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Zimbabwe: 2010 Article IV Consultation—Staff Report; Staff Supplement; 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 2010 Article IV consultation with Zimbabwe, the following documents have been released and are included in this package:

- The staff report for the 2010 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on March 17, 2010, 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 29, 2010. 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 supplement on the Debt Sustainability Analysis.
- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its May 17, 2010 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 2010 Article IV Consultation

Prepared by the staff representatives for the
2010 Article IV consultation with Zimbabwe

Approved by Sharmini Coorey and Dominique Desruelle

April 29, 2010

Mission: March 3–17, 2010.

Meetings: The mission met with Prime Minister Tsvangirai, Minister of Finance Biti, Minister of Economic Planning and Investment Promotion Mangoma, Reserve Bank of Zimbabwe Governor Gono, and other senior government officials, as well as representatives of the diplomatic and business communities, and civil society organizations and labor unions.

Team: Mr. Kramarenko (head), Mr. Engstrom, Ms.Verdier (all AFR), Ms. Fernandez (SPR), Messrs. Hughes and McHugh (both FAD), Messrs. Oppers and Sullivan (both MCM), and Ms. Yang (FIN).

Exchange regime. Since 2009 Zimbabwe has adopted hard currencies for transactions (i.e., multi-currency regime) with the U.S. dollar as principal currency; and use of the Zimbabwe dollar as domestic currency was discontinued over the period 2010–12. The de facto exchange regime is classified as *exchange arrangement with no separate legal tender.*

Exchange restrictions. Zimbabwe has one exchange restriction subject to Fund jurisdiction arising from nonsettled balances under a non-operational bilateral payments agreement with Malaysia.

"Zimbabwe: Challenges and Policy Options after Hyperinflation, (DP/10/03)" is available on http://www.imf.org/external/pubs/cat/createx/AFRDeptpapers.aspx.

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

The previous Article IV consultation discussions were concluded on May 4, 2009. The related consultation documents have been published.

Consultation cycle: Recommended to be held on the standard 12-month cycle.

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I. Summary and Staff Appraisal

The nascent economic recovery, underpinned by significant improvements in policies in 2009, remains very fragile. The previously implemented liberalization of prices, goods markets, and foreign exchange transactions would support economic activity in 2010. Significant improvements in tax policy and administration have increased available fiscal space. However, rapid unsustainable government expenditure growth, including of wages, a large reduction in capital inflows because of increased uncertainty about the indigenization process, and exuberant credit growth have negatively affected the macroeconomic outlook and intensified external and banking system vulnerabilities.

In light of these vulnerabilities, policies need to be strengthened to sustain the economic recovery:

The approved 2010 budgetary expenditures would need to be curtailed by about 3 percent of GDP to return to a path toward medium-term fiscal and external sustainability and reduce the economy's vulnerability to shocks. This would also help maintain a fiscal reserve of at least $250 million of SDR holdings (2 months of expenditures). Although reaching consensus on the recommended fiscal measures is a major political challenge, delaying their implementation could increase the social and economic costs of the future necessary adjustment.

The key fiscal challenge is to reduce the wage bill relative to revenues in 2010 and beyond to leave sufficient fiscal space for urgent infrastructure upkeep expenses (e.g., electricity, water, and sanitation), maintain competitiveness, and prevent an unsustainable buildup of domestic expenditure arrears. The recent payroll audit presents an opportunity to eliminate ghost workers, and political support needs to be forged for additional measures for 2010 and the medium term to further reduce the wage bill.

To address increasing systemic vulnerabilities in the banking system, urgent measures need to be implemented: (i) improving Reserve Bank of Zimbabwe (RBZ) governance, and downsizing and restructuring it; (ii) reducing banks' exposure to the financially distressed RBZ; (iii) containing credit and liquidity risks; and (iv) discontinuing moral suasion on banks to lend to specific sectors. The authorities' stated intentions to implement these recommendations need to be followed through with speedy implementation.

The multi-currency system would serve Zimbabwe well during its intended lifespan (2010–12). The Zimbabwe dollar can be reintroduced as sole legal tender only once a track record of sound policies is established and a credible central bank governance framework focused on price stability is adopted.

Sound macroeconomic policies, a significant improvement in the business climate, in particular regarding enforcement of property rights and labor legislation, and debt relief are essential for moving toward external and domestic stability. Zimbabwe is in debt distress, and the debt overhang cannot be resolved without debt relief even if policies are improved and mineral extraction is increased. The government needs to reach consensus on a resolution strategy for external debt arrears and to improve relations with the international community, whose support would be vital for obtaining debt relief and rebuilding the Zimbabwe economy.

II. FRAGILE RECOVERY FOLLOWING A DECADE OF ECONOMIC DECLINE

1. **Following a decade of economic decline and hyperinflation during 2007–08, policies improved significantly in 2009.** The multi-currency system adopted in early 2009 helped restore price stability, restart financial intermediation, and impose fiscal discipline by precluding the option of budget deficit monetization. Following implementation of many Fund technical assistance (TA) recommendations, budget revenue increased significantly, which helped finance improved delivery of public services, while the fiscal position was broadly balanced in 2009. Price and exchange system liberalization improved allocation of resources and availability of goods in the domestic markets. In response to better policies, short-term capital inflows and FDI increased in 2009, providing financing for a widening current account deficit. These positive steps supported a nascent economic recovery (Figures 1–2 and Tables 1–5).

2. **The humanitarian situation is also improving.** Most schools and hospitals have been re-opened. Owing to good rainfall and effects of better policies in 2009, food security improved and production of the staple crop, maize, increased from 0.6 million tons in 2008 to an estimated 1.1 million tons in 2009. Incidence of cholera also has declined. In 2009, donors provided significant off-budget financing for social services and humanitarian assistance (12 percent of GDP) to help fill the gap left by constrained fiscal resources.

Text Table 1. Zimbabwe: Millennium Development Goals

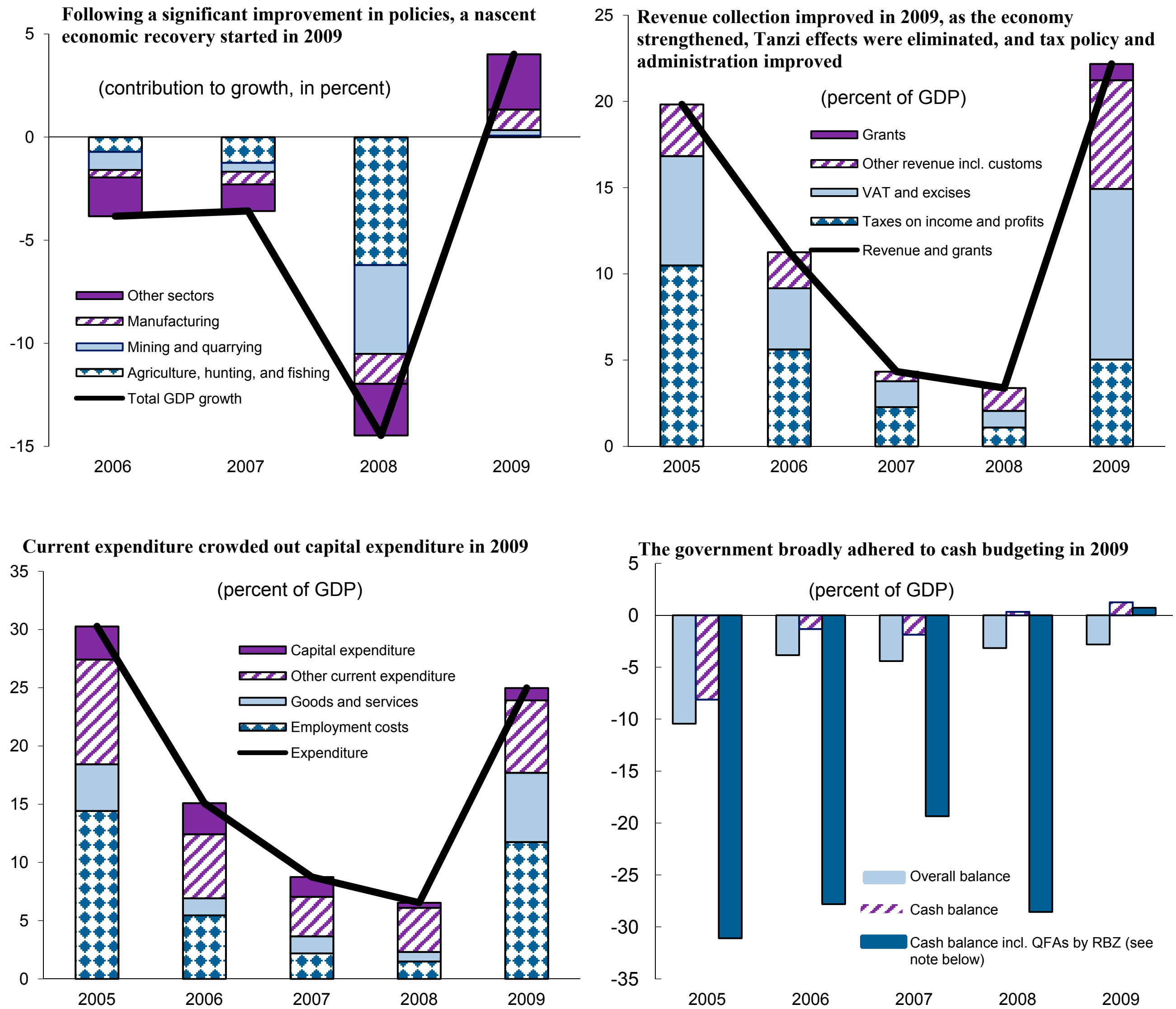
	Zimbabwe			SSA
	1990	2000	2008 1/	2008 1/
Population (millions)	10.2	12.7	11.7	818.0
Life expectancy at birth, total (years)	60.0	44.0	45.0	52
Literacy rate, youth female (% of females ages 15-24)	94.0	...	*88.0*	*67*
Literacy rate, youth male (% of males ages 15-24)	97.0	...	*94.0*	*77*
Under 5 mortality rate (per 1,000)	95.0	122.0	90.0	*146.0*
Maternal mortality ratio (per 100,000 live births)	...	...	880	*900.0*
Prevalence of HIV, total (% ages 15-49)	14.2	27.3	*15.3*	*5.0*
Access to an improved water source (percent of population)	78.0	80.0	*81.0*	*58.2*

1/ Italics refer to earlier periods
Source: World Development Indicators.

3. **However, significant challenges remain unaddressed and some previous staff recommendations have not been implemented**. Recent large wage increases, a poor financial position of state-owned enterprises (SOEs), rising vulnerabilities in the banking system, weak governance, particularly at the RBZ, growing weaknesses in the business climate, and a precarious external position (Figure 3 and Table 2) are threatening the economic recovery and progress in poverty reduction. In light of these challenges, the consultation discussions focused on the following issues:

- Creating sufficient fiscal space for growth- and socially-oriented spending while moving toward fiscal sustainability;
- Safeguarding financial sector stability in the multi-currency regime;
- Moving toward external stability and sustainable growth.

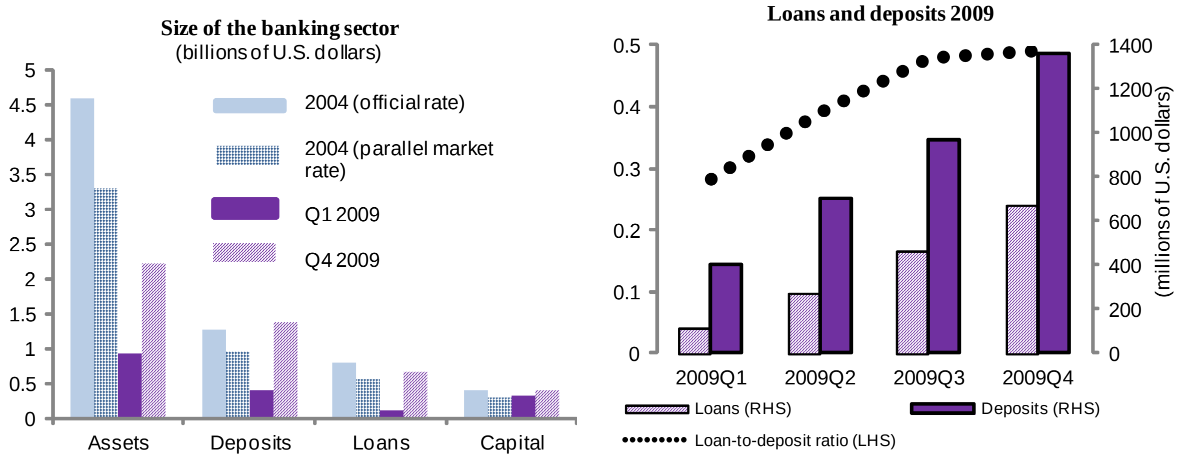
Figure 1. Zimbabwe: Recent Economic and Budgetary Performance



Note: Quasi-fiscal activities (QFAs) by the Reserve Bank of Zimbabwe (RBZ) 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.

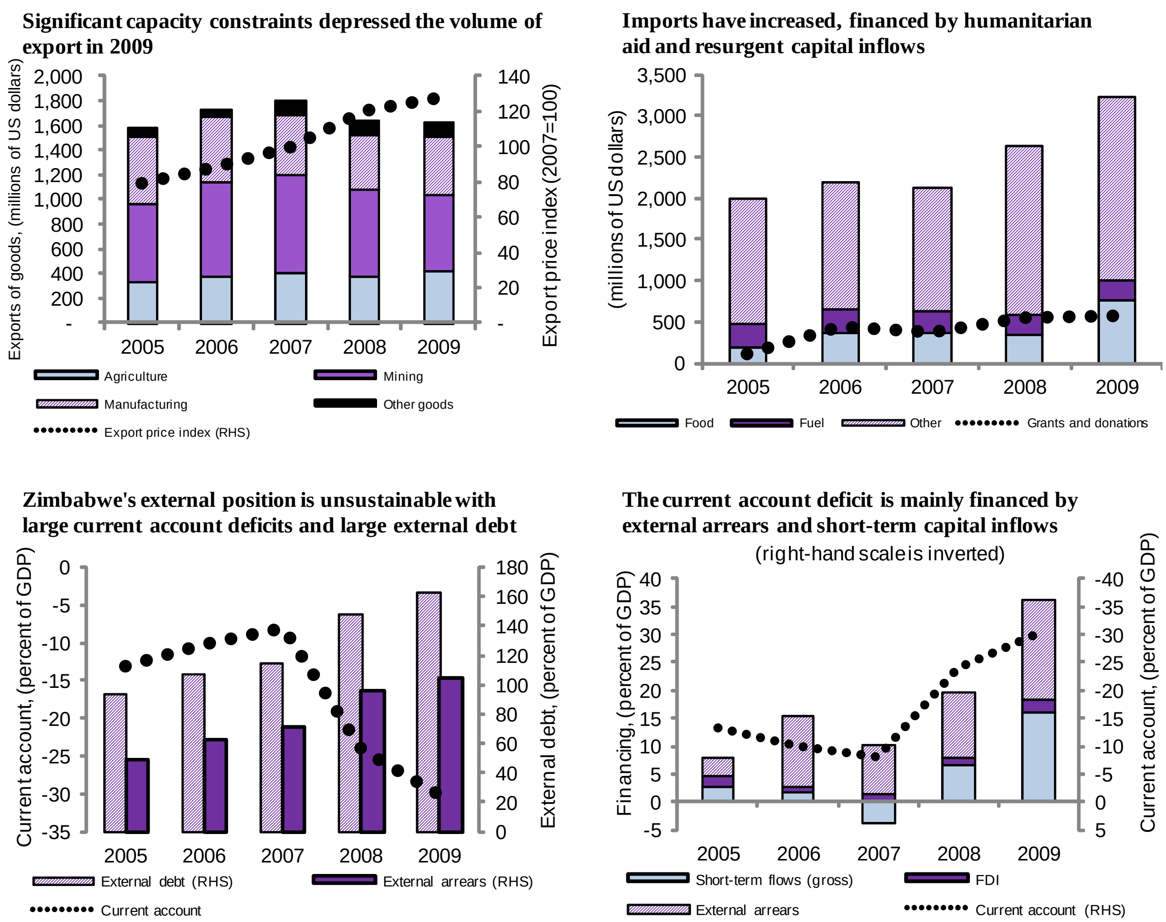
Sources: Zimbabwe authorities and IMF staff estimates.

Figure 2. Zimbabwe: The Banking System Is Returning to Its Size before Hyperinflation



Source: Zimbabwe authorities.

Figure 3. Zimbabwe: The External Position Remains Precarious



Sources: Zimbabwe authorities and IMF staff estimates.

III. MACROECONOMIC OUTLOOK

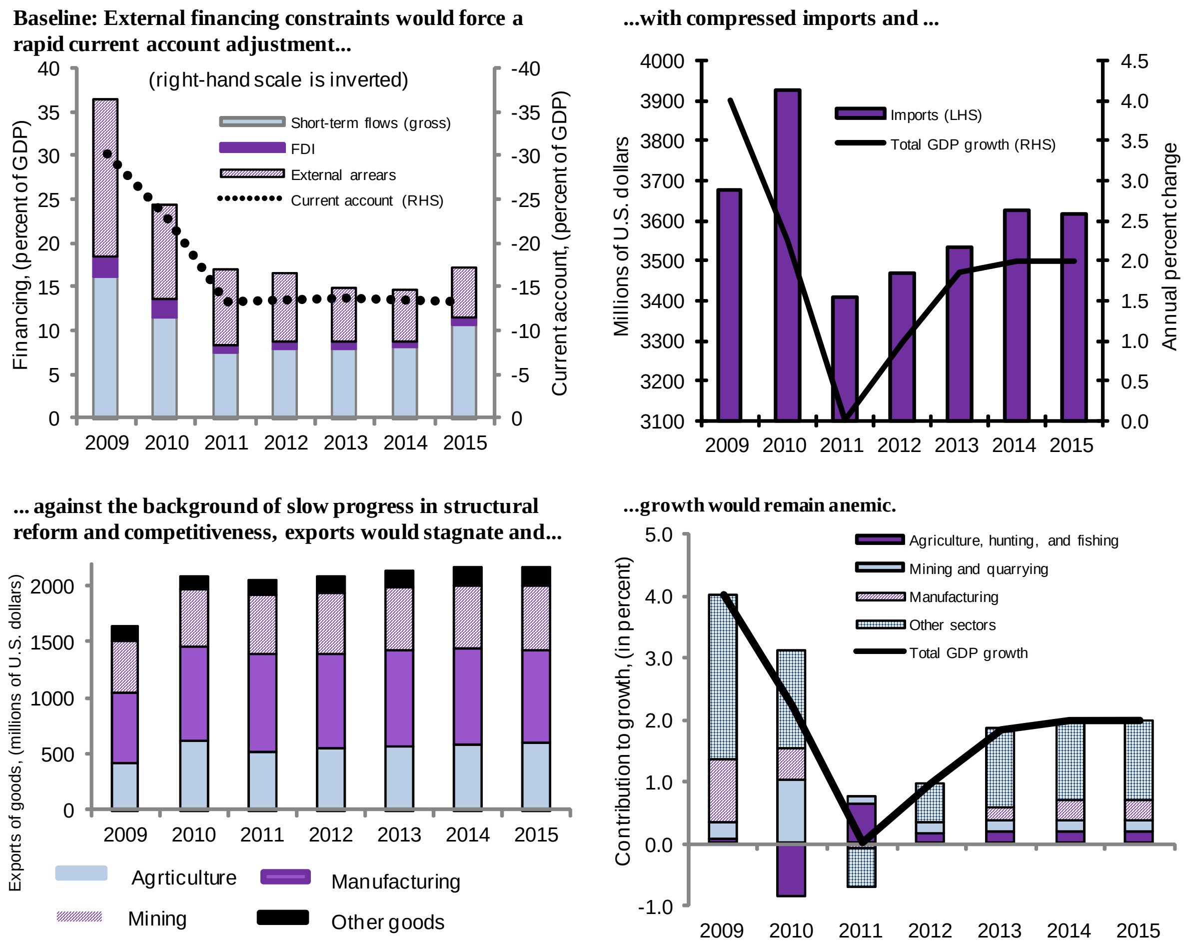
A. Outlook on Unchanged Policies

4. **The macroeconomic outlook for 2010 on unchanged policies is daunting.** The previously implemented liberalization of prices, goods markets, and foreign exchange transactions would support economic growth. However, continued political tensions and increased uncertainties regarding implementation of the Indigenization and Empowerment Act are causing a significant decrease in private capital inflows. As a result, the external current account deficit would be forced to adjust to 23 percent of GDP in 2010, from 30 percent in 2009, and banks' foreign assets—their main source of liquidity—would decline. The projected current account adjustment would lead to a sharp slowdown in import growth (Table 2). Consequently, real GDP growth would decelerate to about 2 percent in 2010 from 4 percent in 2009 (Table 1). The unsustainable wage-driven fiscal expansion, financed by drawing down part of Zimbabwe's SDR holdings, would increase the vulnerability of the external position and set the stage for an abrupt and potentially destabilizing contraction in nonwage expenditures and imports in 2011 (Tables 2–3).

5. **Short-term risks are skewed to the downside:** (i) potential liquidity or solvency problems in a fragile banking system, as a result of the balance of payments-induced reduction in its foreign assets, with a high negative impact on economic activity, budget revenues, and social conditions; (ii) drought with significant negative spillover effects on food security, economic growth, and banking system stability; and (iii) possible breakdowns of public infrastructure with a negative impact on key industries. At the same time, higher-than-expected donor financing, as well as possible additional export and budget receipts from diamonds, represent upside potential.

6. **The medium-term outlook is bleak in the absence of significant improvement in policies.** The illustrative baseline scenario assumes that there would be limited direct donor budget support and structural reforms would advance slowly, reducing the country's attractiveness to domestic and foreign investors. Zimbabwe would remain highly dependent on large humanitarian assistance (about $600 million per year). The tightening of the external financing constraint projected for 2010 would continue into the medium term. Consequently imports and investment would be compressed, and economic growth would remain anemic (Figure 4). The current account deficit would need to adjust from 23 percent of GDP in 2010 to less than 15 percent over the medium term. The tight balance of payments position would also restrict the scope for a further increase in financial intermediation.

Figure 4. Zimbabwe: Baseline Scenario



Sources: Zimbabwe authorities and IMF staff estimates.

B. Active Policy Scenario

7. **The macroeconomic outlook could significantly improve if policies are strengthened.** For the economy to grow at 4 to 5 percent in 2010 and the medium term, budgetary expenditures need to be reoriented toward growth- and socially-oriented projects, the business climate improved, wage costs contained, and the financial system strengthened (see specific staff recommendations below). The active policy scenario does not account for the possible impact of debt relief, which, if realized, would unlock access to fresh International Financial Institutions' (IFI) financing, strengthen growth potential, and accelerate progress in moving toward achieving the Millennium Development Goals.

Authorities views

8. The authorities broadly agreed with the staff assessment of the outlook and risks under the unchanged policy scenario. They also stressed that they would seek to build domestic political consensus for the implementation of key staff recommendations under the active policy scenario to improve prospects for economic growth and poverty reduction. The authorities also indicated that donor financial support could be significantly higher than projected by staff under the active policy scenario, thereby helping the economy to grow faster.

IV. Policy Discussions

A. Creating Sufficient Fiscal Space for Growth- and Socially-Oriented Spending While Moving Toward Fiscal Sustainability

Background

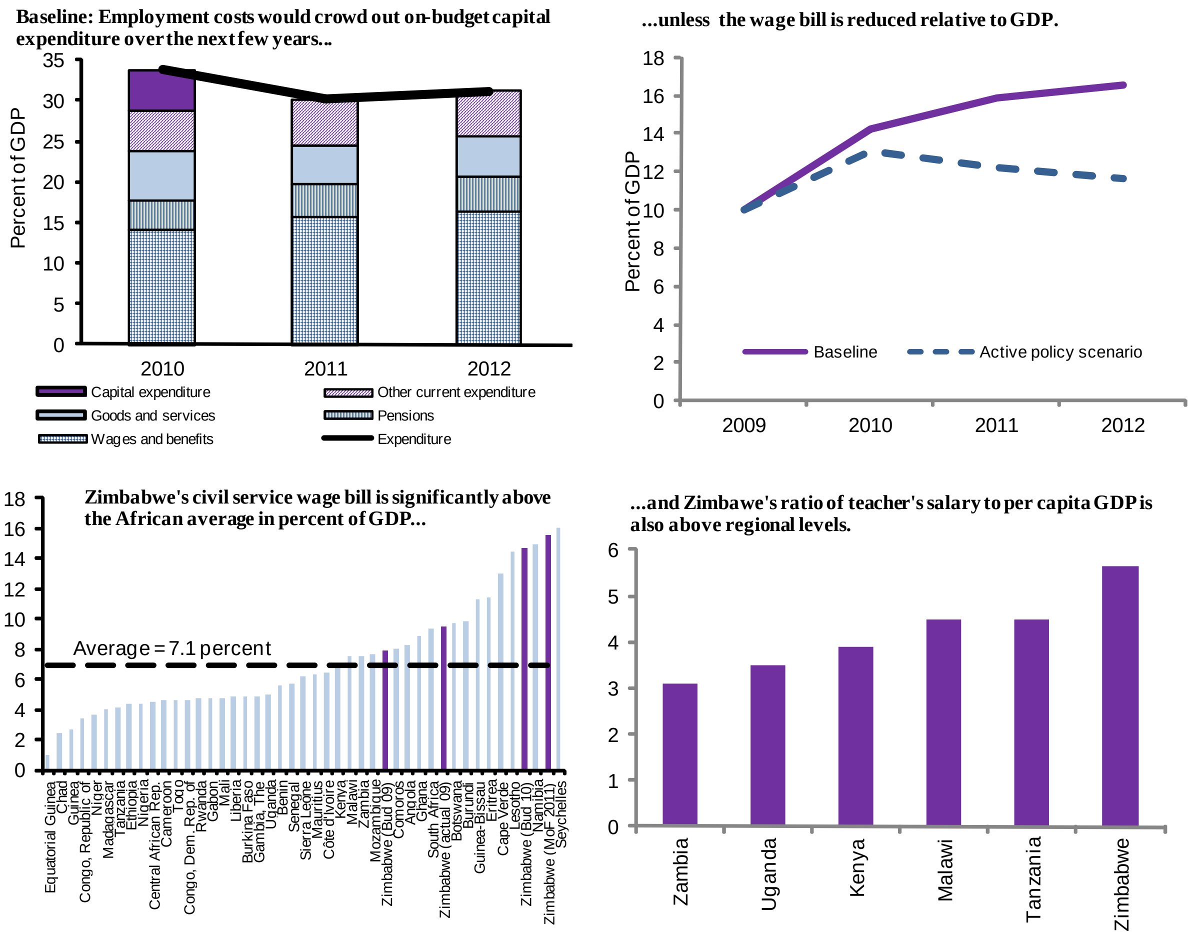
9. **Counting on a significant increase in donor financing and budget revenue, the approved 2010 budget ramped up both wages and capital expenditures.** However, large donor financing of capital expenditures is unlikely. Staff also project a revenue shortfall of about $100 million (2 percent of GDP), despite implementation of many Fund TA recommendations in tax policy and administration, because of the projected deterioration in the outlook for 2010. As a result, large employment costs, including wages, benefits, and pensions (68 percent of budget revenue), would crowd out a sizeable share of planned capital expenditures. Staff also project a cash budget deficit of about $235 million (4.5 percent of GDP) largely financed by drawing down part of Zimbabwe's SDR holdings ($210 million).[1] Further accumulation of expenditure arrears is also highly likely.

10. **The recent increase in the wage bill has significant adverse macroeconomic implications.** Although the government would be able to improve living standards and morale of 230,000 civil servants, many urgent infrastructure projects critical for economic recovery and poverty reduction would remain under-financed in 2010. Moreover, large government wage increases have had a signaling impact on private sector wages and a direct impact on nontradable prices, in particular rents. These factors, in turn, have increased pressures on private sector employers, local governments, and SOEs to grant higher wages, which some of them have not been able to afford in recent months owing to low productivity.

[1] Contrary to staff advice to refrain from using nonconcessional SDR-related funds because of Zimbabwe's low-income status, debt distress, and paucity of international reserves, the authorities have converted an equivalent of $150 million from the country's SDR holdings under the 2009 general SDR allocation ($410 million) and have started to use these resources for budget financing. An additional conversion of an equivalent of $60 million is authorized under the budget.

11. **The medium-term fiscal position is clearly unsustainable.** The government's medium-term budget estimates contain overly optimistic assumptions on revenue and donor financing, inflating expectations about possible expenditure levels, including wages. In the illustrative unchanged policy scenario, based on the staff's lower revenue and grant forecast for 2011–15, the targeted increase in employment costs to $1.1 billion (20 percent of GDP and 74 percent of revenues) in 2011 would largely crowd out budgeted capital expenditures and compress budgeted nonwage current expenses (Figure 5), leading to accumulation of large expenditure arrears and increasing the risk of use of the remaining SDR allocation ($200 million projected at end-2010) which is assumed to be saved in the budget.

Figure 5. Zimbabwe: Employment Costs



Sources: Zimbabwe authorities; IMF staff estimates; and World Economic Outlook (October 2009).

Staff recommendations

12. **The government needs to return to cash budgeting[2] from the second quarter of 2010 to maintain external and domestic stability and preserve the remaining reserve cushion** (about $250 million or 2 months of expenditures as of end-February 2010). To this end, cash expenditures would need to be curtailed by about 3 percent of GDP compared with the approved budget. It would be preferable to reduce the wage bill by about 1 percent of GDP, including through the elimination of ghost workers based on the recently completed payroll audit and a reduction in the number of contractual employees, with the rest of adjustment coming from low-priority capital (e.g., cars, furniture, acquisition of buildings, lending to banks) and current (e.g., travel) spending. However, sufficient resources would need to be allocated to urgent infrastructure maintenance expenses, noncompressible current overhead expenses, and elimination of expenditure arrears ($41 million at end-February). The government could also seek additional donor support for socially important projects to reduce the risk of deterioration in the humanitarian situation.

Text Table 2. Zimbabwe: Staff Evaluation of Central Government Operations on Unchanged Policies, 2010-2011

	2009	2010			2011
	Est.	Budget	Active Policy Scenario	Unchanged Policies 1/	Unchanged Policies
	(millions of U.S. dollars)				
Cash revenues	**975**	**1,440**	**1,360**	**1,345**	**1,469**
Cash expenditures 2/	**920**	**1,650**	**1,508**	**1,577**	**1,475**
Of which: Employment costs	517	919	852	913	1,080
Cash balance	55	-210	-148	-233	-5
Cash financing	-55	210	148	233	5
Bank	-106	52	50	75	5
Change in SDR holdings	50	158	99	158	0
Memorandum items:					
Change in domestic payment arrears	48	0	-48	0	25
Stock of domestic payment arrears	48	0	0	48	73
	(percent of GDP)				
Cash revenues	**22.2**	**28.0**	**26.6**	**26.1**	**26.8**
Cash expenditures 2/	**20.9**	**32.1**	**29.5**	**30.7**	**26.9**
Of which: Employment costs	11.8	17.9	16.7	17.8	19.7
Cash balance	1.2	-4.1	-2.9	-4.5	-0.1
Cash financing	**-1.3**	**4.1**	**2.9**	**4.5**	**0.1**
Bank	-2.4	1.0	1.0	1.5	0.1
Change in SDR holdings	1.2	3.1	1.9	3.1	0.0
Memorandum items:					
Change in domestic payment arrears	1.1	0.0	-0.9	0.0	0.5
Stock of domestic payment arrears	1.1	0.0	0.0	0.9	1.3

Sources: Zimbabwean authorities; IMF staff estimates and projections.

1/ Assuming about 60 percent implementation rate for capital expenditures relative to the budget.

2/ Excluding off-budget donor-financed expenditures.

[2] Cash budgeting is defined as matching non-interest expenditures to cash revenues and grants.

13. **In 2010, budget vulnerabilities could be reduced** by (i) adopting a contingency plan for expenditure reductions in case of revenue shortfalls; and (ii) sustaining the public sector reform momentum with World Bank TA (e.g., strengthening the financial position and management of SOEs and public financial management (PFM) systems). The government also needs to review pricing and billing practices and costs in major utilities to ensure cost-effective service delivery. These efforts would help address concerns about the high cost of living.

Text Table 3. Zimbabwe: Possible Revenue Measures, 2011-2015 (percent of GDP)

Revenue measures	**1.9**
Reform tariff structure	0.7
Corporate income tax	0.2
Income tax	0.6
Domestic VAT collection	0.5
VAT collected on imports	0.3

Source: IMF staff estimates.

14. **In the medium term, re-orienting expenditures toward investment and social programs with World Bank advice would help support growth and poverty reduction.**[3] Additional fiscal space needs to be created by (i) mobilizing additional revenues with further Fund TA (1.5–2.0 percent of GDP); and (ii) limiting employment costs to 15.5 percent of GDP in 2011 and further to 13 percent of GDP in 2015 through further downsizing and wage increases below nominal GDP growth for most grades. It would also be prudent to maintain fiscal reserves at about 2 months of expenditures in light of significant risks facing the economy.

Authorities' views

15. The authorities agreed that the fiscal deficit should be reduced in 2010 in order to restrain unsustainable domestic demand growth and save the remaining SDR holdings ($250 million) as part of fiscal reserves. The government will seek to refrain from additional withdrawals of SDR holdings in 2010, but officials indicated that unexpected expenditure pressures could arise (e.g., food shortages) making the achievement of this objective difficult.

16. Regarding revenues, the authorities shared staff concerns about possible revenue shortfalls in 2010. The government will seek to mobilize additional revenues from exports of diamonds. However, the authorities acknowledged that ensuring compliance with the Kimberley process may take time, thereby delaying inflows of revenues from this source. Some officials were also optimistic that the active policy scenario would materialize, and therefore higher revenue could be mobilized compared to the unchanged policy scenario.

17. Regarding expenditures in 2010, the authorities indicated that the burden of adjustment would most likely fall on nonwage expenditures. Under significant political pressure from civil service labor unions and security forces, the government had to offer sufficiently large wage increases in 2010 to ensure social peace and delivery of essential services in the education sector. Nevertheless, the government intends to eliminate ghost

[3] See DP/10/03, Chapter 4 "Creating Fiscal Space for Growth and Development in Zimbabwe."

workers to be identified during the on-going civil service payroll audit, which could bring some savings already in 2010. With respect to nonwage expenditures, the authorities recognized political difficulties in reducing low-priority expenditures, including foreign travel, purchases of cars, furniture, and the acquisition of buildings. The authorities, however, argued that they would be able to contain nonwage current expenditures by planning monthly cash flow carefully to avoid accumulating new expenditure arrears during the year.

18. The authorities recognized that the key medium-term challenge is to reduce the wage bill relative to revenue in order to leave sufficient fiscal space for growth- and socially-oriented spending. They stated that the wage bill projections included in the medium-term budget framework did not represent firm commitments nor did they reflect possible wage bill-reduction measures (e.g., a further downsizing after elimination of ghost workers) for which the government intends to build broad public support. The authorities were also more optimistic on prospects for budget revenues than staff. As a result, they expected to reduce the wage bill-to-revenue ratio quickly without large reductions in the wage bill-to-GDP ratio. In addition, the government has set up high-level committees to formulate recommendations to reduce the cost of living, including a rationalization of utility tariffs and better management of public utilities. Containing increases in the cost of living would strengthen the government's bargaining position with labor unions.

B. Safeguarding Financial Sector Stability in the Multi-Currency Regime

Background

19. **With the adoption of the multi-currency system, banking deposits tripled and lending increased six-fold between March and December 2009.** This rapid balance sheet expansion, which was in part driven by moral suasion on banks to lend to agriculture, supported economic activity but also contributed to a significant increase in the current account deficit in 2009 and rising banking system vulnerabilities. While officially reported aggregate banking soundness indicators do not raise major red flags (Table 6), they mask vulnerabilities specific to a fully dollarized banking system experiencing rapid credit growth, as well as a significant variation in prudential indicators across individual banks.

20. **The banking system is facing increasing risks in a number of areas (Table 7).** *Counterparty and credit risk is medium to high* due to a significant exposure to the financially distressed RBZ (about 70 percent of banks' capital), the drought-prone agricultural sector (20 percent of the loan portfolios), and the exuberant credit growth. The projected economic slowdown would lead to a significant increase in nonperforming loans. *Liquidity risk is high*, as structural liquidity pressures could arise due to the deteriorating balance of payments position potentially causing a reduction in banks' foreign assets. The banking system is also ill-equipped to deal with temporary liquidity shocks with no lender of last resort, the unavailability of the statutory reserves deposited at the RBZ (see below), virtually no interbank lending, and a level of country risk that precludes liquidity support

from abroad. In this regard, it is of concern that credit expansion is taking place at the expense of prudent liquidity management at some large banks, especially those whose liquidity ratios were below the prudent level of 25 percent at end-December 2009. *Solvency risk is high* as a possible compounding of the liquidity and credit risks, as well as the banking system's difficulties in generating positive incomes, could lead to a rapid erosion of capital.

21. **Serious governance problems remain at the RBZ whose balance sheet has continued to deteriorate.** The RBZ's governing board is not operating, the RBZ did not have an approved budget in 2009, external auditors reported serious weaknesses in internal controls and financial reporting, and comprehensive monetary statistics have not been published since early 2008. Without appropriate oversight, the RBZ used the international reserves backing the statutory reserves of banks ($80 million)[4] and sold shares from its portfolio of securities at the Zimbabwe Stock Exchange ($38 million) to finance its activities during January 2009–March 2010, including operating expenses, quasi-fiscal activities, and repayments of debt to selected creditors. Parliament passed amendments to the RBZ Act, envisaging stronger accountability requirements. However, these amendments do not reflect a number of Fund TA recommendations, including the appointment of a nonexecutive chairman of the supervisory Board, greater central bank operational independence, transitional provisions relevant for the multi-currency system, or the prohibition of government financing.

22. **The government considers the multi-currency regime a temporary arrangement that will be maintained during 2010–12, while a debate on various medium-term options for alternative currency regimes is continuing within the government.** The authorities are revising exchange controls regulations to increase their transparency and are considering options for resolving the issue of small change and the poor quality of banknotes.

Staff recommendations

23. **Stepping up supervisory efforts would help ensure that the banking system can withstand the projected deterioration in the balance of payments position and a possible intensification of credit risk.** Implementing a liquidity requirement of 25 to 30 percent, which should be elevated for banks with weak liquidity management practices, would help contain liquidity risk. The liquidity requirement should exclude, but not extinguish, any claims on the RBZ, until the resolution of the RBZ's negative equity position (see below). In addition, efforts to identify banks with weak underwriting skills should be intensified and remedial actions monitored. Moral suasion on banks to lend to specific

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[4] The statutory reserve requirement of 10 percent of deposits, excluding government's and SOEs' deposits, was implemented on February 1, 2009. From February 1, 2010, the end-January 2010 stock of deposits is still subject to the 10 percent requirement, while any increase in the stock of deposits is subject to a 2.5 percent requirement.

sectors needs to be discontinued and there should not be a perception of possible regulatory forbearance in case banks implement government-prioritized lending.

24. **The existing resolution framework should be applied to ensure an orderly exit of non-viable banks.** In this regard, using public funds to bail out insolvent banks is not an option given the unavailability of sufficient funds to deal with a systemic problem. Crisis management and contingency planning also need to be strengthened.

25. **Reducing banks' exposure to the financially distressed RBZ would help mitigate risks facing the banking system.** Specifically, a dedicated RBZ's *nostro* account backing banks' deposits to the Real Time Gross Settlement (RTGS) account should be established and its balance published daily. The existing 2.5 percent statutory reserve requirement on new deposits should be abolished. Following disposal of the RBZ's noncore assets under appropriate governing board supervision, the mobilized resources could be used to refund banks' statutory reserves on pre-March 2010 deposits. The resolution of the remaining banks' claims on the RBZ would need to be undertaken as part of the overall resolution framework for the RBZ's liabilities (see below).

26. **Establishing effective oversight over the RBZ would strengthen the credibility of the multi-currency system.** Key measures include (i) appointment of an RBZ governing board; (ii) approval of a downsized, fully funded RBZ budget; (iii) bifurcation of the RBZ balance sheet to isolate noncore assets and liabilities from those that are essential for performing RBZ core functions; and (iv) adoption of a resolution framework for overdue liabilities and transparent disposal of noncore assets. The Fund could provide TA in these areas after an effective RBZ governing board is appointed.

27. **The multi-currency regime could continue to serve Zimbabwe well during 2010–12, while further improvements could be made to its functioning**. Specifically, the on-going work on new exchange control regulations is welcome and further advice will be provided to ensure that new regulations improve existing regulations in the areas of transparency of authorization procedures and internal consistency. Moreover, the supply of coins could be improved with assistance from South Africa. However, minting local coins would be counterproductive until RBZ governance issues are fully resolved and its financial position is strengthened.

28. **Options for a future currency regime include full official dollarization with the U.S. dollar or the rand, accession to the rand Common Monetary Area, and in the longer term, a currency board arrangement or intermediate regimes.** The Zimbabwe dollar can be reintroduced as sole legal tender only once a track record of sound policies is

established and a credible central bank governance framework focused on price stability is adopted and enacted.[5]

Authorities' views

29. The authorities broadly agreed with the staff assessment of the risks facing the banking system. They also indicated that they would implement a liquid asset requirement of 25 percent and ring-fence the RTGS account at the RBZ in the near future. The RBZ would also consider abolishing the 2.5 percent statutory reserve requirement once sufficient resources have been mobilized from the disposal of its noncore assets.

30. The authorities attached the highest importance to a speedy resolution of governance problems at the RBZ. They were confident that an RBZ governing Board would be appointed soon and it would quickly take appropriate actions to address governance weaknesses. The authorities also agreed that the RBZ should be downsized and its balance sheet bifurcated under RBZ Board supervision, and they requested Fund TA in these areas.

31. The authorities are committed to maintaining the multi-currency system until end-2012. They also indicated that beyond 2012 options involving some form of official dollarization, including a possibility of a closer monetary cooperation with neighboring countries, would be more realistic, as many pre-conditions for the re-introduction of the Zimbabwe dollar outlined by the staff were not likely to be in place by 2012. The authorities would narrow the list of possible options in the second half of 2010 and request further Fund TA on these issues.

C. Moving toward External Stability and Sustainable Growth

Background

32. **The external position is clearly unsustainable, with external debt projected at 151 percent of GDP by 2015, with 104 percent of GDP in arrears (Supplement).** The economy performs poorly in terms of competitiveness whether it is measured by governance, investment climate, the quality of infrastructure, or price/wage indicators.[6] Even if the authorities implemented the staff policy recommendations, the debt-overhang cannot be resolved without debt relief (see the active policy medium-term scenario).

33. **There is a debate in Zimbabwe on whether the country's mineral wealth can be used to resolve external debt arrears.** Staff estimate that at end-2009, Zimbabwe's net foreign asset (NFA) position, including the net present value of future mineral receipts under

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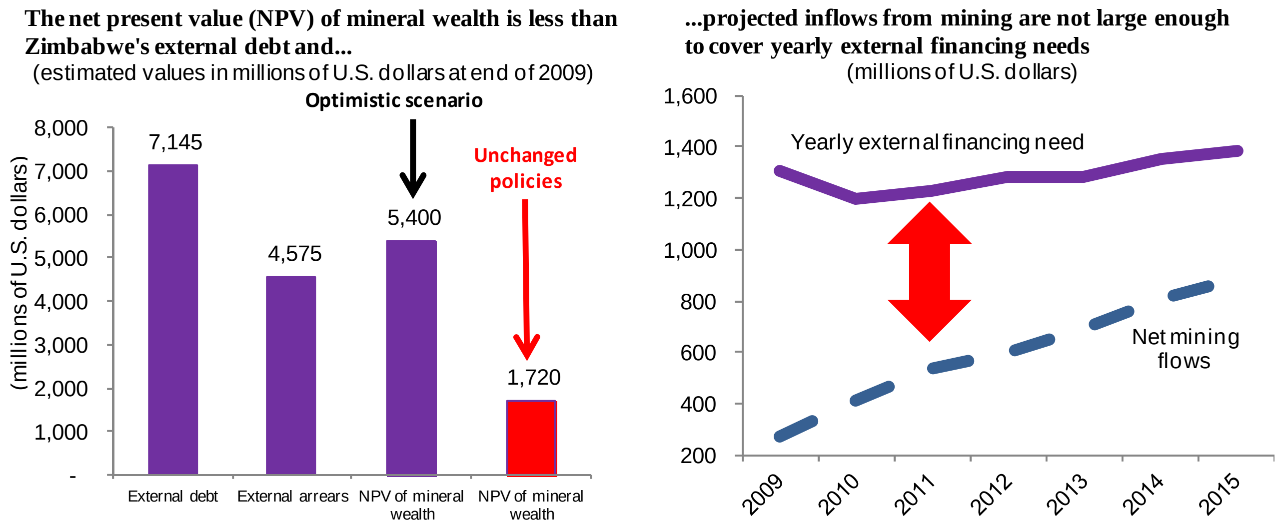
[5] See DP/10/03, Chapter 2 "Choosing a Monetary Regime."

[6] See DP/10/03, Chapter 3 "Assessing Competitiveness and External Sustainability in Zimbabwe."

an optimistic scenario for the extraction of high-value minerals, is significantly negative, in the order of 63 percent of GDP (Figure 6). Just maintaining this high level of the negative NFA would require generating nonmineral primary external current account surpluses whereas this balance now stands in deficit at over 35 percent of GDP. Closing such a large gap without debt relief is not feasible in the foreseeable future, even if the challenges with competitiveness and the business climate are addressed without further delays.

Figure 6. Zimbabwe: Mineral Wealth



Note: Yearly external financing need: Financing gap (balance of payment deficit excluding gold and platinum) plus change in arrears; Net mining flows: Net value of gold and platinum production available for exports.
Sources: Zimbabwe authorities and IMF staff estimates.

Staff recommendations

34. To support economic growth and exports, the government would need to forge political consensus on key structural reforms:

- The regulations under the Indigenization and Economic Empowerment Act need to be reviewed to ensure that empowerment of the indigenous population does not conflict with the government's other objectives of attracting foreign direct investment and ensuring equitable and transparent distribution of wealth.

- A resolution of land ownership issues needs to be expedited to ensure security of land tenure and enable the agricultural sector to undertake long-term investment.

- Measures need to be taken to increase labor market flexibility, including with regard to wage levels, which is essential for sustainability of the multi-currency system.

35. Sound policies and debt relief in the context of a comprehensive arrears clearance strategy (FO/DIS/09/100) agreed on among the government coalition partners and with official creditors would help achieve external and growth sustainability, as well as increase benefits associated with mineral wealth provided it is managed transparently.

36. **A Staff Monitored Program (SMP) would be a stepping stone toward debt relief and new IFI lending.** To make progress toward an SMP, economic policies need to be strengthened, in particular in the areas of RBZ governance, reporting and financial management, and public sector wages, while donors' indications of support for an eventual Fund financial arrangement (which itself requires, among other things, that arrears to official creditors, including $1.4 billion to IFIs, are cleared or programmed to be cleared) would also need to be secured.

Authorities' views

37. The authorities agreed that the country was in debt distress. Following intense debate within the government on possible use of mineral wealth to resolve external debt arrears, consensus is emerging among key government officials that mineral wealth alone would not be sufficient to achieve debt sustainability. As a result, the government is working on a comprehensive "hybrid" strategy involving both a request for debt relief under the HIPC Initiative to resolve external payments arrears and use of fresh IFI financing and mineral wealth to achieve sustainable development. The authorities also expressed strong interest in an SMP. In this regard, they will seek to strengthen policies and data reporting, as well as improve relations with the international community. The authorities agreed that making timely quarterly payments to the Fund and increasing them over time, as the payment capacity improves, will strengthen the credibility of their commitment to normalizing relations with the Fund.

38. The authorities acknowledged significant structural issues hampering competitiveness and growth. Government officials are debating in the Cabinet possible revisions to *indigenization regulations* to provide sufficient assurances to current and potential investors. Pending this debate, the regulations were suspended on April 13, 2010. Regarding *land ownership*, the authorities plan to undertake, in the coming months, a land audit as the first step toward finding a solution for security of land tenure. The government also intends to review *wage setting practic*es in SOEs and municipalities to stop the accumulation of wage arrears and help align wages with productivity. In addition, the authorities intend to examine *labor legislation* to identify steps that need to be undertaken to ensure that companies are not forced to award wages incompatible with productivity by arbitration courts.

V. Conclusion

39. **The government urgently needs to forge political consensus for addressing significant policy challenges to support the fragile economic recovery.** Key staff recomendations include (i) returning to cash budgeting and reducing the wage bill; (ii) containing rapidly rising risks to the banking system through a reduction of banks'

exposure to the financially distress RBZ and stepped up prudential measures;
(iii) strengthening RBZ governance and downsizing it; and (iv) implementing key structural measures, including with respect to enforcement of property rights, security of land tenure, and wage flexibility. Although reaching consensus on the recommended measures is a major political challenge, speedy implementation of the recommendations is essential for reducing significant macrofinancial vulnerabilities and avoiding higher costs of a forced delayed adjustment.

Table 1. Zimbabwe: Selected Economic Indicators, 2008–15 (Baseline)

	Estimated		Projected					
	2008	2009	2010	2011	2012	2013	2014	2015
Real GDP growth (annual percent change) 1/	-14.5	4.0	2.2	0.0	1.0	1.8	2.0	2.0
Nominal GDP (US$ millions)	3,929	4,397	5,144	5,488	5,845	6,159	6,517	6,892
GDP deflator (annual percent change) 1/	-1.3	7.6	14.4	6.6	5.5	3.5	3.8	3.7
Inflation (annual percent change)								
Consumer price inflation (annual average) 2/	5.56E+10	6.5	5.0	5.0	5.0	5.0	5.0	5.0
Central government (percent of GDP, measured in US$)								
Revenue and grants	3.4	22.2	26.1	26.8	26.4	26.3	26.3	26.3
Expenditure and net lending	6.5	25.0	33.7	30.4	31.7	32.0	32.0	32.0
Of which: cash expenditure and net lending	3.1	20.9	30.7	26.9	26.4	26.3	26.3	26.3
Of which: wages and benefits	1.3	9.5	14.1	15.7	16.8	16.7	16.7	16.8
Overall balance (including quasi-fiscal activity)	-32.1	-3.3	-7.6	-3.6	-5.3	-5.7	-5.7	-5.7
Primary balance (including quasi-fiscal activity)	-28.5	0.1	-4.4	-0.4	-2.0	-2.5	-2.5	-2.5
Cash balance	0.3	1.2	-4.5	-0.1	0.0	0.0	0.0	0.0
Money and credit (US$ millions) 3/								
Broad money (M3)	314	1,276	1,511	…	…	…	…	…
Net foreign assets	-314	-256	-647	…	…	…	…	…
Net domestic assets	628	1,531	2,158	…	…	…	…	…
Domestic credit	140	602	1,048	…	…	…	…	…
Of which: credit to the private sector	140	684	1,055	…	…	…	…	…
Reserve money	7	125	145	…	…	…	…	…
Velocity (M3)	12.5	3.4	3.4	…	…	…	…	…
External trade (US$ millions; annual percent change)								
Merchandise exports	-9.3	-0.5	28.2	-1.7	1.4	2.5	1.5	-0.3
Merchandise imports	24.4	22.9	7.7	-13.2	1.7	1.9	2.6	-0.3
Balance of payments (US$ millions; unless otherwise indicated)								
Merchandise exports	1,633	1,625	2,083	2,048	2,076	2,128	2,160	2,154
Merchandise imports	-2,630	-3,232	-3,480	-3,020	-3,070	-3,129	-3,211	-3,201
Current account balance (excluding official transfers)	-945	-1,323	-1,183	-724	-795	-839	-885	-915
(percent of GDP)	-24.0	-30.1	-23.0	-13.2	-13.6	-13.6	-13.6	-13.3
Overall balance	-624	29	-725	-463	-445	-360	-371	-381
Official reserves 4/								
Gross official reserves (US$ millions;end-of-period)	6	312	114	114	114	115	115	115
Gross official reserves (months of imports of goods and services)	0.0	1.0	0.3	0.4	0.4	0.4	0.4	0.4
Debt								
Total external debt (US$ millions; end-of-period) 5/	5,794	7,145	7,662	8,140	8,709	9,268	9,838	10,430
(percent of GDP)	147.5	162.5	149.0	148.3	149.0	150.5	150.9	151.3
Total external arrears 5/	3,781	4,575	5,132	5,603	6,056	6,423	6,803	7,194
(percent of GDP)	96.2	104.0	99.8	102.1	103.6	104.3	104.4	104.4

Sources: Zimbabwean authorities; IMF staff estimates and projections.

1/ In constant 2009 prices.
2/ For 2008, annual average January–September 2008.
3/ Zimbabwe dollar values converted into U.S. dollars at the UN exchange rate at end-2008.
4/ Gross official reserves as reported by the authorities are adjusted for encumbered deposits, securities, banks' current accounts/RTGS, and required statutory reserves.
5/ Includes arrears and amounts for unidentified financing.

Table 2. Zimbabwe: Balance of Payments, 2008-15 (Baseline)

(millions of U.S. dollars, unless otherwise indicated)

	Estimated		Projected					
	2008	2009	2010	2011	2012	2013	2014	2015
Current account (excluding official transfers)	-945	-1,323	-1,183	-724	-795	-839	-885	-915
Trade balance	-997	-1,607	-1,397	-972	-994	-1,001	-1,051	-1,047
Exports, f.o.b.	1,633	1,625	2,083	2,048	2,076	2,128	2,160	2,154
Imports, f.o.b.	-2,630	-3,232	-3,480	-3,020	-3,070	-3,129	-3,211	-3,201
Nonfactor services (net)	-206	-32	-18	30	0	-20	-25	-46
Investment income (net)	-368	-387	-431	-489	-523	-553	-588	-614
Interest	-255	-303	-339	-394	-424	-452	-486	-516
Receipts	2	2	3	2	2	2	2	2
Payments	-258	-306	-341	-396	-427	-454	-489	-518
Other	-112	-84	-93	-95	-98	-101	-102	-99
Private transfers (including transfers to NGOs)	625	703	662	707	721	735	779	793
Capital account (including official transfers)	134	1,146	459	261	351	479	515	534
Official transfers	73	156	200	200	200	200	200	200
Direct investment	44	105	105	50	50	50	50	50
Portfolio investment	0	250	0	0	0	0	0	0
Long-term capital	-174	-179	-237	-192	-158	-58	-54	-49
Government [1]	-227	-140	-163	-150	-128	-37	-33	-33
Receipt	12	2	0	0	0	0	0	0
Payment	-238	-141	-163	-150	-128	-37	-33	-33
Public enterprises	57	-41	-44	-42	-30	-21	-21	-16
Private sector	-5	2	-31	0	0	0	0	0
Short-term capital	192	295	391	203	258	287	319	333
Public sector	0	0	0	0	0	0	0	0
Private sector (loans mediated outside DMBs)	…	190	200	200	250	250	250	250
Cash in circulation (non-banks, -, increase)	…	272	-50	-51	-35	-34	-33	-31
Other short-term capital	…	121	11	80	80	125	125	125
Change in NFA of DMBs	192	-288	230	-26	-37	-34	-38	-41
Change in assets	192	-345	230	-26	-37	-34	-38	-41
Change in liabilities	-179	57	0	0	0	0	0	0
SDR Department	0	519	0	0	0	0	0	0
Change in liabilities	0	519	0	0	0	0	0	0
Errors and omissions	187	206	0	0	0	0	0	0
Overall balance	-624	29	-725	-463	-445	-360	-371	-381
Financing	624	-29	725	463	445	360	371	381
IMF (net)	0	0	0	0	0	0	0	0
Central bank (net)	51	-876	167	-8	-8	-8	-9	-10
Assets	52	-479	167	-8	-9	-8	-9	-10
Change in gross official reserves	52	-300	189	0	0	0	0	0
of which: change in SDR holdings	0	-355	158	0	0	0	0	0
Monetary authorities operations (non reserve)	0	-178	-22	-8	-9	-8	-9	-10
Liabilities	305	-397	0	1	0	0	0	0
Change in arrears (–, decrease)	464	794	557	471	453	368	380	391
Debt relief/rescheduling	109	53	0	0	0	0	0	0
Financing gap (ch. in arrears + unidentified financing)	0	794	558	471	453	368	380	391
Memorandum items:								
Current account balance (pct. of GDP)	-24.0	-30.1	-23.0	-13.2	-13.6	-13.6	-13.6	-13.3
Gross official reserves (US$ millions, e.o.p.)	5.7	312.0	114.1	114.2	114.4	114.6	114.7	114.8
Months of imports of goods and services	0.0	1.0	0.3	0.4	0.4	0.4	0.4	0.4
SDR holdings (US$ millions, e.o.p.)	0	361	194	194	194	194	194	195
External debt (US$ millions, e.o.p.) [2]	5,794	7,145	7,662	8,140	8,709	9,268	9,838	10,430
Percent of GDP	147	162	149	148	149	150	151	151
External arrears (US$ millions, e.o.p.)	3,781	4,575	5,132	5,603	6,056	6,423	6,803	7,194
Percent of GDP	96	104	100	102	104	104	104	104
Nominal GDP (US$ millions)	3,929	4,397	5,144	5,488	5,845	6,159	6,517	6,892
Percentage change	-15.6	11.9	17.0	6.7	6.5	5.4	5.8	5.7
Exports of goods and services	1,801	2,039	2,510	2,468	2,474	2,513	2,551	2,521
Percentage change	-9.9	13.2	23.1	-1.7	0.2	1.6	1.5	-1.1
Imports of goods and services	-3,004	-3,678	-3,925	-3,410	-3,468	-3,534	-3,626	-3,614
Percentage change	22.4	22.5	6.7	-13.1	1.7	1.9	2.6	-0.3

Sources: Zimbabwean authorities; 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 arrears and amounts for unidentified financing.

Table 3. Zimbabwe: Central Government Operations, 2008-15 (Baseline)
(millions of U.S. dollars)

	Estimated		Projected					
	2008	2009	2010	2011	2012	2013	2014	2015
Total revenue & grants	**133**	**975**	**1,345**	**1,469**	**1,546**	**1,617**	**1,715**	**1,816**
Tax revenue	128	883	1,279	1,366	1,436	1,502	1,592	1,686
Personal income tax	22	156	186	232	247	260	275	291
Corporate income tax	18	44	67	71	76	80	85	90
Other direct taxes	3	21	34	55	64	68	72	76
Customs	45	212	247	210	215	218	231	234
Excise	6	68	215	227	223	241	256	283
VAT	32	367	509	544	582	604	641	678
Other indirect taxes	2	14	21	27	29	31	33	34
Non-tax tevenue	5	51	64	68	73	77	81	86
Budget grants	0	41	1	35	37	39	42	44
Off-budget grants	0	351	565	565	565	565	565	565
Total expenditure & net lending	**257**	**1,098**	**1,734**	**1,670**	**1,855**	**1,971**	**2,085**	**2,209**
Of which: Cash expenditure	*120*	*920*	*1,577*	*1,475*	*1,546*	*1,618*	*1,715*	*1,816*
Current expenditure	240	1,052	1,483	1,670	1,855	1,971	2,085	2,209
Employment costs	59	517	913	1,080	1,237	1,294	1,372	1,452
Wages & salaries	52	419	670	797	912	955	1,012	1,071
Pensions	7	98	188	221	253	264	280	297
Benefits	0	0	55	63	72	75	80	84
Interest payments	138	150	162	178	190	196	206	220
Foreign	137	147	162	178	190	196	206	220
Of which: Paid	0	16	5	8	9	9	9	9
Domestic	1	3	0	0	0	0	0	0
Of which: Paid	1	3	0	0	0	0	0	0
Goods & services	32	261	308	285	291	306	326	345
Grants & transfers	11	123	100	127	137	175	181	192
Capital expenditure	14	45	240	0	0	0	0	0
Net lending	3	1	11	0	0	0	0	0
Off-budget expenditure	0	351	565	565	565	565	565	565
Overall balance	**-124**	**-123**	**-389**	**-200**	**-309**	**-353**	**-370**	**-393**
Primary balance	14	27	-228	-22	-119	-157	-164	-173
Cash balance	13	55	-233	-5	0	0	0	0
QFA by RBZ 1/	1,135	23	0	0	0	0	0	0
Overall balance (incl. QFA by RBZ)	**-1,259**	**-146**	**-389**	**-200**	**-309**	**-353**	**-370**	**-393**
Financing	**133**	**123**	**389**	**200**	**309**	**353**	**370**	**393**
Domestic financing (net)	0	-106	75	5	0	0	0	0
Bank	0	-106	75	5	0	0	0	0
Non-bank	0	0	0	0	0	0	0	0
Foreign financing (net)	-226	-90	-4	-150	-128	-37	-33	-33
Change in arrears	360	319	319	345	437	390	403	426
Domestic	0	48	0	25	127	165	172	182
Interest	0	0	0	0	0	0	0	0
Principal	0	0	0	0	0	0	0	0
Expenditure	0	48	0	25	127	165	172	182
Foreign	360	271	319	320	310	225	231	244
Interest	137	130	157	170	182	188	198	211
Principal	223	141	163	150	128	37	33	33
Financing gap	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Total government debt	**3,570**	**4,111**	**4,270**	**4,456**	**4,753**	**5,097**	**5,456**	**5,838**
Domestic government debt 2/	0	468	468	493	620	785	957	1,139
External government debt	3,570	3,644	3,803	3,963	4,133	4,312	4,499	4,699

Sources: Zimbabwean authorities; and IMF staff estimates and projections.
1/ Subsidies provided by the RBZ to the public sector and producers/exporters.
2/ Including estimates of residents' claims on the RBZ.

Table 3 (continued). Zimbabwe: Central Government Operations, 2008-15 (Baseline)
(percent of GDP)

	Estimated		Projected					
	2008	2009	2010	2011	2012	2013	2014	2015
Total revenue & grants	**3.4**	**22.2**	**26.1**	**26.8**	**26.4**	**26.3**	**26.3**	**26.3**
Tax revenue	3.3	20.1	24.9	24.9	24.6	24.4	24.4	24.5
Personal income tax	0.6	3.5	3.6	4.2	4.2	4.2	4.2	4.2
Corporate income tax	0.5	1.0	1.3	1.3	1.3	1.3	1.3	1.3
Other direct taxes	0.1	0.5	0.7	1.0	1.1	1.1	1.1	1.1
Customs	1.1	4.8	4.8	3.8	3.7	3.5	3.6	3.4
Excise	0.2	1.5	4.2	4.1	3.8	3.9	3.9	4.1
VAT	0.8	8.4	9.9	9.9	10.0	9.8	9.8	9.8
Other indirect taxes	0.1	0.3	0.4	0.5	0.5	0.5	0.5	0.5
Non-tax tevenue	0.1	1.2	1.2	1.2	1.2	1.2	1.2	1.2
Budget grants	0.0	0.9	0.0	0.6	0.6	0.6	0.6	0.6
Off-budget grants	0.0	8.0	11.0	10.3	9.7	9.2	8.7	8.2
Total expenditure & net lending	**6.5**	**25.0**	**33.7**	**30.4**	**31.7**	**32.0**	**32.0**	**32.0**
Of which: Cash expenditure	3.1	20.9	30.7	26.9	26.4	26.3	26.3	26.3
Current expenditure	6.1	23.9	28.8	30.4	31.7	32.0	32.0	32.0
Employment costs	1.5	11.8	17.8	19.7	21.2	21.0	21.1	21.1
Wages & salaries	1.3	9.5	13.0	14.5	15.6	15.5	15.5	15.5
Pensions	0.2	2.2	3.7	4.0	4.3	4.3	4.3	4.3
Benefits	0.0	0.0	1.1	1.1	1.2	1.2	1.2	1.2
Interest payments	3.5	3.4	3.1	3.2	3.3	3.2	3.2	3.2
Foreign	3.5	3.3	3.1	3.2	3.3	3.2	3.2	3.2
Of which: Paid	0.0	0.4	0.1	0.2	0.1	0.1	0.1	0.1
Domestic	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Of which: Paid	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Goods & services	0.8	5.9	6.0	5.2	5.0	5.0	5.0	5.0
Grants & transfers	0.3	2.8	1.9	2.3	2.3	2.8	2.8	2.8
Capital expenditure	0.4	1.0	4.7	0.0	0.0	0.0	0.0	0.0
Net lending	0.1	0.0	0.2	0.0	0.0	0.0	0.0	0.0
Off budget expenditure	0.0	8.0	11.0	10.3	9.7	9.2	8.7	8.2
Overall balance	**-3.2**	**-2.8**	**-7.6**	**-3.6**	**-5.3**	**-5.7**	**-5.7**	**-5.7**
Primary balance	0.4	0.6	-4.4	-0.4	-2.0	-2.5	-2.5	-2.5
Cash balance	0.3	1.2	-4.5	-0.1	0.0	0.0	0.0	0.0
QFA by RBZ 1/	28.9	0.5	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (incl. QFA by RBZ)	**-32.1**	**-3.3**	**-7.6**	**-3.6**	**-5.3**	**-5.7**	**-5.7**	**-5.7**
Financing	**3.4**	**2.8**	**7.6**	**3.6**	**5.3**	**5.7**	**5.7**	**5.7**
	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic financing (net)	0.0	-2.4	1.5	0.1	0.0	0.0	0.0	0.0
Bank	0.0	-2.4	1.5	0.1	0.0	0.0	0.0	0.0
Non-bank	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign financing (net)	-5.8	-2.1	-0.1	-2.7	-2.2	-0.6	-0.5	-0.5
Change in arrears	9.2	7.3	6.2	6.3	7.5	6.3	6.2	6.2
Domestic	0.0	1.1	0.0	0.5	2.2	2.7	2.6	2.6
Interest	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Principal	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure	0.0	1.1	0.0	0.5	2.2	2.7	2.6	2.6
Foreign	9.2	6.2	6.2	5.8	5.3	3.7	3.5	3.5
Interest	3.5	3.0	3.0	3.1	3.1	3.1	3.0	3.1
Principal	5.7	3.2	3.2	2.7	2.2	0.6	0.5	0.5
Financing gap	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Total government debt	**90.9**	**93.5**	**83.0**	**81.2**	**81.3**	**82.8**	**83.7**	**84.7**
Domestic government debt 2/	0.0	10.6	9.1	9.0	10.6	12.7	14.7	16.5
External government debt	90.9	82.9	73.9	72.2	70.7	70.0	69.0	68.2

Sources: Zimbabwean authorities; and IMF staff estimates and projections.
1/ Subsidies provided by the RBZ to the public sector and producers/exporters.
2/ Including estimates of residents' claims on the RBZ.

Table 4. Zimbabwe: Monetary Survey, 2008–10 (Baseline) 1/

(millions of U.S. dollars, unless otherwise indicated)

	Estimated		Projected
	Dec. 2008	Dec. 2009	Dec. 2010
Monetary authorities			
Net foreign assets	**-575**	**-805**	**-967**
Official reserve assets 2/	6	312	114
Other foreign assets	78	259	279
Short-term foreign liabilities	-588	-811	-808
Of which: Liabilities to IMF	-136	-140	-137
Other foreign liabilities	-70	-565	-552
Net domestic assets	**582**	**930**	**1,111**
Net domestic claims	-1	-1	-1
Claims on other depository corporations	0	0	0
Net claims on central government	-1	-2	-2
Claims on other sectors	0	1	1
Claims on other financial corporations	0	0	0
Claims on state and local government	0	0	0
Claims on public non-financial corporations	0	0	0
Claims on private sector	0	1	1
Other items (net)	583	931	1,113
Monetary base	**7**	**125**	**145**
Currency in circulation	0	0	0
Liabilities to other depository corporations	6	125	145
Deposit money banks and other banking institutions			
Net foreign assets	**261**	**549**	**319**
Foreign assets	…	606	376
Foreign liabilities	…	-57	-57
Net domestic assets	**53**	**726**	**1,191**
Net domestic claims	146	809	1,274
Claims on RBZ	5	205	225
Currency	0	0	0
Reserve deposits 3/	5	205	225
Net claims on central government	0	-106	-31
Claims on other sectors	140	709	1,079
Claims on public non-financial corporations	0	25	25
Claims on private sector	140	684	1,054
Other items (net)	-93	-83	-83
Liabilities to RBZ	**1**	**0**	**0**
Deposits included in broad money	**314**	**1,275**	**1,511**
Of which: In foreign currency	308	1,275	1,511
Monetary survey			
Net foreign assets	**-314**	**-256**	**-647**
Net domestic assets	**628**	**1,531**	**2,158**
Domestic claims	140	602	1,048
Net claims on central government	-1	-108	-33
Claims on other sectors	140	710	1,080
Claims on public non-financial corporations	0	25	25
Claims on private sector	140	684	1,055
Other items (net)	488	929	1,111
Broad money liabilities (M3)	**314**	**1,276**	**1,511**
Currency	0	0	0
Deposits	314	1,276	1,511
	(annual percentage change)		
Monetary Base	-87	1,731	16
Broad Money (M3)	-48	306	18
Currency	-100	…	…
Deposits	-46	306	18
Private Sector Credit	41	388	54
Memorandum Items:			
Loan-to-deposit ratio (in percent)	45	54	70
Reserves-to-deposit ratio (in percent)	2	10	10
Money multiplier (M3/monetary base)	46	10	10
Velocity (GDP/M3)	12.5	3.4	3.4

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 2008. Zimbabwe dollar values converted into U.S. dollars at the UN exchange rate at end-2008.

2/ Official reserve assets are reported net of banks' current accounts/RTGS and required statutory reserves.

3/ Including frozen residents' deposits lodged at the RBZ.

Table 5. Zimbabwe: Selected Economic Indicators, 2008–15 (Active Policy Scenario)

	Estimated		Projected					
	2008	2009	2010	2011	2012	2013	2014	2015
Real GDP growth (annual percent change) 1/	-14.5	4.0	3.3	5.0	5.0	5.0	5.0	5.0
Nominal GDP (US$ millions)	3,929	4,397	5,113	5,570	6,030	6,532	7,074	7,670
GDP deflator (annual percent change)	-1.3	7.6	12.6	3.7	3.1	3.1	3.2	3.2
Inflation (annual percent change)								
Consumer price inflation (annual average) 2/	5.56E+10	6.5	5.0	5.0	5.0	5.0	5.0	5.0
Central government (percent of GDP, measured in US$)								
Revenue and grants	3.4	22.2	26.6	27.8	28.2	28.8	28.9	28.9
Expenditure and net lending	6.5	25.0	31.6	31.2	31.4	31.3	31.3	31.5
Of which: cash expenditure and net lending	3.1	20.9	29.5	28.1	28.4	28.5	28.5	28.8
Of which: wages and benefits	1.3	9.5	13.0	12.0	11.3	10.7	10.2	9.8
Quasi-fiscal activity by RBZ	28.9	0.5	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (including quasi-fiscal activity)	-32.1	-3.3	-5.0	-3.4	-3.2	-2.5	-2.4	-2.6
Primary balance (including quasi-fiscal activity)	-28.5	0.1	-1.9	-0.2	0.0	0.5	0.6	0.4
Cash balance	0.3	1.2	-2.9	-0.4	-0.2	0.4	0.4	0.1
Money and credit (US$ millions) 3/								
Broad money (M3)	314	1,276	1,570	…	…	…	…	…
Net foreign assets	-314	-256	-449	…	…	…	…	…
Net domestic assets	628	1,531	2,019	…	…	…	…	…
Domestic credit	140	602	968	…	…	…	…	…
Of which: credit to the private sector	140	684	1,000	…	…	…	…	…
Reserve money	7	125	146	…	…	…	…	…
Velocity (M3)	12.5	3.4	3.3	…	…	…	…	…
External trade (US$ millions; annual percent change)								
Merchandise exports	-9.3	-0.5	26.6	3.6	7.7	11.7	5.8	3.2
Merchandise imports	24.4	22.9	10.7	-5.9	7.2	8.7	4.7	1.7
Balance of payments (US$ millions; unless otherwise indicated)								
Merchandise exports	1,633	1,625	2,056	2,131	2,296	2,565	2,714	2,801
Merchandise imports	-2,630	-3,232	-3,579	-3,367	-3,609	-3,922	-4,107	-4,176
Current account balance (excluding official transfers)	-945	-1,323	-1,310	-999	-1,115	-1,158	-1,171	-1,177
(percent of GDP)	-24.0	-30.1	-25.6	-17.9	-18.5	-17.7	-16.6	-15.4
Overall balance	-624	29	-664	-463	-445	-309	-319	-329
Official reserves 4/								
Gross official reserves (US$ millions;end-of-period)	6	312	173	173	174	224	274	324
Gross official reserves (months of imports of goods and services)	0.0	1.0	0.5	0.5	0.5	0.6	0.7	0.8
Debt								
Total external debt (US$ millions; end-of-period) 5/	5,794	7,145	7,662	8,041	8,458	8,918	9,387	9,880
(percent of GDP)	147.5	162.5	149.8	144.4	140.3	136.5	132.7	128.8
Total external arrears 5/	3,781	4,575	5,132	5,603	6,056	6,423	6,803	7,194
(percent of GDP)	96.2	104.0	100.4	100.6	100.4	98.3	96.2	93.8

Sources: Zimbabwean authorities; IMF staff estimates and projections.

1/ In constant 2009 prices.
2/ For 2008, annual average January–September 2008.
3/ Zimbabwe dollar values converted into U.S. dollars at the UN exchange rate at end-2008.
4/ Gross official reserves as reported by the authorities are adjusted for encumbered deposits, securities, banks' current accounts/RTGS, and required statutory reserves.
5/ Includes arrears and amounts for unidentified financing.

Table 6. Zimbabwe: Selected Aggregate Financial Soundness Indicators, 2009
(percent, unless otherwise indicated) 1/

	Mar-09	Jun-09	Sep-09	Dec-09
Capital Adequacy 2/				
Regulatory capital to risk-weighted assets	32.4	31.3	25.7	22.7
Percentage of banks greater or equal to 10 percent	93.3	100.0	93.3	100.0
Percentage of banks below 10 and above 6 percent minimum	6.7	0.0	0.0	0.0
Percentage of banks below 6 percent minimum	0.0	0.0	6.7	0.0
Capital to assets	24.1	18.1	16.5	12.5
Asset quality				
Nonperforming loans 3/	3.5	2.4	1.8	1.8
Special mention loans	12.6	21.1	17.4	18.0
Provisions as percent of past-due loans 4/	9.2	6.3	8.0	10.8
Earnings and profitability				
Return on assets	-1.1	0.7	0.5	0.9
Return on equity	-5.3	1.5	0.4	4.3
Liquidity 5/				
Liquid assets/total assets	46.7	44.7	41.6	40.4
Liquid assets/short-term liabilities	74.0	69.1	59.6	56.4
Loans/deposits	27.8	37.7	48.8	48.0
Liquid assets/total deposits	91.0	79.6	71.3	61.7
Interest rates				
Lending rate minus demand deposit rate	31.5	2.0	2.6	3.0
Commercial banks fixed deposits (12 months)	10.0	6.3	4.2	10.3
Commercial banks lending rate (weighted average)	37.5	7.5	7.7	11.0
Saving deposit rate	1.0	1.0	1.7	1.0

Source: Reserve Bank of Zimbabwe.

1/ Based on commercial banks only.
2/ Claims on the RBZ are counted toward capital.
3/ Non-perfoming assets are defined as the aggregate of substandard, doubtful, and loss loans.
4/ Past due loans are defined as the aggregate of special mention, substandard, doubtful, and loss loans.
5/ Claims on the RBZ are classified as liquid assets.

Table 7. Zimbabwe: Vulnerabilities and Risks in the Banking System

Vulnerabilities	Trigger Events and their Likelihood in the next 1-3 years	Overall Level of Concern Expected Impact on Financial Stability if Events are Realized *(high, medium or low)*
1. The Reserve Bank of Zimbabwe (RBZ) is in financial distress and suffers from weak governance.	*Trigger Event* a. Banks will not be able to obtain a refund of their statutory reserves, for which they are entitled in case of a possible decline in their deposits, because these reserves are not backed by international reserves. b. The RBZ may not be able to return banks' RTGS funds. The RTGS account was backed by international reserves at mid-March 2010, but the backing could fall short of 100 percent, as RBZ governance remains weak. *Likelihood: High* • The governance issues are long-standing and are unlikely to be fully resolved quickly under the recently enacted amendments to the RBZ Act. • There is not any plan in place for downsizing the RBZ to limit its operating expenses. Nor is there a strategy for resolving RBZ's overdue liabilities. • The RBZ could continue quasi-fiscal operations. • Gross income is virtually zero.	*High* • Failure to refund statutory reserves, when required, may lead to loss of confidence in the banking system, resulting in possible bank runs and contagion with spreading liquidity problems. Bank runs may lead otherwise solvent banks to experience large losses, as they struggle to mobilize less liquid assets to meet liquidity needs. These losses could quickly erode the capital position of still weakly capitalized banks. • An inability of the RBZ to return RTGS funds to banks may lead to loss of confidence in the payments system, discouraging its use (which negatively affects economic activity) and possibly to liquidity problems in banks, which cannot make payment on behalf of their customers. This may lead to a general loss of confidence in the banking system, with possibly severe effects on the fragile macroeconomic situation.

Table 7 (continued). Zimbabwe: Vulnerabilities and Risks in the Banking System

Vulnerabilities	Trigger Events and their Likelihood in the next 1-3 years	Overall Level of Concern **Expected Impact on Financial Stability if Events are Realized** *(high, medium or low)*
2. There is no lender of last resort or interbank market for the banking system, exposing banks to increased liquidity risk.	*Trigger Event* Rapid credit growth has been raising the loan-to-deposit ratio to levels where some banks may start to face liquidity constraints. Unexpected liquidity shocks could be difficult for these banks to manage without a lender of last resort. *Likelihood: Medium* • The absence of a lender of last resort or interbank market complicates liquidity management for banks. • The liquid asset-to-short-term liabilities ratio of some banks dropped quickly over the course of 2009.	*High* • Liquidity problems in one or a few banks may lead to bank runs, and contagion to other banks, resulting in a general loss of confidence in the banking system. Bank runs may lead otherwise solvent banks to experience large losses as they struggle to mobilize less liquid assets to meet liquidity needs. These losses could quickly erode the capital position of still weakly capitalized banks.
3. The banking system is weakly capitalized with capital consisting mostly of revalued bank premises, which is not readily available to meet unexpected losses.	*Trigger Event* Banks do not have sufficient capital or cannot make the capital they hold quickly available to meet unexpected losses from loan or other assets, including claims on the RBZ. *Likelihood: Medium* • Banks are weakly capitalized, with significant exposure to the financially distressed RBZ which is now counted toward capital (70 percent of banks' capital). . • The RBZ has required banks to increase their minimum capital and most banks have met the first required tranche in 2009Q4, indicating some ability of the banking system to raise additional capital. However, this ability may have been undermined by increased uncertainties about the indigenization process.	*High* • If banks are unable to use their existing (notional) capital base to meet losses and are unable to raise additional capital, they may be forced into bankruptcy. Failure of one or more banks may lead to a general loss of confidence in the banking system, with adverse effects on the fragile macroeconomic situation.

Table 7 (concluded). Zimbabwe: Vulnerabilities and Risks in the Banking System

Vulnerabilities	Trigger Events and their Likelihood in the next 1-3 years	Overall Level of Concern **Expected Impact on Financial Stability if Events are Realized** *(high, medium or low)*
4. Rapid credit growth in a banking system with possibly eroded underwriting skills creates heightened credit risks.	*Trigger Event* There is a sharp rise in non-performing loans. *Likelihood: Medium* • The long history of high- and hyper-inflation is likely to have eroded loan underwriting skills in banks. • While reported aggregate NPLs remain low, this is likely mostly a reflection of the immaturity of the loan portfolio, a possible lack of experience in correctly assessing loan quality, and potentially hidden evergreening of mostly short-term loans. • High credit growth is usually strongly correlated with future increases in NPLs. • Strong credit growth is in part attributable to moral suasion to lend to drought-prone agriculture.	*Medium* • A sharp increase in nonperforming loans would impact profitability by lowering interest income and requiring loan provisioning. Weakly capitalized banks would have difficulty to withstand significant loan losses. • Failure of one or more banks could lead to a general loss of confidence in the banking system, with negative effects on the fragile macroeconomic situation.
5. The external position is precarious.	*Trigger Event* Balance of payments pressure forces a contraction in banks' liquid foreign assets under the multi-currency system, leading to liquidity difficulties in the banking system. *Likelihood: High* • Under the multi-currency system, balance of payments pressure leads to an outflow of funds (i.e., nostro accounts and cash in vaults) from banks. • With high credit growth and concomitant domestic creation of U.S. dollar-denominated deposits, the above factor may lead to liquidity shortages for banks. • The banking system is unlikely to be able to borrow abroad to resolve these liquidity issues.	*High* • Without a domestic currency or a lender of last resort, a systemic liquidity shortage may lead to bank runs and a general loss of confidence in the banking system, further exacerbating the demand for liquidity. • Faced with a systemic liquidity shortage, banks are likely to respond with a sharp curtailment of credit, with a strong contractionary effect on economic activity. • Knock-on effects of the economic contraction through rising NPLs would exacerbate the effects on the financial sector.

INTERNATIONAL MONETARY FUND

ZIMBABWE

2010 Article IV Consultation—Informational Annex

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

Approved by Sharmini Coorey

April 28, 2010

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Appendix I. Zimbabwe: Fund Relations

A. Financial Relations
(As of March 31, 2010)

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

III. SDR Department:	**SDR Million**	**%Allocation**
Net cumulative allocation[1]	272.18	100.00
Holdings[1]	165.13	60.67

[1] Excluding SDRs allocated and placed in escrow account under the Fourth Amendment of the IMF's Articles of agreement (SDR 66,402,156). Such holdings will be available to Zimbabwe upon the settlement of all overdue obligations to the Fund.

IV. Outstanding Purchases and Loans:	**SDR Million**	**%Quota**
ECF arrangements	73.56	20.82

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
ECF[1/]	Sep 11, 1992	Sep 10, 1995	200.60	151.90

[1/]Formerly PRGF

VI. Projected Payments to Fund[2, 3]

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

	Overdue	Forthcoming				
	March 31, 2010	2010	2011	2012	2013	2014
Principal	73.56					
Charges/interest	15.76	0.38	0.45	0.45	0.45	0.45
Total	89.32	0.38	0.45	0.45	0.45	0.45

2 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.

3 Projected amounts do not include additional interest levied on overdue PRGT 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 PRGT-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 PRGT Trust—the declaration of noncooperation, the suspension of technical assistance, and the removal of Zimbabwe from the list of PRGT-eligible countries. Zimbabwe's arrears to the PRGT Trust remain, amounting to SDR 89.3 million (US$137 million) as of March 31, 2010. On May 4, 2009, the Executive Board lifted the suspension of technical assistance to Zimbabwe in the following areas: (i) tax policy and administration, (ii) payments system, (iii) lender-of-last resort and banking supervision, (iv) central banking governance and accounting (EBS/09/55). The last review of Zimbabwe's overdue financial obligations to the PRGT Trust was completed in August 2009 (EBS/09/131, 8/27/2009), and the Executive Board decided the Fund should continue its technical assistance in targeted areas but that the other measures to address Zimbabwe's arrears to the PRGT Trust should remain in place. On February 19, 2010, the Executive Board restored Zimbabwe's voting rights and its eligibility for general resources.

B. Nonfinancial Relations

X. Exchange Arrangement

Zimbabwe's exchange system has been significantly liberalized and exchange rates have been unified. Apart from one remaining exchange restriction subject to IMF jurisdiction arising from unsettled balances under an inoperative bilateral payments agreement with Malaysia, payments and transfers for current international transactions can now be effected without restriction.

Since 2009, Zimbabwe has adopted hard currencies for transactions (i.e., multi-currency regime) with the U.S. dollar as principal currency; and use of the Zimbabwe dollar as domestic currency was discontinued over the period 2010–12. The de facto exchange regime is classified as *exchange arrangement with no separate legal tender.*

XI. Article IV Consultation

Zimbabwe is on the standard 12-month consultation cycle. The Executive Board discussed the staff report for the 2009 consultation on May 4, 2009.

XII. Technical Assistance

2009 MCM mission on payments systems, lender-of-last resort operations and banking supervision, and central banking governance and accounting

2009 FAD mission on tax policy

2009 FAD mission on revenue administration

2009 FAD follow-up mission on tax policy

Appendix II. Zimbabwe: Relations with the Fund and the World Bank Group

(As of April, 2010)

Thematic area	Areas of collaboration	Bank	Fund
Macroeconomic stabilization	Policies to stabilize the economy	-Complement Fund's macroeconomic policy advice with structural work, focused on fiscal issues in parastatals, public sector management, and civil service payroll. TA in building technical capacity to develop a medium-term fiscal framework.	-Lead the policy dialogue in macroeconomic policies, including fiscal and monetary policies, and the medium-term macroeconomic framework.
Arrears clearance	Strategy for arrears clearance	-Process for arrears clearance with respective Fund/Bank roles agreed in a joint IMF/WB/AfDB note (June 2009). -Fund background paper on competitiveness and external sustainability.	
Growth recovery		-Prepare policy notes on issues in growth recovery on themes, such as competitiveness, and sector notes to support the preparation of the government medium-term plan.	
Taxation	Improve tax laws and administration and identify revenue measures		-TA in tax policy and revenue administration.
Public financial management (PFM) and governance	Strengthen PFM and reduce fiduciary risks	-TA in PFM systems. -Benchmarking assessment of PFM and procurement systems.	
	Payroll audit	-Finalize payroll audit and follow-up with TA in human resource systems.	
	Public spending	-Prepare analytical notes on public expenditure issues.	
	Capacity building	-Funding by World Bank managed analytical Multi-Donor Trust Fund (MDTF).	
Monetary policy and financial sector	Monetary policy operations		-Background paper on options for a future currency regime. -Exchange restrictions reviewed. -TA in RBZ governance, accounting, and restructuring.
	Financial sector reform	-Analytical work on financial sector development issues.	-TA in banking supervision and payment systems. -Background paper on developments in the banking system.
Infrastructure	Investment to rehabilitate SOEs	-Mobilize donor support through the programmatic MDTF. -Analytical support for implementation of capital budget. -Financial support for water and sanitation rehabilitation.	
Poverty reduction		-Support collection and analysis of socio-economic data. -Financial support for fertilizer subsidy.	
Statistics	Capacity building	-Building capacity at the Central Statistical Office.	

APPENDIX III. ZIMBABWE—STATISTICAL ISSUES

As of April, 2010

I. Assessment of Data Adequacy for Surveillance

General: Data have serious shortcomings that significantly hamper surveillance. There are serious shortcomings in all major datasets. The Central Statistics Office (CSO) needs to rebuild its capacity and acquire new equipment. All technical assistance from the Fund was suspended on June 13, 2002, when the Executive Board issued a declaration of noncooperation regarding Zimbabwe. On May 4, 2009, the Executive Board lifted the suspension of technical assistance in targeted areas, including assistance in some areas of monetary and fiscal statistics. 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.

National Accounts: The most recent publication of national accounts data includes developments until 2008 in Zimbabwe dollars and U.S. dollars and uses 1990 as the base year for constant prices. The production of national accounts is constrained by both insufficient input data, limited by low survey response rates, and insufficient processing and other resource capacity. Benchmark data for industrial production are 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. Staff has produced provisional estimates of value added in U.S. dollars for 2009 based on a sector-by-sector production approach. The authorities are reviewing the staff's estimates and plan to produce official estimates in the near future.

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.

Government finance statistics: The Ministry of Finance (MoF) does not report on fiscal developments at the general government level, including local governments and all other government units. Reporting of government finance statistics for the central government has improved significantly over the past twelve months. The MoF collects data on revenue and expenditure, which are published on its website on a bi-annual basis, along with budget statements. The MoF is in the process of reconciling its data on external debt, in particular interest payments on principal and arrears, with external creditors.

Monetary statistics: The RBZ produces monthly monetary and financial statistics with an irregular lag of three to six months. The quality of the data has deteriorated substantially over the years because of previous hyperinflation and the transition to accounting in U.S. dollars, weak accounting practices, and quasi-fiscal activities. The auditors provided an adverse opinion of the 2008 RBZ financial statement based on two observations: the hyperinflationary environment in 2008 and failures within the RBZ's financial reporting systems that is, inability to account for foreign currency purchases and internal control deficiencies. MCM technical assistance in 2009 and the Article IV missions in 2009 and 2010 made recommendations on central bank accounting and the compilation of net international reserves data, including identification of encumbered assets, and the need to ensure completeness of foreign currency liabilities. The authorities provided data based on these recommendations. The RBZ has not published comprehensive monetary statistics since April 2008.	
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	
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*, and annual fiscal data are also not reported for inclusion in the *Government Finance Statistics Yearbook*. National accounts data have not been reported since 2005 and no data are being reported for the new CPI.	

ZIMBABWE: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE

	Date of latest observation (dd/mm/yy)	Date received (dd/mm/yy)	Frequency of data[1]	Frequency of reporting[1]	Frequency of publication[1]
Exchange rates[2]	NA	NA	NA	NA	NA
International reserve assets and reserve liabilities of the monetary authorities[3]	31/12/09	15/03/10	M	I	NA
Reserve/base money	31/12/09	11/03/10	M	I	NA
Broad money	31/12/09	11/03/10	M	I	NA
Central bank balance sheet	31/12/09	11/03/10	M	I	NA
Consolidated balance sheet of the banking system	31/12/09	11/03/10	M	I	NA
Interest rates[4]	31/12/09	03/03/10	Q	I	NA
Consumer price index	02/10	24/03/10	M	M	M
Revenue, expenditure, balance and composition of financing[5]—General government[6]	NA	NA	NA	NA	NA
Revenue, expenditure, balance and composition of financing[5]—Central government	31/01/10	03/03/10	M	M	NA
Stocks of central government and central government-guaranteed debt[7]	31/01/10	03/03/10	M	I	NA
External current account balance	2009	03/03/10	NA	I	NA
Exports and imports of goods and services	2009	03/03/10	NA	I	NA
GDP/GNP	2008	15/10/09	A	I	NA
Gross external debt	2009	03/03/10	A	I	NA
International investment position[8]	NA	NA	NA	NA	NA

[1] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).
[2] The Zimbabwe dollar is no longer traded against foreign currencies on the exchange market.
[3] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.
[4] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[5] Foreign, domestic bank, and domestic nonbank financing.
[6] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[7] Including currency and maturity composition.
[8] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

INTERNATIONAL MONETARY FUND AND

ZIMBABWE

Debt Sustainability Analysis

Prepared by African and Strategic Policy and Review Departments

Approved by Sharmini Coorey and Dominique Desruelle

April 29, 2010

1. **Zimbabwe is in arrears to most of its creditors.** At the end of 2009, total public- and publicly-guaranteed (PPG) debt[1] amounted to US$6.9 billion or 157 percent of GDP, of which 102 percent of GDP was in arrears. About 90 percent of total PPG debt is medium- and long-term debt and about 90 percent of total PPG is owed to official creditors. Zimbabwe's overdue financial obligations to IFIs include the World Bank (US$731 million), African Development Bank (US$483 million), and the IMF (US$140 million).

2. **Zimbabwe's debt sustainability analysis (DSA) is subject to important caveats.** The authorities are reconciling their debt stock and debt service data with individual creditors, but this process has not been completed. As a result, this DSA is based on nonreconciled debt numbers and staff estimates of accrued interest and penalties on arrears. In addition to data deficiencies, making medium- and long-term projections is complicated by the country's poor long-term policy track record and significant uncertainties regarding policy direction. In light of these factors, the results of this exercise should be treated as highly tentative.

3. **Zimbabwe is clearly in debt distress.** If current policies continue and donor financing is largely confined to humanitarian assistance in the medium term (Box), the large debt stock would remain unresolved and arrears would continue to build up. While most debt ratios are projected to decline gradually, they would remain at unsustainable levels over the medium and long term. Historical sensitivity analysis shows that most debt ratios are projected to increase over the long term from current unsustainable levels, reflecting the impact of negative economic trends during the last decade.

[1] 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 initial principal and interest obligations; and (iv) estimated accrued penalties on arrears. The projected use of the SDR allocation of $210 million is not included in external debt, but related net interest charges are included in debt service and present value calculations.

Public and publicly guaranteed external debt sustainability

4. **The baseline scenario assumes a more pessimistic outlook compared with the previous DSA (IMF Country Report No.09/139).** A weakening of macroeconomic policy discipline and the structural reform momentum has worsened prospects for real GDP and export growth, as well as the ability of the country to attract foreign investment and donor financing. Annual real GDP growth is now projected to average at 1.5 percent for the period 2010–15 and at about 3.0 percent during 2016–30 (Box). The non-interest external current account deficit is projected to fall from 16 percent of GDP in 2010 to 6 percent in 2015, mainly as a result of the projected drying up of private capital inflows and concomitant import compression. External financing gaps would remain over the long term, and they are assumed to be financed by continued buildup of external payments arrears.

5. In the baseline scenario, at end-2009, PPG external debt indicators exceed thresholds for LICs that are considered poor performers.[2] These ratios are projected to continue to exceed corresponding thresholds by a large margin, and decline only gradually over the long term.

Box. Key medium-term macroeconomic assumptions for the DSA:

- Real GDP is projected to grow at 1.5 to 3 percent in the medium and long term. Economic growth, in particular in key export-oriented sectors, including mining, manufacturing, and agriculture, would be constrained by persistent infrastructure bottlenecks, relatively high wage costs, and continued problems with the business climate hampering investment.
- Donor support is assumed to be largely confined to humanitarian assistance.
- FDI, portfolio investment, and private sector borrowing would remain limited in the medium and long term.
- Import growth would be constrained by sluggish export performance and low capital inflows and nonhumanitarian official financing.
- Owing to lack of access to foreign and domestic financing, the government is projected to run balanced budgets on a cash basis in the medium and long term, but the stock of domestic payments arrears would increase. Given the current policy of allocating significant budgetary resources to wages and no scope for a significant revenue-to-GDP ratio increase, essential infrastructure projects would remain underfinanced.

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

6. **The sensitivity analysis demonstrates that Zimbabwe's already precarious external debt situation could get even worse.** Due to the poor macroeconomic performance during the past decade, historical analysis suggests that external debt indicators could increase rapidly (rather than gradually decline) in the medium to long term compared with the baseline scenario.

Public debt sustainability

7. **The baseline scenario assumes limited progress in fiscal policy implementation.** Budget revenue is projected to remain at around 26 percent of GDP over the medium to long term. The wage bill will continue to claim a large share of total revenue, leaving virtually no room for growth-enhancing capital expenditures.

8. **The initial public domestic debt level is low, but it is expected to increase in the medium term.** Local currency-denominated domestic debt was fully repaid in January 2009. The RBZ's foreign currency-denominated domestic debt (which forms part of total domestic public debt for the purpose of this DSA) is estimated at $419 million (10 percent of GDP) and government domestic payments arrears at $48 million (1.2 percent of GDP) at end-December 2009. The projected continued accumulation of government domestic payments arrears over the medium term drives the increase in the stock of domestic public debt.

9. **Zimbabwe's overall public debt is unsustainable.** The initial high level of external public debt and relatively high scheduled debt service payments, along with the inability to generate primary surplus or achieve higher real GDP growth, would result in the persistence of public debt ratio above sustainable levels. Public debt is estimated to gradually decline from 157 percent of GDP in 2009 to about 119 percent of GDP in 2020. The present value of the debt-to-revenue ratio is projected to remain at about 400 to 500 percent through 2020. The debt service-to-revenue ratio is projected to decline to about 30 percent by 2020.

Conclusion

Zimbabwe is in debt distress, which is compounded by unresolved economic policy challenges. Achieving debt sustainability would require a significant strengthening of economic policies and an improvement of relations with the international community whose support is essential for securing debt relief.

Table 1. Zimbabwe: External Debt Sustainability Framework, Baseline Scenario, 2007-2030
(In percent of GDP, unless otherwise indicated)

	Actual			Historical Average 1/	Standard Deviation	Projections									
	2007	2008	2009			2010	2011	2012	2013	2014	2015	2010-2015 Average	2020	2030	2016-2030 Average
(1) **External debt (nominal) 2/**	**113.4**	**147.5**	**173.1**			**158.1**	**157.3**	**159.6**	**163.2**	**165.6**	**167.9**		**151.3**	**131.0**	
(2) o/w public and publicly guaranteed (PPG)	107.8	138.9	156.6			140.6	137.3	136.5	137.3	137.3	137.4		128.6	118.4	
(3) Change in external debt	7.5	34.0	25.7			-15.1	-0.7	2.3	3.6	2.4	2.2		-2.9	-1.4	
(4) Identified net debt-creating flows	6.2	44.3	12.6			19.5	14.4	13.6	12.7	12.8	12.8		10.1	8.7	
Non-interest current account deficit	**3.3**	**17.5**	**23.1**	**6.8**	**8.1**	**16.4**	**6.0**	**6.3**	**6.2**	**6.1**	**5.8**		**5.2**	**5.0**	5.2
Deficit in balance of goods and services	9.8	30.6	37.3			27.5	17.2	17.0	16.6	16.5	15.9		15.8	15.8	
Exports	42.9	45.8	46.4			48.8	45.0	42.3	40.8	39.1	36.6		36.6	36.6	
Imports	52.7	76.4	83.7			76.3	62.1	59.3	57.4	55.6	52.4		52.4	52.4	
Net current transfers (negative = inflow)	-9.4	-15.9	-16.0	-7.2	5.3	-12.9	-12.9	-12.3	-11.9	-11.9	-11.5		-11.5	-11.5	-11.5
o/w grants to NGOs and budget support	-7.2	-12.1	-9.7			-7.1	-7.3	-6.9	-6.6	-6.2	-5.9		-4.4	-2.4	
Other current account flows (negative = net inflow)	2.9	2.8	1.8			1.7	1.7	1.6	1.6	1.5	1.4		0.9	0.7	
Net FDI (negative = inflow)	**-1.3**	**-1.1**	**-2.4**	**-0.9**	**0.9**	**-2.0**	**-0.9**	**-0.9**	**-0.8**	**-0.8**	**-0.7**		**-0.7**	**-0.7**	-0.7
Endogenous debt dynamics 3/	**4.3**	**27.9**	**-8.1**			**5.2**	**9.3**	**8.2**	**7.2**	**7.5**	**7.7**		**5.6**	**4.4**	
Contribution from nominal interest rate	5.1	6.9	7.6			8.5	9.4	9.6	10.0	10.5	10.8		10.0	8.2	
Contribution from real GDP growth	3.8	19.5	-5.3			-3.3	-0.1	-1.4	-2.8	-3.1	-3.1		-4.4	-3.7	
Contribution from price and exchange rate changes	-4.6	1.5	-10.4			…	…	…	…	…	…		…	…	
Residual (3-4) 4/	**1.3**	**-10.3**	**13.0**			**-34.6**	**-15.1**	**-11.4**	**-9.0**	**-10.4**	**-10.5**		**-13.0**	**-10.2**	
o/w exceptional financing	-9.9	-14.6	-19.3			-10.8	-8.6	-7.7	-6.0	-5.8	-5.7		-5.5	-5.7	
PV of external debt 5/	...	...	163.4			151.8	151.8	152.3	154.0	154.7	155.1		138.5	118.5	
In percent of exports	...	...	352.2			311.1	337.4	359.9	377.4	395.3	423.9		378.5	323.8	
PV of PPG external debt	**...**	**...**	**146.8**			**134.4**	**131.8**	**129.3**	**128.1**	**126.3**	**124.6**		**115.9**	**106.0**	
In percent of exports	**...**	**...**	**316.5**			**275.4**	**292.9**	**305.4**	**313.9**	**322.8**	**340.7**		**316.7**	**289.6**	
In percent of government revenues	**...**	**...**	**691.3**			**514.6**	**504.1**	**500.9**	**499.8**	**492.1**	**484.9**		**450.9**	**412.3**	
Debt service-to-exports ratio (in percent)	**24.9**	**32.4**	**26.5**			**25.4**	**23.8**	**23.6**	**20.4**	**21.3**	**22.7**		**20.8**	**18.9**	
PPG debt service-to-exports ratio (in percent)	**23.4**	**29.2**	**21.8**			**19.9**	**21.2**	**20.7**	**17.2**	**17.8**	**19.2**		**18.0**	**17.4**	
PPG debt service-to-revenue ratio (in percent)	**231.7**	**395.3**	**47.5**			**37.2**	**36.5**	**34.0**	**27.4**	**27.1**	**27.3**		**25.7**	**24.8**	
Total gross financing need (Billions of U.S. dollars)	0.8	1.5	1.9			2.6	2.3	2.5	2.7	3.0	3.3		3.7	4.5	
Non-interest current account deficit that stabilizes debt ratio	-4.2	-16.5	-2.5			31.5	6.7	4.0	2.6	3.7	3.5		8.1	6.4	
Key macroeconomic assumptions															
Real GDP growth (in percent)	-3.6	-14.5	4.0	-4.7	7.7	2.2	0.0	1.0	1.8	2.0	2.0	1.5	3.0	3.0	3.0
GDP deflator in US dollar terms (change in percent)	4.5	-1.3	7.6	3.5	3.0	14.4	6.6	5.5	3.5	3.8	3.7	6.2	3.0	3.0	3.0
Effective interest rate (percent) 6/	4.8	5.2	5.8	4.6	0.7	5.7	6.3	6.5	6.6	6.8	6.9	6.5	6.9	6.6	6.8
Growth of exports of G&S (US dollar terms, in percent)	2.1	-9.9	13.2	-1.9	8.5	23.1	-1.7	0.2	1.6	1.5	-1.1	3.9	6.1	6.1	6.1
Growth of imports of G&S (US dollar terms, in percent)	-3.8	22.4	22.5	5.2	10.3	6.7	-13.1	1.7	1.9	2.6	-0.3	-0.1	6.1	6.1	6.1
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	...	...	...	...	...	...	... ..	...	... ...	...
Government revenues (excluding grants, in percent of GDP)	4.3	3.4	21.2			26.1	26.1	25.8	25.6	25.7	25.7		25.7	25.7	25.7
Aid flows (in Billions of US dollars) 7/	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.1	0.1	
o/w Grants	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.1	0.1	
o/w 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/	...	...	...			0.0	0.6	0.6	0.6	0.6	0.6		0.6	0.6	...
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			100.0	100.0	100.0	100.0	100.0	100.0		100.0	100.0	...
Memorandum items:															
Nominal GDP (Billions of US dollars)	4.7	3.9	4.4			5.1	5.5	5.8	6.2	6.5	6.9		9.3	16.7	
Nominal dollar GDP growth	0.8	-15.6	11.9			17.0	6.7	6.5	5.4	5.8	5.7	7.9	6.1	6.1	6.1
PV of PPG external debt (in Billions of US dollars)			6.5			6.9	7.2	7.6	7.9	8.2	8.6		10.7	17.7	
Gross remittances (Billions of US dollars)	0.1	0.2	0.3			0.3	0.3	0.3	0.3	0.4	0.4		0.4	0.4	
PV of PPG external debt (in percent of GDP + remittances)	...	...	137.7			126.8	124.5	122.3	121.2	119.2	117.7		110.9	103.4	
PV of PPG external debt (in percent of exports + remittances)	...	...	277.1			245.1	259.2	269.1	275.8	279.9	293.4		282.1	270.7	
Debt service of PPG external debt (in percent of exports + remittances)	...	...	19.0			17.7	18.8	18.3	15.1	15.4	16.6		16.1	16.3	

Sources: Country authorities; and staff estimates and projections.

1/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.
2/ External private debt, public and publicly guaranteed debt and residents' claims on the RBZ denominated in foreign currency.
3/ Derived as $[r - g - \rho(1+g)]/(1+g+\rho+g\rho)$ 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.
contribution from price and exchange rate.
4/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets, portfolio, equity investment, capital transfers; valuation adjustments; errors and omissions (prior to 2009), and changes in domestic foreign currency-denominated debt. For projections, also includes contribution from price and exchange rate changes.
5/ Assumes that PV of private sector debt is equivalent to its face value.
6/ Current-year interest payments divided by previous period debt stock.

Table 2. Zimbabwe: Public Sector Debt Sustainability Framework, Baseline Scenario, 2007-2030
(In percent of GDP, unless otherwise indicated)

	Actual			Average	Standard Deviation	Projections									
	2007	2008	2009			2010	2011	2012	2013	2014	2015	2010-15 Average	2020	2030	2016-30 Average
Public sector debt 1/	107.8	138.9	156.6			140.6	137.3	136.5	137.3	137.3	137.4		128.6	118.4	
o/w foreign-currency denominated	107.8	138.9	156.6			140.6	137.3	136.5	137.3	137.3	137.4		128.6	118.4	
Change in public sector debt	7.3	31.1	17.7			-16.0	-3.3	-0.8	0.8	0.0	0.1		-1.5	-0.7	
Identified debt-creating flows	4.7	23.1	5.6			-11.5	-1.2	0.8	2.8	2.3	2.7		-0.1	-0.5	
Primary deficit	1.8	-0.4	-0.6	2.5	9.5	4.4	0.4	2.0	2.5	2.5	2.5	2.4	0.0	-0.5	-0.2
Revenue and grants	4.3	3.4	22.2			26.1	26.8	26.4	26.3	26.3	26.3		26.3	26.3	
of which: grants	0.0	0.0	0.9			0.0	0.6	0.6	0.6	0.6	0.6		0.6	0.6	
Primary (noninterest) expenditure	…	…	21.6			30.6	27.2	28.5	28.8	28.8	28.9		26.4	25.8	
Automatic debt dynamics	4.1	26.2	-8.5			-15.9	-1.6	-1.2	0.3	-0.2	0.2		-0.1	0.0	
Contribution from interest rate/growth differential	5.7	21.6	-0.8			1.9	5.5	3.7	2.3	2.3	2.4		1.2	1.2	
of which: contribution from average real interest rate	2.0	3.4	4.6			5.3	5.6	5.0	4.8	4.9	5.1		5.0	4.6	
of which: contribution from real GDP growth	3.7	18.2	-5.4			-3.4	0.0	-1.3	-2.5	-2.7	-2.7		-3.8	-3.5	
Contribution from real exchange rate depreciation	-1.7	4.6	-7.7			-17.8	-7.2	-5.0	-2.0	-2.4	-2.3		...	...	
Other identified debt-creating flows	-1.2	-2.8	14.7			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities by the RBZ	0.0	0.0	6.4			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	-1.2	-2.8	-1.2			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (residents' claims on the RBZ)	0.0	0.0	9.6			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes 2/	2.6	8.0	12.1			-4.5	-2.0	-1.6	-2.1	-2.4	-2.5		-1.4	-0.2	
Other Sustainability Indicators															
PV of public sector debt	…	…	146.8			134.4	131.8	129.3	128.1	126.3	124.6		115.9	106.0	
o/w foreign-currency denominated	…	…	146.8			134.4	131.8	129.3	128.1	126.3	124.6		115.9	106.0	
o/w external	...	...	146.8			134.4	131.8	129.3	128.1	126.3	124.6		115.9	106.0	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 3/	14.3	18.0	17.0			36.0	30.5	30.5	30.3	31.6	33.0		26.0	16.6	
PV of public sector debt-to-revenue and grants ratio (in percent)	…	…	662.1			514.2	492.1	488.8	487.7	480.1	473.1		440.0	402.3	
PV of public sector debt-to-revenue ratio (in percent)	…	…	691.3			514.6	504.1	500.9	499.8	492.1	484.9		450.9	412.3	
o/w external 4/	…	…	691.3			514.6	504.1	500.9	499.8	492.1	484.9		450.9	412.3	
Debt service-to-revenue and grants ratio (in percent) 5/	231.7	395.3	45.8			37.2	35.7	33.2	26.7	26.4	26.7		25.1	24.2	
Debt service-to-revenue ratio (in percent) 6/	…	…	47.9			37.2	36.5	34.0	27.4	27.1	27.4		25.7	24.8	
Primary deficit that stabilizes the debt-to-GDP ratio	-5.5	-31.4	-18.3			20.4	3.7	2.8	1.8	2.5	2.4		1.5	0.2	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	-3.6	-14.5	4.0	-4.7	7.7	2.2	0.0	1.0	1.8	2.0	2.0	1.5	3.0	3.0	3.0
Average nominal interest rate on forex debt (in percent)	4.8	4.9	5.1	4.4	0.6	5.1	5.4	5.6	5.6	5.7	5.9	5.5	6.0	6.1	6.0
Average real interest rate on domestic debt (in percent)	...	...	...	…	…	-12.6	-6.2	-5.2	-3.3	-3.6	-3.6	-5.8	-2.9	-2.9	-2.9
Real exchange rate depreciation (in percent, + indicates depreciation)	-1.6	3.5	-5.6	-1.0	2.9	-11.2	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	4.5	-1.3	7.6	3.5	3.0	14.4	6.6	5.5	3.5	3.8	3.7	6.2	3.0	3.0	3.0
Growth of real primary spending (deflated by GDP deflator, in percent)	-47.2	-57.8	640.3	58.6	219.3	44.9	-11.1	5.8	3.0	2.0	2.1	7.8	2.6	2.9	2.0
Grant element of new external borrowing (in percent)	...	...	...	…	…	…	…	…	…	…	…	…	…	…	...

Sources: Country authorities; and staff estimates and projections.

1/ Public and publicly guaranteed debt and residents' claims on the RBZ denominated in foreign currency. For 2007, excludes local-currency denominated debt of about 1 percent of GDP.

2/ Includes accumulation of arrears. The residuals for 2007-2008 in part reflect RBZ's quasi-fiscal activities. In 2010, the residual in part reflects use of the SDR allocation.

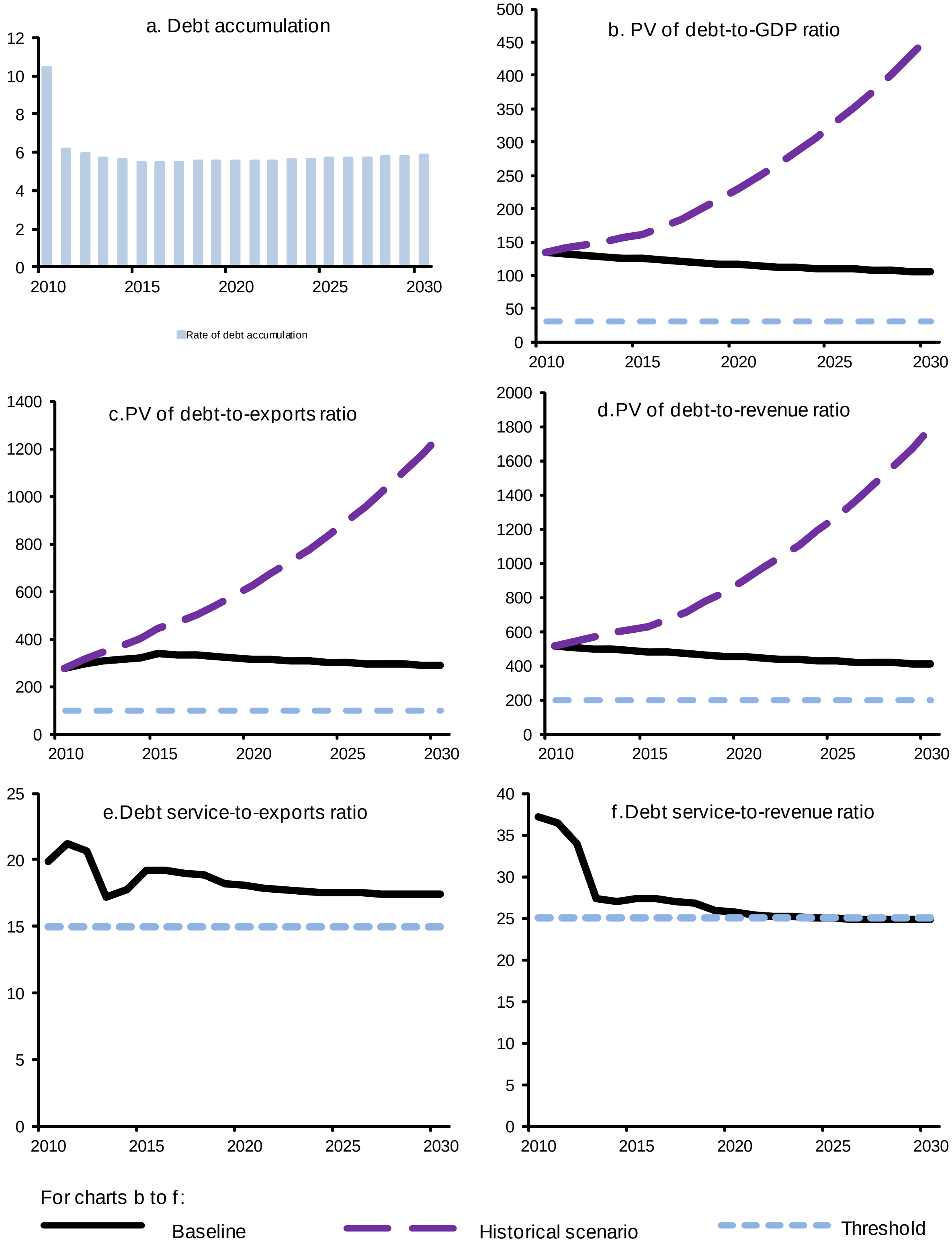
3/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.

4/ Revenues excluding grants.

5/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.

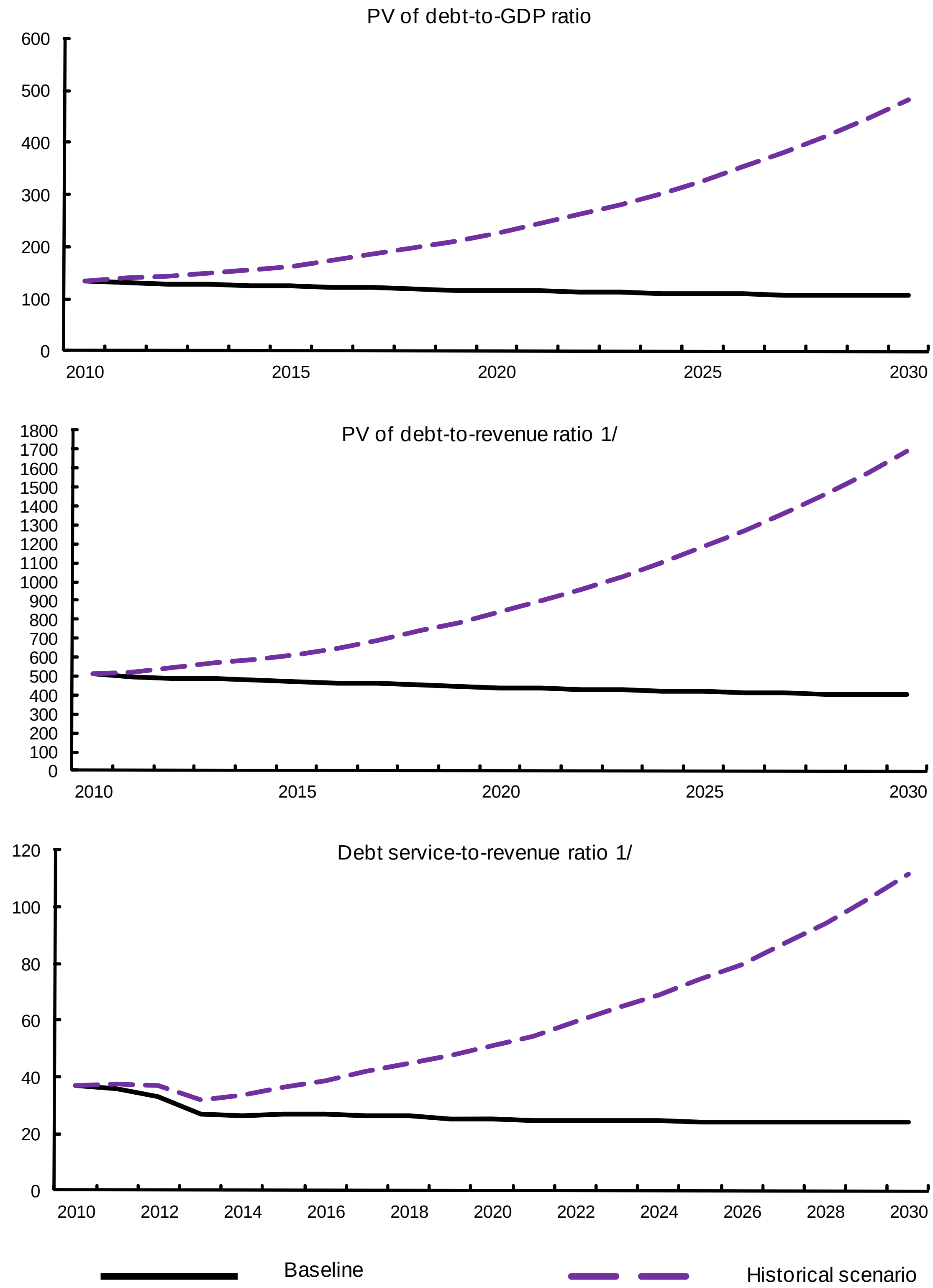
6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Figure 1. Zimbabwe: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2010-2030



Source: Country authorities and IMF staff estimates and projections.

Figure -2. Zimbabwe: Indicators of Public Debt under Alternative Scenarios, 2010 - 2030



Sources: Country authorieis and IMF staff estimates and projections.
1/ Revenues are defined inclusive of grants.

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700 19th Street, NW
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IMF Executive Board Concludes 2010 Article IV Consultation with Zimbabwe

On May 17, 2010, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Zimbabwe.[1]

Background

As a result of significant improvements in policies, real gross domestic product (GDP) is estimated to have grown by about 4 percent in 2009, following a contraction of about 14 percent in 2008. Strong growth was reported in manufacturing and services. The officially reported 12-month consumer price index (CPI) in U.S. dollar terms declined by about 8 percent in December 2009.

The humanitarian situation has improved. Most schools and hospitals have been re-opened. Owing to good rainfall and positive effects of better policies in 2009, food security improved. Incidence of cholera has declined. In 2009, donors provided significant off-budget financing for social services and humanitarian assistance (about US$540 million, or 12 percent of GDP) to help fill some of the gap left by severely constrained fiscal resources.

The government broadly adhered to cash budgeting in 2009. *Budget revenue and grants* increased from less than 4 percent of GDP during hyperinflation in 2008 to an

[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 Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

estimated 22 percent of GDP (US$975 million) in 2009, mainly on account of indirect taxes. The improved revenue performance is attributable to the stabilization of prices and strong tax policy and administration measures (1.3 percent of GDP), which were largely implemented following IMF technical assistance advice. Budgetary cash expenditures—21 percent of GDP (US$920 million)—were skewed toward employment costs (53 percent of revenue), as the government transformed a uniform US$100 per month allowance into wages and implemented large differentiated wage and pension increases on July 1, 2009. As a result, capital expenditures only accounted for 1 percent of GDP and many social programs remained underfunded. The government has strengthened its public financial management system with World Bank assistance.

The multi-currency regime helped promote financial intermediation. Deposits with banks tripled between end-March and end-December 2009, and banks' loan portfolios grew six-fold (although from a very low base). Strong credit growth supported the nascent economic recovery, but it also contributed to a widening current account deficit and rising vulnerabilities in the banking system.

Serious governance problems have remained at the Reserve Bank of Zimbabwe (RBZ). Accounting and internal controls are weak, and there was no approved budget for RBZ operations in 2009. The RBZ's quasi-fiscal activities amounted to 0.5 percent of GDP, substantial resources were used for debt repayments to selected creditors, and its arrears on operating expenses increased significantly in 2009. However, the appointment of an RBZ Board on May 3, 2010 is a step toward resolving RBZ governance issues and refocusing its activities on its core functions under the multi-currency regime.

The external position remains precarious. Volatile short-term capital inflows and external payment arrears financed the current account deficit that is estimated to have widened to 30 percent of GDP in 2009, from 24 percent in 2008. Significant capacity constraints, in part related to a weak business climate, depressed export earnings in 2009, while rapidly increasing domestic credit and capital inflows, as well as higher humanitarian aid, financed increased import demand. The external debt continued to grow mainly as a consequence of new payment arrears and interest and penalty charges on existing payment arrears, but new private sector short-term borrowing also added to the external debt estimated at US$7.1 billion (162 percent of GDP) by end-2009.

The outlook for 2010 is highly uncertain. Large budgetary wage increases crowding out growth-oriented expenditures, a significant slowdown in private capital inflows because of increased uncertainties about the indigenization process, and strong credit growth have intensified external and banking system vulnerabilities. In the absence of timely corrective policy measures, economic growth would slow down significantly in 2010 and risks in the banking system would continue to rise.

Executive Board Assessment

Executive Directors welcomed the recent improvement in Zimbabwe's macroeconomic performance and humanitarian conditions following a decade of economic decline and high inflation. To solidify these gains, as well as to reduce the significant external and financial vulnerabilities, it will be critical that the authorities undertake decisive policy measures.

Directors agreed that the main fiscal challenge is to create sufficient space for social and developmental expenditure. They strongly encouraged the authorities to return to cash budgeting, and reduce the wage bill and other low-priority expenditures. Directors welcomed the significant improvement in revenue performance and emphasized that additional revenue measures would be necessary. They also urged the authorities to refrain from further use of nonconcessional special drawing rights (SDR)-related funds for budget financing and to save Zimbabwe's SDR holdings as part of the country's international reserves.

Directors expressed concern about the increasing systemic vulnerabilities in the banking system. Addressing the governance weaknesses of the Reserve Bank of Zimbabwe is crucial for achieving banking system stability. In this regard, Directors welcomed the recent appointment of the RBZ governing Board, which should oversee a strengthening of RBZ governance and implementation of its downsizing and restructuring. Directors called for stepping up prudential supervision to contain credit and liquidity risks in the banking system and cautioned against moral suasion on banks to lend to specific sectors.

Directors considered that the multi-currency system would serve Zimbabwe well in the coming years. They agreed that the Zimbabwe dollar can be reintroduced as sole legal tender only after a track record of sound policies is established and a central bank governance framework with a focus on price stability is adopted.

Directors welcomed the authorities' intentions to improve the business climate. They emphasized the importance of enforcing property rights and maintaining the rule of law, ensuring security of land tenure, and increasing the flexibility of the labor market, in particular with respect to wage levels. Sustained progress in these areas is essential for improving competitiveness, boosting private sector investment, and increasing growth potential.

Directors agreed that Zimbabwe is in debt distress. Sound policies and good governance will be critical to pave the way for eventual debt relief and access to donor financing. In this context, Directors strongly encouraged the authorities to improve their cooperation with the Fund on policies and payments. Most Directors supported the continuation of the Fund's technical assistance in targeted areas. Many Directors were of the view that a Staff Monitored Program (SMP) could help establish a track record of sound policies. Some Directors, however, stressed that the authorities must demonstrate clear progress in economic policies and data reporting before an SMP could be considered.

Directors noted Zimbabwe's significant deficiencies in the quality and timeliness of data reporting, which are in large part explained by capacity constraints. They underscored the need for rapidly improving macroeconomic statistics with Fund technical assistance.

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, 2008–10

	Estimated		Projected
	2008	2009	2010
Real GDP growth (annual percent change) 1/	-14.5	4.0	2.2
Nominal GDP (US$ millions)	3,929	4,397	5,144
GDP deflator (annual percent change) 1/	-1.3	7.6	14.4
Inflation (annual percent change)			
Consumer price inflation (annual average) 2/	556×10^8	6.5	5.0
Central government (percent of GDP, measured in US$)			
Revenue and grants	3.4	22.2	26.1
Expenditure and net lending	6.5	25.0	33.7
Of which: cash expenditure and net lending	3.1	20.9	30.7
Quasi-fiscal activity by RBZ	28.9	0.5	0.0
Overall balance (including quasi-fiscal activity)	-32.1	-3.3	-7.6
Primary balance (including quasi-fiscal activity)	-28.5	0.1	-4.4
Cash balance	0.3	1.2	-4.5
Money and credit (US$ millions) 3/			
Broad money (M3)	314	1,276	1,511
Net foreign assets	-314	-256	-647
Net domestic assets	628	1,531	2,158
Domestic credit	140	602	1,048
Reserve money	7	125	145
Velocity (M3)	12.5	3.4	3.4
External trade (US$ millions; annual percent change)			
Merchandise exports	-9.3	-0.5	28.2
Merchandise imports	24.4	22.9	7.7
Balance of payments (US$ millions; unless otherwise indicated)			
Merchandise exports	1,633	1,625	2,083
Merchandise imports	-2,630	-3,232	-3,480
Current account balance (excluding official transfers)	-945	-1,323	-1,183
(percent of GDP)	-24.0	-30.1	-23.0
Overall balance	-624	29	-725
Official reserves 4/			
Gross official reserves (US$ millions; end-of-period)	6	312	114
Gross official reserves (months of imports of goods and services)	0.0	1.0	0.3
Debt			
Total external debt (US$ millions; end-of-period) 5/	5,794	7,145	7,662
(percent of GDP)	147.5	162.5	149.0
Total external arrears	3,781	4,575	5,132
(percent of GDP)	96.2	104.0	99.8

Sources: Zimbabwean authorities; IMF staff estimates and projections.

1/ In constant 2009 prices.

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

3/ Zimbabwe dollar values converted into U.S. dollars at the UN exchange rate at the end of 2008.

4/ Gross official reserves as reported by the authorities are adjusted for encumbered deposits, securities, banks' Real Time Gross Settlement accounts, and required statutory reserves.

5/ Includes arrears and amounts for unidentified financing.

Statement by Mr. Majoro on Zimbabwe
May 17, 2010

The Zimbabwean authorities thank the Executive Board for restoring the country's voting and related rights on February 19, 2010. Zimbabwe has benefited from the targeted Technical Assistance (TA), following the Board decision of May 4, 2009 to lift the suspension of TA in targeted areas. The country has embarked on a path of economic recovery following the implementation of liberalization measures including removal of price controls and adoption of multi-currency regime. The country posted a much stronger economic growth performance of 5.1 percent compared to a projection of 4.7 percent in 2009. Hyperinflation dropped from 231 million percent in 2008 to -7.7 percent in 2009. However, economic recovery remains fragile. The country continues to face several challenges, including political and governance issues, high debt-overhang, resource constraints, limited institutional capacity, large external current account deficit, as well as weaknesses in the business environment.

While the authorities recognize staff's concern regarding Zimbabwe's overdue financial obligations to the PRGT, undermined by inadequate progress in the implementation of fiscal consolidation, they have embarked on several fronts to address the associated challenges. The authorities have reviewed salaries but note that, given the relatively high wages in neighboring countries, pressures to raise wages have remained unabated. There is clearly an urgent need to strengthen fiscal policy—including the relatively high public sector wage bill as the economy emerges from a near total collapse—in order to crowd in capital investment and not jeopardize economic recovery and the prospects for satisfactory growth. The authorities are already prioritizing and managing expenditures to ring fence revenues for development capital projects and programs. A cap has been placed on the current wage bill while additional measures are being considered to enhance revenues, including receipts from diamond exports and a reform of income taxes.

On the expenditure side, recruitment in non-critical vacant positions has been frozen, and a review of both labor laws and related institutional arrangements will be expedited to link wages to labor productivity. Moreover, a civil service audit has been undertaken and the report, which is expected by end-May 2010, will be availed to the public in July 2010. The aim of the audit is to improve public service delivery and eliminate ghost workers. A high level committee has also been set up to formulate recommendations to reduce the cost of living, including rationalizing utility tariffs and improving the management of public utilities.

The authorities introduced cash budgeting to contain the budget deficit and they would like to underscore their commitment to this approach. The accumulation of domestic arrears pertains to 2009 and 2010 utilities bills, challenges relating to procurement lags between delivery of goods and services and verification of receipts, and the difficulties that the authorities are encountering in executing the cash budget. While donors have provided significant off-budget financing for social services and humanitarian assistance to help finance the deficit, they have so far lagged behind in meeting their budget support commitments, resulting in delays in implementing several capital projects and the shift of resources to prevent costly postponements. The authorities' ability to attain cash budgeting has further been impaired by the global financial and economic turmoil that has impacted adversely the already meager export receipts and government revenues.

After very careful deliberation, the authorities decided to use the only viable source of financing, their SDR allocation, to meet urgent humanitarian needs and focused spending to rehabilitate the agriculture sector, essential infrastructure, and support ongoing projects. While the authorities are aware of the need to rebuild reserves, the shock to the Zimbabwe economy, the extent of humanitarian needs and the urgency to start rehabilitating the economy could have only been mitigated through the partial use of the SDR allocations. The authorities did not take the decision to use their SDR allocation lightly and this should not be seen as weak fiscal policy implementation.

To strengthen public finance management and reduce the risks for emergency resources, the authorities have passed supportive Public Finance Management and Audit Acts to ensure improved accountability and oversight of the use of public resources, as well as to promote good governance. The new Public Finance Management Act aims at closing loopholes in public finance management and gives confidence to stakeholders. Moreover, it should help in matching expenditures with available resources. Moving the process further, Fund TA could help enhance cash management efforts by public enterprises and local government/authorities.

Further actions to enhance growth include introduction of regulations under the Indigenization and Economic Empowerment Act aimed at correcting imbalances by creating room for greater participation of the local people in all sectors of the economy. However, implementation of the Act has been put on hold to facilitate Cabinet discussion of amendments to the regulations in order to ensure that the country remains attractive for foreign direct investment.

The authorities regret that staff felt there is weakened cooperation with the Fund. Substantial advances have been made by the authorities in implementing TA recommendations on the Reserve Bank of Zimbabwe (RBZ) governance and accounting. Reform of the RBZ is currently underway with the establishment of a new Board on May 3, 2010 as a step towards refocusing the bank to its core functions and addressing the challenges it faces. The new Board is tasked with devising a strategy for right-sizing the RBZ's huge staff compliment, and restoring its operational viability as lender of last resort. Moreover, the Board is tasked to deal with issues of disposing the bank's quasi-fiscal assets and operations, and putting in place committees for monetary policy and audit. The authorities are coming up with legislation that will address the RBZ indebtedness through a RBZ debt reconstruction bill. The Ministry of Finance will continue making budgetary allocations to the RBZ in a bid to restore its viability. With most of its monetary functions "crippled", the bank is committed to focus on other functions, including financial sector oversight and overseeing the national payments system. This is an area where the authorities would welcome Fund TA and consider that the newly instituted Board should be given sufficient time to perform.

In the area of fiscal policy, the authorities have implemented most of the TA recommendations that could be done immediately. This has resulted in a significant improvement in revenue performance. Other recommendations are being considered in the context of the overall medium-term adjustment framework. In this regard, the authorities are working very closely with the IMF, World Bank, and the African Development Bank.

Zimbabwe is in debt distress. The authorities recognize that the debt-overhang cannot be resolved without debt relief from the international community, including from the IMF. They are developing a debt relief and arrears clearance strategy and have taken initial steps, with the support of the African Development Bank, to engage the services of a debt consultant. Further help was received from the UK's Department for International Development (DfID) and Macroeconomic and Financial Management Institute of Eastern and Southern Africa (MEFMI) in the areas of debt management and debt sustainability analysis. A Debt Management office is being set up to undertake debt management and risk analysis, settlements and management of the debt information system, and assist in the mobilization of resources.

Regarding arrears to the Fund, it should be recalled that due to the cash flow difficulties, the authorities developed a quarterly payment plan of US$l00,000 towards clearance of the PRGT arrears in 2009, with emphasis to give priority to increasing such payments as resources become available. This commitment was welcomed by the IMF Executive Board in April 2009. In line with the commitment, the authorities have paid slightly more, demonstrating their clear intent to cooperate fully with the Fund and their commitment to resolve the issue of arrears. The authorities will continue making timely quarterly payments and increasing the amount with improvements in payment capacity.

In order to address the many challenges, the authorities have devised a three year macro-economic policy and budget framework for 2010-2012 (Short Term Emergency Recovery Program II) aimed at enhancing growth, competiveness and poverty reduction. In this regard, the authorities consider a Staff Monitored Program (SMP) as an instrument for advancing their reform efforts and as a critical step towards debt relief. This would also aid in strengthening policies and ameliorating the difficult relationship with the international community. In the context of an SMP, the authorities would continue their efforts to improve data reporting with appropriate TA from the Fund.

In conclusion, the authorities consider an SMP to be an appropriate framework for addressing the issues raised in the 2010 Article IV consultations and request Board support in this direction. They welcome continued cordial working relationship with the Fund.