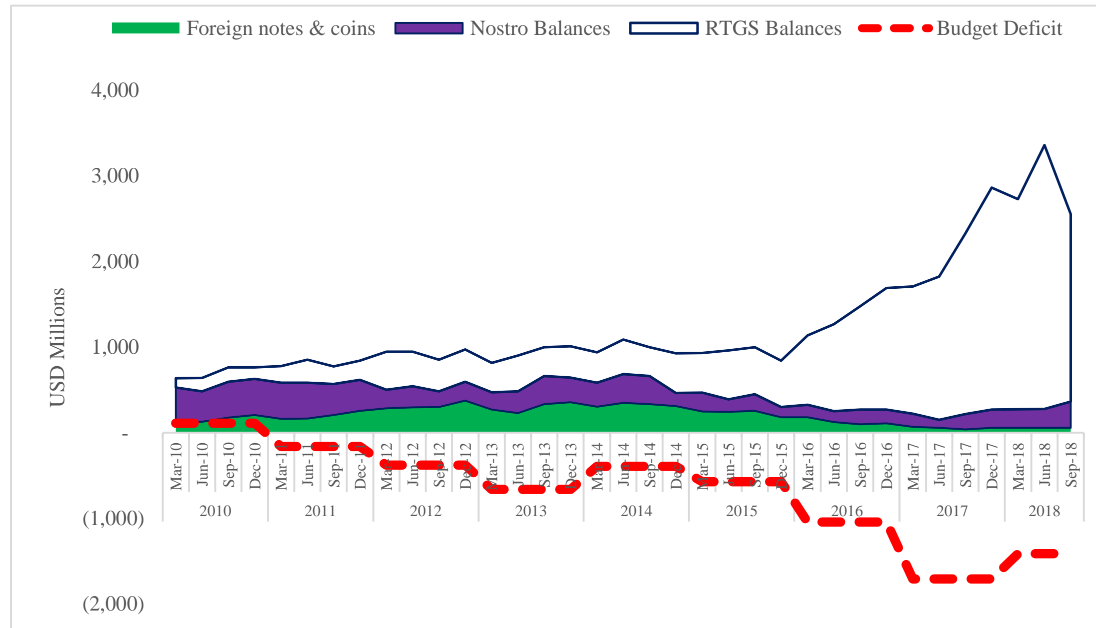
ANALYSIS OF THE 2018 MID-TERM FISCAL & MONETARY POLICIES

The RBZ Governor and the Minister of Finance, on 01 October 2018, both presented the 2018 Mid Term Fiscal Policies. Both authorities aptly *put the moose on the table*, with the Finance Minister noting that "*at the centre of the … challenges, is the unsustainable high budget deficit (dotted red line in the graph below). This challenge has had destabilising implications not only on the financial sector but to the rest of the economy*" as illustrated by the depletion of NOSTRO and FX notes & coins and the swelling of the RTGS balances (money supply) - rest of the series - on the graph to the left.



As such, it was widely expected that the authorities' policy interventions will focus on addressing the root cause of the macroeconomic instability. In particular, the expectation was that the fiscal policy will be directed towards addressing the Government budget deficit, whilst monetary policy will mainly be directed at constraining money supply growth and resolving the cash and currency crisis.

In the section below, therefore, we analyse the mid-term fiscal and monetary policy proposals and interventions, outline the extent to which they complement each other and their adequacy in as far as addressing *the elephant in the room* is concerned.

AREA	POLICY MEASURE (S)	COMMENT (S) & OPINIONS
Money Supply	○ Introduction of Statutory Reserve Requirements "SRR", at a level of 5%, on RTGS FCAs on a weekly compliance basis, effective 1 November 2018. ○ Continuation of RBZ Savings Bonds (*Uptake at US$1.5b in Aug 2018*).	Following the acceleration in money supply to 40.81% in June 2018, amid constrained production, there is definitely a need to reduce the amount of money in circulation in order to stabilise demand. However, our view is that SRRs are not the best policy instrument as they may be counterproductive to other Government driven initiatives. For example, SRRs technically increases banks' cost of funds, which in turn puts pressure on lending rates. To maintain margins, under the current interest rate framework, banks may be forced to reduce the nominal interest rates on deposits, but this somewhat militates against the drive to build national savings, and ultimately perpetuates constrained investment. As such, interventions focused on eliminating only the excess liquidity from the money market – for example through the Savings Bond, the planned issuance of Treasury bills through the auction system, as announced by the Minister, as well as adjustments to the interest rate policy could have been ideal. Meanwhile, given that the primary cause of the excess money supply has been high budget deficits, the Finance Minister commendably complemented the monetary authorities by announcing that the Government will *"limit the use of the RBZ overdraft facility and curtail RBZ advances to Government"*. However, the proposal does not seem to adequately address the reasons why the 20% overdraft limit has been consistently exceeded. It is, therefore, hoped that the forthcoming 2019 fiscal policy will contain more measures towards curtailing the violation of the OD and other statutory limits. It is clear that no amount of monetary policy interventions will be enough to deal with fiscal policy induced imbalances.

AREA	POLICY MEASURE (S)	COMMENT (S) & OPINIONS
Currency & Exchange Rate Management	○ Introduction of Separate FCA accounts for Nostro & RTGS funds, at parity. ○ RBZ finalising a US$500m Nostro Stabilisation Guarantee Facility (NSGF) by end of October 2018. ○ Exporters to retain 100% of their exports except for gold (30%); platinum, diamonds and chrome (35%) and 20% for tobacco and cotton producers. ○ All purchases of gold by Jewellers from FPR shall be in foreign currency with a 100% export retention. ○ Settlement of capital gains tax in foreign currency when using offshore funds.	The authorities seemed to have well read the saying that *"fool me once, shame on you; fool me twice, shame on me"* when they proposed the gradual and sequential approach to stabilising the currency markets, and ultimately resolving the currency issues. It is, therefore, expected that they will buttress these policy measures with more tangible interventions, especially announcement of hard targets under the proposed reduction in the Government budget deficit and the curtailing of money supply growth. Such measures are necessary for stabilising the financial markets and inflation, which in turn instils public confidence. Meanwhile, the partial liberalisation of the export surrender requirements naturally reduces the pressure for unnecessary and/ unplanned expenditure that was being caused by measures such as the 14-day window for utilisation of export proceeds. The move also opens up opportunities for more players, especially banks, to formally participate in the foreign currency market, with may ultimately enhance price discovery on the exchange rate front. It is hoped that the operational modalities for the new framework will continue to create a conducive market for foreign currency.
Interest Rates	○ No specific mention of the interest rate framework. However, the central bank introduced SRRs as part of measures to tighten the monetary system.	As mentioned prior, it appears that a review of the interest rate framework, usage of the Savings Bond and the proposed auction system for Government borrowing would have been more ideal interventions towards tightening monetary policy. Thus, in order to attract and build savings, the monetary authorities would need to, at some point, liberalise the interest rate framework, coupled with price/ inflation stability, so as to enhance banks' ability to mobilise long term deposits/ savings. Such savings will then be utilised to drive

AREA	POLICY MEASURE (S)	COMMENT (S) & OPINIONS
		domestic direct investment, which will be complemented by foreign direct investment. On the other hand, the fiscal authorities would also need to complement the monetary authorities, for example, through providing tax incentives for incremental investments in the productive sectors so as to ensure that the impact of relatively high lending rates is somewhat neutralised.
Price stability	○ RBZ finalising a US$500m facility (*Gemcorp, Afreximbank and Afrigrain*) for importation of strategic requirements i.e. fuel, electricity, cooking oil, etc.	This is a welcome short term measure that is aimed at supporting the ongoing interventions to stabilise the economy. However, given that it is largely adding onto the Government's stock of external debt, amid minimal debt service, it is likely to exacerbate the country's debt position. As such, the long term solution remains the Minister's proposed resolution of the country's debt arrears, as this is the cornerstone to unlocking more private sector and foreign investor led economic growth.
Tax Measures	○ Review of Intermediated Money Transfer Tax from 5 cents per transaction to 2 cents per dollar transacted, effective 01 Oct 2018.	Although there is no clarity with regards the amount to be raised from the tax and the purpose for which the funds will be utilised, it appears the measure is aimed at bridging the gap that will be left when the Government begins limiting its recourse to the central bank. However, as the former French Finance Minister, Jean-Baptiste Colbert, once said, that "*the art of taxation consists in so plucking the goose as to obtain the largest possible amount of feathers with the smallest possible amount of hissing*" it appears the Government's move, through it gets the largest amount of feathers, will leave the goose uncontrollably hissing. In fact, the tax may increase the cost of doing business, including for social oriented institutions such as schools and hospitals. As such, it may be necessary

AREA	POLICY MEASURE (S)	COMMENT (S) & OPINIONS
		for the authorities to come up with a sector specific tax system in-order to cushion the social oriented sectors, at the least.
Other Government Initiatives	○ Accelerate privatisation process for SOEs that rank highly on the privatisation scale. ○ Government to encourage issuance of publicly traded infrastructure bonds. ○ Treasury to finance Government's developmental programmes by use of instruments that crowd-in private sector, including PPPs or Government guarantees to financial institutions.	These measures are expected to ultimately result in a crowding in of the private sector. However, there may be a need for a change in approach with regards SOE reforms, as these have often failed to gather enough traction in previous attempts. Bringing the SOE under a single Ministry, as is the case in other countries, could be the starting point for accelerated reforms for these enterprises.
Other Measures by the Central Bank	○ The central bank also made a number of general announcements and further proposals.	These announcements and proposals include that Aftrades will remain open; Banks to submit revised capitalisation plans by 30 June 2019; All card infrastructure should be compliant with EMV standards by 31 December 2018; Strengthening of the Monetary Policy Committee; Use of Letters of Credit for high value transactions; All imports to be supported by invoices whose banking details match with the payee's name and bank account details; Strict adherence to customer due diligence, and; Remittance of export proceeds to be done on a timely basis in line with rules.

In conclusion, it is expected that more measures will be announced post the World Bank/ IMF Annual Meetings to be held in October 2018.

Contact Details

3rd Floor, Sapphire House,

Cnr Speke/Angwa St,

P O Box 3313,

Harare, Zimbabwe,

Tel: +263 4 759 110-6

Website: www.cbz.co.zw

Analysts

Andrew Chirewo	achirewo@cbz.co.zw
Victor Makanda	vmakanda@cbz.co.zw
Godknows Muwandi	gmuwandi@cbz.co.zw

Disclaimer

CBZ Holdings Limited has prepared this report on behalf of itself and its clients for informative purposes only. Whilst the facts and opinions expressed in this report are based on sources that are believed to be reliable, and every care has been taken in preparing the report, no warranty (implicit or explicit) is made by CBZ Holdings Limited, its employees, directors, associates and affiliates regarding the accuracy, reliability, currency or completeness of the information in this report nor its usefulness for any purpose. CBZ Holdings Limited, its employees, directors, associates and affiliates accept no responsibility or liability, whatsoever, for any loss, damage, cost or expense, howsoever, incurred or arising by reason of any person using or relying on information or opinions expressed in this report. The opinions and estimates expressed in this report are based on the information available as at the date of publication and such opinions and estimates are given in good faith, but without legal responsibility, and may be changed after publication at any time without notice. The information contained in this report does not constitute legal advice or personal recommendation and each recipient may undertake his or her own independent investigation of the issues discussed in this report.