SOUTHERN AFRICA QUARTERLY REVIEW AND ANALYSIS

3RD QUARTER 2011

ISSUE N° 2

ANGOLA
BOTSWANA
LESOTHO
MADAGASCAR
MALAWI
MAURITIUS
MOZAMBIQUE
NAMIBIA
SOUTH AFRICA
SWAZILAND
ZAMBIA
ZIMBABWE

BANQUE AFRICAINE DE DEVELOPPEMENT
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AFRICAN DEVELOPMENT FUND
FONDS AFRICAIN DE DEVELOPPEMENT

3RD QUARTER 2011 www.afdb.org/en/countries/southern-africa

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PREFACE

The Southern Africa Quarterly Review and Analysis Report is a publication jointly produced by the Southern Africa Region Departments A and B of the African Development Bank. This publication is part of the African Development Bank's surveillance of economic and policy developments in Southern African countries. It also attempts to draw some implications of quarterly developments for the outlook period. The report is prepared by the Country Economists and is produced from information gathered through consultations, review of country documents, and other relevant sources.

I. REGIONAL OVERVIEW

The sovereign debt crisis and puttering growth in the euro area are beginning to impact some Southern African countries where signs of weakening growth have started showing, leading to downward revisions in growth forecasts. In South Africa's case, growth decelerated from 4.8 percent during the first quarter of 2011 to 1.3 percent in the second quarter. Marginal downward adjustments in growth are also expected in Mauritius and Mozambique. On the other hand, technical problems in oil production in Angola led to the slashing of growth forecasts from 7 percent to 3.7 percent. Overall, Southern African countries will post near pre-crisis growth levels in 2011, with Botswana, Mozambique, Zambia and Zimbabwe likely to record growth of more than 6 percent. Nonetheless, dependence on commodities heightens the vulnerability of the region's recovery.

Despite increasing inflationary pressures during the first and second quarters of 2011, most countries in the region have been successful in curbing price increases. A combination of tight monetary policies and fiscal consolidation in Angola and Mauritius helped in moderating inflation, while in Mozambique the central bank has maintained a tight monetary policy since the beginning of 2010. Inflation has therefore been kept at levels below 8 percent for most countries in the region and within the target range of between 3 – 6 percent for the Southern Africa Customs Union countries.

Improved export revenues have enabled some of the regional countries to build up their foreign reserve positions. Angola, Botswana, Mauritius and Mozambique saw large increases in their foreign reserve positions, with that of Angola being 22 percent higher than the target, estimated at more than US D 23 billion in August 2011. Given the uncertainty in the global economy and experiences from the 2008 global financial crisis, improving the macroeconomic balances are key to ensuring fiscal space when the economies face external shocks.

Efforts to further deepen regional integration are ongoing. During the 31st Southern African Development Community (SADC) Heads of State Summit held in Angola in August 2011, a ministerial taskforce was set up to expedite work on the design of the roadmap that would lead to an agreement and understanding on the proposed customs union. A similar decision was also taken at the 15th Common Market for East and Southern Africa (COMESA) Summit held in Malawi in September 2011. More importantly, the implementation of the COMESA Multilateral Fiscal Surveillance Framework is expected to support macroeconomic stability. COMESA also took a decision to launch the Regional Payment and Settlement System in February 2012 in order to enhance intra-regional trade.

On the political front, an agreement on the SADC-endorsed elections roadmap in Madagascar is a key and important step towards political stability in the country. Zambia's successful elections and transfer of power from the former ruling party, the Movement for Multiparty Democracy to the Patriotic Front led by Michael Sata in September 2011 has clearly demonstrated a maturing democracy in the country. As a region, Southern Africa has seen such democratic processes taking place in nine out of the twelve countries during the last five years. This development augurs well for a region that is looking at deepening economic, political and social cooperation within the context of SADC.

Building on the inaugural issue of the Southern Africa Quarterly Review and Analysis, this edition of the review includes a special topic on efforts towards enhancing resource mobilization for infrastructure development, with focus on Mozambique. In particular, the robust growth in Southern Africa's economies has exposed the infrastructure bottlenecks that impede the inflow of investment resources and improved competitiveness. Discussed under the title **Mozambique – Infrastructure Bonds: Developing Local Debt Capital Markets For Infrastructure Projects**, the importance of reforms in the financial sector to support development is highlighted. Also noted are experiences from Kenya and the possibility of improving fiscal accountability and transparency through the issuance of infrastructure bonds.

Task Team members, Albert Mafusire, Helga Peres and Imen Chorfi, coordinated the preparation of the Southern Africa Quarterly Review and Analysis Report under the general guidance of the Regional Directors, Ebrima Faal and Chiji Chinedum Ojukwu.

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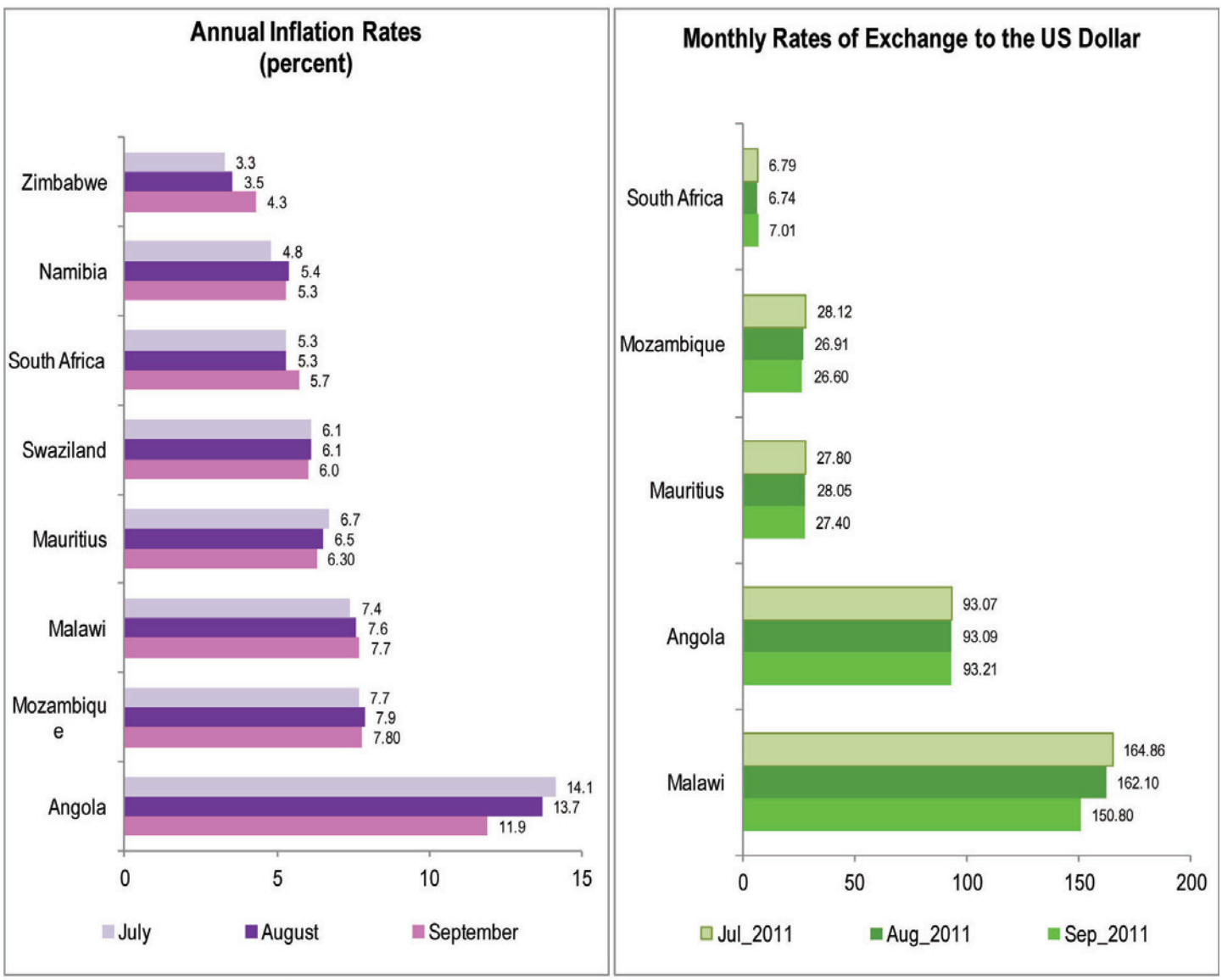
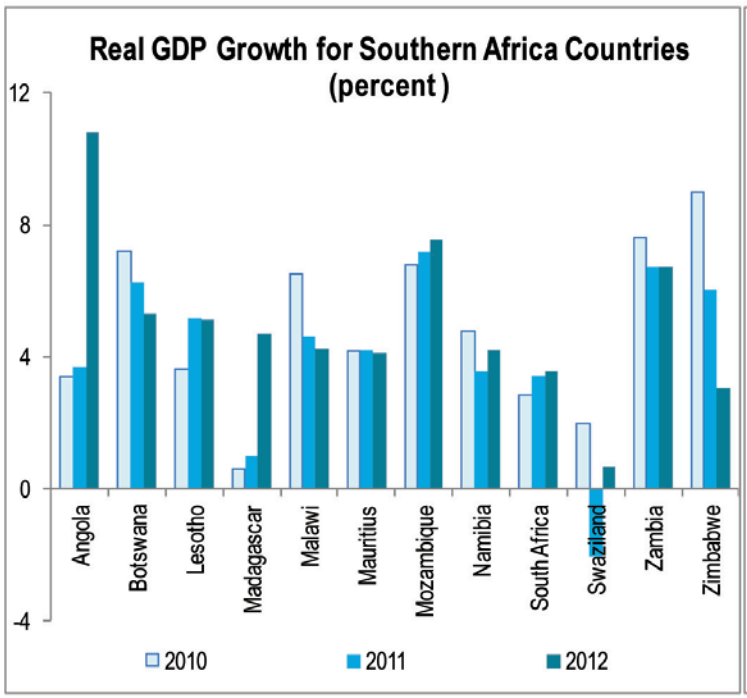
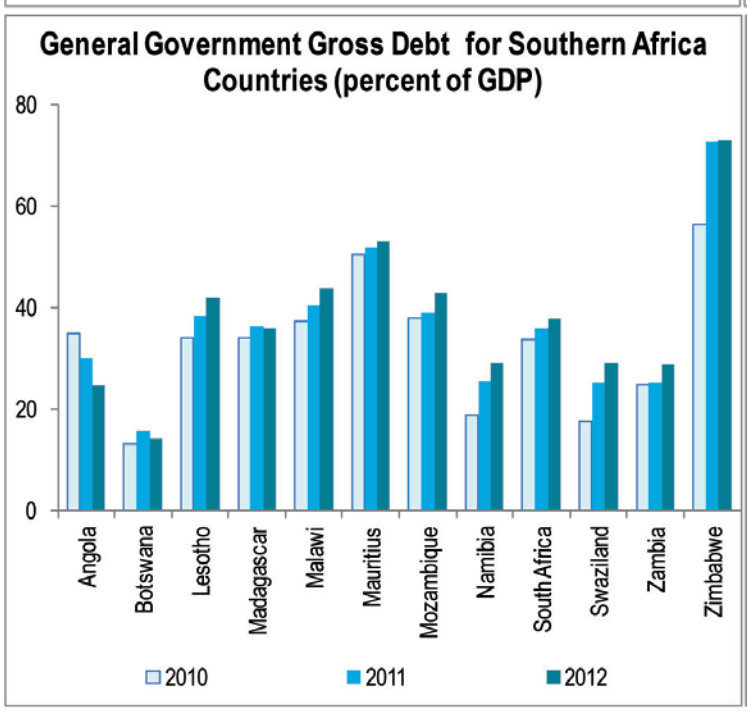
Annual Inflation Rates and Monthly Exchange Rates for Selected Southern African Countries

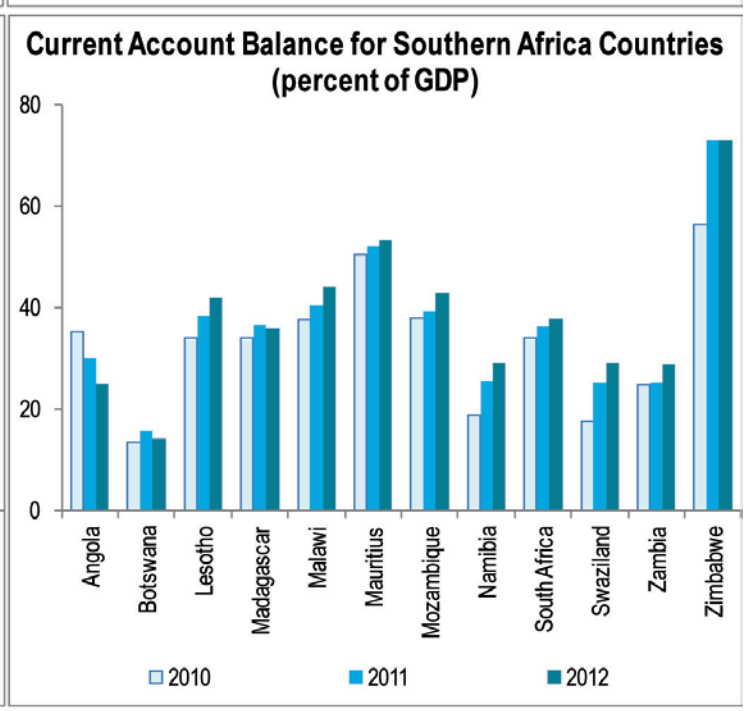


Source: Banco Nacional Angola, ZIMSTAT, Namibia Officials, South African Reserve Bank, Swaziland Ministry of Finance, Mauritius NSO and SACU.
Note: Swaziland, Namibia, Lesotho and Botswana are pegged to the South African Rand

Selected Macroeconomic Indicators for Southern Africa Countries (2010-2012)







Source: International Monetary Fund, World Economic Outlook Database, September 2011

II. COUNTRY ANALYSES

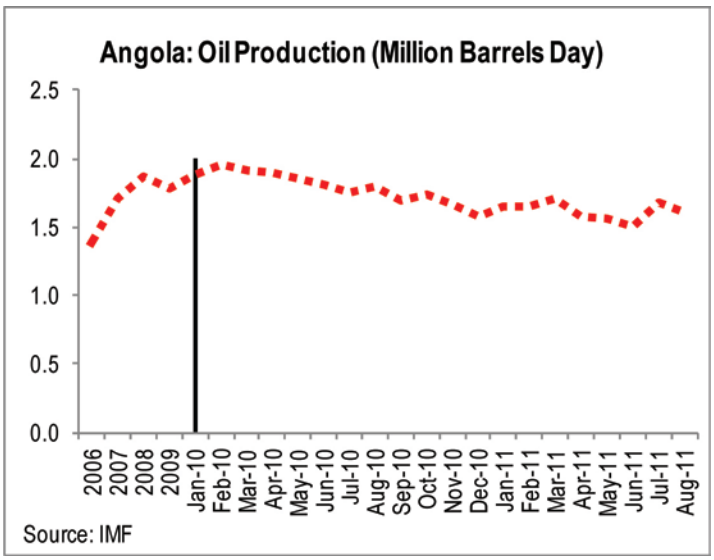
Highlights

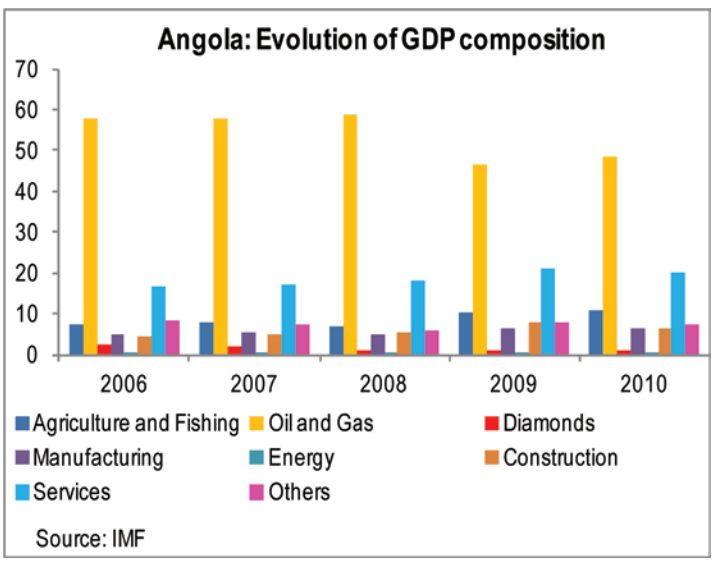
- Unexpected technical difficulties faced by BP in one of its offshore oil extraction operations will curb oil production and slash Angola's GDP growth in 2011 from the initially forecasted 7 percent to 3.7 percent.
- The government approved a new legislation law regulating private investment in Angola, which law includes new and stricter regulations on fiscal incentives, subsidies and profit repatriation. Under the law, the national agency for private investment (ANIP) will now be responsible for the approvals of projects up to US D 10 million.
- Angola dropped one place from the previous year and ranks now at 172 out of 183 countries, just behind Zimbabwe in the World Bank Doing Business Report 2012, making it the lowest ranked country in the SADC community.

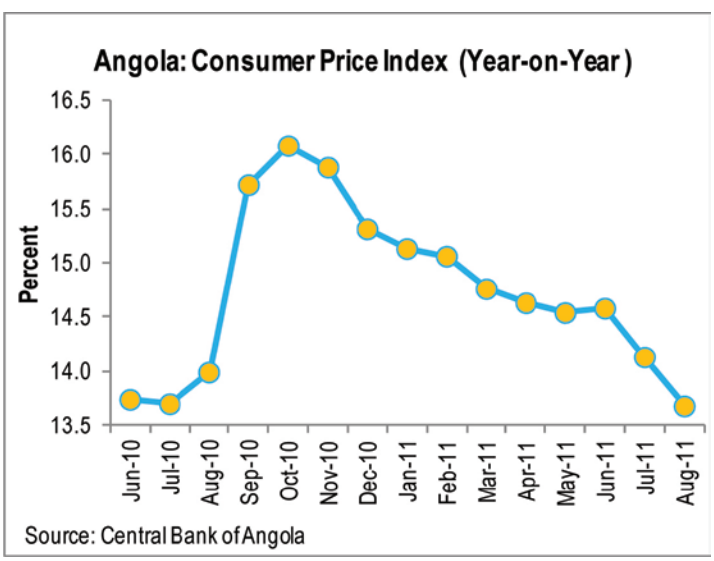
MACROECONOMIC MANAGEMENT OVERVIEW

Economic Growth: Technical problems with one of BP's offshore oil extraction operations will affect Angola's forecasted oil exports in the second semester. Angola's production, which had already seen some variation in the last months, is now estimated to finish the year at 1.69 million barrels per day (bpd), below the expected 1.84 million bpd. In February 2010, the country was Africa's largest oil producer with 1,953 million barrels per day, ahead of Nigeria that also experienced temporary technical problems in its oil extraction. This decrease in exports will nearly halve the country's GDP forecasted growth in 2011, from 7 percent to 3.7 percent. However, Angola's oil output is expected to recover next year, as oil fields come back on line and new projects begin production. The 2012 forecast indicates an oil output of about 1.9 million (bpd), close to Nigeria's output which is considered Africa's biggest oil producer, and pushing GDP growth to 10.8 percent. Despite recent efforts to diversify the economy, the oil sector constitutes nearly 49 percent of GDP, 80 percent of the state budget, and nearly all exports.

Monetary Policy and Banking System: The execution of the 2011 monetary program is on track. The tight monetary policy coordinated between the Government and the National Bank benefitted from external conditions, as oil prices remain high. The country performed well based on the year's three main programmatic objectives: (i) in a continued positive trend, gross international reserves stood at USD 23.239 billion in August, 22 percent above the initial annual target; (ii) the Kwanza also kept its smooth appreciation trend reaching in the same month USD 1 for 93.44Kz; (iii) inflationary pressures were curbed in the first semester. The effects of the tight monetary policy program are slowly sinking into the real economy, helping inflation to get back to 2009 levels. A further decline in inflation from the August level of 13.68 percent to 12 percent target by year's end is within reach. The National Bank reference lending rate cut from 16.5 percent to 16 percent in April targeted an increase in credit to the economy. The market responded well with the 1 year lending interest rate decreasing by a fifth. The Kwanza surpassed the US dollar as the main credit currency. However, this increase was mostly supported by short-term credits, revealing difficulties with longer-term financing to the economy. The Government of Angola is looking forward to the revision of the oil foreign exchange regime in order to reduce the dollarization of the economy and build a strong domestic banking sector.







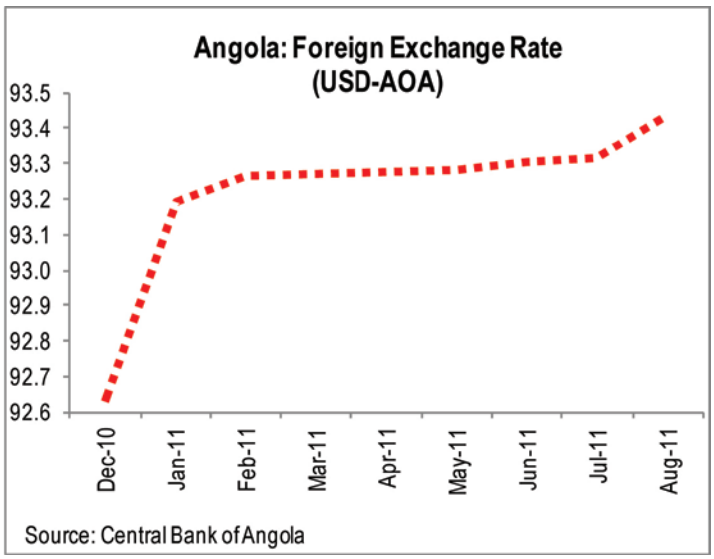
ANGOLA

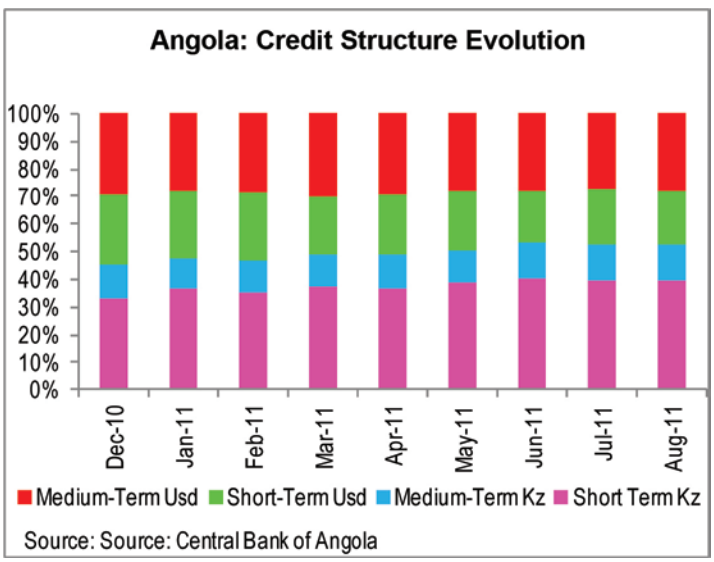
Fiscal Policy: The first quarter budget numbers reveal a preliminary budgetary surplus of 458.866 million Kwanzas, supported by higher than forecasted oil revenues and a slow expenditure execution rate of only 11.5 percent of total annual budget. However, we expect expenditure to increase rapidly due to outlays on investment projects and arrears repayments, whose execution rate is just 8.2 percent and 4.4 percent, respectively. Together the two items account for 45 percent of total budget. Regarding budget allocation, the social sector accounted for 34 percent of expenditures, in line with the IMF Stand-by Arrangement Program's floor of 30 percent. On the revenue side, oil price reached an averaged of US D 108.43 during the first 8 months of 2011, which has largely offset the lower than expected oil barrel production, resulting in an increase in revenues. The 2011 budget assumed a conservative oil barrel price of US D 72. The continuation of these price levels could allow for a fiscal surplus, despite the diminished oil production. However, two factors demand caution during the next periods: (i) the first quarter budget execution reveals disappointing non-oil fiscal revenues of just 17.3 percent of the total programmed, and reducing the non-oil fiscal deficit is the key medium-term fiscal governmental objective; (ii) problems in oil production, which already halved GDP growth, could be aggravated by the possibility of a world economic double dip recession caused by the sovereign debt crisis.

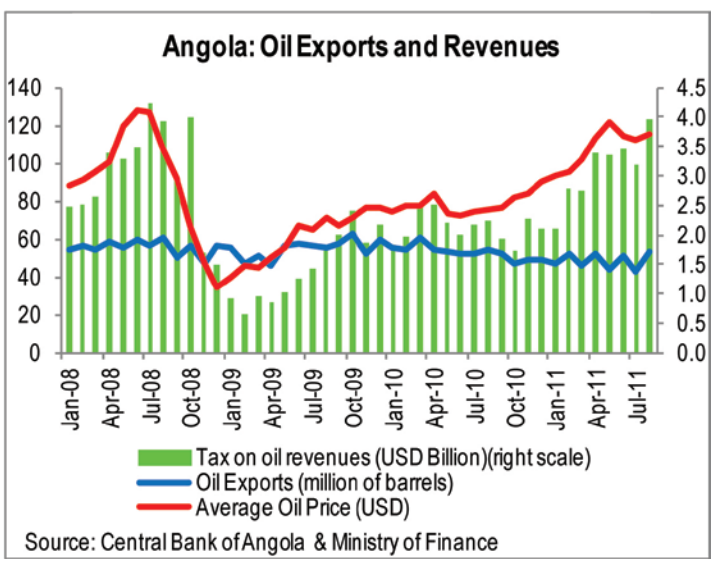
INSTITUTIONAL AND STRUCTURAL REFORMS

Public Sector Management: The government has approved a new legal framework for debt management. The recent creation of a debt management unit has already started to bear fruits with a reduction of debt payment penalties. However, the debt management strategy is yet to be finalized.

Private Sector Reform: Ranked at 172nd out of 183 countries, Angola is one place lower in the World Bank's Doing Business rankings. Its performance in five out of the ten items analysed was worse than that of the previous year. The lowest ratings continue to be on "Enforcing Contracts" and "Starting a Business". Despite the implementation of reforms such as the creation of a "One-Stop Shop" for streamlining the process of starting a company, which helped to push up the "Starting a Business" indicator last year, this year, it declined by three points, illustrating the need for continued reform efforts. The implementation of an electronic property registration system has allowed a noticeable jump of 45 points on the item "Registering Property", before one of the worst poorest performers. Two other positive evolutions of five points were Getting Credit and Accessing Electricity.



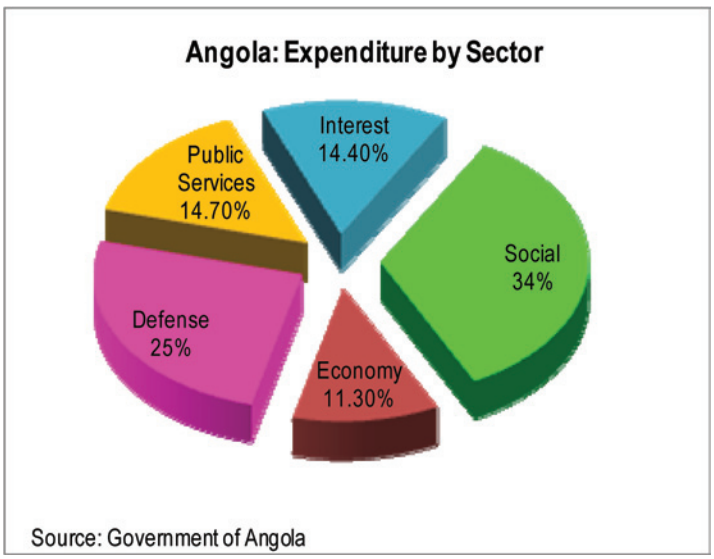




Overall, the Doing Business score is the lowest in the SADC region, reinforcing the need for continued reforms to enhance the country's regional competitiveness. Despite the expected improvement in the business environment, the impact of the approval of the new legislation regulating private investment in Angola is uncertain. The new legislation represents a fundamental shift in attracting FDI, from a more open regime to a stricter one. It includes new and more rigid regulation on fiscal incentives, subsidies and profit repatriation, in particular, for new projects below US D 10 million. Projects above this threshold will be decided directly by the President's cabinet, but will also include new restrictions on profit repatriation. The new legislation is broadly perceived by the international community as restrictive to foreign direct investment in the country.

ISSUES NEEDING PARTICULAR ATTENTION

The possibility of an oil price crash still looms high, given signals of a global recession similar to the 2008 global melt-down that triggered an economic crisis in Angola. Therefore, a cautious fiscal policy and conservative management of oil windfalls are essential to put an end to the disruptive boom-bust cycle associated with oil price volatility. The disappointing result regarding the "Doing Business" report emphasizes the need to intensify private sector reforms to foster the much-needed economic diversification away from the extractive industries.



DONOR COORDINATION ACTIVITIES

Without a formal aid coordination framework in place and a difficult operational environment, donor coordination activities have been limited. The Bank's field office which will be fully functional during the last quarter of 2011 is expected to foster enhanced donor coordination.

BOTSWANA

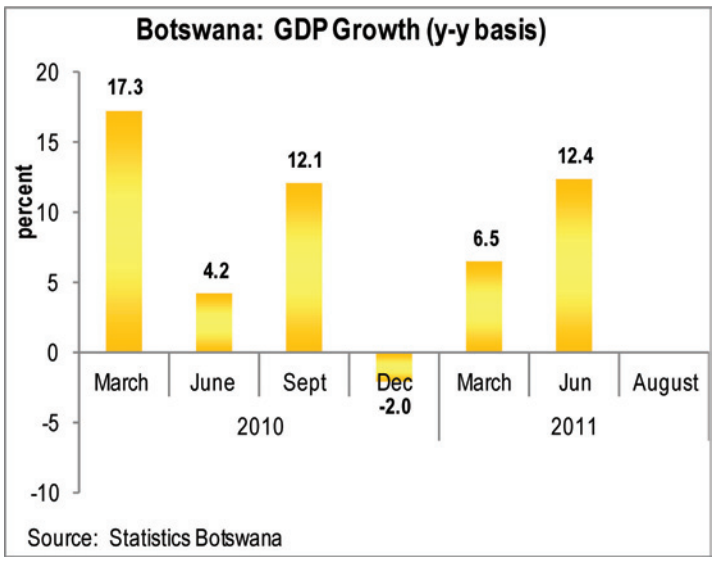
Highlights

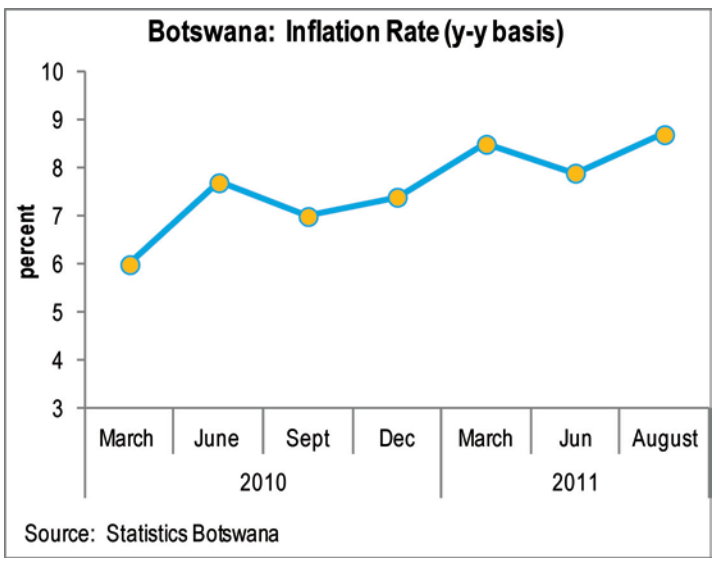
- Preliminary results of the 2011 Population and Housing Census show that Botswana's population has grown to 2,038, 228 compared with 1, 680, 863 in 2001. These results suggest the country's annual population growth rate over this period is 1.9 percent.
- During the second quarter of 2011, the economy recorded commendable growth of 12.4 percent, much higher than 6.5 percent attained during the first quarter.

MACROECONOMIC MANAGEMENT OVERVIEW

Economic Growth: The economy recorded commendable growth of 12.4 percent in the second quarter of 2011 compared with 4.2 percent during the same quarter of 2010; an increase of 8.2 percentage points. The growth was mainly driven by construction and mining sectors, which grew by 28.3 percent and 23.7 percent, respectively. Agriculture and personal services sectors contracted by 17.5 percent and 1.1 percent, respectively, a reflective of the ongoing drought season and moderate personal incomes. Total final consumption increased by 9.9 percent in the second quarter of 2011, despite a significant decrease in government final consumption by 10.4 percent on account of the ongoing fiscal consolidation efforts towards a balanced budget by 2012/13. Fixed capital formation grew by 23.4 percent compared with 8.9 percent in the same period in 2010, as a result of increase private investment for the construction of new large shopping malls in Gaborone.

Monetary Policy and Banking System: Inflation has ranged outside the Bank of Botswana's objective target range of 3-6 percent. In August 2011 year-on-year, inflation was recorded at 8.7 percent. Inflation was driven largely by rising prices of imported products, with an annual inflation of 11.1 percent, compared with non-tradable goods inflation rate of 6.7 percent. The Bank of Botswana prime lending rate that was reduced to 9.5 percent in December 2010 is likely to be increased, in view of the persistent high inflation rate. The Pula has remained stable against major international currencies despite rising inflation; aided mainly by the recovery in mining exports. It has also recovered its lost value against the rand. The growth in money supply has been modest, reflecting in part, the low growth in credit to government and the household sector.





Fiscal Policy: Botswana's budget for the 2011/12 fiscal year demonstrates that the Government is committed to controlling spending and ensuring the country's long-term fiscal sustainability. The fiscal balance significantly improved, with the overall deficit falling from 10.9 percent in 2009/10 to 8.1 percent in 2010/11 and projected to fall further to 5.2 percent in 2011/12. The medium term objective is to attain a balanced budget by 2012/13.

Balance of Payments: Consistent with the trends in the internal balances, Botswana has seen significant improvement on its external balance. The recovery in global demand for diamonds has also seen export receipts increasing. Total export receipts for the period January-July 2011 reached US D 2,599.6 million, about 60 percent of the amount in 2010. Diamond exports amounted to US D 2,186 million, accounting for 84 percent of total exports for the seven-month period. Gross foreign reserves also increased to US D8.944 billion by July 2011, an amount equivalent to 18.9 months of imports of goods and services.

INSTITUTIONAL AND STRUCTURAL REFORMS

Support for economic diversification: Efforts to spur economic diversification through the beneficiation of diamond sales will see a significant boost following an agreement reached between the Government and the De Beers to relocate its Diamond Trading Centre in London to Gaborone by 2013. Under the agreement signed on 16 September 2011, all diamonds produced in Botswana will be processed and marketed from Botswana. Furthermore, the Government will be able to market 10 percent of the diamonds from Debswana outside the De Beers sales channels, with this proportion rising to 15 percent in five years. This move will enable the transformation of Botswana into a World Diamond Trading Centre, as diamonds from South Africa, Namibia and Canada will be aggregated and sold from Botswana.

To further ensure the swift implementation of the newly adopted National Strategy on Economic Diversification Drive (EDD), the Government has launched an EDD Council to oversee the implementation of the strategy. The new EDD Strategy envisages the diversification of the economy through the development of globally competitive enterprises that need little or no government protection and support. In the short-term, the EDD strategy will be based on the use of government interventions such as local procurement, preference margins and citizen empowerment to promote sustainable procurement and consumption of locally manufactured goods and services. These administrative interventions are aimed at promoting local consumption and production.❋

LESOTHO

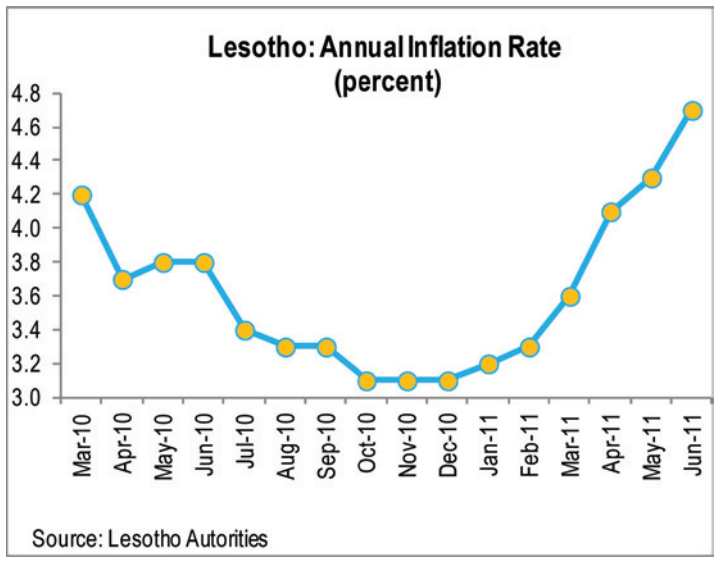
Highlights

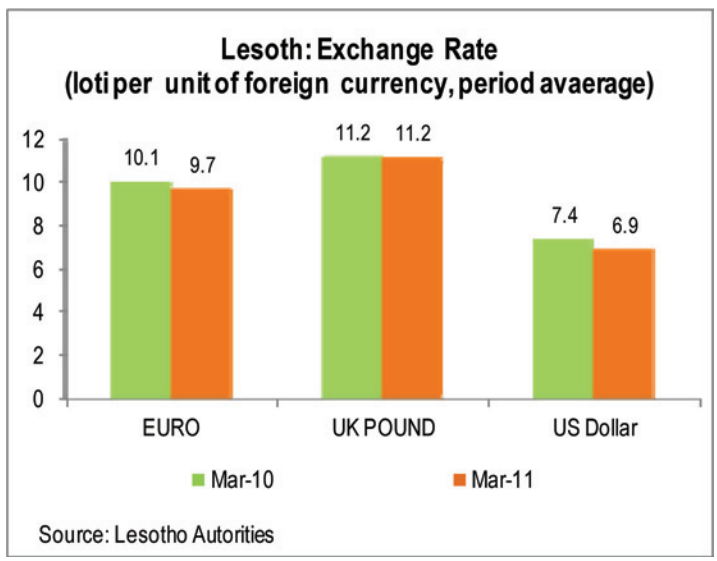
- The economy continues to show signs of recovery in response to increased global demand for diamond and textiles.
- Fiscal balance records a surplus reflecting improvements in revenue performance and a decrease in capital spending. However, personnel expenditures remain high.
- Inflation continues to rise, reflecting in part, higher global energy prices.

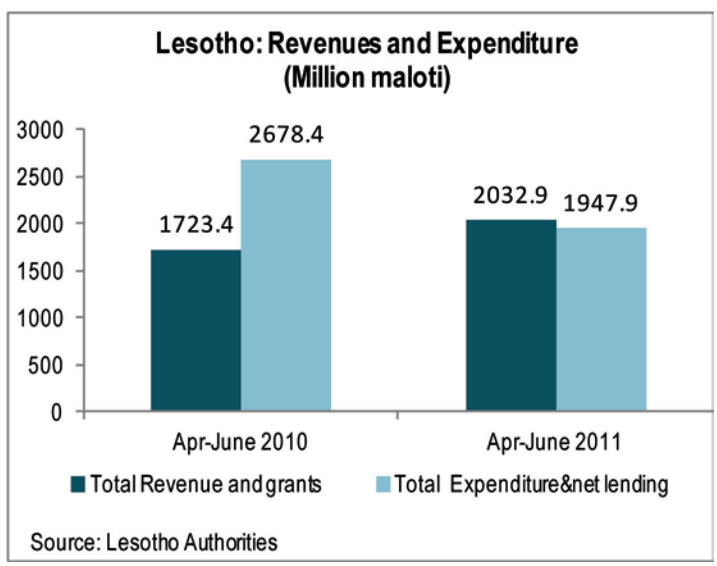
MACROECONOMIC MANAGEMENT OVERVIEW

Economic Growth: Broad-based economic recovery continued in the second quarter ending June 2011. The recovery was supported by moderate increases in global demand; in particular, textiles exported to the US and improved mining output. Increased manufacturing and mining activities have contributed to growth in services. This is particularly reflected in increased electricity consumption, which has risen from 154KW to 174 KW.

Monetary Policy and Banking: The monetary policy stance of the Central Bank of Lesotho is driven by the need to maintain price stability, which in turn is anchored by the maintenance of parity between the loti and the South African rand. Money supply (MI) grew by 4.3 percent on annual basis, reflecting increases in public and demand deposits. During the second quarter, the credit to deposit ratio was recorded at 41.7 percent, representing a marginal increase of 1.7 percent over the previous quarter. The increase was on the back of credit extension to the private sector. This increase notwithstanding, the credit to deposit ratio remains low as liquidity at the commercial banks is still very high. The government net position with the banking system improved. Net claims on government decreased by 6.0 percent compared to the same period in 2010. The bulk of this decline was due to an increase in government deposits held at the Central Bank.







In the quarter ending June 2011, year-on-year inflation was registered at 4.7 percent, representing an increase of 1.1 percent compared to the previous quarter. Inflation was driven by higher prices of housing, electricity, gas and other fuels category, alcoholic beverages and tobacco, food and non-alcoholic beverages as well as furniture, households equipment and routine maintenance of house categories. Lesotho's inflation is closely linked to developments in South Africa, reflecting heavy import dependency. However, inflation remained within the Common Market Area target range of 3-6 percent per annum.

The loti appreciated by 11.1and 2.7 percent against the US dollar and the pound sterling respectively in June 2011compared to the same period last year. The appreciation of the exchange rate was on account of higher commodity prices, improvements in South Africa's current account position and increased portfolio inflows. However, the loti depreciated against the Euro (4.7 percent) and the Yen (40 percent) over the same period.

Fiscal Policy: During the second quarter, Lesotho recorded a budget surplus of one-half percent of GDP. This was due to good performance in almost all categories of revenues compared to the same period in 2010, while total expenditure and net lending dropped by 4.6 percent of GDP during the same period. The decrease in expenditure was mainly due to decreases in capital expenditure and domestic interest payments. In contrast, personnel payments, which constitute 55.4 percent of recurrent expenditure increased by 1.3 percent of GDP. The budget surplus enabled the government to build up deposits and improve its net financing position with the financial sector.

Balance of Payments: The current account narrowed by 12.3 percent compared to the same period in 2010, due to higher current transfers and the good performance of merchandise exports such as diamonds as well as textiles and clothing.

INSTITUTIONAL AND STRUCTURAL REFORMS

Private Sector Reform: The government is drafting a financial institutions bill that seeks to stabilize the financial sector and increase the private sector's participation in the development process. However, there is still a need to further improve the enabling environment.

MADAGASCAR

Highlights

- Despite a recovery in tourism and export sectors, Madagascar's economic growth was expected to remain subdued at 0.7 percent, the same level as that of last year and much lower than an initial forecast of 2.8 percent.
- Madagascar moved up seven places to 137 in the 2012 Doing Business Report of the World Bank compared to its position in the 2011 rankings. In contrast, the 2011 Ibrahim Index on African Governance shows that Madagascar is the only country whose governance performance has continually declined between 2006 and 2010 and now ranking 33 in Africa.
- The official signing of the elections roadmap on 17 September 2011 inspires great hope and it is expected to help the country return to constitutional order. International recognition will only be effective after the establishment of inclusive Transitional Institutions, in particular, the organization of legislative and presidential elections.

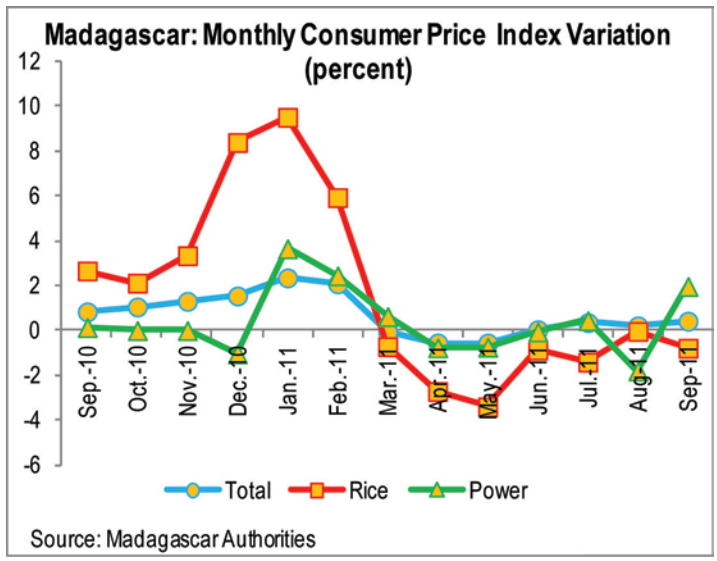
MACROECONOMIC MANAGEMENT OVERVIEW

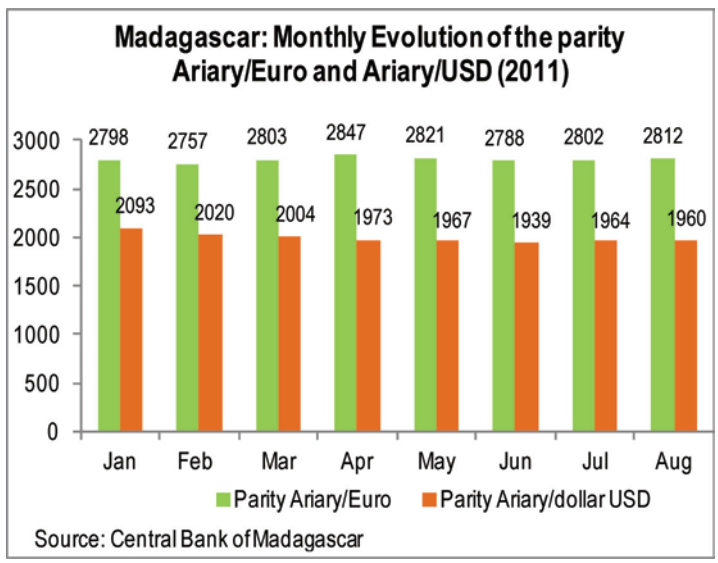
Economic Growth: Preliminary estimates of the Ministry of Finance and Budget forecast a slightly positive growth of 0.7 percent in 2011, (as against 0.5 percent in 2010), driven mainly by the secondary sector (especially in the extractive industry with a growth rate of 25.4 percent) and the tertiary sector (especially in telecommunications, banking and insurance). Tourism and the export sub-sectors have also grown by 16 percent and 11.4 percent over the first nine months of the year. The primary sector is expected to decline by 2.3 percent due to low rainfall. Projections for 2012 indicate a growth recovery of 2 percent, driven by the secondary (+6 percent) and tertiary (+2.3 percent) sectors, as against a stagnation of the primary sector.

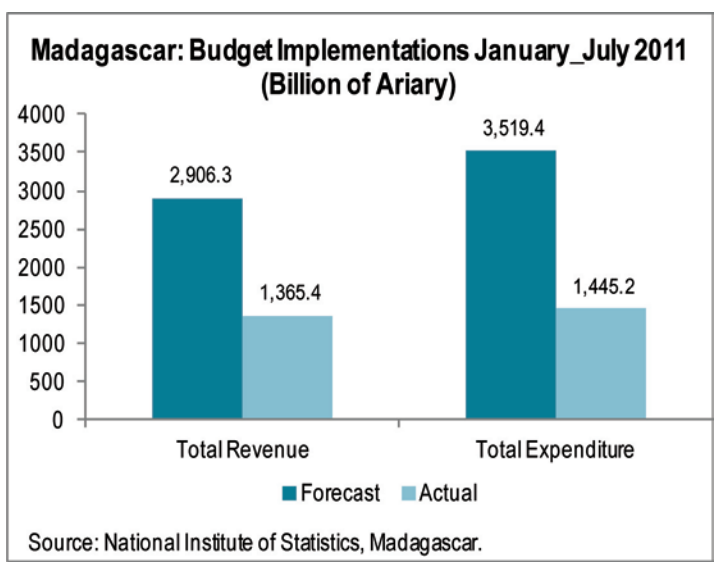
Monetary and Banking System

Inflation: Growth in the monetary aggregate, M3, accelerated despite credit stagnation due to sluggish economic activity and the Central Bank's maintenance of its key interest rate at 9.5 percent since August 2009. According to the National Institute of Statistics (INSTAT) data, prices have increased by 4.3 percent on average between December 2010 and September 2011. Year-on-year, price increases stood at 8.4 percent between September 2010 and September 2011. This increase has affected local products, especially rice (+5,5 percent), the population's staple as well as imported products, especially petroleum products (+5.7 percent) reflecting increasing crude oil prices on global markets. The increase in the price of rice in the first quarter was moderated as better harvests reduced the supply deficit. In response to rising fuel prices, the government has fixed pump prices, further weakening the financial situation of oil companies.

Exchange rate: Statistics from the Madagascar Central Bank for the January-August 2011 period show relative stability of the national currency relatively to the Euro. The local currency, however, appreciated against the US dollar at the end of August.





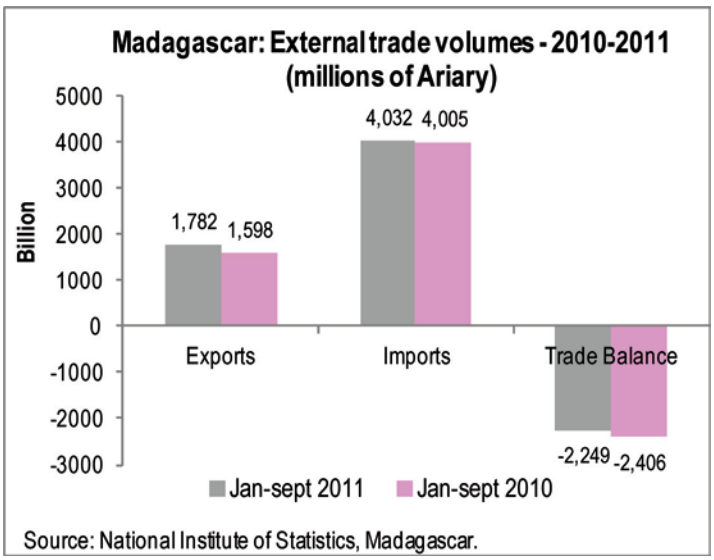


Fiscal Policy: With the suspension of most foreign aid, the Malagasy government has been implementing fiscal austerity measures, especially strict controls on expenditures that have been in line with revenue inflows since 2010. The provisional information on budget execution during the first 7 months of the year show an income receipts rate of 47 percent (as against 50.5 percent in July 2010), in line with a slowdown in economic activity. The overall expenditure rate commitment is projected at 40.5 percent (as against 37 percent in July 2010), or 50.5 percent for operating expenses and 24.3 percent for capital expenditure. The financing of the deficit was mainly provided by the banking system, mainly through the auctioning of treasury bills, crowding out of the private sector. The 2012 draft budget law under discussion by the Government provides for the continuation of the fiscal austerity measures with a broader tax base and tax exemption measures on the importation of seeds, inputs and farm machinery in order to boost agricultural production.

Balance of Payments: According to preliminary data from the National Institute of Statistics, exports rose by 11.4 percent from January to September 2011, compared to the same period in 2010. Export growth was mainly driven by minerals (+41 percent), foodstuffs (+38 percent) and prawns (+18 percent). Vanilla exports declined by 29 percent over this period due to falling prices in the global market. Significant increases in energy (+77 percent), rice (+75 percent), sugar (+47 percent) and foodstuffs (+34 percent) imports were recorded compared to their levels in September 2010. Given the slump in economic activity, imports of capital goods decreased by 43 percent compared to the same period in 2010. As a result, the trade balance improved by 6.5 percent compared to September 2010.

INSTITUTIONAL AND STRUCTURAL REFORMS

During this transition period, the Government has suspended most reforms, except in the area of public finances and improving the business environment. In the area of public finances, a new investment code characterized by incentivized fiscal and custom policies was introduced. This saw the country's ranking in the World Bank's 2012 Doing Business Report, improving by 7 places to 137th position with respect to the ease of doing business. The most significant progress has been made in the area of setting up enterprises and the abolition of minimum capital, enabling the country to jump up by 50 places regarding this indicator. However, the country's performance regressed in several other indicators, in particular, the granting of building permits, property transfer, protecting investors, tax payments, trans-border trade and bankruptcy-related issues.



ISSUES NEEDING PARTICULAR ATTENTION

Special attention should be given to resolving the political crisis that has compromised the country's growth prospects and threatens to reverse some of the past economic and social gains. The Bank is keeping a close eye on developments in Madagascar and will be sending an evaluation mission in October to assess the country's situation. The outcome of this mission will guide the Bank's operations in the country.

DONOR COORDINATION

Despite the crisis, donor coordination remains active at both the global and sectoral levels (private sector development, water supply and sanitation, rural development and social sectors). The Bank is the leading partner in the water supply and sanitation sector.❋

MALAWI

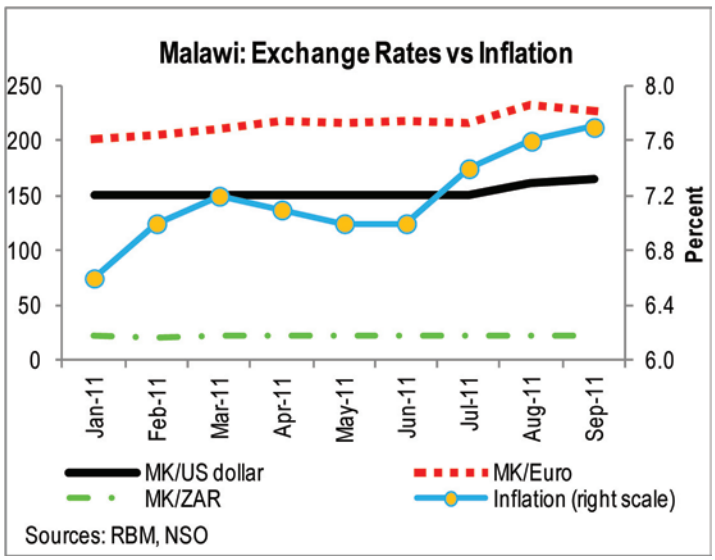
Highlights

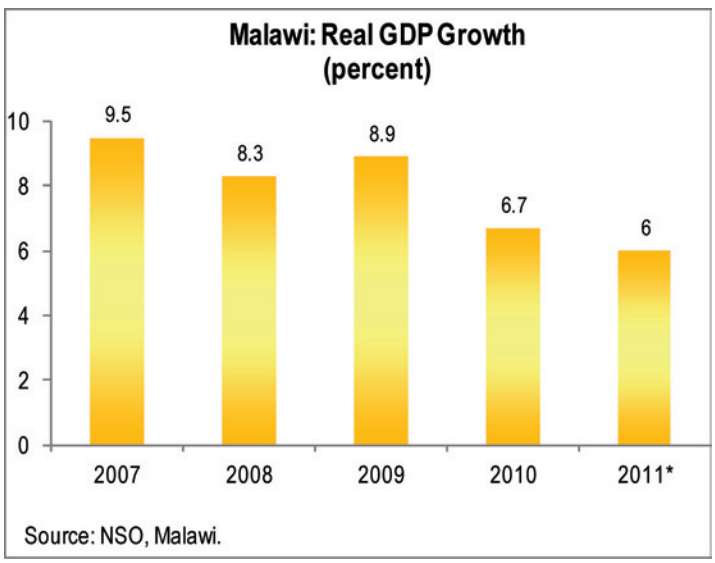
- Malawi is unlikely to meet its GDP growth target of 6.9 percent in 2011 due to foreign exchange and fuel shortages, lower than expected export earnings from Tobacco which is the country's major export crop and inability to meet optimal production in the mining sector.
- The country has faced a number of social and governance challenges in the second half of the year that have led to incidents of riots, arson and civil society concern. In response to these concerns, the United Nations is facilitating dialogue between the Government and the civil society since mid-September.
- The Government has kicked off the Farm Input Subsidy Program for season 2011/12. The FISP has been successful in ensuring food security in the country where necessary and assisting in keep food inflation down.

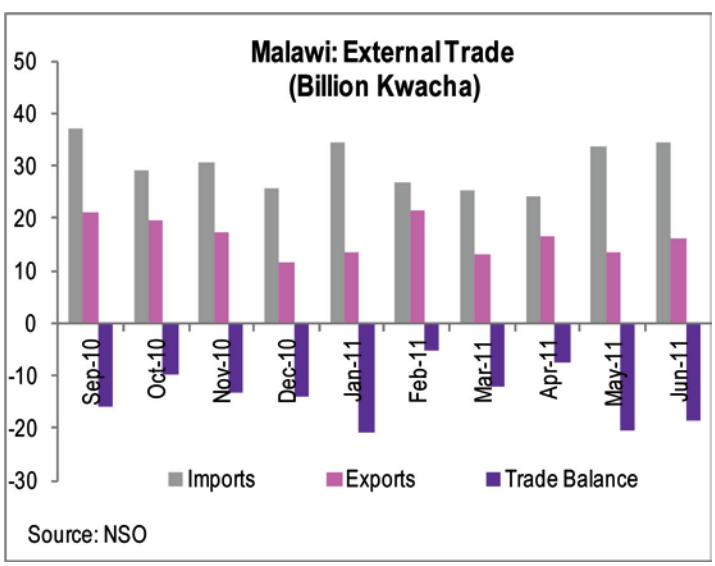
MACROECONOMIC MANAGEMENT OVERVIEW

Economic growth: Malawi's GDP growth has performed well above Sub-Saharan Africa's growth rates since 2007. In 2011 and 2012, the economy was projected to grow at 6.9 percent and 6.6 percent respectively. However, the foreign exchange and fuel shortages facing the country have slowed down growth. GDP forecasts for 2011 and 2012 now stand at 6.0 percent and 6.7 percent. Growth will be supported by continued positive performance in the agricultural sector, largely driven by the Government's Farm Input Subsidy Programme (FISP).

Monetary Policy and Banking system: While inflation has largely been in line with seasonal expectations in 2011, inflationary pressures are building up. Inflation was registered at 7.6 percent in August 2011, with non-food inflation being 12.4 percent compared to 9.9 percent for the same period last year. Annual average inflation is therefore projected at 7.1 percent for 2011. The Malawian kwacha depreciated by 4 percent, 9 percent and 13 percent against the South African Rand, US dollar and Euro year-on-year. The government has also instituted measures to increase foreign exchange. These measures include the introduction of foreign currency denominated accounts by Malawians; quarterly returns by NGO's; payment in foreign currency for services rendered by tourism operators and the repatriation of export proceeds to the country.







Fiscal Policy: In the 2011/2012 Budget, the Government intends to employ a Zero deficit budget. Domestic revenues are expected to increase by 20 percent from the 2010/11 fiscal year, with tax revenues accounting for 84 percent and non-tax revenues for 16 percent.

External Sector: Total merchandise exports registered a 61 percent increase in the first half of 2011, compared to the same period last year. This increase in export values led to the marginal decline in the trade balance; although imports have also seen a 30 percent increase over the same period, with petroleum products being the main composition. As a result of the continued trade deficit, the country is unlikely to meet its reserves target of 3.1months of import cover, with recent estimates suggesting closer to 1.2 months at end of 2011.

INSTITUTIONAL AND STRUCTURAL REFORMS

Private sector reforms: The 2012 "Doing Business report ranks Malawi at 145 out of 183 countries, down four places from last year. The only area where progress was recorded was in "Enforcing contracts" where the country improved from 122 to 121.

Trade and Regional Integration: Malawi has taken over as Chair of the Common Market for Eastern and Southern Africa (COMESA) following the 15th COMESA Summit which was hosted by the country. The summit noted the increase in intra-COMESA trade of 27 percent in 2010 (USD17.4billion) recovering from the 2009 levels (USD 12.7 billion) which were affected by the global economic crisis. COMESA is Malawi's third regional destination for exports. During the first half of 2011, the country continued to maintain a positive trade balance with the region, as it did in the same period last year.

Dialogue on IMF-ECF programme: The Government of Malawi is taking steps to bring the Extended Credit Facility (ECF) back on track. Government officials led by the Finance Minister held discussions with the IMF in Washington DC during the IMF/World Bank Annual Meetings and expressed the country's commitment to undertake macroeconomic and structural reform measures in line with IMF and other partners' requirements. Besides the August 2011 devaluation of the kwacha by 10 percent, the government indicated that it would implement more reforms as part of meeting the conditions under the ECF.✱

MAURITIUS

Highlights

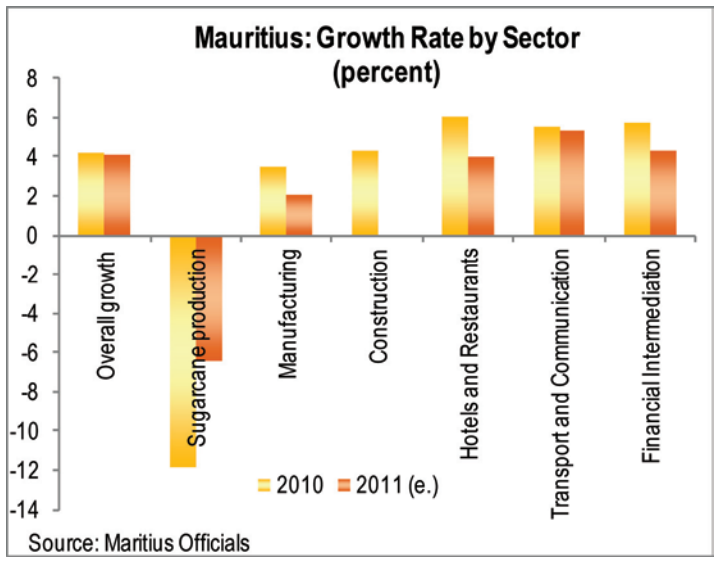
- The coalition government's majority in parliament has been reduced to five seats from 25 following Mr. Pravind Jugnauth's decision to move his Mouvement Socialiste Militant (MSM) into opposition. Mr. Jugnauth, a former Minister of Finance is currently answering corruption charges.

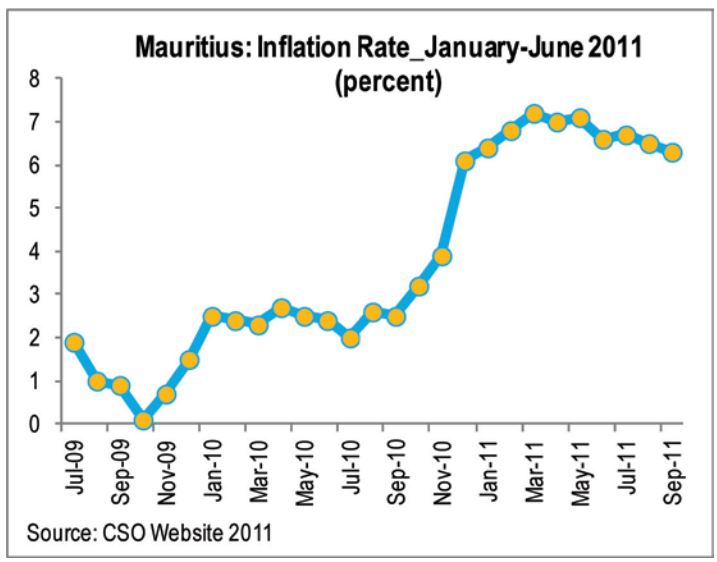
MACROECONOMIC MANAGEMENT OVERVIEW

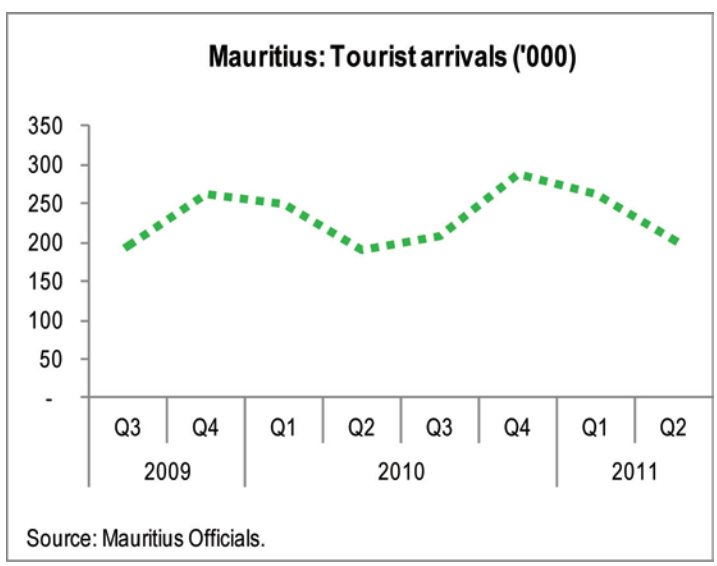
Economic growth: Third quarter estimates show that growth of the Mauritian economy will slow to 4.1 percent in 2011, down from 4.2 percent in 2010. Robust transport and communications and financial services sectors and a rebound from the textile sector are expected to anchor growth. Sugar production is expected to further contract by 11.8 percent from 6.8 percent in 2010. Tourist arrivals have held up well. They were 5.8 percent higher during the January to June 2011 period compared to the same period in 2010.

Monetary Policy and Banking System: Having peaked at 7.2 percent in the 2nd quarter of 2011, year -on-year inflation has continued to ease, falling to 6.3 percent in September 2011 from 6.5 percent in August 2011. After raising the key repo rate by an aggregate of 75bp in the second quarter of 2011, the Monetary Policy Committee in September 2011 decided to maintain the rate at 5.50 percent, observing that threats to growth were higher than threats from inflationary pressures.

Fiscal Policy: During the third quarter of 2011 the new Minister of Finance made consultations on the 2012 budget. Following an expansionary fiscal stance since 2008, the authorities are keen to start gradual consolidation. Spending cuts should help reduce the fiscal deficit, estimated at 4.8 percent of GDP in 2011 but could accelerate unemployment which slowed down to 8.0 percent in the second quarter from 8.3 percent in the first quarter of 2011.







External Sector: During January to June 2012 perio d, Mauritius posted a trade deficit of MUR33.3bn representing a 6.1 percent year on year rise. Compared to the 15.7 percent year-on-year increase recorded in first quarter of 2011, this moderate pace reflects strong growth in the value of exports at 15.4 percent against a 10.6 percent growth in value of imports. Registering a second quarterly decline in a row, Foreign Direct Investments (FDIs) amounted to MUR1.8bn in the second quarter of 2011 compared to MUR3.5bn same period in 2010. At an estimated USD 2.7 billion in August 2011, foreign reserves remain strong.

Going forward, a soft Eurozone economy, the destination for 63 percent of the country's exports and origin of 65 percent of the country's tourists, will continue to undermine recovery prospects for Mauritius. Sustaining a strong business environment and improving its competitiveness will remain a priority as the authorities turn to new emerging markets. Although the country has maintained its premier position in Africa, its global rank in Doing Business 2012 is at 23 compared to 21 in the Doing Business 2011 showing that there is a need to expedite the pace of reforms.

MOZAMBIQUE

Highlights

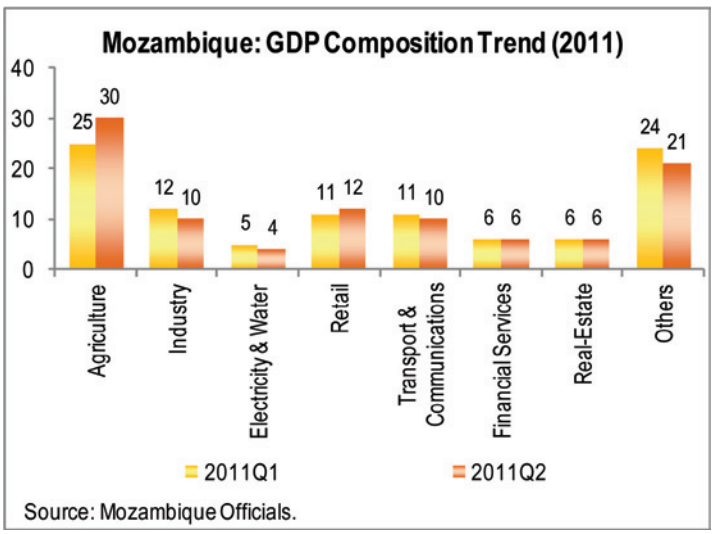
- Coal shipments have begun during the third quarter. Coal exports are expected to more than double the contribution of the mining sector to Mozambique's GDP in the next three year, rising from 3 percent at the moment, to 7 percent, and overtaking Aluminum as the main export.
- Despite initial concerns during the first quarter, inflationary pressures are waning and the average inflation target of 8.4 percent by the end of 2011 seems now within reach.
- Mozambique dropped 7 places in the Doing Business Report for 2012 to 139th out of 183 countries. Negative performance was observed in 8 out of the 10 criteria, with the worst performance recorded for Access to Credit and Access to Electricity.

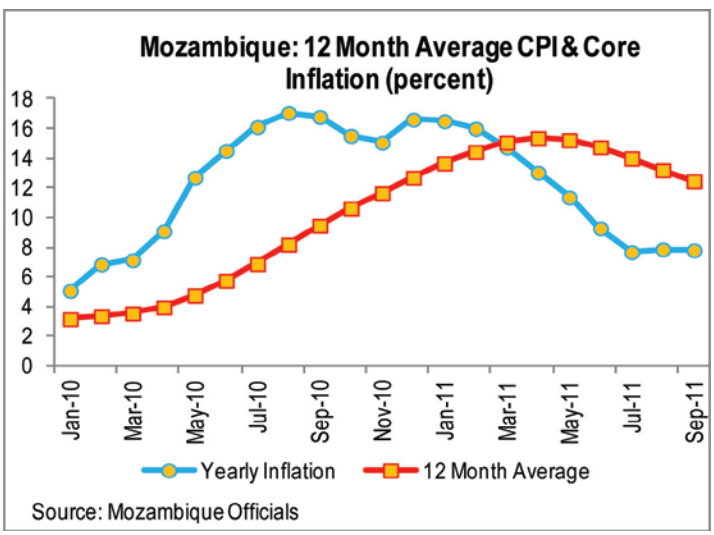
MACROECONOMIC MANAGEMENT OVERVIEW

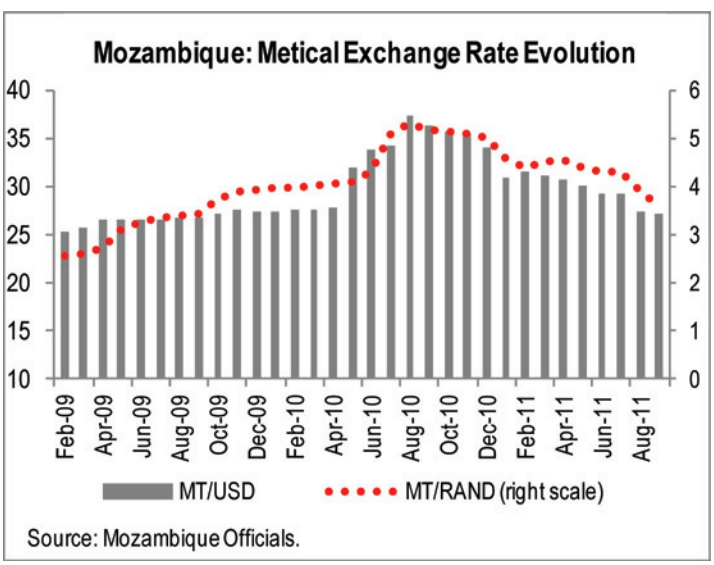
Economic Growth: During the second quarter, in line with previous seasonal patterns, economic growth slowed down to 6.8 percent. It is however aligned with the annual moving average of 6.83 percent. The continuation of strong public investment, coupled with the expected increase in megaproject activities, provides good prospects for the annual target of 7.25 percent growth. The transport and communications sector was again the most dynamic, recording growth of 8.5 percent followed by retail and restaurants that grew by 7.8 percent and 6.1 percent respectively. The primary sector also registered strong growth of 7.5 percent while agriculture increased its weight on GDP from 25 percent to 31 percent. The key economic drivers will continue to be the increase in public spending, notably in infrastructure and the social area, and the inflows of foreign direct investment targeted mostly to the natural resources sectors. During the second half of the year, the commencing of coal exports will have a strong influence on growth.

Monetary Policy and Banking System: The BoM kept its lending rate unaltered during its August meeting, maintaining the tight monetary policies enforced throughout 2010 and the first half of 2011 when it raised the reserve requirement ratio and intervened in the monetary market to absorb excessive liquidity. These measures, together with international lower food and fuel prices, helped to pull down inflation below 10 percent. The yearly inflation has stabilized just below 8 percent since August and the 12 month average, which peaked at 15.37 percent in April, is now at 12.46 percent. The prospects for containing inflation are positive as the Metical has appreciated against the US dollar and the ZAR, the main currency for most import transactions. Growth in domestic credit to the economy has also slowed down significantly to 3.93 percent since January, compared to 16.16 percent in the previous year. Borrowing interest rates remained high and peaked in July at 23 percent. The policy challenge is to strike a balance between allowing sufficient growth in credit to the private sector and the control of inflation.

Fiscal Policy: Following the budget revision in April, the fiscal deficit almost doubled to 7 percent compared to the previous year's level. The new revised budget reallocated resources from capital to current expenditure, mostly to support subsidies and social programs. However, by the end of







the first six months of the year, current expenditure had increased by 19 percent, while capital expenditure increased by 34.8 percent. Given the increase in public expenditure from 14.3 percent to 19.4 percent of GDP, the government needs to enhance revenue collection if it has to keep its debt levels under control.

External Sector: Net international reserves increased for the fifth month in a row, reaching US D 2,205.5 million at the end of the second quarter. At this level, reserves provide a comfortable level of roughly 6 months of imports cover. The increase in foreign reserves has been supported mostly by strong growth in raw material exports compared to imports, which have shown resilience to the Metical appreciation, coupled with regulatory restrictions to foreign exchange outflows. Reserves should be further bolstered by the commencement of coal exports during the second semester, which are expected to rapidly become one of the country's main commodity exports, exceeding aluminium, which currently accounts for 80 percent of all exports.

INSTITUTIONAL AND STRUCTURAL REFORMS

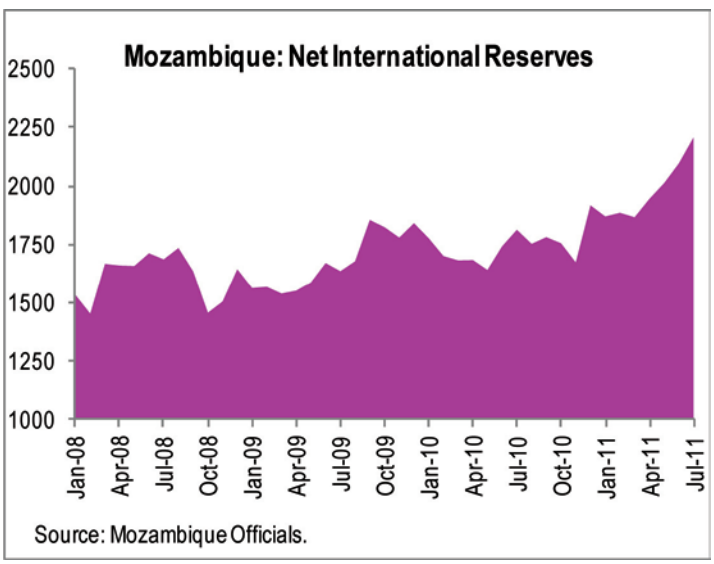
Public Sector Management: The second public survey on corruption perceptions has shown an overall improvement. In an effort to further bolster anti-corruption and transparency, a legislative package on anti-corruption was approved by the Council of Ministries. During the second semester, the government will be preparing the new 2012 budgetary law, which should include sectorial reforms on tax administration and investment project selectivity. Project selection and financing will be informed by the 2012 Annual Borrowing Plan, to be delivered by the new Debt Management Committee. The Medium-Term Debt Strategy should also be approved by the end of 2011, together with the finalization of the second Government Debt Sustainability Analysis.

Natural Resource Management: The GoM submitted its application to become a full member of the Extractive Industries Transparency Initiative. The organization's secretariat welcomed the application and signaled areas where the country needed to enhance its compliance to attain membership. Together with other partners, the Bank is working closely with the GoM on the application. The Government is also considering options to enhance revenues from the natural resources sector.

Private Sector Reform: Despite the implementation of several reforms to enhance its business climate, Mozambique's ranking on the recently released Doing Business Report 2012 dropped to 139th from 132th in 2011. The two worst performing categories were access to electricity (a drop of 13 points) and access to credit with a loss of 20 points, reflecting the tight monetary policies put in place by the government during the last year. The sole positive evolution in Mozambique's ranking was in dealing with construction permits, which rose 3 points.

ISSUES NEEDING PARTICULAR ATTENTION

The 2012 budgetary law will be designed around the approved PARP (Poverty Reduction Action Plan), which lays particular emphasis on agricultural production, human and social development, and employment creation. Crucial to the effectiveness of the program is the balance between inflation control, as a safeguard to the poorer population which is highly vulnerable to increases in food prices, and the expansion of credit to kick-start the much-needed development of small and medium enterprises that are crucial for fiscal sustainability and employment generation. Budgetary pressures for the implementation of social safety nets and the ambitious infrastructure development agenda are likely to strain the macroeconomic balance. Finally, the possibility of a slowdown in global demand for commodities in 2012 poses downside risks for growth in the next year.



DONOR COORDINATION ACTIVITIES

In collaboration with the government of Mozambique and the civil society, the G-19 (the group of 19 main donors providing budget support), has approved Performance Evaluation Frameworks (Quadros de Avaliação Programática) of the government and donor for the 2012 – 2014period. The frameworks derive from the Poverty Reduction Action Program matrix, approved on May. It has three objectives, namely, increased agricultural and fisheries productivity and production; employment promotion; human and social development, and two support pillars, namely; governance and macro-economic performance.

NAMIBIA

Highlights

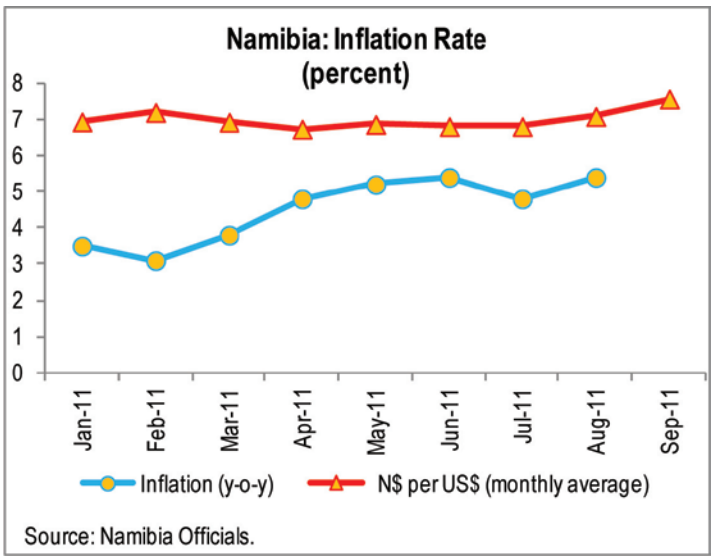
- Real GDP growth is expected to weaken slightly in 2011, reflecting modest performances in mining and agricultural activities due to flooding.
- Inflationary pressures have started building up in 2011 due to the surge in food prices and in line with higher inflation in South Africa.
- Key source of uncertainty to economic growth is a severe slowdown in the global economy emanating from the Eurozone debt.

MACROECONOMIC MANAGEMENT OVERVIEW

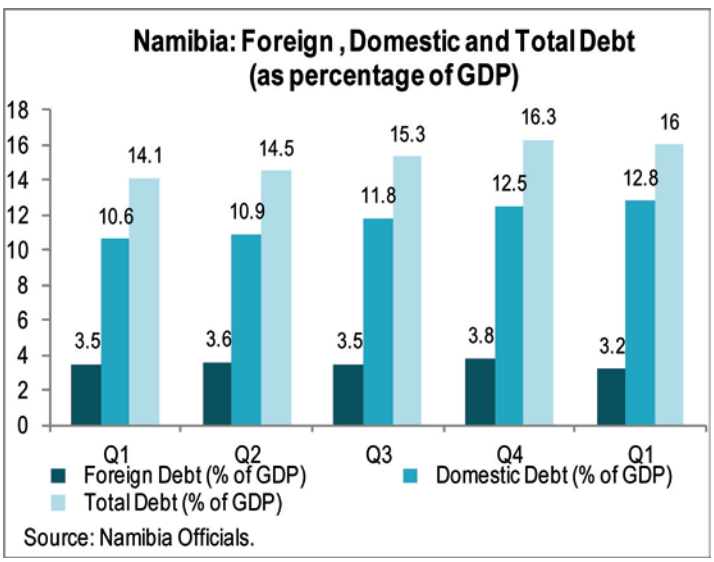
Economic growth: The authorities revised 2011 GDP growth downwards to 4.1 percent on account of weak performance in mining and agricultural activities during the first half of the year due to flooding. The manufacturing sector was the main driver of growth, with improved production of blister copper, cement and beer. The construction sector also recorded better performance compared to the same period in 2010.

Monetary Policy and Banking System: Inflationary pressures started building up from the beginning of 2011, with year-on-year inflation accelerating to 5.4 percent in August 2011 due to rising food prices and the depreciation of the Namibian dollar (NAD), and in line with higher inflation in South Africa. Inflation is expected to remain around 6 percent in 2011. The Bank of Namibia decided to keep the Repo rate unchanged at 6 percent in the third quarter of 2011 to stimulate domestic demand and support growth. This was in recognition of the fact that the economy was showing signs of weakening, suggesting that the economic recovery was not firmly entrenched.

The Namibia dollar, which is fixed at par to the South African rand, has undergone considerable volatility in recent years. It appreciated sharply against the US dollar, reaching a peak in early January 2011. The local currency lost its value as political events in North Africa eroded investors' confidence in emerging markets. It then rallied but depreciated sharply reaching N$8.3 vis-à-vis the US dollar in September, as global investors became more risk-averse due to the Eurozone debt crisis, which eroded confidence in emerging currencies in favour of the safe-haven US dollar.



Source: Namibia Officials.



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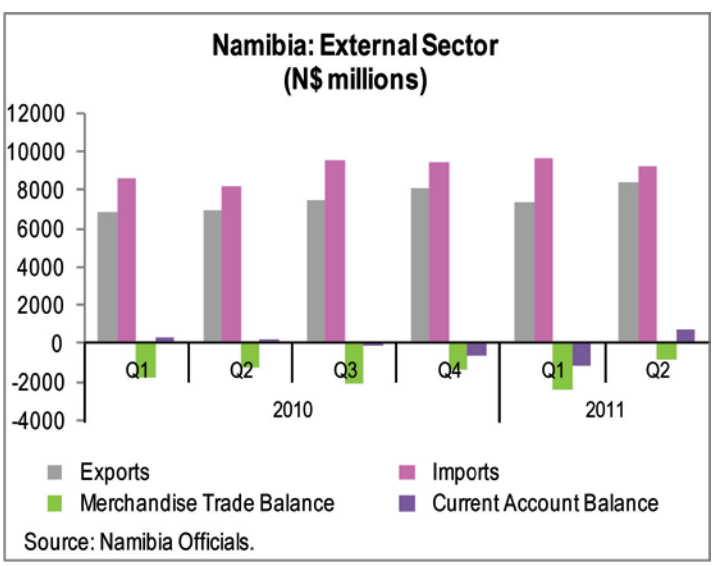


Source: Namibia Officials.

Fiscal performance: The domestic debt position remained sound during the first half of 2011. Total Government debt and guarantees were within the target bands of 25.0 percent and 10.0 percent of GDP, respectively. The Government, however, intends to maintain the fiscal stimulus to cushion the economy against the impact of the global economic crisis. Hence, borrowing is expected to increase due to a higher fiscal deficit estimated for the 2011/12 fiscal year. Government debt stock increased by 14.1 percent, quarter-on-quarter, to N$15.8 billion (16.0 percent of GDP) at the end of the first quarter of 2011/12.

External sector: The current account recorded a surplus during the second quarter from a deficit during the previous quarter. The surplus was mainly influenced by a considerable increase in SACU receipts. The merchandise trade deficit narrowed during the second quarter of 2011 due to a rise in exports, in particular, of diamonds, food and live animals. The overall balance of payments recorded a significant surplus during the second quarter of 2011, a turnaround from deficits recorded since the fourth quarter of 2009, on account of reduced outflows on the capital and financial account. Namibia's gross reserves improved from 10.8 weeks to 13.5 during the second quarter.

OUTLOOK

The Government forecasts GDP growth to revert to the pre-financial crisis trajectory of around 5.5 percent per annum during 2012-2014. The recovery is expected to be driven by expansion in mining activity arising from increasing demand for minerals and strengthened commodity prices. However, this outlook is subject to a variety of threats, including a severe slowdown in the global economy emanating from the Eurozone debt crisis.

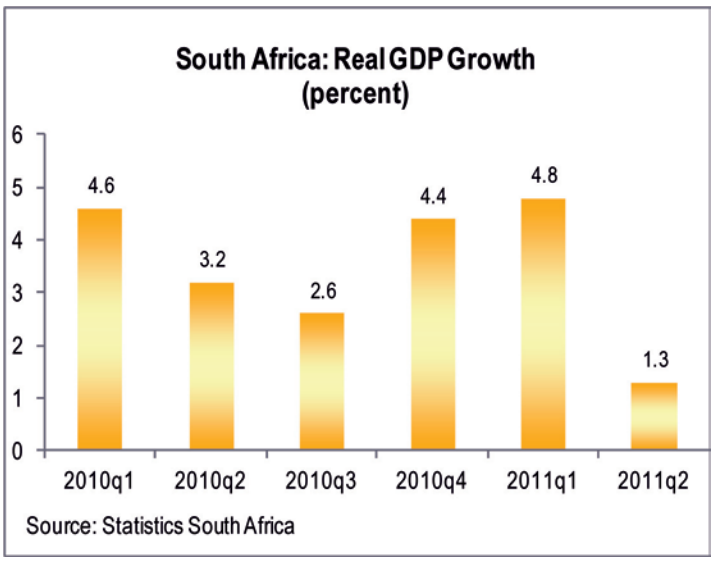
ISSUES NEEDING PARTICULAR ATTENTION

In September, Moody's assigned a rating of Baa3 to Namibia, equal to Tunisia's and three steps below South Africa's. It reflects Namibia's track record of prudent fiscal management and the maintenance of low public debts, as well as an investor friendly policy framework. The rating, Moody's first for Namibia, comes after Fitch recently revised Namibia's outlook to positive from stable and granted the country a rating of BBB-. The rating was requested as the country plans to issue bonds worth about N$ 500m (USD 61m) on the international markets this year, to partly finance the fiscal deficit in 2011/12.

SOUTH AFRICA

Highlights

- Real GDP growth decelerated from 4.5 percent during the first quarter to 1.3 percent during the second quarter, while unemployment rose to a seven year high of 25.7 percent from 25 percent during the previous quarter. The slowdown in growth is due to continued low and uncertain recovery in advanced economies, which are the main destinations of South Africa's manufactured exports.
- Infrastructure investment remains key to economic recovery and job creation. The Presidential Infrastructure Commission, launched in September 2011, will focus on accelerating the planning of priority social and economic infrastructure projects going forward.
- Exchange rate movements could be more important, especially given the 18.6 percent depreciation of the rand since the beginning of the year, most of it in the third quarter.



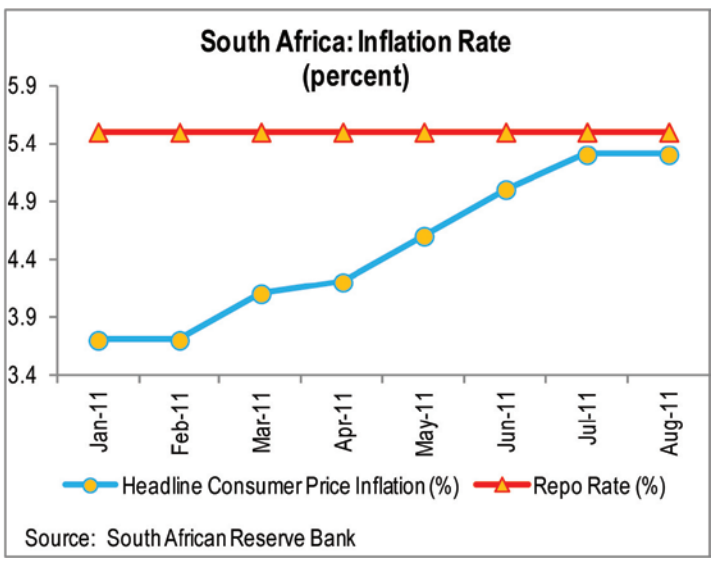
MACROECONOMIC MANAGEMENT OVERVIEW

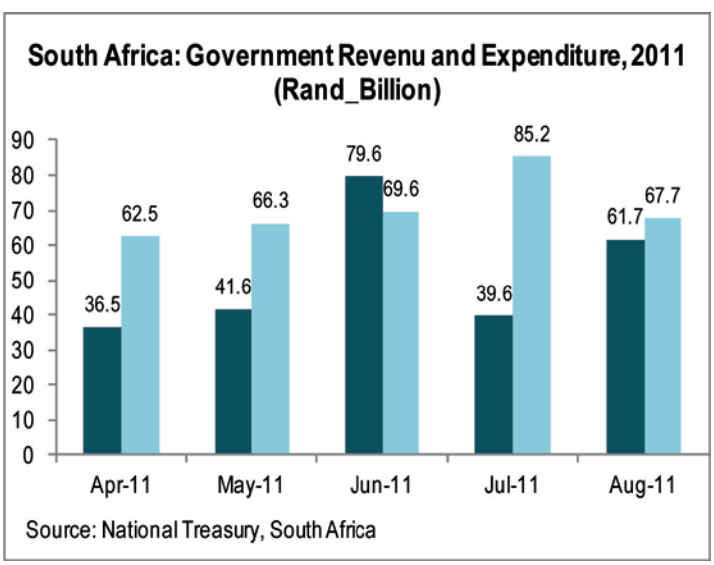
Economic Growth: Real economic growth decelerated from 4.5 percent during the first quarter of 2011 to 1.3 percent during the second quarter. The manufacturing sector contracted by 7 percent, subtracting 1.1 percentage points from the overall economic growth during the quarter.

On the demand side, real final private consumption growth slowed down partly due to reduced household disposable income. The widespread industrial action and continued volatility of economic recovery in advanced economies are likely to further dampen the growth prospect during the third quarter. The Reserve Bank has lowered its forecast for average growth in 2011 to 3.2 percent from 3.7 percent.

Monetary Policy and Banking System: Headline consumer price inflation rose to 5.3 percent in July and August from 5 percent in June 2011, nevertheless remaining within the policy target range of 3 – 6 percent. The accelerated increase in prices of food and transport were the main drivers of the rise in consumer price inflation during the third quarter of 2011. As opposed to headline inflation, administered price inflation continues to remain above the policy target range for the twentieth month reaching 11.7 percent in July 2011. The main upside risks to inflation outlook remain a sharp depreciation in rand at the end of the third quarter and food and administered prices. In September, the rand traded at 8.33 per US dollar, depreciating by 15.6 percent, a two year low. The depreciation was triggered by capital outflow and increased risk aversion against emerging market assets. Net capital inflow fell by nearly 60 percent from R 55.1billion during the first quarter to R 23.7 billion during the second quarter of 2011.

Broad money supply (M3) growth declined slightly from 6 percent in June to 5.6 percent in July 2011, contracting by 1 percent during the second quarter from a growth of 3.8 percent during the first quarter, while growth in quasi-money (M2) rose from 5.46 percent in May to 6.12 percent in June 2011 due to slow domestic credit demand.





Fiscal Policy: South Africa continues to face fiscal policy dilemma as growth weakens and unemployment rises to a 7- year high during the second quarter of 2011. In the first quarter of fiscal year 2011/12, the primary balance amounted to a deficit of R 20.8 billion, or 2.9 percent of gross domestic product compared to a primary deficit of 2.7 percent during the same period of the previous fiscal year. Public expenditure rose by 8.8 percent year-on-year during the first quarter of fiscal 2011/12, compared with the same period a year earlier and is projected to increase at a rate of 13.2 percent to R888 billion in fiscal 2011/12 as a whole, representing 27.4 percent of GDP during the second quarter compared to 27.7 percent during the same period previous year.

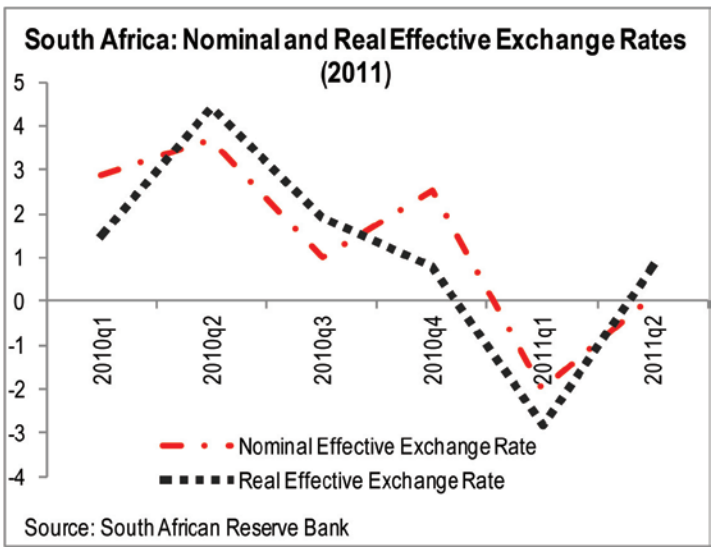
Total tax revenue net of SACU payments for the first five months of fiscal year 2011/12, was R259 billion while total expenditure was R351.3 bn. Total gross loan debt of the national government reached R 1 trillion in June 2011from R 976 billion at the end of the first quarter representing 36.3 percent of GDP. Domestic debt accounted for 90 percent of the total national government loan debts during the second quarter of 2011. Gross external debt reached USD 109 billion at the end of June 2011 and remains at about 27 percent of GDP.

External Sector: The current account deficit widened to 3.3 percent from 3.1 percent of GDP as the trade surplus shrank to R 15.2 billion during the second quarter from R 22 billion during the first quarter. Foreign direct investment rose from R5 billion during the first quarter to R12.3 billion during the second quarter, registering quarter-on-quarter growth rate of 146 percent. Foreign reserves rose to an all-time high of USD 51.4 billion in August 2011 covering about 5 months of import. However, the rand has depreciated by about 12.7 percent on trade weighted basis during the same period.

The nominal effective exchange value of the rand decreased by 4 percent during July and August 2011 due to the depreciation of rand against all major currencies. On the other hand, the rand year-on-year real effective exchange rate decreased by 0.7 percent, but increased by 1.3 percent month-on-month in June 2011, signifying a marginal impact in the competitiveness of exportable goods producing sector.

INSTITUTIONAL AND STRUCTURAL REFORMS

The government proposed a new Land Reform legislation, which will create two institutions: the Land Management Commission and the Land Valuer General. The Commission will be entrusted with the validation of land ownership, seizure or confiscation of land, while the Valuer General responsibility will involve setting property values. This development reflects the government's resolve to influence the pace, form and debate on economic empowerment issues, including greater state control of economic and reform directions.



According to the Global Competitiveness Report 2011-2012, South Africa's competitiveness position improved by four points, placing the country at the 50th position, the highest in Sub-Saharan Africa and the second highest in BRICS group after China. Major improvements were noted in the quality of institutions, with respect to intellectual property protection (ranked 30th) and property rights (30th), as well as a well-developed financial market (4th), business sophistication (38th) and innovation (41st). However, weaknesses still remain in some areas, including the labor market with highly rigid hiring and firing practices, lower university enrolment rate currently at 15 percent, poor security and aging infrastructure.

ISSUES NEEDING PARTICULAR ATTENTION

The key challenge for the country is to successfully reform product and labour markets in support of productivity growth and job creation. The Government intends to reduce unemployment by 10 percent over the coming decade as envisioned in the New Growth Path (NGP) strategy. To achieve this, the rigid labour laws will need to be overhauled and entry barriers to product markets removed.

South Africa needs to properly manage the volatility of capital flows to reduce exchange rate uncertainty. Net capital inflows fell by nearly 60 percent from R 55.1billion during the first quarter to R 23.7billion during the second quarter of 2011. This, together with increased risk aversion for emerging market assets, triggered a steep rand depreciation since the end of the third quarter.

SWAZILAND

Highlights

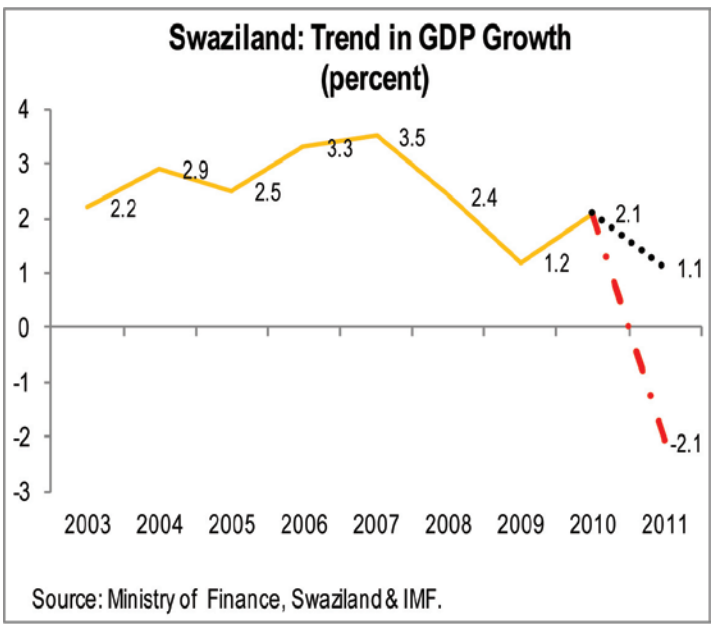
- The macroeconomic environment in Swaziland continues to worsen as external resources to partly finance the budget financing gap of about E 3 billion are not forthcoming.
- A soft monetary stance has been maintained to encourage domestic credit in the face of declining economic activity, with a 2.1 percent forecast decline in GDP.
- Despite the emergence of inflationary pressures at the beginning of the year, inflation has moderated, though at a higher level than that of last year.
- The Government has indicated its intention to own the reform program by setting up an Economic Recovery Strategy Team and approving the team's terms of reference so as to expedite the implementation of the reform agenda, including recommendations contained in the Fiscal Adjustment Roadmap.

MACROECONOMIC MANAGEMENT OVERVIEW

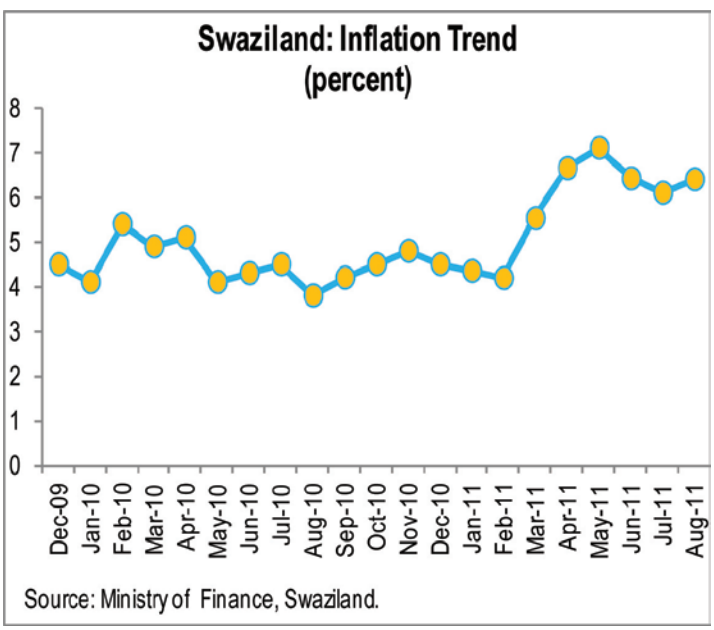
Economic Growth: Further cuts of about E 556 million in government expenditure, though less than E 800 million recommended by the IMF are likely to result in the contraction of the economy in 2011. These expenditure cuts come at a time when the private sector, especially the small and medium enterprises, is owed in excess of E 1,200 million in domestic payments arrears by the government. Private sector activity, especially construction and tertiary sectors, have been depressed. Access to bank credit continues to be a major constraint for small and medium enterprises, resulting in serious challenges in financing their businesses. Despite the good agricultural season, limited recovery in the export sectors due to depressed growth in major export markets is another downside risk.

Monetary Policy and Banking System: Inflation, which had shot up to 7.1 percent in May 2011, has moderated to just over 6 percent in the last quarter to September 2011. The moderation in inflation was on account of the slowdown in food inflation from 7.6 percent in June to 6.8 percent in July 2011. Also, weakening domestic credit expansion and low policy interest rates given dampened growth will help to keep inflation low. While policy interest rates have been kept at 5.5 percent, domestic credit increased by only 12 percent in July 2011 on a year-on-year basis, which is about half the growth recorded over the same period in 2010. Credit growth was driven largely by business and housing finance borrowing, with personal loans increasing by less than 10 percent over the same period.

Fiscal Policy: External resources required to close the financing gap for fiscal year 2011/12 have not been secured to date. About E 3 billion is required, most of which should be externally sourced. Also, local financial institutions have been cautious to provide the needed financing resources, with treasury bills allotments declining during the third quarter of this year. For the June – September 2011 period, less than 50 percent of the issued bills have been allotted. The Government has therefore been in a net paying position on its short term domestic debt. Overall, interest rates on treasury bills have been increasing since the beginning of the year, reflecting the increased risk of lending to government. The government has largely used foreign reserves, domestic revenue and SACU revenue receipts to meet its payment obligations. The Swaziland Revenue Authority exceeded its target for revenue collection by 18 percent during the first quarter. Despite the improved efficiency in domestic resource mobilization, meeting the current 24 percent increase in the target revenue compared to that of the last fiscal year will be a challenge, given reduced economic activity.



Source: Ministry of Finance, Swaziland & IMF.



Source: Ministry of Finance, Swaziland.

External Sector: The weakening global economy poses a serious downside risk for export recovery and could result in a wider current account deficit than the forecasted 13.6 percent for 2011. The Government's recourse to financing the fiscal deficit through the running down of foreign reserves has continued. Foreign reserves declined by

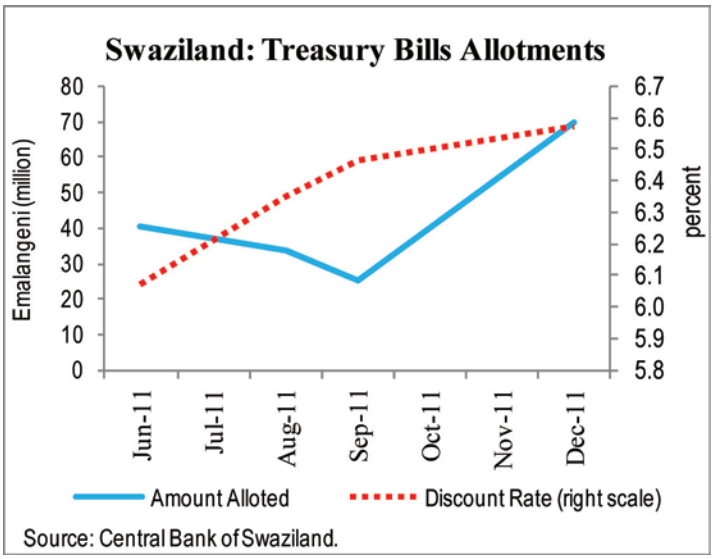
6.3 percent in August 2011 to E 4.1 billion compared with their level in July. At this level, foreign reserves can only cover 2.5 months of imports, which is less than the preferred 3 months import cover.

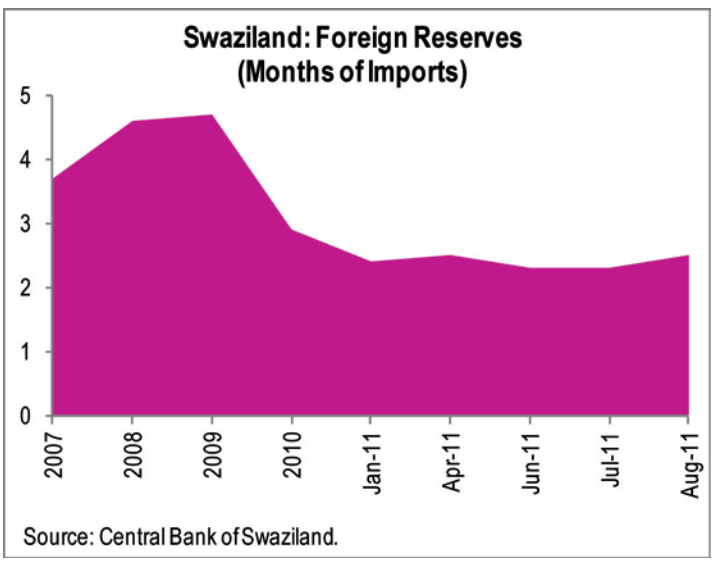
INSTITUTIONAL AND STRUCTURAL REFORMS

The cabinet recently ratified the African Charter on Human Rights and People's Rights of Women in Africa of 2003, the SADC Protocol on Gender and Development of 2008 and United Nations Convention Against Corruption (UNCAC) of 2005. The first two seek to enhance and protect the rights of women through the greater involvement of women in decision-making bodies, access to justice and equal protection before the law. The UNCAC aims to prevent and combat corruption, promote international cooperation to fight corruption, and accountability and proper management of public affairs and public property. Also approved was the Tinkhundla and Regional Administration Bill of 2011 that provides for the establishment and operation of Regional Councils. Furthermore, the cabinet approved the 2011 Economic Recovery Strategy of and the terms of reference for the team that will oversee the implementation of the reform agenda. The Economic Recovery Strategy aims to raise annual economic growth to 5 percent per annum and create 30 thousand jobs by 2014.

ISSUES NEEDING PARTICULAR ATTENTION

Gains made with respect to net primary enrolments stand to be reversed as government is struggling to fully provide education grants to orphans and vulnerable children in 2011. Since 2009, the government has progressively offered free primary education for grades 1 to 3. With no immediate solution in place to improve the fiscal situation, the government will be unable to meet the costs of free primary education and this might see the program being abandoned





DONOR COORDINATION ACTIVITIES

Swaziland has indicated its intention to create a framework for donor coordination by organizing a retreat for development partners to be held for the second time in two years. These efforts will help plug the information gaps that currently exist among development partners and improve the focusing of donor activities in areas of their comparative advantage.

ZAMBIA

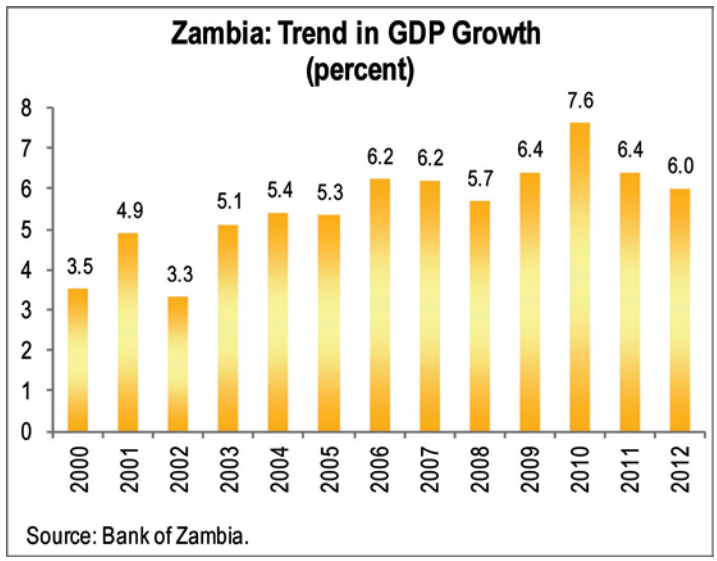
Highlights

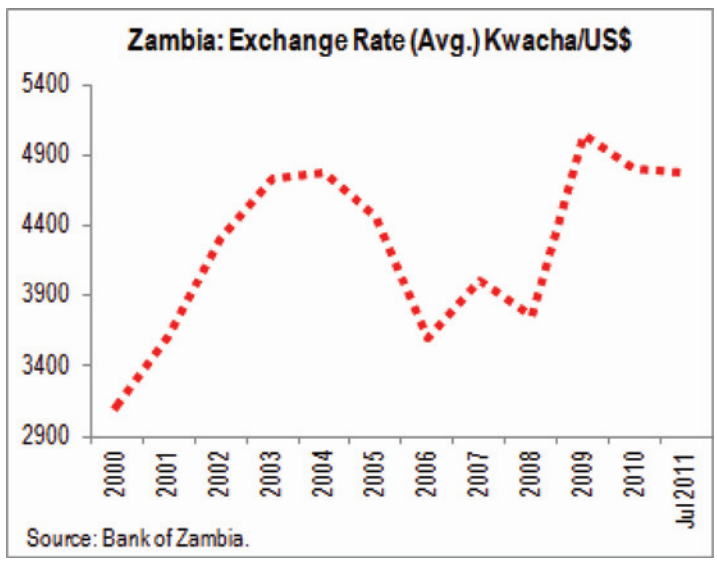
- Zambia recently (September 2011) and successfully managed a smooth political transition, resulting in the election of H.E Michael C. Sata as Head of State followed by the formation of a new government by the Patriotic Front (PF) - formerly the leading opposition party. The country has since undergone key changes in the top layers of government and the wider public sector, including the retirement of the former governor of the Central Bank as well as the heads of security agencies and key parastatal organizations.

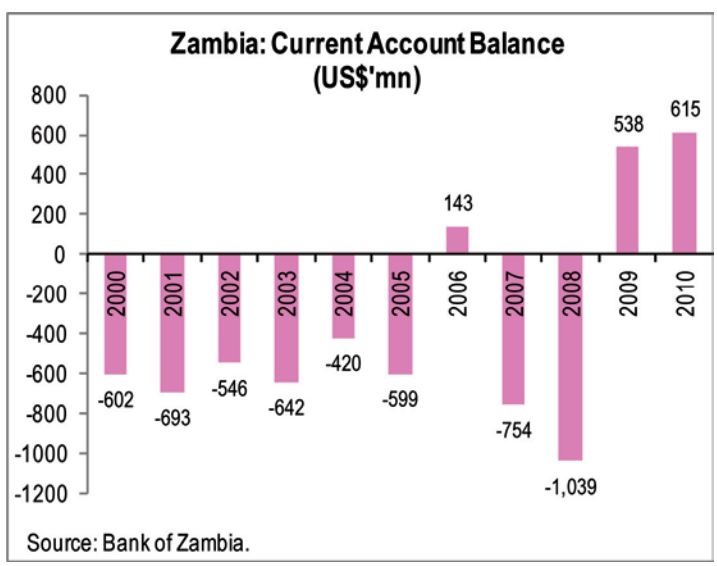
MACROECONOMIC MANAGEMENT OVERVIEW

Economic Growth: Zambia's growth continues to be driven largely by its huge mineral reserves; particularly copper mining, whose production increased dramatically in the past 2-3 years. This has been supported by high international prices, until September 2011. The weak global growth outlook, coupled with the continued Euro area debt worries, pushed copper prices to their lowest levels in almost a year. This notwithstanding, strong real GDP growth of about 7.1 percent is forecasted, driven mainly by robust mining, agriculture and financial sector performance. During 2010/11 Copper and Cobalt output increased by 5.5 percent to 414,981 metric tonnes and 8.5 percent to 4,352.7 metric tonnes respectively. Also, Zambia recorded another successive bumper maize harvest, estimated at 3,020,380 metric tonnes, 8.0 percent higher than in 2010 (2,795,483 mt). Further output increases have been recorded for wheat (38.0 percent), tobacco (18 percent), cotton (68.0 percent), barley (715.2 percent), soya-beans (4.0 percent), and Irish potatoes (20.0 percent).

Monetary Policy and the Banking System: Annual inflation has remained within single digits despite increasing from 7.9 percent in December 2010 to 8.3 percent in September 2011. Although Broad money (M3) increased by 14 percent, reserve money declined by 3.7 percent. With regard to interest rates, the yield rates on government securities rose whilst Commercial banks' lending interest rates have declined by close to four percentage points.







Fiscal Policy: Pre--election period preliminary data indicated that the central government budget recorded a surplus of K 692.2 billion against the programmed deficit of K 1, 548.9 billion. This was a result of better than expected tax revenues. Election spending related activities and weakening international copper prices are however likely to have reversed the previously strong overall fiscal position. A supplementary budget is therefore being considered for the coming weeks. Though still uncertain, this development could lead to fiscal management challenges for the new authorities. The financing of a deficit will be eased by the strong demand for government securities, underpinned by increased domestic participation by commercial banks, institutional investors, and the return of non-resident investors, particularly following the recovery in yields on all tenors and an improved macroeconomic environment.

External Sector: The supply of foreign exchange decreased causing the Kwacha to depreciate by 1.7 percent, 10.0 percent against the Euro and 5.7 percent against the US dollar, the Euro and the Pound, respectively. The export sector's good performance is expected to limit further depreciation of the kwacha and ensure relative exchange rate stability. Despite a decline in export receipts, the trade balance is expected to remain in a surplus position of about USD 1,187.3 million, with export earnings growing by 7.5 percent to USD 4,317.3 million from USD 3,998.3 million. Merchandise trade is being driven by both metals and non- traditional exports, especially, copper wire, cane sugar, cement, lime and maize.

INSTITUTIONAL AND STRUCTURAL REFORMS

The Patriotic Front government has, since coming to power on September 20 2011, taken significant steps towards reducing the overall size of the government/public sector. This is likely to reduce the wage bill. Further public sector reforms, including effective decentralization, improving Public Finance Management and the civil service compensation framework will rein in government expenditure. The government is continuing with the implementation of the Single Treasure account, new procurement regulations, a series of anti-corruption measures and rolling out the national integrated financial management system (IFMIS). Also, within the framework of the Private Sector Development Strategy, the government, and other stakeholders are continuing to undertake key reforms. The government has enacted a public-private partnership (PPP) law and has set up a special Unit under the Ministry of Finance and National Planning. These measures will further enhance the business environment that has seen improvements in the cost of doing business. Zambia's global ranking in the Ease of Doing Business report for 2011/12 moved from 84 to 76.

ISSUES NEEDING PARTICULAR ATTENTION

The major challenges facing the new government include the need to narrow the rural-urban poverty gap through a more inclusive growth framework supported by the diversification of the economy; vulnerability of the Kwacha to external factors and weak capacity across government.

DONOR COORDINATION

The Bank has taken up lead roles in four key sectors; i) The Heads of Cooperation/Mission Cooperating Partners Group (CPG), ii) the Agriculture, Livestock and Fisheries Cooperating Partners Working Group, iii) the Water Supply and Sanitation Cooperating Partners, and Transport Cooperating Partners Working Group. The Bank is also preparing to be part of the second Joint Assistance Strategy for Zambia (JASZ.II). Collaborative work in non-lending activities is also ongoing, with the Bank collaborating with DfID, Norway, the IMF, and the World Bank on a key study - Zambia Domestic Resource Mobilization Potential.

ZIMBABWE

Highlights

- The government projects an improvement in the balance of payments position from a deficit of US D789.7 million in 2011 to a deficit of US D 438.2 million in 2012 on account of export growth and a slowdown in the growth of imports. Food imports are expected to decline by 31.1 percent.

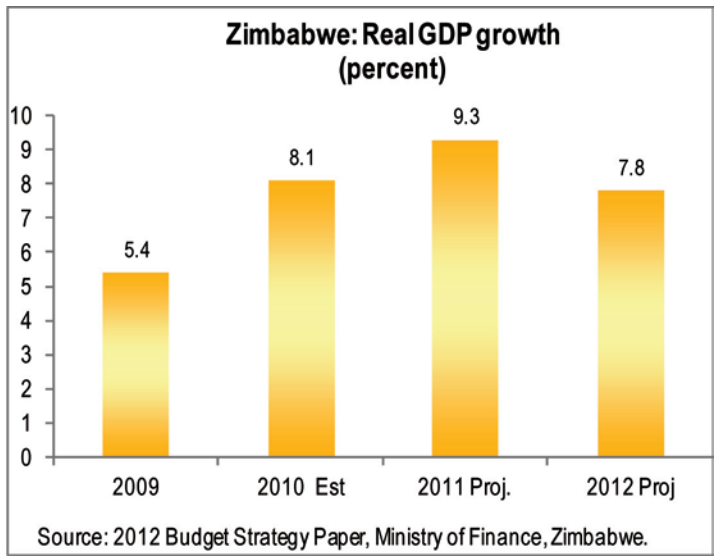
MACROECONOMIC MANAGEMENT OVERVIEW

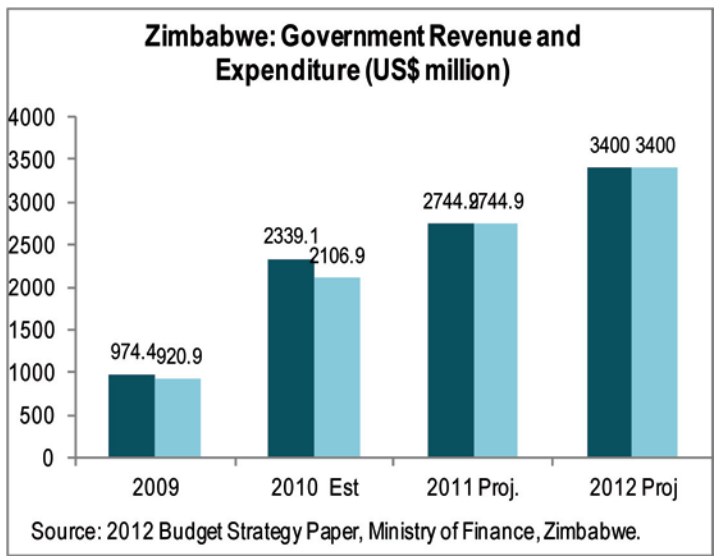
Economic Growth: Projected real GDP growth for 2011 remains unchanged at 9.3 percent, underpinned by strong growth in the agriculture and mining sectors. Agriculture growth in 2011 remains in line with projections of 19.3 percent, largely attributed to better preparedness through support from the government and cooperating partners, timely availability of inputs through the open market, contract farming arrangements as well as own farmer resources. Favorable mineral prices and strong output growth in the first half of 2011, contributed to making the mining sector one of the major GDP growth drivers alongside agriculture.

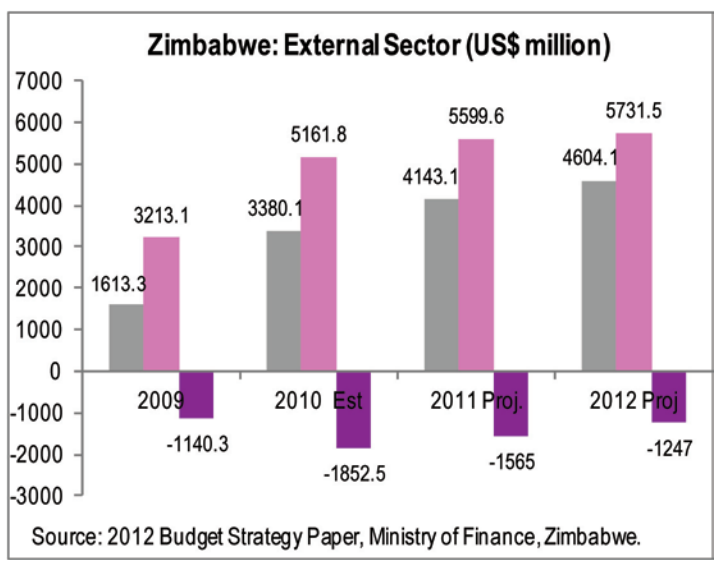
According to a recent ZIMSTAT survey, average capacity utilization during the first half of 2011 remains within the 40-50 percent range, reflecting high levels of idle capacity. Companies in the foodstuffs, drinks, beverages and tobacco, non-metallic minerals, mining and chemicals recorded marginally higher levels of capacity utilization of over 50 percent, reflecting marginal investments in those sectors

Monetary Policy and the Banking System: A moderate inflation rate of around 4-5 percent is targeted for 2011, anchored on continued use of multiple currencies and increasing production capacities of the industries. Whereas year-on-year inflation declined from 3.5 percent in January to 2.5 percent in May, inflation marginally increased to 2.9 percent in June 2011.

External Sector: The tourism sector performed better during the first half of 2011 with tourist arrivals and bed occupancy rate having both registered a 14.3 percent growth when compared to the same period in 2010. A total of 650, 000 tourists visited the country during the first half of 2011 while average bed occupancy rate increased from 31 percent to 36 percent.







During the first half of 2011, exports increased by 56.5 percent to about US D2 billion compared to US D1.3 billion over the same period in 2010. This improvement is partially attributed to the recovery of global demand, which also pushed up export prices. Imports increased significantly by 32.9 percent during the first six months of 2011 from US D2.6 billion in the same period of 2010 to US D3.4 billion. The increase in imports reflects the influx of cheap imports of clothing and textiles, motor vehicles and machinery as well as rising crude oil prices.

OUTLOOK

Real GDP growth is projected in the range of 7.8-9.0 percent for 2012. Inflation is expected to remain below 5 percent, assuming limited impact from exogenous shocks such as fuel prices and rand appreciation as well as containment of domestic costs, particularly the wage bill.

ISSUES NEEDING PARTICULAR ATTENTION

Political challenges surrounding the slow implementation of the GPA continue to impact economic performance. More importantly, uncertainty regarding the policy environment is reducing the planning horizon, compounding country risk.

The size of Zimbabwe's external debt, estimated at over US D7 billion, is a serious development constraint on the economy. With the continued build up in external arrears, the level of external debt implies that the country cannot leverage new financial support from both bilateral and multilateral sources and cannot access any new non-concessional borrowings.

III. SPECIAL THEME: MOZAMBIQUE – INFRASTRUCTURE BONDS: DEVELOPING LOCAL DEBT CAPITAL MARKETS FOR INFRASTRUCTURE PROJECTS

MOZAMBIQUE – INFRASTRUCTURE BONDS: DEVELOPING LOCAL DEBT CAPITAL MARKETS FOR INFRASTRUCTURE PROJECTS

Robust economic growth and a stable macroeconomic environment provide a basis for sustainable financing of the country's infrastructure needs but further financial sector reforms are critical to ensure the sector's further development and deepening.

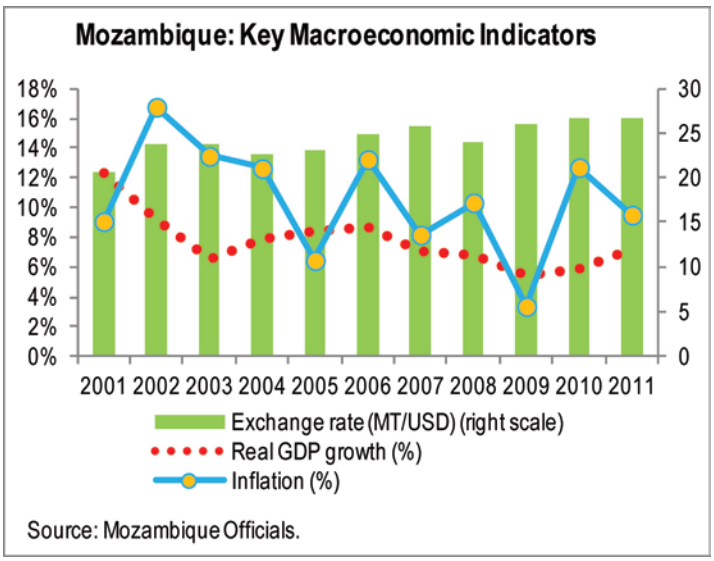
Mozambique's economic performance has been robust with a GDP growth rate averaging 7 percent per annum over the past decade, and its outlook remains strong amidst a fairly stable currency and declining inflation (Chart 1). However, Mozambique faces important short- and medium- term policy challenges, including:

- Fighting inflationary pressures and ensuring exchange rate stability;
- Sustaining economic growth and making it more inclusive;
- Improving the management of revenues from the natural resources sector; and
- Channeling much-needed resources to help finance the infrastructure and skills gaps and the expansion of social safety nets.

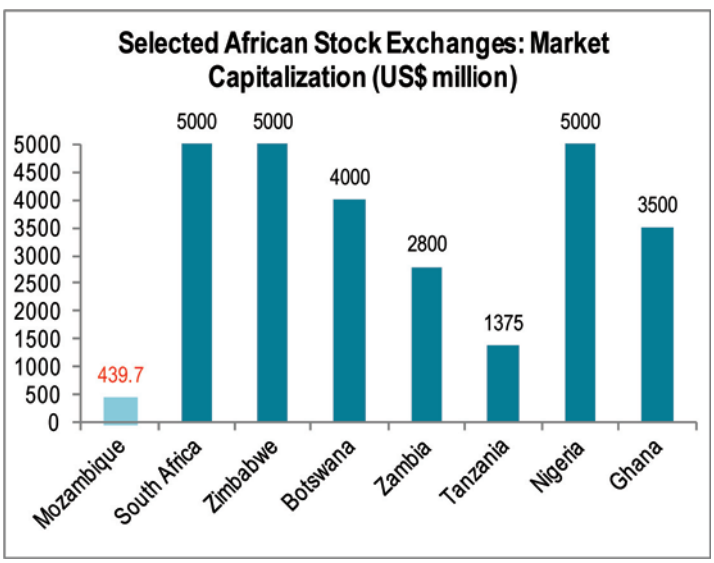
Mozambique has made significant progress toward developing and strengthening the financial sector and improving Central Bank operations. The authorities have promulgated new laws to strengthen bank supervision, introduced International Financial Reporting Standards (IFRS) for banks, and laid the foundations for risk-based supervision. Bank soundness was improved through the restructuring of problem banks and the cleaning up of balance sheets. All these factors, including the macroeconomic performance have helped the country to keep a stable foreign currency and sovereign credit ratings of B+/Stable and B by S&P and Fitch, respectively.

Despite the progress made to ensure macroeconomic stability and to strengthen the financial sector, progress in financial deepening has been less satisfactory. Non-bank financial intermediaries and corporate debt and equity markets remain small and underdeveloped. For instance, the Mozambique stock exchange (BVM) is among the smallest stock exchanges in Africa, with a market capitalization of only US D 439.7 million (see Chart 2). Despite its nascent state, corporate companies are increasingly participating in the stock market.

Mozambique, like many Sub-Saharan African countries has a huge infrastructure financing gap, and efforts are ongoing to raise more financing, through private and public channels. Some of the challenges for raising this financing include the limitations of local financial markets that are more inclined to provide short-term financing and the risk profiles typical of infrastructure projects, which have not been attractive to foreign investment. Given the huge financing gap, the government would like to ramp up efforts to mobilize internal resources to finance infrastructure development.



Source: Mozambique Officials.



Local debt capital markets: why should they be developed?

The argument for developing local debt capital markets arises from the challenges faced by local credit markets, notably:

- The inadequate volume of local currency credit to the private sector (to minimize foreign currency exposure);
- The requirement for longer term local currency financing; and
- A lack of long term investment instruments into which domestic savings could be channeled.

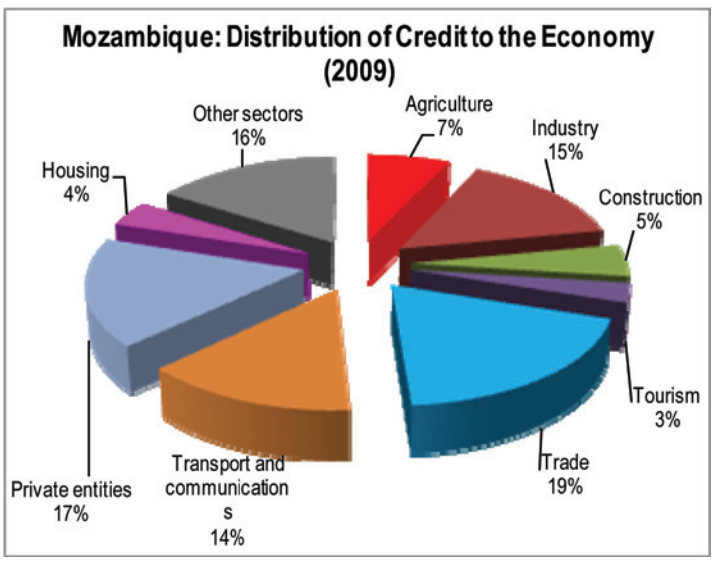
Like many African countries, Mozambique's local credit market cannot adequately cater to the financing needs of infrastructure projects (Chart 3 indicates a 14 percent allocation to two infrastructure sub-sectors). Despite being inadequate, current financing options pose two main risks:

- Financing infrastructure projects is limited to medium term bank loans, leaving large unfunded portions and creating a re-financing risk towards the end of the project life;
- Many infrastructure projects are funded in foreign currency, which increases foreign currency risk.

Although the Mozambican capital market is at a fairly nascent stage, it has seen several corporate and government bond issuances. The government has issued some long dated bonds, namely, a perpetuity bond with a fixed coupon and a few 10 year bonds (one with a callable feature). The government is the single largest issuer. Corporate bond issuances have largely been for shorter tenors, the only infrastructure-related issuances being those by M-Cell, a quasi-government telecommunications firm. Market participants are aware that more can be done to stimulate the capital markets. Evidence to date indicates that there is appetite for longer dated paper, signaling potential interest for infrastructure bonds.

The development of local bond markets in Mozambique could provide long term solutions such as: Reducing the foreign currency risk associated with infrastructure financing;

- Minimizing tenor mismatches and re-financing risk;
- The creation of diversified asset classes and broadening investment opportunities and
- Promoting further financial deepening.



Infrastructure bonds: Some experiences from Kenya and South Africa

The financial markets in most sub-Saharan African (SSA) countries are shallow, and have inadequate access to finance. Mobilization of domestic resources as an alternative source of financing long-term investments is becoming increasingly important, with governments focusing on domestic markets in order to avoid renewed or unsustainable external indebtedness. It is now widely acknowledged that financial sector stability and depth are critical to efficient mobilization and allocation of domestic financial resources in the quest for development and poverty reduction. The benefits of an efficient domestic bond market are numerous and well-known, as they provide both private and public borrowers with access to cheaper and longer term financing; this in turn assists governments in funding their development programs on more attractive terms and allows the African private sectors to fund their long term expansion and development needs at competitive levels.

Infrastructure bonds (IBs) are becoming increasingly popular in developing countries, as they seek to reduce the backlog of infrastructure development needed to support the rapid economic growth. Coupled with this, overall bond market development in many countries has created the opportunity to better match asset and liability maturity associated with long-term infrastructure projects. Yet, many markets remain in dire need of infrastructure funding while their bond markets are underdeveloped.

Consequently, this has created a need for governments to backstop long-term infrastructure bonds[1] as a means of creating confidence and supporting socially desirable and commercially viable infrastructure projects under a risk sharing mechanism. Some governments are also actively marketing infrastructure in order to raise funding for specific infrastructure projects.

Infrastructure bonds have been issued to fund infrastructure projects like electricity generation and transmission, gas, telecoms, roads, rail, airports, ports, storage, irrigation and water supply and sewerage. These bonds often come with benefits like lower or no taxes on interest income, and similar asset risk and liquidity weighting as sovereign bonds. Other than public bond issuances, the private sector is slowly getting involved to finance infrastructure projects under public-private partnership (PPPs) arrangements mainly in the form of). In some cases government guarantees have been provided to enhance the attractiveness of such bonds.

Infrastructure bonds may be issued as General Obligation Bonds (GOB) or as Revenue Bonds (RB). GOBs have the payment obligation to the general revenues/resources of the issuer. RBs pay interest and principal obligations from the proceeds of the project/s they finance. IBs enable sponsors to match funding currency and tenor to project requirements. African countries that frequently issue infrastructure bonds are: Kenya and South Africa. Cameroon recently[2] issued an infrastructure bond worth CFA 200 billion (US D 400 million) partly to finance the Lom Pangar dam. A few state corporations within these markets have also taken to issuing infrastructure bonds. South Africa is the leading issuer of infrastructure bonds with institutions such as TCTA, Eskom and Transnet playing leading roles in this area. This is a characteristic of the overall market sophistication.

In Kenya, the infrastructure bonds have been issued by the Central Bank of Kenya (CBK) on behalf of the Government of Kenya to finance specific infrastructure projects. The government began to tap into the bond market to finance infrastructure projects included in the 2008/09 financial year. The issuance of project-specific bonds is also considered as a way of promoting transparency on the use of proceeds from long term bonds.

Key lessons from the Kenya experience are yet to be distilled. General lessons will include the need for the Mozambican government to determine:

- What types of incentive structure they will want embedded in the bond in order to entice investors (e.g. tax exemptions);
- The structure of the infrastructure bonds – what tenor can the market sustain, will investors have appetite for an amortizing bond, will callable features suit the market?;
- Pricing[3]; and relationship with conventional government bonds and the overall debt management framework;
- Reporting and monitoring the projects to be developed against the proceeds of this bond.

The role of the Bank and the Government of Mozambique in the development of local debt markets

The African Development Bank (AfDB) has devised a multi-pronged approach to develop African capital markets, based on Knowledge Management, Direct Market Interventions and Advisory Services. Knowledge management activities include initiatives to raise awareness on African capital market development such as the African Financial Market Initiative (AFMI); the facilitation of knowledge exchanges through the Partnership for Making Finance Work for Africa (MFW4A) and the production of knowledge material such as the African Fixed Income Guidebook. Direct market interventions include loans for financial sector reforms, and technical assistance to governments and financial products to stimulate local currency lending.

The African Development Bank is positioning itself as a major player in advancing the development of the financial sector, and in particular Africa bond markets. The Bank's dedicated effort in the development of African bond markets is twofold: firstly, under the two key strategic areas of the Medium Term Strategy, namely, private sector development and governance; and secondly, through a strategic decision to issue local currency bonds in African markets. The first domestic issue by a supranational was in the South African market in 2007. The Bank has also issued bonds in Ugandan shilling, Botswana Pula, Nigerian naira, Tanzanian shilling, Kenyan shilling and the Ghanaian cedi.

In the case of developing local markets to sustain infrastructure bonds, the Bank can provide three distinct types of support:

- Technical assistance to develop the capacity of market participant, including authorities to issue such a bond;
- An African Development Fund loan to further carry out existing financial sector reforms; or through the issuance of a domestic currency (meticais) denominated bond, possibly as a benchmark to test longer tenors;

1 Issued by Quasi-government entities or Parastatals
2 December 2010
3 Government has pursued strategies to lengthen the maturity of their bonds in order to improve trading liquidity.

- The issuance of a supranational in the Mozambican market would familiarize authorities with some of the best practices in terms of regulation and international capital market requirements;
- The Bank could also provide capacity building to market participants in order to bring them in line with regional and international capital market practices.

The establishment of contractual savings channels, often in the form of government-initiated pension funds, can also contribute to the successful issuing of long-term fixed rate debt. Mozambique currently has 5 private pension funds and one majority state-owned company that actively invest in bond issuances. The AfDB and World Bank assistance to improve the soundness, efficiency, reach and depth of the Mozambican financial system through the Financial Sector Technical Assistance Project (FSTAP)[4] will contribute to the development of institutional investors. Moreover, the adoption of law 1/2010 of 31st December is expected to pave the way towards the establishment of more pension funds.

The main legal and regulatory issues which need to be addressed by the authorities prior to a debut AfDB bond issue in the Mozambique capital markets would include:

- tax exemptions from the Ministry of Finance; elimination of restrictions on investors; institutionalization of asset-risk weighting for the bonds;
- domestic rating exemptions;
- extension of the tenor of Treasury Bills beyond (e.g. beyond one year) in order to establish a yield curve that will form a benchmark for pricing other long-term debt instruments ;
- the existence of a securities commission with the power to regulate the issuance of and the dealings in securities, to encourage the development of the securities market, and to curb improper dealings;
- the existence of a Capital Market Master plan[5] with a comprehensive plan charting the strategic positioning and future direction of the Mozambique capital market, including strategies to encourage more private (as well as foreign) investor participation in the bond market.

Also, a regional approach to bond market development should be considered, given the benefits from economies of scale. It will help to widen the pool of bidders and mitigate the problem of savings' scarcity. Other issues for consideration will have to include whether the market will require state guarantees for infrastructure bonds issued by Parastatals and improving transparency. Currently, some infrastructure bonds are not allocated through bidding processes and are susceptible to political and regulatory interference. The development of a strong pipeline of bankable projects and adherence to good contract management practices and procurement standards are other areas that need to be adequately addressed to prevent contract renegotiations, which may delay project implementation.

4 The project aims to develop the institutional capacity of the financial sector by financing activities that will (a) strengthen the regulatory and supervisory frameworks for banks and non-bank financial institutions, including the insurance and pensions sector; (b) develop a more robust payments system; (c) improve the legal and judicial environment for lending operations; (d) introduce sound debt management; and (e) expand financial services particularly in the rural areas by improving the operations of microfinance institutions.

5 This discussion should enable the Management to see if the proposed intervention is aligned with country strategy (in the financial sector)

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