ZIMBABWE: THINKING BEYOND THE CURRENT LIQUIDITY CRISIS

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MISCONCEPTIONS

- In addressing this topic, it is critical to tackle the many misconceptions surrounding Zimbabwe’s so-called “liquidity crisis”.

MONEY SUPPLY

- Since 2008, money supply in Zimbabwe has grown from 7% of GDP to 38%.
- Although this ratio is below the Sub-Saharan average of 47%, it is higher than in the rest of SADC except Mauritius (100%), South Africa (75%), Namibia (63%) and Botswana (44%).

NOT ALONE

- In other words, if Zimbabwe has a "liquidity crisis", then the squeeze is even greater in Zambia, Tanzania, Angola and Mozambique, all of which are faster-growth economies.

SPECIAL CASE

- However, Zimbabwe is something of a special case:

1. Hyperinflation and dollarization (2005-2009) decimated national savings – at corporate and at household level.

- This gave rise to an unusually heavy demand for funds.
- Traditionally firms rely on retained earnings for the bulk of their investment (though far less so in mining and agriculture).

EXTERNAL FUNDING

- Because retained earnings were wiped out, firms had no choice but to look outside the business for funding.
- In Zimbabwe this invariably meant going offshore because funds were either not available – or expensive – locally.

NO QUANTITATIVE EASING

2. Because the Central Bank is unable to pump liquidity into the system and savings are negligible, money supply is exogenously (externally) determined.

EXOGENOUSLY DETERMINED

- Money supply depends on:
  - Net exports – but because Zimbabwe is a net importer of 30% of GDP there is a net outflow of liquidity
  - Capital and financial inflows – FDI, offshore borrowing, foreign aid, Diaspora remittances, etc

BOP DEFICIT ON CURRENT ACCOUNT

- We currently spend some $2.5 billion to $3 billion a year more than we earn.
- The bulk of that – $2 billion – is "covered" by inflows of one kind and another, but that leaves a net outflow of liquidity of $500 million upwards each year.

BOP CRISIS

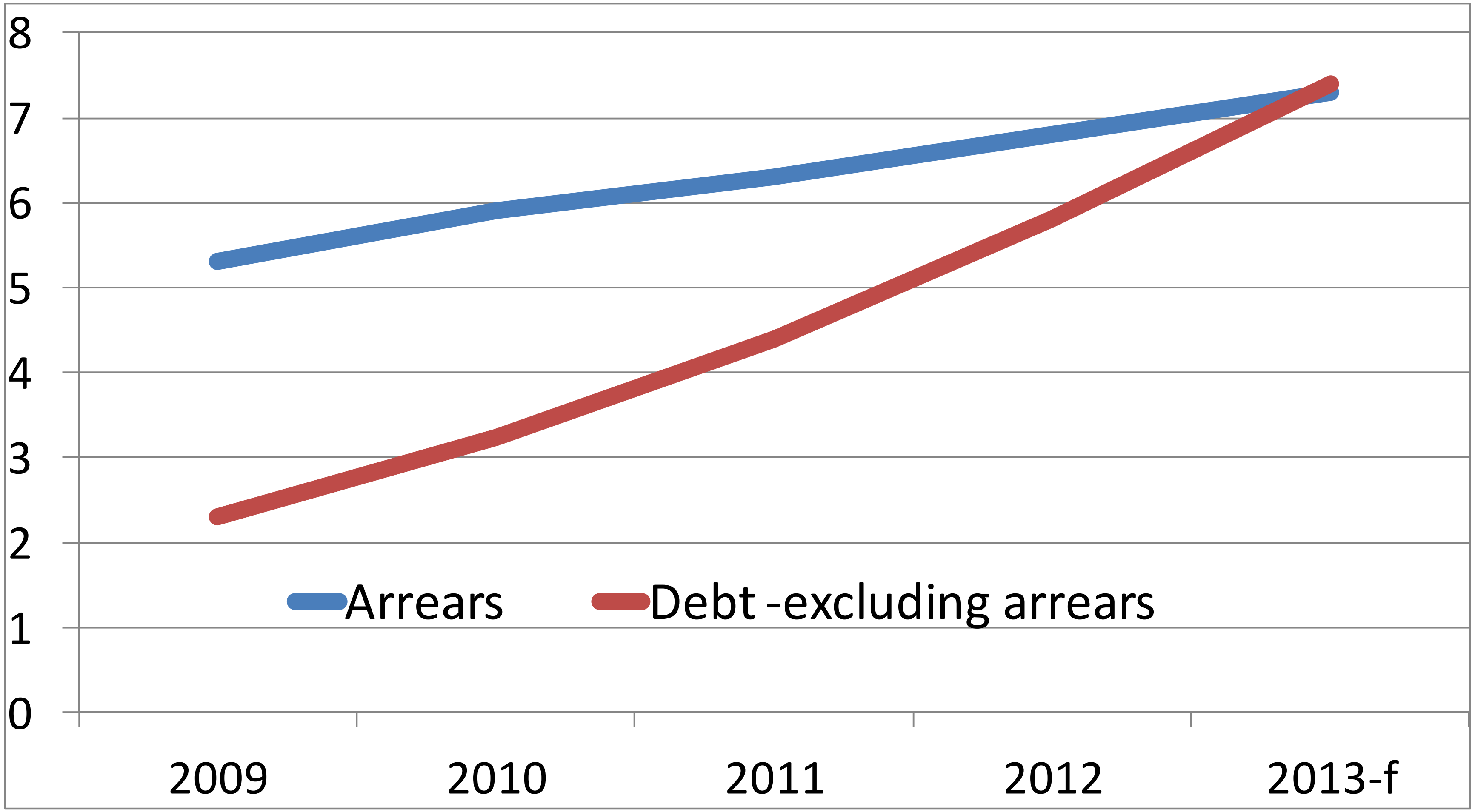
- In other words, the “liquidity crisis” is not so much a liquidity issue as a balance-of-payments problem, exacerbated by:

- The foreign debt overhang (110% of GDP) and
- A high political risk premium, which makes offshore funding problematic as well as costly.

DEBT OVERHANG

- Ignoring arrears of $7.3 billion, the country has been borrowing at an annual rate of $1 billion, as a result of which foreign debt – <u>excluding arrears</u> – jumped from $2.4 billion in 2009 to over $7 billion today.

OFFSHORE BORROWING ($ billions)



UNSUSTAINABLE MODEL

- This is not a sustainable business model because at today's "notional" international cost of capital of around 7%, then the annual cost of Zimbabwe's (non-arrears) debt is close on $500 million (13% of current exports).

NET CAPITAL IMPORTER

- Given the projections suggesting that Zimbabwe needs to invest $2 billion annually for the next 20 years in infrastructure alone, it is obvious that for many years the country will be a net importer of capital.

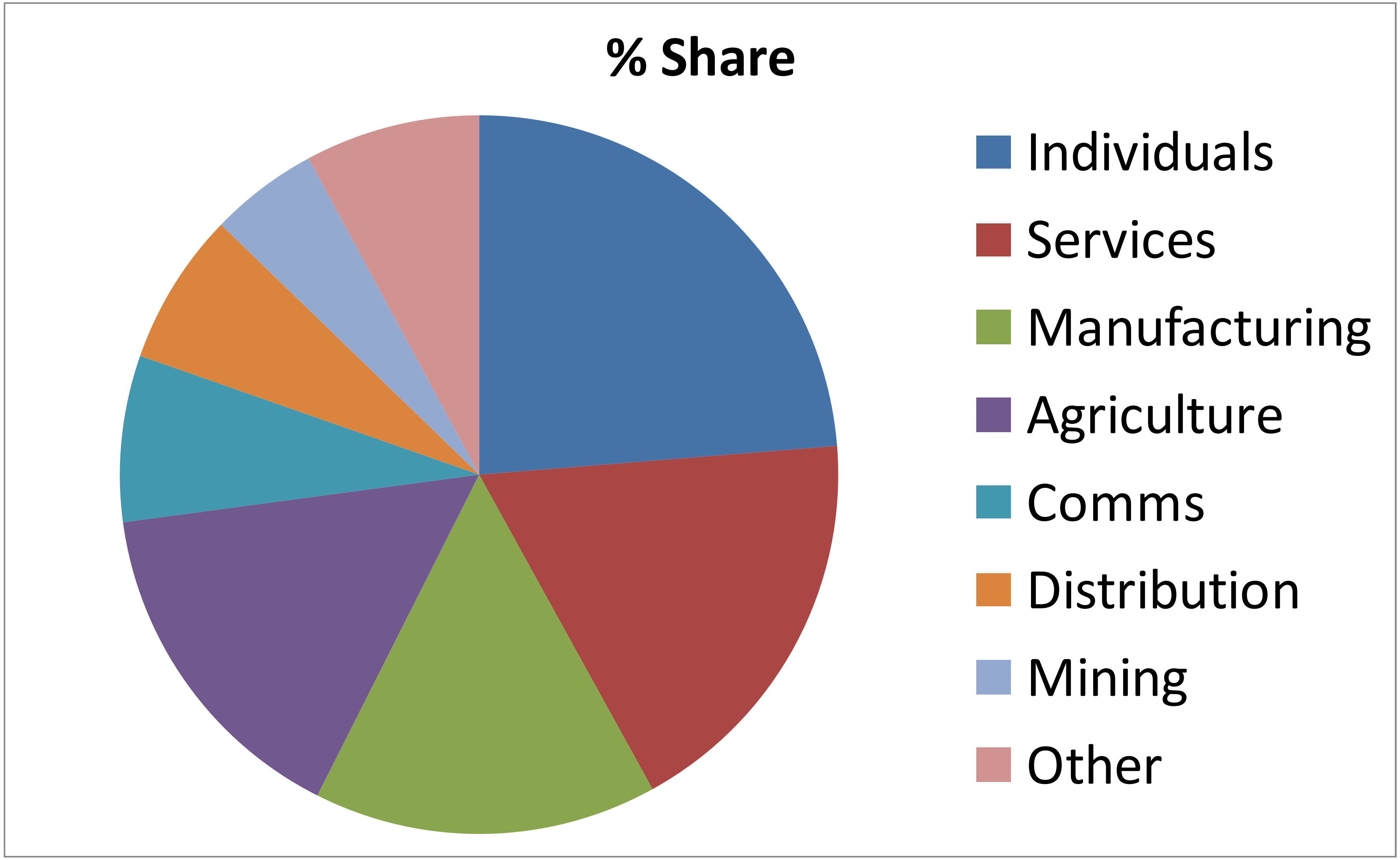
THE DEMAND SIDE

3. Almost a quarter of bank lending in this country goes to private households - though this almost certainly includes an unknown but possibly large element of informal sector borrowing.

SKEWED LENDING PATTERN

- As the slide shows, this is much more than loans to agriculture, manufacturing, mining or services.
- What is more, during this time of "liquidity crisis" (since 2011), household borrowing has more than quadrupled and now exceeds $900 million (8% of GDP)

BANK LENDING BY SECTOR



WHY SO MUCH LENDING TO INDIVIDUALS?

This leaves an awkward question:

- Why, if the demand for liquidity is so strong from businesses, do banks lend so much to individuals?
- Is it because individuals are better credit risks?

RISK ESCALATES

- 4. Lending is constrained by high levels of borrower risk.
- Non-performing loans account for 15.6% of total lending up from 8% two years ago, forcing the worst-affected banks to curtail their lending.

NO LENDER OF LAST RESORT

5. The RBZ is financially incapacitated and thereby unable to fulfil its traditional role as lender of last resort.
6. In the past - though this will likely change soon – government has been unwilling to issue Treasury Bills.

REVIVE INTERBANK LENDING

- Hopefully the TB market will be revived thereby paving the way for the RBZ to resume LOLR activities while freeing up liquidity currently frozen due to the absence of suitable collateral for inter-bank lending.

LARGE INFORMAL SECTOR

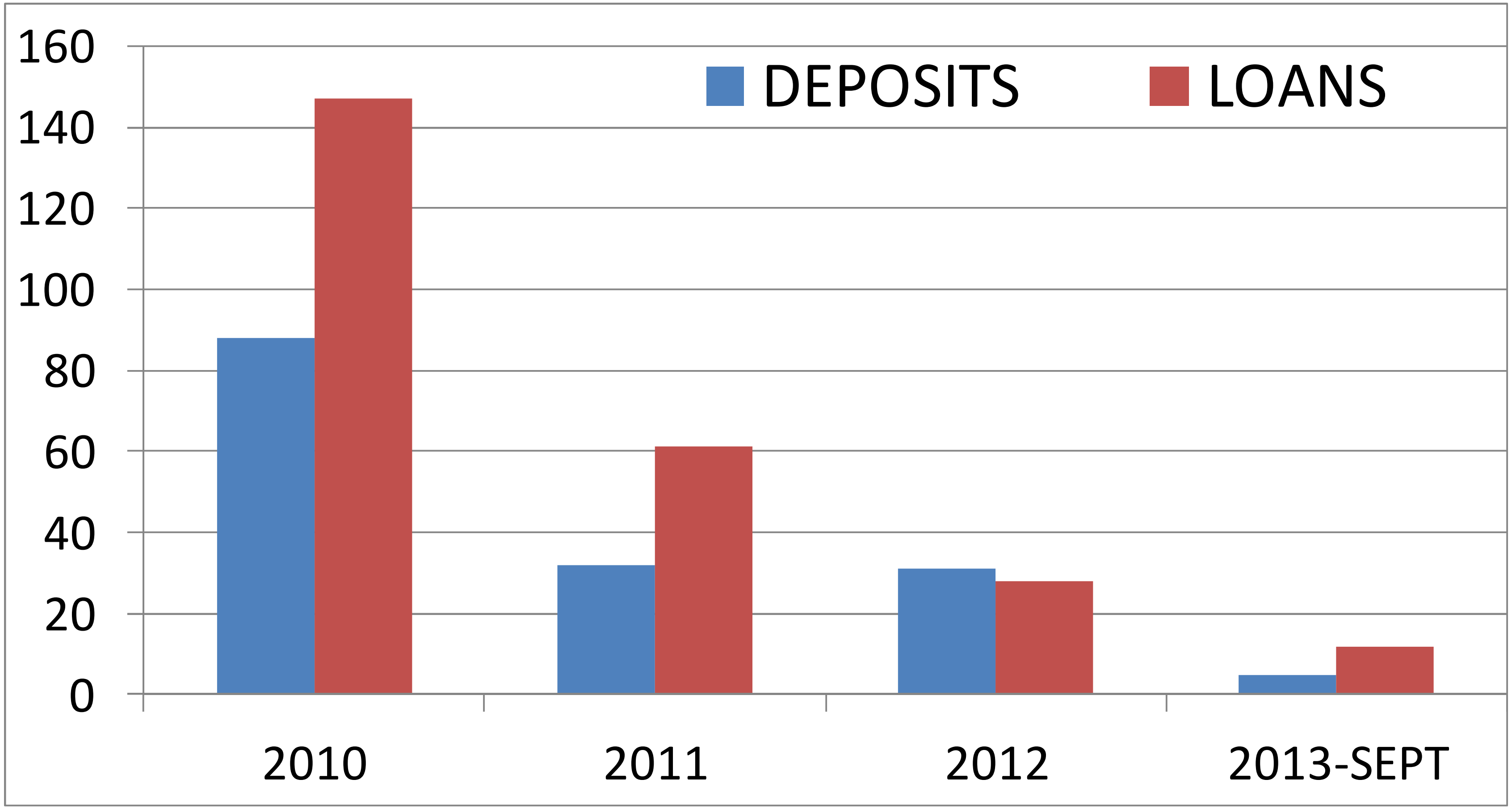
7. At least $2 billion in cash is outside the banking system in the informal sector.

- It is, if you like, that sector's working capital, so it is not 'idle' but it is not available for normal bank intermediation activity.

LIQUIDITY TIGHTENS

- Liquidity has tightened significantly in the last 3 years.
- The loans-to-deposits ratio has risen from 60% during 2010 to 82% at present.

GROWTH RATES (%): DEPOSITS & LOANS



- Tighter liquidity is partly explained by deposit growth stagnation as the balance-of-payments has worsened due to a 6% decline in export proceeds while imports rose 11%.

RESOLVING THE PROBLEM

NO QUICK FIX

- For the reasons just outlined there is no quick fix to the liquidity crisis.
- Unless and until we have some major changes to the economic environment - abroad as well as at home – the problem will remain.

THE SPECTRE OF DEFLATION

- Indeed, it may be that the liquidity crisis masks an even deeper malaise - the spectre of deflation,
- Prices rising at less than 1% annually, massive unemployment, sluggish growth and weak credit demand from bankable borrowers – all symptoms of deflation.

FUNDING NOT LIQUIDITY

- The fact is that the problems facing business extend well beyond liquidity.
- Investment levels are pitifully low – half or less than those needed to achieve 7% growth.
- This is a funding problem not a liquidity one.

FUNDING, NOT LIQUIDITY

- Firms as well as banks are – on the whole – undercapitalized, often operating with costly, obsolete plant and machinery.
- In industry this capital is ‘dead’ in the sense that it cannot be used as collateral against which new funding can be raised.

AGRICULTURE

- The same applies right across the agricultural sector, where thousands of farmers cannot borrow against their main asset, land, because they do not have secure property rights in the form of individual tenure.

THREE MISCONCEPTIONS

- Nor does it help that there are three widely-held misconceptions about the role of banks in this country.

1. They do not have money of their own to lend – only the money of their depositors that they have responsibility to manage wisely.

TRANSITORY DEPOSITS

2. Because they borrow short and lend long – 85% of deposits in this country are transitory - they cannot be a source of long-term risk capital but of short- and medium-term trade finance and working capital.

DEPOSITORS' MONEY

- Expecting banks with short term deposits to finance long-term, high-risk projects, is simply unrealistic.
- That is not what banks are supposed to do.
- They are not meant to take risks with their depositors' money.

DIFFERENT MARKET SEGMENTS

- Risk capital is not the same as bank lending – they are two very different segments of the financial market.
- Risk capital is sourced from stock markets, long-term lenders in the form of bonds and loans, venture capital firms, and increasingly these days, private equity investors.

PRIVATE EQUITY

- Private equity activity, both on the part of local investors and foreigners, is a partial answer.
- But, unfortunately, private equity funds are unlikely to be attracted so long as the indigenization law – in its current form – is in place.

Step in the right direction

- However, the mooted Cairns deal, which would give foreign private equity players seven years to indigenize fully (51% local ownership), is a significant step in the right direction .

3. Unlike manufacturing or agriculture, banks have very little spare capacity.

- They are fully loaned up – 82% of deposits are lent out.
- Yes – some banks are underlent, but others are overlent.

DEMAND SIDE

- In other words, we are facing both a demand-side problem and a supplyside one.
- On the demand side, we have weak cash-flow, under-collaterized, high risk, borrowers (especially SMEs) that desperately need longer-term funding.

SUPPLYSIDE

- Supplyside constraints include:

❑The balance-of-payments

❑The debt overhang

❑High levels of political/country risk

❑ A constrained central bank

❑ Loaned up banks, and

❑ A large unbanked informal sector

EXTERNAL IMBALANCES

- Getting beyond the liquidity problem is therefore a combination of:
- ❑ Strengthening the BOP to increase financial inflows of all kinds
- ❑ Boosting investor confidence both at home and abroad
- ❑ Increasing access to long-term offshore finance

RESTORING CONFIDENCE

- Restoring confidence in the banks and the currency (banishing the spectre of the return of the Zimdlr)
- Restructuring the financial markets with the growth of private equity funds, a strengthened stock market and greater access to institutional funding

GETTING BEYOND FINANCE

- Too many people in Zimbabwe – in business, government, academia, the media and the labour unions believe that economic development is about access to finance.
- While there is some truth in this, it is not the whole story.

INVESTMENT MUST RISE

- For the economy to grow at 7.3% annually - the Zim-Asset target – Zimbabwe will need to invest 33% (or so) of GDP each year.
- Since 2009, the investment-GDP ratio has averaged 15%, less than half of the amount needed.

HIGH CONSUMPTION ECONOMY

- This is not just a financial problem.
- Zimbabweans under-save and over-consume.
- Household consumption has averaged 88% of GDP since 2009 and, with government consuming 14% and not-for-profit bodies another 5%, consumption is 107% of GDP.

NEGLIGIBLE SAVINGS

- In other words savings are negligible.
- We cannot realistically expect – nor could we afford – to rely on foreign capital for finance.
- FDI averages 3% of GDP in Sub-Saharan Africa and aid grants another 1%.

REDUCE CONSUMPTION'S SHARE

- Including foreign borrowing, we might get some 15% to 20% of GDP in foreign funding.
- That would necessitate a switch of some 15% of GDP out of consumption into savings.

Consumer spending growth must slow

- Put another way around, if - and it is a very big if – GDP grows at 7.3% for 5 years, and the share of consumption falls to around 75% from 88%, consumer spending would grow by only 3% a year, compared with 20% annually since 2009.

INCONVENIENT TRUTH

- It is high time many in business factored that inconvenient reality into their calculations.
- If growth depends (heavily) on investment and investment depends (significantly) on savings, then consumption growth must slow substantially.

- Of course, there is much more to growth than investment.
- Going forward growth will be limited by a number of “binding constraints” that will make it extremely difficult to reach the Zim-Asset target.

BINDING CONSTRAINTS

- Electricity supply
- Savings - excessive consumption
- Balance of Payments
- Debt Overhang
- Investment climate – doing business conditions
- Overvalued exchange rate
- Other – non-power - infrastructure

- None of these is susceptible to a quick-fix solution
- All will take a minimum of 5 years, while the exchange rate issue is wholly exogenous – unless solved by changing the peg or bringing back the local currency.

EXTERNAL RELIANCE

- This highlights another set of constraints that are beyond our control.
- Today Zimbabwe is hugely externally-reliant.
- Exports are a third of GDP, imports over 60%.

STAGNANT METAL PRICES

- Net exports i.e. foreign funding, are 30% of GDP.
- Over 90% of exports are primary materials whose prices are set in global markets.
- Prices of metals (two thirds of exports) are forecast to stagnate over the next 2 to 3 years.

- Given the binding electricity constraint on mining volumes, the scope for increased volumes is limited, meaning that the immediate outlook (2014/15) for mineral exports is not great.

CAPITAL COSTS WILL STAY HIGH

- Zimbabwe’s dependence on foreign capital, at a minimum cost of 12% (7% notional required rate of return plus 5% country risk premium)
- Means that a project must return 15% to be bankable.

THE DOLLAR PROBLEM

- Should the US dollar strengthen – and there are good reasons to believe that it will – Zimbabwe, which is already a high-cost location for doing business, will become even more so.

POLITICAL REALITY

- This highlights a stark – Greek-style – reality.
- If a country is uncompetitive and it cannot devalue its exchange rate (Greece in the Euro area, Zimbabwe in the US dollar area) there is only one way out – internal devaluation.

INTERNAL DEVALUATION

- That means holding prices and wages below their rates of increase in trading partner nations, AND
- Raising productivity.
- Zimbabwe's official figures (that come with a health warning) show wages rising some 50% faster than productivity since 2009.

PLAYING CATCH-UP

- That is no surprise, since employees are playing (or trying to play) catch-up.
- That cannot continue.
- Wages must be tied to productivity, not to cost-of-living or worse to how many children an employee has at private schools.

NOT ON THE POLICY MENU

- Unfortunately, these twin realities:
- ➡The necessity of slowing consumption growth in favour of higher savings, and
- ➡ That of linking wage increases to productivity growth
- Are not visible on the radar screens of policymakers.

- Given that we have not created a single non-farm formal sector job since the 1980s – we still have 800 000 people employed in the non-farm formal economy, policymakers must shift their focus from higher wages to more jobs.

CONCLUSION

- Beyond the liquidity crisis, can Zimbabwe grow at over 7% annually as in Zim-Asset?
- For the record, the IMF puts our medium-term growth rate at 4% to 4.5%, while the World Bank's long-term scenario for all developing countries is 4.8%.

LOWERING EXPECTATIONS

- So Zimbabwe, which has done worse that emerging markets as a whole over the last 50 years, needs a paradigm shift.
- This must start by lowering – not raising – expectations and facing up to the harsh realities of the real world.