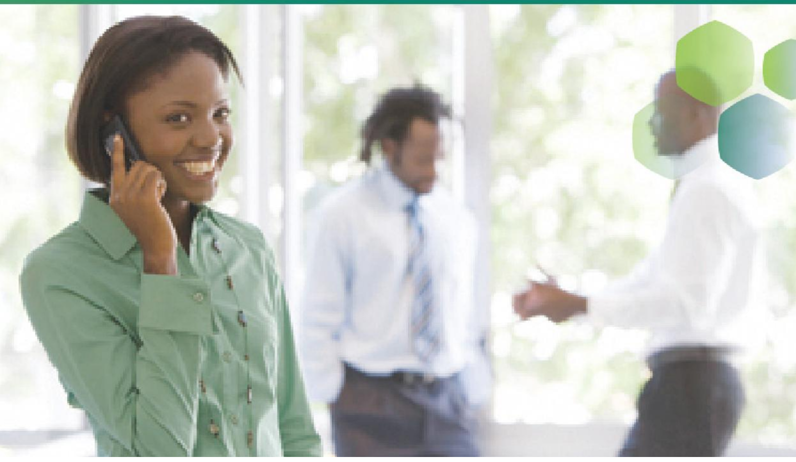
Quarterly Economic Brief

Q1' 2016



Highlights

Downside risks have become more tangible across emerging and developing markets.

U.S monetary policy actions still directing global financial market flows

M&A activity across Africa and the Middle East fell below 100 transactions for the first time in Q1'2016

Zimbabwe intensified pressure on foreign firms to comply with empowerment laws

ZSE total market capitalization retreated 12.6% to close the quarter at usd2.808 billion

Global| Africa's resource curse: missing billions…

Nigeria's Auditor-General disclosed that the national oil company withheld US$16 billion in oil revenues in 2014 alone. The state-run oil entity is mandated to remit oil revenues to the Federal government. A commission set up to investigate the allegations further revealed that the 'missing' revenue amounts to approximately US$25 billion over the period January 2011 to December 2015. Despite being Africa's largest economy and holding massive oil and gas reserves, Nigeria experiences frequent energy shortages.

Nigeria is heavily reliant on oil and gas revenue which constitute about 35% of its GDP. Petroleum products also account for more than 90% of Nigeria's export earnings. This is not the first time that massive corruption allegations have surfaced in Nigeria's oil sector. In 2013, the Central Bank alleged that US$50 billion in oil revenue had not been accounted for. Government responded to the allegations by suspending the Central Bank governor.

BRICS bubble bursting?

Leading emerging and developing countries, Brazil, Russia, India, China and South Africa (BRICS) are increasingly struggling to justify predictions that they underpin the future of global economic growth. Investor confidence in the BRICS has been premised on the non-western economic powerhouses holding approximately 25% of the world's total land mass and housing more than 40% of the world's population. The BRICS concept and acronym was coined by Goldman Sachs Asset Management in 2001, as the new investment frontier.

Of the 5 BRICS member countries, only India has sustained a relatively stable growth path. Brazil faces a potential political crisis amid allegations of high level corruption. Russia is currently under international sanctions and is being adversely affected by weak oil prices. In 2015 China registered its lowest GDP growth rate in 25 years at 6.9% and the 2016 target has been set at between 6.5% and 7%. South Africa faces an increasingly uncertain political outlook worsened by a lingering threat of a sovereign credit rating downgrade.

In November 2015, Goldman Sachs closed its BRIC investment fund, declaring that it did not expect 'significant asset growth in the foreseeable future,' as asset values in the fund had retreated 88% from a 2010 peak. Such divestment from the BRICS portfolio has reinforced an increasingly fashionable notion among market analysts that the BRICS bubble is bursting. The assertions are fueled by incessant structural underperformance exacerbated by chronic political-economy vulnerabilities across emerging markets.

The Panama papers… latest high level confidential data leak

Approximately 11 million confidential documents held by a Panama based law firm were leaked. Information in the documents dates back to 1977, going up to December 2015, detailing how some of the world's most powerful people may have used offshore bank accounts and shell companies to avoid taxes and conceal their wealth. To put the amount of information leaked, the WikiLeaks expose' of 2010 carried 1.7GB of data, while the 'Panama papers' carry 2,600GB of data, with emails making up most of the data.

It is unclear if the confidential papers document any criminal activity given that holding money in offshore companies by itself is not criminal. This notwithstanding, such suspicious transactions may be used to conceal criminality, including money laundering, tax evasion and dodging of sanctions. The secrecy provided by offshore shell companies makes it easy and arguably tempting to wade into tax evasion. The papers are expected to provide some interesting reading.

A luta continua: still finding ourselves

The Mozambican government called for 'talks' with rebels to end violent conflict that begun in 2012. Angola's President Jose Eduardo dos Santos plans to step down in 2018. He has been in power since 1979 and did not cite reasons for his decision. Kenya's anti-corruption commission estimates that a third of the national budget is lost to corruption annually. Zambia approached the IMF for a financial rescue package, citing fiscal pressure from depressed mineral earnings.

Reprieve for emerging market currencies, funds flow…

Minutes of the March 2016 U.S Federal Reserve Bank (Fed) meeting signaled a high likelihood that there will be no interest rate increase in April 2016. The Fed is expected to adopt a cautious approach to interest rate increases, at least until the global economy shows signs of a sustained recovery. The low interest rate policy is aimed at jumpstarting economic growth in the U.S by making money less costly to households and firms. Low U.S interest rates exert downward pressure on the US$ on a supply/demand basis.

Prospects of continued loose monetary policy in the U.S provide support for emerging and developing market currencies. Emerging and developing market currencies have been under considerable pressure from a strengthening US$, in-part due to capital flow reversals from emerging and developing markets to the U.S in light of higher U.S yields. Overall, a cautious Fed approach caps US$ appreciation, easing pressure on (US$ denominated) commodity prices, global capital flows and the aggregated threat of global financial market volatility.

Huge drop in global mergers and acquisitions

A report by Mergermarket revealed a considerable drop in global merger and acquisition (M&A) activity. The first quarter of 2016 registered global M&A deals worth US$597.4 billion; the lowest M&A value since the first quarter of 2014. Each of the preceding three quarters registered deals in excess of US$1 trillion. Africa and the Middle East were the worst affected by the decline in transactions, registering the worst performance since the first quarter of 2013.

The quarterly volume of M&A deals in Africa and Middle East fell below 100 for the first time in the first quarter of 2016 at only 71. Much of Africa's M&A underperformance is premised on its biggest economies. Nigeria and Angola, both hugely reliant on oil revenues, have experienced significant fiscal pressures, making them less attractive destinations for global capital. In South Africa, macroeconomic stability was compromised by the appointment of 3 different Finance Ministers in a week towards the end of last year.

Forget *El Nino*… *La Nina* is coming

UNICEF estimates that 15% of Malawi's population faces hunger induced by prevailing *El Nino* conditions and that in January 2016 cases of 'severe acute malnutrition' more than doubled in Malawi. South Africa is going through its driest summer in more than a century and will require imports to cover more than half its annual maize requirement. Zimbabwe declared a State of emergency and announced that it requires an estimated US$1.5 billion to cover the food deficit through imports. Food prices across the region have increased in light of the deficit.

The International Research Institute for Climate and Society (IRI) projects that *El Nino* induced drought conditions in Southern Africa are slowly waning. *El Nino* occurs when temperatures in the Pacific Ocean become excessively warm leading to a disruption in Oceanic wind flows, that typically leads to erratic weather in Southern Africa. IRI however predicts that the wakening *El Nino* will transition into a La Nina event during the summer of 2016/17. In contrast to the *El Nino* induced drought, *La Nina* is expected to bring excessive rains.

ZAR on the rebound; like most emerging market currencies

Continued low interest rate policies being pursued by the U.S Fed presented significant support for trading partner currencies. The US$ closed the quarter ended 31 March 2016 2.4% firmer against the South African Rand (ZAR), closing at ZAR15.04, from an opening position of ZAR15.40 per US$. Against the Euro, the US$ retreated 3.7% during the quarter under review, to close at US$1.13 per Euro, from an opening position of US$1.09. ZAR recovery has been kept in check by South Africa's underlying political-economy fragilities.

Softer dollar supported international commodity prices

International commodity trade is primarily conducted in US$ terms. A weaker US$ makes commodities on the international market cheaper in relative currency terms. The following table highlights commodity price movements for the quarter under review against the full year price movement in 2015.

Commodity	**Price**	**Q1'16**	**FY'15**
Nickel (usd/ton)	8,400.00	-2.44%	-42.04%
Crude Oil (usd/barrel)	39.42	7.41%	-34.80%
Gold (usd/oz)	1,235.49	16.27%	-11.23%
Platinum (usd/oz)	974.70	11.75%	-27.84%
Coffee (usd/lb)	127.25	2.75%	-24.78%
Maize (usd/ton)	144.28	2.02%	-11.47%
Sugar (usc/lb)	15.74	3.48%	3.47%
Cotton lint (usc/lb)	57.48	-9.79%	4.70%

Commodity prices responded positively to US$ weakness, with the exception of nickel and cotton prices which bucked the general trend. Cotton prices retreated 9.79%, reversing the gains registered in 2015 on the back of increasing interest in cheaper synthetic substitutes, signaling a looming cotton oversupply situation. Oil prices found considerable support from reports of a looming supply ceiling to be implemented by the Organization of Petroleum Exporting Countries (OPEC). Nickel prices conspicuously maintained a downward trend, ostensibly in line with slowing Chinese economic growth.

Global Economic Outlook

Inherent vulnerabilities in the emerging and developing markets, exacerbated by concerns of an underperforming U.S economy, threaten global economic output. Weaker global aggregate demand is likely to cascade to lower commodity export earnings for commodity-reliant economies. Familiar factors, including but not limited to political uncertainties and fiscal imbalances, are expected to dominate the sub-Saharan Africa region, becoming entrenched as part of the environment. Potential centers on cumulative past underperformance across the region and the associated output gap.

We anticipate global capital flows to stabilize in relative terms, following the U.S Fed's decision to maintain a loose monetary policy stance. Resultantly, we anticipate less BOP and exchange rate pressure for emerging and developing markets. International commodity prices present limited scope of recovering past losses in the current year, particularly as structural adjustment in China presents a 'new normal' demand scenario. Gold could find support from safe-haven demand.

Economic difficulties have deepened, despite SMP success

An IMF mission was in the country holding discussions with authorities and private sector representatives on the 2016 Article IV consultations and reviewing the 3rd and final Staff Monitored Program (SMP). At the conclusion of the mission, the IMF team highlighted that: 'Economic difficulties have deepened,' and Zimbabwe needs to act fast to revive economic growth.

A major positive from the IMF review was that Zimbabwe successfully met all quantitative targets and structural benchmarks under the SMP and is in the process of developing an economic transformation program. All things normal, meeting policy targets under an IMF program enhances public and investor confidence as it highlights a commitment to reforms. Note that SMP is an 'informal' agreement between a country and IMF staff to monitor the implementation of a country's economic program.

Indigenise or shut down…

Cabinet reportedly directed that from the 1st of April 2016; line Ministries must cancel the operating licenses of firms that fail to meet a 31 March 2016 deadline to submit indigenisation compliance plans. Cabinet also reversed the initially proposed non-compliance levies such that foreign firms must either 'indigenise' or close. Foreign firms in reserved sectors such as fuel retail, agriculture and transport are likely to be the most affected as reserved sectors require 100% local equity. Such measures compromise investor sentiment.

Minister of Mines, Hon. Chidhakwa reportedly said there will be no going back on government's February 2016 decision to bar 9 diamond firms from mining the Marange diamond fields. The decision follows allegations of contractual irregularities. Concessions that belonged to affected firms have already been registered under a newly formed State owned entity. Mafia-type syndicates have reportedly invaded the fields following the directive. Hundreds of illegal diggers have been arrested while 3 reportedly died in the ensuing chaos.

Restrained potential…

Japanese Prime Minister Shinzo Abe hosted President Mugabe on an official State visit and extended a US$5 million grant-in-aid pledge to Zimbabwe. Japan also pledged to fund road projects in Zimbabwe, extending the list of deals that Zimbabwe has entered into with China, Russia and Nigerian billionaire Aliko Dangote. In the words of Deng Xiaoping: 'It doesn't matter whether the cat is black or white, as long as it catches mice.' In the context of Zimbabwe, any source of investment is welcome in order to revive the economy.

Meanwhile, the U.S Office of Foreign Assets Control (OFAC) added fertilizer manufacturers Chemplex Holdings and Zimbabwe Fertilizer Company (ZFC) to its sanctions list. The State-owned Industrial Development Corporation of Zimbabwe (already on the sanctions list) wholly owns Chemplex and has a 50% holding in ZFC. The economic cost of the sanctions is mitigated by inherent domestic structural constraints. This notwithstanding; the sanctions serve as a symbolic and brutal reminder of Zimbabwe's strategic international isolation.

Germany's second largest bank, Commerzbank, requested all Zimbabwean banks to close their nostro accounts held with the bank. The request was made a few weeks after Barclays Plc was fined US$2.5 million by the U.S Treasury for processing transactions from three Barclays Zimbabwe corporate clients whose beneficial owner is on the U.S sanctions list. Though Barclays' fine was a fairly small amount, it effectively served a symbolic purpose, ostensibly feeding into Zimbabwe's strategic isolation in typical 'big stick philosophy' fashion.

Low tobacco forecast threatens market liquidity

The 2016 tobacco marketing season officially opened on 30th of March 2015 with prices ranging from US$0.11 to US$4.50 per kg. The Tobacco Industry and Marketing Board projects seasonal output to decline by 20% to 170 million kgs from last year's 198.95 million kgs. Resultantly, national earnings are compromised unless if there is compensating increase in prices. Tobacco exports are critical to domestic liquidity, contributing US$857 million in export earnings last year.

Zimbabwe's total exports and imports for the first two months of 2016 declined from same period last year by 13.1% and 15.7%, to US$458.9 million and US$838.4 million, respectively. The trade deficit for the two months closed at US$379.5 million, down from US$466.2 million in the corresponding period last year. Zimbabwe's cumulative trade deficit since dollarization is estimated around US$22 billion, partly explaining prevailing tight market liquidity conditions.

Generalised tension filled the market

Sporadic (though predominantly low-tone) incidents of rioting and generalised unease characterised the environment in January 2016. Hot spots ranged from public service employees demonstrating against government's failure to honour 2015 bonuses, to urban transport crews demonstrating against increased operating fees. Street vendors also engaged municipal police in running battles as authorities intensified efforts to rid the streets of illegal vending.

Media reports alleged that opposition political parties were intensifying efforts to force an early election. This was despite a constitutional clause ensuring that the ruling party remains unchanged at least until elections in 2018. Former Vice President Dr Joice Mujuru's officially launched an opposition party, 'Zimbabwe People First'. Zimbabwe People First reportedly maintained pressure on the ruling party, amid reports of several meetings with several opposition leaders angling towards a coalition force.

Old risks have escalated, as new ones emerge

The first month of the year is a significant forward-indicator of the year ahead and January 2016 was no exception for Zimbabwe. Signs on the ground presented a considerably difficult outlook. Old risks mainly centred on deteriorating central government funding conditions and a generalised policy uncertainty while erratic weather conditions emerged as a new threat to the environment. By the end of the quarter under review, the old risks had degenerated while new risks became increasingly entrenched.

Government failed to honour 2015 bonuses in January 2016 as had been promised in December 2015. Treasury then committed to staggered bonus payments, which were also reportedly erratic during the quarter under review, despite some payments. The World Economic Forum ascribed a 61.5% probability to Zimbabwe falling into a fiscal crisis in 2016. As was the case with the rest of the Southern African region, Zimbabwe's food security and agriculture related output was significantly compromised by *El Nino* conditions.

Shrinking 'revenue cake'

Net revenue collections declined by 3% to US$3.50 billion in 2015. Revenue was largely realised from indirect taxation, which contributed 65.7% to total revenue. There was a decline in PAYE relative to the previous year due to massive retrenchments that took place during the year. Corporate tax grew by 7.25% on 2014 levels driven by tighter collections measures. Continued company closures and lower corporate profits are however likely to have a negative impact on corporate tax collections going forward.

Collections for 2015 largely reflected subdued economic output where formal employment is shrinking. The significant contribution by indirect taxes such as VAT captures the rising informalisation of the economy, partly supplanting corporate and personal tax contributions. According to figures from the ZIMSTAT, informal employment contribution to total employment increased from 84% in 2011 to 95% by 2014.

Declining purchasing power fuelling deflation

Year on year inflation closed February 2016 at -2.22%, down from -2.19% in the previous month. Monthly inflation softened from -0.05% to -0.10%, depressing the year to date inflation rate to -1.15%. In the same period last year, year to date inflation was -0.42%. Persistent deflation is primarily attributed to low domestic aggregate demand, which in the absence of an expansionary fiscal policy is likely to persist. Expansionary fiscal policy entails increased government expenditure or reduced taxes to free up household purchasing power.

Zimbabwe's poverty datum line for a family of five retreated by 0.3%, from US$482.86 to US$481.60 between December 2015 at February 2016. On a year on year basis, the poverty datum line retreated 2.8% from the same time last year. During the corresponding period last year, the poverty datum line was US$495.61, down 0.6% on a year to date basis, then.

Money market rates buckled under depressed deposit appetite

Domestic money market interest rates remained depressed in light of a low appetite for deposits for on-lending by banks. A low inflation premium driven by persistent deflation also worked against nominal money market interest rates. The average 90 days interest rate quote declined from 3.32% at the beginning of the year to 2.95% as of 31 March 2016. A generalized high credit risk environment is likely to continue incentivizing cautious lending by banks, sustaining downward pressure on money market interest rates on a supply and demand basis.

Foreign investors selling out of local equities

ZSE underperformance continued unabated during the quarter under review. ZSE total market capitalization shed 12.57% to close at US$2.8 billion as investors remained coy of risky assets, in line with persistent consumer deflation escalating to asset deflation. The following table highlights ZSE market movements during the quarter under review.

Sector	**31 Mar'16**	**Q1'16**	**FY'15**
Commodities	231.26	-20.54%	-24.03%
Consumer	133.12	-16.43%	-33.07%
Financial	75.76	5.03%	-7.50%
Listed Property	99.53	-15.11%	9.35%
Manufacturing	40.17	-12.94%	-28.69%
Industrial	**97.61**	**-15.01%**	**-29.45%**
Mining	**19.53**	**-17.66%**	**-66.92%**
Market Cap (usd bln)	**2,808**	**-12.57%**	**-32.50%**

The following table shows the top and bottom 3 performing stocks during the quarter under review.

Top 3 Performers	**Price USc**	**Q1'16**	**Market Cap**
GBH	0.02	100.00%	107,318
STARAFRICA	1.00	66.67%	5,184,691
ZIMRE	1.80	40.63%	27,552,173

Bottom 3 Performers	**Price USc**	**Q1'16**	**Market Cap**
CAFCA	18.00	-55.00%	1,531,214
MEDTECH	0.02	-50.00%	559,927
INNSCOR	18.73	-37.48%	101,440,452

ZSE total value of trades for the quarter ended 31 March 2016 firmed 16.7% to close at US$43.3 million. Compared to the same period last year, total value of trades was 37.8% weaker. The average daily value of trades gained 16.8% to close the quarter under review at US$2.1 million.

Foreign trades constituted 63.8% of total trades. Net foreign portfolio flows recorded a net outflow position of US$14.7 million, up from US$4.7 million in the previous quarter. In the same period of last year, foreign investment net portfolio inflows were US$3.1 million.

Economic Outlook

The likelihood of further underperformance is considerably high. Negative net portfolio investments underscore fatigued investor sentiment, presenting an adverse forward indicator for gross investment growth. Combined with a persistent trade deficit, negative capital inflows threaten domestic liquidity conditions, more so in the prevailing multi-currency regime framework. The confluence of tight market liquidity, deepening deflation and limited policy response mechanisms significantly inflates policy risk into the foreseeable outlook. The environment still prescribes caution.