Investing in People for Social and Economic Justice

ZIMCODD

YEAR-END ECONOMIC COMMENTARY

DECEMBER 2023

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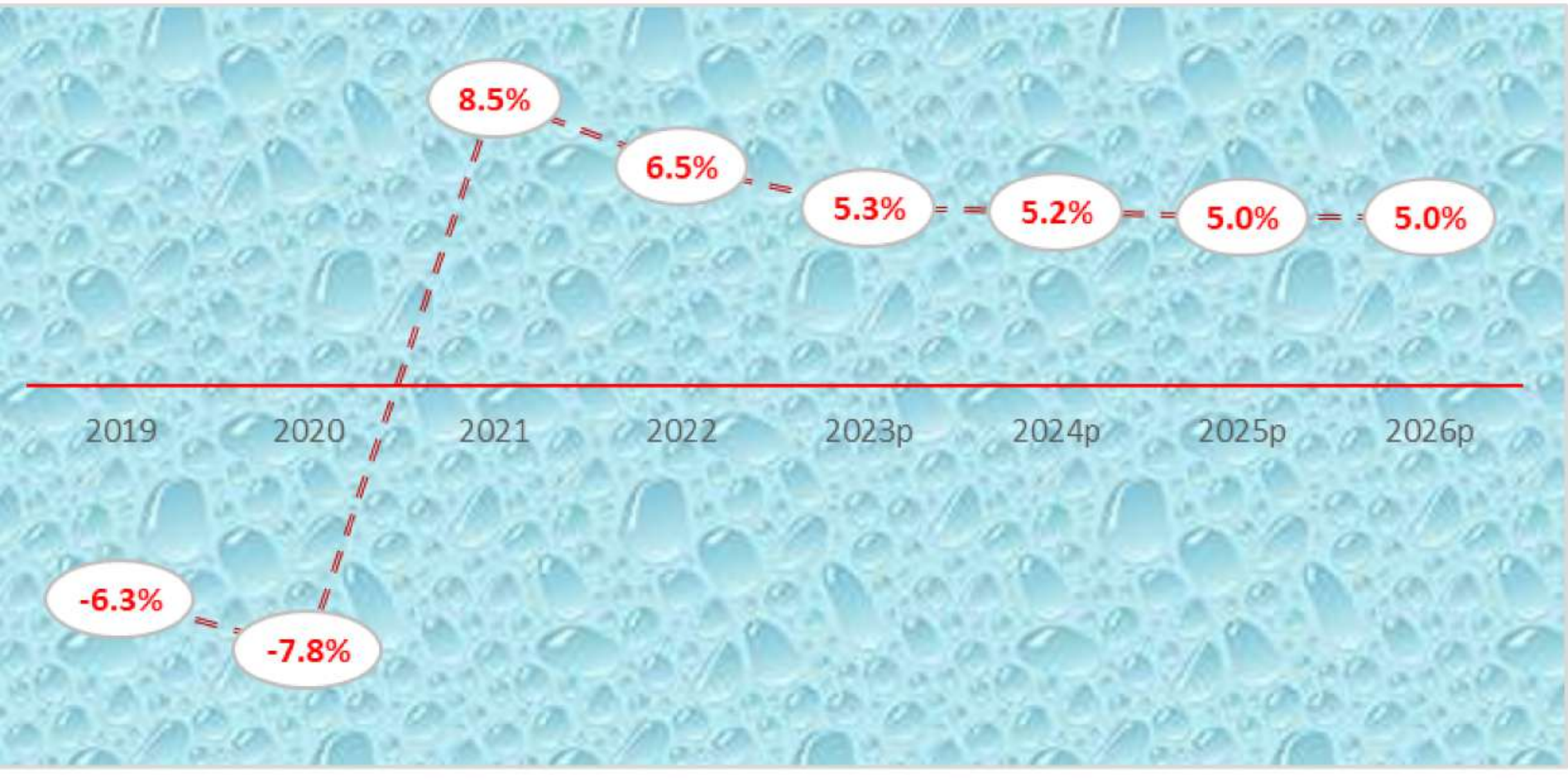
INTRODUCTION

In 2023, the Zimbabwe Coalition on Debt and Development (ZIMCODD) is proud to have contributed to the local economic discourse through its various publications, including, among others, the Weekly Economic Reviews, Monthly Economic Reviews, Monthly Situational Reports, and Debt, Budgets, and Monetary Policy Analyses. As the 2023 fiscal year ends, many economic policies have been implemented, and the results have been mixed. The year-end economic commentary seeks to take stock of what transpired in 2023 and anticipate the risks likely to be experienced in 2024.

A DISAPPOINTING FIRST HALF-YEAR

The severe macroeconomic fluctuations witnessed in the first half of 2023 (1HY23) derailed some key assumptions underpinning the 2023 budget, such as a stable local currency (ZWL), low inflation, and increased domestic electricity production. These fluctuations remarkably subdued economic activity by sending operating and production costs haywire while disrupting business predictability. The resultant hyperinflation in 1HY23 also eroded the real earnings value, constrained aggregate consumer demand, subdued social service delivery, widened societal inequalities, and plunged many citizens into abject poverty. Figure 1 shows the Treasury's Gross Domestic Product (GDP) projections in the first half of 2023 (1HY23).

FIG 1: REAL GROSS DOMESTIC OUTPUT (GDP) GROWTH (%)



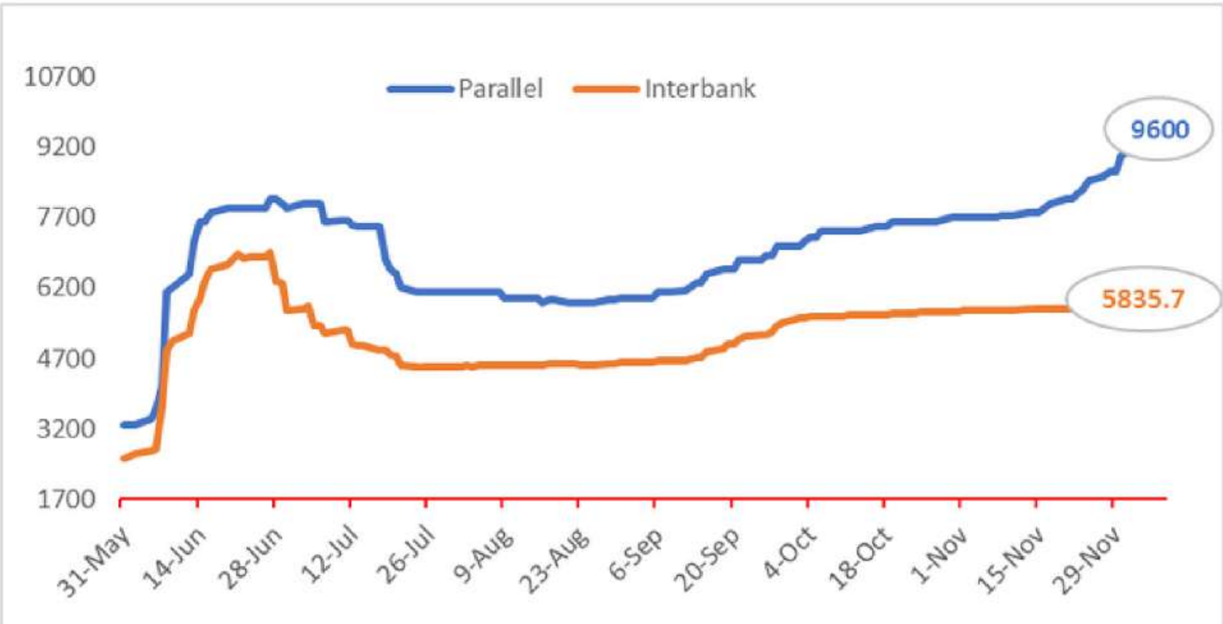
SOURCE: ZIMBABWE TREASURY

To tame the increased economic instability experienced in 1HY23, the government instituted many policy measures between May 2023 and June 2023. The initiated measures include suspension of import duty on basics, revamp of the forex auction system, introduction of gold-backed instruments, reduction of Reserve Bank of Zimbabwe's (RBZ) quasi-fiscal operations (settlement of export surrender requirements and external debt servicing), and demanding 50% settlement of corporate taxes in local currency. Due to these policy actions, ZWL depreciation and price growth moderated significantly from July 2023 through August 2023. Likely buoyed by the prevailing sense of stability during that time, authorities revised the 2023 national output (GDP) growth projections to 5.3% in the second half of the year (2HY23), up from the initial forecast of 3.8% in the early 1HY23.

A MIXED SECOND HALF YEAR (2HY23)

According to the Treasury, the upward revision of the 2023 GDP growth projection in the 2HY23 highlighted above was supported by a relatively better 2022/23 agriculture season, government-funded infrastructure projects, and relatively favorable global mineral commodity prices. However, the 2HY23 experienced a perpetual downward trend in global mineral commodity prices, mainly due to significant improvements in global mineral commodity supply and the fears of a synchronized 2024 global economic slowdown, particularly in advanced economies. The prolonged Russia-Ukraine war and its sanctions and countersanctions constrained global supply chains and deepened economic fragmentation, thus threatening international trade and cooperation. All this negatively impacted export earnings, where mineral exports contribute 70% to the total on average per year.

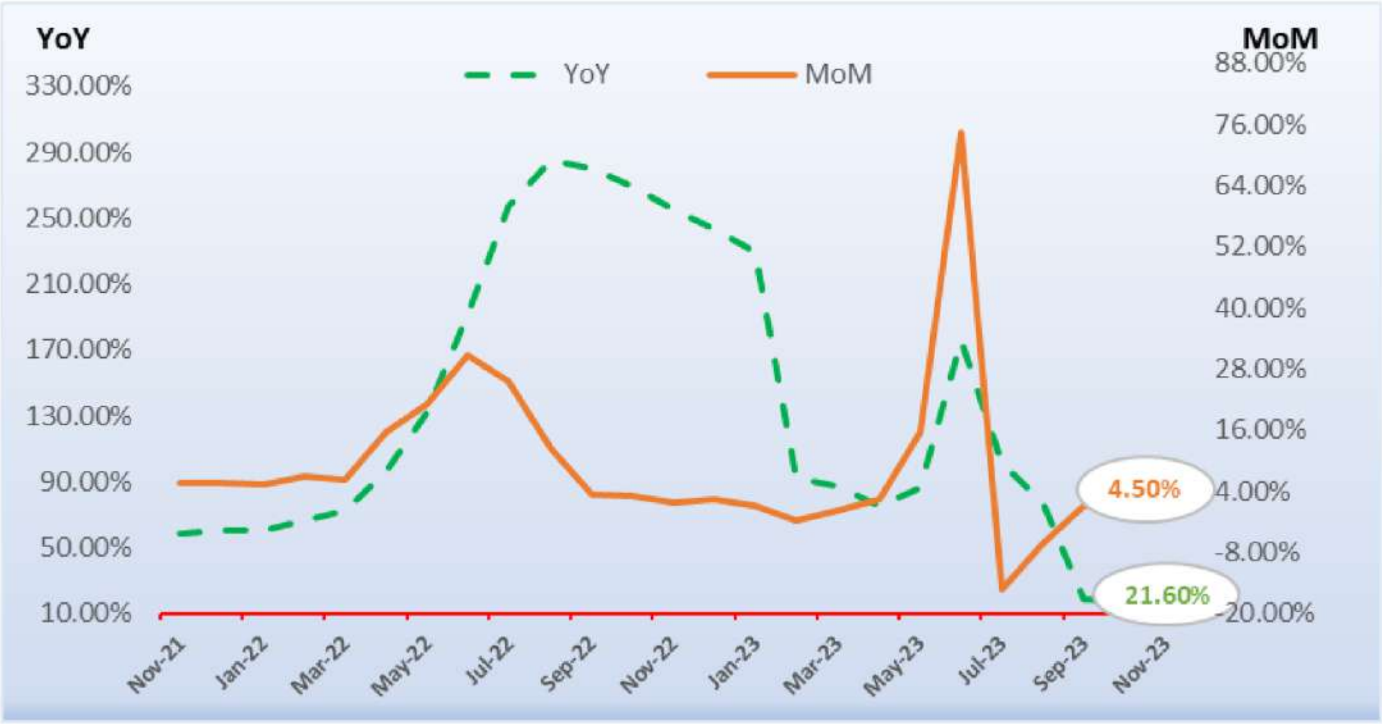
FIG 2: DAILY OFFICIAL AND PARALLEL EXCHANGE RATE



SOURCE: RESERVE BANK OF ZIMBABWE (RBZ), DIRECT MARKET OBSERVATION

Also, as shown in Figure 2, the parallel market premia (the gap between official and parallel market exchange rates), which declined from mid-June 2023 to the end of July 2023 and sailed relatively stable through the end of September 2023, started to spike substantially in October 2023. As of the end of November 2023, the average parallel market premium was about 50%, up from 30% in early October 2023. The ZWL depreciation likely emanated from increased government spending, which is generally associated with the fourth quarter (23Q4). The 23Q4 coincides with the start of the primary summer cropping season (funding agricultural subsidies) and payment of 13th cheques to civil servants. In addition, both ZWL and USD private-sector earnings are generally high in the fourth quarter due to the effect of the festive holidays. So, elevated ZWL earnings at a time when market confidence and trust in the government and its policies is plummeting is fueling currency substitution, causing severe ZWL decline during the fourth quarter.

FIG 3: MONTHLY AND YEARLY INFLATION OUTTURN (%)



SOURCE: ZIMBABWE NATIONAL STATISTICS AGENCY (ZIMSTAT)

Typically, a highly deteriorating local currency (ZWL) exerts enormous pressure on ZWL prices. Businesses will be forced to benchmark their prices at or above parallel market rates to reduce exchange rate-linked cost build-up and losses. In line with declining ZWL, the blended inflation rate as measured by the Zimbabwe National Statistics Agency's (ZimStat) all-items Consumer Price Index (CPI) spiked from a deflation (-6.2%) in August 2023 to 1% (September) to 2.5% (October), and 4.5% (November). The inflation statistics show the economy is experiencing persisting macroeconomic volatility, raising the likelihood of a bleak macroeconomic outlook in 2024.

2024 FISCAL YEAR: A BUMPY ROAD AHEAD

Zimbabwe is facing numerous risks that may undermine macroeconomic performance in 2024. These risks include the likely persistence of exchange rates and commodity price volatilities. The latest 2023 World Bank Zimbabwe Economic Update (ZEU)[1] highlighted that the expected high global food and energy prices will sustain inflation pressures. The public is also of the view that the various regressive revenue-generating proposals in the 2024 executive budget, like the crowding out of informal traders from supply chains and hiking of fuel levy, passport, vehicle registration, and toll fees, will probably lead to the "Laffer Curve (LC) effect" in 2024. The LC effect suggests that a country's taxpayers will have a decreasing incentive to work beyond a certain tax rate, thereby reducing tax compliance. As such, the likely LC effect will adversely affect government revenue collection, derail service delivery, and increase the debt service burden, ceteris paribus.

Rampant public corruption, impunity, illicit dealings, and rising cash dollarization also pose severe revenue risks to the Treasury. A cash economy creates a fertile ground for deep corruption, informality, tax evasion, money laundering, and externalization of foreign currency. Again, a disputed August 2023 election may negatively affect international relations and cooperation, foreign direct investment (FDI), and official development assistance. Also, electoral disputes generally lead to deep societal polarization, disruptive partisanship, economies of affection, plunder of natural resources, and capital flight, among others.

[1] https://www.worldbank.org/

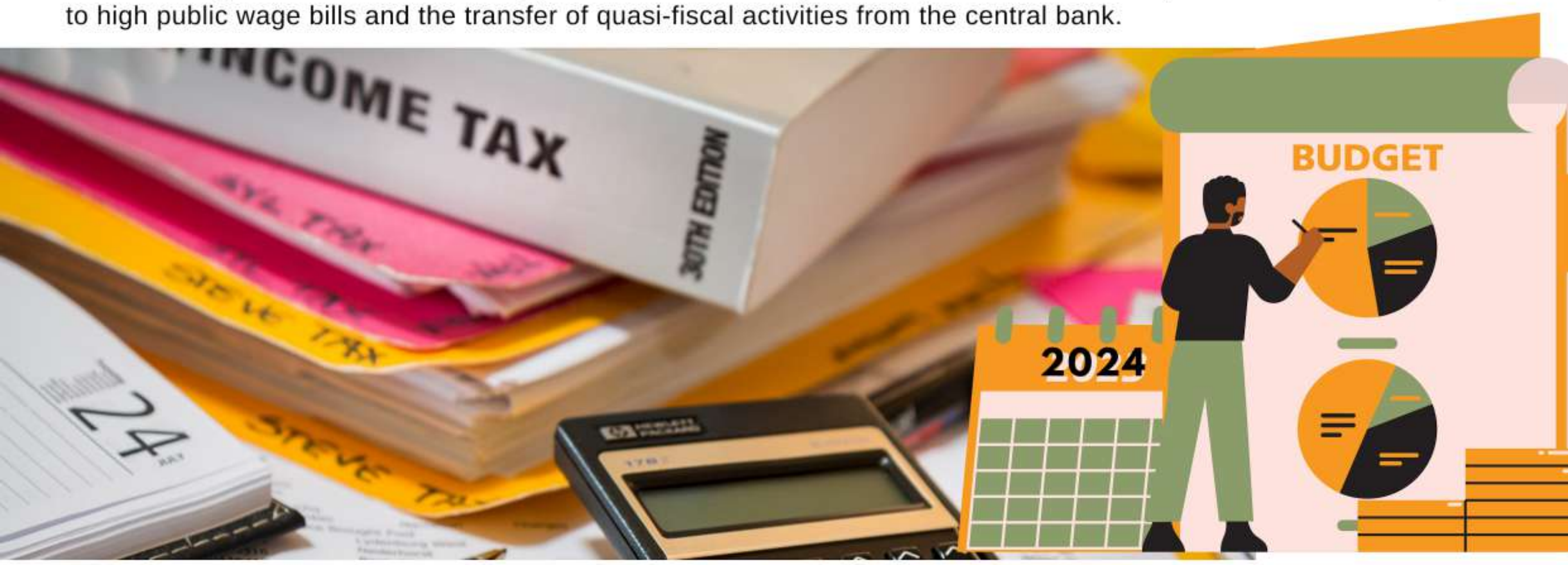
The World Bank's 2023 ZEU highlighted that Zimbabwe's external debt remains in distress, that is to say, struggling to honor existing financial obligations. Debt distress will likely exert enormous fiscal pressures, constrain public service delivery, and fuel resource-backed loans. For instance, it was recently reported that Zimbabwe uses the funds generated from its platinum exports to repay a US$400 million loan from the African Export-Import Bank.[1] However, leveraging mineral wealth to establish credit lines has dire developmental impacts, including increased unsustainable extraction of natural resources. The global mineral commodity prices are expected to remain subdued in 2024, primarily due to rising fears of a synchronized slowdown, particularly in China and other advanced economies. As mentioned earlier, low global mineral prices entail low export earnings for Zimbabwe, posing severe financial and monetary risks.

Furthermore, electricity production will likely face severe threats from dwindling Kariba Dam water levels due to projected El Nino weather conditions (below-average rainfall and above-average temperatures). In addition, the frequent breakdowns of aging Hwange thermal units (Units 1 to 6) will continue to constrain thermal power output. If this holds, prolonged power rationing schedules, which subdue economic activity and balloon the cost of living, will likely become a permanent feature in 2024. The latest World Bank's ZEU for 2023 posits that the energy deficit is costing Zimbabwe approximately 6.1% of its GDP.

Again, El Nino weather conditions forecasted to dissipate by mid-2024 will drive below-average rainfall across much of Southern Africa.[2] For an agro-based Zimbabwean economy that is too dependent on rainfall, the below-average rainfall will significantly constrain the agriculture sector, leading to below-average 2024 harvests. Treasury estimates show that agricultural sector activity will decline by about 4.1% due to the projected climatic shocks. The drought weather conditions follow localized below-average harvests in 2023 and poor macroeconomic performance, which might further trap the nation in a severe humanitarian and economic crisis through crop failure, low labor opportunities, high food prices, and elevated food insecurity. The agriculture sector supplies more than 60% of industrial raw materials, provides income and employment for 60-70% of the population, and accounts for at least 15% of the national output (GDP).[3] The sector's challenges are further compounded by elevated fertilizer prices coupled with higher domestic prices of other farm inputs like maize seeds, which will crowd out use by farmers.

As such, government spending in this sector is expected to jump significantly to provide farm input subsidies, water harvesting projects, and food aid to the most vulnerable groups of the population. Typically, elevated fiscal spending increases ZWL liquidity in the market, destabilizing the ZWL and ZWL market prices. Moreover, adverse spillover effects from deteriorating geopolitical tensions fueled by the Russia-Ukraine war, such as higher input prices, volatile crude oil prices, and dislocation of global supply chains, will constrain global economic activity. Zimbabwe, a perennial net importer, will disproportionately bear the brunt of these global fluctuations through imported inflation.

In light of the preceding risks, the government is now projecting a modest GDP growth of about 3.5% in 2024, down from initial projections of 5.3%. The vital underpinning assumptions for 2024 include constrained access to finance, unfavorable global mineral commodity prices, a decline in agriculture production, and a squeeze on the Treasury due to high public wage bills and the transfer of quasi-fiscal activities from the central bank.

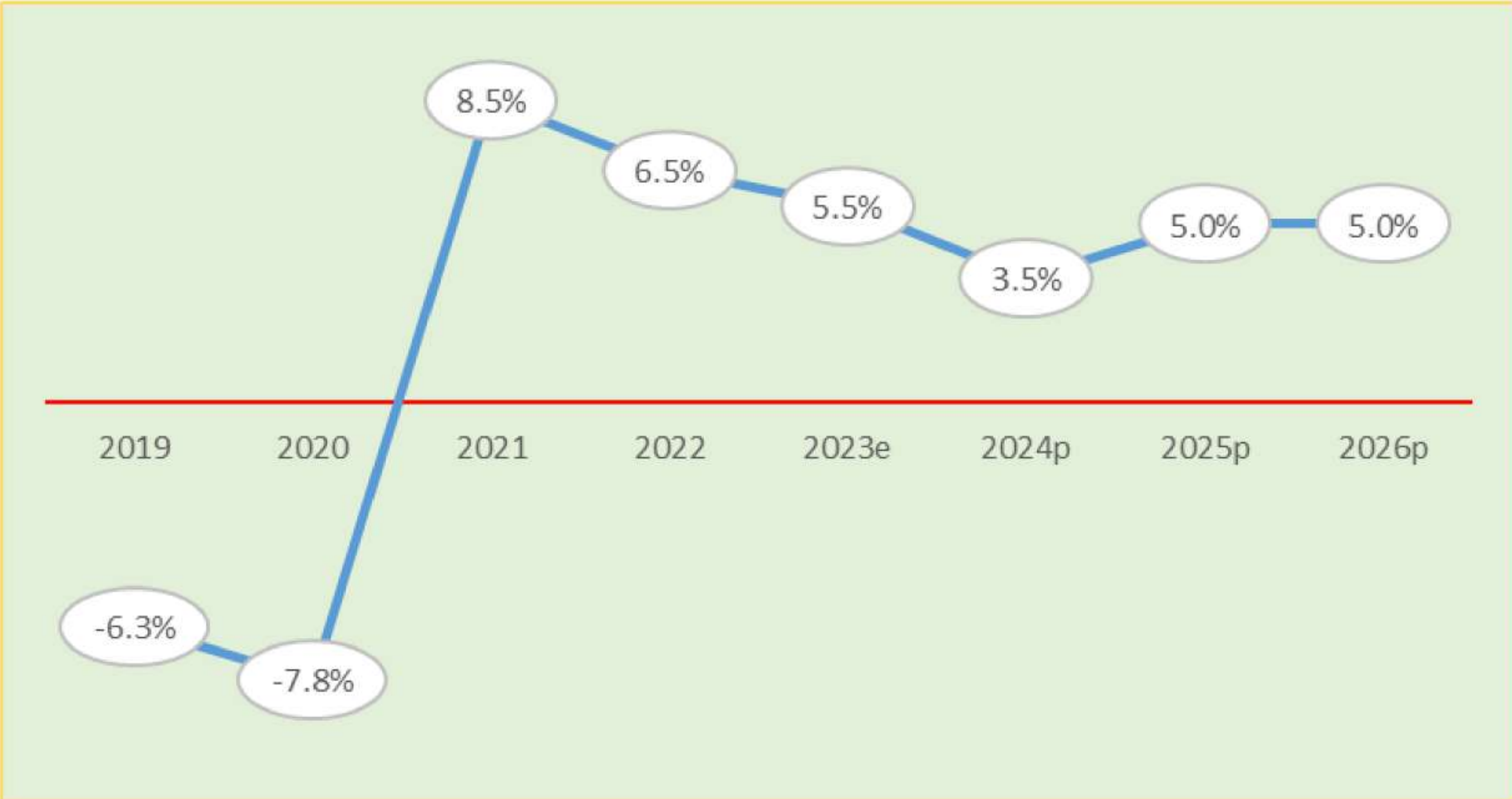


[1] https://africa.businessinsider.com/local/markets/zimbabwe-is-paying-dollar400-million-afrexim-bank-debt-with-platinum-exports/

[1] https://fews.net/southern-africa/alert/november-2023

[1] https://www.fao.org/zimbabwe/fao-in-zimbabwe/zimbabwe-at-a-glance/en/

FIG 4: REVISED GOVERNMENT REAL GDP GROWTH PROJECTIONS (%)



SOURCE: 2024 NATIONAL BUDGET STATEMENT

As discussed earlier, the major 2024 potential risks include elevated fiscal pressures, debt distress, prolonged power cuts, climate change shocks, and sustained global turmoil driven by deteriorating geopolitics. It is also worth noting that the low GDP growth rates make it a mammoth task for authorities to achieve the nation's vision - Vision 2030 - of attaining an upper-middle-income economy status by the end of 2030. Also, persisting currency and price volatility widen societal inequalities and deepen poverty, thus militating against achieving the desired stable, inclusive, and sustainable economic growth. If unattended, this will contradict the government's development agenda of "Leaving no one and no place behind."

RECOMMENDATIONS

Mitigating the 2024 budget risks, as discussed above, will require, among others:

- **Political dialogue:** This is critical in addressing underlying socio-political bottlenecks for political reforms to achieve inclusive solutions to existing institutional weaknesses or politics of identity.
- **Political will**: This is needed to implement critical reforms to strengthen democracy, improve government efficiency, reduce leakages, and subdue market pricing distortions.
- Authorities must continue meaningful dialogue with all creditors to help clear debt arrears and increase the chances of getting needed debt relief.
- The 2024 national budget must be a pro-poor budget supporting the provision of quality, affordable, and accessible public services, particularly to the most vulnerable groups.
- Climate-proofing of the agriculture sector to minimize the effects of unfavorable rainfall patterns caused by climate change.
- **There** is a need to strengthen existing legal and regulatory frameworks to curb resource leakages. Also, capacitating oversight and accountability institutions must be prioritized to help detect and deter corrupt tendencies of public officials.
- **Embrace** non-tax increase-induced domestic resource mobilization, such as formalizing the rapidly growing informal sector economy and diversifying the economy through value addition and beneficiation.
- Authorities must continue to engage and re-engage with the global community to boost investor confidence and improve capital inflows.
- There is a need for policy consistency and consultations to increase stakeholder buy-in, thus promoting inclusive policy-making and policy ownership.

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