Monthly Economic Bulletin

Bankers Association of Zimbabwe

April 2014

Editor's Note

Alarm bells are being rang as the economy signaled the onset of a deflationary spiral as inflation hit minus 0,91% for March after the CPI hit negative territory in February after a sustained three year period of disinflation.

As full year financial results of listed companies on the ZSE came through for the year ended , all the annual reports seemed to be singing from the same hymn book and are all are chorusing the observed slowdown in the economy. Economists concur that the negative inflation rate points to waning domestic aggregate demand, and its not very good news. This made especially worse by the fact that this is happening in the face of rising imports, meaning that local industry productionis now shrinking at an even faster rate than before.

The financial results of banking institutions that have been released of late also tell a story about the economy.

Whilst the negative effects of the MoU on charges and interest rates entered between the RBZ and the banking sector last year on earnings are visible, the increasing cost of bad loans is also seen to be taking its toll.

NPLs represent a charge on bank capital and become a real cost of doing business for banks, especially when money has to be written off.

An industry solution is being sought to address the growing NPL problem. Banks on the other hand should remain prudent not to worse price themselves out of the market.

Four months into the year, the economy is still shacky with Zimra warning of tough times ahed. Revenue perfamance is going to be difficult to sustain at past levels as the ecnomy shrinks. The taxman has to expand tax net and perhaps bring more of the informal sector into the tax fold. They have already hinted on this.

The Banking sector was treated to positive news with the announcement of career banker, Dr John Mangudya as the incoming Governor of the Reserve bank to replace Dr Gideon Gono. The filling of this void by appointing a definitive leader at the apex bank, was seen by the market as a critical step in the restoration of confidence in the financial sector.

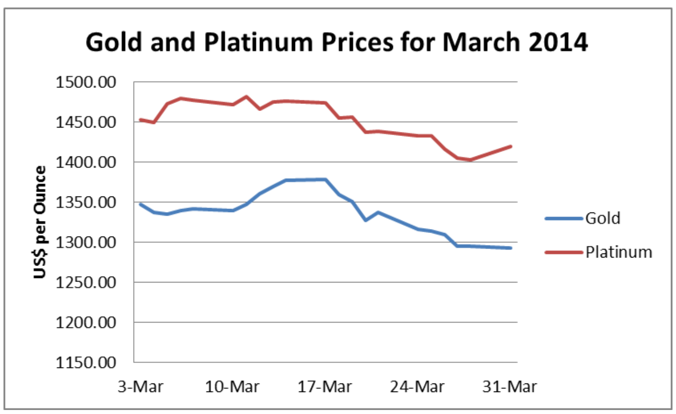
Another welcome development was the announcement by BancABC , of a substantial investment by a foreign investor. This together with a similar recent announcement of a significant investment into Afrasia Bank by its lead foreign partners only serve to show that there is value in Zimbabwe's banking sector, at least sufficient enough to attract substantial interest from foreign partners.

That is and can only be a good thing.

World Economic Developments

International Commodity Prices

Gold and platinum recorded declining prices during the month of March. The declines in the prices of gold and platinum which are the major sources of mining revenue have a negative repercussion on the fiscus. With the treasury in dire need of more resources to finance the various government operations, depressed international prices of the minerals will lead to a cut down on various government initiates programmes. From a policy perspective there is need to have a conservative approach in determining the contribution of those commodities whose prices are determined exogenously and outside our control.



The price of gold started the month at US$ 1346 and closed the month at US$1292. The average price of the gold for the month of March was US$1336.The plunge in the price of gold in the tail end of March coincided with the depreciation of the Euro, Aussie dollar and Japanese yen against the US dollar.

Whilst platinum prices which started the month at US$1453 ended the month lower at US$ 1420 with an average monthly average of US1451 per ounce. The average price for March was higher than that recorded in January and February which stood at US$1420.43 and US$1409.51 per ounce respectively.

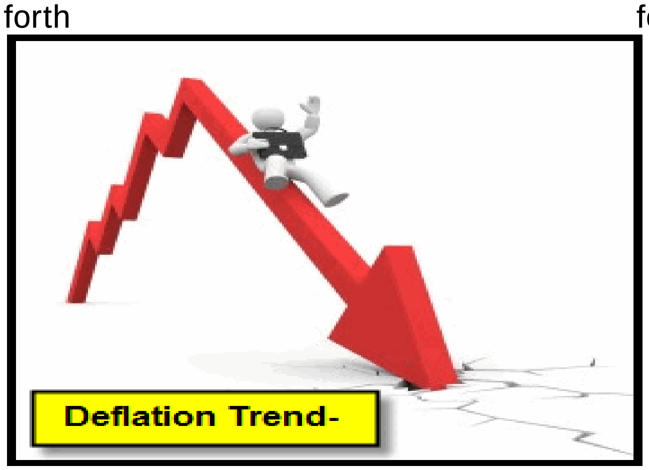
Macroeconomic Performance

Fiscal Developments

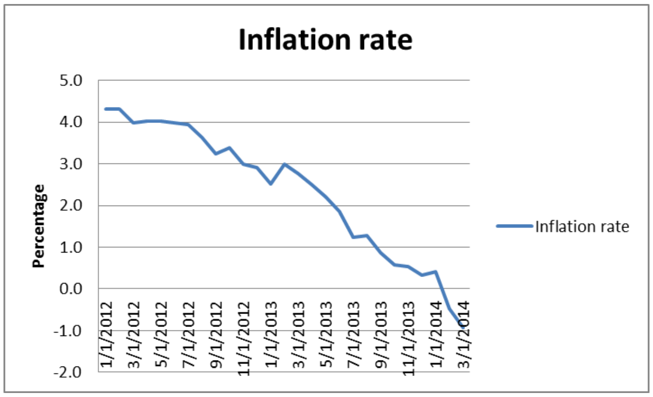
Treasury continue to battle to raise revenue with the January and February registering a negative variance implying the projected revenue inflows were less than the actual collections. Revenue collections were US$266.6 Million and US$248 Million against the targets of US$278.6 million and US$273.26 Million for January and February 2014 respectively. Cumulatively the two months had a variance of US$ 37 Million. The poor revenue performance is sign of the deep rooted challenges currently bedeviling the country. This is reflective of the company closures resulting in the increase in the ever high unemployment rates. This is further exacerbated by the deflationary trend that is now characterizing the economy.

Inflation developments

The inflation rate continues to decline and for the second consecutive month it is hovering in the negative territory depicting a deflation. The inflation figure for the month of March stood at -0.91 percent down from the February figure of –0.49 percent. Deflation is the reduction of prices of goods. It should be noted that deflation is an indication that economic conditions are deteriorating. This hence calls forth for



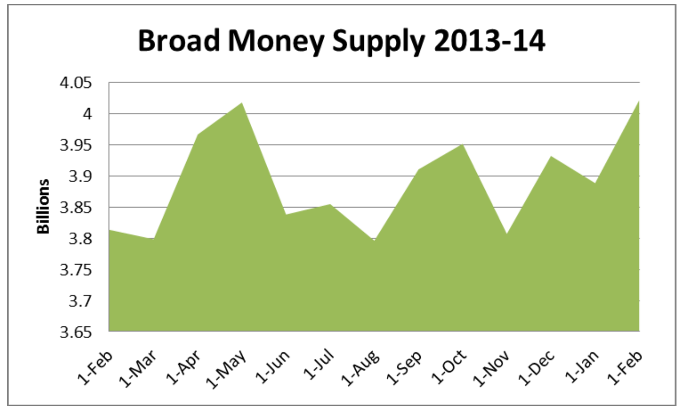
tightening of the various policies to allow demand to increase in the economy.



Some of the fundamental problems facing the economy that has led to the deflation include reduced aggregate demand, liquidity constraints, reduced capacity utilization, reduced government expenditure due to low fiscal revenue inflows and the company closures. Measures to address these factors will simultaneously assist in resolving the deflation problem.

Monetary Developments

Broad money managed to surpass the US$4 Billion mark for the first time in 2014 after having managed the same feet mid last year. In February 2014 the total money supply was US4 021.78 Million as compared to US3 813.62 which was recorded in the February 2013. This means that total money supply grew by US$ 208.96 Million, reflecting a 5.5 percentage increase over the year.



The growth in annual broad money supply was mostly underpinned by the expansion in aggregate deposits mostly driven by expansion in inflows from the parastatals. Long term deposits grew by 33.75 percent, demand deposits by 2.21 percent and savings deposits grew by 16.99 percent between February 2013 to February 2014.

On a month on month basis, broad money supply increased from US$3888.65 Million to US$4 021.78 Million.

Credit to the Private Sector

Reflective of the challenges facing the country, the banking sector has been cutting down on the amount of credit to the private sector. The general slowdown in economic activity mostly depicted by the deflation situation, the banking sector is taking a cautious approach to lending. This is further worsened by the general slowdown in the growth of the deposit base. This has seen the commercial banks' credit to the private sector falling significantly, from an annual growth of 28.77 percent in February 2013 to 1.50 percent in February 2014.

On a month on month basis total credit to the private sector by the commercial banks and the merchant banks grew from US$ 2 785 366 700 to US$ 2 870 076 300 reflecting a 3.04 percent increase. Of the outstanding loans and advances in the whole banking system, there were distributed as follows; households (19.40 percent); agriculture (19.26 percent);

distribution (17.34 percent); and services (15.29 percent).

Sectoral Analysis of commercial Banks Loans and Advances

Sector	Amount Outstanding 000's	Percentage
Agriculture	519,154.6	21.25
Construction	38,918.1	1.59
Communication	24,765.4	1.01
Distribution	460,528.2	18.85
Financial and Investments	10,397.3	0.43
Financial Organisations	47,488.6	1.94
Manufacturing	385,038.1	15.76
Mining	116,670.5	4.78
Services	401,619.6	16.44
Transport	32,978.1	1.35
Individuals	396,800.8	16.24
Conglomerates	8,542.7	0.35
Total	**2,442,902**	**100**

An analysis of the commercial loans and advances to the private sector, agriculture continues to dominate, followed by distribution, manufacturing, services and individuals respectively. This distribution shows that the commercial banks are supporting sectors across the whole economy though at various levels. The prominence of agriculture shows that the Banks in the country are fully supportive of the sector which forms part of the pillars of ZimAsset.

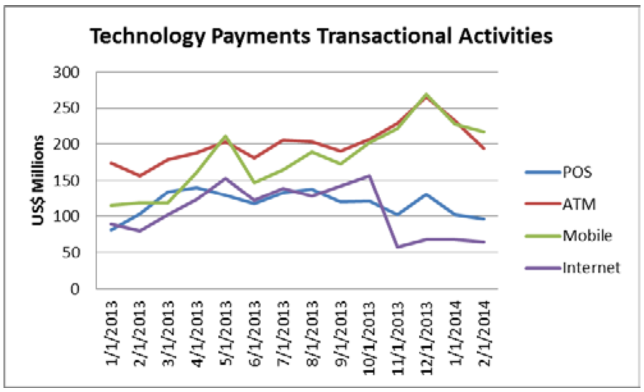
Despite the high levels of support to the various sector of the economy, the banking sector continues to be affected by the high levels of non-performing loans. These were pegged at around 16 percent as of December. Financial results which has been produced by the various banks so far show that the performance of the banks in 2013 were affected mostly by the non-performing loans, the effects of the Memorandum of Understanding which was signed between the Reserve Bank of Zimbabwe and Bankers Association of Zimbabwe and the general operating environment.

There is need for putting in place an urgent solution to resolve the problem of the Non-Performing Loans. The setting up of the National Credit Reference Bureaus and the crafting of the associate legislation as announced in the 2014 National Budget Statement and the Monetary policy statement should be fast tracked so that banks concentrate on lending while vital information on the creditworthiness of the borrower is provided by the CRBs.

Cleaning the balance sheets of the banks is another issue which requires urgent attention to allow banks to start on a clean sheet. The process would involve the setting up of a Special purpose vehicle. This is not new to Zimbabwe given the process has been done before through the setting up of Climax Investments and CBZ nominees. These two institutions were set up to buy off the toxic assets of the banks that were bedeviled by the non-performing loans.

TECHNOLOGY BASED TRANSACTIONS

Technology based monetary transactions have been lo for the first two months of 2014. Between January and February, a decline was registered in the value of point of sale, Automated teller machines, mobile based payment system and internet based transactions. This is a disturbing trend given that the world over, there is a general movement from cash based transactions towards technology based transactions. It seems there is little education that is being put forward to the general public especially around the use of financial innovation instruments such as POS, ATMs and Internet based transactions to reduce the demand for cash.



Financial literacy becomes key as it entails providing relevant information to the bank clients and the general public on the importance of adopting the use of various methods for making payment. With the Central Bank having made it mandatory that every account holder should have a credit card which can be used on the ATM and the POS, there should be general awareness on the importance of using these methods including its advantages of helping reduce the dependence on cash. It is also important that the banking public should be made aware that general transactions done over the ATM and POS are cheaper as compared to making the cash withdrawals in the banking halls. There is need for the economy to embrace financial innovation as much as possible.

Capital Markets Review

The benchmark ZSE Industrials Index lost another 6.83% in the March to bring the year to date return to negative -12.67%. The minings followed suit, with the Mining Index dipping a significant 24.80%. Total trade volumes were largely unchanged, marginally increasing by 1.73% to US$29million during the month. Total foreign participation was also unchanged from the previous month, coming in at 47% of all market trades.

Net outflows of only US$0.4million indicate that largely buying interest dominated trading, possibly reflecting massive bargain hunting by buyers.

As the reporting season came to a close, highlighting the difficult trading environment most companies find themselves operating in, most companies, in their annual reports indicate that they have found the going tough. Not quite surprising, in an economy where costs are high and aggregate demand is falling, hence deflation.

Monthly Article Feature

Are All Financial Innovations Good? By Sanderson Abel (Senior Economist)

In looking at financial innovation over time, it is natural to ask if it is good or bad. Does all innovation make us better off? This is a difficult question, because it is very difficult to measure the benefits or the costs of particular innovations at the time they are concieved.

Since the 1960's some of the significantly more positive financial innovations that have come across include the following:

- Automated Teller Machines (ATMs)
- The massive expansion of credit card usage
- Debit cards
- Money market funds
- Indexed mutual funds
- Exchange Traded Funds (ETFs) as a kind of extension of indexed funds
- Treasury Inflation Protected Securities (TIPS)
- Credit scoring to assist in lending decisions
- Basic forms of securitization
- Venture capital funds
- Interest rate and currency swaps

To what extent can we say these financial innovations have played a key role in easing the lives of the public and to what extent are they beneficial to society at large? This seems more of an empirical question requiring detailed research.

However, evidence from the financial crisis amply shows that there are consequences associated with financial innovations when the risks are not properly taken into consideration.

Positive Innovations

Financial innovation has somewhat increased material wellbeing of economic players; positive innovation has helped individuals and businesses to attain their economic goals more efficiently, enlarging their possibilities for mutually advantageous exchanges of goods and services.

Financial innovation by increasing the variety of products available and facilitating intermediation, has promoted savings and channeled these resources to the most productive uses. It has also assisted to widen the availability of credit, help refinance obligations and allow for better allocation of risk, matching the supply of risk instruments to the demand of investors willing to bear it.

Innovation is also at the centre stage of encouraging technological progress when the requirements for information technology generate new technological projects, and induce their funding as in the case of venture capital.

Financial innovation lowers the cost of capital, promote greater efficiency, and facilitate the smoothing of consumption and investment decisions with considerable benefits for households and corporations. As the new products contribute to the deepening of financial markets, innovation, in turn, fosters economic development.

Financial innovation may also help to moderate business cycle fluctuations. Innovations such as credit cards and home equity loans allow households to keep their consumption smooth even when their incomes are not. The increased availability of credit to businesses allows them to smooth their spending across short periods when revenues do not cover costs.

The success of any innovation depends on three things. The first is how good the product is to begin with. Some financial products are poorly conceived or designed. Next is the appropriate use of the product: Is the product meant for a particular market or type of risk? And finally, the value of an innovation hinges on the competence of the person implementing it.

Negative effects of financial innovation

However, the World financial crisis of 2007-09 is a sharp reminder that financial innovations can bring substantial costs along with the benefits described above. However, sometimes the costs may outweigh any benefits making such financial innovations negative. Many households lost their homes when falling house prices made it impossible to refinance their subprime mortgages. Many intermediaries underestimated the risks of new financial products and were compelled to deleverage in the crisis. The resulting uncertainty contributed to the seizing up of key markets for liquidity, such as the interbank lending market

Rapid financial innovation can be a source of systemic risk as evidenced during the financial crisis. When financial products without a track record expand rapidly in a buoyant economic environment, investors tend to underestimate the risks that only occur in periods of economic stress. Separately, innovations that help conceal concentrations of risk can make the financial system more vulnerable to a shock. In both cases, the problem is that investors do not obtain adequate compensation for the risks that they take because they do not understand the risks or because the risks are invisible.

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In conclusion, it should be noted that on balance, financial innovation has had a crucial and positive role in financial modernization, leading to the improvement of economic wellbeing. Hence, provided that we strengthen prudential regulation to discourage excessive risk taking in the future, innovation cancontinue to benefit our societies. It should be further noted that potential problems are likely to increase with the complexity of the instruments, the insufficiency of information conveyed by sellers, and the lack of due diligence on the part of investors.

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