Zimbabwe Investment Notes

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History is Repeating Itself; Same Old, Same Old

Predictably the ZWL continued to plummet throughout the quarter ending June at around ZWL100 to USD1 based on parallel market levels. This compares with the rate at the end of March of ZWL39 and of course with the introductory rate of ZWL2.5 to USD1 just over a year before. In short the introduction of the ZWL has been a disaster from start to finish and has once again destroyed the country's domestic capital base and wealth.

Such was the recent gap between the official rate of ZWL25 to USD1 and the parallel rate, the Government announced that the official exchange rate would be determined by a foreign exchange auction system that would set the rate each Tuesday starting on June 23rd. On that day the ZWL traded at ZWL57 with a volume of USD10.3m. That new rate had an immediate knock-on effect on fuel prices which more than doubled the following day. This of course then pushed up prices across the economy. We estimate that inflation for June may be in excess of 1000% from 785% in May 2020. The auction system was first introduced in 2004 but it failed as the rate became controlled.

There have now been three auctions since the auction system was launched in early June. As we understand it, the RBZ has borrowed USD250million from Afreximbank in order to jump start the auction system. In short it is being funded by foreign debt that traditionally has been backed by future gold exports. Of the $250million, $100million will go toward fuel that should start trading through the auction system shortly. As such the vast majority of the USD traded has come from the RBZ and not from the private sector but their hope is that after a while there will be more confidence for exporters to start trading their foreign exchange. At this stage, those requiring foreign exchange bid for it through the Reuters system. High bids will be accepted, while bids below the median bid have a lower success rate; the intention is that over time the high bids will fall toward the median. The system does not allow offers of foreign exchange to be inputted onto the system but one hopes that will be the case if transparency and a market rate is to be achieved. The most recent auction set the rate at ZWL66 to USD1.

On June 26th, the Government announced that it was suspending all mobile money transfers and the ZSE with immediate effect. This was based on their belief that these 'systems' or institutions were being abused by various unscrupulous individuals and that these actions were the root cause of the devaluation of the ZWL. Whilst Government may indeed have some evidence of such actions, the root cause of the devaluation must be blamed on the creation of ZWL by the Central Bank as we have stated before. A simple experiment that can be tried at home best illustrates this. Place a ZWL20 note alongside a USD1 note. Assuming no further additions of USD, if you then add another ZWL10 to the ZWL20 note, there are now ZWL30 against the initial USD1. The 'exchange rate' has moved driven by an increase in the ZWL money supply. Having published no economic monthly data in 2020, the RBZ published a statement providing the growth in reserve money in early June which showed that since the end December 2019, reserve money had expanded by 30%. The RBZ is publishing these statistics on a regular basis (fortnightly) which is to be commended. Also in June the RBZ published its April Monthly Economic Bulletin (along with those of January, February and March it would appear). These statistics show that broad money M3 expanded by 48% over the first four months of the year or by 358% over the previous 12 months.

Fortunately the RBZ announced 24 hours after the Government's press statement that mobile money transfers for individuals would continue to be permitted although a raft of other restrictions would be imposed. Their statement averted a disaster for the public at large who rely on mobile money for their regular transactions. Had mobile money been shut down, and in the absence of ZWL cash or bank account swipe cards, USD cash or barter would have been the only options for transactions thereby driving further dollarization across the economy.

The Zimbabwe Stock Exchange (ZSE) rose by 42% over the past quarter in USD terms and by 65% over the first six months of 2020 making Zimbabwe the best performing market in the World (based on the parallel rate of exchange). The ZSE however as we write remains suspended 'pending investigations'. Whilst the ZSE has finally performed well in USD terms so far in 2020 it is not a source of money creation, as some Government officials assume, from the simple perspective that for every seller of shares, there is a buyer of the equivalent. So whilst the seller gains liquidity, the buyer loses it. Net net there is no change.

As we saw in 2008 however as ZWL liquidity increases within the economy and avenues to spend that ZWL become that much harder, the ZSE becomes one of the few places a real asset can be bought for ZWL money on a daily basis. So if businesses or individuals cannot buy raw materials that require foreign exchange which itself is harder to access, then the ZSE provides an avenue to park that liquidity. Interestingly volumes traded on the ZSE rose sharply in June as foreigners chose to sell their shares in the hope that the foreign exchange auction system would allow them to repatriate their funds in foreign exchange. We hope they are right but we fear they may not be. Domestic investors on the other hand were happy buyers given the difficulty of accessing other assets. The same was true in 2008. We hope that trading will resume soon for the simple reason that it will be hard for the pension and insurance industry, who are the largest investors on the ZSE, to make payments and to provide a service to the many millions of customers that they have on their books.

Following the outbreak of the COVID-19 in Zimbabwe, the Minister of Finance appealed to the international financial institutions for financial assistance. This was rejected until such time as Zimbabwe improves its economic and human rights track record. The Paris Club of lenders went a stage further by stating that Zimbabwe must successfully implement an IMF Staff Monitored Programme (SMP) before dialogue can begin and that the poor performance under the 2019 SMP was a missed opportunity for Zimbabwe in this sense. This confirms our view outlined in our April Notes that we should expect no outside assistance other than humanitarian aid and technical assistance. This will make it very much harder for Zimbabwe to achieve stability especially given the appetite for the RBZ to fall back on quasi-fiscal policies when the need arises. This will only serve to undermine the ZWL.

Government policies being enacted at the moment, including the closure of the ZSE, the introduction of a foreign exchange auction system, exchange controls and other such measures have all been tried before in the 2003 to 2008 years. All failed and hence it is hard for the public at large to believe that this time will be any different without radical economic and political reform none of which looks likely. There remains no confidence in the ZWL and in our view it will continue to devalue both officially and unofficially.

Such is the loss of confidence in the ZWL that the Government was forced to pay civil servants an allowance in June of US$75 each on top of a 50% increase in their ZWL salaries. Whilst this was touted as an interim arrangement meant to last three months, we believe it will be difficult to withdraw once the scheme has been launched. Since we doubt that Government has the USD to pay them, the RBZ has stated that civil servants should open a nostro account with their bank into which the allowance will be paid. Banks will refer to these as 'Nostro FCA Domestic'. They will not be allowed to withdraw USD cash and will only be able to access the funds by using a "USD" swipe card in shops paying for goods priced in "USD". We can only assume that "USD" equals RTGS dollars as defined in October 2018. Shops will no doubt offer a discount on "USD" prices for USD cash as before if they are unable to convert those monies into real USD to import product. The RBZ will be able to create the electronic "USD" dollars as it did previously. That implies there will be three currencies available; USD cash, "USD" swipe (RTGS) and ZWL cash/swipe. Presumably with three different exchange rates. The irony of course is that paying civil servants in swipe "USD" further undermines the ZWL as Zimbabwe's local currency!

We don't wish to repeat the points we made in our April Notes and refer the reader to our previous publications which remain on our website. Our predictions and strategy have not changed as a result. The fact that the ZSE is currently closed also does not change our strategy but it does make doing business in Zimbabwe that much harder than it was before and will have a further detrimental impact upon the public at large. As we witnessed the last time the ZSE was closed in 2008, ultimately the majority of ZSE listed companies preserved their value in real terms and re-rated sharply with political and economic reform which began in 2009. Despite the gains so far achieved in 2020 on the ZSE in USD terms, asset values based in US dollars remain very low by historical standards and are arguably lower now than they were in 2008. This reflects the dire outlook for the Zimbabwe economy as it stands today.

As for COVID-19, sadly it remains a relatively minor issue in the lives of Zimbabweans compared with all the other issues they face on a day to day basis!

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