Zimbabwe: Staff-Monitored Program-Press Release and Staff Report

INTERNATIONAL MONETARY FUND

INTERNATIONAL MONETARY FUND

IMF Country Report No. 19/144

ZIMBABWE

May 2019

STAFF-MONITORED PROGRAM—PRESS RELEASE AND STAFF REPORT

In the context of the Staff-Monitored Program, the following documents have been released and are included in this package:

- A **Press Release.**
- The **Staff Report** prepared by a staff team of the IMF, issued and circulated as for information to the Executive Board on May 22, 2019, following discussions that ended on April 5, 2019, with the officials of Zimbabwe on economic developments and policies underpinning the IMF arrangement under the Staff-Monitored Program. Based on information available at the time of these discussions, the staff report was completed on May 21, 2019.

The documents listed below have been or will be separately released:

Letter of Intent sent to the IMF by the authorities of Zimbabwe*
Memorandum of Economic and Financial Policies by the authorities of Zimbabwe*
Technical Memorandum of Understanding*

*Also included in Staff Report

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
PO Box 92780 • Washington, D.C. 20090
Telephone: (202) 623-7430 • Fax: (202) 623-7201
E-mail: publications@imf.org Web: http://www.imf.org
Price: $18.00 per printed copy

International Monetary Fund
Washington, D.C.

Press Release No. 19/189
FOR IMMEDIATE RELEASE
May 31, 2019

International Monetary Fund
Washington, D.C. 20431 USA

IMF Managing Director Approves a Staff-Monitored Program for Zimbabwe

The Managing Director of the IMF approved on May 15, 2019, a Staff-Monitored Program (SMP) for Zimbabwe, covering the period of May 15, 2019 to March 15, 2020.[1]

Zimbabwe faces deep macroeconomic imbalances. After moving to full dollarization in late 2008 to break a period of hyperinflation, fiscal deficits increased substantially during 2016–18, financed by the issuance of quasi-currency instruments nominally at par to the US dollar and the continued accumulation of external arrears. The fragile equilibrium was maintained through exchange controls and other restrictions on access to foreign exchange, providing a deep distortion for economic activity.

The new government that assumed office following the July 2018 elections is committed to addressing the macroeconomic imbalances, removing structural distortions to facilitate a resumption in growth, and to re-engaging with the international community including by clearing its external arrears. The authorities have elaborated a comprehensive structural reform program—the Transitional Stabilization Program—to address structural rigidities in the economy while also taking key steps to address the macroeconomic imbalances by halting the issuance of quasi-currency instruments to finance the deficit (since September 2018) and introducing a new domestic currency in February 2019.

The SMP is designed to support the authorities' reform agenda. The SMP will be monitored on a quarterly basis, and is intended to assist the authorities in building a track record of implementation of a coherent set of economic and social policies that can facilitate a return to macroeconomic stability and assist in reengagement with the international community. Economic policies under the SMP emphasize the restoration of macroeconomic and financial sector stability through: implementing a large fiscal adjustment, the elimination of central bank financing of the fiscal deficit, and adoption of reforms to allow the effective functioning of market-based foreign exchange and debt markets. Structural reforms include steps to reform and privatize state owned enterprises, enhance governance including in procurement and revenue administration, and to improve the business environment. The SMP also includes important safeguards to protect the country's most vulnerable people.
Risks to the SMP are high, including due to the materialization of two external shocks—the El Niño related drought impacting both agricultural production and electricity supply as well

[1] An SMP is an informal agreement between country authorities and Fund staff to monitor the implementation of the authorities' economic program. SMPs do not entail financial assistance or endorsement by the IMF Executive Board.

as the extensive damage caused by Cyclone Idai in March. The impact of these two shocks complicate an already difficult near-term economic outlook as the economy adjusts to the new policy regime. To mitigate the potential risks from capacity constraints, the IMF will support the authorities' efforts in all policy areas covered by the SMP through tailored technical assistance.

Zimbabwe: Selected Economic Indicators

Population (2017, millions):	16.5
GDP per capita (2017, constant 2011 PPP)	$2,212
Quota (current, SDR millions, % of total)	706.8 (0.15%)
Main products and exports:	Tobacco, gold, platinum, diamonds
Key export markets:	China, EU, South Africa, Zambia

	2016 Act.	2017 Act.	2018 Proj.	2019 Proj.
Output and Prices				
Real GDP growth (%)	0.7	4.7	3.4	-2.1
Nominal GDP (US$ millions)	20,549	22,041	23,113	22,679
Inflation (%, average)	-1.6	0.9	10.6	80.8
Inflation (%, eop)	-0.9	3.4	42.1	49.6
Central government finances				
Revenue and grants (% GDP)	16.8	14.1	12.8	13.3
Expenditure and net lending (% GDP)	23.9	24.0	18.5	17.3
Overall balance (% GDP)	-6.7	-9.7	-7.1	-4.0
Public debt				
Consolidated public sector debt (% GDP)	49.1	54.9	66.4	55.9
Public and publicy-guaranteed external debt (% GDP)	38.9	40.1	41.6	45.4
Money and credit				
Money supply (% change)	18.8	44.2	24.1	32.3
Credit to private sector (% change)	-3.9	5.9	4.0	5.0
Exchange rate (RTGS per USD, eop)	1.1	1.5	3.5	…
Balance of payments				
Current account (% GDP)	-3.5	-1.3	-4.5	-2.2
FDI (% GDP)	1.7	1.4	1.6	0.9
Reserves (months of imports)	0.6	0.5	0.1	0.2

Sources: Zimbabwean authorities; IMF staff estimates and projections.

INTERNATIONAL MONETARY FUND

ZIMBABWE

STAFF-MONITORED PROGRAM

May 21, 2019

EXECUTIVE SUMMARY

Zimbabwe faces deep macroeconomic imbalances. After a period of relative macroeconomic stability when hyperinflation was broken in 2008 with the move to full dollarization, the fiscal situation has deteriorated sharply since 2015. Large fiscal deficits during 2016–18, financed by the issuance of quasi-currency instruments nominally at par to the U.S. dollar, built up pressure in the dollarized economy. The fragile equilibrium was maintained by exchange controls and other restrictions on access to foreign exchange (FX).

Significant economic reforms are underway. The new government that was sworn into office following the July 2018 elections tightened the fiscal stance since September 2018 and introduced a new domestic currency (the "RTGS dollar") in February 2019. The authorities are also advancing on structural reforms as elaborated in their Transitional Stabilization Program (TSP), which seeks to achieve macroeconomic stability and aims at reforming and privatizing state-owned enterprises (SOEs), addressing corruption in procurement and revenue administration, and promoting private-sector investment by improving the business climate.

The authorities request an SMP covering the period May 15, 2019 to March 15, 2020. Staff supports this request, which would assist the authorities to implement key reforms outlined in their TSP, and help Zimbabwe build a track record of sound economic policies as it seeks to normalize relations with external creditors. The revised 2019 budget adopted by Cabinet on April 23 entails further fiscal consolidation by containing the wage bill, reducing transfers to SOEs and improving the design of agricultural subsidies, while protecting vulnerable households and infrastructure spending. The revised budget is anchored on stopping central bank financing of the budget, which is critical to support the new currency.

Risks to the SMP are very high. The large fiscal adjustment needed will be politically and socially difficult to implement. In response to the materialization of two external shocks—the El Niño related drought and the extensive damage inflicted by Cyclone Idai in March 2019—the government increased spending for recovery and protection of the most vulnerable, but the funds available are significantly below estimated needs. With limited access to external financing and the very low level of international reserves, the authorities' room for maneuver is very narrow. There are also significant implementation risks of the monetary and exchange rate reforms, as well as addressing governance and corruption weaknesses, which could adversely impact the attainment of SMP objectives.

Approved By
David Robinson (AFR) and Maria González (SPR)

Prepared By
African Department

Discussions took place in Harare during November 7–20, 2018 and April 1–5, 2019. The missions met with Finance Minister Ncube; Reserve Bank of Zimbabwe Governor Mangudya; other senior government officials; and representatives of the donor community and the private sector. The staff team comprised H. Leon (head), N. Hobdari, T. Lessard, F. Lima (all AFR), Y. Jung, D. Gurara (both SPR), E. Karlsdóttir and I. Gudbjartsdottir (both MCM). P. Imam, P. Chishawa, and B. Banda (IMF Resident Representative in Harare office and local staff) assisted the mission. D. Robinson (AFR) and W. Nakunyada (OED) participated in key policy discussions. L. Almeida, J. Vibar, and S. Ourigou (all AFR) assisted from headquarters.

CONTENTS

TABLES

ANNEX

APPENDIX

CONTEXT

1. **President Mnangagwa—who headed the transitional government following the resignation of former President Mugabe in November 2017—secured a narrow majority in the July 30, 2018 elections.** The ZANU-PF party that has ruled since independence, retained its large majority in Parliament, winning 66 percent of seats with staunch support coming from rural communities, its traditional stronghold. The pre-election period and election day were viewed by international observers as mostly peaceful, free, and fair. The violent repression of protests that occurred on August 1, 2018 and January 24, 2019 were universally condemned by the international community, setting back Zimbabwe's efforts to re-engage with its external partners.

2. **While the dollarization of the economy in late 2008 restored macroeconomic stability after hyperinflation, the economy deteriorated sharply after 2015 with high deficits financed through the issuance of quasi-currency instruments from the Reserve Bank of Zimbabwe (RBZ) (Figure 1).** After running fiscal deficits of less than 3 percent of GDP between 2008 and 2015, the fiscal deficit jumped to 9.9 percent of GDP in 2017, driven by current expenditure increases, especially agricultural subsidies and spending on goods and services, with the wage bill remaining unsustainably high (text table). Revenues also declined as a percentage of GDP as the commodity cycle reversed. Fiscal deficits were mostly financed through monetary accommodation by the issuance of domestic quasi-currency instruments, comprising bond notes and coins as well as RTGS$ bank balances.

Zimbabwe: Fiscal Outturn 2017 vs. 2015
(percent of GDP)

	2015	2017	Change
Revenue	**18.7**	**14.1**	**-4.6**
Tax	17.8	13.2	-4.6
Nontax	0.9	0.9	-0.1
Expenditure	**21.0**	**24.0**	**3.0**
Current	20.8	23.4	2.6
Wage bill	15.2	12.7	-2.4
Subsidies	2.5	5.8	3.4
Goods and services	1.6	3.2	1.6
Transfers	0.7	0.8	0.1
Interest	0.9	0.8	0.0
Capital	0.2	0.5	0.4
Deficit	**-2.3**	**-9.9**	**-7.6**

Source: Zimbabwean authorities and IMF staff calculations.

3. **Zimbabwe remains in debt distress, with external arrears of US$5.7 billion at end-2017, which prevent new financing from the IFIs and limit access to external financing to non-traditional official and commercial creditors (Box 1 and Table 1).** Total consolidated public debt outstanding at end-2017 (net of RBZ loans) was 55 percent of GDP, although the recent sharp increase in inflation together with the 1:1 conversion from US$ to $RTGS has inflated away a sizable portion of the real value of domestic public debt, which is projected to decline from about 25 percent of GDP at end-2018 to an expected 11 percent at end-2019. While the complete debt picture at end-2018 is not available, arrears to IFIs (World Bank, AfDB, and EIB) amounted to US$2.6 billion as of end-December.

Box 1. Current Debt Situation

Zimbabwe's public debt has increased sharply in recent years due to unsustainable fiscal deficits that have fueled debt issuances. External debt reached 40 percent of GDP at end-2017, most of which is in arrears (Text Table 1). With limited access to external financing, the deficit has been, until recently, largely financed domestically through money creation by the RBZ, the accumulation of external arrears, and domestic banks purchasingT-bills.

Text Table 1. Zimbabwe: Public and Publicly Guaranteed Debt
(USD millions; as of end-2017)

	DOD	Arrears	Total	% of GDP
External Debt[1]	**3,177**	**5,652**	**8,829**	**40%**
Bilateral Creditors	1,443	3,327	4,770	22%
Paris Club	240	2,990	3,230	15%
Non Paris Club	1,203	336	1,539	7%
Multilateral Creditors	1,060	2,262	3,322	15%
World Bank	246	1,174	1,420	6%
African Development Bank	37	641	678	3%
European Investment Bank	22	287	309	1%
Afreximbank	622	67	690	3%
Others	133	93	226	1%
Commercial Creditors	674	63	737	3%
Domestic debt[2]	**6,983**	**149**	**7,131**	**32%**
Government Bonds	4,785	-	4,785	22%
RBZ loans	2,103	-	2,103	10%
Domestic Arrears	-	149	149	1%
Other	94	-	94	0%
Farmer's compensation[3]	**2.4-10 USD billion (11-45% GDP)**			

Source: Zimbabwean authorities and IMF staff calculations.
1/ External public and publicly-guaranteed debt, including RBZ and SOEs.
2/ Unconsolidated domestic debt of the central government.
3/ Contingent liability.

Establishing a definitive picture of Zimbabwe's debt outlook is difficult given the considerable uncertainty surrounding the current macroeconomic background and significant contingent liabilities.

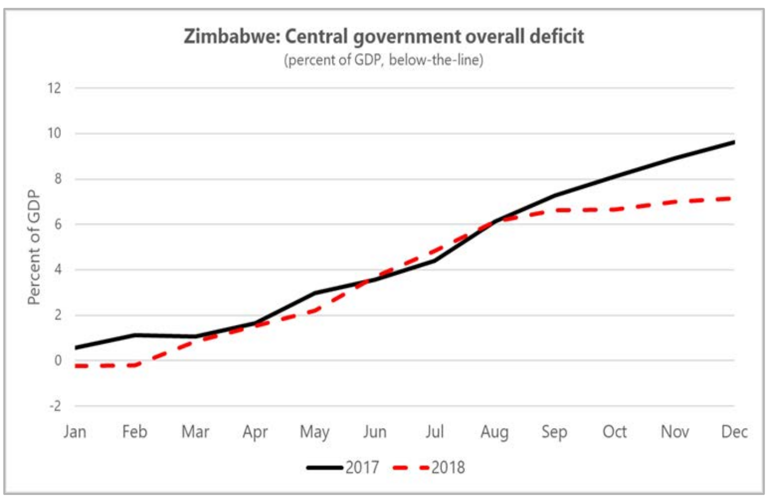
- First, the recent currency reform (see ¶6) has added significant uncertainty to the outlook for inflation and interest rates, as well as the level of GDP at the new domestic currency (see Box 3). These large uncertainties make it particularly difficult to assess the public debt outlook at present, but the expectation is that an updated debt sustainability analysis (DSA) will be conducted at the 1st Review of the SMP (to be coupled with the Article IV consultation).
- Second, official debt data does not include contingent liabilities related to compensation for the expropriated farm land and expulsion of white farmers that occurred under the Mugabe-era Indigenization program (current estimates vary from US$2.4-10 billion). The government has committed to partially compensate farmers for costs incurred from the expulsion off the farmland, but the amount, as well as the modalities for the compensation, has not been agreed. A first payment of RTGS$60 million is included in the 2019 Budget.
- Third, the authorities have committed to assume FX-losses of banks (related to their negative net open positions at the time of currency reform (see ¶25)) and non-financial corporates (related to foreign currency debt arrears that were accumulated prior to the currency reform).

Zimbabwe has protracted arrears on external debt, which has cut off access to official financing. The authorities have expressed a renewed commitment to reengage with the international community, beginning by clearing multilateral arrears with the IFIs, and they have recently made token payments to the IFIs. However, the authorities have also contracted a new commercial debt from an established external creditor that has been collateralized with future mineral exports. While the loan is necessary to assist in the authorities' response to the economic and humanitarian crisis, it has the potential to further complicate negotiations with external creditors to restore debt sustainability.

RECENT ECONOMIC AND POLITICAL DEVELOPMENTS

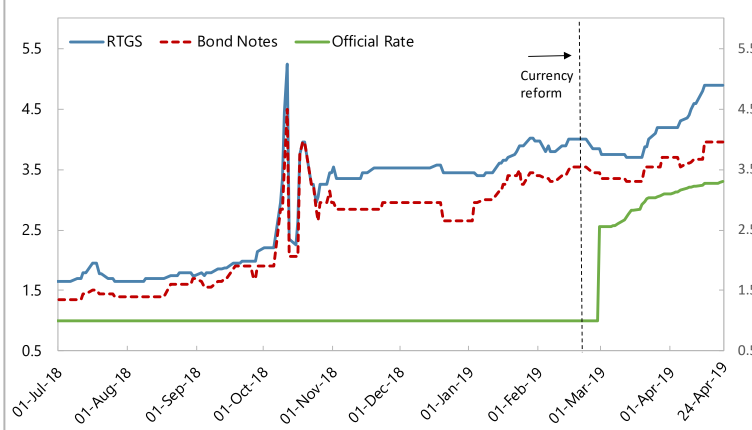
4. Economic outcomes have deteriorated in recent months, in part a result of near-term disruptions as the authorities seek to address the distortions created by past policies. Inflation increased to 66 percent (y-o-y) in March 2019 from 5.3 percent in September 2018, reflecting continued exchange rate pass-through and uncertainty about the currency reform. The second-round impact of the 150 percent hike in fuel prices (January 2019), increases in education fees and food prices, and expected hikes in electricity and telecommunication prices are expected to push inflation higher in the near term. Real GDP growth is estimated to have weakened to 3.4 percent in 2018 (from 4.7 percent in 2017), due to disruptions that began in late-2018 owing to foreign exchange and fuel shortages, especially in the mining sector. Activity in agriculture has also been adversely affected by a severe drought, but tourism is holding up. The current account deficit widened to an estimated 4.5 percent of GDP in 2018, due to a rapid expansion of imports driven by the loose fiscal and monetary policies.

5. Fiscal policy has been significantly tightened since September 2018. The overall fiscal deficit (on a cash basis) in 2018 was about 7.1 percent of GDP compared to 9.7 percent in 2017, with the adjustment coming since the new government came into office following the July 2018 elections (text figure, and Tables 1 and 3). Preliminary data for the first quarter of 2019 show revenues at about RTGS$1.9 billion (about 30 percent higher than expected), reflecting proceeds from the 2 percent financial transaction tax introduced in October 2018, the hike in the fuel excise in January 2019, and higher inflation. To signal its commitment to fiscal consolidation, the government has repaid maturing government debt in the first quarter of 2019.



6. The authorities are introducing significant monetary reforms. On February 20, they introduced a domestic currency (the "RTGS dollar") and announced the creation of an interbank FX market where it would be traded.[1] To jumpstart the newly established FX market, the RBZ has sold relatively small amounts of FX on the interbank market (about US$50 million through end-March), though non-RBZ supply has so far been negligible. While the premium in the parallel FX market fell immediately after the reform, it has since risen, reversing the temporary reduction in economic distortions (text figure). The RBZ also announced the adoption of a monetary policy framework based on money targets to help anchor inflation and stabilize the exchange rate, but also suggested in the February 2019 Monetary Policy Statement that it would intervene to stabilize the exchange rate.

Zimbabwe: Parallel Market Exchange Rate
(Local currency unit per 1 US$)



7. Broader structural reforms are underway. The government has approved the reform framework for 43 SOEs and parastatals, aimed at making them fully accountable, transparent, and economically viable, complementing government's broader efforts in promoting economic growth and improving service delivery. In addition, the government is targeting 5 key SOEs for privatization/divestiture and is preparing turnaround strategies for at least 20 SOEs with technical assistance from various development partners. To ease the cost of doing business, a one-stop shop for investors is expected to become operational in the second quarter of 2019, aimed at significantly improving the investment climate by facilitating investment approvals.

8. Political reforms are advancing. Cabinet has approved the repeal of the Public Order and Safety Act (POSA) and Access to Information and Protection of Privacy Act (AIPPA), and these are expected to be voted on in the National Assembly by end-June 2019. In addition, modifications to the Police Act and Citizenship Act are expected to be tabled soon in the National Assembly and government has expressed a commitment to broader political and governance reforms in their TSP, including upholding freedoms of expression and association, respect for human and property rights, improved governance and rule of law, and an aggressive fight against corruption.

[1] In a letter dated April 30, 2019, Zimbabwe has formally notified the Fund of its intention to change the representative rate from the U.S. dollar to RTGS$ in Zimbabwe's IMF accounts, as required under the Fund's Rule O-2 (b). Further consultation with the authorities is needed to fully effect this change. Staff will seek Executive Board approval on this change as required under the Fund's rule O-2(c).

9. **Significant international financial support would be needed to provide emergency assistance to Zimbabwe in the wake of Cyclone Idai (Box 2).** The cyclone that hit eastern Zimbabwe in March caused substantial loss of life and extensive damage to communities, exacerbating an already difficult food security situation from persistent drought conditions. While the amount of losses from business disruption is still unclear, recovery costs are expected to be very high and significant external financial support would be needed for emergency response and infrastructure rehabilitation, including for essential foods, pharmaceuticals, and fuel.

Box 2. Impact of Cyclone Idai on Zimbabwe

Cyclone Idai, the strongest cyclone on record in the Southern Hemisphere, struck Malawi, Mozambique, and Zimbabwe on March 13–15, 2019. The devastation is affecting about 3 million people across the three countries while domestic and international stakeholders continue working towards a comprehensive response effort to the cyclone.

The United Nations estimates that nearly 250,000 Zimbabweans have been affected, and nearly 30 percent of households in affected areas need shelter. The cyclone has also exacerbated food insecurity in Zimbabwe, which was already at high levels because of the persistent drought conditions; before the cyclone hit the WFP had estimated that approximately 5 million Zimbabweans would be food insecure in 2019. While the international community is starting to mobilize grants to assist with the recovery efforts, the government has allocated RTGS$100 million (about US$30 million at the official rate) for emergency response and infrastructure rehabilitation, including for essential foods (e.g., maize), pharmaceuticals, and fuel.

The World Bank estimates the physical damage to the capital stock from the cyclone to be around US$640 million (3 percent of GDP). The losses from business disruption, including lost agricultural output will add to the direct cost of the cyclone, as losses on agriculture and other economic activities will slow investment and growth. The UN launched a revised Flash Appeal of US$294 million (including an additional US$60 million for the cyclone) on April 5th, and the World Bank is providing an exception allocation up to $75 million under the IDA Crisis Response Window. However, financing needs are expected to rise. In response to the cyclone devastation and humanitarian consequences of the drought, the authorities have had to resort to commercial borrowing, collateralized against future commodity exports, and administered by the RBZ. The new debt worsens the country's debt distress, but will finance critical imports that will assist in avoiding the worst of aspects of the unfolding humanitarian and economic shocks. The debt, with a maximum of US$500 million, is expected to be disbursed in tranches, as needs dictate.

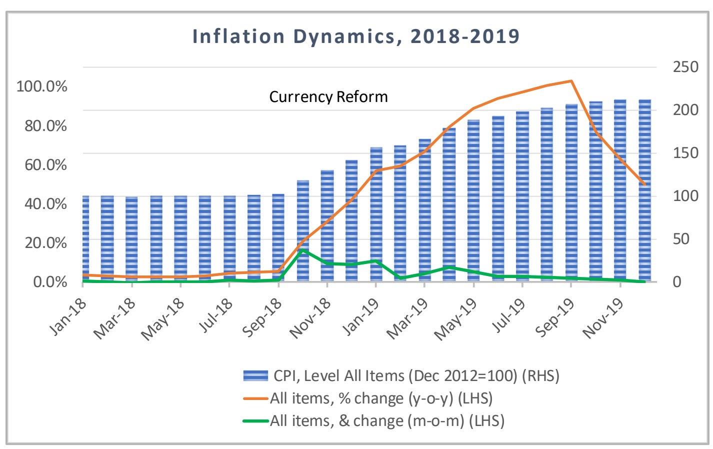
THE STAFF-MONITORED PROGRAM

10. The SMP is anchored on the policies laid out in the authorities' TSP. The SMP foresees the elimination of central bank financing of the fiscal deficit—implying a significant fiscal consolidation—as a critical step in addressing Zimbabwe's key macroeconomic challenges. Specifically, the main objectives of the SMP are to: (i) reduce the fiscal deficit to restore macroeconomic stability, while maintaining investment in infrastructure and priority social spending; (ii) stop monetary accommodation of the fiscal deficit to stabilize inflation and the exchange rate; (iii) increase financial sector stability by implementing financial sector reforms and tightening the regulatory framework; (iv) address governance and corruption vulnerabilities; and (v) advance the structural reform agenda, including in Public Financial Management (PFM) and revenue administration.

A. Macroeconomic Outlook and Risks

11. The baseline is built on the implementation of the revised 2019 Budget approved by Cabinet on April 23 together with additional reforms to facilitate growth. The baseline includes: continued fiscal consolidation (text table and section B below); a tight monetary policy, including no monetary financing of the deficit; and comprehensive structural reforms to facilitate private investment, increase the efficiency and transparency of public spending, and address governance vulnerabilities. Specifically:

- The ***exchange rate***, after a period of high volatility and overshooting, is expected to appreciate slightly relative to the current level in the parallel market, consistent with the tight fiscal and monetary policies targeted under the program.
- Real GDP ***growth*** is projected to be negative in 2019 (-2.1 percent), as the significant consolidation and the impact of the drought and the cyclone drag down economic activity. A rebound in economic activity is expected in 2020 and over the medium term, as uncertainty declines, distortions from multiple exchange rates are removed, and relations with external creditors normalize.



- Monthly ***inflation*** is expected to moderate starting in mid-2019, which would help to anchor inflation expectations and nominal interest rates. Nevertheless, the headline year-on-year inflation would remain high throughout 2019 due to base effects.

Medium-Term Macroeconomic Framework—Baseline (Reform Scenario)

	2016 Act.	2017 Act.	2018 Est.	2019 Proj.
Real GDP growth (in percent)	0.7	4.7	3.4	-2.1
Inflation (percent, average)	-1.6	0.9	10.6	80.8
Inflation (percent, eop)	-0.9	3.4	42.1	49.6
Current account balance (percent of GDP)	-3.5	-1.3	-4.5	-2.2
Overall fiscal balance (cash basis, percent of GDP)	-6.7	-9.7	-7.1	-4.0

1) Excludes (i) any potential external debt restructuring, and (ii) contingent liabilities to farmers.

Sources: Zimbabwean authorities; IMF staff estimates and projections.

12. **However, the outlook for 2019 remains very uncertain and the program will likely need to be recalibrated, perhaps significantly, as the situation unfolds.** The FX shortages and sharp widening of the spread in the parallel market in late 2018 caused significant disruptions in the availability of essential goods (fuel, pharmaceuticals), adversely impacting economic activity and causing a spike in inflation. The currency reform introduced in February is an important step forward, but there is substantial uncertainty as to how economic activity and prices will adjust to the new policy regime with a market-determined exchange rate, improved access to FX, and tight monetary and fiscal policy. Mining disruptions are ongoing, while for agriculture strong, but late, rains will at least partially offset the erratic weather effects of El Niño and input shortages (fuel and fertilizer). For the banking sector, the impact of currency liberalization and projected slowdown in economic activity could impair balance sheets. The reduction in support to SOEs and their privatization could also cause disruptions and lead to higher-than-expected price increases. There is also a significant uncertainty on the level of GDP in domestic currency (Box 3).

13. **Risks to the outlook remain tilted to the downside and include factors both within and outside the authorities' control.** Policy slippages, or interference by vested interests, could impede ongoing efforts to have market-determined exchange and interest rates. Similarly, spending pressures, particularly on wages, social support, subsidies to SOEs and agriculture, and financial sector bailouts could jeopardize fiscal goals. The envisaged deep fiscal adjustment needs to be carefully implemented to avoid a too heavy toll on vulnerable portions of the population. However back tracking on the fiscal adjustment by resorting to central bank financing of the deficit could precipitate a vicious wage-price spiral. Factors beyond the authorities' control include a worse-than-envisaged agricultural season, exacerbating risks of poverty and social discontent, and a slow recovery in confidence that delays a resumption of economic activity, particularly in export industries like mining. The outlook also does not factor in a significant macroeconomic impact from Cyclone Idai or the drought. On the other hand, there are also potential upside risks if confidence is quickly restored.

Box 3. Nominal GDP in Domestic Currency

Following the currency reform, many statistical series (e.g. nominal GDP) need to be re-estimated in the new currency, the RTGS$. Zimbabwe's National Statistics Agency (ZIMSTAT) aims to have revised macroeconomic statistics series ready in 2019; until then, a proxy for nominal GDP is required to guide policy discussion. A key implication of the depreciation of the RTGS$ against the USD is that nominal GDP in local currency has grown rapidly, driven by a large GDP deflator. As a temporary measure until ZIMSTAT finalizes the new series of nominal GDP in RTGS$, Fund staff has developed an approximation using the following approach:

- First, nominal GDP is estimated in US dollars. For the historical years between 2009 and 2017, the data produced by ZIMSTAT are used. For 2018 and after, we develop projections in U.S. dollars using standard methodologies, including sector-level forecasts, as well as international commodity price and United States GDP deflator forecasts taken from the WEO.

- Second, annual tax collections in US dollars are estimated to produce a tax ratio. Tax payments in Zimbabwe are predominantly paid through domestic bank transfers, and thus are paid in RTGS$. We use monthly data on tax collections and the RTGS$:US$ parallel market exchange rate to convert RTGS$ tax collections into US dollars. A key observation of these calculations is that the tax ratio has been declining rapidly, falling from 18 percent in 2015 to 12 percent in 2018. While tax collections have been increasing rapidly in nominal terms, the steady depreciation of the RTGS$ against the US$ implies that the US$ value of tax revenue has been declining in recent years.

Using the tax ratio from the US dollar-based calculations and total tax collections in RTGS$, we then obtain an estimate of nominal GDP in RTGS$ for 2018 and earlier years. Although a crude estimate, the RTGS$ series could be underestimated: similar declines in the tax ratio were observed a decade ago during the high inflation period, and now as then tax evasion is a key contributor. For example, it became common in recent years to compute tax liabilities based on the "US dollar cash" price, while paying taxes in RTGS$ at 1:1. Thus, while prices measured in RTGS$ increased rapidly (owing to depreciation), tax liabilities in "US dollar cash" price lagged.

B. Fiscal Policies: Restoring Macroeconomic Stability

14. Significant fiscal adjustment is needed to stabilize the economy and restore confidence. For 2019, under the revised budget, the authorities are targeting a deficit of RTGS$ 2.8 billion (about 4.0 percent of GDP compared to 7.1 percent in 2018). Over the medium term, the authorities' twin fiscal anchors are a public debt level under 60 percent of GDP and an overall fiscal deficit under 3 percent of GDP, as legislated in the Public Financial Management Act and consistent with SADC agreements (MEFP ¶9).

15. The revised 2019 budget is consistent with ending monetary financing from the RBZ (MEFP ¶12). Deficit financing from the central bank was halted starting from December

2018.[2] The RBZ overdraft will be used only for short-term cash management, with new drawdowns to be fully repaid by the end of each quarter and limited to no more than 5 percent of revenue in the previous year.

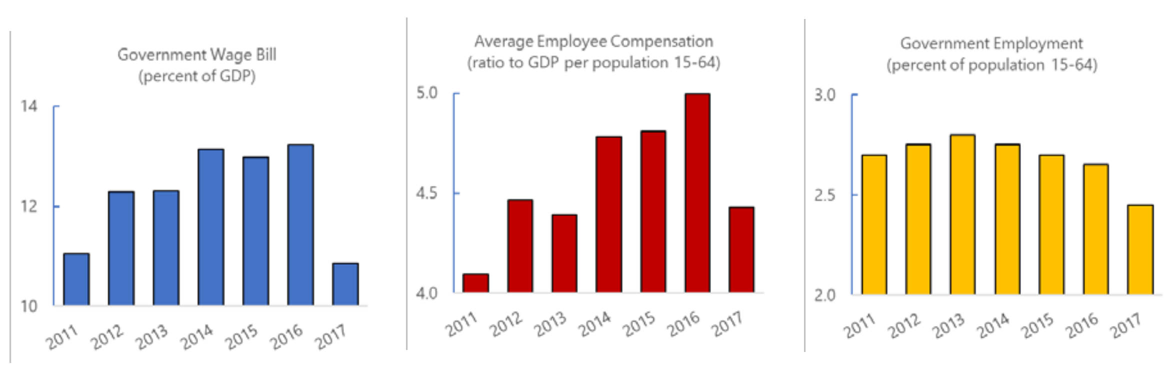
16. To achieve this deficit target, the Budget focuses on containing spending in real terms, while protecting vulnerable households and infrastructure investment. The key consolidation measures include:

Cabinet-Approved Revised Budget 2019 (highlights)
(percent of GDP)

	2018	2019		
	Outturn	Initial Budget	Cabinet-approved Revised Budget	Revised vs. 2018
Expenditure				
Lower expenditure				
Containing wage bill	9.2	5.8	6.6	-2.6
Rationalizing agricultural support	4.2	0.9	2.3	-1.9
of which: Grain subsidies	2.5	0.4	0.8	-1.7
of which: Input schemes	1.6	0.4	1.4	-0.2
Lower transfers to SOEs	0.7	0.1	0.5	-0.2
Higher expenditure				
Ring-fencing social spending	0.3	0.3	1.1	0.8
Infrastructure spending	1.3	1.6	2.5	1.3
Transfers to provinces	0.0	0.4	0.4	0.4
Pension reform	0.0	0.3	0.1	0.1
Revenue				
Higher revenue				
Electronic transactions tax	0.4	0.9	1.7	1.3
Fuel excise increase	1.5	1.0	2.4	0.9
Improved compliance and tax arrears clearance	0.0	0.3	0.9	0.9
Total consolidation effort				-5.2
plus: Other revenue and spending adjustments to inflation				2.2
Deficit	7.1	2.2	4.0	-3.1

- **Wage bill (MEFP ¶10).** The public wage bill will be reduced by 2½ percent of GDP by (a) limiting wage increases in 2019 to 18 percent in nominal terms, at a time that average inflation is projected to be over 4 times as high; (b) revising the 13th cheque formula to apply only to basic salary; (c) retrenching a number of youth officers; and (d) adopting a 5 percent nominal pay cut for top civil servants. These measures, which are a first step to address the main driver of the rise in the wage bill in recent years (the increase in compensation, text figure), will bring the ratio of the wage bill to tax revenue from 82 percent in 2017 to 47 percent in 2019.

Drivers of the Public Wage Bill, 2011-2017



Source: Zimbabwean authorities and IMF staff calculations. Wage bill excludes pension costs.

- **Addressing grain subsidies (MEFP ¶10 bullet 2).** Reducing expenditure to 2.3 percent of GDP in 2019, by ensuring that the proceeds from grain sales are returned to the

[2] This excludes the T-bills issued through February 20, 2019 by the RBZ for incentives related to the repatriation of remittances and the surrendering of export proceeds. These incentives result from purchasing FX at a rate between 1.05 and 1.2 US$/$RTGS, rather than the then official rate of 1:1, depending on the type of FX inflows.

budget, and by keeping the difference between purchase and selling prices for grain at their current levels (Box 4), with a view to phasing them out by the 2021 budget. These actions will limit the fiscal costs of agricultural support as the government develops a comprehensive reform plan for the sector that will not only rationalize spending but also improve efficiency (end-September structural benchmark, MEFP ¶10). However, drought and food security concerns will necessitate additional support for the sector and government has allocated additional resources, especially for production of maize.

Box 4. Agricultural Support

Agricultural support has greatly expanded in recent years to an estimated direct fiscal cost of 4.2 percent of GDP in 2018; up from less than 1 percent in 2013. The programs are intended to overcome structural barriers, increase productivity, and reduce poverty. Key elements include:

A grain subsidization program for the purchase (and sale) of maize was a fundamental driver of the 2018 fiscal deficit, costing nearly RTGS$1.1 billion. The losses on operations stemmed from the difference between the guaranteed purchase price for maize, (US$390 per ton) vs. a prevailing regional market price of US$290, and the subsidized selling price of US$240. While maize represents the bulk of the agricultural price subsidy costs, similar price guarantee schemes have been put in place for other crops (e.g. wheat), with similar loss-making price differentials.

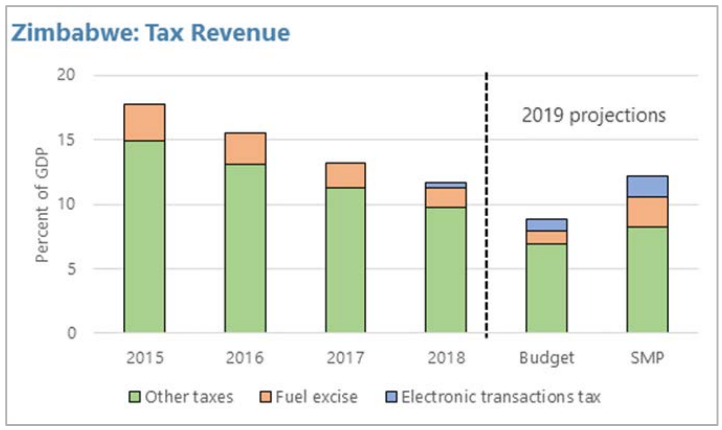
The 'Presidential Input Scheme' and 'Command Agriculture' are the central programs in the authorities' agricultural system, which they plan to rationalize in 2019. The former program oversees the distribution of inputs to farmers for free (or at highly subsidized rates), and aims to protect vulnerable households, but suffers from a lack of targeting. Command agriculture is the main vehicle for the authorities to spur agricultural production, mostly by focusing on the provision of loan guarantees to farmers for the purchase of inputs. Despite successful agricultural seasons in recent years, the default rate on these loans has been very high (above 35 percent), with strategic default and off-selling playing an important role. Despite these drawbacks, and the large fiscal costs, the Ministry of Lands, Agriculture, and Rural Resettlement remains bullish on the program and the possibility of further expanding it into other agricultural commodities.

Overall, there is substantial scope for improving the efficiency, targeting, and catalytic role of government support to the agricultural sector while rationalizing expenditures. Leakages, rent seeking, and high default rates limit the ability of the current agricultural schemes to tackle the root causes of agricultural inefficiency, which are rooted in human and physical capital shortages. The 2019 Budget envisages a gradual phasing out of these subsidies, allowing the private-sector to take the lead in driving sustainable growth in the agricultural sector. This could generate significant productivity improvements, which is low by regional standards, but requires a reorientation of support to improving infrastructure, human capital, and access to finance.

- **Limiting transfers to SOEs (MEFP ¶15 and ¶16).** The Budget significantly reduces transfers to SOEs, in line with the authorities' efforts to privatize or liquidate 43 parastatals and strengthen governance and accountability in 31 other state-owned companies and reduce the scope for corruption. In addition, the Government has committed to reviewing the mandate of ZAMCO (its asset management corporation), and to freeze any additional financing for its operations. The authorities have established a

SOE restructuring agency and Cabinet has approved an ambitious plan to reduce the public sector's imprint on the economy. That said, while significant preparatory work has taken place, there are significant risks of slippages to the aggressive timelines as the authorities need to overcome vested interests and find suitable parties interested in assuming the enterprises. No privatization proceeds have been included in the 2019 budget.

- **Revenue increases (MEFP ¶10).** The 2 percent tax on electronic financial transactions introduced in October 2018 is projected to raise about RTGS$1.2 billion (or 1.7 percent of GDP) in 2019. In addition, the hike in fuel excise taxes in January contributed temporarily to revenue growth, but the planned change later in 2019 to establish a transparent fuel price adjustment formula would lock in a much lower excise tax for diesel and petrol sales. The reduced excise tax will allow fuel importers to receive payment that is enough for cost recovery plus a margin without further immediate adjustment to fuel prices. Once the situation stabilizes, prices will move downward or upward based on the price adjustment formula. Nevertheless, overall excise receipts are projected to increase revenue by RTGS$1.1 billion (an increase of 0.7 percent of GDP relative to 2018). The authorities have also increased efforts to improve compliance and clear tax arrears, which are expected to yield about RTGS 600 million (about 0.9 percent of GDP) in 2019.



17. Expenditure is being reoriented towards social spending, undertaking the legally required changes to improve the long-term sustainability of the pension system, and complying with Constitutional requirements on devolution (MEFP ¶11).

- The World Bank estimates that the national poverty rate would increase significantly because of the drought and Cyclone Idai. To alleviate the impact of these weather-related shocks, as well as from the economic contraction and the significant increase in inflation, the revised Budget increases spending on education, health, and social protection programs targeted at vulnerable households. Poverty alleviation measures in the revised Budget include the distribution of food reserves to the most vulnerable population at subsidized prices, scaling up the cash transfer program, support to rural areas (farmers) affected by drought, expanding the free food program in schools, and subsidies for public transportation following the sharp increase in fuel prices in January.

- A defined-contribution pension system is expected to be introduced in the last quarter of 2019. This reform is expected to cost an additional 0.07 percent of GDP (0.3 percent of

GDP on an annualized basis), while delivering significant savings over the long-term (Box 5).[3]

- The revised Budget earmarks five percent of projected revenue (about ½ percent of GDP) to be transferred to provinces and municipalities, in line with Constitutional requirements (Box 5). To help ensure effectiveness of spending by sub-national governments, the authorities plan to require 37 districts to adopt the financial management provisions in the PFM Act and undertake IFMIS coverage by end-December 2019 (MEFP ¶13). Staff expressed support for the devolution reform, but nevertheless encouraged the authorities to ensure that this important reform is well planned and executed, especially in view of fiscal constraints and the need to protect the quality of services provided.
- **To protect the most vulnerable in society the authorities have proposed a target within the SMP that puts a minimum floor on social spending (MEFP ¶11).** The floor on social spending (RTGS$750 million for 2019) ensures that funds for various social programs, (including school meals, maternal and child health, and cash transfers) will have the necessary fiscal resources.

18. The financing of the fiscal deficit in 2019 relies mainly on issuing debt instruments in the domestic market. The program targets raising 3½ percent of GDP from commercial banks, which is not expected to crowd out lending to the private sector given banks' excess liquidity and weak demand for credit from the private sector. Issuance is to be at market interest rates, with auctions of Treasury bills expected to start in the second half of 2019, which will put pressure on the government interest bill. Non-banks—insurance, pension and asset management firms—are projected to contribute about ½ percent of GDP in budget financing in 2019, reflecting in part a doubling of the minimum asset ratios these institutions are required to hold in government securities.

19. PFM reforms under the SMP focus on strengthening expenditure control, transparency, and budget formulation, which will help address governance vulnerabilities and reduce the scope for corruption (MEFP ¶13). The authorities are committed to enforcing compliance with their Public Finance Management Act, including by imposing penalties for non-compliance. The reforms include an immediate stop to all quasi-fiscal activities by the RBZ and prohibiting line ministries and other budgetary units from either committing expenditure outside the PFM system or issuing Treasury bills for unbudgeted spending and payment to private-sector contractors. Finally, the authorities will conduct a stock-take of existing domestic arrears and improve the tracking of arrears in their PFM system, with the assistance of a forthcoming FAD technical assistance mission (MEFP ¶17).

[3] While the central government deficit is affected by the pension reform, the general government deficit (that includes the social security fund) is not.

Box 5. Pension and Devolution Reforms

Pension reform. The pension reform included in the 2019 budget is the first step in moving from the current "Pay-as-you-go" pension arrangement to a funded pension scheme as laid out in the TSP and Budget Strategy Paper and approved by the National Assembly on January 29, 2019. The new pension scheme aims to improve fiscal sustainability by aligning future pension benefits (16.5 percent of pensionable compensation) with the level of actual pension contributions. Initially, this reform will represent a fiscal cost to the budgetary central government, but nothing additional to the general government (see footnote 3), since all employers will be required to make social contributions directly to a Pension Fund scheme.

Devolution reform. The requirement to devolve power and responsibilities to lower tiers of government in Zimbabwe is enshrined in the 2013 Constitution. The objectives of the devolution are to preserve national unity, foster democratic participation in government, support an equitable allocation of national resources, and help ensure the participation of local communities in the determination of development priorities within their areas.

A political consensus to move expeditiously towards devolution emerged after the 2018 election. Most provinces in Zimbabwe have not had any direct disbursements from the Treasury previously, except for recent emergency interventions to fight a cholera outbreak or infrastructure rebuilding after the 2017 floods.

The revised 2019 budget allocates 5 percent of central government revenue (RTGS$310 million) to the 10 provincial and 92 local councils in Zimbabwe. The allocations target mainly capital expenditures, with 5 percent directed to operational expenditures and 95 percent towards infrastructure development; 20 percent of the capital grant is directed to provincial councils while 80 percent is directed to local councils (text table). Resources are allocated based on a simple average index of population size, poverty incidence, and share of unpaved roads (as a proxy for infrastructure gaps).

Proposed Share of Intergovernmental Transfers

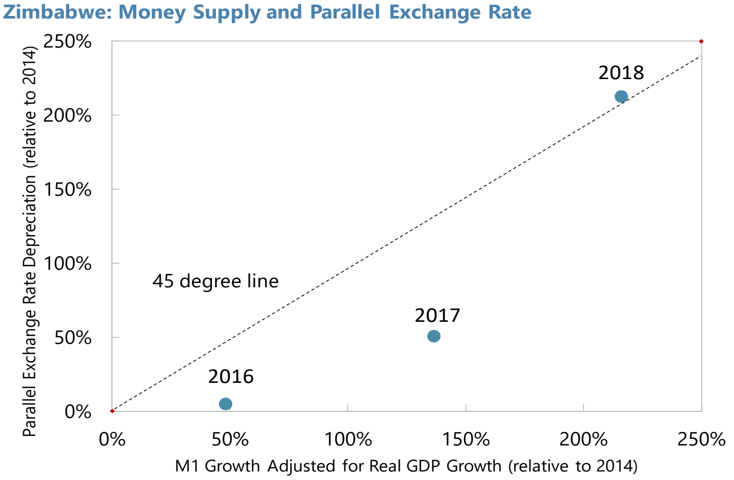
Expenditure Class	Total Share	Government Tier		Total
		Prov. Councils	Local Councils	
Operational Grant	5.0%	100%	0%	100%
Capital Grant	95.0%	20%	80%	100%

20. There are significant implementation risks for this ambitious fiscal consolidation and for securing the targeted domestic financing. Higher-than-projected inflation or a continued exchange rate depreciation could increase spending pressures, while failure to enforce PFM controls could lead to unbudgeted expenditure (as observed in recent years) and/or an accumulation of domestic arrears. In addition, the continued currency distortions could lead to revenue underperformance, either by reducing economic activity more than expected or by promoting tax avoidance, and domestic financing could fall short of the targeted amounts under the program. The authorities recognize these risks and have indicated a willingness to implement contingency measures in the event of slippages, which would rely mainly on expenditure cuts with a focus on lower-priority capital expenditure and agricultural input support programs.

C. Monetary and Exchange Rate Policies: Restoring Stability

21. The RBZ's monetary policy framework in the near term will be based on reserve money targeting (MEFP ¶19). The growth in money supply that started to accelerate rapidly in 2016 has by now been passed through fully into the parallel market premium (text figure), contributing to the sharp rise in inflation. To stabilize the exchange rate and bring inflation under control, it is therefore critical to contain the growth in monetary aggregates. To that end, the RBZ will target a growth of base money (bond notes and coins, and RTGS$ balances of banks with RBZ) of 8-10 percent in 2019. Over the medium term, once the money targeting framework achieves its objective of anchoring a low rate of inflation, thus building credibility, the authorities will consider alternative monetary frameworks that are better suited for low-inflation environments (such as inflation targeting).

Zimbabwe: Money Supply and Parallel Exchange Rate



Sources: Reserve Bank of Zimbabwe and IMF staff calculations.

22. Operationalizing the reserve money targeting framework poses significant challenges at the current juncture. For many years until the currency reform in February 2019, Zimbabwe operated a monetary system based on parity vis-à-vis the US dollar and fixed interest rates for the RBZ liquidity instruments. In contrast, the effectiveness of the new monetary framework is predicated on the flexibility of the exchange rate and interest rates, amid high uncertainty about the impact of the announced fiscal consolidation and monetary tightening. Against this background, the authorities recognize that short-term interest rates should rise to stabilize the money and FX markets, but are also concerned on the adverse impact of higher rates on economic activity and cost of public debt. Staff stressed that delays in establishing a credible monetary anchor could undermine confidence, and that reserve money growth may need to be lower if inflationary and exchange rate expectations do not stabilize as expected. To enhance the effectiveness of liquidity operations and avoid locking in higher interest rates, staff recommended that the RBZ gradually replaces its savings bonds (maturity of 1-5 years) with short-term instruments (maturity up to 7 days). The authorities anticipate the use of IMF technical assistance to strengthen the operational monetary policy framework and to underpin the functioning of the payments system based on market-based transactions.

23. Deepening the interbank FX market is essential for it to function as the basis for a market-determined exchange rate and to close the parallel market spread. Staff encouraged the authorities to take steps to increase the supply of FX in the market, including by allowing exporters to sell directly into the interbank FX market the amount they are required to surrender

to the RBZ, which would allow for an effective price formation. Existing exchange controls, which limit FX purchases in the official interbank market for current account transactions, would continue to control demand for FX, but the sanctioning and enforcement framework would be applied transparently and uniformly. Consistent with the desire to move towards a unified exchange rate any subsidies for specific goods or sectors (e.g., fuel or medicine) should be channeled through the budget, not through administered exchange rates. The authorities envisage gradually eliminating exchange controls to eventually allow for a full unification of the exchange rate.

D. Financial Sector Policies: Maintaining Financial Stability

24. The introduction of the RTGS$ raises several challenges for the banking sector. While reported financial soundness indicators (Table 5 and Figure 5) suggest banks were solvent and liquid at end-2018, risks have increased. Following the currency conversion, banks with large net open foreign exchange positions (NOP) face reductions in their capital base. Banks holding long-maturity, fixed-interest rate Treasury bills could also face exposure to potential maturity mismatch relative to their liabilities.

25. To support financial stability, the authorities have committed to cover the adverse impact of banks' negative NOPs (MEFP ¶21). The RBZ has agreed to prepare and share with Fund staff by end-June 2019 its strategy to assume this risk. Further, with NPLs likely to rise from weak economic activity, the RBZ noted that it will consider conducting an asset quality review of banks, in consultation with Fund staff.

26. The authorities are committed to addressing gaps in the financial sector supervision and financial stability frameworks (MEFP ¶22). The Financial Sector Stability Review (FSSR), conducted in November 2018, found the current legal framework for bank resolution to contain some elements necessary for preparedness, but gaps remain. The authorities have agreed to upgrade the banking law to align banking supervision and resolution frameworks with international best practice (end-December 2019 structural benchmark) and strengthen the Emergency Liquidity Assistance facility.

E. Structural Reforms: Promoting Inclusive Growth

27. The public sector has a large footprint in the economy and extensive red tape chokes private sector activity. Export proceeds are required to be surrendered at below the parallel market rate, effectively taxing exporters and reducing their competitiveness. Agricultural productivity reflects low physical and human capital and small-scale of plots, while access to credit remains constrained by the limitation on using land as collateral. Bureaucratic red tape, governance weaknesses and vulnerabilities to corruption stifle entrepreneurial activity in the formal sector, leaving Zimbabwe with a large informal economy, estimated at about 60 percent of GDP. Meanwhile, foreign investment inflows remain subdued despite some recent recovery, a result of policy uncertainty and difficulty in securing FX for imports and dividend payments.

28. Zimbabwe's competitiveness is weak. The Doing Business index of the World Bank, for example, shows significant weakness in the judicial/administrative area, including resolving insolvency, enforcing contracts, ease of starting a business, and securing construction permits (text figure). The infrastructure deficit is large, exemplified by challenges to secure a reliable supply of electricity and the ability to trade easily across borders. The WEF competitiveness index ranks Zimbabwe 125 out of 140 countries (2017–18).

29. The authorities are initiating wide-ranging reforms to facilitate the transition to a more private sector-led economy. The indigenization policy has been relaxed, investment-promoting institutions merged into a single Zimbabwe Investment and Development Agency, and a policy has been established to collapse multiple licensing requirements into single omnibus licenses in the tourism and transportation sectors, which would effectively lower the entry barriers once implemented. However, a strong coordinating framework for prioritizing, sequencing, and monitoring of reforms need to be established, as well as elaborating implementation strategies and institutional responsibilities to ensure coordination between ministries and stakeholders.

30. The SMP contains several measures to enhance governance and reduce corruption. In addition to structural benchmarks on PFM, a joint diagnostic mission from LEG and FAD on governance vulnerabilities is tentatively planned for early Fall 2019 (during the Article IV), that will support the government in its preparation of a governance assessment report to be published at end-December 2019. The government is promoting good governance through building capacity in constitutional institutions (e.g., the Electoral Commission and the National Peace and Reconciliation commission) mandated to promote democratic principles. Also, it has launched a national political dialogue to confront national socio-political and economic challenges, aimed at improving trust, restoring public confidence, and promoting a shared national vision.

PROGRAM AND OTHER ISSUES

31. The SMP will cover the period May 15, 2019—March 15, 2020 and will be monitored based on quantitative targets and structural benchmarks (MEFP Tables 1 and 2). The quantitative targets under the program include (i) ceilings on: the primary budget balance, net domestic assets of the RBZ, net financing of the nonfinancial public sector by the RBZ, and new contracted and guaranteed non-concessional external public debt; and (ii) floors on net international reserves, and social spending. The structural benchmarks focus on enhancing public financial management, improving fiscal transparency and accountability, increasing financial stability, and advancing governance reforms. The SMP will be monitored quarterly based on performance through end-June 2019, end-September 2019, and end-December 2019.

32. Risks to the program. The main risk to the program is failure to implement the fiscal consolidation. There are also risks associated with the increased financial sector's exposure to the government, which would further reinforce sovereign-bank feedback loops. In addition,

commitment to the base money targeting framework, moving towards a freely floating exchange rate and market-based fiscal financing will be tested by likely volatile interest and exchange rates. Failure to adopt a credible monetary anchor and a unified foreign exchange market would undermine confidence and feed inflationary expectations, posing significant risks to the economy and the SMP. Further, banks' ability and willingness to continue to finance the fiscal deficit in 2019 as assumed under the program remains to be tested. Insufficient progress in addressing AML/CFT shortcomings in the 2016 Mutual Evaluation Report could place Zimbabwe at increased risk of being listed by the Financial Action Task Force as a high-risk jurisdiction, which can have potentially negative economic effects to corresponding banking relationships, remittances, and foreign direct investments. Other risks, as discussed in ¶16 above, include lower GDP growth from El Niño, the related drought, and the impact of Cyclone Idai.

33. The authorities have committed to take additional policy measures to ensure the attainment of the program objectives, if these risks were to materialize (MEFP ¶26). Poor policy coordination and weak technical capacity in certain areas could affect program implementation.

34. Capacity development (Annex I). Capacity development needs for Zimbabwe are vast given the multiplicity and severity of the economic issues facing the country. TA to support the SMP, including by development partners, should prioritize enhancing the efficiency of spending, the transition to a new monetary policy framework, and improving the timeliness of the macroeconomic statistics. These include expenditure management, budget preparation and execution, tax administration, mitigating financial stability risks, and CPI and national account statistics.

STAFF APPRAISAL

35. The economic policies of the new administration as described in the TSP and detailed in the attached LOI constitute a comprehensive stabilization and structural reform program to address Zimbabwe's deep macroeconomic imbalances. A large fiscal adjustment, critical to stabilizing inflation and the exchange rate, is being implemented and the pace of money growth has slowed sharply. The currency reforms introduced in February broke the formal parity of locally issued instruments to the US dollar, and once completed can eliminate a key economic distortion and provide for transparent access to FX. The near-term outlook though is for an economic contraction as the economy adjusts to the new policy regime and reflecting the two large external shocks: the drought affecting agriculture and the impact of Cyclone Idai.

36. The revised budget for 2019 envisages further fiscal consolidation, while appropriately protecting spending for the vulnerable and critical infrastructure. The revised budget includes key measures adopted by parliament in January 2019 and has been recalibrated to capture recent macroeconomic developments. The fiscal consolidation is large, and anchored on sizable reductions in the wage bill, agricultural subsidies, and transfers to SOEs. It is, thus

critical that the authorities implement the envisaged expansion of social spending to protect the most vulnerable—including those impacted by the drought and the Cyclone.

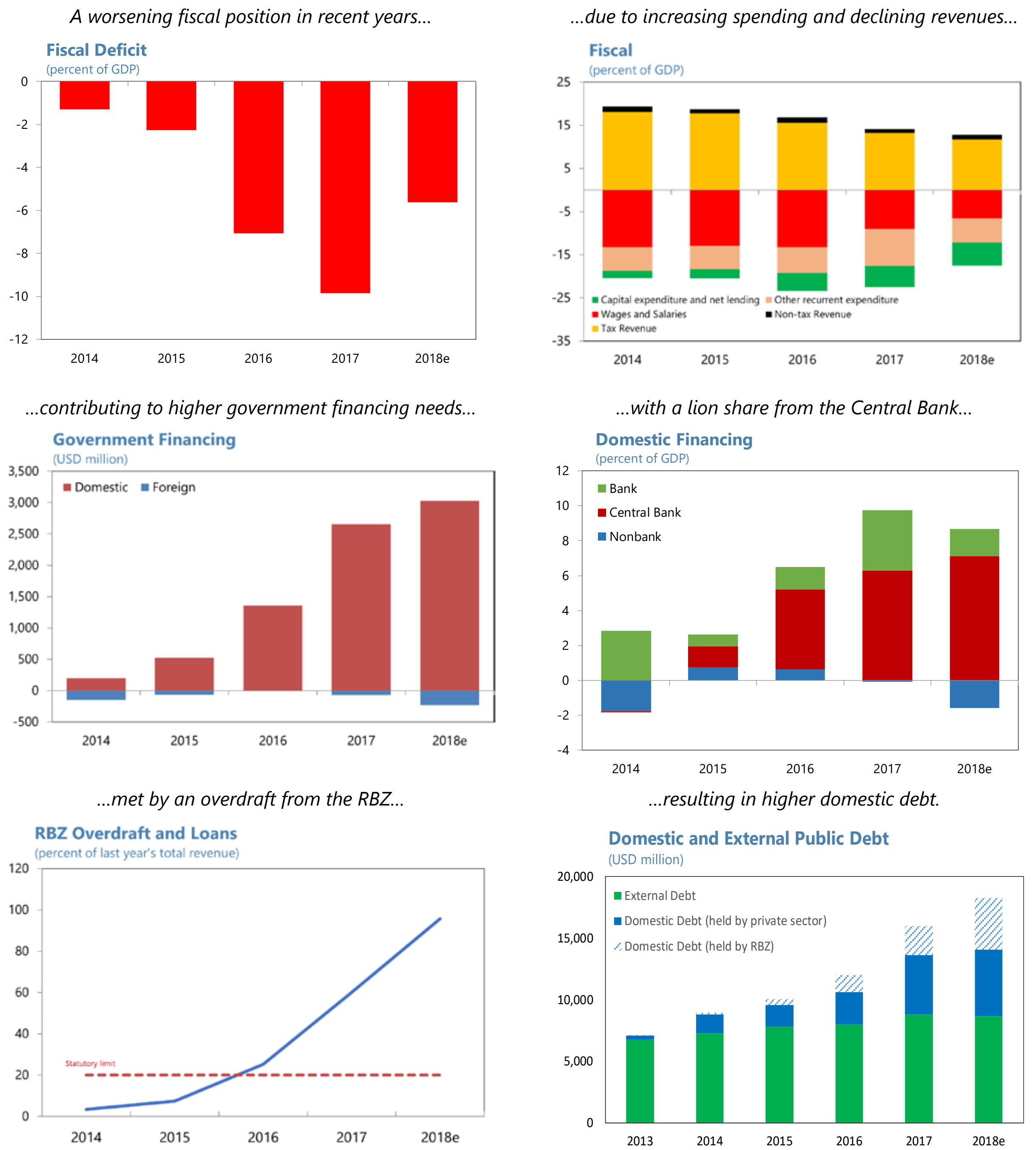
37. The new monetary targeting policy framework is appropriate at the current juncture. The rapid growth in money supply during 2016–18 has been the key driver behind the sharp exchange rate depreciation and spike in inflation in recent months. To stabilize macroeconomic conditions, it is therefore critical to contain growth in monetary aggregates. The authorities' approach to containing reserve money growth is appropriate at this stage and it is critical that interest rates be allowed to adjust fully to facilitate this objective. Over the medium term, once the authorities succeed in delivering low inflation on a sustained basis, other monetary frameworks (such as inflation targeting) can be considered.

38. The currency reform introduced in February 2019 has reduced the deep economic distortions of the previous system, but more effective implementation is needed. The premium in the parallel FX market narrowed sharply after the currency reform, but has since widened again with few trades occurring beyond the limited sales by the RBZ. While volumes in the market can be expected to pick up as confidence is gained in the new policy framework, the authorities should also consider options to encourage a greater supply of FX into the market, while maintaining the existing exchange controls to constrain demand for the time being. Staff encourages the authorities to increase their FX reserves when conditions permit, to provide a greater reserve cushion and to smooth exchange rate changes during lean periods of FX inflows (i.e., towards end of the year).

39. Given financial sector risks and vulnerabilities, steps to support financial sector stability are a priority. Developing a strategy for the RBZ/government's assumption of banks' legacy foreign exchange risk, consistent with the authorities' ability to repay, is urgent. It is essential to continue strengthening banking supervision, including close monitoring of weakly capitalized banks with elevated levels of NPLs. To that end, it is important to review banks' asset quality and develop a strategy to address any capital shortfalls. Staff also urges the RBZ to urgently allocate resources to update and operationalize its framework for managing weak banks, including their exit, strengthen legal and regulatory requirements to support bank supervision and enhance crisis preparedness, and advance efforts to increase the effectiveness of the AML/CFT framework.

40. Although the risks to a successful SMP are considerable, staff supports the SMP as a strong step to restoring macroeconomic stability. Steadfast and successful implementation of the program is key to establishing a strong track record of performance, and to initiate a path towards eventual arrears clearance and exiting debt distress. To mitigate the potential risks from capacity constraints, the IMF will support the authorities' efforts in all policy areas covered by the SMP through tailored technical assistance.

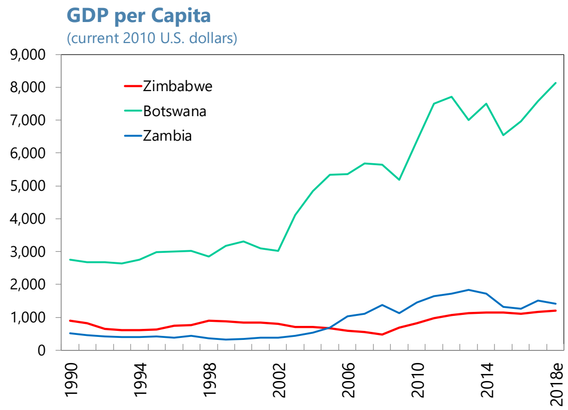
Figure 1. Zimbabwe: Fiscal Challenges



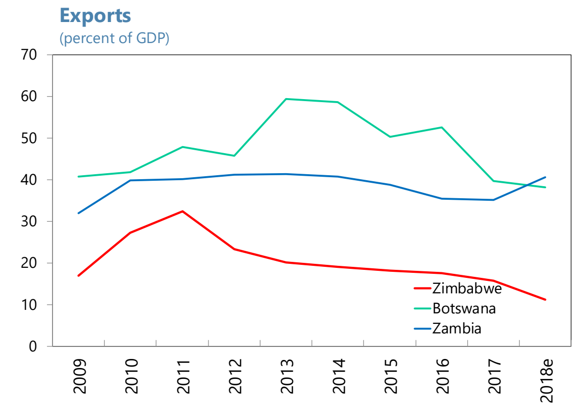
Sources: Zimbabwean authorities and IMF staff calculations.

Figure 2. Zimbabwe: Evolution of Selected Economic and Social Indicators

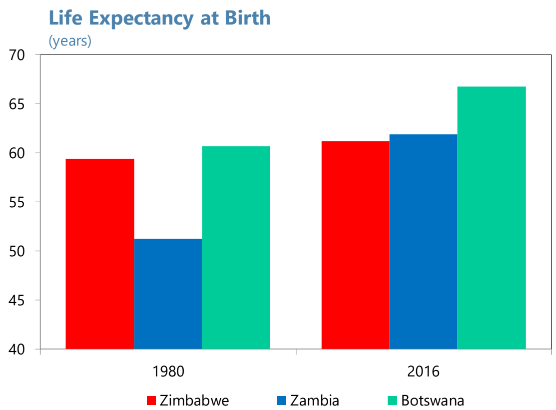
GDP per capita has remained stagnant since the 1990s.



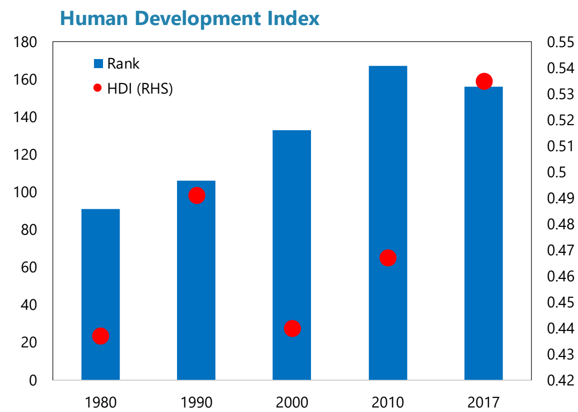
Export performance has been weak.



Life expectancy is below that in neighboring countries.



Notwithstanding the improvement in human development, Zimbabwe's ranking has deteriorated.



Sources: Zimbabwean authorities, International Energy Agency, and IMF staff calculations.

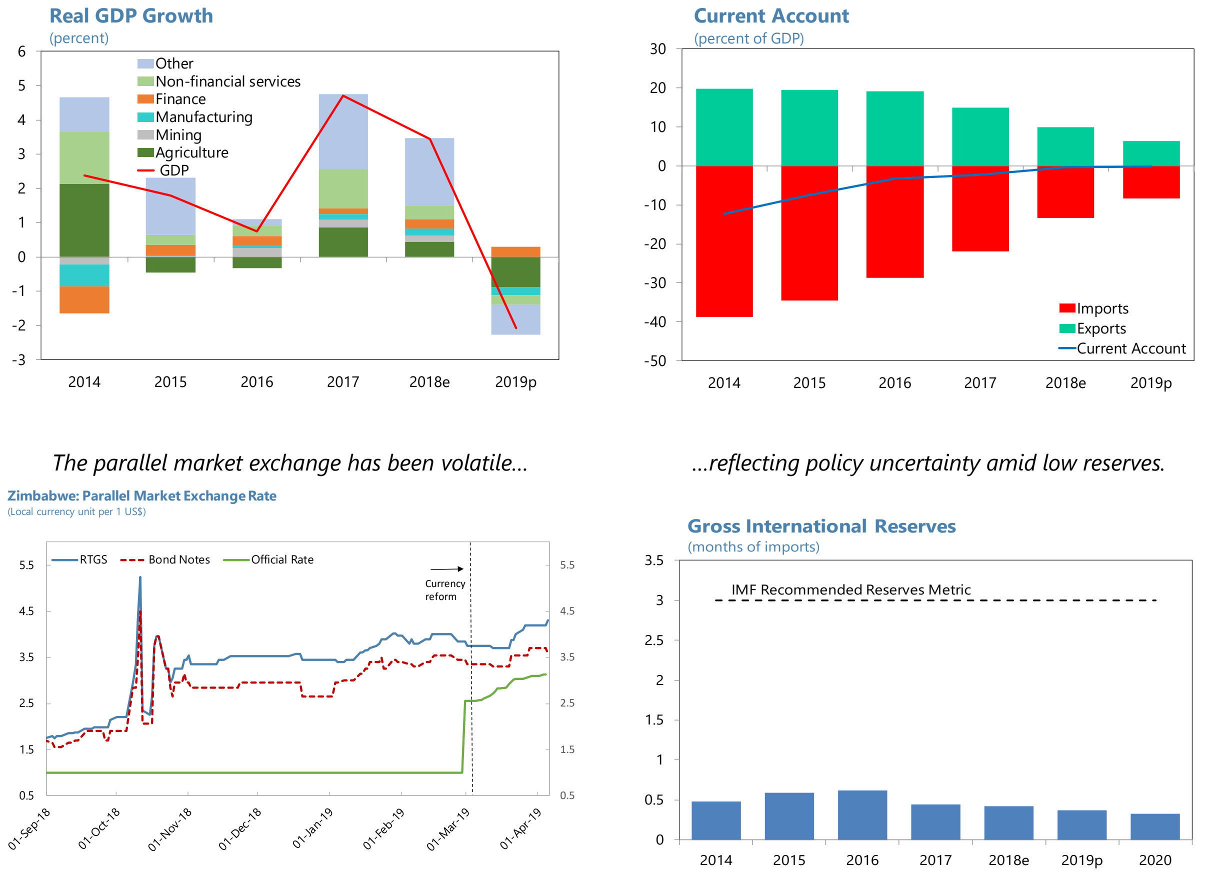
Figure 3. Zimbabwe: Recent Macroeconomic Developments

The economy is expected to contract in 2019.

The current account deficit has shrunk due to limited external financing.

The parallel market exchange has been volatile…

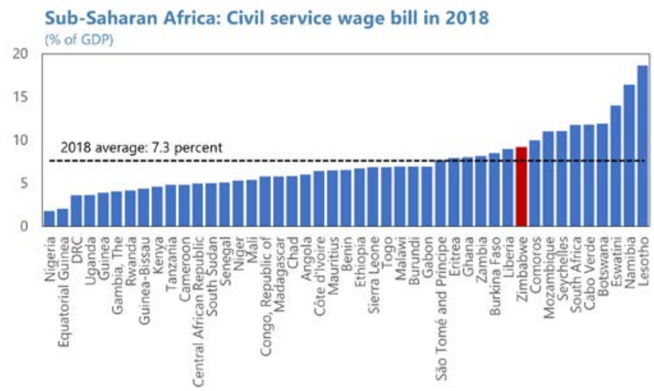
…reflecting policy uncertainty amid low reserves.



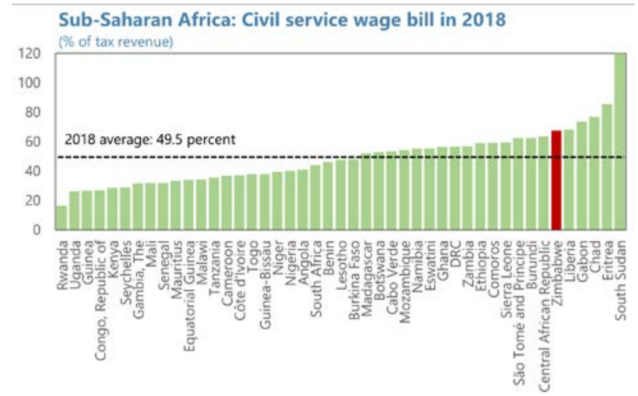
Sources: Zimbabwean authorities and IMF staff calculations.

Figure 4. Zimbabwe: Government Revenue and Spending in Zimbabwe Relative to Peers

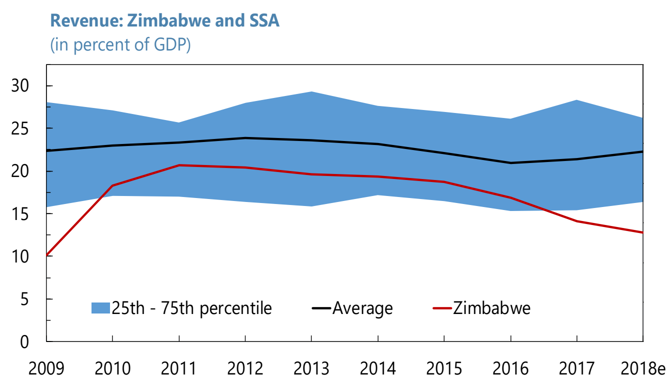
Zimbabwe's wage bill is above average both relative to GDP…



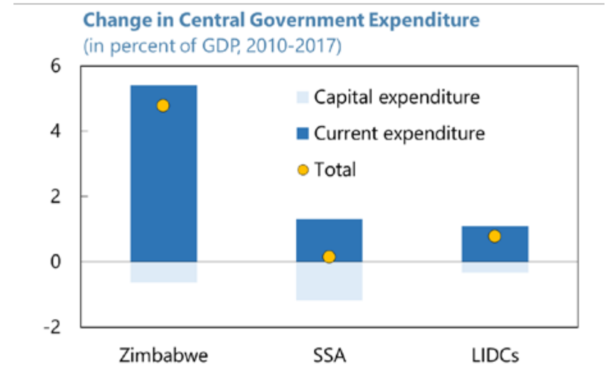
…and as a share of revenue…



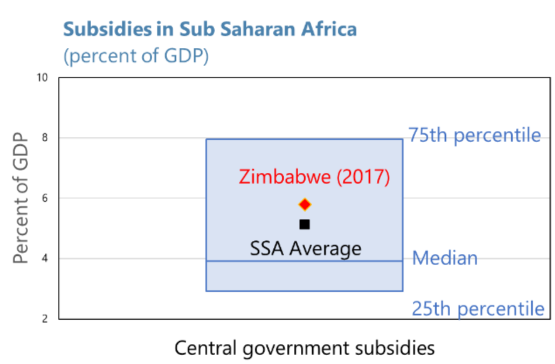
…whereas revenue has fallen below peers.



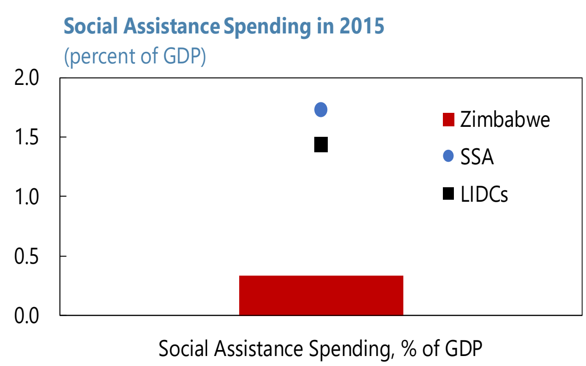
Higher spending reflects an increase in current expenditure…



…which mostly go towards subsidies to agriculture and SOEs…



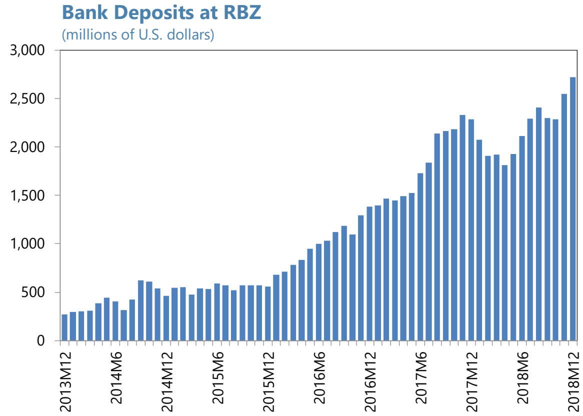
…whereas social spending is below the peers.



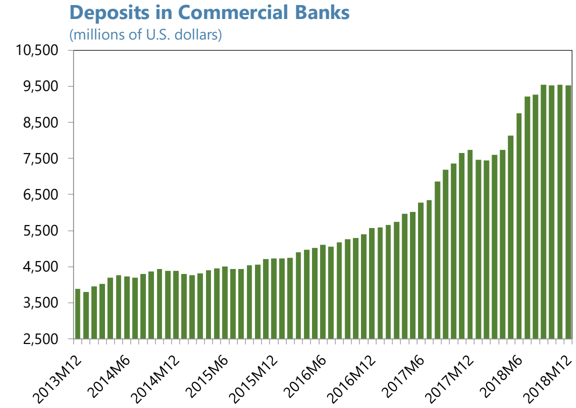
Sources: Zimbabwean authorities and IMF staff calculations.

Figure 5. Zimbabwe: Banking Sector Fragility

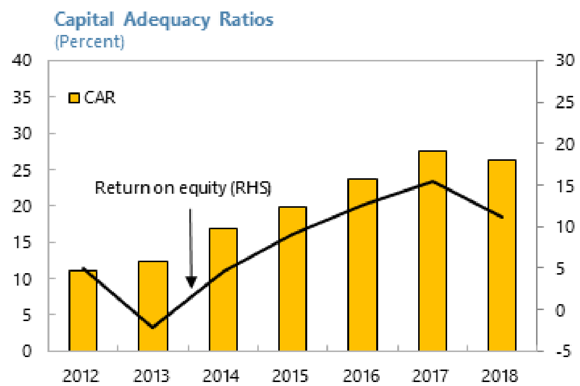
Commercial banks have increasingly illiquid deposits at the RBZ…



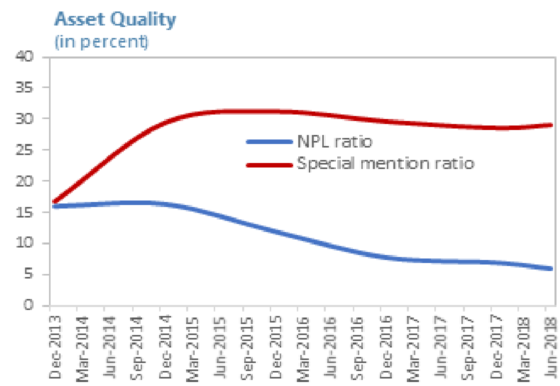
…as do private depositors with commercial banks.



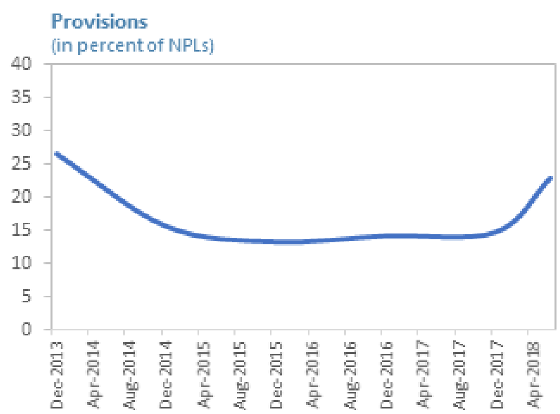
Reported CAR and ROE have been on the rise.



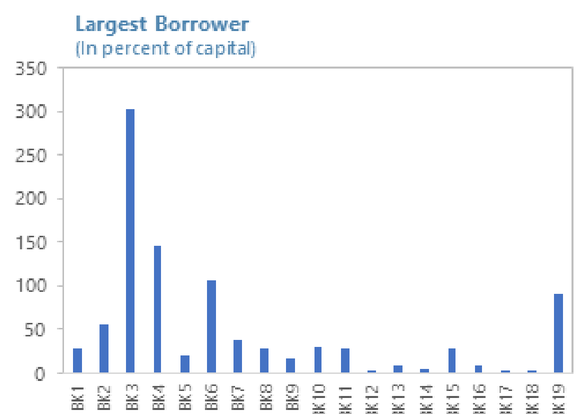
While NPLs declined, loans classified as "special mention" have increased.



Loan loss provisions are low…



…and concentration risk is high.



Sources: Zimbabwean authorities and IMF staff calculations.

Table 1. Zimbabwe: Selected Economic Indicators, 2015–20

	2015	2016	2017	2018	2019	2020
		Actual		Prel.	SMP	Proj
	(annual percentage change, unless otherwise indicated)					
Output and prices						
Real GDP growth[1/]	1.8	0.7	4.7	3.4	-2.1	3.3
Nominal GDP (US$ millions)	19,963	20,549	22,041	23,113	22,679	23,471
Nominal GDP (LCU millions)	19,963	20,806	27,438	42,777	70,304	82,150
GDP deflator	0.6	3.5	26.0	50.7	67.9	13.1
CPI (annual average)	-2.4	-1.6	0.9	10.6	80.8	14.1
CPI (end-of-period)	-2.5	-0.9	3.4	42.1	49.6	8.1
	(RTGS$ per US$)					
Exchange rate						
RTGS:USD exchange rate (annual average)	1.0	1.0	1.3	2.0		
RTGS:USD exchange rate (end-of-period)	1.0	1.0	1.3	3.5		
	(percent of GDP)					
Central government						
Revenue and grants	18.7	16.8	14.1	12.8	13.3	14.5
Expenditure and net lending	21.0	23.9	24.0	18.5	17.3	17.8
Of which: Employment costs	15.2	15.5	12.7	9.2	6.6	7.1
Of which: Capital transfers and net lending	2.5	4.1	5.8	5.0	1.7	1.6
Overall balance	-2.3	-7.1	-9.9	-5.6	-4.0	-3.4
Primary balance	-1.4	-6.4	-9.0	-4.8	-2.5	-1.6
	(US$ millions, unless otherwise indicated)					
Balance of payments						
Exports of goods and services	4,001	4,060	4,734	5,329	5,220	5,411
(annual percentage change)	-1.9	1.5	16.6	12.6	-2.0	3.7
Imports of goods and services	7,504	6,427	6,555	7,909	6,919	7,760
(annual percentage change)	-8.3	-14.4	2.0	20.7	-12.5	12.2
Current account balance (excluding official transfers)	-1,521	-718	-284	-1,035	-493	-1,209
(percent of GDP)	-7.6	-3.5	-1.3	-4.5	-2.2	-5.2
Gross international reserves	324	310	293	87	137	387
(months of imports of goods and services)	0.5	0.6	0.5	0.1	0.2	0.6
Public debt						
Consolidated public sector debt (e.o.p.)	9,477	10,089	12,090	15,343	12,687	13,389
(percent of GDP)	47.5	49.1	54.9	66.4	55.9	57.0
Public and publicly guaranteed external debt (e.o.p.)	7,809	7,997	8,829	9,610	10,298	10,771
(percent of GDP)	39.1	38.9	40.1	41.6	45.4	45.9
Of which: Arrears	5,011	5,157	5,652	6,040	6,364	6,450
(percent of GDP)	25.1	25.1	25.6	26.1	28.1	27.5

Sources: Zimbabwean authorities; IMF staff estimates and projections.

1/ At constant 2012 prices.

Table 2. Zimbabwe: Balance of Payments, 2015–20

	Actual		Est.	Projections		
	2015	2016	2017	2018	2019	2020
	(US$ millions, unless otherwise indicated)					
Current Account	-1,642	-718	-284	-1,035	-493	-1,209
Balance on goods	-2,366	-1,500	-1,147	-2,214	-1,349	-1,390
Exports of goods	3,614	3,663	4,315	4,804	4,672	4,969
Imports of goods	5,980	5,163	5,462	7,018	6,021	6,359
Balance on services	-1,137	-867	-674	-365	-350	-959
Primary income (net)	-159	-178	-161	-136	-135	-125
Secondary income (net)	2,020	1,827	1,697	1,681	1,342	1,265
of which: Workers' Remittances	1,253	1,103	1,013	946	880	805
Capital Account	398	242	278	209	148	235
Financial Account	-1,050	-906	-994	-1,385	-71	-498
Direct investment	-399	-343	-306	-366	-213	-229
Portfolio investment	-123	80	101	-87	185	-68
Financial derivatives and employee stock options	0	0	0	0	0	0
Other investment	-528	-643	-789	-932	-44	-201
Currency and Deposit (net)	56	22	144	-54	-14	5
Loans (net)	-584	-559	-685	-877	-100	-183
Assets	-175	-62	41	-109	43	-12
Liabilities	353	581	830	823	86	188
Central bank	-71	534	499	532	23	-25
General government	58	18	83	132	42	328
Other sectors (NFCs, HH, NPISHs))	366	29	248	159	21	-115
Errors and Omissions	-517	522	1,362	879	…	…
Overall Balance	324	-92	-374	-320	-273	-476
Financing	-324	92	374	320	273	476
Accumulation of external arrears	-303	78	357	114	323	86
Reserve accumulation (minus = increase)	-21	14	18	206	-50	-250
Unidentified financing	…	…	…	…	…	639
Percent of GDP						2.7
Memorandum:						
Reserve assets	324	310	293	87	137	387
Months of import cover	*0.5*	*0.6*	*0.5*	*0.1*	*0.2*	*0.6*
	(percent of GDP)					
Current account	-8.2	-3.5	-1.3	-4.5	-2.2	-5.2
Exports of goods and services	20.0	19.8	21.5	23.1	23.0	23.1
Imports of goods and services	37.6	31.3	29.7	34.2	30.5	32.2
	(annual percentage change)					
Exports of goods and services	-1.9	1.5	16.6	12.6	-2.0	3.7
Imports of goods and services	-8.3	-14.4	2.0	20.7	-12.5	9.3
Terms of Trade	3.0	1.2	0.9	0.9	-0.3	-1.4

Sources: Zimbabwean authorities; IMF staff estimates and projections.

Table 3a. Zimbabwe: Central Government Operations, 2015–20

(Millions of RTGS$)

	2015	2016	2017	2018	2019		2020
					Initial	Cabinet-approved	
	Act.	Act.	Act.	Prel.	Budget	Revised Budget	Proj
Revenue and grants	**3,737**	**3,502**	**3,870**	**5,491**	**6,199**	**9,367**	**11,887**
Tax revenue	3,548	3,237	3,628	5,000	6,037	8,598	11,365
Personal income tax	770	736	729	856	971	1068	1901
Corporate income tax	422	338	485	802	784	1034	1385
Other direct taxes	204	187	203	261	295	344	623
Customs	345	273	295	433	485	631	1290
Excise	714	642	676	909	944	2000	1682
VAT	985	963	1,075	1,363	1,697	2,150	3,042
Other indirect taxes	108	98	165	377	862	1372	1443
Non-tax revenue	189	265	242	491	162	769	522
Grants	0	0	0	0	0	0	0
Expenditure and net lending	**4,189**	**4,970**	**6,573**	**7,895**	**7,765**	**12,194**	**14,663**
Current expenditure	3,666	4,004	4,831	5,220	5,747	8,073	10,688
Employment costs	3,030	3,231	3,495	3,935	4,050	4,646	5,838
Wages & salaries (incl. grants & transfers)	2,592	2,753	2,978	3,382	3,456	4,042	5,070
Pensions	438	478	517	553	594	604	767
Interest payments	177	127	233	368	351	1,074	1,429
Foreign	102	20	68	43	24	176	181
Of which: Paid	10	13	68	6	24	106	
Domestic	75	107	165	325	327	898	1,248
Goods & services	319	370	887	703	738	1,596	2,048
Current transfers	140	276	216	214	608	756	1,374
Capital expenditure and net lending	523	966	1,742	2,675	2,018	4,121	3,974
Capital transfers [1/]	400	754	1,193	1,735	1,007	1,937	1,150
Other capital expenditure	31	105	145	542	843	2,016	2,628
Net lending	91	107	404	398	168	168	196
Overall balance (commitment basis)	**-452**	**-1,468**	**-2,703**	**-2,403**	**-1,566**	**-2,827**	**-2,776**
Primary balance (commitment basis) [2/]	-274	-1,341	-2,471	-2,035	-1,215	-1,753	-1,347
Overall balance (cash basis)	**-380**	**-1,421**	**-2,719**	**-2,371**	**-1,566**	**-2,757**	**-2,595**
Primary balance (cash basis) [2/]	-327	-1,301	-2,486	-2,050	-1,215	-1,753	-1,347
Targeted overall fiscal balance (commitment basis)	…	…	…	…	**-1,566**	**-2,827**	**-538**
Unidentified Financing					0	0	**2,238**
Financing	**614**	**1,401**	**2,671**	**3,044**	**1,566**	**2,827**	**538**
Domestic financing (net)	526	1,354	2,658	3,031	1,373	2,825	776
RBZ	238	950	1,727	3,038	0	0	0
Of which: Loans (incl. RBZ overdraft)	24	635	736	2,455	0	0	0
Bank	138	274	953	667	1,144	2,525	376
Non-bank	150	130	-22	-673	229	300	400
Foreign financing (net)	-69	0	-73	-231	0	-576	-808
Disbursements	0	210	145	4	0	59	56
Amortization	187	210	218	234	0	635	864
of which: Paid	69	210	116	13	0	127	475
Change in arrears	157	46	86	244	193	578	569
Domestic	-53	40	-16	-15	0	0	0
Foreign	210	7	102	259	193	578	569
Interest	92	7	0	37	20	70	181
Principal [3/]	118	0	102	222	172	508	389
Errors and omissions	162	-67	-32	641	…	…	…

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

[1/] Capital transfers include spending related to subsidized grain imports and agricultural support programs, which could be classified as current expenditures

[2/] The difference between the fiscal balance on a commitment and cash basis is the change in domestic and foreign interest arrears.

[3/] Accumulated arrears on foreign debt do not include valuation adjustment. The stock of arrears could differ from that in the balance of payments table.

Table 3b. Zimbabwe: Central Government Operations, 2015–20

(Percent of GDP)

	2015	2016	2017	2018	2019		2020
	Act.	Act.	Act.	Prel.	Initial Budget	Cabinet-approved Revised Budget	Proj
Revenue and grants	**18.7**	**16.8**	**14.1**	**12.8**	**8.8**	**13.3**	**14.5**
Tax revenue	17.8	15.6	13.2	11.7	8.6	12.2	13.8
Personal income tax	3.9	3.5	2.7	2.0	1.4	1.5	2.3
Corporate income tax	2.1	1.6	1.8	1.9	1.1	1.5	1.7
Other direct taxes	1.0	0.9	0.7	0.6	0.4	0.5	0.8
Customs	1.7	1.3	1.1	1.0	0.7	0.9	1.6
Excise	3.6	3.1	2.5	2.1	1.3	2.8	2.0
VAT	4.9	4.6	3.9	3.2	2.4	3.1	3.7
Other indirect taxes	0.5	0.5	0.6	0.9	1.2	2.0	1.8
Non-tax revenue	0.9	1.3	0.9	1.1	0.2	1.1	0.6
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure & net lending	**21.0**	**23.9**	**24.0**	**18.5**	**11.0**	**17.3**	**17.8**
Current expenditure	18.4	19.2	17.6	12.2	8.2	11.5	13.0
Employment costs	15.2	15.5	12.7	9.2	5.8	6.6	7.1
Wages & salaries (incl. grants & transfers)	13.0	13.2	10.9	7.9	4.9	5.7	6.2
Pensions	2.2	2.3	1.9	1.3	0.8	0.9	0.9
Interest payments	0.9	0.6	0.8	0.9	0.5	1.5	1.7
Foreign	0.5	0.1	0.2	0.1	0.0	0.3	0.2
Of which: Paid	0.0	0.1	0.2	0.0	0.0	0.2	
Domestic	0.4	0.5	0.6	0.8	0.5	1.3	1.5
Goods & services	1.6	1.8	3.2	1.6	1.1	2.3	2.5
Current transfers	0.7	1.3	0.8	0.5	0.9	1.1	1.7
Capital expenditure and net lending	2.6	4.6	6.3	6.3	2.9	5.9	4.8
Capital transfers [1/]	2.0	3.6	4.3	4.1	1.4	2.8	1.4
Other capital expenditure	0.2	0.5	0.5	1.3	1.2	2.9	3.2
Net lending	0.5	0.5	1.5	0.9	0.2	0.2	0.2
Overall balance (commitment basis)	**-2.3**	**-7.1**	**-9.9**	**-5.6**	**-2.2**	**-4.0**	**-3.4**
Primary balance (commitment basis) [2/]	-1.4	-6.4	-9.0	-4.8	-1.7	-2.5	-1.6
Overall balance (cash basis)	**-1.9**	**-6.8**	**-9.9**	**-5.5**	**-2.2**	**-3.9**	**-3.2**
Primary balance (cash basis) [2/]	-1.6	-6.3	-9.1	-4.8	-1.7	-2.5	-1.6
Targeted overall fiscal balance (commitment basis)	…	…	…	…	**2.2**	**-4.0**	**-0.7**
Unidentified Financing	…	…	…	…	**0.0**	**0.0**	**2.7**
Financing	**3.1**	**6.7**	**9.7**	**7.1**	**2.2**	**4.0**	**0.7**
Domestic financing (net)	2.6	6.5	9.7	7.1	2.0	4.0	0.9
RBZ	1.2	4.6	6.3	7.1	0.0	0.0	0.0
Of which: Loans (incl. RBZ overdraft)	0.1	3.1	2.7	5.7	0.0	0.0	0.0
Bank	0.7	1.3	3.5	1.6	1.6	3.6	0.5
Non-bank	0.8	0.6	-0.1	-1.6	0.3	0.4	0.5
Foreign financing (net)	-0.3	0.0	-0.3	-0.5	0.0	-0.8	-1.0
Disbursements	0.0	1.0	0.5	0.0	0.0	0.1	0.1
Amortization	0.9	1.0	0.8	0.5	0.0	0.9	1.1
Of which: Paid	0.3	1.0	0.4	0.0	0.0	0.2	0.6
Change in arrears	0.8	0.2	0.3	0.6	0.3	0.8	0.7
Domestic	-0.3	0.2	-0.1	0.0	0.0	0.0	0.0
Foreign	1.1	0.0	0.4	0.6	0.3	0.8	0.7
Interest	0.5	0.0	0.0	0.1	0.0	0.1	0.2
Principal [3/]	0.6	0.0	0.4	0.5	0.2	0.7	0.5
Errors and omissions	0.8	-0.3	-0.1	…	…	…	…

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

[1/] Capital transfers include spending related to subsidized grain imports and agricultural support programs, which could be classified as current expenditures

[2/] The difference between the fiscal balance on a commitment and cash basis is the change in domestic and foreign interest arrears.

[3/] Accumulated arrears on foreign debt do not include valuation adjustment. The stock of arrears could differ from that in the balance of payments table.

Table 4. Zimbabwe: Monetary Survey, 2015–19
(Millions of RTGS$; unless otherwise indicated)

	Actual				Proj.
	2015	2016	2017	2018	2019
Reserve Bank of Zimbabwe (RBZ)					
Net foreign assets	-639	-574	-1,126	-1,758	-5,909
Net domestic assets	1,203	2,047	3,794	5,016	9,493
Net credit to financial corporations	70	-149	-406	-2,246	-2,164
Claims on central government	1,350	2,338	3,986	7,025	7,025
of which: Government securities	214	566	1,479	2,062	2,062
of which: Loans (incl. overdraft)	1,136	1,771	2,507	4,962	4,962
Other items, net	-217	-142	214	237	4,632
Monetary base	563	1,473	2,668	3,258	3,584
Banks					
Net foreign assets	-4	18	162	383	290
Net domestic assets	4,733	5,549	7,576	9,135	12,403
Credit to the RBZ	753	1,643	2,605	3,831	4,184
Net credit to central government	1,105	1,379	2,332	2,999	5,500
of which: Government securities	1,108	1,403	2,397	3,030	5,555
Credit to other public sector	106	121	215	285	468
Credit to private sector	3,602	3,497	3,694	3,847	4,039
Other items, net	-834	-1,091	-1,269	-1,826	-1,789
Deposits	4,729	5,567	7,739	9,518	12,693
Monetary survey					
Net foreign assets	-644	-556	-964	-1,375	-5,619
Net domestic assets	5,380	6,194	9,072	11,413	18,879
Net credit to central government	2,374	3,598	6,277	9,982	12,483
Credit to other public sector	217	288	637	775	958
Credit to private sector	3,656	3,514	3,719	3,868	4,060
Other Items, net	-868	-1,205	-1,562	-3,212	1,377
Broad money (M3)	4,736	5,638	8,108	10,038	13,260
Money (M2)	4,691	5,575	8,040	9,979	13,201
Currency	7	70	332	503	553
		(Annual percentage change)			
Memorandum items					
Credit to private sector	-2.4	-3.9	5.9	4.0	5.0
Net credit to central government	52.7	51.6	74.5	59.0	25.1
Monetary base	21.4	161.5	81.2	22.1	10.0
M2	10.2	18.8	44.2	24.1	32.3
Nominal GDP growth	2.4	4.2	31.9	55.9	64.4

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

Table 5. Zimbabwe: Financial Soundness Indicators

	Dec-2013	Dec-2014	Dec-2015	Dec-2016	Dec-2017	Jun-2018
Capital Adequacy						
Regulatory capital to risk-weighted assets	12.3	16.9	19.9	24.5	27.6	26.3
Percentage of banks greater or equal to 10 percent	88.9	85.7	100.0	100.0	100.0	100.0
Percentage of banks below 10 and above 6 percent minimum	5.6	7.1	0.0	0.0	0.0	0.0
Percentage of banks below 6 percent minimum	5.6	7.1	0.0	0.0	0.0	0.0
Capital to assets	7.3	10.4	11.3	13.4	12.3	11.1
Asset Quality						
Foreign exchange loans to total loans	5.0	1.4	3.0	0.1	0.5	0.1
Past-due loans to gross loans/2	32.8	45.8	43.2	37.5	35.6	35.4
Nonperforming loans/3	16.0	16.3	12.0	7.9	7.1	6.1
Watch-listed loans/4	16.8	29.4	31.2	29.6	28.6	29.1
Provisions as percent of past-due loans	26.6	15.5	13.2	14.1	14.7	22.9
Earnings and Profitability						
Net profit (before tax and extraordinary items)/net income	-93.2	129.9	149.9	120.4	121.3	122.5
Return on assets	-0.2	0.8	1.8	2.5	2.6	1.7
Return on equity	-2.2	4.6	9.0	13.4	15.5	11.2
Expenses/ income	98.0	93.0	81.8	73.5	70.7	63.4
Liquidity						
Liquid assets/total assets	27.8	27.3	36.1	44.1	52.9	55.5
Liquid assets/short-term liabilities	34.8	35.6	46.8	55.9	65.5	66.9
Loans/deposits/5	102.3	76.5	84.7	69.8	49.2	49.0
Liquid assets/total deposits	51.4	48.6	64.3	72.9	77.1	82.1
Foreign exchange liabilities/total liabilities	0.5	4.3	2.1	3.1	2.0	2.4
Excess Reserves to Broad Money*	9.0	9.5	11.8	17.2	16.2	23.1
Sensitivity to market risk						
Net foreign exchange assets (liabilities) to shareholders' funds	53.5	21.5	112.6	136.3	157.0	197.9

Source: Reserve Bank of Zimbabwe.

Annex I. Capacity Development Strategy for 2019

The Zimbabwean authorities are closely engaged with Fund staff on economic policy formulation and implementation, including through this SMP. They see technical assistance from the IMF as important for supporting their economic and financial policies under the program. As such, the Fund's capacity development program for Zimbabwe, including related technical assistance delivery, is a key component of the SMP and Fund's surveillance priorities for Zimbabwe.

Overall Assessment of Capacity Development

1. The provision of Fund TA to Zimbabwe started recently. Following Zimbabwe's payment of its arrears to the PRGT, the Fund's Executive Board removed, effective November 14, 2016, all remedial measures including limitations on the provision of Fund TA. In the beginning, the bulk of Fund TA to Zimbabwe focused on public financial management (PFM), revenue administration, and macroeconomic statistics (BOP, GDP, and CPI). A Financial Sector Financial Stability Review (FSSR) was conducted in November 2018, from which the authorities and staff have tentatively agreed a TA Road Map to support the authorities´ efforts to address key gaps and vulnerabilities. The TA will also play a complementary role in helping the authorities meet some obligations under the SMP and any potential subsequent programs.

2. The recent track record on implementing TA recommendations has been mixed. In part this reflects the need for legislative changes in many of the targeted areas, which have often faced delays given the significant political uncertainty in the run up to the presidential and parliamentary elections of July 2018.

Forward-Looking Priorities

3. Zimbabwe faces vast capacity development needs given the multiplicity and severity of the economic issues it faces following an extended period of international isolation. The Fund's TA remains crucial, as Zimbabwe transitions toward a functioning economy and seeks to restore macroeconomic stability. Given the brain drain that the civil service experienced during the hyperinflationary era, and the resulting near complete erosion of systems, particularly in debt management, statistics and PFM, TA has been, and will be, a critical element on the path to normalizing relations with the international community.

4. The focus of the TA in the near term will be on areas that facilitate fiscal consolidation, support the transition to a new monetary policy framework, and protect financial sector stability. To that end, targeted areas include PFM reforms aimed at strengthening expenditure management, budget preparation and execution, and fiscal reporting; further developing the debt management framework; reviewing the design of the tax system; enhancing tax and customs administrations; strengthening the financial stability framework and assessing banks' asset quality once the macroeconomic situation has stabilized; and providing financial modelling and forecasting training for supervisors.

5. TA priorities under the SMP include:

Priorities	Objectives
PFM	Strengthen budgeting, reporting, fiscal forecasting, cash management, and fiscal oversight.
Revenue policy and administration	Broaden the tax base, mostly by reducing tax incentives (which reduce collections and make the economy less efficient). Modernize revenue administration to improve its efficiency and effectiveness by addressing taxpayer segmentation and strengthening audit and risk management capacity.
Debt management	Strengthen government's debt management capacity for achieving fiscal sustainability and effective budgeting.
Monetary policy framework	Update, adopt, and operationalize the 2014 draft Crisis Management Plan. Support the authorities in designing and operationalizing a monetary policy framework to deliver macroeconomic stability. Reduce the distortions from exchange controls.
Financial supervision and crisis management	Operationalize RBZ's framework for managing weak banks and raise crisis preparedness. Review banks' quality once the macro economic situation has stabilized.
Macroeconomic statistics	Enhance macroeconomic analysis, budget preparation, and policy design.

Appendix I. Letter of Intent

May 13, 2019

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

Dear Ms. Lagarde:

Following the elections of July 2018, the new Government took office inheriting a difficult economic situation characterized by large fiscal deficits, rising inflation, shortages of basic goods, and critically low international reserves. Some progress has been made, notably the introduction of the new RTGS$, which is a critical first step towards normalizing the Foreign Exchange market. The economy has experienced significant challenges and the effects of Cyclone Idai that hit Zimbabwe in March 2019 poses yet another obstacle to strong, sustainable, balanced, and job-rich growth.

Even before the cyclone, which has impacted nearly 250,000 individuals, poverty levels were already high and widespread, infrastructure gaps were large, and drought had shocked the agricultural sector, resulting in more than 5 million Zimbabweans facing food insecurity in 2019. Access to external financing is negligible, a consequence of our external arrears to multilateral and bilateral official creditors, which cripples our ability to provide additional support for cyclone recovery, inclusive growth, poverty reduction, and job creation.

Against this background, the Cabinet adopted in October 2018 a Transitional Stabilization Program (TSP) for 2018-20. The key objectives of the TSP are designed to stabilize the economy and lay the foundations for strong, sustainable, and balanced growth. We have already taken some steps towards these objectives, as described in the attached Memorandum of Economic and Financial Policies.

Immediately, after taking office the new government took steps to increase revenue and contain spending and as a result, the deficit has moderated. In addition, we introduced in February 2019 the RTGS$, which is a critical first step towards normalizing the Foreign Exchange (FX) market and addressing economic distortions. Government has also initiated steps to introduce a monetary targeting framework to complement fiscal and FX market reforms in our pursuit of economic stability.

- The 2019 Budget approved on January 29, 2019 targeted an overall fiscal deficit of 5 percent of GDP in 2019, based on the previous US$ estimated nominal GDP. The consolidation was to

be achieved by measures to raise revenues and contain re-current spending, including on the public wage bill, agriculture, and state-owned enterprises (SOEs). To cushion the impact of the fiscal adjustment on the vulnerable, the allocation for social spending was increased.

- However, a sharp spike in inflation, introduction of RTGS$, and aftermath of the cyclone Idai have necessitated a significant recalibration of the budget. On April 23, Cabinet approved a revised budget that targets a fiscal deficit of RTGS$ 2.8 billion (about 4.0 percent of staff-estimated RTGS$ GDP), which is expected to be financed from domestic resources, as well as a further increase in social spending.
- Key elements in our reform strategy are the elimination of RBZ financing of the fiscal deficit and the implementation of a new monetary policy framework that targets growth of monetary aggregates in 2019. Under structural reforms, we are working to reform, privatize, and liquidate SOEs, address corruption in procurement and tax payment, improve expenditure control and transparency, strengthen financial stability, and promote private-sector investment by improving the business climate and access to finance.
- On political reforms, Cabinet has approved the repeal of the Public Order and Safety Act (POSA), Chapter 11:17. The Maintenance of Peace and Order Bill will repeal POSA and that Bill will be passed by Parliament by May 30, 2019. Cabinet has also approved the repeal of the Access to Information and Protection of Privacy Act (AIPPA), Chapter 10:27. The Freedom of Information Bill, Personal Information Bill, and the Zimbabwe Media Commission Bill will repeal AIPPA and these Bills will be passed by Parliament by June 30, 2019. Government has initiated amendments to the Police Act and Protection of Property Rights, and we are continuing constructive dialogue with key members of the international community. Further, we remain committed to broader political and governance reforms, including on improving the rule of law, fighting against corruption, and upholding freedoms of expression and association.

In support of our reform agenda and program, the Government of Zimbabwe hereby requests an International Monetary Fund (IMF) Staff-Monitored Program (SMP) from May 15, 2019 through March 15, 2020. We consider the SMP to be essential in supporting our macroeconomic and stabilization efforts, building a track record of sound policy towards a future Fund-supported program, and an indispensable further step towards normalizing relations with the international community, including the mobilization of critical support from our Development Partners for a comprehensive arrears clearance and debt relief strategy. The enclosed Memorandum of Economic and Financial Policies (MEFP) and the Technical Memorandum of Understanding (TMU) provide comprehensive details of our reform agenda and program.

We believe that the policies set out in the attached MEFP are adequate and robust enough to make substantial progress towards our overall medium-term objectives and stand ready to take further measures that may become necessary to achieve our goals. The Zimbabwean authorities will consult with IMF staff, at our own initiative or whenever the Managing Director of the IMF requests, 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.

The Government of Zimbabwe will provide IMF staff with such information as may be requested in connection with the progress made in implementing the economic and financial policies and in achieving the objectives of the program. 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/
Prof. Mthuli Ncube Minister of Finance and Economic Development Government of Zimbabwe	Dr. John P. Mangudya Governor Reserve Bank of Zimbabwe

Attachment I. Memorandum of Economic and Financial Policies

I. Recent Economic Developments

1. **Real GDP moderated to 3.4 percent in 2018 (having accelerated to 4.7 percent in 2017 from 0.7 percent in 2016), reflecting strong performances especially in the agricultural, electricity generation, and mining sectors.** This strong growth performance occurred largely in the first three quarters of 2018, with large fiscal deficits supporting consumption and agricultural production and investments helping expand the tourism and mining sectors. However, a sharp spike in turbulence in the Foreign Exchange (FX) market during October weakened confidence and resulted in shortages in several essential products. While relative stability has returned to the FX and product markets, uncertainty remains high.

2. **The rapid rise of premia in the parallel FX market, reflecting the unsustainable increase in money supply in the previous years, has led to a sharp increase in inflation.** Consumer price inflation remained low until recently (3.4 percent at end-2017 and approximately 3 percent in the first half of 2018). However, the disproportionate increase in deficit financing from the RBZ fueled a sharp growth in RTGS balances and put pressure on the FX parallel market. With the premia in the FX market rising sharply in recent months, inflation jumped to 66.8 percent (year-on-year) in March 2019.

3. **Since taking office in September 2018, the new Government has taken steps to contain spending.** As a result, the deficit has moderated since the last quarter of 2018. For the entire year, the overall deficit reached RTGS$3 billion (7.1 percent of estimated 2018 GDP), compared with the annual target of RTGS$693 million in the 2018 Budget. While revenue was higher than projected, this was more than offset by large expenditure overruns. The latter was driven primarily by unbudgeted increases in the public wage bill, capital expenditure (includes transfers and subsidies to agriculture), and recapitalization of parastatals.

4. **The current account deficit widened in 2018, due to a sharp increase in imports.** Exports of goods and services increased by 16 percent in 2018, reflecting strong performances in gold, tobacco, and manufacturing exports. However, imports rose by 21 percent, boosted by offshore borrowings and remittances, increases in fuel imports, and precautionary inventory buildup as stakeholders reacted to developments in October 2018. Financial account flows declined by 29 percent, largely because of lower external borrowing. International reserves remain at critically low levels, equivalent to roughly two weeks of imports.

5. **External public debt remains unsustainable and an agreement with international creditors to restore debt sustainability is required to eliminate the debt overhang of Zimbabwe and pave the way for the country to become again eligible to access funding from the international financial system.** Nevertheless, the Government, through the RBZ, has managed to secure limited external borrowing to support the fledgling currency and finance critical imports of

fuel, pharmaceuticals, and maize. The import needs for these critical goods has increased in the aftermath of cyclone Idai.

II. MEDIUM-TERM OBJECTIVES AND POLICIES

6. **Vision 2030 outlines our objective to transform Zimbabwe into an upper-middle income economy by the end of the next decade, and the first step on this path is our Transitional and Stabilisation Programme (TSP), which covers the period through end-2020**. The TSP focuses on four broad objectives: (i) stabilizing the macro-economy and financial sector; (ii) undertaking the necessary structural and institutional reforms to move towards sustainable private-sector led growth; (iii) addressing infrastructure gaps; and (iv) targeting quick-wins to stimulate growth during the transition period. The TSP is focused on macroeconomic stabilization, but also includes important social and political reforms to empower citizens, tackle corruption, and strengthen the rule of law.

7. **The TSP acknowledges that measures needed to achieve macroeconomic stabilisation will be tough and require sacrifices by all stakeholders**. This is necessary to address the fundamental challenges facing the economy, restore confidence, and make Zimbabwe an attractive investment destination. The recalibrated 2019 Budget is the first step in translating these policy objectives into concrete measures, consisting of fiscal consolidation that tackles unsustainable expenditures, while safeguarding social spending for the most vulnerable, responding to the needs created by the El-Nino-induced drought and Cyclone Idai, and eventually creating space for growth-supporting public infrastructure spending. This is supported by currency reform aimed at reducing important distortions in the economy, including the elimination of large implicit taxes on foreign exchange earners, and the adoption of a money targeting framework to help anchor inflation and stabilise the exchange rate.

III. MACROECONOMIC FRAMEWORK

8. **While the growth potential of Zimbabwe is high, we expect a significant slowdown in 2019 reflecting fiscal drag from consolidation and the impact of unfavorable weather.** GDP growth in 2019 is expected to be negative, before rebounding in 2020 as confidence grows from the implementation of our comprehensive stabilization program outlined below and the investment climate improves. Nevertheless, while we are prudently planning our 2019 macroeconomic and fiscal frameworks on an economy which is expected to see some contraction, we also see upside potential from macroeconomic stabilization and key investments in the mining sector (particularly diamonds). We expect month-on-month inflation to fall sharply beginning in Q2/2019, although the annualized rate will remain relatively high in 2019, reflecting base effects. This containment of inflation is predicated on continued fiscal consolidation and a tightening of monetary policy.

IV. FISCAL POLICY: STRENGTHENING FISCAL MANAGEMENT AND RESTORING DEBT SUSTAINABILITY

A. The 2019 Budget

9. **The recalibrated 2019 budget targets a fiscal consolidation while supporting the vulnerable and creating fiscal space necessary for cyclone and drought-related expenditures.** Fiscal adjustment is urgently needed to stabilize the economy and restore confidence. The recalibrated 2019 budget targets an overall budget deficit of RTGS$2.8 billion and strives to be below the SADC threshold of 3 percent of GDP in the medium term. This large fiscal adjustment, along with a comprehensive arrears-clearance strategy, will contribute to reigning in public indebtedness and reduce it to below 60 percent of GDP over the medium term, in line with the Public Finance Management Act and the threshold agreed within the SADC.

10. **Fiscal consolidation measures focus mainly on containing re-current spending.** The recalibrated 2019 budget will focus on containing re-current expenditures, while protecting spending for social services and development as well as improve revenue collection. The key measures include:

- **Public wage bill.** Government's employment costs remain unsustainable at 79 percent of tax revenue as of end-2018, well above the regional average and the COMESA target of 35 percent of tax revenue. The recalibrated budget will reduce the real wages of public servants and reduce the wage bill's relative burden in the budget. The restrained wage increases in a period of high inflation will reduce the ratio of the wage bill to tax revenue to 67 percent in 2019. Nevertheless, further efforts to rationalize the Civil Service and strengthen wage bill management are needed to create additional fiscal space for growth-supporting public investment and improving service delivery.
- **Agricultural support.** Our ultimate objective is to expand commercial investment opportunities in agriculture to first reach self-sufficiency and eventually establish Zimbabwe as a major contributor to agricultural production (and exports) in Southern Africa. While our agriculture support program has increased production, this has been driven by unsustainable increases in public expenditure, which has been an essential contributor to the fiscal deficit. Therefore, our objective is to reorient the financing model for agriculture to crowd in private-sector financing, reduce significantly government footprint in production, and lessen the dependence on the budget. Without losing track of these medium-term goals, the Government is also responding to the El Nino-induced drought and cyclone Idai, which is expected to result in a significant contraction in agriculture in 2019. To support the survival of a sector that we believe is key to our long-term growth prospects, while also supporting the most vulnerable during these challenging times, the recalibrated 2019 budget will provide approximately RTGS$1.6 billion (about 2 percent of GDP) through various agricultural support programs. The key measures supporting these targets are:
    - **Grain subsidies.** In 2019, the Government intends to purchase grain from farmers at market prices, while continuing to sell grain at subsidized prices as a means of social

protection. This support is in addition to input subsidies that producers will continue to benefit from. The recalibrated budget envisages rationalization in spending on grain production support to RTGS$490 million, on the following basis:

- Starting **December 2018**, the proceeds from subsidized grain sales are being transferred to the Treasury (expected to yield about RTGS$1.3 billion in 2019);
- Support to farmers under the Special Maize Production Programme in 2019 will entail a fiscal cost of RTGS$616 million. Net subsidies will be kept at their current levels throughout 2019, including RTGS$200\ton for maize, and RTGS$257\ton for wheat, but with a view to being phased out in the 2020 and 2021 budgets;
- A less favorable agricultural season is expected to lower grain purchases, while increasing grain sales.
- The price subsidy support to farmers will be reduced in 2019 and eventually eliminated over the medium-to-long term. To achieve this elimination and other agricultural goals, we intend to complete and publish a review of agricultural support facilities by end-September (**structural benchmark).**

- **Command Agriculture.** The 2019 Budget is predicated on a comprehensive review of the implementation modalities of "Command Agriculture," to ensure higher efficiency in input procurement and recoveries. In view of the high default rate by farmers, Government will cap the total amount provided for default guarantees at RTGS$616 million and exclude from new loan guarantees any farmers who have not had a positive track record of repayment in previous years. The modalities to enforce this cap will be adopted by the Cabinet by June 30, 2019.
- **Vulnerable Input Support Scheme.** This program provides social protection through agricultural inputs to vulnerable farmers for free or subsidized prices. However, the program continues to suffer from deficiencies in identifying and targeting vulnerable farmers, leading to inefficient spending. Government is improving the efficiency of this social support program by implementing several actions to improve targeting and reduce leakages.
- **Special Maize Program.** As a rain fed crop, this food staple is particularly affected by varying rainfall patterns, including the El Nino-induced drought. As a result, we expect maize production to fall by 56 percent in 2019, which is a major contributor to the millions of Zimbabweans that will be food insecure in 2019. In this regard Government has announced the Special Maize Program that will allocate RTGS$616 million in support. The government considers this a critical intervention in 2019 to cushion the effects of the three exogenous shocks experienced by farmers this year, namely drought, cyclone Idai, and introduction of a market-determined exchange rate.

- **Tax on electronic transactions.** The government introduced in October 2018 a 2 percent tax per USD value transacted, replacing a previous tax of 5 cents per transaction. The tax is expected to raise an additional RTGS$1.2 billion in 2019.

11. **The consolidation measures outlined above create fiscal space for targeted offsetting measures that will protect the vulnerable, promote long-term sustainability, and comply with constitutional obligations on transfers to provinces**.

- **Social spending.** Government will ring-fence targeted social spending to cushion the impact of fiscal adjustment on vulnerable households. Specifically, RTGS$766.6 million is allocated for social spending in the 2019 budget, inclusive of RTGS$331 million that has been allocated to support the victims of Cyclone Idai.
- **Pension reform.** Government will also begin to transition away from an unfunded 'Pay-As-You-Go' pension arrangement and towards a funded defined-contribution pension arrangement, in line with best practice in neighboring countries. This is expected to cost $200 million on an annual basis in the short term, while resulting in significant savings over the long-run.
- **Transfers to provinces.** Government is committed to the transfer of functions to provincial councils and local authorities in line with the Devolution Policy of the new Dispensation. According to the constitutional and statutory requirements, 5 percent of current year's revenue (RTGS$310 million) will be transferred.
- **Infrastructure spending.** The country's huge infrastructure deficit is weighing down on the competitiveness and development of the economy. Thus, the government will strive to refocus the capital budget on priority infrastructure projects, with an aim to allocating 30 percent of total expenditure to fixed capital investment over the medium term. As a first step, and taking into consideration tight fiscal and financing constraints, in 2019 we intend to allocate RTGS$1.79 billion for infrastructure spending, targeting integrated transportation networks, water and sanitation, energy, ICT, and public amenities.

12. **We will discontinue the unsustainable practice of financing the fiscal deficit through RBZ accommodation.** Total lending of the RBZ to the central government stood at RTGS$3 billion as of end-December 2018, which represents 55 percent of the previous year's revenue, against a statutory maximum of 20 percent as stipulated in the Reserve Bank Act. To help restore confidence in our macroeconomic management, we commit to cease RBZ lending to the government. First, the RBZ will not increase its net exposure to the government for the duration of the SMP. Second, we will convert the stock of RBZ lending to the government at end-December 2018 into marketable debt instruments that the RBZ can use for its monetary policy operations. Third, going forward, short-term recourse to the overdraft facility will be permitted only for transient funding mismatches and limited to 5 percent of the previous year's revenue, with any drawdowns to be fully repaid by the end of each quarter. Fifth, we will reduce the statutory maximum of RBZ lending to the government through any instrument (overdraft, T-Bills, and other advances) from 20 to 5 percent of previous year's revenue. This will be affected together with any other amendments to the RBZ Act, at an appropriate time.

B. Structural Fiscal Reforms

13. **Public financial management.** Government is introducing several measures to improve expenditure control and fiscal transparency going forward, including:

- **Public financial management (PFM).** Key to the restoration of fiscal sustainability and discipline is compliance and adherence to the PFM Act and Regulations. In this regard, the Ministry of Finance and Economic Development will finalize the PFM regulations to enforce compliance with PFM Act, including penalties for non-compliance with provisions in the PFM Act (**end-June 2019 structural benchmark**). Similarly, the financial management provisions in the PFM Act and IFMIS coverage will be extended to 37 districts **(end-December 2019 structural benchmark).**
- **Treasury bills issuance.** We will discontinue the practice of settling Government obligations through Treasury bills, including the issuance of Treasury bills directly by the RBZ for unbudgeted spending. Effective immediately, Treasury bills will be issued only to raise resources for deficit financing and for cash flow management, and only via a Treasury Bill Issuance Note by the Accountant General.
- **Quasi-fiscal activities.** Previous quasi-fiscal activities of the RBZ have been discontinued and to avoid a repetition of these activities we have adopted procedures to ensure that no payment requests for government expenditures will be processed by the RBZ without specific authorization in writing by the Accountant General **(prior action).** In this regard, the government will also abolish the practice of line ministries, departments, and agencies issuing purchase requisitions without prior approval from the Ministry of Finance and require all purchase requisitions to be affected through the IFMIS system. Non-compliance will result in a freeze of the budgetary allocation of the relevant government unit, as well as disciplinary action, including financial penalties, on individuals responsible for the breach.
- **Fiscal transparency and reporting.** Government has resumed and will continue to publish online comprehensive monthly budget execution reports with a one-month lag, as these are a key input in monitoring performance under the TSP. With more market-based financing arrangements, the MOFED will broaden the scope of financial information disseminated, including on outstanding debt, gross financing needs, and issuance/borrowing plans, by end-September 2019.

14. **Revenue administration.** Government will promote optimal resource mobilization via its 2019–23 Strategic Management Framework, which will target increased revenue mobilization, facilitation of trade, and the fighting of corruption. Other measures include the implementation of an enhanced compliance program in 2019, focusing on improvements in data matching and integrity, upgrading ICT systems, and strengthening controls. Moreover, Government will continue efforts to collect existing tax debts and review mining legislation with a view to improving transfer pricing regulations.

15. **State Owned Enterprises (SOEs).** Government will continue to pursue restructuring of SOEs, with the objective of reducing their reliance on fiscal support. Specifically, following the

Cabinet decision of April 2018, 43 entities have been earmarked for privatization, liquidation, or merger. For 31 other entities, a stronger focus will be put on enhancing performance, and improving accountability and governance, building on the 2018 Corporate Entities and Governance Act.

16. **ZAMCO.** We have issued an instruction to ZAMCO confirming the existing limit of $1 billion issuance of Treasury bills for its financing and disallowing any future acquisitions on non-performing loans, effective end-November 2018 (**prior action**). This measure aims to strengthen banks' incentives to improve their credit risk management and ensure progress towards more sustainable public debt. In addition, we will review ZAMCO's mandate, strengthen operational effectiveness, and limit recourse to financing from the RBZ. ZAMCO will publish on its website audited 2018 financial accounts by end-June 2019.

17. **Domestic arrears.** Economic stabilization can be impaired by government arrears to its private-sector suppliers. Thus, the government recognizes the importance of not accumulating domestic arrears going forward. To this end, Government will conduct a comprehensive stock-taking exercise of its arrears as of end-2018, including publishing a report by end-September 2019 (**structural benchmark**), while at the same time improving the coverage and tracking of domestic arrears within the IFMIS system.

V. MONETARY POLICY FRAMEWORK: ANCHORING MACROECONOMIC STABILITY

18. **The RBZ has intervened aggressively to sterilize the liquidity impact of excessive fiscal deficits, to help contain inflationary and foreign exchange pressures.** The RBZ has scaled up the issuance of RBZ's savings bonds, with the stock of such bonds increasing to RTGS$2.7 billion at end-2018 from $0.6 billion at end-2017. In addition, the RBZ introduced a 5 percent reserve requirement on bank deposits effective from November 2018. Nevertheless, the ability of the RBZ to contain pressures in the goods and FX markets has been hampered by excessive fiscal deficits during 2016–18 financed largely through monetary accommodation.

19. **The monetary policy framework in the near term will be based on targeting monetary aggregates.** The envisaged fiscal consolidation in 2019 and the end of RBZ financing of the fiscal deficit, starting in December 2018, will reduce fiscal dominance. The RBZ will use reserve money as the operational target for monetary policy. Specifically, the RBZ will target an appropriately calibrated growth in broad money (M3) of about 15 percent in 2019 (excluding revaluation changes), with a view to help stabilize the macroeconomic environment, support the new currency, and restore investor confidence. To achieve this, the RBZ will use base money (comprised of bond notes and coins, and RTGS$ balances of banks with RBZ) as an operational target for monetary policy. Specifically, we will target a base money growth of 8-10 percent in 2019, and consistent with this objective we have set quarterly targets for net domestic assets of the RBZ (Table 1). To achieve these targets, the RBZ will use all instruments at its disposal, including interest rates, changes in the minimum reserve requirements and open market operations (securities discount window), as needed. With IMF technical assistance, we will strengthen our operational monetary policy framework towards controlling reserve money consistent with a stable macroeconomic framework and to underpin the functioning of the payments system based on market-based transactions.

20. **We are taking measures to improve the efficiency of the new FX interbank market, which was introduced at the same time as the RTGS$ and support the new currency.** Consistent with our monetary targeting framework, we will pursue a floating exchange rate regime, with any interventions by the RBZ limited to avoiding excessive exchange rate fluctuations. To that end, we will seek to build international reserves in the coming months if market conditions permit. In addition, we are committed to an eventual unification of the exchange rate in the official and parallel FX markets and an effective functioning of the interbank and debt markets. In response to U.S. dollar cash shortages, we will continue to implement exchange controls, including a surrender requirement. However, to improve effectiveness and reduce distortions that lead to rent seeking and hamper economic growth, we are revising the exchange controls in line with the recommendations made by the IMF during a recent technical assistance mission. Going forward, in consultation with Fund staff, we will prepare a strategy to enable further liberalization of the foreign exchange controls, as circumstances permit.

VI. MAINTAINING FINANCIAL SECTOR STABILITY

21. **An inclusive and robust banking sector capable of efficiently mobilizing and allocating resources is key for supporting Zimbabwe's long-term growth.** While the introduction of the RTGS$ was necessary to begin unraveling the distortions constraining the growth potential of the economy, it has increased financial stability risks. Following the currency reform, some banks have large negative net open foreign exchange positions (NOP), which largely reflect foreign liabilities acquired under the RBZ Debt Assumption Act of 2015. The RBZ/government has committed to assume the foreign exchange risk related to these legacy NOPs and will elaborate by end-June 2019 arrangements underlying the assumption of this risk, consistent with the authorities' ability to repay. Banks´ asset quality can be expected to deteriorate in an unfavorable economic environment and we will closely monitor the impact of the currency reform on banks´ financial health. We will act proactively to contain financial stability risks, including through the conduct of an asset quality review (AQR), if necessary and in consultation with Fund staff, and implementing risk mitigation measures.

22. **We will strengthen the financial stability framework.** We are well advanced with the development of a framework to identify domestic systemically important banks (D-SIBs) and aim to publish the framework by end-June 2019. Banks are currently in the process of submitting their first recovery plans, based on RBZ guidelines. A Financial Sector Stability Review (FSSR) conducted by the Fund in November 2018, reviewed the institutional arrangements, data, tools, and reporting systems for assessing micro- and macro-level financial risks, highlighting areas of financial vulnerability, and increasing resilience to shocks. Guided by the FSSR, we will prepare a time-bound plan to address identified gaps and have agreed with Fund staff a 3-year technical assistance plan provided through the Financial Sector Stability Fund. With Fund technical assistance, we will draft amendments to the banking law—including the triggers for bank resolution, improvements to the bank liquidation regime, clarifying the hierarchy of claims, and elaborating on the role of the courts in bank resolution—to bring our legislation in line with international best practice. We will submit the amendments to Parliament by end-December 2019 (**structural benchmark**). To improve

surveillance and financial stability analysis, we will publish, starting June 2019, the Fund-encouraged Financial Soundness Indicators for deposit takers.

VII. OTHER STRUCTURAL REFORMS

23. **We are committed to undertake wide-ranging structural reforms to facilitate a transition to a more private sector-led economy.** Such reforms will focus on improving the ease of doing business and opening the country to international investors. We will strengthen our efforts to ensure policy consistency and credibility so that private investors are able to establish long-term business plans, as well as targeting quick-wins to reduce market entry and operational costs in product and labor markets. In line with the TSP, our policy priorities include:

- Establish Zimbabwe Investment Development Authority to consolidate scattered investment supporting institutions and operate as a one-stop investment authority.
- Collapse multiple licensing requirements into single omnibus licenses, particularly in tourism and transportation sectors.
- Expedite a Land Audit to review the agricultural land tenure system, register farm ownership, and facilitate use of land as financial collateral.
- Provide basic infrastructure (roads, water, sewer, and electricity) in designated Special Economic Zones, in coordination with private sector financing.
- Accelerate ratifications and honor obligations of the signed Bilateral Investment Promotion and Protection Agreements (BIPAs), including the protection against expropriation and for repatriation of dividend proceeds.

24. **Governance reforms.** Our TSP targets eradication of corruption, which is a major source of leakages to public revenues and imposes large costs to various productive activities. In addition to the reforms for strengthening the PFM framework and SOE restructuring discussed above, we plan to address: (i) tax evasion and avoidance practices; (ii) smuggling and money laundering; and (iii) unethical procurement practices. To reduce tax evasion and rent seeking, we will remove discretionary authority of tax and custom officers by adopting: (i) a Standard Valuation System for second-hand motor vehicles by end-June 2019; (ii) a penalty loading model for the determination of penalty levels for failure to adhere to tax laws (included in the 2019 Budget); and (iii) a penalty regime that ensures persons guilty of corruption are subject to effective, proportionate, and dissuasive financial penalties. On AML/CFT, we are addressing deficiencies identified in the 2016 Mutual Evaluation Report, aimed at protecting correspondent banking relationships and fostering strong cross-border financial flows. In addition, and with assistance from the IFIs, we plan to complete and publish the report of a diagnostic assessment of Zimbabwe's governance vulnerability (**end-December 2019 structural benchmark**).

VIII. RELATIONSHIP WITH EXTERNAL CREDITORS

25. Zimbabwe continues to have protracted arrears to official external creditors, including multilateral creditors with preferred creditor status. Taken in totality, Zimbabwe has an

unsustainable debt overhang that needs to be addressed at the earliest opportunity through a comprehensive treatment of Zimbabwe's external obligations. We are committed to redoubling efforts to engage our external partners to find a mutually agreeable framework to eliminate the debt overhang, building on the Round Tables that took place during the 2018 Annual Meetings in Bali and the 2019 Spring Meetings in Washington DC. We consider the SMP to be an indispensable part of establishing a track record that can eventually pave the way for arrears clearance and renewed support from the IFIs (including an IMF financing programme). Nevertheless, we are aware that macroeconomic reforms alone will not be sufficient to galvanize the support necessary within the international community to restructure our debt and clear arrears. Consequently, we are committed to advance political and other reforms in 2019 that, in tandem with the SMP, could pave the way for an agreement with our international partners.

IX. RISKS AND CONTINGENCY PLANS

26. We see several potential downside risks to our program. These relate to: an unsuccessful implementation of further fiscal consolidation measures that build on the consolidation that began in Q4/2018, without which it is not possible to stabilize prices and restore confidence in the economy; a further negative impact on agricultural growth emanating from the El Niño phenomenon, and adverse terms of trade from price volatility for key exports and imports. We also see risks in further delays in clearing arrears and reengagement with the international community, jeopardizing external and debt sustainability. If these or other risks materialize, the Government, in consultation with IMF staff, stands ready to take additional policy measures to ensure the attainment of our program's objectives.

X. TECHNICAL ASSISTANCE AND DATA ISSUES

27. Government has identified priority areas for technical assistance to strengthen our capacity to implement our ambitious reform plan. In the fiscal sector, our top priorities relate to improving debt management, domestic revenue mobilization, budget development and execution, public financial management, medium-term expenditure frameworks, and public enterprise reform.

28. In the monetary and financial sectors, our most urgent need is related to the strengthening of our operational monetary policy framework and safeguarding financial stability. Other priorities include an assessment of central bank legislation and monetary operations, and reviews of RBZ's internal auditing, and accounting and IT systems, including documentation.

29. Government recognizes the importance of accurate and timely statistics for policy making and verifying implementation of the authorities' economic reform programme. Given resource constraints that limit the ability to address fully the implications of the introduction of the new RTGS$, Zimstat will prioritize projects to efficiently deploy its scarce resources, committing to make an urgent priority the finalization of recent GDP rebasing and the conversion of the national accounts to RTGS$ (to be completed by July,2019. Technical assistance will be requested to facilitate the timely compilation needed for the international re-engagement process.

XI. Safeguards Assessment

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

XII. Program Monitoring

31. The Government will closely monitor the implementation of the SMP program with the help of quarterly quantitative targets (Table 1) and structural benchmarks (Table 2). The SMP will be monitored through 3 reviews based on performance through end-June 2019, end-September 2019, and end-December 2019, respectively. The quantitative targets and the benchmarks are defined in the Technical Memorandum of Understanding (TMU, Attachment I).

32. Government is committed to ensuring that the program remains on track, given its importance as a bridge towards arrears clearance and a Fund-supported financial program. To this end, we will appoint at the start of the SMP a monitoring committee comprised of officials from the Ministry of Finance and Economic Development, Office of the President and Cabinet, 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 all information to be monitored (reporting requirements are outlined in the attached TMU).

Table 1. Zimbabwe: Proposed Quantitative Targets[1]
(in units as indicated)

	2018	2019		
	Dec. Actual	Jun. Prog.	Sep. Prog.	Dec. Prog.
1. Floor on the primary budget balance of the central government (RTGS$ million) [2]	...	-1,203	-1,604	-2,005
2. Floor on protected social spending (RTGS$ million) [2]	...	225	500	750
3. Floor on the stock of net official international reserves (in US$ million)	-1,267	-1,267	-1,267	-1,267
4. Continuous ceiling on the stock of new non-concessional external debt contracted or guaranteed by the public sector with original maturity of one year or more (in US$ million) [3]	...	0	0	0
5. Ceiling on changes in net domestic assets of the RBZ (RTGS$ million) [4]	...	300	350	400
6. Ceiling on credit to the nonfinancial public sector from the RBZ (RTGS$ million) [4]	...	0	0	0

[1] Program performance will be monitored based on the quantitative targets for June, September, and December 2019.
[2] Value of cumulative flows since December 31 of the previous year.
[3] Cumulative from April 30, 2019.
[4] Cumulative from March 1st, 2019. For the NDA target, excludes foreign exchange valuation changes.

Table 2. Zimbabwe: SMP Structural Benchmarks

Benchmark	Objective	Completion Date
Cabinet to approve a revised 2019 budget consistent with a deficit of RTGS$2.8 billion (¶9 and ¶10)	Restore macroeconomic stability	Prior Action
Issue instructions to ensure that no payments shall be made by the RBZ on behalf of Government without explicit and case-by-case authorization by the MoFED (¶13)	Improve PFM, budget execution, and fiscal discipline	Prior Action
Issue an instruction to disallow, with immediate effect, any future acquisitions of non-performing loans by ZAMCO (¶16)	Improve governance, PFM, and budget monitoring/execution	Prior Action
Adopt regulations implementing the Public Financial Management (PFM) Act., including to ensure all expenditure commitments are recorded in IFMIS (¶13)	Improve governance, PFM, and budget monitoring/execution	June 2019
Complete a comprehensive stock-take of domestic expenditure arrears across the central government as of end-2018 (¶17)	Improve PFM, budget execution, and fiscal discipline	September 2019
Complete a review of agricultural support programs and develop an action plan based on its findings (¶10)	Improve targeting and efficiency of agricultural support programs	September 2019
Extend the coverage of IFMIS to 37 Districts by establishing 31 additional kiosks (¶13)	Improve governance, PFM, and budget monitoring/execution	December 2019
Submit to Parliament draft amendments to the Banking Law to address gaps identified by the FSSR (¶22)	Maintain financial stability	December 2019
Complete, with assistance from the IMF, and publish the report of a diagnostic assessment of Zimbabwe's governance vulnerabilities (¶24)	Strengthen governance and combat corruption	December 2019

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, structural benchmarks, applicable adjusters, and the respective reporting requirements for the Staff-Monitored Programme (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 all the accounts whose total revenues and expenditures are authorized through the Blue Book (including line ministries, the Parliament of Zimbabwe, the Auditor General's Office, and Vote of Credit). 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. The nonfinancial public sector excludes the RBZ and nine other public financial corporations (Agribank, Infrastructure and Development Bank of Zimbabwe, Infrastructure Development Bank, Jewel Bank (CBZ), People's Own Savings Bank, Women's Development Bank, ZAMCO, and the Zimbabwe Reinsurance Corporation).

5. **Domestic arrears** are overdue domestic payment obligations of the central government, whether verified or not, owed to entities legally incorporated in Zimbabwe and residents of Zimbabwe. They include obligations to domestic service providers, agricultural input suppliers, and domestic private sector contractors, but excludes government liabilities to other public sector units. Except in cases where the terms and conditions of the transaction stipulate a longer period, payments are deemed to be in arrears when:

(i) Debt remains unpaid for more than 30 days after the due date stipulated in the agreement between the parties (creditor/debtor).

(ii) Wages or pensions remain unpaid 90 days after their due date.

(iii) Payments for goods and services rendered received more than 90 days after processing of the supporting documents submitted by suppliers.

QUANTITATIVE TARGETS

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

6. **The primary budget balance of the central government** is measured on a cash basis as the sum of net foreign financing and net domestic financing minus interest payments. Net foreign financing is the difference between disbursements of foreign loans to Treasury and actual (not scheduled) foreign loan repayments by Treasury, as reported by Treasury. Net domestic financing is the sum of net financing from the Reserve Bank of Zimbabwe (RBZ), other depository corporations (ODCs), and domestic non-banks. Net financing from the RBZ (ODCs) is equal to the change in net claims on the central government from the RBZ (ODCs) between the start and end of the relevant period, as obtained from the Central Bank Survey, IFS S1G submission, code 69812AN..J...{M} (ODC Survey, IFS S2G submission, code 69822AN..J...{M}). Net financing from domestic non-banks is equal to the change in the central government domestic debt stock between the start and end of the relevant period, as reported by Treasury, excluding (a) financing from the RBZ and ODCs (as above), (b) the change in the stock of domestic arrears, (c) asset purchases and other capitalisation operations recorded below-the-line (including Treasury Bills issued to finance the acquisition of non-performing loans by ZAMCO), and (d) the (negative of) the change in government deposit accounts held with non-banks. Interest payments shall be measured above the line using budget execution data.

B. Floor on Protected Social Spending

7. **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; spending on the school feeding program; expenditures on the Student Stipend Support portion of the National Education and Training Fund;
- **Health:** Recurrent spending on preventative health programmes; medical supplies procured for ARVs and TB drugs; co-financing of GAVI programmes; current expenditures for government hospitals and health centres; grant aided institutions Parirenyatwa/Mission Hospitals/Local authorities; and recurrent expenditures on maternal and child health.;
- **Social protection:** Recurrent spending on the basic education assistance module; harmonized cash transfer; health assistance; support for disabled persons; expenditures for children in difficult circumstances; and drought mitigation.

C. Floor on the Stock of Net Official International Reserves and Ceiling on Net Domestic Assets of the RBZ

8. **Net Domestic Assets (NDA) of the RBZ** are defined as the difference between reserve money and net foreign assets, as obtained from the Central Bank Survey, calculated at the program exchange rate of US$1.388 per SDR.

9. Reserve money includes quasi-currency instruments (bond notes and coins) in circulation, and liabilities of the RBZ to depository and non-depository corporations (including required reserves, transferable deposits, other deposits, and securities other than shares), as presented in the Central Bank Survey, IFS S1G submission, code 69814.

10. Net official international reserves (NIR) are defined as the difference between the RBZ's liquid, convertible gross official foreign reserve assets and its short-term official foreign reserve liabilities. For the purposes of the programme, SDR-denominated accounts will be valued at the programme exchange rate of US$1.388 per SDR.

- **Gross official reserve assets** of the RBZ are defined as the sum of: (i) Zimbabwe's SDR holdings; (ii) refined gold: (iii) balances with foreign banks; (iii) foreign treasury bills, securities, and investments in convertible foreign currencies, and convertible foreign currency held by the Reserve Bank of Zimbabwe; and (iv) Zimbabwe's reserve position in the Fund. Pledged or otherwise encumbered assets, including but not limited to, assets used as collateral or as guarantee for third-party external liabilities are excluded from official reserve assets.
- **Short-term official reserve liabilities** of the RBZ are defined as short-term foreign currency liabilities to non-residents with maturity of up to and including one year. Official foreign liabilities used to calculate the NIR do not include long-term liabilities such as SDR allocations.

D. Ceiling on Credit to the Nonfinancial Public Sector from the RBZ

11. Credit to the nonfinancial public sector is defined as the total claims of the RBZ on the nonfinancial public sector (as defined above), including all loans, advances, guarantees, Treasury bills and any other obligation. It shall be measured from the Central Bank Survey, IFS S1G submission, by the sum of net claims on the central government (code 69812AN..J...{M}), claims on state and local governments (code 69812B...J...{M}) and claims on other nonfinancial public corporations (code 69812C...J...{M}).

E. Ceiling on New Non-Concessional External Public Debt

12. Contracting or guaranteeing of new external debt by the public sector 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 starting from April 30th, 2019.

13. For program purposes, a debt is concessional if it includes a grant element of at least 35 percent, calculated as follows: the grant element of a debt is the difference between the present value (PV) of debt and its nominal value, expressed as a percentage of the nominal value of the debt. 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. The discount rate used for this purpose is the unified

discount rate of 5 percent set forth in Executive Board Decision No. 15248-(13/97). For debts with a grant element equal or below zero, the PV will be set equal to the nominal value of the debt.

14. Discussion on the contracting and/or guaranteeing of any new non-concessional debt will only be undertaken after consultation with the IMF. For program purposes, a debt and/or guarantee is considered contracted when all conditions for its coming into effect have been met, including approval by the Ministry of Finance and Economic Development. The contracting of credit lines with no predetermined disbursements schedules or with multiple disbursements will be also considered as contracting of debt.

15. For debts carrying a variable interest rate in the form of a benchmark interest rate plus a fixed spread, the PV of the debt would be calculated using a program reference rate plus the fixed spread (in basis points) specified in the debt contract. The program reference rate for the six-month USD LIBOR is 3.34 percent and will remain fixed for the duration of the program. The spread of six-month Euro LIBOR over six-month USD LIBOR is -250 basis points. The spread of six-month JPY LIBOR over six-month USD LIBOR is -300 basis points. The spread of six-month GBP LIBOR over six-month USD LIBOR is -100 basis points. For interest rates on currencies other than Euro, JPY, and GBP, the spread over six-month USD LIBOR is -200 basis points. Where the variable rate is linked to a benchmark interest rate other than the six-month USD LIBOR, a spread reflecting the difference between the benchmark rate and the six-month USD LIBOR (rounded to the nearest 50 bps) will be added."

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			
Balance Sheet and income statement of the RBZ	RBZ	Monthly	1 week
NIR, NFA, monetary control programme	RBZ	Weekly	1 week
Monetary surveys (CBS, ODCS, DCS)	RBZ	Monthly	2 months
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 (aggregate and by bank)	RBZ	Quarterly	2 months

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

Data Description	Reporting Institution	Reporting Frequency	Submission Lag
Individual operational balance sheets of banks with detailed information on deposits (by type of accounts (FCA Nostro, RTGS) and type of depositors), central bank funding, interbank funding, debt securities, and asset quality loan classification.	RBZ	Monthly	1 month
Financial soundness indicators (aggregate and by bank)	RBZ	Quarterly	2 months
Lending activity of banks (by sector)	RBZ	Quarterly	2 months
Commercial bank interest rates (deposits and lending)	RBZ	Monthly	1 month
External Sector			
RBZ purchases and sales of foreign currency	RBZ	Monthly	1 month
Banks' purchases and sales of foreign currency (specified by bank and by type of flow)	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	MoFED	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)	MoFED	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	MoFED	Monthly	1 month
Detailed data on the execution of the budget (by economic and administrative classification)	MoFED	Monthly	1 month
Total stock of domestic arrears, with a breakdown between domestic service providers, agricultural input suppliers, capital certificates, and other creditors, at end-month	MoFED	Monthly	1 month
Stock of domestic debt, disbursements, amortization, interest, and other fees and charges; face value, maturity, interest rate, and payments schedule for new domestic loans and securities	MoFED	Monthly	1 month
Detailed data on resource revenue (by type)	MoFED	Quarterly	1 month
Detailed data on the budget execution of protected social spending (as defined in this document)	MoFED	Quarterly	1 month
Details of disbursed external budget support and project grants and loans	MoFED	Quarterly	1 month
Total volume of Treasury bills issued, including by RBZ, with details on interest rate, maturity, and recipient	MoFED and RBZ	Monthly	1 month
All guarantees provided by the central government and RBZ, including guarantees to public corporations, RBZ (from central government), and private sector (including agricultural guarantees).	MoFED and RBZ	Quarterly	Quarterly
Real Sector			
Consumer Price Index	ZIMSTAT	Monthly	1 month
Fuel price indices, including Petrol, Diesel, and Paraffin	ZIMSTAT	Monthly	1 month
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	6 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	3 months
Structural Benchmarks			
Update on the status of implementation of the structural benchmarks specified in Table 2 of the LOI/MEFP	MoFED/RBZ	Quarterly	4 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 lessee 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.