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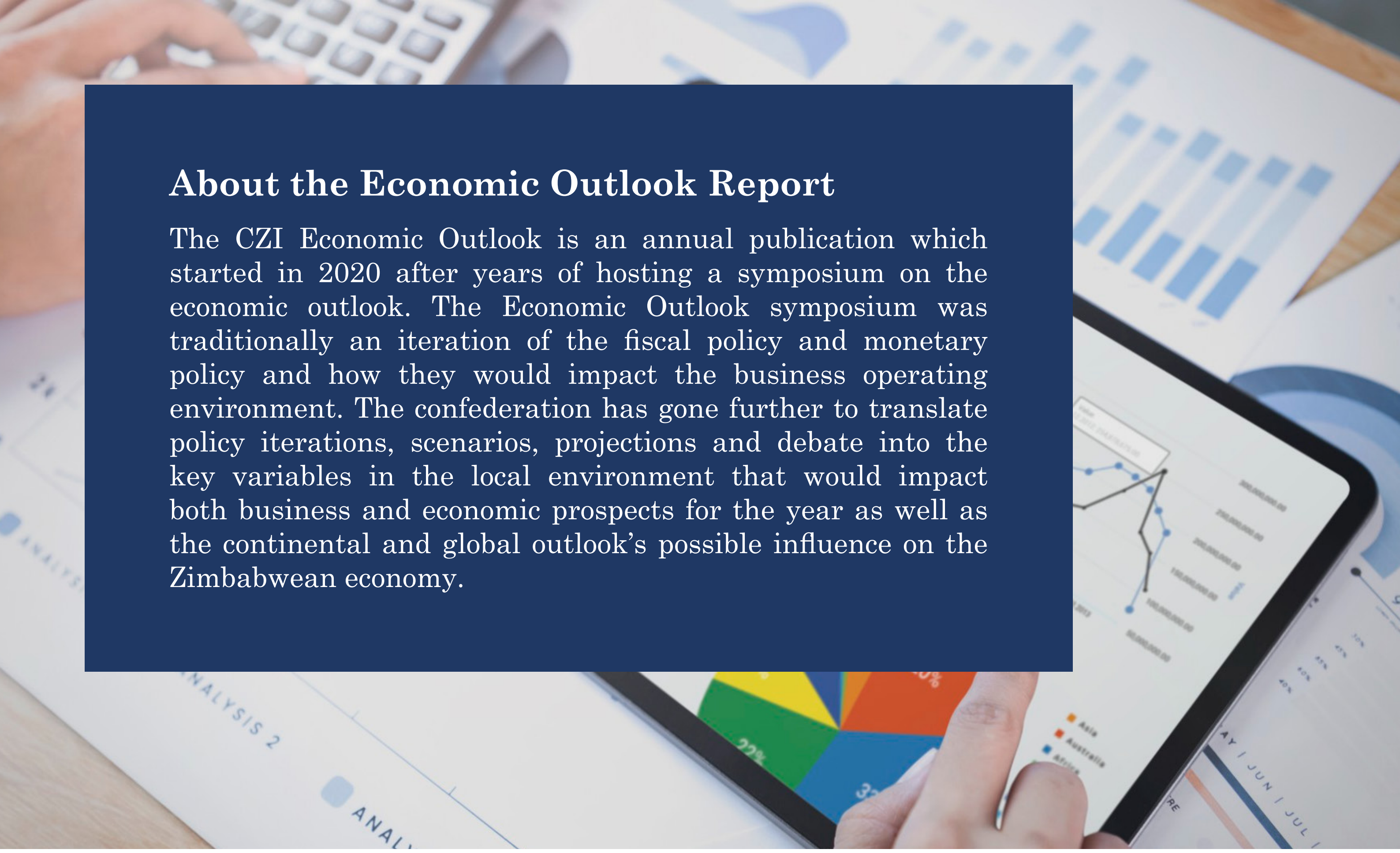
CZI ANNUAL ECONOMIC & BUSINESS OUTLOOK 2023

10 March 2023



Contents



About the Economic Outlook Report

The CZI Economic Outlook is an annual publication which started in 2020 after years of hosting a symposium on the economic outlook. The Economic Outlook symposium was traditionally an iteration of the fiscal policy and monetary policy and how they would impact the business operating environment. The confederation has gone further to translate policy iterations, scenarios, projections and debate into the key variables in the local environment that would impact both business and economic prospects for the year as well as the continental and global outlook's possible influence on the Zimbabwean economy.

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a) Honourable C. Chiduwa, Deputy Minister, Ministry of Finance and Economic Development
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g) Farai Mutambanengwe, SMEAZ CEO and Member of Economists Round Table @CZI
h) Archie Dongo, Director, N Richards Group and Member of Economists Round Table @CZI
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j) Gloria Zvaravanhu, Managing Director, Old Mutual Insurance Company Zimbabwe
k) Reneth Mano, CEO, Livestock and Meat Advisory Council and Member of Economists Round Table @CZI
l) Wellington Dangarembizi, Managing Director, Hunyani and Member of CZI Regional And International Trade Committee

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1. Introduction

The year 2022 was generally a tale of two halves, with the first half characterised by economic instability that was being sparked by a depreciating parallel market exchange rate and high inflation. However, following a cocktail of measures that were introduced whose main effect was to curtail liquidity in the market, there was a noticeable wave of stability in the second half, reflected by stability in the parallel market exchange rate as well as the narrowing of the parallel market exchange rate premium.

This brings a number of questions as far as the economic outlook is concerned:

- Will the positive momentum that was registered towards the end of 2023 likely to be sustained?
- Are the economic drivers, specifically, the key economic sectors, revealing positive prospects that could anchor expectations for a favourable economic position in 2023?
- Are the developments in the region and across the globe reflecting some positives which could also filter through into the Zimbabwe economic environment?
- What could be some of the fiscal and monetary policy implications on the economic prospects for growth and development?
- Given that inflation and currency issues continue to be the main determinant factors in terms of stability, what could be their status in 2023 which could affect the economic outlook?
- What are some of the key risks across the key sectors which have the potential to derail the economic outlook?

The quest to provide some answers to these questions is generally the purpose of this CZI 2023 Economic Outlook report.

2. Review of 2022 economic performance and the momentum that is being brought into 2023

2.1 Overview of 2022 Economic Performance

Just as the Zimbabwean economy was on a recovery path from the noxious effects of the Covid19 induced slowdown- benefitting from the multi-currency regime- it was not spared from the financial turmoil in the world. Notable price increases were recognized in fuel, wheat, fertiliser, cooking oil among other commodities. The situation was made worse by a strong dollar owing to the Fed's hike in interest rates to try and rein in on inflation. These multiple shocks continued to weigh on Zimbabwe's economic growth resulting in the country's estimated GDP growth rate declining to below 4.0% in 2022 from 8.5% in 2021 (Table 1). Nonetheless, despite all these headwinds, the World Bank's 2023 and 2024 economic growth rate forecast for Zimbabwe is expected to move in line with that of Sub-Saharan Africa.

Table 1: GDP Growth Rate and Forecast for Zimbabwe in comparison with the rest of the world

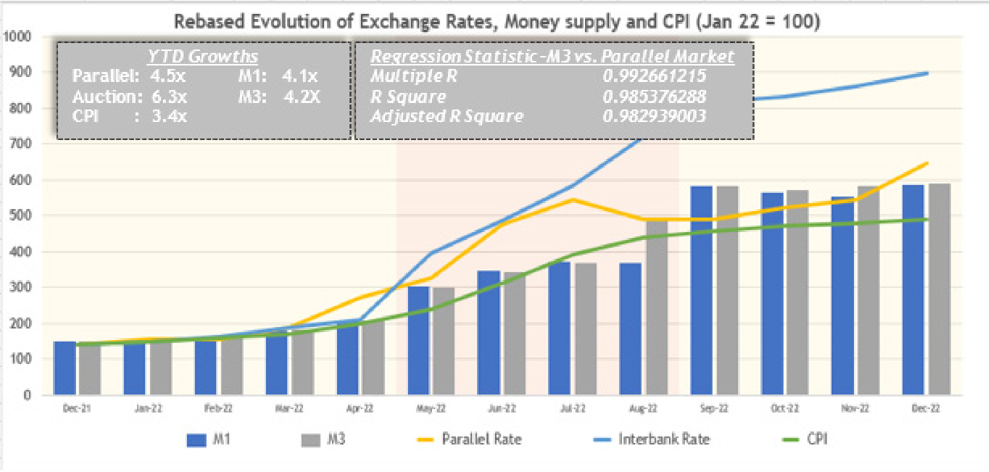
	2021	2022	2023F	2024F
Zimbabwe	8.5%	3.4%	3.6%	3.6%
Sub-Saharan Africa	4.3%	3.4%	3.6%	3.9%
South Africa	4.9%	1.9%	1.4%	1.8%
World	5.9%	2.9%	1.7%	2.4%
Advanced Economies	5.3%	3.5%	0.5%	1.6%

Source: World Bank Group

2.2 Money Supply, Inflation and Exchange Rate

While exogenous global issues played a notable role in the challenges experienced locally, Zimbabwe also had its own internal issues. Most of the issues stemmed from the increase in money supply in the economy. Empirical evidence has proven that a positive correlation exist between money supply, exchange rate and inflation (Figure 1). One year regression statistics, which explain the extent to which two variables are linearly related, confirm the positive nature of the relationship between broad money supply (M3) and local currency depreciation, as measured by the parallel rate. Multiple 'R' which measures the fit of the model and the strength of association between the dependent (rate) and independent variable (M3), and both the R-squared measuring how much the dependent (rate) variable is explained by the independent variable (M3) and its adjusted version all confirm how much influence growth in M3 has on the parallel over the defined period.

Figure 1: Inflation rate in Zimbabwe is mainly driven by the parallel market exchange rate



Source: Reserve Bank of Zimbabwe, IAMZ (2023)

Historically, growth in broad money supply (M1/M3) has been the main inflation and currency depreciation driver with M1 and M3 growing by 4.1 times and 4.2 times respectively in 2022. During the same period, the USD appreciated against the ZWL by 530% and 352% on the official and parallel market respectively. On the other hand, while it came down notably after accelerating in the early parts of the year, year on year ZWL$ inflation remained elevated closing the year at 244%- with the highest rate of 285% recorded in August 2022. Compared to the RBZ inflation target of below 20% for 2022, the actual/realised inflation figure for the year was significantly higher.

In the money markets, ZWL bank deposit rates averaged 80%, which is well below inflation. In line with accelerating dollarisation in the economy, demand for USD funding blossomed, resulting in a notable growth in activity within the USD fixed income space, largely from corporates. While deposit rates offered by banks predominantly started the year at the lower end, at around 5% per annum, these gradually increased to average 9% towards the end of the year as demand for real funding increased. With official inflation ending December at 243.8% after a month on month increase of 2.4%, this implied substantially negative interest rates on money market assets.

2.3 Accelerated Dollarization and Informalization

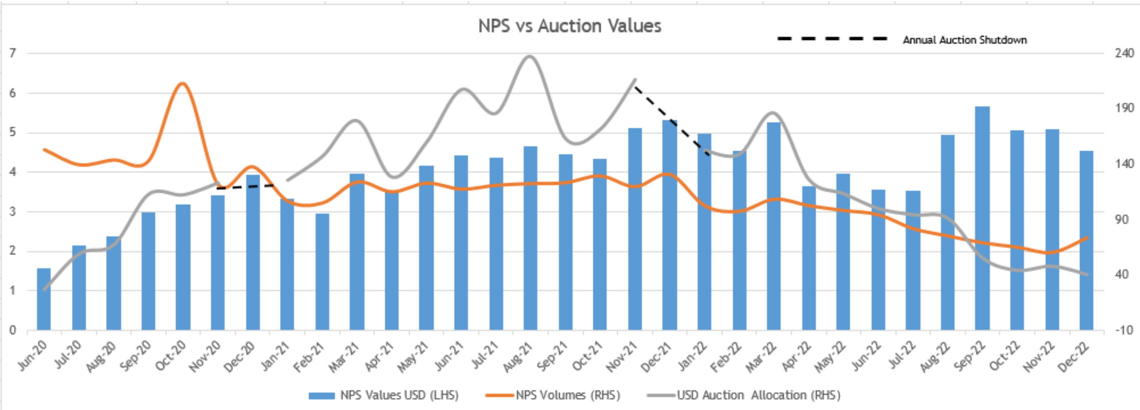
Dollarization definitely intensified within the broader economy. The use of the dollar brought with it a number of positives in the economy. For starters, it allowed corporates to price and accept USD for their goods/services and made it easier for them to plan and fund growth internally. It also helped reduce pressure on the auction system. Beyond being a reference pricing point for some products, the auction system lost relevance during the year as businesses have continued to shun it for various reasons.

In order to curb the runaway inflation and stop the ZWL free fall, the government put in place a combination of measures that were meant to ultimately reduce money supply in the economy. These included a total ban on lending to a significant increase in the cost of borrowing from 80% to 200% so as to reduce 'speculative borrowing'. These have since been all reversed, but had far reaching effects on the economy. At the same time, government made an abrupt stop to all its payments and introduced the "*Value For Money*" department whose main role was to review invoices for all government departments to check for any pricing anomalies before payments were initiated.

These policies meant to reduce ZWL liquidity, however, had unintended consequences of accelerating the rate at which the economy was dollarizing.

The volume of transactions going through the National Payment System (NPS)- an RBZ overall payment system that consolidates all formal transactions and forex auction (measures of formal market activity) continued dwindling post the liquidity tightening measures announcement. Having started the year at over 130 million transactions, the number of transactions that went through the formal payment streams (namely RTGS platform, POS, ATMs, mobile payments and internet transactions) dropped to just over 70 million in December 2022 (Figure 2). These at some point hit over 210 million transactions and have been trending down over the last three years from an average of 150 million transactions in 2021 to 80 million transactions in 2022. Juxtaposed against well performing companies, both private and public, whose USD revenues are north of 70%, this data could indicate an economy that is significantly informalising. Having peaked at USD5.7 billion in September, the value of these transactions also dropped to USD4.5 billion in December. Another telling signal, and explained by various reasons, including the increasing use of USD cash outside formal systems has been the drop in auction allocations from a historic peak of over USD200 million to the current USD50 million monthly average at a time USD bank deposits have not significantly gone up.

Figure 2: There has been some Quickening of Informal Sector Led Dollarization



Source: Reserve Bank of Zimbabwe, IAMZ (2022)

2.4 Momentum Being Brought Into 2023

The aforementioned relationship between money supply and other performance indicators still exist and is expected to continue in 2023. The parallel market rate has been depreciating over the past two months, most likely fuelled by an injection of fresh liquidity by government. This resulted in the ZWL$ losing more than 30% of its value in a period of a month.

With 2023 being an election year, there is a possibility for government decisions to result in the creation of excess liquidity. As long as ZWL$ remains part of the multi-currency basket, ZWL$ inflation could remain elevated and local currency devaluation subsisting. There is need to keep a closer look at the parallel exchange rate since ZWL$ inflation numbers have become somewhat meaningless due to the fact that in excess of 70% of local transactions are now done in USD. In their January 2023 inflation publication, ZimStat mentioned that going forward they will start using blended inflation taking into account the blended nature of local transactions. RBZ echoed the same sentiments in their 2023 Monetary Policy Statement. However, blended inflation numbers will not add much value in decision making. Ideally, we would have preferred ZIMSTAT to publish both USD and ZWL$ inflation numbers separately.

At a micro level, economic activity remains robust supported by strong foreign currency receipts including diaspora remittances. In recent years, the value of these inflows have been growing, with the remittances for 2022 exceeding the USD2 billion mark up from USD1.4 billion which was received in 2021. This has also helped fuel dollarization in the economy as these funds remain accessible in cash.

In the money markets, an upward review in interest rates is not expected, as these are guided by inflation which should trend downwards considering its blended nature dominated by USD transactions. Government is also incentivised to keep the rate low since they are the single largest borrower. For example, in their 2023 borrowing plan, Treasury intends to raise ZWL$0.6 trillion through various government backed papers. An increase in interest rates would mean that their debt service obligations would also increase implying it would thus be in their best interest to keep rates lower and crowd our private players.

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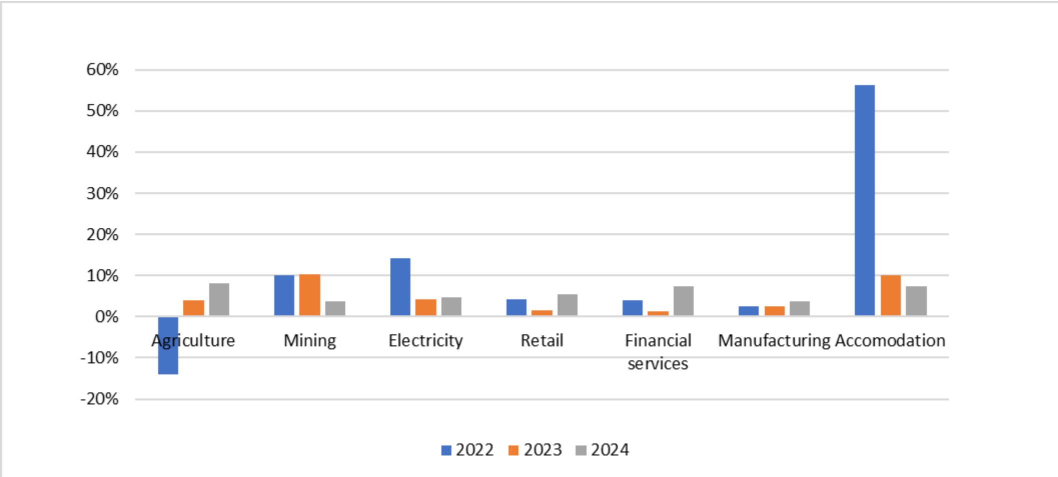
3. Indications from the Key Drivers of Economic Performance

Government estimates 2022 GDP to have grown by 4.0%, slowing down significantly from 8.5% in 2021 and the initial 4.6% mid-year projection. Relative to global economies which went up by an average of 2.9% - owing to a number of challenges including monetary tightening, higher inflation and the Russia-Ukrainian war- Zimbabwe fared considerably better.

Going forward, Zimbabwe is expected to grow by 3.8% in 2023- which again misses the NDS1 annual target of at least 5% annual growth. This economic uptick is expected to be anchored by recovery in agriculture, continued growth in mining and a notable boom in the accommodation sectors benefitting from the opening of the Chinese economy (Figure 3).

Figure 3: Sectoral growth estimates and forecasts for Zimbabwe



Source: 2023 Annual Budget

3.1 Energy: Direct additional burden on households and businesses

Zimbabwe and the region have been experiencing notable power challenges arising from depleted infrastructure due to decades of non-maintenance and lack of investment. For Zimbabwe in particular, power generation deteriorated significantly in the second half of the year with Kariba, which supplies over 40% of our installed capacity, on the verge of being switched off.

Hwange Power Station has not been able to produce to its capacity due to the incessant breakdown of the aged units. It generated with an average of 3 units in comparison to the target 5 units in the last quarter of 2022. On the other hand, Kariba South Power Station overused its allocation of water in 2022 exceeding its generation capacity of 606MW in a bid to augment low power generation at Hwange. This led to a pronounced reduction of water levels available for power generation in Lake Kariba thus necessitating the reduction in the station's generation to 250MW by the Zambezi River Authority. This resulted in increased load shedding in both Zimbabwe and Zambia. With demand increasing- in response to various expansion projects in the economy- and forecast to increase to over 3,500MW by 2025, an accelerated programme to create new sources of power is needed.

Short to medium term plans

In its 2023 budget, government prioritised the completion of Hwange 7 and 8 units. In addition to internal resources, disbursements from the China Exim Bank loan facility will be directed towards the completion of Hwange 7 and 8 expansions, which is anticipated to bring another 600 MW to the grid (Table 2). Positively, water levels at Kariba are gradually improving due to an increase in local rainfall activity, flows in the immediate streams and mainstream Zambezi River, with end of February 2023 measurements showing an increase to 477.48m or 13.7% usable storage.

Table 2: The electricity generation capacity is expected to increase in 2023

SOURCE	TARGET CAPACITY	TIMELINE
Kariba	425MW *(Increase to 775MW from current 350MW)*	Kariba Dam water levels improvement April/May 2023
Hwange 7 & 8	600MW	300MW March 2023 300MW June 2023
IPP (Solar)	50MW	December 2023
Hwange Stage 1&2 Life Extension	400MW (additional)	2024

Source: ZETDC, 2023

Holding all other things constant, the expectation is to have a supply-demand balance in the second half of 2023. Power shortages will continue to be a major economic headwind for 2023 should the various new and expansion projects fail to materialise. Energy drives economic growth and industrial productivity, hence the anticipated GDP growth may be negatively affected by power shortages.

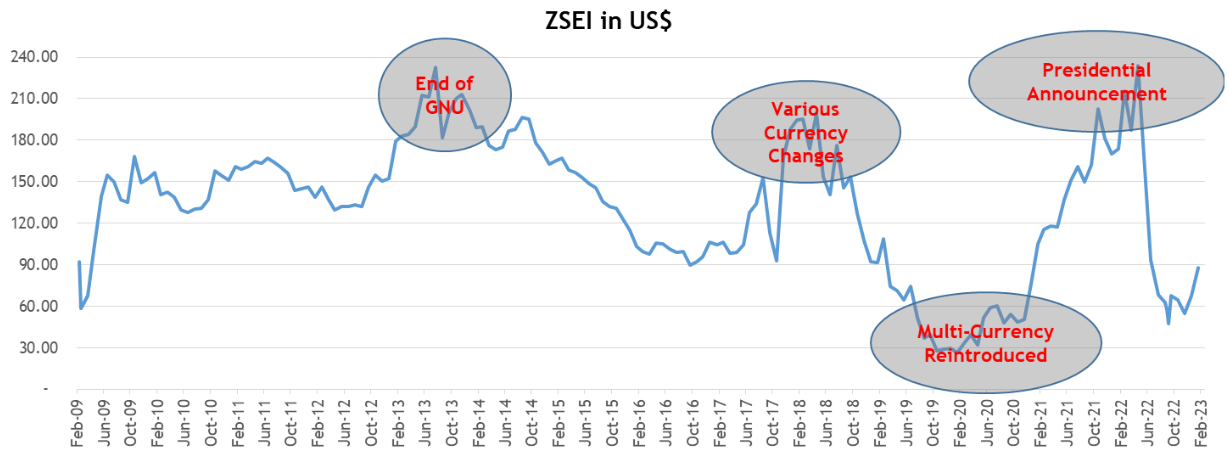
ZESA would also need to address its pricing matrix in order to remain viable and attract privately funded Independent Power Producers (IPP) - who currently contribute an average of 1.5% to domestic generation. On the other hand, ZETDC as the guaranteed off taker for private players can only pay these players in local currency and at the official rate which creates no incentive for the setup of new renewable energy plants. An effective local tariff of just under USc7/kWh is inefficient especially when juxtaposed against production costs nearing USc10/kWh. For example, while ZERA has licenced more than 60 IPPs with a combined capacity to generate 2,000MW, offtake has been extremely low largely on account of viability issues. Early days yet, but towards the end of last year, ZESA proposed to charge all exporting customers an average of USc12.2c/kWh. This should help, if exporters can afford it. An ambitious target to move all the customers to a prepaid platform, from a current 30%, will also help fund imports which predominantly work on a prepayment basis.

3.2 Financial Markets- notable real upside exists

After a stellar 2021, the ZSE had a relatively muted 2022 losing close to two thirds of its beginning of year USD value (Figure 4). A number of policy interventions that had a net effect of tightening liquidity accompanied by a deliberate blitz on the market dampened investor mood. Having started with relatively fairly valued assets, the year closed with equity valuations that are exceptionally low in USD terms and remain so despite the mini recovery in the fourth quarter. The ZSE experienced a bull-run beginning of 2022 up to end of April where it reached its peak; the Index had gone up by 161.8% over that period (Figure 4). Government blamed the stock market for fuelling inflation and currency depreciation and thus introduced measures meant to slow down inflation which impacted the stock market negatively.

In August 2022, government undertook a contractionary monetary policy stance by stopping payments to its suppliers and increasing lending rates as it tried to control money supply and inflation. This further starved the stock market of liquidity resulting in a contraction of 25.5% in the third quarter. There was an odd rally of 30% towards the end of Q4; however, the ZSEI shed 71% in real terms in 2022

Figure 4: ZSE had a relatively muted 2022, losing close to two thirds of its USD value



Source: IAMZ (2023)

The ZSE should recover from its current lows having significantly lagged currency devaluation and inflation in 2022. Gold coin supply has been erratic and pension funds cannot play the parallel market. This leaves one home for ZWL- the ZSE- which has remained extremely cheap in real terms. It's rare to be given such an opportunity to buy cheap quality assets. Underlying companies have recorded increase in revenue and profitability in USD. Price/Sales ratios are low in comparison to historical numbers pointing to very cheap stocks. The current distortion in correlations reflects market inefficiencies, they do not last for long and we believe a correction is underway.

On the fixed income side, short term dollar-based investments are most attractive in the current environment. Uncertainties related to the tenure of the multi-currency regime further make longer term USD investments riskier. Exposure should however be limited to foreign currency generating assets. Globally, the Fed is trying to achieve a 'soft-landing', slowing growth enough to curtail inflation while at the same time avoiding a recession. Currently financial markets believe a soft landing is possible and the IMF is less pessimistic. But inflation may take longer to fall which will delay an interest rate cut.

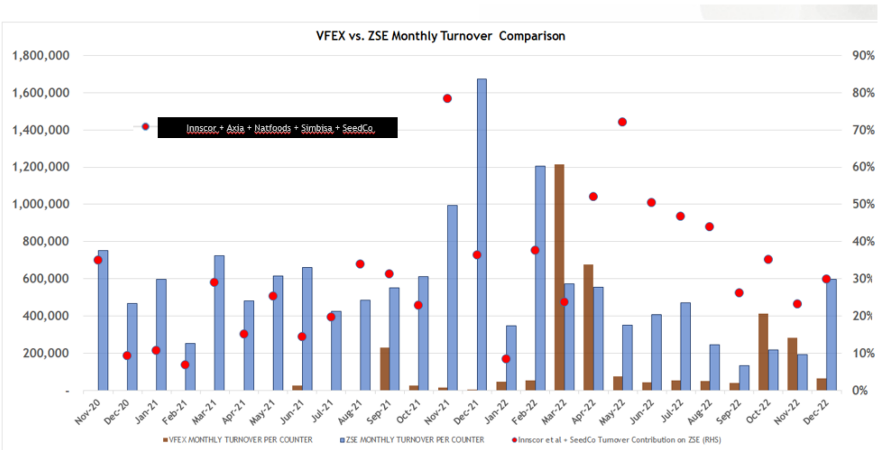
Due to the recent pricing challenges associated with the ZSE and intensified dollarization in the economy, the VFEX has seen an increase in the number of counters and securities migrating to the bourse. These have, however, been largely direct de-listings from the ZSE and not new listings *per se*. We speculate a few other companies will also be migrating to the dollar denominated bourse during the year. This has helped increase the pool of assets one can invest in USD and enhance currency diversification. USD reporting will also make analysis easier.

Caution has to be taken before a company decides to migrate to the VFEX as liquidity constraints could potentially remain a concern and may result in challenges around portfolio rebalancing and restructuring. Since inception in the second half of 2020, activity has remained constrained on the VFEX with both volumes and value significantly lagging similar statistics on the ZSE, even for the same stocks.

Average monthly turnover per counter at less than USD0.2m is not even half of what goes through the ZSE. Of the grand total all-time value traded on VFEX, 76% comprises activity in Bindura (41.70%) and Padenga (35.03%) arising out of structured trades in the 2 stocks. Stripping out the block trades described below average daily value traded plummets to USD25,000.

However, there is a possibility of an increase in liquidity as the economy dollarizes resulting in a surge in trading activity on the bourse. The resultant reduction in the pool of quality ZSE listed counters is likely to result in an increase in activity for mid-tier and low cap stocks on the ZSE. For example, all the recent listings namely Simbisa, Innscor, NatFoods and Axia historically contributed more than 35% of activity to the ZSE (Figure 5). The number would have gone up if Seedco had gone ahead with their transition to the VFEX. Excess ZWL will still need a liquid home.

Figure 5: VFEX historical performance- the jury is still out!



Source: IAMZ, 2023

3.3 WHOLESALE & RETAIL SECTOR- bearing the brunt of an overvalued ZWL

This sector experienced a difficult year dominated by exchange rate volatilities and high inflation which presented complications in terms of product pricing. Most suppliers either insisted on expensive shorter trading terms, foreign currency payments or prepayments for all goods sold in ZWL. Other challenges related to intensified competition, forex shortages, erratic power supply, and high interest rates. The widening gap between the auction and parallel rate had a huge impact on revenue since they can only price their goods and services using formal rates, a higher premium between the two rates results in less USD inflow to their tills.

Growth in USD denominated informal sector increased competition for the formal sector as the locally priced goods in shops were less attractive. On the other hand, manufacturers deliberately increased product supply to channels offering hard currency payments rather than formal retail chains where mandatory use of the legal exchange rates led to significant price premiums. Competition within the retail space also intensified with manufacturers preferring to move their goods into the informal sector where pricing is in USD or reflects parallel market dynamics. Government instituted measures that included an increase in interest rates had a negative impact on the demand dynamics in the economy resulting in products taking longer to be sold increasing inventory holding costs. Increase in the bank policy rate from 80% to 200% increased the burden of ZWL obligations and made it difficult for retailers to manage their cash flows, offer credit terms and borrow for working capital purposes.

Aggregate demand within the sector contracted significantly and was more pronounced during the third quarter of 2022 as a result of the contractionary monetary policy stance taken by government that saw ZWL being scarce.

Using statistics provided by the more visible and listed groups, namely OKZIM and Meikles (for Pick'n'Pay), as a barometer for the overall sector performance we note remarkable volume drops in the aforementioned periods. Pick'n'Pay volumes were down 16.5% with OKZIM following suit, dropping by 11.3% in the same quarter. About 75% of the players in the sector showed volume declines over the third quarter ranging from 8% to 23%. The outlook is not promising as well with the sector expected to grow by a marginal 1.6% in 2023, down from 4.3% in 2022 (which itself was a halving of the notable 8.1% jump in 2021)[1]. In the short term, while other sectors are witnessing strong growth on the back of increased USD based transactions, the formal wholesale/retail sector remains in the doldrums due to the use of an overvalued exchange rate.

3.4 MINING- all glitter?

Global challenges caused notable supply chain disruptions leading to elevated prices for most commodities for the greater part of the last two years. While there is an expected slowdown, commodity prices are expected to remain above pre-crisis levels. By all accounts mining in Zimbabwe is growing rapidly. Indeed, the country would appear to be blessed with such a variety of minerals and sought after ones at that, such as platinum and now lithium, in addition to the valuable gold deposits that are well known. As such, exports are expected to be considerably higher in value than they currently are.

Despite all the uncertainties in the pricing of commodities in 2022, government has remained bullish, forecasting the mining sector to grow by 10.4% in 2023 after an 8% growth in 2022. Contributing approximately 12% to overall GDP and more than two-thirds of total exports, this sector remains critical in aiding economic growth. Gold and platinum anchor the sector, bringing in the bulk of the exports. Of the USD 5.6 billion in export receipts from the mining sector, platinum contributed USD 2.5 billion (44.6%) and gold USD 2.3 billion (41.1%). Growth is coming from increased prospecting activities and relatively higher prices. A number of projects, both new, expansionary and resuscitation of closed mines, were announced in the past year. These include a totally new PGM investment by Karo Resources (USD400 million) an additional USD20 million Cam & Motor BIOX plant by RioZim and resuscitation of Eureka Gold mine, Sandawana and Kamativi amongst others. Lithium mining deserves a special mention due to the increased prospecting and transacting activity within that space, dominated by Chinese investors seeking to lock in resources considered critical for EV batteries. With Zimbabwe currently the sixth largest global producer of lithium, government banned exports of unprocessed ore to promote beneficiation.

Major headwinds relate to increased political interference, elevated operating costs and protracted power shortages. An uncertain and unattractive tax and royalty payment structure could also impede growth in the sector. For example, effective 1 January 2023, the royalty rate for platinum miners being doubled to 5% and a similar rate was proposed for lithium miners. . These factors might conspire to put downward pressures on the already, overly optimistic, projected sector growth rate for 2023 and result in the country missing out on the currently prevailing higher commodity prices.

[1] CZI 2023 Economic Outlook Symposium discussions

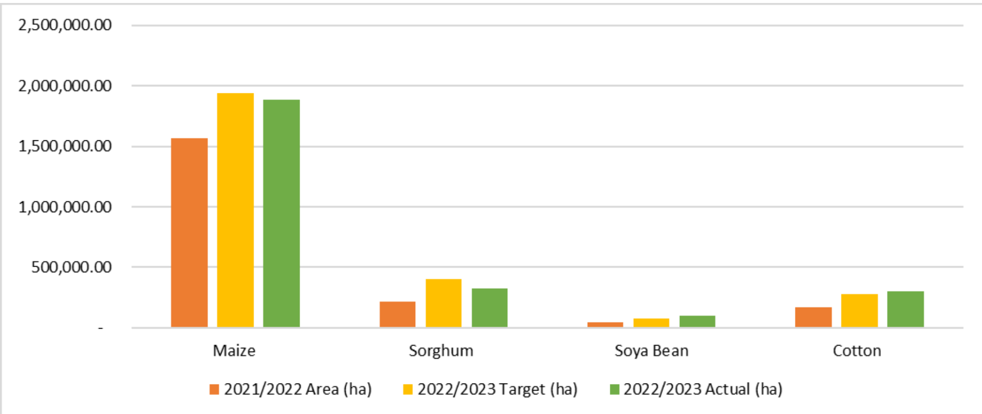
3.5 AGRICULTURE- needs to evolve.

The 2022 agricultural sector was characterized by a false start to the season, late rainfall onset, and uneven rainfall patterns in most parts of the country. As a result, the sector that was originally projected to grow by 5.5%, shrunk by 14.1% due to erratic rainfall patterns experienced during the course of the season.

In 2023 the sector is projected to grow by 4.0% before rising to 8.2% and 7.9% in 2024 and 2025 respectively. The 2023 growth is anchored on expected normal to above normal rainfall forecast, offsetting various funding related challenges and a late planting season. Even though planted area for maize is about 20% ahead of last year, it still fell short of the targeted 1.9 million hectares (Figure 6). Funding of the crop remains a major issue with close to 85% of the crop being self-financed exposing the myth that government is a major funder of the sector. This trend is repeated in almost all the crops including soya and sorghum- clearly depicting the need for financiers to support the sector. As at February 2023 a sizeable chunk of USD bank funding allocation seemed to be favouring tobacco with a huge allocation of USD150 million (about 50% of disbursements). Maize and soya only managed to attract just over 10% of the available funds.

A much noticeable, but maybe not surprising, trend has been the more than doubling in soya planted area from 44,845 ha in the prior year to 94,504 ha in the current year- 60% of that being self-financed. At the end of December, Government announced the minimum prices it would pay for maize and soya which were based on the landed – or imported price at that time. These prices are too low relative to the costs of production, especially with regard to maize where the cost of production per hectare has skyrocketed in 2022/2023. It is estimated that there is a 21.8% (USD2, 001/ha) and 8.9% (USD1,643/ha) increase in the cost per hectare of producing maize and soya respectively from the 2021/22 agricultural season to the 2022/23 season[2].

Figure 6: Crop production planted area



Source: Crop, Livestock and Fisheries Assessment Report

As a result of prior years' below par outturn, stock positions at Grain Marketing Board (GMB) are very low. There is currently only 360,000 tonnes of maize held in silos by GMB. Juxtaposed against monthly normal usage requirements of 75,000 tonnes/month, this leaves less than five months stock cover. As a result, rationing has been put in place with only a third of the monthly requirements being released. The situation is much better in wheat, with close to 10 months cover (210,000 tonnes) in stock benefitting from an unprecedented, good winter wheat crop. This almost guarantees the need to import maize from the region and or beyond.

Perennial issues related to security of tenure, droughts, high input costs, low yields will remain an impediment to the realisation of the sector's full potential.

[2] Author's own calculations

3.6 Implications from the sectoral growth patterns

Achieving the projected growth is going to be an uphill battle given the country's ongoing power shortages, ZWL$ inflation and depreciating local currency. There is a need to create a clear and concise plan to tap into the informal sector and increase its formal contribution to the economy. While there have been announcements to prioritise focused support services around finance, training and access to markets, more needs to be done to reduce barriers limiting the growth, contribution and formalisation of this critical sector. High on the list will be a need to streamline taxes in order to make it more attractive for the sector to register with ZIMRA. Another downside risk will emanate from elections which will take place in 2023. The country faces risk from likely increased spending to finance election-related activities ahead of and during forthcoming polls.

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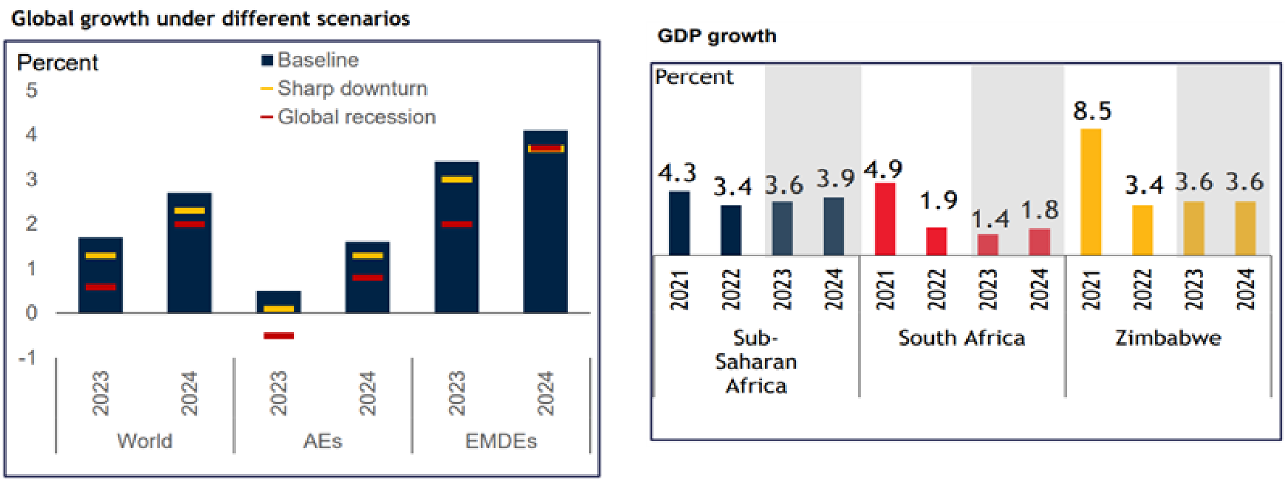
4. Implications from global and regional economic outlook on Zimbabwe's 2023 prospects

The global economy is expected to slow down significantly in 2023 with the median aggregated expectation being a sharp downturn. Even more pessimistic estimates are anticipating a global recession. The growth rate is projected to decline from 5.9% in 2021 and 2.9% in 2022 to 1.7% in 2023 (Figure 7). This slowdown will have adverse effects on emerging and developing economies, especially those that rely on commodity exports. Zimbabwe is one of these economies that faces a downbeat outlook for 2023, having already succumbed to triple digit inflation, currency instability, soaring interest rates, and low agricultural production in 2022. Encouragingly, Zimbabwe's own growth rate is forecast to be slightly ahead of the globe at 3.6% for 2023.

Figure 7: Estimated global growth rates and forecasts



Source: World Bank, Global Economic Prospects, January 2023

AEs=Advanced Economies, EMDEs=Emerging Markets and Developing Economies

Considerable risk factors and proceedings from the global and regional outlook that will directly affect Zimbabwe's prospects heading into 2023 include:

Persistent Inflation

Geopolitical Turmoil

Climate-Related Disasters

Intensified Monetary Tightening

Energy and Food Security

Financial Stress

Weak Longer-Term Growth Prospects and Larger Development Challenges

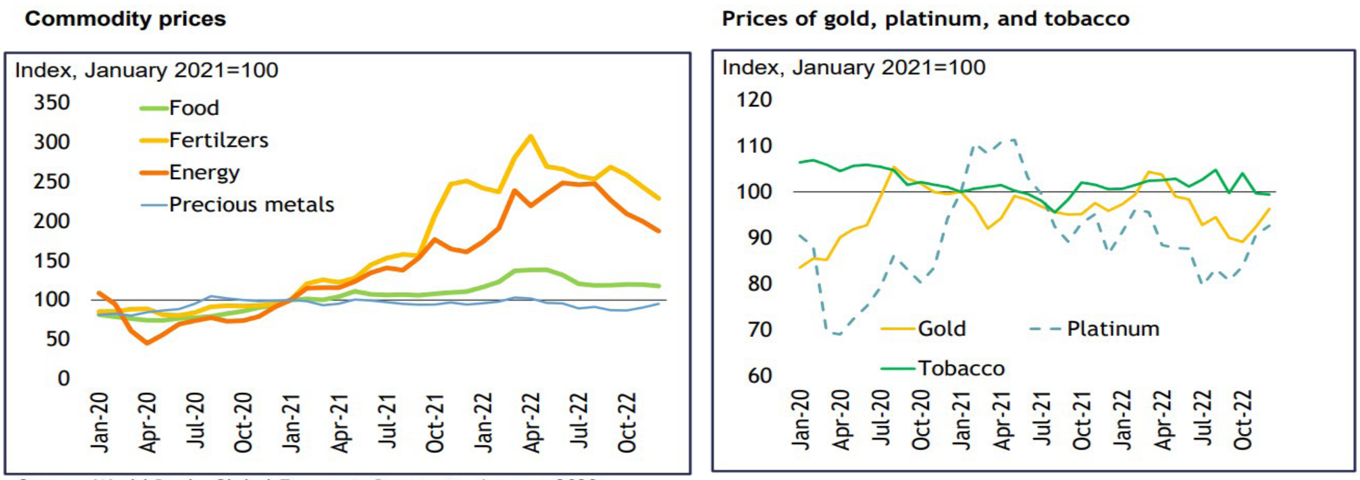
COVID-19 Outbreaks

4.1 Fragmentation of Global Trade, Investment, and Financial Networks

The biggest threat to the local economic outlook in regard to global trade and financial networks relates to uncertain commodity pricing dynamics with global expectations for commodities in 2023 mixed (Figure 8). In general, global recessions can affect different commodity prices in various ways, depending on the demand and supply factors for each commodity. For example, energy and metal prices tend to be more synchronized with global economic activity than agricultural commodities and fertilizers. Oil and copper prices have been weakening recently, despite China's reopening, which some economists see as a sign of a global recession loading.

Pricing and demand dynamics for productive metals such as copper, nickel and other ferroalloys are often seen as leading economic indicators because they are widely used in construction, manufacturing, and electrical applications. When prices fall, it suggests that demand for these activities is weakening, which could signal a slowdown or recession in the global economy. Gold however still stands out as a universally accepted hedge against inflation. With global inflation persisting, gold prices are expected to remain strong, and this could act as a cushion for Zimbabwe as a gold exporting country. However, as interest rates rise and bond yields become more attractive, the jury is still out on how long demand for the metal will persist.

Figure 8: Two-year commodity pricing trajectory



Source: World Bank, Global Economic Prospects, January 2023.

A global economic slowdown should negatively affect Zimbabwe's main trading partners, such as South Africa, China, and the UAE. These partners cumulatively account for more than 80% of Zimbabwe's exports, which consist mainly of minerals, tobacco, and agricultural products. In 2021, USD2.9 billion or 50% of Zimbabwean exports went to South Africa, while USD1.7 billion (30%) went to the UAE, USD0.5 billion (8.7%) to Mozambique and USD0.3 billion (4.4%) to China. A decline in global demand for these commodities will reduce Zimbabwe's export earnings and foreign exchange reserves. This will worsen Zimbabwe's balance of payments deficit and increase its external debt burden.

The SSA region is expected to grow by 3.6% in 2023; a marginal improvement on 3.4% in 2022 according to estimates by The World Bank. The African Continental Free Trade Area (AfCFTA), which Zimbabwe has ratified, aims to create a single market for goods and services across Africa. Even though the trading block is still facing implementation hurdles such as tariff negotiations, infrastructure gaps, and non-tariff barriers, Zimbabwe will need to improve its competitiveness and diversify its production base to benefit from these regional integration initiatives.

4.2 Persistent Inflation

The Sub-Saharan Africa region recorded an inflation figure of 4.6% in 2021 and is estimated to have reached close to 14% in 2022. Neighbour South Africa's 7% inflation figure for 2022 is notably above its average over the last 5 years of 4.35%. Persistent global inflation as well as a strengthening US dollar on the global front can affect Zimbabwe through various channels, such as imported inflation, terms of trade (the ratio of export prices to import prices), and external debt. Stubborn inflation statistics across the globe will be a burden on the local economy and imply a downward adjustment on outlook figures for Zimbabwe. Further to the already existing debt obligation, the dollar index which measures the value of the currency against a weighted basket of other world currencies increased by more than 15% since the start of 2021 – putting additional pressure on already fragile emerging market economies. Moreso, this should be considered in light of the industry specific prospects. Should we fail to meet our agriculture and power generating targets, Zimbabwe will likely be more susceptible to imported inflation.

4.3 Geopolitical Turmoil & Food Security

Zimbabwe's economy is mainly driven by the "primary" industry with agriculture and mining largely contributing to the country's exports- close to 80% on a combined basis. Therefore, any geopolitical tension that affects trade, tourism, commodity prices or foreign investment could have an impact on Zimbabwe's economic performance and stability. The tension between Russia, Ukraine, the USA and China remains a serious threat to global trade and security. Zimbabwe depends on Russia and Ukraine for both wheat and fertilizers. Since Russia invaded Ukraine, the price of bread and flour in Zimbabwe has increased drastically as exports have been disrupted. Should tensions persist heading into 2023 and export channels for the aforementioned countries remain stifled, this could worsen food insecurity and inflation in Zimbabwe. An improved and record local wheat crop should however help alleviate these concerns even though Zimbabwe still need to import some gristing wheat.

4.4 Intensified Monetary Tightening

Continued monetary tightening from global central banks can affect developing countries in various ways, depending on their economic conditions, exchange rate regimes, trade linkages, and financial vulnerabilities. Generally speaking, higher interest rates in advanced economies can reduce capital flows to emerging markets and developing economies, increase borrowing costs, depreciate local currencies, and lower growth prospects.

4.5 Financial Markets

Interest hikes by global central banks increased global bond yields resulting in the worst equities annual drop since 2008. This put to an end the supply of cheap money that has fuelled a 'golden decade' for investors. Tight money is not good news for financial markets; whilst hi-tech shares fell dramatically in 2022, an increasing number of credit defaults are a possibility, many of which will likely be in the private equity space where business models fail under a rising cost of debt. As a counterbalance, China too is now emerging from lockdown after three years and this may sustain commodity prices in 2023, including oil. International investors are hoping that the Fed will 'pivot' by becoming less aggressive on inflation and lower interest rates which is why markets have been more upbeat and the US dollar has been weak in recent weeks. If inflation stays higher for longer the Fed may not be so kind to investors. Indeed should US interest rates stay higher than currently anticipated, the US dollar may move upwards again thereby putting further pressure on emerging countries with dollar debt. A recession is looming and its severity could hit corporate earnings by more than currently anticipated. So globally we are certainly not out of the woods yet and the next six months could be volatile and tough going in global financial markets. This makes the likes of Delta and other undervalued equities in Zimbabwe all the more attractive at these bargain basement levels.

5. Fiscal and monetary policy implications on business economic prospects for 2023

The 2023 National Budget was announced on the 24th of November 2022, setting the context for the general fiscal policy environment that will be expected to anchor the envisaged economic trajectory for 2023. The National Budget indicates the following with respect to economic prospects for 2023:

- The economy is expected to grow by 3.8% in 2023, which would be closer to the estimated 2022 growth rate of 4%;
- The mining and quarrying subsector, which is expected to grow by 10.4%, will be the main driving force for the overall growth rate of 3.8%;
- Other drivers, as reflected by a higher value than the overall growth rate of 3.8% include the following:
    - Accommodation and food services expected to grow by 10%
    - Construction, which is expected to grow by 5.8%
    - Arts, entertainment and recreation which is expected to grow by 5.4%
    - Electricity, gas, steam and air conditioning supply, which is expected to grow by 4.2%; and
    - Agriculture expected to grow by 4%;
- Manufacturing is the only real sector to have a below the annual average growth at only 2.5%.

The year 2023 is also set to continue to be characterized by a tight fiscal policy, which has been credited for at least ensuring some stability in the economy. Government expenditure will be controlled to ensure that fiscal deficit would be curbed to at most 1.5% of GDP, regardless of the fact that 2023 is an election year. Thus, it is not expected that there would be some fiscal shocks that would destabilise the economy in 2023.

The 2023 Monetary Policy Statement was announced on the 2nd of February 2023. Announced under the theme "*Sustaining Price Stability and Economic Resilience*", its general thrust also reveals that a tight monetary policy statement will be maintained in 2023. This is reflected by the maintenance of the Bank policy rate for ZWL$ borrowing at very high levels, although there was a reduction from 200% to 150% per annum. This means that the sacrifice of growth in pursuit of stability will be maintained in 2023.

However, while both monetary and fiscal policy are geared to ensure stability, it is also important to ensure that they both point towards the desired policy path as stated under the National Development Strategy 1 (NDS1). One of the stated objectives of NDS1 include ensuring that there is "increased use of Zimbabwe dollar as the dominant legal tender by 2025". However, there are a number of potential misalignments between fiscal and monetary policies, as reflected in some policy signals that facilitate dollarisation rather than de-dollarisation.

Both fiscal and monetary policies have elements that actually appear to be signalling dollarisation rather than de-dollarisation. For fiscal policy, the taxation regime is designed to maximise collection of taxes in USD. This means that those businesses that want to trade exclusively in USD can successfully do so, which would leave them with reduced need for the ZWL$. As a result of the design of the tax regime:

- There are no incentives for holding ZWL$, resulting in its depreciation;
- The Willing Buyer Willing Seller platform, which is supposed to result in a market driven exchange rate, fails to find willing sellers, as no one has any reason to willingly sell their USD for the ZWL$. Thus no market exchange rate emerges;
- The use of two currencies in taxation creates tax complications on USD and ZWL$ accounting, which further creates incentives for preference on only one currency (USD).

The year 2023 also gives a blended inflation target with NO ZWL$ inflation target. This also tends to give the signal that focus on the ZWL$ in isolation has ceased to be an important policy issue, as the blended inflation now has a huge USD component and a very small ZWL$ component.

The year 2022 was also characterised by episodes where the tight monetary policy framework, reflected in controlled money supply growth, would be undermined by treasury through the injection of uncalibrated liquidity into the economy. The injection of liquidity would in turn cause the depreciation of the ZWL$ as holders exchange it at the parallel market for the more stable USD.

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This means that stability under the current dual currency regime in 2023 can only be sustained depending on the extent to which both monetary and fiscal policy would try to create demand for the local currency. The current focus on exchange rate stability has mainly been on the supply side, with little attention being given to the demand side, that is, putting in place measures to make holding of the local currency attractive. Such measures need to emerge in 2023 if economic stability is to be ensured.

6. Currency and inflation expectations for 2022

6.1 Currency outlook

For the whole of 2022, Zimbabwe was using a dual currency system and Treasury highlighted that Zimbabwe will be in a multicurrency regime for the duration of National Development Strategy (NDS1), which lapses in 2025. The value of Zimbabwe's local currency has been on a free fall in the year 2022. Since 1 January 2022 up to 31 December 2022, the local currency (ZWL$) depreciated by 530% on the official exchange rate and by 368% on the parallel market (Figure 9). The continued depreciation of the local currency has resulted in preference of the more stable US dollar by economic agents. In January 2023 approximately 76% of expenditure was in USD (Reserve Bank of Zimbabwe, 2023).

Figure 9: Zimbabwean dollar depreciation in year 2022

1 January 2022 exchange rate	
(Official) ZWL 108.666	(Unofficial) ZWL 205
31 December 2022 exchange rate	
(Official) ZWL 684.334	(Unofficial) ZWL 960
Depreciation	
530%	368%

Source: CZI compilation

The dual currency regime will continue in 2023. However, the preference of the US dollar will likely intensify, as the local currency continues to deteriorate. The ratio of USD expenditure in the Zimbabwean economy will probably increase to 90% by end of year 2023, if the policy environment remains as it is. Thus, the degree of dollarisation will increase, as the economy moves closer to full dollarisation. To ensure that the ZWL$ does not lose relevance in this environment of accelerated dollarisation, the following, if implemented as a package, could help:

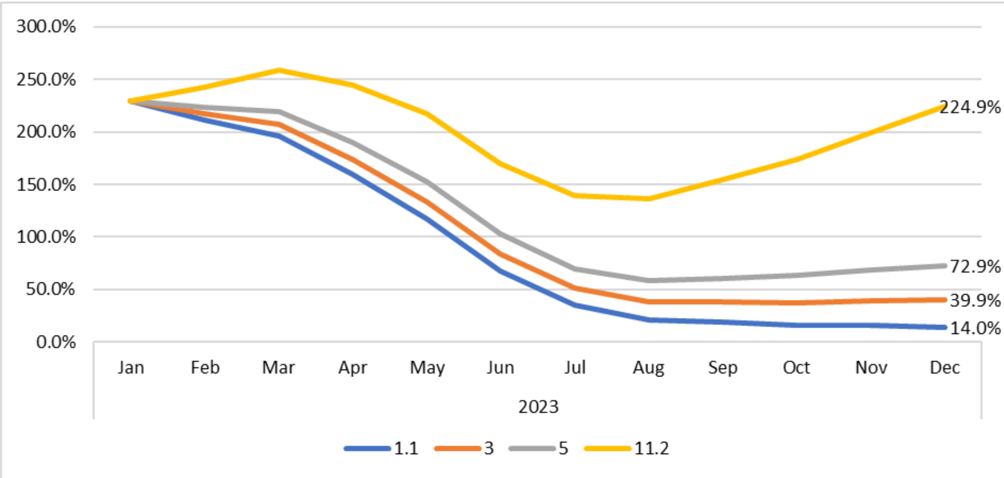
- Migrating certain taxes to being payable only in local currency. PAYE would be a good start as this would bring many institutions including foreign missions, into the foreign exchange market as sellers.
- Smoothening of Government Ministries' payment methods, to avoid liquidity disruptions from simultaneous payments at some specific point due to delays;
- Full liberalisation of the Willing Buyer Willing Seller (WBWS) foreign exchange trading platform to make it a market determined exchange rate. Stability of the exchange rate will be a game changer, as it will eliminate inflation and stabilise the local currency.
- Tight money supply control, including both narrow and broad money.

6.2 Inflation outlook

In year 2022 inflation movements generally missed set targets; the average annual inflation target was 32.6%, yet the annual average inflation in 2022 was 184.1%. The monetary policy statement urged the economy to focus more on the blended inflation since the Zimbabwean economy has dollarized and it forecast an average monthly **blended** inflation target of below 1.5% and annual **blended** inflation end period range of 10% to 30% in 2023. While these targets could be achievable, this might largely be due to expanded dollarization and be reflective of the stability of the USD inflation rather than the ZWL$ inflation.

While a blended inflation rate makes sense in accurately defining the nature of inflation, it does not take away the need for publishing inflation rates of ZWL and USD, as these are more useful to business for planning purposes based on their income and cost mixtures of USD and ZWL$. The average month on month ZWL$ inflation for the year 2022 was 11.2%. Thus, if month on month inflation averages 11.2% from February 2023 to December 2023, annual inflation will close the year at 224.9% (Figure 10). The best-case scenario is if the January 2023 month on month inflation rate of 1.1% is maintained; annual ZWL$ inflation would close the year 2023 in double digit levels at only 14%.

Figure 10: ZWL$ Inflation outlook under different month-on month inflation rates



Source: Construction from Zimstat

Maintaining month on month ZWL$ inflation under 5% is possible and it is actually the norm for many countries. The authorities need to maintain the current policy and in addition to the current policies the authorities should:

- Control Money supply growth

The agriculture summer season is coming to a close and winter season is about to commence. In the past agriculture financing has led to unprecedented money supply growth, which in turn resulted in increased inflation. Agriculture needs to be financed in a non-inflationary manner, which includes private sector participation with government playing a largely supporting role rather than unleashing liquidity into the economy.

- Careful calibration of election expenditure

Elections are expensive and they draw a lot of resources. Sudden injection of massive liquidity in the Zimbabwean economy has proven suicidal in the past, as evidenced by the growing parallel market premium over the period leading up to September 2022 when liquidity tightening was instituted. Due to lack of confidence in the local currency, service providers usually change their money into US dollars soon after being paid and if the market gets awash with ZWL$, the local currency will depreciate on the parallel market.

- Transforming the Willing Buyer Willing Seller (WBWS) market into a market determined exchange rate market

The WBWS must be market determined without intervention to fix the rate from authorities. Banks should canvas willing sellers and willing buyers every morning and determine a realistic reference rate for transactions to take place. The WBWS was introduced in March 2022 but has not yet transformed into a market platform with confidence from users. The WBWS has the potential of curtailing the parallel market if the exchange rate is market determined with reduced interference from the RBZ. The depreciation of the local currency on the parallel market fuels inflation, regardless of whether the depreciation is due to market fundamentals or just sentiments.

7. Key risks for 2023

Whilst the outlook for 2023 remains generally positive, it can be easily threatened by a number of risks, which need to be adequately managed. For the manufacturing sector, the key risks that can derail the outlook include:

a) Energy unavailability, including electricity as well as other sources of energy. The migration to other alternative sources of energy through innovation and investments at firm level would also go a long way in reducing the exposure to shocks in electricity supply at the national level.
b) Fragile economic stability. Economic instability has a higher toll on the manufacturing sector which has a longer period in terms of realising a return on investment. Manufacturing sector investment tends to be low during times of unstable economic environment.
c) The growing informalisation of the economy, which is not only more adaptable to the unstable economic environment but has also managed to emerge as a lucrative market for producers who get access to USD rather than to the ZWL$ when supplying to the formal sector.

The agriculture sector outlook is also subject to some key risks, which need to be well managed. These include:

a) Climate change, which needs to be adequately mainstreamed to ensure that produce remains assured in the face of drought and floods.
b) Grain price distortions, which tend to create sub-optimal decisions on production as well as choices of produce.

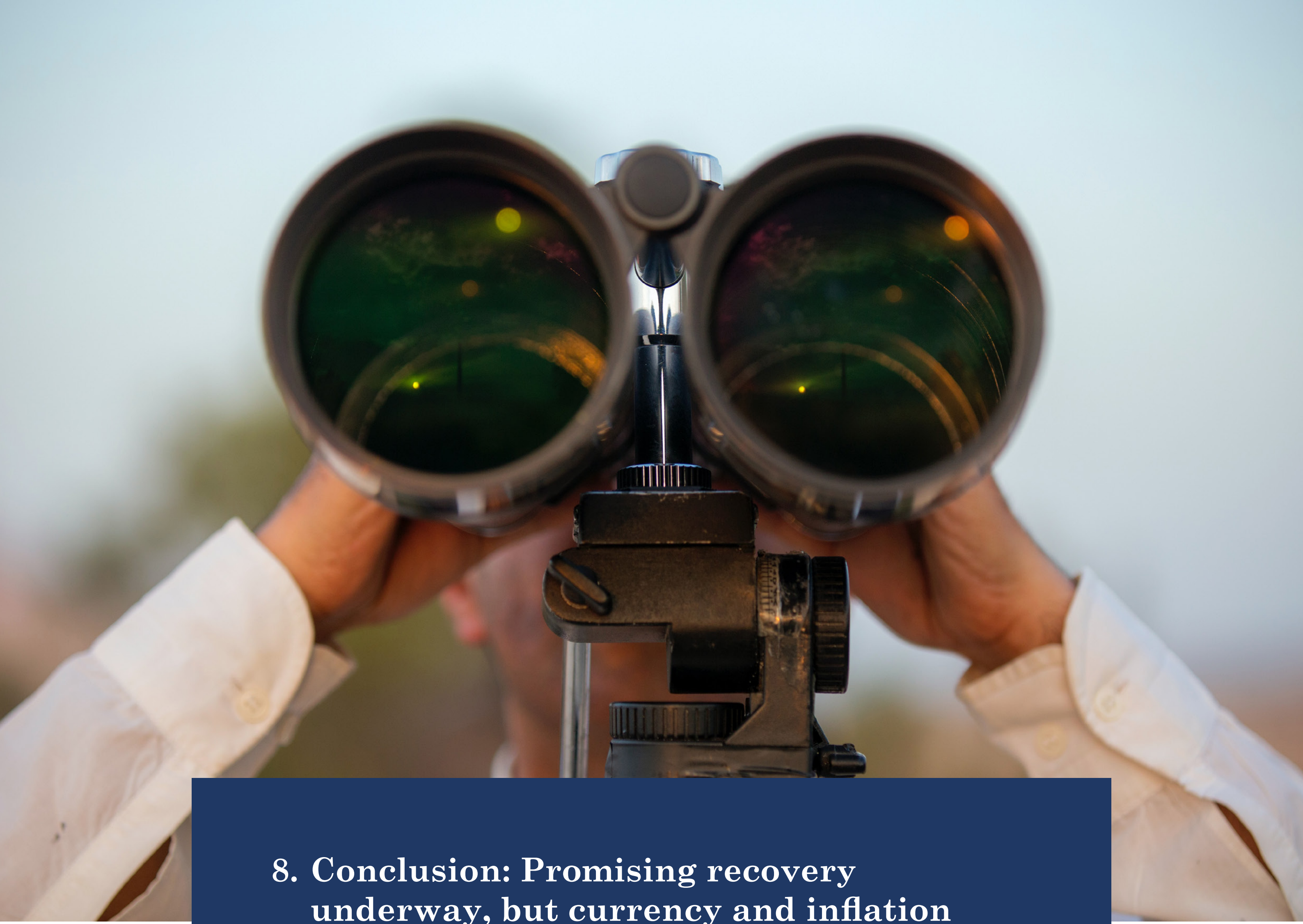
For the agriculture, risk management measures being introduced include weather insurance, where financial institutions have introduced some innovative products for farmers to insure against the adverse weather conditions.

The financial services sector is also subject to some risks, which can threaten the realisation of the envisaged positive outlook. These include:

a) The great trek to the Victoria Falls Stock Exchange and the challenges associated with it in these nascent stages. Such challenges include being a less liquid market with low volume of transactions, making it difficult to raise the capital that listed firms so greatly desire
b) Lack of alternative investment opportunities, given the limited financial options that can be possible in an environment characterised by instability and shocks.
c) Continued government interference and policy changes which makes certain investors unwilling to participate and inhibits our ability to attract long term patient capital

The operating environment for the wholesale and retail sectors is also characterised by some risks which are mainly related to the unstable operating environment, namely:

a) High inflation, which makes it difficult to profitably price in USD without causing a flock to the informal sector;
b) Compliance risks, as the sector pricing is regulated by Statutory Instrument 118A of 2022, which enforces the use of a sub-optimal exchange rate
c) Performance risk, as the sector is now subject to intense competition from the informal sector, which is difficult to compete against as they face low overheads and are not subject to regulatory directives with a bearing on pricing.



8. Conclusion: Promising recovery underway, but currency and inflation headwinds remain

The 2023 economic prospects remain positive as far as overall economic growth is concerned. However, there continues to be some headwinds which could easily derail the positive outlook. Such headwinds include both externally and internally transmitted challenges which negatively affect business performance. Externally induced headwinds include unpredictable commodity and fuel price movements as well as global inflation pressures. At the local level, the ability to adequately rein in ZWL$ inflation is key, despite strong pressures for natural dollarisation. The ability to rein in the parallel market rate by controlling liquidity as well as ensuring that there is adequate supply of power could be instrumental in ensuring that the positive outlook is realised.