Monthly Economic Bulletin

Bankers Association of Zimbabwe

May

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Editor's Note

A slight uptick in inflation in April should not be viewd as a reversal of the deflation spiral that set in the economy since February. Alarm bells were being rung after inflation hit minus 0,91% for March after the CPI hit negative territory in February after a sustained three year period of disinflation. Inflation ticked up 0.65 percentage points but remained a negative 0.26% for April with some economists indicating that this could be the bottoming out of the deflation trend.

We would however attribute the slight uptick in inflation to technical aberrations rather than a reversal of fortunes. Aggregate consumptive demand and output remain weak and incomes are getting lower as liquidity gets tighter. So firms are being forced to push prices lower and will continue to do so.

The rand factor is also playing its part as continued softening of the rand means south African goods are landing at a slightly lower cost reflecting as softer shelf prices

As long as economic activity remains subdued as companies continue to face challenges in accessing capital due to the tightening of creditconditions as well as the lack of competitivenesson theinternational markets, the outlook for Zimbabwe's inflation rate isexpected to remain negative and subdued due to a

reduction inaggregate demand,weaker commodityprices, and aweakening of theRand.

It remains to be seen how the Zimbabwe economy will respond to the current continuing softening of the Rand.

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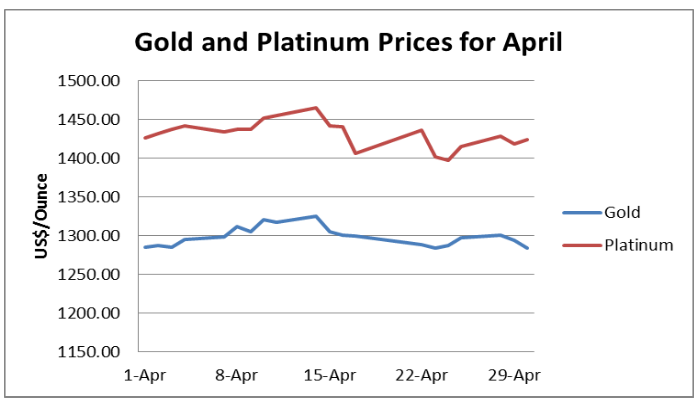
World Economic Developments

International Commodity Prices

On the international market, the prices of precious metals didn't do much during the month of April as they kicked off the month on a positive note only to change course and slowly decline in the last two weeks of April. Their unclear trend coincided with the low volatility in the foreign exchange market, in which the US dollar slightly depreciated against the Euro, Aussie dollar and Japanese yen.

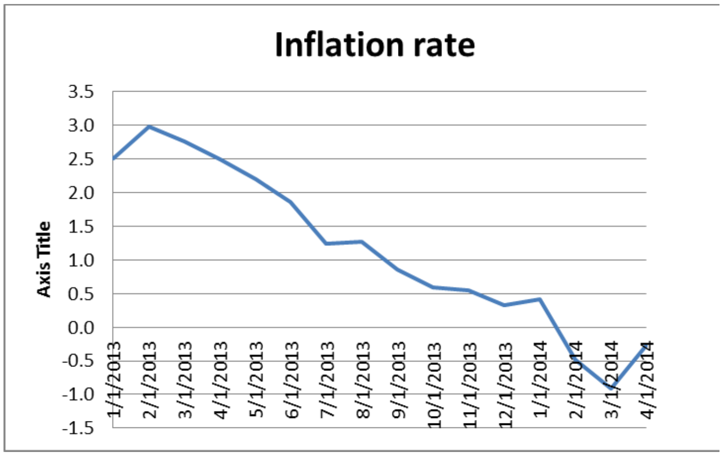
The price of Gold started the month at US$1285.13 per ounce before closing the month at US$1284.50 per ounce. The maximum price that was achieved during the month was US$1325.13 per ounce. This shows that the prices of Gold are still characterized by greater volatility witnessed through the ups and downs of the prices.



Similar to the movement in the price of Gold, Platinum prices were also not stable during the month of April. Platinum started at US$1426.50 per ounce before closing the month $2 less at US$1424 per ounce. The highest price was attained mid-month when it reached US$1465 per ounce before the prices started to decline. The current industrial action taking place in the platinum sector in South Africa will be taking its effects soon given that the action has now taken too long and it is predicted that more than R17 billion worth of production revenues have been lost and workers have lost incomes totaling to R8 Billion.

Macroeconomic Developments

The inflation rate continues to be in the negative territory. The year on year inflation rate for the month of April 2014 as measured by the all items Consumer Price Index (CPI) stood at -0.26 percent, gaining 0.65 percentage points on the March 2014 rate of -0.91 percent. What remains to be seen is whether the economy will be able to move out of the negative inflationary territory. Experiences from other countries show that it has always been a difficult situation for countries that have been in a deflation to move out of this situation. There is need for robust policy measures to be rolled for the economy to be able to arrest the situation and lead the economy into low and positive inflation rate.



Stock Market Developments

Having shed 1.93% in April, bringing the total year to date return on equities to -14.45% as of April 30 2014, the market however regained 1.15% in May with the Industrial index gaining from 172.91 in April to 174.89 in May. The Mining Index also regained lost ground in May the Mining index improving 3.86% from 29.64 to 33.89.

The total market Capitalisation of the ZSE however improved in sympathy by 2.86% to US$4.551 billion from US$4.424 billion.

Monetary Developments

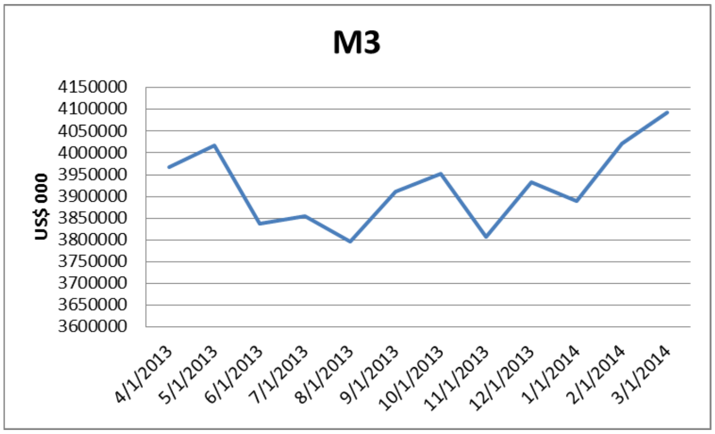
Money supply grew by US$ 72 Million on a month on month basis. This reflected a 1.8 percent growth from the US$ 4 021 779 600 recorded in February 2014 to US$ 4 093 939 200 recorded in March 2014.

Tobacco sales have improved the amount of liquidity in the economy hence the amount of money supply. The tobacco sales for the current season as at 28 March 2014 totaled US$121.3 million, representing a significant liquidity inflow into the economy. Tobacco sales are solely financed from offshore sources hence bringing in additional cash into the country. Tobacco selling season has been characterized by increased liquidity in the country with the previous saw the money supply breaching the $4 Billion mark in May due to the same phenomena.

Decomposing the growth in the month on month money supply shows that the following classes of deposits registered a growth: savings deposits (US$15.8 million), demand deposits (US$52.7 million) and under 30-day deposits (US$74.0 million). The increase in these classes was weigh down by the decrease which was registered in over 30-day deposits 0f US$70.4 million. This decomposition shows that the banking sector is still faced with the problem of short term deposits when the economy is in need of long term deposits.

From a policy perspective there is need for the country to put in measures that encourages the citizens to save long term so that industry can be financed to return back to productivity. Failure to attract long term funding in the financial system will see the current liquidity crunch persisting into the long term. Tax incentives on savings are very important at this juncture of economic development so that we ameliorate the liquidity challenges.

Money Supply



Lending to the Private Sector

The total Credit to the private sector declined by 0.5%, from US$3 627.0 million in February 2014 to US$3 610.4 million in March 2014. Given the prevailing macroeconomic environment, the banking sector has been taking a cautious approach to lending in order to safeguard the low deposit base characterized by short term deposits. With the Non-Performing Loans last reported at 16 percent and affecting the whole spectrum of the banking industry, the sector has been revising the lending criteria hence also the reduced amount of lending. The macroeconomic environment and characteristic of the deposit in the banking sector has seen the players taking a risk aversion strategy which hinges on lending based on quality of the loan book rather than the quantity.

Sectoral Analysis of Commercial Bank Loans and Advances

An analysis of the Commercial Bank loans and advances shows that the agricultural sector continues to dominate the loans and advances at 20.3 percent. The banking sector understands the centrality of the agriculture in the economy and in the success of the ZimAsset which has set agriculture under its first pillar (Food and Nutrition) hence continued increased support to the sector.

The other sector that benefited mostly from the loans and advances from the Commercial Banks were Distribution (19.9 percent); Individuals (16.4 percent); Services (15.9 percent) and Manufacturing (15.1 percent)

Sector	Deposits	Total Advances (US$ 000)
Agriculture	118239.1	503868.1
Construction	55167.5	42707.9
Communication	135807.9	35785.1
Distribution	382675.5	494663.8
Financial & Investments	216025.3	5257.4
Financial Organisations	791776	52722
Manufacturing	275549.1	374809.1
Mining	103298.7	116653
Services	806185.9	396000.6
Transport	42432.8	38089.3
Individuals	521381.5	406503.1
Conglomerate	72990.9	15833.1
	3521530.2	2482892.5

The table above shows that the Commercial Banks are supporting the whole spectrum of the sectors of the economy.

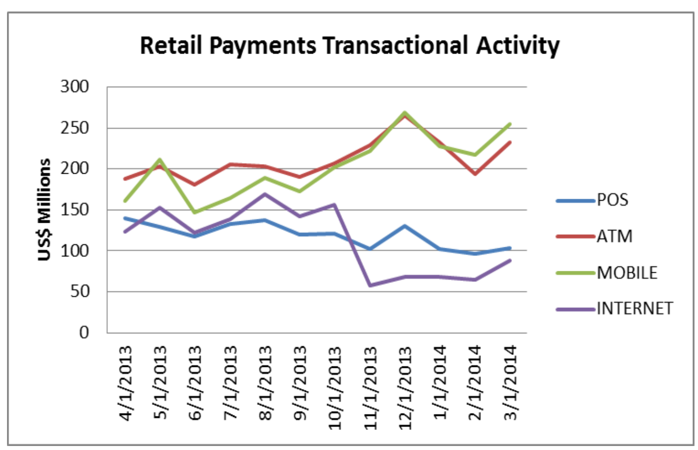
The average loan deposit ratio for the commercial banks as at March 2014 was 71 percent. The loan to deposit ratio is used to calculate a lending institution's ability to cover withdrawals made by its customers. A lending institution that accepts deposits must have a certain measure of liquidity to maintain its normal daily operations. In this case the 71 percent loan deposit ratio means that the banks are on lending on average $71 for every $100 dollars in deposits.

Commercial Banks were quoted to be lending at between 6 percent and 35 percent during the month of March while the merchant banks were lending at between 15 percent and 23 percent. The high lending rates above for the Merchant banks and Commercial banks are reflection of the scarcity of resources on the local market. With offshore financing attracting a risk premium for the country, the end product which is offered by the Banks becomes expensive. The weighted average lending rates for individuals and corporates were 14.25 percent and 9.27 percent for corporates while 18.8 percent and 17.73 percent respectively for Merchant Banks. Measures to reduce the country's sovereign risk should be put forward including dealing with the debt issue. There is need for the country to follow through the Staff Monitored programme by the IMF and World Bank.

Deposit rates are quoted depending on the types of savings. Those savings of long tenure are paid high interest rates as compared to demand deposits. The savings deposits with Commercial Banks attracted interest rates of between 0.15 percent and 8 percent while three months deposits attracted interest rates of between 3 percent and 20 percent. The majority of the deposits in the country are short term hence getting low interest rates.

Retail Payments Transactions

In March, there was a surge in the use of electronic payments system with the use of Point of sale, Automated Teller Machines, Mobile banking and Internet banking increasing in both volume and value. This is a commendable development given the current liquidity situation prevailing in the country. These methods of payment if there are embraced by the whole economy it will go a long way in resolving the cash challenges that usually experienced in the country.



In value terms the biggest increase was registered on the internet payment system which recorded a 36.5 percent, followed by use of automated teller machines at 20.1 percent and Mobile payments at 17.6 percent. The least increase was registered in the use of Point of sale machines at 7.6 percent. With these encouraging developments, it is important that the momentum on the use of the various platforms continues till the economy attains the cashless society status. This is a situation where the society will no longer be demanding cash but using these various methods of payment. To be able to attain this there is need for the various financial sector stakeholders to roll out extensively the financial literacy and financial inclusion programmes to enlighten the various groups in the society.

Monthly Article Feature

Credit Reference Bureau Crucial for Financial Sector Stability

Sanderson Abel

In a modern economy, economies are usually run on credit with corporates, individual, societies and clubs providing credit to one another. A cycle of credit is thus created in an economy where each economic agent is one way or the other in receipt of credit from another. Any hiccup within the cycle might end up disturbing the smooth flow of resources among the economic agents.

It is then important that the economic agents understand the centrality of keeping the cycle ongoing without deliberate actions to disturb it. This is so given that credit is important especially for the industry responsible for producing goods and services. In Zimbabwean scenario this cannot be overemphasized. With the current level of capacity underutilization credit either from suppliers or banks helps firm to expand the control of production which means more goods and services, more surplus. Credit for the producers also serves as a channel for greater profit, well, if they retail product for credit more income will gather. The important part of it is that the banks are usual at the end of the spectrum through underlying the majority of credit flowing in the economy.

The weaknesses currently inherent in our corporate sector makes banks more reluctant to provide much credit which result in decreases in aggregate demand leading again, to an even worse borrowers' condition. Whilst from household perspective inadequate access to credit, limits poor people from a fair share of resources in society, depriving them of basic needs and opportunities in life.

Universally, the credit providers are now facing the big challenge of non-repayment of credit. These credit providers include Banks, credit retail shops, telecommunication companies, service providers and other involved in providing credit. The challenge of non-payment of credit is hence derailing economic progress as the good candidates for credit are being denied credit as the credit providers are not sure of the creditworthy of them. This brings to the fore two important interrelated terms in economics which need to be dealt now rather than later: adverse selection and moral hazard.

Adverse selection: is the problem created by asymmetric information before the transaction occurs. Adverse selection in financial markets occurs when the potential borrowers who are the most likely to produce an undesirable (adverse) outcome – the bad credit risks- are the ones who actively seek out a loan and are the most likely to be selected.

Moral hazard is the problem created by asymmetric information after the transaction occurs. Moral hazard in financial markets occurs when the lender is subjected to the hazard that the borrower has incentives to engage in activities that are undesirable (immoral) from the lenders point of view, because those activities male it less likely that the loan will be repaid back.

The problem of moral hazard and adverse selection can be overcome through monitoring the behavior of borrowers and this can be done through well-established institutions underpinned by strong legislation. These institutions are the credit reference bureaus.

The credit reference bureau should be a privately owned, profit-making establishment that as part of its regular business collects and compiles data regarding the solvency, character, responsibility, and reputation of a particular individual or business in order to furnish such information to subscribers, in the form of a report allowing them to evaluate the financial stability of the subject of the report. Credit bureaus ordinarily prepare and issue reports for lending institutions and stores that investigate the financial reliability of an applicant for credit prior to the execution of the credit agreement.

The Credit Reference Bureau (CRB) should be established so as to assist banks in determining credit worthiness of their borrowers. CRBs allows for credit information sharing among the financial institutions and other credit providers. In this case the lemons in an economy (those who have reputation of failing to honor their obligations) are distinguished from oranges (those with good credit record). This will resolve the question of how can banks differentiate oranges from lemons or how can we resolve the challenge of moral hazard and adverse selection.

Studies around the world have shown that there are benefits associated with the establishment of credit reference bureau in an economy and these should be underpinned by strong legislative framework. The legislation is important because of the nature of information that is supposed to be held by these institutions. Given the extent of confidentiality of the information and the associated sensitivities, it is important that the government through its various arms comes up with legislative framework that will create a win-win scenario for the economy and the various economic agents without prejudice to any one section.

Some of the benefits of creating a credit reference bureau are; CRB reduces borrowing costs and loan delinquencies to a significant extent; CRB can enhance effective risk identification/monitoring and credit extension and CRB can ensure that credit flows to deserving borrowers and reduce to those less deserving ones. Given that ultimately all credit providers are reliant on Banks to some extent, a well functional credit reference bureau will help in maintaining financial stability in an economy.

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