Monthly Economic Bulletin

March 2014

Editor's Note

The economy remains on a tough road and last month, inflation hit negative territory, sending the economy into official deflation after a sustained three year period of disinflation.

Sentiment across various industry sectors remains largely negative, with commentaries from leading companies in the various sectors are pointing to a relative slowdown in the economy. A major player in the FMCG sector reported a slowdown in volumes in the last trading quarter, whilst a major retailer decried a drop in annual sales in the immediate last twelve months of tradingcompared with the prior year.

All this pointed to waning domestic demand, albeit in the face of rising imports.

The monetary policy statement announced in January was generally viewed as quite friendly to the banking sector.

Many positive changes were proposed, chief amongst which are that the Reserve Bank of Zimbabwe will have its role as banker to Government restored.

Consequently The Bank will host the Exchequer account effective Monday 31 March 2014 and whilst this will result in a net drain of liquidity from the banking sector, the impact has been said by the current commercial bankthe effects will be offset by the restoration of the Reserve Bank's function as a Lender of Last Resort.

However, results of banking institutions that have been released of late tell a story about the effects of the MoU on Charges and interest rates entered between the RBZ and the banking sector last year. In the MPS, the Acting Governor sated that Banking Institutions will now be required to justify increases in their charges or interest rates from the 31st October 2013 before approval is granted by the R.B.Z. In an environment where controls do not work, an application for approval to increases interest rate or charges is equivalent to price controls which are detrimental to market forces. In the past, the MoU militated against efforts by banks to raise capital from foreign investors. The Central Bank should allow individual Banks to determine their interest rates according to their own cost build up and do away with the need for prior approvals to adjust prices. Allowing banks free play in their pricing models is inconsistent with the principles of free competition in the banking sector. Banks on the other hand should remain prudent not to price themselves out of the market.

Much has also been said about the mobile banking war between the banks and some MNOs. The principle on which the banks are raising objections to the current structures is that the current framework perpetuates an environment of high cost of mobile banking services. Both the Monetary policy statement and the 2014 National Budget Statement were clear that the country should be embracing financial inclusion so as to bring as many people as possible into the fold of formal financial services. This will enable the economy to tap into the resources presently circulating outside the banking system. It is our view as bankers that the monetary policy statement should have been firmer in articulating the regulatory framework that cover all aspects of mobile banking especially on the need ensure that the platform for mobile money services is made more transparent and accessible to serve all Zimbabweans. The failure to instruct mobile network operators to open their gateways to banks to execute inward and outward mobile money transactions without restrictions is inconsistent with the concept of financial inclusion and the promotion again of free competition in the mobile banking space.

It is pleasing however to note that the regulators and competition authorities are looking into the dymanics of competition between banks and MNOs and a satisfactory regulatory framework shall soon be propounded.

The framework should also seek to level the playing field and enable banks to simplify account opening procedures and requirements in order to attract savings through the adoption of basic account opening requirements which comply with the Know Your Customer (KYC) principle without violation of the Bank Use Promotion and Suppression of Money Laundering Act.

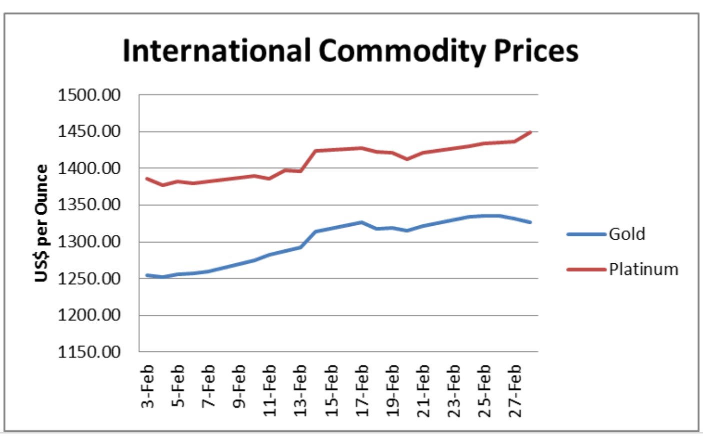
World Economic Developments

International Commodity Prices

The prices of gold and platinum were on an upward trend during the month of February. This is a welcome development given that the prices had ended the year 2013 on a downward trend which had led to concerns on the ability of the economy to grow strongly during 2014. If the momentum of growth as recorded in the first two month maintains then the sector can achieve some modest growth.

Gold started the year at US$1195.75 per ounce has since risen to US$1327 per ounce as at the end of February showing significant increase on the international market. The increase in the price of gold will benefits the gold producers who had ended the year complaining about increasing costs of production at the expense of declining international prices. The increase in the price should motivate the producers to increase production which will assist the country in its quest to becoming an accredited member of the London Bullion Marketers Association (LBMA). This fit is possible if the gold output realized by the country, exceeds the 10 tones annual threshold required to maintain membership with the London Bullion Metal Exchange.

The advantage of this move would be that gold produced and refined in the country would be directly exported at the international gold prices obtaining at the LBMA, without any middlemen or intermediary. This would benefit the producers and the country at large.



Platinum prices also continue to be on the rebound. The prices of platinum started the year at US$ 1411.50 per ounce before declining, started February at US1386.00 per ounce before closing the month of February at US1449.50. The ups and downs in the prices of platinum brings in uncertainty on the direction of platinum which has the effect of jeopardizing planning especially during this period when the platinum producers are under pressure to be constructing refineries for local beneficiation processes.

Macroeconomic Developments

It is clear that the economy is now characterized by the general economic slowdown. This is evidenced through job cuts in the industry, inflation rates in the negative territory, decline in the amount extended to the private sector, continued liquidity crunch and other economic ills.

The inflation rate has now gone into the negative territory. The year on year inflation rate (annual percentage change) for the month of February 2014 as measured by the all items Consumer Price Index (CPI) stood at -0.49 percent, shedding 0.90 percentage points on the January 2014 rate of 0.41 percent.

Debate among economists is now centered on whether the country is now in deflation or not. In economics, deflation is a decrease in the general price level of goods and services. Deflation occurs when the inflation rate falls below 0% (a negative inflation rate). From the above definition, the country is in a deflation hence the question that needs to be put across is that what needs to be done and for how long is this going to be with us. With the productive capacity below 50 percent, it might become a challenge for the country to come out of this deflation.

Stock Market Developments

Reduced activity by foreign buyers continued to put a damper on the ZSE performance during February, continuing the trends recorded in January.

The trading updates by the key players in the economy and the results issued out so far are indicative of the fact that demand has slowed, highlighting a stagnant or declining macroeconomic environment.

FMCG counters such as Delta and Meikles have already reported slower trends. Volumes were lower for Delta in the last quarter whilst retail sales took a slump for TM supermarkets.

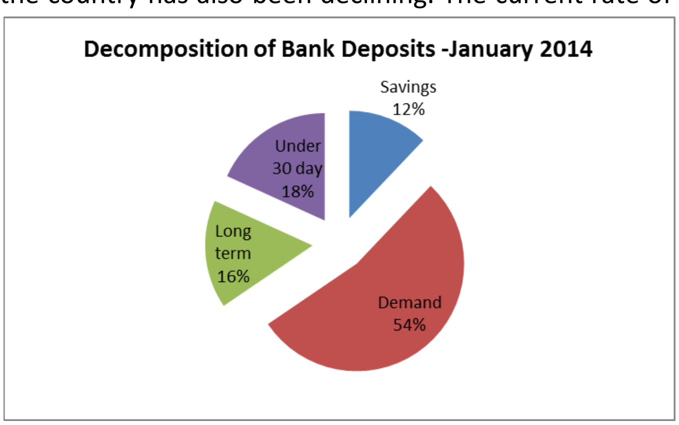
Consequently, the Industrial Index shed off 5.96% in January 2014 to 189.25 points from 201.25 level at 31 December 2013 whilst the Mining index dropped significantly by 23.48% to close at 35.04 points.

Value traded was however up significantly 31.24% to $64.5million. Foreign participation constituted a major chunk ie 39.5% of the total trading activity on the market, a drop of 25% from a peak of 65% of total market turnover in December.

A net outflow of $20.2million, reflecting a major sell off by foreign investors during the month as they cashed out of emerging markets.

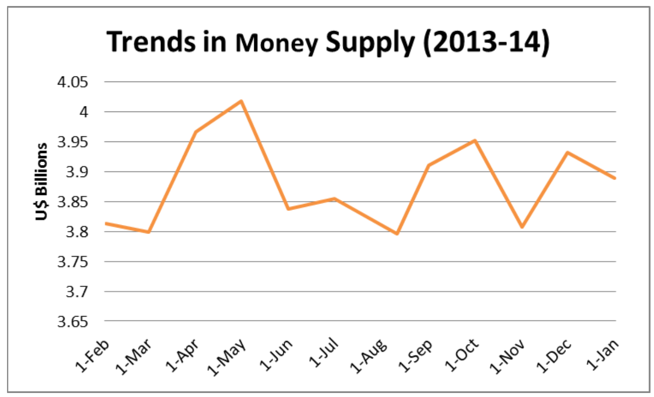
Money Supply

Money supply in the economy is a function of the economic activity. The slowdown in the growth of the money supply witnessed in January (0.7 percentage) was way below the average growth as recorded in the last quarter of 2013 showing that economic activity in the country has also been declining. The current rate of



inflation of -0.49 percent is a signal that there is little that is currently taking place in the economy.

On a month on month basis, however, broad money declined by US$43.7 million (-1.1%). The monthly decline was on the back of contractions of US$88 million in over 30-day deposits and US$77.2 million in savings deposits. Partially offsetting these declines were increases of US$116.8 million and US$4.7 million in demand and under 30-day deposits, respectively.

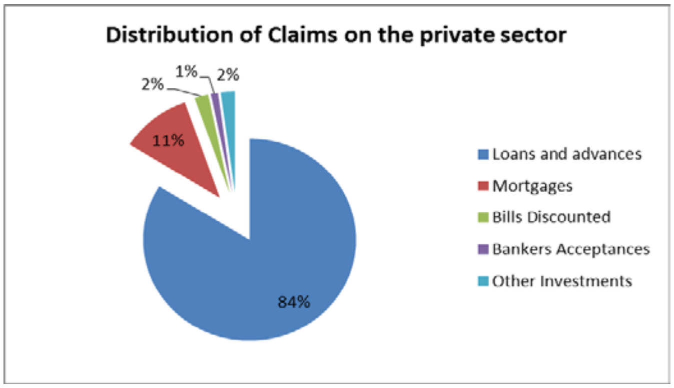


The majority of the deposits with the banks continue tobe short term. Long term deposits constituted 16 percent of the toal deposits. The long term deposits are the ones which can give the banks the leverge to lend long term. In a market who appetite for long term financing is high, there is need for the mobilisation of long term deposits from both the domestic market and the international lines of credit to help quench the appetite for economic development.

Annual money supply declined from US$3,932 billion recorded in December 2013 to US$3,888 billion in January 2014. The fragile trend in the amount of deposits has been attributable to the weak performance in the country's external sector where exports are outpacing the performance of the imports. The balance of payments position is hence influencing the amount of money supply in the economy currently characterized by the unavailability of the government printing press.

Credit to the Private sector

At the backdrop of the various challenges bedeviling the banking sector, there was a slowdown on the amount of credit to the private sector. On a month-on-month basis, credit to the private sector, declined by 2.3% from US$3 650.1 million in December 2013 to US$3 566.6 million in January 2014.



The slowdown in the amount of the credit to the private sector has been attributable to a host of factors among them liquidity challenges, constrained deposit base and increasing nonperforming loans. Non-performing loans now estimated at an average of 16 percent. It is understood that the deteriorating asset quality is also reflective of the adverse operating macroeconomic environment and institution-specific deficiencies. In addition, the mismatch between long-term funding requirements for the productive sectors and short-term volatile deposits has exacerbated asset quality vulnerabilities.

Claims on the private sector are mostly dominated by loans and advances at 83.85% and mortgages advanced by building societies at 10.78%. Other categories included bills discounted, (2.13%); bankers' acceptances (1.09%) and other investments (2.14%). This reflects the shortage of requisite credit instruments on the market due to little activity on the interbank market.

It is encouraging to note that mortgage financing is also increasing given that during the previous years, mortgages were on the low side due to reduced construction activities. There is a realization among the financial sector players on the need for the long term mortgage finance which has seen one of the biggest Building Society (CABS) advancing montage finance over a period of twenty years. The increased repayment period comes as a relief to the citizens who had an appetite for long term financing which gives them flexibility. Hopefully other financial institutions will follow suit and take advantage of the tax reliefs that were announced by the Minister of Finance on those financing mortgages.

Sectoral Analysis of Commercial Bank loans and Advances

Sector	Amount (US$ 000)	Proportion of total
Agriculture	489585.3	20.54
Construction	43743	1.84
Communication	18574.7	0.78
Distribution	464097.6	19.47
Financial and Investments	5467.4	0.23
Financial organisations	48086.1	2.02
Manufacturing	362554	15.21
Mining	116635.5	4.89
Services	412901.1	17.33
Transport	37722.2	1.58
Individuals	367126.2	15.40
Conglomerates	16773.1	0.70
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A review of the distribution of the Commercial Bank Loans and Advances show that the banks are supporting sectors across the whole spectrum of the economy though at various levels. The major beneficial sectors of the loans and advances were Agriculture (20.54 percent); Distribution (19.47 percent); Services (17.33 percent); and individuals (15.4 percent).

Concerns have been raised about the preference given to the individuals at the expense of productive sectors of the economy. It is important to understand that the majority of the individual do not default on the payment of loans given that there have constant streams of income. Another important factor is that the majority of loans advanced to individuals are meant for productive purposes such as home development, house construction, purchase of durables, support to SMEs and other productive sectors. The smaller portion is the one that is used for consumption purposes.

Monthly Article Feature

Financial Innovation with Sanderson Abel

Financial innovation can be defined as the act of creating and then popularizing new financial instruments, technologies, institutions, markets, processes and business models including the new application of existing ideas in a different market context. This can be further defined as advances over time in the financial instruments and payment systems used in the lending and borrowing of funds. These advances include innovations in technology, risk transfer and credit and equity generation. The creation of new technological advances in the financialproductsmarket have increased available credit for borrowers and given banks new and less costly ways to raise equity capital.

With the economic transformation that has taken place in Zimbabwe over the last decade, it seem the financial services sector and the stakeholders in the economy should embrace new innovations so that new economic structures (SMEs, new farmers, etc) can get adequate funding through innovative financing mechanisms, products and systems.

Motives of financial innovations

- To provide ways of clearing and settling payments to facilitate trade (Credit and debit cards, PayPal, stock exchanges)
- To provide mechanisms for the pooling of resources and for the subdividing of shares in various enterprises (Mutual funds, securitization)
- To provide ways to transfer economic resources through time, across borders and among industries (Savings accounts, loans)
- To provide ways of managing risk Insurance (many derivatives)
- To provide price information to help coordinate decentralized decision-making in various sectors of the economy (Contracting by venture capital firms)
- To provide ways of dealing with the incentive problem created when one party to a transaction has information that the other party does not or when one party acts as agent for another

The implementation of an online banking system that allows a user to instantly transfermoney from multipleaccounts is considered an example of financial innovation. As seen with the global credit crunch sparked in 2008, which was triggered at least in part by innovative financial products there will always be a need for careful scrutiny of innovative financial products and their risks.

The very reasons financial firms can be so beneficial to society; their links to the wider economy, leverage and interconnectedness magnify the economic and social effects of failures in innovation risk management. It is not only the individual institution that will feel the effect of its failure but the wider economy through spillover effects. Besides the harm financial innovation can bring, research shows financial innovation has more benefits than costs.

Types of financial innovations

Financial innovation enhances sustainability of institutions and their outreach to the poor. Useful distinctions between different types of financial innovations include:

1. **Financial system innovations**

Such innovations can affect the financial sector as a whole, relate to changes in business structures, to the establishment of new types of financial intermediaries, or to changes in the legal and supervisory framework. Important examples include the use of the group mechanism to retail financial services, formalizing informal finance systems, reducing the access barriers for women, or setting up a completely new service structure.

2. Process innovations

Such innovations cover the introduction of new business processes leading to increased efficiency, market expansion, etc. Examples include office automation and use of computers with accounting and client data management software.

3. Product innovations

Such innovations include the introduction of new credit, deposit, insurance, leasing, hire purchase, and other financial products. Product innovations are introduced to respond better to changes in market demand or to improve efficiency in the market.

Benefits of financial Innovations

Financial systems provide vital services: they evaluate, screen and allocate capital, monitor the use of that capital, and facilitate transactions and risk management. If financial systems provide these services well, capital flows to the most promising firms, promoting and sustaining economic growth. Financial innovation, the creation of new securities, markets and institutions can improve financial services and thereby accelerate economic growth.

The question that come to the fore in the whole debate around financial innovation is; Is there scope for further financial innovation in the Zimbabwean Financial System and how can the economy leverage on this for economic development?

What is most disturbing in the Zimbabwean case is the low uptake of the few financial products on the market due to the supply side or demand side constraints. Good examples will include internet banking. Given the time period of time that internet banking was introduced on the market there seem to be low uptake in terms of volume of transactions and the value of transactions. With the country crying far loud on the need for financial inclusion, this one innovation continues to be shunned by the public.

It seems the majority of the Zimbabweans are accustomed to the use of cash. Hence innovations such as Automated teller machines (ATMs) and Point of Sale (POS) terminals are not being used fully with the banking public despite owning either debit or credit cards. Volumes and values of transactions on a monthly basis as produced by the Reserve Bank shows that there is less interest in the these products despite the security of using these platforms and the problem of liquidity affecting the economy.

With the introduction of innovations such as mobile platforms such as Ecofarmer an insurance product, statistics still have to prove the acceptance and uptake of the product on the market. With Financial innovation, the economy should be moving towards paperless society hence the mobile platforms should be well received by the public.

In my next article I will be looking at financial innovation from the banking sector perspective. How banks assist the public to increase their uptake of the various products on the market and leverage on them for economic development. I would be glad to get your input on how the banks can assist the economy grow through financial innovation.

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