

Inflation – Zimbabwe has been in a deflationary environment, except for the three months leading to end-September 2014. However, deflationary pressures have eased since November 2015. The Zimbabwe National Statistics Agency (ZimStat) published its consumer price index (CPI) recently, in which it reported that headline deflation for July had accelerated to 1.6% y-o-y, compared with 1.4% y-o-y the previous month. We expect headline deflation to average 0.8% in 2016.

Growth – Economic headwinds deepened in 2015 as a result of poor rains and a slump in commodity prices, as well as a contraction in the output of some minerals. The economy grew by 1.1% in 2015, the worst performance since the economic decline that ended in 2008. To turn around the economic tide, the country intends to increase gold production, with a notable increase in gold and platinum output already witnessed in 2016 Q1. However, manufacturing capacity utilisation remains depressed against a backdrop of low business confidence in the country. The recently imposed import-restrictive measures and cash shortages will negatively impact economic growth. We project the economy to grow by 1.2% this year, with the little growth expected to stem from the services and mining sectors. A significant downside risk to our forecasts remains, most notably given the context of weak global commodity prices.

National development plan – Zimbabwe Agenda for Sustainable Socio-Economic Transformation (Zim Asset) is the country’s economic blueprint and meant to turn around the economy’s fortunes. The vision of the policy is *“towards an empowered society and a growing economy”*. Zim Asset focuses on food security, social services and fighting poverty, the development of infrastructure and public utilities, as well as mining beneficiation and value addition. The country has made major strides in infrastructure development. Last year, the country completed a rehabilitation project of the Harare-Bulawayo-Plumtree and Harare-Mutare roads covering 820 km at a cost of \$206m, and was financed by a loan from the Development Bank of Southern Africa (DBSA). The expansion of the Victoria Falls International Airport, which started in 2013 at a cost of \$150m, is expected to be completed in H2 2016 after missing several deadlines, with a similar project earmarked for the Harare International Airport. This year, the government approved a tender for the dualisation of the Harare-Beitbridge and Harare-Chirundu roads at a cost of \$2bn.

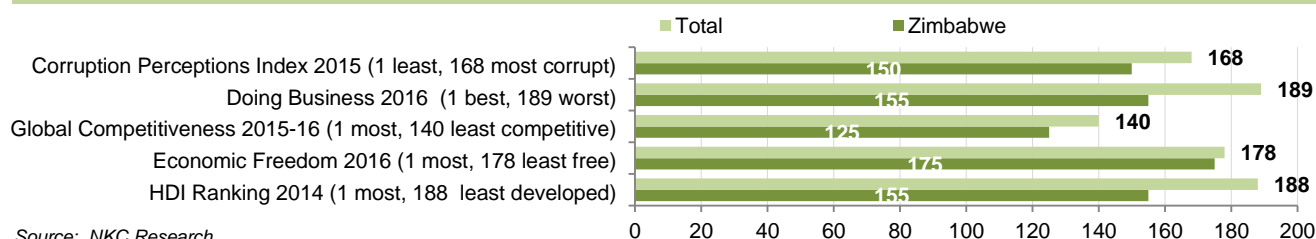
| OPPORTUNITIES | STRENGTHS |
|--|---|
| Zimbabwe was once the bread basket of Southern Africa, and has scope to significantly increase its agricultural production over the long term. | The multi-currency regime keeps inflation under control and offers stronger buying power for Zimbabweans at a time that the South African rand is depreciating. |
| Large mineral reserves offer long-term investment potential – dependent on resolving political constraints. | Production of tobacco (the country’s largest export by value) increased by 30% p.a. during 2009-14. The long-term outlook remains positive. |
| The government is re-engaging multilateral organisations and creditors, which has led to (slow) progress towards external debt relief. | The country’s literacy rate is among the highest in Africa, offering Zimbabwe the human resources to further its economic recovery. |
| Imports: the agricultural and factory sectors are producing significantly less food products and durable goods than consumers are demanding. | Despite a myriad of uncertainties in the country, healthy foreign direct investment (FDI) into the mining sector has been evident since 2009. |

| VULNERABILITIES | WHAT IS BEING DONE? |
|--|--|
| Policy uncertainty following the removal of moderate Zanu-PF leaders in late-2014/early-2015 is a key obstacle to faster economic growth as it curtails FDI. | Some factions within the government are actively courting foreign investors, while other elements counteract this with anti-Western statements. |
| Highly dependent on imported food & consumer goods – most of the goods sold locally are imported from South Africa. Industrial capacity utilisation dropped to 34.3% during 2015. | The country imposed import-restrictive measures this year. There is little chance of manufacturing recovering due to structural constraints. |
| Government finances are handled on a cash basis due to a lack of domestic and external borrowing opportunities as well as no direct budgetary aid since 2009. | Re-engagement with the IMF will (hopefully) over the medium term translate into a better financial relationship with past / future development partners. In a mid-term fiscal policy review statement announced on 8 September 2016, the Ministry of Finance and Economic Development advised of the Government’s intention to reduce the number of Government workers by as much as 25 000 and also to suspend the payment of annual bonuses for all civil servants for 2 years in an effort to reduce recurrent expenditure. |
| The banking sector is under pressure from high levels of non-performing loans (NPLs) – 12% of gross loans at the end of 2015. The most recent data points to a 10.8% reading for March 2016. | The central bank has set up a special fund to buy up to \$700m in bad debt - \$480m has been realised so far. The central bank continues to review and (where applicable) close down troubled banks. |
| The country is currently faced with severe liquidity challenges mostly characterised by the shortage of bank notes and inability to quickly make external payments. This together with other economic pressures has resulted in some level of social unrests in the form of civil demonstrations and a general increase in political temperatures. | The Government has indicated its intention to introduce bond notes (a form of local currency backed by a US\$200 million facility from the Africa Export and Import Bank). The authorities are reportedly working towards introducing the bond notes during October 2016. |

| MEGA TRENDS | |
|---|--|
| Population | 14,229,541 (July 2015 est.); Age 15 - 64: 58.6% |
| Population growth rate (%) | 2.2% (2015 est.) |
| Life expectancy at birth | Total population: 57.1 years; male: 56.5 years; female: 57.6 years (2015 est.) |
| HIV/AIDS | Adult prevalence rate: 14.7%; People living with HIV/AIDS: 1.4 million (2015 est.) |
| Adult literacy rate (age 15 and over, can read and write) | Total population: 86.5%; male: 88.5%; female: 84.6% (2015 est.) |
| Urbanisation | Urban population: 32.4% of total population (2015); Urban population growth: 1.9% (2015) |
| Population below national poverty line | 72.3% (2012 est.) |

| | |
|--|---|
| Unemployment rate | 11.3% (2014 est.) |
| Employment (% of total) | Agriculture: 65.8%; Industry: 9.1%; Services: 25% (2011 est.) |
| Labour participation rate (% of total population ages 15+) | 86.7% (2014) |
| Business languages | English, Shona, Ndebele |
| Telephone & Internet users | Main lines in use: 333,702; Mobile cellular: 12.8 million; Internet users: 2.33 million (2015 est.) |

Sources: CIA World Factbook, World Bank, UNESCO, Trading Economics ITU, UNAIDS, UNDP, ZimStat & NKC Research



Source: NKC Research

Risk environment / Risk outlook

| Sovereign Risk Ratings | | |
|------------------------|-------|---------|
| S&P Global Ratings | Fitch | Moody's |
| N/R | N/R | N/R |

Zimbabwe is not currently rated by any of the three major rating agencies: S&P Global Ratings, Fitch and Moody's Investors Service (Moody's).

| Infrastructure | Diversity of the Economy | Banking Sector | Continuity of Economic Policy | GDP Growth | Key Balances | Foreign Investment | Socio-economic Development | Forex Reserves |
|--|--------------------------|--------------------------------|--|-----------------------|---|---|---------------------------------------|----------------|
| Dilapidated, severely limited spending | Quite diverse | Still functioning, but fragile | Continued populist policies result in much uncertainty | Strong during 2009-12 | Small fiscal deficit, large current account deficit | Volatile but still healthy in mining sector | Low, social spending mostly from NGOs | Still limited |

| Stock Market | Primary Listed Companies | Liquidity | Market Cap | Dominant Sector | Daily Trading Volume |
|--|---|------------|--------------------------------------|---------------------|-----------------------------------|
| Zimbabwe Stock Exchange (ZSE) | 59 (11 Aug 2016) (Source: ZSE) | Limited | \$2.74bn (11 Aug 2016) (Source: ZSE) | General industrials | 7.03 million shares (Source: ZSE) |
| Capital Market | Development | Liquidity | Maturity Range | Municipal Bonds | Corporate Bonds |
| Sovereign debt was issued to compensate companies for financial losses under pre-2009 government | Treasury bills sold until end-2008, short- and medium-term debt instruments again issued from late-2012 | Negligible | 91-day to 5-year | N/A | N/A |

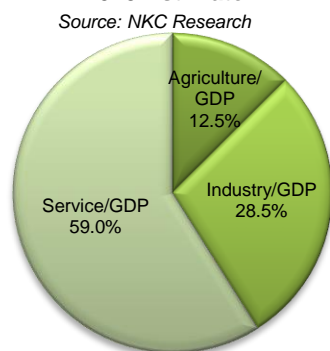
Macro-economic overview

Economic headwinds deepened in 2015 as a result of poor rains and a slump in commodity prices, as well as a contraction in output of some minerals. According to the central bank, agricultural and mining output is estimated to have contracted by 3.6% and 2.5%, respectively, in 2015. Overall, the economy grew by 1.1% in 2015, the worst performance since the economic decline that ended in 2008. To turn around the economic tide, the country intends to increase gold production. Gold output rose by 22% y-o-y to just above 5,000 kg in 2016 Q1, supported by increased output from small-scale miners. Platinum production also surged by 43% y-o-y to about 4,300 kg in 2016 Q1. Nevertheless, manufacturing capacity utilisation remained depressed in 2016 Q1 against a backdrop of low business confidence. The challenging operating environment witnessed 13 manufacturing company closures in 2016 Q1, compared with 17 closures last year over the same period, according to the central bank. In addition, severe cash shortages are expected to depress aggregate demand, leading to slower economic growth over the short to medium term. The recently imposed import-restrictive measures will depress the economy further. Against this backdrop, we project the economy to grow by 1.2% this year. The little growth we expect to see will emanate from the services and mining sectors. A significant downside risk to our forecasts remains, most notably given the context of weak global commodity prices.

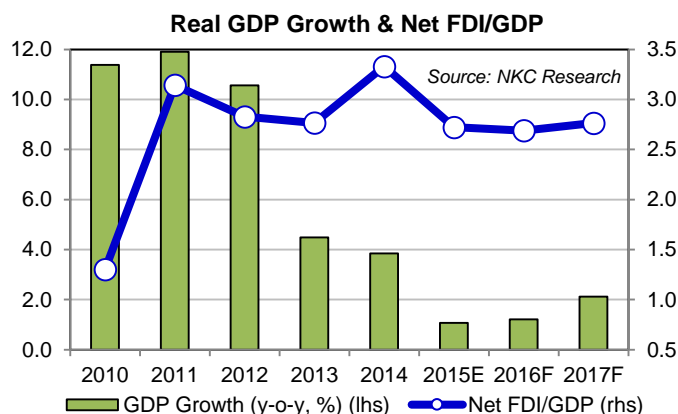
Zimbabwe's monetary policy statement (MPS) – entitled 'Economic transformation through transparency and accountability' was presented on 4 February 2016. The MPS highlighted that leakages through illicit financial flows were haemorrhaging the economy to the extent of reducing aggregate demand and causing deflation in the economy. In an effort to plug leakages and to instil discipline and transparency, the central bank is now monitoring offshore operations of companies' subsidiaries and it removed the "free funds" classification of foreign currency. With regards to liquidity, the monetary regulator encouraged banks to buy foreign currencies within the multi-currency basket from the public for onward sell to the central bank. However, the liquidity constraints deepened in 2016 Q2, which led the central bank to implement measures to address the cash shortages challenge including daily ceilings on cash withdrawals and an export incentive support facility was also established and is backed by the \$200m loan from African Export-Import Bank (Afreximbank), which will provide a 5% incentive on all export receipts. To mitigate the abuse of this facility through capital flight, bond coins and notes will be granted to qualifying foreign exchange earners.

Zimbabwe is in debt distress as a result of high levels of external debt, with \$1.8bn to international financial institutions in arrears. Critically, the country's re-engagement with international financiers is dependent on clearing arrears. The International Monetary Fund (IMF) has recently reiterated that normalisation of relations with Zimbabwe and any approval of a financing programme will only be considered after arrears are cleared. During a press release in July 2016, the Fund said that even after settling arrears, there are other factors that should be in place before the multilateral organisation will fund the country's programme, which include designing "some economic policies to ensure that the structural imbalances are meaningfully addressed" and "obtaining financing assurances regarding Zimbabwe's ability to service and sustain its debt."

Economic Structure as % of GDP 2015 Estimate

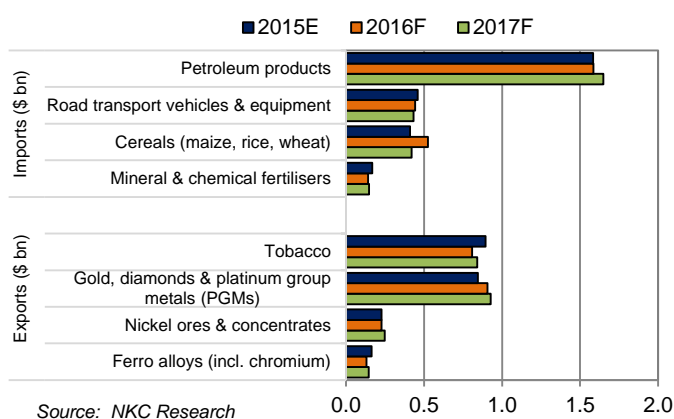


Farming and mining dominate primary sector activities in Zimbabwe. Agricultural activity is focused on cash crops like tobacco, cotton and edible produce, with small-scale operators representing the majority of farmers. The agricultural sector's contribution to GDP decreased from 14% in 2014 to 12.5% in 2015. The secondary sector has a small manufacturing component and a waning industrial component. Since 2012, the industrial sector's contribution to GDP has been trending lower, falling from 31.6% of GDP in 2012 to 28.5% of GDP in 2015. The services sector continues to be the largest contributor to GDP. It is mainly driven by the finance & insurance subsector, the distribution, hotels & restaurants subsector and the transport & communication subsector. As a result, the contribution of the services sector to GDP increased from 54% in 2011 to 59% in 2015.



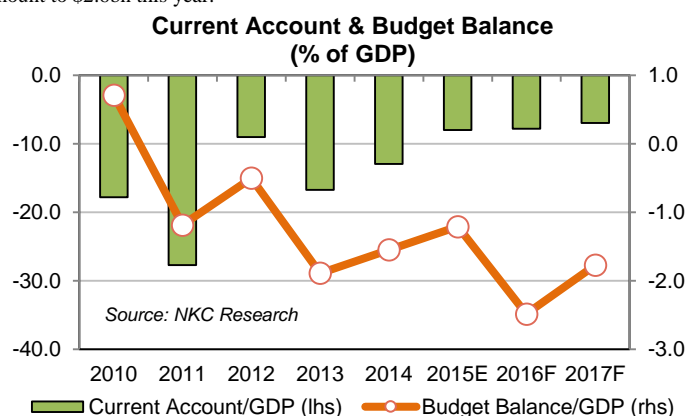
Zimbabwe remains in great need of foreign direct investment (FDI), which makes it important for the country to mend its relations with the international community to lure foreign investors. Zimbabwe's FDI inflows in 2014 amounted to \$545m, the highest since 2009. FDI inflows are estimated to have dropped to \$421m in 2015. Some of Harare's macroeconomic policies – such as the controversial indigenisation and empowerment policy – counter measures to lure FDI into the country. Furthermore, the government's policy inconsistency is a challenging reality in Zimbabwe. Despite challenges that stifle FDI, the country continues to attract some foreign investment. In October 2015, the Zimbabwe Investment Authority (ZIA) issued licenses to the value of \$1.2bn to the Dangote Group for various cement manufacturing, coal mining and energy projects. According to *The Herald*, the Indian billionaire Ravi Jaipuria's \$30m PepsiCo plant in the country was approved, with work expected to start in Q3 2016, and production expected to commence early next year. Nonetheless, the ratio of net FDI to GDP has remained stable since 2012, except for the spike in 2014. We project net FDI to remain stable over the 2016-17 period, averaging 2.7% of GDP.

| Main Imports: % share of total | 2015E | 2016F | 2017F |
|-------------------------------------|-------|-------|-------|
| Petroleum products | 26.12 | 26.99 | 28.17 |
| Road transport vehicles & equipment | 7.58 | 7.55 | 7.40 |
| Cereals (maize, rice, wheat) | 6.76 | 8.93 | 7.17 |
| Mineral & chemical fertilisers | 2.79 | 2.40 | 2.53 |
| Main Exports: % share of total | 2015E | 2016F | 2017F |
| Tobacco | 24.81 | 24.62 | 24.11 |

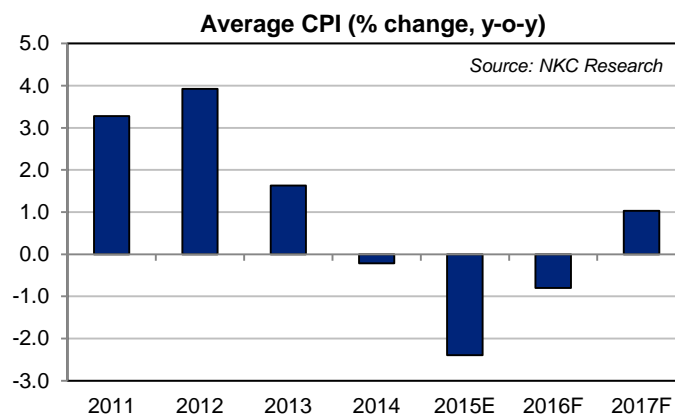


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|---|-------|-------|-------|
| Gold, diamonds & platinum group metals (PGMs) | 23.49 | 27.64 | 26.59 |
| Nickel ores & concentrates | 6.33 | 6.92 | 7.10 |
| Ferro alloys (incl. chromium) | 4.58 | 4.03 | 4.17 |

Balance of payments developments are instrumental in providing liquidity in the national economy given the multi-currency system. Due to a plethora of issues, including a weak performance in manufacturing exports following the closure of many companies, as well as the use of the strong US dollar; exports have been trending lower since 2012. The recent slump in global commodity prices compounded the weak performance of commodity-dominated exports. During 2016 H1, the country's total exports fell by 8.7% y-o-y to \$1.13bn as the economy remains subdued. Exports are projected to decline to \$3.32bn this year from \$3.6bn in 2015. Turning to imports, the import bill has been trending lower since 2014 as a result of a slump in international oil prices, a decline in global food prices, and liquidity constraints. Most recently, imports declined by 14.9% to \$2.51bn in 2016 H1. A decline in the import bill is expected as a result of recently imposed import-restrictive measures. The trade balance has remained in negative territory for more than a decade. However, it has shown signs of narrowing in recent years. We expect the trade deficit to amount to \$2.6bn this year.



Turning to the invisible accounts on the balance of payments, the combined (small) surplus on the invisibles account – which includes the services, income and current transfer accounts – is expected to remain in place over the medium term. Overall, the current account deficit is expected to remain wide, albeit narrowing from \$1.11bn (7.98% of GDP) in 2015 to \$1.09bn (7.81% of GDP) in 2016. On a separate note, the IMF, in its most recent Article IV Consultation, commended authorities for a prudent fiscal stance over the 2014-15 period, which culminated in a successive narrowing of the fiscal deficit, despite operating in a challenging fiscal environment. Nonetheless, the slowdown in economic growth over the past three years has negatively impacted fiscal revenues. Annual revenue collection by the Zimbabwe Revenue Authority (Zimra) amounted to \$3.5bn in 2015 against a target of \$3.76bn. Revenue collected in the first half of 2016 amounted to almost \$1.55bn, which is 6.6% lower than the amount collected last year over the same period. Furthermore, the import-restrictive measures introduced recently will weigh on revenue collection. Last year, VAT on imports contributed \$440.65m (12% of the total revenue collected) to government coffers. Against this backdrop, we now expect the fiscal deficit to widen from 1.2% of GDP in 2015 to 2.5% of GDP in 2016, before narrowing to 1.8% of GDP in 2017. The government's wage bill has remained high, accounting for almost 80% of total government spending. The country is developing a medium-term economic transformation programme that will address fiscal discipline. The ambitious plan intends to shift resources to infrastructure development and social investment.



The central bank's lack of control over domestic money supply and of commercial bank interest rates has resulted in a persistent deflationary environment. Headline inflation continues to trend in negative territory as it averaged 0.2% in 2014 and 2.4% in 2015. However, deflationary pressures have eased since November 2015. Our projections show that headline deflation will decelerate to an average of 0.8% in 2016. The expected introduction of bond notes will likely increase inflationary expectations. Furthermore, we expect a build-up in inflationary pressures as a result of shortages stemming from the recent ban on certain products from the open import system. The manufacturing sector's utilisation capacity is very low, hampered by liquidity constraints and aging equipment and will not be able to meet demand.

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