Macro-Economic Update

Zimbabwe 2020 Monetary Policy Committee Deliberations

Pre-emptive statement on what to expect from the forthcoming MPS

The Monetary Policy Committee issued a statement yesterday, indicating the main focus of the RBZ in terms of policy. As expected, the RBZ has indicated that it will continue to focus on stabilizing inflation and exchange rates; the introduction of the Reuters electronic trading platform, interest rate management and strengthening the financial sector, with particular focus on the banking sector. Notable takeaways from the released statement include:

Inflation Development and Outlook: The central bank has indicated that the slowdown in m-o-m inflation was in close range of its target of 10% as December 2019 m-o-m closed at 15%. Going forward, the RBZ expects the m-o-m to continue to decelerate and forecasts that by the end of 1Q20 the monthly inflation will close in single digit levels. By the end of the year, y/y inflation is targeted to be circa 50%. We believe that despite the central bank's forecast, inflation will continue to rally, largely based on the liberalisation of food imports and rising cost of imported inputs. We anticipate increased appetite for foreign currency as the local currency continues to depreciate which will result in a spike in inflation levels, as the cost of procuring free funds is passed on to consumers and corporates alike. Pressure on the local currency will be further exacerbated by lower foreign currency reserves as tobacco and gold output are expected to be subdued in 2020.

Exchange rate stability to be premised on RBZ's adherence to monetary targeting, enhanced currency inflows and confidence in the use of the local currency. According to the RBZ, total foreign exchange receipts for the 9 months to 30 September 2019, were down 9% to US$5.46bn from US$5.98bn. Notably, key contributors to foreign currency receipts such as mining, tobacco and international money remittances declined compared to the previous period. Due to the current economic and environmental woes which include, power cuts, surging operating costs and a severe drought, we anticipate subdued output from the major currency earners. In turn, exerting additional pressure on a devalued currency resulting in a further loss of confidence. We note discussions around a potential currency swap agreement between Zimbabwe and China could indirectly lead to a further weakening of the local currency as hard currency liquidity moderates.

Foreign Exchange Trading System aims to improve on operational efficiencies in the interbank by making price discovery more transparent. This system marks a significant step towards further liberalisation of foreign currency trading and is in support of the move towards the complete liberalisation of the current account, including the sourcing of funds for the importation of strategic commodities. Despite, the steps towards liberalisation, the central bank will continue to set aside resources to intervene and 'stabilise' the market. Market intervention results in market inefficiencies, continued interventions will lead to further divergence between the parallel and formal market rates, giving the parallel market longevity.

Increased capitalisation of banks in line with our previous view on minimum capital requirements. The RBZ has reviewed capital requirements and pegged them to USD. To ensure that all banking institutions are well covered, all Tier 1 banking institutions are now required to hold core capital equivalent to US$30mn by December 2020 to support the risk associated with their business activities, whilst the minimum capital requirement for banking institutions under Tier 2 are expected to hold the equivalent of US$20mn. Tier 3 institutions (deposit taking Microfinance banks) are expected to hold the equivalent of US$5mn, whilst credit only Microfinance Institutions are required to hold US$25k equivalent. We believe that the upward revision of capital requirements will further strengthen the financial sector. As a result, we anticipate a quickening in consolidation within the broader sector particularly given the stringent deadline. Financial institutions will have to re-assess risk and their lending capacity which in the short term may further strain liquidity.

I**ncreased cash for transactions and curbing interest rates for the productive sector.** The MPC has resolved to maintain the overnight bank rate at 35%, to curb exchange rate fluctuations and inflation, which breached the 521% y-o-y mark in December 2019, according to our estimates. Meanwhile, the interest rate on the Medium-term Bank Accommodation (MBA) facility, which aims to support banks with productive sector funding requirements – particularly cereal growers, shall continue to reflect the yield on the T-Bills auction rate which is currently at between 15 – 18%. A total of $800mn has so far been disbursed, in line with the target of $1bn. However, the disbursement still remains below the capital requirements in real terms given other variables, including power shortages. While low interest rates are effective in curtailing inflation, we believe that Zimbabwe's negative yield curve, a consequence of acute currency devaluation, has eroded capital value and thus, spiralled the urge for capital preservation in non-productive sectors, despite industrial players remaining undercapitalised. Moreover, the recent court ruling for debt incurred prior to SI 33 to be recognised as RTGS lays an assault on the capitalization of financial institutions. The MPC has resolved to increase the quantity of bank notes and coins (M1) in circulation, by $400mn off which $150mn was already disbursed in 4Q19 to give a total of $1.1bn of notes and coins in circulation in the country as at 31 December 2019. The $1.1bn of notes and coins in circulation, represents 3.2% of total banking sector deposits of $34.5bn as at 31 December 2019, vs a target of 10%. These funds were sold to local banks for distribution to clients in exchange for RTGS balances, to neutralize any expansion of money supply, despite the escalation of cash premiums to record highs in the later part of 2019. Furthermore, RBZ is resolute in introducing notes of larger denominations in line with inflation to reach the target of 10% of deposits.

Our thoughts: balancing between improving productivity and stabilisation of inflation and the exchange rate

The introduction of the Reuters systems, if truly liberalised will result in narrowing of the spread between the parallel and formal interbank market. The pegging of the minimum capital requirements in USD terms is also a positive development as the banks will revisit their balance sheets and credit risk models to ensure that they are building loan books with quality assets. However, in the short term, it is likely to result in liquidity constraints for the productive sector. Without the harmonisation of policies between the monetary and fiscal policies, we are likely to witness further currency depreciation and runaway inflation. Thus, finding an equilibrium between ensuring there is enough liquidity to stimulate production, whilst remaining within range of the target inflation remains critical to returning the economy to productivity.

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Ratings Definition

Buy - Expected 1-year return is at least 20%

Hold - Expected 1-year return of between -10% and 20%

Sell - Expected 1-year return of -10% and below

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