INTERNATIONAL MONETARY FUND

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ZIMBABWE

STAFF-MONITORED PROGRAM

July 2013

In the context of Zimbabwe – 2013 Staff Report for the Staff-Monitored Program, the following document has been released:

- **Staff Report** for Zimbabwe – 2013 Staff-Monitored Program, prepared by a staff team of the IMF, following discussions that ended on March 1, 2013, 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 June 10, 2013. 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.

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International Monetary Fund
Washington, D.C.

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EXECUTIVE SUMMARY

Zimbabwe made considerable progress in stabilizing the economy since the end of the hyperinflation period in 2009. However, policies deteriorated in 2011 and early-2012, with large wage increases crowding out priority infrastructure and social spending. This, combined with significantly lower-than-expected diamond revenue in 2012, resulted in fiscal stress, including accumulation of domestic arrears. In addition, rapid credit growth combined with slow implementation of financial sector reforms, has exacerbated financial sector vulnerabilities.

The authorities have adopted a comprehensive adjustment and structural reform program to restore fiscal and external sustainability, and strengthen financial sector stability. Fiscal consolidation efforts target to move the primary balance from a deficit in 2012 to a surplus over the medium term, while protecting priority social spending, increasing fiscal space and allowing for a gradual rebuilding of international reserves. Strong emphasis will also be placed on structural reforms to strengthen public financial management (payroll and human resource management); increase transparency in the diamond sector; and strengthen financial sector regulation and oversight.

In the staff's judgment, the authorities' program is sufficiently strong and therefore capable of achieving its targets. If successfully implemented, the policies in the program could lay the foundation for increased fiscal and external sustainability, and reduce financial sector vulnerabilities, helping Zimbabwe build a track record of sound policy towards a future Fund-supported program. The SMP could be an important step on the road towards normalization of Zimbabwe's relations with its creditors, and could help mobilize valuable donor support for the authorities' arrears clearance strategy. The program has been endorsed by the cabinet, a strong signal of their commitment.

There are risks associated with the program. Risks stem mainly from a challenging political environment with national elections likely in the second half of 2013, which could complicate the pace of reforms and increase the risk of policy slippages. There are also risks of financial sector instability arising from weakly capitalized banks and the absence of a lender of last resort facility; and from the pace of the global economic recovery, which would affect the demand for and prices of key exports. The authorities are committed to responding should exogenous shocks materialize.

Approved By
Anne-Marie Gulde-Wolf, AFR and Vivek Arora, SPR
Prepared By
African Department

Discussions took place in Harare from October 31 to November 13, 2012. The mission met with the Finance Minister Biti; Reserve Bank of Zimbabwe Governor Gono; other senior government officials; representatives of the donor community, and the private sector. There was a follow-up mission February 25–March 1, 2013, and further discussions were held during the 2013 Spring Meetings in April. The staff team comprised Mr. Cuevas (head), Ms. Morgan and Mr. Slavov (AFR), Ms. Lis (FAD), Mr. Narita (FIN) and Mr. Cipollone (SPR).

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BACKGROUND

1. **In September 2012, the Executive Board concluded the 2012 Article IV consultation with Zimbabwe.** Directors welcomed Zimbabwe's continued improvement in cooperation with the Fund on policies and on payments to the Poverty Reduction and Growth Trust (PRGT).[1] Directors viewed such cooperation as allowing for the lifting of relevant technical assistance (TA) restrictions, and making it possible to advance towards discussion of a staff-monitored program (SMP) to support Zimbabwe's reform efforts. Directors stressed the importance of strong implementation of measures announced in Zimbabwe's July 2012 mid-year budget review to address policy slippages, and a credible commitment to comprehensive reforms before embarking on an SMP.

2. **On October 23, 2012, the Executive Board relaxed most restrictions on TA to Zimbabwe, opening the way for an SMP.[2]** At the review of Zimbabwe's Overdue Financial Obligations to the PRGT, the Board approved, *inter alia*, the resumption of TA in certain new areas to support Zimbabwe's formulation and implementation of a comprehensive adjustment and structural reform program that can be monitored by Fund staff.

3. **The authorities have requested staff assistance in monitoring their adjustment program (Appendix 1, Attachment 1).** Against the background of a challenging economic environment and existing capacity constraints, the authorities have requested Fund TA in designing and monitoring the implementation of their adjustment strategy. The authorities regard an SMP as important to strengthen their macroeconomic stabilization efforts, support their reform program, and re-engage with the international community. The SMP plays a crucial role in re-engaging with the international community and donors, following more than a decade without an IMF program, including by helping to establish a track record of cooperation with the IMF on policies and payments that can signal to creditors and donors the member's commitment to a credible and sound policy framework. The successful completion of the SMP could be a first step towards a comprehensive normalization of relations with creditors.

RECENT DEVELOPMENTS

4. **The pace of growth is moderating after a period of strong rebound (Figure 1).** GDP growth is estimated to have moderated from 10½ percent in 2011 to around 4½ percent in 2012, with strong growth in mining offset by a poor agricultural season, power shortages, and the slow pace of economic reforms. Consumer price inflation was well contained at around 3 percent at

[1] See *Zimbabwe—Staff Report for the 2012 Article IV Consultation* (SM/12/240, 9/10/12, Correction 1; 9/20/12).

[2] See *Zimbabwe—Review of Overdue Financial Obligations to the PRGT (EBS/12/133)*.

end- March 2013, helped by a moderation in global food and fuel prices and an appreciation of the US dollar against the South African rand.[3]

5. Food security is a concern after the bad agricultural season. Drought conditions experienced during the latter part of the 2012/13 agricultural crop season (particularly in the southern parts of the country) and limited supply of fertilizers resulted in poor harvests for a number of crops, including maize—the country's main staple. An estimated 1.4 million people are receiving assistance from the authorities and humanitarian agencies.

6. Zimbabwe's external position remains precarious, despite some recent narrowing of the current account deficit (Figure 2). The trade deficit decreased in 2012, mainly reflecting lower imports (following a one-off spike in 2011). While exports of diamonds, gold and tobacco continued to increase, exports of manufacturing declined substantially. Overall, the current account deficit declined from 37 percent of GDP in 2011 to 23 percent of GDP in 2012. The current account deficit was financed mainly by capital inflows in the form of private short-term debt. Errors and omissions remain large, reflecting difficulties gathering comprehensive data on exports, remittances and financing. After a drawdown of SDR holdings, usable international reserves fell further to about one week of imports of goods and services at end-2012. The trade deficit widened by $74 million (⅔ percent of GDP) in January-March 2013, relative to the 2012 period, as imports grew by 4 percent—driven mainly by consumer goods, fuel and motor vehicles, while exports declined by ½ percentage point.

7. Zimbabwe remains in debt distress with total external debt estimated at 88 percent of GDP at end-2012, of which 50 percent of GDP is in arrears (Figure 2). The external arrears continue to stifle economic growth by limiting the country's access to new financing. Zimbabwe's arrears to the PRGT have declined since 2011, thanks to repayments of SDR 5.5 million ($8.2 million), and as of end-May 2013 stood at SDR 82.1 million ($123 million). Zimbabwe's largest creditors are the World Bank Group ($994.2 million as of end-May 2013) and the African Development Bank (AfDB; $592.3 million as of end-April 2013).

8. The public finances continued to face headwinds in the second half of 2012. Fiscal slippages in the first half of 2012 could not be fully offset by the policy measures announced in July 2012, which included a hiring freeze, suspension of diamond-revenue-financed projects, and increased excises on fuel. As a result, capital expenditure was further squeezed by $133 million (1½ percent of GDP). Total revenue and expenditure for 2012 is estimated at about 35¾ percent of GDP and 37¼ percent of GDP, respectively, resulting in an overall fiscal deficit of some 1½ percent of GDP (Figure 3). This represented a contraction in the fiscal deficit of about 1½ percent of GDP

[3] Recent analytical work by Fund staff (Appendix II, IMF Country Report No. 12/279, and subsequent work) suggests that South African CPI and PPI inflation are among the best predictors of domestic CPI inflation in Zimbabwe, as around half of Zimbabwe's imports come from South Africa. For the same reason, movements in the rand/U.S. dollar exchange rate can also influence CPI inflation in Zimbabwe.

compared with 2011. The deficit was financed by a drawdown of SDRs, a small amount of domestic debt issuance (3-month T-bills)[4] and accumulation of external and domestic arrears.

9. Fiscal pressures persisted in the first quarter of 2013, despite higher than projected revenue (Text Table 1). Total revenue amounted to $838 million, 2 percent higher than projected, of which tax revenue accounted for $804 million, due mainly to higher VAT, PAYE and excise duty. Continued underperformance of diamond dividends resulted in an $11 million shortfall in nontax revenue. Total expenditure (cash basis) during the first quarter is estimated at $863 million, 4½ percent above projection, reflecting higher than budgeted cost of the constitutional referendum, travel expenses and employment costs, partially offset by lower capital and social expenditure. This resulted in a primary deficit of $13 million and an overall cash deficit of $25 million.

Text Table 1: Zimbabwe: Central Government Operations
Jan-March 2013
(Millions of U.S. dollars)

	Projected Q1 2013	Actual Q1 2013
Total revenue	**825**	**838**
Tax revenue	780	804
Non-tax revenue	45	34
Total expenditure & net lending	**815**	**858**
Of which: Cash expenditure	*818*	*863*
Current expenditure	756	787
Of which: Referendum costs	25	41
Capital expenditure and net lending	59	49
Overall balance (commitment basis)	**10**	**-20**
Overall balance (cash basis)	**7**	**-25**
Primary balance (cash basis)	16	-13
Financing	**-10**	**20**
Domestic financing (net)	16	57
Foreign financing (net)	-31	-70
Change in arrears	6	33

Sources: Zimbabwean authorities; and IMF staff estimates.

10. The authorities took actions to mitigate the domestic payment arrears situation. As of end-September 2012, the authorities had a stock of *unverified* domestic payment arrears of $277 million (Text Table 2). There were cross arrears problems, with the central government owing utilities companies for services received, and the companies owing taxes to the Zimbabwe Revenue Authority (ZIMRA). A partial clearance of these mutual overdue obligations was achieved in December with the support of a $100 million short-term bridge loan intermediated by a domestic bank,[5] with ultimate funding from the African Export and Import Bank (Afreximbank). Despite this operation, some new bills went unpaid in the close of the year, so that as of end-December 2012, the stock of *unverified* domestic payment arrears had fallen only to $211 million, of which $169 million have been verified. This comprised overdue obligations to service providers, seed and fertilizer suppliers, and contractors of capital projects. The verification process to determine domestic arrears at end-December 2012 is scheduled for completion in mid-2013.

Text Table 2: Government Domestic Payment Arrears

	2012				
	End-Sept. stocks (unverified)	End-Sept. stocks (verified)	Net flows	End-Dec. stocks (unverified)	End-Dec. stocks (verified)
	(in million $)				
Goods and Service Providers 1/	205	114	-36	169	127
Agricultural Input Suppliers 2/	40	40	-9	31	31
Capital Certificates 2/	0	0	11	11	11
TOTAL	245	154	-34	211	169

Source: Ministry of Finance and IMF staff estimates

1/ Payments are in arrears if they have not been made within 60 days after invoice receipt.
2/ Payments are in arrears if they have not been made within 90 days of the date of the invoice.

4 Prior to this, government securities were last issued in 2008.

5 The bank is the CBZ, the largest bank, and also the bank used by their government for its fiscal operations.

11. Banking sector vulnerabilities persist despite measures to further strengthen prudential requirements and address systemic liquidity (Figure 4). Deposit growth has slowed—in line with the economy and partly reflecting the impact on confidence of a number of bank failures in mid-2012. Growth in credit to the private sector has also slowed, but less markedly, so the loan-to-deposit ratio rose to 95 percent at end-December, up from 90 percent at end-June 2012.

12. A number of small banks remain weakly capitalized with poor quality loan portfolios, reflecting unsound lending practices, poor risk management and weak corporate governance (Figure 5). The level of NPLs is high and unevenly distributed across banks. Overall NPLs stood at 14 percent at end-December, up from 12 percent at end-June. The high levels of NPLs mainly reflect unsound lending practices, including cases of insider and related party loan exposures, weak corporate governance, and poor risk management. The highest levels of NPLs are concentrated in a few small weak banks, most of which are already under "special status".[6] In August 2012, the RBZ announced a steep increase in the minimum capital requirement for banks, from $12.5 million to $100 million over a two-year period, which was expected to stimulate a consolidation and strengthening of the banking sector, which includes a large number of small weakly capitalized banks. Fourteen (14) banks met the December 2012 $25 million minimum capital requirement; five banks had made significant progress towards compliance, and the remaining two banks submitted recapitalization plans that needed improvement to be considered credible.[7] The RBZ is working closely with weakly capitalized banks. Liquidity remains low and unequally distributed across banks, with 9 of the 22 operating banks below the 30 percent prudential liquidity ratio at end-December 2012.[8] To address the systemic liquidity challenges and the absence of appropriate instruments for use as collateral to facilitate interbank trading, the authorities reintroduced T-bill auctions in October 2012. There were four auctions between October and November, with only one successful issuance.

13. In November 2012, the government announced in its budget the intention to moderate large differentials between banks' deposits and lending rates,[9] and high service fees. Following intense negotiations between the RBZ and the Bankers Association of Zimbabwe, an agreement was reached on a framework for moderating interest rate margins and bank service fees. The corresponding Memorandum of Understandings (MOU), signed on January 31, 2013, went into

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[6] These banks are on the RBZ's "watch list:" they have been given letters of warning, and are required to undertake mandatory remedial actions and to provide the RBZ with frequent updates. The list also includes Interfin Bank which was placed under curatorship in mid-2012.

[7] The 22 operating banking institutions include the Post Office Savings Bank (POSB). However, POSB is exempt from the minimum capital requirement given its limited functions.

[8] The RBZ raised the prudential liquidity ratio in two steps from 25 percent to 30 percent by end-June 2012.

[9] Deposit rates ranged from 0-24 percent; and lending rates from 3-35 percent.

effect in March. The MOU envisions regular reviews of the measures and their impact on individual banks and the sector as a whole. [10]

OUTLOOK AND RISKS

14. Under the program scenario, GDP growth is projected to recover somewhat in 2013 and stabilize around 5½ percent in the medium term (Figure 6). Growth is expected to be driven by a continued expansion in mining. Inflation is projected to average 4.3 percent in 2013, reflecting temporary pressures stemming from possible speculative price increases ahead of the elections, as well as expected inflation in South Africa; and to stabilize around 4 percent over the medium term.[11] The current account deficit is projected to gradually decline, and prudent fiscal policy should allow for a modest but steady rebuilding of external buffers.

15. Significant downside risks to the outlook remain. These include the possible resurgence of political instability ahead of the elections expected in 2013,[12] policy slippages, a deeper global downturn, fluctuations in global commodity prices (especially for precious metals and stones), a possible reduction in agricultural production again in 2013 owing to reported erratic rains—which are causing flooding in some regions—and weaknesses in the financial sector, which might lead to further tightening of credit conditions.

[10] The MOU makes provision for quarterly reviews by a Standing Committee comprised of the RBZ, the Bankers Association of Zimbabwe and the Ministry of Finance. However, a review meeting can be called at anytime, if the need arises.

[11] Medium term forecasts would imply a mild real exchange rate appreciation for Zimbabwe (assuming, among other things, a roughly constant real exchange rate of the rand), which would be broadly consistent with equilibrium. The main risk to competitiveness would come from pressures to increase wages in the economy ahead of productivity gains.

[12] The three political parties agreed on a new constitution in January 2013, which was ratified at the March 16th constitutional referendum. Once parliament votes on the new constitution, national elections are expected to follow in the second half of 2013.

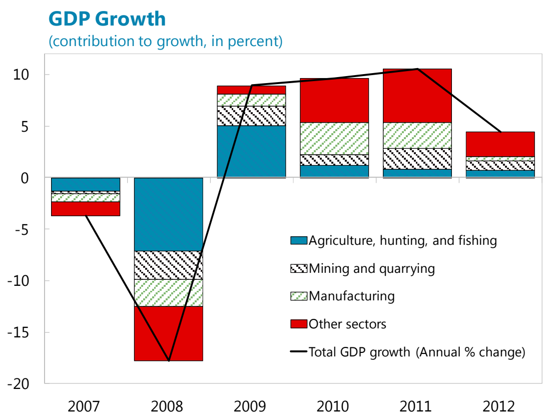
Box. 1: Zimbabwe Constitution-Making and Election Process

After long and difficult negotiations, on January 17, 2013, the principals to Zimbabwe's Global Political Agreement (GPA) — ZANU-PF, MDC-T and MDC— agreed on a new constitution.[1] The final draft of the constitution was tabled in Parliament on February 6. A constitutional referendum was held on March 16, with an overwhelming majority of the votes supporting adoption of the new constitution. The draft constitution went back to Parliament as the Constitution Bill and was passed by the House of Assembly on May 14 and by the Senate on May 15. The Constitution Bill was signed into law by President Mugabe on May 22 and gazetted on May 22, 2013. This paves the way for the holding of harmonized elections. The date for national elections is yet to be announced, but elections are expected to take place no later than October.

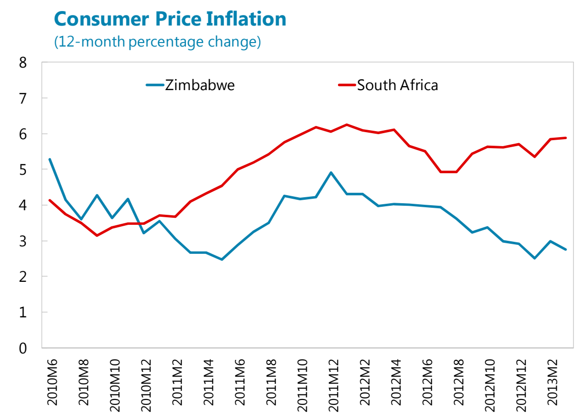
[1] Article VI of the GPA sets out a broad framework to be followed in the constitution-making process.

Figure 1. Zimbabwe: Recent Economic Performance

Economic growth decelerated in 2012, due mainly to droughts and power shortages.



Inflation remains low since dollarization and is broadly in line with major trading partners.

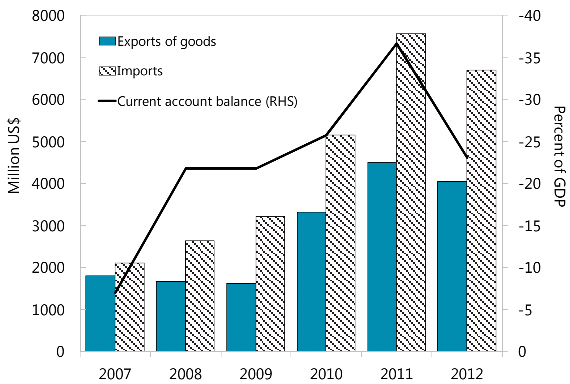


Sources: Zimbabwean authorities and IMF staff estimates.

Figure 2. Zimbabwe: External Sector Performance

The current account deficit fell in 2012, due mainly to lower imports following a one-off spike in 2011.

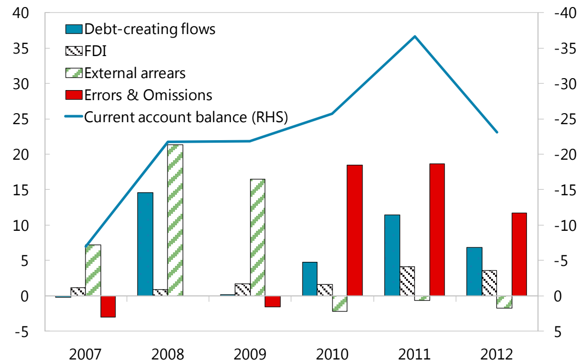
Current Account, Exports and Imports[1/]



External financing has come to rely more on private sector debt inflows and large flows remain unregistered. [2/]

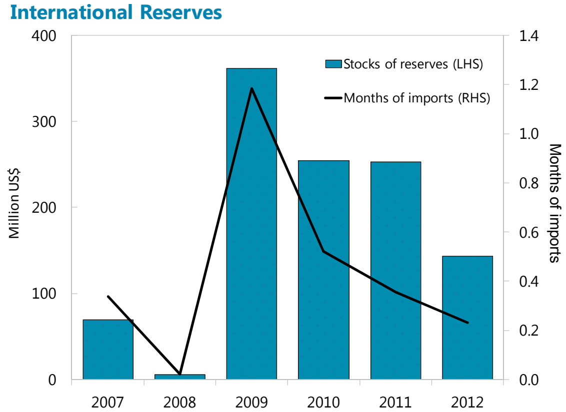
Current Account and Financing

(percent of GDP)



International reserves continued to decline…

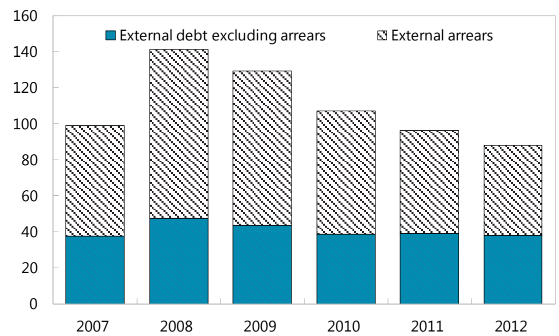
International Reserves



…and the external debt remained unsustainably high.

External Debt [3/]

(percent of GDP)

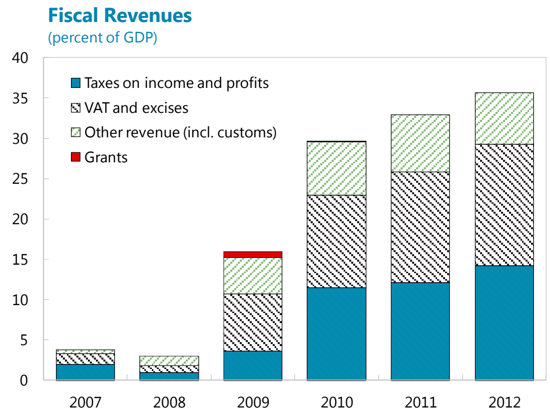


Sources: Zimbabwean authorities and IMF staff estimates.

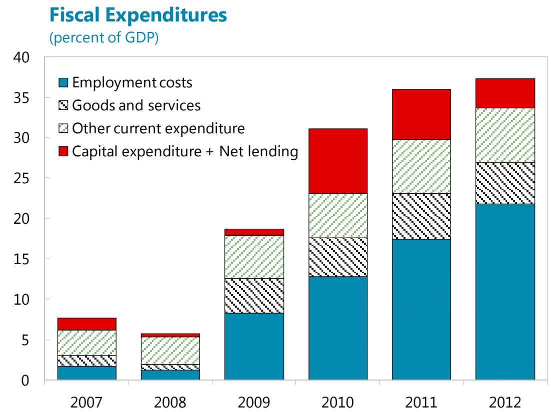
1/ Structural break in trade data in 2010. Exchange control data are used up to 2009 and customs data are used starting in 2010.
2/ These unregistered flows are likely related to unregistered remittances and exports, which would lower the current account deficit.
3/ Debt stocks and arrears are estimates, except for the 2011 debt stock which is based on preliminary results from the authorities' external debt reconciliation exercise concluded in January 2013.

Figure 3. Zimbabwe: Recent Budgetary Performance

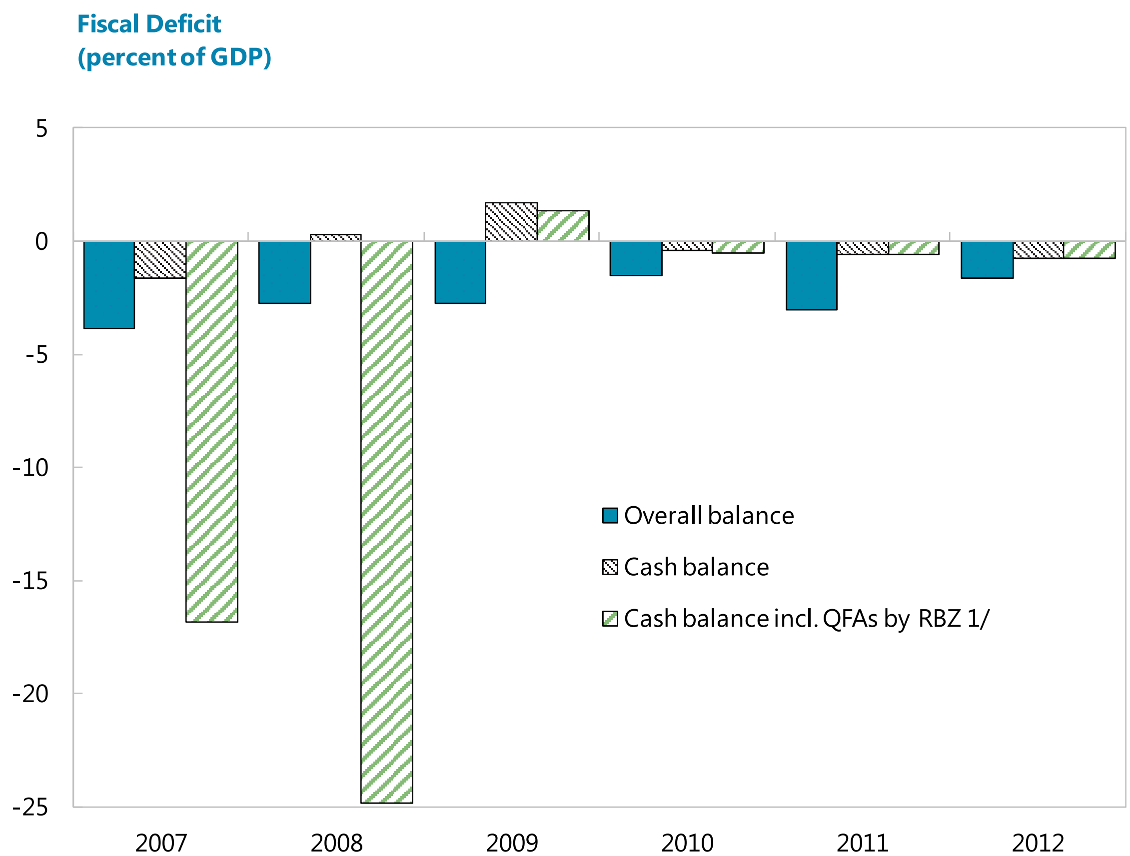
While revenue collection improved…



…employment costs continued to grow, crowding out capital and social expenditures.



A cash deficit emerged since 2010, financed mainly by arrears and SDR sales.

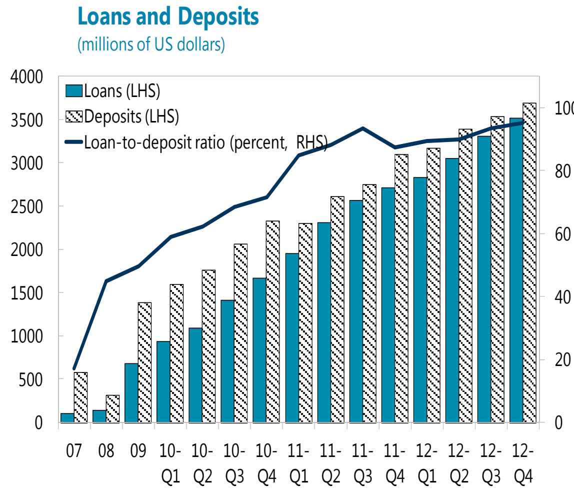


Sources: Zimbabwean authorities and IMF staff estimates.

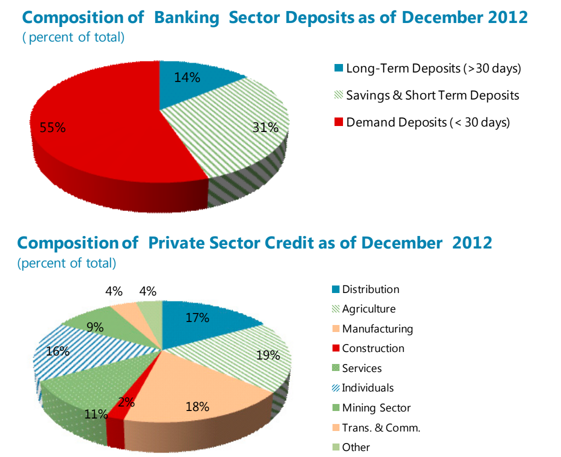
Note: Quasi-fiscal activities (QFAs) by the Reserve Bank of Zimbabwe (RBZ) include election-related expenses, transfers to parastatals, subsidized direct lending, below-cost provision of equipment and fertilizers to farmers, and allocation of foreign exchange at subsidized exchange rates.

Figure 4. Zimbabwe: Banking System Indicators

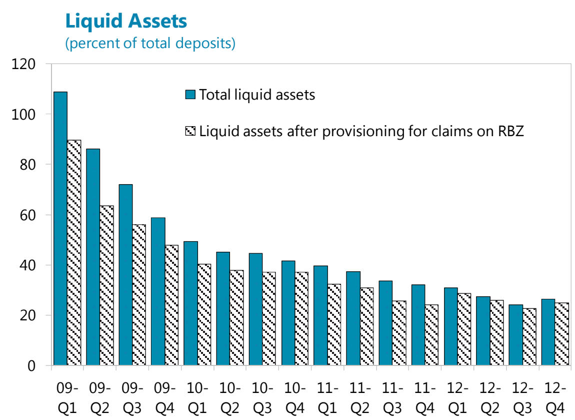
Deposits and credit continued to grow, but the pace slowed.



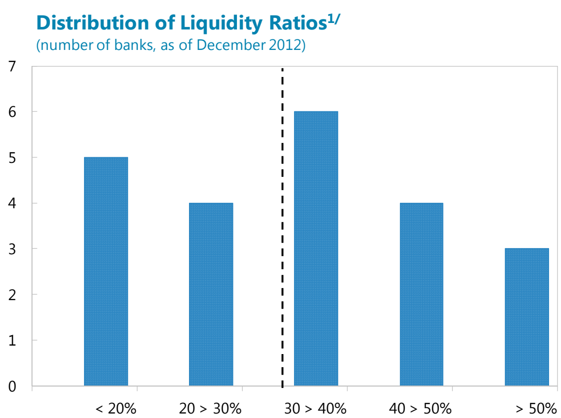
Deposits remained predominantly short-term and credit largely funded consumption.



Liquidity risks remained…



…as 9 out of 22 operating banks faced tight liquidity.

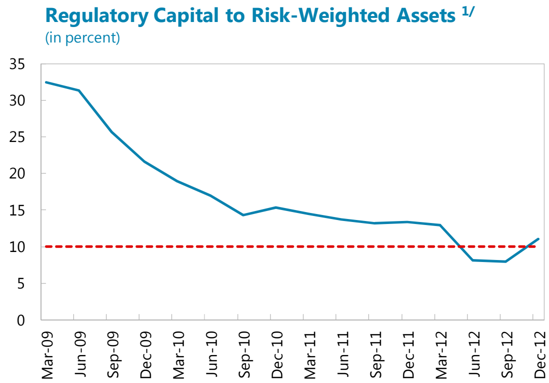


Sources: Zimbabwean authorities and IMF staff estimates.

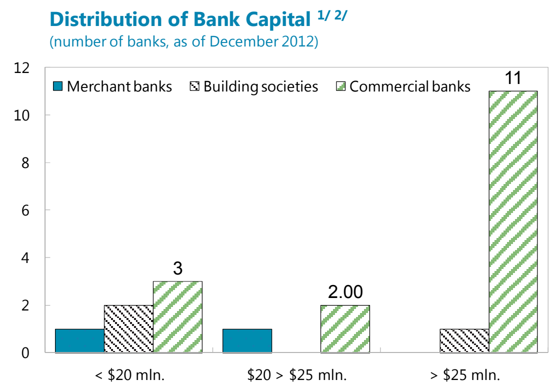
1/ The ratio of liquid assets to short-term liabilities. Liquid assets are defined as cash, claims on nonresident banks, interbank claims, and clearing balances at the RBZ. Illiquid claims on the RBZ are excluded. Short-term liabilities comprise all deposits, interbank liabilities, and liabilities to nonresidents. The prudential liquidity ratio was increased from 25% in March 2012 to 30% in June 2012.

Figure 5. Zimbabwe: Banking System Performance and Soundness

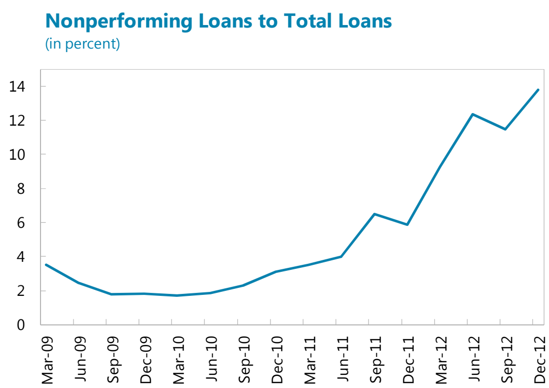
Banking system capital began to recover but still remained low…



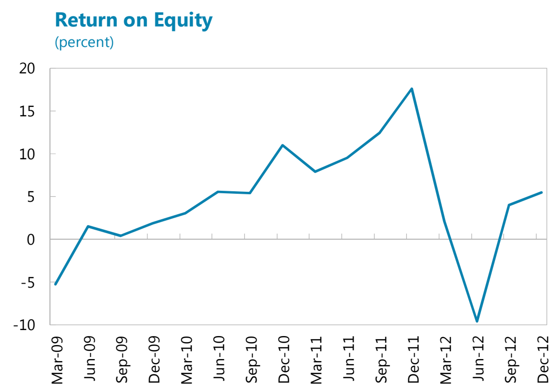
…and solvency remained an issue in a number of small banks.



Assets quality has deteriorated with high and rising levels of NPLs…



…this, in addition to the economic slowdown, has impacted bank profitability.

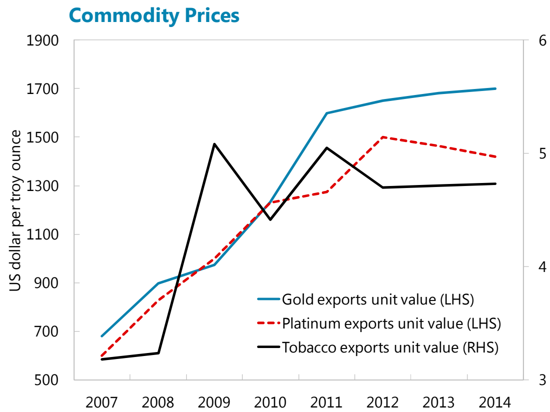


Source: Reserve Bank of Zimbabwe.

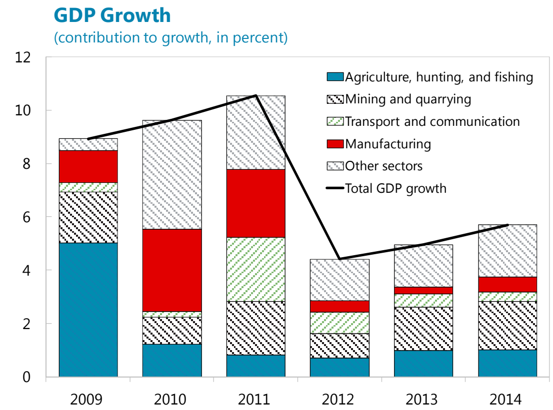
1/ Illiquid claims on the RBZ count toward capital.
2/ As of end-December 2012, minimum capital requirements are US$25 million for commercial banks and building societies, and US$20 million for merchant banks.

Figure 6. Zimbabwe: Program Scenario

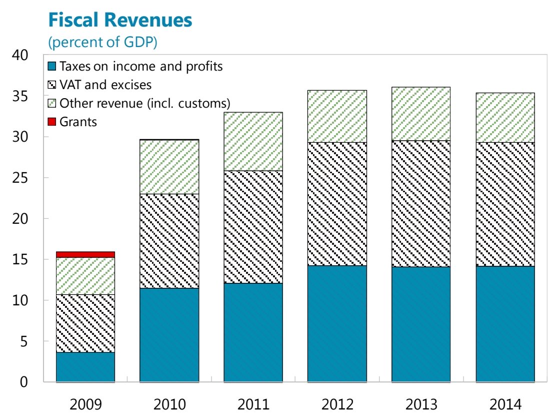
The prices of Zimbabwe's main exports are expected to stabilize at high levels.



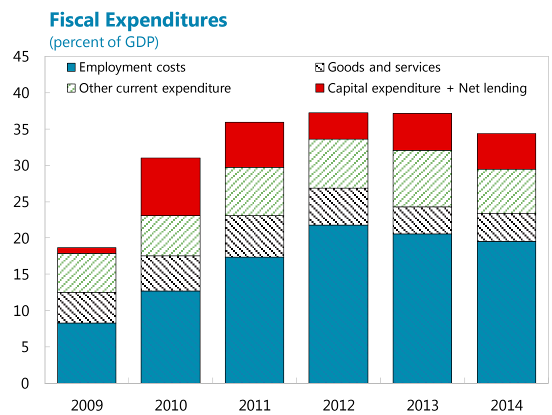
The economic rebound is expected to moderate.



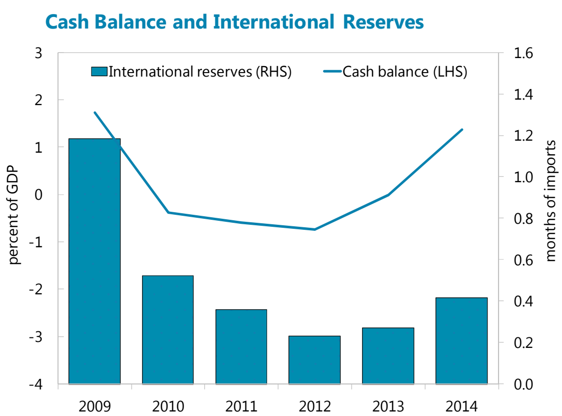
As fiscal revenues are projected to stagnate...



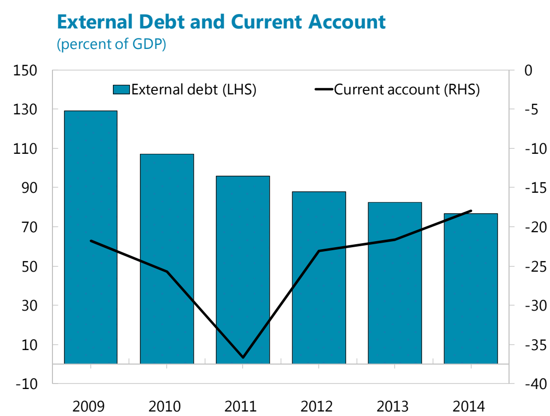
...expenditures need to be curtailed, especially by containing high employment costs.



The resulting cash surplus will allow for the re-building of appropriate buffers against external shocks...



...but the large current account deficit will persist and external debt will remain unsustainable. 1/



Sources: Zimbabwean authorities and IMF staff estimates.

1/ Debt stocks include arrears and are estimates, except for the 2011 debt stock which is based on preliminary results from the authorities' external debt reconciliation exercise concluded in January 2013.

THE STAFF-MONITORED PROGRAM FOR 2013

16. The authorities' SMP focuses on Zimbabwe's key macroeconomic challenges—taking steps to improve fiscal and external sustainability, and increase financial sector stability. The main objectives of the SMP are to: (i) strengthen fiscal sustainability by ensuring expenditure is kept in line with fiscal revenues, protecting investment in infrastructure and priority social spending, and gradually clearing outstanding domestic arrears; (ii) begin rebuilding international reserves; (iii) increase financial sector stability by implementing financial sector reforms and tightening the regulatory framework; and (iv) advance the structural reform agenda, including in the areas of PFM, tax policy and administration, and increasing transparency in diamond revenues (Memorandum of Economic and Financial Policies (MEFP, ¶15).

A. Restoring Fiscal Sustainability and Strengthening Fiscal Management

17. Strengthening fiscal sustainability and budget execution through a strong 2013 budget is at the core of the SMP. The 2013 budget submitted to parliament in November 2012 aimed to strengthen fiscal management and sustainability with an expenditure program in line with a realistic revenue forecast.[13] The budgeted revenue projection of $3.86 billion is consistent with tax and nontax collections observed in 2012 (adjusted for one-time effects[14]), the projected nominal GDP growth in 2013, a prudent projection of diamond dividends, and an increase in some excise taxes.[15] Increased excise duties on beer and cigarettes are expected to yield about ⅕ percent of GDP in additional revenue. The fiscal path would see the primary balance—the SMP's fiscal anchor—moving from a deficit of some ½ percent of GDP in 2012 to a small surplus of 0.2 percent of GDP in 2013, on a cash basis. The targeted primary surplus, combined with projected net loan disbursements, would allow the buildup of a small fiscal buffer and international reserves of $30 million.[16] In addition, to strengthen fiscal sustainability the program includes measures to monitor and prevent new accumulation of domestic arrears.

18. Budgeted expenditures are consistent with the available resources. Total expenditure, on a cash basis, is budgeted at $3.93 billion (35¾ percent of GDP) in 2013. The authorities granted a 6 percent average wage increase to civil servants for 2013 and introduced a rural allowance to attract civil servants to remote locations. While the increase was above the 5.5 percent increase announced in the budget,[17] it was significantly lower than the 15 percent average wage increase in 2012. The authorities do

[13] The budget was presented to the parliament on November 15, 2012 and approved in December 2012.

[14] These include $40 million for licensing fees and $75 million from compliance efforts.

[15] The Budget also establishes specific uses for any diamond dividends in excess of the amount included in the budget's resource envelope. The authorities would seek the corresponding appropriation by parliament in the 2013 mid-year review.

[16] International reserves would be built up by partially reconstituting Zimbabwe's SDR holdings.

[17] The budget proposal of 5.5 percent was motivated by the objective of ensuring a moderate increase in the real value of the salary. Agreements between the unions, and the government were completed in January 2013, two months after the 2013 budget was announced, but were retroactive to January 1. The authorities have committed to

(continued)

not intend to grant additional increases in 2013. The authorities also plan to maintain the hiring freeze which started in July 2012, while allowing for the filling of vacancies for critical positions on a case-by-case basis. These measures are projected to place the wage bill on a downward path, relative to GDP and government revenue, after several years of increases in these ratios. Within the limited fiscal space, the program seeks to provide for inflation-related adjustments in key social spending programs and establish a floor on high-value and high-impact capital projects and social spending in the amount of $145 million, including the Basic Education Assistance Module (BEAM), harmonized cash transfers, preventive health programs, drought mitigation, and community recovery (MEFP, ¶18).

19. Additional resources are being mobilized for elections. The cost of the constitutional referendum was about $53 million, while the funding requirements for the general elections are estimated at $120 million. Thus, a total financing need of some $175 million has been estimated, against a provision of only $25 million in the budget. To complete the financing, the excise duty on fuel was increased by $0.05 per liter for a period of 10 months, which is expected to yield about $50 million in revenue; and $40 million in one-year treasury bills were issued to domestic non-bank financial institutions in March; in addition, a substantial portion (at least $50 million) of the revenue from mobile phone operating licensing fees[18] due in June can be directed to fund the elections. Thus, the government expects to be able to cover most of the election costs with its own resources, albeit some cash-flow timing issues remain, as a fraction of the election costs would be incurred in the second quarter of the year. To avoid any funding gap, the authorities have approached development partners for assistance, applying to the UNDP to help coordinate this support—although so far it has proved difficult to find a formula that will permit the UNDP to perform this function. The authorities have also requested SADC to contribute towards the financing of the elections.

20. As a contingency plan, the authorities have also obtained approval from cabinet for additional revenue measures. These are estimated at some $50 million. The authorities also laid out plans for moderate additional borrowing from domestic financial markets in the form of treasury bills, although they do not expect that these actions will prove necessary.

21. The overall budget deficit and upcoming amortization will be financed mainly by nonconcessional foreign borrowing. A China Eximbank loan contracted in 2011 for the purchase of medical equipment in the amount of $90 million (1 percent of GDP) is expected to be disbursed in 2013. The authorities would continue to accumulate external arrears as amortization and interest payments come due, but plan to repay domestic debt ($130 million or 1¼ percent of GDP) covering maturing government securities and the short- term bridge loan intermediated by a domestic bank which was used to help clear some domestic arrears. They also intend to service some external debt

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one wage increase per year, which already took place in January 2013. Hence, no further wage increases are expected during 2013.

[18] Two mobile phone voice and data operating licensing fees are due in June. The authorities are currently in discussion with the mobile operators on the fees.

and to make payments to the PRGT and to other multilateral creditors as explained below. The re-engagement with international community, in particular traditional donors, would facilitate access to grants and concessional financing, which are the best option to support investment in a country in debt distress.

22. The authorities are committed to gradually re-accumulating international reserves. The authority's strategy is to generate cash surpluses to help rebuild fiscal and external buffers which have been reduced in the past two years. This would contribute to a gradual buildup of the international reserves position, from a very low level.

B. Increasing Financial Sector Stability

23. The authorities are implementing measures to further enhance the financial sector's legal and regulatory framework and reduce vulnerabilities. Recent bank failures highlighted persistent vulnerabilities in the financial sector stemming from weak capitalization, low liquidity, poor asset quality and related-party exposures, persistent losses and weak corporate governance and internal control deficiencies. The authorities intend to implement measures to further increase financial stability, including: amending the Banking Act (structural benchmark) to improve oversight and surveillance and strengthening the Troubled Bank Resolution framework; developing a framework for contingency planning and systematic crisis management (structural benchmark); establishing an independent banking ombudsman; enhancing coordination among the financial sector regulatory bodies; facilitating the establishment of a credit bureau; and enhancing the AML/CFT framework (MEFP, ¶28-30).

24. The authorities are cognizant of the need to resolve the problem of high levels of NPLs in the banking sector. The NPL problem is in the worst cases one of resolving troubled institutions, and in others, one of addressing underlying weaknesses to allow viable banks to gradually reduce NPL ratios through write-offs, work-outs, and growth. Sorting out the NPL situation would improve the capacity of the banks to ensure sustainable growth in private sector credit, and enhance financial sector stability. To this end, Fund technical assistance has been requested to assist in designing a comprehensive approach to the problem.

25. Advancing the restructuring of the RBZ will enhance financial sector stability (Box 2). The authorities plan to submit the amended RBZ Debt Bill to parliament by the second review (structural benchmark). These amendments will provide for the transfer of the noncore assets and liabilities from the RBZ balance sheet to a special purpose vehicle managed by the Ministry of Finance (MEFP, ¶32).

26. The RBZ has stressed that priority should be given to financial stability in the design and implementation of the indigenization of the banking sector. While expressing support for indigenization in general, the RBZ Board and management have emphasized that all laws, rules and regulations aimed at ensuring financial stability need to be upheld under any efforts to proceed with indigenization of the banking system. Given "fit and proper" requirements for investors and managing partners in the banking system, the RBZ is of the view that in the banking system indigenization cannot rely on simple equity transfer operations such as those that have been proposed for other sectors of the economy, and has called for alternative approaches to be designed. These could include measures such as mobilization of credit in support of indigenous firms and procurement preferences for indigenous suppliers.

Box 2. The RBZ Balance Sheet Weakness

In early-2010, the RBZ Amendment Act was enacted, restricting quasi-fiscal activities and strengthening accountability requirements. Prior to 2009, extensive quasi-fiscal activities and weak corporate governance resulted in a significant deterioration of the RBZ balance sheet, resulting in a negative equity position of some $1.2 billion (12 percent of 2012 GDP). Creditor actions have claimed many assets of value held by the RBZ or its subsidiaries; and in 2012, some of the commercial banks' claims on the RBZ were exchanged by newly-issued government bonds. With its very limited income generating capacity, the RBZ's operating costs are funded by budgetary grants and occasional asset sales.

The RBZ's impaired balance sheet has constrained its ability to undertake its core functions—including as a lender-of-last-resort, exacerbating financial sector vulnerabilities. However, the lack of fiscal space and the absence of functional debt markets limit the options for recapitalizing the RBZ.

Fund TA recommendations since 2010 have included the "bifurcation" of the RBZ's balance sheet—a process that would transfer noncore assets and liabilities to a special purpose debt resolution entity. After that the RBZ would probably still need budgetary resources to fully cover operating expenses and any residual negative equity position. Hence, the RBZ would need to develop a medium-term financial plan identifying sustainable income streams and a tightly controlled expenditure plan, closely related to achieving its functions in a dollarized economy.

Progress on the RBZ balance sheet restructuring has been slow, although other actions have been implemented, including appointment of a new governing Board and the retrenchment of some 1,450 employees.

Under the program, the authorities have attached high importance to RBZ's balance sheet restructuring to improve financial stability.

C. Structural Reforms

Fiscal Reforms

27. Steadfast implementation of fiscal reforms is key to support the adjustment efforts. In particular, the authorities plan to**:** (i) strengthen PFM by modernizing the payroll and human resource management systems, (ii) contain accumulation of domestic payment arrears, and (iii) improve revenue administration to strengthen revenue collections. To better monitor diamond revenue flows, ZIMRA inspectors require specialized training, for which the authorities have expressed the intention to seek technical assistance from their development partners. The new Income Tax Bill was submitted to Parliament May 7, 2013(structural benchmark) (MEFP, ¶26).

28. The authorities will improve the Public Financial Management System (PFMS) (MEFP, ¶22). The Public Service Commission (PSC) will develop and submit to the Ministry of Finance by the first review, a time-bound action plan to modernize payroll and human resource management systems (structural benchmark)**.** In addition, as a part of the e-Governance Policy thrust, the PSC will carry out a pilot of the electronic Human Resource Management Information System (HRMIS) aimed at improving the retrieval, archiving and sharing of human resource-related data. In addition, under the Public Service Training and Development Policy, the authorities will seek to enhance the professional development of human resources personnel in the public service.

29. Improving the monitoring of domestic payment arrears and preventing any new accumulation is a priority under the program. The authorities are committed to clearing the December 2012 verified arrears by end-2014, and to not accumulate new arrears in 2013 (MEFP, ¶24). Measures designed to avoid falling behind on payments of utility bills include advising service providers about ministries' budget resources for utilities, centrally monitoring the timely payments of monthly bills by ministries, and various demand management measures for electricity, telecommunications, transport, and water supply.

30. The program seeks to address outstanding overdue obligations in three steps: (i) define a calendar for clearing outstanding arrears to seed and fertilizer suppliers; (ii) finish the verification of the claims from service suppliers outstanding as of end- December 2012; and (iii) formulate a strategy for clearing domestic arrears by end-2014, at the latest. The authorities plan to publish a report on the stock of verified arrears and the strategy to clear the validated arrears by the first review (structural benchmark).The authorities have also committed to ring-fence a portion of any diamond revenues realized above the budgeted amount for early clearance of verified domestic payment arrears in 2013. The 2014 budget would include appropriations for the clearance of any remaining arrears (MEFP, ¶24).

Other Reforms

31. The lack of transparency in the diamond sector is a significant obstacle to effective budgeting. While $600 million of diamond dividends were initially budgeted for 2012, only about $45 million were realized. The authorities had to resort to various measures in mid-2012 to address the pressures created by the large shortfall in diamond revenue. For 2013, consistent with staff advice, the budget includes a moderate amount in diamond dividends and establishes contingent plans for the eventuality of diamond dividends exceeding that mark. However, budgeting would be more effective if better informed forecasts of these revenue flows could be made. More transparency would also ease potential concerns related to the proper accounting of diamond related resources. As an important signal, the authorities intend to prepare by end-June a report accounting for the shortfall in diamond dividends in 2012.

32. The new diamond policy, approved and published in late-2012, is a step in the right direction towards increasing transparency and accountability. The policy envisions, inter alia, tasking ZIMRA to work with the Ministry of Mines in monitoring diamond proceeds, and placement of a government-appointed diamond valuator to value all rough diamonds (with an independent valuator to settle disputes between producers and the government-appointed valuator). The authorities plan to issue a statutory instrument (SI) establishing a formula for the calculation and payment of interim dividends to the Treasury by the state-owned companies through which the government participates in the diamond industry. The SI, which requires presidential assent, is a structural benchmark for the first review. The authorities have committed to fast-track amendments to the Precious Stones Trade Act that give force of law to certain aspects of the Diamond Policy and bring the Act in line with international best practices. They intend to submit the amendments to cabinet and to parliament by the second review (structural benchmarks). In addition, the authorities intend to submit to Parliament a new Mines and Minerals Act by the second review (structural benchmark). The new legislation is intended to establish a coherent dividend policy for the state-owned enterprises in mining (MEFP, ¶36).

D. Relationship with External Creditors

33. As part of the implementation of ZAADDS, the authorities have made substantial progress on the external debt reconciliation process, with support from development partners. All creditors, including multilaterals and bilaterals are involved in the exercise. Some 95 percent of the external data base has been reconciled; and the outstanding issue on the remaining 5 percent of the base mainly relates to the computation of penalty charges on overdue loans. The authorities intend to step up contacts with creditors with the objective of defining more concretely the contours of their strategy to seek debt relief.

34. Zimbabwe remains in external debt distress, which will continue to constrain development. Therefore, the authorities are committed to seek only grants and concessional loans to finance the national development agenda. In exceptional circumstances, if grants and concessional loans are not available, the authorities might contract or guarantee non-concessional borrowing only to implement critical projects in the areas of water and sanitation, electricity and roads. The total amount of this non-concessional borrowing will not exceed 3 percent of GDP ($330 million) during the program period. Moreover, before signing any agreement, the authorities have committed to seek assessments from the African Development Bank, the Development Bank of South Africa or the World Bank to ensure that the identified projects will have high economic and social impact (MEFP, ¶38; TMU, ¶14). The debt management office in the Ministry of Finance, in consultation with the Fund, will assess the financial terms of any external borrowing. Nevertheless, staff urges the authorities to refrain from further nonconcessional borrowing and avoid selective debt servicing as these may complicate reaching agreement with creditors on a debt resolution strategy.

35. Given their restricted access to credit and payment constraints, a priority in the authorities' strategy is to remain current with creditors providing new disbursements. The authorities plan to amortize loans from China Eximbank ($91.8 million), Afreximbank ($14.5 million), the Eastern and Southern African Trade and Development Bank (PTA Bank, $3.4 million), and the Arab Bank for Economic Development in Africa (BADEA, $0.6 million). With the exception of BADEA, these creditors have recently provided, and/or are expected to continue providing, resources for infrastructure and other projects, and/or to maintain trade credits and lines of credit for the private sector.

36. **The authorities' priorities also include stepping up their engagement with multilateral creditors.** For 2013, the authorities are committed to making monthly payments in the amount of $150,000 to the PRGT (quantitative target), down from the amount paid in 2012 ($7.5 million) on account of tightening budget constraints in 2013 (Text Table 3). The authorities are committed to maintaining a track record of cooperation in payments to the IMF and to extend cooperation to their other multilateral creditors. For the rest of 2013, the authorities have indicated their inten tion to make payments to the World Bank in line with the amounts indicated in the *Interim Strategy Note* recently considered by the Board of that institution, and broadly comparable payments to the AFDB.[19] Staff urges the authorities to engage in coordinated discussions with all three IFIs on the appropriate extent of payments going forward, so these can be incorporated in the authorities' financial framework at the time of the first review of the SMP, and the necessary provisions included in the 2014 Budget. The authorities intend to increase the payments to IFIs gradually over time as their capacity to repay improves.

Text Table 3. Zimbabwe: Transactions with the Fund, 2009-13
(In millions of SDRs)

	PRGT		
	Principal	Interest	Total Payments
2009	0.07	-	0.07
2010	2.61	-	2.61
2011	-	-	-
2012	4.90	-	4.90
2013 [1/]	0.60	-	0.60
Total	**8.18**	**-**	**8.18**
Memorandum items:			
Overdue financial obligations to the PRGT at end-May			*82.09*

[1/] As at end-May 2013

Source: Finance Department, IMF

PROGRAM MONITORING

37. **The SMP will cover a 9-month period, April through end-December 2013 and will be monitored based on quantitative targets and structural benchmarks (MEFP, Tables 1 and 2).** The structural benchmarks focus on enhancing public financial management, improving fiscal transparency and accountability and increasing financial stability. The SMP will be monitored based on performance through end-June and end-December 2013, respectively. The authorities have

[19] In paragraph 23 of the Interim strategy Note (Report No. 74226-ZW), is stated that "[…] quarterly payments of $900,000, commencing in early 2013, would seem to be appropriate, to be increased as payment capacity improves."

established a monitoring committee comprised of officials from the main institutions with responsibility for macroeconomic policy.

PROGRAM RISKS

38. A main risk to the program is the possibility of political instability ahead of national elections, expected in the second half of 2013. The difficult relationship between the partners in the coalition government will be further tested by the need they will probably see to accentuate their differences during electoral campaigning. The political calendar could complicate the pace of reforms, raising the risk of substantial policy slippages in the run-up to the elections. There are potential risks to the budget from lower revenues if growth were to slow down, pressure to advance a potentially costly pension reform, calls for additional wage increases, and continued weak expenditure controls, which could possibly lead to further arrears accumulation. There are also significant risks of financial instability from the weakly capitalized banks that have low liquidity buffers and very high levels of NPLs. Other potential downside risks relate to: (i) the pace of the global economic recovery, which would affect the demand and prices for the country's main exports; (ii) unpredictable supply shocks which could affect output levels in the key sectors; and (iii) slowdown in private investment as a result of election related uncertainty.

39. The authorities have committed to take additional policy measures to ensure the attainment of the program objectives, if these risks were to materialize (MEFP, ¶40). Poor policy coordination and weak technical capacity in certain areas could affect program implementation. However, the program will benefit from the expansion of Fund TA following the Board's relaxation of most restrictions on provision of TA to Zimbabwe, including in areas to support the formulation and implementation of an SMP. In addition, a number of development partners have committed to provide material support for training and TA.

STAFF APPRAISAL

40. Zimbabwe has made good progress in restoring macroeconomic stability since the end of hyperinflation in 2009, but the economic rebound is waning and key challenges need to be tackled. Strong policies are needed to sustain the economic recovery, restore fiscal and external sustainability, and increase financial stability. This would place the economy on a long-term, sustained inclusive growth path. Implementation of indigenization and empowerment policies according to transparent rules and with due respect to property rights remains essential to build investor confidence and attract needed FDI.

41. The staff and the authorities have reached an understanding on an SMP that has the potential to move Zimbabwe towards such a path. Key elements of the authorities' program (which they started implementing since January 2013), are fiscal consolidation, including wage increases that would help contain wage bill growth; improving PFM by adopting further measures to control the payroll; increasing transparency in the diamond sector; strengthening the financial regulatory and supervisory framework to enhance governance, improve the banks resolution framework, and strengthen consolidated supervision; and restructuring the RBZ balance sheet. Steadfast and successful implementation of the program is key to establishing a strong track record of performance, and to start the way towards eventual arrears clearance and debt relief. In this regard, full ownership of the program by the authorities is critical.

42. Strong execution of the 2013 budget will be critical for meeting the program targets and laying the foundation for fiscal sustainability. To this end, the authorities need to contain expenditure within available resources, while protecting priority infrastructure and social spending, and rebuilding fiscal buffers. Strong emphasis must therefore be placed on maintaining expenditure controls and strengthening PFM. The authorities have made some progress in reducing the stock of domestic arrears. Staff welcomes the authorities' commitment to develop an arrears clearance strategy and to avoid accumulation of new domestic arrears in 2013. Staff welcomes the authorities' efforts to work with development partners to secure funding for the elections to augment domestic resources.

43. It is vital that measures to increase transparency in the diamond sector are implemented expeditiously to reduce fiscal pressures by ensuring the requisite revenues flow to the treasury. Staff is encouraged by the inclusion of ZIMRA in the diamond value chain, and for its full access to trade and financial records of companies in diamond activity established in the diamond policy. Staff urges the authorities to implement the proposed reforms of the legal and regulatory framework governing the sector.

44. Given financial sector risks and vulnerabilities, increasing financial sector stability must be a priority. The authorities have been taking actions to strengthen the financial regulatory and supervisory framework and reduce liquidity risks. The amendments to the Banking Act will go a long way toward enhancing oversight and surveillance, strengthening the troubled bank resolution framework, improving corporate governance, increasing transparency, promoting efficiency and enhancing coordination among the regulators—consistent international best practices. Staff encourages early passage of the legislation. Continued strengthening of banking supervision—including intense monitoring of weakly capitalized banks with low liquidity buffers, high levels of NPLs—will be critical. In addition, advancing the restructuring of the RBZ remains critical for financial stability. Going forward, the authorities also need to build their capacity to provide emergency liquidity assistance to banks.

45. Efforts to facilitate mobilization of savings and protect consumers from high lending rates, while commendable, must not compromise financial stability. Some aspects of the agreement reached with banks could have adverse side effects, which would be inconsistent with the authorities' objective of increasing financial stability. The review process in the MOU agreed with the banks should provide the opportunity to identify problem spots and correct them.

46. Staff welcomes the authorities' continued cooperation on payments to the PRGT. In light of the tight fiscal situation and the authorities' intention to avoid further drawing down their SDR holdings, staff acknowledges the authorities' intention to make monthly payments of $150,000 to the PRGT (payments they began making since January 2013). Staff also welcomes the authorities' plan to extend cooperation on payments to their other multilateral creditors. Staff strongly encourages the authorities to engage in coordinated discussions with the international financial institutions (IFIs) on future payments, to increase the size of the payments as the country's capacity to repay improves, and to respect the preferred creditor status of the IFIs. Avoiding selective debt servicing would facilitate agreement on a debt resolution strategy. Staff urges the authorities to continue to engage in discussion with other official creditors.

47. While the risks to the SMP are considerable, the authorities have assured staff of their commitment and preparedness to take the steps necessary to achieve program objectives, and the SMP has been endorsed by cabinet, in itself a strong statement. They see the SMP as very important in supporting their macroeconomic and stabilization efforts, and key to their arrears clearance and debt relief strategy— which are vital for Zimbabwe's medium-term development. To mitigate the potential risks from capacity constraints, the authorities have been taking advantage of Fund technical assistance, including in areas covered by the further relaxation of restrictions on the provision of technical assistance approved by the IMF Board in October 2012. Fund TA will also be complemented by assistance from other development partners.

Table 1. Zimbabwe: Selected Economic Indicators, 2009–14 (Program Scenario)

Population (millions):	13.0 (2012)	Per capita GDP (US$)	756 (2012)
Quota (current, SDR millions, % of total)	353.4 (0.15%)	Literacy rate (%):	91.9 (2009)
Main products and exports:	Platinum, gold, diamonds, tobacco		
Key export markets:	South Africa, European Union		

	Actual			Est.	Projected	
	2009	2010	2011	2012	2013	2014
Real GDP growth (annual percentage change) 1/	6.3	9.6	10.6	4.4	5.0	5.7
Nominal GDP (US$ millions)	6,133	7,433	8,865	9,802	10,978	12,280
GDP deflator (annual percentage change)	23.6	10.6	7.9	5.9	6.7	5.8
Inflation (annual percentage change)						
Consumer price inflation (annual average)	6.5	3.0	3.5	3.7	4.3	4.2
Consumer price inflation (end-of-period)	-7.7	3.2	4.9	2.9	4.6	4.0
Central government (percent of GDP)						
Revenue and grants	15.9	29.6	32.9	35.7	36.1	35.3
Expenditure and net lending	18.7	31.1	36.0	37.3	37.2	34.3
Of which: cash expenditure and net lending	15.0	30.0	33.5	36.4	36.5	33.9
Of which: employment costs	8.4	14.3	20.7	25.5	24.2	22.9
Quasi-fiscal activity by RBZ	0.4	0.2	0.0	0.0	0.0	0.0
Overall balance (including quasi-fiscal activity) 2/	-3.2	-1.7	-3.0	-1.6	-1.1	1.0
Primary balance (including quasi-fiscal activity) 2/	0.1	-0.1	-1.7	-0.5	0.0	2.0
Cash balance	1.7	-0.4	-0.6	-0.7	0.0	1.4
Money and credit (US$ millions)						
Broad money (M3)	1,381	2,329	3,100	3,694	4,225	4,735
Net foreign assets	-295	-151	-290	-435	-361	-292
Net domestic assets	1,677	2,480	3,391	4,129	4,586	5,027
Domestic credit (net)	649	1,683	2,754	3,559	4,064	4,559
Of which: credit to the private sector	684	1,665	2,711	3,524	4,061	4,206
Reserve money	125	256	186	273	312	349
Velocity (M3)	4.4	3.2	2.9	2.7	2.6	2.6
Balance of payments (US$ millions; unless otherwise indicated)						
Merchandise exports 3/	1,613	3,317	4,496	4,054	4,189	4,515
Value growth (annual percentage change) 3/	-2.8	...	35.5	-9.8	3.3	7.8
Merchandise imports 3/	-3,213	-5,162	-7,562	-6,710	-6,862	-7,007
Value growth (annual percentage change) 3/	22.2	...	46.5	-11.3	2.3	2.1
Current account balance (excluding official transfers)	-1,339	-1,913	-3,249	-2,262	-2,373	-2,201
(percent of GDP)	-21.8	-25.7	-36.7	-23.1	-21.6	-17.9
Overall balance 4/	-347	76	10	141	-971	-596
Official reserves (end-of-period)						
Gross international reserves (US$ millions) 5/	437	453	366	398	465	602
Usable international reserves (US$ millions) 6/	361	254	252	143	171	270
(months of imports of goods and services)	1.2	0.5	0.4	0.2	0.3	0.4
Debt (end-of-period)						
Total external debt (US$ millions, e.o.p.) 7/ 8/	7,918	7,962	8,504	8,603	9,041	9,414
Percent of GDP	129.1	107.1	95.9	87.8	82.4	76.7
PPG external debt (US$ millions, e.o.p.) 7/	6,466	5,897	5,610	5,700	5,958	6,166
Percent of GDP	105.4	79.3	63.3	58.2	54.3	50.2
Of which: Arrears	4,664	4,368	4,336	4,528	4,715	4,890
Percent of GDP	76.0	58.8	48.9	46.2	42.9	39.8
Other external debt (US$ millions, e.o.p.) 7/ 8/	1,452	2,065	2,895	2,902	3,082	3,248
Percent of GDP	23.7	27.8	32.6	29.6	28.1	26.5

Sources: Zimbabwean authorities; IMF staff estimates and projections.

1/ At constant 2009 prices.

2/ Quasi-fiscal activity includes subsidies provided by the central bank to the public sector and producers/exporters.

3/ Structural break in trade data in 2010. Trade data based on information from exchange control data in 2009 and customs data starting in 2010.

4/ Includes errors and omissions through 2012.

5/ Excluding encumbered deposits and securities.

6/ Defined as the higher of Zimbabwe's SDR holdings and gross international reserves less amounts deposited in banks' current/RTGS accounts and statutory reserves, and amounts in SDR escrow account.

7/ Includes arrears.

8/ Debt stocks are estimates, except for the 2011 debt stock which is based on preliminary results of the authorities' external debt reconciliation exercise concluded in January 2013.

Table 2. Zimbabwe: Balance of Payments, 2009–14

(Millions of U.S. dollars; unless otherwise indicated)

	Actual			Est.	Projected	
	2009	2010	2011	2012	2013	2014
Current account (excluding official transfers)	-1,339	-1,913	-3,249	-2,262	-2,373	-2,201
Trade balance	-1,600	-1,844	-3,066	-2,656	-2,673	-2,492
Exports, f.o.b.	1,613	3,317	4,496	4,054	4,189	4,515
Imports, f.o.b.	-3,213	-5,162	-7,562	-6,710	-6,862	-7,007
Food	-741	-554	-513	-731	-754	-696
Nonfood	-2,472	-4,608	-7,050	-5,980	-6,108	-6,311
Nonfactor services (net)	-266	-449	-654	-456	-464	-458
Investment income (net)	-399	-193	-342	-210	-425	-472
Interest	-337	-131	-277	-142	-317	-320
Receipts	6	5	5	8	3	3
Payments	-344	-135	-282	-150	-320	-323
Other	-61	-62	-65	-68	-108	-152
Private transfers (including transfers to NGOs)	926	573	813	1,061	1,189	1,221
Remittances	198	263	470	700	700	757
Capital account (including official transfers)	1,027	611	1,602	1,254	1,402	1,605
Official transfers	391	231	210	230	233	238
Direct investment	105	123	373	354	334	341
Portfolio investment	67	63	10	99	92	119
Long-term capital	-101	-2	744	50	225	366
Government[1]	-141	-168	-61	-116	104	293
Receipts	0	0	93	20	219	339
Payments	-141	-168	-154	-136	-115	-47
Public enterprises	-13	-140	-4	-21	-18	-10
Private sector	53	307	809	187	139	84
Short-term capital	46	296	264	521	518	540
Public sector	0	0	0	0	0	0
Private sector (loans mediated outside DMBs)	62	200	179	343	361	364
Cash in circulation (non-banks, - denotes increase	272	75	0	0	0	0
Other short-term capital	0	0	0	0	0	0
Change in NFA of DMBs	-288	20	85	178	7	76
Change in assets	-345	-85	47	2	-13	16
Change in liabilities	57	105	39	176	20	60
SDR Allocation	520	0	0	0	0	0
Errors and omissions	-35	1,378	1,657	1,148	0	0
Overall balance	-347	76	10	141	-971	-596
Financing	347	-76	-10	-141	971	596
IMF (net)	0	0	0	0	0	0
Central bank (net)	-1,238	-19	40	21	-72	-142
Assets	-529	-32	55	22	-69	-137
Change in usable official reserves	-350	100	1	109	-28	-99
Monetary authorities operations (non-reserve)	-179	-132	55	-88	-42	-38
Liabilities	-709	13	-15	0	-3	-5
Change in arrears (– denotes decrease)	1,013	-157	-50	-163	208	197
Debt relief/rescheduling	53	0	0	0	0	0
Unidentified financing	**0**	**100**	**0**	**0**	**836**	**540**
Memorandum items:						
Current account balance (percent of GDP)	-21.8	-25.7	-36.7	-23.1	-21.6	-17.9
Usable international reserves (US$ millions, e.o.p.)	361	254	252	143	171	270
Months of imports of goods and services	1.2	0.5	0.4	0.2	0.3	0.4
SDR holdings (US$ millions, e.o.p.)[2]	361	254	252	143	171	270
Total external debt (US$ millions, e.o.p.)[3,4]	7,918	7,962	8,504	8,603	9,041	9,414
Percent of GDP	129	107	96	88	82	77
PPG external debt (US$ millions, e.o.p.)[3]	6,466	5,897	5,610	5,700	5,958	6,166
Percent of GDP	105	79	63	58	54	50
Of which: Arrears	4,664	4,368	4,336	4,528	4,715	4,890
Percent of GDP	76	59	49	46	43	40
Other external debt (US$ millions, e.o.p.)[3,4]	1,452	2,065	2,895	2,902	3,082	3,248
Percent of GDP	24	28	33	30	28	26
Nominal GDP (US$ millions)	6,133	7,433	8,865	9,802	10,978	12,280
Percentage change	35.7	21.2	19.3	10.6	12.0	11.9
Exports of goods and services	1,796	3,541	4,771	4,344	4,488	4,838
Percentage change	-1.8	97.2	34.7	-9.0	3.3	7.8
Imports of goods and services	-3,662	-5,834	-8,491	-7,456	-7,625	-7,788
Percentage change	21.9	59.3	45.5	-12.2	2.3	2.1

Sources: Zimbabwean authorities; IMF staff estimates and projections.

[1] May not match data for government external financing in the fiscal table because this line is on an accrual basis.
[2] Excludes amounts in SDR escrow account.
[3] Includes arrears.
[4] Debt stocks are estimates, except for the 2011 debt stock which is based on preliminary results of the authorities' external debt reconciliation exercise concluded in January 2013.

Table 3. Zimbabwe: Central Government Operations, 2009–14

(Millions of U.S. dollars)

	Actual			Est.	Budget 1/	Projected	
	2009	2010	2011	2012	2013	2013	2014
Total revenue & on-budget grants	**975**	**2,199**	**2,921**	**3,496**	**3,860**	**3,960**	**4,341**
Tax revenue	883	2,074	2,660	3,279	3,646	3,696	4,079
Personal income tax	156	428	588	661	685	685	778
Corporate income tax	44	256	296	445	457	457	516
Other direct taxes	21	168	188	287	404	404	442
Customs	212	340	333	354	392	392	426
Excise	68	165	307	394	483	533	568
VAT	367	689	912	1086	1,165	1165	1288
Other indirect taxes	14	28	36	52	61	61	61
Non-tax revenue	51	124	261	217	214	264	262
Of which: Licensing fees	0	0	0	40	0	50	0
Of which: diamond dividends	0	0	151	44	…	…	…
Budget grants	41	1	0	0	0	0	0
Off-budget grants 2/	650	587	460	519	500	500	500
Total expenditure & net lending	**1,145**	**2,310**	**3,189**	**3,655**	**3,934**	**4,081**	**4,215**
Of which: Cash expenditure	*919*	*2,228*	*2,974*	*3,568*	*3,862*	*4,007*	*4,166*
Current expenditure	1,099	1,717	2,638	3,301	3,369	3,520	3,616
Employment costs	508	947	1,544	2,134	2,260	2,260	2,396
Wages & salaries	409	758	1,269	1,733	1,841	1,841	1,928
Pensions	98	188	275	401	419	419	468
Interest payments	198	113	122	114	117	120	126
Foreign	194	113	122	112	113	113	120
Of which: Paid	*16*	*31*	*34*	*18*	18	16	17
Domestic	3	0	0	3	4	7	6
Of which: Paid	3	0	0	3	4	7	6
Goods & services	260	362	504	505	407	407	486
Grants & transfers	133	295	468	548	585	733	608
Of which: Employment costs	10	117	290	370	402	402	411
Of which: Referendum costs	0	0	0	0	25	53	0
Of which: Election costs	0	0	0	0	0	120	0
Capital expenditure and net lending	46	593	551	355	565	561	599
Off-budget expenditure	650	587	460	519	500	500	500
Overall balance (commitment basis)	**-170**	**-111**	**-268**	**-160**	**-75**	**-121**	**125**
Primary balance (commitment basis) 2/	28	3	-147	-45	42	-1	251
Overall balance (cash basis)	56	-30	-53	-72	-3	2	175
Primary balance (cash basis) 2/	76	1	-19	-52	20	26	198
QFA by RBZ 3/	23	12	0	0	0	0	0
Overall balance (incl. QFA by RBZ)	**-193**	**-123**	**-268**	**-160**	**-75**	**-121**	**125**
Financing	**170**	**113**	**268**	**160**	**75**	**71**	**-125**
Domestic financing (net)	-156	-72	-25	8	-57	54	-25
Bank	-156	-44	4	44	-57	14	-25
Of which: Government securities, net	0	0	0	93	-35	5	-25
Of which: Clearance of statutory reserves	0	0	0	-83	0	0	0
Non-bank	0	-28	-30	-36	0	40	0
Foreign financing (net)	-41	-231	-48	8	-64	-116	-213
Disbursements	50	2	78	0	90	90	0
Amortization due	141	333	127	101	124	176	113
Of which: Paid	0	0	0	44	0	116	50
Movement in Zimbabwe's SDR holdings (net)	50	100	0	109	-30	-30	-100
Other	0	0	0	0	0	0	0
Change in arrears	367	415	342	144	196	134	113
Domestic	48	0	128	-6	-23	-23	-53
Expenditure	48	0	128	-6	-23	-23	-53
Arrears accumulation	48	0	128	116	0	0	0
Arrears clearance	0	0	0	-122	-23	-23	-53
Foreign	319	415	214	150	219	156	166
Interest	178	82	87	93	95	96	102
Principal	141	333	127	57	124	60	63
Financing gap	**0**	**2**	**0**	**0**	**0**	**-50**	**0**
Contingency measures	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**50**	**n.a.**

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

1/ Presentation in keeping with the definitions in the Technical Memorandum of Understanding.
2/ The difference between the primary balance on a commitment and cash basis is the change in domestic arrears.
3/ Subsidies provided by the RBZ to the public sector and producers/exporters.

Table 3. Zimbabwe: Central Government Operations, 2009–14 (concluded).

(Percent of GDP)

	Actual			Est.	Budget [1/]	Projected	
	2009	2010	2011	2012	2013	2013	2014
Total revenue & on-budget grants	**15.9**	**29.6**	**32.9**	**35.7**	**35.2**	**36.1**	**35.3**
Tax revenue	14.4	27.9	30.0	33.5	33.2	33.7	33.2
Personal income tax	2.5	5.8	6.6	6.7	6.2	6.2	6.3
Corporate income tax	0.7	3.4	3.3	4.5	4.2	4.2	4.2
Other direct taxes	0.3	2.3	2.1	2.9	3.7	3.7	3.6
Customs	3.5	4.6	3.8	3.6	3.6	3.6	3.5
Excise	1.1	2.2	3.5	4.0	4.4	4.9	4.6
VAT	6.0	9.3	10.3	11.1	10.6	10.6	10.5
Other indirect taxes	0.2	0.4	0.4	0.5	0.6	0.6	0.5
Non-tax revenue	0.8	1.7	2.9	2.2	1.9	2.4	2.1
Of which: diamond dividends	0.0	0.0	1.7	0.4	...	...	...
Budget grants	0.7	0.0	0.0	0.0	0.0	0.0	0.0
Off-budget grants 2/	10.6	7.9	5.2	5.3	4.6	4.6	4.1
Total expenditure & net lending	**18.7**	**31.1**	**36.0**	**37.3**	**35.8**	**37.2**	**34.3**
Of which: Cash expenditure	*15.0*	*30.0*	*33.5*	*36.4*	35.2	36.5	33.9
Current expenditure	17.9	23.1	29.8	33.7	30.7	32.1	29.4
Employment costs	8.3	12.7	17.4	21.8	20.6	20.6	19.5
Wages & salaries	6.7	10.2	14.3	17.7	16.8	16.8	15.7
Pensions	1.6	2.5	3.1	4.1	3.8	3.8	3.8
Interest payments	3.2	1.5	1.4	1.2	1.1	1.1	1.0
Foreign	3.2	1.5	1.4	1.1	1.0	1.0	1.0
Of which: Paid	*0.3*	*0.4*	*0.4*	*0.2*	0.2	0.1	0.1
Domestic	0.1	0.0	0.0	0.0	0.0	0.1	0.0
Of which: Paid	*0.1*	*0.0*	*0.0*	*0.0*	0.0	0.1	0.0
Goods & services	4.2	4.9	5.7	5.1	3.7	3.7	4.0
Grants & transfers	2.2	4.0	5.3	5.6	5.3	6.7	4.9
Of which: Employment costs	0.2	1.6	3.3	3.8	3.7	3.7	3.3
Of which: Referendum costs	0.0	0.0	0.0	0.0	0.2	0.5	0.0
Of which: Election costs	0.0	0.0	0.0	0.0	0.0	1.1	0.0
Capital expenditure and net lending	0.8	8.0	6.2	3.6	5.1	5.1	4.9
Off budget expenditure	10.6	7.9	5.2	5.3	4.6	4.6	4.1
Overall balance (commitment basis)	**-2.8**	**-1.5**	**-3.0**	**-1.6**	**-0.7**	**-1.1**	**1.0**
Primary balance (commitment basis) 2/	0.5	0.0	-1.7	-0.5	0.4	0.0	2.0
Overall balance (cash basis)	0.9	-0.4	-0.6	-0.7	0.0	0.0	1.4
Primary balance (cash basis) 2/	1.2	0.0	-0.2	-0.5	0.2	0.2	1.6
QFA by RBZ 3/	0.4	0.2	0.0	0.0	0.0	0.0	0.0
Overall balance (incl. QFA by RBZ)	**-3.2**	**-1.7**	**-3.0**	**-1.6**	**-0.7**	**-1.1**	**1.0**
Financing	**2.8**	**1.5**	**3.0**	**1.6**	**0.7**	**0.6**	**-1.0**
Domestic financing (net)	-2.5	-1.0	-0.3	0.1	-0.5	0.5	-0.2
Bank	-2.5	-0.6	0.0	0.5	-0.5	0.1	-0.2
Of which: Government securities, net	0.0	0.0	0.0	1.0	-0.3	0.0	-0.2
Of which: Clearance of statutory reserves	0.0	0.0	0.0	-0.9	0.0	0.0	0.0
Non-bank	0.0	-0.4	-0.3	-0.4	0.0	0.4	0.0
Foreign financing (net)	-0.7	-3.1	-0.5	0.1	-0.6	-1.1	-1.7
Disbursements	0.8	0.0	0.9	0.0	0.8	0.8	0.0
Amortization due	2.3	4.5	1.4	1.0	1.1	1.6	0.9
Of which: Paid	0.0	0.0	0.0	0.4	0.0	1.1	0.4
Movement in Zimbabwe's SDR holdings	0.8	1.3	0.0	1.1	-0.3	-0.3	-0.8
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Change in arrears	6.0	5.6	3.9	1.5	1.8	1.2	0.9
Domestic	0.8	0.0	1.4	-0.1	-0.2	-0.2	-0.4
Expenditure	0.8	0.0	1.4	-0.1	-0.2	-0.2	-0.4
Arrears accumulation	0.8	0.0	1.4	1.2	0.0	0.0	0.0
Arrears clearance	0.0	0.0	0.0	-1.2	-0.2	-0.2	-0.4
Foreign	5.2	5.6	2.4	1.5	2.0	1.4	1.3
Interest	2.9	1.1	1.0	1.0	0.9	0.9	0.8
Principal	2.3	4.5	1.4	0.6	1.1	0.5	0.5
Financing gap	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**-0.5**	**0.0**
Contingency measures	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**0.5**	**n.a.**

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

1/ Presentation in keeping with the definitions in the Technical Memorandum of Understanding.
2/ The difference between the primary balance on a commitment and cash basis is the change in domestic arrears.
3/ Subsidies provided by the RBZ to the public sector and producers/exporters.

Table 4. Monetary Survey, 2009–14

(Millions of U.S. dollars; unless otherwise indicated)

	Actual			Est.	Projected	
	Dec. 2009	Dec. 2010	Dec. 2011	Dec. 2012	Dec. 2013	Dec. 2014
Monetary authorities						
Net foreign assets	**-845**	**-680**	**-734**	**-700**	**-620**	**-475**
Usable international reserves 1/	361	254	252	143	171	270
Other foreign assets	259	389	334	422	464	502
Short-term foreign liabilities 2/	-810	-671	-662	-658	-652	-646
Of which: Liabilities to IMF	-140	-134	-134	-127	-121	-115
Other foreign liabilities	-605	-595	-588	-592	-585	-583
Net domestic assets	**970**	**936**	**919**	**973**	**931**	**825**
Net domestic claims	-1	-4	-1	-8	-8	-8
Claims on other depository corporations	0	0	0	0	0	0
Net claims on central government	-2	-5	-2	-11	-11	-11
Claims on other sectors	1	1	1	4	4	4
Claims on other financial corporations	0	0	0	0	0	0
Claims on state and local government	0	0	0	0	0	0
Claims on public non-financial corporations	0	0	0	0	0	0
Claims on private sector	1	1	1	4	4	4
Other items (net)	971	940	921	980	939	832
Monetary base	**125**	**256**	**186**	**273**	**312**	**349**
Statutory reserves	71	83	83	0	0	0
Banks' current/RTGS accounts	54	173	102	273	312	349
Deposit money banks and other banking institutions						
Net foreign assets	**549**	**529**	**443**	**266**	**259**	**183**
Foreign assets	606	690	644	642	655	639
Foreign liabilities	-57	-162	-200	-376	-396	-456
Net domestic assets	**832**	**1,799**	**2,657**	**3,428**	**3,966**	**4,552**
Net domestic claims	856	1,959	3,105	3,892	4,436	4,969
Claims on RBZ	205	272	349	325	365	402
Currency	0	0	0	0	0	0
Deposits	205	272	349	325	365	402
Net claims on central government	-59	0	0	-5	-38	312
Claims on other sectors	709	1,687	2,755	3,572	4,109	4,254
Claims on public non-financial corporations	25	23	45	52	52	52
Claims on private sector	684	1,664	2,710	3,520	4,058	4,202
Other items (net)	-24	-160	-448	-463	-470	-417
Liabilities to RBZ	**0**	**0**	**0**	**0**	**0**	**0**
Deposits included in broad money	**1,381**	**2,328**	**3,100**	**3,694**	**4,225**	**4,735**
Monetary Survey						
Net foreign assets	**-295**	**-151**	**-290**	**-435**	**-361**	**-292**
Net domestic assets	**1,677**	**2,480**	**3,391**	**4,129**	**4,586**	**5,027**
Domestic claims	649	1,683	2,754	3,559	4,064	4,559
Net claims on central government	-61	-5	-2	-17	-49	301
Claims on other sectors	710	1,688	2,756	3,575	4,113	4,258
Claims on public non-financial corporations	25	23	45	52	52	52
Claims on private sector	684	1,665	2,711	3,524	4,061	4,206
Other items (net)	1,027	797	636	570	522	468
Broad money liabilities (M3)	**1,381**	**2,329**	**3,100**	**3,694**	**4,225**	**4,735**
Deposits	1,381	2,329	3,100	3,694	4,225	4,735
	(annual percentage change)					
Monetary Base	1,738	104	-27	47	14	12
Broad Money (M3)	340	69	33	19	14	12
Currency	...	...	...	...	...	...
Deposits	340	69	33	19	14	12
Private Sector Credit	388	143	63	30	15	4
Memorandum Items:						
Loan-to-deposit ratio (in percent)	50	71	87	95	96	89
Reserves-to-deposit ratio (in percent)	9	11	6	7	7	7
Money multiplier (M3/monetary base)	11	9	17	14	14	14
Velocity (GDP/M3)	4.4	3.2	2.9	2.7	2.6	2.6

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

1/ Defined as the higher of Zimbabwe's SDR holdings and gross international reserves less amounts deposited in banks' current/RTGS accounts and statutory reserves, and amounts in SDRs escrow account.

2/ Some $150 million of short-term loans reclassified to domestic liabilities in 2010.

APPENDIX I. LETTER OF INTENT

June 5, 2013

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington, DC 20431

Dear Ms. Lagarde:

The coalition Government in Zimbabwe has made significant progress in stabilizing the economy since its formation in February 2009. The adoption of the multiple currency system, the introduction of cash budgeting, and the discontinuation of the quasi-fiscal operations of the Reserve Bank of Zimbabwe (RBZ) since 2009 have resulted in strong economic growth averaging about 7½ percent, single-digit inflation below 5 percent, and a doubling of fiscal revenue collection from 16 percent of GDP in 2009 to an estimated 36 percent of GDP in 2012.

Notwithstanding the achievements realized since 2009, the economy continues to operate under a very difficult environment characterized by huge demands on a small national budget, the absence of direct budget support, weak institutional capacity, and very low international reserves. Poverty levels remain high and widespread, savings and investment ratios remain low, and formal employment levels and incomes are still low, while the infrastructure gap has remained very high. Social services have also remained inadequate.

Since 2009, the financial sector has been on the rebound, with deposits growing from as little as US$ 385 million in 2009, to the current levels of almost US$ 4 billion. Although the sector has rebounded, it is still facing vulnerabilities which are threatening the stability of the sector, especially among the smaller locally owned banks.

The external debt overhang of 88 percent of GDP at end-2012 is seriously stifling sustainable economic growth, and it is limiting the country's ability to access new financing which is critical to the achievement of inclusive growth, poverty reduction, and job creation. Exogenous factors such as the continued global economic crisis, volatile commodity prices, and the impact of sanctions are also negatively affecting the performance of the economy.

Against this background, Government has formulated a comprehensive macroeconomic reform agenda aimed at unleashing Zimbabwe's economic growth potential. Sustainable and inclusive growth will be achieved by the implementation of sound and credible economic policies and thereby guaranteeing a stable macroeconomic environment. The 2013 National Budget, presented to Parliament in November 2012, is a key element of the reform agenda. In order to avoid the fiscal slippages which occurred during 2012, the 2013 Budget is premised on prudent and realistic revenues and will reinforce our cash budgeting policy stance.

The programme will focus on the following structural reform agenda:

- fiscal consolidation and strengthening public financial management;
- enhancing financial sector stability and reducing vulnerabilities;
- completing the reforms at the Reserve Bank of Zimbabwe, especially the restructuring of its balance sheet and strengthening the banking sector regulatory and supervisory framework; and
- implementing a prudent borrowing strategy and strengthening debt management through the implementation of measures contained in our policy document—the Zimbabwe Accelerated Arrears Clearance, Debt and Development Strategy (ZAADDS).

The enclosed Memorandum of Economic and Financial Policies (MEFP) and the Technical Memorandum of Understanding (TMU) provide comprehensive details of our reform agenda and programme.

In support of our reform agenda and programme, the Government of Zimbabwe hereby requests an International Monetary Fund (IMF) Staff-Monitored Program (SMP). We consider the SMP to be a very important in supporting our macroeconomic and stabilization efforts, building a track record of sound policy towards a future Fund-supported program, and a critical first step towards normalising relations with the international community, including all our creditors, as enunciated in our policy document—the ZAADDS. The SMP will, therefore, help us to mobilise critical support from our Development Partners for a comprehensive arrears clearance and debt relief strategy.

We believe that the policies set out in the attached MEFP are adequate and robust enough to achieve the overall objectives of our reform agenda and programme, and we stand ready to take further measures that may become necessary to achieve our policy objectives. The Zimbabwean authorities will consult with IMF staff, at our own initiative or whenever the Managing Director of the IMF requests such a consultation, on the adoption of these measures and in advance of any revisions to the policies contained in our MEFP, in accordance with the IMF's policies on such consultations.

The Government of Zimbabwe will provide IMF staff, with such information as IMF staff may request in connection with the progress made in implementing the economic and financial policies and in achieving the objectives of the programme.

The Government of Zimbabwe authorizes the IMF to publish this letter, the attached MEFP and TMU, and the related staff report, including placement of these documents on the IMF website, subject to the removal of market-sensitive information.

Sincerely yours,

/s/	/s/
Tendai L. Biti	Gideon Gono
Minister of Finance	Governor
Government of Zimbabwe	Reserve Bank of Zimbabwe

ATTACHMENT I. MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

INTRODUCTION

1. In its 2009 Budget Statements, the Government of Zimbabwe acknowledged and noted with concern its unsustainable stock of external debt, which then stood at 118 percent of GDP, including the accumulation of external payment arrears which prevented it from participating in international development programmes, particularly with the International Financial Institutions (IFIs).

2. Pursuant to this, a comprehensive internal consultation process commenced in search of a solution to deal with Zimbabwe's arrears and debt overhang, as well as with its international isolation. Under a Cabinet team led by the Deputy Prime Minister Professor Arthur Mutambara, the Government of Zimbabwe adopted a three-pronged approach to deal with its debt, based on the following pillars:

- using Zimbabwe's natural resources for debt clearance;
- lifting the sanctions on Zimbabwe and ending the country's international isolation; and
- pursuing the traditional methods of debt relief initiatives.

3. On the basis of the above framework, in April 2011 the Government of Zimbabwe adopted the Zimbabwe Accelerated Arrears Clearance, Debt and Development Strategy (ZAADDS) whose key tenets are as follows:

- establishing and operationalising a Debt Management Office;
- undertaking a validation and reconciliation exercise of the external debt database;
- re-engaging with creditors and the international community towards the removal of international sanctions;
- negotiating for arrears clearance, new financing and comprehensive debt relief; and
- leveraging Zimbabwe's natural resources in pursuit of debt relief and development.

4. In the process of implementing ZAADDS, Zimbabwe has now come to a stage where there has to be accelerated reengagement with the IMF within the context of the Zimbabwe Accelerated Reengagement Programme (ZAREP).

5. This memorandum summarises the Government of Zimbabwe's economic and financial programme for April-December 2013, for which the Government is seeking assessments of progress under an IMF Staff-Monitored Programme (SMP). Our policy agenda, as contained in the ZAREP, seeks to address Zimbabwe's main policy challenges—restoring fiscal and external sustainability, and increasing financial sector stability. The policies outlined below are consistent with ZAREP's objectives.

RECENT ECONOMIC DEVELOPMENTS

6. The economy has decelerated from the fast pace of growth experienced in 2010–11, and we expect it to have grown at 4.4 percent in 2012, partly due to the impact of drought on agriculture. Consumer price inflation for 2012 (eop basis) came in just under 3 percent.

7. The budget faced significant fiscal slippages in 2012, as a result of a large shortfall in diamond-related revenues, in particular, dividends from joint-venture enterprises under the Zimbabwe Mining Development Corporation (ZMDC) and the larger-than-budgeted increase in allowances to civil servants. In our 2012 Mid-Year Fiscal Policy Review, submitted to Parliament on July 18, 2012, we put forward a set of revenue and expenditure measures to close this gap. While painful, the expenditure cuts were helped by the fact that diamond dividends had been earmarked for specific projects which could not, therefore, be implemented.

8. The policy measures announced in July 2012 helped restore control of the public finances, but they could not fully offset the initial fiscal slippages. In addition, further accumulation of arrears to domestic service providers could not be avoided in 2012. Service providers, in turn, fell behind on their tax payments. To address the emerging problem of mutual arrears, we arranged a short-term bridging loan with CBZ Bank Limited, which financed the partial settlement of unpaid 2012 utility bills against tax arrears by utility providers. In addition, we cleared all outstanding obligations to farmers and we intend to clear the remaining US$ 22 million of pre-2012 arrears to agricultural input suppliers during 2013.

9. The Reserve Bank of Zimbabwe (RBZ) uncovered some irregularities that led to the placement of one bank under curatorship and the voluntary closure of two small banks in 2012. To strengthen banks' balance sheets, the RBZ has announced a gradual increase in the minimum capital requirement for banks from US$ 12.5 million to US$ 100 million over a two-year period. This is expected to enhance capital adequacy and stimulate a process of consolidation in the banking sector, currently characterized by the presence of a relatively large number of small and weakly capitalised banks. Fourteen (14) of the 21 banking institutions subject to the requirement met the December 2012 new minimum of US$ 25 million. Additionally, five banking institutions made significant progress towards attaining the capital adequacy requirement, and the remaining two banking institutions submitted plans that need improvement to enhance their credibility.

10. In 2012, the trade deficit is estimated to have declined from 2011, relative to GDP, although remaining at a high level. Mining exports have continued to increase, and constitute around half of total exports. Slower growth in manufacturing exports has largely offset the more dynamic mining exports. Private capital inflows continued to finance the trade deficit, particularly through an increase in short-term capital inflows. However, the balance of payments' (BOP) errors and omissions line remained substantial in 2012.

MEDIUM-TERM OBJECTIVES AND POLICIES

11. The Government has adopted a pragmatic medium-term economic and social programme aimed at accelerating economic growth, stepping up employment creation and social inclusion, and fighting poverty. With the support of the World Bank and the African Development Bank (AfDB), the Government is also committed to initiating the development of an Interim Poverty Reduction Strategy Paper (I-PRSP), guided by our Medium Term Plan (MTP) for 2011-2015.

12. Under the programme, the external financing gap is expected to progressively narrow, mainly driven by the upward trend in mining exports and private capital inflows. Together with a continued improvement in the fiscal balance, this would contribute to reversing the recent depletion of international reserves.

13. Given Zimbabwe's financial constraints, improvements in the physical and human capital needed to achieve sustained high economic growth will require substantial external support for an extended period. To this end, a full normalisation of Zimbabwe's relationship with the international community is urgently needed. Even though the international community is progressively increasing its technical support in various areas, a full reengagement with them is necessary to access development partners' financial resources. To this end, the Government laid out a comprehensive policy document—the Zimbabwe Accelerated Arrears Clearance, Debt and Development Strategy (ZAADDS)—aimed at ultimately restoring debt sustainability and unlocking debt relief. We see the consistent implementation of the ZAREP as an important step in meeting our programme objectives.

MACROECONOMIC OBJECTIVES AND POLICIES IN 2013

14. Our forecast for economic growth in 2013 is around 5 percent. This represents a modest improvement from 2012 and is based on the assumption of gains in agriculture (as rains normalize) and in mining (where new capacity will be brought on line). We project CPI inflation to average about 4.5 percent in 2013, reflecting inflation expectations in our main economic partner, South Africa, as well as a relative moderation in wage growth in non-traded sectors in Zimbabwe.

15. The main objectives for the 2013 economic programme as derived from the MTP and the 2013 National Budget Statement are to:

- restore stability to the public finances by ensuring that expenditure is kept in line with fiscal revenues, even as provisions are made for (i) maintaining the purchasing power of civil servants' salaries and pensions; (ii) boosting the fraction of revenues going to capital and social spending; and (iii) gradually clearing outstanding domestic payment arrears;
- start rebuilding international reserves;
- carry out financial sector reforms that will, among other things, seek to increase financial stability by reducing financial vulnerabilities and tightening the regulatory framework; and
- advance the implementation of the structural reform agenda, including in the areas of tax policy and administration, public financial management, payroll administration, and increasing transparency in the diamond sector.

A. Restoring Fiscal Sustainability and Strengthening Fiscal Management

The 2013 Budget

16. The 2013 budget is based on a prudent forecast of fiscal revenues and targets a small surplus in the primary balance. The US$ 3.86 billion revenue projection is consistent with the tax and nontax collections observed in 2012 (adjusted for one-time items), the projected 5 percent real economic growth in 2013, and an increase in excise taxes on cigarettes and alcoholic beverages. The targeted primary balance, together with the projected net financing of the budget, will allow the Government to start increasing international reserves and fiscal buffers.

17. The room available for increasing expenditure in the 2013 Budget is limited and we plan to use it carefully in this election year. We have granted civil servants a 6.0 percent average pay increase for 2013 and introduced a rural allowance to attract civil servants to remote locations. We will maintain the hiring freeze in Government which started in July 2012, while allowing some limited flexibility in filling vacancies that open up as a result of natural attrition in the education and health sectors, and for critical positions. The budget includes an increased appropriation for the payment of utility services, with the objective of preventing the accumulation of domestic payment arrears in 2013. In addition, we are introducing measures to rationalize consumption of electricity, water and telephone services by Government Ministries and Departments.

18. Within the limits of the budget, we will ring-fence resources for key capital projects and social spending. For example, the budget will progressively increase provisions for key social spending programmes, and the yield from higher excise taxes will fund the refurbishment of schools. We are increasing spending on a group of high-value and high-impact social programmes, including the Basic Education Assistance Module (BEAM), the harmonised cash transfer, preventive health programs, and drought mitigation and community recovery. Within the programme, we have established a floor on such social spending.

19. Compared to the 2012 budget outturn, the 2013 Budget projects a somewhat improved flow of diamond revenues to the Treasury, including from royalties, taxes, and dividends, reflecting increased production. Should the volume of these revenues exceed the amounts projected in the Budget, we will use the extra revenue to support critical Government programmes including clearance of validated domestic payment arrears, capital projects, as well as the 2013 constitutional referendum and the harmonised general elections.

20. The 2013 Budget provides very limited funding for the constitutional referendum and the harmonised general elections, whose total cost is estimated to be around US$ 175 million. In view of these financing needs, we have increased excise duty on fuel since the beginning of March (the increase will be rolled back at end-December), and organized a special placement of one-year treasury bills with pension fund managers. The election will have the first call on the resources from renewing operating licence fees for fixed and mobile phone operators, due in June. While these measures are significant, it is possible that they may not be sufficient to finance the elections. The Government is, therefore, seeking assistance from the donor community. We are asking the UNDP to play a key role in coordinating and disbursing donor support, as they did during the constitution-making process. These requests are being considered by the donor countries. But we are committed ultimately to generating the resources to fund the harmonised elections with new measures if need be.

Fiscal Reforms

21. In light of existing budgetary constraints, we intend to increase efforts to boost the efficiency in the use of Government resources. The Public Financial Management Information System (PFMS) has been operationalised and training of users is ongoing to facilitate the work of internal auditors and to ensure timely reporting and strengthened control of expenditures at the various procurement stages.

22. The Government is modernising and strengthening its payroll and human resource management systems. It has already introduced measures to increase the accountability of human resource directors in line ministries, by making them responsible for monitoring vacancies, acquitting pay sheets, and monitoring personnel in their line ministries. By end-June 2013, the Public Service Commission (PSC) will submit to the Ministry of Finance (MoF) a time-bound action plan on measures to modernize the human resources and payroll systems (structural benchmark). Next steps include the following:

- As a part of the e-Governance Policy thrust, the PSC will replace the current manual public sector database with an electronic Human Resource Management Information System (HRMIS). HRMIS will provide secure electronic retrieval, archiving, and sharing of data with the human resource databases of line ministries. With support from the 2013 budget, there will be HRMIS pilots starting in the PSC head office and rolling out to several line ministries and departments over the year. Eventually, the HRMIS will be integrated with the HR databases of all line ministries and departments and with the PFMS. This will strengthen payroll management and help prevent payroll irregularities.

- The Government has developed a Public Service Training and Development Policy to guide the professional development of HR personnel in the public service. Under that policy and with funding from the 2013 budget, it will provide professional training for HR staff in line ministries.

23. Resource constraints have placed the Government and state-owned enterprises in a complex web of cross arrears. While the central and local Governments owe the parastatals, the parastatals owe the Zimbabwe Revenue Authority (ZIMRA), each other, as well as their private sector suppliers. This web of claims and counterclaims burdens the budget and public service delivery, and undermines the solvency and liquidity of both parastatals and the private sector.

24. Our programme includes a strategy to address outstanding arrears and to curb the accumulation of new arrears toward parastatals and other creditors. By end-June 2013, the Ministry of Finance will complete the validation process between the line Ministries and service providers, and publish a report on the stock of verified arrears as of end-December 2012, which will also outline a strategy to clear these arrears by December 2014 (structural benchmark). The strategy will entail, among other things, identifying potential funding and regular reporting through the PFMS. Finally, we commit not to accumulate new domestic payment arrears in 2013.

25. Going forward, we will make sure that payments to service providers take place within 60 days of invoice receipt, and that payments to Public Sector Investment Programme (PSIP) contractors take place within 90 days of the issue of the corresponding certificates of work completion under our capital projects. The Government, in consultation with line ministries and service providers, will put in place standardised and timely billing arrangements by June 2013. The Government also plans to introduce demand management measures to control its consumption of services provided by utilities.

26. On the revenue side, by end-May 2013 we will submit to Parliament the new Income Tax Bill that seeks to simplify and modernise the income tax system in a revenue-neutral way (structural benchmark). We will also develop training programmes for ZIMRA staff assigned to monitor revenue compliance in the mining sector. Technical Assistance (TA) on these issues will be sought from the Fund and our development partners.

27. The Government is undertaking an analysis of the implicit pension liabilities associated with civil servants' retirement schemes. The ultimate objective of this work is to design a reform strategy to ensure a sustainable retirement system that is financed both by employees and the Government as an employer, and is consistent with the Government's overall budget constraint. This is an important and complex issue which requires careful study. We will avoid any actions that could be destabilizing for the budget.

B. Increasing Financial Sector Stability

28. Increasing financial stability is crucial for sustaining economic growth and, despite intensified efforts by financial regulators, significant vulnerabilities persist in the sector. The recent failures of Renaissance Merchant Bank and Interfin Bank Limited underscore the urgent need to enhance the financial sector framework. Toward that end, the Government of Zimbabwe is currently reviewing the Banking Act. Amendments to the Act will be approved by Cabinet and submitted to Parliament by end-September 2013 (structural benchmark). The amendments will focus on the following key areas:

- improving corporate governance in the financial sector, for example, by mandating the disclosure of banks' ultimate beneficial shareholders and by requiring banks to strengthen risk management, corporate governance, and compliance;
- strengthening the Troubled Bank Resolution Framework;
- enhancing consumer protection and transparency by establishing an independent Office of the Banking Ombudsman;
- significantly enhancing coordination among the various regulators in the financial system; and

- facilitating the establishment of a Credit Reference Bureau, which would allow borrowers to capitalize on their good credit histories.

29. Government is also working on strengthening the framework for Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT). This is being done through amendments to the Bank Use Promotion and Suppression of Money Laundering Act. We plan to submit the amended bill to Parliament by end-June 2013.

30. Financial stability is multi-faceted and requires a multi-sectoral approach as challenges to stability may emanate from the banking sector, as well as the non-bank financial sector. Beginning in 2013, we intend to hold quarterly meetings of the Multidisciplinary Financial Stability Committee (MFSC) established in April 2012, which comprises the RBZ, the Securities Commission, the Insurance and Pension Commission, and the Deposit Insurance Corporation. The Committee is responsible for identifying systemic risks and vulnerabilities, as well as for recommending remedial actions. Work is under way to set the minimum parameters for the regular exchange of information among regulators by end-June 2013. The RBZ plans to conduct financial stability assessments in liaison with the MFSC. The RBZ also intends to pay increased attention to macro prudential issues, and to launch its new Financial Stability Report in June 2013. Finally, we will develop a framework for contingency planning and systemic crisis management, which will be submitted to the RBZ Board by end-June 2013 (structural benchmark).

31. The RBZ remains committed to further strengthening and deepening the implementation of risk-based supervision through the Basel II/III framework. Technical guidance was issued in this connection and we introduced Basel II on January 1, 2013. The RBZ incorporated the experience from the preparatory work into updated Basel II/III guidelines.

32. Advancing the restructuring of the RBZ's balance sheet is key to increasing financial sector stability, and we have studied various options in this area. We expect to bring this project to the implementation phase in 2013 with the submission to Parliament of the RBZ Debt Relief Bill by end-September 2013 (structural benchmark). This bill will provide for the creation of a Special Purpose Vehicle which will warehouse the RBZ's non-core assets and liabilities, thus allowing the RBZ to focus on its core responsibilities.

33. The indigenisation of banks will be subject to the need to enhance the stability of the sector and deepen financial sector intermediation, in order to create a conducive environment for mobilising domestic savings to support the productive sectors of the economy.

34. The RBZ has negotiated with the Bankers Association of Zimbabwe a package of measures aimed at promoting savings and strengthening consumer protection, especially for low-income users of financial products and services. The negotiations culminated in the signing of a Memorandum of Understanding between the Central Bank and the bankers in early 2013. The negotiations were guided by the imperative of balancing these objectives against the need to maintain a healthy and stable financial system. To that effect, in addition to giving fair hearing to the representatives of the industry, we conducted a detailed analysis of the impact of the new regulations on all banks. As part of this understanding, we will be conducting regular reviews of the impact of these measures on each bank.

C. Other Structural Reforms

35. In November 2012, Cabinet approved a new Diamond Policy for Zimbabwe, which among other things, gives the Treasury and ZIMRA a right to access trading and financial records for diamond companies. It also gives joint responsibility to the Ministry of Finance and the Ministry of Mines and Mining Development to ensure the accurate computation, accounting, and repatriation of diamond proceeds from companies in which Government has a stake. On that basis, by end-June 2013, the Treasury will produce a report accounting in detail for the diamond dividends, royalties, and other diamond-related cash flows received in 2012 by the Treasury from all enterprises in joint-venture partnership with the state-owned ZMDC involved in the diamond industry.

36. The Government plans to issue a Statutory Instrument (SI) by the end of June 2013, establishing a clear formula for the calculation and remittance of any dividends to Government from those entities it holds shares in (structural benchmark). This is an important step towards ensuring that all diamond revenue is remitted to Treasury, in keeping with the Government's commitment under the Diamond Policy. In addition, all rough diamonds produced shall be sold through a Government-appointed agent. The Government also plans to:

- Submit to Cabinet by end-September 2013 and to Parliament by end-December 2013 amendments to the Precious Stones Trade Act to incorporate the principles contained in the Diamond Policy (structural benchmarks).
- Submit to Parliament by end-December 2013 a new Mines and Minerals Act, which will modernize the legislation to be consistent with international best practices and will also deal with the granting of mining rights and concessions, and with transparency in the mining sector (structural benchmark).

RELATIONSHIP WITH EXTERNAL CREDITORS

37. As part of our implementation of the ZAADDS, we have started the debt validation and reconciliation exercise of our external debt database, with the assistance of UNCTAD and the Macroeconomic and Financial Management Institute (MEFMI), as well as the Paris Club Secretariat. We have contacted all creditors to confirm and sign off on the reconciled data. In this regard, we have received a large number of responses and we hope to conclude the exercise by June 2013.

38. Zimbabwe will remain in external debt distress until ZAADDS, our arrears clearance and debt relief strategy, is fully implemented. We understand fully the implications of any further non-concessional borrowing. In light of this, our priority will be to seek grants and concessional financing from development partners and other sources. If we need to access non-concessional borrowing under exceptional circumstances, we will do so only after receiving a technical assessment report by the AfDB, the Development Bank of Southern Africa, or the World Bank on each project. Such non-concessional borrowing will be restricted to the financing of key enablers such as electricity generation, water supply and sanitation, and the rehabilitation of roads. The technical assessments will cover the effect on debt sustainability of each proposed project, as well as its expected economic and social impact. New non-concessional loans and guarantees by the general government are limited to 3 percent of GDP in 2013. We will consult with Fund staff and provide related documents about non-concessional external borrowing without general government guarantee by state-owned enterprises.

39. We reaffirm our strong commitment to make regular payments to the Poverty Reduction and Growth Trust Fund. Given the tight fiscal space, we are committed to making monthly payments during 2013 of US$ 150,000. We also intend to make payments to the World Bank in the amounts described in their Interim Strategy Note, and comparable payments to the AfDB, during the rest of 2013. We will also engage with the three IFIs on discussions concerning the appropriate payments going forward, with a view to reaching understandings by the time of the first review of the SMP. Over time, as our capacity to pay improves, we expect to gradually increase the size of these payments. We will not draw down further our SDR holdings in 2013.

RISKS AND CONTINGENCY PLANS

40. We see a number of potential downside risks to our programme. These relate to: (i) the pace of the global economic recovery, which will affect the demand and prices for our main exports; (ii) unpredictable supply shocks which could affect the output levels in our key sectors; (iii) perceptions among domestic and foreign investors about our electoral process; and (iv) spending and other policy-related pressures in an election year. In particular, if private investment were to slow down significantly in the period before the elections, this could undermine the overall level of economic activity and revenue collections. If these or other risks were to materialize, the Government, in consultation with IMF staff, stands ready to take additional policy measures to ensure the attainment of our programme's objectives.

TECHNICAL ASSISTANCE

41. Government has identified a number of technical assistance needs to further strengthen our institutional capacity. In the fiscal sector, our top priorities are debt management, medium-term expenditure frameworks and results-based budgeting, expenditure tracking, operationalisation of PFM legislation and regulations, diamond revenue administration, and pension reform. Other priority areas include project management, monitoring and evaluation tools, public enterprise reform, and reform of taxation of pension and insurance sectors.

42. In the monetary sector, our most urgent need is for a financial sector diagnostic assessment, as well as reviews of RBZ's accounting and IT systems and manuals; internal auditing, accounting, and documentation systems; and RBZ's corporate governance and reporting practices. Other high-priority areas include risk-based bank supervision, regulation of the non-bank financial sector, and assessment of financial sector legislation (including central bank legislation).

43. In the area of macroeconomic statistics, our emphasis is on balance of payments, national accounts, price, monetary, and fiscal statistics (including reporting to the Government Finance Statistics Manual (GFSM) and accounting for the country's financial position with the Fund). Other priority areas for TA include macroeconomic data analysis and modelling, and financial programming and policies.

SAFEGUARDS ASSESSMENT

44. On a strictly voluntary basis, and in the spirit of preparing the ground for future cooperation with the Fund, we plan to make a request to the IMF for a Safeguards Assessment (SA) of the RBZ. The voluntary SA will assist us in assessing RBZ's financial controls and its findings will allow us to institute corrective measures, as necessary.

PROGRAMME MONITORING

45. The Government will closely monitor the implementation of its programme for 2013 with the help of quarterly quantitative targets (Table 1) and structural benchmarks (Table 2). The SMP will be monitored based on performance through end-June and end-December 2013, respectively. The quantitative variables and the benchmarks are defined in the Technical Memorandum of Understanding (TMU, Attachment II).

46. Government is committed to ensuring that the programme remains on track, given its importance as a bridge towards a Fund-supported financial programme and hence the importance of establishing a good track record of implementing sound economic policies. To this end, we will appoint a monitoring committee comprised of officials from the Ministry of Finance, Office of the President and Cabinet, Ministry of Economic Planning and Investment Promotion, the Reserve Bank of Zimbabwe, the Zimbabwe National Statistics Agency (ZIMSTAT), ZIMRA, and the Public Service Commission. The committee will coordinate the compilation and reporting of monitoring information (reporting requirements are outlined in the attached TMU).

Table 1. Zimbabwe: Proposed Quantitative Targets
(In millions of U.S. dollars, unless otherwise indicated)

	2013[1]			
	Est.	Program		
	March	June[2]	Sept.	Dec.[2]
1. Floor on primary budget balance of the central government[3,4,5,6,7]	-13	18	80	26
2. Continuous ceiling on new domestic payment arrears	0	0	0	0
3. Floor on protected social spending	19	51	93	144
4. Floor on stock of usable international reserves	143	149	169	171
5. Floor on payments to the PRGT	0.45	0.90	1.35	1.80
6. Continuous ceiling on the stock of new non-concessional external debt contracted or guaranteed by the general government with original maturity of one year or more	330	330	330	330
Memorandum Items:				
Broad Money (stock)	3,948	4,043	4,226	4,225
Reserve Money (stock)	227	232	243	312
Disbursements on medical equipment and supplies loan	0	90	90	90
Unbudgeted costs related to the referendum and elections	28	148	148	148
Unbudgeted revenues from telecom licence fees	0	50	50	50

[1] Value of cumulative flows since December 31, 2012, unless otherwise indicated.

[2] Program performance will be monitored based on the quantitative targets for June 2013 and December 2013.

[3] To be adjusted downwards in any quarter and subsequent quarters by the full amount of any new borrowing disbursed and utilized by central government for priority infrastructure projects.

[4] To be adjusted downwards in any quarter and subsequent quarters by the full amount of any domestic debt issuance by central government ring-fenced for clearance of domestic payment arrears.

[5] To be adjusted upwards (downwards) in any quarter and subsequent quarters by the full amount of any shortfall (excess) in unbudgeted costs related to the constitutional referendum and national elections and incurred by central government, relative to programme assumptions.

[6] To be adjusted downwards (upwards) in any quarter and subsequent quarters by the full amount of any shortfall (excess) in unbudgeted revenues from telecom licence fees received by central government, relative to programme assumptions.

[7] To be adjusted downwards in Q1 by the value of the medical equipment and supplies project loan if the loan were disbursed in that quarter. To be adjusted upwards in Q2 and subsequent quarters by the shortfall in the cumulative disbursement on the loan effected through these quarters, relative to the programme assumption of US$ 90 million.

Table 2. Zimbabwe: Structural Benchmarks, 2013

Benchmarks	**Review**	**Macroeconomic Rationale**
Tax Policy		
1. Submit to Parliament the new Income Tax Bill.	1st	Enhance tax administration
2. Issue a Statutory Instrument establishing a clear formula for the calculation and remittance of dividends from entities in which the Government holds shares.	1st	Increase transparency and accountability
3. Submit to Cabinet amendments to the Precious Stones Trade Act to incorporate the principles of the Diamond Policy.	2nd	Increase transparency and accountability
4. Submit to Parliament amendments to the Precious Stones Trade Act.	2nd	Increase transparency and accountability
5. Submit to Parliament a new Mines and Minerals Act.	2nd	Increase transparency and accountability
Public Financial Management		
6. PSC to submit to MoF a time-bound action plan on measures to modernize the human resources and payroll systems.	1st	Enhance public expenditure and financial management
7. Publish a report on the stock of verified arrears and a strategy to clear validated arrears by December 2014 on MoF's website.	1st	Enhance public expenditure and financial management
Financial Sector		
8. Submit to the RBZ Board a framework for contingency planning and systemic crisis management.	1st	Reduce financial sector vulnerabilities
9. Submit amendments to the Banking Act to Parliament aimed at strengthening the Troubled Bank Resolution Framework.	2nd	Strengthen legal and regulatory framework and reduce systemic liquidity risks
10. Submit the RBZ Debt Relief Bill to Parliament to complete the restructuring of the RBZ balance sheet.	2nd	Reduce financial sector vulnerabilities

ATTACHMENT II. TECHNICAL MEMORANDUM OF UNDERSTANDING

INTRODUCTION

1. This memorandum sets forth the understandings between the Government of Zimbabwe and the IMF staff regarding the definitions of the quantitative targets, the structural benchmarks, the applicable adjusters, and the respective reporting requirements for the Staff-Monitored Program (SMP). The quantitative targets and structural benchmarks are reported in Tables 1 and 2 of the Government's Memorandum of Economic and Financial Policies (MEFP).

DEFINITIONS

2. **Central government** represents a single institutional unit consolidating the 38 accounts (35 ministries, the Parliament of Zimbabwe, the Auditor General's Office, and Vote of Credit) whose total revenues and expenditures are authorized through the Blue Book.[1] The definition excludes public entities with autonomous legal personae whose own budgets are not included in the central government budget.

3. **The general government** comprises the central government, the Reserve Bank of Zimbabwe (RBZ), extra-budgetary funds, social security, and local governments.

4. **The public sector** comprises the general government and all state-owned enterprises.

5. **Non-interest expenditures** are measured on a cash basis. Non-interest expenditures include current expenditures (wages and salaries, pensions, goods and services, grants and transfers), capital expenditures, and net lending. Net lending comprises loans granted by the central government, except in the case of on-lending of externally borrowed funds, which is included as a negative domestic financing item ("below the line"). All expenditures and net lending financed with loans to be serviced by the central government fall within the programme's definition of expenditures and net lending, even if the cash did not transit through the treasury. Non-interest expenditures will be measured from the budget execution data.

6. **Broad money** is defined as total banking sector deposits, net of interbank deposits and excluding government deposits in the banking sector.

[1] The supplementary estimate of expenditure submitted to Parliament by the Minister of Finance together with the budget statement.

7. Reserve money comprises bank and non-bank deposits with the Reserve Bank of Zimbabwe, including bankers' current accounts.

QUANTITATIVE TARGETS

A. Floor on the Primary Budget Balance of the Central Government

8. The primary budget balance of the central government is measured on a cash basis and defined as revenues and grants minus non-interest expenditures. The central government primary balance will be measured from above the line using the budget execution data.

B. Continuous Ceiling on New Domestic Payment Arrears

9. Domestic payment arrears are defined as undisputed overdue domestic payment obligations of the central government to service providers, employees, creditors, capital project contractors, and agricultural input suppliers, including payment obligations on wages, salaries, pensions, transfers, goods and services; and tax refund obligations. Payments on wages, salaries, pensions, and transfers are in arrears if payment is not made within 60 days after their due dates. Domestic debt service obligations are in arrears if the payment is not made on the due date. Payments for goods and services are in arrears if they have not been made within 60 days after invoice receipt for service providers and within 90 days after the invoice date for contractors executing capital projects for the government.

C. Floor on Protected Social Spending

10. Protected social spending is measured on a cash basis and comprises central government spending in the following areas:

- **education** (recurrent spending on teaching and learning materials, on student stipend support from the National Education and Training Fund; and capital spending on upgrading of schools and other facilities);
- **health** (recurrent spending on government hospitals and health centers, on grant-aided institutions such as Parirenyatwa Hospital, mission hospitals, and local authorities, on maternal and child health, on results-based financing, on preventive health programmes, on procurement of ARVs and TB drugs; and capital spending on revitalisation of health institutions, on medical equipment, and on procurement of ambulances and service vehicles);
- **social protection** (recurrent spending on the Basic Education Assistance Module (BEAM), on the harmonised cash transfer, on health assistance, on rehabilitation of disabled persons, on

government social protection institutions; and capital spending on refurbishment of rehabilitation centers);

- **water and sanitation** (capital spending on water and sewer infrastructure for local authorities, on water supply infrastructure for small towns and growth points, and on water and sanitation for rural areas);
- **agriculture** (recurrent spending on animal diseases and risk management, and capital spending on irrigation rehabilitation and development and on input support for disadvantaged households); and
- **other** (capital spending on construction and rehabilitation of rural roads).

D. Floor on the Stock of Usable International Reserves

11. Usable international reserves are defined as the sum of (i) Zimbabwe's SDR holdings; and (ii) the higher of zero and the difference between gross international reserves as reported by the Government of Zimbabwe (adjusted for encumbered deposits and securities and excluding SDR holdings) and the amounts in commercial banks' current and Real Time Gross Settlement (RTGS) accounts. Gross international reserves, excluding Zimbabwe's SDR holdings, include refined gold, balances with foreign banks, foreign treasury bills, securities and investments, foreign currency held by the Reserve Bank of Zimbabwe, and Zimbabwe's reserve position in the Fund. SDRs allocated under the Fourth Amendment of the IMF's Articles of agreement (SDR 66.4 million) and placed in escrow account at the IMF are excluded from the definitions in this paragraph. For the purpose of the programme, SDR-denominated accounts will be valued at the programme exchange rate of US$ 1.54 per SDR.

E. Ceiling on the Amount of New Non-concessional External Debt Contracted or Guaranteed by the General Government with Original Maturity of One Year or More

12. Contracting or guaranteeing of new external debt by the general government applies to debt to non-residents with original maturity of one year or more. For the purposes of the programme, the definition of "debt" is set forth in point No. 9 of the "Guidelines on Performance Criteria with Respect to External Debt" (see Decision No. 6230-(79/140) as revised on August 31, 2009 (Decision No. 14416-(09/91)), attached in Annex I). This quantitative target will be assessed on a continuous basis.

13. The concessional nature of debt will be determined on the basis of the commercial interest reference rates (CIRRs) published by the Organization for Economic Cooperation and Development

(OECD). Debt is defined as concessional if, at the time of its contracting, the ratio between the present value (PV) of debt computed on the basis of reference interest rates and the face value of the debt is less than 65 percent (equivalent to a grant element of at least 35 percent). The PV of debt at the time of its contracting is calculated by discounting the future stream of payments of debt service due on this debt. For debt with a maturity of at least 15 years, the ten-year-average CIRR will be used to calculate the PV of debt and, hence, its grant element. For debt with a maturity of less than 15 years, the six-month average CIRR will be used. To both the ten-year and six-month averages, the same margins for differing repayment periods as those used by the OECD need to be added (0.75 percent for repayment periods of less than 15 years, 1 percent for 15 to 19 years, 1.15 percent for 20 to 29 years, and 1.25 percent for 30 years or more).

14. New non-concessional debt will be contracted or guaranteed only as financing for priority infrastructure projects that have been assessed in consultation with a reputable and independent financial institution, such as the African Development Bank, the Development Bank of Southern Africa, or the World Bank, prior to the signing of the loan agreement and project documents.

F. Adjusters

15. The quantitative target on the primary budget balance of the central government specified under the programme is subject to the following adjusters:

- The floor on the cumulative primary budget balance in any quarter and subsequent quarters will be adjusted downwards by the full amount of any new borrowing disbursed and utilized by central government for priority infrastructure projects.
- The floor on the cumulative primary budget balance in any quarter and subsequent quarters will be adjusted downwards by the full amount of any domestic debt issued by central government ring-fenced for clearance of domestic payment arrears.
- The floor on the cumulative primary budget balance in any quarter and subsequent quarters will be adjusted upwards (downwards) by the full amount of any shortfall (excess) in unbudgeted costs related to the constitutional referendum and national elections and incurred by central government, relative to programme assumptions.
- The floor on the cumulative primary budget balance in any quarter and subsequent quarters will be adjusted downwards (upwards) by the full amount of any shortfall (excess) in unbudgeted revenues from telecom licence fees received by central government, relative to programme assumptions.

- The floor on the cumulative primary budget balance in Q1 will be adjusted downwards by the value of the Medical Equipment and Supplies Project loan if the loan were disbursed in that quarter. The floor for Q2 and subsequent quarters will be adjusted upwards by the shortfall in the cumulative disbursement on the loan effected through these quarters relative to the programme assumption of US$ 90 million. The disbursement date for the purpose of this adjuster is the same as the disbursement date officially communicated by the Lender to the Borrower, as explained in the loan contract.

DATA REPORTING

16. To facilitate the monitoring of programme implementation, the Government of Zimbabwe will prepare and forward to the Fund staff electronically information in accordance with the agreed reporting framework contained in Table 1.

Table 1. Zimbabwe: Data Reporting for Programme Monitoring

Data Description	Reporting Institution	Reporting Frequency	Submission Lag
Monetary and Financial Sector			
NIR, NFA, monetary control program	RBZ	Weekly	1 week
Broad money survey	RBZ	Monthly	2 months
RTGS transactions	RBZ	Monthly	1 month
Prudential liquid asset ratios	RBZ	Monthly	1 month
Cash flow of the RBZ	RBZ	Monthly	1 month
Balance sheets and income statements for financial institutions	RBZ	Quarterly	2 months
Financial soundness indicators (aggregate and by bank)	RBZ	Quarterly	1 month
Lending activity of banks (by sector)	RBZ	Quarterly	1 month
Commercial bank interest rates	RBZ	Monthly	1 month
External Sector			
RBZ purchases and sales of foreign currency	RBZ	Monthly	1 month
Balance of payments (incl. revised outturn for previous quarters)	RBZ/ZIMSTAT	Quarterly	3 months
Import and export data, for aggregated sectors	RBZ/ZIMSTAT	Monthly	1 month
Net international reserves (incl. reserve assets/liabilities by currency)	RBZ	Monthly	1 week
Foreign exchange flow data (by type of flow)	RBZ	Monthly	1 month
Diamond production, exports, and prices	RBZ	Quarterly	1 month
RBZ Monthly Economic Review	RBZ	Monthly	6 weeks
Quarterly report on macroeconomic developments	MoF	Quarterly	1 month
External debt stock, disbursements, amortization, interest, other fees and charges, and repayment (by creditor and currency); detailed terms and conditions of all new contracted and government-guaranteed external borrowing (concessional and non-concessional); and committed undisbursed balances (by creditor)	MoF	Monthly	1 month

Table 1. Zimbabwe: Data Reporting for Programme Monitoring (concluded)

Data Description	Reporting Institution	Reporting Frequency	Submission Lag
Fiscal Sector			
Central Government operations – revenue, expenditure, and financing	MoF	Monthly	1 month
Detailed data on resource revenue (by type)	MoF	Quarterly	1 month
Detailed data on the execution of the capital budget	MoF	Monthly	1 month
Detailed data on the execution of the recurrent budget (by economic and administrative classification and by line ministry)	MoF	Monthly	1 month
Detailed data on the budget execution of protected social spending (as defined in this document)	MoF	Monthly	1 month
Gross payment and gross accumulation of domestic payment arrears (as defined in this document); and stock of domestic payment arrears at end-month	MoF	Monthly	1 month
Domestic debt stock, disbursement, amortization, interest, other fees and charges, and repayment; Treasury bills, including auction date, type of security issued (i.e., maturity), announced auction volume, actual amount issued, amount of bids received, number of bidders, number of successful bidders, discount rate, bid rate; and other government securities	MoF	Monthly	1 month
Details of disbursed external budget support and project grants and loans	MoF	Quarterly	6 weeks
Employment data (for each ministry), and wage bill data (basic salary and allowances for each ministry)	MoF/PSC	Monthly	1 month
Real Sector			
Consumer Price Index	ZIMSTAT	Monthly	1 month
Fuel price indices, including Petrol, Diesel, and Paraffin	ZIMSTAT	Monthly	2 months
Producer Price Index; Building Materials Price Index; Poverty Datum Lines; and Civil Engineering Materials Index	ZIMSTAT	Quarterly	6 weeks
Agricultural production data (volume/value of major products)	ZIMSTAT	Semi-annually	4 months
Mining production data (volume/value by minerals), excluding production from sand and stone quarries	ZIMSTAT	Quarterly	6 weeks
National Accounts (breakdowns of production and expenditure side in real and nominal terms)	ZIMSTAT	Annually	8 months
Quarterly Digest of Statistics	ZIMSTAT	Quarterly	6 weeks
Structural Benchmarks			
Provide a regular report on the status of implementation of the structural benchmarks specified in Table 2 of the MEFP	MoF/RBZ	Monthly	3 weeks

GUIDELINES ON EXTERNAL DEBT

Excerpt from Executive Board Decision No. 6230-(79/140) as revised on August 31, 2009 (Decision No. 14416-(09/91)):

- For the purpose of this guideline, the term "debt" will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows:

  (i) loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);

  (ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until sometime after the date on which the goods are delivered or services are provided; and

  (iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lesser retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property.

- Under the definition of debt set out in this paragraph, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

ATTACHMENT III. LETTER ENDORSING THE SMP

Telephone: 707091/9
Telegram: "SECPRES"

ZIMBABWE

Reference:

OFFICE OF THE CHIEF SECRETARY
TO THE PRESIDENT AND CABINET
Private Bag 7700, Causeway, Zimbabwe

Ref:

7 May 2013

The Director
African Department
International Monetary Fund
Washington, D. C. 20431

Dear Ms Antoninette Sayeh

This note serves to notify you that Zimbabwe's debt resolution strategy, the Zimbabwe Accelerated Arrears Clearance, Debt and Development Strategy (ZAADDS) was approved by the inclusive Government's Cabinet in November 2010. The key tenets of ZAADDS include the following:

- The establishment and operationalisation of a Debt Management Office;
- Undertaking a validation and reconciliation exercise of the external debt data base;
- Reengagement with the creditors and the international community;
- Negotiating with creditors for arrears clearance, a comprehensive debt programme and new financing; and
- Leveraging Zimbabwe's natural resources in pursuit of debt relief and development.

The Inclusive Government has remained committed to the implementation of ZAADDS and significant progress has been made in the implementation of ZAADDS. Cabinet commends the accelerated reengagement with the IMF within the context of the Zimbabwe Accelerated Reengagement Programme (ZAREP), which seeks to address the country's main economic policy challenges which include among others, restoring fiscal and external sustainability, and increasing financial sector stability.

The inclusive Government welcomes the progress achieved in the discussions with the IMF staff on the SMP under the auspices of ZAREP.

In this regard, please be advised that the Cabinet of the Inclusive Government has discussed and endorsed the Programme.

Please be guided accordingly.

Dr MJM Sibanda
CHIEF SECRETARY TO THE PRESIDENT AND CABINET