

Zimbabwe: 2005 Article IV Consultation—Staff Report; Public Information Notice on the Executive Board Discussion; and Statement by the Authorities of Zimbabwe

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2005 Article IV consultation with Zimbabwe, the following documents have been released and are included in this package:

- the staff report for the 2005 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on July 25, 2005, with the officials of Zimbabwe on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on July 29, 2005. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its September 9, 2005 discussion of the staff report that concluded the Article IV consultation.
- a statement by the authorities of Zimbabwe.

The document listed below has been or will be separately released.

Selected Issues and Statistical Appendix

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

ZIMBABWE

Staff Report for the 2005 Article IV Consultation

Prepared by the Staff Representatives for the
2005 Consultation with Zimbabwe

Approved by Benedicte Vibe Christensen and Mark Plant

July 29, 2005

- The 2005 Article IV consultation discussions were held in Harare during June 13-25, 2005. The staff met with Finance Minister Murerwa, Reserve Bank of Zimbabwe Governor Gono and other senior government officials as well as representatives of the private sector, political parties, trade unions, NGOs, and the diplomatic community.
- The staff team comprised Ms. Coorey (head), Mr. Heytens, Ms. Muñoz, and Mr. Mohapatra (all AFR); and Mr. Andrews and Ms. Mbabazi-Moyo (both MFD). Mr. Mafararikwa, Senior Advisor to the Executive Director, and World Bank staff attended some of the meetings.
- This report covers developments and policy discussions with the authorities through mid-July. Staff will report on subsequent developments and policies in a staff supplement issued closer to the Board date.
- In past Article IV consultations, the Board has strongly urged the authorities to adopt a comprehensive policy package aimed at restoring confidence and restarting sustained growth. Despite some policy improvement in 2004—notably in reducing inflation—the authorities have, on the whole, failed to implement such a package.
- Zimbabwe has been in continuous arrears to the Fund since February 2001. Following a decision by the Executive Board on December 3, 2003, the Managing Director issued a complaint on February 6, 2004 that initiated the procedure on Zimbabwe's compulsory withdrawal from the Fund.
- Zimbabwe has accepted the obligations of Article VIII, Sections 2, 3, and 4, but maintains exchange restrictions and multiple currency practices subject to Fund approval. Zimbabwe has incurred external payments arrears on official debt.

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Executive Summary

After some improvement in 2004, Zimbabwe's economic and social conditions have deteriorated sharply this year. Staff estimates a further contraction in real GDP of 4 percent in 2004. While inflation slowed from a peak of 623 percent in early 2004 to around 130 percent in early 2005, it has picked up again to 164 percent in June. With the official exchange rate overvalued and imports restricted, shortages of basic goods have become pervasive. The parallel market premium widened sharply to 100 percent by early July 2005. Social indicators have worsened and Zimbabwe is off-track in meeting all but two MDGs.

The authorities have not met the policy commitments made last December and, absent decisive policy action, the outlook appears bleak. Staff projects a further decline in real GDP of 7 percent in 2005, mainly due to difficulties in agriculture. The fiscal deficit would widen to 14 percent of GDP (from 4¾ percent of GDP in 2004) and contribute—together with the RBZ's expanding quasi-fiscal activity—to a pick up in inflation to 320 percent by end-2005. Food security is an urgent concern. Non-food imports will be squeezed further, increasing vulnerability to a rise in world oil prices. "Operation Restore Order" could add to fiscal pressures and—by curtailing informal markets—could lower GDP and raise price pressure. Over the medium term, GDP would continue to contract given difficulties in agriculture and foreign exchange shortages. Inflation would remain in the 200-300 percent range reflecting substantial fiscal deficits and quasi-fiscal activities. Given limited external financing, the current account would be broadly stable and arrears would accumulate.

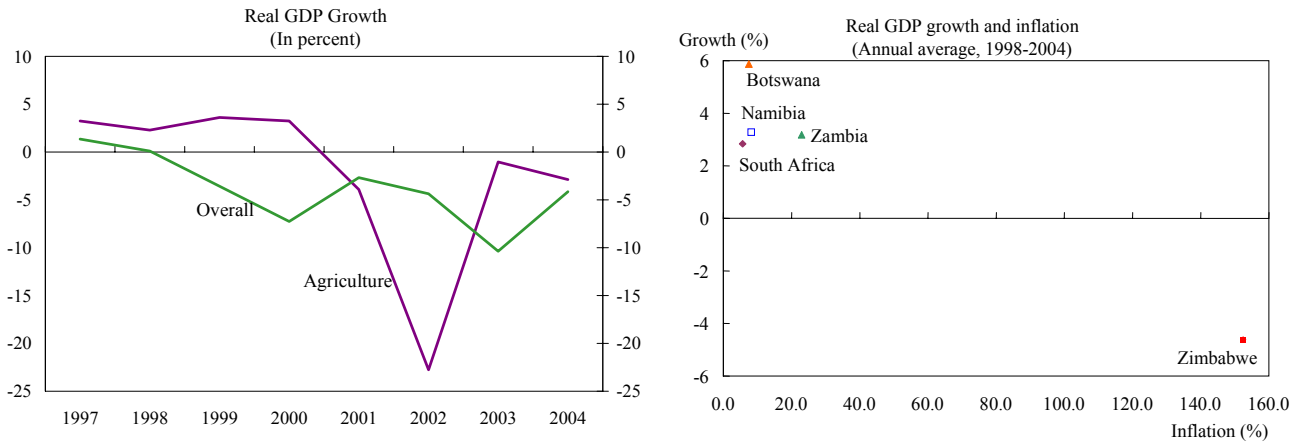
Staff pressed for a comprehensive policy package to achieve sustained growth, external viability, and low inflation. Macrostabilization, the immediate priority, could be achieved by: (i) strong fiscal adjustment to limit this year's deficit to 5 percent of GDP to ensure a broadly neutral fiscal stance; (ii) liberalizing the exchange regime and unifying the exchange rate, with immediate substantial depreciation; (iii) tightening monetary policy to achieve the authorities' end-year inflation target of 80 percent; and (iv) curtailing the RBZ's quasi-fiscal activity. Staff noted that the financial system appeared to be adequately supervised and resilient to significant shocks. It would be critical to ensure that supervisors remain empowered to take timely action to address identified weak institutions.

Fundamental structural reform is essential over the medium term to ensure a stable and efficient financial system; increase the role of markets; place the fiscal accounts on a strong medium-term footing and reform public enterprises; improve agricultural productivity including through further land reform; and strengthen governance. Relations with the international community would need to be rebuilt and a strategy formulated to reduce arrears.

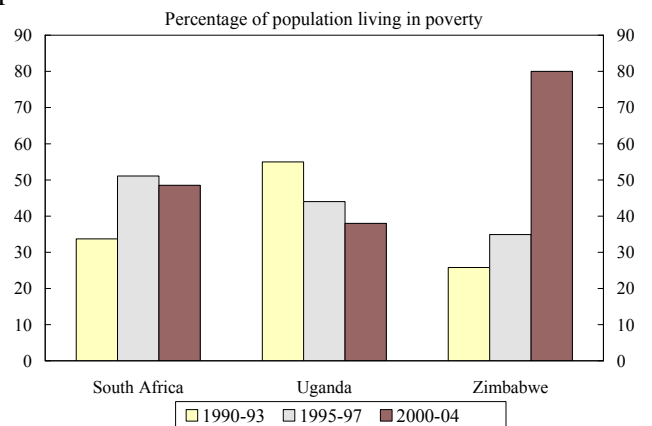
The authorities had a different view of prospects and policies. In their estimate, output would grow by 2 percent this year due to strong performance in tobacco, wheat and mining. Moreover, inflation was still much lower than early last year. They would attempt to stay within the budget deficit limit by taking offsetting measures for appropriated (discretionary) spending. Their room for maneuver on the exchange rate was limited, but sufficient flexibility would be maintained to ensure export viability. Broad money growth would be lowered to 80 percent by end-2005, in line with their inflation target. Producer and credit subsidies were needed, given the lack of foreign financing, and would be effective in lowering inflation through increases in productivity and output growth. Credit subsidies would be eliminated by end-2006.

I. BACKGROUND AND KEY ISSUES

1. **Zimbabwe's economy has deteriorated sharply since 1997.** Real GDP declined by almost 30 percent from 1997 to 2003, while inflation soared from about 20 percent in December 1997 to a peak of 623 percent in January 2004 (Table 1 and Figure 1). Agricultural production—the mainstay of the economy—collapsed with the disruption caused by the violent implementation of fast-track land reform. With the official exchange held constant at Z\$55 per U.S. dollar—and later at Z\$824 per U.S. dollar—(Figure 2) , and declining exports and foreign financing, the supply of foreign exchange to the official market shrank, leading to sharp restrictions on imports and accumulation of external arrears (Figure 3). Investment fell sharply and shortages of food, fuel, electricity and other basics became pervasive. The performance of the economy lagged markedly behind those of other countries in the region.



2. **The human cost of these policies has been high.** Zimbabwe's human development indicators—once among the best in sub-Saharan Africa—have deteriorated sharply to a rank of 147th out of 177 countries in the world. More than two out of three Zimbabweans are unemployed while poverty and emigration have risen sharply. The HIV/AIDS pandemic has been left largely unchecked, with the infection rate estimated at about 25 percent of the adult population. Life expectancy has declined to below 40 years from around 60 years fifteen years ago, while child mortality has risen sharply to 126 (per 1,000 live births) from 90 in 1995, partly reflecting declining immunizations and the AIDS pandemic.



Selected Social Indicators
(latest data available)

| | Zimbabwe | South Africa | Zambia | Botswana | Uganda |
|---|----------|--------------|--------|----------|--------|
| GNI per capita (World Bank Atlas Method) | 480 | 2500 | 340 | 3010 | 240 |
| Human Development Indicator (HDI) rank | 147 | 119 | 164 | 128 | 146 |
| Unemployment | 70.0 | 29.5 | ... | 22.8 | ... |
| Poverty Headcount ratio | 80.0 | 48.5 | 72.9 | 30.3 | 38.0 |
| Life expectancy at birth (years) | 38.5 | 46.5 | 36.9 | 38.1 | 43.1 |
| Child mortality under 5 (per 1,000 live births) | 126.0 | 65.0 | 182.0 | 110.0 | 141.0 |

Source: United Nations, Human Development Report 2004; World Bank, WDI 2005; and IMF staff estimates.

3. **Zimbabwe's political situation mains difficult.** Relations with the international community have become increasingly strained—the United States and European Union imposed targeted sanctions on top officials in 2002, and external financial support is confined to humanitarian assistance. The ruling ZANU-PF party won a two-thirds majority in the parliamentary elections held on March 31, 2005. Although less violence was reported than in the past, the opposition party and Western governments have criticized the elections as being neither free nor fair, but governments in the region, as well as the Southern African Development Community (SADC) and the African Union have accepted the results.

4. **As of June 30, 2005, Zimbabwe's arrears to the Fund totaled SDR 199.6 million (US\$ 290.7 million).**¹ The authorities have followed through on their pledge to increase payments to US\$9 million per quarter beginning in April 2005, which has begun to reduce arrears. The Executive Board at its February 16 meeting deferred for another six months taking action on the Managing Director's complaint regarding Zimbabwe's compulsory withdrawal in order to provide the country a further opportunity to significantly strengthen cooperation with the Fund. The next review of Zimbabwe's overdue financial obligations will take place at the time of the Board's discussion of the 2005 Article IV consultation.²

5. **Against this background, the discussions focused on the following key issues:**

- What are the prospects and risks for Zimbabwe's economy?
- Are the authorities' macroeconomic and structural policies adequate for addressing Zimbabwe's pressing economic problems? How sound is the banking

¹ At end-June 2005, arrears to the World Bank stood at US\$352.8 million and arrears to the African Development Bank at US\$270.8 million.

² See "Zimbabwe—Overdue Financial Obligations to the Fund—Further Consideration of Complaint with Respect to Compulsory Withdrawal" (to be issued).

system, financial supervision, and the authorities' framework for resolving problem banks?

- What macroeconomic and structural policies are needed for Zimbabwe, both in the short and medium term, to achieve sustained growth with low inflation as well as improved cooperation with the Fund?

II. REPORT ON THE DISCUSSIONS

A. Overview

6. **The discussions took place against the backdrop of a deteriorating economic and social situation.** In view of economic prospects and risks, staff pressed for a comprehensive package of measures to stabilize the economy and create the conditions for sustained growth, external viability, and low inflation.

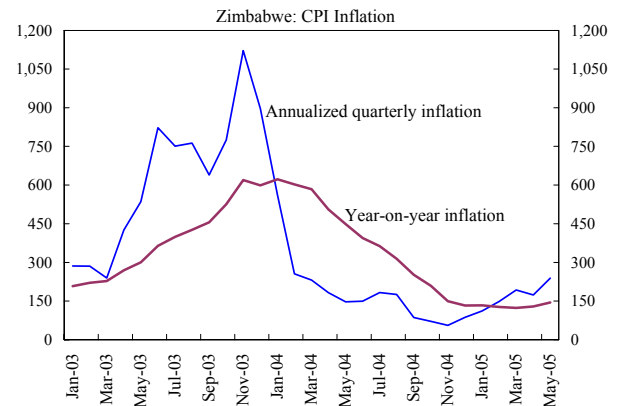
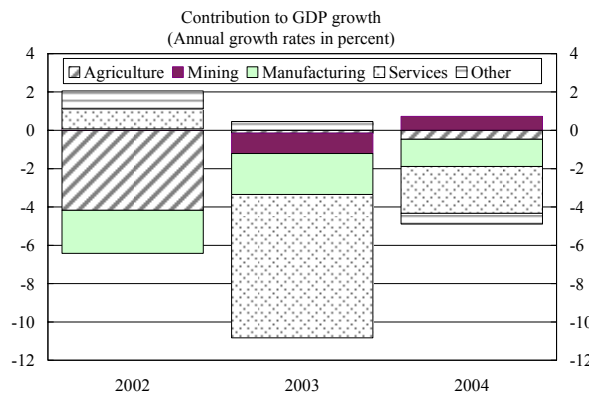
- **Macro stabilization** is the immediate priority and could be achieved with a package comprising: (i) strong fiscal adjustment; (ii) liberalizing the exchange rate regime and unifying the exchange rate; (iii) tightening monetary policy; and (iv) curtailing the quasi-fiscal activities of the Reserve Bank of Zimbabwe (RBZ).
- **Fundamental structural reforms** initiated in 2005-06 and followed through by a comprehensive medium-term program will be essential, particularly to: ensure a stable and efficient financial system; increase the role of markets; strengthen the fiscal position and public enterprises; improve the conditions in agriculture, including through land reform; and strengthen governance.
- **Relations with the international community will need to be rebuilt** to obtain external support for domestic policy reforms.

B. Economic Prospects

7. **The pace of economic deterioration slowed somewhat in 2004, but showed signs of picking up again in the first five months of 2005.** Staff estimates that real GDP fell by about 4 percent in 2004, compared with a contraction of 10½ percent the preceding year, reflecting a marked recovery in mining and a slower decline in services that partly offset the continued contraction in agriculture. Year-on-year inflation decelerated sharply from a peak of 623 percent in January 2004 to stabilize around 130 percent in early 2005, before picking up again to 164 percent in June.³ (Seasonally-adjusted 3-month data indicate rising price pressure since November 2004). Price

³ The CPI likely understates inflation, (see paragraph 35), but the extent is difficult to quantify. Inflation is also probably repressed as publicly-administered prices (e.g., for electricity and fuel) are held at artificially low levels.

controls were reinstated and an Income and Price Commission was established to review public and private sector prices. With the Reserve Bank able to meet only 4-8 percent of bids in its foreign exchange tender, shortages of basic necessities, especially fuel, have become more acute, particularly since end-March. The parallel market premium which had narrowed markedly in the first quarter of 2004, widened sharply from 45 percent in January 2005 to about 100 percent by early July.



8. Without decisive policy action, the outlook for 2005 and beyond is bleak.

Staff projects that continued difficulties agriculture (the maize crop was well below expectations partly due to low rainfall), rising inflation, and foreign exchange shortages, particularly for fuel imports, would cause real GDP to contract by some 7 percent this year (Table 1). The widening fiscal deficit and quasi-fiscal activities would contribute to money growth, pushing inflation to about 320 percent by end-2005. The current account deficit would widen temporarily to 7½ percent of GDP due to higher food imports. Output is projected to contract again in 2006, with a less severe decline in agriculture assuming normal levels of rainfall. Inflation would decelerate to 200 percent by end-year as the fiscal deficit is held back by the erosion of government expenditure in real terms.

9. Over the medium term, output would decline further in the absence of significant structural reform (Table 2). Following past patterns, the fiscal deficit is projected to narrow and then widen again, with inflation fluctuating in the 200-300 percent range.⁴ With no appreciable change in external assistance, the current account would remain broadly stable in U.S. dollar terms and arrears would accumulate.

10. Zimbabwe is off-track in achieving most Millennium Development Goals (MDGs). A recent assessment indicated that under current policies only two targets are

⁴ In the past, fiscal deficits and inflation have followed a cyclical pattern, partly related to the election cycle, with the deficit periodically narrowing as inflation is allowed to erode expenditure in real terms (Figure 4). See *Selected Issues* paper on “Fiscal Deficits and Inflation”.

achievable: immunization of one-year olds against measles and access to safe drinking water (Table 3).⁵ The HIV/AIDS pandemic, falling incomes, and the rapidly deteriorating health and education services affects most of the other MDGs. Progress will depend on achieving sustainable growth, controlling the HIV/AIDS pandemic, and improving food security.

11. **The authorities took a different view of recent developments and the economic outlook.** In their estimate, output declined by only 2½ percent in 2004 and will grow by 2 percent this year. Although drought had severely affected the 2004-05 maize crop,⁶ tobacco and wheat (which were less affected) as well as mining would perform well this year while manufacturing would bottom out. The support prices and subsidized credit facilities for agriculture and manufacturing were evoking a supply response and would increase flows into the official market. Moreover, they stressed that in comparison to the peak in early 2004, inflation had declined considerably by mid-2005 on account of their policies to turn around the economy.

12. **Staff noted several risks and vulnerabilities to the outlook.** In particular,

- **Food security.** Food imports will need to rise sharply this year, with the World Food Programme aiming to raise 300,000 tons of maize out of an import requirement of 1.2 million tons during April 2005-March 2006. Moreover, capacity constraints at ports and railways could hamper rapid delivery of large quantities of maize. The authorities indicated that they had obtained private external financing to meet grain import needs this year.
- **The squeeze on non-food imports.** Staff's balance of payments projection indicates that even with food imports financed externally, non-food imports would decline by some 15 percent in real terms—a sharp compression from already low levels (Table 4). Zimbabwe would thus be highly vulnerable to any deterioration in the terms of trade, particularly a further rise in world oil prices.
- **The economic consequences of “Operation Restore Order,”** the government's recent effort to remove unauthorized dwellings and structures. Given uncertainty over the magnitudes, the projections do not fully incorporate these consequences. Pressures for additional fiscal spending may result (see paragraph 14). Also, by reducing informal market activity and real incomes, the operation could contribute to lower GDP and upward price pressures.

⁵ See *Selected Issues* paper on “Recent Trends in Poverty and Social Indicators.”

⁶ Many farmers' groups, and international organizations, however, noted that while rainfall was low during the 2004-05 growing season, the main reasons for the poor maize crop were unsettled conditions in agriculture following land reform, official delays in getting seeds and fertilizer to farmers, and the lack of extension services to new farmers.

C. Fiscal Policy

13. **The fiscal deficit for 2004 is estimated at 4.7 percent of GDP, compared with a projected deficit in the budget of 7½ percent of GDP and an estimated deficit of 3 percent of GDP reported at the February Board meeting.** Revenue performance was broadly in line with expectations in February, but final data indicate that statutory spending on pensions and interest payments picked up sharply late in the year (Table 5).⁷

14. **Staff projects the fiscal deficit to increase substantially in 2005 to 14.3 percent of GDP due to higher spending.** This estimate well exceeds the projected deficit of 7½ percent in the budget and the authorities' commitment communicated to the Board in February to keep the fiscal deficit unchanged from the previous year. Revenue is expected to perform as budgeted despite lower-than-expected customs duties (due to lower non-food imports), given efforts to improve collections by bringing new tax payers into the tax net and the strong performance of corporate taxes, partly reflecting the shift to taxation of contemporaneous income. Expenditure would rise due to higher-than-budgeted spending on elections; drought-related welfare programs; larger pension payments from unexpectedly large retirements (particularly from the military); higher interest costs from the doubling of treasury bill issues in the first quarter; as well as Z\$1 trillion (1½ percent of GDP) in unbudgeted spending to address the consequences of "Operation Restore Order".⁸

15. **Staff urged the authorities to submit a mid-year supplementary budget to lower the deficit to 5 percent of GDP as part of a comprehensive stabilization package and in line with previous commitments.** Such a level of the deficit—unchanged from the previous year—would provide a broadly neutral fiscal stance to support the stabilization.⁹ With the expenditure ratio now close to 50 percent of GDP, the bulk of the adjustment would need to come from spending restraint, particularly on the wage bill. Staff noted that Zimbabwe's government wage bill was high

Fiscal indicators, 2004
(In percent of GDP)

| | Tax Revenue | Wage bill |
|-----------------|-------------|-------------|
| Zimbabwe | 32.6 | 15.4 |
| Botswana | 37.1 | 14.2 |
| Lesotho | 39.0 | 12.9 |
| Mozambique | 13.1 | 7.5 |
| South Africa | 23.5 | 9.4 |
| Zambia | 17.6 | 7.8 |
| Tanzania | 11.2 | 3.9 |
| Uganda | 11.7 | 5.2 |

⁷ There are two types of fiscal spending: appropriated (discretionary) spending that requires parliamentary approval and statutory spending (such as pensions and interest) that requires only a ministerial warrant to exceed the approved budget allocation.

⁸ The actual deficit in January-April, 2005 reached some 14½ percent of GDP. Staff's projections assume that food imports will be financed externally (see paragraph 12).

⁹ The authorities committed last December, prior to the February Board review of Zimbabwe's overdue obligations, to keep the fiscal stance broadly neutral in 2005.

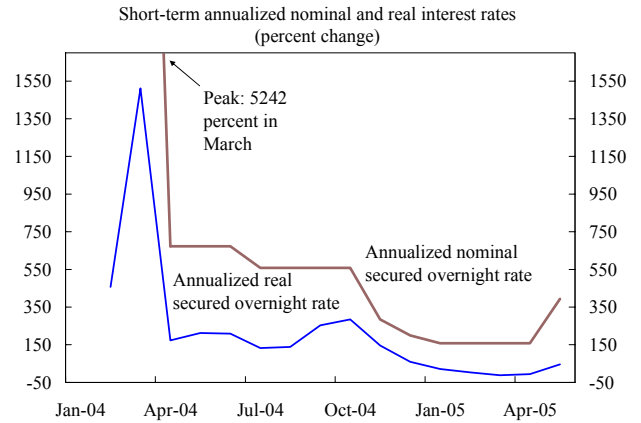
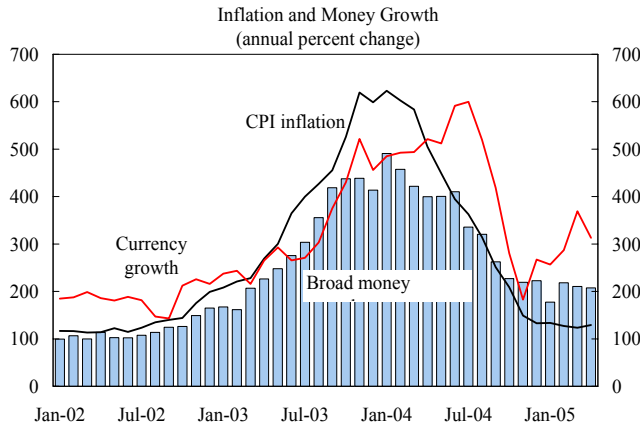
by regional standards—even before the 270 percent wage increase at the beginning of 2005. Although expenditure was concentrated on education and health, there was a sizeable deficit of workers in these areas (due to emigration and AIDS) and government wages were considered low.¹⁰ Staff urged an overall hiring freeze as well as a payroll audit to eliminate possible ghost workers and improve spending efficiency—without compromising the already deteriorating quality of services. Civil service reform would be needed over the medium term to obtain a sustained reduction in the wage bill. Capital outlays and transfer payments, which have risen sharply, could also be curtailed while cash management practices could be improved. Given the size of the adjustment, some revenue measures would also be needed, such as a significant narrowing of exemptions and zero rating in the VAT and an increase in income tax and VAT rates.

16. **The authorities indicated their intention to stay within the budget’s deficit limit, while emphasizing the difficulties given the lack of external support.** They acknowledged that the front-loading of expenditure in the first quarter would make it more difficult to find cuts later in the year, but underscored their track record of over-performing on budget targets in recent years. They were already implementing a hiring freeze (excluding limited additional posts created after the elections for a Senate and an expanded Cabinet) and were limiting capital spending to completing existing projects. A supplementary budget would likely be submitted to Parliament in July to accommodate the additional spending pressures (noted above), which would be offset by cutbacks in other spending and revenue measures, such as a drought levy that could augment selected taxes by some 5 percent. The authorities acknowledged, however, that even if they stayed within the budget limit for appropriated expenditure, the increase in statutory spending on pensions and interest would increase the fiscal deficit to about 10 percent of GDP.

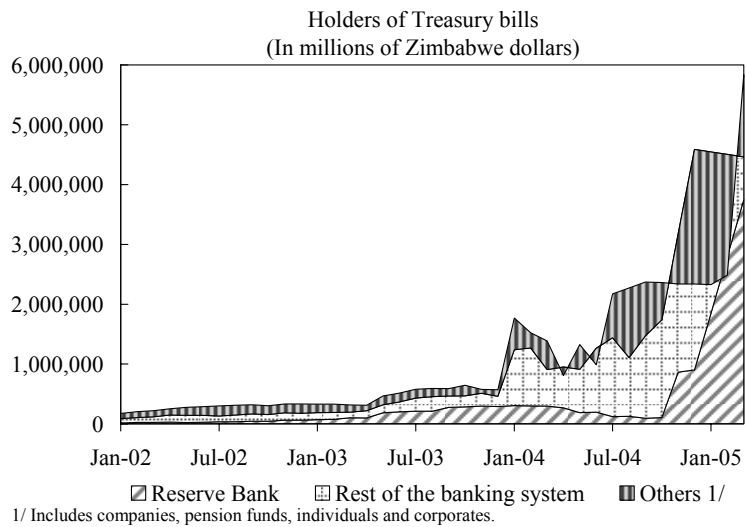
D. Monetary Policy

17. **Monetary policy was tightened in 2004, but the stance was relaxed prematurely.** Overnight interest rates were raised sharply in early 2004 and lowered subsequently as inflation declined, with real interest rates maintained at high levels for most of the year (albeit with credit subsidies for selected borrowers). Interest rates were lowered sharply around the end-2004 and reduced further in early 2005, despite evidence from monthly data of rising price pressures. The January Monetary Policy Statement preannounced a path of further rate cuts if inflation continued to decline, although this was reversed in May by an increase in the RBZ’s overnight rate to 390 percent (annualized).

¹⁰ See *Selected Issues* paper, “Recent Trends in Poverty and Social Indicators.”



18. **The high rates of money growth that have fuelled the triple-digit inflation are mainly due to the RBZ’s quasi-fiscal activities, reflected in mounting losses on its balance sheet** (Table 6). Although fiscal deficits eventually lead to high inflation, the link is indirect in Zimbabwe given the scope for non-RBZ financing through treasury bills. Much of the reserve money growth in 2004 can be attributed to: (i) exchange losses from foreign exchange purchases from exporters at a higher exchange rate than sales to importers (see text table below);¹¹ and (ii) the RBZ’s initial provision of prolonged liquidity support to troubled banks. Following the resolution of troubled banks (see paragraph 28), credit to banks declined and reserve money growth in early 2005 stemmed mainly from substantial losses due to interest payments on RBZ bills issued to mop up liquidity, as well as to continued exchange losses. Subsidies paid to gold and tobacco producers also contributed. With the higher fiscal deficit, continued interest payments on outstanding RBZ bills, as well as the enlargement and proliferation of producer and credit subsidies in the May 2005 Monetary Policy Statement, staff projects broad money growth to pick up to almost 250 percent by end-2005 from over 200 percent at end-April (Table 6).



¹¹ In 2004, almost half the inflows to the official market—purchased at the higher auction rate—were sold at Z\$824/US\$ for official imports of oil, electricity, and essential inputs.

Contributions to Changes in Reserve Money 1/
(In billions of Zimbabwe dollars)

| | Dec-03 | Dec-04 | Apr-05 2/ |
|------------------------------|------------|--------------|--------------|
| Δ Reserve Money | 585 | 1,596 | 2,334 |
| Δ NIR | -227 | -2,529 | 881 |
| Δ Claims on Banks | 361 | 2,379 | -31 |
| Δ Troubled Bank Fund 3/ | 131 | 1,841 | 130 |
| Δ Overnight loans 3/ | 230 | 472 | -282 |
| Δ Net Claims on Government | 239 | 544 | 201 |
| Δ RBZ Securities | 0 | -3,794 | -2,224 |
| Δ Other items net 4/ | 213 | 4,997 | 3,507 |
| Δ Subsidies | 68 | 199 | 207 |
| Δ Exchange losses | 329 | 3,092 | 923 |
| Δ Losses of the central bank | 0 | 1,207 | 1,382 |

1/ These detailed data are based on the authorities' monetary control program and do not correspond precisely with the balance sheet data in Table 6.

2/ Change since end of previous year.

3/ Liquidity support for banks.

4/ Includes losses related to exchange rate losses, the gold and tobacco subsidies, losses of the central bank and discrepancy in RBZ/IMF Fund Credit Reporting.

19. **Staff urged the authorities to tighten monetary policy—and the growth in the monetary aggregates—sufficiently to ensure the achievement of their inflation target of 80 percent by end-2005 and to limit the RBZ’s activities to its core function of achieving low inflation via a money anchor.**¹² Staff estimates that reserve money growth will need to be brought down sharply to about 60 percent by end-year in order to ensure a rate of broad money growth consistent with such a target (Table 7). Such a monetary program would be tighter than the one committed to by the authorities last December—notwithstanding the relaxation of the inflation target—as real money demand is likely to have declined with the deterioration in confidence and the increase in inflation expectations (signaled by the sharp depreciation in the parallel market rate).¹³ Staff noted that producer and credit subsidies would need to be phased out without delay and the losses of the RBZ (especially from interest payments on RBZ and PLARP bills)¹⁴ transferred to the budget in order for money growth—and hence inflation—to be reduced on a sustained basis. In this context, staff regretted the apparent change in procedures last year that postponed the transfer of these losses to the budget as it reduces transparency. Staff also cautioned against the issuance of bonds indexed to inflation

¹² The authorities’ inflation objective for end-2005 was revised upward from 60 percent. Staff accepted the revision given the deterioration in economic conditions.

¹³ See *Selected Issues* paper on “High Inflation and the Demand for Money.”

¹⁴ See paragraph 32 for a description of the Parastatal and Local Authority Reorientation Program (PLARP).

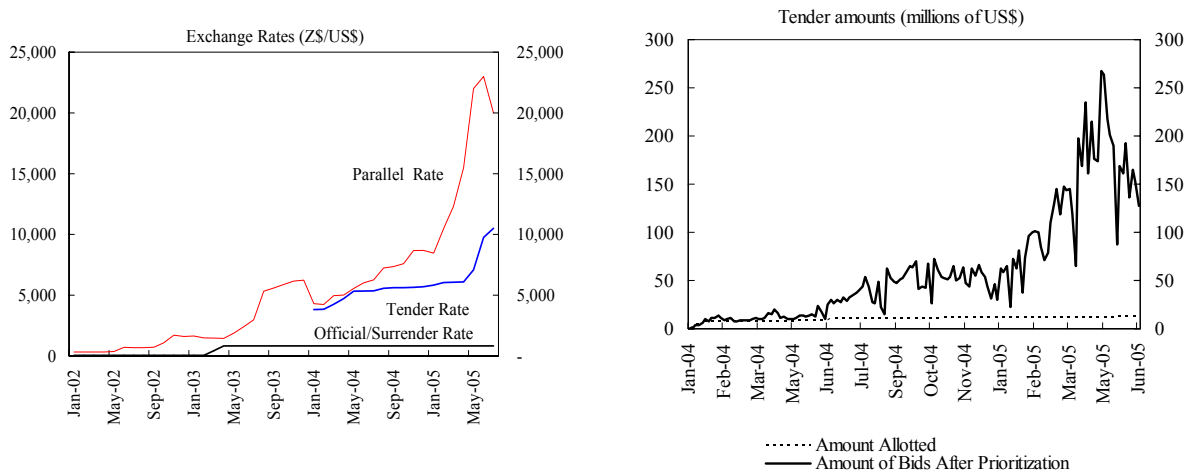
(recently floated to support PLARP) given the prospect for continued high inflation and the potentially unsustainable debt burden arising from fiscal and quasi-fiscal activity.

20. The authorities emphasized that they intended to run a tight monetary policy to achieve their inflation target by end-year and single-digit inflation by end 2006.

Broad money growth would be lowered to 80 percent by end-year given: (i) there was a limit on the government's overdraft with the RBZ; (ii) exchange losses would not recur since exporter and importers now face the same tender rate; and (iii) the new credit facilities were based on recycling banks' statutory reserves. In addition, they explained that producer and credit subsidies—targeted at key sectors—were needed given the dearth of foreign financing and would contribute to lowering inflation through increases in productivity and output growth. Moreover, they intended to gradually eliminate credit subsidies by end-2006. Staff noted that the limit on the government's overdraft had been exceeded in the past; and moreover, that, like the PSF, the new credit facilities would add to broad money growth even if they were notionally netted out of statutory reserves (see footnote 1 to Table 6).

E. Exchange Rate and External Policies

21. The official exchange rate was effectively depreciated significantly in 2004, but the degree of overvaluation appears to have increased again this year. The introduction of a foreign exchange tender system early in 2004 and the gradual relaxation of surrender requirements on exporters resulted in a de facto depreciation of the official rate from Z\$824/US\$ at end-2003 to about Z\$6,100/US\$ by mid-May 2005. The tender rate was allowed to depreciate further to some Z\$10,500 by early July. Nevertheless the sharp widening of the parallel market premium this year reflected the loosening of monetary policy in early 2005 and declining availability of foreign exchange at the tender. Zimbabwe's foreign exchange position remains precarious—usable international reserves remained essentially constant during 2004 at just US\$25 million (0.1 months of imports).



22. Staff urged the authorities to fully liberalize the foreign exchange regime for current account transactions and unify the exchange rate by end-year as part of a

comprehensive stabilization package. Eliminating foreign exchange restrictions, multiple currency practices, and abolishing the surrender requirements were key (see Appendix I).¹⁵ Staff noted that with international reserves low, the exchange rate should be determined by the market (via commercial banks)—which would be feasible in Zimbabwe given its relatively developed domestic financial sector. As a first step towards unification, the official exchange rate should be depreciated immediately and substantially (say by 60–65 percent based on June data) while monetary policy is tightened.¹⁶ The foreign exchange tender needs to be operated as a true auction—with the exchange rate allowed to depreciate to meet all bids—and producer and credit subsidy schemes quickly phased out. Indeed, there was a widespread view among the private sector participants that a depreciation of this magnitude would be appropriate from a purchasing power parity perspective and that the inflationary impact would be minimal as traded goods were already priced at the more depreciated parallel market rate.

23. **The authorities indicated that their room for maneuver on the exchange rate was limited, in part because of the lack of foreign financing and concerns about the inflationary impact, but they intended to maintain sufficient exchange rate flexibility to ensure export viability.** They voiced some doubt about the responsiveness of exports to a more depreciated tender rate in short run given that the output of agricultural exports such as tobacco was already set for the year. They were also of the view that producer supports and subsidized credit were necessary, and indeed more effective, in ensuring competitiveness of exporters at the auction exchange rate and market interest rates. Staff noted that even with a given output, an official depreciation could elicit a shift of export earnings to the official market.¹⁷ Moreover, producer and credit subsidies were not only costly and ultimately inflationary, but also ineffective, as it was difficult to ensure that the cheap credit was being put to the use for which it was intended.

24. **Zimbabwe has an unsustainable debt burden and is projected to continue to accumulate external arrears over the medium term.** Available data (which are not of a high quality) indicate that approximately 70 percent of external debt is owed to official creditors with half of the total in arrears (Table 8). The standard low-income debt sustainability analysis indicates a NPV-of-debt to export ratio in excess of 225 percent over the medium term (Appendix IV).

¹⁵ Since the last Article IV consultation, two new multiple currency practices have been identified: the preferential exchange rate for inward family remittances and the surrender of export receipts from international gold sales.

¹⁶ See *Selected Issues* paper on “Estimating the Short-Run Equilibrium Real Exchange Rate.”

¹⁷ See *Selected Issues* paper on “Export Performance: the Impact of the Parallel Market and Governance Factors.”

25. **Staff encouraged the authorities to rebuild relations with the international community, including the Fund, by implementing sound economic and social policies and eliminating arrears.** A strategy should be formulated for reaching understandings with foreign creditors to settle arrears and restructure debt. Social policies need to be improved to facilitate progress toward the MDGs, particularly by combating the HIV/AIDS pandemic. Greater efforts could also be made to obtain external assistance to support such policies and, in the short run, especially to finance food imports and address the substantial humanitarian and economic consequences of “Operation Restore Order”. Staff noted that over the longer-term, domestic policy reforms would be better sustained if they receive external support, including both technical and financial assistance. The authorities stressed that implementing a turn-around strategy was made doubly difficult by the lack of external assistance. They had been repaying the Fund in accordance with their December commitment, despite foreign exchange shortages, and felt their efforts deserved greater external support.

F. The Financial System

26. **Zimbabwe’s financial system has shown remarkable resilience to the very difficult macroeconomic environment.** Despite the turmoil in 2004 from the collapse of a number of insolvent institutions, the stability of the banking system—where five large banks account for almost 65 percent of deposits—was not threatened. With the exit of weak institutions, the sector is now largely populated by banks with high capital adequacy ratios, little foreign exchange risk, and very short-term maturities for both assets and liabilities to cope with fluctuating interest rates (Table 9).

27. **Staff noted that the banking system appeared generally sound, supervision broadly adequate, with stress tests indicating that the system is resilient to significant shocks, including credit, interest rate, and foreign exchange risks.**¹⁸ Although loan quality has deteriorated significantly, banks’ vulnerability has been reduced by the shift in asset composition towards short-term low-risk securities (treasury bills), with loans now accounting for only about 25 percent of total assets. The few remaining troubled banks are known and regularly monitored and the risk of contagion is minimal given their limited trading in the interbank market. Staff supported the efforts since end-2003 to strengthen bank supervision and standards of governance and risk-management in the financial sector. Staff stressed that the provision of full powers for banking supervision to the RBZ was instrumental in ensuring timely intervention in problem banks. In this context, the recent revision to the Banking Act requiring the RBZ to consult with the Minister of Finance in registering banks and intervening in troubled banks is a regressive step.

28. **Staff commended the decisive action taken by the RBZ to deal with troubled financial institutions in 2004, but questioned the previous approach of providing**

¹⁸ A detailed analysis is provided in the *Selected Issues Paper* “The Soundness of the Zimbabwe Banking System.”

liquidity assistance to insolvent banks. The authorities acknowledged that systemic stability had not been at risk and indicated that the liquidity support had been motivated by a desire to preserve the existing degree of domestic ownership of the banking sector. Staff noted that the RBZ's resolution of troubled banks was in line with recommended international practice,¹⁹ but cautioned that the holding arrangements for the ZABG need to be regularized at the earliest opportunity. Also, while recoveries by curators and liquidators have been impressive in nominal terms, the costs of bank restructuring have been financed by an inflation tax on depositors and creditors (including the RBZ) whose claims have fallen sharply in real terms.

29. **Staff suggested strengthening the adequacy and effectiveness of the deposit insurance scheme through a broader mandate dealing with receivership and liquidation.** While the fund is relatively new and may be built up over time, its effectiveness in strengthening confidence is constrained by its limited mandate—which allows it to only pay out when a bank is in liquidation—and by limited awareness among depositors.

30. **Staff also noted that the very high statutory reserve requirements (60 percent of demand deposits) were impeding the ability of the financial sector to effectively intermediate saving and investment to support economic growth.** These resources were not only being notionally “used” by the RBZ to undertake directed lending at subsidized rates, but also contributed to high lending rates and low deposit rates. The growing rules and restrictions were adding to the administrative burden of borrowers and banks and, furthermore, substantially diverting the RBZ's supervisory resources to policing restrictions that had no prudential foundations. Staff suggested that policy objectives could be better achieved by lowering reserve requirements over the medium term, with offsetting open market operations to mop up excess liquidity whose costs would be transferred to the budget.

31. **The authorities were receptive to staff's recommendation to cease the practice of extending liquidity support to insolvent banks and to take faster action to intervene in identified troubled banks.** Efforts would continue to train and develop new staff and improve off- and on-site analysis. The authorities indicated that the mandate and powers of the deposit protection fund would be reviewed during the coming year. As noted above, they did not see scope for reducing the producer and credit subsidies and were convinced that administrative controls would be effective in ensuring that such subsidies were not misused.

G. The Medium-Term Agenda: Structural Reform

32. **The authorities have embarked on an ambitious medium-term public enterprise reform program—run by the RBZ—to address the problem of poor performance and**

¹⁹ In late 2004, nine deposit-taking institutions were placed in curatorship and three others were liquidated. Based on the determination of the curators, the Zimbabwe Allied Banking Group (ZABG) was created to receive assets and liabilities of three of the failed banks.

high costs in that sector. A Parastatal and Local Authorities Reorientation Program (PLARP) is being created to reform public enterprises and local government. The RBZ plans to issue medium-term bonds of Z\$10 trillion dollars (around 16 percent of GDP) starting in 2005 to finance the program, with the debt to be serviced by the budget starting in 2006. The authorities explained that the intention is to provide financing to public enterprises that come forward with externally audited financial statements and substantive restructuring plans that would place them on a commercial footing. Privatization could be an option for some enterprises further down the road. While agreeing on the need for public enterprise reform, staff expressed reservations that the PLARP could prove costly in the absence of a hard budget constraint on public enterprises, including the option to wind down nonviable enterprises. Staff noted the importance of increasing the transparency of the process, including with regard to the auditing and evaluation standards used to assess restructuring plans and progress, and access to public funds.

33. **Land and agricultural reforms are key for sustaining growth over the medium term.** Most of the country's private commercial farms have now been seized under the authorities' fast-track land reform policy. However, actual resettlement continues to fall significantly short of the government's targets and large areas of productive land remain idle.²⁰ In addition, the introduction of 99-year leases has been delayed and appears not to provide adequate tenure security to new farmers. Weak technical know-how, equipment and input shortages, deteriorating infrastructure, and a lack of extension services also continue to impede agricultural recovery. Staff stressed the need to move rapidly on key issues, such as providing security of tenure and extension services to farmers, followed by a coordinated program of reform over the medium term (Box 1). The authorities noted President Mugabe's commitment to investment protection and desire to compensate investors who might have been inadvertently harmed by the land reform program. They indicated that issues such as allowing land to be mortgaged as collateral were being worked out and that solutions could be found that would allow farmers access to financing without running the risk that banks would end up owning the land (for instance, by increasing the role of the state-owned Agribank).

34. **Staff also urged the authorities to initiate action in several other key areas as part of a medium-term agenda for reform:**

- **Deregulation and liberalization** to increase market forces in the economy. Actions include eliminating price controls and other, less formal, means of setting prices, as well as dismantling the monopoly positions held by public enterprises in the distribution sector, particularly in fuel and grains.

²⁰ See *Selected Issues* paper, "Land Reform, Agricultural Policies, and Outcomes."

- **Fiscal reforms**, particularly civil service restructuring to achieve a sustainable wage bill and strengthen the medium-term fiscal position, as well as improvements to expenditure and cash management systems.
- **Improving governance** to increase investor confidence, reduce corruption, and encourage private business activity. Strengthening the protection of property rights and reducing the threat of nationalization are key.

Box 1: Land Reform and Agriculture

A recent World Bank study recommends a strategy for agricultural recovery and social protection based on five pillars: 1/

- Increase security of tenure and complete the land reform program.
- Provide strong market-based incentives for production and investment in agriculture, especially by restoring and enhancing profitability in the sector.
- Implement a broader social protection program for poor and marginalized groups of the population.
- Build and/or rebuild a cohesive policy and institutional framework for land administration and management, and for agricultural growth and development.
- Mobilize financial resources from taxation, community and private sectors, and external partners.

1/ *Agricultural Growth and Land Reform in Zimbabwe: Assessment and Recovery Options*, The World Bank Report No. 31699-ZW, February 28, 2005.

III. DATA AND OTHER ISSUES

35. **Zimbabwe's statistical base has important weaknesses for surveillance purposes—including with regard to timeliness and coverage.** The CPI is likely understating inflation because of the use of controlled or administered prices, rather than market prices, in the index and outdated weights (from 1997), which may understate the importance of items such as rent and transportation. The coverage and timeliness of balance of payments and external data could be improved. Comprehensive fiscal data are also needed on general government, consolidated public sector debt, as well as the operations and financial position of public enterprises. Moreover, monetary data need to be reconciled with the fiscal accounts. In addition, the lag in receiving fiscal and monetary data has increased to about 4-6 months from 2-3 months previously.

36. **On trade policy, the authorities face conflicting obligations arising from membership of Southern African Development Community and the Common Market for Eastern and Southern Africa, as well as recent bilateral trade agreements with Botswana, Zambia and Malawi.** They are participating in ongoing regional discussions toward an Economic Partnership Agreement with the European Union. The authorities have

continued to lower intra-regional tariffs in line with their commitments, reducing the average tariff to about 10 percent.

IV. STAFF APPRAISAL

37. **Zimbabwe faces immense challenges in arresting the ongoing economic and social decline and turning the economy around to achieve sustained growth, external viability, and low inflation.** Without a bold change in policy direction, the economic outlook is bleak, with likely prospects of continued triple-digit inflation and further output declines, with particularly detrimental effects on the poorest segments of the population. Food security is an urgent concern. Given stagnant export earnings and the necessary increase in food imports, non-food imports will be squeezed, increasing Zimbabwe's vulnerability to external shocks, including further increases in world oil prices. By reducing informal market activity, "Operation Restore Order" could contribute to lower GDP and upward price pressures.

38. **Staff urges the authorities to implement without delay a comprehensive package of macroeconomic measures to stabilize the economy—an immediate priority.** Fundamental structural reform and rebuilding relations with the international community, including the Fund, will also be key for laying the basis for sustained growth, low inflation, and external viability over the medium term. A stabilization package would need to comprise several mutually reinforcing actions: strong fiscal adjustment; liberalizing the exchange rate regime and unifying the exchange rate; tightening monetary policy; and curtailing the quasi-fiscal activity of the RBZ.

39. **Decisive fiscal adjustment is essential in the near term.** A supplementary budget should be submitted to Parliament without delay, with measures to contain this year's fiscal deficit to no more than 5 percent of GDP, which would ensure a broadly neutral stance in support of stabilization. Given the high spending ratio, the bulk of the adjustment would need to come from spending cuts, especially in the wage bill, subsidy/transfer payments, and capital outlays. Cash management could be improved and revenue measures taken—such as a significant narrowing of VAT exemptions and zero rating and an increase in income tax and VAT rates.

40. **The exchange rate regime needs to be fully liberalized for current account transactions and a unified exchange rate established by end-year.** The tender rate remains highly overvalued. As a first step towards unification, this rate needs to be depreciated substantially (by about 60-65 percent) without delay while monetary policy is tightened. The tender should be operated as a true auction. Exchange controls on current payments and all surrender requirements should be eliminated subsequently and the determination of the exchange rate left to the market.

41. **Monetary policy should be tightened substantially and immediately.** To achieve the end-year inflation target of 80 percent, reserve money growth will need to be brought down sharply to keep broad money growth by end-2005 well below the inflation target given

the likely reduction in the demand for real money balances this year. The RBZ should thus shift to a broad money anchor with reserve money as the operational target, in conjunction with the freely floating exchange regime. With any delay in taking such action, the authorities' end-2005 inflation target will remain illusory.

42. **The RBZ should focus on its core function of ensuring price stability and rapidly phase out the many quasi-fiscal activities that fuel money growth and inflation.** A unified exchange rate would obviate the need for costly producer and credit subsidies, which in any case, are likely to be ineffective. Moreover, the many quasi-fiscal activities of the RBZ are increasing the web of controls that hamper the efficient functioning of the economy. Staff cautions against the issuance of bonds that are indexed to inflation given the prospect for continued high inflation and the potentially unsustainable public debt burden. To lower money creation durably, the losses of the RBZ (particularly from interest payments on RBZ and PLARP bills) would need to be transferred to the budget, which would also help increase the transparency necessary for policy makers to make informed choices.

43. **Decisive action to deal with troubled financial institutions in late 2004 was a welcome departure from the previous approach.** Systemic stability was never at risk and the earlier decision to provide liquidity support to preserve indigenous ownership of small banks has proved costly. The subsequent placement of troubled institutions under curatorship or liquidation is broadly in line with recommended international practice and has stemmed the provision of liquidity support, although the holding arrangements for the ZABG need to be regularized at the earliest opportunity.

44. **Measures taken by the RBZ to strengthen banking supervision and standards of governance and risk management in the financial sector are commendable and it will be critical, moving forward, to ensure that supervisors remain empowered to take timely action to address identified weak institutions.** Based on current data, the banking system appears resilient to significant shocks, having taken a number of steps to adapt to the very difficult macroeconomic environment. The measures to strengthen supervision will take a number of years to implement fully. In particular, there is scope for further training and development of the supervision staff as well as to improve the quality of off-site analysis and on-site inspections. Timely and independent supervisory action to address any identified weak institutions will be key. The adequacy and effectiveness of the deposit insurance scheme could also be strengthened.

45. **Over time, the RBZ should lower the very high statutory reserve requirements, which impede the financial sector's ability to effectively intermediate saving and investment to support economic growth.** The notional use of these resources for subsidized, directed lending operations are diverting supervisory resources to greater policing activity that has no prudential foundations. Statutory requirements should be lowered over the medium term and the costs of offsetting mopping up operations absorbed by the budget.

46. **Over the medium term, fundamental structural reform will be essential for sustaining macroeconomic stability and achieving durable growth.** Staff urges the

authorities to initiate action without delay in at least five key areas, followed up by a comprehensive medium-term reform program: deregulation to increase market forces in the economy; public enterprise reform; fiscal reforms, particularly civil service reform, to achieve a sustainable fiscal position; land and agricultural reform; and improvements in governance to increase investor confidence, reduce corruption, and encourage private business activity. The ongoing public enterprise reforms should be geared to ensuring that a hard budget constraint is imposed on enterprises—including the option to wind down nonviable entities—and that the transparency of the restructuring process is increased. Land and agriculture reforms are essential for restoring orderly conditions in the agricultural sector. Key issues such as the provision of security of tenure and extension services to farmers should be resolved urgently.

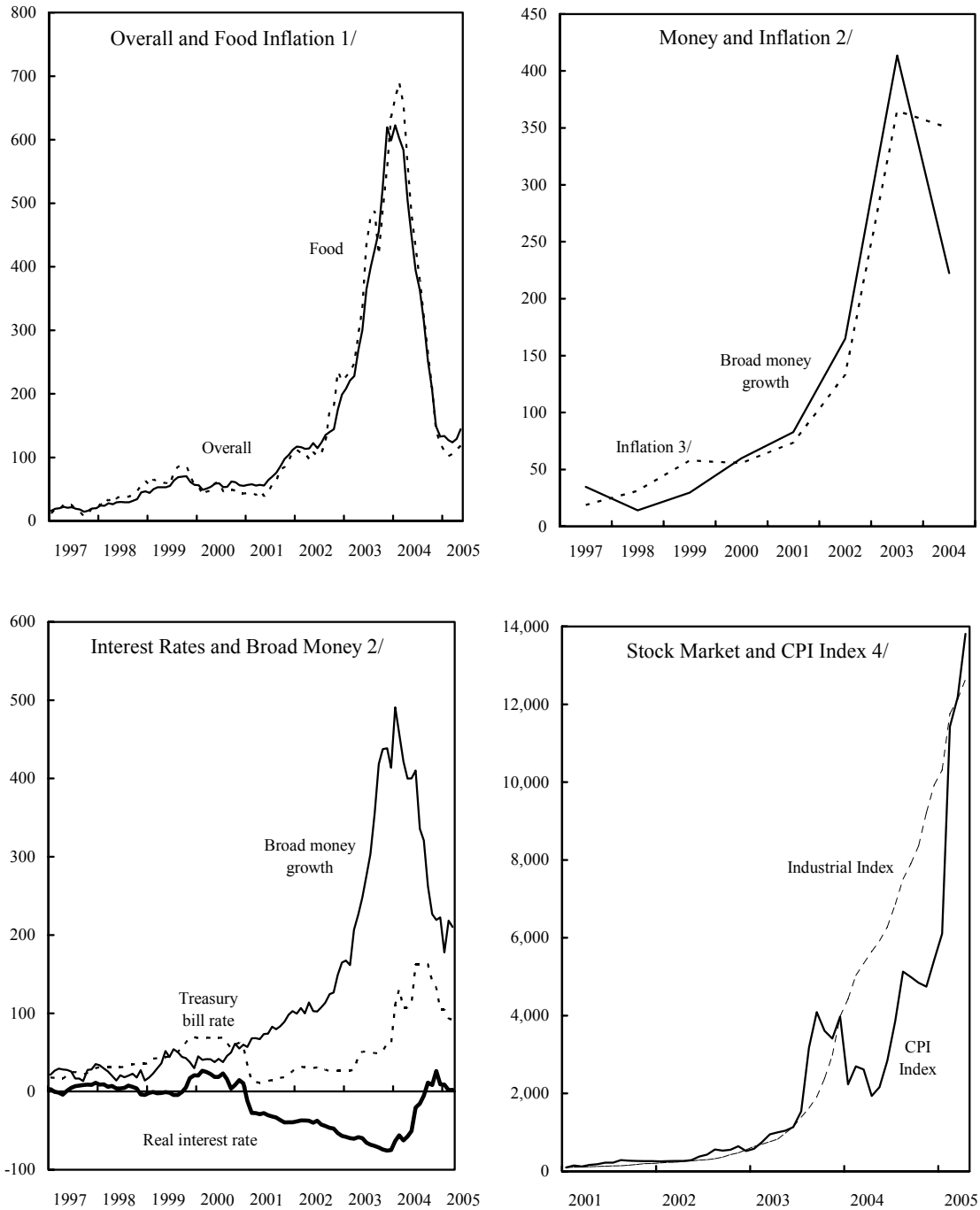
47. **There is considerable scope for improving the provision of data for surveillance purposes.** The methodology underlying the CPI should be scrutinized to ensure that market prices are being recorded and that the weights are representative of the current consumption basket. Better coverage and timeliness of balance of payments and external debt data as well as comprehensive data on general government, consolidated public debt, and public enterprises are key as is the reconciliation of the fiscal and monetary accounts.

48. **Staff urges the authorities to rebuild relations with the international community, including the Fund, through the implementation of sound policies and a strategy to reach understandings with external creditors to settle arrears and restructure debt.** Social policies need to be improved and donor assistance could be sought in the short-term to finance food imports, address the consequences of “Operation Restore Order”; combat HIV/AIDS, and facilitate progress towards the MDGs. Over the longer term, external assistance—both technical and financial—could help support domestic reform efforts.

49. **In the absence of a timetable for its elimination, staff does not recommend approval by the Fund of the newly-identified multiple currency practices** in the form of a preferential exchange rate for inward remittances and the surrender of export receipts from international gold sales.

50. It is proposed that Zimbabwe remain on the standard 12-month consultation cycle.

Figure 1. Zimbabwe: Prices and Money



Sources: Zimbabwean authorities; Zimbabwe market sources; and staff estimates for 2004.

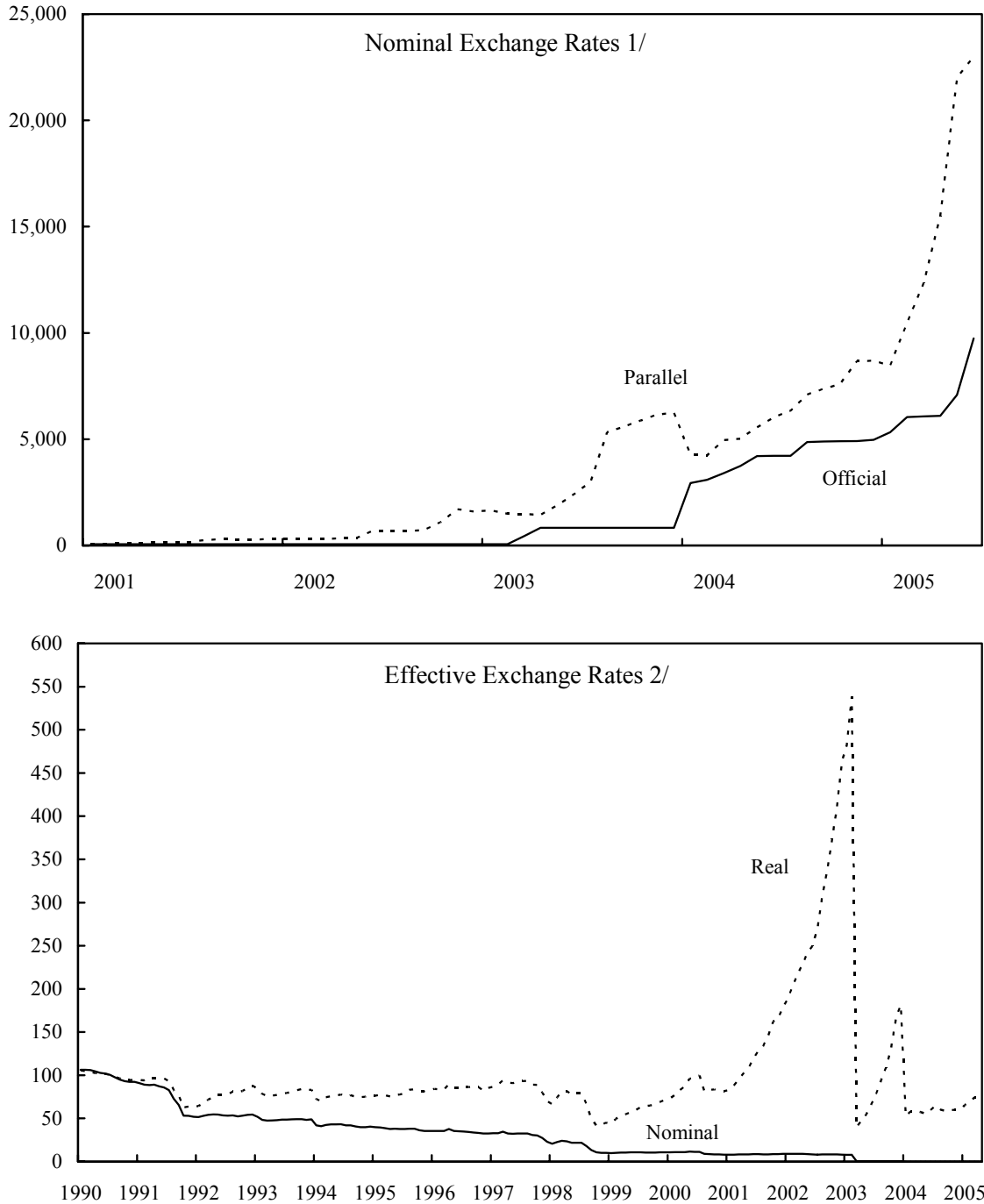
1/ Percentage change in consumer prices (year-on-year).

2/ In percent.

3/ Percentage change in consumer prices (yearly average).

4/ Index 2000=100.

Figure 2. Zimbabwe: Exchange Rates

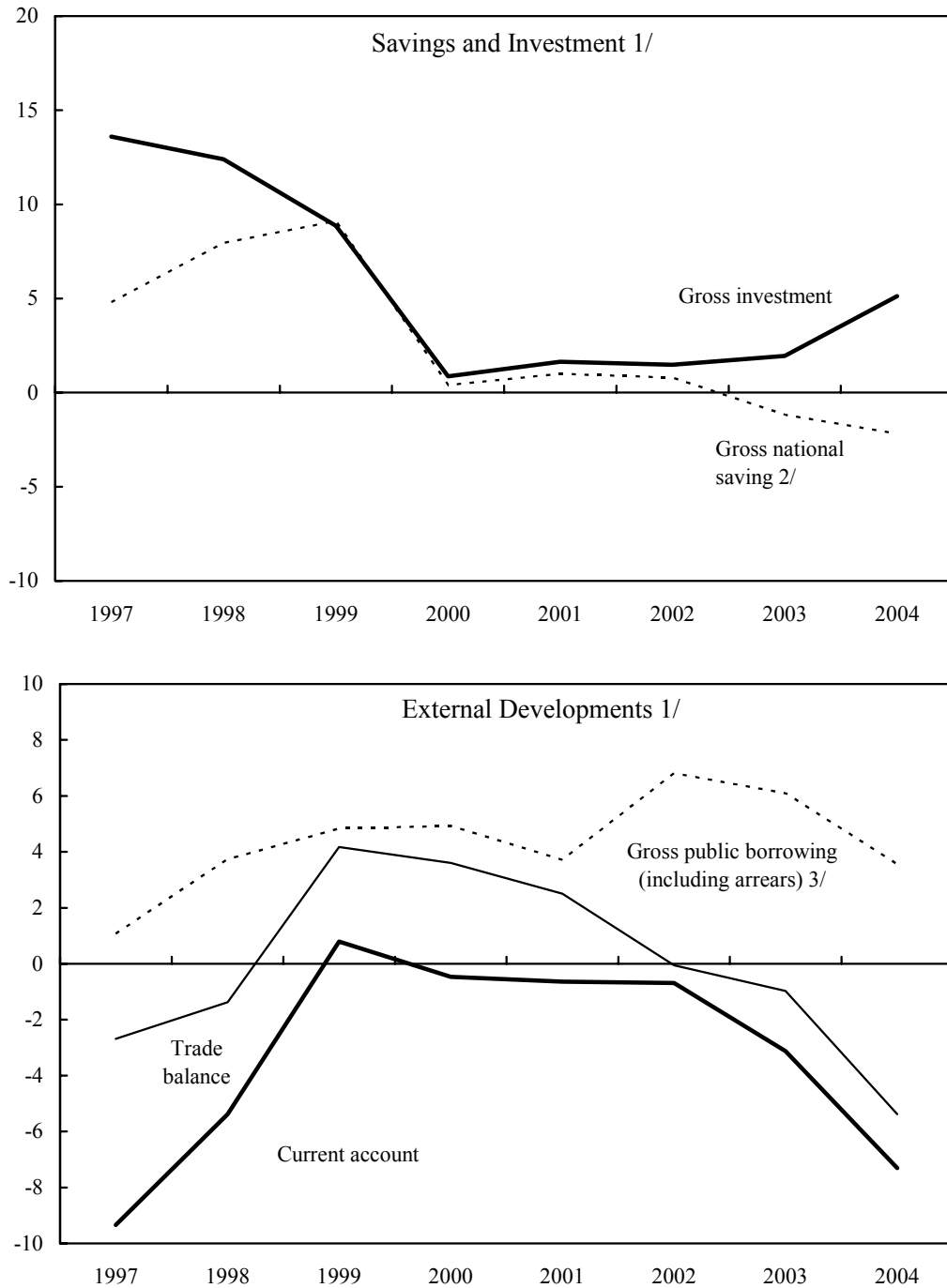


Sources: Zimbabwean authorities; Zimbabwe market sources; and staff estimates for 2004.

1/ In Zimbabwe dollars per US\$. From January 2004 onwards, the official rate reflects a blend between the surrender rate of Z\$824 per US\$ and the average tender rate.

2/ Index 1990=100. Based on the official exchange rate.

Figure 3. Zimbabwe: Saving/Investment and External Balances



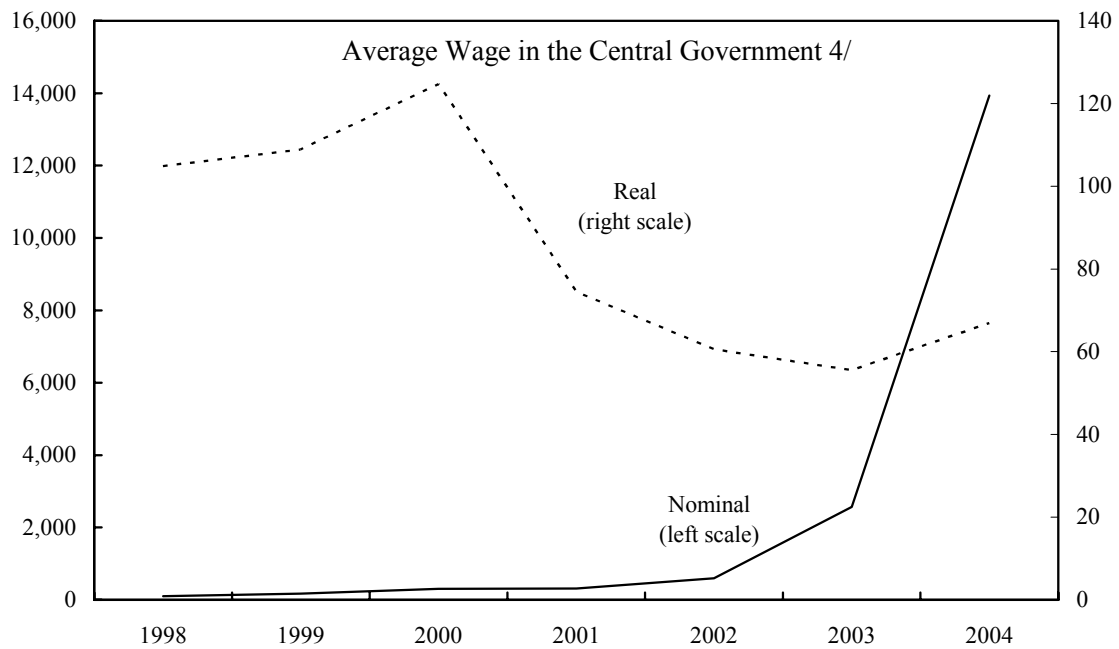
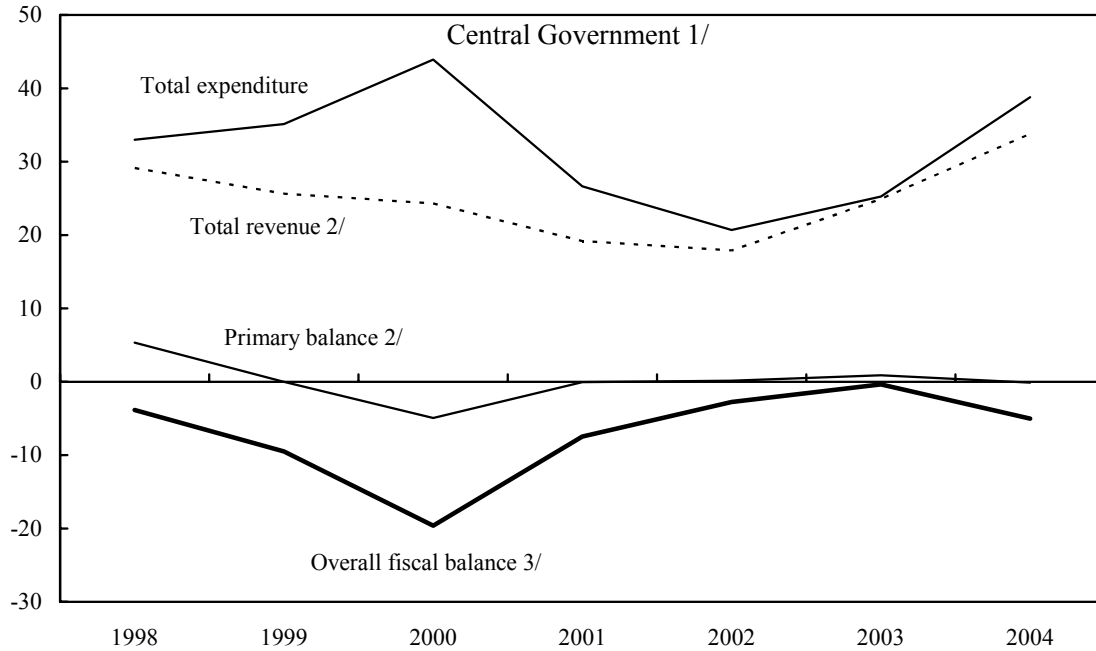
Sources: Zimbabwean authorities; and staff estimates for 2004.

1/ In percent of GDP.

2/ Excludes grants.

3/ Includes IMF.

Figure 4. Zimbabwe: Government Finances



Sources: Zimbabwean authorities; and staff estimates for 2004.

1/ In percent of GDP.

2/ Excluding grants.

3/ Including grants (cash basis).

4/ In thousands of Zimbabwean dollars per employee.

Table 1. Zimbabwe: Selected Economic Indicators, Baseline Scenario, 2001-2006

| | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 |
|---|-------|-------|-------|-------|----------------------|-------|
| | | | | Est. | Baseline Scenario | |
| GDP | | | | | | |
| Real GDP (market prices; percentage change) | -2.7 | -4.4 | -10.4 | -4.2 | -7.1 | -4.8 |
| Real per capita GDP (percentage change) | -2.4 | -4.1 | -11.3 | -3.9 | -7.1 | -4.8 |
| Savings and investment (percent of GDP) 1/ | | | | | | |
| Gross national savings (excluding grants) | 1.0 | 0.8 | -1.2 | -2.2 | 0.6 | 4.2 |
| Gross investment | 1.6 | 1.5 | 2.0 | 5.1 | 7.3 | 6.2 |
| Prices and interest and exchange rates (percent) | | | | | | |
| Consumer price inflation (annual average) | 73.4 | 133.2 | 365.0 | 350.0 | 190.4 | 253.1 |
| Consumer price inflation (end of period) | 112.1 | 198.9 | 598.7 | 132.7 | 320.7 | 199.0 |
| 91-day treasury bills (annualized yield; end of period) | 25.9 | 26.6 | 60.7 | 105.0 | 150.0 | 130.2 |
| Real effective exchange rate (percentage change) | 47.6 | 131.5 | 28.7 | ... | ... | ... |
| Central government budget (percent of GDP) | | | | | | |
| Revenue | 19.2 | 17.9 | 24.9 | 33.9 | 35.6 | 35.5 |
| Expenditure and net lending | 26.6 | 20.7 | 25.3 | 41.0 | 51.7 | 45.0 |
| <i>Of which</i> : interest on central government debt | 7.4 | 2.9 | 1.3 | 5.5 | 5.4 | 2.5 |
| Overall balance, commitment basis (excluding grants) | -7.5 | -2.8 | -0.4 | -7.1 | -16.1 | -9.4 |
| Primary balance, excluding grants | 0.0 | 0.1 | 0.9 | -1.7 | -10.7 | -7.0 |
| Overall balance, cash basis (including grants) | -5.4 | -2.2 | -0.2 | -4.7 | -14.3 | -8.4 |
| Domestic financing (including privatization) | 5.3 | 2.3 | 0.2 | 4.7 | 14.3 | 8.4 |
| External financing | 0.1 | -0.1 | 0.0 | 0.0 | 0.0 | 0.0 |
| Money and credit (percentage change; end of period) | | | | | | |
| Broad money (M3) | 102.7 | 164.8 | 413.5 | 222.6 | 248.0 | 153.2 |
| Domestic credit | 79.1 | 130.0 | 433.8 | 179.0 | 205.9 | 95.2 |
| <i>Of which</i> : real credit to the private sector | -21.2 | -6.0 | -11.0 | 0.7 | -36.1 | -52.1 |
| External trade (percentage change) | | | | | | |
| Export volume | -20.3 | -14.3 | 4.1 | -9.5 | -3.8 | 6.6 |
| Import volume | -0.5 | -0.5 | -19.8 | -6.2 | -7.6 | -9.2 |
| Terms of trade | -4.8 | 1.3 | -5.8 | -6.8 | -6.6 | -1.1 |
| Balance of payments (billions of U.S. dollars, unless otherwise indicated) | | | | | | |
| Exports | 2.1 | 1.8 | 1.7 | 1.7 | 1.6 | 1.7 |
| Imports | -1.8 | -1.8 | -1.8 | -2.0 | -2.0 | -1.8 |
| Current account balance (excluding official transfers) | -0.1 | -0.2 | -0.3 | -0.4 | -0.5 | -0.3 |
| (In percent of GDP at the official exchange rate) 1/ | -0.6 | -0.7 | -3.1 | -7.3 | -6.8 | -2.0 |
| (In percent of GDP at world prices) 2/ | -1.0 | -2.6 | -4.6 | -5.7 | -7.7 | -3.8 |
| Overall balance | -0.2 | -0.5 | -0.5 | -0.2 | -0.3 | -0.3 |
| Official reserves (gold valued at market price) | | | | | | |
| Usable reserves (millions of U.S. dollars; end of period) | 16.0 | 15.1 | 15.6 | 24.8 | 24.8 | 24.8 |
| (months of imports of goods and services) | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| (percent of reserve money) | 43.3 | 0.6 | 1.8 | 5.3 | 3.2 | 3.5 |
| External debt and arrears (including private debt) | | | | | | |
| Total external debt (percent of GDP at world prices; end of period) 2/ | 45.3 | 53.0 | 64.4 | 67.4 | 74.4 | 80.6 |
| <i>Of which</i> : total external arrears | 9.5 | 18.4 | 28.5 | 35.1 | 41.5 | 47.2 |
| Debt service (percent of exports of goods and services) | 23.2 | 25.3 | 23.5 | 18.7 | 18.5 | 18.0 |
| Social indicators | | | | | | |
| Life expectancy at birth (in years) | 39.5 | 39.0 | ... | ... | ... | ... |
| Infant mortality rate (per 1,000 live births) | 76.0 | 76.0 | ... | ... | ... | ... |
| Adult illiteracy rate (percent of adults ages 15 and above) | 10.7 | 10.0 | ... | ... | ... | ... |
| HIV/AIDS adult infection rate (percent of adults ages 15-49) | ... | ... | 24.5 | ... | ... | ... |

Sources: Zimbabwean authorities; World Bank, *World Development Indicators 2004, UNAIDS and CDC (2003)*; and IMF staff estimates and projections.

1/ Foreign currency units are converted into Zimbabwe dollars at the official exchange rate.

2/ GDP at world prices using real GDP growth and trading partner countries' inflation (base year is 1996).

Table 2. Medium Term Outlook, 2003-2010

| | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|-------|-------|-------|-------|-------|-------|-------|-------|
| | | Est. | Proj. | Proj. | Proj. | Proj. | Proj. | Proj. |
| GDP | | | | | | | | |
| Real GDP (market prices; pct change) | -10.4 | -4.2 | -7.1 | -4.8 | -3.6 | -2.9 | -2.4 | -0.8 |
| Real per capita GDP (percentage change) | -11.3 | -3.9 | -7.1 | -4.8 | -3.6 | -2.9 | -2.4 | -0.8 |
| Savings and investment (percent of GDP) 1/ | | | | | | | | |
| Gross national savings (excluding grants) | -1.2 | -2.2 | 0.6 | 4.2 | 3.2 | 3.6 | 2.8 | 1.2 |
| Gross investment | 2.0 | 5.1 | 7.3 | 6.2 | 5.6 | 6.2 | 5.6 | 5.0 |
| Prices and interest rates (percent) | | | | | | | | |
| Consumer price inflation (annual average) | 365.0 | 350.0 | 190.4 | 253.1 | 210.2 | 262.9 | 248.7 | 178.7 |
| Consumer price inflation (end of period) | 598.7 | 132.7 | 320.7 | 199.0 | 219.7 | 300.9 | 206.4 | 156.0 |
| 91-day treasury bills (annualized yield; end of period) | 60.7 | 105.0 | 150.0 | 130.2 | 169.2 | 237.2 | 184.2 | 115.2 |
| Central government budget (percent of GDP) | | | | | | | | |
| Revenue | 24.9 | 33.9 | 35.6 | 35.5 | 34.8 | 35.9 | 35.0 | 33.5 |
| Expenditure and net lending | 25.3 | 41.0 | 51.7 | 45.0 | 42.5 | 47.6 | 43.6 | 41.1 |
| <i>Of which</i> : interest on central government debt | 1.3 | 5.5 | 5.4 | 2.5 | 3.7 | 3.6 | 2.9 | 2.5 |
| Overall balance, commitment basis (excluding grants) | -0.4 | -7.1 | -16.1 | -9.4 | -7.8 | -11.7 | -8.6 | -7.7 |
| Primary balance, excluding grants | 0.9 | -1.7 | -10.7 | -7.0 | -4.1 | -8.2 | -5.7 | -5.2 |
| Overall balance, cash basis (including grants) | -0.2 | -4.7 | -14.3 | -8.4 | -7.2 | -11.0 | -7.9 | -6.9 |
| Domestic financing (including privatization) | 0.2 | 4.7 | 14.3 | 8.4 | 7.0 | 10.7 | 7.4 | 6.5 |
| External financing (including principal arrears) | 0.0 | 0.0 | 0.0 | 0.0 | 0.2 | 0.3 | 0.4 | 0.4 |
| Domestic debt (percent of GDP) | 10.7 | 7.2 | 17.0 | 13.4 | 11.5 | 13.9 | 11.5 | 10.7 |
| Money and credit (percent change; end of period) | | | | | | | | |
| Broad money (M3) | 413.5 | 222.6 | 248.0 | 153.2 | 200.0 | 278.9 | 191.4 | 147.7 |
| Domestic credit | 433.8 | 179.0 | 205.9 | 95.2 | 176.9 | 390.5 | 226.1 | 195.3 |
| External trade (percent change) | | | | | | | | |
| Export volume | -4.1 | -9.5 | -3.8 | 6.6 | 4.7 | 5.2 | 4.8 | 5.2 |
| Import volume | -19.8 | -6.2 | -7.6 | -9.2 | 6.5 | 5.4 | 5.5 | 9.4 |
| Terms of trade | -5.8 | -6.8 | -6.6 | -1.1 | -0.3 | 0.0 | 0.1 | 1.2 |
| Balance of payments (billions of U.S. dollars, unless otherwise indicated) | | | | | | | | |
| Exports | 1.7 | 1.7 | 1.6 | 1.7 | 1.8 | 1.9 | 2.0 | 2.1 |
| Imports | -1.8 | -2.0 | -2.0 | -1.8 | -1.9 | -2.1 | -2.2 | -2.4 |
| Current account balance (excluding official transfers) | -0.3 | -0.4 | -0.5 | -0.3 | -0.3 | -0.3 | -0.3 | -0.4 |
| (In percent of GDP at the official exchange rate) 1/ | -3.1 | -7.3 | -6.8 | -2.0 | -2.4 | -2.6 | -2.8 | -3.8 |
| (In percent of GDP at world prices) 2/ | -4.6 | -5.7 | -7.7 | -3.8 | -4.5 | -4.6 | -5.0 | -6.6 |
| Overall balance | -0.5 | -0.2 | -0.3 | -0.3 | -0.3 | -0.3 | -0.3 | -0.4 |
| Official reserves (gold valued at market price) | | | | | | | | |
| Usable reserves (millions of U.S. dollars; end of period) | 15.6 | 24.8 | 24.8 | 24.8 | 24.8 | 24.8 | 24.8 | 24.8 |
| (months of imports of goods and services) | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| (percent of reserve money) | 1.8 | 5.3 | 3.2 | 3.5 | 3.7 | 3.9 | 4.1 | 4.2 |
| External debt and arrears (including private debt) | | | | | | | | |
| Total external debt (percent of GDP at world prices; end of period) 2/ | 64.4 | 67.4 | 74.4 | 80.6 | 85.9 | 91.0 | 95.8 | 100.5 |
| <i>Of which</i> : total external arrears | 28.5 | 35.1 | 41.5 | 47.2 | 52.5 | 57.6 | 62.4 | 67.4 |
| Debt service (percent of exports of goods and services) | 23.5 | 18.7 | 18.5 | 18.0 | 17.6 | 16.9 | 16.0 | 16.0 |

Sources: Zimbabwean authorities; and staff estimates and projections.

1/ Foreign currency units are converted into Zimbabwean dollars at the official exchange rate.

2/ GDP at world prices using real GDP growth and trading partner countries' inflation (base year is 1996).

Table 3. Zimbabwe: Millennium Development Goals

| | 1990 | 1995 | Latest data | 2015 MDG Target |
|--|-------|-------|---------------|-----------------|
| Goal 1 - Eradicate extreme poverty and hunger | | | | |
| Poverty Headcount 1/ | 25.8 | 34.9 | 80.0 (2004) | [12.9] |
| Undernourished people (as % of total population) | 43.0 | 44.0 | 39.0 (2001) | [21.5] |
| Under-weight children under 5 | 11.5 | 15.5 | 13.0 (2001) | [5.8] |
| Share of poorest 20 percent in national income | ... | 4.6 | 4.6 (1995) | ... |
| Goal 2 - Achieve universal primary education | | | | |
| Net school enrollment, primary | ... | ... | 79.9 (2002) | [100.0] |
| Net school enrollment, secondary | ... | ... | 37.8 (2002) | [100.0] |
| Youth illiteracy rate (% of people ages 15-24) | 6.1 | 4.1 | 2.4 (2002) | [0.0] |
| Goal 3 - Promote gender equality and empower women | | | | |
| Ratio of girls to boys in primary education (%) | 99.0 | 97.1 | 98.4 (2002) | [100.0] 2/ |
| Ratio of girls to boys in secondary education (%) | 87.6 | 83.9 | 88.6 (2002) | [100.0] 2/ |
| Ratio of girls to boys in tertiary education (%) | 35.8 | 41.7 | 57.6 (2001) | [100.0] |
| Goal 4 - Reduce child mortality | | | | |
| Under 5 mortality rate (per 1,000 live births) | 80.0 | 90.0 | 126.0 (2003) | [26.7] |
| Immunization, measles (% of children 1-2 year old) | 87.0 | 87.0 | 80.0 (2003) | [100.0] |
| Goal 5 - Improve maternal health | | | | |
| Maternal mortality ratio (per 100,000 live births) | 570.0 | 610.0 | 1100.0 (2001) | [142.5] |
| Births attended by skilled health staff (% of total) | 69.6 | 69.2 | 72.5 (2001) | ... |
| Contraceptive prevalence (% of women ages 15-49) | 43.1 | 48.1 | 53.5 (1999) | ... |
| Goal 6 - Combat HIV/AIDS, malaria and other diseases | | | | |
| HIV prevalence ratio among adults (15-49 years) | ... | ... | 24.6 (2003) | ... |
| Goal 7 - Ensure environmental sustainability | | | | |
| Access to sanitation facilities (% of population) | 56.0 | ... | 62.0 (2001) | ... |
| Access to safe drinking water (% of population) | 78.0 | ... | 83.0 (2001) | [89.0] |
| Goal 8 - Develop a global partnership for development | | | | |
| Fixed line and mobile telephones (per 1,000 people) | 12.6 | 14.2 | 57.8 (2003) | ... |
| Personal computers (per 1,000 people) | 0.2 | 3.1 | 52.7 (2003) | ... |
| <i>Memorandum Items:</i> | | | | |
| GDP per capita (constant 2000 U.S. dollars) | 601.8 | 570.1 | 479.2 (2002) | |
| Population growth | 3.1 | 1.9 | 0.8 (2003) | |
| Aid (% of GDP) | 4.0 | 7.2 | 1.9 (2001) | |
| Investment (% of GDP) | 17.4 | 19.7 | 8.3 (2002) | |
| GINI index 3/ | ... | 56.8 | ... | |

Source: World Development Indicators 2005, Zimbabwe Human Development Report 2004, UN Statistics Division, UNAIDS and IMF estimates.

1/ The poverty headcount ratio is the proportion of population below the poverty line.

2/ Preferably by 2005.

3/ A value of the GINI index of 1 denotes perfect distribution or equality, while a value smaller than 1 denotes degree of inequality.

Table 4. Zimbabwe: Balance of Payments, 2001-2005
(In millions of U.S. dollars, unless otherwise indicated)

| | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|--------|--------|--------|--------|-------------------|
| | | | | | Baseline Scenario |
| Current account (excluding official transfers) | -82 | -213 | -346 | -421 | -534 |
| Trade balance | 323 | -18 | -108 | -310 | -359 |
| Exports, f.o.b. | 2,114 | 1,802 | 1,670 | 1,680 | 1,644 |
| Imports, f.o.b. | -1,791 | -1,821 | -1,778 | -1,989 | -2,003 |
| Food | -68 | -337 | -206 | -161 | -347 |
| Nonfood | -1,724 | -1,580 | -1,573 | -1,828 | -1,656 |
| Nonfactor services | -186 | -181 | -216 | -108 | -169 |
| Receipts | 256 | 217 | 185 | 317 | 310 |
| Payments | -441 | -398 | -401 | -424 | -479 |
| Investment income | -333 | -242 | -191 | -208 | -194 |
| Interest | -149 | -123 | -114 | -99 | -93 |
| Receipts | 10 | 10 | 10 | 7 | 7 |
| Payments | -159 | -133 | -124 | -106 | -100 |
| Other | -184 | -119 | -76 | -109 | -101 |
| Private transfers (incl. transfers to nongovernmental organizations) | 114 | 228 | 169 | 204 | 188 |
| Capital account (including official transfers) | -386 | -317 | -210 | -170 | 187 |
| Official transfers | 40 | 38 | 38 | 24 | 77 |
| Direct investment | 0 | 23 | 4 | 9 | 13 |
| Portfolio investment | -68 | -2 | 4 | 2 | 0 |
| Long-term capital | -285 | -281 | -228 | -221 | 7 |
| Government | -203 | -183 | -168 | -138 | -162 |
| Receipt | 8 | 3 | 0 | 0 | 0 |
| Payment | -211 | -186 | -168 | -138 | -162 |
| Public enterprises | -59 | -62 | -36 | -60 | 185 |
| Private sector | -23 | -37 | -24 | -24 | -17 |
| Short-term capital | -73 | -94 | -27 | 17 | 91 |
| Public sector | 13 | -13 | 0 | 0 | 145 |
| Private sector | -86 | -81 | -27 | 17 | -54 |
| Errors and omissions 1/ | 292 | 74 | 79 | 344 | 0 |
| Overall balance | -177 | -456 | -476 | -247 | -347 |
| Financing | 177 | 456 | 476 | 247 | 347 |
| Gross official reserves (- increase) | 6 | 1 | 1 | 9 | 0 |
| Net use of Fund resources | -86 | -86 | -65 | -23 | -7 |
| Drawings | 0 | 0 | 0 | 0 | 0 |
| Repayments | -86 | -86 | -65 | -23 | -7 |
| Other short-term liabilities (net) | -41 | -30 | 98 | 21 | 0 |
| Change in arrears (decrease, -) | 292 | 570 | 443 | 240 | 354 |
| Debt relief/rescheduling | 0 | 0 | 0 | 0 | 0 |
| Memorandum items: | | | | | |
| Current account balance (in percent of nominal GDP at world prices) | -1.0 | -2.6 | -4.6 | -5.7 | -7.7 |
| Current account balance (in percent of nominal GDP) | -0.6 | -0.7 | -3.1 | -7.3 | -6.8 |
| Gross official reserves 2/ 3/ | 16 | 15 | 16 | 25 | 25 |
| In months of imports of goods and services | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Reserve liabilities 4/ | 347 | 325 | 452 | 487 | 467 |
| Net international reserves 4/ | -331 | -310 | -436 | -462 | -442 |
| External debt | 3,845 | 4,370 | 4,843 | 4,960 | 5,184 |
| Of which: arrears | 803 | 1,520 | 2,141 | 2,584 | 2,895 |
| External debt service due 5/ | 549 | 510 | 436 | 373 | 361 |
| Debt service ratio (as a percent of exports of goods and non-factor services) | 23.2 | 25.3 | 23.5 | 18.7 | 18.5 |
| Nominal GDP at the official exchange rate (US\$ millions) | 12,883 | 30,856 | 11,080 | 5,762 | 7,901 |
| Nominal GDP at world prices (US\$ millions) 4/ | 8,492 | 8,243 | 7,524 | 7,356 | 6,968 |

Sources: Zimbabwean authorities; and staff estimates and projections.

1/ Include flows associated with underinvoicing of exports and arrears on short-term private debt.

2/ End of period.

3/ Gold valued at market prices. Usable gross reserves.

4/ Nominal U.S. dollar GDP adjusted for real growth and international inflation (1996 base year).

Table 5. Zimbabwe: Central Government Operations (concluded), 2001-05

| | 2001 | 2002 | 2003 | 2004 | | 2005 | | Staff Proj. |
|--|-------|-------|---------|--------------------|----------------------------|------------------------------|-----------------------------|----------------|
| | | | | Original Budget | Prel. Est. Feb. 2005 | Revised Est. June 2005 | Budget Auth. Baseline | |
| (In billions of Zimbabwe dollars) | | | | | | | | |
| Total revenue | 136.0 | 304.2 | 1,374.7 | 6,888 | 8,106 | 8,072 | 23,000 | 22,867 |
| Tax revenue | 128.5 | 284.6 | 1,325.8 | 6,646 | 7,870 | 7,763 | 22,060 | 22,327 |
| Domestic taxes | 111.1 | 257.4 | 1,232.9 | 6,227 | 6,823 | 6,833 | 19,660 | 20,983 |
| Customs duties | 17.4 | 27.2 | 92.9 | 419 | 1,047 | 930 | 2,400 | 1,344 |
| Nontax revenue | 7.4 | 19.6 | 49.0 | 243 | 236 | 309 | 940 | 540 |
| Total expenditure and net lending | 188.9 | 351.3 | 1,394.6 | 8,704 | 8,740 | 9,771 | 27,494 | 33,208 |
| Current expenditure on goods and services | 99.9 | 216.0 | 924.3 | 5,589 | 5,620 | 5,016 | 16,444 | 18,711 |
| Wages and salaries | 64.5 | 123.9 | 528.0 | 3,181 | 3,652 | 3,658 | 11,489 | 11,703 |
| Goods and services | 35.4 | 92.1 | 396.4 | 2,407 | 1,968 | 1,359 | 4,955 | 7,008 |
| <i>Of which:</i> unallocated reserve | ... | ... | ... | 1,368 | ... | ... | ... | ... |
| Interest payments | 52.8 | 49.5 | 69.2 | 1,000 | 600 | 1,302 | 1,000 | 3,285 |
| <i>Of which:</i> domestic | 41.1 | 40.3 | 65.9 | 996 | 600 | 734 | 748 | 1,870 |
| Subsidies and transfers | 24.1 | 55.2 | 239.7 | 1,159 | 1,528 | 2,092 | 5,056 | 6,040 |
| Capital expenditure and net lending | 12.2 | 30.6 | 161.4 | 956 | 992 | 1,360 | 4,994 | 4,994 |
| Capital expenditure | 11.6 | 25.2 | 107.7 | 948 | 912 | 1,220 | 4,712 | 4,712 |
| Net lending | 0.6 | 5.4 | 54 | 8 | 80 | 140 | 282 | 282 |
| Budget balance, excl. grants (commitment basis) 1/ | -53.0 | -47.2 | -19.8 | -1,816 | -622 | -1,699 | -4,494 | -10,341 |
| <i>Of which:</i> primary balance | -0.2 | 2.3 | 49.3 | -816 | -22 | -397 | -3,494 | -6,877 |
| Grants | 3.0 | 0.7 | 6.1 | 12 | 12 | 23 | 0 | 0 |
| Foreign interest arrears | 11.5 | 8.8 | 3.3 | ... | ... | 568 | 0 | 1,163 |
| Budget balance, incl. grants (cash basis) | -38.5 | -37.7 | -10.5 | -1,804 | -610 | -1,115 | -4,494 | -9,178 |
| External financing (net) | 0.7 | -1.5 | 0.9 | -1 | -1 | -2 | 0 | 0 |
| Domestic financing (net) | 37.8 | 39.2 | 9.6 | 1,805 | 611 | 1,117 | 4,494 | 9,178 |

Sources: Zimbabwean authorities; and IMF staff estimates and projections.

1/ Commitments with respect to foreign interest payments.

Table 6. Zimbabwe: Monetary Survey, 2001-2005

| | 2001 | 2002 | 2003 | 2004 | 2005 | | | | 2005 Baseline Scenario 1/ |
|---|-------|-------|--------|--------|--------|--------|--------|--------|---------------------------------|
| | | | | | Jan. | Feb. | Mar. | Apr. | |
| (Annual percentage change) | | | | | | | | | |
| Reserve money | 164.9 | 171.2 | 394.8 | 217.6 | 284.3 | 369.1 | 453.1 | 411.5 | 232.2 |
| Broad money (M3) | 102.7 | 164.8 | 413.5 | 222.6 | 177.6 | 218.5 | 210.4 | 207.6 | 248.0 |
| Currency | 161.1 | 215.8 | 456.0 | 267.3 | 256.6 | 287.2 | 369.0 | 313.1 | 232.2 |
| Deposits | 97.6 | 158.9 | 407.6 | 215.7 | 166.8 | 208.1 | 188.3 | 191.7 | 250.8 |
| (Contribution to reserve money growth, in percent) | | | | | | | | | |
| Monetary authorities | | | | | | | | | |
| Net foreign assets of reserve bank 2/ | -7.2 | -3.0 | -153.7 | -232.6 | -288.9 | -189.6 | -124.0 | -76.0 | -53.7 |
| Net domestic assets of reserve bank | 172.1 | 174.2 | 548.5 | 450.2 | 573.2 | 558.8 | 577.1 | 487.5 | 286.0 |
| Credit to government (net) | 102.4 | 31.7 | 167.9 | 39.5 | 161.9 | 86.7 | 289.3 | 39.9 | 78.8 |
| Credit to non-financial public enterprises | 6.7 | -2.5 | -0.4 | 34.7 | 46.3 | 54.6 | 47.8 | 37.7 | 95.5 |
| Credit to private sector | 71.1 | 66.5 | 246.9 | 330.2 | 358.4 | 299.6 | 262.2 | 144.1 | -25.3 |
| Other items (net) 3/ | -8.1 | 78.5 | 134.1 | 746.5 | 923.9 | 1069.3 | 857.7 | 782.3 | 264.2 |
| RBZ bills | | | | -700.6 | -917.2 | -951.4 | -879.9 | -516.5 | -127.3 |
| Reserve money 4/ | 164.9 | 171.2 | 394.8 | 217.6 | 284.3 | 369.1 | 453.1 | 411.5 | 232.2 |
| Currency outside banks | 73.8 | 97.4 | 239.6 | 157.9 | 195.8 | 242.3 | 287.9 | 235.3 | 158.6 |
| Nonbank deposits | 0.2 | 0.9 | 4.4 | 6.2 | 7.1 | 8.9 | 9.5 | 6.0 | 4.3 |
| Other banking inst. reserves | 2.9 | 2.6 | 4.9 | 6.8 | 7.2 | 7.8 | 20.2 | 11.4 | 6.0 |
| Deposit money bank (DMB) reserves | 88.0 | 70.3 | 145.9 | 46.8 | 74.2 | 110.1 | 135.5 | 158.7 | 63.3 |
| (Contribution to broad money growth, in percent) | | | | | | | | | |
| Monetary survey | | | | | | | | | |
| Net foreign assets | -0.2 | 0.0 | -20.7 | -46.5 | -43.5 | -26.3 | -17.5 | -13.7 | -9.8 |
| Net domestic assets | 102.9 | 164.8 | 434.2 | 269.1 | 221.1 | 244.8 | 227.9 | 221.3 | 257.8 |
| Domestic credit | 97.1 | 141.1 | 408.9 | 175.4 | 146.1 | 158.6 | 180.4 | 128.9 | 174.4 |
| Claims on government (net) 5/ | 38.5 | 19.4 | 44.4 | 55.2 | 55.7 | 77.8 | 118.0 | 68.0 | 52.7 |
| Claims on nonfinancial public enterprises | 9.0 | 11.3 | 26.5 | 14.7 | 10.5 | 12.3 | 7.9 | 6.7 | 25.5 |
| Claims on private sector | 49.6 | 110.4 | 338.0 | 105.4 | 79.9 | 68.5 | 54.4 | 54.3 | 96.3 |
| Other items (net) | 5.8 | 23.7 | 25.3 | 93.8 | 75.0 | 86.1 | 47.5 | 92.4 | 83.4 |
| Broad money (M3) | 102.7 | 164.8 | 413.5 | 222.6 | 177.6 | 218.5 | 210.4 | 207.6 | 248.0 |
| Currency | 12.9 | 22.3 | 56.3 | 35.7 | 30.9 | 37.6 | 45.1 | 41.0 | 35.3 |
| Deposits | 89.8 | 142.4 | 357.2 | 186.9 | 146.7 | 180.8 | 165.3 | 166.6 | 212.7 |
| (Ratios, unless specified otherwise) | | | | | | | | | |
| Memorandum items: | | | | | | | | | |
| Currency-deposit ratio | 11.5 | 14.1 | 15.4 | 18.0 | 18.3 | 18.9 | 22.6 | 21.4 | 17.0 |
| Reserves-deposit ratio | 14.0 | 12.6 | 10.5 | 7.8 | 7.0 | 7.8 | 10.9 | 13.3 | 7.4 |
| Money multiplier (M3/reserve money) | 4.4 | 4.3 | 4.4 | 4.5 | 4.6 | 4.4 | 3.6 | 3.4 | 4.7 |
| Velocity (GDP/M3) | 3.1 | 3.4 | 4.1 | 2.9 | ... | ... | ... | ... | 3.2 |
| CPI inflation (12 months end-of-period; percent) | 112.1 | 198.9 | 598.7 | 132.7 | 133.6 | 127.2 | 123.7 | 129.1 | 320.7 |
| Private sector credit growth (12 months; percent) | 67.1 | 181.0 | 522.1 | 134.4 | 100.7 | 75.3 | 61.3 | 67.5 | 169.0 |
| Real private sector credit growth (12 months percentage change) | -21.2 | -6.0 | -11.0 | 0.7 | -14.1 | -22.8 | -27.9 | -26.9 | -36.1 |

Sources: Zimbabwean authorities; and IMF staff estimates and projections.

1/ Reserve money growth slows more sharply than broad money growth from April 2005 to end-2005 due to the netting out from banks' statutory reserves of loans under the new credit facilities (especially PSF). This reduction would be more than offset by an increase in the money multiplier due to the effective reduction in the required reserve ratio. (A reversal of this process, as the PSF was wound down, partly explains the increase in reserve money and the fall in the multiplier from December 2004 to April 2005).

2/ Reserve Bank of Zimbabwe's net foreign assets and net domestic assets have been adjusted for memorandum of deposits. Includes valuation effects.

3/ Subsidies and exchange rate losses amounted to Z\$ 3,688 billions in 2004.

4/ Reserve money also includes liquidity support provided by RBZ to trouble banks.

5/ Credit to the government differs from the fiscal table as it includes accrued interest on domestic government debt, while domestic interest in the fiscal table is recorded as it falls due.

Table 6. Zimbabwe: Monetary Survey, 2001-2005 (concluded)

| | 2001 | 2002 | 2003 | 2004 | 2005 | | | | 2005 Baseline Scenario 1/ |
|---|-------|-------|-------|--------|--------|--------|--------|--------|---------------------------------|
| | | | | | Jan. | Feb. | Mar. | Apr. | |
| (In billions of Zimbabwe dollars) | | | | | | | | | |
| Monetary authorities | | | | | | | | | |
| Net foreign assets of reserve bank 2/ | -13.0 | -14.7 | -243 | -1,949 | -2,072 | -2,228 | -1,990 | -1,907 | -3,200 |
| Net domestic assets of reserve bank | 67.7 | 162.9 | 976 | 4,278 | 4,515 | 5,186 | 5,969 | 6,571 | 10,941 |
| Credit to government (net) | 25.8 | 43.1 | 292 | 582 | 1,212 | 439 | 2,021 | 693 | 2,417 |
| Credit to nonfinancial public enterprises | 2.0 | 0.6 | 0 | 254 | 294 | 344 | 344 | 344 | 2,480 |
| Credit to private sector | 31.0 | 67.4 | 433 | 2,856 | 2,834 | 3,041 | 3,560 | 2,906 | 2,266 |
| Credit to deposit money banks | 28.7 | 64.7 | 426 | 2,820 | 2,752 | 2,927 | 3,446 | 2,790 | 2,163 |
| Credit to nonbank private sector | 2.3 | 2.7 | 7 | 35 | 82 | 114 | 114 | 115 | 103 |
| Other items net 3/ | 8.9 | 51.8 | 251 | 5,726 | 6,374 | 7,995 | 7,616 | 8,647 | 11,882 |
| RBZ bills | | | | -5,139 | -6,200 | -6,634 | -7,572 | -6,018 | -8,105 |
| Reserve money 4/ | 54.7 | 148.2 | 734 | 2,330 | 2,442 | 2,957 | 3,979 | 4,664 | 7,741 |
| Currency outside banks | 24.7 | 77.9 | 433 | 1,591 | 1,729 | 2,059 | 2,632 | 2,831 | 5,286 |
| Nonbank deposits | 0.2 | 0.7 | 7 | 53 | 50 | 60 | 91 | 84 | 153 |
| Other banking institution reserves | 1.3 | 2.7 | 10 | 60 | 62 | 66 | 167 | 126 | 200 |
| Deposit money bank reserves | 28.6 | 67.0 | 283 | 626 | 601 | 772 | 1,089 | 1,624 | 2,101 |
| Deposit money banks and other banking institutions | | | | | | | | | |
| Net foreign assets | 0.7 | 2.3 | 100 | 299 | 315 | 391 | 480 | 442 | 522 |
| Reserves | 31.9 | 91.5 | 620 | 4,092 | 4,390 | 4,968 | 5,655 | 5,995 | 10,406 |
| Net credit from the reserve bank | -19.1 | -61.2 | -474 | -2,990 | -3,337 | -1,874 | -2,279 | -1,393 | -2,163 |
| Total credit | 228.5 | 548.4 | 2,876 | 7,986 | 8,815 | 10,238 | 10,735 | 11,120 | 22,091 |
| Credit to government (net) | 67.8 | 96.7 | 128 | 1,629 | 2,090 | 3,394 | 3,864 | 3,757 | 5,300 |
| Credit to nonfinancial public enterprises | 17.7 | 45.9 | 214 | 437 | 391 | 481 | 401 | 439 | 873 |
| Credit to private sector | 143.1 | 405.8 | 2,534 | 5,921 | 6,334 | 6,362 | 6,470 | 6,924 | 15,918 |
| Other items (net) | -28.6 | -28.6 | -322 | -577 | -774 | -2,907 | -3,049 | -2,993 | 85 |
| Total deposits | 213.5 | 552.4 | 2,800 | 8,811 | 9,409 | 10,816 | 11,542 | 13,171 | 30,941 |
| Monetary survey | | | | | | | | | |
| Net foreign assets | -12.3 | -12.4 | -143 | -1,650 | -1,758 | -1,837 | -1,510 | -1,465 | -2,678 |
| Net domestic assets | 250.6 | 643.3 | 3,383 | 12,104 | 12,946 | 14,773 | 15,775 | 17,551 | 39,059 |
| Domestic credit | 258.6 | 594.8 | 3,175 | 8,857 | 10,403 | 11,135 | 13,215 | 12,272 | 27,092 |
| Claims on government (net) 5/ | 93.5 | 139.8 | 420 | 2,210 | 3,302 | 3,833 | 5,885 | 4,450 | 7,717 |
| Claims on nonfinancial public enterprises | 19.7 | 46.5 | 214 | 691 | 686 | 825 | 745 | 783 | 3,353 |
| Claims on private sector | 145.3 | 408.4 | 2,541 | 5,956 | 6,416 | 6,476 | 6,584 | 7,039 | 16,021 |
| Other items (net) | -8.0 | 48.5 | 208 | 3,247 | 2,543 | 3,638 | 2,560 | 5,279 | 11,968 |
| Broad money (M3) | 238.3 | 631.0 | 3,240 | 10,454 | 11,189 | 12,935 | 14,265 | 16,086 | 36,381 |
| Currency | 24.7 | 77.9 | 433 | 1,591 | 1,729 | 2,059 | 2,632 | 2,831 | 5,286 |
| Deposits | 213.6 | 553.1 | 2,807 | 8,863 | 9,459 | 10,876 | 11,633 | 13,255 | 31,095 |
| (In millions of U.S. dollars) | | | | | | | | | |
| Memorandum items: | | | | | | | | | |
| Net foreign assets of reserve bank | -237 | -267 | -294 | -340 | -348 | -368 | -327 | -312 | -320 |
| Of which: gross usable reserves | 16 | 15 | 16 | ... | ... | ... | ... | ... | ... |
| Net foreign assets of banking system | 13 | 42 | 121 | 52 | 53 | 65 | 79 | 72 | 52 |

Sources: Zimbabwean authorities; and IMF staff estimates and projections.

1/ Reserve money growth slows more sharply than broad money growth from April 2005 to end-2005 due to the netting out from banks' statutory reserves of loans under the new credit facilities (especially PSF). This reduction would be more than offset by an increase in the money multiplier due to the effective reduction in the required reserve ratio. (A reversal of this process, as the PSF was wound down, partly explains the increase in reserve money and the fall in the multiplier from December 2004 to April 2005).

2/ Reserve Bank of Zimbabwe's net foreign assets and net domestic assets have been adjusted for memorandum of deposits. Includes valuation effects.

3/ Subsidies and exchange rate losses amounted to Z\$ 3,688 billions in 2004.

4/ Reserve money also includes liquidity support provided by RBZ to trouble banks.

5/ Credit to the government differs from the fiscal table as it includes accrued interest on domestic government debt, while domestic interest in the fiscal table is recorded as it falls due.

Table 7. Zimbabwe: Selected Economic Indicators, Revised December Commitments, 2003-2006

| | 2003 | 2004 | 2005 Proj. | 2006 Proj. |
|---|-------|-------|---------------|---------------|
| GDP | | | | |
| Real GDP (market prices; percentage change) | -10.4 | -4.2 | -5.1 | 1.6 |
| Real per capita GDP (percentage change) | -11.3 | -3.9 | -5.1 | 1.6 |
| Savings and investment (percent of GDP) | | | | |
| Gross national savings (excluding grants) | -2.2 | -2.3 | -8.9 | -13.1 |
| Gross investment | 2.0 | 5.1 | 2.9 | 3.4 |
| Prices and interest rates (percent) | | | | |
| Consumer price inflation (annual average) | 365.0 | 350.0 | 116.7 | 57.9 |
| Consumer price inflation (end of period) | 598.7 | 132.7 | 80.0 | 40.0 |
| 91-day treasury bills (annualized yield; end of period) | 60.7 | 105.0 | 90.0 | 50.0 |
| Central government budget (percent of GDP) | | | | |
| Revenue | 24.9 | 33.9 | 36.6 | 35.7 |
| Expenditure and net lending | 25.3 | 41.0 | 44.1 | 38.9 |
| <i>Of which</i> : interest on central government debt | 1.3 | 5.5 | 10.0 | 5.6 |
| Overall balance, commitment basis (excluding grants) | -0.4 | -7.1 | -7.5 | -3.2 |
| Primary balance, excluding grants | 0.9 | -1.7 | 2.5 | 2.4 |
| Overall balance, cash basis (including grants) | -0.2 | -4.7 | -4.9 | -0.9 |
| Domestic financing (including privatization) | 0.2 | 4.7 | 4.9 | -0.1 |
| External financing | 0.0 | 0.0 | 0.0 | 1.0 |
| Domestic debt (percent of GDP) | 10.7 | 7.2 | 8.4 | 5.2 |
| Money and credit (percent change; end of period) | | | | |
| Broad money (M3) | 413.5 | 222.6 | 51.7 | 58.8 |
| Domestic credit | 433.8 | 179.0 | 106.6 | 20.0 |
| <i>Of which</i> : real credit to the private sector | -11.0 | 0.7 | 6.6 | 3.2 |
| Velocity (GDP/M3) | 4.1 | 2.9 | 3.1 | 1.8 |
| Reserve money (percent change; end of period) | 394.8 | 217.6 | 59.8 | 57.3 |
| External trade (percent change) | | | | |
| Export volume | 4.1 | -9.5 | 48.4 | -3.2 |
| Import volume | -19.8 | -6.2 | 24.2 | -5.7 |
| Terms of trade | -5.8 | -6.8 | -6.6 | -1.1 |
| Balance of payments (billions of U.S. dollars, unless otherwise indicated) | | | | |
| Exports | 1.7 | 1.7 | 2.5 | 2.4 |
| Imports | -1.8 | -2.0 | -2.7 | -2.6 |
| Current account balance (excluding official transfers) | -0.3 | -0.4 | -0.3 | -0.3 |
| (In percent of GDP at the official exchange rate) 1/ | -4.2 | -7.4 | -11.8 | -16.5 |
| (In percent of GDP at world prices) 2/ | -4.6 | -5.7 | -4.7 | -4.6 |
| Overall balance | -0.5 | -0.2 | -0.2 | -0.2 |
| Official reserves (gold valued at market price) | | | | |
| Usable reserves (US\$ millions, end of period) | 15.6 | 24.8 | 135.2 | 284.5 |
| (months of imports of goods and services) | 0.1 | 0.1 | 0.7 | 1.1 |
| (percent of reserve money) | 1.8 | 5.3 | 104.5 | 195.7 |
| External debt and arrears (including private debt) | | | | |
| Total external debt (percent of GDP at world prices; end of period) | 64.4 | 67.4 | 72.8 | 73.9 |
| <i>Of which</i> : total external arrears | 28.5 | 35.1 | 40.7 | 43.3 |
| Debt service (percent of exports of goods and services) | 23.5 | 18.7 | 13.9 | 15.3 |

Sources: Zimbabwean authorities; and staff estimates and projections.

1/ Foreign currency units are converted into Zimbabwean dollars at the official exchange rate.

2/ GDP at world prices using real GDP growth and trading partner countries' inflation (base year is 1996).

Table 8. Zimbabwe: External Debt Outstanding By Creditors, 1998-2004

| | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 |
|--|---------------------|-------|-------|-------|-------|-------|-------|
| Public and publicly guaranteed debt (excl. arrears) | 3,785 | 3,556 | 3,112 | 2,664 | 2,594 | 2,545 | 2,306 |
| Medium- and long-term debt (excl. arrears) | 3,553 | 3,324 | 2,880 | 2,432 | 2,362 | 2,313 | 2,074 |
| Bilateral creditors | 1,238 | 1,141 | 1,031 | 926 | 977 | 1,019 | 935 |
| Multilateral institutions | 1,904 | 1,829 | 1,582 | 1,320 | 1,229 | 1,170 | 1,038 |
| IMF | 392 | 368 | 284 | 190 | 98 | 41 | 7 |
| IBRD | 498 | 473 | 416 | 392 | 421 | 449 | 417 |
| Others | 1,014 | 989 | 881 | 738 | 710 | 680 | 614 |
| Private creditors | 410 | 353 | 267 | 186 | 156 | 124 | 102 |
| Short-term debt (excl. arrears) | 232 | 232 | 232 | 232 | 232 | 232 | 232 |
| Private debt (excl. arrears) | 672 | 642 | 498 | 377 | 256 | 157 | 70 |
| Total debt (excl. arrears) | 4,457 | 4,198 | 3,610 | 3,042 | 2,850 | 2,702 | 2,376 |
| Arrears on public and publicly guaranteed debt | 9 | 123 | 404 | 803 | 1,520 | 2,141 | 2,584 |
| Medium- and long-term debt | 9 | 7 | 213 | 636 | 1,173 | 1,703 | 2,049 |
| Bilateral creditors | 1 | 1 | 69 | 166 | 337 | 519 | 642 |
| Multilateral institutions | 0 | 0 | 78 | 314 | 585 | 839 | 1,009 |
| IMF | 0 | 0 | 0 | 76 | 169 | 262 | 305 |
| IBRD | 0 | 0 | 0 | 5 | 0 | 62 | 95 |
| Others | 0 | 0 | 78 | 233 | 416 | 515 | 609 |
| Private creditors | 8 | 6 | 66 | 157 | 251 | 344 | 398 |
| Short-term external debt | 0 | 7 | 44 | 57 | 65 | 71 | 84 |
| Other public and publicly guaranteed arrears ^{1/} | 0 | 109 | 147 | 109 | 282 | 368 | 451 |
| Total arrears | 9 | 123 | 404 | 803 | 1,520 | 2,141 | 2,584 |
| Total debt | 4,466 | 4,321 | 4,014 | 3,845 | 4,370 | 4,843 | 4,960 |
| Public and publicly guaranteed debt | 3,794 | 3,679 | 3,516 | 3,468 | 4,114 | 4,686 | 4,890 |
| Private debt | 672 | 642 | 498 | 377 | 256 | 157 | 70 |
| | (In percent of GDP) | | | | | | |
| Medium and long-term debt | 40.9 | 40.6 | 40.6 | 39.7 | 48.2 | 60.0 | 63.7 |
| Of which: public and publicly guaranteed | 38.3 | 38.1 | 37.9 | 37.4 | 46.3 | 58.3 | 62.2 |
| Short-term debt | 7.2 | 7.2 | 6.4 | 5.6 | 4.9 | 4.4 | 3.7 |
| Memorandum item: | | | | | | | |
| GDP (in millions of U.S. dollars) ^{2/} | 9,294 | 9,037 | 8,545 | 8,492 | 8,243 | 7,524 | 7,356 |

Sources: Reserve Bank of Zimbabwe, World Bank, and IMF staff estimates.

1/ Arrears on supplier credits and interest on arrears.

2/ Nominal U.S. dollar GDP adjusted for real growth and international inflation (1996 base year).

Table 9. Zimbabwe: Financial Soundness Indicators, 1999-2004
(In percent, unless otherwise indicated 1/)

| | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 |
|--|-------|-------|-------|-------|-------|-------|
| Capital adequacy | | | | | | |
| Capital to risk-weighted assets | 15.3 | 18.3 | 22.4 | 16.2 | 15.0 | 34.4 |
| Tier 1 capital to risk-weighted assets | 11.9 | 16.9 | 12.1 | 7.1 | 12.4 | 33.4 |
| Capital to total assets | 6.0 | 9.5 | 10.4 | 8.0 | 7.5 | 12.1 |
| Asset quality | | | | | | |
| NPLs to gross loans | 14.1 | 18.2 | 13.7 | 7.9 | 4.2 | 23.2 |
| Total provisions to NPLs | 38.9 | 45.4 | 50.0 | 70.5 | 75.5 | 48.6 |
| NPLs net of specific provisions to capital | 48.2 | 45.5 | 35.7 | 10.1 | 14.9 | 38.2 |
| <i>Loan concentration</i> | | | | | | |
| Agriculture | 15.8 | 14.5 | 12.8 | 11.2 | 10.9 | 21.4 |
| Construction | 1.5 | 4.3 | 1.9 | 2.3 | 3.1 | 2.2 |
| Communication | 1.6 | 0.7 | 3.0 | 1.3 | 0.7 | 2.5 |
| Distribution | 17.4 | 16.5 | 27.8 | 23.8 | 22.0 | 15.3 |
| Finance & investments | 3.1 | 12.1 | 10.8 | 5.0 | 1.7 | 0.4 |
| Financial Organizations | 2.7 | 7.4 | 1.6 | 6.8 | 2.1 | 0.3 |
| Manufacturing | 17.6 | 14.0 | 20.6 | 20.9 | 19.1 | 20.6 |
| Mining | 7.2 | 9.7 | 4.4 | 2.5 | 6.0 | 9.5 |
| Services | 19.9 | 11.3 | 6.7 | 14.0 | 18.7 | 15.1 |
| Transportation | 3.3 | 3.4 | 2.3 | 3.3 | 2.3 | 3.1 |
| Individuals | 8.7 | 5.6 | 6.5 | 7.8 | 11.6 | 7.6 |
| Others | 1.2 | 0.4 | 1.6 | 1.2 | 1.8 | 2.0 |
| Earnings and profitability | | | | | | |
| Return on assets | 2.4 | 3.8 | 1.4 | 3.4 | 6.1 | 9.7 |
| Return on equity | 50.1 | 43.1 | 18.7 | 62.7 | 121.6 | 125.8 |
| Interest income to noninterest income | 482.0 | 515.0 | 230.0 | 300.0 | 482.7 | 744.1 |
| Net interest income to interest expenses | 89.0 | 103.3 | 351.1 | 565.3 | 77.3 | 176.6 |
| Personnel expenses to gross income | 16.1 | 15.3 | 28.1 | 21.3 | 10.4 | 13.2 |
| Liquidity | | | | | | |
| Liquid assets to total assets | .. | .. | .. | .. | 18.1 | 47.4 |
| Liquid assets to demand deposits | .. | 53.5 | 44.8 | 53.9 | 56.6 | 164.2 |
| Total (non-interbank) loans to customer deposits | .. | .. | .. | .. | 74.1 | 65.0 |
| FX deposits to total deposits | .. | .. | .. | .. | 6.8 | 12.0 |
| Sensitivity to market risk | | | | | | |
| Net open positions in FX to capital | .. | .. | .. | .. | -5.9 | 3.8 |

Source: Reserve Bank of Zimbabwe

1/ Based on commercial banks only which account for about 80 percent of total banking sector assets.

Zimbabwe: Relations with the Fund²¹
(As of May 31, 2005)

I. **Membership Status:** Joined: 09/29/1980; Article VIII obligations accepted 2/5/1995.

| | | |
|---------------------------------------|--------------------|----------------|
| II. General Resources Account: | <u>SDR Million</u> | <u>% Quota</u> |
| Quota | 353.40 | 100.0 |
| Fund holdings of currency | 462.47 | 130.86 |
| Reserve position in Fund | 0.33 | 0.09 |

| | | |
|-----------------------------|--------------------|---------------------|
| III. SDR Department: | <u>SDR Million</u> | <u>% Allocation</u> |
| Net cumulative allocation | 10.20 | 100.0 |
| Holdings | 0.00 | 0.0 |

| | | |
|--|--------------------|----------------|
| IV. Outstanding Purchases and Loans: | <u>SDR Million</u> | <u>% Quota</u> |
| Stand-By Arrangements | 63.94 | 18.09 |
| Extended Arrangements | 46.45 | 12.86 |
| Poverty Reduction Growth Facility (PRGF) Arrangements | 75.23 | 21.29 |

V. **Financial Arrangements:**

| | Approval | Expiration | Amount Approved | Amount Drawn |
|---------------------------------|-------------|-------------|----------------------|----------------------|
| <u>Type</u> | <u>Date</u> | <u>Date</u> | <u>(SDR Million)</u> | <u>(SDR Million)</u> |
| Stand-By Arrangement | 08/02/1999 | 10/01/2000 | 141.36 | 24.74 |
| Stand-By Arrangement | 06/01/1998 | 06/30/1999 | 130.65 | 39.20 |
| Extended Fund Facility (EFF) | 09/11/1992 | 09/10/1995 | 114.60 | 86.90 |

VI. **Projected Obligations to Fund** (SDR million; based on existing use of resources and present holdings of SDRs):

| | Overdue ²² | Forthcoming | | | | |
|------------------|-----------------------|-------------|-------------|-------------|-------------|-------------|
| | <u>05/31/2005</u> | <u>2005</u> | <u>2006</u> | <u>2007</u> | <u>2008</u> | <u>2009</u> |
| Principal | 184.63 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Charges/interest | 20.03 | 2.54 | 4.67 | 4.67 | 4.67 | 4.66 |
| Total | 204.66 | 2.54 | 4.67 | 4.67 | 4.67 | 4.66 |

²¹ For further information, please contact Mr. Heytens (IMF/AFR, (202) 623 99 23), or Ms. Muñoz, (IMF/AFR, (202) 623 66 53).

²² The projection of charges and interest assumes that overdue principal at the report date will remain outstanding, but forthcoming obligations will be settled on time.

VII. Application of Remedial Measures under the Arrears Strategy

Zimbabwe has been in continuous arrears to the Fund since February 2001. On September 24, 2001 the Executive Board declared the country ineligible to use the general resources of the Fund and removed it from the list of PRGF-eligible countries. On June 13, 2002, the Board issued a declaration of non-cooperation with respect to Zimbabwe and suspended all technical assistance to the country. On June 6, 2003, the Board suspended Zimbabwe's voting and related rights in the Fund. A complaint with respect to compulsory withdrawal was issued on February 6, 2004. The Executive Board has so far considered this complaint twice—on July 7, 2004 and on February 16, 2005. On both occasions the Board decided—in light of increased payments and some improvements in policy implementation—to postpone a recommendation for compulsory withdrawal in order to provide Zimbabwe a further change to improve cooperation with the Fund. The Board will again consider the Managing Director's complaint no later than August 16, 2005.

VIII. Exchange Rate Arrangement:

Zimbabwe has a rationed multiple exchange regime (3 "official" rates) where most transactions take place at the main auction ruling rate (Z\$10,150/US\$ on July 4, 2005) but have foreign exchange controls on current account transactions (and hence an active parallel exchange market). The authorities maintain a secondary rate of Z\$9,000/US\$ for inward remittances and a surrender exchange rate of Z\$824/US\$ that has been eliminated for export remittances. Subsidies to gold, tobacco and cotton, and incentives to exporters are implemented to compensate for the overvalued exchange rate. Effective January 30, 2005, Zimbabwe's exchange arrangement has been reclassified to the category of managed floating with no preannounced path for the exchange rate from the category of conventional pegged arrangement.

- A tender system operates by the RBZ to sell foreign exchange three times a week (US\$100 million per month for the main auction and US\$2 million per month for SMEs and individuals). Authorized dealers submit detailed bids on behalf of customers, including transaction information such as intended use of foreign exchange and approval number by the RBZ. An RBZ committee scans the bids and eliminates those that are for non-priority purposes. The rest of the bids are admitted to the tender system and allocated foreign exchange on the basis of price. The main rate at the auction is heavily managed in the sense that although bids are submitted, an increasing number are not met—which would not be the case in a true auction.
- A “carrot and stick” retention scheme is in place in order to encourage faster repatriation of export proceeds. Exporters are allowed to retain 55 percent in foreign currency accounts (FCAs) if earnings are repatriated before 30 days for a maximum period of 21 days and the remainder is sold to the tender at the ruling rate. The surrender requirement at the tender exchange rate increases in a graduated fashion up to a maximum of 80 percent for export proceeds repatriated after 90 days. Foreign currency retentions are stricter for horticulture.
- Tobacco prices are quoted in US dollars at the auctions, but producers receive the local currency equivalent at the tender exchange rate, and in addition receive a direct subsidy of Z\$5,000 per kilogram (from May 19, 2005) for tobacco sold on the auction. The producer subsidy is invariant to the price received on the auction. Tobacco producers from February 2005 were treated as direct exporters for purposes

- of exchange rate management and, like all direct exporters, surrender their export proceeds at the prevailing tender rate.
- Gold producers sell 60 percent of their output at a fixed support price—which was raised to Z\$175,000/gram on May 19, 2005—and sell the remaining 40 percent on the international market. The proceeds from the latter are deposited in the producers' FCAs, which are subject to the same retention periods as other exporters (see the second bullet above).
 - A new subsidy amounting to Z\$3,500/kg for cotton producers was introduced on July 1, 2005.
 - The parallel market exchange rate has depreciated since mid-2004 and was trading at about Z\$20,000/US\$ in early July 2005.
 - The authorities have stated that the RBZ no longer allocates foreign currency at the Z\$824/US\$ rate for Treasury operations, NOCZIM, ZESA and GMB imports, and debt service with Afreximbank, but has not provided documentary evidence of this.

After an initial appreciation of the tender rate from Z\$4,197/US\$ in mid-January to Z\$3,520/US\$ in early February 2004, the tender rate depreciated to about Z\$10,500/US\$ by early July 2005. The tender is managed in a way that does not allow the tender rate to fully reflect market forces.

As a result of this system, Zimbabwe currently has restrictions on the making of transfers and payments for current international transactions, and multiple currency practices, inconsistent, respectively, with Article VIII Sections 2(a) and 3 of the Fund's Articles of Agreement. Zimbabwe maintains multiple currency practices (MCP) arising from the lack of a mechanism to prevent a divergence of more than 2 percent between (i) the exchange rates in the official and parallel markets, (ii) the exchange rates applicable for private sector imports and government imports, (iii) the exchange rates paid by successful bidders in the same tender, (iv) the exchange rate used for surrender of export receipts, including from international gold sales (weighted average rate from each auction) and the other rates in the exchange market, and (v) the exchange rate applicable to inward remittances of foreign exchange. Zimbabwe also maintains exchange restrictions arising from (i) limitations on the availability of foreign exchange, in the form of priority lists that limit the provision of foreign exchange for certain specified transactions which are subject to the approval of the RBZ, and (ii) the existence of private sector external payment arrears inconsistent with Article VIII Section 2(a). These restrictions and MCPs have not been approved by the Board.

Staff was informed of the existence of bilateral payments arrangements with Fund members, which may raise issues of compliance by Zimbabwe with Article VIII obligations. Staff was unable to obtain relevant materials, but is continuing to seek information from the authorities in order to reach a conclusion on these issues. Exchange restrictions arising from certain outstanding contracts under a discontinued RBZ scheme for foreign exchange cover have been discontinued.

IX. Article IV Consultation:

Zimbabwe is on the standard 12-month consultation cycle. The last Article IV consultation was concluded on July 7, 2004 (Country Report No. 04/297).

X. Technical Assistance:

The Executive Board suspended Fund technical assistance to Zimbabwe in June 2002. Past Fund technical assistance to Zimbabwe is summarized in the attached table. A long-term advisor sponsored by MFD provided assistance in the area of banking supervision between August 1996 and October 1999. Another MFD expert on monetary operations provided advice to the RBZ and trained staff in the implementation of open market operations and the use of repurchase agreements during October 1998 – October 2000. A third MFD expert on the payments system, who also advised the RBZ on the array of monetary instruments to be used to monitor and manage liquidity in the financial sector, completed a one-year assignment in October 1999.

XI. Resident Representative:

A resident representative office was opened in July 1993. Mr. G. G. Johnson's term as Senior Resident Representative expired at end-September 2003. The office remained open with local staff until September 2004 when it was closed.

Zimbabwe: Technical Assistance from the Fund (Since the Inception of the PRGF/EFF Arrangements in September 1992)

| Date | Department | Purpose | Result |
|--------------------------------|-----------------|---|---|
| November 1992 | STA | Revise monetary statistics. | Revision initiated. |
| April 1993 | MFD | Liberalize foreign exchange system. | Comprehensive reforms launched; completed in July 1994. |
| Spring 1994 | LEG | Revise the Reserve Bank Act and the Banking Act. | Completed. |
| Spring 1995 | FAD | Improve the system of budgeting and public expenditure control. | Initial steps taken. |
| Spring 1995 | STA | Harmonize the reporting system for monetary statistics. | Harmonization completed. |
| Winter 1995 | STA | Provide training in balance of payments methodology. | Seminar provided. |
| January 1996 | STA | Improve foreign trade statistics. | Advice being implemented. |
| August 1996 | MFD (long term) | Strengthen banking supervision. | Some of the advice being implemented. |
| October 1996 | STA | Improve national accounts. | Some of the advice being implemented. |
| January 1996, November 1996 | MFD | Improve monetary and foreign exchange operations. | Some of the advice being implemented. |
| November 1997 | MFD | Improve monetary operations. | Some of the advice being implemented. |
| May 1999 | MFD | Review and advise on monetary operations, the payments system, and supervision; assess vulnerability of the financial sector. | Report recommendations being reviewed. |
| July 2001 | MFD | Deposit insurance scheme. | Report recommendations being reviewed. |

Zimbabwe: Relations with the World Bank Group

While noting continuing and serious concerns about governance and human rights, as well as the overall decline in political and economic conditions in the country, the Board of Executive Directors of the World Bank has endorsed a one-year Interim Strategy for Zimbabwe on March 17, 2005. The Strategy aims to close vital analytical gaps in the areas of poverty and safety nets, social service delivery, and agriculture and infrastructure sectors. It also includes the HIV/AIDS pilot project initiative. The activities to be carried out under the Strategy will cost US\$ 1.8 million and that funds will be sourced from administrative sources and the LICUS Trust Fund. While implementation will be coordinated with the government, development partners or local organizations will be the implementing agents. Zimbabwe went on non-accrual (i.e. disbursements are suspended) status in October 2000. The stock of arrears to the Bank will reach US\$ 347.2 million by April 1, 2005, representing an increase by US\$ 62 million since end-July 2004. A resumption of lending would be contingent upon clearance of arrears.

Currently, the Bank does not have any active lending projects in Zimbabwe. The last active project was canceled in December 2002.

Zimbabwe was historically one of IFC's largest portfolios in Africa and has hosted a strong private sector. IFC's portfolio totals US\$20.6 million disbursed as of August 1, 2004, with a focus on financial sector. IFC's current priority is to monitor the existing portfolio and to work with the companies which have IFC investment in managing the financial difficulties caused by the current economic crisis. In anticipation of losses, the IFC has substantially increased loan loss provisions for its investments in Zimbabwe and constantly reviews the need to make additional provisions.

While investors have expressed interest in MIGA's coverage for projects in Zimbabwe, the current internal political climate is not conducive to FDI. MIGA's on-line investment promotion services (www.fdixchange.com and www.ipanet.net) feature 61 documents on investment opportunities and the related legal and regulatory environment in Zimbabwe.

World Bank Loan/Credit Summary for Zimbabwe
(in millions of U.S. dollars; as of January 31, 2005)

| | IBRD | IDA | TOTAL |
|-------------------------------------|--------|--------|----------|
| Original principal | 896.20 | 661.95 | 1,558.15 |
| Cancellations | 53.21 | 202.96 | 256.17 |
| Disbursed | 842.92 | 459.07 | 1,301.99 |
| Undisbursed | 76.12 | 1.59 | 77.71 |
| Repaid | 414.62 | 5.31 | 419.93 |
| Due | 428.29 | 506.93 | 935.22 |
| Exchange adjustment | 31.62 | 0.00 | 31.62 |
| Borrower's obligation ²³ | 459.91 | 506.93 | 966.84 |

²³ Does not include interest arrears.

Zimbabwe: Statistical Issues

The economic and financial statistics database in Zimbabwe is inadequate, its quality is deteriorating, and data provision to the Fund is not timely. While some monetary data are of adequate quality, foreign reserves are not reported in a meaningful fashion by the Reserve Bank of Zimbabwe (RBZ), data on external arrears are not reported systematically, and budgetary and monetary data are reported to the staff with a substantial lag. The Central Statistical Office (CSO) conducts several sectoral surveys, but GDP data are reported with a substantial lag and harbor major inconsistencies. There are also shortcomings in external trade and finance data, the consumer price index (CPI) most likely understates inflation because of the use of controlled and administered prices, and no information is available about unemployment and wages.

Zimbabwe participates in the General Data Dissemination System (GDDS) project for Anglophone African countries. Metadata for Zimbabwe (posted on the Fund's Dissemination Standards Bulletin Board in November 2002) indicate the country's plans for improvements in macroeconomic, financial, and sociodemographic statistics. Under the GDDS, the authorities were to have confirmed the accuracy of, or updated, the metadata and plans for improvement on Zimbabwe's GDDS participation anniversaries in November 2003 and 2004. Despite reminder letters, no confirmation or update has been received. However, in the absence of technical assistance and funding, progress in improving the quality, coverage, and timeliness of Zimbabwe's statistical base is likely to be slow.

Real sector statistics

National accounts. The CSO benefited from substantial technical assistance from the Fund, the World Bank, and the United Kingdom in 1996-97. This allowed the CSO to publish revised national accounts in late 1997, covering the period 1985-96, with 1990 as the base year for constant price estimates. STA provided a peripatetic advisor to assist with the improvement of real sector statistics in 2001, but these efforts were discontinued because of the deteriorating security situation. While the revised national accounts are a significant improvement over the previous estimates, the coverage of economic activity in the informal sector remains poor. National accounts data for 2001 were not published until March 2004 and had inconsistencies between sectoral developments and other activity indicators, and are being reviewed. Historical data is constantly revised.

Prices, production, labor. The CSO produces a CPI. In 2001, the base year was changed from 1990 to 1995 and expenditures weights based on a 1995-96 household survey. A number of prices in the index are either controlled or administered. A manufacturing production index, with a base year of 1990 is reported with a significant delay. Data on employment and wages, which had very limited coverage, are no longer published. A comprehensive labor market survey is long overdue.

Government finance statistics

Key weaknesses continue to impair the analysis of fiscal developments and the formulation of appropriate adjustment policies. Monthly revenue and expenditure data for the central government's budgetary accounts are generally available with a lag of 6 to 8 weeks. There are discrepancies between the budget financing need (computed from the income/expenditure side) and financing data from banking and other sources. In addition, a significant part of donor-financed development expenditure is off budget, the economic classification of expenditure is insufficiently disaggregated, and a functional classification of expenditure is not available. Large quasi-fiscal operations by the RBZ and significant contingent liabilities, including in the form of loan guarantees, are not systematically reported.

The authorities do not provide Fund staff with budget data according to an organizational classification on a regular basis. They provide limited access to source data, so staff has to rely on aggregated data of unverifiable quality. Also, the operations of the social security fund and several self-financing funds under the purview of the central government are not included in reported data. Furthermore, although operating targets for public enterprises are provided occasionally, it is still not possible to compile reliable consolidated accounts for the nonfinancial public sector, since financial operations of public enterprises are neither reported nor regularly audited. The accounts of local governments become available only with a lag of several years, and consolidated general government accounts are not compiled.

The latest published data in the *Government Finance Statistics (GFS) Yearbook* are for 1997. No recent fiscal data have been provided for publication in *International Financial Statistics (IFS)*.

Monetary and financial statistics

Significant progress has been made in developing a unified system for reporting monetary statistics to the Fund based on international standards of data classification, and in improving the collection and reporting of financial data. However, there continues to be some difficulty in reconciling the balance sheet of the RBZ provided in the monetary control program (MCP) with the monetary survey (MS). More recently, an issue has emerged with respect to the accounting for treasury bills issued by the RBZ in the monetary data. The monetary control program used to be available within two weeks of the end of each month, and the monetary survey was produced within six-eight weeks of the end of each month; recently, delays in submitting these data have increased to 2 to 3 months. In addition, serious discrepancies are frequently detected in the data reported to STA. For example, RBZ bills outstanding in

liabilities of RBZ accounts is always reported as zero while RBZ bills held in assets of commercial banks, discount houses, accounting houses and merchant banks are reported in a significant amount (e.g., 732.2 million Zimbabwe dollars in total as of December 2004). Furthermore, the IMF No. 1 Account is not systematically reported in same location in the RBZ balance sheet, thereby affecting the gross international reserves. Discrepancies among the different components of reserve money figures between the MS and MCP were recorded since early 2004.

External sector statistics

There is a pressing need for the authorities to compile and provide comprehensive external sector data on a more timely basis.

The trade balance in goods is still being reported with lags of more than 4 to 5 months, even though, following the installation of the new Automated System for Customs Data (ASYCUDA) at the customs department, data are being provided by customs to the CSO within seven days of the end of each month. Private remittance inflows have become significant in recent years, but the authorities report only the small proportion of remittances made through official channels.

Compilation of capital and financial account transactions suffers from considerable delays, and there is a significant lag in reporting balance of payments data to the Fund. The RBZ provides estimates of the balance of payments for surveillance purposes, but these require substantial adjustments. Measures are also needed to improve the estimates and shorten the lag in the compilation and reporting of such data. Balance of payments data published in the *IFS* and *Balance of Payments Yearbook* are even less timely—the latest data are for 1994, as annual data through 2001 provided for publication are of questionable quality. Data on short-term external debt are reported to the Fund by the RBZ with a one- to two-month lag. External debt data (by debtor/creditor) are reported with a considerable delay and information on the terms and maturity profile of the external debt is not systematically available from the authorities. The authorities have provided staff only with partial information on the extent of their collateralized external borrowing.

There are no data available on Zimbabwe's international investment position.

Sociodemographic data statistics

The CSO produces various sociodemographic statistics, offering information on population, the provision of health and education services, and indicators of poverty. However, since the data are usually collected through infrequent surveys and population censuses, the information is somewhat dated

ZIMBABWE: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE
AS OF JULY 7, 2005

| | Date of latest observation | Date received | Frequency of Data ⁵ | Frequency of Reporting ⁵ | Frequency of publication ⁵ |
|---|----------------------------|---------------|--------------------------------|-------------------------------------|---------------------------------------|
| Exchange Rates | July 4 2005 | 7/4/2005 | D | M | M |
| International Reserve Assets and Reserve Liabilities of the Monetary Authorities | Apr. 2004 | 6/13/2005 | M | M | M |
| Reserve/Base Money | Apr. 2004 | 6/13/2005 | M | M | M |
| Broad Money | Apr. 2004 | 6/13/2005 | M | M | M |
| Central Bank Balance Sheet | Apr. 2004 | 6/13/2005 | M | M | M |
| Consolidated Balance Sheet of the Banking System | Apr. 2004 | 6/13/2005 | M | M | M |
| Interest Rates ¹ | Mar. 2004 | 6/13/2005 | M | M | M |
| Consumer Price Index | May 2005 | 6/20/2005 | M | M | M |
| Revenue, Expenditure, Balance and Composition of Financing ² – General Government ³ | NA | NA | NA | NA | NA |
| Revenue, Expenditure, Balance and Composition of Financing ² – Central Government | Apr. 2005 | 6/15/2005 | M | I | NA |
| Stocks of Central Government and Central Government-Guaranteed Debt ⁴ | Jan. 2005 | 6/13/2005 | M | M | M |
| External Current Account Balance | 2004 | 6/13/2005 | A | V | A |
| Exports and Imports of Goods and Services | 2004 | 6/13/2005 | A | V | A |
| GDP/GNP | 2004 | 6/13/2005 | A | V | A |
| Gross External Debt | 2004 | 6/13/2005 | A | V | A |

¹ Officially-determined, including discount rates, money market rates, and rates on treasury bills.

² Domestic bank, and domestic nonbank financing.

³ The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

⁴ Including currency and maturity composition.

⁵ Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); on mission or staff visits (V); Not Available (NA).

Zimbabwe: Debt Sustainability Analysis²⁴

Under the staff's baseline scenario, Zimbabwe's external debt is not expected to be sustainable in the absence of a debt rescheduling. The baseline scenario assumes an average negative real GDP growth at 4 percent until 2010 and an average positive growth of 3 percent thereafter with exports growing at 5 percent. On the fiscal front, budgetary consolidation is not expected in the near future although deficit declines after 2009.

Zimbabwe's total external public debt was US\$5 billion (67 percent of GDP) at end-2004, of which US\$2 billion were owed to multilateral creditors. Domestic public debt denominated in local currency accounted for about 7 percent of GDP in 2004. The baseline assumes a tentative arrears rescheduling in 2011—outside of the medium-term scenario. The total stock of outstanding debt at the end of 2011 would amount to US\$2.4 billion (34 percent of GDP).

In the baseline scenario, all public and publicly guaranteed external debt indicators are projected to improve only slowly following the debt rescheduling. The NPV of the debt-to-GDP ratios are expected to fall to about 50 percent, the NPV of the debt-to-exports ratios to fall about 130 percent and the debt service-to-exports would decline to 1 percent in the long-run. However, private external debt is projected to increase from 2010 given the need to obtain foreign financing.

The debt dynamics are most vulnerable to a depreciation and export decline. A one-time 30 percent depreciation would push up the NPV of the debt-to-GDP ratio to about 120 percent in 2010. A one-time two standard deviation shock in exports would raise the debt service-to-exports to 30 percent compared with 20 percent in 2025 in the baseline scenario, and the NPV of the debt-to-exports ratio would rise to 217 percent compared with 122 percent in the baseline scenario in 2015.

The public debt sustainability analysis could not be conducted due to difficulty in choosing applicable exchange rates since the analysis is undertaken in national currency. Given the highly overvalued official exchange rate and the multiple exchange rate system, large swings in the exchange rate have a dramatic effect on dollars amounts converted into national currency that are to be divided by GDP in national currency. To circumvent this problem we use nominal U.S. dollar GDP calculated by using the national real growth and the international inflation (1996 base year) in the external DSA since the analysis is undertaken in U.S. dollars.

²⁴ Standard Fund templates for low income countries and sensitivity tests are used to assess Zimbabwe's debt dynamics. The DSA was undertaken by the Fund only.

Table 1a. Zimbabwe: External Debt Sustainability Framework, Baseline Scenario, 2002-2025 1/
(In percent of GDP, unless otherwise indicated)

| | Actual | | | Historical | | Estimate | | | | | | | | | | 2011-25 Average |
|---|--------|-------|-------|--|-------|----------|-------|-------|-------|-------|--------------------|-------|-------|--|--|--------------------|
| | 2002 | 2003 | 2004 | Average 6/ Standard Deviation 6/ | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2010-10 Average | 2015 | 2025 | | | |
| External debt (nominal) 1/ | 53.0 | 64.4 | 67.4 | | 74.4 | 80.6 | 85.9 | 91.0 | 95.8 | 100.5 | | 33.0 | 28.1 | | | |
| o/w public and publicly guaranteed (PPG) | 49.8 | 62.2 | 66.0 | | 73.3 | 77.1 | 80.0 | 82.7 | 85.0 | 87.6 | | 22.5 | 21.0 | | | |
| Change in external debt | 7.7 | 11.4 | 3.1 | | 7.0 | 6.2 | 5.4 | 5.0 | 4.8 | 4.8 | | -0.5 | -0.6 | | | |
| Identified net debt-creating flows | 3.7 | 9.6 | 7.1 | | 12.6 | 7.5 | 7.4 | 7.2 | 7.4 | 7.4 | | 4.7 | 3.2 | | | |
| Non-interest current account deficit | 1.0 | 2.9 | 4.3 | 2.7 | 6.2 | 1.2 | 1.6 | 1.5 | 1.5 | 2.9 | | 5.9 | 4.6 | | | |
| Deficit in balance of goods and services | 2.4 | 4.3 | 5.7 | | 7.6 | 3.0 | 3.6 | 3.7 | 3.9 | 5.2 | | 4.2 | 2.3 | | | |
| Exports | 24.5 | 24.7 | 27.1 | | 28.0 | 30.7 | 32.4 | 34.6 | 36.5 | 38.2 | | 38.2 | 40.0 | | | |
| Imports | 26.9 | 29.0 | 32.8 | | 35.6 | 33.7 | 36.0 | 38.2 | 40.4 | 43.4 | | 42.4 | 42.4 | | | |
| Net current transfers (negative = inflow) | 1.3 | 0.9 | 1.4 | | 1.3 | 1.1 | 0.9 | 0.7 | 0.6 | 0.6 | | 4.2 | 4.2 | | | |
| Other current account flows (negative = net inflow) | -2.8 | -2.2 | -2.8 | 0.5 | -2.7 | -2.8 | -2.9 | -2.9 | -2.9 | -2.9 | | -2.5 | -1.9 | | | |
| Net FDI (negative = inflow) | -0.3 | 0.0 | -0.1 | 1.4 | -0.2 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | | -1.0 | -1.0 | | | |
| Endogenous debt dynamics 2/ | 3.0 | 6.7 | 2.9 | | 6.5 | 6.2 | 5.8 | 5.7 | 5.6 | 4.5 | | -0.2 | -0.4 | | | |
| Contribution from nominal interest rate | 1.6 | 1.7 | 1.4 | | 1.4 | 2.6 | 2.9 | 3.1 | 3.4 | 3.7 | | 0.7 | 0.4 | | | |
| Contribution from real GDP growth | 2.0 | 6.0 | 2.7 | | 5.1 | 3.6 | 2.9 | 2.5 | 2.2 | 0.7 | | -1.0 | -0.8 | | | |
| Contribution from price and exchange rate changes | -0.7 | -1.0 | -1.3 | | ... | ... | ... | ... | ... | ... | | ... | ... | | | |
| Residual (3-4) 3/ | 4.1 | 1.7 | -4.0 | | -5.6 | -1.3 | -2.0 | -2.1 | -2.4 | -2.6 | | -5.2 | -3.8 | | | |
| o/w exceptional financing | -6.9 | -5.9 | -3.3 | | -5.1 | -4.3 | -4.6 | -4.7 | -4.6 | -5.8 | | 0.0 | 0.0 | | | |
| NPV of external debt 4/ | ... | ... | 68.8 | | 75.1 | 80.8 | 85.9 | 90.8 | 95.6 | 100.5 | | 57.2 | 60.1 | | | |
| In percent of exports | ... | ... | 253.7 | | 267.9 | 263.4 | 264.9 | 262.8 | 261.6 | 263.1 | | 149.9 | 150.0 | | | |
| NPV of PPG external debt | ... | ... | 67.4 | | 74.0 | 77.3 | 80.0 | 82.5 | 84.9 | 87.5 | | 46.7 | 53.0 | | | |
| In percent of exports | ... | ... | 248.5 | | 263.9 | 252.0 | 246.7 | 238.7 | 232.3 | 229.3 | | 122.4 | 132.3 | | | |
| Debt service-to-exports ratio (in percent) | 25.3 | 23.5 | 18.7 | | 18.5 | 18.0 | 17.6 | 16.9 | 16.0 | 16.0 | | 5.4 | 2.7 | | | |
| PPG debt service-to-exports ratio (in percent) | 22.8 | 22.2 | 17.6 | | 18.0 | 17.4 | 16.7 | 15.6 | 14.5 | 14.2 | | 2.5 | 0.8 | | | |
| Total gross financing need (billions of U.S. dollars) | 1.0 | 1.1 | 1.0 | | 1.1 | 0.9 | 1.1 | 1.2 | 1.4 | 1.7 | | 1.9 | 2.0 | | | |
| Non-interest current account deficit that stabilizes debt ratio | -6.8 | -8.4 | 1.2 | | -0.7 | -4.9 | -3.8 | -3.5 | -3.2 | -1.9 | | 6.4 | 5.2 | | | |
| Key macroeconomic assumptions | | | | | | | | | | | | | | | | |
| Real GDP growth (in percent) | -4.4 | -10.4 | -4.2 | | -7.1 | -4.8 | -3.6 | -2.9 | -2.4 | -0.8 | | -3.6 | 3.0 | | | |
| GDP deflator in US dollar terms (change in percent) | 1.5 | 1.8 | 2.0 | | 2.0 | 1.9 | 2.0 | 2.1 | 2.1 | 2.2 | | 2.0 | 1.9 | | | |
| Effective interest rate (percent) 5/ | 3.5 | 2.8 | 2.2 | | 3.4 | 3.4 | 3.5 | 3.6 | 3.8 | 3.9 | | 3.4 | 2.3 | | | |
| Growth of exports of G&S (US dollar terms, in percent) | -14.8 | -8.1 | 7.6 | | -2.1 | 6.2 | 4.0 | 5.6 | 5.4 | 5.9 | | 5.0 | 5.0 | | | |
| Growth of imports of G&S (US dollar terms, in percent) | -0.6 | -1.7 | 10.7 | | 2.8 | -8.3 | 5.1 | 5.2 | 5.4 | 8.8 | | 3.2 | 4.5 | | | |
| Grant element of new public sector borrowing (in percent) | ... | ... | ... | | 7.9 | 7.9 | 7.9 | 7.9 | 7.9 | 7.9 | | 7.9 | 12.3 | | | |
| <i>Memorandum item:</i> | | | | | | | | | | | | | | | | |
| Nominal GDP (billions of US dollars) | 8.2 | 7.5 | 7.4 | | 7.0 | 6.8 | 6.7 | 6.6 | 6.6 | 6.7 | | 8.5 | 13.2 | | | |

Source: Staff simulations.

1/ Includes both public and private sector external debt.

2/ Derived as $[r - g - p(1+g)] / (1+g-p+g)$ times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and p = growth rate of GDP deflator in U.S. dollar terms.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

4/ Assumes that NPV of private sector debt is equivalent to its face value.

5/ Current-year interest payments divided by previous period debt stock.

6/ Historical averages and standard deviations are generally derived over the past 10 years.

Table 1b. Zimbabwe: Sensitivity Analyses for Key Indicators of Public and Publicly Guaranteed External Debt, 2005-25
(In percent)

| | Estimate | | Projections | | | | | |
|--|----------|------|-------------|------|------|------|------|------|
| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2015 | 2025 |
| NPV of debt-to-GDP ratio | | | | | | | | |
| Baseline | 74 | 77 | 80 | 82 | 85 | 88 | 47 | 53 |
| A. Alternative Scenarios | | | | | | | | |
| A1. Key variables at their historical averages in 2006-25 1/ | 74 | 74 | 74 | 74 | 74 | 75 | 22 | 31 |
| A2. New public sector loans on less favorable terms in 2006-25 2/ | 74 | 77 | 80 | 82 | 85 | 88 | 54 | 76 |
| B. Bound Tests | | | | | | | | |
| B1. Real GDP growth at historical average minus one standard deviation in 2006-07 | 74 | 80 | 86 | 89 | 91 | 94 | 50 | 57 |
| B2. Export value growth at historical average minus one standard deviation in 2006-07 3/ | 74 | 82 | 94 | 97 | 100 | 103 | 58 | 55 |
| B3. US dollar GDP deflator at historical average minus one standard deviation in 2006-07 | 74 | 79 | 83 | 86 | 89 | 91 | 49 | 55 |
| B4. Net non-debt creating flows at historical average minus one standard deviation in 2006-07 4/ | 74 | 79 | 83 | 86 | 89 | 91 | 50 | 54 |
| B5. Combination of B1-B4 using one-half standard deviation shocks | 74 | 82 | 94 | 97 | 100 | 103 | 58 | 56 |
| B6. One-time 30 percent nominal depreciation relative to the baseline in 2006 5/ | 74 | 110 | 113 | 117 | 120 | 124 | 66 | 75 |
| NPV of debt-to-exports ratio | | | | | | | | |
| Baseline | 264 | 252 | 247 | 239 | 232 | 229 | 122 | 132 |
| A. Alternative Scenarios | | | | | | | | |
| A1. Key variables at their historical averages in 2006-25 1/ | 264 | 241 | 227 | 214 | 203 | 197 | 57 | 79 |
| A2. New public sector loans on less favorable terms in 2006-25 2/ | 264 | 252 | 247 | 239 | 232 | 229 | 142 | 189 |
| B. Bound Tests | | | | | | | | |
| B1. Real GDP growth at historical average minus one standard deviation in 2006-07 | 264 | 252 | 247 | 239 | 232 | 229 | 122 | 132 |
| B2. Export value growth at historical average minus one standard deviation in 2006-07 3/ | 264 | 323 | 413 | 401 | 391 | 386 | 217 | 197 |
| B3. US dollar GDP deflator at historical average minus one standard deviation in 2006-07 | 264 | 252 | 247 | 239 | 232 | 229 | 122 | 132 |
| B4. Net non-debt creating flows at historical average minus one standard deviation in 2006-07 4/ | 264 | 257 | 257 | 249 | 243 | 240 | 130 | 134 |
| B5. Combination of B1-B4 using one-half standard deviation shocks | 264 | 302 | 358 | 347 | 339 | 334 | 187 | 173 |
| B6. One-time 30 percent nominal depreciation relative to the baseline in 2006 5/ | 264 | 252 | 247 | 239 | 232 | 229 | 122 | 132 |
| Debt service ratio | | | | | | | | |
| Baseline | 18 | 17 | 17 | 16 | 14 | 14 | 3 | 1 |
| A. Alternative Scenarios | | | | | | | | |
| A1. Key variables at their historical averages in 2006-25 1/ | 21 | 17 | 15 | 13 | 10 | 9 | 4 | 15 |
| A2. New public sector loans on less favorable terms in 2006-25 2/ | 21 | 17 | 16 | 14 | 12 | 10 | 9 | 23 |
| B. Bound Tests | | | | | | | | |
| B1. Real GDP growth at historical average minus one standard deviation in 2006-07 | 21 | 17 | 16 | 14 | 12 | 10 | 7 | 20 |
| B2. Export value growth at historical average minus one standard deviation in 2006-07 3/ | 21 | 21 | 24 | 22 | 19 | 17 | 16 | 30 |
| B3. US dollar GDP deflator at historical average minus one standard deviation in 2006-07 | 21 | 17 | 16 | 14 | 12 | 10 | 7 | 20 |
| B4. Net non-debt creating flows at historical average minus one standard deviation in 2006-07 4/ | 21 | 17 | 16 | 14 | 12 | 10 | 8 | 20 |
| B5. Combination of B1-B4 using one-half standard deviation shocks | 21 | 20 | 21 | 19 | 17 | 14 | 13 | 26 |
| B6. One-time 30 percent nominal depreciation relative to the baseline in 2006 5/ | 21 | 17 | 16 | 14 | 12 | 10 | 7 | 20 |
| <i>Memorandum item:</i> | | | | | | | | |
| Grant element assumed on residual financing (i.e., financing required above baseline) 6/ | 11 | 11 | 11 | 11 | 11 | 11 | 11 | 11 |

Source: Staff projections and simulations.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.

2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline, while grace and maturity periods are the same as in the baseline.

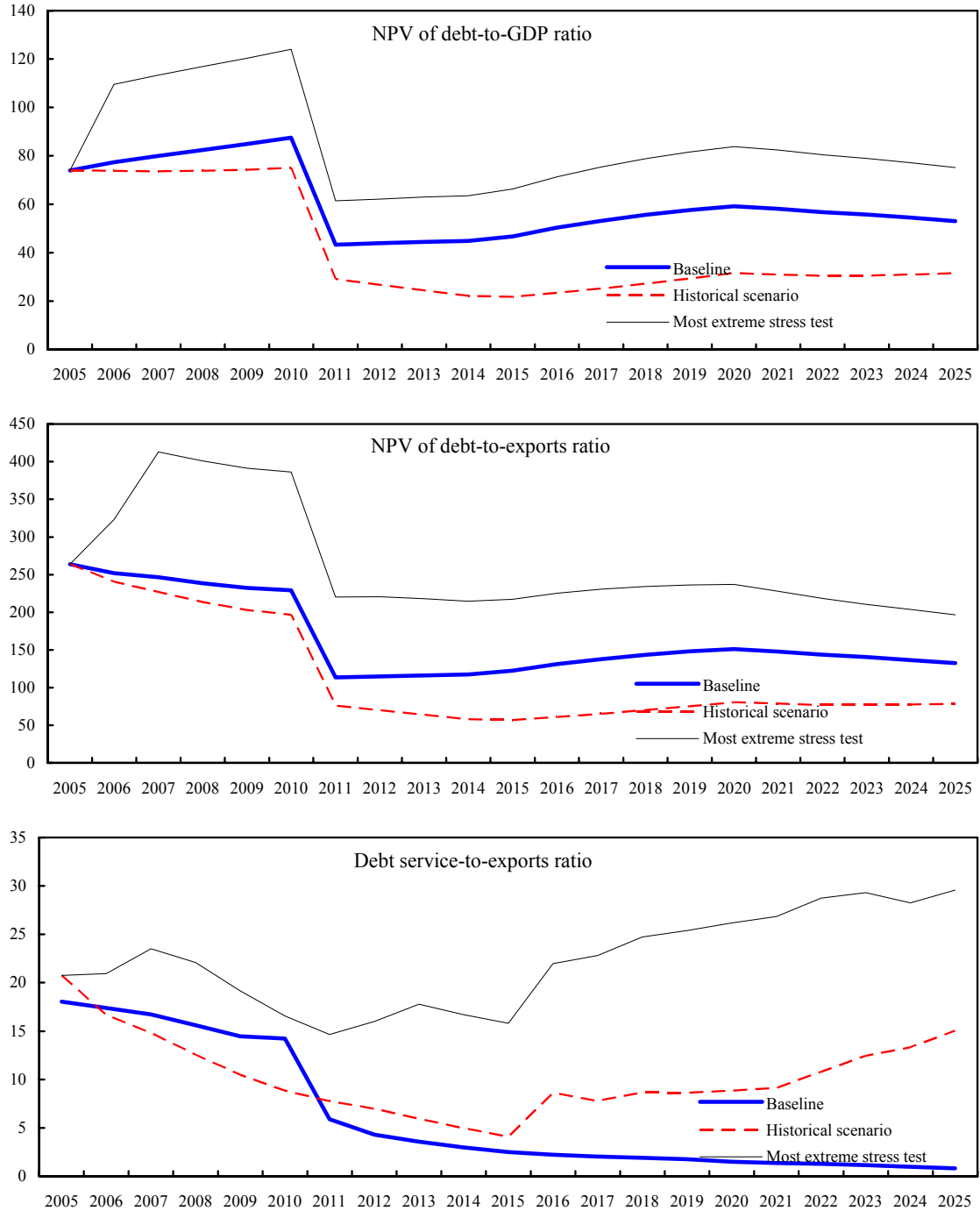
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).

4/ Includes official and private transfers and FDI.

5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.

6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Figure 1. Zimbabwe: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2005-2025 (In percent)



Source: Staff projections and simulations.

Statement by Dr. Gideon Gono
Governor, Reserve Bank of Zimbabwe
September 9, 2005

Introduction

The Government of Zimbabwe greatly appreciates the opportunity granted to it to present the country's case before the IMF Board. Zimbabwe has, over the past seven years faced several socio-economic challenges as reflected in; high inflation, foreign exchange shortages, decline in overall economic output, rising unemployment, low savings and investment levels. These setbacks were exacerbated by recurrent droughts, absence of Balance of Payments (BOP) support, the rising fuel prices, among others. The Government's Land Reform Program that began in 1997, which has now been largely completed has had its own fare share of challenges and obstacles that have inhibited its smooth implementation. Most of the challenges and or shortcomings are, however, being addressed with a view to bringing the redistributed land to full and viable production.

Relations with the IMF

Zimbabwe's relations with the IMF over the past five years have not been as they should be, with some divergence of views with the Fund on some aspects of economic policy and with the country accumulating arrears to the institution. The Zimbabwean Government has, over the past 20 months, therefore, been persistently working to address the three main areas of concern raised by the IMF Management, which are: (a) non-payment of arrears, (b) the need for implementation of a comprehensive macroeconomic package of measures to stabilize the economy, (c) cooperation with the IMF in respect of communication and data exchange.

Economic Turnaround Measures Implemented

Payments to the IMF

The Zimbabwe Government has, over the past 20 months, consistently complied with commitments it made to the IMF on payments of arrears. This saw the country's payments being increased from an initial US\$1,5 million per quarter, to the current US\$9 million per quarter, which we yet again commit to increase to US\$15 million per quarter, with effect from the fourth quarter of 2005, and to US\$40 million per quarter beginning April, 2006. In order to relieve the burden imposed by Zimbabwe's arrears on Fund membership, Zimbabwe made a payment of US\$120 million to the General Resources Account (GRA) out of the country's own resources. This payment significantly reduced Zimbabwe's arrears in the GRA to US\$ 51,3 million. This decision was made notwithstanding the non-existence of international balance of payments support, the current severe drought and food shortages and the acute shortage of foreign currency for essential imports. The Zimbabwean Government is committed to ensuring that the remaining outstanding amount under the GRA and the PRGF accounts are fully repaid by 30 November, 2006.

The Government has also been and continues to attach great importance on making good its financial obligations with other international creditors, as reflected in the schedule below and the Zimbabwe Government commits to maintaining the momentum of these external debt repayments as an integral part of the turnaround program.

Loan Repayments to International Creditors: A Selected Sample of some of the Payments made

| Creditor | Repayments | | Growth % |
|---------------------------------------|------------------------------|-------------------------------|----------|
| | 2004 Jan-Dec US\$ million | 2005 Jan-Sept US\$ million | |
| IMF | 22,57 | 134,0 | 449% |
| World Bank | 3,0 | 6 ¹ | 100% |
| AfDB | 4,3 | 6,4 ¹ | 49% |
| DFID | 1,17 | -- | -- |
| Govt. of Botswana | 6,05 | -- | -- |
| ZESA Trade Creditors (Electricity) | 48,2 | 9,1 | -- |
| NOCZIM (Trade Creditors (Fuel)) | 80,0 | 25,5 | -- |

^{1/} Commitment to pay by end-September 2005.

Macroeconomic Policies

The Zimbabwean Government has, over the past 20 months, implemented bold macroeconomic policies to stabilize the economy. Reflecting the positive impact of greater flexibility in the exchange rate, as well as the supportive structural policies being implemented, export performance has increased over the period January, 2004 to August, 2005. Export volumes are expected to register a positive growth of 12.5% in 2005, further strengthening the country's recovery prospects.

Removal of Subsidies

The Zimbabwean Government has also taken bold steps to eliminate distortions in the economy, as reflected by the elimination of the following subsidies: (a) lending to productive sectors at concessional rates was discontinued with effect from 30 June, 2005; (b) a 5% credit facility to exporters was discontinued with effect from 21 July, 2005; (c) a 25% bonus scheme that used to be paid to exporters was discontinued with effect from 21 July, 2005; (d) subsidies paid to gold, cotton and tobacco exports were abolished with effect from 21 July, 2005; (e) exchange rates to exporters and importers were converged, such that importers no longer impose a burden on the balance sheet of the central bank through any form of implicit subsidies; and (f) preferential exchange rates for priority Government payments were abolished such that with effect from May 2005, all Government payments are effected at the Auction rate.

Exchange Rate Adjustment

In place of the above supporting schemes which were creating distortions in the economy and imposing a burden on the Government budget and the balance sheet of the central bank, Government has allowed the exchange rate to substantially adjust from Z\$824/US\$ at the start of 2004, to the current level of Z\$24500/US\$, representing a cumulative adjustment of 2873%. At current levels, the exchange rate is now in line with recent submissions by exporters and consistent with the purchasing power parity (PPP) thresholds.

Monetary Policy; Interest Rates and Nominal Anchor

The Zimbabwean Government had fruitful interactions with the various IMF Staff Missions over the past 20 months and cultivated convergence of minds on the need to allow for interest rates convergence, as well as maintenance of positive real interest rates. Against this background, interest rates have been realigned to levels above inflation, except for the support to the agricultural sector. The highly positive real rates now obtaining in the economy are expected to restrain inflationary credit expansion, at the same time, promoting growth in aggregate savings.

Government deliberations with the most recent IMF Mission Staff culminated in a convergence of minds that the bold decision on the exchange rate front needs to be buttressed by greater monetary austerity to anchor and thaw down inflation expectations. In this regard, the central bank is implementing a tighter monetary program, supported by adept liquidity management and positive real interest rates.

Curtailement of Central Bank Quasi-Fiscal Operations

The Government fully acknowledges concerns raised by IMF Staff regarding the Central Bank's quasi-fiscal operations over the past 20 months. These operations were intended to avert a worsening of the recession, rejuvenate a supply response and engineer a soft landing of the economy. There was also the conscious realization that parastatals (public enterprises) and local authorities had become a retardation and a missing link on the structural side of the economy, so much as to blunt the effectiveness of the supply response to fiscal and monetary policy interventions. Official intervention in these entities was also aimed at imposing a hard budget constraint, instilling greater accountability, sound corporate governance and operational and managerial efficiency.

Satisfactory progress has been registered in re-orienting parastatals and local authorities to an extent where official support and intervention are no longer necessary. Thus, with immediate effect, the central bank has scaled down the Parastatals and Local Authorities Reorientation Program (PLARP) from the original Z\$12 trillion, to no more than Z\$3 trillion. This policy position, thus, entails that henceforth, the Central Bank will tail off further disbursements, and work to manage down the under Z\$3 trillion exposure, through an adept sinking fund framework with the beneficiary parastatals and local authorities.

Financial Stability

Notwithstanding the transitory problems experienced at a few institutions in the financial sector during 2004 and the current prevailing difficult operating environment, Zimbabwe's banking sector remains generally stable and sound, both in terms of liquidity and solvency. The disruptions at the few institutions in 2004 did not inflict any systematic problem on the entirety of the financial sector, given the central bank's resolute action in dealing with the few affected institutions, which accounted for less than 10% of the market share. The Government commits to ensuring that the financial sector remains stable and sound, through a swift and responsive surveillance and supervision framework.

Fiscal Consolidation

Zimbabwe faced a number of expenditure pressures in 2005, emanating from the ongoing and ravaging drought, the devastation being caused by the HIV/AIDS pandemic, the need to realign Zimbabwe's Electoral Code to the regional SADC code, increase in interest and pension payments, supporting a supply response in the economy in the face of economic decline and the need to cool social pressures in an environment of high unemployment. The difficult economic environment is also undermining the revenue base. Notwithstanding these setbacks, Government maintained tight control on expenditures to ensure that the fiscal budget deficit is contained to sustainable levels and that fiscal policy plays a complementary role in reducing inflation. Reflecting this, the fiscal budget deficit for 2005 is expected to be no more than 8,6% of GDP, inclusive of the drought-induced budgetary obligations.

This restrained position is being supported by the following measures on the fiscal front: (a) deferment of salary reviews for the public service to the 2006 budget; (b) adoption of a strict cash budgeting framework across all line ministries; (c) redeployment of existing public service staff to new ministries to minimize cost effects of the new arms of Government; (d) expenditure cuts across line ministries, which has saved Z\$3 trillion; (e) carrying out a civil service audit, as well as restructuring the public service to enhance cost-effectiveness; (f) employment freeze across all ministries; (g) tighter control on usage of Government assets to ensure value for money; (h) shifting from a defined benefit to a defined contribution pension system for Government employees; (i) enhancement of revenue buoyancy, through improved tax administration and broadening of the tax base, increase in VAT tax from 15 percent to 17.5 percent, broadening the VAT base and other tax measures.

Privatization Program

As part of the economic turnaround, Government has commenced a comprehensive State Enterprise Restructuring program with the following key features: (a) commercialization of targeted enterprises; (b) entering into joint ventures with strategic partners, through an articulate divestiture program; (c) privatization of non-strategic state enterprises; (d) winding down of price controls; and, (e) targeting subsidies to the most vulnerable groups.

Economic Outlook and Targets

Real GDP

The above fiscal, monetary and structural policy initiatives are expected to arrest further GDP decline over the outlook period. On the back of the unanticipated set-backs of the drought, the cost push effects of rising global fuel prices, the resource constraints arising from the need to comply with the SADC principles on elections, as well as the lower than anticipated absorptive capacity of the non-agricultural sectors, the Government estimate a moderate real GDP decline of -1,5% in 2005. Adherence to a policy regime that will successfully stabilize the economy, supported by the expected normal rainy season for 2005/2006, are expected to contribute to the country's overall economic performance rebounding to a positive growth of 4,5 – 5% in 2006.

Inflation

Reflecting the exogenous effects of the drought, the sharp increase in oil prices, the short-run knock-on effects of exchange rate depreciation, the supply side constraints attendant in the economy, as well as high monetary expansion, the country is experiencing a temporary resurgence in inflation to around 260% by end of 2005. Thereafter, the Government's refocused anti-inflation strategy, where monetary targeting has become the nominal anchor, supported by the austerity measures being implemented on the fiscal and structural sides of the economy, inflation has been targeted to decline to 50-70% by end of 2006; and to single digit by March 2007.

The following deliberate efforts currently underway to enhance productivity in agriculture are also expected to play a supportive role in increasing food production, boosting real GDP growth and hastening the disinflation process: (a) finalization and implementation of the 99-year lease framework; (b) comprehensive redress of any infringements on investments protected under Bilateral Investment Protection Agreements (BIPAs); (c) irrigation rehabilitation, which seeks to dilute the country's dependence on dry-land agricultural production; (d) creation of the Agricultural Marketing Authority (AMA), whose main purpose is to guarantee farmers' viability through better coordination in the marketing and pricing of produce.

Cooperation with IMF

Underscoring the strategic importance Zimbabwe attaches to cordial engagement with the Fund, the Government has, over the past 20 months consistently cooperated with the IMF, which culminated in the meeting between His Excellency the President of Zimbabwe and the Director of the African Department, Mr. Bio-Tchane in November, 2004. Zimbabwe has also persistently cooperated with various IMF Staff Missions, which has provided invaluable interface for policy dialogue and advice. The Zimbabwean Government commits to the IMF Board that this cordial and cooperative engagement will be persistently upheld, as the country further consolidates its turnaround program.

Conclusion

Notwithstanding the difficult current macroeconomic environment, the Zimbabwean Government is committed to restoring macroeconomic stability within the time frames as set out in the foregoing. The painful self-imposed road of macroeconomic adjustment the country and its people is traversing will bear fruit, and the Government of Zimbabwe pleads to the IMF to support this process of adjustment through allowance for the measures being implemented to take their full effect within the time frame to December, 2006. A decision to expel Zimbabwe from the IMF Community would not only be precipitous in terms of eroding confidence in Zimbabwe and worsen the economic situation, but also in terms of eternally destroying the Zimbabwean public's faith in self-imposed macroeconomic adjustment.

The Government of Zimbabwe remains concerned by the outstanding arrears, especially to the PRGF Trust and their impact to the rest of the membership. The Government is working tirelessly to clear these outstanding IMF arrears, and it is the humble appeal of the authorities that the IMF Board and Management notices the sincere efforts Zimbabwe is making, notwithstanding the 7 years of no external BOP support and the ongoing severe drought.

Finally, Zimbabwe is making a sincere appeal to the IMF Board to recognize the country's efforts in single-handedly resolving what could have been a catastrophic financial crisis, and grant Zimbabwe the benefit of qualifying for technical assistance. Such technical assistance is needed to strengthen the resolve in formulating a consistent macroeconomic framework, designing a nominal anchor, liquidity forecasting, fiscal consolidation, strengthening the financial sector and other critical areas. Zimbabwe's experience indicate that denial of technical assistance should not form part of any remedial measures under the Fund's Strengthened Arrears Strategy as such ban on TA does more harm than good in any effort to reform.



INTERNATIONAL MONETARY FUND

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EXTERNAL
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700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2005 Article IV Consultation with Zimbabwe

On September 9, 2005, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Zimbabwe.¹

Background

Zimbabwe's pace of economic deterioration slowed somewhat in 2004, but appears to have picked up again in the first half of 2005. Staff estimates that real GDP fell by about 4 percent in 2004, compared with a contraction of 10½ percent the preceding year. Year-on-year inflation decelerated sharply from a peak of 623 percent in January 2004 to stabilize around 130 percent in early 2005, before surging again to 254 percent in July 2005. Staff projects that continued difficulties in agriculture, rising inflation, and foreign exchange shortages, particularly for fuel imports, will cause real GDP to contract by some 7 percent this year. The widening fiscal deficit and quasi-fiscal activities would contribute to money growth, pushing inflation to over 400 percent by end-2005.

Monetary policy has been tightened, but not consistently. Overnight interest rates were raised sharply in early 2004 and lowered subsequently as inflation declined, with real interest rates maintained at high levels for most of the year (albeit with credit subsidies for selected borrowers). Interest rates were lowered sharply around the end-2004 and reduced further in early 2005, despite evidence from monthly data of rising price pressures. In late August, the overnight rate was raised to the equivalent of 1,373 percent (on a compounded annualized

¹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

basis) from 394 percent in June. The high rates of money growth that have fuelled the triple-digit inflation were mainly due to the sharp increase in the Reserve Bank of Zimbabwe's (RBZ) quasi-fiscal activities during 2004 and first half of 2005 that have resulted in mounting losses on its balance sheet. Some of these quasi-fiscal activities have recently been reduced or discontinued. In particular, the authorities have indicated that all official foreign exchange transactions are now conducted at a unified tender rate, tobacco and gold price supports have been discontinued, and producer price support for cotton will be discontinued, effective January 2006.

Staff projects the fiscal deficit to widen substantially in 2005 to 11½ percent of GDP from 4.7 percent of GDP in 2004 due to higher spending. While much of this increase is due to higher interest payments, the primary deficit (excluding interest payments) is also projected to increase by almost 2½ percent of GDP, compared with the outcome in 2004. This expansion is due to a sharp increase in the government wage bill from 15½ percent of GDP in 2004 to about 20 percent of GDP in 2005, a level that is very high by international standards, as well as other spending increases. This higher spending is projected to be only partially offset by higher revenue, due in part to measures adopted in the August 2005 supplementary budget, including an increase in the VAT rate to 17½ percent from 15 percent and a broadening of the VAT base. The authorities also announced public service and pension reforms, with details to be unveiled in the 2006 budget.

The official exchange rate was effectively devalued in 2004 and allowed to depreciate during the first eight months of 2005 but the parallel market premium widened. The introduction of a foreign exchange tender system early in 2004 and the gradual relaxation of surrender requirements on exporters resulted in a de facto depreciation of the official rate from Z\$824/US\$ at end-2003 to about Z\$6,100/US\$ by end-May 2005. The tender rate was allowed to depreciate further to some Z\$24,500/US\$ by early September 2005. Nevertheless the parallel market premium which had narrowed markedly in the first quarter of 2004, widened sharply from 45 percent in January 2005 to about 100 percent by early September 2005. The exchange rate regime remains highly restricted. The proportion of bids met at the foreign exchange tender has declined to about 10 percent and has been reflected in acute shortages of basic goods, particularly fuel and food.

Zimbabwe's financial system has shown remarkable resilience to the very difficult macroeconomic environment. Despite the turmoil in 2004 from the collapse of a number of insolvent institutions, the stability of the banking system was not threatened. With the exit of weak institutions, the sector is now largely populated by banks with high capital adequacy ratios, little foreign exchange risk, and very short-term maturities for both assets and liabilities to cope with fluctuating interest rates. The provision of full powers for banking supervision to the RBZ was instrumental in ensuring timely intervention in problem banks, although the Banking Act was recently amended to require the Governor of the RBZ to consult with the Minister of Finance in registering and intervening in troubled banks.

Progress has been limited on structural reforms. The authorities have embarked on a reform of public enterprises, but noted the difficulties with imposing hard budget constraints on these enterprises. They underscored their recent decision to privatize non-strategic public enterprises and to enter into joint ventures. The authorities also indicated their intention to

remove price controls. On land reform, the private sector expressed concerns that the recent constitutional amendment and the lack of both transferability and protection from cancellation of the 99-year leases would adversely affect economic activity.

Zimbabwe's social situation remains difficult. According to the United Nations Special Envoy's report "Operation Restore Order", issued in late July, the government's recent drive to remove unauthorized dwellings and structures, has left some 700,000 people across the country either homeless, or without any source of livelihood, or both, and a further 2.4 million people indirectly affected in varying degrees. Food security is also an urgent concern given the drought and the slow progress in mobilizing food assistance.

Zimbabwe's recent payments performance to the IMF compares favorably with its past payments record. On August 29, Zimbabwe paid the Fund US\$120 million (SDR 82 million) to settle its arrears to the General Resource Account (GRA). With this payment, Zimbabwe's total arrears to the Fund now stand at SDR 119 million (about US\$175 million). Of this amount, arrears to the GRA are SDR 37 million (about US\$54 million) and those to the PRGF Trust are SDR 82 million (about US\$121 million).

Executive Board Assessment

Executive Directors expressed deep concern over the continued sharp economic and social decline in Zimbabwe, with prospects of continued triple-digit inflation, further output declines, and increased poverty. Food security is an urgent issue, given the sharp fall in agricultural production. Directors noted that stagnant export earnings and the necessary rise in food imports will squeeze non-food imports, increasing Zimbabwe's vulnerability to external shocks. In addition, the substantial humanitarian and economic consequences of "Operation Restore Order" pose further downside risks to the outlook. Directors observed that without a bold change in policy direction, the economic outlook will remain bleak, with particularly detrimental effects on the poorest segments of the population.

Directors urged the authorities to implement a comprehensive package of macroeconomic policies and structural reform to lay the basis for sustained growth, low inflation, and external viability. While welcoming recent measures, they noted that current policies fall short of what is needed to address the deteriorating economic situation. There is a significant risk that unless strong macroeconomic policies are implemented urgently, economic conditions—particularly inflation—will deteriorate even further. Directors therefore called for urgent implementation of a comprehensive package comprising several mutually reinforcing actions. These should include: strong fiscal adjustment; full liberalization of the exchange rate regime; adoption of a strong monetary anchor; elimination of all quasi-fiscal activity by the Reserve Bank of Zimbabwe (RBZ) and the absorption of RBZ losses by the budget; and fundamental structural reform, including improvements in governance. Strengthening relations with the international community and providing adequate social safety nets and food security for vulnerable groups, particularly those affected by "Operation Restore Order" and HIV/AIDS, are critical priorities that will also contribute to progress towards the Millennium Development Goals. A number of Directors suggested that the Fund could consider resuming technical assistance to Zimbabwe to facilitate strengthening of policies and co-operation with the Fund.

Directors stressed that decisive fiscal adjustment is essential in the near term. While regretting the substantial deterioration in the fiscal position in 2005, Directors stressed that a sharp fiscal tightening will be required in the 2006 budget. Given the high spending ratio, the bulk of the adjustment will need to come from spending cuts, especially in the wage bill and subsidy and transfer payments. In this context, Directors welcomed the authorities' intention to undertake public service and pension reforms, which should be aimed at cutting the wage bill while improving public service delivery. Directors noted that cash management could also be improved.

Directors urged the authorities to move towards full liberalization of the exchange rate regime for current account transactions. They welcomed the recent unification and increased flexibility of the tender rate, but noted that, despite the recent depreciation, the tender rate remains overvalued, as indicated by the substantial parallel market premium. Exchange controls on current payments and all surrender requirements should be eliminated, and the determination of the exchange rate left to the market in conjunction with establishment of a strong, credible monetary anchor. Directors noted that Zimbabwe continues to maintain exchange restrictions and multiple currency practices that have not been approved by the Fund under Article VIII, Section 2 (a) and 3. They urged Zimbabwe to eliminate these exchange restrictions and multiple currency practices as soon as possible.

Directors welcomed the recent tightening of monetary policy, and noted that a further sustained tightening along with the establishment of a monetary anchor is urgently needed to bring inflation under control. Given the likely reduction in the demand for real money balances, reserve money growth will need to be brought down sharply to keep broad money growth in 2005-06 well below the inflation target. The RBZ should shift to a broad money anchor with reserve money as the operational target.

Directors welcomed the recent announcements by the RBZ to discontinue cotton, tobacco, and gold subsidies, which were helping to fuel money growth and inflation. To lower money creation durably and help increase transparency, Directors suggested that the losses of the RBZ need to be absorbed by the budget, with fiscal measures taken, as noted above, to offset these costs. Directors cautioned against the issuance of bonds that are indexed to inflation given the prospect for continued high inflation and the potentially unsustainable public debt burden. They also urged the authorities to delay the operation of the Infrastructure Development Bank of Zimbabwe pending further review, given the risk of new quasi-fiscal activity and potential contingent public liabilities.

Directors commended the measures taken by the RBZ to strengthen banking supervision and standards of governance and risk management in the financial sector. They underlined the importance of ensuring that supervisors remain empowered to take timely action to address identified weak institutions, and in this context they regretted the recent amendment to the Banking Act requiring the RBZ to consult with the Minister of Finance before granting or withdrawing the licenses of financial institutions. Directors recommended that, over time, the RBZ should lower the very high statutory reserve requirements, which impede the financial sector's ability to effectively intermediate saving and investment to support economic growth.

Directors stressed that fundamental structural reforms will be essential for sustaining macroeconomic stability and achieving durable growth over the medium-term. They urged the authorities to initiate action without delay in a number of areas, including: deregulation to increase market forces in the economy; public enterprise reform; fiscal reforms and particularly civil service reform to achieve a sustainable fiscal position; land and agricultural reform; and improvements in governance to increase investor confidence, reduce corruption, and encourage private business activity. While welcoming the ongoing public enterprise reforms, Directors emphasized that these should be geared to ensuring that a hard budget constraint is imposed on enterprises—including the option to wind down nonviable entities—and that the transparency of the restructuring process should be increased. On land reform, Directors urged steps to restore orderly conditions in the agricultural sector, including stronger security of land tenure and transferability, and the provision of extension services to farmers.

Directors agreed that there is considerable scope for improving the provision of data for surveillance purposes, particularly on the balance of payments, international reserves, and external debt data as well as comprehensive data on general government, consolidated public debt, public enterprises, and the reconciliation of the fiscal and monetary accounts.

Directors called for strengthened cooperation with the Fund, including a satisfactory track record on payments, and timely disclosure of information. In this context, they welcomed Zimbabwe's recent payment to the Fund, which has substantially reduced arrears. A number of Directors sought clarification regarding the source of the funds for this payment. The Executive Board urged the authorities to resolve Zimbabwe's outstanding overdue financial obligations to the Fund, and decided to give Zimbabwe more time to demonstrate its commitment to improving cooperation with the Fund before considering a recommendation to the Board of Governors with respect to the Managing Director's complaint for Zimbabwe's compulsory withdrawal from the Fund. It was agreed that the Board will review Zimbabwe's overdue financial obligations and the Managing Director's complaint again in six months.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Zimbabwe: Selected Economic Indicators, 2002-2005

| | 2002 | 2003 | 2004 | 2005 Proj. |
|---|-------|-------|-------|---------------|
| GDP | | | | |
| Real GDP (market prices; percentage change) | -4.4 | -10.4 | -4.2 | -7.2 |
| Savings and investment (percent of GDP) | | | | |
| Gross national savings (excluding grants) | 0.8 | -1.2 | -2.1 | -4.8 |
| Gross investment | 1.5 | 2.0 | 5.1 | 4.9 |
| Prices and interest rates (percent) | | | | |
| Consumer price inflation (annual average) | 133.2 | 365.0 | 350.0 | 219.2 |
| Consumer price inflation (end of period) | 198.9 | 598.7 | 132.7 | 404.6 |
| 91-day treasury bills (simple annual, end of period) | 26.6 | 60.7 | 105.0 | 186.1 |
| Central government budget (percent of GDP) | | | | |
| Revenue | 17.9 | 24.9 | 33.9 | 36.7 |
| Expenditure and net lending | 20.7 | 25.3 | 41.0 | 51.0 |
| <i>Of which: interest on central government debt</i> | 2.9 | 1.3 | 5.5 | 10.1 |
| Overall balance, (excluding grants, including interest arrears) | -2.8 | -0.4 | -7.1 | -14.2 |
| Primary balance, excluding grants | 0.1 | 0.9 | -1.7 | -4.1 |
| Overall balance, (including grants, excluding interest arrears) | -2.2 | -0.2 | -4.7 | -11.6 |
| Domestic financing (including privatization) | 2.3 | 0.2 | 4.7 | 11.6 |
| External financing | -0.1 | 0.0 | 0.0 | 0.0 |
| Combined government and RBZ balance 1/ | ... | ... | -24.4 | -30.6 |
| Money and credit (percent change; end of period) | | | | |
| Broad money (M3) | 164.8 | 413.5 | 222.6 | 275.8 |
| Domestic credit | 132.7 | 426.4 | 180.6 | 195.6 |
| <i>Of which: real credit to the private sector</i> | -6.6 | -10.6 | 1.5 | -40.5 |
| Velocity (M3) 2/ | 3.4 | 4.1 | 2.9 | 3.6 |
| Reserve money (percent change; end of period) | 171.2 | 394.8 | 217.6 | 258.8 |
| External trade (percent change) | | | | |
| Export volume | -17.6 | -19.3 | -9.0 | -7.3 |
| Import volume | -0.5 | -19.9 | -5.8 | -11.9 |
| Terms of trade | 1.4 | -5.9 | -6.6 | -7.9 |
| Balance of payments (billions of U.S. dollars, unless otherwise indicated) | | | | |
| Exports | 1.8 | 1.7 | 1.7 | 1.6 |
| Imports | -1.8 | -1.8 | -2.0 | -1.9 |
| Current account balance (excluding official transfers) | -0.2 | -0.3 | -0.4 | -0.5 |
| (In percent of GDP at the official exchange rate) 3/ | -0.7 | -3.1 | -7.2 | -9.7 |
| (In percent of GDP at world prices) 4/ | -2.6 | -4.6 | -5.7 | -7.5 |

| Zimbabwe: Selected Economic Indicators, 2002-2005 | | | | |
|---|------|------|------|------|
| Overall balance | -0.5 | -0.5 | -0.2 | -0.2 |
| Official reserves (gold valued at market price) | | | | |
| Usable reserves (US\$ millions, end of period) 5/ | 15.1 | 15.6 | 24.8 | 24.8 |
| (months of imports of goods and services) | 0.1 | 0.1 | 0.1 | 0.2 |
| (percent of reserve money) | 10.2 | 1.8 | 5.3 | 11.7 |

Sources: Zimbabwean authorities; and IMF staff estimates and projections.

1/ Combines (i) the central government overall balance, including grants and excluding interest arrears, and (ii) the RBZ's net losses, including from subsidies, exchange rate losses, and net interest expense.

2/ Velocity is calculated using end-period stock of money, and real GDP valued at end-period prices.

3/ Foreign currency units are converted into Zimbabwean dollars at the official exchange rate.

4/ GDP at world prices using real GDP growth and trading partner countries' inflation (base year is 1996).

5/ These data are not consistent with data on the RBZ's inflows and outflows of foreign exchange.