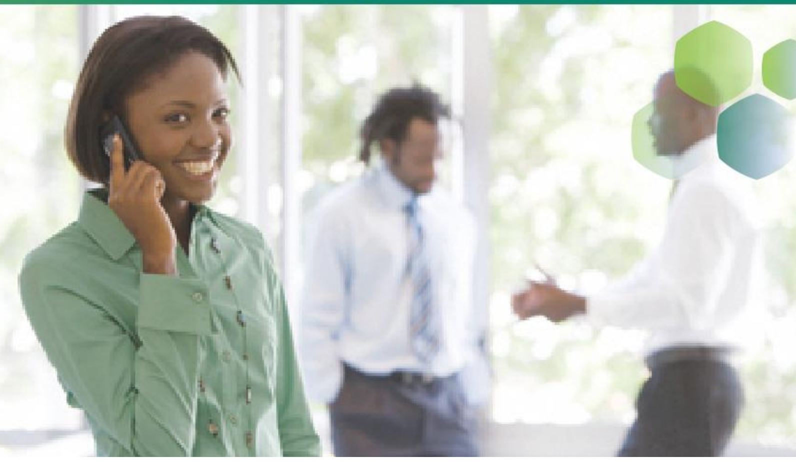
Quarterly Economic Brief

Q3’ 2018



Highlights

The IMF revised its 2018 global GDP growth projection down from 3.9% to 3.7%

Easy Chinese loans to struggling economies fuelled concerns of possible capture

South Africa attracting significant global attention over land reform proposals

Zimbabwe’s Constitutional Court upheld election results by the Zimbabwe Electoral Commission

Radical macro-economic policy reform proposals as H1’18 budget deficit reached $1.4 billion

ZSE market capitalization firmed 16.1% to close the quarter under review at $112.218 billion.

Global | Growth Forecast Revised Downwards

The International Monetary Fund (IMF) revised its 2018 global economic growth projection downwards from 3.9% to 3.7% - same as 2017’s closing growth estimate. The IMF noted that despite growth becoming less balanced, the steady growth trajectory experienced since 2016 continues. The downward revision was in part premised on a rise in downside risks over the past six month, particularly around the negative effects of tit for tat trade tensions between the world’s two largest economies, the United States and China.

As part of policy prescriptions, the IMF urged countries to strengthen the potential for higher and more inclusive growth – particularly by adopting policies that raise productivity; for instance by encouraging technological innovation and diffusion. The IMF prescribed fiscal policies that build buffers ‘for the next downturn.’ For low-income developing countries, the IMF prescribed decisive progress to strengthen fiscal positions accompanied by measures to boost the resilience of their financial systems.

Escalating U.S-China Trade Tensions

U.S President Donald Trump’s election was in-part on the promise of prioritizing growth in American output over imported goods. Resultantly, the U.S administration imposed stringent tariffs on imports from China, Mexico, Canada and the European Union in an attempt to incentivize consumption of locally manufactured goods. All the countries have retaliated, but none more than China. Retaliation by China has fuelled a tit for tat trade tiff.

In 2018 alone, the U.S has imposed three tranches of import tariffs on Chinese goods worth about $250 billion. The most recent one was in September 2018, targeting Chinese goods worth about $200 billion; starting at 10% import tax effected on 24 September 2018 before increasing to 25% at the start of next year. China has committed to accelerate ‘necessary counterattacks’. Meanwhile, the U.S warned that retaliation would attract further tariffs.

Growing Skepticism over Chinese Loans…

About twice as many African leaders attended the China-Africa forum (FOCAC) than the United Nations General Assembly. The discrepancy suggests a shift in geopolitical influence from the West towards China. It also ostensibly exposes the priorities and/or preferences of African governments. This notwithstanding, several allegations of China ‘taking over’ Africa suggests the need for a clear eyed coverage on any dealings with China. Chinese loans to a struggling Zambia recently raised eyebrows.

Malaysia’s new Prime Minister pushed back against Chinese-funded projects - describing them as too costly. On the other hand, Sri Lanka ended up giving China a 99-year lease and a 70% stake in a port due to its inability to repay Chinese loans that funded the port construction. Sierra Leone is the latest country to raise concern at Chinese project funding, with the new government cancelling a $400 million airport construction contract. Sierra Leone President Bio said the airport (planned by the previous government) was not only unnecessary, but unfair in light of many people still in need of basic services like education and health. Earlier, the World Bank had called into question the financial prudence of the airport project.

South Africa Land Reform: Skating on Thin Ice…

South Africa's land reform (without compensation) proposals gained prominence during the quarter under review. The South African government said it will change the constitution to allow for expropriation of land, citing the need to reverse forced eviction of black farmers under previous white colonial rule. Under the Natives Land Act of 1913, black people were restricted from buying or renting land, leading to their eviction from fertile land. Informal estimates suggest that whites, accounting for 9% of the population, own 72% of individually owned farmland.

United States President Donald Trump fuelled further debate on the matter after reportedly tweeting that he asked United States Secretary of State Mike Pompeo to closely study 'farm seizures and the large scale killing of farmers' in South Africa. The comments attracted a backlash from some political quarters in South Africa - citing undue interference. British independent Parliamentarian Janice Atkinson unsuccessfully pushed for a parliamentary debate on farm murders in South Africa. She recently added that South Africa 'is on the brink of another Zimbabwe'

Rise of Islamic Bonds…

African economies are notably diversifying funding options with a noteworthy rise in their appetite in Islamic finance. Moody's financial agency estimates that since 2014; US$2.3 billion in '*sukuk*,' or Sharia-compliant bonds have been issued in Africa, with many conventional banks across the continent setting up departments to service the niche sector. Islamic finance prohibits collection and payment of interest on lending and is based on profit sharing. The World Bank recently lauded the financing model as a mechanism towards shared prosperity.

Ivory Coast has a slight edge ahead of South Africa as Africa's largest issuer of Islamic bonds. Ivory Coast has issued US$501 million worth of Islamic bonds, only one million ahead of South Africa, with Nigeria ranked third after issuing US$351 million worth of the Sharia-compliant debt instruments. Notwithstanding Africa's impressive rise in the Islamic finance sector, Moody's estimates that the continent's banking assets account for less than 5% of Africa's total banking assets. Globally, Moody's estimates that *sukuk* instruments make up just 0.5% of total issuance.

Emerging Markets Weighed on Global Equities

Global equities closed the quarter to 30 September 2018 firmer, primarily driven by advanced market gains as highlighted by MSCI indices below:

Index	Q3'2018	YTD'2018
MSCI All Country	4.4%	4.3%
MSCI Advanced Markets	5.1%	5.9%
MSCI Emerging Markets	-1.0%	-7.4%

Emerging market equities weighed on the all country index during the quarter under review. Structural vulnerability in Argentina and South Africa, exacerbated by concerns of negative externalities from U.S – China trade tensions depressed emerging market equities performance.

Commodities struggled for direction

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

Commodity	Price	Q3'18	YTD
Nickel (usd/ton)	12 620,00	-14,21%	4,38%
Crude Oil (usd/barrel)	82,11	4,00%	23,51%
Gold (usd/oz)	1 183,03	-5,40%	-8,76%
Platinum (usd/oz)	813,30	-4,53%	-12,52%
Coffee (usd/lb)	99,50	-13,44%	-20,27%
Maize (usd/ton)	143,79	2,03%	4,21%
Wheat	512,75	3,95%	20,22%
Sugar (usc/lb)	11,01	-8,93%	-26,40%
Cotton lint (usc/lb)	77,59	-7,18%	-1,27%

Commodity prices struggled for direction, exhibiting no obvious trend across the board. Oil prices firmed, propped by concerns of supply constraints as the United States is set to enforce sanctions against Iran in November 2018. Safe haven attractiveness (in light of generalized global vulnerabilities) of gold was overshadowed by the commodity price's customary inverse relationship with the US$.

Dollar on the back foot

The United States Dollar (US$) closed the quarter to 30 September 2018 weaker against major trading currencies. Persistent trade war concerns weighed on the dollar amid rising global supply chain fragilities. The dollar retreated 1,1% to close the quarter under review at US$1.17 per Euro.

Global Economic Outlook

Global economic growth is increasingly fragile, particularly in light of escalating trade tensions between the United States and China (*et al*). Structural policy proposals in South Africa threaten regional economic stability if not handled carefully, with a specific risk to regional capital flows, exchange rate stability and inflationary pressures. Overall, global downside risks are inflated.

Elections… Done and Dusted?

For the first time in 38 years, former president Mr. Mugabe did not participate in Zimbabwe's July 2018 elections. Ironically, the list of presidential candidates reached an all-time record high at 22 (past record was 5; in 2013). The pre-election environment and the voting process were notably peaceful and arguably free. The Zimbabwe Electoral Commission (ZEC) declared President Mnangagwa winner of the presidential election. ZANU-PF secured supra-majority with 145 of the 210 contested parliamentary seats.

The Constitutional Court (ConCourt) bench of nine unanimously upheld the 2018 election results as announced by the ZEC. The ConCourt dismissed, with costs, an MDC Alliance petition challenging the results. Incumbent President Mnangagwa reportedly said the ConCourt events (screened live on national television) were a clear testimony of the high level of Zimbabwe's justice system. He also urged citizens to put their differences behind and focus their energy on nation building.

Hitting the Ground Running…

President Mnangagwa was sworn into office on the 26th of August 2018 (two days after the ConCourt ruling). Speaking at the event, he committed to non-tolerance of bureaucratic bottlenecks, zero tolerance to corruption, promotion of savings, fairness and impartiality as well as pursuance of external debt resolution. Overall, his macro-economic rebuilding plan seemed to hinge primarily on structural domestic policy reforms and reciprocal reintegration into the mainstream international economy.

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

The TSP covers a corrective and short-term policy reform phase - setting the foundation for two five year economic policies to 2030. TSP focus is on strict adherence to quick-win stabilization policies that require 'painful trade-off and sacrifice.' Monetary policy reforms under TSP include a move towards a market based foreign currency allocation system as well as a new currency - while acknowledging that a new currency cannot be introduced under conditions of low confidence and reserves.

Bullish Aggregate Output Projections

Government revised its 2018 GDP growth forecast up from 4.5% to 6.3%, while revising the 2017 estimate from 3.7% to 4.8%. GDP growth revisions are primarily based on the rebasing of the economy from 2009 to a 2012 base in line with international best practice. Inflation is projected to end the year below 7%. Going forward, government noted that the unsustainable budget deficit threatened policy stability. The deficit has been largely funded by public debt, currently estimated at $16.9 billion.

Fiscal Policy Reform

Minister of Finance Hon. Prof. Mthuli Ncube presented policy measures to curtail budgetary imbalances. Treasury estimated the H1'18 budget deficit at $1.4 billion, projecting it to reach $2.7 billion by year end in the absence of corrective measures. Resultantly, Treasury imposed an upward review of money transfer tax from 5c per transaction to 2% of value transacted, with exemptions. Treasury also committed to contain Treasury Bill issuance in favour of government guarantees.

Review of the transfer tax significantly widens the tax collection base, particularly in harnessing tax from the informal sector. The efficacy of the measure is enhanced by limited transacting methods in the absence of cash. On the flipside, the tax presents an additional cost, typical of a contractionary fiscal policy. Overall, the move to fund government expenditure through revenue enhancement is welcome. We are however worried by the absence of complementary policies to contain spending.

Monetary Policy Reform

Reserve Bank of Zimbabwe (RBZ) Governor Dr. John Mangudya presented monetary policy reforms towards strengthening the multi-currency system. Reforms include the creation of new foreign currency accounts (Nostro FCA) and reclassification of current balances into RTGS FCA. The measure is aimed at preventing 'dilution of new deposits' - thus incentivizing new foreign currency deposits. The RBZ reiterated that parity between the Bond Notes, bank balances and the United States Dollar remains.

Market reaction to monetary policy reforms has been panicky, amid media reports of planned civil protests and legal challenges. Concerns are mostly around inherent fears of loss of value. Parallel market US$ premia swung violently between 100% and 500%, with some service providers and retailers demanding US$ settlement or ascribing parallel market premia on 'RTGS-FCA' payments, amid market speculation official parity would not be sustainable. Ostensibly responding to the panicky market reaction; President Mnangagwa reiterated that the multi-currency regime will be maintained into the foreseeable future and announcing a guarantee on value of RTGS balances. He stressed that currency reforms would follow the completion of corrective fiscal reforms. Overall, generalized uncertainty on policy interpretation, implementation and implication sustains environment fragility.

Tax Collections Ahead of Target

Net tax collections closed Q3'2018 at $1.19 billion. Collections represent growth of 23% from the same period last year, while exceeding target for the quarter by 9%. Cumulatively, for the year to Q3'2018, collections reached $3.8 billion, 19% above target ($3.2 billion). Zimbabwe's tax debt was estimated at $4.55 billion at the end of September 2018. In order to enhance tax collections, Treasury is targeting enhanced automation among other structural reforms at the Zimbabwe Revenue Authority.

Sustained Risk to Balance of External Payments

National gold deliveries to the country's sole authorised gold buyer (Fidelity Printers) reached a record 28.2 tons in the nine months period to 30 September 2018. Small scale producers accounted for 68% of output to date. In 2017, full year gold output closed at 24.5 tons, while the previous annual record output was 27.1 tons, registered in 1999.

Zimbabwe's trade deficit over the nine months to 30 September 2018 reached $2.01 billion, up 34% from the same period last year. Imports over the nine month period amounted to $5.07 billion mostly comprised of fuel, electricity and food. Primary mining and agriculture produce, led by gold and tobacco dominated exports. In the absence of significant capital account net inflows, persistent trade deficits (current account deficit) sustain negative balance of external payments - compromising foreign currency availability under the multi-currency framework.

Simmering Inflation Pressures

Year on year consumer inflation increased from 4.83% in August 2018 to 5.39% in September 2018 (highest since May 2010). Inflation for the quarter under review was 2.3%, up from 0.1% in the previous quarter. Year to date inflation reached 2.49%, compared to 0.61% in the same period last year. Inflationary pressures were mainly driven by the tradable goods; in line with general foreign currency shortages and associated parallel market premia being passed onto consumers.

Foreign Buyers Supported ZSE Gains

The ZSE industrial index firmed a noteworthy 12.89% during the quarter ended 30 September 2018, extending year to date gains to 16.2% as highlighted in the following table.

Sector	Value	Q3'18	YTD'18
Commodities	999,83	-1,10%	0,99%
Consumer	707,10	34,51%	42,66%
Financial	186,91	5,35%	-0,21%
Listed Property	180,08	25,58%	-10,03%
Manufacturing	231,90	18,62%	18,64%
Industrial	**386,97**	**12,89%**	**16,20%**
Mining	**163,76**	**1,54%**	**15,00%**
Top Ten	**117,60**	**13,83%**	**17,60%**
All Share	**115,12**	**12,75%**	**15,12%**
Market Cap ($ bln)	**12.218**	**16,07%**	**20,73%**

The following tables highlight the ZSE top and bottom three performing stocks for Q3'2018.

Top 3 Performers	Price USc	Q3'18 Mvt	M.Cap $m
POWERSPEED	14,99	114,14%	56,098
TURNALL	2,07	88,18%	10,205
ZIMPLOW	20,25	76,09%	47,681

Bottom 3 Performers	Price USc	Q3'18 Mvt	M.Cap $m
MEDTECH	0,01	-80,00%	0,303
STARAFRICA	0,89	-31,54%	41,964
ZIMRE	1,60	-16,23%	27,466

Foreign investors bought and sold stocks worth $72.5 million and $65.7 million, respectively on the ZSE during the quarter ended 30 September 2018. The net portfolio inflow position closed at $6.8 million down from $34.9 million in the prior quarter. Foreign investor participation increased from 25.3% to 29.9% during the quarter under review.

Economic Outlook

Macro-economic reforms to date, if accompanied by full implementation of austerity measures, point to significant budgetary rebalancing on the way. Consolidation presents a likely drain on aggregate demand. Monetary policy sustains a muted but real risk of implosion if not handled carefully; more so in the context of rational expectations of economic agents (confidence is of the essence).

Overall environment prospects are likely to hinge on the depth and sustainability of on-going (painful) policy reforms, political will and reciprocal international reintegration.