IMF – Macroeconomic Debrief – Key Pointers

Development Partner Group Meeting – September 6, 2012

Victor Lledó, IMF Resident Representative

I. Introduction

- IMF staff visit took place last week (September 27-31).
- The focus of the mission was to discuss the 2013 budget.
- Mission also updated growth projections and inflation outlook for 2012 and 2013.
- Mission looked at the fiscal outlook for 2012, including the implementation of PARP priority spending.
- Mission assessed whether there has been any noticeable impact from the Euro zone crisis and the recent spike in international food prices.
- Mission also assessed performance through June 2012 under the IMF program (PSI).

II. Economic Outlook

The economic outlook remains buoyant with robust growth and low inflation.

a) Growth

- Numbers for the second quarter of 2012 shared by the authorities during the visit show annual growth at 8 percent driven mainly by agriculture (6.8 percent), transport and communications (15 percent), and the continued mining sector boom (54 percent).

-Numbers show a marked pick up in the activity relative to Q1 when growth was at less than 6.5 percent.

-Our analysis is that the pickup reflects good performance across the board and the rapid start-up of coal production and exports that are quickly approaching transport and port capacity limits.

-The mission could not identify any transmission channels from the Euro zone crisis in the real economy.

- Against this background, the mission revised 2012 growth from 6.7 percent to 7.5 percent and for 2013 from 7.2 to 8.4 percent.

b) Inflation

- Inflation has come down more rapidly than anticipated under the program and fell below 2 percent in July.

- It was helped by lower-than-expected prices of imported food (mainly from South Africa) and a stable nominal exchange rate over the last year that reflected both the tight monetary policy and strong capital inflows.

- The authorities are monitoring food prices closely, but so far no strains are evident in regional food markets and the authorities did not expect major pressures beyond seasonal factors.

- Inflation is likely to pick up in the next few months due to seasonal factors and the lagged effects of monetary loosening since early 2012, reaching a 12-month rate of 5½ percent by end-2012.

- *The mission expects inflation to remain at 5-6 percent in 2013.*

III. Policy Performance

a) Fiscal Policy

- *Fiscal revenue performance was below program in the first half of 2012.*

-This reflected lower than anticipated inflation and higher than anticipated exchange rate and transition problems in customs with the introduction of a single window for trade transactions.

-Customs revenue has picked up since and the authorities expect to narrow, if not close, the shortfall by year-end.

-They also expect windfall capital gain tax revenues of ½-1 percent of GDP from the sale of shares in a major gas project between private parties (aka Cove sale).

-*Investment spending under-executed in the first semester of 2012 due to delays in donor disbursements. Mission expects a pickup in the second half of the year in line with previous year's patterns.*

-A number of donor disbursements were delayed to the second and third quarter of the year, thus leading to slow expenditure implementation, particularly in capital spending, and an increase in arrears on VAT reimbursements; some catching up is expected in the second half of the year.

- E*xecution patterns in priority spending for the first semester broadly similar to 2011 with lower than half of the budget executed in most sectors. IMF program target met.*

-*Mission discussed some areas where fiscal policy was not entirely consistent with the central bank efforts to improve access to credit: VAT refunds and medium-term domestic debt*.

-Mission was quite adamant that the issue of VAT reimbursements needs to be resolved shortly as it compromises the business environment and adds to the cost of capital, particularly for small and medium-enterprises. Delays in VAT refunds are a form of involuntary financing from enterprises to the government rendering even less effective BM's efforts to increase credit to the economy by loosening liquidity conditions.

-Recent domestic debt issuance of T-bonds in line with 2012 budget, but backward indexation of T-bond rates result in high cost of domestic financing of government.

-Mission questioned whether the historical motivation for this indexation was still valid in an era of declining and very low inflation. Banks would be willing to hold government securities at lower rates—as long as they pay more than deposits at the BM.

-High rates on government securities and the still high BM lending rates may impede banks' lending and deposits rates from coming down to more reasonable levels in real terms, and thus keep real cost of credit very high.

b) Monetary Policy

Credit to the private sector remains relatively subdued despite the monetary policy easing.

- Not the focus of the mission. Review mission in later October will discuss in more detail.

- Credit to the private sector has picked up mildly (to about 9 percent on annualized growth terms), but it is still way below the initial end-year growth target of 20 percent.

c) IMF Program

The PSI-supported program is broadly on track.

- All quantitative targets for June met except net credit to the government and fiscal revenue. The quantitative targets for end-2012 are within reach.

-The structural benchmarks through June were met with the exception of the implementation of the single taxpayer database and identification number, which is facing some technical delays, but is already operating on an experimental basis. Progress is being made on those through year-end.

d) Budget for 2013

The mission reached agreement on the broad outline of the budget for 2013, with the authorities being optimistic on revenue projections and cautious on projections of external disbursements.

-*The mission sees a different funding mix (higher donor funding and lower tax revenue) for the same expenditure envelope*.

-Government revenue projections are not based on the nominal GDP numbers recently released by the National Statistics Agency, which implied a downward revision on the nominal GDP for 2011 that is translating into lower nominal GDP projections for 2013. Therefore, by assuming a larger nominal GDP for 2013, nominal revenue projections seem overly optimistic.

-On the other hand, authorities are rather cautious in their approach of projecting external donor disbursements. Only 2013 commitments that have been "formally submitted" are included as part of the external financing envelope.

-Our estimates are that external resources (grants and loans) could well be US$100-160m higher than authorities are assuming.

-The mission thinks that the target of increasing revenues by at least 0.5 percent of GDP is becoming not only less realistic (policy measures may start to be less effective incurring "decreasing returns"), but also less desirable, if continued to be pursued.

-Revenue to GDP ratios has increased from 17.6 percent of GDP in 2009 and 23.1 percent in 2012, i.e. 5.5 percentage points in 3 years. This far exceeds the medium-term target of a 2.5 percent increase in 5 years. In the current stage, where most of the contribution comes from the non-resource sector, a slower pace may be desirable from the point of giving non-resource, non-megaproject enterprises some breathing space to grow their business and create jobs, critical to foster more inclusive growth.

-The mission encouraged authorities to start considering separate revenue mobilization targets for the resource (coal, gas, and other megaprojects) and non-resource sectors or to look at revenue targets as a percentage of the non-resource sector. Work needs to be done to refine the measurement and contribution of the resource sector.

- *The budgeted level of domestic financing will not crowd-out the private sector.* The 2013 budget has domestic financing at 0.5 percent of GDP, which is below the 0.6 percent of GDP target for 2013 under the IMF program. The mission thinks that domestic financing could be higher without crowding out the availability of credit to the private sector. However, any increase in the domestic financing target is subject to lowering the applicable interest rates on T-bills as discussed above.

-*The wage bill is rising and remains a concern.*

-The wage bill in the 2013 budget is expected to reach 10 percent of GDP and above the government's self-imposed limit of 9 percent. Less than 20 percent of the nominal increase is due to new hiring in priority sectors, such as health and education; the bulk is due to nominal increases, promotions, and adjustments in non-wage benefits.

-The mission expressed their concern as it limits the room available for other spending.

-*Details of the investment budget and priority spending are still to be worked out, but the authorities are trying to reflect the medium-term priorities of the poverty reduction strategy (PARP) in the annual budgets*.

-*Breakdown into priority spending not yet available and the review mission will continue to monitor it closely to ensure that it shows an increased orientation of government resources towards PARP priorities*.

-*Staff welcomes the progress in implementing social protection programs, but noted that number of beneficiaries is still very small and needs to be pushed further*. Transfer levels for some of the programs (MT 150) are very low and should be raised closer to the poverty line (MT 540 pm for children). There is the fiscal space for that.

- *Domestically financed investment up marginally*; have components of big projects like Catembe Bridge and the Ring Road.

-The mission stressed the need to do less visible projects such as construction and maintenance of rural roads to allow farmers to transport their surplus to the market and, together with extension services, raise agricultural productivity.

-*Above all the mission, urged authorities to continue to document and publish their public investment priorities framed on sound cost-benefit and socio-economic impact analyses and consistent with their medium-term and annual borrowing capacity*.

-Ensuring good quality in forthcoming government documents such as *the Integrated Investment Program, the Medium-Term Debt Strategy, and the Annual Borrowing Strategy*, all past or future benchmarks under the IMF program would be critical to this effect.

-*The 5th review of the IMF PSI, scheduled for October 17-31, will resume and deepen discussions on all of the above issues*.