EXECUTIVE BOARD MEETING

SM/20/43
Correction 1

March 13, 2020

To: Members of the Executive Board

From: The Secretary

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

Board Action: The attached corrections to SM/20/43 (2/12/20) have been provided by the staff:

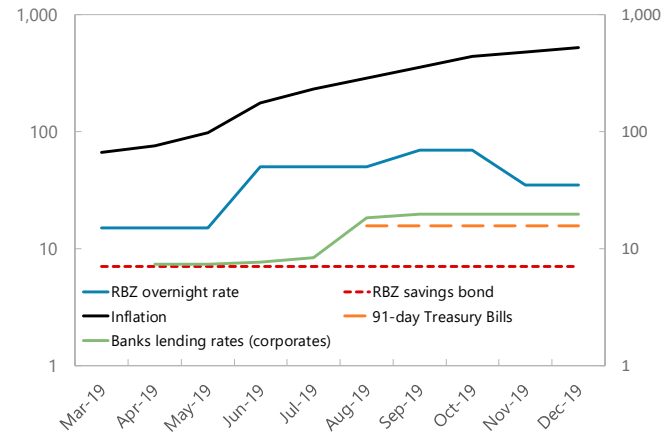
Factual Errors Not Affecting the Presentation of Staff's Analysis or Views

Pages 10, 13, 14

Questions: Mr. Leon, AFR (ext. 36115)
Mr. Hobdari, AFR (ext. 36276)

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~~ 0.8 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).

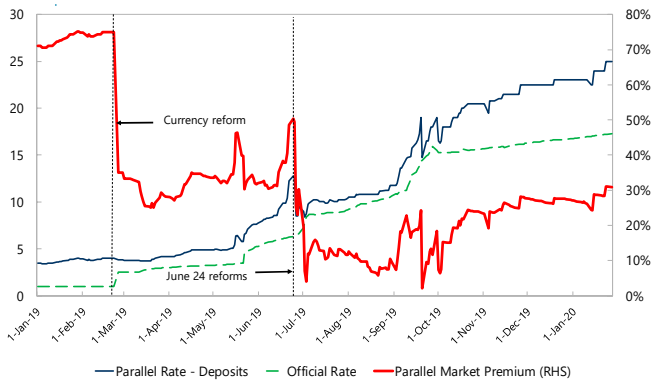
Text Figure 8. Zimbabwe: Domestic Interest Rates
(in percent, log scale)



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.

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)	-9.9	-5.7	-3.4	-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 2020~~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.