International Monetary Fund

Zimbabwe and the IMF

Press Release: IMF Managing Director Approves a Staff-Monitored Program for Zimbabwe
Jun3 17, 2013

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Zimbabwe: Staff-Monitored Program: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

June 5, 2013

The following item is a Letter of Intent and a Memorandum of Economic and Technical Memorandum of Understanding of Zimbabwe. The document, which is the property of Zimbabwe, is being made available on the IMF website by agreement with the member as a service to users of the IMF website. This memorandum describes the policies that is implementing in the framework of a staffmonitored program. A member's staff-monitored program is an informal and flexible instrument for dialogue between the IMF staff and a member on its economic policies. A staff-monitored program is not supported by the use of the Fund's financial resources; nor is it subject to the endorsement of the Executive Board of the IMF.

Letter of Intent

June 5, 2013

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

Dear Ms. Lagarde:

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

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

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

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

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

The programme will focus on the following structural reform agenda:

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

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

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

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

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

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

Sincerely yours,

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

ATTACHMENT I. MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

INTRODUCTION

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

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

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

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

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

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

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

RECENT ECONOMIC DEVELOPMENTS

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

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

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

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

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

MEDIUM-TERM OBJECTIVES AND POLICIES

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

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

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

MACROECONOMIC OBJECTIVES AND POLICIES IN 2013

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

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

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

A. Restoring Fiscal Sustainability and Strengthening Fiscal Management

The 2013 Budget

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

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

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

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

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

Fiscal Reforms

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

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

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

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

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

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

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

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

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

B. Increasing Financial Sector Stability

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

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

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

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

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

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

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

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

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

C. Other Structural Reforms

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

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

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

RELATIONSHIP WITH EXTERNAL CREDITORS

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

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

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

RISKS AND CONTINGENCY PLANS

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

TECHNICAL ASSISTANCE

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

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

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

SAFEGUARDS ASSESSMENT

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

PROGRAMME MONITORING

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

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

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

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

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

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

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

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

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

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

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

Table 2. Zimbabwe: Structural Benchmarks, 2013		
Benchmarks	**Review**	**Macroeconomic Rationale**
Tax Policy		
1. Submit to Parliament the new Income Tax Bill.	1st	Enhance tax administration
2. Issue a Statutory Instrument establishing a clear formula for the calculation and remittance of dividends from entities in which the Government holds shares.	1st	Increase transparency and accountability
3. Submit to Cabinet amendments to the Precious Stones Trade Act to incorporate the principles of the Diamond Policy.	2nd	Increase transparency and accountability
4. Submit to Parliament amendments to the Precious Stones Trade Act.	2nd	Increase transparency and accountability
5. Submit to Parliament a new Mines and Minerals Act.	2nd	Increase transparency and accountability
Public Financial Management		
6. PSC to submit to MoF a time-bound action plan on measures to modernize the human resources and payroll systems.	1st	Enhance public expenditure and financial management
7. Publish a report on the stock of verified arrears and a strategy to clear validated arrears by December 2014 on MoF's website.	1st	Enhance public expenditure and financial management
Financial Sector		
8. Submit to the RBZ Board a framework for contingency planning and systemic crisis management.	1st	Reduce financial sector vulnerabilities
9. Submit amendments to the Banking Act to Parliament aimed at strengthening the Troubled Bank Resolution Framework.	2nd	Strengthen legal and regulatory framework and reduce systemic liquidity risks
10. Submit the RBZ Debt Relief Bill to Parliament to complete the restructuring of the RBZ balance sheet.	2nd	Reduce financial sector vulnerabilities

ATTACHMENT II. TECHNICAL MEMORANDUM OF UNDERSTANDING

INTRODUCTION

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

DEFINITIONS

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

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

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

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

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

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

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

QUANTITATIVE TARGETS

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

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

B. Continuous Ceiling on New Domestic Payment Arrears

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

C. Floor on Protected Social Spending

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

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

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

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

D. Floor on the Stock of Usable International Reserves

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

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

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

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

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

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

F. Adjusters

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

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

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

DATA REPORTING

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

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

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

GUIDELINES ON EXTERNAL DEBT

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

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

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

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

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

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

ATTACHMENT III. LETTER ENDORSING THE SMP

Reference:

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

Telephone: 707091/9
Telegram: "SECPRES"

ZIMBABWE

Ref:

7 May 2013

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

Dear Ms Antoninette Sayeh

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

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

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

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

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

Please be guided accordingly.

Dr MJM Sibanda
CHIEF SECRETARY TO THE PRESIDENT AND CABINET