May 2009
IMF Country Report No. 09/139

Zimbabwe: 2009 Article IV Consultation—Staff Report; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Zimbabwe

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2009 Article IV consultation with Zimbabwe, the following documents have been released and are included in this package:

- The staff report for the 2009 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on March 23, 2009, with the officials of Zimbabwe on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on April 20, 2009. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its May 4, 2009, discussion of the staff report that concluded the Article IV consultation.

- A statement by the Executive Director for Zimbabwe.

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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ZIMBABWE

Staff Report for the 2009 Article IV Consultation

Prepared by the Staff Representatives for the 2009 Consultation with Zimbabwe

Approved by Sharmini Coorey and Dominique Desruelle

April 20, 2009

Mission dates: March 9–24, 2009.

Staff team: Vitaliy Kramarenko (head), Lars Engstrom, Misa Takebe (all AFR), Joanna Grochalska (FIN), Richard Hughes (FAD), and Brad McDonald (SPR). Ms. Coorey (AFR) joined the policy discussions in the latter part of the visit.

Meetings: Acting Prime Minister Khupe, Minister of Finance Biti, Minister of Economic Planning and Investment Promotion Mangoma, Reserve Bank of Zimbabwe (RBZ) Governor Gono, and other senior government officials, as well as representatives of civil society and the business, financial, and diplomatic communities.

Exchange regime. Since February 2, 2009 Zimbabwe has adopted hard currencies for transactions. On March 19, 2009, the South African rand was announced as the reference currency. Zimbabwe dollar-denominated currency is not functional, and there is no functioning foreign exchange market for Zimbabwe dollars. The de facto exchange arrangement is classified as *other managed exchange arrangement*.

Exchange restrictions. Based on available information, Zimbabwe has eliminated the multiple currency practices identified in the last Article IV staff report. It has also lifted many of the controls on current account transactions under newly issued exchange control regulations. The staff is still reviewing the new foreign exchange regulations and their implementations to determine whether there remain any restrictions subject to Fund jurisdiction.

Data. Data have serious shortcomings that significantly hamper surveillance due to capacity constraints.

The previous Article IV consultation discussions were concluded on February 23, 2007. The related documents have not been published.

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GLOSSARY

CPI	Consumer price index
DSA	Debt sustainability analysis
LIC	Low-income country
MDG	Millennium Development Goals
PPG	Public and publicly guaranteed
PV	Present value
QFA	Quasi-fiscal activities
RBZ	Reserve Bank of Zimbabwe
RTGS	Real Time Gross Settlement
STERP	Short-Term Emergency Recovery Program
VAT	Value-added tax

EXECUTIVE SUMMARY

Background. The economic and humanitarian situation worsened dramatically in 2008. Hyperinflation, fueled by the RBZ's quasi-fiscal activities, and a further significant deterioration in the business climate contributed to an estimated 14 percent fall in real GDP in 2008, on top of a 40 percent cumulative decline during the period of 2000–07. Unemployment, poverty, malnutrition, and incidence of infectious diseases have risen sharply.

The official adoption of hard currencies for transactions in early 2009 recognized the de facto virtually complete dollarization of Zimbabwe's economy. The government also recently announced that the rand would be the reference currency. Dollarization has helped stabilize prices, improve revenue performance, and impose fiscal discipline, including on the RBZ.

Outlook. Reversing output decline and improving social conditions would require determined efforts to maintain sound macroeconomic policies, and to attract domestic and foreign investors and significant donor support. In the absence of cash budget support, higher humanitarian assistance, and wage restraint, the economic and social situation could deteriorate significantly in 2009. Zimbabwe's external debt burden is unsustainable even if policies are improved and medium-term financing gaps are filled by concessional financing.

Policy discussions. The staff welcomed the authorities' commitment to refrain from quasi-fiscal activities and implement cash budgeting (i.e., matching monthly expenditure to monthly revenue) in 2009. Given a sizable unfilled budget financing gap projected by the staff and the necessity to cover critical humanitarian expenses that are not provided for in the budget, the government would need to improve revenue performance, contain the wage bill, enhance public financial management, and seek donor financial and humanitarian assistance.

There was broad agreement that the official adoption of hard currencies for transactions had provided a strong nominal anchor. To improve the functioning of the new monetary framework, in line with staff recommendations, the authorities intend to enable the payments system to process transaction in foreign exchange and attune banking supervision to new risks. The merits of reviving the national currency and appropriate preconditions (e.g., macroeconomic stability and a credible legal framework) will be considered in late 2009.

Further progress in structural reforms is essential for reviving economic growth and reducing poverty. The authorities are committed to maintain recently adopted critical measures, including price and exchange regime liberalization, and imposition of hard budget constraints on parastatals. The staff encouraged the authorities to forge a political consensus over reforms aimed at ensuring protection of property rights and the rule of law. It also cautioned against trade protectionism and wage increases beyond levels justified by productivity.

I. BACKGROUND

1. **Zimbabwe's economic and social situation deteriorated significantly over the last ten years, culminating in a severe humanitarian crisis in 2008**. During the period 1999–2008, real GDP shrank by more than 40 percent. Decade-long high inflation spiraled out of control and reached unprecedented levels in 2008 (Table 1). Over the last ten years, there has been no significant progress in achieving Millennium Development Goals (MDG), and in some areas—child and maternal mortality—MDG indicators have deteriorated (Table 2). At present, almost 70 percent of the population are in need of food assistance and a cholera epidemic is ravaging the country. These disastrous outcomes have resulted from poor policies and weak governance.

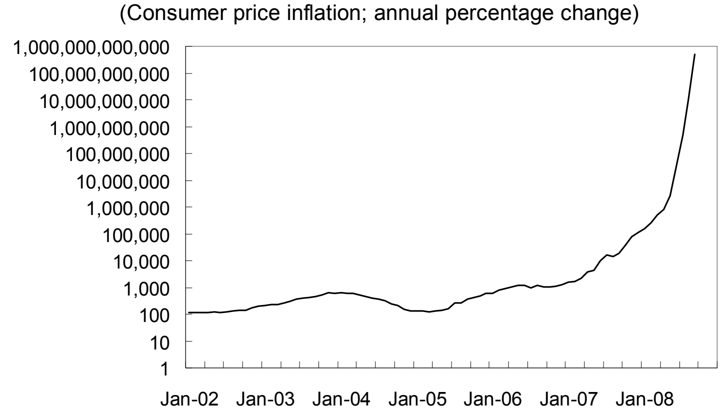
2. **The formation of the government of national unity in February 2009 opens the door for tackling the difficult economic and humanitarian crisis facing the country.** The new government has started to address the most pressing short-term economic recovery needs and has initiated work on medium-term reforms. In this context, **the consultation discussions focused on**

- the post-hyperinflation transition to sound fiscal management and the need to ensure the delivery of essential public services;
- the appropriate nominal anchor and banking system issues; and
- key growth- and competitiveness-oriented structural reforms.

II. SPONTANEOUS STABILIZATION

3. **Unprecedented hyperinflation led to the demise of the local currency and almost complete dollarization**[1] **in late 2008.** Twelve-month consumer price index (CPI) inflation is estimated to have peaked in September 2008 at about 500 billion (10^9) percent. Since October–November 2008, the local currency has virtually disappeared from circulation, and pricing of goods and services has shifted to foreign currency units (mostly, the U.S. dollar and rand). Dollarization helped stop hyperinflation. The newly compiled U.S. dollar CPI for February 2009 registered a

Inflation spiraled out of control in late 2007–early 2008
(Consumer price inflation; annual percentage change)



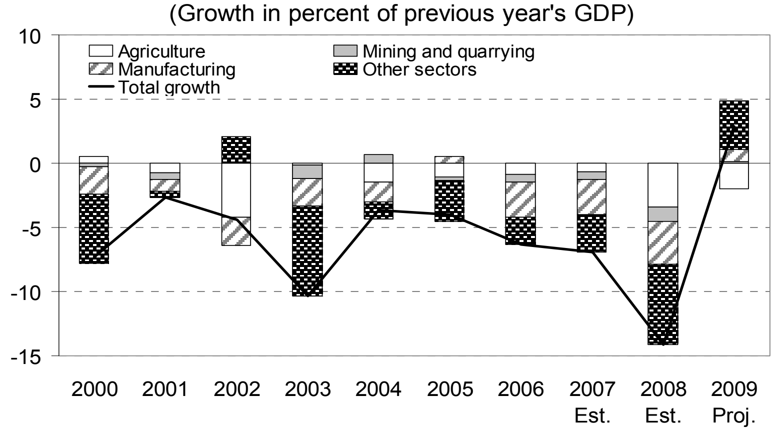
Source: Zimbabwean authorities.

[1] Dollarization is shorthand for use of any foreign currency in transactions among residents.

3 percent month-on-month decline, as a reduction in tradable prices more than offset a significant increase in utility tariffs.

4. **The collapse in economic activity and public services contributed to a significant deterioration in the humanitarian situation in 2008.** Economic disruptions caused by hyperinflation and a further significant deterioration in the business climate led to an estimated 14 percent decline in real GDP in 2008 (Table 2). Poverty and unemployment have risen to catastrophic levels, with 70 percent of the population in need of food assistance and the cholera epidemic claiming more than 4,000 lives.

Following broad-based output decline during 2000–08, real GDP is projected to recover in 2009
(Growth in percent of previous year's GDP)

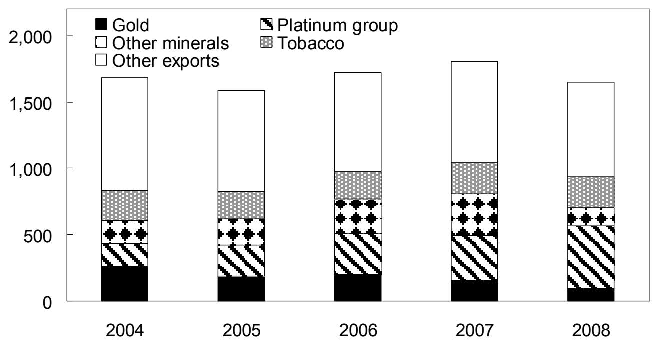


Sources: Zimbabwean authorities; and IMF staff estimates.

5. **The external position remained precarious in 2008.** The current account deficit increased to 28 percent of GDP in 2008, from 11 percent in 2007 (Table 3). In 2008, exports declined on account of the disruptive domestic economic environment and a fall in international commodity prices. Higher food and fuel prices, as well as increased volumes of donor-financed humanitarian aid (US$490 million) and capital grants (US$80 million), led to a significant increase in imports. The current account deficit was mainly financed by a further accumulation of external payments arrears, a decline in net international reserves, large RBZ external borrowing, a sizable decline in banks' foreign assets, and modest private capital inflows (foreign direct investment and short-term suppliers credits). At end-2008, gross international reserves amounted to US$6 million, while external debt is estimated at US$6.0 billion (189 percent of GDP), of which arrears accounted for US$3.8 billion (120 percent of GDP).[2] Overdue financial obligations to the IMF amounted to SDR 89 million (US$133 million) at end-March 2009.

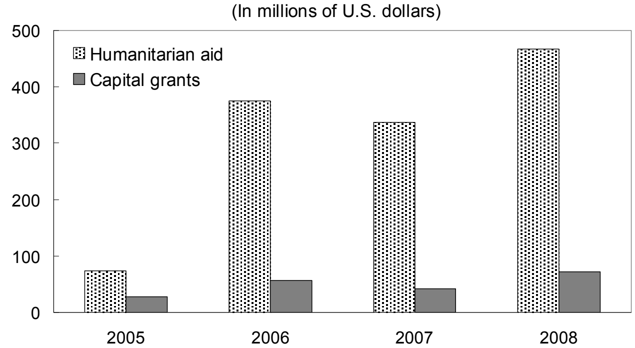
[2] External debt arrears include initial principle and interest obligations in arrears, and estimated penalties on interest and principle arrears.

Exports have stagnated over the last five years mainly due to a constrained economic environment
(In millions of U.S.dollars)



Source: Zimbabwean authorities.

The international community increased humanitarian aid in response to the deepening humanitarian crisis
(In millions of U.S. dollars)



Sources: United Nations Office for the Coordination of Humanitarian Affairs (OCHA), www.reliefweb.int.

6. **In 2008, unprecedented money growth fueled hyperinflation (Figure 1).** The monetization of the RBZ's massive quasi-fiscal activities led to a rapid increase in banks' deposits with the RBZ and ultimately in local currency M3.[3] However, the printing press was not able keep pace with the expansion of local currency M3, which led to cash shortages and a significant divergence between the parallel cash and electronic transaction exchange rates. As inflation accelerated in the third quarter of 2008, real money demand and the parallel market exchange rates collapsed. As a result, at the UN exchange rate of Z$35 quadrillion ($10^{15}$) per US$1,[4] reserve money declined to an equivalent of about US$7 million and local currency-denominated M3, to US$6 million by end-2008. Foreign currency deposits are estimated at about US$300 million at end-2008 (Table 4).

7. **The RBZ's quasi-fiscal activities increased in 2008.** Estimated at US$1.1 billion (36 percent of GDP) in 2008 (US$0.8 billion, 23 percent of GDP in 2007), they included election-related expenses, transfers to parastatals, subsidized directed lending, below-cost provision of equipment and fertilizers to farmers, and allocation of foreign exchange at subsidized exchange rates. These expenses were mainly financed by surrender requirements on export proceeds, the retention of foreign exchange earnings of the gold and agricultural sectors in excess of mandatory surrender requirements, the confiscation of most foreign currency deposits, external borrowing, purchases of foreign exchange at the parallel market exchange rates, and monetization.

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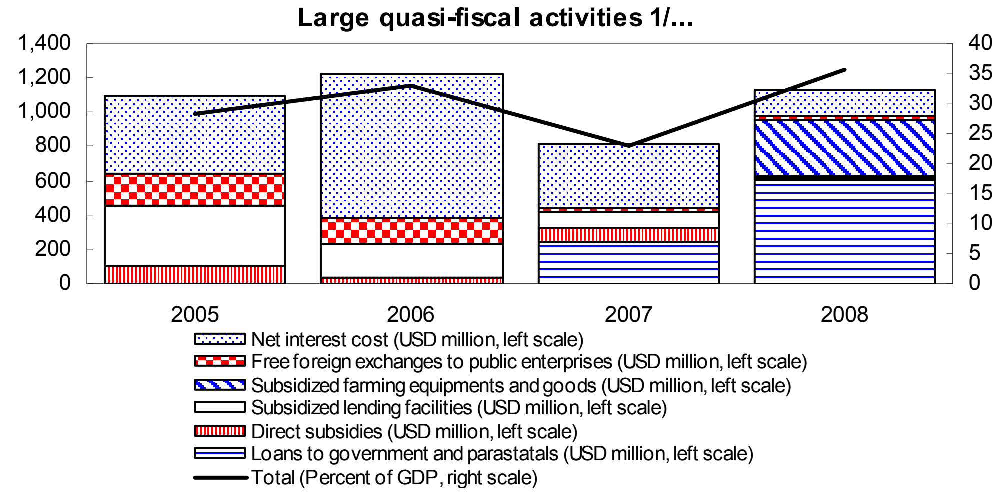
[3] Includes local currency-denominated cash in circulation and deposits with the banking system.

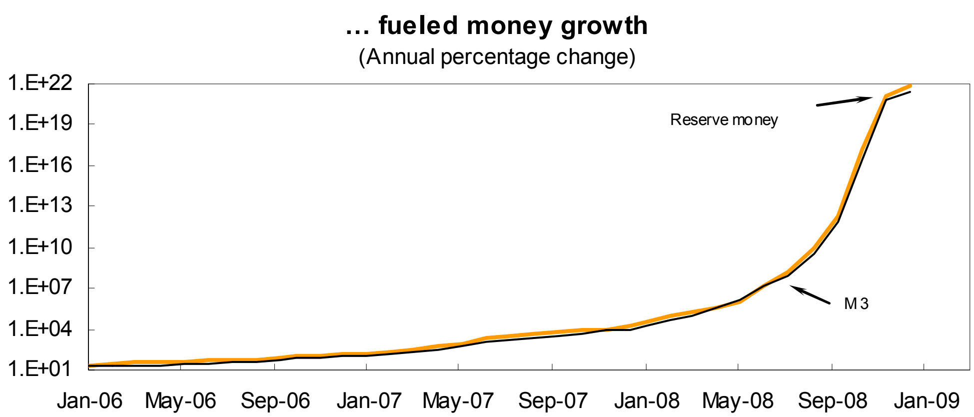
[4] This rate (which is posted on http://www.un.org/Depts/treasury/) closely followed the noncash parallel exchange rate.

Figure 1. Recent Monetary and Exchange Rate Developments

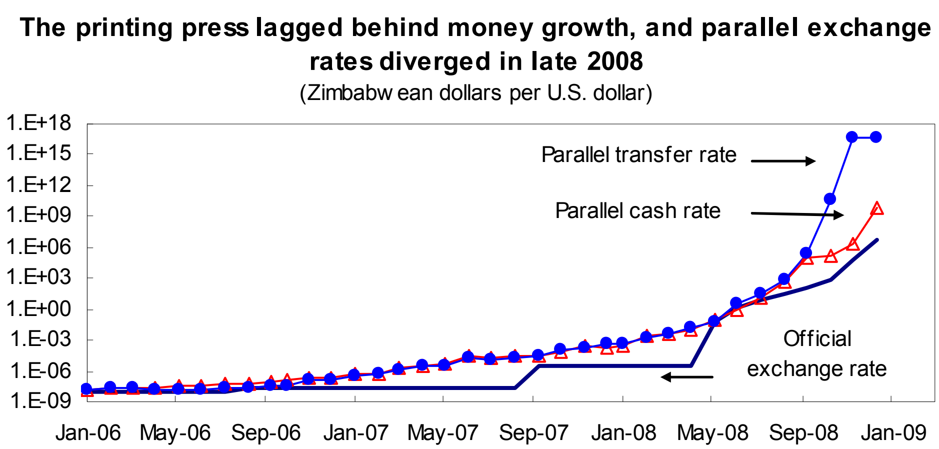


Sources: Reserve Bank of Zimbabwe; and IMF staff estimates.

1/ The coverage of quasi-fiscal activities was changed in 2007 as the Reserve Bank of Zimbabwe started new forms of quasi-fiscal activities. The data under the new coverage before 2006 is not available. For detailed descriptions of the old coverage, see WP/07/98 "Central Bank Quasi-fiscal Losses and High Inflation in Zimbabwe: A Note."



Source: Reserve Bank of Zimbabwe.

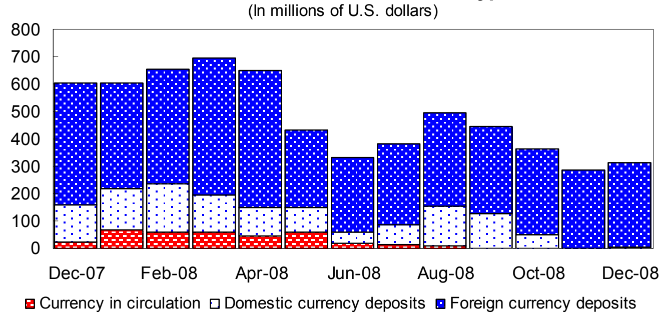


Source: Reserve Bank of Zimbabwe.

8. **The expansion of the quasi-fiscal activities took place in the context of weak RBZ governance and accountability.** Specifically, the composition of the RBZ Board is not fully consistent with the RBZ Act, which hampers effective oversight of RBZ operations. The RBZ financial reporting practices do not adhere to international standards in many areas, including inadequate disclosure of operations of its subsidiaries. The RBZ 2008 financial statements expressed in Zimbabwe dollars may not represent a true and fair view because of hyperinflation and the multiplicity of exchange rates.

9. **The financial sector appears to have shrunk significantly in 2008.** There is no reliable information on the impact of hyperinflation, the confiscation of most foreign currency accounts in mid-2008, and dollarization on the banks' balance sheets. Although banks reportedly hedged against inflation by investing in real assets, this does not appear to have prevented their balance sheets from contracting considerably.

M3 in U.S. dollar terms contracted due to hyperinflation 1/
(In millions of U.S. dollars)



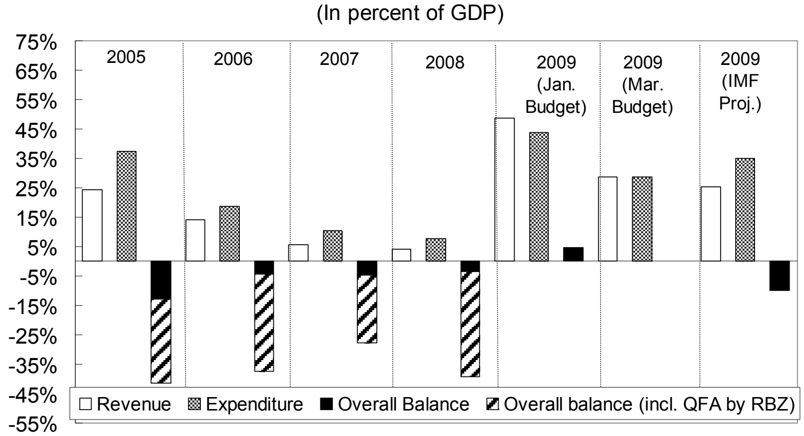
Sources: Reserve Bank of Zimbabwe; and IMF staff estimates.

1/ UN exchange rate used to convert Zimbabwe dollar data into U.S. dollars.

10. **The central government's revenue and expenditure effectively collapsed in 2008.** With economic decline and a rapid erosion of the real value of accrued tax liabilities (Tanzi effect), budget revenue fell from almost US$1 billion (25 percent of GDP) in 2005 to US$133 million (4 percent of GDP) in 2008. Expenditure shrank from about US$1.4 billion (37 percent of GDP) in 2005 to US$258 million (8 percent of GDP) in 2008 causing an almost complete collapse in the provision of public services (Table 5). With public sector wages declining to US$2–US$3 a month, most public schools and hospitals were closed, and absentee rates among civil servants exceeded 50 percent in many ministries. Lack of maintenance and investment resulted in a significant reduction in electricity generation capacity, collapse of water supply, and major disruptions in railway services.

Central government revenue and expenditure collapsed, while quasi-fiscal activities remained large during 2005–08

(In percent of GDP)



Sources: Zimbabwean authorities; and IMF staff estimates.

11. **A further deterioration in the business climate exacerbated the economic decline in 2008.** A tightening of price controls and exchange restrictions, a pickup in land invasions, the confiscation of foreign currency deposits, and frequent changes in business regulations made it more difficult to conduct business in Zimbabwe. The country continues to rank low in terms of ease of doing business among regional comparators.

Unfavorable business regulations constrain Zimbabwe's private sector

(Ranking from the 2009 Doing Business Survey)

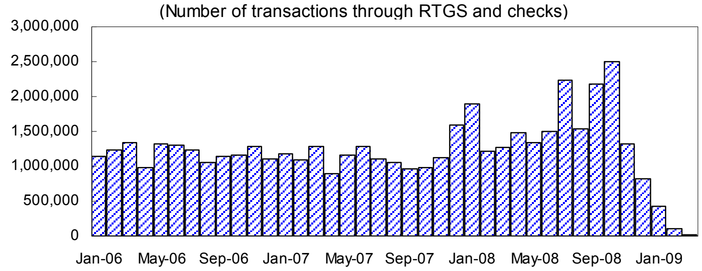
	Zimbabwe	Malawi	Mozambique	Zambia	South Africa
Ease of doing business	158	134	141	100	32
Starting a business	164	122	144	71	47
Dealing with construction permits	174	156	153	146	48
Employing workers	127	96	161	135	102
Registering property	85	96	149	91	87
Getting credit	84	84	123	68	2
Protecting investors	113	70	38	70	9
Paying taxes	157	58	88	38	23
Trading across borders	162	167	140	153	147
Enforcing contracts	77	138	124	87	82
Closing a business	154	135	133	80	73

Source: Doing Business 2009.

12. **In early 2009, the authorities announced a transition to a multi-currency system.** Under this system, transactions in foreign currency are authorized, payments of most taxes are mandatory in foreign exchange, trading at the Zimbabwe Stock Exchange is conducted in foreign exchange, and many foreign exchange restrictions on current account transactions are liberalized. The Zimbabwe dollar remains legal tender, but this provision is not enforced, and economic agents consider that the currency is not functional. Transactions in local currency are mainly limited to payments of government taxes related to 2008 obligations; and following the abolition of all surrender requirements on foreign exchange proceeds on March 19, 2009, there has not been a functioning foreign exchange market for Zimbabwe dollars.

Economic agents virtually abandoned the Zimbabwe dollar in late 2008 1/

(Number of transactions through RTGS and checks)



Sources: Reserve Bank of Zimbabwe.

1/ Transaction volume conducted through RTGS and checks. Zimbabwe dollars have been used only for tax payments, public servants' salaries, customer payments, and pension payments since late 2008.

III. Discussions of the Authorities' Emergency Recovery Program

13. **Against the backdrop of the acute economic and humanitarian crisis, the recently formed government of national unity prepared a Short-Term Emergency Recovery Program (STERP) for 2009.**[5] This program focuses on macroeconomic policy and supply-side measures aimed at achieving low inflation, arresting economic decline, and improving social conditions.

14. **The authorities emphasized that low inflation would be maintained based on strict fiscal discipline and a strong nominal anchor.** Specifically, the RBZ has been mandated to stop quasi-fiscal activities, and cash budgeting (i.e., matching monthly expenditure to monthly revenue) will be implemented in 2009. To this end, the government revised down the initial 2009 budget's unrealistic revenue and expenditure estimates by nearly 50 percent. The authorities underscored that credibility of their fiscal efforts is underpinned by their inability to rely on inflationary sources of financing under the dollarized system and their commitment to price liberalization and imposition of hard budget constraints on parastatals.

A. Implementing Cash Budgeting While Addressing Critical Social Needs

15. **The revised 2009 budget[6] targets a balanced fiscal position on a month-by-month basis.** The authorities expect that hard currency budget revenue, which rose from US$6 million in January 2009 to US$31 million in February 2009, would steadily increase in the course of 2009 and would reach US$1 billion (29 percent of GDP), as economic activity picks up. Customs duties, excises, and the value-added tax (VAT) are expected to account for 60 percent of budget revenue. Expenditure, including those quasi-fiscal operations that were transferred to the treasury, is budgeted at US$1 billion. This would represent an expenditure cut of 15 percent of GDP compared with the 2008 outturn for budgetary expenditure and the RBZ's quasi-fiscal operations (Table 5).

16. **The authorities acknowledged that budget revenue estimates of the 2009 revised budget may not fully materialize.** They noted the staff's estimate that revenue would be US$100–US$150 million lower (Table 5) and indicated that they would consider revenue measures in the context of a planned July 2009 budget revision to address downside risks to revenue. These measures may include increasing royalties on mineral resources and broadening the VAT and customs tax bases. In addition, the government intends to enhance the Zimbabwe Revenue Authority's capacity to assess taxes in foreign exchange and automate recording of tax payments in multiple currencies.

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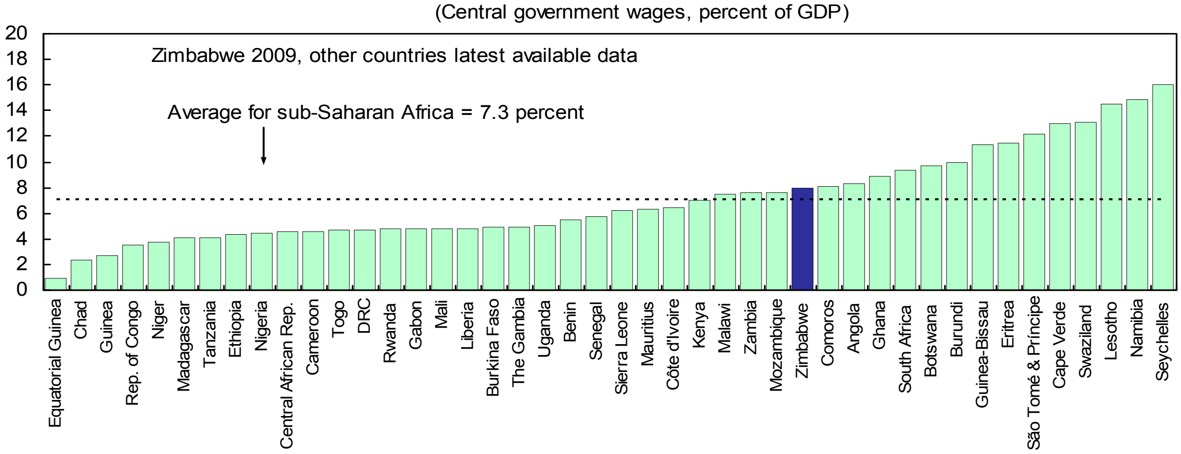
[5] Posted on http://www.mofed.gov.zw/html/publications.shtm

[6] Posted on http://www.mofed.gov.zw/html/budget_stmt.shtm

17. **The authorities and staff agreed that the revised 2009 budget expenditure was understated and higher humanitarian assistance was needed to ensure the provision of critical public services.** The authorities noted the staff's estimate that overhead expenses of public institutions and essential transfers to key parastatals were understated by at least US$80 million (Table 5). In addition, they saw a need for an increase of US$200–US$300 million dollars in humanitarian assistance compared with the 2008 outturn, which would be required to provide sufficient food relief, contain the cholera epidemic, and address critical needs in health and education sectors.

18. **There is significant political pressure to increase public sector wages.** The staff underscored the importance of maintaining the wage bill within the budget allocation on affordability and competitiveness grounds. The authorities indicated that maintaining the current flat civil service allowance of US$100 per month would be detrimental to morale. While the authorities shared the staff's concern that a civil service pay rise may lead to an unaffordable increase in the wage bill (which is already higher than those in low-income neighboring countries) and may undermine competitiveness, they felt that some decompression of the wage scale would be justified in 2009 to improve motivation and retention of skilled civil servants. In this regard, the authorities indicated that they would conduct a government payroll audit with a view to removing ghost workers. After reassessing the revenue forecast and prospective financial assistance flows in July 2009, the authorities would consider decompressing the wage scale while maintaining the wage bill within a fully financed budgetary envelope.

Zimbabwe's public sector wage bill is above those of low-income neighboring countries
(Central government wages, percent of GDP)



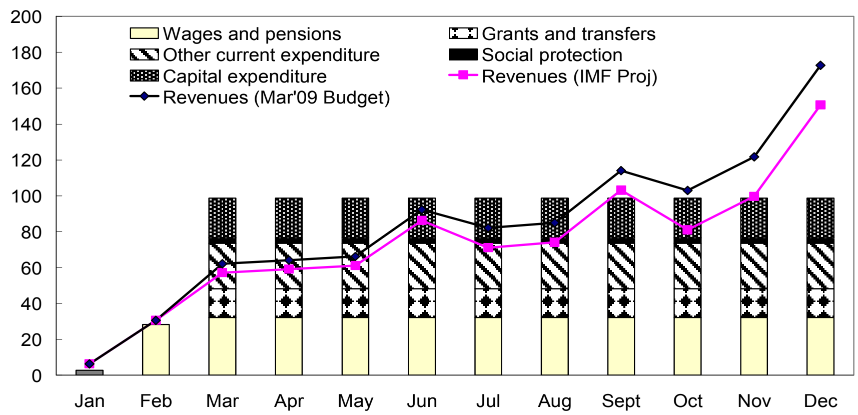
Source: World Economic Outlook.

19. **The authorities are seeking donor budget support to cover the unfilled front-loaded budget financing gap for 2009.** They indicated that the budget financing gap would be particularly large during the first half of 2009, when budget revenue can only cover the wage bill, public sector pensions, and a fraction of overhead costs of public institutions. The staff and the authorities shared a view that domestic financing would only be possible in very limited amounts. Therefore, in the absence of donor financial support, the government would

be bound to reduce expenditures on social programs, postpone public investment projects, and incur payments arrears, which could contribute to a deterioration in the social and economic situation.

Large unfilled budget financing gaps are expected in the first half of 2009

(In millions of U.S. dollars)



Sources: Zimbabwean authorities; and IMF staff estimates.

20. **The government intends to address significant weaknesses in public financial management.** To this end, it is working on resolving technical and legal issues related to the transition to a multi-currency treasury account in the banking system and improving procedures for budgetary cash management and expenditure control with the advice of the World Bank. The authorities concurred that sound public financial management was essential for unlocking donor support.

B. Maintaining Official Dollarization as the Nominal Anchor

21. **The authorities saw the multi-currency system with the rand as the reference currency as the essential element of their stabilization strategy.** With widespread dollarization and lack of a strong institutional framework ensuring credibility and accountability of the central bank, the multi-currency system was the only realistically feasible and credible monetary framework. The authorities justified their choice of the rand as the reference currency by optimal currency area considerations and potential significant benefits of closer regional integration. Given the adoption of the rand as the reference currency, the authorities concurred with the staff's recommendations to present the next budget in rands, and mandate tax assessments in rands and adopt the rand as the sole unit of account for the public and private sectors in the near future.

22. **The authorities intend to address outstanding banking sector issues to facilitate payment services and improve credit availability in the near term.** They agreed with the staff recommendation that there was an urgent need to enable the domestic payments system to process payments in foreign exchange and attune banking system supervision to the needs

of the multi-currency system. In addition, the RBZ plans to conduct a thorough review of the financial conditions of individual banks based on their end-March 2009 balance sheets translated into foreign currency and address identified vulnerabilities, which may include capital erosion due to hyperinflation and increased risks of currency mismatches and illiquidity under the multi-currency system. The authorities and the staff also discussed ways to improve liquidity management in a dollarized environment, including through the introduction of limited lender of last resort operations provided funding for such operations can be mobilized. The authorities are seeking technical assistance in these areas.

23. **The authorities agreed that RBZ governance needed to be strengthened.** As a first step in this direction, the staff underscored the importance of ensuring compliance with the RBZ Act's accountability requirements. In line with staff recommendations, the minister of finance intends to recommend five non-Executive Board members who should be appointed by the President by end-April 2009. The government also noted that the Board would seek to ensure effective oversight of RBZ operations, including through a thorough review of the 2008 audited financial statements of the RBZ and its subsidiaries, the submission to the minister of finance of the 2009 budget consistent with the RBZ's refocused functional responsibilities, and close monitoring of the RBZ's international reserves management, and borrowing, guaranteeing, and pledging activities.

24. **Merits of a revival of the national currency will be considered at the end of 2009.** The authorities concurred with the staff that the multi-currency system should be maintained until prerequisites for a revival of the national currency are met, which may take some time. There was convergence of views on key prerequisites, including the establishment of a track record of sound fiscal policy implementation, the achievement of a sustainable external position, the resumption of economic growth, and adoption of new central bank legislation focusing on price stability and ensuring central bank credibility and accountability. In the meantime, the government is considering repurchasing local currency-denominated reserve money, which the staff supported.

C. Pressing Ahead with Structural Reforms to Enhance Growth Potential and Competitiveness

25. **The government is committed to maintaining critical policies that have already been implemented.** These include price liberalization, the removal of surrender requirements and most exchange restrictions, the imposition of hard budget constraints on parastatal enterprises, and the elimination of the Grain Marketing Board monopoly.

26. **The authorities intend to boost the real economy through a number of supporting policies.** While they are considering merits of tax incentives, subsidies, preferential treatment of specific sectors, and trade protection measures, they highlighted that these measures would be implemented on a limited basis. The staff cautioned against protectionism and unaffordable tax incentives, while highlighting the need to make

Zimbabwe's producers competitive in foreign markets through improvements in the business climate.

27. **There is consensus among domestic and foreign investors, as well as donors and representatives of civil society, that respect of property rights and the rule of law are essential for reviving investment and economic growth.** The STERP recognizes the urgency of addressing these issues and formulates general principles of land reform and measures pertaining to the enforcement of property rights in other areas. The staff called for drafting, adopting, and implementing the necessary legislative acts ensuring protection of property rights in close cooperation with all the stakeholders. Government officials underscored that adoption and implementation of the necessary legislation would require strong political will among coalition partners to find a workable solution to these issues.

28. **The government is initiating a comprehensive review of parastatal enterprises.** The authorities re-iterated their commitment to impose hard budget constraints on parastatal enterprises by eliminating quasi-fiscal subsidies previously extended to them by the RBZ. They stated that price liberalization would help some parastatals regain financial viability. The staff encouraged the authorities to follow through with the STERP's commitments to restructure, privatize, or liquidate nonviable parastatals in the medium term to ensure that they do not burden the budget. The authorities are seeking technical advice in this area from the World Bank and the African Development Bank.

IV. Macroeconomic Outlook and Risks

29. **Based on discussions with the authorities, the mission prepared an illustrative macroeconomic scenario (Tables 1 and 6).** It assumes that staff recommendations and the authorities' policy intentions, as discussed above, are fully implemented. The authorities concurred with the main conclusions of the baseline scenario and the assessment of risks.

30. **In staff's view, an economic turnaround would not be possible without foreign assistance and private capital inflows, even assuming sound policy implementation.** The fiscal discipline imposed by the multi-currency system would underpin a reduction in CPI inflation (in U.S. dollar terms) below 10 percent in 2009. Low inflation, the on-going liberalization of economic activities, and a gradual pickup in financial intermediation would help arrest the decade-long economic decline in 2009. The significant improvement in Zimbabwe's terms of trade projected by the IMF's World Economic Outlook, and an expected increase in foreign credit lines and private capital inflows would also support economic growth. However, for real GDP growth to turn positive in 2009, in addition to sound policies, as described above, official budget support of at least US$200 million (6 percent of GDP)[7] would need to be mobilized. Furthermore, humanitarian assistance in the

[7] South Africa is in discussions with Zimbabwe's authorities on a possible provision of R 300 million (US$33 million) to fill part of this gap.

areas of food relief, health, and education may need to increase by US$200–US$300 million in 2009. Despite a brighter short-term macroeconomic outlook, Zimbabwe will not be able to discharge its external debt service obligations in 2009.

31. **There are significant downside risks to the short-term outlook:**

- Political disagreements among coalition partners may emerge, potentially resulting in policy reversals.

- Budget revenue and foreign financing shortfalls could lead to a large compression in expenditure, which, in turn, may trigger social unrest.

- If wages exceeded levels justified by the economy's productivity, competitiveness could suffer, resulting in output contraction and higher unemployment.

- The banking system, which has become more fragile because of hyperinflation, is subject to new risks under the multi-currency system. If these risks were not addressed in a timely manner, the intermediation capacity of the banking system would not improve and growth would suffer.

- If projected external private and official inflows, including financing to close the external gap, did not materialize, under the virtually complete dollarization, the resulting liquidity squeeze could lead to deflation.

- Significant capacity constraints pose a high risk to the implementation of the authorities' emergency recovery program.

32. **Large financing gaps would persist over the medium term.** Based on illustrative estimates, for real GDP growth to reach 5–6 percent per year over the medium term, there would need to be a significant improvement in policies, including sound macroeconomic management, a substantial strengthening in the investment climate (in particular, ensuring protection of property rights and the rule of law), competitive wage levels, a further progress in deepening financial intermediation, as well as sizable donor support and debt relief.

33. **Zimbabwe is in debt distress.** Under the baseline Debt Sustainability Analysis (Appendix I) scenario assuming relatively optimistic assumptions on policies and the external environment, the present value of external debt-to-exports ratio is expected to persist above 250 percent for almost a decade, reflecting the initial external debt overhang and sizable gross financing requirements.

V. Other Issues

34. **The authorities intend to improve timeliness of data reporting and transparency of government and RBZ operations.** The government intends to ensure timely compilation, reporting, and publication of standard monthly monetary and fiscal statistics in foreign currency terms.

35. **The government attaches significant importance to the normalization of relations with external creditors.** It acknowledged that sound policy implementation and bilateral donors' support are key preconditions for a resolution of overdue financial obligations to official creditors. The authorities also intend to start reconciling external debt numbers with creditors as an important step toward a comprehensive assessment of the country's repayment capacity.

VI. Staff Appraisal

36. **Zimbabwe is at a critical juncture.** Following years of high inflation, economic decline, and rising poverty, the recently formed government of national unity has a historic opportunity to improve prospects for economic growth and poverty reduction. Strong policies, better governance, and donor support are critical for a successful reconstruction of the Zimbabwe economy.

37. **The short-term macroeconomic outlook has improved but it is subject to significant downside risks.** The government's STERP and the revised 2009 budget contain a number of important macroeconomic policy and structural measures that would support a private sector-led economic turnaround in a low-inflation environment in 2009. However, downside risks to the economic recovery are significant. Potential political instability and implementation capacity constraints may undermine reform efforts. In addition, the 2009 revised budget has a large unfilled financing gap which can grow larger if civil service wages are raised. Also, private capital inflows and donor support may not pick up as expected by the authorities.

38. **The government's STERP put forward sound principles of macroeconomic management.** The government's commitment to eliminate quasi-fiscal activities and implement cash budgeting (i.e., matching monthly expenditure to monthly revenue) is welcome. The credibility of this approach to fiscal management is reinforced by the decision to maintain the multi-currency system because under such a system it is not possible to monetize the budget deficit.

39. **Maintaining fiscal discipline and mobilizing donor budget support is key to preserving macroeconomic and social stability.** The authorities need to follow through with their plans to improve tax administration and review the tax regime to increase budget revenues. With regard to expenditure, it would be important to maintain the wage bill within the budgeted amount, improve public financial management systems, allocate sufficient resources to critical social and infrastructure needs, and resist pressures from parastatals to finance nonessential activities. Given the sizable unfilled budget financing gap and the

necessity to cover critical humanitarian expenses that are not provided for in the budget, the government needs to intensify its efforts in mobilizing donor budget support and increased humanitarian assistance.

40. **The government's decision to anchor expectations by maintaining the multi-currency system with the rand as the reference currency is appropriate under current circumstances.** Repurchasing the remaining amount of local currency-denominated reserve money and strengthening accountability and transparency of the RBZ's operations in conformity with the RBZ Act would strengthen the credibility of the current monetary framework. An eventual reintroduction of the national currency can only succeed if a sound track record of policy implementation is established and a credible institutional framework underpinning central bank operations with a focus on price stability is adopted and implemented.

41. **Banking system issues need to be addressed without delay**. Enabling the payments system to process transactions in foreign exchange, identifying and addressing vulnerabilities in the banking system, and implementing a sound liquidity management framework would be essential for catalyzing financial reintermediation.

42. **The revival of the economy depends critically on quickly attracting private domestic and foreign investors and improving competitiveness.** Specifically, the government needs to ensure protection of property rights, maintain the rule of law, guard against trade protectionism, and pursue prudent wage and income policies. Also, commendable efforts in reestablishing market signals through price liberalization and the elimination of many exchange restrictions need to be sustained.

43. **Even if policies were improved and private sector inflows increased, large external financing gaps would persist and external debt would remain unsustainable over the medium term.** In this regard, establishing a track record of sound policy implementation is a critical first step to resolving overdue financial obligations to official creditors, including the IMF, and ultimately securing donor financial support for the reconstruction of Zimbabwe's economy. The authorities are urged to resume payments to the Fund as soon as Zimbabwe's payment capacity improves.

44. **Significant improvement is needed in all areas of economic statistics, and transparency of government and RBZ operations.** Priority should be given to timely compilation, reporting, and dissemination of standard monthly monetary and fiscal statistics, financial soundness indicators for the banking system, as well as the reconciliation of debt data with external creditors. It would also be important to publish the 2008 audited financial statements of the RBZ and all its subsidiaries.

45. **It is proposed that Zimbabwe remain on the standard 12-month consultation cycle**.

Table 1. Zimbabwe: Selected Economic Indicators, 2007–09

	Estimated		Proj.
	2007	2008	2009
Real GDP growth (annual percent change)	-6.9	-14.1	2.8
Nominal GDP (US$ millions)	3,553	3,180	3,498
Inflation (annual percent change)			
Consumer price inflation (annual average) 1/	10,453	5.56E+10	6.9
Consumer price inflation (end-of-period) 2/	108,844	4.89E+11	…
Central government (percent of GDP, measured in US$)			
Revenue	5.7	4.2	25.2
Expenditure and net lending	10.8	8.1	35.7
Quasi-fiscal activity by RBZ	22.9	35.7	0.0
Primary balance (including quasi-fiscal activity)	-24.5	-35.2	-5.9
Overall balance (including quasi-fiscal activity)	-28.0	-39.6	-10.5
Money and credit (US$ millions) 3/			
Broad money (M3)	603	314	513
Net foreign assets	61	-707	-651
Net domestic assets	542	1,021	1,164
Reserve money	52	7	58
Velocity (M3)	5.9	10.1	6.8
External trade (US$ millions; annual percent change)			
Merchandise exports	4.8	-8.5	-8.1
Merchandise imports	-3.8	24.4	0.4
Balance of payments (US$ millions; unless otherwise indicated)			
Merchandise exports	1,804	1,651	1,518
Merchandise imports	-2,113	-2,630	-2,641
Current account balance (excluding official transfers)	-383	-906	-666
(Percent of GDP)	-10.8	-28.5	-19.1
Overall balance	-647	-612	-1,090
Official reserves			
Gross official reserves (US$ millions;end-of-period)	58.0	5.8	5.8
Gross official reserves (months of imports of goods and services)	0.3	0.2	0.2
Debt			
Total external debt (US$ millions; end-of-period) 4/	5,285	6,027	6,719
Total external debt (percent of GDP; end-of-period) 4/	149	189	192

Sources: Zimbabwean authorities; IMF staff estimates and projections.

1/ For 2008, annual average January–September 2008.
2/ For 2008, inflation at end-September 2008.
3/ Zimbabwe dollar values converted into U.S. dollars at the UN exchange rates at end-2007 and end-2008.
4/ Includes arrears and amounts for unidentified financing.

Table 2. Zimbabwe: Millennium Development Goals

	1990	1995	Latest data	MDG Target 2015
Goal 1 - Eradicate extreme poverty and hunger				
Poverty headcount 1/	…	55.0	63.0 (2003)	12.9
Undernourished people (% of total population)	43.0	44.0	45.0 (2004)	21.5
Underweight children under 5 (% of children under 5)	11.5	15.5	17.0 (2003)	5.8
Share of poorest 20 percent in national income	...	4.6	4.6 (1995)	…
Goal 2 - Achieve universal primary education				
Net school enrollment, primary (% of relevant age group)	84.1	...	87.8 (2006)	100.0
Net school enrollment, secondary (% of relevant age group)	...	...	37.1 (2006)	100.0
Youth illiteracy rate (% of people ages 15-24)	6.1	4.1	3.0 (2003)	0.0
Goal 3 - Promote gender equality and empower women				
Ratio of girls to boys in primary education (%) 2/	96.5	97.1	99.0 (2007)	100.0
Ratio of girls to boys in secondary education (%) 2/	78.9	83.9	93.0 (2007)	100.0
Ratio of girls to boys in tertiary education (%)	49.6	59.4	63.1 (2003)	100.0
Goal 4 - Reduce child mortality				
Under 5 mortality rate (per 1,000 live births)	76.0	99.0	105.0 (2007)	26.7
Immunization, measles (% of children 1-2 years old)	87.0	87.0	90.0 (2007)	100.0
Goal 5 - Improve maternal health				
Maternal mortality ratio (per 100,000 live births)	570.0	610.0	1,068.0 (2002)	142.5
Births attended by skilled health staff (% of total)	69.6	69.2	80.0 (2007)	...
Contraceptive prevalence (% of women ages 15-49)	43.1	48.1	60.0 (2007)	...
Goal 6 - Combat HIV/AIDS, malaria, and other diseases				
HIV prevalence ratio among adults (15-49 years)	...	...	15.3 (2007)	...
Goal 7 - Ensure environmental sustainability				
Access to improved sanitation facilities (% of population)	44.0	45.0	46.0 (2007)	...
Access to safe driking water (% of population)	78.0	...	81.0 (2007)	89.0
Goal 8 - Develop a global partnership for development				
Fixed line and mobile telephones (per 1,000 people)	11.7	12.9	120.0 (2007)	...
Personal computers (per 1,000 people)	0.2	2.8	77.3 (2004)	...

Sources: World Development Indicators; Zimbabwe Human Development Report 2003; Zimbabwe MDGs 2005 Progress Report; UN Statistics Division; UNAIDS; and IMF staff estimates.

1/ The poverty headcount ratio is the proportion of the population below the total consumption poverty line.

2/ For MDG Target, preferably by 2005.

Table 3. Zimbabwe: Balance of Payments, 2007–13

(In millions of U.S. dollars; unless otherwise indicated)

	Est. 2007	Est. 2008	Proj. 2009	Proj. 2010	Proj. 2011	Proj. 2012	Proj. 2013
Current account (excluding official transfers)	-383	-906	-666	-1,237	-1,247	-1,206	-1,194
Trade balance	-310	-979	-1,124	-1,326	-1,215	-1,040	-932
Exports, f.o.b.	1,804	1,651	1,518	1,631	1,935	2,219	2,473
Imports, f.o.b.	-2,113	-2,630	-2,641	-2,957	-3,150	-3,258	-3,405
Food	-365	-341	-390	-280	-216	-137	-109
Nonfood	-1,748	-2,289	-2,252	-2,676	-2,933	-3,122	-3,296
Nonfactor services (net)	-144	-194	-121	-129	-105	-72	-50
Investment income (net)	-370	-369	-393	-425	-467	-506	-545
Interest	-231	-257	-299	-320	-352	-382	-412
Other	-138	-112	-94	-106	-115	-124	-134
Private transfers (including transfers to NGOs)	440	637	971	643	539	412	333
Capital account (including official transfers)	-106	465	-424	47	216	332	416
Official transfers	42	73	92	120	120	120	120
Direct investment	66	44	60	90	140	180	210
Portfolio investment	-27	0	20	30	70	100	120
Long-term capital	26	-173	-245	-262	-179	-153	-140
Government 1/	-96	-227	-141	-162	-150	-126	-113
Receipt	86	12	0	0	0	0	0
Payment	-181	-238	-141	-162	-150	-126	-113
Public enterprises	-12	59	-38	-32	-29	-27	-27
Private sector	134	-5	-66	-68	0	0	0
Short-term capital	-213	521	-351	69	65	85	105
Public sector 2/	75	275	-395	34	0	0	0
Private sector short-term loans	-22	54	200	100	130	150	170
Change in NFA of DMBs	-266	192	-5	-10	-10	-10	-10
Cash in circulation (nonbanks, -, increase)	…	…	-100	-50	-50	-50	-50
Monetary authorities operations (nonreserve)	…	…	-51	-5	-5	-5	-5
Errors and omissions	-158	-171	0	0	0	0	0
Overall balance	-647	-612	-1,090	-1,190	-1,031	-874	-779
Financing	647	612	1,090	1,190	1,031	874	779
Gross official reserves (–, increase)	-29	52	0	0	0	0	0
Net use of Fund resources	0	0	0	0	0	0	0
Drawings	0	0	0	0	0	0	0
Repayments	0	0	0	0	0	0	0
Other short-term liabilities (net)	21	-2	0	-1	-1	0	0
Change in arrears (–, decrease)	599	453	837	540	481	474	479
Debt relief/rescheduling	56	109	53	0	0	0	0
Unidentified financing	…	…	200	650	550	400	300
Financing gap (ch. in arrears + unidentified financing)	…	…	1,037	1,190	1,031	874	779
Memorandum items:							
Current account balance (pct. of GDP)	-10.8	-28.5	-19.1	-30.4	-26.4	-22.3	-19.6
Gross official reserves (US$ millions, e.o.p.)	58	6	6	6	6	6	6
Months of imports of goods and services	0.3	0.2	0.2	0.2	0.2	0.1	0.1
External debt (US$ millions, e.o.p.) 3/	5,285	6,027	6,719	7,781	8,764	9,651	10,461
Percent of GDP	149	189	192	191	186	178	172
External arrears (US$ millions, e.o.p.)	3,319	3,771	4,608	5,149	5,630	6,104	6,582
Percent of GDP	93	119	132	126	119	113	108
Nominal GDP (US$ millions)	3,553	3,180	3,498	4,074	4,719	5,412	6,090

Sources: Zimbabwean authorities; and IMF staff estimates and projections.

1/ May not match data for government external financing in the fiscal table because this line is on an accrual basis.
2/ Includes short-term credit guaranteed by the RBZ.
3/ Includes arrears and amounts for unidentified financing.

Table 4. Zimbabwe: Monetary Survey, 2007–09 1/

	2007	Est. 2008	Proj. 2009
	(In millions of U.S. dollars)		
Monetary authorities			
Net foreign assets of reserve bank	-392	-968	-917
of which to residents (gross) 2/	-260	-457	-457
Net domestic assets of reserve bank	444	975	975
Credit to government (net)	-10	-1	-1
Credit to nonfinancial public enterprises	0	0	0
Credit to private sector	4	0	0
Credit to deposit money banks	3	0	0
Credit to other sectors	0	0	0
RBZ bills	-29	0	0
Other items (net)	479	976	976
Reserve money	52	7	58
Currency outside banks	23	0	0
Nonbank deposits	0	0	0
Bank deposits	28	6	58
Statutory reserves	27	2	58
Current accounts	1	4	0
Deposit money banks and other banking institutions			
Net foreign assets	453	261	266
Reserves	64	5	58
Net credit from the RBZ	-22	-1	0
Total credit	132	187	342
Credit to government (net)	40	0	-5
Credit to nonfinancial public enterprises	2	0	0
Credit to private sector	99	140	346
Valuation adjustment	-10	46	…
Other items (net)	-46	-139	-153
Total deposits	580	314	513
of which foreign currency deposits	443	308	…
Monetary survey			
Net foreign assets	61	-707	-651
Net domestic assets	542	1,021	1,164
Domestic credit	131	140	341
Claims on government (net)	30	-1	-6
Claims on nonfinancial public enterprises	2	0	0
Claims on private sector	99	140	346
Other items (net)	411	837	823
Broad money (M3)	603	314	513
Currency	23	0	0
Deposits	580	314	513

Table 4. Zimbabwe: Monetary Survey, 2007–09 1/ (concluded)

	2007	Est. 2008	Proj. 2009
	(Annual percentage change)		
Reserve money	-81	-87	753
Broad money (M3)	-44	-48	63
Currency	-89	-100	…
Deposits	-34	-46	63
Private sector credit	-66	42	147
	(Contribution to reserve money growth, percent)		
Monetary authorities			
Net foreign assets of reserve bank	-22	-1,115	753
Net domestic assets of reserve bank	-59	1,028	0
Credit to government (net)	18	18	0
Credit to nonfinancial public enterprises	-1	0	0
Credit to private sector	-12	-7	0
RBZ bills	111	57	0
Other items (net)	-175	961	0
Reserve money			
Currency outside banks	-65	-44	0
Nonbank deposits	-1	0	-5
Bank deposits	-15	-42	758
	(Contribution to broad money growth, percent)		
Monetary survey			
Net foreign assets	19	-127	18
Net domestic assets	-63	79	45
Domestic credit	-26	1	64
Claims on government (net)	-8	-5	-2
Claims on nonfinancial public enterprises	-1	0	0
Claims on private sector	-18	7	66
Other items (net)	-37	71	-4
Broad money (M3)			
Currency	-16	-4	0
Deposits	-28	-44	63
Memorandum items:			
Change in foreign currency in circulation (in US$ millions)	…	…	100
Domestic currency-to-deposit ratio (in percent)	4	0	0
Reserves-to-deposit ratio (in percent)	11	2	11
Money multiplier (M3/reserve money)	12	46	9
Velocity (GDP/M3)	6	10	7
Velocity (GDP/period-average M3)	5	7	8

Sources: Zimbabwean authorities; and IMF staff estimates and projections.

1/ The monetary accounts may be distorted by hyperinflation and the use of multiple exchange rates in 2007 and 2008.

2/ Foreign currency-denominated liabilities to residents.

Table 5. Zimbabwe: Central Government Operations, 2005–09

(In millions of U.S. dollars)

	2005	2006	2007	Est. 2008	Budget (March) 2009	Proj. 2009
Total revenue	942	520	202	133	1,000	880
Tax revenue	909	504	193	128	885	765
Personal income tax	276	122	56	22	120	111
Corporate income tax	169	88	33	18	117	81
Other direct taxes	53	50	17	3	28	28
Customs	89	68	12	45	280	220
Excise	31	17	8	6	65	65
VAT	270	147	62	32	265	251
Other taxes	20	12	5	2	10	10
Nontax revenue	33	17	9	5	115	115
Total expenditure and net lending	1,438	696	384	258	1,000	1,248
Current expenditure	1,303	572	305	241	807	1,005
Wages and salaries	565	211	89	52	278	278
Pensions	120	41	12	7	75	75
Interest payments	228	178	125	139	0	163
Foreign	110	114	122	138	0	162
Of which : Paid	0	0	0	0	0	0
Domestic	117	64	3	1	0	1
Of which : Paid	117	64	3	1	0	1
Grants and transfers	200	74	49	18	163	178
Other current expenditure	191	68	29	32	290	310
Capital expenditure and net lending	135	123	79	17	193	243
Capital expenditure	115	121	70	14	182	182
Net lending	19	2	9	3	12	62
Overall balance	-496	-175	-183	-125	0	-368
Of which : Primary balance	-268	3	-58	14	0	-205
Quasi-fiscal activities (QFA) by RBZ 1/	1,091	1,224	814	1,135	0	0
Overall balance (including QFA)	-1,587	-1,399	-997	-1,260	0	-368
Overall balance (excl. QFA and foreign interest payments)	-386	-61	-60	13	0	-206

Table 5. Zimbabwe: Central Government Operations, 2005–09 (concluded)

(In percent of GDP; unless otherwise indicated)

	2005	2006	2007	Est. 2008	Budget (March) 2009	Proj. 2009
Total revenue	24.5	14.0	5.7	4.2	28.6	25.2
Tax revenue	23.7	13.6	5.4	4.0	25.3	21.9
Personal income tax	7.2	3.3	1.6	0.7	3.4	3.2
Corporate income tax	4.4	2.4	0.9	0.6	3.3	2.3
Other direct taxes	1.4	1.3	0.5	0.1	0.8	0.8
Customs	2.3	1.8	0.3	1.4	8.0	6.3
Excise	0.8	0.4	0.2	0.2	1.8	1.8
VAT	7.0	4.0	1.7	1.0	7.6	7.2
Other taxes	0.5	0.3	0.1	0.1	0.3	0.3
Nontax revenue	0.9	0.5	0.2	0.2	3.3	3.3
Total expenditure and net lending	37.5	18.8	10.8	8.1	28.6	35.7
Current expenditure	33.9	15.4	8.6	7.6	23.1	28.7
Wages and salaries	14.7	5.7	2.5	1.6	7.9	7.9
Pensions	3.1	1.1	0.3	0.2	2.1	2.1
Interest payments	5.9	4.8	3.5	4.4	0.0	4.7
Foreign	2.9	3.1	3.4	4.3	0.0	4.6
Of which : Paid	0.0	0.0	0.0	0.0	0.0	0.0
Domestic	3.1	1.7	0.1	0.0	0.0	0.0
Of which : Paid	3.1	1.7	0.1	0.0	0.0	0.0
Grants and transfers	5.2	2.0	1.4	0.6	4.7	5.1
Other current expenditure	5.0	1.8	0.8	1.0	8.3	8.9
Capital expenditure and net lending	3.5	3.3	2.2	0.5	5.5	7.0
Capital expenditure	3.0	3.3	2.0	0.4	5.2	5.2
Net lending	0.5	0.1	0.3	0.1	0.3	1.8
Overall balance	-12.9	-4.7	-5.1	-3.9	0.0	-10.5
Of which : Primary balance	-7.0	0.1	-1.6	0.4	0.0	-5.9
Quasi-fiscal activities (QFA) by RBZ 1/	28.4	33.0	22.9	35.7	0.0	0.0
Overall balance (including QFA)	-41.3	-37.7	-28.0	-39.6	0.0	-10.5
Memorandum items:						
Domestic government debt (US$ millions) 2/	372	391	34	0	0	502
External government debt (US$ millions) 3/	2,991	3,209	3,478	3,575	3,972	3,972
Total government debt (US$ millions)	3,363	3,600	3,513	3,575	3,972	4,474
Of which : Arrears	1,368	1,582	1,862	2,082	2,268	2,268
Total government debt (percent of GDP)	88	97	99	112	114	128

Sources: Zimbabwean authorities; and IMF staff estimates and projections.

1/ Subsidies provided by the RBZ to the public sector and producers/exporters.
2/ Includes the RBZ's foreign currency-denominated liabilities to residents in 2009.
3/ Includes arrears, estimated interest charges on arrears and amounts for unidentified financing.

Table 6. Zimbabwe: Medium-Term Projections, 2007–13

	Estimated		Projected				
	2007	2008	2009	2010	2011	2012	2013
Real GDP growth (annual percent change)	-6.9	-14.1	2.8	6.0	6.0	6.0	6.0
Nominal GDP (US$ millions)	3,553	3,180	3,498	4,074	4,719	5,412	6,090
Consumer price inflation (annual average) 1/	10,453	5.56E+10	6.9	9.9	9.2	8.2	6.2
Central government (percent of GDP, measured in US$)							
Revenue	5.7	4.2	25.2	27.3	28.0	29.0	30.5
Expenditure and net lending	10.8	8.1	35.7	47.5	43.8	40.8	39.4
Quasi-fiscal activity by RBZ	22.9	35.7	0.0	0.0	0.0	0.0	0.0
Primary balance (including quasi-fiscal activity)	-24.5	-35.2	-5.9	-14.5	-10.4	-6.7	-4.1
Overall balance (including quasi-fiscal activity)	-28.0	-39.6	-10.5	-20.2	-15.8	-11.8	-8.9
External trade (US$ millions; annual percent change)							
Merchandise exports	4.8	-8.5	-8.1	7.5	18.6	14.7	11.4
Merchandise imports	-3.8	24.4	0.4	11.9	6.5	3.5	4.5
Balance of payments (US$ millions; unless otherwise indicated)							
Exports, f.o.b.	1,804	1,651	1,518	1,631	1,935	2,219	2,473
Imports, f.o.b.	-2,113	-2,630	-2,641	-2,957	-3,150	-3,258	-3,405
Current account balance (excluding official transfers)	-383	-906	-666	-1,237	-1,247	-1,206	-1,194
Percent of GDP	-10.8	-28.5	-19.1	-30.4	-26.4	-22.3	-19.6
Overall balance	-647	-612	-1,090	-1,190	-1,031	-874	-779
Debt							
Total external debt (US$ millions; end-of-period) 2/	5,285	6,027	6,719	7,781	8,764	9,651	10,461
Percent of GDP	149	189	192	191	186	178	172
External arrears (US$ millions; end-of-period)	3,319	3,771	4,608	5,149	5,630	6,104	6,582
Percent of GDP	93	119	132	126	119	113	108

Sources: Zimbabwean authorities; and IMF staff estimates and projections.

1/ For 2008, annual average January–September 2008.

2/ Including arrears and estimated interest charges on arrears.

Appendix I. Debt Sustainability Analysis[8]

46. **Zimbabwe's debt sustainability analysis (DSA) exercise is subject to major caveats.** While the authorities have begun to shore up their debt management capacity, external debt and debt service data are not reconciled with the creditors' data and remain incomplete. Data deficiencies are compounded by the difficulty in making medium- and long-term projections because of the country's poor policy record. Against this background, the DSA projections and simulations can only be considered as highly indicative.

47. **Zimbabwe is in debt distress.** Even under relatively optimistic assumptions on policies and the external environment, most debt ratios are projected to remain at unsustainable levels over the medium and long term. Under the historic sensitivity analysis, debt ratios are projected to increase over the long term from the current unsustainable levels.

Public and publicly guaranteed external debt sustainability

48. **The starting external debt level is high.** At end-2008, the staff estimates that Zimbabwe's nominal medium- and long-term public and publicly guaranteed (PPG) external debt stood at US$5.1 billion (166 percent of GDP).[9] Scheduled service of PPG external debt in 2009 is equivalent to 14 percent of projected exports and 28 percent of projected government revenue (Table 7).

49. **The baseline scenario assumes improvements in policies and a reversal of Zimbabwe's decade-long economic contraction.** In particular, the scenario is built on implementation of sound macroeconomic policies and essential structural reforms as discussed in Section IV of the staff report. Annual real GDP growth is projected at 6 percent during the period of 2010–15 and 5.5 percent thereafter. The noninterest external current account deficit would initially fall—from 25 percent of GDP in 2010 to 14 percent of GDP in 2015—but would then decline more gradually. It is assumed that private capital inflows can only cover a fraction of gross external financing requirements. Because there are no commitments of concessional financing or debt relief, for illustrative purposes, external financing gaps are identified and assumed to be financed on highly concessional terms. The scenario also assumes some real effective exchange rate appreciation reflecting positive productivity differentials with trading partners.

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[8] The DSA was undertaken by the Fund staff, in collaboration with the World Bank staff. It uses the standard Bank/Fund templates and sensitivity analyses for low-income countries (LICs) to assess Zimbabwe's debt dynamics.

[9] Staff estimates of the stock of external PPG medium- and long-term debt include (i) external PPG medium- and long-term debt based on original maturities; (ii) domestic foreign currency-denominated debt; (iii) arrears on intial principal and interest obligations; and (iv) estimated accrued penalties on arrears.

50. **Under the baseline scenario, PPG external debt indicators are projected to remain far in excess of the corresponding thresholds for a LIC that is a poor performer.**[10] These debt ratios begin at levels some three to five times above the thresholds. They would decline only gradually and approach the threshold levels after 20 to 30 years, assuming that external gaps are filled with concenssional financing (as mentioned above).

51. **The sensitivity analysis demonstrates an extreme fragility of Zimbabwe's external debt position.** Reflecting the poor past macroeconomic performance, under the historical scenario, all external debt indicators are projected to increase continuously over the long term.

Public debt sustainability

52. **The baseline scenario assumes improvements in fiscal policy implementation.** Budget revenue is projected to increase from 25 percent of GDP in 2009 to 30 percent in 2014 and beyond on account of better tax policy and administration. While the wage bill is assumed to be contained, large humanitarian and infrastructure rehabilitation needs would justify a significant increase in expenditure over the medium term. As a result, projected budget gross financing requirements are large over the medium term, but they are expected to decline over the longer term. For illustrative purposes, unidentified financing is reflected in budget financing gaps.

53. **The starting level of domestic government debt is moderate, and prudent domestic debt management policy is assumed going forward.** Local currency-denominated domestic debt was fully repaid in late January 2009. The RBZ's foreign currency-denominated domestic debt (which is added to total domestic public debt for the purpose of this DSA) is estimated at US$457 million (13 percent of GDP) at end-December 2008. The baseline scenario assumes modest government domestic borrowing in 2009 and over the medium term. As a result, domestic government debt-to-GDP ratios are projected to decline gradually over the medium and long term.

54. **However, under the baseline scenario, Zimbabwe's overall public debt[11] is unsustainable.** The initial external public debt overhang and large budget financing requirements would prevent public external debt ratios from reaching sustainable levels in the medium and even long term. Public debt is projected to gradually decline from a peak of over 200 percent of GDP in 2010 to about 150 percent a decade later. The PV of the public

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[10] Zimbabwe is treated as a weak policy performer for the specific purposes of this LIC DSA. The policy-based thresholds for the present value (PV) of PPG external debt are therefore low: 200 percent of revenue; 100 percent of exports; and 30 percent of GDP.

[11] Including the domestic and external debt of both central government and parastatals.

debt-to-revenue ratio remains above 400 percent through 2018; and the debt service-to-revenue ratio only falls below 20 percent in 2014.

Table 7. External Debt Sustainability Framework, Baseline Scenario, 2006–29 1/

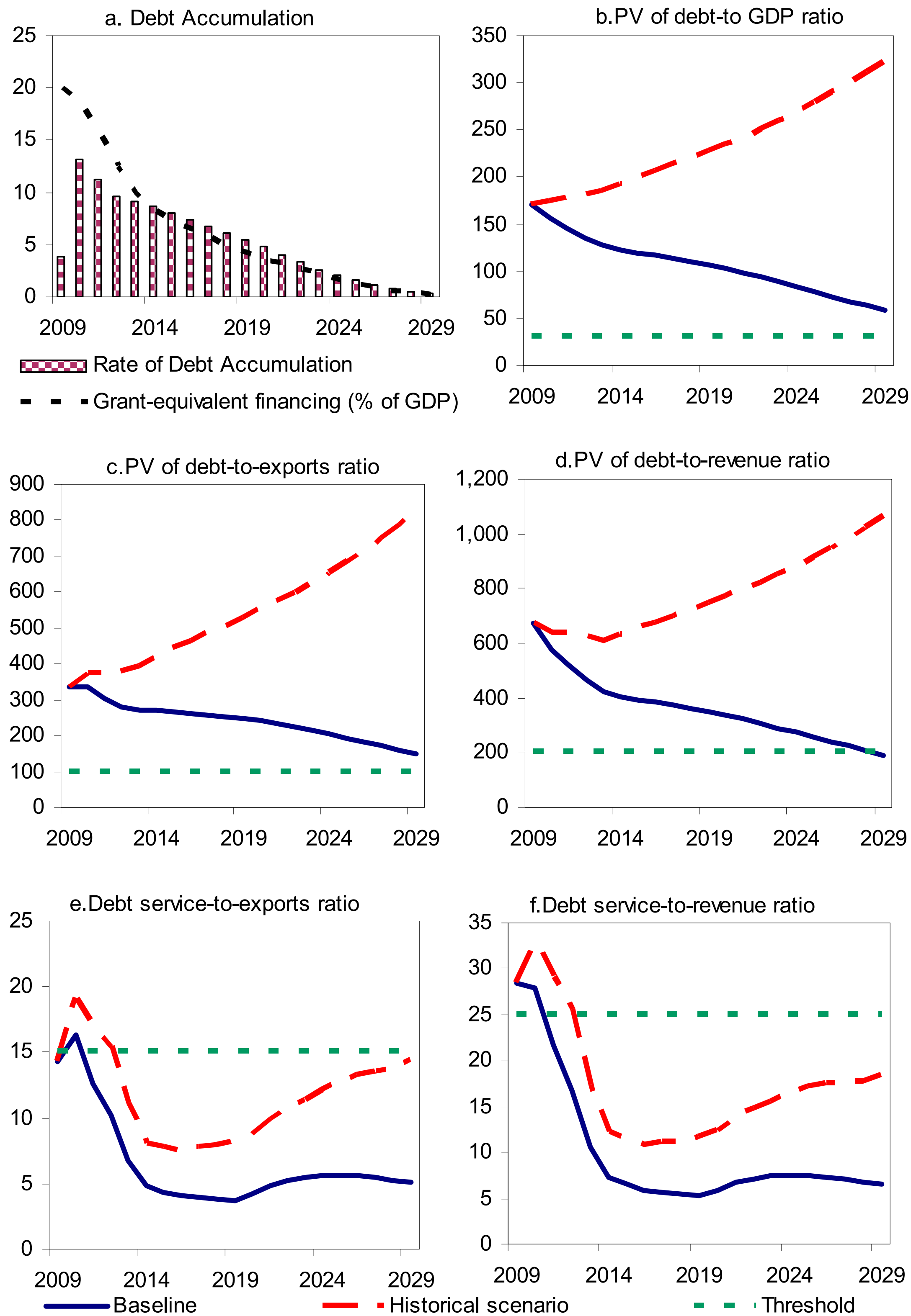
(In percent of GDP, unless otherwise indicated)

	Actual			Historical	Standard	Projections						Average	Projections		Average
	2006	2007	2008	Average	Deviation	2009	2010	2011	2012	2013	2014	2009–14	2019	2029	2015–29
External debt (nominal) 1/	120.5	139.6	174.8			207.0	211.0	210.2	210.0	207.1	202.3		177.1	93.0	
Of which: public and publicly guaranteed (PPG)	117.9	136.6	166.0			197.0	199.9	197.9	196.5	192.3	188.2		165.4	84.6	
Change in external debt	11.9	19.1	35.1			32.3	4.0	-0.8	-0.2	-2.9	-4.9		-6.3	-8.1	
Identified net debt-creating flows	13.6	13.2	41.2			-1.1	-3.8	-7.7	-10.0	-9.0	-7.5		-8.1	-9.0	
Noninterest current account deficit	4.6	2.3	23.7	6.4	8.1	14.2	25.5	22.2	18.6	16.3	14.9		9.7	4.2	7.8
Deficit in balance of goods and services	13.2	15.5	20.0			35.6	35.5	27.8	20.4	16.0	14.7		9.9	4.4	
Exports	52.7	56.3	57.2			50.3	46.8	47.9	47.9	47.5	46.0		43.1	38.9	
Imports	65.9	71.8	77.2			85.9	82.4	75.7	68.3	63.5	60.7		52.9	43.3	
Net current transfers (negative = inflow)	-11.8	-12.4	-20.0	-8.1	5.6	-27.8	-15.8	-11.4	-7.6	-5.5	-5.5		-5.5	-4.5	-5.3
Of which: official	-1.5	-1.2	-2.3			-2.6	-2.9	-2.5	-2.2	-2.0	-2.0		-2.0	-2.0	
Other current account flows (negative = net inflow)	3.2	-0.8	23.8			6.4	5.8	5.8	5.8	5.8	5.7		5.3	4.3	
Net FDI (negative = inflow)	-1.1	-1.9	-1.4	-0.9	0.9	-1.7	-2.2	-3.0	-3.3	-3.4	-3.6		-4.7	-6.0	-5.1
Endogenous debt dynamics 2/	10.1	12.8	18.9			-13.6	-27.1	-26.9	-25.3	-21.9	-18.8		-13.1	-7.2	
Denominator: 1+g+r+gr	1.0	1.0	0.9			1.1	1.2	1.2	1.1	1.1	1.1		1.1	1.1	
Contribution from nominal interest rate	6.4	7.4	2.5			2.3	2.2	2.0	1.6	1.5	1.5		1.3	0.7	
Contribution from real GDP growth	7.1	8.7	22.0			-4.5	-10.7	-11.0	-11.0	-11.2	-11.2		-9.3	-5.1	
Contribution from price and exchange rate changes	-3.4	-3.3	-5.7			-11.3	-18.6	-17.9	-16.0	-12.2	-9.0		-5.1	-2.8	
Residual (3-4) 3/	-1.7	5.9	-6.1			33.3	7.7	6.9	9.8	6.1	2.6		1.8	0.9	
Of which; exceptional financing	-5.9	-1.4	-12.9			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	191.9			179.9	168.3	157.6	148.6	142.9	137.5		118.2	67.1	
In percent of exports	...	...	335.5			357.8	359.4	328.8	310.0	301.1	298.6		274.4	172.6	
PV of PPG external debt	...	...	183.1			169.9	157.2	145.3	135.1	128.1	123.5		106.5	58.7	
In percent of exports	...	...	320.1			337.9	335.8	303.2	281.8	269.9	268.2		247.4	151.0	
In percent of government revenues	...	...	4,378.3			675.3	575.2	518.3	465.4	420.3	405.0		349.4	192.7	
Debt service-to-exports ratio (in percent)	24.5	26.4	22.2			18.5	25.9	13.2	10.6	7.3	5.3		4.1	5.6	
PPG debt service-to-exports ratio (in percent)	22.8	24.9	19.7			14.2	16.3	12.7	10.2	6.8	4.8		3.7	5.1	
PPG debt service-to-revenue ratio (in percent)	85.8	247.2	270.1			28.4	27.9	21.7	16.8	10.6	7.3		5.2	6.6	
Total gross financing need (Millions of U.S. dollars)	760	727	1,406			1,382	1,942	1,832	1,863	1,903	2,005		2,031	2,127	
Noninterest current account deficit that stabilizes debt ratio	-7.3	-16.8	-11.4			-18.0	21.6	23.0	18.8	19.2	19.7		16.0	12.3	
Key macroeconomic assumptions															
Real GDP growth (in percent)	-6.3	-6.9	-14.1	-6.3	3.6	2.8	6.0	6.0	6.0	6.0	6.0	5.5	5.5	5.5	5.5
GDP deflator in US dollar terms (change in percent)	3.2	2.9	4.2	5.7	42.8	6.9	9.8	9.3	8.2	6.2	4.6	7.5	2.8	2.8	3.0
Effective interest rate (percent) 5/	5.7	5.9	1.6	4.6	1.2	1.4	1.2	1.1	0.9	0.8	0.8	1.0	0.8	0.8	0.8
Growth of exports of G&S (US dollar terms, in percent)	1.3	2.4	-9.1	-3.1	6.7	-3.3	8.4	18.6	14.7	11.4	7.5	9.6	7.5	7.0	7.4
Growth of imports of G&S (US dollar terms, in percent)	1.3	4.3	-3.8	-3.3	10.5	22.4	11.7	6.6	3.5	4.5	6.0	9.1	6.0	7.0	6.2
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	61.0	61.0	61.0	61.0	61.0	61.0	61.0	61.0	61.0	61.0
Government revenues (excluding grants, in percent of GDP)	14.0	5.7	4.2			25.2	27.3	28.0	29.0	30.5	30.5		30.5	30.5	30.5
Aid flows (in Millions of US dollars) 7/	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Of which: Grants	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Of which: Concessional loans	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			20.0	18.6	15.5	12.4	10.0	8.4		4.1	0.2	3.0
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			61.0	61.0	61.0	61.0	61.0	61.0		61.0	61.0	61.0
Memorandum items:															
Nominal GDP (Millions of US dollars)	3,711	3,553	3,180			3,498	4,073	4,719	5,412	6,090	6,750		10,360	23,424	
Nominal dollar GDP growth	-3.3	-4.3	-10.5			10.0	16.4	15.9	14.7	12.5	10.8	13.4	8.5	8.5	8.6
PV of PPG external debt (in Millions of US dollars)			5,823			5,943	6,403	6,857	7,311	7,804	8,334		11,037	13,759	
(PVt-PVt-1)/GDPt-1 (in percent)						3.8	13.2	11.1	9.6	9.1	8.7	9.3	5.5	0.3	3.7

Source: Staff simulations.

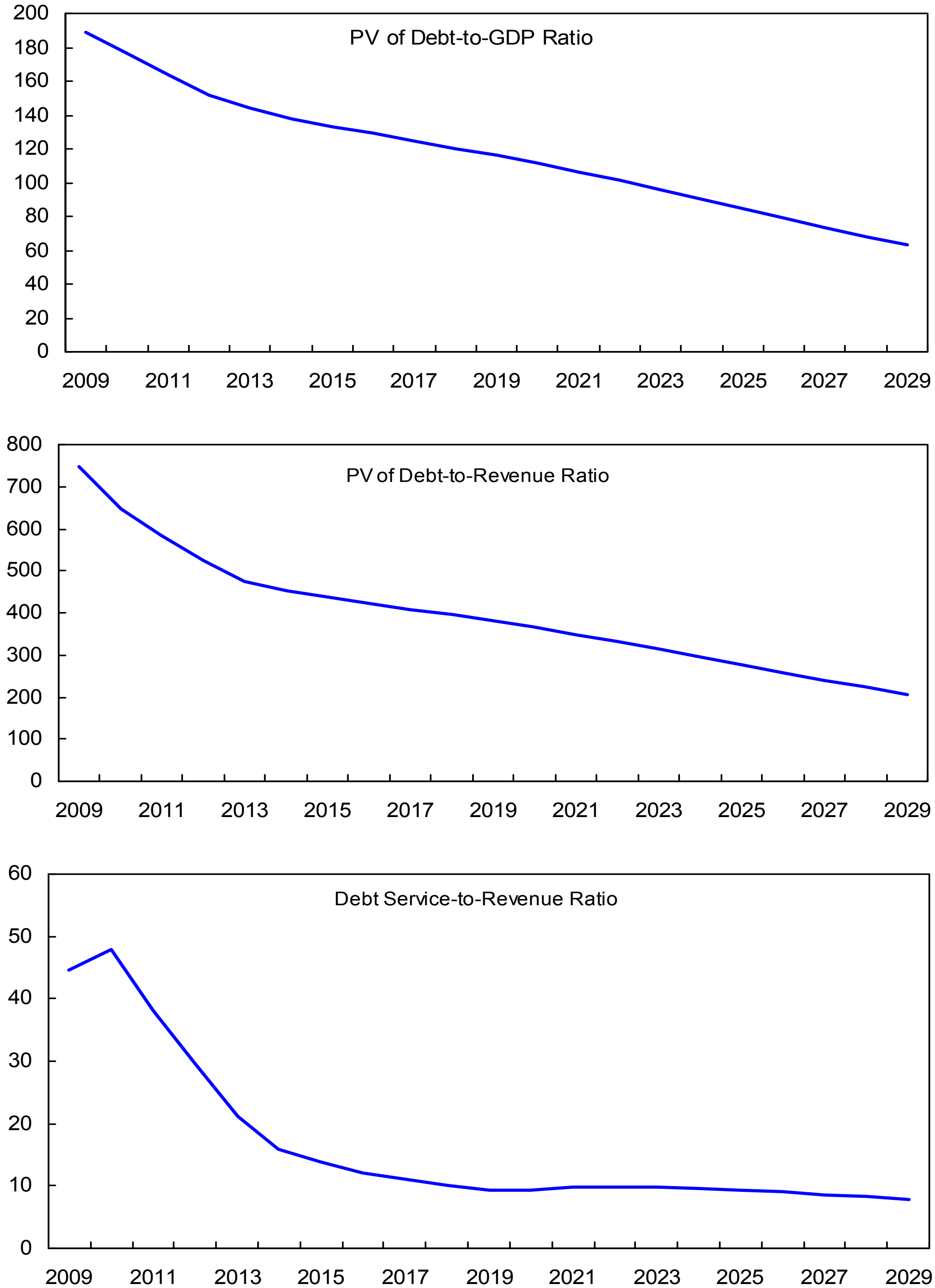
1/ Includes both public and private sector medium- and long-term external debt; and foreign currency-denominated domestic public debt as from 2009.
2/ Derived as [r - g - ρ(1+g)]/(1+g+r+gr) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.
3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.
4/ Assumes that PV of private sector debt is equivalent to its face value. Foreign currency-denominated domestic public debt is not included in PV calculations.
5/ Current-year interest payments divided by previous period debt stock.
6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.
7/ Defined as grants, concessional loans, and debt relief.
8/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

Figure 2. Zimbabwe: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2009–29



Source: IMF staff projections and simulations.

Figure 3. Zimbabwe: Indicators of Public Debt, Baseline Scenario, 2009–29 1/



Source: IMF staff projections and simulations.

1/ Estimates of the stock of public debt in 2009 include central government, RBZ, parastatal and publicly-guaranteed liabilities. Forecasts of revenue and expenditure are for central government only.

INTERNATIONAL MONETARY FUND

ZIMBABWE

2009 Article IV Consultation—Informational Annex

Prepared by the African Department
(In collaboration with other departments)

Approved by Sharmini Coorey

April 20, 2009

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Appendixes

Appendix I. Zimbabwe: Fund Relations

A. Financial Relations
(As of March 31, 2009)

I. Membership Status: Joined: September 29, 1980; Article VIII

II. General Resources Account:	**SDR Million**	**%Quota**
Quota	353.40	100.00
Fund holdings of currency	353.07	99.91
Reserve position	0.33	0.09
Holdings exchange rate		

III. SDR Department:	**SDR Million**	**%Allocation**
Net cumulative allocation	10.20	100.00
Holdings	0.00	0.00

IV. Outstanding Purchases and Loans:	**SDR Million**	**%Quota**
PRGF arrangements	73.83	20.89

V. Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-by	Aug 02, 1999	Oct 01, 2000	141.36	24.74
Stand-by	Jun 01, 1998	Jun 30, 1999	130.65	39.20
EFF	Sep 11, 1992	Sep 10, 1995	114.60	86.90

VI. Projected Payments to Fund[1, 2]

(SDR Million; based on existing use of resources and present holdings of SDRs):

	Overdue	Forthcoming				
	Mar 31, 2009	2009	2010	2011	2012	2013
Principal	73.83					
Charges/interest	15.41	0.38	0.35	0.35	0.35	0.35
Total	89.23	0.38	0.35	0.35	0.35	0.35

[1] The projection of charges and interest assumes that overdue principal at the report date (if any) will remain outstanding, but forthcoming obligations will be settled on time.
[2] Projected amounts do not include additional interest levied on overdue PRGF interest.

VII. Implementation of HIPC Initiative: Not Applicable

VIII. Implementation of Multilateral Debt Relief Initiative (MDRI): Not Applicable

IX. Application of Remedial Measures under the Arrears Strategy
Zimbabwe has been in continuous arrears to the Fund since February 2001. On September 24, 2001, the Executive Board declared Zimbabwe ineligible to use the general resources of the Fund and removed it from the list of PRGF-ESF-eligible countries. On June 13, 2002, the Board issued a declaration of non-cooperation with respect to Zimbabwe and suspended all technical assistance to the country. On June 6, 2003, the Board suspended Zimbabwe's voting and related rights in the Fund. A complaint with respect to compulsory withdrawal was issued on February 6, 2004. The Executive Board considered the complaint on July 7, 2004, on February 15, 2005, and again on September 9, 2005 and decided to postpone the recommendation on Zimbabwe's compulsory withdrawal from the Fund to the Board of Governors so as to give more time for Zimbabwe to improve cooperation with the Fund. On February 15, 2006, Zimbabwe fully settled its arrears to the General Resources Account. As a consequence, the Managing Director withdrew his complaint for compulsory withdrawal. However, the Executive Board decided not to restore Zimbabwe's voting and related rights, nor did it terminate Zimbabwe's ineligibility to use the general resources of the Fund. The Executive Board kept in place the decisions taken to address Zimbabwe's arrears to the PRGF-ESF Trust—the declaration of noncooperation, the suspension of technical assistance, and the removal of Zimbabwe from the list of PRGF-ESF-eligible countries. Zimbabwe's arrears to the PRGF-ESF Trust remain, amounting to SDR 89 million (US$133 million) as of March 31, 2009. The last review of Zimbabwe's overdue financial obligations to the PRGF-ESF Trust was completed in January 2009, and the Executive Board decided that the measures to address Zimbabwe's arrear to the PRGF-ESF Trust shouldl remain in place.

B. Nonfinancial Relations

X. Exchange Arrangement
Since February 2, 2009 Zimbabwe has adopted hard currencies for transactions. On March 19, 2009, the South African rand was announced as the reference currency. Zimbabwe dollar-denominated currency is not functional. Following the abolition of the surrender requirements on foreign exchange proceeds on March 19, 2009, there has not been functioning foreign exchange market for Zimbabwe dollars. Many controls on international payments and transfers have also been lifted under newly issued exchange control directives.

Based on available information, Zimbabwe has eliminated the multiple currency practices. The staff is still reviewing the newly adopted foreign exchange regulations and their implementation to determine whether there remain any restrictions subject to Fund jurisdiction.

XI. Article IV Consultation

Zimbabwe is on the standard 12-month consultation cycle. The Executive Board discussed the staff report for the 2006 consultation on February 23, 2007.

Appendix II. Zimbabwe: Relations with the World Bank Group
(As of April 2009)

Table: Summary of Bank-Fund Collaboration
Immediate Priority Actions

Thematic area	Areas of collaboration	Bank	Fund
Macroeconomic stabilization	Policies to stabilize the economy	Complement the IMF's macroeconomic policy advice with various structural and sectoral work, focusing on fiscal issues related to parastatals, public sector management, and the civil service payroll.	Lead the policy dialogue in macroeconomic policies, including fiscal and monetary policies.
	Bring into the budget quasi-fiscal operations and prioritize them	Analyze the fiscal implications of losses of major public enterprises.	Examine the authorities' plans for moving quasi-fiscal activities to the budget and prioritizing them.
	Social safety nets	Assess needs for critical expenditure in health, education, and social safety nets in the short term.	
	Debt sustainability	Collaborate with the Fund on the preparation of a DSA.	Prepare a LIC DSA in close cooperation with the World Bank.
Public financial management and governance	Strengthen public financial management and reduce fiduciary risks	Identify needs and provide technical assistance in the areas of budgeting, budget execution, government accounting and reporting, audit, procurement, and the payroll. Discuss tax recoding issues related to changes in the currency regime.	
	Improve economic policy implementation	Assist the ministry of finance and the ministry of economic planning and investment promotion possibly through advisory services.	
Monetary policy and financial sector	Monetary policy operations		Review exchange restrictions.
	Financial sector reform		Discuss priorities in financial sector reform.

Appendix III. Zimbabwe—Statistical Issues As of April 13, 2009
I. Assessment of Data Adequacy for Surveillance
General: Data have serious shortcomings that significantly hamper surveillance. There are serious shortcomings in all major datasets. Given the deterioration in technical capacity and quality of institutions, Zimbabwe will need substantial technical assistance across a broad front to improve data quality and timeliness. The Central Statistics Office (CSO) needs to rebuild its capacity and acquire new equipment. Zimbabwe participates in the General Data Dissemination System (GDDS) project for Anglophone African countries. All technical assistance from the Fund has been suspended since June 13, 2002, when the Executive Board issued a declaration of noncooperation regarding Zimbabwe.
National Accounts: The most recent publication of national accounts data includes developments until 2005 and uses 1990 as the base year for constant prices. The production of national accounts is constrained by both insufficient input data and processing capacity. Benchmark data for industrial production is based on a survey made in 1999 and services are based on a survey made in 1981. The last income, consumption, and expenditure survey of any reasonable quality was made in 2001 (a survey made in 2007/08 collected data that is distorted due to hyperinflation). At the same time, some input data, for example a recent agriculture and livestock survey, remains unprocessed due to insufficient capacity. Following the abandonment of the Zimbabwe dollar, the CSO needs to change the accounting of economic activity into Rand (the chosen reference currency).
Price statistics: The CSO published a new consumer price index (CPI) based on prices in U.S. dollars, with December 2008 as the base, for the first time on March 24, 2009. Data on employment and wages are no longer published, and a new labor force and child labor survey will be needed to revive the publication of comprehensive labor statistics.
Government finance statistics: The Ministry of Finance (MoF) does not report on fiscal developments at the general government level, including local governments and the Reserve Bank of Zimbabwe’s (RBZ) quasi-fiscal activities. Hyperinflation and staff absences have rendered the collection and reporting of public finance statistics for the central government very challenging during the past 18 months. The MoF has continued to collect data on revenue, expenditure, and debt through this period, but the last reliable consolidated quarterly bulletin on fiscal developments was published in the first quarter of 2007.

Monetary statistics: The RBZ produces monthly monetary and financial statistics with a lag of three to six months. The quality of the data has deteriorated substantially over the years because of hyperinflation, weak accounting practices, multiple exchange rates, growing quasi-fiscal activities, and a series of re-denominations of the Zimbabwe dollar. As a result, it is difficult to reconcile the RBZ's data with the government's reports on bank financing. Discrepancies often reflect numerous changes in the classification of various quasi-fiscal activities and different exchange rates used for various operations. In addition, financial institutions currently use historical cost accounting for their financial statements, which in combination with hyperinflation makes it difficult to detect true vulnerabilities in the financial system. The 2009 Article IV mission advised the authorities on the compilation of net international reserves data, including identification of encumbered assets and the need to ensure completeness of foreign currency liabilities.
External sector statistics: Balance of payments and external debt statistics are subject to a number of data issues. Labor income and workers' remittances do not include estimates of cash and in-kind transfers from Zimbabweans working abroad. Interest payments are not reconciled with creditors' records and do not contain accrued interest on overdue financial obligations. Current and capital transfers to nongovernmental organizations and to the government are not fully reconciled with donors' data. The financial account is incomplete, as it does not record substantial transactions in assets that are reported by central banks that are members of the Bank for International Settlements. The RBZ's initial submission of flows and stocks of gross international reserves and its net foreign assets position often require substantial adjustments. Exceptional financing does not fully capture the flow of overdue financial obligations. External sector data are reported to the staff irregularly with significant delays.

II. Data Standards and Quality	
Not a General Data Dissemination System participant.	No data ROSC is available.

III. Reporting to STA
Zimbabwe does not report balance of payments statistics to STA for redissemination in the *International Financial Statistics* or the *Balance of Payments Statistics Yearbook*. No monetary or fiscal data are currently reported to STA for publication in the *International Financial Statistics*.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL
RELATIONS
DEPARTMENT

Public Information Notice (PIN) No. 09/53
FOR IMMEDIATE RELEASE
May 6, 2009

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2009 Article IV Consultation with Zimbabwe

On May 4, 2009 the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Zimbabwe.[1]

Background

Economic and social indicators in Zimbabwe worsened significantly in 2008. Real Gross Domestic Product (GDP) is estimated to have fallen by about 14 percent in 2008 (on top of a 40 percent cumulative decline during the period of 2000–07) due to economic disruptions caused by hyperinflation and a further significant deterioration in the business climate. Poverty and unemployment have risen to catastrophic levels, with 70 percent of the population in need of food assistance and a cholera epidemic claiming more than 4,000 lives.

In 2008, quasi-fiscal activities undertaken by the Reserve Bank of Zimbabwe (RBZ) increased in the context of weak RBZ governance. They are estimated at US$1.1 billion (36 percent of GDP) in 2008, and included election-related expenses, transfers to parastatals, subsidized directed lending, subsidized provision of equipment and fertilizers to farmers, and allocation of foreign exchange at subsidized exchange rates. Besides monetization, these activities were financed by surrender requirements on export proceeds, the retention of foreign exchange earnings of the gold and agricultural sectors in excess of mandatory surrender requirements, a freeze of most foreign currency deposits, external borrowing, and purchases of foreign

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Chairman of the Board summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

exchange at the parallel market exchange rates. These large operations unrelated to central banking core activities were conducted in the context of weak oversight of RBZ operations. Key governance weaknesses include lack of enforcement of the RBZ Act's accountability requirements and noncompliance with the International Financial Reporting Standards.

The central government's revenue and expenditure effectively collapsed in 2008. With economic decline and hyperinflation eroding the real value of accrued tax liabilities, budget revenue fell from almost US$1 billion (25 percent of GDP) in 2005 to US$133 million (4 percent of GDP) in 2008. Expenditure shrank from about US$1.4 billion (37 percent of GDP) in 2005 to US$258 million (8 percent of GDP) in 2008 causing an almost complete collapse in the provision of public services, including a significant reduction in electricity generation capacity, collapse of water supply, and major disruptions in railway services.

Unprecedented hyperinflation led to the disappearance of the local currency and a contraction of the financial system in 2008. Fueled by the monetization of the RBZ's quasi-fiscal operations, twelve-month CPI inflation is estimated to have peaked in September 2008 at almost 500 billion (10^9) percent. Since October–November 2008, the local currency has virtually disappeared from circulation and dollarization has gained momentum. The banking system shrank, as reflected in deposits that declined from almost US$1 billion at end-2005 to about US$300 million (of which local currency-denominated deposits amounted to an equivalent of US$6 million) at end-2008.

With the demise of the Zimbabwe dollar hyperinflation has stopped. De facto dollarization was recognized by the official transition to use of hard currencies for transactions and adoption of the rand as the reference currency in early 2009. Under this monetary system, transactions in hard currencies are authorized, payments of most taxes are mandatory in foreign exchange, trading at the Zimbabwe Stock Exchange is conducted in foreign exchange, and many foreign exchange restrictions on current account transactions are liberalized. During January–February 2009, the CPI in U.S. dollar terms experienced a decline.

The short-term macroeconomic outlook is uncertain. The government's short-term emergency recovery program and the revised 2009 budget contain a number of important macroeconomic and structural policy commitments which, if fully implemented and supported by donor assistance, could lay the foundation for a private sector-led economic recovery in a low-inflation environment. However, there are significant downside risks to the economic recovery due to potential policy reversals.

Executive Board Assessment

A decade of high inflation, severe economic decline, and rising poverty has culminated in an acute, ongoing humanitarian crisis. Directors considered that Zimbabwe is now at a critical juncture. They welcomed the efforts by the recently formed government of national unity to seize the historic opportunity to improve prospects for economic growth and poverty reduction by forging the necessary political consensus among all stakeholders for ambitious reforms.

Directors welcomed the authorities' Short-Term Emergency Recovery Program (STERP) that is based on sound principles of macroeconomic management. They underscored that following through with the STERP's commitment to establish fiscal discipline, eliminate quasi-fiscal activities, maintain a multi-currency monetary framework, and accelerate structural reforms would be essential for an economic turnaround in a low-inflation environment. However, Directors cautioned that downside risks were significant. Potential political instability and limited implementation capacity may undermine reform and stabilization efforts, weakening the prospects for mobilizing donor financial support and attracting private capital inflows.

Directors underscored the importance of establishing fiscal discipline while ensuring the delivery of essential public services. They were encouraged by the authorities' intentions to improve tax administration and review the tax regime to increase budget revenues. Directors emphasized that the budgeted wage bill needs to be maintained and spending pressures from parastatals to finance nonessential activities should be resisted to leave sufficient resources for critical social needs and infrastructure. They also called for rapid progress in strengthening the public financial management system. Given the sizable unfilled financing gap and the necessity to cover critical humanitarian expenses, Directors encouraged the authorities to intensify their efforts to establish workable budget aid delivery mechanisms in close cooperation with the donor community. Directors noted that Zimbabwe is in debt distress and large financing gaps would persist over the medium term even if policies were improved.

Given the circumstances, Directors supported the authorities' decision to anchor inflation expectations by introducing a multi-currency system with the rand as the reference currency. They also emphasized that a significant strengthening of governance and transparency, including through an independent audit, at the Reserve Bank of Zimbabwe is urgently needed to enhance the credibility and durability of recent macroeconomic policies. Directors concurred that reintroduction of the national currency should await the establishment of a credible institutional framework that would underpin central bank operations with a focus on price stability.

Directors noted that banking system issues need to be addressed to improve payment services and access to credit. They underscored that the payments system, banking supervision, and liquidity management would need to be attuned to the requirements of the multi-currency monetary framework.

Directors underscored that the revival of the economy depends critically on quickly attracting private domestic and foreign investors and improving competitiveness. It is essential that the government ensures the protection of property rights, maintains the rule of law, guards against protectionism, and pursues prudent wage and income policies. Directors emphasized that recent commendable efforts to liberalize prices and exchange restrictions for current account transactions needed to be sustained. They also stressed the importance of improving the quality and timeliness of data.

Directors observed that a track record of sound policy implementation, supported by targeted technical assistance, including related statistics, from the Fund and other international financial institutions, is a critical first step to securing donor financial support for the reconstruction of Zimbabwe’s economy and regularizing its arrears to official creditors.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Zimbabwe: Selected Economic Indicators, 2007–09

	Estimated		Proj.
	2007	2008	2009
Real GDP growth (annual percent change)	-6.9	-14.1	2.8
Nominal GDP (US$ millions)	3,553	3,180	3,498
Inflation (annual percent change)			
Consumer price inflation (annual average) 1/	10,452.6	$556*10^{8}$	6.9
Consumer price inflation (end-of-period) 2/	108,844.1	$489*10^{9}$	...
Central government (percent of GDP, measured in US$)			
Revenue	5.7	4.2	25.2
Expenditure and net lending	10.8	8.1	35.7
Quasi-fiscal activity by RBZ	22.9	35.7	0.0
Primary balance (including quasi-fiscal activity)	-24.5	-35.2	-5.9
Overall balance (including quasi-fiscal activity)	-28.0	-39.6	-10.5
Money and credit (US$ millions) 3/			
Broad money (M3)	603.1	313.9	513.0
Net foreign assets	61.0	-707.0	-650.7
Net domestic assets	542.1	1,020.9	1,163.7
Reserve money	51.7	6.8	58.1
Velocity (M3)	5.9	10.1	6.8
External trade (US$ millions; annual percent change)			
Merchandise exports	4.8	-8.5	-8.1
Merchandise imports	-3.8	24.4	0.4
Balance of payments (US$ millions; unless otherwise indicated)			
Merchandise exports	1,804	1,651	1,518
Merchandise imports	-2,113	-2,630	-2,641
Current account balance (excluding official transfers)	-383	-906	-666
(Percent of GDP)	-11	-28	-19
Overall balance	-647	-612	-1,090
Official reserves			
Gross official reserves (US$ millions;end-of-period)	58.0	5.8	5.8
Gross official reserves (months of imports of goods and services)	0.3	0.2	0.2
Debt			
Total external debt (US$ millions; end-of-period) 4/	5,285	6,027	6,719
Total external debt (percent of GDP; end-of-period) 4/	149	189	192

Sources: Zimbabwean authorities; IMF staff estimates and projections.

1/ For 2008, annual average January–September 2008.
2/ For 2008, inflation at end-September 2008.
3/ Zimbabwe dollar values converted into U.S. dollars at the UN exchange rates at end-2007 and end-2008.
4/ Including arrears and estimated interest charges on arrears.

Statement by Samuel Itam, Executive Director for Zimbabwe
May 4, 2009

Introduction

1. The Zimbabwean authorities appreciate the encouragement and support of the Fund. They thank staff for their constructive dialogue during the 2009 Article IV consultation and for the lucid set of reports, and broadly agree with the analyses and recommendations.

Background

2. In the ten years prior to the emergence of a government of national unity in February 2009, economic and social conditions in Zimbabwe deteriorated significantly and reached crisis proportions. In that period, GDP growth declined by about 40 percent; unprecedented hyperinflation, fueled largely by excessive money growth, resulted in macroeconomic instability and the demise of the national currency; and the debt position became very precarious, with external debt estimated at US$6 billion (189 percent of GDP) at end-2008. The central government's spending capacity collapsed in 2008 as economic decline and rapid erosion of the real value of accrued tax liabilities contributed to a drastic drop in revenues. At the same time, the Reserve Bank of Zimbabwe's (RBZ's) quasi-fiscal activities increased. Furthermore, the tightening of price controls and exchange restrictions exacerbated the deterioration in business climate, exacerbating the economic decline. These factors, coupled with the collapse in the public sector capacity to provide basic services, accentuated unemployment, poverty, and the incidence of infectious diseases.

Economic developments and policy responses by the new government

3. Against the background of the economic and humanitarian crisis, the new administration has rapidly taken several macroeconomic and supply-side policy actions in the fiscal, monetary, financial, and structural areas aimed at maintaining low inflation, halting and reversing the economic decline, and improving social conditions. These actions are articulated in the Short-Term Emergency Recovery Program (STERP) of the new administration. Specifically, macroeconomic stability is to be restored and inflation contained through strict fiscal discipline and appropriate monetary policy.

Fiscal policy

4. The authorities have made considerable progress in implementing prudent fiscal policy. They introduced a cash budgeting system in 2009. In order to implement the cash budgeting system realistically while addressing critical social needs, the authorities have revised the 2009 budget and have targeted a balanced fiscal position. They project hard currency revenue to increase to US$ 1 billion in 2009 (29 percent of GDP). In this regard, they are stepping up the collection of customs and excise duties as well as value-added tax (VAT), which are expected to account for 60 percent of budget revenue. Expenditure is also budgeted at US$ 1 billion, representing a cut of 15 percentage points of GDP relative to the 2008 outturn. As a contingency plan in case of a shortfall in revenue, the authorities will consider measures to raise additional revenue in July 2009--including increasing royalties on mineral resources and broadening the VAT and customs tax bases--to ensure the provision of critical public services (including food relief, education and health).

5. The authorities are under intense political pressure to increase public sector wages, cognizant that maintaining the current flat civil service allowance of US$ 100 per month would weaken morale. However, any reasonable pay raise may lead to an unaffordable increase in the wage bill. Thus, the authorities and staff, agree that some decompression of the wage scale would be justified in 2009 to improve motivation and retention of skilled civil servants. This should be preceded by a payroll audit to remove "ghost workers". Regarding any unfilled financing gap in 2009, the government is vigorously seeking donor financing support to help forestall the prospect of drastically reducing expenditures on social programs and incurring payments arrears that could worsen economic and social conditions.

Monetary policy

6. The new administration's timely adoption of the use of hard currencies (especially the US dollar and the South African Rand), with the Rand as the reference currency, has assisted Zimbabwe in addressing the acute problem of hyperinflation. In addition, the abolition of exchange controls and liberalization of trade and payments (for all transactions in foreign currency) is helping to restore confidence. Furthermore, the RBZ has been directed to stop quasi-fiscal activities, which hitherto included subsidized direct lending and allocation of foreign exchange, below-cost provision of equipment and fertilizers to farmers, and transfers to parastatals. The expenses arising from the quasi-fiscal activities were mainly financed by surrender requirements on export proceeds, the retention of foreign exchange earnings of the gold and agricultural sectors in excess of mandatory surrender requirements, the confiscation of most foreign exchange deposits, external borrowing, and purchases of foreign exchange at the parallel market exchange rate. These unconventional practices have also been abolished.

7. The authorities have agreed with the staff recommendation to urgently enable the domestic payments system to process payments in foreign exchange and attune banking system supervision to the needs of the multi-currency system. In addition, ways to improve liquidity management in the new multi-currency system, including through limited lender-of-last-resort operations, are being examined. Also, the authorities are considering measures for strengthening the RBZ's governance and accountability framework, including

the appointment of five non-Executive Board members. The authorities plan to explore the merits of possible re-introduction of a national currency at end-2009, taking into account all requisite conditions.

Structural reforms to enhance growth and competitiveness

8. The authorities have been pressing ahead with structural reforms since the inception of the new government. Reforms in this area include price liberalization, discontinuation of the foreign exchange surrender requirements and restrictions, abolition of the Grain Marketing Board, and imposition of hard budget constraints on parastatal enterprises. The government is seeking technical advice from the World Bank on other aspects of the reform agenda, including privatization.

The STERP recognizes the urgency of dealing with the general concern regarding property rights and the rule of law. However, staff call for drafting, adopting and implementing necessary legislative acts to deal with these governance issues needs to bear in mind that enacting such legislations requires strong political consensus among the coalition partners. The government intends to continue working hard on confidence boosting measures to elicit the necessary political consensus in the period ahead.

Challenges and risks ahead

9. Notwithstanding the laudable policy and reform measures already taken by the authorities to improve economic and social conditions, there remain many challenges and risks. The authorities are, however, unwavering in their commitment to devote all efforts and available resources to address the challenges and mitigate the risks-- which include possible strain in political cohesion; shortfalls in budget revenue and foreign financing; issues related to wage, productivity, employment and competitiveness; capacity constraint; data limitations; debt burden; and, importantly, normalization of relations with the Fund.

10. However, these challenges and risks are not insurmountable. Indeed, the authorities have addressed several of them through a series of policy actions and reforms, while remaining strongly committed to finding appropriate solutions to the others. But for complete success, the authorities are counting on firm support from the Fund, other IFIs and development partners to complement their efforts. As staff indicated, “economic turnaround would not be possible without foreign assistance and private capital flows, even assuming sound policy implementation”. The authorities are, therefore, looking forward to the Fund being favorably disposed to their request for targeted provision of TA in the critical areas highlighted in the “Proposed Decision”. It stands to reason that no meaningful economic analysis and decision-making can take place, especially in the fiscal and monetary-financial areas, without properly collated, reliable and timely data. Going forward, therefore, the provision of Fund TA to strengthen statistics should be an integral component of the TA package which should not require a formal listing or ‘Decision’.

11. The authorities acknowledge, with appreciation, policy advice by the World Bank. They thank the governments and peoples of Botswana, the Republic of South Africa and

other members of SADC for commitments of financial support, which demonstrate the region's aspiration to see Zimbabwe's economy recover quickly. At the same time, the authorities call on other IFIs and donors to come to the aid of Zimbabwe at this critical juncture when the emergence of a new administration has created an opening for consultation and cooperation. Zimbabwe stands ready to strengthen its cooperation with the Fund and other relevant partners by continuing to build and establish a credible record of strong policy implementation to ensure macroeconomic stability, entrench reforms, collaborate on debt sustainability work, and meet financial obligations to the Fund and other creditors under mutually agreed terms. The authorities look forward to Zimbabwe's full integration into the Fund, with all rights restored in the not too distant future.

Conclusion

12. The authorities have established an encouraging record of economic policy implementation and reform during the short period of the new government's existence. They are committed to continued implementation of necessary policies and structural reforms to maintain macroeconomic stability essential for reversing the deterioration in economic conditions and tackling poverty. They value the Fund's policy advice and engagement, and look forward to continued strong support for the country by the international community, including the Fund. This new approach reflects the desire of Zimbabwe to cooperate fully.