IMARA INVESTING IN AFRICA

Zimbabwe Investment Notes

Region Zimbabwe

Date May 2016

Issued by: Imara Asset Management (Zimbabwe) Ltd

New Bond Notes and Exchange Controls - Our Initial Take

Last Wednesday's announcement from the Reserve Bank of Zimbabwe regarding the introduction of Bond Notes and changes to Exchange Controls certainly took the country by surprise, including ourselves. With hindsight though the problems facing Zimbabwe have been brewing for many months now; the fact that US dollar cash was hard to come by and international transfers harder to make ultimately prompted the Reserve Bank's action. A number of factors have occurred to bring about this situation, some of our own making but in addition some that have been caused by global policy related to the fight on terrorism and money laundering.

The first relates to the differing sanctions imposed upon Zimbabwean corporates and individuals by the US Government. In recent years, European banks have paid enormous fines to the US regulators for infringements of the US global sanctions policy. For example, $15 billion has been paid in fines by European banks since 2012 for European bank dealings in US dollars with Iran. Both BNP Paribas and Standard Chartered Bank were fined heavily in this regard and the latter was at risk of losing its US dollar clearing licence. In February this year Barclays Bank PLC in the UK was fined $2.5million for US dollar dealings that Barclays in Zimbabwe had with Zimbabwean corporates considered to be related to sanctioned companies in Zimbabwe. The net result is that global banks do not wish to risk their balance sheets or operating licences when dealing with sanctioned countries. European banks have been important providers of Zimbabwean banks' nostro accounts (foreign currency accounts), accounts that facilitate international US dollar transfers. A week after the Barclays fine, Commerzbank pulled its nostro services, one assumes due to the potential risks that they believed they were taking for little return. With this, they also pulled their credit lines to local banks. This immediately makes it harder for local banks to buy US dollar cash for importation into Zimbabwe or for international money transfers.

The second aspect and related to the above, is the impact on Governments globally of the Global Fight on Terror, and the financing of terrorist organisations. In particular the emphasis on Know Your Client (KYC) and the fight on Money Laundering has become a growing issue for most financial services companies worldwide. Our own firm has not been able to transact in cash since it was established in 1998. Concerns about cash being used by terrorists to finance their actions has prompted the European Central Bank to consider the removal of the large Euro500 note in favour of smaller denominations. The Bank of England is looking at withdrawing the GBP50 note for similar reasons. Zimbabwe is the only country in Africa that uses the US dollar as its primary currency and so could be seen as a haven for money launderers in the region. The media has speculated that the Chinese or Nigerians could be at work here although we have no evidence at all to substantiate that. It is a risk that the Zimbabwean Government is extremely concerned about, especially as it is attempting to re-engage with the international financial institutions to open the all-important credit lines for the economy to grow. The favourable report from the Executive Board of the IMF last week makes that prospect ever closer and so it will do everything not to jeopardise its efforts. As such it must be seen, especially by the US Government, whose currency we have adopted, to be doing its bit in the fight against the money launderers. As such they have been all too aware of the increasing demand for US dollar cash (and presumably so have the Americans) that the country has experienced over the past months.

The third and in our view related factor to our recent problems, stems from the Monetary Policy Statement issued at the end of January, which did away with free funds (that could be transferred outside the country without restriction) and re-introduced exchange controls whereby international money transfers required pre-approval from the authorities. Unfortunately such controls destroy public confidence in the banking system especially in a country with Zimbabwe's recent past. Why put money into a bank if you cannot get it out again? Further, if you have money in the bank which appears blocked for an international transfer, why not withdraw US dollars in cash and take it out of the country to make the desired payment?

Herein lies the problem of imposing exchange controls on a US dollar; such a policy only works when the cash notes are not transferrable outside of the country which was the case in the Zim dollar era. We suspect that dollar cash demand increased dramatically following the introduction of this policy.

We met last Thursday with one of the Deputy Governors of the Reserve Bank who made it very clear that Zimbabwe had little choice but to RETAIN the multi-currency system and the US dollar since the general public would not accept a local currency so soon after the ravages of hyperinflation. Not surprisingly there is little trust in the monetary authorities who happily printed money in the past. This is well understood by Government.

Herein lies the dilemma. How to maintain a multi-currency system but at the same time be seen by the Americans and others to be fighting the money launderers? The answer is to introduce a Zim US dollar that cannot be used outside of the country but at the same time is transferrable into US dollar deposits one for one. Hence the Bond notes, which like the bond coins, will be backed by US dollars held offshore. In very simple terms, this is the concept behind a Currency Board such as the one in use in Hong Kong. It can only work if the public remains confident that the local note is transferrable one for one for a US dollar. New notes can only be printed with the backing of new inflows of US dollars. The current intention of the Reserve Bank is NOT to introduce a full currency board system, preferring instead for the US dollar and the rand to be used as the principal mediums of exchange for goods and services, but supported by Bond Notes. We further clarified that civil servants would not be paid in Bond Notes, although such notes could be used by the public to settle accounts with Government bodies and parastatals.

Zimbabwe has a high usage of cash which makes little sense given new technologies such as mobile money and Chip and Pin debit cards. In Kenya mobile money is extensively used, in South Africa debit cards can be used almost everywhere. The authorities need to work with the private sector to make it easier and cheaper to use electronic forms of payment rather than cash. At the moment, electronic transfers are expensive either due to ATM, web or money transfer commissions. Hence cash hoarding is more common place.

Other factors at work that could have resulted in the lack of internationally transferable US dollars could relate to the domestic issuance of treasury bills to settle local debts. If these are bought by the private sector, typically at discounts to par value, and the proceeds are externalized, there will be additional demand for US dollars in nostro accounts over and above what would have occurred. In addition, Zimbabwe's drought has caused additional demands for foreign exchange to fund food imports.

This leads us back to the importance of an "IMF Deal" that we have highlighted to our clients for almost a year now. Zimbabwe has not had easy access to cheap lines of credit since the late 1990s when the country fell into arrears with the IMF and the World Bank. At the centre of Government's economic policies since dollarization in 2009, has been a quest to re-engage with the international financial institutions (IFIs) led by the IMF and the World Bank in order to correct this situation. The result to date has been Zimbabwe's debt arrears clearance programme that was agreed by the IFIs in Lima last October and the successful conclusion of the IMF's Staff Monitored Programme (SMP) that was concluded in December 2015. The final report by the Executive of the IMF that was issued last week stated clearly that Zimbabwe had met the policy targets set for it under that programme but that it now needed to implement a credible economic reform programme that was acceptable to the IMF and to clear its arrears. They further stated that it would be very difficult for Zimbabwe to undertake those reforms WITHOUT international financial assistance. We take that comment positively. It is our understanding that Zimbabwe intends to clear its debts, which will include a loan from Algeria that will be used to re-pay a part of those loans. A draft economic reform programme has already been submitted to the IMF for their feedback. It is not impossible therefore that credit lines may start to be re-opened this year which we hope would assist in replenishing our nostro accounts and improve liquidity in the domestic economy.

We have yet to engage corporate Zimbabwe since the new exchange controls were introduced in order to better understand the full implications on businesses, whether positive or negative. This particularly relates to exporting companies who will see 50% of their export proceeds converted to rand and euros. The fact that the rand has been strengthening so far this year against the dollar may make it not such a bad thing for the time being at least! In addition the cash crisis would likely have had a negative effect on cash related consumer goods. The cash crisis should be good for Econet's Ecocash and they would do well to capitalize on that! Making it cheaper would be a good start as that would encourage demand.

We will keep our clients updated as the facts emerge.

John Legat, Chief Executive,

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