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PREFACE
The Southern African Resource Center (SARC) of the AfDB produces the Southern Africa Quarterly Overview and Analysis. The publication is part of the ADB’s surveillance of economic and policy developments in Southern African countries. It also draws some implications of quarterly developments for the outlook period. Individual country reports are prepared by the country economists and produced from information gathered through consultations, the review of country documents and other relevant sources.

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I. REGIONAL OVERVIEW

ECONOMIC GROWTH
Growth in Southern Africa in the third quarter of 2014 was generally subdued, and none of the countries are expected to meet the Southern African Development Community (SADC) macroeconomic convergence target of 7 percent in 2014. The strongest growth was registered in Mozambique (6.9 percent) and Zambia (6.5 percent). Mozambique benefitted from strong growth in agriculture, fisheries and coal mining and Zambia from strong growth in agriculture. Malawi’s growth is expected to remain steady at 6.2 percent in 2014 supported primarily by good maize and tobacco harvests. In São Tomé and Príncipe (STP) growth is likely to reach 5 percent in 2014, up from 4.3 percent in 2013, supported by growth in agricultural productivity, foreign direct investments (FDIs) and the construction sector.

The rest of the region is expected to continue on a moderate growth path. Quarterly growth decelerated in Lesotho, Namibia and Botswana, reflecting a contraction of publicly funded construction activities (in Lesotho), subdued performance of the mining sector (in Botswana), and contraction of manufacturing and mineral processing, as well as lower livestock exports (in Namibia). The South African economy recovered to a modest growth rate of 0.6 percent in the quarter under review, following a contraction in the previous quarter. The economy is still suppressed by domestic structural constraints such as electricity supply and labour unrests, as well as weak performance of the global economy, and remains one of the slowest growing economies in the region. Mauritius grew at a modest 3.4 percent, reflecting sluggish global demand, and subdued capital investments in construction and domestic manufacturing. Swaziland is expected to grow at a slower pace (2 percent in 2014), reflecting lower output from coalmines due to geological and technical challenges, and a decline in iron ore mining due to unfavourable international prices. Zimbabwe’s economic growth is expected to drop to 3 percent in 2014, lower than the 6 percent growth rate projected at the beginning of the year. The lower-than-expected growth is a result of a confluence of factors including low capacity utilisation in manufacturing due to power shortages, liquidity constraints, and low demand, and contraction of output in the mining sector due to lower international commodity prices and power shortages. Angola is expected to record the steepest deceleration in growth in 2014, with growth expected to decline to 3.9 percent compared to 6.8 percent recorded in 2013, reflecting mostly the low oil exports that were a result of unscheduled maintenance and repairs in some ageing oil fields. However, growth in the non-oil sector remained strong at 7.3 percent, improving the expected outturn.

INFLATION
Inflation remained in the single digit level across the region, except in Malawi, where it accelerated to 24.5 percent in August 2014, from 22.5 percent in June. Initially, a devaluation of the Malawi kwacha (MWK) in 2012 triggered high inflation in Malawi, which accelerated in the third quarter of 2014 due to rising food prices, and a looser monetary policy stance adopted to reduce the cost of government borrowing in the face of fiscal constraints. Zimbabwe recorded the lowest inflation rate of 0.09 percent supported by low domestic demand and decreasing food and non-food prices. Lower food and fuel prices contributed to containing inflation within the SADC convergence target of 7 percent in 2014. The strongest growth was registered in Mozambique (6.9 percent) and Zambia (6.5 percent). Mozambique benefitted from strong growth in agriculture, fisheries and coal mining and Zambia from strong growth in agriculture. Malawi’s growth is expected to remain steady at 6.2 percent in 2014 supported primarily by good maize and tobacco harvests. In São Tomé and Príncipe (STP) growth is likely to reach 5 percent in 2014, up from 4.3 percent in 2013, supported by growth in agricultural productivity, foreign direct investments (FDIs) and the construction sector.

Countries in the region (except Mozambique, Zambia, Angola and Mauritius) are expected to meet the SADC convergence target of fiscal deficits not exceeding 3 percent of Gross Domestic Product (GDP) in 2014. Improvements in the fiscal performance were recorded in Botswana, Lesotho and
Namibia, which posted fiscal surpluses of between 0.97 and 5.7 percent of GDP. The performance is attributed to fiscal consolidation measures (in Botswana and Namibia), strengthened domestic resource mobilisation (in Namibia), low budget execution and increased Southern Africa Customs Union (SACU) revenues (in Lesotho). Despite this positive performance, there are concerns over the rising public wage bill in Namibia. Zimbabwe is expected to record a budget deficit of 0.67 percent of GDP in 2014, falling slightly short of its balanced budget target. This performance reflects high recurrent expenditure, as well as a lower revenue outturn, which can be explained by lower corporate taxes due to company closures and low consumer taxes due to low demand. Elsewhere in the region, fiscal deficits widened. On the expenditure side, the deficits reflected increasing capital expenditures (Angola, Mozambique and Swaziland), an increasing public wage bill (Mauritius, South Africa and Swaziland), increased grants to autonomous entities (Mauritius) and increased allocations to provincial governments (South Africa). On the revenue side they reflected continued suspension of budget support (in the case of Malawi), lower revenues due to weak performance of oil exports (for Angola) and lower corporate income tax and value added tax (VAT) (Mauritius). Fiscal deficits in Mozambique (12.5 percent of GDP) and Zambia (5.1 percent of GDP) were the highest in the region during the quarter under review, reflecting strong capital investments.

The external balance continued in surplus in Botswana and Lesotho, benefitting from the recovery in diamond exports and a contraction of imports (Botswana), and from improved exports in textiles and clothing as well as higher SACU receipts (Lesotho). Consistently, foreign currency reserves increased to 15 months of import cover in Botswana and 5.8 months in Lesotho. In Angola, while the current account remained in surplus, a decline was recorded owing to the decline in crude oil exports, slow growth in diamond exports, and increasing imports driven by growth in construction and maintenance activities. In Mauritius and Namibia, a narrowing of current account deficits (and improvement in the volume of international reserves) was recorded, benefitting from slower growth in imports due to weak performance of the construction sector, improved performance of the tourism sector (Mauritius), increased diamonds receipts and a growth in SACU receipts (Namibia). However, a number of countries registered a widening of the current account deficit during the quarter under review. This performance is explained by the lower exports due to suspension of uranium exports and growth in imports to support expansion of manufacturing activity (for Malawi), low exports due to industrial action in platinum sector (for South Africa), a drop in the trade surplus and deterioration of service account deficit (for Swaziland), and a decrease in non-traditional exports (for Zambia). Overall, most countries met the SADC convergence target of a current account deficit of not more than 9 percent of GDP, with the exception of STP, Zimbabwe and Mozambique. On the contrary, only three countries (Angola, Botswana and Mauritius) achieved the SADC target of six months of import cover with respect to international reserves.

Reforms aimed at addressing structural constraints to growth were evident in nearly all countries in the region and included public finance management and energy sector reforms in Angola, revision of the regulatory and legal framework for extractive industries in Mozambique, establishment of public private partnership (PPP) legislation and institutions in Namibia and Malawi, approval of legislative instruments to reopen land restitution efforts in South Africa, as well as review of customary land legislation in Zambia. These reforms are occurring in the context of a number of entrenched challenges in the region, including the need to accelerate economic diversification and widen the export base in the region’s resource rich countries, and to address infrastructural constraints across the region. In Zimbabwe, efforts to re-engage with the international financial community are yet to yield results, leading to a deepening liquidity crisis. The successful conclusion of phase two of the International Monetary Fund (IMF) staff monitored programme (SMP) in December 2015 is seen as crucial to the re-engagement process. Finally in Malawi, continued efforts to build robust and sustainable Public Finance Management (PFM) systems are important to restore confidence and unlock budget support and should be complemented with measures to improve efficiency in spending.
Key Macroeconomic Indicators for SADC Countries in 2014 (2015 Targets)

**Real GDP Growth**
- Target for SADC: 7 percent

**Inflation**
- Target for SADC: 6 percent

**Government Debt**
- Target for SADC: < 68 percent of GDP

**Budget Deficit**
- Target for SADC: within 3 percent of GDP

**Current Account Balance**
- Target for SADC: < 9 percent of GDP

**International Reserves**
- Target for SADC: > 6 months of import cover

Source: International Monetary Fund, World Economic Outlook Database, April 2014
Note: SADC targets do not apply to São Tomé and Príncipe
II. COUNTRY ANALYSES
HIGHLIGHTS

- Angola’s GDP growth was expected to moderate to 3.9 percent in 2014 down from 6.8 percent in 2013 due to the decline in oil exports and deceleration of agriculture output.

- The process of rebuilding infrastructure and improving quality of public services was a priority to the government.

- Continued improvement of public expenditure management was needed to ensure sustained macroeconomic stability.

I. MACROECONOMIC MANAGEMENT OVERVIEW

Economic Growth: Angola’s GDP growth was expected to average 3.9 percent in 2014, down from 6.8 percent registered in 2013. This was mainly due to the decline in oil exports and deceleration of agriculture output. The non-oil sector continued to be the main growth driver; it was expected to grow by 7.3 percent in 2014, mostly due to strong investments in agriculture, manufacturing, electricity and services. After an initial decline in oil exports, by 8 percent between January and July 2014, which was due to unscheduled maintenance and repair works in some ageing oil fields, oil output recovered and reached 1.7 million barrels per day by end-July 2014. To guarantee the sustainability of the recently achieved macroeconomic stability, the government was putting in place a sound economic policy mix with a focus on better public expenditure management. In July a new tax code for the non-oil sector was approved. Reforms were continuing to restructure the energy sector, phase out subsidies and improve efficiency. Investments worth USD 2.4 billion were in place to revitalise the country’s food and beverage industry, as part of import substitution and infant industry development policies. These measures were expected to generate 13,000 new jobs during the period 2013-2017. The conclusion of the pre-qualification process for auctioning 10 new onshore oil blocks in the Kwanza basin and lower Congo, as well as the on-going exploration in the pre-salt oil fields opened new prospects for the oil industry. Despite Angola’s significant oil wealth, unemployment and poverty remained high. Unemployment stood at 26 percent, and the poverty headcount ratio was estimated at 37 percent of the total population, of which 60 percent was in rural areas.

Monetary Policy and Banking System: Government efforts to reduce inflation were successful. The combination of tight monetary policy, a stable exchange rate and declining international food and fuel prices contributed to the softening in inflation from 7.84 percent in January 2014 to 7 percent in August 2014. However, end-year inflation was projected to rise slightly to 7.5 percent, reflecting the impact of the phasing-out of fuel subsidies in September 2014 and an import tariff schedule that entered into force in March 2014. Broad money supply (M3) increased by 2.17 percent owing to a slight increase in time deposits. In line with declining inflation, the short-term interest rate (LUIBOR overnight) fell from 6 percent at end-2013 to 3.63 percent in August 2014, and the Central Bank reduced its policy rate by 50 basis points, from 9.25 percent to 8.75 percent in July 2014 (the second decrease in eight months). The declining interest rates induced credit growth of nearly 19 percent, mostly directed to households,
private sector companies, wholesale and retail trade and real estate. The new foreign exchange law led to a significant change in the structure and composition of credit, with a significant increase in the loans denominated in local currency (currently accounting for 73 percent of total credit). Meanwhile, Angola’s financial soundness indicators pointed to a stable financial system, although the level of non-performing loans increased from 6.1 percent to 9.8 percent by end-2013.

The nominal exchange rate depreciated slightly from AOA/USD 97.08 in July to AOA/USD 97.61 in August 2014, mostly due to lower-than-expected oil export revenues, which resulted in a weaker external trade surplus. This led to a 15 percent widening of the spread between the official and parallel exchange rate markets. The IMF’s September 2014 staff report suggests that Angola’s real effective exchange rate was overvalued and would need to depreciate by almost 15 percent in order to restore equilibrium.

Fiscal Policy: Angola’s fiscal revenues had been vulnerable to international crude oil price volatility and had not always been able to keep pace with expenditures. Data from the Ministry of Finance show that total expenditure increased by 47.7 percent during the first six months of 2014, driven by vigorous implementation of the public investment infrastructure programme. In contrast, total revenue declined by 11.6 percent, due to a 21 percent reduction in oil revenues. Despite international oil prices standing below the 2014 state budget’s benchmark price of USD 98 per barrel at the time, the fiscal execution of the budget had not been affected with the overall fiscal balance standing at 3.7 percent of GDP.

Oil exports declined by 8 percent between January and July 2014, reflecting unscheduled maintenance and repair work in some oil fields. Exports for the year were expected to decline by 3.5 percent as production recovered in the second semester. Total oil production reached 1.7 million barrels per day in July from 1.48 million barrels per day in May (the lowest output level in 14 months). A recovery in oil production during the second half of the year was expected to contain the decline in oil revenue. Meanwhile, total public expenditure (currently estimated at 40.7 percent of GDP) was expected to increase to 41.7 percent of GDP, mostly due to an increase in spending on goods and services, and on infrastructure.
4.1 percent in 2014 down from 5.5 percent in 2013, as the revenues from crude oil exports continued to decline. Preliminary data from the Angola Customs Services show that exports declined by 37.7 percent during the first half of 2014 as a result of lower-than-expected oil output and slow growth of the diamond industry. By contrast, imports increased by 17.3 percent, mostly driven by importation of oil industry equipment, construction materials, chemical products, vehicles and jet fuel.

IV. ISSUES NEEDING PARTICULAR ATTENTION

The progress Angola had made at the time in terms of economic management, most notably the success in reducing inflation and keeping the macroeconomic indicators stable, was encouraging. However, the authorities needed to accelerate the pace of economic diversification to reduce the dependence on oil and improve the efficiency of public investment.
HIGHLIGHTS

- The economy slowed down in the second quarter of 2014.
- Inflationary pressures eased since the beginning of 2014.
- Gross reserves remained strong at about 15 months of imports of goods and services.

I. MACROECONOMIC MANAGEMENT

**Economic Growth:** The economy slowed down in the second quarter of 2014; it grew by 4.5 percent compared to the 5.2 percent registered in the previous quarter. Real GDP growth was held back by the weak performance of the mining sector with diamond and copper/nickel production contracting by 1.5 percent and 21.3 percent, respectively. The mining sector was an important driver of economic growth in Botswana, contributing 26.6 percent to the country’s GDP in the second quarter of 2014. The uncertain external environment continued to pose substantial downside risks to Botswana’s economic outlook. Real GDP was expected to grow by an average of just over 5.0 percent during 2014-2016.

**Monetary Policy and Banking System:** Inflationary pressures eased since the beginning of 2014. Year-on-year headline inflation slowed to 4.5 percent in July 2014 before accelerating marginally to 4.6 percent in August. Core inflation also declined to 4.2 percent in August 2014, compared to 5.4 percent in August 2013. The declining trend in inflation between August 2013 and August 2014 was mainly on account of decelerating costs of transport as well as food and non-alcoholic beverages, which dropped by 5.5 and 1.8 percentage points, respectively. Inflation was expected to remain within the Bank of Botswana’s objective range of 3 to 6 percent in the medium term due to weak domestic demand and a moderation in external price developments. With inflationary pressures expected to remain benign, the authorities maintained the Central Bank rate at 7.5 percent in order to stimulate economic activity. The annual growth in credit extended to the corporate sector decreased from 15.9 percent at the end of June 2013 to 10 percent at the end of June 2014, while the annual expansion in credit to individuals fell from 27.3 percent to 18.6 percent during the same period.

**Fiscal Policy:** In line with medium-term fiscal consolidation goals, the government adopted a less expansionary fiscal stance in the 2014/15 financial year. Botswana’s fiscal position continued to improve, reflecting government’s prudent macroeconomic management and commitment to fiscal consolidation. Accordingly, the fiscal position remained strong, and for the third successive financial year since the 2008 global financial crisis a budget surplus was projected for 2014/15. A projected surplus equalling nearly 1 percent of GDP was on account of higher mineral revenue and efforts by the government to rebalance some spending priorities, including reining in unproductive elements of current expenditure. Accompanying measures pursued to achieve fiscal consolidation included restraining the size of the wage bill, broadening the revenue base, streamlining the large-scale discretionary tax incentives to minimise losses and continuing to restructure some of the state owned enterprises.

**External Sector:** The merchandise trade balance recorded a surplus of BWP 4.29 billion in the second quarter of 2014, compared to a deficit
BWP 1.36 billion in the first quarter. Exports increased significantly by 36 percent to BWP 17.02 billion, boosted mainly by the strong performance of diamond exports, which rose by 38 percent. On the other hand, imports totalled BWP 12.73 billion, an 8 percent contraction from the first quarter of 2014. Reflecting these developments, Botswana’s gross foreign reserves amounted to USD 8.5 billion at the end of June 2014, equivalent to about 15 months of imports. Trends in bilateral nominal exchange rates showed that on an annual basis (12 months to June 2014), the Botswana pula (BWP) depreciated against the major currencies (the euro by 5.9 percent, the pound sterling by 12.3 percent and the US dollar (USD) by 2.8 percent) while it appreciated by 3.4 percent against the South African rand the currency of Botswana’s main source of imports and manufactured exports. The appreciation against the rand was mainly on account of weakening of the rand against major currencies. However, this may have had some price-competitiveness implications on Botswana-manufactured goods in the South African market.

II. INSTITUTIONAL AND STRUCTURAL REFORMS

As part of the strategy to promote financial inclusion, legislative processes were underway to strengthen the Non-Bank Financial Institutions Regulatory Authority’s (NBFIRA) legal and regulatory infrastructure. These included: (i) reviewing the NBFIRA Act of 2006 to remove detailed regulatory and supervisory conditions and remedies from the Act and to assign such issues to sector specific legislation, (ii) re-enacting the Retirement Funds Act to repeal the Pension and Provident Funds Act (CAP27:03) in order to incorporate detailed regulatory and supervisory provisions from the NBFIRA Act, and (iii) re-enacting the new Insurance Industry Act to import all detailed processes and duties relating to the insurance industry from the NBFIRA Act as indicated above.

III. ISSUES NEEDING PARTICULAR ATTENTION

Over the medium term, potential growth will remain constrained by supply side factors. Botswana faces major challenges with adequacy and security of electricity supply due to inadequate generating capacity and level of available imports to complement domestic production to meet demand. The country should continue investing in high impact infrastructure to improve competitiveness, and further enhance skills development.
HIGHLIGHTS

- During the second quarter of 2014, the economy contracted by 5.5 percent; it was largely constrained by a recession in the construction, telecommunication and financial sectors.
- The government recorded a fiscal surplus equivalent of 5.7 percent of GDP largely on the back of low spending occasioned by delayed implementation of the budget.
- High energy and food prices largely drove inflation, which continued at above 6 percent.

I. MACROECONOMIC MANAGEMENT OVERVIEW

Economic Growth: The preliminary data for the quarter ending June 2014 showed growth contracting by 5.5 percent after picking up in the previous quarter. Growth was mainly constrained by a recessionary environment in the construction, telecommunications and financial sectors. Some of these sectors, in particular the construction sector, are dependent on government activity, which also contracted during the second quarter. However, growth improved in the manufacturing, mining, electricity, water and trade sectors. This represented a modest recovery from their transitional decline in the previous quarter. Recovery in the mining sub-sector was derived from favourable international prices for diamonds. The manufacturing sector was mainly bolstered by an increase in the production of food and beverages, and textiles and clothing. On the demand side, there was an increase in the household consumption of electricity owing to the winter season. This was complemented by the rise in consumption as a result of increased activity in mining and other sectors. The water sector was also bolstered by increased mining activities, in addition to new water connections.

Monetary Policy and Banking System: Owing to the decline in net domestic credit and slow increase in net foreign assets, monetary policy remained contractionary during the quarter ending June 2014. Money supply broadly defined as M2 contracted by 4.7 percent quarter on quarter following a 5.1 percent growth the previous quarter. The increase in SACU revenues and disbursements of donor funded projects (such as the Metolong Dam) coupled with slow government spending reduced domestic credit to government. While credit to the private sector marginally increased following upward adjustment to the salaries of civil servants and downward adjustment in the income tax rates, this was outweighed by the decline in net credit to government. Subdued economic activity somewhat reduced credit extension during the quarter under review. Net foreign assets increased owing to the increase in SACU receipts, but the increase remained marginal due to a drop in foreign deposits of business enterprises, including in mining, in response to the subdued economic conditions.

Following a decline at the end of the first quarter in March 2014, annual headline inflation steadily increased during the second quarter (April-June). Inflation increased from 5.9 percent at the beginning of the second quarter, reaching a period high of 6.7 percent in May before declining to 6.5 percent at the end of the quarter. The increase in inflation was on the back of increases in food and non-alcoholic beverages; clothing and footwear; housing; electricity, gas and other fuels; as well as transport. With close trade links between the two neighbouring countries, the bulk of Lesotho’s inflation was underpinned by price developments in South Africa.

Fiscal Policy: The government fiscal balance recorded a surplus of 5.7 percent of GDP during the second quarter following a deficit of 5.4 percent in the previous quarter. This was mainly underpinned by the drop in spending from both recurrent and capital expenditures, which allowed revenues to surpass total spending during the second quarter. The drop was observed in the purchase of goods and services owing to the low absorption occasioned by the slow process of budget implementation, which equally affected capital spending. Revenues dropped by 2.1 percent of GDP. The seasonally high payments of taxes in the first quarter of every year had a negative effect. Additionally, the decrease in taxes on international trade, in particular for diamonds (export taxes), also contributed to the drop in revenues. Other contributory factors included reduced interest earnings on property, and a decline in receipts from the Lesotho Highlands Water Project authorities, which affected revenues from the sales of goods and...
services. Notwithstanding the above developments, SACU revenues, which constitute 47 percent of total revenues, increased by 16.2 percent from the previous quarter. Public external debt reached 46.6 percent of GDP from 43.5 percent the previous quarter. External debt makes up 88.8 percent of the stock of public debt. Domestic debt increased by 2.8 percent from the previous quarter. Government non-bank borrowing in the form of short-term Treasury bills (T-bills) and long-term treasury bonds were the main drivers of the increase.

External Sector: During the second quarter the external sector as measured by the overall balance of payments recorded a surplus of 14.4 percent of GDP. The surplus in the current account narrowed to 3.9 percent of GDP during the second quarter, from 5 percent of GDP the previous quarter. The performance in the current account in part reflected an increase in SACU receipts that dominate the current transfers and improvements in exports of textile and clothing, which more than offset the decline in the diamonds exports. The net income account reached 20.8 percent of GDP, up 0.9 percent of GDP over the same period. A rise in the foreign portfolio earnings of the commercial banks and the Central Bank as well as lower interest payments on government’s external loans were the big drivers of the improvement in the net income account.

II. ISSUES NEEDING PARTICULAR ATTENTION

Low absorption of the donor funds remained a risk to planned investment and overall growth. Urgent measures were needed to improve the implementation capacity.

The second quarter registered a 6.7 percent increase in gross international reserves (equivalent to 5.8 months of imports), mainly supported by the build-up of government deposits, owing to the increase in the SACU receipts as well as the lower interest payments on external debt.
HIGHLIGHTS

- In September 2014 the Minister of Finance, Economic Planning and Development presented the budget for the 2014/15 fiscal year, amidst continued uncertainty regarding donor budgetary support to Malawi and a deteriorating fiscal position.

- The deceleration in consumer price index (CPI) inflation was reversed in August, as uncertainty over food situation heightened ahead of the agricultural lean season.

- The 2014 tobacco-marketing season closed in September with a 14 percent increase in sales volume, but with lower tobacco prices.

I. MACROECONOMIC MANAGEMENT

Economic Growth: Real GDP growth in 2014 was projected to reach 6.2 percent, up from 6.1 percent in 2013. Agriculture was to remain the key driver of growth. The sector was projected to grow by 5.6 percent in 2014, supported by a good maize harvest and expansion in tobacco output. Maize output during the 2013/14 crop season was 3.9 million metric tonnes, representing an increase of 8 percent over the previous season. Tobacco output in the 2014 season increased by 14 percent on the previous season’s output, reaching 188 million kilograms. However, the value of tobacco sales remained unchanged at the 2013 level of USD 366 million due to the decline in tobacco prices from an average of USD 2.15 per kilogram in 2013 to USD 1.81 per kilogram in 2014.

The manufacturing sector was expected to perform strongly in 2014 with a projected growth of 5.7 percent. The sector stood to benefit from improved availability of foreign exchange for importation of inputs, increased disposable income as inflationary pressures moderated, and stability in power supply following the commissioning of the Kapichira Hydro Phase II Project. On the back of increased agricultural production, strong performance in the agro-processing sub-sector was to underpin manufacturing growth. The construction sector was projected to grow at 5.6 percent, as implementation of large construction projects, like the Vale railway project and the national stadium, gathered pace. In contrast, growth in the mining sector was projected to slow down to 7.8 percent from 12 percent in 2013 on account of the temporary closure of the Kayelekera uranium mine owing to depressed uranium prices.

Monetary Policy and Banking System: Inflation, which had been on a downward trajectory since January 2014, started to pick up in August. Year-on-year inflation edged upwards to 24.5 percent in August 2014 from 22.5 percent in June. Urban and rural rates stood at 31.3 percent and 20.7 percent, respectively, compared to 29.9 percent and 18.5 percent in June 2014. Rising food prices was the main driver of inflation during the third quarter. Food inflation accelerated from 19.8 percent in June 2014 to 24.0 percent in August. The acceleration in food prices was likely to continue as the lean agriculture season commenced. End-of-period inflation in 2014 was projected at 14.2 percent in 2014, significantly higher than the initial target of 7 percent.

The Reserve Bank of Malawi had maintained a tight monetary policy stance in order to contain inflationary pressures and anchor expectations. However, in July 2014 the Reserve Bank reduced the policy rate by 2.5 percentage points to 22.5 percent, the first change since December 2012.
The pressure to bring down interest rates to support private investment and reduce the high cost of servicing government debt influenced the decision to cut the policy rate. In August, the Reserve Bank of Malawi issued a directive effectively capping yields on T-bills at 2.5 percentage points below the policy rate. The move was intended to defend the policy rate by bringing market interest rates closer to the policy rate and reducing the cost of government borrowing.

Overall, liquidity conditions improved compared to the previous quarter. Despite the improvement, market money rates declined in response to the fall in the policy rate. The average interbank interest rate decreased to 10.5 percent in September from 15 percent in June 2014. Commercial bank lending rates were also easing, albeit slowly. The average base lending rate remained high even though it decreased from 37 percent to 34 percent. On the other hand, the savings deposit rate was negative in real terms; it ranged from 9.6 percent to 7 percent. The high interest rates prevailing in the economy had eroded the debt servicing capacity of borrowers, leading to an increase in the ratio of non-performing loans in the banking sector. According to the latest financial stability report at the time, the ratio of non-performing loans to gross assets reached 15.7 in March 2014.

The weighted average yield on T-bills decreased from 24 percent in June 2014 to 18 percent in September, reflecting improved liquidity conditions. The authorities continued to restrain monetary expansion to contain aggregate demand. Growth in broad money supply declined to 14.2 percent in August from 24.8 percent in June.

Exchange Rate: Since June 2014, the Malawi kwacha (MWK) had remained relatively stable against the USD; it traded at around MWK 398 to 1 USD. The MWK’s stability was attributed largely to the Reserve Bank of Malawi’s purchases of foreign exchange from the private sector (mainly from tobacco sales) in order to support the local currency and build foreign exchange reserves. In September, the MWK depreciated by 3.5 percent against the USD. The MWK was expected to come under pressure during the next quarter as the lean tobacco season commenced and uncertainty about inflows of international development assistance continued.

At end September gross official foreign exchange reserves increased slightly, from USD 458 million at end June to USD 464 million (equivalent to 2.4 months of import cover). The Central Bank aimed to build foreign exchange reserves to the required minimum of three months coverage in order to provide an adequate buffer against exogenous shocks. Tight monetary policy was to support these efforts. While foreign exchange market pressures were likely to intensify during the lean tobacco season, the Central Bank considered the level of reserves at the time sufficient to minimise seasonal volatility in exchange rate movements.

Fiscal Policy: Fiscal performance deteriorated markedly in 2013/14, mainly on account of non-disbursement of programmed budgetary support and dedicated grants due to the “Cashgate” fiscal scandal. External grants as a share of GDP declined to 3.5 percent in 2013/14 from 10.5 percent in 2012/13. Tax revenue performance strengthened in 2013/14, increasing from 18 percent to 21 percent of GDP. However, the increase in tax collection was inadequate to compensate for the large shortfall in external grants. Total expenditure as a share of GDP fell marginally from 29.9 percent of GDP in 2012/13 to 29.7 percent in 2013/14. Recurrent expenditure increased from 23.7 percent to 25.2 percent mainly on account of higher-than-planned interest rate payments on the domestic debt. However, development expenditure declined from 6.2 percent of GDP to 4.6 percent, as some locally financed development projects had to be postponed. The fiscal deficit in 2013/14 widened from 1.7 percent in 2012/13 to 6 percent. The deficit was financed mainly from domestic borrowing. The fiscal pressure was exacerbated by an accumulation of payment arrears amounting to MWK 157 billion.

The 2014/15 budget presented to parliament in September reflected a prudent fiscal policy stance, and it was prepared on the assumption of no donor financing of the recurrent budget. The 2014/15 budget was estimated at MWK 742.8 billion, representing an increase of 14 percent on the previous year’s budget. An amount of MWK 535.1 billion (72 percent) was allocated to finance recurrent expenditure, while 28 percent of the budget (MWK 194.6 billion) was allocated to development expenditure. Overall balance was estimated at MWK 107.1 billion, to be financed by foreign borrowing (MWK 92.1 billion) and domestic borrowing (MWK 14.0 billion).
External Sector: The current account deficit was projected to widen from 3.5 percent of GDP in 2013 to 4 percent in 2014, mainly on account of the deterioration in the trade deficit. Export growth was projected to slow down to 1.7 percent in 2014 from 8.3 percent in 2013. The expected deceleration in export growth was attributed mainly to the suspension in uranium mining, which halted uranium exports. In 2013, Malawi earned USD 133 million from uranium exports. Tobacco export earnings in 2014 were projected to increase to USD 710 million from USD 610 million the previous year, reflecting the higher level of carry-over stocks from 2013. Import growth was expected to outstrip export growth by 2.8 percentage points, as demand for capital and intermediary goods increased in line with expansion in economic activity.

In August, the government announced the creation of a one-stop service centre housed under the Malawi Trade and Investment Centre. Five agencies were expected to second their staff to the centre to provide services to investors. They included the Malawi Revenue Authority; the Immigration Department; the Registrar’s office; and the Ministry of Lands, Housing and Urban Development. Private investment in infrastructure, particularly energy and transport, was to be promoted through PPP arrangements. A PPP law was passed in 2012, and government was developing the necessary institutional and regulatory capacity for PPPs. The PPP Commission had been established to provide regulatory oversight over PPPs and support sector ministries in PPP negotiations and transactions. Stronger policy coordination and predictability and macro stability was projected to be key in attracting private investment into strategic sectors of the economy going forward.

III. ISSUES NEEDING PARTICULAR ATTENTION

The 2014/15 budget was formulated in the context of a tight resource envelope and difficult fiscal conditions caused by the freeze in donor budgetary support arising from the “Cashgate” fiscal scandal. While the zero aid budget passed by parliament was prudent and conservative, fiscal risks remained high due to the constrained resource envelope. Fiscal discipline was, therefore, seen as critical to ensure that there would be no over-spending and to avoid payment arrears. In addition, measures to improve efficiency of spending were seen as important to create more room in the budget for priority spending, notably in the social sector.

Confidence in Malawi’s development partners' use of the country’s PFM system remained low in the wake of the “Cashgate” fiscal scandal. Building on the initial actions taken in response to the “Cashgate” incident, the government committed to intensify efforts to address the underlying causes of the fiscal scandal. The restoration of development partners and other stakeholders’ confidence in the PFM systems depended largely on improving the PFM systems in order to safeguard public funds. The key aspects requiring particular attention included stricter enforcement of PFM regulations and stronger budget oversight mechanisms. The government was developing a comprehensive PFM reform action plan. The plan was to include measures to enforce compliance with existing PFM regulations. Going forward, there was a need to build synergies between PFM systems and public sector reforms to ensure sustainability and impact.

Malawi’s current account continued to be in deficit due to persistent structural trade deficits. This underscored the importance of expanding and diversifying the export base to boost foreign exchange earnings. The National Export Strategy provided a sound framework for achieving this goal. The government committed to implement the strategy through adopting interventions aimed at building the production base and enhancing the capability of local enterprises focusing on priority clusters.

II. INSTITUTIONAL AND STRUCTURAL REFORMS

Malawi’s regulatory and institutional framework for private business was weak, indicating limited progress in structural reforms. The country was ranked 171 out of 189 countries on the 2014 Ease of Doing Business Index. Malawi had adopted reforms in order to streamline business registration and licensing procedures to reduce the time required to establish businesses and lower the cost of doing business. A number of key pieces of legislation, notably the Business Names Registration Act and amendments to the Company Act, were passed by Parliament in 2012 and 2013 in order to strengthen the regulatory framework. More reforms, however, were needed in order to improve the business climate and enhance Malawi’s competitiveness, both regionally and globally. The government had signalled its commitment to deepen business climate reforms in order to support private-sector-led growth and foster job creation.
HIGHLIGHTS

• Statistics Mauritius maintained its GDP growth forecast for 2014 at 3.5 percent, with domestic and global demand expected to remain relatively modest for the rest of 2014.

• At its July 2014 Monetary Policy Committee meeting, against a backdrop of excess bank liquidity and low inflationary pressures, the Bank of Mauritius decided to hold its key repo rate steady at 4.65 percent.

• Unemployment stood at 7.4 percent, down from 8 percent at the turn of the year and remained prevalent among young people and women.

I. MACROECONOMIC MANAGEMENT

Economic Growth: Preliminary estimates from Statistics Mauritius showed that, during the quarter under review, growth slowed to 3.4 percent year-on-year, against a backdrop of sluggish global demand and subdued capital investment levels. The principal drivers of growth during the period were financial intermediary services and information and communication technology, which grew by 7.3 and 5.4 percent, respectively. Tourism continued its steady performance in terms of tourist arrivals, on the back of higher arrivals from Asia. During the period July to September, arrivals reached 248,959, representing an increase of 350 arrivals over the corresponding period in 2013. As in previous quarters, the construction industry continued to be a drag, knocking 0.2 percentage points off growth during the quarter. Manufacturing was another major drag, making negative contributions of 0.5 percentage points. Major employment generators for Mauritius, the construction and manufacturing sectors were labour intensive, raising concerns regarding inclusive growth.

Latest CPI data released by Statistics Mauritius showed that headline inflation remained broadly stable throughout the period, dropping slightly to 3.9 percent in September 2014, from 4.0 percent recorded in June 2014, on the back of lower prices of vegetables and other food products and gasoline. Similarly, core inflation remained stable. Price growth was expected to remain well within the Central Bank’s target range of 3.0 to 6.0 percent for the remainder of 2014. The Central Bank was to maintain the key repo rate at 4.65 percent through the remainder of 2014 but remains concerned about the weak monetary policy transmission mechanism and the persistently low national savings rate. Monetary expansion, measured by the year-on-year growth rate of broad money liabilities, continued to remain subdued while growth in credit by the banks slowed down in July 2014, reflecting sluggish economic activity. The annual growth rate
of monetary base was 19.7 percent in August 2014 compared with 17.0 percent in June 2014.

**Fiscal Policy:** Fiscal space continues to narrow as growth in spending outpaces increase in revenues. Domestic fiscal revenues performed moderately during the quarter. Corporate income tax and revenue from value added tax were the main drivers of tax revenue, increasing by 3.8 percent and 2.4 percent, respectively. During the same period, total spending increased by 12.9 percent to reach MUR 48.05 billion, with a notable increase of 15.2 percent in compensation to employees. Another driver of expenditure during the period was grants to autonomous entities, which had been expected to decrease by 2.5 percent but instead increased by 9.5 percent. Capital grants excluding special funds increased by 6.6 percent, whereas they had been projected to decrease by 56 percent. Finally, other expenses increased by 5 percent. The budget deficit widened to 3.5 percent of GDP from 2.7 percent the corresponding period in 2013. Debt to GDP ratio reached 58.1 percent of GDP at end September 2014. Even though the country’s overall debt trajectory remained sustainable, the government therefore needed to accelerate fiscal consolidation to meet the 50 percent debt-to-GDP ratio in 2018 in line with the Public Debt Management Act.

**Balance of Payments:** During the third quarter of 2014, Mauritius’ current account deficit narrowed to 3.1 percent of GDP, from 3.42 percent in the previous quarter. This was driven in large part by the slow growth in imports of goods, which expanded by just 0.4 percent compared with 1.5 percent the previous quarter. The sluggish growth of import of goods, especially capital goods, was attributed to the weak performance of the construction sector. The services account surplus continued to trend upwards, growing by MUR 5.3 billion compared with MUR 4.6 billion in the corresponding period of 2013, driven to a large extent by the recovery in the tourism sector. The industry struggled in recent years, due largely to the two years of economic contraction in the eurozone, the principal source of visitors. However, the on-going economic recovery in the eurozone and expected increase in tourists from Asia and Africa was expected to see numbers beginning to pick up. The current account deficit was partly offset by a modest surplus on the capital and financial account, with FDI reaching MUR 4.32 billion. The main sources of the inflows were France (22 percent), South Africa (17 percent) and China (14 percent), with 50 percent directed towards real estate and close to 33 percent to the financial sector. It should be noted, however, that the level of FDI actually trended downwards during the quarter, resulting from the slowdown of inflows to the construction sector and investors seemingly taking a “wait and see” approach towards the revision of the double taxation avoidance agreement between Mauritius and India. The Bank of Mauritius continued to intervene in the foreign exchange market to bolster reserves and smooth volatility of the MUR. Gross foreign reserves increased over the period under review, from USD 4.02 billion at the end of June 2014 to USD 4.06 billion as at September 2014 (equivalent to 6.2 months of imports cover). In the 12 months ending in August 2014, the MUR depreciated against the euro by 2.2 percent and the pound sterling by 3.9 percent. However, it appreciated by 1.5 percent against the USD.

**II. INSTITUTIONAL REFORMS**

During the period under review, four banks (Barclays Bank Mauritius Limited, Bramer Banking Corporation Ltd, Standard Bank (Mauritius) Limited and the Mauritius Commercial Bank Ltd) got connected, on a real-time basis, to the SADC Integrated Regional Electronic Settlement...
System (SIRESS), a cross-border payment system dealing exclusively in ZAR-denominated payments and operated by the South African Reserve Bank (SARB), which also acts as the settlement bank. Spearheaded by the SADC Committee of Central Bank Governors and the SADC Banking Association, of which the Mauritius Bankers Association is a fully fledged member, SIRESS first went live in July 2013 in the rand Common Monetary Area (CMA) consisting of Lesotho, Namibia, South Africa and Swaziland. It has now been extended to non-CMA countries, namely Malawi, Mauritius, Tanzania, Zambia and Zimbabwe. Mauritian banks were the first in the group of non-CMA countries to effect transactions using the new platform on 15 September 2014. Other banks in Mauritius are expected to join the SIRESS platform in the 2015 phase.

III. DONOR COORDINATION

During the period under review the World Bank hosted a workshop to discuss the current opportunities and challenges facing Mauritius at the time, within the context of the World Bank’s Mauritius Systemic Country Diagnostic (SCD), a prerequisite to the World Bank’s Country Partnership Framework for Mauritius for the period 2015-18. The workshop brought together government representatives, the private sector, civil society and other resident development partners in Mauritius, including the AfDB. The discussions focused on the challenges that Mauritius needed to overcome to enhance the quality of growth and accelerate the country’s transition to a high-income country by 2025. One major area of importance for Mauritius was deepening human and institutional capacity in key areas of the economy, such as the electricity and water sub-sectors. In this regard, the AfDB approved a MUR 14 million grant in August 2014 to enhance the technical capacity of the Ministry of Energy and Public Utilities in water management by providing independent experts in dam planning, design and implementation.

IV. ISSUES NEEDING PARTICULAR ATTENTION

- The unemployment rate remained an issue of concern due to its structural nature. The government, in collaboration with the private sector, needed to continue exploring ways of addressing youth and women unemployment and skills enhancement.
- The on-going uncertainty over the future of Mauritius as a conduit through which funds are invested in India and Africa – taking advantage of favourable double taxation avoidance agreements – resulted in loss of the island state’s position as the primary source of FDI into India and was having a negative impact on Mauritian business. India and other countries such as South Africa were re-examining these arrangements and considering introducing general anti-avoidance rules to stem tax evasion. The Mauritian government needed to focus on finding a resolution with India over the revision of the double taxation avoidance agreement.
HIGHLIGHTS

- During the second quarter real GDP grew by 6.9 percent.
- The government introduced a revised budget with expenditure rising by 1.6 percent to 46.6 percent of GDP.
- A new legal framework for the hydrocarbons and mining sectors was approved during the quarter, including legislation regulating the sector’s operations and tax regimes.

I. MACROECONOMIC MANAGEMENT OVERVIEW

Economic Growth: During the second quarter the economy registered real GDP growth of 6.9 percent (0.7 percentage lower than the previous quarter). The secondary sector grew the fastest, growing by 10.9 percent supported by a 12.5 percent expansion in manufacturing. The tertiary sector lost some dynamism expanding by 6.6 percent. Production increased in agriculture by 6.3 percent and fisheries by 5.5 percent, while the progressive build-up in coal production pushed up growth in the extractive industries by 12.6 percent.

Monetary Policy and Banking System: Mozambique continued to experience deflation. CPI decreased in July (by 0.04%) and August (by 0.55%). Consequently, the yearly and the 12-month average of the CPI ended the period with a deflation of 2.64 percent and 3.25 percent, respectively. The minor gains of the Mozambican metical (MZN) against the ZAR and a good agriculture season were the main contributors to the reduction in the CPI. Despite the reference lending interest rate being at a historical low of 8.25 percent, the money market was showing signs of liquidity pressure. Maturities for T-bills and inter-money-market rates rose steadily since the previous quarter. The one-year average lending rate to the private sector was declining since June while credit to private sector was declining.

Fiscal Policy: The government presented a revised budget during the third quarter that included a USD 187 million windfall capital gains tax and USD 81.9 million from non-tax revenues collected during the first quarter. The added resources increased total expenditure by 1.6 percent of GDP, to 46.6 percent of GDP.

External Position: The foreign exchange market was mostly stable throughout the third quarter. The MZN appreciated by 1.71 percent against the ZAR but remained stable against the USD. Net foreign currency reserves benefitted from added inflows of aid and externally financed projects, increasing by 3 percent in the quarter to USD 3.243 billion (4.5 months of import cover).
II. INSTITUTIONAL AND STRUCTURAL REFORMS

Mozambique was in the process of revising its legal and regulatory framework for the extractive industries. During the third quarter parliament approved a new gas and petroleum law. The bill establishes that the state “controls production, transport, marketing and transformation of liquid and gaseous hydrocarbons and their derivatives”. In addition, the new law prohibits exporting all the gas; it requires that some of the gas be used in the domestic market. The bill also sets the framework for local content in the sector. Two additional pieces of legislation were put before parliament: a Mozambique mining tax law and a gas and petroleum tax law. It was expected that the new tax laws would be signed before the end of the year.

III. ISSUES NEEDING PARTICULAR ATTENTION

The high fiscal deficit was a cause for concern. The fiscal deficit after grants without windfall capital gains tax revenues from gas was estimated to reach 12.4 percent of GDP in 2014. The indicative decrease in donor pledges to the next year’s direct budget support made fiscal consolidation more urgent. A prudent fiscal stand required the containment of expenditures at the time, particularly the wage bill, as well as a reduction in capital expenditure. Contingent windfall revenues were able to ease the fiscal deficit, but it was not advisable to use it to finance expenditures at the time.
HIGHLIGHTS

- Economic recovery remained on-course although the momentum slowed down in the second quarter of 2014 with growth estimated at 3.0 percent from 4.4 percent in the first quarter.

- In tandem with the return to a tighter policy stance, the inflation rate continued to moderate, reaching 5.4 percent in August 2014 from 6.1 percent in June 2013.

- The budget balance for 2014/15 was projected to return to a surplus of 5.0 percent of GDP for the first time since 2008 as the authorities progressed with fiscal consolidation measures.

- The merchandise trade deficit in the second quarter of 2014 benefitted from a strong export performance, which helped narrow the current account deficit.

I. MACROECONOMIC MANAGEMENT OVERVIEW

Economic Growth: Prospects for sustained economic recovery remained strong, with second quarter growth estimated at 3.0 percent, albeit softer than the first quarter. Growth was largely driven by a robust construction sector, a recovery in mining and quarrying and electricity generation. Construction benefited from both public and private sector programmes, while mineral production accelerated on the back of improvements in operational efficiency and better grade mineral ores. Improved water levels at the Ruacana Reservoir increased local electricity generation by 27.7 percent. There was a significant contraction in manufacturing as mineral processing slowed down and subdued activities in hotels and restaurants weighed down growth. In the agriculture sector, an increase in marketed livestock bolstered economic activities although growth remained in negative territory. Livestock exports slowed down as stringent health regulatory requirements in South Africa came into effect in May 2014. The Namibian authorities revised upwards real GDP estimates to 5.4 percent in 2014 from 5.1 percent.

Monetary Policy and Banking System: The authorities continued with monetary tightening to stabilise escalating consumer prices. In August 2014, the Bank of Namibia increased the repo rate by 25 basis points to 6 percent. The year-on-year inflation rate since moderated from 6.1 percent in June 2014 to 5.4 percent in August 2014. It remained within the policy target range. Rising costs of food and transport exerted pressure on prices. Rising demand from the business sector drove the expansion of credit extended to the private sector by 3.8 percent at the end of June 2014 compared to 2.9 percent at the end of March 2014. During the period, credit extended to businesses rose by 6.8 percent, up from 2.6 percent, while private individuals’ credit grew by 2.0 percent in the period under review compared to 3.1 percent in the preceding period. At 55.1 percent, the commercial banks’ exposure to the “other residents” credit category, which largely comprises individuals, remained high and warranted close monitoring. The Bank of Namibia proposed some targeted intervention measures to address rising levels of credit to private individuals. The implementation of these measures was expected to take long, as legislative changes were required.

Fiscal Policy: Revised forecasts for 2014/15 showed that the government could achieve a budget surplus of 5.0 percent of GDP, returning to a surplus position for the first time since 2008. The 2013/14 budget recorded a deficit equivalent to 1.1 percent of GDP following a balanced budget in 2012/13 financial year. While growth in revenues benefitted from robust domestic tax mobilisation and SACU receipts, expenditure increased at a much faster pace. Underpinned by a stimulus environment, total spending during the 2013/14 fiscal year was 10 percent higher than the previous year, reaching 38 percent of GDP (still below the fiscal cap of 40 percent). Nonetheless, quarterly estimates showed a slight increase in nominal public debt stock with movements observed on both domestic and foreign debt. External debt was driven by disbursements on a loan from China and a 6.5 percent increase in the EuroBond on the back of a weakening NAD against the USD. In spite of the nominal increase, public debt as a share of GDP slowed down on a quarterly basis from 23.7 percent to 22.3 percent over the corresponding quarter. Public sector debt remained sustainable and significantly below Namibia’s fiscal benchmark of 35 percent of GDP. In the 2014/15 budget, the authorities committed to deepen consolidation
efforts through expenditure rationalisation and strengthening domestic resource mobilisation. The 2014/15 budget provided for NAD 22 billion spending on the public sector wage bill, which was expected to push the share of the wage bill to 22 percent of GDP, up from 15.8 percent in 2013/14 and representing almost 50 percent of total revenues. The rising level of the public sector wage bill needed attention and close monitoring if the government was to achieve fiscal sustainability.

External Sector: The current account balance improved on the back of a narrowing merchandise trade deficit. In the second quarter, the current account deficit narrowed to NAD 1.6 billion from NAD 3.3 billion in the previous period as growth in exports significantly outpaced that of imports. Exports grew by 24.8 percent while imports increased by 8.7 percent. Exports benefitted from an accelerated increase in receipts from diamonds and re-exports of vessels. Benefiting from an improved current account position and a surplus on the capital and financial account, the overall balance of payments moved out of a deficit position in the preceding period to register a surplus of NAD 1.4 billion in the second quarter. The capital and financial account registered a surplus of NAD 3.1 billion, up from NAD 1.5 billion in the preceding quarter. International reserves increased by about 9.2 percent to reach NAD 15.9 billion (equivalent to 2.1 months of imports); accelerated growth in net SACU receipts was the main driver here.

II. DONOR ACTIVITIES

In July 2014, the governments of Germany and Namibia signed an agreement worth an estimated NAD 1 billion (about 73.2 million euro) in technical and financial cooperation to assist Namibia in addressing joblessness and infrastructure development. The projects will be financed through the German Development Bank and the Deutsche Gesellschaft für Internationale Zusammenarbeit.

III. INSTITUTIONAL AND STRUCTURAL REFORMS

The authorities are progressing with reforms that aim to modernise public sector systems to improve performance and efficiency in service delivery. The government embarked on further consultations and redrafting of the new PFM Bill and the Audit Bill in preparation for re-tabling in parliament. The PFM Bill, which would replace the State Finance Act of 1991, seeks to improve transparency, accountability and efficiency in the use of public resources. The Audit Bill was being reviewed to take into account provisions of the new PFM Bill. The long awaited Procurement Bill was undergoing further consultation and re-drafting on parliamentary recommendation. Among its key provisions, the Procurement Bill proposed the establishment of the Procurement Policy Office, the Central Procurement Board and a framework to ensure preference was given to local individuals, companies and entities. Following the adoption of the PPP policy, the authorities also started formulating enabling legislation.

IV. ISSUES NEEDING PARTICULAR ATTENTION

Government efforts to create employment were commendable, although youth unemployment and skills mismatch remained an issue of concern. The authorities needed to reinforce the development of skills in science, technology, mathematics and engineering to respond to labour market needs. The government was urged to continue with efforts to create an enabling environment for private sector development. This was expected to reduce the pressure on the government wage bill.
SÃO TOMÉ AND PRÍNCIPE (STP)

HIGHLIGHTS

• Real GDP grew by 4.3 percent, with the service sector the main driver.
• Foreign reserves stood at 5.1 month of imports.

I. MACROECONOMIC MANAGEMENT OVERVIEW

Economic Growth: In 2013, São Tomé and Príncipe’s (STP) economic performance was rated satisfactory during the review conducted under the extended credit facility programme 2012-2015 with the IMF. Driven by the service sector, real GDP grew by 4.3 percent, compared to 4 percent reported in 2012. The government projected the economy to grow by 5 percent in 2014, on account of an increase in agricultural production (particularly organic cacao) and FDI and in the construction and tourism sectors.

Monetary Policy and Banking System: Supported by easing of food price and fuel products in international markets as well as the fixed exchange regime, the government kept its inflation target at 6 percent for the year 2014. Driven by hotels, coffee and restaurants (4.9 percent); culture and entertainment (3.7 percent); housing, energy and fuel (2.8 percent); and education (2.1 percent), the inflation rate stood at 7 percent at the end of the third quarter 2014, at the same level obtained in the third quarter of 2013. Credit to the economy, in particular to private sector, expanded by 0.77 percent, driven by a 0.99 percent increase in local currency credits and a 0.23 percent decrease in the credit in foreign currency. To strengthen the credibility of the financial sector, the Central Bank concluded the process for the resolution of Island Bank, which was acquired by Energy Bank STP.

Fiscal policy: In January 2014, parliament approved the 2014 state budget, estimated at USD 159 million. The budget was USD 9 million more than the 2013 budget. The bulk of the capital expenditure (93 percent) was to be funded by external aid (47.6 percent from grants and 52.4 percent from loans). Improving public service delivery continued to top the government’s agenda. The general public services sector is the main consumer (taking up 18.8 percent of the budget) followed by housing and community services (15.4 percent) and infrastructure (transport and telecommunication (14.1 percent)). The government estimated that the primary budget deficit, at 3 percent of GDP, was to be financed by World Bank budget support, resources from heavily indebted poor countries and transfers from the national oil accounts.

In the first semester of 2014 (January-June 2014), in terms of revenue collection, the government mobilised, mainly through non-tax revenue, 39 percent of the programmed resources for the year 2014. Tax revenue also performed well, with 38 percent of the resources collected against the programmed resources. With regards to the current expenditure, the government had up until that point consumed 53 percent of the allocated
budget for the year. The government also received about 18 percent of the programmed grant resources, mainly through project grants.

**External Sector:** The current account deficit, including official transfers, was projected at 15 percent of GDP in 2014, down from 20.2 percent of GDP observed in 2013. The expected positive performance was linked to improvement in the trade balance, the result of a reduction in imports of goods (projected at 36 percent of GDP in 2014 from 40 percent observed in 2013), and current transfers.

II. INSTITUTIONAL AND STRUCTURAL REFORMS

**Public Sector Development:** The government continued its efforts to attract private investors. During the period of analysis, the government, with support from the Investment Program Association (IPA) and the World Bank’s Angola projects, managed to mobilise funds to build 52 houses in the district of Mé-Zochi. Similarly, the government also mobilised funds through the IPA to build a new city in São Tomé that was to be completed within 58 months. The programme also entailed the abolition of printed documents and adopted electronic means to approve signatures. This project, estimated at USD 2.6 million, was to be financed by the World Bank Group and the AfDB.
HIGHLIGHTS

- The economy grew by 0.6 percent in the second quarter, narrowly avoiding recession.
- The unemployment rate increased to 25.5 percent in the second quarter from 25.2 percent in the first quarter.
- South Africa registered trade deficits for three consecutive months in the third quarter.

I. MACROECONOMIC MANAGEMENT

Economic Growth: The economy grew by 0.6 percent in the second quarter, narrowly avoiding recession following a 0.6 percent contraction during the first quarter of 2014. The growth was driven by the transport, storage and communication industries and general government services, which increased by 4 percent and 2.9 percent, respectively. The traditional growth drivers, the mining and manufacturing sectors, contracted by 9.4 percent and 2.1 percent, respectively during the quarter, due mainly to prolonged labour strikes. In spite of the decline in primary sector output, growth in agriculture output (driven by higher crop production) accelerated to 4.5 percent in the second quarter from 2.5 percent in the preceding quarter. Growth in the tertiary sector, driven by transport and general government services, remained at 1.8 percent during the second and the first quarters. Economic growth was constrained by continued labour unrest and constrained electricity supply. Weak investment by the private sector due to deteriorating business confidence was also contributing to slower growth. On the demand side, growth in real gross domestic expenditure decelerated to 1.8 percent in the second quarter from 2.7 percent in the preceding quarter. This was due to moderation in real final consumption expenditure by households and real gross fixed capital formation. On the other hand, net exports deducted 1.3 percentage points from growth during the second quarter. Slower growth in household consumption was mainly due to slower growth in real disposable income (1.3 percent in the second quarter compared to 1.7 percent in the previous quarter) as a consequence of rising inflation and labour unrest that negatively affected the growth in wages. Tighter lending conditions also contributed to weak household demands. Growth in real gross fixed investment by private business enterprises contracted by 1.1 percent in the second quarter from a growth of 1 percent in the preceding quarter. This was due mainly to the decline in fixed investments in the mining, trade, construction, transport and personal services sectors. Lower fixed investments in the electricity and transport sectors led to a 0.7 percent contraction in fixed investment by public enterprise in the second quarter from a growth of 6 percent in the preceding quarter. The unemployment rate increased to 25.5 percent in the second quarter from 25.2 percent in the preceding quarter. Between the second quarter 2013 and second quarter 2014, the economy created 403,000 jobs. The main employers were community and social services, trade and private households. The manufacturing and agriculture sectors continued to shed jobs. Economic growth is expected to improve in the third quarter owing mainly to a stable labour environment.

Monetary Policy and Banking System: Consumer price accelerated to 6.6 percent in May and June before falling to 6.3 percent in July. It picked up to 6.4 percent again in August 2014. Inflation remained above the 6 percent upper limit of the monetary policy target since April 2014. Inflation was driven primarily by higher fuel and food prices. Core inflation increased to 5.7 percent and 5.8 percent in July and August, respectively, from 5.6 percent in June. Nonetheless, total inflation of both regulated and non-regulated administered prices decreased to 6.2 percent in August from 8.6 percent in June 2014. The upside risk to inflation remained the continued weakening of the exchange rate of the rand and wage demands in excess of inflation and growth in labour productivity.

Credit to the private sector grew by 9.7 percent in July 2014 compared to 8.6 percent in June while growth slowed to 8.7 percent in August. Growth in private sector credit is driven primarily by improved demand for imports and capital investments. On the other hand, the growth of total domestic credit has improved to slightly above 9 percent in both July and August compared to 8.5 percent in June.
Stock Exchanges: During the five-year period of September 2009 to September 2014, the return of the FTSE/Johannesburg Stock Exchange (JSE) All Share Index declined while its level of volatility improved. The one year return in rand for the All Share Index declined from 32.7 percent in the June 2009 to June 2014 period to 15.4 percent in the September 2009 to September 2014 period. On the other hand, one-year volatility of the All Share Index declined from 11.8 percent to 10.5 percent during the same period. Similarly, for the Top 40 Index, the one-year return declined from 35.2 percent in the June 2009 to June 2014 period to 15.2 percent in the September 2009 to September 2014 period. The five-year return reached 128.9 percent and 127.8 percent for the All Share Index and the Top 40 Index, respectively in the current period. The Top 40 Index remained more volatile than the All Share Index, with volatility reaching 11.4 percent for one year and 13.3 percent for five years, compared to 10.5 percent for one year and 12.1 percent for five years for the All Share Index. The market capitalisation reached over USD 1 trillion at the end of May 2014 from USD 966 billion at the end of January 2014, while the monthly liquidity ratio was 32 percent in May. The equity markets in emerging economies generally displayed higher average returns, low correlation with returns in developed markets, and higher volatility. Nonetheless, since South Africa’s capital market was well developed, it is more integrated with the global capital markets, and therefore volatilities in major global capital markets had direct bearing on the level of volatility in South Africa’s capital markets. Thus the FTSE/JSE Index volatilities were driven both by global and local market sentiments.

Fiscal Policy: Depressed by the slowing economic growth, in the July to August period, total government revenue reached R130 billion. On the other hand, total government expenditure for the two months reached R207 billion leading to a budget deficit of R77 billion on account of higher current account payments and transfers and subsidies. During the preceding quarter, the national government revenue was R217.3 billion compared to total expenditure of R253.4 billion, leading to a budget deficit of billion or 4.1 percent of GDP. During the same quarter, national government’s primary deficit amounted to R15.9 billion or 1.8 percent of GDP compared to a primary deficit of 1.5 percent of GDP during the same period the previous year.

External Sector: During the second quarter, South Africa’s export performance was dented by the prolonged industrial action in the platinum mining sector, weaker global demand and declining commodity prices. As

Driven by higher long-term borrowing by the domestic banking sector, South Africa’s total external debt reached R 1.487 billion (40.7 percent of GDP) at the end of March 2014, up from R1.435 billion (39.1 percent of GDP) in December 2013. Total foreign debt increased to 120.1 percent of export earnings, up from 117.8 percent year-on-year. Nonetheless, South Africa’s 7.9 percent debt service to export ratio for the period 2009 to 2013 was far below the IMF/World Bank debt sustainability framework threshold of 15 to 25 percent. Due to large redemption during the second quarter of 2014, public foreign debt declined from R144 billion at the end of March to R132 billion at the end of June 2014. Total public gross loan debt, including both domestic and foreign debt, increased to 1.640 billion at the end of June 2014 from R 1.584 billion in March 2014, reaching 46.8 percent of GDP, up from 45.9 percent. New issuance of domestic bonds and T-bills to meet the fiscal deficit in the quarter contributed to the rise in total public debt. Domestic public debt accounted for 90 percent of total public debt.
a result, the trade deficit increased to R101 billion (2.8 percent of GDP) in the second quarter, up from R75 billion (2.1 percent of GDP) in the first quarter. Moreover, driven by higher net income payments to non-resident investors, the deficit on services, income and the current transfer account also widened, leading to a 6.2 percent increase in the current account deficit in the second quarter of 2014, up from 4.5 percent in the first quarter.

The current account deficit was financed by capital inflow. In spite of the country’s subdued economic growth and the continued tensions in the labour market, the net capital inflow reached R43.2 billion in the second quarter, up from R 39 billion in the first quarter. The increase in capital inflow was mainly driven by portfolio investment, which increased to R27.4 billion in the second quarter from R12.3 billion in the preceding quarter. Direct investment also expanded in the second quarter, reaching R24.6 billion from R8 billion in the preceding quarter. As a result, the balance on the financial account reached 4.8 percent of GDP in the second quarter, from 4.5 percent in the first quarter.

In July and August 2014, driven by an increase in policy interest rate and end of the labour strike in the manufacturing sector, the nominal effective exchange rate of the appreciated by 1.4 percent. The also appreciated against the USD, the British pound and euro by 0.1 percent, 2.7 percent and 3.7 percent, respectively during the same period. Similarly, the real effective exchange rate appreciated by 0.2 percent from June 2013 to June 2014. This did not, however, have a significant negative impact on the external price competiveness of the export sector. Gross international reserves increased marginally from USD 48.6 billion in June to USD 49.7 billion in August 2014, covering about 5.6 months of imports.

II. ISSUES NEEDING PARTICULAR ATTENTION

The economy narrowly avoided recession in the second quarter after a mild contraction in the first quarter. Growth continued to be hampered by a host of structural factors. Infrastructure deficit in the power sector remained a key bottleneck to growth. Although the government had been spending billions of USD in infrastructure investment in the years leading up to the period under review, the pace of implementation remained slow due to technical, capacity and labour issues. Power generation by the first of six units at the Medupi mega power project had been delayed for over three years. The government needed to ensure timely completion of the project to help reduce the current energy deficit and boost investor confidence.
HIGHLIGHTS

- Real GDP growth continued on a positive trajectory from 2 percent in 2012 to 2.8 percent in 2013, but a moderation was expected in 2014, mainly due to subdued prospects in South Africa.

- The inflation rate rose from 5.3 percent in June to 6.0 percent in August 2014, mainly driven by an increase in transport prices.

- The IMF noted the need for the authorities to resolve the country’s eligibility status for the African Growth and Opportunity Act (AGOA) by January 2015 so as to pre-empt the plausible adverse significant social and employment impacts.

I. MACROECONOMIC MANAGEMENT OVERVIEW

Economic Growth: Preliminary estimates indicated the onset of a modest recovery with real GDP growth improving from 2 percent in 2012 to 2.8 percent in 2013. Growth was expected to moderate to 2.1 percent in 2014, reflecting subdued prospects in South Africa, the country’s major trading partner. While there was paucity of overall quarterly data on economic performance, trends in output in major sectors indicated a mixed performance. Information from the Central Bank of Swaziland indicated that in the mining sector, coal production remained on a downward trend for the fifth successive quarter, declining to 39,701 tonnes in the second quarter of 2014 from 40,972 tonnes in the first quarter, reflecting persistent geological and technical challenges. A significant decline of 23 percent was also registered in production of iron ore – from 262,524 tonnes in the first quarter of 2014 to 203,233 tonnes in the second quarter of 2014 – due mainly to a slump in international iron ore prices that discourage production volumes. In contrast, quarry production increased by 19 percent reaching 74,903 cubic metres in the quarter ended June 2014, reflecting positive performance in the construction sector.

Monetary Policy and Banking System: During the quarter under review, the monetary authorities resolved to increase the discount rate by 25 basis points to 5.25 percent in its meeting in July 2014 and left it unchanged in the subsequent meeting in September 2014. This decision was guided by trends in key economic indicators in the local economy, particularly growth in credit extension to the private sector. Consequently, commercial banks reduced the prime rate to 8.25 percent in August from 8.5 percent in June. Annual growth in credit extended to the private sector decelerated to 14.4 percent in August 2014 compared to 18 percent recorded in June 2014, with credit to businesses amounting to 54.7 percent of the total. The expansion in credit to businesses was mainly in the mining and quarrying, and distribution and tourism sectors. Credit extended to the household sector accounted for 39.7 percent of the total and was largely extended for mortgages and the acquisition of motor vehicles. It was expected that the interest rate stance would create an environment for commercial banks to increase lending to the business sector, particularly small- and medium-sized enterprises, ultimately enhancing job creation and stimulating economic growth. Inflationary pressures continued, with the rate of inflation rising from 5.3 percent in June to 6.2 percent in July before declining marginally to 6.0 percent in August 2014. The higher prices reflected the recent increase in administered prices, mainly in electricity and water tariffs, fuel prices, public transport fares and a weakening of the exchange rate.

Fiscal Policy: According to the 2014/15 financial year budget, the total resource envelope amounted to ZSL 15.3 billion, representing an increase of 19 percent over the level in the 2013/14 financial year. However, the country’s dependence on SACU revenues was expected to continue, although the government was making efforts to improve domestic revenue mobilisation. To this end, the Swaziland Revenue Authority embarked on upgrading the Automated System of Customs Data aimed at improving customs administration, including the direct payment of VAT at the border. Thus, in the 2014/15 financial year, SACU receipts were expected to finance 49 percent of the budget compared to 56 percent in the 2013/14 financial year. On the expenditure front, recurrent and capital expenditures were expected to increase by 9.3 and 44 percent, respectively. As a result, the overall fiscal outturn was expected to decline from a surplus of 4.3 percent in the 2013/14 financial year to a deficit of less than 1 percent of GDP in the 2014/15 financial year.
External Sector: Data for the first quarter of 2014 showed that the overall balance of payments remained in surplus at SZL 300.2 million (0.8 percent of GDP), although this was a remarkable deceleration from the surplus of SZL 638.2 million (1.7 percent of GDP) in the previous quarter. This outcome mainly reflected a turnaround in the financial account to a surplus that counteracted the deceleration in the current account surplus. The lower surplus in the current account reflected a decline in the trade account surplus as well as a deterioration in the services account deficit. However, movements in the financial account counteracted the impact of the smaller current account surplus on the overall balance of payments. Preliminary figures indicate that during the quarter ending March 2014, the financial account recorded a remarkable turnaround, registering a surplus of SZL 485.3 million from the deficits recorded in the last three quarters since June 2013. This mainly emanated from substantially higher net inflows amounting to SZL 402.2 million from SZL 4.9 million recorded in the previous quarter, thereby leading to an overall surplus in net FDI. The increase in FDI reflected a rise in reinvestment earnings that counteracted the higher capital outflows arising from enhanced long- and short-term loans. Recent data on gross foreign reserves show a slight decline from SDR 455.5 million at the end of June 2014 to SDR 427.5 million at the end of September 2014, equivalent to 3.6 months of imports of goods and services. The decline was mainly due to government’s external obligations.

II. INSTITUTIONAL AND STRUCTURAL REFORMS

The Prime Minister launched the government’s Programme of Action 2013-18 on 30 June 2014. The document spells out the initiatives aimed at helping the authorities to move the country into first-world status by 2022. To this end, it contains eight focal areas: economic prosperity, agriculture and environmental sustainability, education, health, service delivery, infrastructure, and governance and anti-corruption. The programme’s prevailing theme is to ensure an expansion of large-scale foreign and domestic investment and substantially accelerated growth in small-, medium- and micro-scale enterprises, which was expected to give rise to taxes and duties that would enable government to meet the service targets of 2022. The formulation of the programme entailed broad stakeholder consultations and also informed the Swaziland Development Index (SDI), which specifies current (baseline) data for each indicator and provides a useful monitoring framework to gauge progress for annual targets to 2018 and subsequently to 2022.

III. ISSUES NEEDING PARTICULAR ATTENTION

While it was notable that Swaziland continued to register surpluses in the trade account, a development regarding the country’s eligibility in the AGOA may have been a cause for concern. In June 2014, the US announced that the country’s AGOA eligibility would be withdrawn in January 2015. The decision followed protracted engagement with the government on concerns about its implementation of the AGOA eligibility criteria related to worker rights. After an extensive review, the US government concluded that Swaziland had not demonstrated progress on the protection of internationally recognised worker rights. According
to the IMF Article IV report released in July 2014, the authorities were making efforts to meet the conditions by the end of 2014, with a view to renewing the AGOA eligibility. The report noted that if Swaziland lost its eligibility from 2015, the trade and growth impacts would likely have been moderate, given the relatively low share of the textile industry contribution to GDP. Nonetheless, such an eventuality could have large employment and social impacts, because the textile sector employed about 17,000 Swazis, and the country was still grappling with a high unemployment rate, estimated at about 29 percent.
HIGHLIGHTS

- GDP growth was maintained at 6.5 percent. Growth was expected to remain strong in the medium term.

- The Zambian kwacha (ZMW) stabilised around 6.1 against the USD, following a 13 percent depreciation during the first six months.

- The Central Bank started to ease monetary policy as inflation stabilised around 7.8 percent.

I. MACROECONOMIC MANAGEMENT OVERVIEW

Economic Growth: Real GDP growth was estimated at 6.5 percent for 2014. Although the mining sector had seen production fall in the first half of the year, overall growth was maintained due to strong agriculture performance. According to official figures, agriculture production increased by more than 34 percent in 2014 compared to 2013.

The third quarter mining production figures were not available during drafting, but were expected to slightly increase compared to the second quarter. The Kansanshi mine, one of the largest copper producers, had increased production in the first half of the year to 136,845 tonnes from 127,085 tonnes a year before. Konkola Copper Mines Plc, which operates underground mines, reduced production by 32 percent, reaching 34,000 tonnes in the third quarter. A planned one-month maintenance shutdown of the company’s smelter and shaft interruptions affected production. The mining sector remained the primary source of foreign currency earnings. On average, copper prices trended downwards throughout the third quarter, reaching USD 6,977 per tonne but higher than the second quarter average of USD 6,763 per tonne.

The growth outlook continued to look good, with average growth rates above 7 percent in the three years following the period under review. According to the government’s medium-term expenditure framework released in August, the economy was projected to grow by 7.3 percent in 2015, accelerating to 7.7 percent in 2017. The government indicated that it would prioritise agriculture diversification and mechanisation, and expansion of industrial zones to support manufacturing. It was also set to continue with infrastructure expansion programmes and power supply expansion.

Monetary Policy and Banking System: The Central Bank’s tightening of monetary policy, which was continued throughout the first half of the year, effectively stabilised inflation and the foreign exchange rate.

Inflation rose throughout the first half of the year but stabilised in the third quarter as a result of lower food prices. At the end of the quarter, overall inflation fell to 7.8 percent year-on-year from 7.9 percent in the second quarter. Food inflation, which accelerated in the first half of the year, fell following increased supply of agriculture produce. Prices of non-food items, on the other hand, increased sharply at the beginning of the quarter. This was due to inflationary pass-through-effects from the depreciation of the ZMW, which peaked in May. However, non-food inflation trended downwards during the quarter as the exchange rate stabilised around ZMW 6.1 per US dollar.

The ZMW stabilised during the quarter following a temporary overshooting in May when the exchange rate peaked at ZMW 7.1 per US dollar. The
average exchange rate was ZMW 6.15 per US dollar in September compared to ZMW 6.61 per US dollar in May. However, the ZMW appreciated against the ZAR by 27 percent during two years preceding the period under review.

The Central Bank policy measures taken in the first half of the year – which included an increase of the monetary policy rate to 12 percent, an increase in the commercial bank statutory reserve requirements to 14 percent from 8 percent, and an increase of the overnight lending facility to 22 percent – were effective in containing inflation and stabilising the ZMW. Going forward, and as announced by the Central Bank, there was to be a need to ease monetary policy, as the tight policy had added pressure to private sector lending in the months leading up to the period under review.

The cost of finance, which rose rapidly in the first half of the year, dropped during the third quarter. The interest rates on the one-year T-bill peaked at 23 percent in August but fell to 19 percent in the September. The 2024 EuroBond, which was issued in April at 8.625 percent, also saw a drop in yield to below 6.9 percent at the end of the quarter.

During the quarter, broad money (M2) growth stabilised at 19 percent year-on-year compared with the previous quarter, where growth exceeded 29 percent, while M3 growth was stabilised at 13.8 percent year-on-year.

**Fiscal Policy:** The medium-term expenditure framework, released in August, was projecting an overall fiscal deficit of 5.1 percent of GDP (from 6.6 percent in 2013), which was within the 2014 target of 5.5 percent of GDP.

During the first half of 2014 total domestic revenue collected amounted to ZMW 15.1 billion in addition to grants amounting to ZMW 87 million. Tax revenues performed well, achieving ZMW 12.9 billion, which was ZMW 1.6 billion better than projected. Higher revenue performance of pay-as-you-earm amounted to ZMW 3.3 billion, ZMW 500 million better than projected. The additional ZMW 1.1 billion was due to the withholding of domestic VAT refunds until exporting companies could provide adequate import documentation. This amount will have to be refunded once the Zambia Revenue Authority receives proper documentation. Taking into account the refunds, domestic VAT revenue was projected at ZMW 216 million.

Non-tax revenues performed below target due to lower collection of mineral royalties and road tolls, and lower Farmer Input Support Programme (FISP) recoveries; they were, however, partly offset by higher proceeds from maize sales, user fees and fines. The first six months thus achieved ZMW 2.2 billion, which was ZMW 400 million below target. Mineral royalties achieved ZMW 886 million (ZMW 189 million below target), and FISP recoveries were ZMW 159 million below target.

Total expenditures amounted to ZMW 17.7 billion, which was ZMW 1.8 billion below projected as some externally financed projects had not started. Personal emoluments accounted for the single largest expenditure line item, at ZMW 7.6 billion, in line with projected expenditure. Other major expenditures included ZMW 1.9 billion to the construction of roads, ZMW 1.7 billion in debt servicing, ZMW 2 billion for goods and services, ZMW 600 million for the FISP, and ZMW 185 million for the power utility.

Total financing of the deficit amounted to ZMW 2.7 billion, with the following three main sources: proceeds from the sales of treasury bonds amounting to ZMW 1.4 billion, carryover funds from the 2013 budget amounting to
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ZMW 750 million, and proceeds from the sale of the 2024 EuroBond amounting to ZMW 1.2 billion.

External Sector: The current account had entered negative territory during the first half of 2014. The deficit amounted to USD 107 million compared to a surplus of USD 220 million during the same period a year earlier. The trade surplus also shrunk during the first half of the year, to USD 753 million, which was USD 113 million lower than the same period the year before. The driving force behind the decline was a drop in non-traditional exports by 34 percent, combined with higher fuel imports of 44 percent. Even though other imports had dropped by 36 percent, it was not enough to offset the fall in exports and maintain the trade balance.

Zambian exports on the whole continued to perform well, helped by the ZMW depreciation achieving ZMW 15.3 billion during the third quarter, which was up from ZMW 15.0 billion in the second quarter. Imports to Zambia also continued to grow, achieving K15.0 billion in the third quarter, up from K14.9 billion in the second quarter.

By the end of June, gross international reserves increased to USD 3.5 billion from USD 2.7 at the end of March. The increase followed the issuance of the USD 1 billion 2024 EuroBond in April. The increase corresponded to 3.5 months of import cover, which was slightly below the Central Bank medium-term target of four months.

II. INSTITUTIONAL AND STRUCTURAL REFORMS

The Zambian Authorities recently embarked on a review of the land legislation and prepared a draft customary land administration bill, which was undergoing stakeholder consultation during the period under review. The review was prompted by allegations that headmen and chiefs had on many occasions terminated land occupancy, often to the detriment of the poor rural populations, while selling land to investors beyond the legal quotas. The Land Act from 1995, which was considered a drastic reform protecting the rights of small landholders, had become inadequate as the value of land in many places had increased, and customary land had become scarcer.

A reform of the land titling procedures and the implementation of the Zambia Integrated Land Management and Information System was also set to help in land administration and its taxation. A private members' bill was unanimously passed in Parliament shortly before the period under review to give the government powers to repossess land allocated to investors in suspicious circumstances.
HIGHLIGHTS

• The economy was estimated to grow by about 3 percent in 2014 on mounting evidence of weak FDI, liquidity constraints and continued lack of policy clarity.

• Deflationary pressures persisted in the third quarter of 2014. The yearly inflation rate decelerated to 0.09 percent in September.

• Weak revenue performance persisted into the first month of the third quarter of 2014. The cumulative revenue was 7 percent below the target.

• Zimbabwe’s trade deficit was registered at USD 2.0 billion in July 2014. This was despite continued decline in imports, as exports remain constrained.

I. MACROECONOMIC MANAGEMENT

Economic Growth: Despite some good performance in agriculture and tourism, Zimbabwe’s economy was expected to grow by 3.1 percent in 2014, against the projection of 6.1 percent at the beginning of the year. The downward revision was prompted by challenges in the economic sectors. In 2014, average capacity utilisation in the manufacturing sector shrank by 3.3 percentage points to 36.3 percent due to, among others factors, prolonged effects of power cuts and related production costs, liquidity challenges, low domestic demand, obsolete machinery and high costs of borrowing. In the mining sector, total gold deliveries decreased by 4.4 percent from 1,248.5 kilograms in July 2014 to 1,193.78 kilograms in August 2014. Overall, prospects in the mining sector were dim due to poor performance of international commodity prices, frequent power outages and inadequate funding for recapitalisation. To this effect, the Ministry of Finance and Economic Development expected the mining sector to contract by 1.9 percent in 2014 from the initial projection of a 10.7 percent growth. The economy continued to experience company closures and job losses.

Monetary Policy and Banking System: Annual growth in money supply (M3) increased to 13.9 percent in August 2014, against 9.6 percent a month earlier. On a month-on-month basis, M3 registered a 2.3 percent growth, compared to -2.3 percent in July 2014. The decline in month-on-month M3 growth in July was partly explained by the transfer of the exchequer account from the Commercial Bank of Zimbabwe to the Reserve Bank of Zimbabwe, subsequently leading to the exclusion of USD 44.98 million government deposits from broad money aggregates. The annual growth in broad money in August was driven by increases in all classes of deposits, except short-term deposits. Domestic credit rose to 6.2 percent in August, largely reflecting an 86.9 percent increase in net credit to government, mapping Treasury bill holdings by commercial and merchant banks, which increased by 113.1 percent, to USD 237.5 million, between August 2013 and August 2014. Lending to the private sector grew by an annual 0.87 percent in July, only to decline by 1.5 percent in August. The decline largely reflected a conservative lending approach by banks on the back of high non-performing loans, which stood at 18.5 percent as at end June 2014.
Zimbabwe’s year-on-year inflation, which has been hovering in negative territory since February 2014, dropped from 0.31 percent in July to 0.15 in August and further decelerated to 0.09 percent in September. Inflation was expected to increase in the months following the period under review due to the recent tax increases that were announced during the mid-term fiscal policy review statement in September 2014. The month-on-month inflation for August 2014 was -0.31 percent, while that of July was 0.01 percent. The month-on-month inflation rate in September 2014 was -0.01 percent, gaining 0.30 percentage points on the August rate. The overall month-on-month decline in inflation was buoyed by the decline in both food and non-food inflation rates.

The weighted average lending rates for individuals by commercial banks declined to 14.28 percent in August 2014, from 14.33 percent in July 2014. However, the commercial banks’ corporate bond weighted average lending rates remained unchanged at 9.45 percent during the same period. The monetary policy statement by the Reserve Bank of Zimbabwe outlined new measures that could further have softened the lending rates in the months following the period under review. The measures include the setting up of the Zimbabwe Asset Management Corporation (ZAMCO), a special purpose vehicle aimed at dealing with the issue of non-performing loans; the creation of a credit registry system; and the establishment of the forums for bank chief executive officers to review and discuss monetary and financial sector issues such as interest rates. The July 2014 monetary policy statement stated that ZAMCO would be funded by a combination of non-funded lines of credit, new inflows, long-term bonds and T-bills.

**Fiscal Policy:** Weak revenue performance persisted into the first month of the third quarter of 2014. The cumulative revenue collections for the period to July 2014 stood at USD 2.03 billion. This was 7 percent below the target revenue outturn. The continued lower-than-expected monthly revenue performance in 2014 could be attributed to macroeconomic challenges, including company closures that led to lower corporate tax outturn, and weak domestic demand, manifesting through lower outturn from consumption taxes. Government expenditure remained relatively high during the first two months of the quarter. The cumulative expenditures for the period to July 2014 were USD 2.12 billion against the revenues of USD 2.03 billion. This resulted in a cumulative deficit of about USD 90 million, approximately 0.67 percent of GDP. While the primary deficit had largely been kept at a minimum, the government’s medium-to-long-term fiscal policy was largely to focus on rebuilding fiscal buffers, which remained inadequate. The importance of realigning the expenditure mix towards more growth enhancing capital expenditures could not be overemphasised. At the time, recurrent expenditures of USD 1.97 billion accounted for 93.01 percent of total expenditure, which was highly unsustainable and unsupportive of the government’s growth objectives.

**External Sector:** The decline in imports that was experienced during the first two quarters of the year continued into the third quarter. Total imports to July 2014 were USD 3.5 billion, a 20.9 percent decline, compared to the same period in 2013. The downward pressure on imports was mainly a direct result of the import duty levied on selected products in order to protect local industries against the influx of cheap foreign goods. The downward pressure on the import bill was expected to continue due to the taxes for motor vehicles and fuel product imports that had recently been increased. The slowdown in imports is, however, not having a significant impact on the trade deficit, as exports are also on a downward trend. Total exports to July 2014 stood at USD 1.5 billion, a decline of 18.3 percent from the same period in 2013. The decline in exports was largely due to low international prices for commodities such as gold and diamonds, and challenges faced by the local industry, including company closures.

**II. INSTITUTIONAL AND STRUCTURAL REFORMS**

**IMF Staff Monitored Programme (SMP):** The IMF Mission undertook the third and final review of the SMP-1 in September 2014. The mission concluded that Zimbabwe met all structural benchmarks and the quantitative targets for the third review. A successor SMP had been negotiated and was to be implemented over 15 months from October 2014 to December 2015. Zimbabwe’s acceptance of the second SMP demonstrated the authorities’ commitment to restore a track record of sound policies.
Tourism Sector Developments: Zimbabwe launched the National Tourism Policy in July 2014 to guide operations in the industry. The government also undertook to facilitate the establishment of a tourism revolving fund for onward lending to players in the industry who may require funds for investment.

Financial Sector: In an effort to address non-performing loans, Cabinet approved the establishment of ZAMCO, which will acquire non-performing loans (including collateral and rights attached to the loans) from banks on commercial terms to clean up and strengthen banks’ balance sheets, provide them with liquidity and mitigate loss of confidence.

III. DONOR COORDINATION ACTIVITIES

With other development partners, the AfDB continued to support the Zim asset clusters in developing prioritised cluster action plans. To this effect, a key strategic retreat to discuss the operationalisation of the strategy was held in September 2014. The United Nations Development Program, the World Bank and the AfDB continued to support the government in setting up special economic zones. The other major event in donor coordination was the commissioning ceremonies for the Zim-Fund Phase I power and water projects. Phase II operations had since commenced, with donors reaffirming their confidence in the Zim-Fund; some made new pledges to fill the financing gap. In addition, a joint donor review mission was undertaken from 25 August to 5 September 2014.

IV. ISSUES NEEDING PARTICULAR ATTENTION

The overall short- and medium-term economic performance continued to depend on the government’s efforts to address macroeconomic vulnerabilities (including the huge debt and arrears), address structural impediments and ensure coherence of policy responses and re-engagement with the international financial community.