Monthly Macro Economic Developments – June 2016

1. Introduction

Money supply increased by 12.8% on an annual basis and 1.8% on monthly basis from March 2016 to April 2016 to reach US$ 5 billion. The increase in money supply is set to be reversed partly due to the announcement of the introduction of bond notes and also the fluid political environment. As each day passes, the country's sovereign risk tends to worsen partly due to gravitation towards election mode by political parties. Despite all this, the country's conditions of doing business has had marked improvement as Zimbabwe was among the seven countries in Africa that improved between 2014 and 2015 partly due to availability of information and government's effort in improving the conditions of doing business the IMF SMP. However, the country's score of 2.9 shows that there is still a long way to go. Government has revised the country's growth outlook to 1.4% in 2016 in line with World Bank and IMF projections. The country continues in a deflation mode and lending interest rates continue facing downward pressure and deposits face upward pressure and this will continue to squeeze the Bank's interest margin.

2. World Economy

2.1 Overview of World Economy and Growth Prospects

Global economic growth is expected to further slowdown from initial 2.9% 2016 growth to 2.4% as a result of slow growth in advanced economies, low international commodity prices, weak global trade and decreasing capital flows. The impact of economic slowdown has been greater on countries depending on primary exports than the net importers of primary products. Even though, the net importers did not realise the anticipated gains from low commodity prices. China's growth is estimated at 6.7% in 2016 from 6.9% in 2015, India-7.6%, South Africa – 0.6%, while Brazil and Russia remain in recession for the period.

Britain has finally voted to exist the European Union and this has had immediate implications to the world economy as stock markets tumbled, gold and other currencies gained while the pound declined to an all-time low in its 31 year history. This is also set to affect geopolitical relations, increasing tensions as the European Union's stablisation effect on Britain will be missed in international relations. Britain Investment climate has already suffered a huge dent as some companies had already shelved employment plans. It is estimated that in the aftermath of the Brexit the richest has suffered close to US$ 3.9 trillion loss (various sources).

African countries continued to be ranked low in their policy environment according to the World Bank, as seven countries registered improvements while 12 registered decline in the ranking of the Country Policy and Institutional Assessment (CPIA).[1] The CPIA score is also used to determine the allocation of financing under the International Development Association fund (IDA). SSA's score remained at 3.2 in 2016 and Rwanda led in the scores with a score of 4. Zimbabwe is among the seven countries whose ratings on important institutions that matter for investment improved[2]. Zimbabwe's CPIA score went up from 2.2 in 2012 to 2.9 in 2015 thanks to better availability of data and information coupled with implementation of economic policies under the International Monetary Fund (IMF) staff-monitored program (SMP) (World Bank, 2016).

However, economic growth in Zimbabwe is expected to continue declining on the account of the combined effects of the El Nino induced drought, lower commodity prices, reduced capacity utilization in the manufacturing sector, persistent liquidity challenges, low industrial capacity utilization, de-industrialisation, infrastructure and energy supply deficits, weak aggregate demand, low savings and investment, appreciation of the United States dollar and unsustainable current account deficit, (Ministry of Macro-economic Planning and Investment Promotion (MMPIP), 2016). This has resulted in the downward revision of the economic growth forecasts from the initial projection of 2.7% to 1.4% during the first quarter of 2016 well below the ZimAsset target for 2016 of 6.5%.

3. Marco-economic Developments

FAO (2016), has highlighted that early aggregate outlook for the 2016 cereal crops points to a fall in production, mostly resulting from expected drought reduced harvest in North and

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[1] http://www.worldbank.org/en/news/press-release/2016/06/28/african-countries-show-mixed-results-in-quality-of-policies-and-institutions

[2] http://www.worldbank.org/en/region/afr/publication/development-policies-institutions-improve-in-few-african-countries

Southern Africa. Outlook improved in East Africa on account of recent favorable rains. However, 23 African States are in need of food external assistance. In Zimbabwe about 2.8 million people require food assistance; Malawi- 2.9 million; Mozambique – 1.8 million; Swaziland – 300 000; Lesotho – 535 000; and Cameroun- 2.4 million. In Cameroun civil unrest have compounded the food security situation in the country. In other countries, the weaker currencies are making available food unaffordable to the populace increasing vulnerability. *These developments means that government budget and funding towards infrastructure is going to be limited.*

3.2 Inflation and Interest Rates

Year on year inflation declined further by 0.10 percentage points to reach negative 1.69% in May 2016. The month on month inflation remained at negative 0.24% as shown in Figure 1. For more than year and half now the country has been in deflation and economic activity has been contracting by day. Declining aggregate demand is forcing businesses to adjust their prices downwards to attract more customers leading to declining revenues as there is no significant increase in demand. Even if the products are price elastic, the declining purchasing power due to continuous job loses limit increase in demand. Despite these price declines, Zimbabwean prices remain higher by regional and international standards. This is attributed to inflexible labour costs, use of a strong currency and structural rigidities including the use of antiquated machinery by industry. *The resultant poor financial performance of companies will continue to compromise the viability of infrastructure projects.*

Table 1: Inflation by sector, Zimbabwe,Zimstats, May, 2016

	Index			Inflation %	
Sector	**May 2015**	**April 2016**	**May 2016**	**Year on year**	**Month on Month**
Food and non alcoholic beverages	94.60	91.1	90.70	-4.12	-0.44
Alcoholic beverages and tobacco	105.02	103.9	103.60	-1.35	-0.29
Clothing and Footwear	98.30	97.3	97.10	-1.22	-0.21
Housing water, electricity, gas and other fuels	100.00	97.7	97.90	-2.10	0.20
Furniture household equipment and maintenace	96.30	92.8	92.70	-3.74	-0.11
Health	103.10	103.2	103.00	-0.10	-0.19
Transport	101.00	98.5	98.40	-2.57	-0.10
Communications	74.00	73.7	72.50	-2.03	-1.63
Recreation and Culture	98.10	97.3	97.40	-0.71	0.10
Education	116.80	133.4	133.40	14.21	0.00
Restaurants and Hotels	100.10	99.9	100.00	-0.10	0.10
Miscellaneous goods and services	97.00	95.3	95.00	-2.06	-0.31
Non Food Inflation	**99.76**	**99.35**	**99.23**	-0.53	-0.12
All Itmes	98.03	96.6	96.37	-1.69	-0.24

Food and non-alcoholic beverages declined by 4.12% in May 2016 on a year on year basis and also registered a 0.44% decline on a month on month basis. Non-food items declined by 0.59% year on year and 0.12% month on month as shown in Table 1. Bread and Cereals, meat, fish and sea food, milk, cheese and eggs, oils and fats, fruits and vegetables registered price declines on year on year basis.

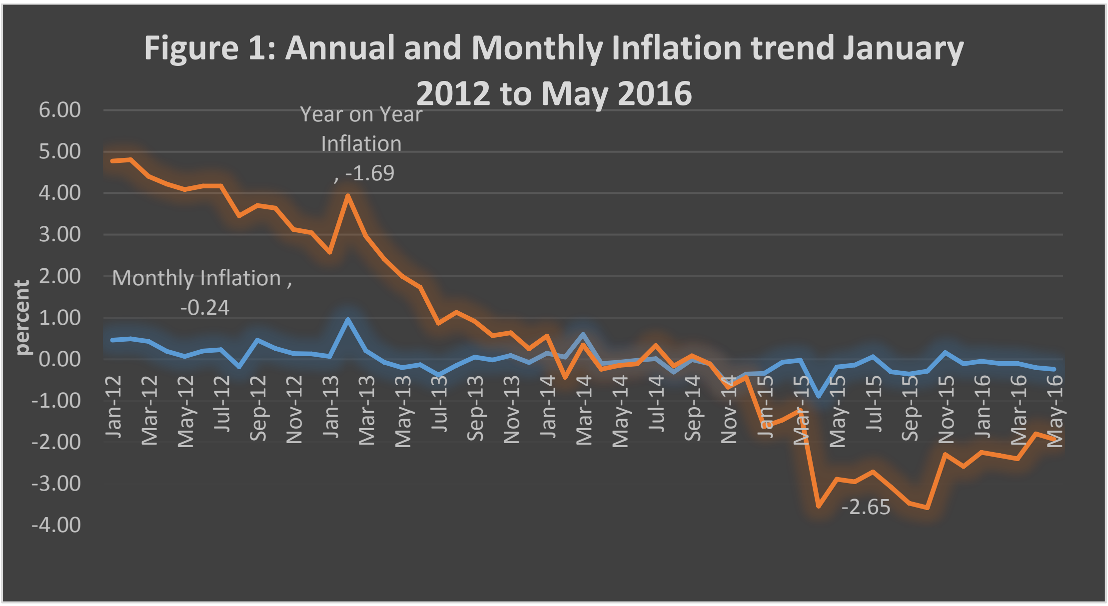

Figure 1: Annual and Monthly Inflation trend January 2012 to May 2016

The developments in inflation are reflective of declining economy, with depressed aggregate demand and high levels of unemployment. Low inflation implies that the country's interest rates are expected to go down as the authorities will naturally adopt accommodative policies. However, with lingering suspicion of return of a local currency, investors are likely to take refuge in properties.

Money supply increased by 1.8% between March 2016 and April 2016 to reach US$ 5004.9 million representing a 12.8% annual increase. Money supply reached US$ 5 billion of which, 53% consist of demand deposits and base money, 13.9% savings deposits, 14.9% U-30-day deposits and 18.3% O-30 day and Time deposits. S*hort term deposits are dominant but are not suitable for long term infrastructure projects.* Nominal lending rates to individuals marginally decreased from 11.45% as at 20 May 2016 to 11.39% as at 17 June 2016, while for corporate clients interest rates marginally increased from 7.36% to 7.46% over the same period.

Savings deposit rates were stable between 20 May 2016 to 17 June 2016, as savings deposits slightly increased from 3.03% to 3.7%, 1 month deposits decreased from 6.21 to 5.93%, and 3 months deposits decreased from 6.74% to 6.44% respectively. *With the current liquidity challenges persisting, there is going to be pressure to increase deposit rates. The possibility of introduction of Bond notes will have negative effects on overall liquidity on this period before introduction and immediately soon after as economic agents contemplates the government real intentions in introducing these. The bond notes have suffered from speculative attack. The high level of uncertainty created in the economy will affect the country's liquidity situation going forward.*

Conclusion

The liquidity situation is projected to worsen going forward as economic agents speculate on the introduction of bond notes and the political environment worsens.