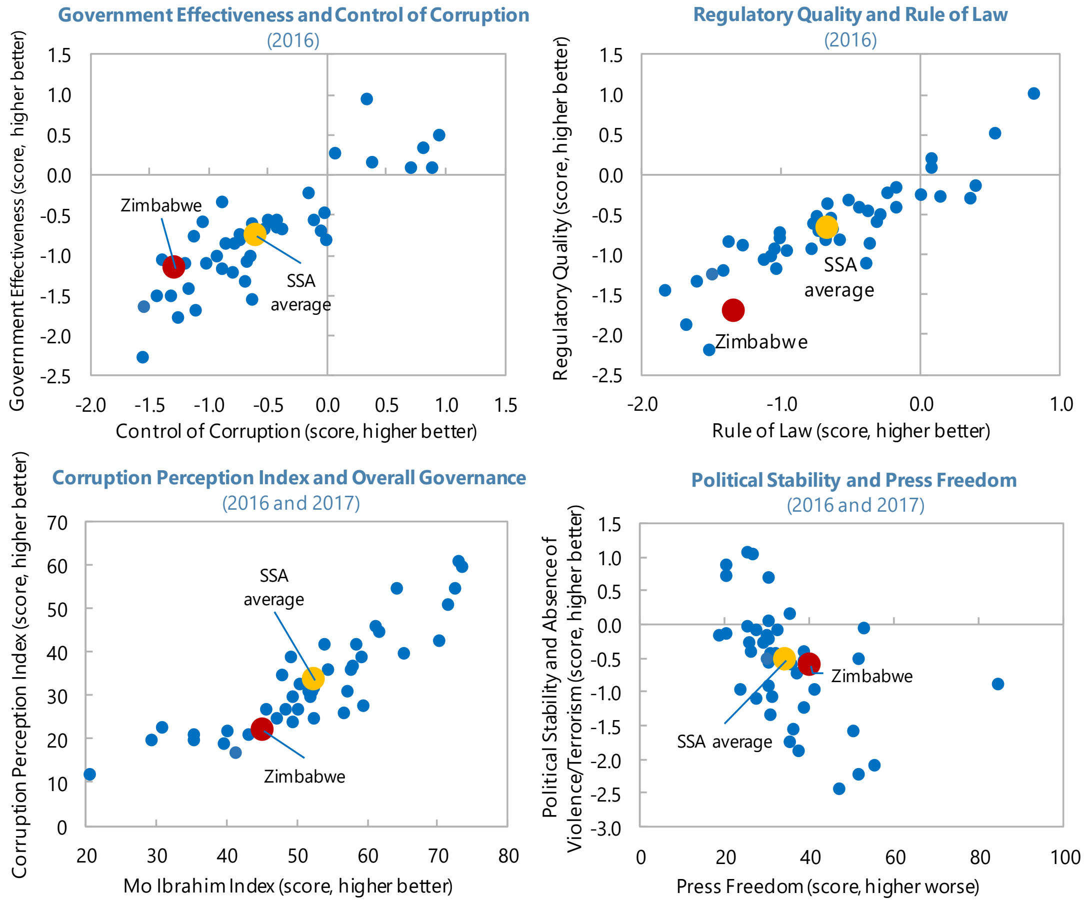
Text Figure 16. Zimbabwe: Business Environment Indicators



Source: Staff computations based on WEF Global Competitiveness Database

Notes: The above non-IMF indicators provide qualitative information about the indicators listed in these figures, and the accuracy of the indices can be biased by experts' views (instead of facts). They do not represent the IMF's assessment on any of these indicators.

Text Figure 17. Zimbabwe: Governance and Development Indicators Across Sub-Saharan Africa



Sources: Worldwide Governance Indicators; Transparency International; Mo Ibrahim Foundation; Doing Business Database; United Nations Development Programme; and Reporters Without Borders.

Notes: The above non-IMF indicators provide qualitative information about the indicators listed in these figures, and the accuracy of the indices can be biased by experts' views (instead of facts). They do not represent the IMF's assessment on any of these indicators.

Authorities' Views

42. The authorities agreed on the need to deepen structural and institutional reforms. Consistent with the TSP, their focus is on reforms that would support private sector activity, including by reallocating spending towards infrastructure rehabilitation; accelerating public enterprise reforms to improve their service delivery; continuing ease of doing business reforms especially to reduce constraints for starting a business, acquiring construction permits, and registering property; and implementing the ambitious governance reform program to combat corruption. The authorities also note that with international credibility and reengagement an essential aspect of achieving the Vision 2030 goals.

OTHER ISSUES

43. **Zimbabwe remains in debt distress (see attached DSA), with long standing external arrears to IFIs, official, and commercial creditors.** Domestic debt has grown in recent years due to large fiscal deficits and negligible access to external finance, but the recent currency conversion and high inflation have significantly eroded its real value. In the event that the Government assumes the liabilities from losses associated with the currency reform, then external debt situation would worsen further. Staff emphasized that this and continued recourse to collateralized external borrowing on commercial terms may potentially complicate any future arrears clearance operation for Zimbabwe. Restoring debt sustainability will require fiscal prudence across the public sector, as well as support for a debt arrangement by creditors.

44. **Zimbabwe has large capacity development needs and has benefitted significantly from TA provided by the Fund and other stakeholders** (Annex V). Following the clearance of arrears in 2016, the IMF has provided much technical assistance to Zimbabwe. The focus of Fund TA will continue to be on areas that expand revenue mobilization, improve expenditure controls/efficiency, support monetary and exchange market operations, and address governance concerns. The World Bank is providing support on the design of the social safety net and agriculture subsidies, as well as PFM and SOE reforms, among others.

STAFF APPRAISAL

45. **The administration that took office in September 2018 has embarked on economic reforms aimed at addressing Zimbabwe's large macroeconomic imbalances and reducing distortions.** Notable steps include a significant fiscal consolidation that has helped reduce, although not entirely eliminate, the monetary financing of the deficit; the introduction of the new domestic currency in February 2019 and the creation of an interbank FX market; the establishment of a new monetary policy committee at the RBZ with outside members, which has broadened the consultative process in setting monetary policy and increased the transparency of RBZ operations through regular publication of the minutes of its deliberations; and the restructuring of the command agriculture financing model to a public-private partnership with commercial banks.

46. **Progress has not been balanced, implemented smoothly, or without cost, and has been severely hampered by climatic shocks.** Uneven implementation, notably delays and missteps in FX and monetary reforms, have failed to restore confidence in the new currency despite the sharp tightening in fiscal policy. Continued rapid money growth for quasi-fiscal operations has resulted in a significant exchange rate depreciation and very high inflation. Together with a deep economic contraction from weather shocks and unavoidable fiscal adjustment, this has contributed to a sharp decline in living standards with more than half of the population now expected to be food insecure in 2019–20.

47. The near-term macroeconomic imperative is simultaneous and coordinated fiscal, FX, and monetary policies to stabilize the exchange rate and inflation, but this has to be achieved while addressing food insecurity.

- **Fiscal policy.** Approved spending in the 2020 budget exceeds realistic revenue mobilization and commercial bank financing. Delivering on the authorities' commitment of no RBZ financing of the budget will require identifying measures to scale-back spending, such as eliminating export gold incentives and containing low-priority current and capital spending. In addition, it will be important to contain the fiscal implications of any assumption of losses related to the currency reform, to: limit such assumptions using transparent criteria; require that any such debt takeover be approved by the MOFED, and eventually Parliament, consistent with the provisions in the Constitution and Public Debt Management Act; and use long-dated government securities for any assumption of such liabilities to limit the impact on liquidity and FX market in the near term. Continued recourse to collateralized external borrowing on commercial terms may potentially complicate any future arrears clearance operation for Zimbabwe and should be avoided.

- **FX reforms**. More determined implementation of currency reform is needed if a market is to be created. Continued liberalization of FX controls—such as removal of FX allocation via the priority list, allowing exporters to sell more of the surrender amount, and eliminating restrictions set on the rate at which banks can transact in the market—is key. Measures to de-dollarize the economy, including to increase incentives to hold local currency over FX—especially requiring that all of government's domestic transactions be carried out in ZWL$—are also essential. Staff welcomes the discontinuation of the practice of providing FX at a preferential rate, and urges the authorities that any subsidies for specific goods should not be done through preferential FX rates and be included transparently in the budget.

- **Monetary policy**. Reserve money targeting is the most appropriate anchor at this time for the new currency, given the paucity of international reserves and lack of credibility on inflation management. With rapid growth in money supply driving the sharp exchange rate depreciation and high inflation, stabilizing macroeconomic conditions will require the RBZ to achieve moderate reserve money growth. The introduction of short-term instruments to allow the RBZ to conduct open market operations would facilitate the operationalization of the reserve money targeting framework. In addition, the RBZ should stop direct lending to its subsidiaries.

- **Social protection**. The impact of the cyclone and prolonged drought, on top of the high inflation and exchange rate depreciation depleting the income and savings of many, has produced a humanitarian crisis. The budget has significantly increased the allocations for social spending, but even with the assistance pledged by the international community, these fall short of projected needs. Closing the gap to ensure a minimum level of social protection will require further reprioritization of budgetary resources and further engagement with the international community.

48. Staff urges the authorities to eliminate the exchange restrictions and MCPs described in paragraph 34. Staff does not support the policies that have given rise to these exchange restrictions and MCPs. Although the authorities have indicated that they plan to gradually relax them, there is presently no timetable to do so. Staff urges the authorities to articulate an exit strategy for their removal as economic conditions permit, to allow an improved functioning of the foreign exchange market.

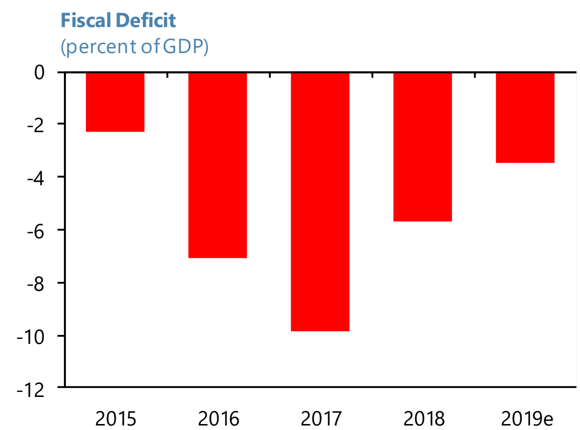
49. Given financial sector risks and vulnerabilities, steps to support financial sector stability are a priority. Key steps include close monitoring of weakly capitalized banks with elevated levels of NPLs and to that end, the RBZ should initiate a review of banks' asset quality and develop a strategy to address capital shortfalls. The RBZ should urgently allocate resources to update and operationalize its framework for managing weak banks, including their exit; strengthen legal and regulatory requirements to support bank supervision and enhance crisis preparedness; and advance efforts to increase the effectiveness of the AML/CFT framework to support the exit from the FATF list.

50. Structural reforms should focus on addressing governance vulnerabilities and improving the business environment to boost medium-term growth and reduce poverty. Combating corruption and improving governance will contribute to reducing the cost of doing business. Steadfast implementation of the recently adopted action plan aimed at addressing governance vulnerabilities will be a critical signal of the authorities' commitment in this regard. Agricultural reforms, key for medium-term growth and poverty reduction, should be continued, especially by improving improve irrigation infrastructure, expanding skills development for new farmers, facilitating the leasing of farms to productive farmers, and making the 99-year leases truly bankable so as to be used as collateral to secure needed financing.

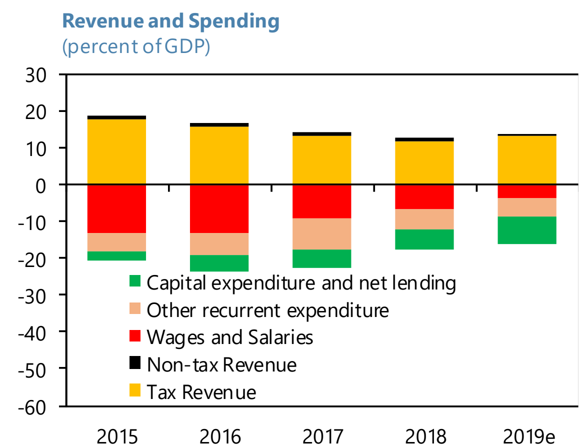
51. Staff recommends that the next Article IV consultation with Zimbabwe be held on the standard 12-month consultation cycle.

Figure 1. Zimbabwe: Fiscal Developments

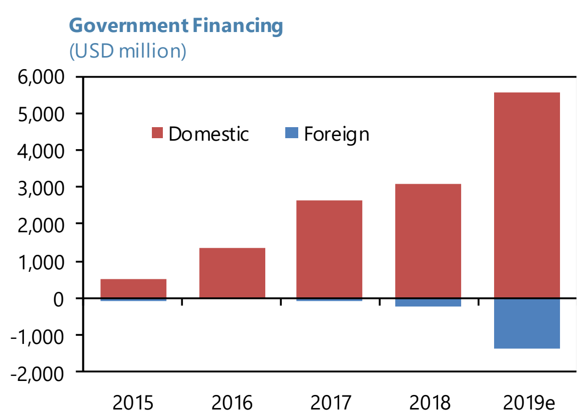
Significant fiscal adjustment after the July 2018 elections…



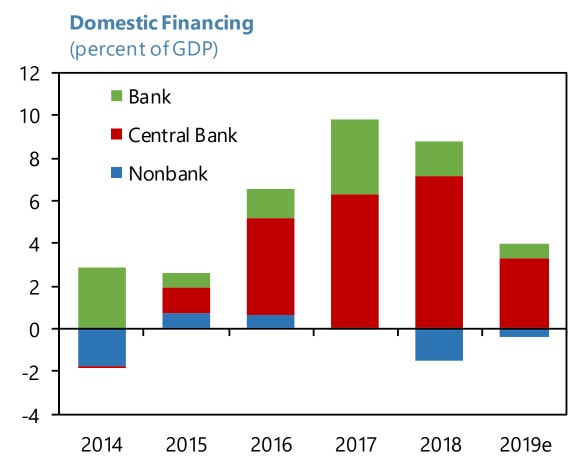
…reflecting revenue measures and expenditure cuts especially on wages …



…reducing government financing needs…



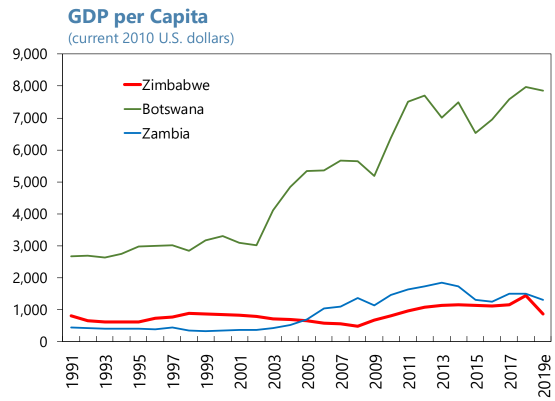
…especially from the Central Bank.



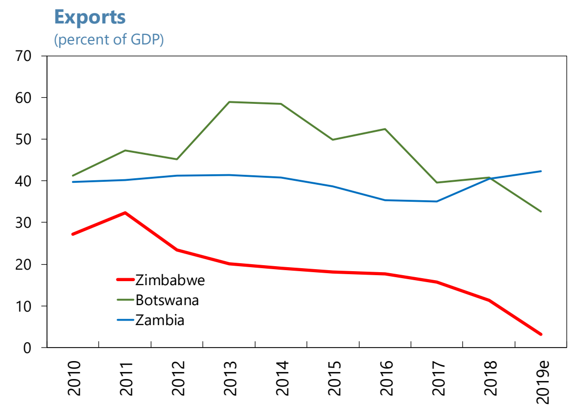
Sources: Zimbabwean authorities and IMF staff calculations

Figure 2. Zimbabwe: Evolution of Selected Economic and Social Indicators

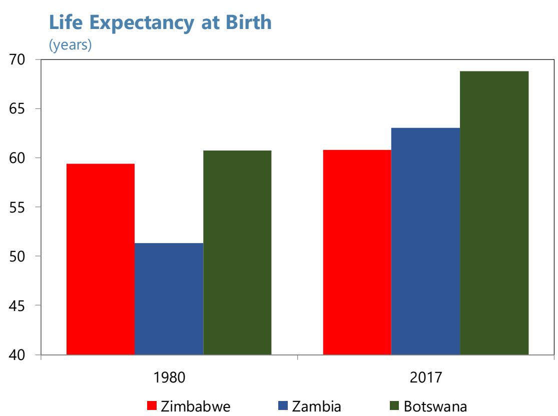
GDP per capita has remained stagnant since the 1990s.



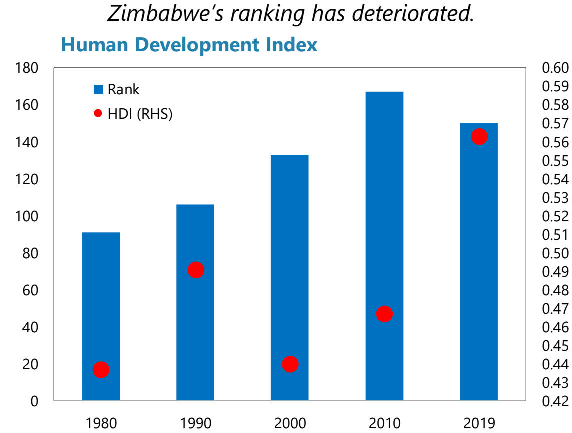
Export performance has been weak.



Life expectancy is below that in neighboring countries.



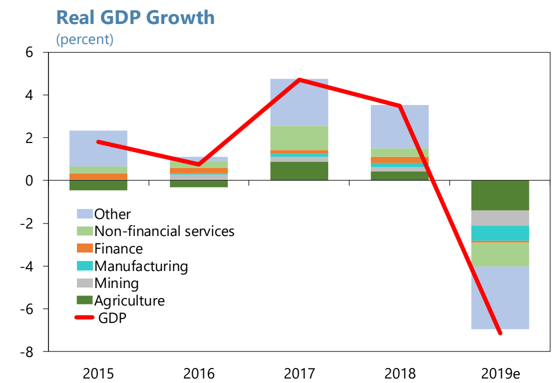
Notwithstanding the improvement in human development, Zimbabwe's ranking has deteriorated.



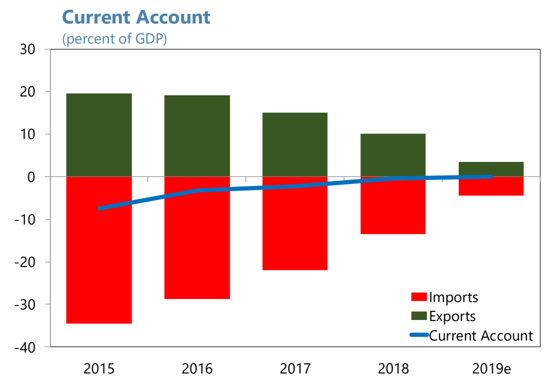
Sources: Zimbabwean authorities, International Energy Agency, and IMF staff calculations.

Figure 3. Zimbabwe: Recent Macroeconomic Developments

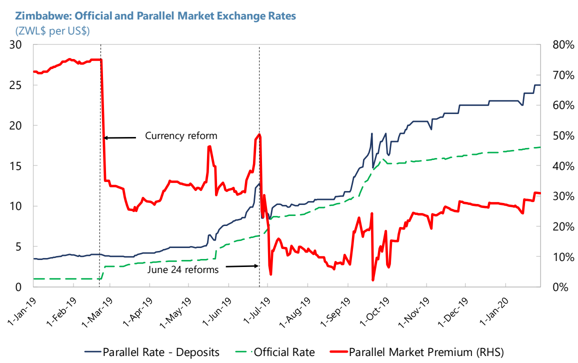
Growth contracted sharply in 2019 due to a severe drought and unavoidable fiscal consolidation



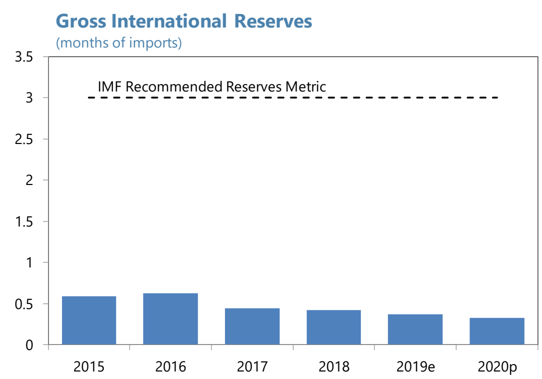
The current account deficit has shrunk due to limited external financing.



The parallel market exchange has been very volatile recently…



…reflecting policy uncertainty amid a very low level of international reserves.

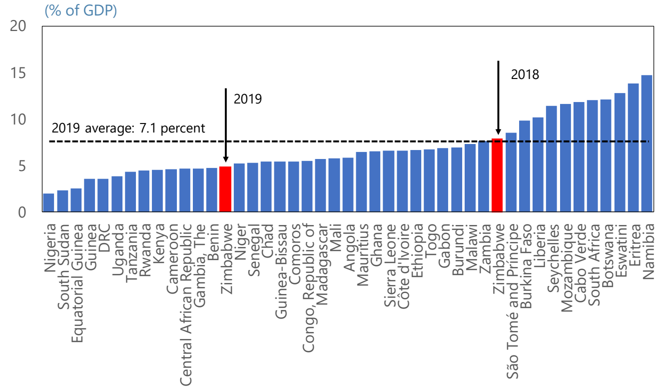


Sources: Zimbabwean authorities and IMF staff calculations.

Figure 4. Zimbabwe: Government Revenue and Spending in Zimbabwe Relative to Peers

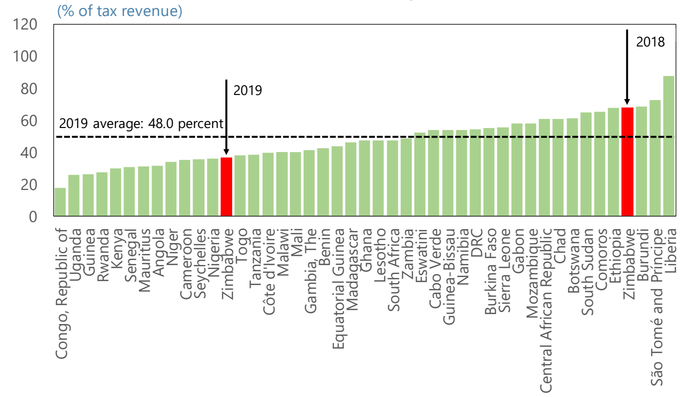
Zimbabwe's wage bill was until 2018 among the highest among peers both relative to GDP…

Sub-Saharan Africa: Civil service wage bill in 2019
(% of GDP)



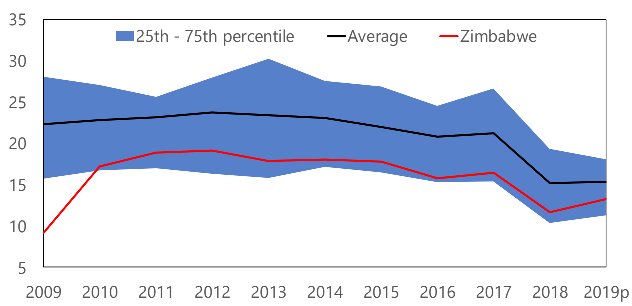
…and as a share of revenue, but has since declined well below SSA average…

Sub-Saharan Africa: Civil service wage bill in 2019
(% of tax revenue)



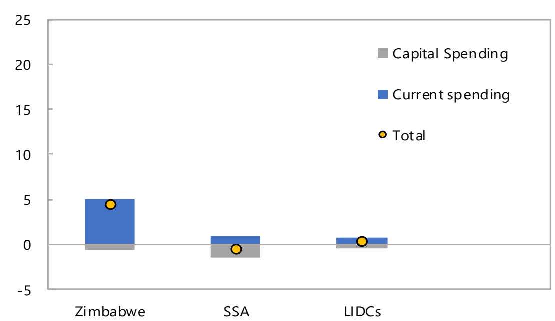
…whereas revenue is below SSA average.

Revenue: Zimbabwe and SSA
(in percent of GDP)



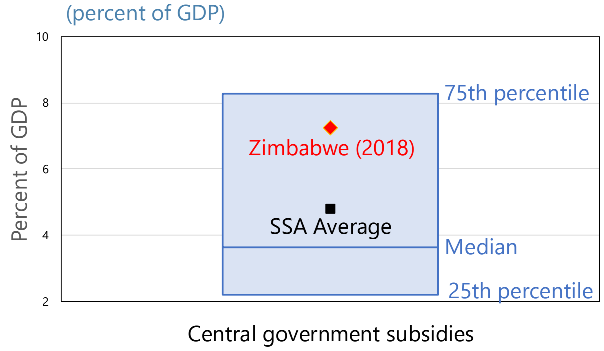
Higher government spending in the last decade reflects an increase in current expenditure…

Change in Central Government Expenditure
(in percent of GDP, 2010-2017)



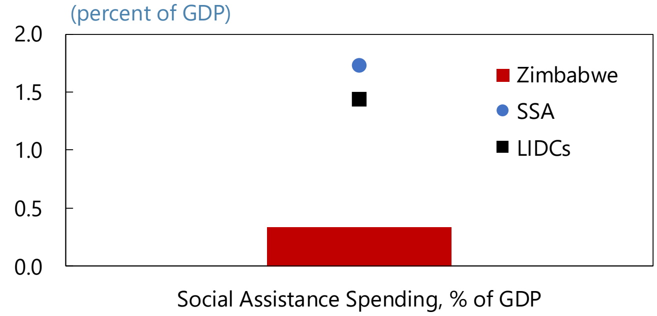
…which mostly go towards subsidies to agriculture and SOEs…

Subsidies in Sub Saharan Africa
(percent of GDP)



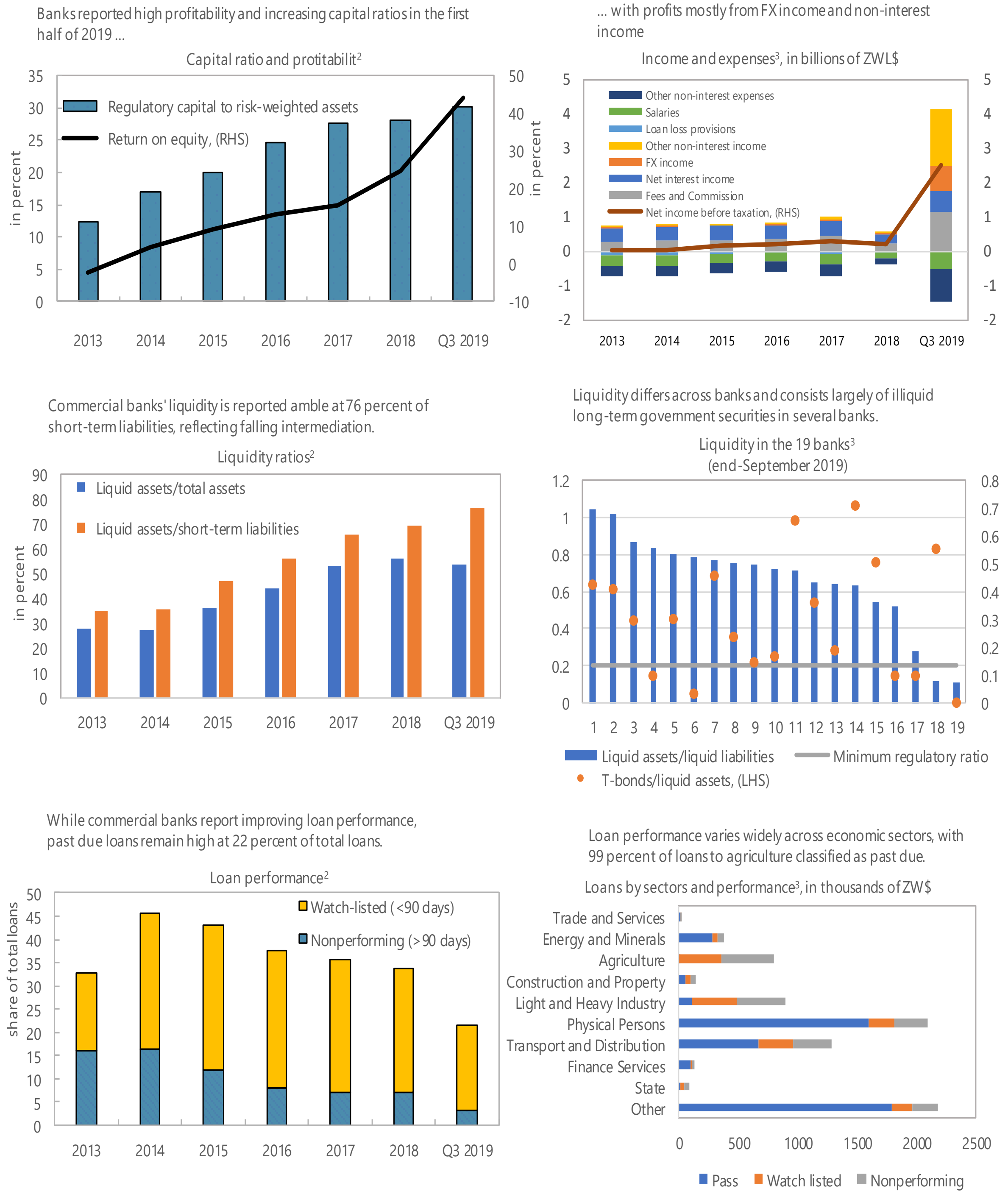
…whereas social spending is below the peers.

Social Assistance Spending in 2015
(percent of GDP)



Sources: Zimbabwean authorities and IMF staff calculations.

Figure 5. Zimbabwe: Financial Soundness Indicators[1]



Source: RBZ, staff calculations.

[1] Reported data for September 2019 reflects banks´ expectations about the size and form of government compensation for FX losses, both of which was undetermined at the time.

[2] Commercial banks (13).

[3] Commercial banks (13), building societies (5) and savings bank (1).

Table 1. Zimbabwe: Selected Economic Indicators, 2016–23

	2016	2017	2018	2019	2020	2021	2022	2023
		Act		Prel		Proj		
	(annual percentage change, unless otherwise indicated)							
Output and prices								
Real GDP growth[1/]	0.7	4.7	3.5	-8.3	0.8	2.5	2.5	2.2
Nominal GDP (US$ millions)	20,549	22,041	22,946	20,703	20,563	21,339	22,607	23,588
Nominal GDP (ZWL millions)	20,806	27,438	42,468	156,165	390,666	442,791	476,139	504,257
GDP deflator	3.5	26.0	49.5	300.9	148.1	10.5	4.9	3.7
CPI (annual average)	-1.6	0.9	10.6	255.3	221.1	3.7	3.0	3.0
CPI (end-of-period)	-0.9	3.4	42.1	521.1	52.0	3.0	3.0	3.0
Money and credit								
Money supply (M2)	18.8	39.0	24.0	127.5	24.4	…	…	…
Credit to the private sector	-3.9	5.9	9.1	174.1	56.7	…	…	…
Credit to the central government	51.6	74.5	59.2	62.3	27.5	…	…	…
	(ZWL$ per US$)							
Official Exchange rate								
ZWL:USD exchange rate (annual average)	1.0	1.3	2.0	8.5				
ZWL:USD exchange rate (end-of-period)	1.0	1.3	3.5	16.8				
	(percent of GDP)							
Central government								
Revenue and grants	16.8	14.1	12.9	13.5	12.8	12.7	12.6	12.7
Expenditure and net lending	23.9	24.0	18.6	16.9	17.8	15.0	14.7	14.8
Of which: Employment costs	15.5	12.7	9.3	4.9	4.3	4.3	4.5	4.9
Of which: Capital transfers and net lending	4.1	5.8	5.0	3.3	4.0	3.5	3.2	2.8
Overall balance	-7.1	-9.9	-5.7	-3.4	-5.0	-2.3	-2.1	-2.1
Primary balance	-6.4	-9.0	-4.8	-3.0	-4.6	-1.5	-1.4	-1.4
	(US$ millions, unless otherwise indicated)							
Balance of payments								
Exports of goods and services	4,060	4,734	5,304	4,634	5,038	5,215	5,447	5,772
(annual percentage change)	1.5	16.6	12.1	-12.6	8.7	3.5	4.5	6.0
Imports of goods and services	6,427	6,555	7,617	5,455	6,417	6,511	6,730	7,359
(annual percentage change)	-14.4	2.0	16.2	-28.4	17.7	1.5	3.4	9.3
Current account balance (excluding official transfers)	-718	-284	-1,229	155	-204	-302	-302	-538
(percent of GDP)	-3.5	-1.3	-5.4	0.7	-1.0	-1.4	-1.3	-2.3
Gross international reserves	310	293	87	111	109	109	109	109
(months of imports of goods and services)	0.6	0.5	0.1	0.2	0.2	0.2	0.2	0.2
Public debt								
Consolidated public sector debt (e.o.p.)	10,089	11,998	14,459	10,372	11,082	11,950	12,639	13,144
(percent of GDP)	49.1	54.4	44.2	50.1	53.9	56.0	55.9	55.7
Public and publicly guaranteed external debt (e.o.p.)	7,997	8,829	8,672	9,865	10,591	11,238	11,786	12,151
(percent of GDP)	38.9	40.1	37.8	47.6	51.5	52.7	52.1	51.5
Of which: Arrears	5,157	5,652	6,109	6,284	6,421	6,559	6,698	6,837
(percent of GDP)	25.1	25.6	26.6	30.4	31.2	30.7	29.6	29.0

Sources: Zimbabwean authorities; IMF staff estimates and projections.

1/ At constant 2012 prices.

Table 2. Zimbabwe: Balance of Payments, 2016–20

	2016	2017	2018	2019	2020
		Act.		Est.	Proj.
	(US$ millions, unless otherwise indicated)				
Current Account	-718	-284	-1,229	148	7
Balance on goods	-1,500	-1,147	-1,787	-486	-620
Exports of goods	3,663	4,315	4,804	4,138	4,569
Imports of goods	5,163	5,462	6,591	4,624	5,189
Balance on services	-867	-674	-526	-342	-345
Primary income (net)	-178	-161	-311	-339	-340
Secondary income (net)	1,827	1,697	1,396	1,314	1,311
of which: Workers' Remittances	1,103	1,013	898	839	839
Capital Account	242	278	309	53	54
Financial Account	-906	-994	-703	375	200
Direct investment	-343	-306	-358	-118	-223
Portfolio investment	80	101	-55	-7	69
Financial derivatives and employee stock options	0	0	0	0	0
Other investment	-643	-789	-291	500	354
Currency and Deposit (net)	22	144	137	556	93
Loans (net)	-559	-685	-293	22	-167
Assets	-62	41	140	192	49
Liabilities	581	830	430	534	260
Central bank	534	499	87	-9	0
General government	18	83	158	-7	167
Other sectors (NFCs, HH, NPISHs))	29	248	186	550	93
Errors and Omissions	522	1,362	104	23	…
Overall Balance	-92	-374	-320	-175	-139
Financing	92	374	320	152	139
Accumulation of external arrears	78	357	114	175	137
Reserve accumulation (minus = increase)	14	18	206	-24	2
Unidentified financing	…	…	…	…	0
Percent of GDP	…	…	…	…	0.0
Memorandum:					
Reserve assets	310	293	87	111	109
Months of import cover	*0.6*	*0.5*	*0.1*	*0.2*	*0.2*
	(percent of GDP)				
Current account	-3.5	-1.3	-5.4	0.7	0.0
Exports of goods and services	19.8	21.5	23.1	22.4	24.5
Imports of goods and services	31.3	29.7	33.2	26.4	29.2
	(annual percentage change)				
Exports of goods and services	1.5	16.6	12.1	-12.8	9.8
Imports of goods and services	-14.4	2.0	16.2	-28.4	10.9
Terms of Trade	1.2	0.9	0.9	-0.3	-1.4

Sources: Zimbabwean authorities; IMF staff estimates and projections.

Table 3a. Zimbabwe: Central Government Operations, 2016–23
(millions of ZWL$)

	2016	2017	2018	2019	2020	2020	2021	2022	2023
		Act.		Proj	Budget		Proj.		
Revenue and grants	**3,502**	**3,870**	**5,491**	**21,042**	**58,640**	**49,908**	**56,109**	**60,024**	**64,020**
Tax revenue	3,237	3,628	5,000	20,641	56,458	48,923	52,169	55,184	58,895
Personal income tax	736	729	856	3,000	7200	7,214	8540	9551	10115
Corporate income tax	338	485	802	2,458	6012	4,974	4385	4514	5312
Other direct taxes	187	203	261	891	3364	3,075	3244	3341	3441
Customs	273	295	433	1,793	3655	3,945	4063	4185	4311
Excise	642	676	909	3,928	11509	7,738	7970	8209	8456
VAT	963	1,075	1,363	5,609	15831	14,601	15,806	16,608	17,588
Other indirect taxes	98	165	377	2,962	8886	7,376	8161	8776	9672
Non-tax revenue and Grants	265	242	491	401	2182	985	3,940	4,840	5,126
Expenditure and net lending	**4,970**	**6,573**	**7,895**	**26,403**	**63640**	**69,601**	**66,303**	**70,086**	**74,571**
Current expenditure	4,004	4,831	5,220	13,456	38850	38,709	47,737	51,394	55,983
Employment costs	3,231	3,495	3,935	7,700	17751	16,740	19,096	21,635	24,513
Wages & salaries (excl. grants & transfers)	2,753	2,978	3,382	6,618	15257	14,388	16,412	18,595	21,068
Pensions	478	517	553	1,082	2494	2,352	2,683	3,040	3,444
Interest payments	127	233	368	669	704	1,574	3,708	3,198	3,340
Foreign	20	68	43	424	200	1,047	1,406	1,319	1,321
Domestic	107	165	325	245	504	527	2,302	1,879	2,019
Goods & services	370	887	703	3,559	11234	11,234	15,498	16,415	17,384
Current transfers	276	216	214	1,528	9161	9,161	9,436	10,146	10,746
Capital expenditure and net lending	966	1,742	2,675	12,947	24790	30,892	18,566	18,691	18,588
Capital transfers[1]	754	1,193	1,735	9,503	…	15,448	15,448	15,081	14,024
Other capital expenditure	105	145	542	2,532	…	15,242	2,916	3,408	4,362
Net lending	107	404	398	912	…	202	202	202	202
Overall balance (commitment basis)	**-1,468**	**-2,703**	**-2,403**	**-5,360**	**-5000**	**-19,693**	**-10,194**	**-10,062**	**-10,551**
Primary balance (commitment basis)[2]	-1,341	-2,471	-2,035	-4,691	-4296	-18,119	-6,487	-6,864	-7,210
Overall balance (cash basis)	**-1,421**	**-2,760**	**-2,371**	**-5,360**	**-5000**	**-20,704**	**-10,194**	**-10,062**	**-10,551**
Primary balance (cash basis)[2]	-1,301	-2,527	-1,959	-4,691	-4296	-18,119	-6,487	-6,864	-7,210
Unidentified Financing and Fiscal Measures	…	…	…	…		**14,912**	**4,695**	**4,461**	**4,613**
Financing	**1,401**	**2,631**	**3,186**	**5,364**	**5000**	**4,781**	**5,499**	**5,601**	**5,938**
Domestic financing (net)	1,354	2,658	3,082	5,566	8170	4,851	5,662	5,921	6,317
RBZ	950	1,727	3,038	5,178	0	0	0	0	0
Bank	274	953	677	1,106	4550	4,600	5,562	5,821	6,217
Non-bank	130	-22	-633	-655	3620	400	100	100	100
Foreign financing (net)	0	-73	-231	-1379	-3170	-3463	-4805	-4478	-4553
Disbursements	210	145	4	92	0	307	353	143	84
Amortization	210	218	234	1,471	-3170	3,770	5,158	4,621	4,637
of which: Paid	210	116	13	294	-3170	377	516	462	464
Change in arrears	46	46	335	1,177	0	3,393	4,642	4,159	4,174
Domestic	40	-56	76	0	…	0	0	0	0
Foreign	7	102	259	1,177	…	3,393	4,642	4,159	4,174
Interest	7	0	37	0	…	0	0	0	0
Principal[3]	0	102	222	1,177	…	3,393	4,642	4,159	4,174
Errors and omissions [4]	-67	-72	783	…	…	…	…		

Sources: Zimbabwean authorities; and IMF staff estimates and projections.

[1] Capital transfers include spending related to off-budget agricultural support programs and RBZ quasi-fiscal activitieswhich could be classified as current expenditures.

[2] The difference between the fiscal balance on a commitment and cash basis is the change in domestic and foreign interest arrears.

[3] Accumulated arrears on foreign debt do not include valuation adjustment. The stock of arrears could differ from that in the balance of payments table.

[4] A negative (positive) number means that Financing is lower (higher) than the Overall Balance on commitment basis.

Table 3b. Zimbabwe: Central Government Operations, 2016–23

(in percent of GDP)

	2016	2017	2018	2019	2020	2020	2021	2022	2023
		Act.		Est.	Budget		Proj.		
Revenue and grants	**16.8**	**14.1**	**12.9**	**13.5**	**15.0**	**12.8**	**12.7**	**12.6**	**12.7**
Tax revenue	15.6	13.2	11.8	13.2	14.5	12.5	11.8	11.6	11.7
Personal income tax	3.5	2.7	2.0	1.9	1.8	1.8	1.9	2.0	2.0
Corporate income tax	1.6	1.8	1.9	1.6	1.5	1.3	1.0	0.9	1.1
Other direct taxes	0.9	0.7	0.6	0.6	0.9	0.8	0.7	0.7	0.7
Customs	1.3	1.1	1.0	1.1	0.9	1.0	0.9	0.9	0.9
Excise	3.1	2.5	2.1	2.5	2.9	2.0	1.8	1.7	1.7
VAT	4.6	3.9	3.2	3.6	4.1	3.7	3.6	3.5	3.5
Other indirect taxes	0.5	0.6	0.9	1.9	2.3	1.9	1.8	1.8	1.9
Non-tax revenue and Grants	1.3	0.9	1.2	0.3	0.6	0.3	0.9	1.0	1.0
Total expenditure & net lending	**23.9**	**24.0**	**18.6**	**16.9**	**16.3**	**17.8**	**15.0**	**14.7**	**14.8**
Current expenditure	19.2	17.6	12.3	8.6	9.9	9.9	10.8	10.8	11.1
Employment costs	15.5	12.7	9.3	4.9	4.5	4.3	4.3	4.5	4.9
Wages & salaries (incl. grants & transfers)	13.2	10.9	8.0	4.2	3.9	3.7	3.7	3.9	4.2
Pensions	2.3	1.9	1.3	0.7	0.6	0.6	0.6	0.6	0.7
Interest payments	0.6	0.8	0.9	0.4	0.2	0.4	0.8	0.7	0.7
Foreign	0.1	0.2	0.1	0.3	0.1	0.3	0.3	0.3	0.3
Domestic	0.5	0.6	0.8	0.2	0.1	0.1	0.5	0.4	0.4
Goods & services	1.8	3.2	1.7	2.3	2.9	2.9	3.5	3.4	3.4
Current transfers	1.3	0.8	0.5	1.0	2.3	2.3	2.1	2.1	2.1
Capital expenditure and net lending	4.6	6.3	6.3	8.3	6.3	7.9	4.2	3.9	3.7
Capital transfers[1]	3.6	4.3	4.1	6.1	…	4.0	3.5	3.2	2.8
Other capital expenditure	0.5	0.5	1.3	1.6	…	3.9	0.7	0.7	0.9
Net lending	0.5	1.5	0.9	0.6	…	0.1	0.0	0.0	0.0
Overall balance (commitment basis)	**-7.1**	**-9.9**	**-5.7**	**-3.4**	**-1.3**	**-5.0**	**-2.3**	**-2.1**	**-2.1**
Primary balance (commitment basis)[2]	-6.4	-9.0	-4.8	-3.0	-1.1	-4.6	-1.5	-1.4	-1.4
Overall balance (cash basis)	**-6.8**	**-10.1**	**-5.6**	**-3.4**	**-1.3**	**-5.3**	**-2.3**	**-2.1**	**-2.1**
Primary balance (cash basis)[2]	-6.3	-9.2	-4.6	-3.0	-1.1	-4.6	-1.5	-1.4	-1.4
Unidentified Financing and Fiscal Measures	…	…	…	…	**0.0**	**3.8**	**1.1**	**0.9**	**0.9**
Financing	**6.7**	**9.6**	**7.5**	**3.4**	**1.3**	**1.2**	**1.2**	**1.2**	**1.2**
Domestic financing (net)	6.5	9.7	7.3	3.6	2.1	1.2	1.3	1.2	1.3
RBZ	4.6	6.3	7.2	3.3	0.0	0.0	0.0	0.0	0.0
Bank	1.3	3.5	1.6	0.7	1.2	1.2	1.3	1.2	1.2
Non-bank	0.6	-0.1	-1.5	-0.4	0.9	0.1	0.0	0.0	0.0
Foreign financing (net)	0.0	-0.3	-0.5	-0.9	-0.8	-0.9	-1.1	-0.9	-0.9
Disbursements	1.0	0.5	0.0	0.1	0.0	0.1	0.1	0.0	0.0
Amortization	1.0	0.8	0.6	0.9	-0.8	1.0	1.2	1.0	0.9
Of which: Paid	1.0	0.4	0.0	0.2	-0.8	0.1	0.1	0.1	0.1
Change in arrears	0.2	0.2	0.8	0.8	0.0	0.9	1.0	0.9	0.8
Domestic	0.2	-0.2	0.2	0.0	…	0.0	0.0	0.0	0.0
Foreign	0.0	0.4	0.6	0.8	…	0.9	1.0	0.9	0.8
Interest	0.0	0.0	0.1	0.0	…	0.0	0.0	0.0	0.0
Principal[3]	0.0	0.4	0.5	0.8	…	0.9	1.0	0.9	0.8
Errors and omissions [4]	-0.3	-0.3	1.8	…	…	…	…	…	…
Memo: Nominal GDP (LCU, millions)	20,806	27,438	42,468	156,165	390,666	390,666	442,791	476,139	504,257

Sources: Zimbabwean authorities; and IMF staff estimates and projections.

[1] Capital transfers include spending related to off-budget agricultural support programs and RBZ quasi-fiscal activitieswhich could be classified as current expenditures.

[2] The difference between the fiscal balance on a commitment and cash basis is the change in domestic and foreign interest arrears.

[3] Accumulated arrears on foreign debt do not include valuation adjustment. The stock of arrears could differ from that in the balance of payments table.

[4] A negative (positive) number means that Financing is lower (higher) than the Overall Balance on commitment basis.

Table 4. Zimbabwe: Monetary Survey, 2016–20
(Millions of ZWL$; unless otherwise indicated)[1]

	2016	2017	2018	2019	2020
		Act.		Est.	Proj.
Reserve Bank of Zimbabwe (RBZ)					
Net foreign assets	-574	-1,126	-1,758	-50,741	-66,576
Net domestic assets	2,047	3,794	5,016	60,141	77,386
Net credit to financial corporations	-149	-406	-2,246	-4,684	-3,274
Claims on central government	2,338	3,986	7,025	14,182	14,182
of which: Government securities	566	1,479	2,062	9,872	9,872
of which: Loans (incl. overdraft)	1,771	2,507	4,962	4,311	4,311
Other items, net[2]	-142	214	237	50,642	66,478
Monetary base	1,473	2,668	3,258	9,400	10,810
Banks					
Net foreign assets	18	-201	-119	10,448	12,815
Net domestic assets	5,549	7,649	9,610	21,724	34,166
Claims on the RBZ	1,643	2,605	3,970	8,167	9,401
Net credit to central government	1,379	2,332	3,009	4,052	8,500
Credit to other public sector	121	215	285	313	793
Credit to private sector	3,497	3,694	4,037	11,038	17,355
Other items, net[2]	-1,091	-1,196	-1,692	-1,846	-1,884
Deposits	5,567	7,448	9,491	32,172	46,980
of which: FX deposits	0	0	343	11,216	20,483
Monetary survey					
Net foreign assets	-556	-1,328	-1,877	-40,292	-53,762
Net domestic assets	6,194	9,145	11,887	75,571	104,000
Net credit to central government	3,598	6,277	9,992	16,213	20,661
Credit to other public sector	288	637	775	3,389	3,870
Credit to private sector	3,514	3,719	4,059	11,125	17,442
Other Items, net[2]	-1,205	-1,490	-2,939	44,843	62,027
Broad money (M3)	5,638	7,817	10,010	33,309	48,269
Money (M2)[3]	5,575	7,749	9,608	21,858	27,190
Currency	70	332	502	1,011	1,162
Memorandum items			*(Annual percentage change)*		
Credit to private sector	-3.9	5.9	9.1	174.1	56.8
Net credit to central government	51.6	74.5	59.2	62.3	27.4
Monetary base	161.5	81.2	22.1	188.5	15.0
M2[3]	18.8	39.0	24.0	127.5	24.4
Nominal GDP growth	4.2	31.9	54.8	267.7	152.4
			(Percent of GDP)		
Credit to private sector	16.9	13.6	9.6	7.1	4.4
Monetary base	7.1	9.7	7.7	6.0	2.7
M2[3]	26.8	28.2	22.6	14.0	6.9

Sources: Zimbabwean authorities; and IMF staff estimates and projections.

[1] Parity between the ZWL$ and the USD$ is assumed before 2019.

[2] Includes valuation adjustment from currency reform.

[3] Excludes FX deposits.

Table 5. Zimbabwe: Financial Soundness Indicators

Financial Soundness Indicators	Dec-2014	Dec-2015	Dec-2016	Dec-2017	Dec-2018	Sep-2019[1]
Capital Adequacy						
Regulatory capital to risk-weighted assets	16.9	19.9	24.5	27.6	28.1	30.1
Percentage of banks greater or equal to 10 percent	85.7	100.0	100.0	100.0	100.0	100.0
Percentage of banks below 10 and above 6 percent minimum	7.1	0.0	0.0	0.0	0.0	0.0
Percentage of banks below 6 percent minimum	7.1	0.0	0.0	0.0	0.0	0.0
Capital to assets	10.4	11.3	13.4	12.3	11.4	8.8
Asset Quality						
Foreign exchange loans to total loans	1.4	3.0	0.1	0.5	0.4	1.2
Past-due loans to gross loans[2]	45.8	43.2	37.5	35.6	34.8	21.7
Nonperforming loans (past due > 90 days)[3]	16.3	12.0	7.9	7.1	7.2	3.2
Watch-listed loans (past due < 90 days)[4]	29.4	31.2	29.6	28.6	26.4	18.5
Provisions as percent of past-due loans	15.5	13.2	14.1	14.7	24.3	20.6
Earnings and Profitability						
Net profit (before tax and extraordinary items)/net income	129.9	149.9	120.4	121.3	117.9	106.0
Return on assets	0.8	1.8	2.5	2.6	3.9	6.2
Return on equity	4.6	9.0	13.4	15.5	24.7	44.3
Expenses/income	93.0	81.8	73.5	70.7	65.2	35.5
Liquidity						
Liquid assets/total assets	27.3	36.1	44.1	52.9	56.4	54.0
Liquid assets/short-term liabilities	35.6	46.8	55.9	65.5	69.1	0.0
Loans/deposits	76.5	84.7	69.8	49.2	43.9	39.7
Liquid assets/total deposits	48.6	64.3	72.9	77.1	83.0	100.8
Foreign exchange liabilities/total liabilities	4.3	2.1	3.1	2.0	2.9	16.2
Excess Reserves to Broad Money	9.5	11.8	17.2	16.2	23.2	16.5

Source: Reserve Bank of Zimbabwe.

[1] Based on commercial banks only. The Sep-2019 prudential ratios reflect banks' own expectation regarding government the size of compensation for FX losses.

[2] Past due loans are defined as the aggregate of special mention, substandard, doubtful, and loss loans.

[3] Non-perfoming loans are defined as the aggregate of substandard, doubtful, and loss loans.

[4] Watch-listed loans are the same as special mention loans.

Table 6. Zimbabwe: SMP Quantitative Targets[1]
(in units as indicated)

	Dec.	End-June 2019			End-September 2019		
	Actual	Prog.	Prel.	Status	Prog.	Prel.	Status
1. Floor on the primary budget balance of the central government (ZWL$ million) [2]	...	-1,203	38	met	-1,604	-2,502 [3]	not met
2. Floor on protected social spending (ZWL$ million) [2]	...	225	268	met	500	561	met
3. Floor on the stock of net official international reserves (in US$ million) [4]	56	-1,267	186	met	-1,267	66	met
4. Continuous ceiling on the stock of new non-concessional external debt contracted or guaranteed by the public sector with original maturity of one year or more (in US$ million) [5 6]	...	0	108	not met	0	108	not met
5. Ceiling on changes in net domestic assets of the RBZ (ZWL$ million) [7]	...	300	-240	met	350	1,057	not met
6. Ceiling on credit to the nonfinancial public sector from the RBZ (ZWL$ million) [8]	...	0	-191	met	0	1,572	not met

[1] Program performance will be monitored based on the quantitative targets for June, September, and December 2019.

[2] Value of cumulative flows since December 31 of the previous year.

[3] Although in nominal terms the primary deficit target for end-September was missed, this reflects the higher inflation (as a share of GDP the deficit was below the SMP target).

[4] The SMP targeted an unchanged level of NIR relative to end-December stock (US$56 million), but the numbers erroneously reflected NFA (US$-1,267 million). This has been corrected for the end-September and end-December 2019 targets.

[5] Cumulative from April 30, 2019.

[6] Reflects augmentation of loans for infrastructure projects (energy, water and telecommunication) originally signed between 2012 and 2015 but not disbursed.

[7] Cumulative from March 1st 2019. For the NDA target, excludes foreign exchange valuation changes.

Table 7. Zimbabwe. SMP Structural Benchmarks

Benchmark	Objective	Completion Date	Comments
Cabinet to approve a revised 2019 budget consistent with a deficit of RTGS$2.8 billion (Country Report No. 19/144, MEFP ¶9 and ¶10)	Restore macroeconomic stability	Prior Action	**Done**
Issue instructions to ensure that no payments shall be made by the RBZ on behalf of Government without explicit and case-by-case authorization by the MoFED (Country Report No. 19/144, MEFP ¶13)	Improve PFM, budget execution, and fiscal discipline	Prior Action	**Done**
Issue an instruction to disallow, with immediate effect, any future acquisitions of non-performing loans by ZAMCO (Country Report No. 19/144, MEFP ¶16)	Improve governance, PFM, and budget monitoring/execution	Prior Action	**Done**
Adopt regulations implementing the Public Financial Management (PFM) Act., including to ensure all expenditure commitments are recorded in IFMIS (Country Report No. 19/144, MEFP ¶13)	Improve governance, PFM, and budget monitoring/execution	June 2019	**Done –** Gazetted on the 14th of June 2019 (SI 135 of 2019)
Complete a comprehensive stock-take of domestic expenditure arrears across the central government as of end-2018 (Country Report No. 19/144, MEFP ¶17)	Improve PFM, budget execution, and fiscal discipline	September 2019	**Done –** The report has been produced
Complete a review of agricultural support programs and develop an action plan based on its findings (Country Report No. 19/144, MEFP ¶10)	Improve targeting and efficiency of agricultural support programs	September 2019	**Done** – Smart Agriculture introduced in 2020 National Budget. Financing for Agriculture will be from the private sector with Government providing guarantees
Extend the coverage of IFMIS to 37 Districts by establishing 31 additional kiosks (Country Report No. 19/144, MEFP ¶13)	Improve governance, PFM, and budget monitoring/execution	September 2019	**Done**
Submit to Parliament draft amendments to the Banking Law to address gaps identified by the FSSR (Country Report No. 19/144, MEFP ¶22)	Maintain financial stability	December 2019	After the Financial Sector Stability Review (FSSR) Mission, the Reserve Bank requested for Technical Assistance (TA). The proposed TA has not yet commenced, and this will influence the recommendations to the Banking Law amendments.
Complete with assistance from the IMF and publish the report of a diagnostic assessment of Zimbabwe's governance vulnerabilities (Country Report No. 19/144, MEFP ¶24)	Strengthen governance and combat corruption	December 2019	The authorities have agreed to publish shortly their own assessment of governance vulnerabilities, which will feed into a comprehensive anti-corruption strategy.

Annex I. Progress Against IMF Recommendations

Policies	2017 Article IV Recommendations	Actions since 2017 Article IV Consultations
Fiscal Policy	Fiscal consolidation to achieve fiscal surplus over the medium term	Fiscal deficits in 2017 and 2018 were much higher than targeted under the budget. Significant fiscal consolidation in 2019.
	Contain wage bill	Significant progress despite high inflation that has made containing the wage bill very challenging.
	Streamline the civil service	No action taken. Authorities agreed with staff assessment, but disagreed with policy recommendations.
	Eliminate the agricultural command program	Financing of inputs under the program has been transferred to the banking system. Risks to the budget remain high as the government provided full guarantee against credit default.
	Implement PFM Reforms	Authorities adopted regulations to implement the Public Financial Management Act, gazetted on the 14th of June 2019.
Monetary and Financial Polices	Refrain from monetary financing	Although direct financing of the central government deficit has stopped, large quasi-fiscal activities by the RBZ have continued.
	Lift the interest rate cap	All caps on interest rate have been removed following the June 2019 increase in overnight interest rate from 15 to 50 percent.
	Strengthen AML/CFT framework	Steps taken since the 2016 ESAAMLG assessment were insufficient to prevent a grey listing of Zimbabwe by the FATF in October 2019.
Structural Polices	Improve governance	A comprehensive governance assessment was undertaken by Fund staff, and the authorities will adopt shortly an anti-corruption strategy.
	Improve the management of SOEs	The government has approved a reform framework for 43 SOEs and parastatals, aimed at making them fully accountable, transparent, and economically viable. In addition, the government is targeting 5 key SOEs for privatization/divestiture and is preparing turnaround strategies for at least 20 SOEs with technical assistance from various development partners.
	Provide clarity to land rights	The first phase of the National Agricultural Land Audit was undertaken in 2018. The second phase is planned for 2020.
	Improve business climate	The indigenization policy has been relaxed, investment-promoting institutions merged into a single Zimbabwe Investment and Development Agency, and a policy has been established to collapse multiple licensing requirements into single omnibus licenses in the tourism and transportation sectors.

Annex II. Risk Assessment Matrix[1]

Source of Risks	Likelihood/ Time Horizon	Expected Impact on Economy	Policy Response
		Potential Domestic Shocks	
Delay in fiscal consolidation	**High/Short to Medium Term**	**High.** Absent expenditure rationalization or continued quasi-fiscal activities by the RBZ, the financing needs would continue to remain high. Given limited external financing, resorting to large monetary financing would lead to continued depreciation, threatening price and financial sector stability.	Create the domestic political consensus to contain current spending, improve revenue collection, and increase spending efficiency. Reduce the footprint of the government in the economy by leveraging the private sector.
Stalled reengagement from delays in political and economic reforms	**Medium/Short to Medium Term**	**High.** A failure to advance political and economic reforms and garner the support of the international community would maintain the status quo, exacerbating the economic imbalances and further worsening policy confidence.	Advance political and economic reforms to gain support of international community and pave the way for arrears' clearance. This would unlock financing from IFIs and help restore access to international financial markets.
Worsened drought conditions	**Medium/Short to Medium Term**	**High.** Most of the agricultural sector is rainfed and highly susceptible to rainfall, and hydropower provides much of electricity generation.	Create fiscal space for grain imports and social spending to support the most vulnerable parts of the population.
		Potential External Shocks	
Weaker-than-expected global growth, and/or rising protectionism	**Medium/Short to Medium Term**	**High**. Zimbabwe would be impacted mainly through the trade channel, especially from South Africa. Financing and remittances would also suffer, increasing BOP pressures.	Advance structural reforms to improve productivity and competitiveness, and re-engage with the international community to gain access to financial support.
Sharp rise in risk premia	**High/Short term**	**High**. In addition to adverse effects from the trade channel, tighter global financial conditions could hit Zimbabwe's competitiveness through an appreciation of the U.S. dollar, and raise the cost of Zimbabwe's external borrowing.	Renew efforts to implement structural reforms to improve the business climate and reduce the cost of doing business, to increase productivity and strengthen competitiveness.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term (ST)" and "medium term (MT)" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.

Annex III. External Sector Assessment[1]

***Overall Assessment:** The external position of Zimbabwe in 2019 was broadly consistent with the medium-term fundamentals and desirable policies. The current account (CA) gap is assessed at -0.5 percent, translating into a two percent real effective exchange rate (REER) gap. The sharp depreciation of Zimbabwe dollar in 2019, over and above the concurrent sharp rise in inflation, has helped reduce the large REER gap observed in 2018.*

A. Current Account and Real Effective Exchange Rate

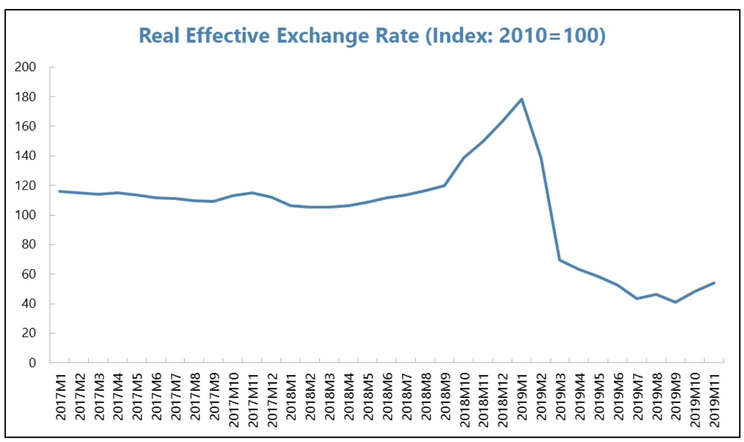
1. **The current account registered a small surplus in 2019, on account of a sharp import compression driven by foreign exchange constraints and possibly the expenditure switching effects of the currency reform.** Although exports have declined by 12.8 percent mainly because of drought, energy shortages, and exchange rate issues, the sharp fall in imports (28.4 percent) and stable remittance inflows have contributed to the positive current account balance.

Balance of Payments, 2017-2019
Percent of GDP

	2017	2018	2019
Current Account	-1.3	-5.4	0.7
Trade balance on goods and services	-8.3	-10.1	-3.9
Exports of goods and services	21.5	23.1	22.0
Imports of goods and services	29.7	33.2	25.9
Income	7.0	4.7	4.6
Primary Income	-0.7	-1.4	-1.6
Secondary Income	7.7	6.1	6.3
Capital Account	1.3	1.3	0.3
Financial Account	4.5	3.1	-1.8

Source: Authorities and Fund staff calculations.

2. **The Real Effective Exchange Rate (REER) depreciated by about 70 percent at end-2019 relative to end-2018.** The depreciation reflects the sharp devaluation of the domestic currency following the currency reform in February 2019 and the subsequent depreciation of the currency. Although domestic prices accelerated sharply by about 500 percent at end-2019, the domestic currency depreciated by much more (losing more than 4/5 of its value during 2019)—leading to a significant REER depreciation.



[1] The external balance sheet is not covered here for lack of IIP data.

B. External Sustainability Assessment

3. The external position is broadly consistent with the fundamentals and desirable policies. The EBA-lite current account model suggests a current account gap of -0.5 percent of GDP, implying a 2 percent REER gap. The REER model suggests a slight undervaluation, about 3 percent, on account of a fifteen-fold depreciation of the domestic currency while prices increased by five-fold by end-2019. However, multiple breaks in the historical real effective exchange rate data series could distort the results of the REER index model.

Summary Table: Current Account Balance Approach

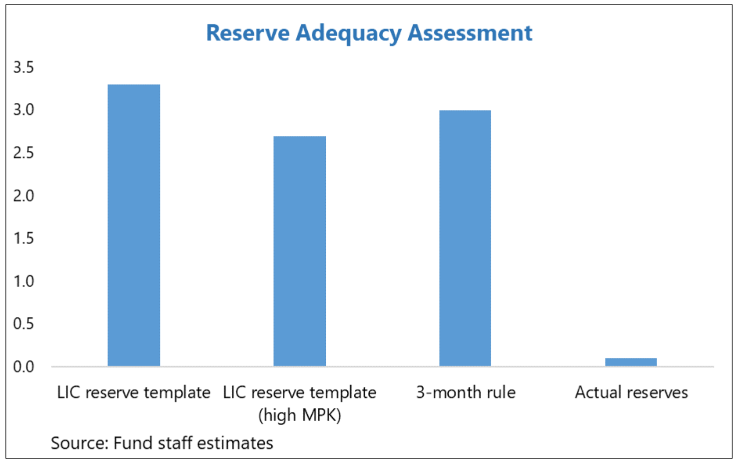
CA-Actual	0.7%
Cyclical Contributions (from model)	1.0%
Cyclically Adjusted CA	-0.3%
CA-Norm	0.6%
Cyclically Adjusted CA Norm	-0.5%
Multilaterally Consistent Cyclically Adjusted CA Norm	0.2%
CA-Gap	-0.5%
of/which Policy Gap	-2.4%
Elasticity	-0.31
REER Gap	2.0%
CA-Fitted	-1.7%
Residual	2.4%
Natural Disasters and Conflicts	0.2%

Source: IMF staff estimates.

4. The CA adjustment has been achieved through significant import compression that cannot be sustained over the medium term. As the country is faced with a foreign exchange crunch with little prospects for external financial flows over the medium term, import compressions could persist as export receipts are earmarked for servicing massive foreign debt obligations, leading to significant economic contraction.

C. Capital Flows and International reserves

5. The financial account turned to a net lending position on the back of huge repayments for offshore facilities. Non-debt creating inflows, notably FDI, were subdued as uncertainties regarding political and economic reforms are lingering. Private capital flows in the forms of loans are also depressed on account of high perceived country risk premium.



6. Reserves have fallen below what could be considered adequate because of weak capital inflows. Gross international reserves stood at US$ 109 million by end-2019, covering about a week of imports. Zimbabwe's foreign reserves are much lower than both the rule-of-thumb (3-month rule) and the model-based benchmark—the IMF template for assessing reserve adequacy in low income countries suggests 2.7 to 3.3 months[2] equivalent of imports as the adequate level for Zimbabwe.

Policy implications

7. Accelerating the ongoing foreign exchange market, monetary market, and structural reforms are essential to boost investors' confidence and attract private capital flows. The interbank FX market should be allowed to play its role of price discovery for private investors to price the exchange rate risks. A functioning interbank FX market and stabilizing inflation through restrictive fiscal and monetary policies are important for restoring and maintaining market confidence. Fiscal policy has been significantly tightened in 2019 but it has to be in tandem with tight monetary policy in order to bring inflation down. In addition, structural reforms including strengthening the property rights regime and improving the business climate could help unlock private capital flows.

[2] The low end of the estimate assumes high cost of holding reserves (marginal productivity of capital) as Zimbabwe is struggling to finance essential imports.

Annex IV. Governance and Corruption Challenges

1. Addressing Zimbabwe's governance and corruption vulnerabilities will resolve huge economic challenges and have a large positive impact on medium- to long-term inclusive growth. Several international indicators show Zimbabwe's scores on governance, transparency and corruption perception to be well below the regional average. The consensus across different sectors (public, private, civil society and the international community) is that the country's serious governance weaknesses have proliferated corruption, thus dampening prospects for the sustained long-term growth of fiscal revenue and output.

2. The government has embarked on reforms to restore trust and enhanced governance. It established a high-level working group of relevant department and agencies, chaired by the Ministry of Finance and Economic Development (MoFED) and the Office of the President and Cabinet (OPC), and requested the IMF staff's assistance to conduct a diagnostic assessment of Zimbabwe's governance and corruption challenges.[1] In line with the IMF's revised policy on governance,[2] the diagnostic assessment focuses on macro-critical issues related to governance and corruption in Zimbabwe. Based on this assistance from IMF staff, the government is planning to publish its final assessment of governance vulnerabilities by the first quarter of 2020 which will feed into a comprehensive anti-corruption strategy.

3. The Zimbabwe authorities correctly recognize the importance of governance reform and addressing corruption but faces serious challenges in tackling it. The Transitional Stabilisation Programme (TSP) adopted in October 2018, is focused on macroeconomic stabilization, but also lays out important social and political reforms to empower citizens, tackle corruption, and strengthen the rule of law. Several new laws have been put in place as well as institutional reforms to strengthen the judiciary and revamp the Anti-Corruption Commission. These reform initiatives are taking place amid severe economic conditions and resource constraints. They face serious challenges due to generally poor enforcement of laws and regulations and deep mistrust between the government, the business sector and civil society.

4. In assisting the authorities to assess governance vulnerabilities in Zimbabwe, IMF staff focuses on the six areas covered by the Fund's 2018 Framework. These areas are: fiscal governance, the financial sector, central bank governance and operations, market regulation, the rule of law, and the AML-CFT framework. In addition, IMF staff also helped assess Zimbabwe's overall anti-corruption framework.

[1] IMF, Technical Report on Governance, *Zimbabwe: Governance and Anti-Corruption Assessment*, January 2020.

[2] IMF, *Review of the 1997 Guidance Note on Governance—A Proposed Framework for Enhanced Fund Engagement*. April 2018.

A. Fiscal Management

Public Financial Management

5. In Zimbabwe, subsidies are extensively used in many sectors and areas. These include agriculture, electricity, fuel and other import subsidies via Foreign Exchange (FX) allocation at preferential rates, as well as subsidies to gold and platinum exporters. Subsidies included in the budget are recorded as capital expenditures and cover subsidized grain imports and agricultural support programs.

6. The Command Agriculture Program that was introduced in 2016 has created governance vulnerabilities due to lack of clarity, transparency and accountability in its design and implementation. The program included two schemes: (i) the input scheme (Special Maize Production Program), which provided inputs, irrigation, and mechanized equipment to farmers through designated suppliers; and (ii) the price subsidy scheme for grain purchases (especially of maize) through the Grain Marketing Board (GMB) at an administered price backed by law. Governance issues related to the input scheme included lack of strict criteria for eligibility, low take-up of the subsidies provided, and no transparent selection criteria for designated input suppliers. The price subsidy scheme also gave rise to corruption vulnerabilities (i.e., round-tripping). These vulnerabilities arose when the GMB purchases maize from farmers at the official higher price and sells it to millers and other customers at a subsidized lower price. As discussed in the staff report (¶8), starting with the 2019/20 agriculture season, the financing of inputs under the command agriculture program has been transferred to the banking system. However, risks to the budget remain high as the government provided a full guarantee against credit default and it is too early to assess the impact on addressing governance challenges stated above.

7. Debt management is weak and debt statistics are not systematically compiled and published. Even though the Public Debt Management Office has been working on the publication of a debt bulletin, currently no debt data are disseminated on the Ministry of Finance's (MoFED) web site, except for the limited data included in the annual budget documentation. No public debt report has been submitted to the Parliament despite the provisions of the Constitution and the legislation on public debt.

8. There is lack of full utilization of the expenditure controls available in Zimbabwe's automated financial management information system (PFMS). Many transactions occur outside the PFMS despite provisions of the PFMA and related Treasury Instructions. Procuring goods and services outside the PFMS is possible and no penalties are applied to ministries, departments and agencies (MDAs) who take this approach. Given this, expenditure arrears have started accumulating due to weak expenditure controls and the worsened fiscal conditions. The authorities have been working with the World Bank on a stocktaking exercise. In the meantime, MDAs pay some of these arrears without having transparent criteria to prioritize the payments, thus creating a governance vulnerability.

9. The government is not complying with some legal requirements in respect of public financial management and fiscal reporting. Preparing accurate, comprehensive and timely fiscal reports is crucial for transparency and accountability and to avoid governance vulnerabilities. The government currently publishes the budget execution reports and monthly consolidated financial statements but there is limited or no regularly published information on extrabudgetary funds or state-owned enterprises (SOEs). There has been slow progress in improving fiscal reporting in budget execution, fiscal statistics and government financial statements, though the authorities have improved compliance with international standards for statistical reports (the IMF's *Government Finance Statistics Manual*, 2014).

10. The systems of internal control and internal audit are weak in Zimbabwe, creating many opportunities for financial irregularities and corruption. Internal audit functions have been established in all line ministries which receive appropriations from the Central Government by votes. Implementation by the government of the recommendations of the Auditor General's Office (the supreme audit institution in Zimbabwe) on fiscal reporting and internal control covering the period 2014-2017 has been very limited. In some cases, the MoFED and line ministries have not complied with legal requirements.

Revenue Administration

11. Zimbabwe Revenue Authority (ZIMRA), has in place many of the elements of an integrity strategy, but more can be done. Good practice is evident in ZIMRA's integrity processes—both procedurally and operationally. But governance gaps created by inefficiencies in processes have negatively impacted perceptions of the tax system. It is critical that reforms underway continue to address governance gaps already identified on taxpayer compliance and additional high-risk governance vulnerabilities.

12. ZIMRA's governance framework is set out in its enabling legislation (the Revenue Authority Act). The Act states that ZIMRA will act as "an agent of the state in assessing, collecting and enforcing payment of all revenues." Its further states that ZIMRA will be "controlled and managed by the board" but is silent on the specific role of the board. The ZIMRA governance framework under the Revenue Act assigns some far-reaching roles and responsibilities to the board that weaken government oversight. The law, for example, enables the board to control and manage ZIMRA operations with potential access to taxpayer information without secrecy constraints. The law gives the board powers normally provided to a Minister and Commissioner General. In addition, the Minister must consult the Board before making regulations related to contraventions and penalties, e.g., for non-filing.

13. The existence and lack of coordination among multiple (up to 26) government agencies at the 18 border posts in Zimbabwe promotes disorder and fraudulent transactions. Drawing on the experience of neighboring countries such as Zambia, a coordinated border management law would reduce governance vulnerabilities by clearly defining the role and responsibility of ZIMRA and other government agencies operating at the border.

State-Owned Enterprises (SOEs) and Extractive Industries

14. The management of SOEs remains challenging and raises governance concerns. The challenges relate to weak governance and failure to implement announced government policies. Despite reforms launched in the 2011 budget and the following budgets, the SOE sector continues to operate with losses and increasing liabilities. The government has outlined a comprehensive program to reform state enterprises and parastatals. The program aims to strengthen the governance of state enterprises and improve their financial performance and service delivery. Also, the government has earmarked 43 enterprises for privatization, liquidation, or merger. Currently, several milestones have been achieved, notably the approval of the Public Entities Corporate Governance (PECG) Act in November 2018, and the establishment of a Corporate Governance Unit under the OPC.

15. Other serious governance challenges, however, still need to be addressed:

- The nominations of the members of SOEs' boards do not yet comply with the PECG Act and its regulations.
- The principles of good governance require the publishing of annual financial statements by SOEs, but this is not yet a standard practice, and information is both limited and untimely.
- The public finance law requires public entities to submit quarterly and annual reports to MoFED, but many SOEs have not observed this requirement.
- Lack of clarity in the inter-ministerial arrangements for managing the privatization of 25 SOEs announced in November 2018 creates risks of rent-seeking opportunities.

16. There are substantial governance vulnerabilities in the mining sector which includes both private companies and SOEs.[3] These vulnerabilities include lack of scrutiny of agreements with investors (including fiscal concessions), undue discretion in the award of mining licenses, inefficient or conflicted SOE performance, lack of monitoring of production leading to theft and/or smuggling of minerals, and inefficient allocation/spending of natural resource revenues. Several investment incentive regimes are available to investors and SOEs are also entering into agreements with investors. These contracts can include fiscal terms, but little information is publicly disclosed on what has been agreed with investors. Several SOEs (Minerals Marketing Corporation of Zimbabwe—MMCZ, Zimbabwe Consolidated Diamond Company—ZCDC and Fidelity Printing and Refining—FPR, which is an RBZ subsidiary) play a prominent role in the mining industry and have been afforded exclusive rights to undertake essential market functions, powers that create substantial governance vulnerabilities.

[3] The IMF's assessment of the extractive industries was also limited by challenges in convening meetings with some entities and persons and in receiving certain key data.

B. Reserve Bank Governance and Financial Sector Oversight

17. The RBZ's mandate is convoluted and weak by international standards. As a pre-condition for robust decision making, the RBZ Act should distinguish clearly between the Bank's objectives, functions and powers, which is not yet the case. The Act currently blurs the distinction between objectives and functions. This weakness is exacerbated by an overly complex and non-transparent monetary system. While a recent Regulation defines the ZWL$ as sole legal tender, the concept of legal tender remains unclear and there have been cases where payments due after the introduction of the ZWL$ have been allowed in the old currency and exchange rates.

18. The framework for the RBZ's lending operations to the banking sector is not transparent. These lending operations cover both standard monetary policy operations and Emergency Liquidity Assistance (ELA). As noted in the IMF's Financial Sector Stability Review (FSSR) conducted in 2018, monetary policy and ELA operations should be clearly differentiated. Although the RBZ has addressed the differentiation, it has not communicated this in a transparent way.

19. The RBZ conducts quasi-fiscal operations that fall outside of typical central bank activities. Some of these operations are carried out through the RBZ's subsidiaries—for example, financial support to gold miners via the FPR. Another significant example was the RBZ's preferential exchange rates for fuel imports (discontinued since October 2019), which provided fuel subsidies estimated to have amounted to over US$ 300 million in 2019. All gold mined in Zimbabwe must be sold to the FPR. While the RBZ has introduced incentives aimed at enhancing gold deliveries to FPR, it also needs to ensure that its subsidiary follows the requirements of the Gold Trade Act to purchase gold only from authorized persons.

20. The RBZ's broad discretion in applying the foreign exchange regulations reveals further governance vulnerabilities. The allocation criteria are opaque and open to mismanagement (e.g., the allocation of foreign exchange to priority imports). Another risk relates to the RBZ directive for authorized dealers to transfer legacy debt to the RBZ. The legal basis for this RBZ decision is unclear.

21. The RBZ's decision-making framework is not in line with leading international practices and should be strengthened to mitigate the above-mentioned vulnerabilities. While the Board exercises supervision over the executive management of the RBZ, there is a concentration of power at the executive level. In addition, the composition of the Audit and Oversight Committee (AOC), which is typically charged with close oversight of financial matters, is not in line with leading practices with respect to the independence and experience of the members.

22. The rules on conflicts of interest have major weaknesses. While the RBZ Act does contain a provision on disclosure of information in the Codes of Conduct for managerial and non-managerial staff, the latter do not apply to the Governor, Deputy Governors, and Board members. This also applies to the Zimbabwe Asset Management Company (ZAMCO)—the RBZ subsidiary managing non-performing loans—which does not have specific provisions that describe its powers and governance.

23. The RBZ does not have full autonomy from the government in relation to its policies, decision-making, and operations. The RBZ Act contains an extensive list of provisions which allow for direct undue political influence over the Bank's policies and operations. Stronger safeguards are needed to insulate the Bank from political interference in respect of the appointment and dismissal of the Governor, the Deputy Governor(s), other Board members and MPC members. Leading practices require a double veto procedure (i.e., the involvement of two separate bodies to ensure a transparent and objective procedure) for appointments and dismissals.

24. The RBZ framework for financial sector oversight creates governance vulnerabilities. A weak legal framework does not allow the supervisory authority to adequately perform its responsibilities. The significant role of the MOFED with respect to bank supervision undermines the supervisory authority's (RBZ) operational independence and creates governance vulnerabilities. Contrary to leading practices, the Banking Act contains many instances where the MOFED is involved in the final decision-making, grants approval on certain applications, or has the authority to reverse the supervisory authority actions.

C. Rule of Law

25. Corruption vulnerabilities may arise in the administration of land resources. Sources of vulnerability include: (i) lack of clarity in the criteria for administering land resources (i.e., ambiguous conditions for granting land use permits and leases, for granting permission to sublease or to use land in joint investment venture, and for government retaking of the land); (ii) lack of transparency in the decision-making process; and (iii) lack of proper control over this process (i.e., role of an independent and capable agency and judiciary to safeguard against potential abuses). These weaknesses create an opportunity for arbitrary decisions, and together with the lack of transparency and proper control, the risk of official abuse could significantly increase.

26. The government is undertaking further reforms to enhance the judiciary's capacity and efficiency. The relative efficiency of the judiciary in Zimbabwe appears to have improved significantly in recent years, mainly due to a performance management system for judges and magistrates which was launched by the Judicial Service Commission in 2014.

D. AML/CFT

27. Corruption and the laundering of its proceeds present a significant threat in Zimbabwe. The authorities are working to address the AML/CFT deficiencies identified in the recent

FATF listing and the 2016 ESAAMLG report. Legislative amendments have addressed some weaknesses in the AML framework, including an obligation on financial institutions to identify and verify their customers' beneficial owners. Further efforts to enhance the effectiveness of the AML/CFT framework (including capacities for conducting financial investigations and public access to beneficial ownership information) will help detect and deter corruption. Effective implementation of risk-based AML/CFT supervision can also contribute to ensuring financial institutions' compliance with fit and proper controls, enhanced customer due diligence obligations for politically exposed persons, and dynamic suspicious transaction reporting. A robust online asset declaration system for politically exposed persons should also be introduced.

E. Recommendations

28. Despite a fairly adequate legal framework, enforcement of anti-corruption has so far been relatively ineffectual and there is also a perception that the authorities' fight against corruption is selective and highly politicized. Several factors may have contributed to these problems. First, there is no top-down overall anti-corruption strategy and framework for implementation across the entire public administration. Second, information and data in many critical areas (e.g., fiscal information in mining contracts or central bank financial statements) is kept secret or not transparent. Third, there is no formal system or protocol to address the conflicts of interest that inevitably arise when the government is both regulator and involved in the business. Fourth, appointments to boards of public entities are not based on clear, publicly-disclosed criteria and are not transparent. Finally, enforcement agencies are not well coordinated and fall behind in enforcing existing law.

29. The IMF staff's report includes a set of recommendations for dealing with the governance vulnerabilities identified in the report. Listed below are some of the main high-level measures identified in the report that require action immediately or in the short term. Implementing the actions identified in this report will require political leadership at the highest level, and a dedicated central secretariat, as well as broad-based support from civil society and other groups. In each of the areas identified the ministries or agencies concerned will need to undertake further work to develop project plans, and to identify benchmarks and performance indicators that can be monitored. Budgets will need to be allocated for implementing new laws and procedures together with communication plans, action plans, change management strategies, and timeframes. Progress reports should be published on a regular basis. Development partners may be asked to provide technical support and where appropriate financing to support the reforms.

Anti-Corruption Framework

- Develop an anti-corruption strategy consistent with international good practice principles.
- Enact whistleblower legislation and protection in line with international good practice.
- Introduce an asset declaration regime.

- Enhance transparency and formalize clear procedural guidance on the government's anti-corruption strategy and policies, and strengthen the capacity of enforcement agencies and their coordination.

Public Financial Management

- Conduct a comprehensive review of the Command Agriculture Program by the Auditor General or an external audit firm, taking account of the need to protect vulnerable citizens.

- Tighten the enforcement of legal provisions on the submission of public debt reports.

- Accelerate the roll-out of the PFMS to local governments and extrabudgetary units.

- Enforce the constitutional and legal requirements in respect of financial reports and internal controls.

- Enforce sanctions on MDAs and/or officials who fail to submit fiscal reports.

- Introduce data dissemination dates and follow those dates for publishing regular and timely fiscal information.

- Publish public procurement plans, introduce e-procurement, and establish an online procurement database.

Revenue Administration (ZIMRA)

- Continue important ongoing reforms to increase taxpayer compliance through improved IT systems, dispute resolution procedures, compliance risk management, and taxpayer support services.

- Clearly specify the role of the board to include oversight of administrative functions and reporting, while removing the management of operations by the board;

- Prohibit the disclosure of taxpayer information to board members and issue a specific tax secrecy requirement for Board members should they receive such information;

- Remove the authority of the board to appoint Commissioners and staff, but allow vetting of candidates for board membership by a sub-committee of the board; and

- Remove the involvement of the Board in policy matters considered by the Minister of Finance.

- Enact new legislation to coordinate the management of border controls and reduce fraud.

SOEs and Extractive Industries

- Increase capacity for enforcing the provisions and regulations of the PECG Act and publish data on appointments to the boards of SOEs.
- Build capacity in MoFED to provide effective oversight of the financial performance of SOEs, and issue instructions based on the PFMA requiring SOEs to submit quarterly and annual financial statements.
- Prepare and enact a law on the privatization process, and issue clear criteria and guidance on the role and responsibilities of the MoFED, line ministries and other agencies in managing the process.
- Publish all resource contracts with investors including those signed by SOEs, as a first step towards implementation of the Extractive Industries Transparency Initiative (EITI).

Reserve Bank

- Amend the RBZ Act to distinguish clearly between the Bank's objectives, functions and powers and simplify the current wording on legal tender.
- Remove the extensive list of provisions, including on prudential supervision, which allow for undue political influence over the RBZ's operations.
- Prohibit in law and discontinue RBZ's quasi-fiscal operations, with measures to mitigate potentially adverse social impacts, and operationalize the RBZ's financial stability mandate.
- Consolidate the RBZ's subsidiaries in its financial statements and clarify ZAMCO's powers, including fit and proper rules and strict conflict of interest requirements for its board of directors.
- Verify the basis and feasibility for the transfer of legacy debt (noting approval by the MoFED and the Parliament) and engage an external audit firm to certify the process of validating the legacy debt.

Rule of Law

- Develop clear criteria for granting and cancelling land permits and leases, and for authorizing different forms of land use (e.g., sublease or investment partnership), and publish these criteria.
- Publish decisions related to land use.
- Establish an independent agency to handle complaints relating to land administration.

AML/CFT

- Develop and implement a risk-based approach to AML/CFT supervision, focusing on compliance with fit and proper controls, customer due diligence requirements for politically exposed persons and suspicious transaction reporting.

Annex V. Capacity Development Strategy for 2020

The Zimbabwean authorities are closely engaged with Fund staff on economic policy formulation and implementation, including through an SMP. They see technical assistance from the IMF as important for supporting their economic and financial policies under the program. As such, the Fund's capacity development program for Zimbabwe, including related technical assistance delivery, is a key component of the SMP and Fund's surveillance priorities for Zimbabwe.

Overall Assessment of Capacity Development

1. The provision of Fund TA to Zimbabwe started recently. Following Zimbabwe's payment of its arrears to the PRGT, the Fund's Executive Board removed, effective November 14, 2016, all remedial measures including limitations on the provision of Fund TA. In the beginning, the bulk of Fund TA to Zimbabwe focused on public financial management (PFM), revenue administration, and macroeconomic statistics (BOP, GDP, and CPI). Recently, there has also been extensive TA on national accounts, price, balance of payments, and public sector debt statistics. A Financial Sector Financial Stability Review (FSSR) was conducted in November 2018, from which the authorities and staff have tentatively agreed a TA Road Map to support the authorities´ efforts to address key gaps and vulnerabilities. The TA will also play a complementary role in helping the authorities meet some obligations under the SMP and any potential subsequent programs.

2. The recent track record on implementing TA recommendations has been mixed. In part this reflects the need for legislative changes in many of the targeted areas, which have often faced delays given the significant political uncertainty in the run up to the presidential and parliamentary elections of July 2018.

Forward-Looking Priorities

3. Zimbabwe faces vast capacity development needs given the multiplicity and severity of the economic issues it faces following an extended period of international isolation. The Fund's TA remains crucial, as Zimbabwe transitions toward a functioning economy and seeks to restore macroeconomic stability. Given the brain drain that the civil service experienced during the hyperinflationary era, and the resulting near complete erosion of systems, particularly in debt management, statistics and PFM, TA has been, and will be, a critical element on the path to normalizing relations with the international community.

4. The focus of the TA in the near term will be on areas that facilitate fiscal consolidation, support the transition to a new monetary policy framework, and protect financial sector stability. To that end, targeted areas include PFM reforms aimed at strengthening expenditure management, budget preparation and execution, and fiscal reporting; further developing the debt management framework; reviewing the design of the tax system; enhancing tax and customs administrations; strengthening the financial stability framework and assessing banks' asset quality once the macroeconomic situation has stabilized; and providing financial modelling and forecasting training for supervisors.

5. TA priorities include:

Priorities	Objectives
PFM	Strengthen budgeting, reporting, fiscal forecasting, cash management, and fiscal oversight.
Revenue policy and administration	Broaden the tax base, mostly by reducing tax incentives (which reduce collections and make the economy less efficient). Modernize revenue administration to improve its efficiency and effectiveness by addressing taxpayer segmentation and strengthening audit and risk management capacity.
Debt management	Strengthen government's debt management capacity for achieving fiscal sustainability and effective budgeting.
Monetary policy framework	Support the authorities in designing and operationalizing a monetary policy framework to deliver macroeconomic stability. Reduce the distortions from exchange controls.
Financial supervision and crisis management	Legal reforms to strengthen bank supervision and resolution, and payment system oversight. Update, adopt, and operationalize the 2014 draft Crisis Management Plan. Review banks' quality once the macro economic situation has stabilized.
Macroeconomic statistics	Enhance macroeconomic analysis, budget preparation, and policy design.

Appendix I. Draft Press Release

INTERNATIONAL MONETARY FUND

COMMUNICATIONS DEPARTMENT

Press Release No. xx/xx
FOR IMMEDIATE RELEASE
February [], 2020

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2020 Article IV Consultation with Zimbabwe

On February 24, 2020, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Zimbabwe.

Zimbabwe is experiencing an economic and humanitarian crisis. Macroeconomic stability remains a challenge: the economy contracted sharply in 2019, amplified by climate shocks that have crippled agriculture and electricity generation; the newly introduced ZWL$ has lost about [90] percent of its value; inflation is very high; and international reserves very low. The climate shocks have magnified the social impacts of the fiscal retrenchment, leaving more than half of the population food insecure. With another poor harvest expected, growth in 2020 is projected at near zero, with food shortages continuing.

The government that came to office following the 2018 elections adopted an agenda focused on macro stabilization and reforms. This was supported by a Staff Monitored Program from the IMF, adopted in May 2019, but is now off-track as policy implementation has been mixed. Notable reforms include a significant fiscal consolidation that has helped reduce the monetary financing of the deficit, the introduction of the new domestic currency in February 2019, the creation of an interbank FX market, and the restructuring of the command agriculture financing model to a public-private partnership with commercial banks. However, uneven implementation

[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.

of reforms, notably delays and missteps in FX and monetary reforms, have failed to restore confidence in the new currency.

Reengagement with the international community continues to face delays. The Zimbabwean government has yet to define the modalities and financing to clear arrears to the World Bank and other multilateral institutions, and to undertake reforms that would facilitate resolution of arrears with bilateral creditors. This continues to constrain Zimbabwe’s access to external official support. As a result, the authorities face a difficult balance of pursuing tight monetary policy to reduce very high inflation and prudent fiscal policy to address the macroeconomic imbalances and build confidence in the currency, while averting a crisis. While the 2020 budget includes a significant increase in social spending, it is likely insufficient to meet the pressing social needs. Absent a scaling up of donor support, the risks of a deep humanitarian crisis are high.

Executive Board Assessment[2]

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

Table 1. Zimbabwe: Selected Economic Indicators, 2016–23

	2016	2017	2018	2019	2020	2021	2022	2023
		Act		Prel		Proj		
	(annual percentage change, unless otherwise indicated)							
Output and prices								
Real GDP growth[1/]	0.7	4.7	3.5	-8.3	0.8	2.5	2.5	2.2
Nominal GDP (US$ millions)	20,549	22,041	22,946	20,703	20,563	21,339	22,607	23,588
Nominal GDP (ZWL millions)	20,806	27,438	42,468	156,165	390,666	442,791	476,139	504,257
GDP deflator	3.5	26.0	49.5	300.9	148.1	10.5	4.9	3.7
CPI (annual average)	-1.6	0.9	10.6	255.3	221.1	3.7	3.0	3.0
CPI (end-of-period)	-0.9	3.4	42.1	521.1	52.0	3.0	3.0	3.0
Money and credit								
Money supply (M2)	18.8	39.0	24.0	127.5	24.4	…	…	…
Credit to the private sector	-3.9	5.9	9.1	174.1	56.7	…	…	…
Credit to the central government	51.6	74.5	59.2	62.3	27.5	…	…	…
	(ZWL$ per US$)							
Official Exchange rate								
ZWL:USD exchange rate (annual average)	1.0	1.3	2.0	8.5				
ZWL:USD exchange rate (end-of-period)	1.0	1.3	3.5	16.8				
	(percent of GDP)							
Central government								
Revenue and grants	16.8	14.1	12.9	13.5	12.8	12.7	12.6	12.7
Expenditure and net lending	23.9	24.0	18.6	16.9	17.8	15.0	14.7	14.8
Of which: Employment costs	15.5	12.7	9.3	4.9	4.3	4.3	4.5	4.9
Of which: Capital transfers and net lending	4.1	5.8	5.0	3.3	4.0	3.5	3.2	2.8
Overall balance	-7.1	-9.9	-5.7	-3.4	-5.0	-2.3	-2.1	-2.1
Primary balance	-6.4	-9.0	-4.8	-3.0	-4.6	-1.5	-1.4	-1.4
	(US$ millions, unless otherwise indicated)							
Balance of payments								
Exports of goods and services	4,060	4,734	5,304	4,634	5,038	5,215	5,447	5,772
(annual percentage change)	1.5	16.6	12.1	-12.6	8.7	3.5	4.5	6.0
Imports of goods and services	6,427	6,555	7,617	5,455	6,417	6,511	6,730	7,359
(annual percentage change)	-14.4	2.0	16.2	-28.4	17.7	1.5	3.4	9.3
Current account balance (excluding official transfers)	-718	-284	-1,229	155	-204	-302	-302	-538
(percent of GDP)	-3.5	-1.3	-5.4	0.7	-1.0	-1.4	-1.3	-2.3
Gross international reserves	310	293	87	111	109	109	109	109
(months of imports of goods and services)	0.6	0.5	0.1	0.2	0.2	0.2	0.2	0.2
Public debt								
Consolidated public sector debt (e.o.p.)	10,089	11,998	14,459	10,372	11,082	11,950	12,639	13,144
(percent of GDP)	49.1	54.4	44.2	50.1	53.9	56.0	55.9	55.7
Public and publicly guaranteed external debt (e.o.p.)	7,997	8,829	8,672	9,865	10,591	11,238	11,786	12,151
(percent of GDP)	38.9	40.1	37.8	47.6	51.5	52.7	52.1	51.5
Of which: Arrears	5,157	5,652	6,109	6,284	6,421	6,559	6,698	6,837
(percent of GDP)	25.1	25.6	26.6	30.4	31.2	30.7	29.6	29.0

Sources: Zimbabwean authorities; IMF staff estimates and projections.

1/ At constant 2012 prices.