I. REGIONAL OVERVIEW

Economic activity in Southern Africa remained quite strong in the second quarter, giving optimism that the region is on course to attain a projected annual average growth rate of 4.4 percent. Angola witnessed a pickup in growth in the non-oil sector, which combined with strong oil production to maintain a healthy second quarter performance. Botswana sustained its strong growth on the back of a resurfacing mining sector. However, recent adverse weather conditions in the country moderated overall growth during the second quarter. Growth was positive in Lesotho, largely reflecting good performance in the mining and textile sub-sectors and in construction. Similarly, in Malawi growth was strong in the second quarter, with the main drivers being stronger agricultural output, especially maize production and the positive effect of improved tobacco prices on output. Growth accelerated moderately in Mauritius, with strong performance in financial services and information and communications technology (ICT). In Mozambique, the second quarter performance was also moderate with the limiting factor being major flooding that affected the agricultural provinces. Growing output from the agricultural and mining sectors as well as rising construction activity underpinned Namibia’s strong performance in the second quarter. São Tomé and Príncipe also maintained strong second quarter performance on the back of major infrastructure projects from the first quarter and strong growth in the services sector. Growth remained rather subdued in South Africa due to falling consumer demand, depressed manufacturing activity and the adverse impact of continued weakness in the European markets. Similarly, Swaziland saw depressed economic activity in the second quarter as the precarious fiscal situation constrained investment activity. In Zambia, the outbreak of armyworm early in the planting season combined with poor rainfall to hamper agricultural production – particularly maize production – and overall economic activity. Continued problems in the agricultural sector as well as depressed manufacturing activity hampered the second quarter growth performance in Zimbabwe.

Growth performance in Southern Africa is benefiting from prudent macroeconomic policies, which are becoming a mainstay in many countries. Fiscal restraint has contributed to easing inflation across the region. Inflation in Southern Africa is expected to slow down slightly to 6.1 percent in 2013 from 6.8 percent in 2012, and in several countries the second quarter performance was in line with the decline. Inflation was subdued in Botswana, Lesotho, Mauritius, Mozambique, Namibia, São Tomé and Príncipe, Swaziland and Zimbabwe. On the other hand, inflation rose slightly in Angola due to high food and fuel prices. Malawi faced high inflationary pressures from the recent upward adjustments in the prices of maize and gasoline. Similarly, pressure from food and oil prices and the weakness in the South African rand (ZAR) kept inflation high in South Africa. In Zambia, increases in fuel prices largely explained the rising inflationary pressures.

Strong adherence to institutional and structural reforms continues to aid the growth and development effort in Southern Africa. In Angola, the new Oil Sector Foreign Exchange Law is expected to give fresh impetus to rising liquidity in the banking sector. Botswana’s adoption of the mid-term review (MTR) of the 10th National Development Plan will help fast track the development process. In Lesotho, the desire to attract more foreign direct investment (FDI) has led to the unveiling of specific plans targeting investors from France, Belgium and Switzerland. Malawi has re-instated the Malawi-Mozambique Transmission Interconnection Project to enhance the country’s energy capacity. Mozambique approved a new petroleum law to strengthen the development of the country’s recently discovered hydrocarbons. In Namibia, the Government embarked on a process to reform the public procurement system. Likewise, São Tomé and Príncipe is implementing the SAFE public finance management system to enhance transparency and accountability in the management of public funds. During the second quarter, South Africa amended the Special Investigating Units and Special Tribunals Act in an effort to improve the effectiveness of the criminal justice system. The Swazi authorities took steps to enhance public financial management (PFM), with the Cabinet approval of the PFM Bill. The approval of the Communication Commission and Electronic Bill in Swaziland will also introduce much needed
liberalization in the telecommunication industry. Zambia has taken steps to remove some Government subsidies on fuel and maize millers, long seen as unaffordable. In Zimbabwe, significant progress continues to be made towards finalizing negotiations with the International Monetary Fund (IMF) in the country’s drive to re-engage with the international community.

Going forward, Southern African countries’ continued adherence to strong macroeconomic and structural reforms will be key for accelerated and inclusive growth. In Angola, the need for Government to enhance greater domestic resource mobilization by broadening the tax base has become imperative. Although the Government in Botswana has taken cognizance of substantial delays and poor performance of various mega projects in the country, action now needs to be taken to address the situation, including Government’s enhancing supervisory capacity. In Malawi, there is a need for policy continuity to curb rising inflation and exchange rate instability.

In Mauritius, external sector vulnerabilities will remain a major risk factor for inclusive growth unless there are renewed efforts at structural reforms to enhance the country’s global trade and investment competitiveness. The IMF recently downgraded Mozambique’s debt distress level, raising concern over debt management, particularly the increasing acquisition of non-concessional financing. São Tomé and Príncipe has to address the fragile political outlook that might delay implementation of key reforms and lead donors to withhold pledged funds. In South Africa, an energy deficit continues to constrain economic growth and rapid industrialization. The endless labor unrest in the mining sector also remains a destabilizing factor, eroding investor confidence in South Africa. Zambia has to maintain vigilance in monitoring the sustainability of the Public Sector Wage Bill.

Key Macroeconomic Indicators for SADC Countries (2012)

Source: International Monetary Fund, World Economic Outlook Database, April 2013
II. COUNTRY ANALYSES
HIGHLIGHTS

• Angola’s economic growth remains robust amid volatile international oil prices.

• A new foreign exchange law for the oil sector is expected to boost economic growth.

• Domestic resource mobilization remains key to enhance efficiency in tax collection.

I. MACROECONOMIC MANAGEMENT OVERVIEW

Economic Growth: Angola continues to experience rapid economic growth and macroeconomic stability. The authorities expect robust gross domestic product (GDP) growth of 7.1 percent in 2013, although it is slightly lower than the 7.4 percent registered in 2012. Non-oil output decelerated in 2012 compared to 2011 but is expected to grow by 8.7 percent in 2013. On the external sector side, the volatile oil prices pose a risk to the country’s economic growth. Oil production increased from 44.54 million barrels in February to 55.7 million barrels in April 2013 as technical disruptions in some oil production blocks were solved; in particular, the recovery in the Pazflor oil block had a significant impact. Notwithstanding this growth, cumulative oil revenues from January to May 2013 stood at United States dollar (USD) 15.07 billion (USD 2.98 billion lower than the level registered in similar period of last year). The decline in international oil prices from USD 108.2/barrel in December 2012 to USD 100.6/barrel in May 2013 is one of the critical factors behind this weaker than expected oil revenue performance. In the real sector, agricultural output witnessed a slight improvement despite the prevailing drought in the southern parts of the country. Electricity and other public utilities grew by 5.4 percent over the quarter but still fail to match growth in demand. Given the low quality and coverage of basic services (water, electricity and roads), infrastructure development is critical for Angola to sustain its high growth, increase competitiveness and further reduce poverty levels.

Monetary Policy and Banking System: Government’s macroeconomic adjustment efforts continue to pay dividends. Annual inflation increased from 9 to 9.25 percent between April and May before declining to 9.19 percent in June 2013. The major factor driving inflation is related to significant increases in food and non-alcoholic beverage prices, which account for 57 percent of the consumer price index (CPI) composition. Preliminary data from the National Bank of Angola indicate an expansion of total deposits by 0.60 percent in May 2013. Interest rates also displayed a declining trend for all maturities. Monetary expansion has been very weak, mainly because of low budget implementation and liquidity injected into the economy. As a result, private sector credit only grew by 1.20 percent in June following the 1.54 percent growth registered in May 2013. Nonetheless, this is expected to improve in the following quarters as Government expenditure picks up. The kwanza (AKz) depreciated by 1.03 percent against the USD in June 2013, having closed the second quarter of the year at AKz/USD 96.3. Coupled with lower inflation, the depreciation significantly reduced the overvaluation of the real exchange rate. To stabilize the exchange rate, the National Bank of Angola increased the liquidity injections in the market from USD 1.2 billion in March to USD 1.8 billion in May 2013.
**Fiscal Policy**: The 2013 state budget projects total revenues of USD 46.4 billion and total expenditures of USD 52.1 billion (excluding debt service), which will translate into a fiscal deficit equivalent of 3.8 percent of GDP. Budget implementation for 2013 was slightly delayed due to a late parliament approval and slow implementation. Notwithstanding the challenges, preliminary data from the Ministry of Finance indicates that stronger oil revenues more than compensated for weak non-oil revenues. Nonetheless, spending commitments were slow to pick up during the second quarter of 2013. However, the National Bank of Angola’s Monetary Policy Committee expects the fiscal execution, especially that of the capital expenditure component, to pick up during the third quarter.

**External Sector**: Angola’s external position remains favorable, with international reserves of over USD 34.0 billion providing adequate cover for imports and short-term external shocks. The dependency on oil is an issue for medium to long run policy on diversification. Under the new National Development Plan (2013-2017), Government has embarked on an ambitious reform plan to modernize the trade regime with the adoption of a new customs policy. However, there is a need to reduce transaction and logistical costs, improve the country’s infrastructure network and promote competitiveness.

**II. INSTITUTIONAL AND STRUCTURAL REFORMS**

**New Foreign Exchange Regime for Oil Sector**: From 1 July 2013, the new oil sector foreign exchange regime makes it compulsory for all oil companies operating in the country to pay suppliers using current accounts with Angolan banks, and these payments have to be made in local currency. The Economist Intelligence Unit estimates that this groundbreaking change could bring liquidity of more than USD 10 billion a year to the country and allow for independent monetary policy. The regime gives fresh impetus to liquidity in the national banking system, a sector that has expanded by 16 percent a year on average. It is expected that the increased liquidity will boost the country’s foreign currency reserves and support the local currency by limiting imported inflation. Moreover, the substantial liquidity entering the banking system could also mean increased lending and therefore rising domestic inflation. Meanwhile, the National Bank of Angola has put in place a series of measures to ensure a smooth transition to the new regime. This includes measures to ensure commercial banks upgrade their service systems, human resources training, enforcement of supervision mechanisms to limit foreign exchange exposure, and measures to curb inflation.

**Regional Integration**: Angola is well placed to benefit from enhanced economic integration with its neighbors. The country is currently implementing regional infrastructure projects with its neighbors, notably the power interconnection project with the Democratic Republic of Congo (DRC) and Namibia, and the Zambia border road. There are also ongoing investments to revitalize and develop railway links to the markets, especially through the railway link between Benguela, the DRC and Zambia under the Lobito Development Corridor. Cognizant of the benefits that regional integration brings in terms of market and trade expansion and consequent increased incomes, the ADB is collaborating with the Government of Angola to provide assistance for regional integration and trade promotion through the implementation of the Lobito Corridor and Trade Facilitation Project and corresponding logistical platforms.

**III. ISSUES NEEDING PARTICULAR ATTENTION**

In spite of high growth, Angola’s capacity to mobilize domestic resources and manage non-traditional sources of financing such as public-private partnerships (PPPs) is limited. Therefore, it is imperative for the Government to consider enhancing the sustainability of the high economic growth rates, ensure a smooth transition to the new foreign exchange regime for the oil sector and enhance broader economic diversification of the economy. Finally, enabling the kind of environment required to attract private sector investment will play a great role in sustaining the country’s economic growth.
HIGHLIGHTS

• Real GDP growth decelerated significantly to 3.2 percent during the first quarter of 2013 from 7.0 percent recorded during the same quarter in 2012.

• Inflation declined consistently during the second quarter of 2013 to reach 5.8 percent in June, falling within the medium-term objective target range of 3 to 6 percent for the first time since late 2009. This mainly reflected declines in food and transport prices.

• Public concern about the substantial delays in mega projects brought to the fore the existence of weak supervisory capacity that Government needs to address.

I. MACROECONOMIC MANAGEMENT OVERVIEW

Economic Growth: During the first quarter of 2013, the economy continued to suffer under adverse weather conditions, and real GDP growth decelerated to 3.2 percent, slightly less than half the rate of 7.0 percent that was experienced during the same quarter of 2012.

The effect of the drought was felt particularly in the water and electricity sector, which registered a massive decline of -155 percent in value added. The effect on overall growth was compounded by declines in manufacturing (9.5 percent), agriculture (5.0 percent) and mining (3.6 percent). On a positive note, all other sectors posted improved growth of more than 2.0 percent over the period. Economic performance during the second quarter of 2013 is expected to remain subdued, mainly due to the persistent electricity shortfalls.

Monetary Policy and Banking System: The annual rate of inflation continued on the downward trend recorded since the end of the last quarter and declined to 5.8 percent in June 2013 from 7.6 percent in March 2013. More significantly, for the first time since the last quarter of 2009, the rate is now within the Bank of Botswana's objective target range of 3 to 6 percent. The lower inflation mainly reflects declines in food and transport prices. The recent decline in inflation has prompted the Bank of Botswana to start relaxing the tight monetary policy through a reduction in its lending rate from 9.5 percent, which had been in force since December 2010, to 9 percent in April 2013 and further to 8.5 percent in June. The reduction in inflation is expected to continue in the short term as fuel and food prices stabilize, and a further relaxation in the monetary policy could be considered as inflation is anticipated to slowing down.

Fiscal Policy: Botswana’s medium-term budget remains focused on fiscal sustainability and promotion of economic growth. Projections for the last quarter (January to March 2013) of the 2012/13 financial year indicate a surplus of Botswana pula (BWP) 790 million (about 2.0 percent of GDP). This represents a remarkable turnaround from the deficit of BWP 3,693 million (about 14.1 percent of GDP) recorded in the corresponding quarter of the 2011/12 financial year.
The outturn reflects a sizeable increase of 45 percent in revenue and a decline in expenditure of 3.5 percent. The increase in revenue was mainly due to substantially high non-mineral income tax revenues and value added tax and customs collections, while the decline in expenditure reflected a decrease in recurrent expenditure that counteracted an increase in development expenditure. Taking into account the challenges emanating from the persistent uncertainty in the global economy and the associated adverse effect on revenues, the 2013/14 budget forecasts only a modest surplus of 0.6 percent of GDP. Public debt is projected to decline to 13.5 percent of GDP in 2013/14 from 14.9 percent in 2012/13; 10.2 percent will be external public debt (including publicly guaranteed debt).

External Sector: Botswana realized a trade surplus of BWP 583.2 million during the first month of the second quarter of 2013 (April), continuing a similar outcome recorded in February and March 2013. This reflected a 167 percent increase in total exports from that recorded in April 2012 compared to a 62 percent increase in imports. The increase in exports was mainly due to mineral products, particularly diamonds, which realized a three-fold increase. The trade surplus for the third consecutive month this year signals renewed prospects for the economy, although it remains to be seen whether this can be sustained in view of the continuing gloomy global environment. The improvement in the trade balance has led to an increase in gross foreign reserves, from USD 7.63 billion as at end December 2012 to USD 8.07 billion (equivalent to 13 months of imports). The nominal value of the BWP exhibited mixed performance against major foreign currencies during the second quarter of 2013. The currency depreciated against the euro (by 6.1 percent), the pound sterling (GBP) (4.3 percent) and the USD (by 4.1 percent). This was due to Botswana's persistent higher inflation rates compared with those in these economies. However, the local currency appreciated against the ZAR by 3.2 percent (mainly reflecting a weakening of the ZAR against major currencies and its large weight in the basket) and marginally against the yen by 0.9 percent.

II. INSTITUTIONAL AND STRUCTURAL REFORMS

In April, the Botswana Parliament adopted the draft MTR of the 10th National Development Plan. The MTR reiterates Government’s recognition of the importance of monitoring and evaluation to guide its policy orientation. In his presentation to Parliament, the Minister of Finance and Development Planning pointed out that Government recognized that the country's impressive economic growth rates recorded over the years had not generated employment opportunities, especially among the youth. As a result, the Government would continue to develop and implement employment creation initiatives as well as poverty eradication programs for the Batswana to live a dignified life. Going forward, the MTR underscores the continued focus on infrastructural development and enhancing private sector development. This approach resonates with the AfDB’s strategy for the period 2013 to 2022 and will guide orientation of the upcoming medium-term Country Strategy Paper. In terms of implementation, the MTR postulates a restrained approach to spending to the effect that no new projects have been included in the NDP. Government has emphasized that it will implement only high impact projects that will be reviewed annually for funding and also improve the implementation of major projects that have resulted in cost overruns, frequent scope changes and completion delays.

III. ISSUES NEEDING PARTICULAR ATTENTION

The issue of substantial delays in mega projects has recently attracted public concern and attention. In June 2013, the Permanent Secretary in the Ministry of Infrastructure, Science and Technology appeared before the Public Accounts Committee (PAC) to answer queries about the poor performance of various mega projects that are adversely affected by poor workmanship and disputes on cost overruns leading to either termination of contractors or project delays. The projects that were cited include the delayed Morupule B energy project and the uncompleted Serêtie Khama International Airport. The PAC noted that Government’s poor supervision
was a problem, and this needs to be addressed immediately. The Permanent Secretary admitted that supervisory capacity by Government remains weak and added that some contractors and consulting engineers have taken advantage of this loophole to misappropriate public funds. In view of the capacity constraints identified by Government in project supervision, it is imperative that this issue is given due attention in the design of projects that the AfDB will consider for financing.
HIGHLIGHTS

- The economy continues on the recovery trajectory underpinned by construction, post and telecommunication and mining.
- The fiscal balance continues to post a surplus position largely due to decline in capital spending.
- Inflation plummets in spite of pressure from high fuel and food prices.

I. MACROECONOMIC MANAGEMENT OVERVIEW

Economic Growth: The economy continues on the recovery trajectory despite the slowing global economy that is threatening the tradable sector. Economic growth was recorded at 4.2 percent annually, and the expansion of the mining sector (Letseng) was the main driver together with the building of malls in Maseru as well as growth in posts and telecommunications. The contribution of agriculture to growth was somewhat affected by the recurring weather shocks. Manufacturing, in particular of textiles, was affected by the slow global demand and stiff competition from Asian producers. Going forward, the economic prospects remain positive, provided the mining sector continues expanding, agriculture (Government support to farmers) recovers modestly, construction activities related to the Lesotho Highlands Water Project advance and private sector investment in response to Government partial credit guarantee schemes increase.

Monetary Policy and Banking System: Money supply broadly defined as M2 continued to increase in the quarter ending March 2013, although the growth was less faster compared to 4.6 experienced in the previous quarter ending December 2012. The growth in money supply continued to be driven by increases in the net foreign assets of the banking system and domestic credit. Overall annual inflation rose to 5.0 percent in March but was much lower compared to February when it accelerated at 5.1 percent. The rise in inflation was among other factors driven by increases in index division for food and non-alcoholic (6.5 percent); Gas and Other Fuels (9.8 percent). The higher global prices for energy together with the supply shortages for food following weather shocks have continued to impact negatively on the domestic prices with significant welfare implications especially on the poor (most vulnerable groups) due to reduced purchasing power. This was compounded by increases in the index division for education (13.4).

Fiscal Policy: A non-cumulative surplus of 8.0 percent of GDP, which was half a percentage point higher compared to the surplus attained in the previous quarter ending December 2012 was recorded in quarter ending March 2013. This was largely on the back of a decline in the capital expenditures. This is in part reflects the delays associated with timely implementation of capital projects which resulted into low absorption of funds. Consequently, the Basotho were denied timely access to benefits arising from planned implementation of such capital projects.

External Sector: The current account deficit continued to widen during the quarter ending March 2013. The current account registered a deficit of 19.6 percent of GDP largely on the account of the deteriorating trade balance due to a rise in merchandise imports compounded by a decline in merchandise exports. International reserves in months of import cover dropped to 4.6 compared to 4.8 in the previous quarter, which is an undesirable situation given the country’s vulnerability to external shocks.
II. INSTITUTIONAL AND STRUCTURAL REFORMS

Public sector service delivery is still a problem but Government with support of the development partners has already approved a Public Financial Management Action Plan to address the critical challenges in this area. The AfDB, the European Union and the World Bank among other donors support the Action Plan (2012-2018). The implementation of the National Strategic Development Plan (NSDP) started in 2013. Despite of this, some progress has been made. The Government has already developed a monitoring and evaluation framework as well as plans for the individual ministries with identified priorities, which are linked to the NSDP.

III. ISSUES NEEDING PARTICULAR ATTENTION

Delays in implementing capital projects remain a critical concern as it affects the expected impact of the projects on the wellbeing of the Basotho. Additionally, the slowdown in the exports is expected to negatively impact on the reserve accumulation and hence the need diversify both product base and market in order to minimize the future impact.
HIGHLIGHTS

- Malawi’s economy is poised for a rebound. A number of indicators suggest that macroeconomic policy reforms, supported by fiscal discipline and a tight monetary policy stance, have begun to bear fruit: an increased availability of foreign exchange, the recent appreciation of the Kwacha, declining inflation, and rising capacity utilization in the manufacturing sector.

- Malawi is making strides in its efforts to integrate regionally. The country has adopted the National Single Window and established border management on two major transport corridors, namely the Northern and Beira corridors.

- The downside risks to the macro framework are mainly a more relaxed fiscal policy stance in the 2013/14 budget and possible policy reversals in the lead-up to the 2014 general elections, as well as adverse weather conditions. Containing these risks remains important for the economy’s turnaround and for ensuring that the reform momentum is maintained.

I. MACROECONOMIC MANAGEMENT OVERVIEW

Economic Growth: Real GDP growth is estimated to rebound in 2013 after contracting significantly in 2011 and 2012. In 2013, economic activity is expected to accelerate in the agricultural and manufacturing sectors at 5.7 percent and 6.2 percent of GDP respectively. In 2013, according to second-round national crop estimates, maize production is estimated at 3.68 metric tons, up by 1.6 percent from 2012. Tobacco production is forecasted to just about double by increasing from 79.8 metric tons in 2012 to 156.1 metric tons in 2013, with the value of tobacco sales expected to stand at USD 257.6 million up from USD 159 million in 2012. As at the end of June 2013, which represents week 16 of the marketing season, 123.5 million kilograms had been sold for USD 257.6 million at an average price of USD 2.08/kg compared to 72.1 million kilograms sold for USD 159 at an average price of USD 2.20/kg in 2012. This quarter has also seen an improved performance in the manufacturing sector, which is attributable to increased production in the processing of tobacco, tea, sugar, soaps and detergents, beer production, dairy, flour and flour products. Specifically, capacity utilization has increased to over 60 percent. The increased availability of foreign exchange and fuel, as well as a recovery in construction activities and improved efficiency in the utilities sector, will also positively impact the wholesale and retail, construction, mining and quarrying and the services sector which are expected to grow at 4.2 percent, 7.1 percent, 8.5 percent and 41 percent respectively. While business sentiment has improved, high interest rates are of major concern and many manufacturing firms are likely to put their investment plans on hold until the elections. Thus, in 2013 the economy’s growth estimate stands at 5 percent, up from 1.8 percent in 2012. GDP is projected to grow further by 6.1 percent in 2014 given the reforms implemented in 2012 and the expectation that the macroeconomic environment will have stabilized.
Monetary Policy and Banking System: For the first time in the past 12 months, Malawi recorded negative monthly inflation rates in this quarter. The year-on-year headline inflation for the month of June 2013 eased to 27.9 percent, 8.5 percentage points down on the month of March 2013. The slowdown in inflation is being driven by a slower food inflation rate at 25.5 percent on account of increased maize output, not a surprising seasonal trend over this quarter in the year, and by a 5.1 percentage point drop in non-food inflation, from 37.9 percent to 32.8 percent, owing to downward fuel price adjustments and the availability of solid fuels. In addition, beginning this quarter the Malawi kwacha has gained ground, which should restrain the growth in the price of imported commodities, including fuel. Urban and rural rates stood at 37.1 percent and 26.5 percent respectively in June 2013, down from 39.8 percent and 31.8 percent respectively at the end of March 2013. However, Malawi is still recording the highest inflation rate in the region compared to the SADC regional annual average inflation rate of 6.9 percent.

The Reserve Bank of Malawi (RBM) has maintained its benchmark bank rate at 25 percent in this quarter. The central bank is likely to maintain the high interest rate to contain inflationary pressures. The beginning of this quarter marked the onset of the tobacco-marketing season—increased demand for local currency introduced liquidity constraints in the banking system, and commercial banks revised their interest rate structure upward, leading to the base lending rate and the savings rate accelerating to averages of 40.8 percent and 12 percent in June 2013, from 37.5 percent and 11 percent at the end of March 2013. However, following improvements in the liquidity situation—the Treasury Bill yields have dropped accordingly; the average Treasury Bill yield declined to 34.4 percent in June 2013 from 42.3 percent in March 2013. In the next quarter there should also be a further decline in T-bills rate as investors respond to the softening of inflation risk.

The year-on-year growth in money supply dropped to 25.7 percent in June 2013 and was below the projected nominal GDP growth of 32.1 percent for 2013, reflecting a sustained tight monetary policy stance. Net credit to Government from the banking system marginally decreased by MK1.3 billion in June 2013 to MK151.9 billion from MK153.2 billion in March 2013. Going forward, to maintain financial stability and contain systematic risk, RBM will have to strengthen its bank oversight role, especially with respect to banks that continue to have difficulty meeting prudential requirements.

The Malawi kwacha has appreciated to about MWK340 per USD in June 2013 from about MWK405.18 per USD in March 2013, for the first time since Malawi adopted a floating exchange rate regime in May 2012. The appreciation follows the availability of foreign exchange on the market arising from tobacco sales, the country’s main foreign exchange earner thus. Signs of stabilization are also mainly due to weaker demand for foreign exchange as the external arrears were cleared which had accumulated in the previous three years. The weak demand is also complemented by the tight monetary policy stance (despite occasional expansionary measures to address short-term liquidity constraints) by the Reserve Bank of Malawi. In the medium to long-term, the sustainability of the stability of the exchange rate will be key, especially after the tobacco season is over.
Fiscal Policy: On the fiscal side, the Government passed a new budget for FY2013/2014, anchored on the objective of achieving zero net domestic financing; it seeks to consolidate the gains from the economic reforms so far. The planned net domestic debt repayment is at MK 7.2 billion, which is equivalent to 0.5 percent of GDP. This fiscal stance is intended to reduce the domestic debt stock and promote private sector growth, aided in part by grants (estimated at 13 percent of GDP) and domestic revenue mobilization (23.9 percent of revenue). Total revenue and grants for the 2013/14 budget are projected at about 39 percent of GDP up from 37.3 percent in 2012/13. The increase is largely on account of domestic revenues, which are projected to increase moderately from 23.9 percent of GDP in 2012/13, to 24.4 percent of GDP in 2013/14; whereas grants are projected to decline from 15.1 percent of GDP in 2012/13, to 13 percent of GDP in 2013/14. The Budget further projects a narrower fiscal deficit (including grants) to -1.3 percent of GDP from -1.5 percent of GDP in 2012/13, as growth in total revenue is matched by growth in total expenditure.

Fiscal measures to oversee the maintenance of strong fiscal discipline include a combination of expenditure control and prioritization and revenue mobilization measures, which are critical for fiscal sustainability. Tax revenue increase is expected to be moderate as tax measures announced in the Budget focus on promoting domestic production through value addition and encouraging investment in the economy. The risks to the planned resource envelope are moderate considering (1) the strong commitments from development partners, including the Bank; (2) regained confidence in the economy by the private sector; and (3) renewed commitment to good political and economic governance by the Government, which are vital for consistency in policy implementation and economic recovery. Malawi's debt sustainability situation is expected to improve in the long run as the economy is expected to rebound under a floating exchange rate regime and a liberalized current account. Net domestic debt is projected to improve to 14 percent of GDP by 2014 from an average rate of 16.6 percent from 2011 to 2013. Overall, despite the challenging macro environment, Government has been successful in restoring fiscal discipline and macroeconomic stability.

The Government's held its third review of the Extended Credit Facility program with the IMF in June 2013. It was concluded that the program is performing satisfactorily on the fiscal and monetary policy front – reforms are on track and yielding results. Nearly all the quantitative targets for end-March 2013 were met. In particular, after adjusting for shortfalls in the disbursement of aid flows, the targets on net international reserves, Government net domestic borrowing, and the net domestic assets of the RBM have been met. There is also overall progress in the implementation of structural benchmarks. Upon approval by the IMF Executive Board of the completion of the third review under the ECF arrangement, completion of the review will enable Malawi to receive a disbursement of SDR 13 million (about USD 20 million) from the IMF.

External Sector: Malawi experienced a trade deficit in 2012. Exports stood at USD 1.47 billion in 2012 while imports were registered at USD 2.59 billion leading to a trade deficit of USD 1.1 billion. This position should improve later in the year from tobacco proceeds that are boosting the country’s international reserves. The country’s foreign exchange reserves in June 2013 increased to USD 651.44 million (3.5 months of import cover) from USD 353.1 million reported in March 2013. The bulk of foreign exchange reserves were accounted for by a jump in official reserves from USD 188.4 million (1.0 months of imports) end-March 2013 to USD 452.8 million (2.4 months of imports) in June 2013.

II. INSTITUTIONAL AND STRUCTURAL REFORMS

The Government is making efforts to reduce the cost of doing business in Malawi, including the passage of a number of laws and regulatory and administrative reforms. Government has strengthened and revamped efforts to develop the Malawi Investment and Trade Center into an effective “One-stop shop” for investors, and to continue seeking solutions to address key supply-side bottlenecks in transportation, energy, water and communications infrastructure, so as to enhance Malawi’s external competitiveness and help foster sustained, diversified and more inclusive growth. Malawi has adopted the National Single Window and established border management on two major transport corridors, namely the Northern and Beira corridors. The existing Customs and Excise Act is being revised to incorporate the provisions of the Revised Kyoto Convention (RKC) Eastern and Southern African Region and international best practices in customs clearance processes as a trade facilitation tool to simplify, modernize and harmonize customs procedures. Malawi is expected to sign the Convention before the end of the year. The Bank is supporting Malawi’s regional trade facilitation efforts through the funding of regional road corridor development projects. The Multinational Nacala Corridor Road Project, which is currently being processed, includes a trade facilitation component.

III. ISSUES NEEDING PARTICULAR ATTENTION

The Malawi economy is showing signs of stabilization anchored mainly by recent and ongoing reforms. Real GDP is expected to rebound to 5 percent in 2013 if supported by fiscal discipline, lower levels of inflation, a rebound in the agricultural and manufacturing sectors, a stabilizing exchange rate, export diversification, the availability of forex, timely and adequate disbursement of donor budgetary support and favorable fuel price movement on the international market. The current momentum needs to be supported by fiscal restraint and a tight monetary policy to rein in inflationary pressures. To attain price stabilization of the currency, it is also important for the economy to realize additional stable and significant sources of forex. In effect, FDI will be a key and alternate driver of forex generation, and Government should strengthen its efforts to attract it in the long run. Going forward, the downside risks to the macro framework are mainly a more relaxed fiscal policy in the 2013/14 budget and possible policy reversals in the lead up to the 2014 general elections, as well as adverse weather conditions. Containing these risks remains important for turning around the economy and ensuring that the reform momentum is maintained.
HIGHLIGHTS

• The recession in the euro zone, the main trade partner of Mauritius, continues to impact on the recovery prospects for the domestic economy. Statistics Mauritius in June 2013 made a further downward revision to the growth forecasted for 2013 from 3.5 percent as projected in March 2013 to 3.3 percent.

• Against the backdrop of narrowing fiscal policy space, the Monetary Policy Committee in June 2013 reduced the Key Repo Rate (KRR) by 25 basis points to 4.65 percent to support growth and stimulate employment.

• Reflecting a weak domestic economy, unemployment rose to 8.7 percent in the first quarter of 2013 from 7.8 percent in the last quarter of 2012.

I  MACROECONOMIC MANAGEMENT

Economic Growth: The recession in the euro zone continues to impact on the pace of recovery for the Mauritian economy. Forecasts from Statistics Mauritius in June 2013 show that the 3.5 percent growth rebound for 2013 is unlikely to be attained owing to weak external demand and delays in public infrastructure projects. Growth in 2013 is forecasted at 3.3 percent, the same as in 2012 (Figure 1), driven by strong performance in financial services and ICT. With an expected contraction of 7.7 percent, construction is one of the main contributors to the slowdown in 2013. This is mainly due to the completion of major projects and delays in the implementation of the Road Decongestion Program. Growth in tourism is expected to slow down, reflecting a weak economic environment in main source markets. It is expected to grow by 2.5 percent, down from an earlier forecast of 3.5 percent. Between January and June 2013, tourist arrivals from Europe declined by 5.5 percent. Arrivals from Asia and Africa partly compensated for the weak performance in the European market, as it grew by 24.9 percent and 6.4 percent respectively, helping increase overall tourist arrivals by 1 percent to reach 471,664. Tourist receipts for the period May 2012 to April 2013 decreased by 4.8 percent to MUR 42 billion. Nonetheless tourist earnings for 2013 are forecasted to increase by 3.6 percent to reach MUR 46.1 billion.

Monetary Policy and Banking System: A new CPI series, based on an updated basket of goods and services derived from the 2012 Household Budget Survey, has been adopted with effect from April 2013. The base period is now January to December 2012. The CPI, which stood at 103.4 in April 2013, remained at the same level in June 2013. The main movements in the CPI sub-indices emanated from higher vegetable prices and a fall in housing loans. Against this background, year-on-year CPI inflation registered a decline from 3.6 percent in May 2013 to 3.5 percent in June 2013 (Figure 2). At the same time, year-on-year core inflation eased from 2.6 percent to 2.5 percent while headline inflation remained at 3.6 percent during the period. Against the backdrop of easing inflation indicators and a narrowing fiscal policy space, in June 2013 the Monetary Policy Committee unanimously voted to cut the Key Repo Rate (KRR) by 25 basis points to 4.65 percent to support growth and address unemployment as downside risks gradually materialized. Excess liquidity in the banking system remained high with all auctions of Government of Mauritius Treasury Bills (GMTB) between end March 2013 and end April 2013 being oversubscribed. One auction for 182-day and two auctions each for 273-day and 364-day, GMTB were held in April, 2013. At 2.32 percent for May 2013 the overall weighted yield marginally declined from...
to 2.33 percent in April 2013, keeping the yield below the policy rate. A new 15-year inflation index the Government of Mauritius for MUR 1 billion due in May 2028 was also issued during the period. Credit to the private sector declined by 0.5 percent to MUR 371.87 billion between end April 2013 and end May 2013. Nonetheless, this represented an annual growth of 13.2 percent driven by credit growth to the construction and tourism sectors.

**Fiscal Policy:** Domestic fiscal revenues have been on an increasing trend in spite of the economic slowdown (Figure 3). From January to May 2013 total revenues registered a 9 percent increase over the corresponding period in 2012 to reach MUR 28.98 billion, with tax revenues representing 85.5 percent. During the period, total spending increased by 11.7 percent to reach MUR 29.50 billion with a notable increase of 16.9 percent in compensation to employees as the Government started implementing an increase in public sector wages. This translated into a higher budget deficit of MUR 3.87 billion compared to MUR 2.58 billion over the corresponding period. The Government remains committed to fiscal consolidation. The objective is to bring down public debt ratio to 50 percent of GDP by 2018 from 52.4 percent in 2012. Net claims on central Government went down by 3.4 percent, from MUR 28.05 as at end March 2013 to MUR 27.10 billion at end of April 2013. In tandem interest payments during the period declined by 5.9 percent from MUR 4.2 billion during Jan-May 2012 to MUR 3.96 billion. Fiscal policy is expected to be less expansive in 2013.

**Balance of Payments:** Weak external demand continues to impact negatively on Mauritius' external sector position. The current account deficit deteriorated in the first quarter of 2013 to 2.0 percent of GDP (MUR 6.9 billion) from 1.2 percent (MUR 4.2 billion) in the corresponding quarter in 2012. At MUR 15.2 billion (4.4 percent of GDP) the first quarter trade deficit registered a 11.5 percent reduction compared to the corresponding period. However, the narrowing trade deficit was offset by a steep decline in the services surplus, which at MUR 6.13 billion represented a 36 percent fall over the corresponding period in 2012. Reflecting a soft euro zone economy, the net travel earnings from tourists, the main source of income for Mauritius, in the first quarter registered a 20.9 percent year-on-year decline to reach MUR 8.85 billion. In the first quarter of 2013, FDI reached MUR 2.88 billion driven by investments into real estate. Total FDI from Africa reached MUR 0.53 billion, with about 74 percent of the investments coming from South Africa. Africa was the main investment destination for Mauritius in the first quarter. At MUR 449 million it represented 73 percent of the total direct investment abroad. Overall the Balance of Payments registered a net surplus of MUR 5.0 billion compared to a deficit of MUR 1.6 billion over the corresponding quarter in 2012. The Bank of Mauritius (BoM) continued to intervene in the foreign exchange market to bolster reserves and smooth volatility. To this extent the reserves import cover increased from 5.1 months to 5.6 months as at end May 2013. The weighted average deal selling rates of the rupee, depreciated, on average, against the USD but appreciated against the euro between April 2013 and May 2013.

**III ISSUES NEEDING PARTICULAR ATTENTION**

Improving educational outcomes and skills are key to enhancing the country’s global competitiveness. The Government should urgently address obstacles to implementation in the public sector emanating from procurement bottlenecks, weak public sector capacity and a weak legal framework for PPPs under which some of the major infrastructure projects are being implemented. The Government estimates that delays in implementing the USD 1.2 billion road decongestion project could reduce growth by up to 1 percent of GDP. External sector vulnerabilities remain a major risk factor for the Mauritian economy; therefore efforts to enhance regional economic integration need to continue.

**II INSTITUTIONAL AND STRUCTURAL REFORMS**

The Government acknowledges that the country needs to stay the course regarding institutional and structural reforms if the economy is to return to a high growth path and make progress towards its goal of achieving a High Income Country (HIC) status by 2025. With its trade preferences being gradually eroded as its main trade partners (the EU, India and South Africa) renegotiate their bilateral trade and double taxation avoidance agreements, Mauritius needs to compete based on productivity and value addition. However, the IMF Article IV Consultation Mission Country Report of March 2013 notes that productivity indicators for Mauritius suggest potential losses in competitiveness. The report observes that although compensation of employees in manufacturing more than doubled between 2000 and 2012, labor productivity increased by only about 60 percent, while capital productivity decreased during the period. The rising labor costs might indeed have reduced the return to capital and eroded the competitiveness of the economy. Of particular concern in the labor market is the rise in unemployment in the first quarter of 2013 to 8.7 percent from 7.8 percent in last quarter of 2012. Unemployment is considered largely structural, as the unemployed are mainly unskilled youth and women who lose jobs in the textiles and sugar sector and who do not meet the skills requirements in the growing financial services and ICT sectors.
HIGHLIGHTS

• Affected by massive floods experienced during the first two months of 2013, with a particularly negative impact on agricultural production, growth slowed down in the first quarter.

• The new Petroleum Act provides a legal framework for both oil and gas exploration and production. The Act contemplates the allocation of part of the revenue from oil and gas operations to communities living in areas surrounding developments in this regard.

• The IMF downgraded Mozambique’s debt distress level from “low” to “moderate”. The Fund’s latest Debt Sustainability Analysis revealed increased levels of public debt, coupled with the widening of the external current account deficit, which have increased the debt-servicing risk.

I. MACROECONOMIC MANAGEMENT OVERVIEW

Economic Growth: GDP growth slowed down in the first quarter; the economy grew by 4.8 percent compared to 8.9 percent the previous quarter. The heavy rains in January and February in the Mozambican hinterland and adjacent countries resulted in major flooding and affected the agriculture-rich provinces of Gaza and Zambezia. More than 240,000 people were displaced and crops in the region were destroyed. During the first quarter agriculture, which constitutes 23 percent of the GDP, showed a negative growth of 2.6 percent. Other sectors with negative performance were manufacturing (-4.2 percent), and energy and water (-1.5 percent). The more dynamic sectors were transport and communications (which grew by 23.3 percent) and financial services (which grew by 15.6 percent). The progressive increases in production from coal mining companies contributed to a 39.1 percent expansion in the mining sector. Overall the Economic Climate Indicator has maintained its positive trend since May 2012, supported by positive perceptions on market demand and prospects of increased employment.

Monetary Policy and Banking System: After the first quarter’s spike in inflation mostly due to the floods, which affected the supply of food, inflationary pressures eased during the second quarter, with negative monthly inflation in May and June. Annual inflation has stabilized at 5.2 percent, although the 12 months’ average continues to increase and reached 3.07 percent at the end of the second quarter. Agricultural production shows signs of a faster recovery which, coupled with the sharp decline of the ZAR in the period allowed for cheaper food and import of goods, will offset credit expansion to the private sector, thereby constraining inflation. On the back of positive inflation figures, in June the Central Bank decreased its lending and deposit standing facilities by 50 bps to 9 percent and 1.75 percent, respectively. This was the first cut since October 2012. In May the average one-year lending rate from commercial banks increased by 12 bps to 19.77 percent. Since February 2012, the Central Bank has cut the prime lending facility (discount rate) by more than 36 percent, while the average lending rate by commercial banks was reduced by just 5.9 percent. Commercial banks are slow to adjust their lending rates downward in response to the cut in discount rate as a result of which the spread between the discount rate (9 percent) and the average commercial lending rate (19.7 percent) remains high in spite of a low inflation rate (5 percent).
**Fiscal Policy:** Overall fiscal execution during the first quarter was mostly within the objectives initially budgeted for. Revenues collected reached 24.8 billion meticais (USD 859 million) of a total budget of 113.962 billion meticais (USD 3.8 billion), representing a 31 percent real growth over the same period last year, and a 2 percent increase in execution to a total of 22 percent. The biggest contributors were income tax and value-added tax, which went up by 44 percent and 25 percent respectively. The contribution of megaprojects was up by 160 percent, now representing 7.7 percent of revenue. The desired increased weight of fiscal revenues from megaprojects and the different modalities they take, with the spur of sophisticated investment structures, demand a higher level of Tax Administration capacitation for effective revenue collection. On the expenditure side, execution reached 5.234 billion meticais (USD 175 million) of a total of 175 billion meticais (USD 5.86 billion). Current expenditure was executed at 22 percent, a real growth of 3.7 percent, although the wage bill registered an 11 percent real growth. Capital expenditure, as it has become the norm during the 1st quarter, presented a low execution of 17 percent, mostly due to a 6 percent of execution of externally financed expenditure. Chronic low execution rates of capital expenditure expose the country’s limited absorption capacity for investment and are a major challenge in the face of the forecasted increase in revenues coming from natural resources.

**External Position:** The current account deficit expanded by 73.4 percent in 2012, reaching 35.4 percent of GDP. This reflects the massive inflows of FDI, in particular to megaprojects. Since most of the projects are yet to reach maturity, the large imports of machinery and materials outpace exports pressuring the trade balance, with a deficit in 2012 surpassing USD 2750 million (22.3 percent of GDP). The metical showed a robust performance during the 2nd quarter. With a 0.63 percent gain against the USD, the metical reversed most of the year losses, down only 0.81 percent since January and reducing the year-on-year accumulated depreciation to 7.17 percent. However, the Central Bank’s active management of the metical has pressure net foreign reserves. At USD 2,287.1 billion, reserves are down 13.9 percent since the beginning of the year, despite sizeable disbursements of official development aid by development partners in May and June. The reserves cover nearly four months of imports. The strengthening metical also benefited from the weak performance of the ZAR, down by 7 percent in the second quarter. The ZAR has had an accumulated depreciation of 13.45 percent since the beginning of the year, providing a much necessary easing of Mozambique’s import costs.

**II. INSTITUTIONAL AND STRUCTURAL REFORMS**

Mozambique’s Cabinet approved the new petroleum law, which provides a legal framework for both oil and gas exploration and production. The much anticipated law is set to be a centerpiece in the development of the recent large discoveries of hydrocarbons, providing an enhanced clearer and predictable regime to attract investors, while intended to strengthen the country’s position. The Government, through the revised law, intends to allocate part of the revenue from oil and gas operations in favor of communities living in areas around these developments, although the percent of that allocation is yet to be defined. The law also states that explorers must report discoveries to the Government within 24 hours, and introduces several specific measures to ensure the inclusion of local content into the industries’ development process.
III. ISSUES NEEDING PARTICULAR ATTENTION

The increase in public debt levels, consisting almost entirely of external debt, in particular through the use of non-concessional financing of large infrastructural projects, coupled with the widening of the external current account deficit funded by large FDI and privately financed mining operations, has lead the IMF to downgrade the debt distress level of Mozambique from “low” to “moderate”. The outlook for the economy remains positive. However, it is necessary to moderate the pace of new borrowing over the medium term, until the revenues from the coal and natural gas sectors become available. The absorption capacity and effectiveness of investment also need to be strengthened.

IV. DONOR COORDINATION ACTIVITIES

During the annual Performance Assessment Framework (PAF), the development partners and the Government agreed on the need to produce a plan of action to address the Issues needing Special Attention (ISA). These ISA are considered to be key binding constraints that need to be addressed to allow a successful implementation of the poverty reduction strategy. Following the PAF exercise, each sector working group in dialogue with the Government counterparts has produce its specific plan of action to be implemented in the course of the year. The Joint Steering Committee of the aid coordination framework will be responsible for the close monitoring of the implementation of the action plans.
HIGHLIGHTS

• The Namibian economy registered strong growth in 2012, notwithstanding the subdued global economy.

• Inflationary pressures continued to ease on account of decelerating costs of food, transport and alcoholic beverages.

• The debt stock remains sustainable and below the public debt ceiling of 35 percent of GDP.

I. MACROECONOMIC MANAGEMENT OVERVIEW

Economic Growth: The Namibian economy registered strong growth, expanding by an estimated 5.0 percent in 2012 compared to 4.9 percent in 2011, notwithstanding the subdued global economy. The solid growth for 2012 was boosted by the primary industry’s strong performance, which benefitted from robust growth in mineral production, attributed to a recovery in diamond mining, and increased marketing of livestock in the agricultural sector due to a persistent drought. The secondary industry sector of the economy also performed strongly, driven by impressive growth in the construction sector as reflected by the rise in the real value of buildings completed. Increased activities in wholesale and retail trade and the transport sectors were the main drivers behind the acceleration of the tertiary industry. Real growth is projected to soften in 2014. Downside risks stemming from the weaker global environment continue to dominate, with new risks emerging relating to the possibility of a longer growth slowdown in emerging market economies, while the protracted recession remains in the euro area.

Monetary Policy and Banking System: Inflationary pressures continued to ease during the second quarter of 2013, a trend which commenced since the beginning of the year. Namibia’s headline inflation averaged 6.4 percent during the first quarter, slightly lower than the annual inflation of 6.5 percent for 2012. This is on account of decelerating costs of food, transport and alcoholic beverages. Year-on-year inflation slowed down to 6.1 percent in May 2013, matching the inflation posted in the previous month, the lowest since November 2012 when it rose to 7.6 percent. The authorities expect inflation to remain in single digits in 2013 although the depreciation of the Namibian dollar (NAD) against major currencies may present an inflation risk. With the global economy expected to remain weak and to negatively affect Namibia’s growth prospect, the Bank of Namibia decided to continue pursuing a monetary policy stimulus. It maintained the repo rate unchanged at the rate of 5.50 percent as the first line of defense against downside risks, taking advantage of the low inflation.

Fiscal performance: The 2013/14 budget estimated that the fiscal deficit for the current fiscal year will rise to 6.4 percent of GDP from 2.8 percent in 2012/13 in view of the prolongation of the fiscal stimulus. However, the authorities now expect the fiscal deficit to narrow slightly in the current fiscal year despite rising public expenditure. This improvement is on account of increased revenue collection which is consistent with stronger economic growth and associated with initiatives to improve the tax administration regime, the introduction of alternative sources of
revenue, the recovery in the Southern Africa Customs Union (SACU) revenue. Reflecting the prevailing expansionary fiscal stance, Namibia’s total debt stock rose to 24.9 percent of GDP at the end of fourth quarter of 2012/13, a marginal increase of 0.4 percentage over the preceding quarter. The debt stock remains sustainable and below the public debt ceiling of 35 percent of GDP.

External Sector: A current account deficit of NAD 1.5 billion was recorded during the first quarter of 2013, significantly higher than the deficit of NAD 197 million recorded during the fourth quarter of 2012. In spite of the improvement in SACU receipts, the deteriorating deficit in the first quarter was the result of a faster rate of growth in imports compared to exports. Imports increased by 8 percent to NAD 12.2 billion, quarter-on-quarter, compared with only 4.1 percent for exports, which increased to NAD 8.6 billion over the same quarter. The increase in imports was largely driven by the importation of fuel and motor vehicles. Consequently, Namibia’s merchandise trade deficit widened. Overall the balance of payment recorded a surplus of NAD 104 million during the first quarter of 2013, a significant drop compared with NAD 1.1 billion recorded during the previous quarter and NAD 2.4 billion during the corresponding quarter in 2012. The poor performance of the balance of payments was mainly attributed to the continued current account deficit and reduced capital inflows in the capital and financial account during the period under review. Namibia’s gross reserves reached NAD 14.8 billion (representing an import cover of 14.3 weeks) during the first quarter of 2013, sufficient to maintain the currency peg to the ZAR and to meet other international obligations. On the exchange rate front, the Namibian dollar (following the ZAR) depreciated significantly against major currencies on a quarterly and annual basis due to unfavorable economic factors in South Africa.

II. INSTITUTIONAL AND STRUCTURAL REFORMS

The Government has embarked on a process to reform its public procurement system. The enactment of the Procurement Bill is expected to address a number of shortcomings in the public procurement system, including: (i) the need to strengthen the public procurement legal and regulatory framework; (ii) the need to reduce exceptions to tendering; (iii) the absence of a procurement manual or compulsory Government-wide standard bidding documents or general conditions of contract; and, (iv) the creation of an independent procurement oversight body.

III. ISSUES NEEDING PARTICULAR ATTENTION

The widening of the trade deficit is a source of concern. It largely reflects Namibia’s high vulnerability to commodity price shocks due to the country’s heavy reliance on the mining sector. Furthermore, the current level of Namibia’s reserves is also not sufficiently strong to enable the country to respond to significant global commodity price shocks. Greater Government efforts are therefore needed to diversify the economy away from the mining sector in order to increase Namibia’s resilience to global shocks and of its medium-term growth prospects.
SÃO TOMÉ AND PRÍNCIPE

HIGHLIGHTS

- Political relations between the current Government and the outgoing political party remain tense.
- Government and donors discussed key priority action plans for the period 2013 - 2016.
- The Central Bank increases its efforts to monitor and strengthen the financial sector.

I. MACROECONOMIC MANAGEMENT OVERVIEW

Economic Growth: In 2012, the economy of São Tomé and Príncipe (STP) grew by 4 percent, a slight decrease from 4.9 percent growth recorded in 2011, reflecting global uncertainties, a reduction in both private and public consumption, as well a decrease in FDI. The growth was driven by the construction, transport and retail sectors. The relationship between the new Government led by Gabriel Costa and supporters of the ousted Prime Minister, Patrice Trovoada, is set to remain tense, as the latter’s political party continues to boycott Parliament. As the euro zone (STP’s main trade partner and source of investment) economic challenges continue, the growth forecast for 2013 has been adjusted downward to 4.3 percent from 5.2 percent due to delays in project execution and external financing. Even though the oil sector will play a key role in the economy in the future, the service sector will remain the engine of growth accounting for about 60 percent of GDP in 2012, followed by agriculture which represented 22 percent of GDP. Furthermore, the Government has highlighted its key priority action plan for 2013-2016. This includes; (i) Food security, (ii) youth employment; (iii) infrastructure/PPP development; and (iv) human development. At sector level, tourism, industry and services, education and health, were considered crucial to effectively implement the inclusive growth agenda.

Monetary Policy and Banking System: The ongoing fixed exchange rate agreement signed with the Government of Portugal in January 2010 helped to sustain the inflation trends over the years. Although, a further reduction to 7 percent is expected and is mainly linked to easing of food prices, the main driver of inflation at the end of the year, in April 2013 inflation increased to 10.7 percent compared to 8 percent registered in the same period in 2012, representing a percentage change of 0.4 percent compared to 1 percent observed in March 2013. Nevertheless, regular shortages of consumer goods due to limited absorption capacity of the main port, remains a key challenge and a cause of high inflation. Despite the dobra’s peg to the euro (Db24, 500:€1) continues to pose additional pressure on the Government, the level of foreign reserves has been revised upward and projected to stand at a minimum of four months of imports (USD 37.7 million). The accumulation of foreign reserves also contributed to acceleration of money growth (11.8 percent). While the credit to economy is expected to reach 9.4 percent in 2013 against the 7.6 percent initially projected, the Central Bank (CB) kept its requirements for unprofitable banks and maintained the capital risk-weighted ratio to above 10 percent. Furthermore, in Q2 2013, the CB exercised its power by taking control of Island Bank for failing to comply with market regulations. Going forward, in 2013 the CB is envisaging introducing a new chart of accounts to help the authorities with the reporting of their financial statement, and this will comply with international reporting standards.
**Fiscal Policy:** The 2013 State Budget, estimated at USD 150 million, is conservative. Although paying special attention to the social sector (education and health), the main priority of Budget 2013 is in infrastructure (transport and communication), which absorbs 21 percent of the total spending. It is important to note that 93 percent of the capital expenditure will be financed through external assistance. Despite Government’s efforts to improve revenue collection (from 14 percent in 2012 to 15.2 percent of GDP in 2013), managing domestic expenses remains a challenge (from 18.6 in 2012 to 19.6 percent of GDP in 2013). As a result, the domestic primary deficit is estimated at 7.6 percent in 2013 against 11.3 percent of GDP in 2012. The country’s macroeconomic performance was rated satisfactory in the first review held in March 2013 under the extended credit facility (ECF) 2012-2015 program with the IMF. To this effect, the Government was advised to avoid commercial borrowing and to focus on highly concessional loans given the country’s fragile external debt position. Strengthening the tax laws and customs, and enforcing compliance with tax laws will increase domestic resource mobilization.

**External Sector:** Despite the projected improvement in the trade balance deficit, that is, 35.5 percent in 2013 compared to 39 percent in 2012, the current account deficit, including transfers, is projected to improve to 16.6 percent in 2013 from 21.4 percent in 2012, reflecting an improvement on the current transfers. Large public infrastructure works will lead imports. Although the dobra depreciated by 1.3 percent against the dollar in the second quarter of 2013, the Government has kept its policy to maintain the level of international reserves at 3.5 months of imports. In May 2013 international reserves stood at USD 45.3 million against the USD 22.4 million reported at the same time in 2012 due to new grants and an external interest rate. Remittance, which is a major source of private consumption, is expected to remain low in 2013 due to the ongoing fiscal crisis in Portugal where many São Toméans are based and working. In spite of poor performance in recent years, the FDI is expected to recover to USD 25 million during 2013-2015.

**II. INSTITUTIONAL AND STRUCTURAL REFORMS**

**Public Sector Management:** The new Government, appointed on December 12th 2012, is set to continue implementing, key reforms to enhance transparency and accountability in the management of public funds. The 2013 budget will be managed and executed through the SAFE public finance management system. Other key measures include the participation of civil society (CS) in policy dialogue and project implementation.

**Public Sector Development:** The sector is undeveloped and in need of improvement. Conscious of the challenges, the Government is making progress to unleash the country’s potential. To this effect, an operating license was launched and has been awarded to the Angola giant telecommunication company, UNITEL.

**III. DONORS COORDINATION**

Coordination among donor partners is weak, thus significant efforts are required in developing joint initiatives. Nevertheless, the Government is making progress in mobilizing additional resources from bilateral donors. In this connection, the authorities convened a donors’ meeting to discuss its priority areas for the year 2013-2016. The discussion was centered on the need to strengthen the weak coordination in the as there was no in-house representation, which led to the establishment of the Aid Coordination Unit was created. It was agreed that monthly meeting would be held for resident donors, and one every two months for non-resident donors. Thus the first meeting was scheduled for August 2013 and the meeting for non-residents in September 2013. Throughout the discussion, the possibility for establishing a ‘Global Fund’ where resources from donors would be managed was also discussed.

**IV. ISSUES NEEDING PARTICULAR ATTENTION**

The fragile political outlook due to the new ruling coalition, a divided political scene and prospects of an early election, might delay the implementation of key reforms and lead donors to withhold pledged funds.
SÃO TOMÉ AND PRÍNCIPE
HIGHLIGHTS

• Due to contraction in manufacturing production, economic activities decelerated during the first quarter of 2012, registering a real GDP growth of just 0.9 percent compared to 2.1 percent during the preceding quarter. The unemployment rate increased from 24.9 percent in the fourth quarter of 2012 to 25.2 percent in the first quarter of 2013, mainly due to a decrease in employment both in the formal and informal sectors.

• The enactment into law of the Special Investigating Units and Special Tribunals Amendment Bill will go a long way to improving the effectiveness of the criminal justice system.

• Labour unrest and protracted infighting among the unions for recognition continue.

I. MACROECONOMIC MANAGEMENT OVERVIEW

Economic Growth: Economic growth decelerated during the first quarter of 2013 to 0.9 percent from 2.1 percent in the fourth quarter of 2012. The slow growth was primarily due to the collapse in the manufacturing output, which fell by 7.9 percent, thereby subtracting 1.2 percentage points from economic growth during the quarter. The slowdown in the manufacturing output was due to the closure of factories for maintenance purposes, subdued business confidence levels, sluggish domestic and foreign demand, disruptive industrial action and concerns about a sustainable electricity supply. On the other hand, mining output expanded by 14.6 percent, adding 0.7 of a percentage point to economic growth. The expansion in real output in the mining sector was driven mainly by increases in the production of platinum and gold during the quarter in question. Growth in the tertiary sector moderated to 2.4 percent in the first quarter of 2013 from 3 percent in 2012. Real value added in the agricultural sector declined by 4.9 percent during the quarter due mainly to lower field crop production resulting from prolonged dry conditions. The unemployment rate increased by 0.3 percentage points from 24.9 percent in the fourth quarter of 2012 to 25.2 percent in the first quarter of 2013 mainly due to the decrease in employment both in the formal and informal sectors. However, according to the Quarterly Employment Statistics, the number of people employed in the formal non-agricultural sector increased by 0.1 percent in the first quarter of 2013 reaching 8,463,000. The labor absorption rate remained unchanged at 41 percent in the first quarter of 2013.

On the demand side, real gross domestic expenditure grew by 3.5 percent in the first quarter of 2013, after having contracted by 0.9 percent in the fourth quarter of 2012. Real gross domestic final demand increased at an annualized rate of 2.5 percent over the same period despite slower growth in real final consumption expenditure by households (2.3 percent) and gross fixed capital formation (2.5 percent). The slowdown in final consumption expenditure by households was mainly due to the subdued consumer confidence and moderation in the growth of real disposable income, which fell to 2.2 percent in the first quarter of 2013 from 2.4 percent in the preceding quarter, reflecting slower growth in the compensation of
employees. Even though growth in household debt slowed, the ratio of debt to disposable income remained at 75.4 in the first quarter of 2013 compared to 75.8 percent in the fourth quarter 2012. On the other hand, the ratio of debt-service cost to disposable income of the household sector increased marginally to 7.7 percent in the first quarter of 2013 from 7.6 percent in the preceding quarter.

Real gross fixed investment by private business enterprises decelerated to 2.8 percent in the first quarter of 2013 from an annualized rate of 3.8 percent in the fourth quarter of 2012, mainly due to subdued outlays by all sectors, with the exception of the agricultural, construction and financial sectors. Growth in real spending by public corporations slowed from 7.2 percent in the final quarter of 2012 to 1.5 percent in the first quarter of 2013, mainly due to a deceleration in capital investment by the electricity sector. Economic growth was projected to remain subdued during the third quarter of 2013 due to continued labor unrest, and falling consumer and business confidence as weaknesses in the global economy continued.

Monetary Policy and Banking System: Consumer price inflation eased to 5.6 percent in May 2013 from 5.9 percent in April, mainly due to a slowdown in the food and transport inflation following a decrease in the petrol price by 73 cents per litre in early May 2013. While pressure from food and petrol prices eased, upside risk to inflation remained elevated due to the continued depreciation of the ZAR against major currencies and possibly excessive wage settlements. As a result, the South African Reserve Bank left the discount rate unchanged at 5 percent at its May 2013 Monetary Policy Committee meeting. In addition, downside risks to growth and employment creation, a persistent negative output gap, declining domestic and foreign investor confidence, signs of moderation in consumption expenditure, all underpinned the Monetary Policy Committee’s decision. Core inflation increased marginally to 5.3 percent in May 2013 from 5.2 percent in the preceding month. Total inflation of both regulated and non-regulated administered prices decreased, reaching 6.3 percent in May 2013 from 8.9 percent in April 2013. Growth in private sector credit slowed marginally to 9 percent in May from 9.13 percent in April due to the subdued investor confidence.

Fiscal Policy: In the 2012/2013 fiscal year, a primary deficit of ZAR 87 billion (2.7 percent of GDP) was slightly higher than the deficit of 2.4 percent in 2011/12. At the end of the 2012/13 fiscal year, R813.6 billion in tax revenue was collected while total revenue net of SACU payments stood at R787.1 billion. Total expenditure was R175 billion higher than total revenue leading to a deficit of 5.4 percent of GDP for the fiscal year 2012/13. In May 2013, the total tax revenue net of SACU payments reached R50 billion compared to the total expenditure of R73.8 billion while the non-tax revenue was about R0.6 billion. As the country adopts less expansionary fiscal policy stance to reign in the deficit, national Government spending remained broadly unchanged at 29.9 percent in both in 2011/12 and 2012/13 fiscal years.

The domestic debt of national Government increased significantly from R1, 071 billion as at 31 March 2012 to R1, 241 billion at the end of March 2013. Between March 2012 and March 2013, foreign debt increased from R117 billion to R125 billion. Consisting of domestic and foreign debt, national Government’s gross loan debt
increased from R1 188 billion to R1 366 billion between March 2012 and March 2013, reaching 42.5 percent of GDP compared to 39.9 percent the same period last year. About 90 percent of national Government debt constitutes domestic borrowing with foreign debt accounting for the balance.

**External Sector:** The trade deficit decreased to R7.7 billion in March 2013, its lowest level in 2013 but accelerated further to R15.9 billion in May 2013 due to subdued demands for manufactured exports and a rapid expansion in import demands. The trade balance had been in deficit for 17 consecutive months since January 2012. Improvement in trade balance towards the end of the first quarter, coupled with improvement in the shortfall of net service, income and current transfers, led to the current account deficit of 5.8 percent in the first quarter of 2013 compared to a 6.3 percent deficit registered for 2012 as a whole. The current account deficit is fully financed by capital inflows, which reached 6.8 percent of GDP in the first quarter of 2013 from 6.5 percent in 2012 as a whole. Inward FDI reached R12.9 billion in the first quarter of 2013 from an outflow of R1.4 billion in the final quarter of 2012. According to UNCTAD’s World Investment Report 2013, inward FDI flows to South Africa declined by 24 percent in 2012 to USD 4.6 billion, mainly due to divestment by a foreign mining company during the fourth quarter of 2012. Portfolio investment inflows shrank to R1.4 billion in the first quarter of 2013 from R12.5 billion in the fourth quarter of 2012 mainly due to ongoing concerns about the sustainability of South Africa’s current-account deficit, a bleak outlook for domestic economic growth and the downgrading of the country’s sovereign credit ratings. These have affected foreign investors’ appetite for domestic securities. In terms of outward FDI stock, South Africa remains the second largest developing country investor in Africa after Malaysia, according to the same UNCTAD report.

Between end of March 2013 and end of May 2013 the ZAR depreciated by 10.9 percent and 9.3 percent against the euro and the USD, respectively. On the other hand, the real effective exchange rate of the ZAR declined by 11.2 percent between April 2012 and March 2013, improving South Africa’s external price competitiveness. In addition to the widening current account deficit, violent labor unrest in the mining sector in May 2013, which highlighted the risk of continued supply disruptions, contributed to a further weakening of the ZAR. Gross international reserves continue to decline, reaching USD 48 billion in May 2013 from USD 51 billion in January 2013, covering about five months of imports.

**III. ISSUES NEEDING PARTICULAR ATTENTION**

South Africa’s mining sector continues to be plagued by endless labor unrest and infighting among trade unions for recognition. The unprotected strikes in the platinum mines in 2012 left about 44 mineworkers and security officers dead, thereby destabilizing the sector, and leading to a collapse in mining output and a slowdown in economic growth. The instability in the mining sector also prompted the downgrading of South Africa’s sovereign credit ratings by three major ratings agencies. The continued labor disputes are eroding investor confidence, scaring away FDI that the country badly needs and threatening to destroy one of the country’s most important economic sectors, which has negative implications for employment. The Government should take decisive policy actions to stabilize the sector and improve investor confidence. The mining pact brokered by the Deputy President between labor unions, mining companies and Government is seen as crucial in reviving the ailing industry. Nevertheless, like its predecessor signed during the first quarter of 2013, this pact is unlikely to quell the rivalry between feuding unions and continued demands for moderate wage increase due to the entrenched positions of the unions and observable gaps in worker remuneration.
HIGHLIGHTS

- The approval of the PFM Bill by Cabinet is a major step towards implementation of the PFM Action Plan that is being supported by various donors.

- Despite increasing liquidity in the banking sector, credit growth has been slow. This, however, has helped in reducing the interest rates on Government paper.

I. MACROECONOMIC MANAGEMENT OVERVIEW

Economic Growth: The Central Bank of Swaziland reported that primary sector growth was mixed while the secondary sector remained depressed during the first quarter of 2013. Economic growth was therefore likely to be weak and unlikely to have changed significantly in the second quarter. The agricultural sector experienced declines in maize, citrus and livestock production. The agricultural sector supplies a large proportion of the manufacturing sector’s input. Poor growth in the agricultural sector, therefore, has adverse implications for the latter sector’s growth. In mining, positive growth was recorded. Coal production more than doubled to 93,057 metric tons while unprocessed iron ore grew by 44.8 percent in the first quarter of 2013 compared the volumes in the last quarter of 2012. As against this, quarried stone production decreased by 20.3 percent to 60,267 cubic meters down from 75,631 cubic meters the previous quarter. Lower growth in quarry production reflects a weak construction subsector that is still to recover from the effects of the fiscal crisis. Mining and construction sectors constitute less than 5 percent of GDP, hence the impact on overall growth would be minimal.

The continuing uncertainty in the global economy and the projected weaker growth in South Africa present downside risks to Swaziland’s growth outlook. Global growth was revised downward, with Swaziland’s main trading partner South Africa now expected to grow by only 2 percent in 2013 compared to the previous projection of 2.5 percent. The challenge that Swaziland faces, in view of its limited market size, is ensuring a competitive economy. Significant reforms, including some legislation that has economic implications, are needed to improve the business environment. The good news is that the Government realizes the urgency for reforms and some progress is being made in that regard. However, there are delays in getting some legislation passed. The Plant Health Protection Bill is one such example where Swaziland’s ability to continue exporting agricultural products is threatened. As a member of the World Trade Organization, Swaziland is expected to put in place legislation that will ensure transparency in agricultural exports as part of the agreed international standards.

Monetary Policy and Banking System: By the end of the first quarter of 2013 headline inflation declined to 6.6 percent, much lower than the 8.2 percent recorded during the last quarter of 2012. This trend has continued, despite the temporary increase in prices in February 2013. Slower increases in prices of ‘housing and utilities’, which constitutes almost 30 percent of household expenditure, helped reduce inflation. The price index for ‘housing and utilities’ increased by 5.7 percent in March
compared to 5.9 percent in February. Transport, which has a weight of about 10 percent of total expenditure, continued on a downward trend decreasing from 2.9 percent in February to 2.6 percent in March 2013. Given no fuel price adjustments in April and May, the decrease in inflation recorded in April is expected to hold and thus end at below 5.5 percent in June 2013. Persistently high food and oil prices and a relatively weaker ZAR, however, are the main upside risks for inflation in the outlook period; international prices of maize, meat and wheat have increased recently, on account of poor harvests in the United States of America; and uncertainty in global oil prices also remain due to tensions in the Middle-East. In addition, a 9.3 percent tariff increase for electricity, effective from June 2013, is likely to exacerbate pressure on inflation.

Low economic activity has caused a reduced demand for credit despite the low interest rate policy that has been adopted by the Central Bank of Swaziland. Private sector credit demand contracted by 1.1 percent in March 2013 compared to an annual growth of 1.1 percent recorded in January 2013. Growth in household credit was 2.3 percent, lower than the 4 percent recorded in January 2013. Year-on-year motor vehicle credit maintained its downward trend, recording a contraction of 7 percent after a 8.1 percent contraction in January 2013. Overall, the country’s foreign reserves have been increasing. Foreign reserves remain above the three-months target level. In May 2013, foreign reserves were about E 7.4 billion, representing 3.9 months of import cover. However, by mid-June 2013, reserves had fallen to 3.4 months of import cover.

**Fiscal Policy:** Although the Government increased the capital budget by about 25 percent in the current fiscal year, implementation of the capital projects has been slow to take off. The implementation rate of the capital budget in the 2012/13 fiscal year was 85 percent but it is expected to be lower for the current fiscal year. It is therefore expected that the savings from the capital budget would reduce the overall borrowing requirements to finance the gap. While the reduction in company tax rates from 30 percent to 27.5 percent will result in revenue losses, measures have been put in place to compensate for the loss. Among these measures are the abolition of the allowances under the Development Approval Order, the introduction of presumptive and foreign-source income tax and tax on retirement funds. Total domestic revenues are therefore expected to increase to 16.1 percent of GDP in 2013/14 from 15.4 percent the previous fiscal year. The financing gap is therefore not expected to be any higher than projected in the budget.

Swaziland has modest public debt. As of end-March 2013, total public debt was 16.4 percent of GDP, a 4.4 percent increase from the E 2.72 billion recorded in December 2012. E 2.71 billion of this debt is owed by the central Government. A 50-basis point decline in the coupon rate for Treasury bills is expected to reduce the cost of domestic debt. Of the total public debt, 8.8 percent is external and 7.6 percent is domestic. External debt service is 18.2 percent of exports of goods and services, representing a debt-service ratio of 2.3 percent.

**External Sector:** Swaziland recorded an overall balance-of-payments (BOP) surplus of E 710.1 million during the last quarter of 2012, compared to a surplus of E 459.6 million in the third quarter. The improvement in the BOP surplus was on account of a surplus on the trade account combined with large net inflows in current transfers. Although lower than the third quarter, the current account recorded a surplus of E 278.9 million by end-December 2012. Major drivers of export receipts were sugar and textiles, which grew by 16 percent and 31 percent on a quarter-on-quarter basis, respectively. For sugar the increase in export earnings resulted from both higher volumes and prices. The diversification of textile markets in favor of South Africa helped boost revenues.

**II. INSTITUTIONAL AND STRUCTURAL REFORMS**

Swazi authorities are making progress with regard to PFM reforms. Mid-year budget reports are now being produced to enhance transparency. In June 2013, the PFM Bill was approved by Cabinet and now awaits Parliamentary approval. An increase in banking sector liquidity has enabled the Government to introduce 182, 273, and 364-days Treasury Bills while the coupon rates have fallen by 50 basis points. In addition, Communication Commission and Electronic Communications Bills were approved by Parliament on 23 June 2013 and now await the King’s assent. The two bills provide the legal framework for the liberalization of the telecommunication industry. The monopolistic nature of the industry has been singled out as the main reason for the high communications tariffs in Swaziland.

**III. DONOR COORDINATION ACTIVITIES**

During the June 2013 Country Strategy Paper consultations in Swaziland the Bank shared information on potential areas of intervention with a view to soliciting co-financing opportunities. One of the country’s major donors is now expected to cover a gap in financing the completion of Phase I of the Lower Usuthu Irrigation Project. The Southern Africa Regional Resource Center is also continuing to engage with other development institutions and project sponsors to ensure wider mobilization of support to Swaziland.
IV. ISSUES NEEDING PARTICULAR ATTENTION

Institutional support remains a major area for Bank support to the Government of Swaziland. Such interventions will help in building local capacity to manage and implement reforms that are needed to take the country out of the middle-income trap. In particular, Swaziland’s ability to continue exporting agricultural products is threatened as the Plant Health Protection Bill has not been passed. Slow credit growth that has been experienced since last year reflects a cautious approach by the financial sector. This suggests Government still needs to build private sector confidence for sustainable economic recovery to take place.
HIGHLIGHTS

- The crop forecast for the 2012/2013 agriculture season indicates sufficient harvest to cover food requirements, although the maize harvest will be lower than the previous two harvest seasons.

- New Government agricultural reforms and the removal of fuel subsidies combined with lower agricultural production may slow growth in the short term as the economy adjusts. There is an increased likelihood that growth will fall below the Medium-term Expenditure Framework projection of 7.8 percent.

- There are concerns over the effects that the increasing wage bill will have on the fiscal deficit for 2013 and 2014.

I. MACROECONOMIC MANAGEMENT OVERVIEW

Economic Growth: The Ministry of Finance has not released any updated growth forecasts for 2013. A number of events during the period under review are likely to add downward pressure on the ambitious growth forecast of 7.8 percent (Medium-term Expenditure Framework 2013-2015). The downward pressure can be attributed to the following, among other things: The Ministry of Agriculture released the crop forecast for the 2012/2013 agriculture season indicating a fall in the total maize production compared to the previous agricultural season. The lower production was caused by an early outbreak of armyworm, poor rainfall patterns and the slow distribution of fertilizer. Production in the important staple crop maize fell by 11 percent to 2.5 million MT. Another important crop, cotton, has seen production being reduced by almost 50 percent. Other crops are seeing positive trends with increases in wheat, soybeans, sweet potatoes, and rice. Since the 4th quarter of 2012 copper production has been on an upward trend with solid increases from February to April. However, from mid-first quarter copper prices had been dropping below the USD 7,000/MT mark as by the end of June. This can be attributed to a decreasing demand for copper in Chinese manufacturing and the building up of global copper stockpiles. The end year estimate for total copper production is above 800,000 MT, up from 723,000 in 2012. The sectors driving the economy remain agriculture, construction, transport and communications, and manufacturing. Recent increases in fuel prices by more than 21 percent and rising pressure to increase wages in the private sector will add to production costs. As overall prices adjust this will put downward pressure on demand, contributing to an overall slowing of the economy. There is therefore an increased risk that the targeted growth rate will not be reached in 2013.

Monetary Policy and Banking System: The second quarter has seen an increasing overall inflationary trend with inflation rising to 7.3 percent on a year-on-year basis at the end of June. This trend has fully eliminated the downward inflationary trend that was observed in the first quarter that ended at 6.6 percent. The driving force behind the increase is rising food prices. Throughout the quarter food prices have increased from 6 percent at the end of the first quarter to 7.1 percent at the end of the second quarter. Although fuel prices increased by 21 percent in April, non-food price increases slowed in May and stood by the end of the second
quarter at 7.6 percent on a year-on-year basis. Citing the increase in food prices and fuel, and the depreciation of the Zambian kwacha, the Central Bank increased the benchmark policy rate by 25 basis points at the end of May to 9.25 percent. An additional 25 basis points increase of the policy rate was implemented at the end of June, bringing the rate to 9.75 percent. A weakening trade balance and upward trend in inflation has since July 2012 weakened the kwacha against the USD and the GBP, depreciating by 11.4 percent and 10.4 percent, respectively. This has prompted some concerns from businesses that mainly rely on imports for their business. During the past three months the ZMW/USD has decelerated depreciation, which stood at around ZMW 5.42 per USD for the month of June. The ZAR has been weakening since the first quarter with the kwacha appreciating by more than 10.1 percent from January to June (selling at ZMW 0.542 against the ZAR in June from ZMW 0.602 in January). Broad money (M2) growth has slowed down from 26.2 percent at the end of February to 16.8 percent (year-on-year) in April, reducing to levels similar to those in the second half of 2012. Average bank lending rates have stabilized around 16.1-16.3 percent, coming down from 23 percent over a year ago. At the end of April 2013, commercial bank loans and advances grew by 43.5 percent compared to 41.5 percent in January. Total loans and advances stood at ZMW 17.5 billion from ZMW 16.8 billion at end January.

Fiscal Policy: The 2013 State Budget is targeting a total expenditure of ZMW 31.6 billion (26.6 percent of GDP), of which recurrent expenditure will account for ZMW 22.1 billion and capital expenditure ZMW 9.5 billion. Domestic revenues are expected to finance ZMW 24.7 billion, of which income tax will account for ZMW 12.8 billion and value-added tax ZMW 6.0 billion. The mining sector’s contribution to revenue amounts to more than ZMW 4.8 billion in corporate taxes and royalties. Grants from aid agencies will finance ZMW 1.5 billion (5.8 percent of the total revenues), and the remaining through external and domestic borrowing.

The preliminary estimates for the first five months of 2013 indicate that total expenditure has been 7.9 percent below the aggregate budgeted spending by end May of ZMW 13.6 billion. However, the capital budget is falling behind with more than 36 percent of aggregate budgeted expenditure of 4.2 billion, whereas the current expenditure is slightly above budget (ZMW 9.4 billion) with 6.1 percent. Unbudgeted fuel payments (ZMW 1.2 billion) before the subsidy was removed and an extraordinary increase in the public wage bill by more than ZMW 880 million have increased the risk that the budgeted fiscal deficit will surpass the 5.4 billion planned for all of 2013.

External Sector: Exports continue to be driven by copper, as well as exports of maize, raw hides and alcoholic beverages. Capital goods needed for the mining sector are driving imports. Exports and imports have continued to increase into the middle of the second quarter with monthly exports and imports falling in May and June. The 12- month rolling trade surplus improved in the first quarter but slightly deteriorated in the second quarter. On a 12-month basis the trade surplus amounted to ZMW 3,205 million at the end of June 2013. Second-quarter exports amounted to ZMW 14.3 billion, compared to ZMW 13.5 the previous quarter. Imports during the same period amounted to ZMW 13.6 billion compared to ZMW 12.8 billion the previous month. During this period non-traditional exports (copper wire, gemstones, tobacco, sugar, cotton and maize) have maintained the previous period’s level and account for 34 percent of total exports. Gross international reserves have continued to decrease into the month of April, reaching USD 2.5 billion from the highpoint of USD 3.4 billion in October 2012. The main reason for the reduction has been the Central Bank’s efforts to stabilize the kwacha, as well as one-off payments for fuel. At the end of April the import cover amounted to 2.9 months (USD 2.50 billion), down from 3.9 months (USD 3.07 billion) at end-December 2012 and well below the Central Bank’s target of four months’ import cover.

II. INSTITUTIONAL AND STRUCTURAL REFORMS

The PF Government has openly acknowledged that past subsidies were not benefitting the poor and were becoming exceedingly expensive. Fuel subsidies were one area with subsidies amounting to ZMW 754 million in 2012 and expenditure of more than ZMW 1.2 billion has already been incurred in 2013. The PF Government therefore took bold steps to dismantle fuel subsidies in April, resulting in an increase in fuel prices of more than 21 percent.
The Government later in April took additional steps to reform the Maize Miller’s Subsidy by removing the ZMW 5 discount that millers received when buying maize from the Food Reserve Agency. Furthermore, steps were taken to return to the 50-50 cost-sharing arrangement between Government and farmers for the Fertilizer Input Support Programme, effectively increasing the farmers’ contribution from ZMW 50 to ZMW 100. A total of 900,000 farmers will still benefit from the FISP through the promotion of crop diversification by being provided with 10 kg bags of different types of seed.

The Food Reserve Agency has in the past few years overspent on their budget by between 200 and 2,500 percent, which has affected the Government’s budgets. This year the FRA will purchase 500,000 MT of strategic maize from the 2013 agricultural season, but will still be allowed to purchase any excess maize not purchased by the private sector. These purchases would mainly be made in remote rural areas with difficult access, making purchases relatively costly.

III. DONOR COORDINATION ACTIVITIES

The Bank and the African Capacity Building Foundation sponsored an event in May to establish the Regional Community of Practice on Managing for Development Results for the Common Market for Eastern and Southern Africa. The event brought together more than 150 participants from eastern and southern African countries. The main results included the launch of the COMESA-CoP focusing on the public sector, the private sector and civil society; the definition of a governance structure for the CoP-COMESA with members of the core management team appointed, and sharing of good practices on select regional policies and on managing for results.

In June the Africa-Asia Dialogue Forum hosted a four-day conference on achieving universal health coverage through reforms in health financing. The event was co-sponsored by the AfDB and was well attended by multilateral and bilateral donors from Africa and many agency headquarters. Among other things the event addressed how best to extend access to a range of essential health services in order to prevent individuals, households or communities from being excluded from healthcare services.

IV. ISSUES NEEDING PARTICULAR ATTENTION

In the short to medium term the developments of the Government’s fiscal deficit ensuing from the removal of fuel subsidies, reforms in the maize subsidies and an increase in the public Wage Bill by 45 percent should be monitored. Developments in the fiscal deficit should be particularly monitored as the effects of the Wage Bill increase starts to take effect from September. The effects of the Wage Bill adjustment when fully implemented in 2014 would amount to more than 3.5 percent of the GDP, whereas the unbudgeted fuel subsidy has already cost over 1 percent of the GDP.

In April the Central Bank issued a Statutory Instrument Monitoring of Balance of Payments Regulation. This regulation followed criticism from mainly the private sector and replaced a new statutory instrument (SI 55) that took into account some of the criticism. The main criticism was that it would add to private sector business costs and create unnecessary bureaucracy. The revised regulation increases the transaction threshold to which it applies from USD 10,000 to USD 20,000 and expands the income repatriation period to 120 days from 60 days.
HIGHLIGHTS

• The economy is expected to grow by 5 percent in 2013. However, preliminary results of the crop and livestock assessment have indicated reduced agricultural output for most crops. Manufacturing output also continues to be constrained.

• During the first five months of 2013 the external sector reflected a worsening current account deficit, mainly due to the sluggish performance of exports.

• The fiscal sector is likely to remain under stress due to financing requirements for the general elections.

• Inflation continues to decelerate underpinned by the weakening of the ZAR against the USD, as well as low consumer demand due to tight liquidity.

I. MACROECONOMIC MANAGEMENT OVERVIEW

Economic Growth: While the Government expects economic growth to stabilize around 5 percent in 2013 and 2014, on the back of mining and agriculture, preliminary results of the crop and livestock assessment have indicated reduced agricultural output for most crops, including maize, cotton, beans, and sorghum, among others. This has been mainly due to the erratic rainfall and prolonged dry spell experienced during the 2012/13 rainy season. In addition, a survey conducted during the 2013 Zimbabwe International Trade Fair revealed that liquidity constraints, high utility costs, as well as depressed demand continued to militate against increased capacity utilization. This means most economic challenges that faced Zimbabwe in 2012 are expected to spill over into 2013. The year 2013 is again expected to reflect slow activity due to uncertainty around the process and outcome of the elections.

Monetary Policy and Banking System: Annual growth rate of broad money supply (M3), defined as total banking sector deposits (the net of interbank deposits), declined from 31.0 percent in May 2012 to 12.2 percent in May 2013. The higher growth rates recorded in the past were a reflection of the low base from which money supply was growing when the economy adopted the multicurrency system in 2009. The low levels of money supply growth that are currently being obtained are consistent with the level of economic activity. On a month-on-month basis, M3 declined from 4.4 percent in April 2013 to 1.3 percent in May 2013. Demand, savings and short-term deposits declined while long-term deposits increased. Among other factors, if the economy’s external balance of trade improves, and Zimbabwe is able to attract more FDI and portfolio investment, then the liquidity constraints in the economy would improve.

Zimbabwe’s annual inflation continued on a downward trend in the second quarter of 2013, underpinned by the weakening of the ZAR against the USD, as well as weak aggregate demand in the economy due to liquidity constraints. It decelerated from 3.97 percent in June 2012 to 1.87 percent in June 2013. The year-on-year food and non-alcoholic beverages and non-food inflation stood at 2.90 percent and 1.35 percent, respectively. The main categories responsible for the decline in annual inflation in June include communications (-13.40 percent); clothing and footwear (-0.50 percent) and recreation and culture (-0.33 percent). On a monthly basis, inflation increased from -0.21 percent in May 2013 to -0.13 percent in June 2013. Food and non-alcoholic beverages and non-food inflation stood at -0.33 percent and -0.03 percent respectively. The increase in month-on-month inflation in May 2013 was underpinned by the increase in the prices of alcoholic beverages and tobacco (0.17 percent), recreation and culture (0.12 percent) and miscellaneous goods & services (0.06 percent). Commercial and merchant bank-weighted average lending rates for individuals softened from their April 2013 levels of 14.58 percent and 17.77 percent, to 14.25 percent and 17.66 percent in May 2013 respectively. However, over the same period, commercial and merchant bank-weighted average lending rates for corporates firmed from 9.66 to 9.89 percent and 14.35 to 17.02 percent respectively. The range in three-month and savings deposit rates of commercial banks for May 2013 has remained at the November 2012 levels of 4-20 and 0.15-8, respectively. Deposit and savings rates have not improved despite the Memorandum of Understanding between the Central Bank and banks in January 2013, which encourages banks to increase these rates in a bid to attract more savings and deposits into the formal banking system.
Fiscal Policy: The revenue outturn for May 2013 amounted to USD 303.59 million. This brought the cumulative total for the five months to USD 1,412 billion, an improvement of 10.77 percent compared to the same period in 2012. The improvement in revenue outturn largely reflects improved revenue collection by the Zimbabwe Revenue Authority (ZIMRA). The total expenditure for May 2013 amounted to USD 340.48 million, exceeding revenues by USD 36.89 million. Against a cumulative revenue outturn of USD 1,412 billion, Government incurred a deficit of USD 36.95 million. The fiscal position is expected to worsen, in the coming months, as the Government seeks to accommodate election-related expenditure, estimated at USD 107 million. Pressures on the fiscus may adversely affect growth as the Government may be forced to continue accumulating domestic arrears, with negative consequences on service delivery and competitiveness, or redirect funds from the planned public sector investment program towards financing of the elections. Enhanced donor support would thus be required to reduce the negative impact of election-related financing, on the budget. Zimbabwe remains indebted to a number of multilateral development institutions, including the World Bank and the AfDB and arrears clearance remains the top priority of the Government.

External Sector: Trends in the external sector during the first five months of 2013 reflected a worsening current account deficit, largely driven by the trade deficit. The trade deficit stood at about USD 1.9 billion during the five months to May 2013, having increased from USD 1.3 billion over the year. The increase was mostly caused by the sluggish performance of exports. Exports continue to be dominated by primary products, with primary mining products constituting about 62 percent; tobacco constituting about 8 percent and sugar (raw beet sugar and cane sugar in solid form) constituting about 4 percent of the exports. This demonstrated the potential that the country can have in value-added exports, harnessing the competitive advantage it already has in these primary products in the export market.

Imports during the period January to May 2013 increased by about 23 percent compared to the same period in 2012. Unlike exports, imports cut across all categories though some commodities are more pronounced. In May, the main drivers of imports included fuel, which constituted about 20 percent of total imports, followed by motor vehicles (including goods vehicles and trucks), which constituted about 7 percent of the imports while basic food imports (maize, wheat, rice, millet, oats and barley) constituted about 5 percent. The increase in imports implies the crowding out of locally manufactured products from the local market. FDI inflows remain volatile despite the establishment of a one-stop shop in 2010 to facilitate FDI.

II. INSTITUTIONAL AND STRUCTURAL REFORMS

The IMF Staff Monitored Program: On 7 June 2013, the Government of Zimbabwe reached an agreement with the IMF for a staff-monitored program (SMP). The agreement on the SMP marks a significant step towards normalizing Zimbabwe’s relations with the IMF and other creditors, who rely on an IMF seal of approval. For Zimbabwe, the SMP, which runs for nine months from April to December 2013, entails the IMF staff working with authorities on macroeconomic policy reforms. The main objectives of the SMP are to strengthen fiscal sustainability by ensuring expenditure is kept in line with fiscal revenues, increasing investment in infrastructure and priority social spending, and clearing outstanding domestic arrears; rebuilding international reserves; increasing financial sector stability through reforms and tightening the regulatory and supervisory framework; and advancing the structural reform agenda, including public finance management, tax policy and revenue administration, as well as increasing transparency in mining, particularly in diamond revenues.

Elections: The Zimbabwe Constitutional Court ruled on 4 July 2013 that the harmonized election will be held on 31 July 2013, as proclaimed by the President following a 31 May 2013 Order to proclaim the election before 31 July 2013. The Constitutional Court ruling was in response to a request by the Movement for Democratic Change (MDC) and some other applicants to give more time for preparations, including mobilizing the required funding and reforms. The Southern African Development Community (SADC) had, at its Extraordinary Summit of Heads of State and Government in Maputo, on 15 June 2013, agreed on the need for
the Government of Zimbabwe to engage the Constitutional Court to seek more time beyond 31 July 2013 for holding the harmonized elections to provide time to institute measures to create a conducive environment to hold peaceful, credible, free and fair elections. With the date confirmed, political parties are now focused on campaigning in preparation for the harmonized elections.

**Resuscitating the Manufacturing Sector:** The Zimbabwe National Chamber of Commerce (ZNCC) held its annual congress in Victoria Falls from 12 to 14 June 2013 to deliberate on ways to resuscitate the manufacturing sector. Debates during the ZNCC congress revealed that the growth of industry in Zimbabwe is hampered by challenges regarding competitiveness as firms are producing at higher costs compared to competitors from other countries. The underperformance of key enablers such as the railways, water delivery and electricity due to the poor state of infrastructure is among the causal factors for the low competitiveness of manufacturing output. Such infrastructural blockages have been identified as a policy issue for a long time. During the same period, on 13 June, the Government launched the Zimbabwe Leather Sector Development Strategy at the Zimbabwe International Exhibition Centre in Bulawayo. The strategy is intended to introduce measures to boost the leather sector industry in the country, which has suffered from deindustrialization.

### III. DONOR COORDINATION ACTIVITIES

The Zimbabwe Field Office continued to participate in a number of donor coordination activities during the period under review, including the following:

(i) Participation in meetings aimed at mapping the way forward for the IMF Staff-monitored program for the country and arrears clearance.

(ii) Donor consultation meetings - The Zimbabwe Field office hosted a number of donor consultation meetings during the quarter, including with DFID, USAID and ZIMSTAT aimed at harmonizing the partners’ support in improving the country’s economic statistics; the UNDP Country Director’s courtesy meeting with the AfDB and discussions on areas of collaboration in debt management and capacity building; ACBF, UNDP and the Ministry of Finance on collaboration in the implementation of the capacity building for the public finance and economic management project (CBPFEM) approved by the Board in December, 2012; and Worley Parsons Resources and Energy company from South Africa on opportunities for their Company Strategy in Zimbabwe. The office also continued to participate in thematic sessions including the monthly meeting between the World Bank and the AfDB to discuss current activities undertaken by the two institutions in advice on policy, knowledge work and technical assistance; the PFM meeting between the donors and the office of the Accountant General, etc. The ZIMFUND continued to hold a number of technical meetings on the ZIMFUND financed projects.

### IV. ISSUES THAT NEED IMMEDIATE ATTENTION

- **Debt and Arrears Clearance:** Arrears clearance remains a top priority for Zimbabwe. As of January 2013, Zimbabwe owed the World Bank USD 976.45 million, USD 127.4 million to the IMF, USD 587 million to the AfDB, while the European Investment Bank was owed USD 244 million. The Government of Zimbabwe will in this regard be working with international financial institutions to determine its eligibility for debt relief and arrears clearance support.

- **FDI:** The establishment of a one-stop shop for investors in 2010, the Zimbabwe Investment Authority (ZIA) was expected to result in more investment. However, while the total value of investment approvals reached a peak in 2011 at about USD 6.6 billion, the value of investments fell by about 86 percent in 2012. Also, despite the ZIA approving about USD 10.2 billion worth of investment projects between 2008 and 2011, for instance, only about USD 709.5 million actual FDI came into the country. This gave an implementation rate of about 6.9 percent, which is worrisome for a country whose growth rate has slowed down. There is need to investigate and address the bottlenecks delaying the implementation of approved investment projects.