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PREFACE

The Southern Africa Quarterly Overview and Analysis is produced by the Southern Africa Resource Center (SARC) and the Southern Africa Regional Department B (ORSB) of the AfDB. The publication is part of the AfDB’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. Individual country reports are prepared by the country economists and produced from information gathered through consultations, the review of country documents and other relevant sources.

Preparation of the report was coordinated by Albert Mafusire and Imen Chorfi under the supervision of Kennedy Mbekeani (Regional Economist, SARC) and Ernest Addison (Lead Economist, ORSB) and the overall guidance of Ebrima Faal (Regional Director, SARC) and Chiji Ojukwu (Regional Director, ORSB).

The following people contributed to the publication: Andre Almeida Santos, Albert Mafusire, Angela Zeleza, Barfour Osei, Edirisa Nseera, George Honde, Mary Mamokgo Monyau, Martha Phiri, Joel Daniel Muzima, Peninah Karuki, Peter Mwanakatwe, Peter Engbo Rasmussen and Wolassa Kumo.

I. REGIONAL OVERVIEW

Economic activity in Southern Africa picked up in the fourth quarter to propel the region’s average real gross domestic product (GDP) growth rate to an estimated 4.0 percent for 2012. Production recovery in crude oil underpinned higher growth in Angola. Lesotho experienced positive growth driven by the industrial sector, particularly the textile and clothing sub-sectors. In Mauritius, growth was resilient in spite of the continued recession in the Eurozone, which had weakened the external sector of the country. Driven by rising domestic demand, economic activity picked up significantly in Mozambique. Growth was moderate in Namibia, with the primary industries performing well. Similarly, Zambia showed resilience in its growth performance despite lower than expected output from the mining sector. On the other hand, growth remained sluggish in Botswana as the global economic downturn kept output from the mining sector subdued. Output growth in South Africa remained negatively affected by contraction in the primary sector, particularly mining and quarrying. In Swaziland, depression in the small and medium enterprise (SME) sector and an underperforming export sector, following investor pessimism, continued to adversely affect real output growth. Similarly, the adverse impact of continuing drought in Zimbabwe played havoc with agricultural production to negatively affect overall growth.

Across the region, Governments remained steadfast in their implementation of economic policies. Prudence in macroeconomic management contributed to improvement in the overall macroeconomic environment. Inflation eased in Angola, Botswana, Lesotho, Mozambique, Namibia and Zimbabwe to underpin the continuing policy of monetary easing. However, in Malawi, South Africa, Swaziland and Zambia, inflationary pressures remained high.

Structural reforms continued apace in most countries. In Angola, the new foreign exchange legislation, which requires oil companies to shift a large share of their financial transactions from offshore to domestic banks, is expected to boost private participation in the economy. The structural transformation of Botswana was given an added impetus following the trial run through Zimbabwe of a train carrying coal. This strengthened the case for Botswana to exploit its estimated 212 billion tonnes of coal resources. In Lesotho, the private sector continued to benefit from ease of doing business measures put in place by the Government. The Government of Malawi launched the National Export Strategy to enhance the diversification of the economy. In South Africa, the Incubation Support Programme – aimed at nurturing small, micro and medium enterprises (SMMs) into sustainability – will enhance the partnership between Government and the private sector in job creation. Zimbabwe made significant progress in its efforts to improve relations with development partners. The International Monetary Fund (IMF) relaxed most of its restrictions on technical assistance to the country, paving the way for the implementation of IMF-monitored economic programs.

Going forward, strong adherence to economic reforms and more determined efforts at economic diversification is crucial for accelerated, strong, sustained and shared growth in Southern Africa. In Angola, the strategic objective of economic diversification needs to be given greater impetus with measures aimed at closing the infrastructure gap, developing human capital and attracting more foreign financing. In Lesotho, the poor absorption capacity of donor resources, which often leads to slow implementation of development programs, has emerged as a key challenge. Malawi needs to maintain the support of development partners by sustaining policy reforms and, in particular, avoiding policy reversals. In Mauritius, a more determined effort at economic diversification has become imperative in the wake of the continuing Eurozone crisis. Also, the country’s negative real rate of interest on savings deposits and rising unemployment need attention. Further, Mauritius’ ranking on Transparency International’s Corruption Perception Index, which declined in 2012, suggests that the public’s confidence in the authorities’ fight against corruption has been eroded. The authorities in Mozambique need to deepen reforms, especially in the financial and banking sector, to enhance competition and, in particular, to foster growth in the agriculture sector – the main driver of poverty
Also, in Mozambique the rising public debt poses a challenge for private participation in the economy. Namibia needs stronger policies and strategies to manage its mineral wealth and promote value addition of mining products. In South Africa, the continued violent strikes in the mining sector draw attention to some of the deep-seated structural problems in the economy. Swaziland must strengthen the management of public resources for a more resilient economy. Zimbabwe’s progress in its relations with the IMF is pushing forward the country’s re-engagement with the international community. However, progress still hinges on strong adherence to prudent macroeconomic management.

The individual country briefs, which provide further details for each of the 12 countries in Southern Africa, follow this overview.

**Key Macroeconomic Indicators for SADC Countries (Average 2009-2012)**

![Graphs of Real GDP Growth, Inflation, Government Debt, Budget Deficit, Current Account Balance, and International Reserves for SADC countries.](Image)

*Source: International Monetary Fund, World Economic Outlook Database, October 2012*
II. COUNTRY ANALYSES
HIGHLIGHTS

- Oil production bolstered macroeconomic performance in 2012, and overall GDP growth accelerated 8 percent while inflation declined to 9 percent by year-end.

- Government embarked on ambitious reforms to improve governance, and the newly established Sovereign Wealth Fund (SWF) will help insulate the economy from volatile oil prices.

- Angola’s oil output expanded 4.5 percent in 2012 amidst technical constraints in the liquid natural gas project.

I. MACROECONOMIC MANAGEMENT OVERVIEW

Economic Growth: In 2012, Angola attained robust economic growth bolstered by a recovery in oil production and a continuation of non-oil sector growth. GDP growth accelerated 8 percent in 2012 (up from 3.9 percent in 2011) and was mainly driven by the continued expansion in the oil and gas sector and a public expenditure program designed to encourage economic diversification – in particular in the transport, construction and energy sectors. Despite the high economic growth, the country still faces massive developmental policy challenges, including the reduction of dependency on oil and the improvement of human development and living conditions. In 2012, oil production averaged 1.8 million barrels per day (bpd), up from 1.66 million bpd in 2011. The 4.5 percent oil output increase in 2012 was largely due to production recovery in the oil blocks of Grande Plutônio and Pazflor. The Government aims to expand crude output to 1.84 million bpd in 2013 and reach 2 million bpd by 2015. Total oil exports over the fourth quarter of 2012 reached 157 million barrels (1.95 percent above the levels registered in the previous quarter). Oil output increase was also supported by favorable prices, which averaged USD 113 per barrel. In cumulative terms, oil export revenues reached USD 40 billion in 2012, that is 4.7 percent higher than the level registered in 2011.

Monetary Policy and Banking System: In 2012, gross international reserves increased by at least USD 3.4 billion, gradually adjusting the value of the domestic currency, the Angolan kwanza (AKz) in line with market fundamentals and bringing inflation to levels below 10 percent. Gross international reserves reached USD 33 billion (12.1 percent above the initial target). The kwanza maintained a smooth depreciation trend of only 1.66 percent against the United States dollar (USD), with the exchange rate closing the year at USD 1: AKz 95.8, while the spread on the parallel market remained at 5 percent. Year-on-year inflation declined from 11.4 percent in 2011 to 9.02 percent in December 2012, helped by a stable exchange rate and fuel price subsidies, and reached unprecedented single-digit values for the first time in a decade. Based on the above, the country performed well on the three main programmatic objectives of monetary policy. With regard to the implementation of monetary policy, the National Bank of Angola (BNA) maintained its reference lending interest rate at 10.25 percent while the absorption capacity rate stood at an historical low of 1.5 percent. Meanwhile, the BNA’s bill interest rate for 63 days maturity increased from 3.76 percent in September 2012 to 4.12 percent in December 2012 as the BNA intensified its sales of bonds.
in the domestic market to mop up excess liquidity. The apparent excess liquidity also prompted commercial banks to drop their 181 days to one year maturity lending interest rates from 14.25 percent in September 2012 to 12.82 percent in December 2012 and consequently helped narrow the spread between lending and borrowing rates by 1.02 percentage points to levels close to 7.98 percent in December 2012.

Credit to the economy expanded from 16 percent in September 2012 to 22 percent in December 2012, mostly driven by a sharp demand by consumer credit to individuals (18.2 percent), retail trade (16.8 percent), private sector investment (14.7 percent) and construction (11.8 percent). The proportion of medium-term credit also increased from 46 percent in September 2012 to 49 percent in December 2012. The increase in the share of medium-term credit in total banking credit to the economy is favorable for long-term investment. With regard to external sector developments, the current account, boosted by strong exports, improved by 8.2 percent of GDP (USD 9.1 billion) in 2012 but is likely to drop to 7.6 percent of GDP in 2013 due to the rising import bill on capital goods needed to close the country’s infrastructure gap.

**Fiscal Policy:** Government’s rationalization of current expenditure yielded a fiscal surplus of 8.8 percent of GDP in 2012 and allowed the authorities to repay domestic arrears of USD 7.5 billion, which had been incurred since 2009. In comparative terms, revenue execution achieved 96 percent of the planned target for the fourth quarter of 2012 (up from 87.73 percent in the previous period). This was due to the strong performance of oil revenues, which exceeded the target by 24.2 percent, as well as the incorporation of Sonangol (a state-owned oil company) revenues into the budget. On the expenditure side, Government remained prudent; having closed the fourth quarter at 93 percent, total expenditure execution remained within the planned targets. This resulted in a total surplus of AKz 124,180.5 (about USD 1.3 billion) during the last quarter of the year. Meanwhile, capital expenditure execution continued to record low levels in 2012, having closed the year at 58 percent of the planned budget. This can, in part, be attributed to the delays in contractors’ implementation of civil works. In 2013, the fiscal policy will be targeted towards the improvement of social welfare and poverty reduction. To this effect, the expenditure in social priority sectors is expected to increase from 33.1 percent in 2012 to 33.5 percent in 2013. The state budget also predicts a fiscal deficit of 3.4 percent of GDP, largely due to the implementation of the country’s infrastructure rehabilitation program.

II. INSTITUTIONAL AND STRUCTURAL REFORMS

**Institutional Reforms to Enhance Accountability in Public Spending and Predictability of Oil Revenue Transfers to the Budget:** The Government is pressing ahead with the Executive Program for Tax Reform (Programa Executivo para a Reforma Tributaria or PERT) by broadening the tax base and increasing collection, thus helping to ease the current burden of taxation on the petroleum sector. Furthermore, the 2013 budget preparation was set to include a first-ever medium-term (2013-17) macro-fiscal scenario with technical support from the IMF.
Regional Integration Agenda: Angola organized an international conference on the Lobito Corridor that took place from 29 to 30 November 2012. The objective of the conference was to promote the regional corridor potential as well as to entice foreign investors’ interest. The 1,700 kilometer Lobito Corridor extends across Angola, the Democratic Republic of the Congo (DRC) and Zambia. It comprises the Benguela railway, the Lobito port and the international airport of Catumbela. The tri-partite investment foresees a rehabilitation of a direct railway link from Angola to Luau (in DRC) and Zambia with the objective of enabling Zambia and the DRC’s access to the Lobito port for the shipment of their mineral products, thus reducing the transaction costs.

Private Sector Reform: The new foreign exchange legislation (which requires oil companies to shift a large share of their financial transactions from offshore to domestic banks by October 2013) is being implemented. The volume and size of oil sector related transactions going through the domestic banking system will increase significantly, providing an impetus for financial market development. Therefore, the IMF post-stabilization program recommends the authorities ensure high standards of efficiency in the payments system, including for international transactions.

III. DONOR COORDINATION ACTIVITIES

The AfDB and other development partners in Angola are collaborating with the United Nations (UN) in the preparation of a national assessment of the UN’s post-2015 agenda. The national deliberations will be focused on five thematic think pieces, namely: (a) the green economy and the Washington DC consensus; (b) urban growth and the challenges of environmental contamination; (c) youth bulge, unemployment and security; (d) food security and rural development; and (e) unfinished Millennium Development Goals agenda, equity and gender issues. The AfDB has committed to provide inputs on the role of the private sector in economic development and job creation in Angola.

IV. ISSUES NEEDING PARTICULAR ATTENTION

The authorities’ strategic objective of economic diversification requires effective programs to close the infrastructure gap, develop human capital and lower the cost of doing business in Angola. In pursuing this important objective, it is recommended that the authorities balance spending priorities to ensure a strong economic growth while preserving macroeconomic stability. The authorities are also advised to search for ways of diversification of sources and instruments of foreign financing including the development of the local currency bond’s market.
HIGHLIGHTS

• Real GDP growth slowed to 5.7 percent during the third quarter, from a rate of 6.6 percent recorded during the same quarter in 2011.

• Although inflation pressures have subsided for most of 2012, the rate remained above the objective target range of 3 to 6 percent in the medium-term period. This mainly reflected an increase in food prices due to drought conditions experienced during the year. Cognizant of the need to address the situation, the Government has put in place mitigation measures.

• The Government undertook a mid-term review of the 10th National Development Plan that brought to the fore the importance for the country to improve the management of economic shocks.

I. MACROECONOMIC MANAGEMENT OVERVIEW

Economic Growth: During the third quarter of 2012, the global economic downturn continued to adversely affect the local economy, and real GDP growth slowed down to 5.7 percent compared to 6.6 percent in the same quarter of 2011. In particular, the mining sector remained subdued, with a decline of 24 percent during the period under review. Performance of the non-mining sectors was mixed, with significant increases recorded in water (29.3 percent), trade (17.3 percent) and air transport (17.1 percent). However, the positive impact from these sectors was counteracted by declines in electricity (-67.4 percent) and manufacturing (-5.5 percent).

Monetary Policy and Banking System: The annual rate of inflation was on a downward trend during 2012 (except in May and September) and ended the year at 7.4 percent. This was marginally higher than the level of 7.1 percent in September 2012. Nonetheless, the rate remained well above the Bank of Botswana’s objective target range of 3 to 6 percent. The persistent high inflation rate emanates from increases in food and fuel prices; and administered prices of electricity, water and transport services. However, the Bank of Botswana continues to pursue a tight monetary policy given that aggregate demand is likely to be suppressed and inflation is anticipated to converge downward to the official objective range in the medium term.

Fiscal Policy: Botswana’s medium-term budget is geared towards attainment of fiscal sustainability and promotion of economic growth. Fiscal operations during the second quarter of the 2012/13 financial year (July-September) resulted in a deficit of BWP 696.61 million (about 2.4 percent of GDP). This represents a decrease from the surplus of BWP 713.8 million (about 2.8 percent of GDP) recorded in the corresponding quarter of the 2011/12 financial year (FY). While revenue increased by 14 percent, the impact was offset by a larger rise in expenditure of 32 percent. The higher revenue was mainly due to an improvement in customs and excise taxes while the increase in expenditure reflected a rise in recurrent expenditure as capital expenditure declined marginally. For 2012/13 fiscal year, the revenue outlook is expected to remain challenging, thus only a modest budget surplus of 0.6 percent of GDP is projected on account of expenditure restraint. Public debt is projected to decline to 14.9 percent of GDP in 2012/13, down from 17.6 percent in 2010/11, with external public debt (including publicly guaranteed debt) projected to remain at 11.0 percent of GDP.
External Sector: During the first two months in the fourth quarter of 2012, the trade balance recorded a deficit of BWP 1.3 billion, although it was an improvement from a deficit of BWP 2.4 billion in the same period of 2011. While exports increased significantly, by BWP 4.6 billion, there was also a sizeable increase in imports of BWP 3.5 billion. However, since the beginning of 2012 the value of exports has remained lower than that of imports, pointing to the adverse effects of the ongoing eurozone crisis. Despite the persistent trade deficit, gross foreign reserves remained high, at USD 7.52 billion as at end November 2012, equivalent to about 12.4 months of imports of goods and services. In light of these developments, it remains to be seen whether the forecast current account surplus of about 3 percent of GDP in 2012 will be achieved, especially taking into account the slackening demand for mineral exports due to the gloomy global financial environment.

The nominal value of the Batswana pula (BWP) has depreciated against major foreign currencies over the year to December 2012. The BWP depreciated against the British pound (GBP) by 8 percent, the euro by 6 percent and the USD by 3 percent. This was due to Botswana’s persistent high inflation rate and the low demand for the country’s exports into these markets. However, the BWP appreciated against the Japanese yen by 7 percent and held steady against the South African rand (ZAR) mainly because of the weaknesses in these currencies due to the ongoing financial crisis in the eurozone.

II. INSTITUTIONAL AND STRUCTURAL REFORMS

Botswana’s ambitions to become a major coal exporter received a boost in late November 2012 after a train carrying a 1,600 tonne consignment of coal arrived in the port of Maputo in Mozambique. The trial run through Zimbabwe took three days and proved conclusively that bulk coal exports from collieries in Botswana via the Maputo Corridor are feasible. This has rationalized the case for Botswana to exploit the estimated 212 billion tonnes of coal resources.

A remarkable development occurred in the financial sector in October when the Botswana Stock Exchange established an automated trading system. The move is seen as a critical step towards ensuring that the financial sector becomes globally competitive and is expected to boost development of the country’s financial services sector.

III. ISSUES NEEDING PARTICULAR ATTENTION

A mid-term review of the National Development Plan (NDP-10) was held in October 2012, bringing together Government officials and various stakeholders. A major policy lesson emerging from the review was the need for the country to develop its capacity to manage economic shocks, especially those that are of global dimensions. To this end, the Government has committed to ensuring judicious management of national resources by building up financial reserves that can be utilized during these periods of economic shocks. This will be achieved through implementing high economic impact projects and conducting rigorous appraisals, so that only those projects with the highest social returns are selected.
HIGHLIGHTS

• The economy continued to show signs of positive growth driven by the industries including textile and clothing sub-sectors.

• Fiscal balance continued to register a surplus mainly driven by good performance in the Southern African Customs Union (SACU) with unchanged public expenditures.

• Despite upward pressure from food and international fuel prices, inflation dropped to 4.5 percent, the lowest level in the past 12 months.

I. MACROECONOMIC MANAGEMENT OVERVIEW

Economic Growth: The economy showed signs of positive performance during the third quarter ending September 2012. While diamond production fell by 9.0 percent (due to slower production by Letseng and Liqhobong diamond mines), consumption of water and electricity, ‘wet’ industry activity indicators, increased on a year-on-year and quarter-on-quarter basis as well. The textile and garments sub-sector, which are the second largest employers after agriculture, experienced good performance (exports increased) over the same period. However, employment in the manufacturing and Government sector dropped.

Monetary Policy and Banking System: Money supply fell in the quarter ending September 2012 on the back of a decline in net foreign assets. The increase in the net domestic assets was not enough to offset the contraction. Credit extended to both households and enterprises increased on a year-on-year basis. The bulk of the credit (56 percent) continued to go to the households. The increased borrowing was facilitated by the positive provisions in the 2011 Companies Act, which allows people to borrow as individuals, and the eased processing of land titles for use as collateral (as provided for in the 2010 Land Act). The year-on-year overall inflation was estimated at 4.5 percent in December 2012, representing a drop of 1.3 percentage points compared to June the same year. The year-on-year increase in overall inflation was mainly driven by the rise in prices of food (8.3 percent); tobacco (6.1 percent); alcohol (5.7 percent); electricity, gas and other fuels (4.3 percent); water and miscellaneous services relating to dwelling (4.0 percent); other recreational items and equipment, gardens and pets (4.7 percent); and the operation of personal transport (3.6 percent).

Fiscal Policy: During the third quarter, the Government budgetary operations showed a surplus equivalent to 12.2 percent of GDP. The surplus reflected higher SACU receipts in the framework of unchanged expenditures. Given this performance, the Government fiscal position is expected to remain in surplus for the remaining quarter.

External Sector: The current account deficit was registered at 2.8 percent of GDP during the third quarter of 2012. The narrowing of the current account deficit was a result of the improvement in the trade balance as exports increased while imports dropped. The positive performance in SACU transfers also contributed to the narrowing of the current account deficit. Consequently, reserves in months of import cover rose from 3.2 in June to 4.3 in September 2012. The increase epitomized higher official reserves coupled with a decline in imports.
II. INSTITUTIONAL AND STRUCTURAL REFORMS

Public Sector Management: Lesotho has experienced improvements in public financial management (PFM) since 2009, and the passing of the Public Financial Management Act in 2011 was a milestone achievement for the country to start deepening the PFM reforms in all Government agencies. Together with the installation of the integrated financial management system, the implementation of the Public Financial Management Act should ameliorate the critical constraints in implementing PFM reforms. The remaining challenges include widespread failure to undertake bank reconciliations and the slow pace of implementing the 2009 audit law aimed at creating an independent auditor general’s office. There are still glaring weaknesses in procurement, in particular, the absence of standard bidding documents to implement the national procurement regulations of 2007.

Private Sector Reform: The private sector continues to benefit from the ease of doing business afforded by the implementation of the 2011 Companies Act, which has resulted into the registering of 1,330 companies. In addition, credit guarantee schemes as well as the new Industrial Licensing Bill, which have already been drafted and submitted to Parliament, are expected to enhance the development of the private sector in the country.

III. DONOR COORDINATION ACTIVITIES

The AfDB Group has continued to enhance its interaction with the donor community in Lesotho. It is part of the budget support donor group and participated in the interim meeting in Maseru in April 2012. The meeting was convened to review the progress on the outstanding issues emerging from the performance assessment framework meeting in November 2011. The meeting concluded that little progress had been made towards achieving agreed targets in November. Subsequently, the Government was encouraged to undertake further reforms, especially those tailored towards improving PFM.

IV. ISSUES NEEDING PARTICULAR ATTENTION

The poor absorption capacity of the donor resources (65 percent for loans) is a cause of concern since it often leads to slow implementation of development programs. This underlines the need to enhance Government development programs’ monitoring and evaluation mechanisms for efficient and effective implementation.
HIGHLIGHTS

• The first quarterly IMF review of the new extended credit facility (ECF) arrangement concluded that Malawi had met all the quantitative targets for the end of September 2012, with the exception of the performance criterion on the level of net domestic assets of the Reserve Bank of Malawi (RBM), for which a waiver was granted.

• The Government launched its National Export Strategy (NES), which provides a road map for boosting Malawi’s exports, while the Economic Recovery Plan, which aims to address supply side constraints and put the economy back on a sustainable growth path, was also launched.

• The value of the kwacha continued to erode rapidly, and this in combination with deficits in food stocks intensified inflationary pressures.

I. MACROECONOMIC MANAGEMENT OVERVIEW

Economic Growth: Real GDP growth for 2012 was revised downwards to 1.9 percent from the initial projection of 4.3 percent. The slowdown in growth was mainly on account of contraction in agriculture, manufacturing and retail, and wholesale trade.

The Government remained steadfast in its implementation of macro policy reforms, which were adopted in April 2012 to address the macroeconomic challenges facing the country and revive the ailing economy. There are signs that the reforms are beginning to yield results as evidenced by improvement in access to foreign exchange for import of critical inputs, and the easing of fuel shortages. Credit lines that were frozen during the crisis period were restored as more foreign exchange was injected into the market. Between May and December 2012 the RBM had intervened in the market to the tune of about USD 327 million. Business confidence was restored, and some companies started re-hiring workers.

Going forward, agriculture and manufacturing are expected to rebound in 2013, which will boost overall growth. The IMF and Government project 5.5 percent GDP growth in 2013. The rebound in growth is premised on favorable weather conditions, continued easing of foreign exchange constraints, macroeconomic stability and improved investor sentiments. There are already signs that manufacturing capacity utilization is picking up due to improved availability of foreign exchange. The prospects for a good harvest also look favorable, as the rainfall during the current agriculture season has been normal. Other sectors – notably mining, construction and services – are expected to continue to grow rapidly in 2013 as illustrated in the following table.

<table>
<thead>
<tr>
<th>Sector</th>
<th>2012 (Estimate)</th>
<th>2013 (Projection)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture, Forestry &amp; Fisheries</td>
<td>2.9</td>
<td>4.9</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>1.9</td>
<td>8.1</td>
</tr>
<tr>
<td>Services</td>
<td>34.8</td>
<td>34.6</td>
</tr>
<tr>
<td>Mining, Construction &amp; Quarrying</td>
<td>18.7</td>
<td>14.0</td>
</tr>
<tr>
<td>Retail &amp; Wholesale Trade</td>
<td>2.9</td>
<td>4.0</td>
</tr>
<tr>
<td>Real GDP Growth</td>
<td>1.9</td>
<td>5.5</td>
</tr>
</tbody>
</table>

Sources: Ministry of Economic Planning and Development; IMF
There are nonetheless a number of downside risks to the growth outlook. These include the erratic supply of power, the high cost of doing business, and uncertainties in the global economy.

Monetary Policy and Banking System: Inflationary pressures have continued to surge with year-on-year headline consumer price index (CPI) inflation in December 2012 rising by 5.7 percentage points to 34.5 percent from 28.8 percent in September 2012. Average inflation in 2012 stood at 21.4 percent, up from 7.8 percent the previous year. The increase in prices was driven by both food and non-food inflation. Food inflation accelerated by 6.3 percent, from 28.3 percent in September to 34.6 percent in December, while core inflation jumped by 5.7 percent, from 28.8 percent to 34.5 percent. Year-on-year headline urban inflation increased by 8.7 percentage points to 39.8 percent in December 2012, with urban food inflation rising by 10.8 percentage points over this period to 23.3 percent. The rural inflation rate stood at 31.4 percent, up from 26.6 percent in September. However, inflationary pressures are expected to ease with the stabilization of the exchange rate and the anticipated good agricultural harvest. The end-of-period headline inflation rate is projected to decline from 34.5 percent in 2012 to 10.1 percent in 2013.

Monetary aggregates trended upwards during the period. Broad money supply (M2) increased by MK 36.1 billion to MK 386.4 billion in December 2012 from MK 350.3 billion registered in September 2012. Narrow money supply increased by MK 13.1 billion to MK 164 billion from MK 150.9 billion. The surge in money supply is attributed to the increase in net domestic assets by MK 15.1 billion from MK 339 billion and the increase in net foreign assets by MK 21 billion from MK 10.4 billion.

Mainly driven by private sector credit, which grew by 25 percent, year-on-year growth in money supply accelerated to 23 percent in December 2012, from 19.9 percent recorded end September 2012. Private sector credit contributed 61 percent to the monetary expansion. Net credit to the Government sector from the banking system increased from MK 126.7 billion to MK 140.6 billion as spending picked up towards the end of the first half of the 2012/13 fiscal year. However, growth in net credit to the Government on an annual basis was almost zero. During the quarter under review, the authorities further tightened monetary policy in order to curb rising inflation and stabilize the exchange rate. Accordingly, the policy rate was adjusted upwards from 21 percent to 25 percent in December, which subsequently led to a rise in the commercial banks’ prime lending rates to an average of 36.17 percent in December from 31.42 percent in September.

To restrain expansion in liquidity, the RBM closed the non-secured discount window, which was opened in the post-reform period to assist banks that were facing liquidity problems on account of devaluation. This window stood at MK 378.8 billion in December 2012 from MK 354.2 billion registered in September, representing an increase of MK 24.6 billion. Net credit to Government accounted for MK 13.9 billion of the increase emanating mainly from the increase in credit by monetary authorities and drawdown of Government deposits by MK 12.4 billion to MK 29.1 billion from MK 41.5 billion. Ways and means advances to Government increased by MK 24.3 billion to MK 25.8 billion from MK 1.6 billion. In contrast, net credit from commercial banks fell by MK 4.3 billion to MK 30.2 billion from MK 34.5 billion in September 2012. The outturn is attributed to the off-loading of MK 4.5 billion worth of Treasury bills by some commercial banks; reflecting the acceleration in inflation, the average all type Treasury bill yield increased to 23.8 percent in December 2012 from 21.34 percent September 2012. The average yield on the 364-day tenor in December 2012 stood at 26.44 percent, slightly above the policy rate of 25 percent. Monetary policy during the period was generally accommodative, and the authorities have resolved to correct this by further tightening monetary policy in order to curb inflation and ease the pressure on the exchange rate.

Fiscal Policy: Preliminary fiscal data for the first half of the 2012/13 financial year, which ended on 31 December 2012, indicate that the execution of the 2012/13 budget is on track and in line with the zero net domestic financing target. Total domestic revenue performed well on account of the increase in grants by donors and domestic tax revenues. Domestic tax revenue amounted to about MK 134 billion, surpassing the half-year target of MK 130 billion by 3 percent. The over performance on tax revenue partly reflects the effect of inflation and the Malawian kwacha’s (MK’s) depreciation on taxable transactions. Budget support
grant receipts amounted to MK 56.6 billion against the target of MKW 50.6 billion. In contrast, disbursements on dedicated grants (MKW 29.4 billion) fell short of the target of MK 37.4 billion by MK 8 billion. Total expenditure and net lending during the first half amounted to MK 249 billion, which was marginally within the budgeted amount of MK 249.8 billion. Despite the positive outcome, pressures on the budget are expected to mount in the next two quarters on account of growing demands for public sector wage adjustment, escalating cost of goods and services, and the rising cost of servicing Government’s domestic debt. The domestic debt remains at the December 2011 level of 20 percent of GDP, which is barely sustainable. The accumulation of arrears by parastatals is also likely to pose the risk of contingent liabilities. To manage these pressures, the Government will have to re-prioritize expenditures to ensure that priority social sector programs are protected. The Government was expected to make appropriate adjustments to some of the budget lines during the mid-term budget review in February 2013. The Public Expenditure Review, which the Bank is supporting with the World Bank, will help inform the expenditure reprioritization process.

External Sector: Gross official reserves increased by USD 31.7 million to USD 208.8 million in December 2012 from USD 177.1 million in September 2012. The improvement is attributed to the increase in balance of payment and project funds, which more than offset the increase in foreign net exchange transactions. Net foreign exchange transactions increased by USD 24.3 billion from USD 37.7 billion to USD 64.0 billion, whereas donor inflows amounted to USD 185.1 million in this quarter, down from USD 192.6 million the previous quarter. Consequently, the import cover marginally improved to 1.0 month in December 2012 compared to 0.9 months in September 2012. Due to the exchange rate sector reforms, Government has reported a foreign exchange generation by the banking sector of USD 1.2 billion in 2012 with only 20 percent of this coming from the Reserve Bank of Malawi. This is in sharp contrast to the fewer than USD 500 million gross foreign exchange assets that was available to the whole financial sector in 2011. While not adequate in terms of the required three months import cover, more foreign exchange is being channelled into the formal system, leading to clearance of arrears that built up and very low parallel foreign exchange market premiums of below 10 percent over the official exchange rate, compared to around 80 percent that existed before the liberalization of the foreign exchange market. In November 2012, Malawi secured a credit line of USD 250 million from the PTA Bank to finance the import of fuel and fertilizer. However, Malawi’s ability to build adequate reserves to cushion against shocks will largely depend on exports performance.

The MK continued to depreciate during the quarter – the currency depreciated against the US dollar by 13 percent. The continuation of the kwacha’s depreciation since its floating in May 2012 is due to the high demand for foreign exchange against low foreign exchange reserves. The supply of foreign exchange during the quarter was constrained as this coincides with the lean period for tobacco exports. However, the MK is expected to stabilize during the first half of 2013 as tobacco sales resume. Going forward, continued fiscal and monetary policy tightening will be necessary to ease the pressure on the exchange rate and moderate inflation.

II. INSTITUTIONAL AND STRUCTURAL REFORMS

Launching of the National Export Strategy: In December 2012 the Government of Malawi launched the NES. The NES is part of the Malawi Growth & Development Strategy II and provides a prioritized road map for building Malawi’s productive base for expanding export earnings to match inputs through domestic value addition. The NES targets a doubling in exports within five years and rise in share of exports as a share of imports from 51.5 percent to 75.5 percent in 2017. The focus of the strategy is on diversifying exports, enhancing Malawi’s export competitiveness, ensuring economic empowerment, and developing skills.

Restructuring of Air Malawi: The Government announced that Air Malawi was to be placed under receivership, and its assets were to be transferred to a new company, Air Malawi (2012) Ltd. Strategic investors have been invited to bid for the airline, which will operate as a joint venture. The Government has undertaken to settle all the airline’s financial obligations. If successful, the restructuring of Air Malawi should give Malawi’s tourism a big boost and improve regional air connectivity.

III. ISSUES NEEDING PARTICULAR ATTENTION

Although it is showing signs of recovery in response to the reforms, Malawi’s economic recovery remains fragile. The rapid erosion in the value of the MK is a major concern, as devaluation has intensified inflationary pressures, leading to widespread public sector wage increase demands. Of concern also is that most of the domestic debt is held in short term instruments (Treasury bills alone take up around 80 percent). The dominance of very short-term maturities exposes the domestic debt portfolio to refinancing, interest rate and fiscal risks. While access to foreign exchange has improved, the international reserve position, at just over one-month import cover, is still precarious and does not provide an adequate buffer against shocks. Predictable donor inflows will,
therefore, be critical for the stabilization of the MK while providing the necessary resources to support economic recovery. A key challenge for Government is to sustain the macro policy adjustment reforms in the face of growing demands for a reversal of some of the reforms and maintain the implementation of the country’s IMF ECF program as a necessary foundation for economic recovery.

The Government recently announced restrictions on agricultural exports and imports, and this move is likely to lead to market distortions and added incentive to farmers. Market oriented agricultural policies are needed to stimulate production and stabilize prices through greater competition. Going forward, AfDB’s Malawi Field Office will monitor the impact of the reforms and private sector response closely.
HIGHLIGHTS

• In December 2012, Statistics Mauritius announced a marginal upward revision in the GDP growth rate for the calendar year to 3.3 percent from 3.2 percent projected in September 2012.

• The Mauritius Monetary Policy Committee (MPC) voted in December 2012 to maintain the key repo rate (KRR) at 4.90 percent, as upside risks to inflation have been rising amidst continued downside risks to growth.

• Reflecting the authorities’ fiscal consolidation policy stance, central budgetary provisional estimates in the fourth quarter showed a surplus primary balance of 1.2 percent of GDP in 2012.

I. MACROECONOMIC MANAGEMENT OVERVIEW

Economic Growth: The Mauritian economy has remained resilient in spite of the recession in the Eurozone that has weakened its external demand. The fourth quarter saw the authorities revising the real GDP growth rate for 2012 upwards to 3.3 percent from 3.2 percent projected in September 2012. Growth was anchored by strong performance in the financial services, information and communication technology, and seafood sectors, which grew by 5.5 percent, 9.3 percent and 13.3 percent respectively. Economic activities in hotels and restaurants stagnated in 2012 following a 3.5 percent growth rate in 2011. Reflecting a weak economic environment in source markets, tourist arrivals were estimated at 965,000 in 2012, down from 980,000 in 2011. A double-digit growth figure for arrivals from Asia and Africa partly compensated for the weak performance in the European market. Driven by the strong performance of the food sector, manufacturing expanded by 1.9 percent in 2012, up from 0.7 percent in 2011. Within manufacturing, sugar contracted by 6.4 percent compared to a 3.8 percent growth rate in 2011, while the textile sector stagnated. New export data show a 3.0 percent growth rate for textile in 2011, a much lower growth rate than the 7 percent rebound projected at the beginning of the year. In the agriculture sector, sugar production estimates at 410,000 tons showed a contraction of 7 percent in 2012, down from a 3.5 percent growth rate in 2011. In line with a slowing economy, unemployment continued its steady rise, averaging 8.0 percent in 2012 up from 7.9 percent in 2011.

Monetary Policy and Banking System: The CPI basket registered a net increase of 1.3 points from 133.3 in September 2012 to 134.6 in December 2012, which can be explained mainly by higher water charges and prices of food and alcoholic. Nonetheless, year-on-year CPI inflation during this period slowed down from 4.4 percent to 3.3 percent as the base effects got absorbed and global commodity prices trended down. In tandem, both the headline and core inflation eased from 6.4 percent to 3.9 percent and 5.8 percent to 3.3 percent respectively. In December 2012, the country’s MPC, observing that downside risks to growth remained while upside risks to the domestic inflation outlook had risen, voted to maintain the KRR at 4.90 percent. Upside risks to the domestic inflation outlook increased as global fuel and food prices picked up pace in the second half of 2012. Domestic factors – including the depreciation of the Mauritian rupee (MUR), the Bank of Mauritius (BoM) Operation Reserve Reconstitution (ORR) initiative aimed at bolstering foreign reserves announced in June 2012 and the expected public sector pay rise from January 2013 – further increased the upside risks to the inflation outlook. In line with the low KRR, the prime lending rate ranged between 7.0 and 8.50 percent and the savings deposit rate between 3.0 and 3.5 percent. The weighted average MUR deposit rate stood at 3.65 percent and the weighted average MUR lending rate at 8.5 percent, keeping the real interest rate on savings deposits broadly negative.
can be explained by accelerated rise in credit to the private sector, which grew by of 14.5 percent to reach MUR 348.83 billion. Net credit to central Government contracted by 10.8 percent to stand at MUR 41.8 billion as at end November 2012. The construction and trade sectors drove the increase in annual private sector credit, contributing 53.4 percent and 13.9 percent respectively, while the tourism sector contributed only 4.5 percent. Between September and December 2012, commercial banks approved an estimated MUR 0.36 billion under the SME Financing Scheme; from December 2011 to December 2012, then, a total of MUR 1.56 billion had been reached. Commercial banks were expected to release MUR 3 billion over a period of three years at a repo + 3 percent rate as one of the key measures to develop the SME sector and enhance domestic demand during the Eurozone crisis.

The market capitalization of the Stock Exchange of Mauritius (SEM) stood at USD 5.67 billion as at end 2012 representing 51 percent of GDP with a price market earnings ratio of 11.30 percent. The domestic stock market recorded net investments by foreigners of MUR 192.3 million as at end December 2012 compared to a disinvestment of MUR 80.8 million as at end September 2012. Overall, the SEM lost ground over the 12 months to December 2012, falling by 8.28 percent.

At MUR 30.75/USD and MUR 40.34/euro in December 2012, the weighted average MUR exchange rate had depreciated since September 2012 by about 1.2 percent and 3.2 percent against the USD and the euro respectively. The BoM continued with the implementation of the USD 0.6 billion special foreign currency line of credit, announced in June 2012 and aimed at minimizing exchange rate risks for the export and tourism sectors. The bank also intervened regularly in the foreign exchange market to smoothen excess volatility. To this extent, the de facto exchange rate arrangement has been reclassified from free floating to floating.

**Fiscal Policy:** Fiscal performance in the fourth quarter showed accelerated consolidation, a consistent policy measure during the 2012 financial year. At MUR 22.49 billion, spending in the fourth quarter of 2012 was 4.9 percent lower than the revenues compared to the same period in 2011, when spending exceeded revenues by 14.3 percent. Although tax revenues at MUR 64.92 billion (representing 18.8 percent of GDP) reached the authorities’ target for 2012, total revenues collected at MUR 73.74 were 4 percent lower than the budget estimates owing to a slowdown in grants and other revenues. Nonetheless, a significant slowdown in spending over the course of the year more than made up for the decline in revenue, with provisional actual estimates showing a surplus primary balance of 1.2 percent of GDP. The authorities opted not to utilize the MUR 1.3 billion budgeted contingency and reduced net lending/borrowing as a proportion of GDP from the budgeted -3.8 percent of GDP to -1.8 percent of GDP. In the fourth quarter the Mauritian national assembly approved the 2013 budget. Estimated at MUR 91.8 billion (USD 3.01 billion) the budget aims to support growth while maintaining sound macroeconomic management.

**External Sector:** Exports of goods and services reached MUR 189.6 billion in 2012, of which about 57 percent were services. This represented a 4.8 percent growth rate compared to 5.2 percent in 2011. At MUR 230.6 billion in 2012, the imports growth rate had slowed to 1.6 percent, down from 6.2 percent in 2011. For the period of January to September 2012, leading exports included articles of apparel and clothing accessories at 36.6 percent, and fish and fish preparations at 18.6 percent. Sugar exports represented 11.9 percent of total exports. Europe remained the main export destination. However, its share of total exports during the period declined from 61.3 percent in 2011 to 58.9 percent in 2012. Reflecting the authorities’ strategy to diversify and penetrate the African market, exports to South Africa grew by 28 percent, to MUR 4.7 billion, largely driven by textile trade. The main drivers of import growth included mineral fuels, lubricants and related materials, which represented around 22.1 percent of imports. India (at 23.5 percent of total imports) and China (at 15.9 percent of total imports) were the main import source markets. South Africa accounted for 6.4 percent of total imports. The trade deficit widened by 19.4 percent to reach MUR 35.7 billion due to expansion in imports in conjunction with modest growth in exports of goods. The current account deficit was expected to deteriorate further to 10.3 percent of GDP in 2012 as economic uncertainty in Europe and the US reduced export performance. For the first nine months of 2012, foreign direct investment (FDI) reached MUR 6.2 billion, about half of which went into real estate, followed by construction at 19.8 percent. During the period, total FDI from
Africa reached MUR 2.6 billion, driven by FDI from South Africa, which, at MUR 2.1 billion, had more than quadrupled since 2007. Following the introduction of the ORR, gross international reserves increased from MUR 81.47 billion (USD 2.78 billion) in December 2011 to MUR 92.99 billion (USD 3.05 billion) in December 2012, representing close to seven months of import cover.

II. INSTITUTIONAL AND STRUCTURAL REFORMS

After some slippage in 2011, Mauritius posted a strong performance in 2012 on the Doing Business indicators, reflecting good progress in business environment reforms. Maintaining its premier position as the easiest place to do business in sub-Saharan Africa for the sixth year running, the country moved five places, to position 19 out of 185 economies, in the 2013 Doing Business Report. For this achievement, Mauritius adopted an electronic information management system at the registrar general’s department that reduced the number of days it takes to register property from 22 in 2011 to 15 in 2012 and improved access to credit information by distributing payment information from retailers.

III. ISSUES NEEDING PARTICULAR ATTENTION

Developments in the Eurozone will continue to be important for Mauritius, underscoring the need for intensifying diversification efforts. The country's negative real rate of interest on savings deposits as well as rising unemployment will need attention. Mauritius' ranking on Transparency International's Corruption Perception Index declined from 39 out of 174 countries in 2011 to 43 in 2012, indicating the erosion of the public's confidence in the authorities' fight against corruption.
HIGHLIGHTS

- After an administrative freeze of four years, public passenger transport prices were increased by 40 percent in November, with considerable social and economic impacts.

- The Government officially launched its own development bank, the Banco Nacional de Investimento. The bank will finance projects and SMEs in key sectors such as agriculture, infrastructure and development.

- Mozambique’s economic performance surpassed initial expectations to achieve a 7.5 percent real GDP growth rate in 2012, 0.2 percent higher than last year, with coal production contributing 0.8 percent.

I. MACROECONOMIC MANAGEMENT OVERVIEW

Economic Growth: Economic activity picked up considerably during the last quarter, achieving 8.9 percent of real GDP growth. Driven by higher-than-expected coal production, which contributed 0.8 percent to the GDP growth rate, the economy experienced a 7.5 percent real GDP growth rate in 2012. Other drivers of growth were sizable FDI inflows and credit expansion to the private sector together with strong infrastructure investment. The economic confidence index, on the rise since July 2012, advanced even further based on the perception of improved demand - in the tourism, food, transport and light industry sectors in particular - offsetting a negative perception for retail and non-financial services. The employment demand perception index reversed its negative trend in December 2012.

Monetary Policy and Banking System: The 12-month average inflation reached 2.1 percent in December, its lowest level since the country embarked on structural adjustment programs in 1987. The overall fall of inflation in 2012 was driven by low prices of imported products (particularly sugar and wheat), the stabilization of fuel prices, and public services. The 40 percent hike in transport prices, set administratively, pushed inflation up from 1.5 percent in October 2012 to 2.5 percent in November 2012, with a slight adjustment back to 2.2 percent in December 2012, mostly due to lower food prices. Core inflation reversed its yearlong negative trend, increasing from 0.6 percent in November 2012 to 1 percent in December 2012, potentially signaling a tipping point. The low inflation and macroeconomic stability allowed the Central Bank of Mozambique to relax its monetary policy in 2012, reducing its key interest rates. In November 2012, the standing lending facility was cut, for the seventh time, to 9.5 percent and the deposit standing facility for the fourth time to 2.25 percent. The monetary policy was yielding results, with private sector credit increasing 8.77 percent in the fourth quarter to an overall annual increase of 18.31 percent, reaching a total of MZN 116.2 billion.

Fiscal Policy: Revenue collection in 2012 achieved 85.8 percent of the budgeted amount. Despite the surge in external revenue collection from the third quarter onwards and the total fulfillment of budget support commitments, overall the external component comprised 59.2 percent of the initially budgeted figure. This result was partially offset by a 103 percent collection of internal revenues. Consumption taxes registered a
minor slowdown, but income taxes grew by 132 percent. State revenues represented 70.5 percent of resources available in 2012 (64.4 percent in 2011); of this, 45.3 percent was from value-added tax (VAT), 37.3 percent from income taxes and 3.2 percent linked to the extractive industries. Revenues from mega-projects increased 21.7 percent in nominal terms, corresponding to 5.7 percent of total revenues. However, it had not compensated for the decrease in external resource collection; which was also reflected on a low execution of external investments (62.4 percent) compared to 72.6 percent in 2011. Overall capital expenditure decreased again, down to 36.6 percent of the total public expenditure, reinforcing the negative trend (39.8 percent in 2011, and 40.8 percent in 2010). The execution performance of the fiscus came short at 75.4 percent, providing some margin for the deficit. On the other hand, current expenditure execution was 96.5 percent, representing 59.8 percent of total expenditure, up 4.3 percent from 2011. The increase is due to higher payroll (50 percent of current expenditure) reflecting the new admission of public officers, particularly in education and health. Also lower were subsidies, as stabilization of prices in international markets allowed for -25 percent in the overall transport subsidy bill. The potential fiscal deficit increase of the USD 875 million from external resources not collected was mostly offset by funds transiting from last year’s savings, which accounted for USD 823 million. Final fiscal deficit was expected to be at 3.6 percent.

**External Position:** The Mozambican metical (MZN) has devalued against the USD by 8.73 percent since the end of 2011, with the fourth quarter alone accounting for more than a third with a depreciation of 3.2 percent. On the other hand, compared with the end of third quarter, the MZN value at the end of fourth quarter stood fast against the ZAR. The 6 percent appreciation of the ZAR against the MZN achieved during the first quarter had now eroded to 4.52 percent. The value of the MZN against the euro had decreased by 10.79 percent in annual terms. The weakening of the MZN against the main trading currencies has pressured the payment of fuel bills. Despite the decrease of USD 37.6 million in the fourth quarter, net foreign reserves of USD 2.656 billion were accumulated by the end of 2012, enough to cover imports of goods and services for 5.8 months.

**II. INSTITUTIONAL AND STRUCTURAL REFORMS**

**New Tax Regime Legislation:** In December 2012, the Mozambican assembly passed a bill altering the legislation on personal income tax, corporate tax, and taxes on alcohol and tobacco. The level of personal income exempted from tax payment was raised from MZN 100,000 (about USD 3,330) to MZN 225,000 per year. The main change in corporate taxes has been a formalization of capital gains tax on transactions abroad, which involve Mozambican assets.
III. ISSUES NEEDING PARTICULAR ATTENTION

**SME Credit and Public Debt Levels:** The main macroeconomic challenge at the moment is credit to local SMEs that can help diversify the economy away from mega-projects and extractive industries. Additional reforms in the financial and banking sector to enhance competition are increasingly important to provide credit to the real economy, and in particular foster the agriculture sector, the main driver for poverty reduction. Another issue that will require further attention is the level of public debt. With the Government contracting nearly USD 1 billion in loans in 2012 to finance infrastructure projects, the Government’s infrastructure development program is quickly increasing the country’s debt levels.

IV. DONOR COORDINATION ACTIVITIES

**Revision of the General Budget Support (GBS) Memorandum of Understanding (MoU):** The current MoU on the provision of GBS to the Government of Mozambique was signed in 2009 and will expire on 17 March 2014. The document is based on the principles set out in Paris and Accra and regulates the management of GBS operations. Keeping the same principles, the MoU revision will also reflect the relevant commitments of the Busan Declaration, potentially accommodating a much wider partnership of actors envisaged in Busan in the Post-Busan Plan of Action.
HIGHLIGHTS

- Economic growth slowed to 4 percent in 2012, down from 4.8 percent in 2011.
- Despite the prevailing expansionary fiscal stance maintained by the Government, the fiscal deficit is expected to improve in 2012/13 mainly on account of large SACU inflows.

I. MACROECONOMIC MANAGEMENT OVERVIEW

Economic Growth: Namibia's real GDP growth is estimated to have expanded moderately at 4.0 percent in 2012, down from 4.8 percent in 2011. Strong performance in primary industries – reflecting the recovery in both diamond and other mining operations following the reopening of Elizabeth Bay mine and the expansion of uranium projects, including Langer Heinrich Mine – drove the country’s economic growth. Increased construction activities – supported by high Government spending on public works through the Targeted Intervention Program for Employment and Economic Growth, which aims to address persistently high rates of unemployment, poverty and inequality – has also underpinned growth. However, poor performance of the agricultural sector, mainly due to a slowdown in cattle exports to South Africa, dragged down the country’s overall growth in 2012. GDP growth was projected to increase by 4.3 percent in 2012, but downside risks, stemming from the faltering global economy and its impact on commodity demand and prices, remained elevated.

Monetary Policy and Banking System: Year-on-year inflation eased in the first half of 2012, reaching 5.6 percent in June 2012 compared with 5.4 percent recorded during the same period in 2011. Thereafter, it continued to rise, reaching 7.6 percent in November, its highest level since August 2009 and above the South African Reserve Bank (SARB) tolerable target of 3.0 to 6.0 percent. Inflation then dropped to 6.3 percent in December 2012, resulting in an annual inflation rate of 6.5 percent for 2012. Annual inflation for 2012 was higher than the 5 percent and 4.5 percent recorded in 2011 and 2010 respectively. Key factors stoking inflationary pressures in 2012 included high oil prices and their consequent impact on transportation costs. The authorities expected inflation to remain within manageable levels over the medium term, although the resurgence in global food and fuel prices, combined with a weakening ZAR, was expected to exert inflationary pressures in the immediate future.

Annual credit extended to the private sector remained strong, growing by 13.9 percent during 2012 compared to 11.3 percent during 2011. Credit to individuals rose by 31.1 percent during 2012, implying that they responded positively to the favorable conditions that prevailed during the year. However, credit extended to the corporate sector remained much lower, at 15.2 percent. The authorities were, therefore, concerned that bank funding for productive economic sectors might be crowded out. This would have put unwelcome pressure on the country’s international reserves. Against the background of the slowing pace of economic recovery, a supportive policy regime was maintained in 2012, with the Bank of Namibia cutting the repo rate by 50 basis points to 5.5 percent in August 2012. The measure of monetary policy easing was necessary in order to further shore up domestic economic growth given that the spillovers from the weakening of global economic conditions continued to remain high.

Source: Namibian Authorities
**Fiscal Policy:** Reflecting high Government spending, which was expected to increase to over 39 percent of GDP in 2012/13, the fiscal deficit for 2012/13 was projected at 2.8 percent of GDP, down from 11.2 percent in 2011/12 and better than the 4.6 percent projected in the 2012/13 budget. Despite the prevailing expansionary fiscal stance maintained by the Government, the improvement in the fiscal deficit position was mainly on account of large SACU inflows since the beginning of the 2012/13 financial year, proceeds from Namibia’s debut Eurobond issuance of USD 500 million in November 2011 to help finance the fiscal deficit, and some tightening on the expenditure front. SACU revenues, which are known in advance, were expected to nearly double during the financial year to NAD 13.9 billion (about USD 1.5 billion) from NAD 7.1 billion received during 2010/11. They were adjusted upward by NAD 2.5 billion (about USD 280 million) thanks to a surplus recorded in 2010/11. The Government authorities intended to maintain a fairly expansionary fiscal policy during the medium-term expenditure framework period to support economic growth. Consequently, the fiscal deficit was projected to average around 4.6 percent of GDP over this period.

**External Sector:** It was estimated that the current account improved slightly, recording a deficit of 0.7 percent of GDP in 2012, compared to 1.7 percent of GDP that was registered in 2011. The improvement reflected large SACU inflows since the beginning of the 2012/13 financial year and a rise in exports, particularly minerals, even though imports payments were estimated to have increased at a faster pace, partly reflecting the effect of the depreciation of the Namibian dollar (NAD). The trade balance was estimated to have deteriorated from 9.6 percent of GDP in 2011 to 13.0 percent. Namibia’s gross reserves were estimated to have stood at NAD 14.6 billion at the end of 2012, equivalent to 3.4 months of import cover, which is sufficient to maintain the currency peg and complies with international benchmarks.

**II. INSTITUTIONAL AND STRUCTURAL REFORMS**

The Government continued to make strides towards enhancing governance institutions and mechanisms in 2012. It started taking the Public Finance Management Bill through the legislative process with the objective of strengthening public management systems, as well as increasing transparency and accountability. A draft Public Procurement Bill was also being reviewed; aimed at modernizing the procurement system, this Bill was expected to be tabled in Parliament in 2013. In August 2012, the Government launched the Namibia Financial Sector Strategy (NFSS) 2010-2020 in order to drive the financial inclusion agenda and bring about a conducive environment for the development of an inclusive financial sector. A notable milestone of the NFSS was the opening of the SME Bank in December 2012. Parliament passed the new Financial Intelligence Act and the Prevention and Combatting of Terrorist Activities Act in 2012 in order to align the regulatory environment with the best international practices.

**III. ISSUES NEEDING PARTICULAR ATTENTION**

The Namibian economy is highly dependent upon commodity-driven growth due to its heavy reliance on the mining sector. It also remains highly vulnerable to commodity price shocks. Namibia, therefore, needs to establish stronger policies and strategies for managing its available mineral resources and promoting value addition of mining products in order to make growth more inclusive and increase the resilience of the country’s medium-term growth prospects.
HIGHLIGHTS

• Due to a pronounced contraction in the real output of the primary sector, mining and quarrying in particular, and slower growth recorded by the tertiary sector, economic activities contracted during the third quarter, registering a real growth rate of just 1.2 percent, down from 3.4 percent during the preceding quarter. The unemployment rate fell by 0.6 of a percentage point, from 25.5 percent in the third quarter to 24.9 percent in the fourth quarter of 2012.

• The success of the Incubation Support Program will depend on the effectiveness of the envisaged private-public partnership in small business development.

• To sustain the democratic gains of the past two decades, all stakeholders – Government, private businesses and labor – should work hand in hand to address the lingering poverty and massive inequality the country has been battling.

I. MACROECONOMIC MANAGEMENT OVERVIEW

Economic Growth: Massive violent strikes in the platinum and gold mines for higher wages during the third quarter of 2012 led to the death of about 45 people and a decline in real mining output by 12.7 percent, dragging economic growth during the quarter down to 1.2 percent from 3.4 percent in the second quarter. In addition to the generally difficult operating conditions, escalating cost pressures, subdued global demand and lower international commodity prices further aggravated the poor growth performance of the mining sector during the quarter. On the other hand, due to the rise in real domestic final demand and stronger export demand for certain categories of manufactured products, economic activities in the manufacturing sector expanded by 1.2 percent contributing 0.2 percentage points to economic growth during the quarter. The unemployment rate declined by 0.6 percentage points from 25.5 percent in the third quarter to 24.9 percent in the fourth quarter of 2012 due mainly to the decrease in the labor force. The labor absorption rate declined marginally from 41.3 percent during the previous quarter to 41 percent in the fourth quarter while employment declined by 68,000 units.

On the demand side, growth in aggregate real gross domestic expenditure decelerated to 3 percent from 4.9 during the second quarter. This was mainly due to slower growth in households’ real final consumption expenditure, which declined to 2.6 percent during the third quarter from 3.1 percent in the preceding quarter. Household consumption was depressed mainly as a result of the decline in growth in real disposable income from 3.5 percent during the previous quarter to 2.6 percent during the third quarter, reflecting modest employment gains during the period. The increase in household consumption expenditure did not, however, put undue pressure on household debt levels, and the ratio of the household debt to disposable income remained at the same level of about 76 percent both in the second and third quarter of 2012. Nevertheless, the reduction in the interest rate led to decline in the debt service to disposable income ratio from 6.9 percent in the second to 6.5 percent in the third quarter.

Real gross fixed investment by the private business enterprises accelerated marginally to an annualized rate of 2.8 percent in the third quarter of 2012 mainly due to higher capital outlays in the finance and construction sectors. Driven by the sustained robust pace of expenditure by the electricity and transport sectors, growth in real fixed capital expenditure by public corporations accelerated from 7.9 percent in the second quarter to 9.3 percent in the third quarter of 2012. Economic growth was likely to be revived during the fourth quarter of 2012 as widespread labor unrest in the mining sector subsided although weaknesses in in the global economy continued.

Monetary Policy and Banking System: Consumer price inflation accelerated to 5.7 percent in December 2012 from 5.6 percent both in October and November due mainly to the increase in food and fuel costs. In spite of the upside risk to inflation due mainly to pressure from food prices, depreciation of the rand exchange rate, possible high trends in wage settlements, and the planned rebasing of the CPI basket.
by Statistics South Africa in January 2013, the SARB left the discount rate at 5 percent during its November 2012 MPC meeting. Benign demand pressure on inflation, signs of moderation in consumption expenditure, a persistent negative output gap and a downside risk to the growth outlook all underpinned the MPC’s decision. Administered price inflation – including prices of petrol, electricity and municipal levies – remained significantly higher in the fourth quarter of 2012, reaching 8.8 percent in December compared to 7.5 percent in July 2012. Administered prices have risen by 10.3 percent over the past year. Rising international food prices and higher petrol costs combined with a weaker exchange rate were expected to place upward pressure on consumer prices during 2013. Core inflation was also on the rise, having measured 4.9 percent in December, up from 4.6 percent in June 2012.

**Fiscal Policy:** During the first half of the 2012/13 fiscal year, national Government recorded a primary deficit of ZAR 59 billion or 3.7 percent of GDP – significantly lower than the 4.5 percent recorded during the same period previous year. At the end of December 2012, total cumulative tax revenue net of SACU payments reached ZAR 552 billion, while total expenditure reached ZAR 703 billion. During the fourth quarter of 2012, total tax revenue net of SACU payments reached ZAR 197 billion compared to ZAR 175.3 billion during the previous quarter. On the other hand, total Government expenditure slowed to ZAR 238 billion compared to ZAR 251.2 billion during the previous quarter. During the first half of the fiscal year 2012/13, budget deficit slowed to 6.5 percent of GDP compared to 7.1 percent during the same period the previous year. Domestic debt continued to increase from ZAR 1.1 trillion as at 31 March 2012 to ZAR 1.1 trillion as at the end of September. Foreign debt declined from ZAR 117 billion to ZAR 115 billion between March and September 2012 mainly due to net redemptions of foreign debts and loans. Total gross loan debt of national Government, consisting of domestic and foreign debt, increased considerably, from ZAR 1.2 trillion in the first quarter to ZAR 1.3 trillion at the end of September 2012 reaching 40.2 percent up from 39.5 percent in March 2012.

**External Sector:** Trade deficit increased in October to its widest level in over four years, reaching ZAR 21.2 billion from ZAR 13.8 billion in September 2012 due to slower growth in exports and rapid expansion in import demands. But trade deficit improved substantially, falling to ZAR 7.9 billion and ZAR 2.7 billion in November and December 2012 respectively. The trade balance had been in deficit for 12 consecutive months. The cumulative deficit for 2012 as a whole reached ZAR 117.7 billion. This is likely to widen the current account deficit for 2012 to over 6 percent compared to 3.3 percent for 2011, thereby putting pressure on the authorities to attract sufficient capital inflows to cover the gap. The current account deficit had already widened to 6.4 percent of GDP in both the second and third quarter, up from 4.9 percent during the first quarter, due to deterioration in trade and services accounts. Foreign capital inflows amounted to ZAR 56.8 billion during the third quarter, up from ZAR 48 billion in the second quarter of 2012, while FDI increased from ZAR 6.6 billion during the second quarter to ZAR 22.2 billion during the third quarter of 2012. A widening current account deficit was considered to be one of the main risks to the stability of the rand.

**II. INSTITUTIONAL AND STRUCTURAL REFORMS**

Towards the end of the third quarter of 2012 the Government launched its Incubation Support Programme that is aimed at nurturing SMMEs into sustainable enterprises that can provide employment and contribute to economic growth. The Programme became effective on 1 October 2012 and will be administered for a period of 10 years, up to March 2022. Private businesses have been invited to come forward to partner with Government to create 250 new incubators by 2015. The Government-provided package of support involves cost sharing arrangements of 50:50 with large businesses and 40:60 with small and microbusinesses.
III. ISSUES NEEDING PARTICULAR ATTENTION

The continued violent industrial action in the mining sector is a reflection of much deeper structural problems in the South African economy. In spite of remarkable economic performance during the previous decade following the democratic transition in the mid-1990s, the country remains the most unequal society in the world. The majority of the population’s expectation for a better life has never materialized due to the combination of the lack of Government capacity and the high concentration of economic activities. In order to sustain the democratic gains of the past two decades, all stakeholders – Government, labor and business – should work hand in hand to effectively address the current economic malaise.
HIGHLIGHTS

- Although the Government estimates positive economic growth for 2012 at 0.2 percent, indications were that economic contraction might have taken place in 2012.
- The proposed Consumer Credit Act likely to improve access to credit by the SMEs that had not benefitted from the growth in the financial services sector. Access to credit remains very low as revealed in the 2012 FinMark survey.

I. MACROECONOMIC MANAGEMENT OVERVIEW

Economic Growth: A depressed SME sector, continued investor pessimism and an underperforming export sector are likely to have caused economic contraction in 2012. The Government, however, estimated that the economy grew by 0.2 percent. Structural constraints largely accounted for the subdued growth despite the significantly improved fiscal balance in 2012. Swaziland is expected to continue on the low growth path for 2013, with real growth projected at 0.7 percent and further improving to about 2 percent for the outlook period. Weak economic and political governance are major challenges to high and inclusive growth. On a positive side, the re-launch of the Investor Road Map in 2012, if implemented, would represent major steps forward. Although Swaziland’s economy is highly dependent on that of South Africa as a major destination for its exports and a source for imports, signs of worsening labor relations could provide a boost in its manufacturing sector. If the investment climate improves, Swaziland’s relatively healthy labor conditions could entice some South African based firms to relocate. On the supply side, an exceptionally good summer season is likely to boost agricultural output and bring a recovery to food related manufacturing activities. A likely expansionary fiscal stance, following the expected high transfers from the SACU, may also boost construction related activities. However, the demand side may remain depressed, as reflected by the contraction in household credit. In addition, the external sector’s performance will hinge on global and regional growth, which has remained uncertain until now.

Monetary Policy and Banking System: During the last quarter of 2012 base money grew by about 19 percent, while broad money supply increased by 4 percent compared to 9.6 percent during the previous quarter. The slowdown in money supply growth was also reflected in small increases in total credit on a quarterly basis. Total credit increased by about 5 percent in the last quarter of 2012 compared to the third quarter. On a year-on-year basis, however, total credit declined by almost 4 percent. The decline in annual total credit was due mainly to decreases in credit to the agriculture and forestry, construction, and household sectors. Contrary to expectations, the decline in credit took place when interest rates remained relatively low, with prime lending rates at 8.5 percent. For 2012, average inflation stood at 9 percent. The decrease in inflation in the third quarter of 2012 was reversed in the last quarter of the year. In spite of the easing pressures in December, fourth quarter year-on-year inflation was 8.3 percent. Compared to its regional peers, Swaziland continued to experience the highest levels of inflation, which invariably affected its competitiveness. As in the third quarter, increases in the prices of health
care (15.3 percent) and food and non-alcoholic beverages (13.4 percent) were the main drivers of inflation. These two categories constitute more than 50 percent of the consumption basket. Despite the upside risk in inflation, especially due to the depreciation of the Swaziland lilangeni (€) against major currencies, the good agricultural season was expected to moderate price increases for the outlook period. With an accommodative monetary policy in place (5 percent discount rate and 8.5 percent prime lending rate) the expected recovery in Government expenditure following another windfall from SACU receipts may have put further pressure on the exchange rate.

Overall, gross official reserves have been increasing – end-period levels have shown an upward trend. Reserve levels, however, depict a pattern where they are high at the beginning of the period and fall during the next consecutive months before another receipt of SACU revenues comes in. This pattern clearly shows the vulnerability of the reserve position. A commitment to build a reserve buffer at a particular level may therefore be necessary to enhance confidence in the economy.

The FinMark survey on access to financial services concluded that despite the soundness of the financial sector, largely reflecting the discipline that the South African banks have brought to the market, its coverage remained narrow. About 44.4 percent of the adult population does not use any formal or informal banking facilities – they are financially excluded. Yet Swaziland does not yet have any strategy for financial inclusion. The four commercial banks, although highly liquid, continued to focus on conservative financial products and services, completely avoiding activities considered risky.

**Fiscal Policy:** Following a windfall increase in SACU revenue transfers of almost 150 percent (€7.1 billion compared to €2.9 billion the previous year), a primary fiscal surplus of 0.03 percent was now expected down from a budget estimate of 2.3 percent. This still represented a huge improvement compared to a deficit of 5.4 percent in the 2011/12 fiscal year. Government had cleared €980 million of the total €1.5 billion (4.7 percent of 2012/13 GDP) it owed at the beginning of the current fiscal year. Government also reached an agreement to secure €720 million owed to the Public Service Pension Fund. As at end-March 2012, payments arrears stood at about, of which an estimated €400 million (1 percent of GDP) is still to be paid off – most of which is owed to quasi-Government institutions and the private sector.

On the expenditure side, the wage bill allocation was exceeded due mainly to an increase in public service posts. Capital expenditures were cut by an even larger margin, declining by almost 50 percent, and amounted to €1.02 billion. Private sector firms dependent on Government, especially those in construction, were seriously affected, while suppliers of consumables were affected by the arrears accumulation.

On the revenue side, the challenge was that only 40 percent of revenues were collected domestically. With the private sector struggling to increase its share of GDP, especially as most contracts originate from Government, reducing dependence on SACU revenues remained a challenge for the medium-term outlook. Reflecting the job losses that had been associated with the fiscal crisis, the personal income tax revenue category was expected to be below target by year-end, but VAT collection had exceeded
the budget. Maintenance of the SACU revenue transfers for 2013/14 at the same level as for 2012/13 will provide Government with an opportunity to increase its expenditures and boost growth. The impact of the likely increase in Government expenditure, however, will depend on whether productive sectors are allocated significant increases in the forthcoming budget.

The declining trend in Treasury Bills interest rates were a welcome development, especially as domestic debt had risen from only 1.5 percent of GDP in 2009/10 to about 9.0 percent in 2012/13. As a result, overall public debt increased to 15.9 percent in 2012/13 from 14 percent in 2010/11. Treasury Bills interest rates had fallen from the peak of 7.5 percent in May 2012 to 6.5 percent in December 2012. The decline in the Treasury Bill interest rates had helped reduce the interest differential between Swaziland and South Africa, which could be a signal of reduced risk perceptions.

**External Sector:** The first two quarters of 2012 were characterized by lower export receipts compared to the same period in 2011. Reduced economic activity in 2012 is likely to have resulted in an improved trade deficit compared to 2011. On a quarter-by-quarter basis, both the current account and the balance of payments turned positive during the second quarter of 2012 after having been consistently in deficit for the whole of 2011 and the first quarter of 2012. Net FDI is also likely to have declined in 2012 compared to 2011. A total of E$ 761 million net FDI was received in 2011, whereas a negative E$ 106 million was received during the first half of 2012. These developments on the external accounts are likely to have pulled growth down. A recovery in the manufacturing sector, which accounts for the greatest share of exports, and an improved investment climate are therefore critical in ensuring growth revival.

**III. DONOR COORDINATION ACTIVITIES**

Efforts by the Ministry of Economic Planning and Development during the last two years were beginning to yield positive results with regard to donor coordination. A sector-wide approach had been adopted, initially focusing on four sectors: health, agriculture, education, and water and sanitation. The health sector group was already functional, and in addition, the AfDB had started the process of operationalizing the agriculture and food security group.

**IV. ISSUES NEEDING PARTICULAR ATTENTION**

The expected second windfall from the SACU common revenue pool for the 2013/14 fiscal year was expected to further ease the fiscal challenges that Swaziland was facing in the aftermath of the global financial crisis. Prudent management of the resources is critical in ensuring that the Government uses this window of opportunity to deepen reforms and build a more resilient economy. Continued engagement with Government remains important. The AfDB will therefore need to explore ways of further deepening dialogue to support structural reforms.
ZAMBIA

HIGHLIGHTS

• The Zambian economy was estimated to grow at 7.3 percent for 2012, and for 2013 growth was projected to increase to more than 8 percent, despite a more conservative Government growth target of only 7 percent.

• The Government released the 2013 State Budget in October with the theme ‘Delivering Inclusive Development and Social Justice’.

• The main sectors that received increased allocations include transport and energy, education, and health.

I. MACROECONOMIC MANAGEMENT OVERVIEW

Economic Growth: The economy continued to show strong growth despite a small downward correction in estimates during the year. Real growth was estimated at 7.3 percent for the year 2012. The downward correction in growth was attributed to lower than expected output from the mining, electricity, gas and water, and the restaurant and hotel service sector. Construction, manufacturing, and transport and communications were demonstrating strong performance in growth. For 2013 growth is expected to surpass 8 percent due to new investments in the mining sector that will go into the production phase. Initial indications are also that agriculture will pick up in 2013. However, the Government’s own growth target is conservative, with a 7 percent growth rate.

Monetary Policy and Banking System: Inflation had showed a gradual upward increase since July 2012. The year-on-year estimate after the first six months of 2012 was 6.5 percent and had increased to 7.3 percent for December 2012. This was slightly higher than the Government’s target of 7 percent. Inflationary pressure had mainly been driven by the increasing food prices that had been on the rise since May 2011. Year-on-year food price inflation reached 8.4 percent by December 2012. On the other hand non-food prices had, since May 2012, been declining until the fourth quarter of 2012, when they reached their bottom of 5.4 percent. During November and December non-food prices increased to 6.1 percent for the full year 2012.

Inflationary pressure had promoted the MPC of the Bank of Zambia to increase the benchmark policy rate by 25 basis points to 9.25 percent in November. Inflation was still at a comfortable level, giving the Bank of Zambia room for some maneuvering, but the Zambian MPC did note that there was a risk of inflationary pressure from excess liquidity in the market, rising stock feed prices that could contribute to higher meat prices and a global grain deficit that could increase prices of domestic and imported grains.

During the past six months the Zambian kwacha (K) had depreciated to the dollar from 4.86 in July 2012 to 5.21 in December 2012. The increase in the policy rate had contributed to the stabilization of the exchange rate in the fourth quarter.
Fiscal Policy: Strong fiscal performance continued in the fourth quarter. Domestic revenues and budget support were 5.5 percent above the target. During the same period, expenditures were slightly lower than programmed due to absorption capacity, particularly in the road sector. The budget deficit was therefore not expected to surpass the target of 4.3 percent of GDP for the full year.

The 2013 State Budget was released in October with a total spending target of K 32.2 billion (26.6 percent of GDP). Domestic revenues will finance K 24.7 billion, grant aid K 1.5 billion, and external and domestic borrowing the remainder. The main spending areas include transport and energy, education, and health receiving 18.1, 17.5 and 11.3 percent of the annual budget respectively.

External Sector: Zambian exports continued to grow for the third quarter in a row with a slowing down in the fourth quarter. Total merchandise exports at the end of fourth quarter amounted to USD 2.5 billion with total merchandise imports increasing to USD 2.3 billion. Because of a slower increase in exports and a faster pace in imports, the trade surplus declined to USD 299 million in the fourth quarter, down from USD 506 million in the third. The total trade surplus for 2012 amounted to USD 1.4 billion – considerably lower than the USD 2.2 billion trade surplus for 2011.

Although copper was the main export product it is worthwhile to note that non-traditional exports were continuing to show strong growth. Non-traditional exports increased to USD 867 million in the fourth quarter, up from USD 514 million a year earlier. At this level, non-traditional exports account for more than 34 percent of total exports. Gross international reserves grew to USD 3.34 billion in November 2012, up from USD 2.58 billion in July 2012.

II. INSTITUTIONAL AND STRUCTURAL REFORMS

The Government of Zambia is continuing its PFM reforms. In late September 2012 the Zambian cabinet approved the new three-year PFM strategy for the 2013-15 period. The strategy covers 10 thematic areas, including capacity building and legislative reforms.

The 2013 state budget also indicated as part of the tax reforms that the tax system would be simplified, so that tax receipts from SMEs could be improved, and the tax administration modernization process would be continued. Even though there had been concerns with the slow progress in the decentralization program, Government continued to move ahead with the introduction of revenue sharing arrangements with councils; and decentralized procurement functions for ministries, provinces and other spending agencies.

III. DONOR COORDINATION ACTIVITIES

The joint annual review of the Poverty Reduction Budget Support Programme was initiated towards the end of fourth quarter and was expected to be completed during the month of February 2013. Two important issues that will be raised include the large increases in infrastructure investments – particularly roads, with the bearing this has on maintaining the current road network that is falling into disrepair – and the large and increasing subsidies for maize purchases and fertilizer support.

IV. ISSUES NEEDING PARTICULAR ATTENTION

The USD 750 million Eurobond issue that took place in September 2012 started to prompt concerns about debt management and its concomitant future debt sustainability issues. Although there were potential investments in state enterprises – including roads, electricity, and rail – totaling USD 4.5 billion, the Ministry of Finance was clear that there were no plans to issue any new bonds for the moment.

Towards the end of the period under review the Bank of Zambia announced that lending interest rates for financial institutions would be capped in order to stimulate lending. Commercial banks were capped at 18 percent and microfinance institutions at between 30 and 42 percent depending on loan types. The coming period will give an indication of how the financial sector will react to the new regulation.
HIGHLIGHTS

- GDP growth for 2012 was estimated at 4.4 percent due to the adverse effects of drought on agricultural output.

- Most economic challenges that faced Zimbabwe in 2012 may spill into 2013. Notable challenges included limited financing for productive sectors, high average lending rates and uncertainty concerning national elections, which may adversely influence investor confidence, particularly in the first quarter of the year.

- The fiscal space remained severely constrained because of the poor performance of domestic revenue inflows against the background of rising recurrent expenditures.

- Inflation ended the year at 2.9 percent – well below the projected 5 percent mark.

I. MACROECONOMIC MANAGEMENT OVERVIEW

Economic Growth: Real GDP growth was projected to decelerate to 4.4 percent in 2012 from an estimated 9.4 percent in 2011, reflecting a slowdown in economic activity, particularly from the agricultural sector. Most economic challenges that faced Zimbabwe in 2012 may spill into 2013. Challenges facing the economy included limited financing for productive sectors and high average lending rates. In addition, uncertainty concerning national elections was expected to adversely influence investor confidence, particularly in the first quarter of 2013. This notwithstanding, economic growth for 2013 was projected at 5 percent based on the assumption of gains in agriculture as rains normalized, and in mining, where capacity was expected to be brought online.

Monetary Policy and Banking System: Annual growth in broad money supply (M3), defined as total banking sector deposits (net of inter-bank deposits), was on a declining trend during the final quarter of 2012. M3 declined from 33.2 percent in December 2011 to 28.0 percent in December 2012. The decline in M3 growth was a negative development in an economy facing liquidity challenges. Low average incomes, weak depositor confidence and high bank charges still constrained deposit mobilization in the formal banking sector.

Annual total banking sector deposits increased from USD 3.10 billion in December 2011 to USD 3.97 billion in December 2012. However, the annual growth rate declined from 33.2 percent in December 2011 to 28.0 percent in December 2012. On a month-on-month basis, total banking sector deposits increased by 3.8 percent from USD 3.82 billion in November 2012 to USD 3.97 billion in December 2012.

Annual inflation declined from 4.9 percent in December 2011 to 2.9 percent in December 2012 thanks to, among other factors, steady oil prices, low aggregate demand in the face of the prevailing liquidity constraints, and limited capital inflows. The rate of inflation is likely to remain stable in the short term due to the continued use of the multicurrency regime and relatively stable oil and food prices.
On a month-on-month basis, inflation for December 2012 did not change from the November 2012 figure of 0.1 percent. Month-on-month food and non-food inflation stood at 0.3 percent and 0.1 percent respectively. At 1.8 percent, the inflation in the alcoholic beverages and tobacco category (with a weight of 4.9 percent in the CPI basket) was the main driver of month-on-month inflation in December 2012. Zimbabwe’s inflation closed the year within the targeted figure for 2012.

The range in nominal lending rates for individual commercial (10-35 percent) and merchant banks (15-25 percent) continued to be high and wide across the banks by the end of 2012, signaling the need to address funding and interest rate challenges facing the economy. More importantly, beginning November 2012, merchant bank upper limits on quoted lending rates declined from 35 percent to 25 percent. However, the lower limit on merchant bank lending increased from 13 to 15 percent in December 2012, while that for commercial banks increased from 6 to 10 percent. These developments imply that borrowing has become more expensive for borrowers with low capacity and cheaper for borrowers with high capacity. The prevailing pattern in lending rates was unfavorable for borrowers with limited capacity. It also implied that following these changes, some borrowers with low capacity have been priced out of the market.

In December 2012, the range of commercial bank three-month and savings deposit rates remained at the November 2012 levels of 4 to 20 percent and 0.15 to 8 percent, respectively. The range in commercial bank three-month deposit rates is still wide across individual banks (4-20 percent), suggesting different capacities by banks to reward depositors.

**Fiscal Policy:** Cumulative Government revenues for 2012 amounted to USD 3.496 billion and were 4.12 percent lower than the projection of USD 3.640 billion. Underperformance of Government revenues can be attributed to Treasury’s failure to realize projected diamond revenue. Figures from the Zimbabwean Ministry of Finance show that only USD 45.7 million had been received from diamond sales by end-November 2012, against an initial projection of USD 600 million. Government would, therefore, need to improve transparency and accountability in the management of mineral revenues.

Cumulative expenditures to December 2012 amounted to USD 3.608 billion, of which the capital budget amounted to USD 301.66 million, while recurrent expenditures amounted to USD 3.217 billion (89.18 percent). Government therefore incurred a fiscal deficit of USD 111.89 million. To achieve fiscal sustainability, Government would need to ensure that total expenditures are contained within the available resource envelop while at the same time maintaining an expenditure mix that prioritizes growth-enhancing capital projects.

The Budget deficit is projected to worsen in 2013 on the back of anticipated underperformance of diamond revenues and increases in spending ahead of elections.

**External Sector:** The current account balance continued to be in deficit in the final quarter of 2012. Exports stood at USD 3.15 billion during the period January to October 2012, a small increase compared to the same period in 2011. Despite the lower performance of exports in 2012, there was a noticeable improvement in the trade deficit, which totaled about USD 2.59 billion, an improvement of about 34 percent compared to the same period in 2011. The improvement in the trade deficit was largely spurred by the drastic fall in imports in 2012. Imports, which totaled about USD 6.1 billion, fell by about 17 percent in 2012 compared to the same period in 2011. While a number of factors have been advanced for the fall in imports in 2012, one possible factor was the drop in imported second hand vehicles, as the deadline for the proposed ban on the import of second hand vehicles loomed. Statistics from the Zimbabwe National Statistics Agency show that the value of motor vehicle imports, including public transport vehicles and tractors, was about USD 767.62 million between January and July 2011, falling by about 57 percent to USD 329.16 million for the same period during 2012.

The poor performance of exports was a reflection of the local industry’s low production capacity and the absence of diversification and value addition. For example, during the period January to October 2012, mineral exports accounted for 64 percent of all exports, followed by tobacco at 19.4 percent. Thus, about 83 percent of exports were raw materials, emphasizing the need to broaden the export base to also include semi-processed commodities.

**II. INSTITUTIONAL AND STRUCTURAL REFORMS**

On 23 October, the IMF Executive Board relaxed most restrictions on technical assistance to Zimbabwe, paving the way for the implementation of economic programs that will be monitored by the IMF. The IMF Executive Board also resolved to reinstate technical assistance in new areas aimed at extending support to Zimbabwe’s formulation and implementation of a comprehensive adjustment and structural reform program. These areas include: (a) tax policy and administration, (b) PFM and expenditure policy, (c) financial sector reform, (d) central bank reform, (e) monetary and exchange policies, (f) macroeconomic statistics, (g) anti-money laundering and combating the financing of terrorism and (h) any other area that would support the formulation and implementation of a comprehensive adjustment and reform program that can be monitored by the staff. On
the basis of progress made so far by the Government of Zimbabwe, it was expected that the IMF and the Zimbabwean Government would sign off a 12-months staff monitored program effective January 2013.

In addition, the Government disclosed a number of institutional and structural reforms in the 2013 budget speech. In particular, the following pronouncements were made for the financial sector given its key role in lubricating the economy:

**Increase in Minimum Capital Requirements for Insurance Companies and Pension Funds:** The increase is intended to improve the financial strength of insurance and pension companies, which are key pillars of the capital market.

**Removal of Bank Charges on Deposits of up to USD 800:** This measure is intended to enhance savings mobilization from low-income earners and improve depositor confidence.

**Issuance of Debit Cards without Application:** The proposed automatic issuance of debit cards is expected to enhance financial transactions and resolve the small change problem.

**Proposed Banking Sector Ombudsman:** The proposed establishment of the Ombudsman office is expected to deal with aggrieved bank customer issues and be a watchdog that enforces adherence to good banking practices without prejudicing bank clients.

**Proposed Establishment of a Credit Rating Bureau:** The proposed credit rating bureau is intended to alleviate some of the challenges relating to the non-disclosure of critical information of the creditworthiness of borrowers in the financial sector. This may reduce the levels of non-performing bank loans. This institution is critical in an environment where non-performing loans are building up and the demand for bank credit is increasing.

**Reserve Bank of Zimbabwe and Bankers Association of Zimbabwe MoU on the Definition of Lending Rates:** This measure was a response to the outcry on the high lending rates, low deposit rates and high bank charges. Lending rates quoted by different banks ranged from 6 to 35 percent for commercial banks and 13 to 25 percent for merchant banks respectively by the end of 2012.

**Paid-Up Permanent Shares (PUPS):** Government will reinstate the tax-free status on PUPS from the beginning of 2013. PUPS enable building societies to raise funding for periods of up to two years. They are designed to mobilize private sector funds for housing by enhancing building societies’ competitiveness in attracting deposits.

III. Donor Coordination Activities

While there were several donor coordination activities during the review period, the following are worth mentioning:

(a) The Friends of Zimbabwe Forum (FOZ) in Tokyo: In October the AfDB co-chaired another round of the FOZ forum alongside the World Bank/IMF annual meetings in a continued effort to garner support for financing in Zimbabwe in general and debt relief in particular.

(b) Donor consultation meetings: The AfDB’s Zimbabwe Field Office hosted a number of donor consultation meetings during the quarter, including with the Southern African Parliamentary Support Trust. The aim of these meetings was to discuss the Trust’s work with parliaments in the SADC region on the budget process, the establishment of independent parliamentary budget offices, Australian aid, progress in terms of Zimbabwe Multi-Donor Trust Fund activities, etc.

(c) Thematic sessions: The Zimbabwe Field Office also participated in thematic sessions including the monthly meetings with the World Bank to discuss current policy advisory, knowledge work and technical assistance activities undertaken by the two institutions; a high level forum to launch the African Capacity Building Foundation supported Zimbabwe Capacity Development Program; the PFM meeting between donors and the office of the Zimbabwean accountant general; the UN Development Program brown bag event on leveraging debt sustainability; donor discussions on the 2013 budget, etc.