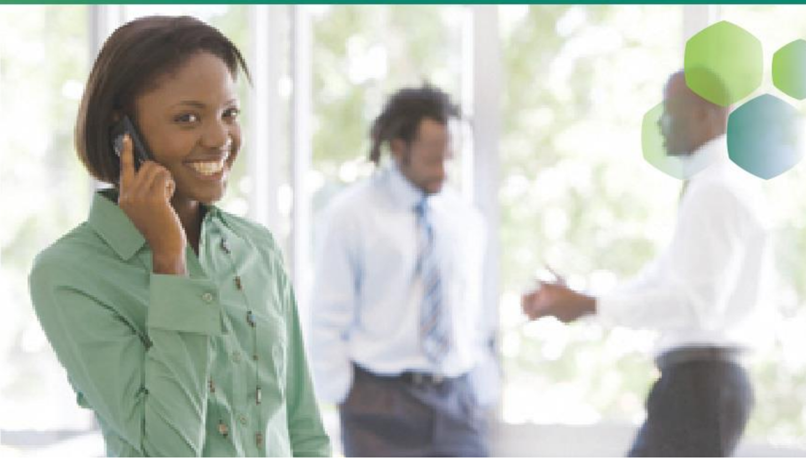
Quarterly Economic Brief

Q4' 2018



Highlights

- **United States partial government shutdown set to unsettle global macro stability.**
- **China registered its lowest annual GDP growth rate since 1990… further deceleration expected.**
- **Brexit uncertainty persistent; near-term contraction seems inevitable.**
- **Violent mass public protests prevailed, from France to Sudan, *et al*…**
- **Zimbabwe's inherent political vulnerability and policy rebalancing spooked the market.**
- **Inflation reached a post-hyperinflation peak of 42.1% in December 2018.**
- **ZSE market capitalization advanced 59.9% to close the quarter under review at $19.534 billion.**

Global | U.S government partial shutdown…

The world's largest economy (the United States of America) closed the quarter under review at a partial standstill - literally. The US government partial shutdown started on the 21st of December 2018 after Republicans and Democrats failed to reach an agreement on President Trump's budget proposal to finance a US$5.7 billion border wall. The ensuing standstill in some government functions cost the US an estimated US$1 billion per week.

The accounting cost might be minor in the context of a US$19 trillion economy. This however depends on how long the shutdown lasts and whether there will be more disruptions in the future. The likely economic cost is however significantly bigger - 'recession proportions'; incorporating adverse investor sentiment and global spillover effects. Overall, the chaos hinted at political disorder, more so as the full shutdown cost could exceed the cost of the wall.

Slowdown for Chinese economy

Trade tensions with the US took a toll on the world's 2nd largest economy - China. Pressure was reflected by several global entities, led by Apple, issuing profit warnings citing slowing demand from China. Independent estimates suggest Chinese manufacturing reached a 19 month low during the quarter under review, while the IMF estimates that China's annual GDP growth closed 2018 at 6.6% - the lowest since 1990.

China's growth concerns present serious global concerns. In 1980, China contributed 2.3% to the global economy, yet by end of 2018, its contribution had surged to 18.7%. China consumes more than half of global base metal output; half the world's cement and pork output as well as about a third of rice output. Consequently, when China is not buying - global demand conditions are shaken, weighing on prices and earnings for net commodity exporters. The IMF projects China to grow by 6.2% in 2019.

Brexit… deal or no deal, contraction seems certain

Brexit negotiations dominated European headlines as United Kingdom (UK) Prime Minister Theresa May sought UK lawmakers' approval for her negotiated 'divorce deal'. The UK is set to leave the union on 29 March 2019, though the terms of the exit are still to be agreed on. The tough route entails total and abrupt separation - exposing the UK to a certain recession as it adjusts to its independent state. A 'deal' could smoothen the separation; easing the UK into a soft landing scenario; with contraction being a common denominator in both scenarios.

Bank vacancy exposes global power dynamics

After serving for six years as World Bank President; Jim Yong Kim issued a surprise resignation from the post, effective 1 February 2019. His term was due to expire in 2022, following a 2nd five year term that commenced in 2017. His sudden resignation rekindled debate on global power dynamics. When the Bank was established in the 1940s, there was an agreement it would be headed by an American -

and that has been the trend since the Bank's formation. Under the same agreement, the head of the World Bank's sister organization, the IMF, would be nominated by European countries.

The arrangement has previously sparked global disquiet, often being cited as outdated, particularly in the context of a shifting (leveling-out) global power base. To its credit, the World Bank has gradually moved towards more formalized selection procedures, such that recent appointments have faced up against non-American candidates. Jim Yong Kim is a Korean American nominated by then US President Barack Obama for both his initial and 2nd terms as World Bank President. The latest vacancy is set to have all eyes on the Trump administration.

Increasingly twitchy crowds…

Violent protests erupted in France since 17 November 2018. Protesters have worn yellow vests and protested every weekend since then. The protests are against a 'green tax' imposed on motor vehicle fuel and have since escalated into general mass discontent. The number of protesters has gradually declined, yet the country continues to experience sporadic yellow-vest associated disruptions. As a result of the unrest, independent media estimates suggest more than 1,400 people have been arrested and several have died.

In Argentina, thousands of protesters marched in the Capital Buenos Aires against austerity policies and associated rising costs of public services. Under the austere policies, subsidies for public utilities were lifted or reduced in an attempt to address chronic budget deficits. Resultantly, prices of electricity have gone up more than 2,000%, and are expected to rise further in 2019. By end of 2018, the economy had contracted and inflation closed at 47% - the highest since 1991 (84%). Austere policies are part of a deal agreed with the IMF for a $57 billion bailout package.

Sudan's government estimates that by end of the quarter under review, 19 people had died (including two members of the security forces) during violent 'bread price' protests that started on the 19th of December 2018. Sudanese authorities had earlier reported the death toll at eight, before Amnesty International put the figure at 37. The protests were sparked by a 200% increase in the price of bread, but have since degenerated into widespread anti-government discontent.

Emerging Markets Weighed on Global Equities

Emerging market equities retreated 7.5% during the quarter ended 31 December 2018, extending full year losses to 14.6%. The stand out emerging market performer was Brazil, up 14% during the quarter under review premised on prospects of improved macro-economic policies under a new government. The following table summarises (MSCI) equity market returns during the quarter under review.

Index	Q4'2018	FY'2018
MSCI All Country	-8.7%	-8.9%
MSCI Advanced Markets	-13.4%	-8.2%
MSCI Emerging Markets	-7.5%	-14.2%

Overall, unresolved trade tariff tensions between the United States and China, firmer US interest rate prospects from a tightening Fed policy stance and generally depressed global economic prospects weighed heavily on global equities.

Commodities struggled for direction

Commodity prices were mixed during the quarter under review, as highlighted in the following table.

Commodity	Price	Q4'18	FY'18
Nickel (usd/ton)	11 540,00	-8,56%	-4,55%
Crude Oil (usd/barrel)	53,78	-34,50%	-19,10%
Gold (usd/oz)	1 283,48	8,49%	-1,01%
Platinum (usd/oz)	796,53	-2,06%	-14,32%
Coffee (usc/lb)	100,40	0,90%	-19,55%
Maize (usd/ton)	147,92	2,87%	7,20%
Wheat	508,00	-0,93%	19,11%
Sugar (usc/lb)	12,25	11,26%	-18,11%
Cotton lint (usc/lb)	72,60	-6,43%	-7,62%

Commodity prices struggled for direction; exhibiting no obvious trend. Oil prices dipped on glut concerns as weak global manufacturing led to production outstripping demand. Sugar prices surged to reduce earlier losses in light of depressed harvest forecasts in the world's largest producer (Brazil).

Dollar on the back foot

The United States Dollar closed the quarter under review firmer against major trading currencies. The Dollar closed the quarter under review 2.1% and 2.2% firmer against the ZAR and Euro, respectively, at ZAR14.4 per Dollar and US$1.14 per Euro. Dollar appreciation was in-part premised on a shaky global macro-economic environment. Persistent trade tensions between the U.S and China weighed on emerging market currencies, while unending Brexit negotiations worked against the Euro.

Global Economic Outlook

Global economic growth is at risk, with noteworthy downside pressures from the United States, China and the United Kingdom. The concomitant dent on commodity demand and prices present second round adverse effects for emerging economies. Prospects of an oil price rebound fuel global inflation risks over the foreseeable outlook.

Zimbabwe | More of the same?

Ruling party annual conference highlights…

The ruling ZANU-PF held its 17th annual national people's conference. Delegates reaffirmed President Mnangagwa as the party's candidate for the 2023 elections. Delegates also resolved to implement a zero tolerance to corruption agenda and intensify international reengagement efforts. Other resolutions included resumption of the youth service program in the first quarter of 2019 and that all war veterans must be allocated farmland. Overall, the party resolutions leave an arguably blurred line between party and national economic policies.

Post-election political fragility persisted, with the opposition MDC Alliance reportedly embarking on a regional outreach drive - to seek the intervention of African leaders in 'Zimbabwe's political and economic situation'. Going into 2019, the MDC Alliance reportedly declared a year of 'rolling mass action against the ZANU-PF regime'. Reports of civil and international organizations trying to broker 'talks' between the ruling ZANU-PF and opposition MDC Alliance persisted, sustaining generalized uncertainty on the political-economy's outlook.

International re-engagement 'at risk'

The Commonwealth Observer Group presented its final report on Zimbabwe's 2018 elections. The Group highlighted improvements from prior elections while noting some concerns that 'unlevelled the playing field.' Resultantly, the Group 'could not endorse all aspects of the process as credible, inclusive and peaceful.' The report will be assessed by the Commonwealth as one aspect under Zimbabwe's readmission process. Consequently, the pace and magnitude of Zimbabwe's international reintegration hinges significantly on the report.

The World Bank affiliated International Centre for Settlement of Investment Disputes (ICSID) rejected Zimbabwe's application to annul US$195 million compensation to a displaced former commercial farmer (Adam von Pezold *et al*). Government had earlier set aside $53 million towards compensation of displaced farmers in its 2019 national budget, against total claims estimated between $3 billion and $9 billion by approximately 4,000 displaced former farmers - underlining inherent fiscal pressures.

Vision 2030 underpins macro-economic policy

Government launched a new macro-economic blueprint (Transitional Stabilization Program - TSP) covering October 2018 to December 2020. The TSP is the first of three blueprints under 'Vision 2030'. Vision 2030 targets upper middle income economy status by 2030. It has five strategic clusters, namely: governance; macro-economic stability; inclusive growth; infrastructure and social development. It targets real GDP of $43.3 bn ($94.9 bn nominal) and per capita GDP of $4,709 for the year 2030.

The TSP is premised on corrective/stabilization reforms - setting the foundation for two five year macroeconomic blueprints to 2030. TSP focus is on strict adherence to quick-win policy reforms 'that require painful trade-off and sacrifice'. Key policy rebalancing prescriptions under TSP include austerity, devolution and international re-engagement. It also recommends a policy shift towards a market based foreign currency allocation system - once confidence and reserves conditions permit such a transition.

Shortages, price spikes and government reaction

A spike in consumer prices, several service providers demanding settlement in foreign currency and shortages of basics including fuel prevailed… as the market reacted adversely to policy measures (separation of accounts into Nostro and RTGS). Symptomatic of the volatility were parallel market US$ premia swinging violently between 110% and 500% during the quarter under review. Consequent to commodity shortages and associated pricing distortions; Cabinet suspended SI 122 indefinitely, allowing the importation of basic commodities without import licenses. Further, Cabinet outlawed 3-tier pricing.

Opening up to imports is likely to improve supply of basics. The concomitant risk from opening up is the threat of local manufacturers struggling to cope with the more competitively priced imports. Outlawing 3-tier pricing has so far been difficult to enforce, in part due to the economy's high level of informalization. Mandatory parity pricing against an informal US$ premium (currently around 300%) underlines the dislocation between informal and formal markets.

Local manufacturing under threat

Manufacturing sector average capacity utilization increased from 45.1% to 48.2% between August 2017 and August 2018. The Confederation of Zimbabwe Industries (CZI) however noted that by November 2018, capacity utilization had declined to 42%. It also projected a further decline to 34% in 2019 'if prevailing conditions persist'. Manufacturing entities are importing about 52% of their raw material requirements, underlining the importance of foreign currency availability to local manufacturing.

Constrained manufacturing conditions incentivise imports as access supplants production. In 2018, imports increased by 28% to $6.9 billion, resulting in a trade deficit of approximately $2.6 billion. Compared to the prior year, Zimbabwe's trade deficit widened by 47%; despite exports growing by 19%. Top exports in 2018 were tobacco and minerals while fuel, grain and fertilizer dominated imports.

Revenue growth diluted by spending pressure

2018 tax collections closed at $5.1 billion, exceeding target ($4.3 billion) by 18.6% and exceeding prior year collections ($3.8 billion) by 34.2%. The strong performance was mostly attributable to the revised automated financial transaction tax and inflation. Inherent difficult operating conditions were captured by corporate tax debt increasing by 21% in 2018 to $1.8 billion, while VAT remittance debt increased by 11% over the same period to $1.5 billion.

Going forward, effective budget rebalancing will hinge significantly on authorities' ability to contain costs. Cost containment is notably compromised by public wage increase demands as well as predictions of an impending drought. Consequently, revenue growth has to significantly exceed the likely growth in spending to curtail further budget deficits.

Gold outturn closed 2018 strongly; outlook weak…

National gold output closed 2018 at a record peak of 33.2 tons, representing growth of 34% from the 24.8 tons collected during the same period prior year. The previous annual peak was 27.1 tons, registered in 1999, while the lowest recorded annual outturn was 3.5 tons in 2008. Of concern is that average monthly output declined by 75% from 2.8 tons during the first 9 months of 2018 to 1.6 tons in the final quarter. Crudely extrapolating into 2019; a decline in aggregate output seems likely.

Consumer purchasing power eroded…

Average consumer prices increased by 38.6% in the final quarter of 2018, compared to 2.8% in the corresponding period in 2017. Consumer inflation for the full year 2018 closed at a post-hyperinflation peak of 42.1%. The food subsector (32% contribution to overall inflation) registered inflation of 54% in 2018, with average meat and bread prices increasing by 68% and 46%, respectively in 2018.

Going forward; inflation pressures hinge on adverse weather expectations, foreign currency constraints and the risk of a currency recalibration.

The poverty datum line (PDL) 'for five' closed December 2018 at $755.22, up 36%, from $555.31 in December 2017. The food PDL for five people closed 2018 at $266.35, up 46.2% over the same period.

ZSE priced in monetary policy risks

The ZSE industrial index advanced 25.9% during the quarter under review, extending full year gains to 46.3% as highlighted in the following table.

Sector	Value	Q4'18	FY'18
Commodities	1 700,53	70,08%	71,77%
Consumer	870,81	23,15%	75,69%
Financial	924,87	394,83%	393,76%
Listed Property	213,17	18,37%	6,50%
Manufacturing	317,10	36,74%	62,23%
Industrial	**487,13**	**25,88%**	**46,28%**
Mining	**227,71**	**39,05%**	**59,91%**
Top Ten	**145,02**	**23,32%**	**45,02%**
All Share	**146,24**	**27,03%**	**46,24%**
Market Cap ($ bln)	**19 534**	**59,87%**	**93,02%**

The following tables highlight the ZSE top and bottom three performing stocks for Q4'2018.

Top 3 Performers	Price USc	Q4'18 Mvt	M.Cap $m
SEEDCO	172,00	239,32%	652,45
TURNALL	5,02	142,51%	24,75
RAINBOW	2,39	117,27%	59,64

Bottom 3 Performers	Price USc	Q4'18 Mvt	M.Cap $m
FIDELITY	8,75	-15,05%	9,53
POWERSPEED	14,00	-6,60%	52,39
FIRSTCAPITAL	5,90	-5,14%	127,18

Foreign investors bought and sold stocks worth $111.8 million and $122.3 million, respectively on the ZSE during the quarter ended 31 December 2018. The net portfolio outflow position closed at $10.5 million compared to net inflows of $6.8 million in the prior quarter. Foreign investors accounted for 31.4% of total ZSE trades during the quarter under review.

Economic Outlook

The overall macro-economic outlook hinges on the authorities' ability to stay the course regards policy rebalancing policies. The likelihood of a knee-jerk reactionary policy measure is amplified. Sustained political fragility and the accompanying threat of further international isolation exacerbate downside risks. Support for listed equities is premised on policy and inflation hedge attractiveness.