I. REGIONAL OVERVIEW

Economic activity in Southern Africa was vibrant during the 3rd quarter as the region remained on course to attain a projected annual average growth rate of 4.4 percent. In Angola strong growth in the non-oil sector continued to boost overall economic activity. Also, planned new gas and oil fields coming on stream are envisaged to drive higher growth. Botswana's economic recovery continued with increasing activity in all sectors. The economy in Lesotho continued to show resilience, largely supported by an improved performance in diamond mining. Malawi is benefiting from improved investor confidence, which is enhancing the availability of foreign exchange to the economy. Also, Malawi's tobacco marketing session for the third quarter showed higher sales that further the increased availability of foreign exchange. Growth picked up in Mozambique as the adverse effects of the large floods from the beginning of 2013 continued to subside. Economic growth rebounded in South Africa – albeit significantly below the estimated potential – at the back of expansion in manufacturing activities. In Swaziland growth continued to improve gradually, largely driven by recovery in manufacturing and construction activities.

On the other hand, growth was stalled in Mauritius amidst a continued slow recovery in external demand. The Namibian economy weakened largely as a result of contraction in mining. In Sao Tome and Principe delays in project execution and weak external financing for both private and public sector projects hampered economic growth. Growth in Zambia was weak, and is attributed to a fall in agricultural value added. Zimbabwe experienced a further slowing economy following a poor performance in agriculture and weakening commodity prices.

Growth performance in Southern Africa is benefiting from prudent macroeconomic policies that are becoming a mainstay in many countries. Fiscal restraint has contributed to easing inflation across the region. Inflation in Southern Africa is expected to mellow slightly to 6.1 percent in 2013 from 6.8 percent in 2012, and in several countries the second quarter performance was in line with the decline. Angola's commitment to reforms to rebuild the country's external buffers and reduce vulnerability to oil price shocks, is contributing to easing inflation through exchange rate stability. In Botswana, the rate of inflation continued on a downward trend and enabled the monetary authorities to ease the monetary stance. Lesotho experienced subdued inflation as the Government made determined effort to contain its expenditures. In Malawi although inflationary pressures are subsiding, the country experienced subdues inflation as the Government made determined effort to contain its expenditures. In Malawi although inflationary pressures are subsiding, the country continues to record the highest inflation rate in the SADC region. The risks to inflation heightened due to an anticipated steep depreciation of the MWK and the decline in maize stocks post-harvest season. In Mozambique, faster than expected recovery in agricultural production and a stronger Metical (against the rand) kept inflation low, and enabled monetary easing from the central bank. Similarly, in Namibia inflationary pressures continued to ease to enable the Bank of Namibia keep its policy rate unchanged. Sao Tome and Principe continued to benefit from its fixed exchange rate agreement with Portugal in terms of exchange rate stability that contributed to lower inflation. However, in South Africa consumer price inflation continued to breach the upper limit set by the monetary authorities at the back of higher Government spending. Swaziland saw inflation, which had increased during the second quarter, began to fall in the third quarter. Inflation also eased in Zambia and the central bank cited this as reason for leaving its policy rate unchanged. In Zimbabwe, where inflationary trends are significantly influenced by movements in the value of the rand, consumer price inflation remained low as the rand weakened.

Strong adherence to institutional and structural reforms continues to aid the growth and development effort in Southern Africa. In Angola the Government is supporting the development of special economic zones to reduce challenges facing businesses. The Government has passed a new investment law, which provides fiscal incentives. Botswana has launched the Okavango Diamond Company (ODC) to create a fully-fledged diamond Center that will provide the country with its own
sustainable, commercial diamond sales channel. Lesotho’s commitment to deepening reforms within the National Strategic Development Plan has attracted considerable donor support. In Malawi, the Government is deepening efforts to improve power supply to increase the country’s competitiveness. Similarly, Mauritius continues to embark on measures to enhance its global competitiveness. Mozambique is focusing on reforms to improve the control, audit and supervision of the state finances with the creation of the General Inspectorate for Finance (IGF). In Namibia the proposed amendments to the Bank Institutions Act (1998) aimed at improving the regulatory frameworks for banks and nonbank financial institutions got underway with public consultations. South Africa passed the Transport Laws and Related Matters Amendment Bill, giving green light to the collection of e-tolls on its Gauteng province freeways.

Going forward, Southern African countries need to maintain the adherence to strong macroeconomic and structural reforms as the key to accelerated and inclusive growth. In particular, the development of a dynamic private sector remains essential to accelerated and sustained growth. In Angola improving the business environment is crucial to rebuilding the country’s industrial base and diversifying the economy. The issue of water sector reforms has emerged as a priority in Botswana, given concerns about the sustainability of Government subsidies in the sector. Malawi needs to maintain fiscal restraint and minimize waste in public spending by emphasizing the public financial management system and strengthening accountability and oversight. In Mauritius, attention needs to be given to a number of areas including, declining trends in both public and private investments; risks to financial market stability emanating from rising private sector indebtedness; and persistent excess liquidity in the money market. In Mozambique the significant increase in public debt, almost entirely consisting of external debt, has raised concern about the heavy reliance on non-concessional financing of the country’s development. Political considerations have become paramount in Sao Tome and Principe as the fragility of the new ruling coalition might delay the implementation of key reforms and lead donors to withhold pledged funds. The South African economy requires structural reforms to address the chronic high level of unemployment – exacerbated by poor education attainments and skills mismatches; a high degree of concentration of economic activities and burdensome regulation with the resultant high barriers to entry; power shortages; and transport bottlenecks. Food security is emerging a major concern in Zimbabwe as the country faces an acute grain shortage, owing to poor harvests experienced during the 2012/2013 agricultural season.

### Key Macroeconomic Indicators for SADC Countries (2013)

- **Real GDP Growth**
  - Target for SADC: (7 percent)
- **Inflation**
  - Target for SADC: (5 percent)
- **Government Debt**
  - Target for SADC: (< 45 percent of GDP)
- **Budget Deficit**
  - Target for SADC: (< 3 percent of GDP)
- **Current Account Balance**
  - Target for SADC: (< 3 percent of GDP)
- **International Reserves**
  - Target for SADC: (> 6 months of import cover)

Source: International Monetary Fund, World Economic Outlook Database, October 2013
Note: SADC targets do not apply to Sao Tome and Principe
II. COUNTRY ANALYSES
HIGHLIGHTS

- Strong non-oil sector output set to accelerate economic growth.
- Government finances remain strong amid slow budget implementation.
- Improved business environment key in rebuilding the country’s industrial base.

I. MACROECONOMIC MANAGEMENT OVERVIEW

Economic Growth: Angola’s strong growth in non-oil sector has supported economic growth. Government has revised the 2013 economic growth prospects downward to 5.1 percent against the initially projected 7.1 percent on account of slow budget implementation. GDP is expected to be driven by the scheduled new gas and oil fields, as well as strong non-oil GDP growth of 8.7 percent. Despite the strong growth, Angola’s economy remains highly dependent on commodities’ exports, particularly oil, making economic diversification central to the Government’s agenda. Oil production rose from an average of 1.58 million barrels per day (bpd) in the first quarter of 2013 to 1.72 million bpd during the third quarter of the year as new oil fields started to yield successful results. Notwithstanding the strong oil output, export revenues were not immune to the unfavorable international oil prices, having only reached a cumulative amount of USD 26.6 billion, from January to September 2013, as compared to the USD 30.3 billion recorded in the same period in 2012. Despite ongoing new oil fields explorations in the country’s offshore deep water, economic activity is currently dominated by new projects that are underway in the transport and housing sectors. This provides optimism for sustained growth in the country’s construction industry in the medium term. With total industry value-add reaching just under USD 10.5 billion in 2012, the authorities are forecasting a 14.2 percent annual growth for the construction industry in 2013.

Monetary Policy and Banking System: The annual inflation rate slowed from 9.04 percent in July 2013 to a new record low of 8.93 percent in September 2013 as a result of a stable exchange rate. The major determinants of inflation are food, non-alcoholic beverages and housing costs. Despite the recent decline in the price levels, further inflation reductions will be harder to achieve in the short run due to its structural nature (e.g. high logistical costs, in particular, with transport, telecommunications and strong dependence on imported products due to a limited domestic supply of goods and services).

The domestic currency (kwanza) experienced a nominal depreciation of 1.54 percent from AKz/USD 95.91 in August 2013 to AKz/USD 97.4 in September 2013. Coupled with declining inflation, this significantly reduced the country’s real exchange rate depreciation. The Government also continues to show signs of being committed to macroeconomic reforms and the implementation of prudent monetary policies in order to rebuild the country’s external buffers and reduce vulnerability to oil price shocks.

The National Bank of Angola’s Monetary Policy Committee (MPC) decided on 30 September to leave the benchmark interest rate on hold at 9.75 percent, after cutting it last month by 0.25 basis points (bp). In setting up this measure the MPC took into consideration the inflation rate, the fiscal and monetary accounts and the national and international economic...
situation. In addition, total banking sector deposits increased by 8.4 percent in August 2013 largely supported by long-term deposits denominated in local currency, explained by the promulgation in July 2013 of the new foreign exchange law that requires oil companies to make payments of taxes and services provided by local suppliers using local banks. This trend is favorable for boosting liquidity and ensure the availability of the much-needed long-term funding. Consistent with the accommodating monetary policy stance, lending interest rates for the period of 181 days to one year have declined from 14.22 percent in January 2013 to 12.81 percent in August 2013. This helped maintain an increasing trend of access to credit to the economy, which rose by 5.7 percent since the beginning of the year, and which has been mostly supported by rising demand for the financing of social and individual activities (22 percent), private sector (19 percent), wholesale and retail trade (16.9 percent) and real estate (10.7 percent).

**Fiscal Policy:** Angola’s fiscal position remains strong, having recorded a fiscal surplus of 8.7 percent of GDP in 2012. The authorities anticipate a narrower budget deficit in 2013 (about 3.8 percent of GDP) due to the rising priority capital spending needed to rebuild the country’s infrastructure network. Angola’s tax system remains heavily dependent on oil revenues, while fiscal expenditure is channeled towards infrastructure and social spending. The Government is overhauling the tax system, including both the legislation and the administration, to boost revenue from the non-oil sector. This is expected to increase the contribution of non-oil revenues in the state budget from 14.8 percent of total revenue in 2012 to 24.5 percent in 2013, while oil revenues are expected to stabilize at 71.8 percent in 2013, down from the 80.4 percent level of the previous year. Despite the improvement in the debt management and budgeting process, the authorities are still struggling with the process of regularizing arrears payment in the construction sector relating to the 2010 and 2011 fiscal years. Other challenges include: the full implementation of a medium-term expenditure framework, and reduction of payment delays between the state-owned oil company Sonangol and the Treasury. On the expenditure side, by September 2013, the fiscal execution rate was only 58.40 percent of the annual target. The slow implementation can be attributed to difficulties in the implementation of public procurement legislation (e.g. bidding documents, terms of reference, standard contracts) and delays in the approval of public bidding contracts by the External Audit Court.

**External Sector:** By the end of the second quarter 2013 the value of exports was USD 16.3 billion while imports stood at USD 7.4 billion, resulting in a trade balance surplus of USD 8.8 billion. Nonetheless, Angola’s trade surplus declined by 27.4 percent compared to the first quarter of the year (USD 12.1 billion). This decline is a result of a 45.1 percent growth in imports driven by a strong demand for equipment and raw materials needed for revitalizing the country’s infrastructure and industries, in line with the National Development Plan, 2013-2017. In view of the rising imports, there is a need to accelerate economic diversification in order to reduce import dependence, increase the value of exports while reducing the high costs of domestic production. Meantime, Government is continuing to pursue its policy of accumulating foreign reserves which reached a new record level of USD 35.4 billion in August 2013, equivalent to 8.3 months of imports coverage. This is mainly aimed at ensuring macroeconomic stability, particularly, the stabilization of exchange rate and creating a buffer against volatile international oil prices.

**II. INSTITUTIONAL AND STRUCTURAL REFORMS**

- **Stimulus to agricultural production:** The Government, in conjunction with development agencies, has set up a number of large commercial farms in order to boost agricultural production and ensure food security. The farms are expected to begin production over the next year. The Government plans to lease these farms to Angolans, where both parties will work to ensure food security. The effectiveness of this project will depend on how well domestic farmers can manage these large-scale projects once foreign development partners have withdrawn.

- **Rebuilding the industrial base to diversify the economy:** The Government is currently supporting the development of special economic zones in order to boost agricultural production and ensure food security. The farms are expected to begin production over the next year. The Government plans to lease these farms to Angolans, where both parties will agree on production targets. The effectiveness of this project will depend on how well domestic farmers can manage these large-scale projects once foreign development partners have withdrawn.
USD 4 billion as a result of these new reforms. Meanwhile, in the first three months of 2013, investment contracts worth USD 200 million were signed by the state National Agency for Private Investment.

III. DONOR COORDINATION

The implications of Angola’s graduation to middle-income country according to the United Nations criteria were discussed by development partners represented in Angola. The Bank office in Angola continued its efforts to establish partnerships with development partners, following the approval of the Bank’s CSP, 2011-2015 Mid-Term Review. These efforts included potential collaboration with the European Union in the areas of water and sanitation, agriculture, and professional training and higher education. AOFO remained active in the development of new business partnerships, particularly, with Sweden. Areas of complementarity included: cooperation for ICT development, energy and private-sector development. The Bank office in Angola is committed to playing a catalytic role in infrastructure maintenance and management, as well as providing policy advisory services for knowledge generation and economic transformation (e.g. the promotion of economic diversification and oil and gas downstream transformation and local content).

IV. ISSUES NEEDING PARTICULAR ATTENTION

Despite the prospect of strong non-oil sector output in accelerating economic growth, the high exposure of the fiscal and external sector performance to international oil prices requires special attention as it may hamper economic growth in the long term. The slow budget implementation performance is likely to compromise the achievement of the economic growth target in 2013. Therefore, it is imperative to improve the business environment in order to rebuild the country’s industrial base and diversify the economy in order to attract more foreign direct investment, create jobs and alleviate poverty.
HIGHLIGHTS

- Real GDP growth improved significantly to 7.9 percent during the second quarter of 2013 from 3.3 percent the same quarter in 2012.

- Inflation continued to decline during the third quarter of 2013 to reach 5.6 percent in August, remaining within the 3-6 percent medium-term objective target range for the third consecutive month this year.

- Revelations that mining and agriculture benefit from large water subsidies at the expense of ordinary consumers have generated public concern, especially against the backdrop of a severe water stress in the country, with the main dam down to 21 percent of capacity due to drought.

I. MACROECONOMIC MANAGEMENT OVERVIEW

Economic Growth: The economy accelerated during the second quarter of 2013, registering growth of 7.9 percent, more than double the 3.3 percent growth recorded in the same quarter in 2012. The high growth reflected an improvement in virtually all sectors, with mining recording the highest growth of 15.6 percent, followed by financial and business services, general Government and personal and social services at 7.7, 6.8, and 6.2 percent respectively. All other sectors also recorded growth of more than 2.0 percent over the period. A significant turnaround occurred in the water and electricity sector and posted a growth of 2.2 percent in stark contrast to its performance in recent quarters when it registered massive declines due mainly to adverse weather. Economic performance during the third quarter of 2013 is expected to remain subdued, mainly due to the adverse effects of the severe water shortage on virtually all sectors.

Monetary Policy and Banking System: The annual rate of inflation continued on the downward trend recorded since the end of the last quarter and declined from 5.8 percent in June 2013 from 5.6 percent in August 2013. For the third consecutive month, inflation remained within the Bank of Botswana’s objective target range of 3-6 percent. The lower inflation mainly reflects declines in food and transport prices. The recent decline in inflation has prompted the Bank of Botswana to start relaxing the tight monetary policy by reducing its lending rate from the 9.5 percent that had been in force since December 2010 to 9 percent in April 2013 and further to 8.5 and 8.0 percent in June and August, respectively. The reduction in inflation is expected to continue in the short term as fuel and food prices stabilize and a further relaxation in the monetary policy may be considered.

Fiscal Policy: Botswana’s medium-term budget remains focused on fiscal sustainability and the promotion of economic growth. The estimated outturn for the last quarter of FY 2012/13 (January-March 2013) indicates a surplus of BWP 790 million (about 2.0 percent of GDP). This represents a remarkable turnaround from the deficit of BWP 3,693 million (about 14.1 percent of GDP) recorded in the corresponding quarter of FY 2011/12. The surplus reflects a sizeable increase of 45 percent in revenue and a decline in expenditure of 3.5 percent. The increase in revenue mainly arose from substantially high non-mineral income tax revenues, VAT and customs collections while the decline in expenditure reflected a decrease in recurrent expenditure that counteracted an increase in development expenditure. The 2013/14 budget takes into account the challenges emanating from the persistent uncertainty in the global economy and the associated adverse effect on revenues and forecasts only a modest budget surplus of 0.6 percent of GDP. Public debt is projected to decline to 13.5 percent of GDP in 2013/14 from 14.9 percent in 2012/13; of which 10.2 percent will be external public debt (including publicly guaranteed debt).
External Sector: During the second quarter of 2013, Botswana realized a trade deficit of BWP 2,657 million, which was an improvement from a deficit of BWP 3,090 million recorded in a similar period of 2012. While exports increased by 44 percent, the impact was counteracted by a 31 percent increase in imports. The increase in exports was mainly due to mineral products, particularly diamonds, which increased by 50 percent. The recovery in diamond exports signals renewed prospects for the economy although it remains to be seen whether this can be sustained in view of the continuing persistent fragile global economic prospects. Reflecting the higher exports, gross foreign reserves have remained substantial and stood at USD 8.09 billion as at end July 2013 (equivalent to 13 months of imports). The nominal value of the pula exhibited mixed performance against major foreign currencies during the third quarter of 2013. The pula held steady against the US dollar and the yen while it depreciated against the pound sterling by 5.7 percent and against the euro by 3.3 percent. However, the local currency appreciated against the rand by 2.2 percent, mainly reflecting a weakening of the rand against major currencies and its large weight in the monetary basket.

II. INSTITUTIONAL AND STRUCTURAL REFORMS

Following the policy to create a fully-fledged diamond center in the country in September, the Government officially launched the Okavango Diamond Company (ODC). The company is expected to provide Botswana with its own sustainable, commercial diamond sales channel so that the country can play a more meaningful role in the international diamond sector. It will provide Government with greater insight into diamond market trends and, as part of the Government’s broader strategy, will help cement the country’s growing position and reputation as a leading centre for the production, sale and manufacture of diamonds. The wholly Government-owned company is tasked to market a portion of the country’s rough diamond production. Under the contractual agreements, ODC is entitled to purchase and sell 12 percent of total diamond production in 2013, rising to 15 percent by 2016. The company’s sales are expected to be about USD 400 million each year, making it a key supplier of rough diamonds to the industry and the largest source of uniquely Botswana diamonds in the market. In addition, the diamond-cutting and polishing sector has continued to grow, and sales to the local polishing industry are expected to grow from USD 618 million in 2012 to USD 770 million in 2013.

III. DONOR COORDINATION

A task team comprising the USAID, EU, UNDP and the Ministry of Finance and Development Planning was set up to assess the problems arising from the Botswana Development Assistance Management Information System (BODAMIS). This is an online database established in 2005 to track the funding of all development assistance in Botswana, as well as planned disbursements. The task team reported that the system failed to start up and a lot of the data has been lost. While Development Partners recognize the importance of BODAMIS, funding remains a challenge as the initial support from the EU has come to an end. Further discussions among the Government and development partners will provide guidance on the way forward.

IV. ISSUES NEEDING PARTICULAR ATTENTION

The issue of water sector reforms, particularly subsidies, has generated considerable public interest ahead of the proposed national Water Policy that is expected to be tabled before Parliament in November 2013. Among the major concerns is the fact that the Government heavily subsidizes the two major consumers of water, mining and agriculture, by as much as 40 percent. This has elicited concern from analysts and the public that this is unfairly high and disadvantages the ordinary people who have to bear the burden of the subsidy.

The debate over water comes at a time when Botswana is faced with severe water stress. Reports indicate that the Gaborone Dam is down to less than 21 percent of capacity, which translates to only about nine months’ water supply if there is no rain. The situation is further compounded by the operations of the Water Utilities Corporation (WUC), which made a massive loss of BWP 482.5 million in 2012. This underscores the need to restructure the water sector, and it is commendable that the Government is doing the right thing by trying to consolidate all of the water activities into one organization rather than have water supplied to villages from various agencies and urban water supplied by WUC. Moreover, one of the factors
behind the substantial losses by WUC is that the corporation inherited poor, old, and dilapidated infrastructure from the former water authorities and has to work on fixing it.

The requisite reforms in the WUC are expected to take about three years. However, the difference between WUC and other parastatals facing financial difficulties has been a refreshing willingness by its management and Board to engage with key stakeholders to explain its situation and what needs to be done. Notably, the WUC has met with the Bank and has initiated discussions to explore the ways in which the best critical support can be provided to address the severe water stress in order to counteract the adverse impact this is exerting on other sectors and on overall economic performance.
HIGHLIGHTS

• The economy continued to show resilience, largely resulting from the good performance of diamond mining and the construction sector.

• The fiscal balance remains in surplus, largely underpinned by good performance in revenues and the containment of expenditure.

• Inflation remains subdued to lower levels in the face of high prices of energy and food.

I. MACROECONOMIC MANAGEMENT OVERVIEW

Economic Growth: Lesotho’s economy is expected to continue to show resilience in 2013 with annual growth projected at 4.1 percent. This positive outlook for 2013 remains predicated on continued expansion in the mining sector and further expansion in the construction sector. While the growth outlook for the global economy appears pessimistic as depicted by the IMF October 2013 forecast, the growth outlook for the advanced economies, including the United States – Lesotho’s key trading partner – will remain unchanged though modest. However, the downward risks remain in the event of a more prolonged shutdown of the United States Government and failure to raise the debt ceiling. This might severely affect the global demand for the country’s key exports, including textiles and diamonds, which will also impact on GDP growth.

Monetary Policy and Banking System: In the quarter ending June 2013, the authorities continued with a tight monetary policy stance owing to the decline in the net foreign assets of the banking sector. This is reflected by the drop in money supply, broadly defined as M2 by 0.9 in June. This was a continuation of the trend decline experienced in the May but contrasted with the growth experienced in the quarter that ended in March 2013 and December 2012. There are short-term uncertainties in the external environment which the monetary authorities of Lesotho should closely monitor. Barring a significant deterioration in global demand conditions, the monetary stance will remain tighter and this will also anchor inflation. Overall during the quarter ending June, inflation was registered at 4.6 percent on a year-on-year basis and was mainly driven by the rising prices of gas and fuels (11.6 percent), as well as prices of food and clothing (5.7 percent). Inflation in Lesotho continues to be driven by the developments in South Africa from where over 80 percent of the consumer goods are imported. Prices in South Africa continued to be adversely affected by the higher petrol prices and the continuing depreciation of the Rand against major world currencies. This continuous depreciation had important pass-through effects to domestic prices in Lesotho.

Fiscal Policy: Fiscal performance was commendably good during the quarter under review. The Government continued with prudent economic management which enabled it to attain a cumulative fiscal surplus of 1.9 percent of GDP in the quarter ending June 2013. This was underpinned by continuation of fiscal consolidation, allowing nominal rather than real growth in spending and sustained improvements in revenue performance. The fiscal surplus during the quarter was, however, lower compared to a surplus of 3.6 percent of GDP in the previous quarter. Steady growth in the revenues and commitment to fiscal consolidation largely underpinned this performance.

External Sector: The position regarding the external sector remained gloomy. This was in view of the current account balance which continued to deteriorate to a deficit of 32.9 percent of GDP during the second quarter of 2013. This unfavorably compares with the deficit of 19.6 percent of GDP in the previous quarter ending in March. The deterioration was largely due to a rise in the merchandise imports and a decline in exports. The decline in exports was in response to the sluggish global demand. Consequently,
gross international reserves in months of imports dropped to 4.3 during the quarter under review from 4.8 during the previous quarter. Given the frequency of external shocks, the economy needs to accumulate reserves in excess of five months of imports. It is noteworthy that the outlook for the external sector is not likely to significantly improve given the global environment which is surrounded with a lot of uncertainties.

II. INSTITUTIONAL AND STRUCTURAL REFORMS

Public Sector Management: The donor community has continued to expeditiously support the Government’s commitment to deepening its reforms and to support the implementation of the National Strategic Development Plan. The Government has already produced a monitoring and evaluation framework for its new development plan. In support of this, the African Development Bank has advanced in its processing of the agreed programs with the Government in the new Country Strategy Paper for the period 2013 – 2017. The Rural Water and Sanitation Project, Institutional Support for the Enhancement of Public Financial Management and e-Government Project have already been approved by the Board and the loan agreements are being prepared for signing.

III. DONOR COORDINATION

Donor coordination in Lesotho is conducted through the Development Partners Consultative Forum (DPCF), and during the quarter under review a total of three monthly meetings were held in Maseru. The discussions were mainly focused on exchange of information on portfolios handled by various development partners.

IV. ISSUES NEEDING PARTICULAR ATTENTION

Sustaining the current fiscal surplus position would call for intensified efforts towards fiscal rationalization – eliminating non-productive spending, as well as enhancing resource mobilization including implementing measures to enhance efficiency in tax collection.
HIGHLIGHTS

- The 2013 tobacco marketing season closed in August with higher sales than the previous season mainly due to improvement in production.
- The Millennium Challenge Corporation (MCC) Compact energy sector project of USD 350 million was launched in September, paving the way for implementation of works to upgrade and expand transmission capacity and the distribution system to ease power supply shortages.
- With the onset of the lean tobacco season the Malawi kwacha (MWK) is set to depreciate against the US dollar and other major trading currencies. The risks to inflation have heightened on account of the anticipated weakening of the kwacha and the pressure on food prices during the post-harvest season.

I. MACROECONOMIC MANAGEMENT OVERVIEW

Economic Growth: The Malawian economy continues to show signs of recovery. Investor confidence in the economy is growing, buoyed by improvement in the availability of foreign exchange and the slowdown in inflation observed since March 2013. The restoration of external credit lines has helped in ease access to a supply of critical input, including fuel. Consequently, capacity utilization during the quarter under review increased to 70 percent from 60 percent in the second quarter. Overall, real GDP growth is expected to rebound to 5 percent in 2013 from 1.8 percent in 2012, underpinned by sound macro policies, donor inflow, recovery in tobacco exports and an improved availability of foreign exchange. Growth in agriculture is forecast to rebound to 6 percent following contraction of 2.3 percent in 2012, with tobacco and smallholder maize production the main drivers. Performance of the 2013 tobacco marketing season – which closed in August- surpassed the previous season providing the basis for economic recovery. The total volume of tobacco sold increased by 111 percent from 79.8 million kg in 2012 to 168.7 million kg in 2013. The amount of tobacco export earnings generated from these sales increased by 103 percent to USD 362 million in 2013, up from USD 177 million in 2012. The significant growth achieved in tobacco sales is mainly attributed to expansion in volume, as prices for both burley and flue-cured tobacco were marginally weaker than in previous season. Reforms in the tobacco industry, particularly, the adoption of the integrated production system (contract farming) contributed to the positive supply response. Although Malawi recorded a jump of 1.6 percent in maize production in the 2012/13 season, 21 districts will face food insecurity as rains were erratic in some parts of the country.

In 2013, growth is expected to be broad-based. Manufacturing is projected to grow at slightly over 6 percent (initial projection was 5.7 percent) underpinned by growth in the processing of tobacco, tea, sugar, soaps, beverages and beer production. Mining, the second foreign exchange earner, is set to grow at 10 percent, up from an initial forecast of 8.5 percent. Construction is estimated to grow at 7 percent supported by a number of large construction projects, notably the construction of the railway line by Vale, shopping malls and the national stadium.

Looking ahead, real GDP growth in 2014 is projected at 6 percent, premised on continued macro-stability, favorable weather conditions and a positive supply response to ongoing structural reforms designed to improve the business climate, enhance competitiveness and diversify the economy.
Monetary Policy and Banking System: Malawi continued to record a deceleration in inflation during the quarter. The year-on-year headline inflation for the month of August dropped to 23.3 percent, 4.6 percentage points down on the June, 2013 CPI of 27.9 percent. **August 2013 marked the sixth consecutive month of the fall in inflation.** The downward trajectory in inflation is attributed to a slowdown in food prices following the harvest and an improvement in food availability. Non-food inflation decelerated by 3.9 percentage points to 28.9 percentage points in August from 32.8 percent in June. The drop in non-food inflation was due to the lagged effect of tight monetary policy and the appreciation of the kwacha in June, which eased the pressure on fuel, transport and utility prices. The urban and rural rates stood at 33.7 percent and 20.6 percent respectively in August 2013, down from 37.2 percent and 26.5 percent respectively in June 2013.

Although inflationary pressures are subsiding, Malawi continues to record the highest inflation rate in the SADC region, whose regional annual average inflation rate is 7.3 percent. The risk for inflation has heightened due to the anticipated steep depreciation of the MWK and the decline in maize stocks post-harvest season. Hence the Government’s inflation target of 14 percent by the end of December 2013 may be missed by a few percentage points.

The Reserve Bank of Malawi (RBM) has maintained its benchmark bank rate at 25 percent in this quarter, despite the deceleration in inflation since March. This reflects the central bank’s resolve to sustain a tight monetary policy against the backdrop of emerging risks for inflation. The central bank is expected to maintain a tight monetary policy stance in the remaining months of the year to contain inflationary pressures. Recent developments in money and foreign exchange markets have impacted on the liquidity situation. During the quarter under review, money market liquidity increased as a result of the central bank’s intervention in the foreign exchange market and the surge in Government borrowings. Reflecting the improvement in the liquidity situation, the interbank market rate declined sharply to 16.54 percent in September 2013, down from 29.30 percent in June. Similarly, the average All Type Treasury bill rate declined to 185 percent in September 2013 from 34.37 percent in June. Similarly, the average All Type Treasury bill rate declined to 185 percent in September 2013 from 34.37 percent in June. However, during the next quarter, the T-bill rate is expected to fall, as the Government’s appetite for T-bills diminishes on account of reduced borrowing in line with the fiscal anchor of zero net domestic financing.

The annual growth in money supply accelerated to 28.3 percent in August, after declining in June. The main driver of monetary expansion was Government borrowing from the banking system, which increased by MWK 45.6 billion in August 2013 to MWK197.5 billion from MWK151.9 billion in June 2013. In contrast, net credit to the private sector declined by MWK 5.5 billion to MWK 226.2 billion in August, 2013 from MWK 231.7 billion in June. On an annual basis, credit growth to the private sector declined from 11.5 percent in June to 7.8 percent in August. In future, fiscal consolidation will be necessary to restrain growth in the domestic debt stock while creating room for increased private sector lending. Financial stability has improved in the wake of the fall in inflation and the recent stability of the kwacha, though high interest rates continue to pose a risk. This will require vigilance and effective supervisory oversight.

Following the sharp appreciation of the kwacha in June, the local currency started showing signs of weaknesses during the quarter. The kwacha depreciated to MWK 337 in September from MWK 331 per US dollar in June. The recent depreciation of the kwacha is attributed to foreign exchange demand pressures as the lean tobacco season kicks in. The temporary easing of the liquidity constraint – as evidenced by the fall in money market interest rates – has contributed to recent pressures on the exchange rate. In the coming months, a steeper depreciation of the kwacha is expected, reflecting seasonal demand and supply factors. A sustained tight monetary policy stance, complemented by periodic central bank’s interventions in the foreign exchange market, should help ease pressure on the exchange rate and ensure exchange rate instability during the post-tobacco season. The timeliness of donor inflows estimated at 40 percent of the 2013/14 budget will be key to achieving exchange rate stability and boosting the reserves during the lean season. Demand for forex peaks during the last quarter, as this is time when the Government imports fertilizer.

Fiscal Policy: The Government is executing the budget for FY2013/2014, which was passed in June 2013 and is anchored on the objective of achieving zero net domestic financing. Government revenue in July 2013 declined by 31 percent to MWK41.1 billion from MWK59.8 billion in June 2013 while expenditure in July increased by 54 percent to MWK56.4 billion from MWK 36.7 billion in June 2013. This resulted in a deficit of MWK15.8 billion in July 2013 from a surplus of MWK23.1 billion, representing 1.2 percent of GDP. While the Government has in the 2013/14 budget committed to contain expenditure within the resource envelope, the Government net domestic borrowing during the first two months of the quarter increased by MWK57.1 billion, partly due to advanced funding for some expenditure. In September 2013, serious financial irregularities were detected reflecting weaknesses in the financial control environment. Government has responded swiftly and is taking appropriate measures to remedy the situation and restore confidence in the public financial management system.
The recent challenges notwithstanding, the fiscal situation is expected to improve in the next quarter as the pace of domestic revenues increase and the Government rectifies emerging weaknesses in budget controls. Adherence to the fiscal rule of zero net domestic financing is necessary to ensure coordination with monetary policy towards achieving macro stability. Although Malawi’s debt stock has increased, the debt sustainability situation is expected to improve over the long run as the economy grows. Net domestic debt is still projected to improve to 14 percent of GDP by 2014 from an average rate of 16.6 percent over the 2011-2013 period.

The Extended Credit Facility (ECF) program with the International Monetary Fund approved in July 2012, remains on track. Two reviews have so far been completed successfully. The IMF Executive Board was expected to complete the third review in the quarter; but due to delays in processing and emerging challenges in public financial management, Board consideration was deferred to January 2014. Completion of the review will enable Malawi to receive a disbursement of SDR 13 million (about USD 20 million) from the IMF.

External Sector: Malawi’s external position in 2013 will be boosted by strong performance of tobacco exports. At the end of the marketing season, Malawi’s total tobacco foreign exchange earnings amounted to USD 366 million. Export growth in 2013 is projected at 18 percent while imports growth will be significantly lower (4 percent) leading to overall improvement in the trade deficit. Malawi’s international reserves position has significantly improved due to higher than expected tobacco export revenues, coupled with tight monetary policy and increased donor inflow. The country’s total foreign exchange reserves increased to USD 661.3 million (3.5 months of import cover) in August from USD 651.4 million in June, 2013 (about 3.5 months of import cover). Gross official reserves in August stood at in USD 442.6 million equivalent to 2.4 months import cover August, marking the highest level of reserves in five years. The higher level of accumulated international reserves should provide the necessary buffer against exogenous shocks and help stabilize the exchange rate through central bank interventions in the foreign exchange market. The potential risk of reduced inflow may, however, exert pressure on the reserves.

II. INSTITUTIONAL AND STRUCTURAL REFORMS

The Government is deepening efforts to improve power supply and address a key constraint to the ease of doing business and competitiveness. The focus of power sector reforms is to promote private sector investment in the energy sector through PPP arrangements. The 2013/14 budget envisages that financing for energy sector projects will be a mix of public and private financing. PPPs in infrastructure would help create fiscal space for increased social spending. Currently, the Government is reviewing the energy sector policy with a view to creating an enabling environment for PPPs and ensure the sustainability of the sector. The Government is negotiating with two prospective independent power producers in the energy sector (including a coal fired power plant). The power sector project of USD 350 million grant under the Millennium Challenge Account entered into force on 16th September, 2013 paving the way for critical investments in the upgrading and expansion of transmission and distribution capacity to address intermittent power supply shortages. The support is linked to key power sector institutional reforms. Under the Power Sector Reform Programme, the Government has undertaken to recapitalize the Electricity Supply Corporation of Malawi (ESCOM) and carry out further electricity tariff reforms with the aim of improving the financial sustainability of the utility.

The Bank is supporting Malawi’s power sector through the financing of Kholombizo Hydro Power feasibility study. In addition, the Bank is assisting the Government with capacity building support for PPPs targeting key infrastructure sectors such as energy where opportunities for private investment exist.

III. ISSUES NEEDING PARTICULAR ATTENTION

While confidence in the economy is growing, there are significant risks ahead. These include the risk of a slippage in fiscal discipline ahead of the elections, reversal in some of the gains that the current administration has achieved in governance, an insufficient power supply, and a narrow export base. Weak public financial management and the perception of an increase in corruption may heighten investor risk and increase pressure on the exchange rate. The Bank and other DPs have intensified dialogue with the Government on governance issues in the light of recent lapses in public financial management.

Going forward, it is recommended that the Government maintains fiscal restraint and minimizes waste in public spending by reinforcing the public financial management system and strengthening accountability and oversight. Due to the heightened risk of inflation and pressure on the exchange rate during the lean season, continued monetary policy tightening is recommended. On the other hand, high interest rates may deter private investment and hurt growth. Although the economy is on the road to recovery and inflation is on a downward trajectory, the macro framework remains highly vulnerable to shocks. Therefore, the Government will need to redouble efforts to diversify the economy, attract more FDI and transform the agricultural sector in order to enhance food security and build resilience against weather-related shocks. Furthermore, Malawi needs to intensify its domestic resource mobilization efforts in order to reduce its dependency on aid.

1 The total amount approved under the ECF arrangement is SDR 104 million. Malawi has to date accessed a cumulative total of SDR 49 million.
HIGHLIGHTS

• The domestic economy grew by 3.3 percent in the second quarter of 2013 compared to 3.6 percent in the first quarter, amidst a continued slowdown in construction and modest signs of recovery in external demand.

• The Monetary Policy Committee of the Bank of Mauritius at their September 2013 meeting kept the key repo rate unchanged at 4.65 percent, amidst concerns about excess liquidity and the impact of prolonged negative real interest rates on domestic savings and the banking sector.

• Fiscal space continues to narrow as growth in spending outpaces the increase in revenues. The budget deficit widened to MUR4.94 billion.

• The current account deficit narrowed in the second quarter, driven by improvements in the merchandise trade balance.

• Benefiting from wide-ranging structural reforms since 2006, Mauritius has overtaken South Africa to become the most competitive economy in Sub Sahara Africa according to the 2013 Global Competitiveness Report.

I. MACROECONOMIC MANAGEMENT

Economic Growth: Preliminary estimates from Statistics Mauritius show that the domestic economy grew by 3.3 percent in the second quarter of 2013 compared to 3.6 percent in the first quarter and 3.1 percent in the corresponding quarter in 2012. Growth was driven by financial services at 5.2 percent, manufacturing at 3.0 percent and wholesale and retail trade at 3.7 percent. Contracting by 3.0 percent, construction continued to slow down for the fourth quarter in a row as the implementation of major construction projects was delayed. Benefiting from a gradual recovery in some of the main source markets, tourism grew by 0.3 percent although lower than 1.5 percent for first quarter and 1.0 percent for the corresponding quarter in 2012. Tourist arrivals at 622,492 for period January to August 2013 showed a 2.2 percent increase over the corresponding period in 2012. Arrivals from Europe at 336,223 declined by 2.9 percent, driven by a 6.0 percent fall in arrivals from France, which generates nearly half of the tourists from the common market. Sugar milling and textiles grew by 2.3 percent and 0.7 percent respectively after a contraction during the corresponding period in 2012. Overall, growth was driven by consumption, which grew by 2.2 percent as investments contracted for the fourth quarter in a row. The unemployment rate, which had risen to 8.7 percent in 2013Q1, fell back to 8.2 percent in 2013Q2. Against this background, Statistics Mauritius forecasts a growth rate of at 3.2 percent in 2013 down from 3.4 percent in 2012.

Monetary Policy and Banking System: Bank of Mauritius (BoM) kept the repo rate unchanged at 4.65 percent per annum amidst concerns about excess liquidity and the impact of prolonged negative real interest rates on domestic savings. Year-on-year CPI inflation registered a decline from 3.6 percent in June 2013 to 3.3 percent in September 2013. In tandem, year-on-year core and headline inflation eased during the period from 2.6 percent to 2.2 percent and from 3.6 percent to 3.5 percent respectively. Upside risks to inflation remain, emanating largely from public sector wage increase. Year-on-year inflation is forecast to accelerate to within the range of 4.5 percent to 4.9 percent by the end of December 2013. Excess liquidity in the money market remained high with all auctions of Government of Mauritius Treasury Bills (GMTB) between end July 2013 and end August 2013 oversubscribed. At 2.85 percent for August 2013 the overall weighted yield marginally declined from 2.94 percent in July 2013, keeping the yield slightly above the policy rate at 2.80 percent. To manage the excess liquidity in August 2013, BoM issued securities for a total nominal amount of MUR4.67 billion compared to MUR2.05 billion BoM securities maturing. Furthermore the fortnightly average Cash Reserve Ratio (CRR) on rupee deposits have been increased from 7.0 percent to 8.0 percent and, in parallel, the fortnightly average CRR on foreign currency deposits have been lowered from 7.0 percent to 6.0 percent. Private sector credit rose by 2.7 percent, to reach MUR381.52 billion in July 2013. As at end 2012, private sector credit represented about 196 percent of GDP. To address the risks to financial market stability emanating from rising private sector indebtedness, particularly in the property market, BoM issued macro prudential policy measures and guidelines to the banking sector.

Fiscal Policy: Fiscal space continues to narrow as growth in spending outpaces the increase in revenues. Domestic fiscal revenues have been on an increasing trend despite the economic slowdown. From January to August 2013 the total revenues registered a 6.7 percent nominal increase over the corresponding period in 2012 to reach MUR48.59 billion, with tax revenues representing 85.9 percent. At MUR99.80 million, grants had increased by 77 percent over the corresponding period in 2012. During the period, total spending increased by 12.9 percent to reach MUR48.05 billion, with a notable increase of 20.4 percent in compensation to employees. Interest payments declined by 6.5 percent to reach MUR 6.05 billion compared to the corresponding period in 2012 driven by a slowdown in domestic interest payments. The budget deficit at MUR4.94 billion was higher than for the corresponding period in 2012 at MUR1.94 billion. The Government is using domestic debt to finance the deficit. To this extent, the debt to GDP ratio at 58.1 percent of GDP as at end June 2013, from 57.9 percent as at end March 2013, had accelerated close...
to the legal limit of 60 percent, raising concern about the Government’s ability to achieve the fiscal target of 50 percent by 2018.

**Balance of Payments:** The current account deficit narrowed in the second quarter of 2013 to 1.9 percent of GDP (MUR7.4 billion) from 2.3 percent (MUR8.6 billion) in the corresponding quarter in 2012, driven by improvements in the merchandise trade balance. At MUR16.89 billion (4.6 percent of GDP) the second quarter trade deficit narrowed by 0.1 percent over the first quarter of 2013 and 15.2 over the corresponding quarter in 2012. The services account registered a lower surplus compared to the corresponding period in 2012. The Bank of Mauritius estimates that tourists’ receipts for the first semester of 2013 declined by 6.3 percent over the corresponding period in 2012 to reach MUR22.05 billion. The modest surplus in the capital and financial account was used to finance the current account deficit. In the second quarter of 2013, Foreign Direct Investment (FDI) in the first semester of 2013 was estimated at MUR4.74 billion, of which 62 percent went into real estate. The main sources of FDI were France (27 percent) followed by China (18 percent) and South Africa (15 percent). Africa was the main destination for Mauritian investment, accounting for about 64 percent share of the MUR1.6 billion total investments abroad. The overall balance of payments registered a record surplus of MUR10.6 billion compared to a deficit of MUR3.0 billion over the corresponding period in 2012. The Bank of Mauritius (BoM) continued to intervene in the foreign exchange market to bolster reserves and smooth volatility. During the period under review, the reserves import cover declined from 5.6 months as at end June 2013 to 5.3 months as at end August 2013 while the dealt rupee exchange rate had appreciated by about 1.9 percent against the USD and had depreciated by 1.7 percent against the euro.

**II INSTITUTIONAL AND STRUCTURAL REFORMS**

Mauritius is making good progress in enhancing its global competitiveness but challenges remain. Overtaking South Africa for the first time, the Global Competitiveness Report 2013-14 of the World Economic Forum (WEF) ranks Mauritius 45 out of 148 economies and first in sub-Saharan Africa from 54 on the 2012-2013 on the Global Competitiveness Report 2011-12. To attain this position Mauritius sustained the good progress on institutions (39th) with notably highly accountable private institutions (14th) and goods market efficiency (25th). It also made strong improvements to financial markets from 35th to 26th, labor market efficiency from 70th to 55th. However, more reforms are needed to improve the participation of women in the labor force (ranked 118th), the availability of scientists and engineers (102nd), and market size (112th from 109th).

**III DONOR COORDINATION**

Development partners issued a joint letter to the Government on the need for establishing a sector working group in the water sector and accelerating reforms to improve policy coordination and efficiency of service delivery. They also participated in updating the policy framework for the 2014-2016 Performance Based Budget.
IV  ISSUES NEEDING ATTENTION

The declining trend in both public and private investments needs attention. While gradual improvements in the euro zone economy could lead to improvements to private investment, the Government needs to address implementation bottlenecks in the public sector emanating from procurement bottlenecks, weak public sector capacity and a weak legal framework for Public Private Partnerships (PPPs), under which some of the major infrastructure projects are being implemented. The risks to financial market stability emanating from rising private sector indebtedness, particularly in the property market, needs attention. Macro prudential policy measures and guidelines announced by BoM in this context needs close monitoring to assess impact. The persistent excess liquidity in the money market and the cost of the mopping-up exercises on the balance sheet of the Bank of Mauritius needs attention. The revisions to the cash reserves ratios need monitoring to assess impact. The unemployment rate, remains an issue of concern due to its structural nature. The Government will need to continue exploring ways of addressing youth and women unemployment. The monetary policy authorities will need to consider normalizing the repo rate to help accelerate savings. At 14.2 percent, the savings rate has fallen from 15.5 percent in 2010. The savings rate on rupee deposits at 3.45 percent in August 2013 remains below the headline inflation at 3.5 percent.
HIGHLIGHTS

• Growth picked up during the second quarter reaching 8.7 percent after having been affected by large flooding during the first quarter.

• The Government approved a budgetary revision in August to accommodate the financing of reconstruction efforts from the flooding in the 1st quarter, and the windfall revenues from capital gains tax of the extractive industries.

• The political dispute between the former civil-war contenders Renamo and Frelimo has resulted in occasional episodes of limited violence. Renamo has threatened to escalate violence if the municipal elections scheduled for November, which it has decided to boycott, indeed take place. Economic confidence indicators have plunged during the 2nd quarter.

I. MACROECONOMIC MANAGEMENT OVERVIEW

Economic Growth: The negative effects of the extensive flooding during the first quarter were reversed, with growth picking up strongly during the 2nd quarter, reaching 8.7 percent. The financial services, and transport and communications sectors presented good performances with 19.8 and 15.5 percent growth respectively, but it was the robustness of the agricultural sector, with 9.5 percent growth, which was the most surprising. On the other hand, the bad weather which took down power transmission lines and the low season in the tourism sector lead to a contraction of 5.4 and 4.4 percent on the electricity & water and hotel & restaurant sectors respectively. The extractive industries production expanded by 33 percent, although contributing by just 1.9 percent to overall GDP growth. Economic sentiments presented an inflexion point with a sharp drop in the quarter, with demand sentiments reaching negative territory. The ongoing political instability on top of the upcoming municipal elections scheduled for November 2014 could be weighing down on the expectations of businesses. Inflation expectations continued on the negative trend despite the easing of monetary policy.

Monetary Policy and Banking System: At -0.5 percent, monthly inflation in August was negative for the 4th month in row, reversing the annual inflation trend, now decreasing since the beginning of 3rd quarter to reach 4.49 percent in August. The faster than expected recovery in agricultural production and the current weak valuation of the rand versus the metical will continue to constrain inflation, offsetting the expansion of credit to the private sector. The monetary easing from the central bank continued with a 50bp cut in June on its standing lending facility (SLF), followed by another 25bp cut in September leaving the SLF now at 8.75 percent. Expansion of credit to the private sector continues to respond reaching in July 38.9 percent (annualized). However, and despite of the SLF cuts, the average one-year lending rate from commercial banks has actually increased after the rate cuts, from 19.56 percent in May to 20.2 percent in July, signaling considerable market distortions and revealing that most of the credit expansion is taken by consumption credit. The metical remained relatively stable against major currencies, presenting slight gains against the rand during the 3rd quarter.

Fiscal Policy: The State Budget was revised in August to accommodate (i) the financing of reconstruction efforts due to major flooding in the first quarter, and (ii) windfall capital gains tax revenue from shares transactions from natural gas consortiums. The revision also allowed the registering of a higher-than-expected increase in revenue collection. Overall revenue will rise by 6 percent to MZN 120,492 million. The extra revenue, coupled...
with external financing, will be used for financing the reconstruction efforts in flood-affected areas, increasing planned capital expenditure by 17 percent to MZN 79,983 million. Overall budget expenditure will expand by 8 percent to MZN 188,720 million, including a 3.5 percent increase in the wage bill which has been expanding constantly during the last years. The budget execution during the 2nd quarter has consistently gone up in line with capital expenditure, even if at only 45 percent of execution, while current expenditure has fluctuated. Revenue collection in the same period has fluctuated, with revenues from goods and services roughly contributing 50 percent of revenues, and income taxes another 40 percent.

**External Position:** International foreign currency reserves have been accumulating since the beginning of the 2nd quarter, in part supported by progressive disbursements by Programmatic Aid Partners. The strong increment in August of more than USD 400 million, to a total of USD 2,820 million, was mostly due to collection of windfall revenues from capital gains tax associated with gas consortium transactions. The impact of deals like these allows one to foresee the huge effect of such future developments on the country’s external position. Reserves are expected to keep their positive trend until the end of the year, reaching USD 3 billion, the equivalent of approximately 3 months of imports. The weight of imports targeting large mega projects and infrastructure is pressuring the merchandise trade balance, leading to an expansion of the current account deficit which grew by 73.4 percent in 2012, to a total of USD 5.2 billion (42 percent of GDP). Recent data for the 1st quarter revealed a 14.8 percent year-on-year increase, with a deficit of USD 3.1 billion. The deficit is being financed by strong FDI inflow that totalled USD 3.5 billion during the 1st quarter.

II. INSTITUTIONAL AND STRUCTURAL REFORMS

The Government has approved the creation of a new unit – the General Inspectorate for Finance (IGF) – along with its budgeting and regulatory framework to enhance PFM control mechanisms. The creation of the IGF aims to improve central control, audit and supervision of the State Financial Administration, and provides an organizational structure, material and human resources to enable it to effectively pursue its defining function within Internal Control, to contribute to the proper management of public resources, in coordination with other public entities

III. DONOR COORDINATION ACTIVITIES

In September the G-19 donor group, together with the Government, undertook the annual planning meeting for the Performance Assessment Framework evaluation that will take place in April 2014. In accordance with the Memorandum of Understanding for Budget Support, during the planning meeting the Government and the Programmatic Aid Partners agreed on the monitoring indicators, and the respective technical notes for both Government and partners that will be used to evaluate mutual performance on the framework for coordinating aid.

IV. ISSUES NEEDING PARTICULAR ATTENTION

The increase in public debt levels, almost entirely made of external debt, particularly through the use of non-concessional financing of large infrastructure projects, coupled with continued significant imports for mega projects in the extractive industries are pressuring the current account deficit. Despite part of the deficit being funded by large FDI, it is crucial to implement a robust project investment appraisal to ensure positive economic returns from these investments, which can potentially rebalance the current account in the future. Political risks are looming with violent disputes between the Government and the former rebel movement, which can further escalate with the approaching of municipal elections in November.
HIGHLIGHTS

- The Namibian economy weakened, dragged down by the contraction in mining and construction activities.
- Inflationary pressures have eased since the beginning of 2013, mainly on account of decelerating costs of food and transport.
- The balance-of-payments position registered a surplus, reflecting improved export performance and SACU receipts.
- The fiscal position remained moderate on account of large SACU receipts since the beginning of the current fiscal year.

I. MACROECONOMIC MANAGEMENT OVERVIEW

Economic growth: The Namibian economy weakened, growing by 2.3 percent in the second quarter of 2013 compared to 13.3 percent growth registered in the corresponding quarter in 2012. The weak performance is attributed to the contraction in mining (mainly diamonds) and construction activities by 10.4 percent, and 17.7 percent, respectively. During the second quarter, the manufacturing sector recorded a slow growth of 1.1 percent, while agricultural output expanded strongly by 42.3 percent driven by a sharp increase in livestock marketed due to persistent drought. The uncertain external environment continues to pose substantial downside risks to Namibia’s economic outlook. The authorities expect medium-term growth to remain below the 6.0 percent target set in the Fourth National Development Plan.

Monetary Policy and Banking System: Inflationary pressures have eased since the beginning of 2013. Year-on-year inflation slowed down to 5.8 percent in July 2013 before accelerating marginally to 6.0 percent in the following month. The declining trend in inflation is mainly on account of the decelerating costs of food and transport. Inflation is expected to follow an upward course and to remain slightly above the South African Reserve Bank’s inflation target of 3 to 6 percent in the coming months as the depreciation of the South African rand against major currencies starts feeding into higher price pressure for goods and services. The credit extended to the private sector remained high, increasing by 13.8 percent year-on-year to N$ 402.2 million by the end of August 2013. It was largely driven by sustained expansion in borrowing from both businesses and households, particularly mortgage loans. Taking advantage of prevailing low inflation and the need to support domestic economic growth, the Bank of Namibia has kept the repo rate unchanged at 5.5 percent.

Fiscal performance: The fiscal position remained moderate on account of large Southern African Customs Union (SACU) receipts since the beginning of the current fiscal year. SACU revenues increased by 6.7 percent from the previous quarter to N$3.7 billion during the second quarter, bringing the total revenue received from the SACU Common Revenue Pool in the first half of 2013 to N$7.1 billion. Against this background and increased revenue collection, the authorities expect a much lower fiscal deficit in 2013/14 than the 6.4 percent of GDP projected in the 2013/14 budget. Total public debt declined to 22.2 percent of GDP at the end of the first quarter of the 2013/14 financial year, compared with 24.4 percent at the end of the previous quarter. Public debt remains sustainable and below Namibia’s debt ceiling of 35.0 percent of GDP.
External sector: The current account recorded a surplus of N$3.1 billion during the second quarter, from a deficit of N$1.8 billion during the previous quarter. The improvement was on account of increased merchandise exports and increased net inflow in investment income and current transfers, including SACU receipts. The merchandise trade deficit narrowed by 53.7 percent to N$2.0 billion, quarter-on-quarter, reflecting a drop in imports by 6.2 percent and higher exports of non-industrial diamonds, uranium, fish and fish products, live cattle, beef and salt. The overall balance registered a surplus of N$1.1 billion during the second quarter despite the capital and finance account balance recording a higher deficit of N$529 million from a deficit of N$31 million due to higher net capital outflows in both portfolio and other short-term investments. Namibia’s gross reserves increased to N$16.1 billion (representing 15.2 weeks of import cover) during the second quarter from 14.8 billion (13.3 weeks of import) during the first quarter. This increase was mainly attributed to a rise in interest income, Government assets inflow and large SACU receipts. The stock of international reserves at the end of the second quarter of 2013 was above the international benchmark of 12 weeks and adequate to sustain the fixed currency peg of the Namibian dollar to the South African rand. On the exchange rate front, the Namibian dollar (following the South African rand) continued to depreciate against all major currencies during the second quarter (6.2 percent against the US dollar, 5.2 percent against the British pound and 5.1 percent against the EUR).

II. INSTITUTIONAL AND STRUCTURAL REFORMS:

The proposed amendments to the Bank Institutions Act of 1998 are currently undergoing public consultation with a view to improving the regulatory frameworks for banks and nonbank financial institutions. Under reforms contained in the new Banking Institutions Bill of 2013, which will repeal the amended Banking Institutions Act of 1998 and the Banking Institutions Amendment Act of 2012, the Government intends to achieve some of the objectives of the Namibia Financial Sector Strategy 2011-21 including:

(i) creating a regulatory framework for microfinance banking institutions as part of the strategy to promote financial inclusion in Namibia;

(ii) restricting foreign ownership in new banking institutions to 55 percent of the total nominal value of shares of a banking institution in order to diversify the shareholding in Namibian banks and encourage ownership of banks by institutional investors;

(iii) strengthening the resolution powers in the Act to ensure that there are adequate measures to effectively deal with weak banks and to ensure that stability is maintained in the entire financial system; and,

(iv) providing clarity relating to “pyramid schemes” and the legal framework for dealing with them.

III. DONOR COORDINATION

An African Development Bank mission visited Namibia from 1 to 12 July 2013 and successfully concluded the consultation process for the preparation of the Bank Group Country Strategy Paper (CSP) for Namibia covering the period 2014-2018. The mission met with the Minister of Finance, the Honorable Mrs Saara Kuugongelwa-Amadhila; Permanent Secretary, Mrs Ericah B. Shafudah; senior Government officials; and representatives of the private sector, non-Governmental organizations and development partners. In collaboration with the Ministry of Finance, the mission organized a workshop on the Bank’s financial products and services which was attended by key Government, state-owned enterprises and private sector officials. The CSP is scheduled to be considered by the Bank’s Board of Directors in January 2014.

IV. ISSUES NEEDING PARTICULAR ATTENTION

The authorities are concerned that the sustained expansion in private-sector credit, particularly long-term mortgage loans, poses some risks to the stability of the financial system in view of the high level of household indebtedness. This calls for a close monitoring of the financial system’s exposure to mortgage loans, including the use of more stringent loan-to-value ratios and strengthening and modernizing the regulations of non-bank financial institutions. The latter is already being pursued through the reforms proposed in the new Banking Institutions Bill of 2013 highlighted above.
HIGHLIGHTS

- The IMF concluded its second review of the Extended Credit Facility (ECF)-2012-2015 and the 2013 Article-IV consultation.
- TOTAL, a French oil company, abandoned oil exploration in block 1 of the Joint Development Zone (JDZ) with Nigeria.
- Government launched a single window for external sector transactions.

I. MACROECONOMIC MANAGEMENT OVERVIEW

Economic Growth: In 2012, the economy of São Tomé and Príncipe (STP) grew by 4 percent, a slight decrease from the 4.9 percent growth recorded in 2011. The slower growth was on account of global uncertainties, a reduction in both private and public consumption, as well as a decrease in FDI. The growth was driven by the construction, transport and retail sectors. The relationship between the new Government led by Gabriel Costa and supporters of the ousted Prime Minister, Patrice Trovoada, remains fragile, although the latter’s political party members have resumed duties in Parliament. The growth forecast for 2013 has been adjusted downward to 4 percent and to 5 percent for 2014 from 5.2 percent due to delays in disbursement for project execution and weak financing prospects for both private and public sector projects. The negative projection is also linked to some extent to the announcement by TOTAL to abandon oil exploration in block 1 of the JDZ with Nigeria, due to exploration costs and the size of the oil reserves. The announcement also swelled uncertainty and speculation among local citizens over oil production and its implications as it will be recalled that the 2008 Debt Sustainability Analysis (DSA) undertaken by the World Bank and IMF showed that under a no-oil scenario and fiscal adjustment, the public debt (both NPV of debt-to GDP and the NPV of debt-to revenue ratios) will rapidly increase. At sector level, tourism, industry and services, education and health, are still considered crucial to the implementation of the inclusive growth agenda.

Monetary Policy and Banking System: The ongoing fixed exchange rate agreement signed with the Government of Portugal in January 2010 helped to sustain the inflation trends over the years. A further reduction to 7 percent is expected at the end of the year and is mainly linked to easing of food prices, the main driver of inflation. In July/August 2013, inflation hit its record low to 6.5 percent, compared to 11.6 percent registered in the same period in 2012, representing a monthly percentage change of 0.2 percent. The increase in deposits and non-concession of new credits by commercial banks contributed to an increase of liquidity in the system. While the credit to economy is expected to reach 9.4 percent in 2013 against the 7.6 percent initially projected, the Central Bank (CB) kept its requirements for unprofitable banks and maintained the capital adequacy ratio above 10 percent to provide soundness in the financial sector. In August 2013, the CB revealed that there has been an increase in the volume of non-performing loan due to rapid credit expansion within the context of weak risk management and a lending culture. It was also revealed that there are two insolvent commercial banks and that immediate action is needed.

Fiscal Policy: The 2013 State Budget is conservatively estimated at USD 150 million. Although special attention is given to the social sector (education and health), its main priority is in infrastructure (transport and communication), which absorbs 21 percent of the total spending. It is important to note that 93 percent of the capital expenditure will be financed...
through external assistance. Despite Government’s efforts to improve revenue collection (from 15.3 percent in 2012 to 16.6 percent of GDP in 2013), managing domestic expenses remains a challenge. As a result, the domestic primary deficit is estimated at 3.5 percent in 2013 against 3.1 percent of GDP in 2012. The country’s macroeconomic performance was rated satisfactory in the second review held in September 2013 under the extended credit facility (ECF) 2012-2015 program with the IMF. The Government was advised to fast-track the process and design an action plan to clear the ongoing cross-arrerars with the Water and Electricity Company (EMAE), and the National Fuel Company (ENCO). Efficient expenditure control and caution on budget projection for 2014 are imperative amidst the upcoming legislative and municipalities elections and the current global economic environment.

External Sector: Despite the projected improvement in the trade balance deficit (35.5 percent in 2013 compared to 39 percent in 2012), the current account deficit, including transfers, is projected to improve to 16.6 percent of GDP in 2013 from 21.4 percent in 2012, reflecting an improvement in current transfers. With regard to the exchange, it is important to note that the dobra appreciated by 5.4 percent against the dollar in the third quarter of 2013. The level of foreign reserves has been revised upward and is projected to stand at a minimum of four months of imports (as at 26th September the net foreign reserves stood at USD 51.68 million), boosted by the receipt of funds from the World Bank and the sale of a telecommunication license. Remittance, which is a major source of private consumption, is expected to remain low in 2013 due to the ongoing fiscal crisis in Portugal where many São Toméans are based and work. Despite poor performance in recent years, FDI is expected to recover to USD 25 million between 2013 and 2015.

II. INSTITUTIONAL AND STRUCTURAL REFORMS

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

Public Sector Development: The sector is undeveloped and in need of improvement. Conscious of the challenges, the Government is making progress in unleashing the country’s potential. To this effect, an operating license has been awarded to the Angola giant telecommunication company, UNITEL. In September 2013, the Government, with the support of IFC and ICF, launched the single window for the external sector by introducing the SYDONIA software system at the customs department. The system will help to, (i) harmonize policy and procedures; (ii) reduce transport cost on the import and export of goods; (iii) improve coordination between line ministries; and, (iv) provide incentive for exports. More importantly, it will help to improve transparency and modernize the customs department.

III. DONOR COORDINATION

As coordination among donor partners is weak, significant efforts are required to develop joint initiatives. Nevertheless, the Government is making progress in mobilizing additional resources from bilateral donors. The authorities convened a donors’ meeting to discuss its priority areas for the year 2013-2016. The discussion was centered on the need to strengthen coordination as there are few donors represented in the country, which led to the establishment of the Aid Coordination Unit. It was agreed that monthly meetings would be held for resident donors, and one every two months for non-resident donors. In September 2013, a donors’ meeting was held to discuss the modus operandi of the Aid Coordination Unit to be established at the Ministry of Foreign Affairs.
IV. ISSUES NEEDING PARTICULAR ATTENTION

The fragile political outlook due to the new ruling coalition, a divided political scene and prospects of an early election might delay the implementation of key reforms and lead donors to withhold pledged funds. Other issues include: (i) developments in the oil sector as a result of Total’s unexpected withdrawal from block 1 of JDZ, and (ii) close attention on the political developments. Nevertheless, it is critical for development partners to continue to support the Government’s efforts to consolidate the implementation of its key reforms.
HIGHLIGHTS

• Due to expansion in manufacturing production, economic activities accelerated during the second quarter, registering a real GDP growth of 3.0 percent compared to just 0.9 percent during the preceding quarter.

• The unemployment rate increased to 25.6 percent in the second quarter from 25.2 percent in the first quarter.

• The enactment into law of the Transport Laws and Related Matters Amendment Bill provided the legal basis for the launching of e-tolls on Gauteng freeways by the South African National Roads Agency Limited.

I. MACROECONOMIC MANAGEMENT OVERVIEW

Economic Growth: Economic growth rebounded during the second quarter to 3 percent from 0.9 percent in the first quarter. This remains significantly below the estimated potential growth rate of 3.5 percent, indicating the widening negative output gap. Growth was driven primarily by expansion in manufacturing activities which grew by 11.5 percent during the quarter, thereby contributing 1.7 percentage points to GDP growth. The expansion in the manufacturing sector was due to higher production in basic iron and steel, machinery, motor vehicles, and textiles, clothing and leather products. On the other hand, mining output contracted by 5.6 percent owing largely to escalating cost pressures, increased safety stoppages and sporadic labor unrest in the sector. Growth in the tertiary sector moderated to 2.3 percent from 2.4 percent in the first quarter of 2013. Real value added in the agriculture sector declined by 3.7 percent during the quarter, due mainly to lower field crop production in the maize-producing areas of the country. The unemployment rate increased by 0.4 percentage points to 25.6 percent in the second quarter. However, the economy created about 100,000 new jobs during the second quarter. According to the Quarterly Employment Statistics, the number of people employed in the formal non-agricultural sector decreased from 8,465,000 in the first quarter to 8,437,000 in the second quarter. The labor absorption rate remained unchanged at 41 percent in the second quarter of 2013.

On the demand side, growth in real gross domestic expenditure decelerated to 2.7 percent in the second quarter from 3.5 percent in the first quarter. Nevertheless, growth in real gross domestic final demand remained unchanged at an annualized rate of 2.5 percent during the first and second quarters despite improvements in growth in real final consumption expenditure by households and gross fixed capital formation. The upward trends in final consumption expenditure by households were mainly due to the improvements in consumer confidence, and growth of real disposable income which rose to 2.4 percent in the second quarter, from 2.2 percent in the previous quarter. The ratio of debt to disposable income increased to 75.8 percent in the second quarter from 75.4 in the first quarter while the ratio of unsecured lending to total household debt remained around 13 percent during the first and second quarter of 2013. Due to low interest rate environment, the ratio of debt-service cost to disposable income of the household sector remained at 7.7 percent in the first and second quarters.

Real gross fixed investment by private business enterprises accelerated to 4.4 percent in the second quarter from 2.8 percent in the first quarter. This was mainly due to increased outlays in the agriculture, mining and manufacturing sectors. Real fixed investment by public enterprises contracted by annualized rate of 2 percent during the second quarter mainly due to unplanned delays in current projects and the slow uptake...
of new projects. Economic growth was projected to improve during the third quarter on the back of strong increases in mining production in July and the relatively quick resolution of the strikes in the gold-mining sector. Growth will also be supported by the recovery in the Eurozone, even though the recovery remains fragile.

Monetary Policy and Banking System: Consumer price inflation continued to breach the upper bound of the monetary policy target range of −3-6 percent, reaching 6.3 percent in July and 6.4 percent in August 2013. Inflation was driven primarily by increases in housing and utilities rates, particularly increases in electricity and water tariffs and the rise in the transport cost. Petrol prices increased by 23 percent year-on-year in August 2013. The upside risk to inflation still remained elevated due mainly to the continued depreciation of the rand against major currencies, and wage settlements above the headline inflation. The South African Reserve Bank nevertheless left the discount rate unchanged at 5 percent at its September Monetary Policy Committee meeting. Subdued consumption expenditure and lack of demand pressure, a high level of household indebtedness, a low level of employment creation, a persistent negative output gap, all underpinned the Monetary Policy Committee’s decision. Core inflation decreased marginally to 5.1 percent in August 2013 from 5.2 percent in the preceding month. Total inflation of both regulated and non-regulated administered prices remained unchanged at 11.1 percent both in July and August 2013, but remained higher than the rate of 7.5 percent recorded in June. Growth in private sector credit slowed marginally to 8.2 percent in August from 8.9 percent in June 2013, with the indication that not only did the demand for credit by the corporate sector remain weak but also that they remained relatively cash flush and increasingly relied on corporate bond issues.

Stock Exchanges: The assessment of the five year (2008-2013) performance and volatility of the FSTE/J Johannesburg Stock Exchange (JSE) All-Share Index and the FTSE/JSE Top 40 Index reveals that the bourse has performed well despite global and domestic economic weaknesses. The one-year return in rand for the All-Share index was 27 percent compared to 28.9 percent for the Top 40 Index. The Top 40 Index remained more volatile than the All-Share Index with volatility reaching 14.9 percent for one year and 17.4 percent for 5 years compared to 13.6 for one year and 16.1 percent for five years for the All-Share Index. The market capitalization for the entire bourse was R7.7 trillion at the end of September 2013.

Fiscal Policy: During the quarter under review Government revenue, excluding SACU payments increased by 8.1 percent reaching R199 billion (23.8 percent of GDP) mainly due to higher income tax collections. On the other hand, spending by the Government amounted to R235 billion (28.1 percent of GDP) during the quarter, leading to a deficit of 4.3 percent. Despite the adoption of a less expansionary fiscal policy stance to rein in the deficit, Government spending continues to outstrip Government revenue with persistent month-on-month fiscal deficits. In the second quarter debt service amounted to 10.1 percent of the net tax revenue.
Foreign debt declined from R125 billion as at 31 March 2013 to R118 billion at the end of June, due mainly to large redemptions recorded in the second quarter, which outpaced the higher revaluation effects arising from the depreciation of the rand against other major currencies. Total foreign debt was 36.6 percent of GDP and 121.7 percent of export earnings at the end of the first quarter of 2013. Total gross loan debt, comprising domestic and foreign debt, increased from R1,366 billion to R1,428 billion between March and June 2013, reaching 43.7 percent from 42.5 percent during the period under review.

**External Sector:** The trade deficit reached R19.05 billion in August 2013 from a revised July deficit of R13.4 billion. The widening trade deficit was due mainly to a faster contraction in exports, which fell by 7.6 percent compared. This was mainly due to a 23 percent decrease in exports of mineral products while the combination of higher global oil prices and the weaker rand exacerbated upside pressure on imports.

The cumulative deficit for 2013 was R107.3 billion in August 2013 compared with R69.9 billion during the same period in 2012. The trade balance had been in deficit for 21 consecutive months since January 2012. The current account deficit widened to 6.5 percent of GDP during the second quarter, from 5.8 percent in the first quarter. The current account deficit was fully financed by capital inflow. Inward foreign direct investment reached R17.4 billion in the second quarter, from R12.9 billion in the first quarter. On the other hand, there was a portfolio outflow of R5.3 billion in the second quarter compared to an inflow of R1.4 billion during the preceding quarter due mainly to a fear of US quantitative easing tapering down, a lower than expected first-quarter economic growth, exchange rate volatility and a decline in commodity prices.

Between March 2013 and June 2013 the rand depreciated by 8.9 percent against the euro and 7.2 percent against the USD, while the nominal effective exchange rate depreciated by 6.8 percent during the same period. The rand exchange rate remained volatile during the third quarter, due mainly to a widening current account deficit, domestic labor disputes and reversal of capital flows into the emerging markets. On the other hand, the real effective exchange rate of the rand declined by 12 percent between June 2012 and June 2013, improving South Africa’s external price competitiveness. In addition to the widening current and fiscal account deficits, lower commodity prices, weak economic growth, persistent high unemployment levels and lingering labor unrest contributed to the further weakening of the rand. Gross international reserves continue to decline, reaching USD 47.9 billion in August 2013 from USD 51 billion in January 2013, covering about 5 months of imports.

### II. INSTITUTIONAL AND STRUCTURAL REFORMS

President Jacob Zuma signed into law the Transport Laws and Related Matters Amendment Bill, giving a green light to South African National Roads Agency Limited (SANRAL) to collect e-tolls on Gauteng freeways. SANRAL’s credit ratings has been downgraded by Moody’s due to the deterioration in the company’s cash flow as a result of the failure to launch the e-tolling system. The bill also amends the previous Cross-Border Road Transport Act to empower the Cross-Border Road Transport Agency to collect tolls on behalf of SANRAL. The Bill was passed by the National Council of Provinces in May 2013 and was awaiting signature by the President to become a law. Nevertheless, the civil society organization, the Opposition to Urban Tolling Alliance and the Congress of South African Trade Unions, as well as the main opposition political parties, continue to oppose the collection of e-tolls on urban freeways.

The Department of Water and Environmental Affairs gazetted a notice of intention to declare hydraulic fracturing (fracking) for shale gas as a controlled activity. As a result, fracking would be regarded as a water use requiring a water use license to be governed by the National Water Act. In 2012, the Government lifted a moratorium on an application to explore shale gas in the Karoo area of the Northern Cape province using the hydraulic fracturing technique. The Government indicated that it would begin authorizing shale gas exploration in the first half of 2014. And in line with the new National Water Act only issues around water resources, such as the water use and the potential impact of chemicals used in fracking on the country’s water resources, would be considered when granting licenses for shale gas exploration. South Africa is an arid country and the sustainable use of water resources remains one of the country’s top priorities.

### III. DONOR COORDINATION

The Southern African Resource Center (SARC) has been engaging with various development partners in the region to identify potential areas of collaboration. The SARC team held a partnership meeting with the World Bank Regional office in Pretoria in which regional strategies of the two institutions were discussed. The two institutions also discussed the performances of the jointly financed projects and agreed to continue dialogue to identify further areas for collaboration. The SARC office is also in dialogue with the British Department for International Development (DFID) and the German Development Bank (KfW), to build partnerships in financing development projects in the region.
IV. ISSUES NEEDING PARTICULAR ATTENTION

Despite impressive economic development over the past 20 years, lower economic growth since the onset of the global economic recession has exacerbated high unemployment, inequalities and vulnerabilities. Over the past five years, growth has been persistently below potential with widening negative output gap. Although weak growth in major trading partners has contributed to the slow growth, domestic factors were the main reason why South Africa’s growth has been below its emerging market peers. In this regard, the Government needs to take immediate steps to address skill shortages by creating a more accommodative regulatory environment to attract skilled labor from abroad in the medium term. It also needs to address the quality of the education system in the longer term. The Government must also take a firm action on the implementation of structural reforms.
HIGHLIGHTS

- Peaceful elections concluded on 20 September 2013 will see women’s participation in Parliament reduced to a maximum of 15 percent even if 50 percent of the King’s appointees in the Senate are women.

- Inflation, which had been increasing since June 2013, started falling again in August, with the annual average inflation now expected to be just above 6 percent.

I. MACROECONOMIC MANAGEMENT OVERVIEW

Economic Growth: Growth in 2012 was 1.7 percent up from a previous reported decline of 0.6 percent. Most of the growth was recorded in the tertiary sector, which saw growth rising from a negative 1.2 percent in 2011 to 2.5 percent in 2012. The transport, storage and communications sector experienced the largest growth at 19.3 percent in 2012 compared to 2.7 percent the previous year. Growth in the primary and secondary sectors was subdued mainly due to a combination of a poor agricultural season, especially the maize and citrus subsectors, and a slow recovery in the manufacturing export markets.

The windfall Southern African Customs Union (SACU) received helped reduce arrears in domestic payments to the private sector, especially the construction sector, where activities that had been suspended were revived. Growth in 2013 is therefore expected to improve, largely driven by a recovery in manufacturing and construction activities. Construction will benefit from public sector investments, especially given the 25 percent increase in the capital budget. Weaknesses in the global economy, however, continue to pose some risks to Swaziland’s growth prospects. Growth in the South African economy, in particular, has slowed down.

Monetary Policy and Banking System: Price pressures experienced in June and July eased in August. Headline inflation marginally declined to 5.9 percent in August from 6 percent the previous month. The food and non-alcoholic beverages consumption basket category benefited from a decline in rice and meat prices, resulting in slower inflation of 5.7 percent in August compared to 6.8 percent in July 2013. The transport subcategory saw a large increase in the rate of price increase from 1.8 percent in July to 4.2 percent. The housing and utilities category experienced a 0.4 percent increase in inflation from 5.4 percent in July.

Annualized private-sector credit growth slowed to 4 percent in July compared to 9.6 percent in June but re-bounced strongly in August and grew by 13.6 percent. Non-financial sector credit expanded by 5.8 percent and personal loans grew by 1.8 percent. The large inflow of SACU receipts pushed foreign reserves to a peak level of E8.03 million in July 2013, equivalent to 4 months of import cover. By end-September the amount had fallen to E7.1 million, giving an average of about 3.7 months of import cover over the third quarter. On average, reserve holding are on an upward trend rising from 2.8 months of import cover at the end of 2012.
Overall, broad money supply (M2) grew by 1.5 percent between July and August 2013, driven mainly by a 5.2 percent growth in transferable deposits. The depreciation of the lilangeni/rand exchange rate against major currencies also affected the growth in money supply, given the rising foreign reserves. The lilangeni/rand exchange rate depreciated from E9.92 to E10.2 to the US dollar over the same period. In view of the sluggish growth, inflation and exchange rate dynamics, global developments, and taking a cue from the South African Reserve Bank, the monetary authorities in Swaziland left interest rates unchanged at 5 percent.

Fiscal Policy: The slow implementation of the capital projects resulted in marginal revision of the fiscal deficit from 1.1 percent to 1.2 percent. Given the small requirement for budget financing, public debt decreased marginally from 16.7 percent of GDP the previous month to 16.4 percent in August 2013. Total external debt remained unchanged at 8.8 percent of GDP while domestic debt fell marginally to 7.6 percent of GDP from 7.7 percent over the same period. In view of the improved confidence in the economy, the Government is gradually moving to restructure its debt tenor towards longer term debt. On August 27, 2013 a 5-year bond was issued at a fixed coupon rate of 8.5 percent. The bond issue was oversubscribed by more than thrice the E150 million that was on offer.

External Sector: Swaziland recorded an overall balance-of-payments (BOP) surplus of E457.9 million during the first quarter of 2013, compared to a surplus of E710.1 million in the last quarter of 2012. Over the same period, the current account surplus increased from E384.9 million from E280.7. The improved current account position is on account of surpluses on the trade balance, current transfers and a narrower income account deficit. Depressed economic activity accounted for lower imports compared to exports. The surplus on the trade account, however, decreased to E291.6 million in the first quarter of 2013 compared to E435.6 million in the last quarter of 2012. The decline in the trade surplus during the first quarter of 2013 was due mainly to import growth (10.5 percent) outstripping export growth (5.4 percent). Sugar exports fell by almost 50 percent as world sugar prices dropped while textile exports also declined due to increased competition from Asian suppliers to the United States of America.

III. ISSUES NEEDING PARTICULAR ATTENTION

Operationalization of the Agriculture and Food Security Working Group has been delayed despite the efforts that the Bank has made. Further engagement with the Swaziland authorities is therefore required to ensure that the group becomes operational.

II. DONOR COORDINATION

As part of its activities, the Aid Coordination and Monitoring Section in the Ministry of Economic Planning and Development conducted its annual compilation of donor financing to Swaziland. Despite an improvement in information gathering with regard to donor activities, little progress has been made on operationalizing some of the planned activities. In particular, the Government has been slow in fulfilling its obligations to ensure that the Agriculture and Food Security Working Group is operationalized. The Ministry of Agriculture, which is supposed to call for a meeting of potential participants in the working group, is still to do so.
HIGHLIGHTS

• Agriculture production is estimated to decrease by 7 percent following lower production in maize and cotton.

• The Government reduces the economic growth projection for 2013 to 6.0 percent from the initial projection of 7.8 percent. Economic growth for 2014, 2015 and 2016 is projected at 7.3, 7.5, and 7.6 percent, respectively.

• The 45 percent wage bill increase takes effect from September, pushing the projected deficit to 8.5 percent of GDP, almost double the target for 2013.

I. MACROECONOMIC MANAGEMENT OVERVIEW

Economic Growth: In August the Ministry of Finance announced a decrease in the 2013 economic growth rate to 6.0 percent, a reduction from the initial target of 7.8 percent. The reduction in growth can be attributed to the estimated fall in agricultural value added of 7.4 percent following a more than 50 percent reduction in cotton production and a 10 percent reduction in maize production. The primary sector will barely stay in positive territory for 2013, even though it is held buoyant by the strong growth in mining stemming from increased investments and output from the sector. Copper prices seem to have stabilized, attaining an average price of 7,113 USD/MT for the past two quarters. Copper production has been increasing for the past 5 quarters with a dip in the second quarter.

Showing the strongest growth, the value added in the secondary sector is expected to grow by 9.1 percent in 2013. This is a reduction compared to 2012 which can be attributed to a slower growth in manufacturing and construction. The utilities sector is expected to increase growth to 4.0 percent.

Overall growth in services is expected to slow slightly from last year, but is projected to increase by 6.6 percent. The slower growth is mainly attributed to a slowdown in commercial activities from wholesale and retail trading. Financial institutions are also projected to slow to 8 percent, though this is still above the average for services. Restaurants, bars and hotels are expected to pick up substantially following the annual meeting of the World Tourism Organization that provided the country with international exposure and put Zambia on the global tourist map.

Monetary Policy and Banking System: During the third quarter inflation decreased as the pressure from food inflation declined. Overall inflation reached 7.0 percent (year-on-year) at the end of the third quarter, down from 7.3 percent at the end of the second. Food inflation, accounting for more than 53 percent of the consumer price index, amounted to 6.5 percent (year-on-year) at the end of the third quarter, down from 7.1 percent at the end of the previous quarter. Important food items have shown relatively moderate increases in prices. Since January maize mealie prices have increased by slightly more than 11 percent, while maize grain has only increased by 4 percent. Locally produced food oil has maintained its price throughout the year. Beer prices have dropped by more than 3.5 percent since January. During the third quarter non-food inflation has been stable at around 7.4 percent.

During the third quarter the Central Bank maintained the policy rate at 9.75 percent, citing inflationary pressure, which had dampened in the quarter. Since January the policy rate has increased by 50 basis points.
The kwacha has been quite stable to the USD and pound during the past 2 quarters with the kwacha to USD slightly appreciating in the current quarter. For the first 9 months both the kwacha to dollar and kwacha to pound depreciated by less than 1 percent. In terms of the South African rand, the kwacha has appreciated by more than 11 percent during the past three quarters. South Africa is Zambia’s largest trading partner in terms of imports.

Broad Money (M2) growth has slowed from 26.2 percent at the end of February to 15.7 percent (year-on-year) in July, reducing to levels similar to the second half of 2012.

Average bank lending rates continue to be stable in the 16.1-16.5 percent band though with a slight upward trend since May. The rates are low compared with the levels about two years ago which stood at over 23 percent. Current account deposit rates have been falling from 3.8 percent to 1.2 percent since the beginning of the year. The 91-d T-bill has been increasing since the beginning of the second quarter, but seems to have stabilized at close to 8 percent, whereas the longer term 364-d T-bill has increased to 13.3 percent since the beginning of the year.

By the end of July, commercial bank loans and advances grew by 39.1 percent (year-on-year) compared to 43.5 percent in April. Since mid-2012 there has been a USD 200 million decrease in the stock of foreign currency loans to about USD 740 million, particularly in the non-exporting sectors. In contrast local currency loans have expanded sharply over the same period with total loans and advances increasing from kwacha 13.0 billion (June 2012) to 18.3 billion (July 2013). Loans to farmers, in particular, have increased rapidly in the past 12 months. The shift from foreign currency loans to kwacha loans can be attributed partly to the implementation of the currency regulation (SI33) mid-2012 which required all local transactions to be made in kwacha, partly to decrease domestic lending rates.

Fiscal Policy: According to the most recent figures from Ministry of Finance for the first 7 months of this fiscal year revenue and grant collection amounted to a total of kwacha 13.3 billion, which was below the target of 15.3 billion representing an under collection of 14 percent. On the expenditure side total spending reached kwacha 17.0 billion with planned spending of 18.5 billion representing 8 percent underspending. The lower than expected revenue collections is mainly attributed to lower tax collections from mining and grant receipts, totalling kwacha 1.5 billion, which were 0.5 billion lower than projected. In terms of spending, unbudgeted payments of fuel arrears of kwacha 1.2 billion has kept the spending higher than it otherwise would have been. The projected fiscal deficit is now projected to reach 8.5 percent of GDP by the end of the year, which is almost double the planned deficit.

The Ministry of Finance released the Medium Term Expenditure Framework for 2014-16 in September. The main objectives of the framework are to return to a higher growth path of 7.3 percent in 2014 increasing to 7.5 percent in 2015 and 7.6 percent in 2016. The other main targets are to reduce and stabilize inflation at 5 percent, increasing foreign reserves to 3.2 months of import cover and maintaining public external debt at no more than 30 percent of GDP. These overarching targets are not unrealistic given the high interest for investing in Zambia evidenced by the more than USD 1 billion annual inflow into the country. The Government will find it challenging to rebalance the large deficit incurred this year with a Ministry of Finance target of 2.5 percent of GDP in 2016.

External Sector: The 12-month rolling trade balance has deteriorated compared to the previous quarter figures. The August (year-on-year) trade balance amounts to kwacha 2.7 billion, which is down from May (year-on-year) that stood at kwacha 3.4 billion. The drop can be attributed to a rise
in intermediate imports and capital investments mainly in the mining sector which have increased in the current quarter. Exports fell slightly during the past 4 months from the April high to about kwacha 4.5 billion in August. Copper is still the main source of exports; however, non-traditional exports have shown strong growth during the past 5 years and for the first 8 months of 2013 accounted for 36 percent of all exports. The two main destinations for all exports are Switzerland and China. Imports have continued to rise from the second quarter standing at kwacha 4.5 billion at the end of August. In August, about 30 percent of the imports came from South Africa, followed by Congo with 17 percent and China with 8 percent.

The decrease in gross international reserves at the beginning of the year has stabilized during the past 4 months, reaching a level of USD 2.5 billion at the end of July. This level has been maintained since April. The decrease in reserves during the first months of the year is attributed partly to the central bank’s efforts to stabilize the kwacha, partly to the once-off payment for fuel arrears. The current level of reserves corresponds to 2.5 months of imports, well below the Government’s target of over 3 months.

II. INSTITUTIONAL AND STRUCTURAL REFORMS

The Medium Term Expenditure Framework was released in September providing the framework for the Government’s plans over the medium term (2014-16). The Government’s main objective is to continue to support the creation of sustainable jobs, reducing poverty and inequality. The specific broad Government objectives are to promote high growth in the labor-intensive sectors of agriculture, tourism, manufacturing and construction. Growth-facilitating sectors such as transport, communication and energy will also receive special attention. The main macro targets are to achieve an average 7 percent growth in GDP, while reducing and stabilizing inflation increasing foreign reserves and maintaining public external debt at a maximum 30 percent of GDP. The Government’s main policy priorities for the medium term are to implement the public service transformation program (2013-2016) that intends to make public service more responsive, service oriented and accountable for the delivery of timely and quality services. The Public Service Pay Policy (2012-2022) continues to be implemented with the aim of rationalizing and harmonizing pay structures. The policy is anchored on two main principles of equal pay for equal work and comprehensive lifespan conditions of service. From September the basic salaries were adjusted averaging a 45 percent increase on the wage bill with individual increases ranging from 4 to 200 percent.

III. DONOR COORDINATION

The first 2013 Poverty Reduction Budget Support review meeting was held in July to assess the Government’s progress for the 2012 Performance Assessment Framework (PAF). The meeting was attended by Government and the 7 Budget Support partners including the African Development Bank. The PAF was reviewed in terms of the Government’ commitments to addressing the underlying principles for sound macroeconomic management, good governance, and poverty reduction, as well as examining sector performance. The main concerns raised about the underlying principles were the deteriorating fiscal position, due mainly to an increase in the wage bill and the need for Government to increase tax collection through broadening the tax base, as well as implementing new taxes such as a property tax. Another issue raised was related to the excessive cost of running the Food Reserve Agency which over the past 4 years has operated well above the annual budget. On sector performance good progress was made in education, health, water and sanitation, and social protection but the quality of service was still lagging behind. There is need for improvement in areas such as public financial management, agriculture, environment and transport. The provisional score for targets met was 57 percent, which is an improvement compared to the 2011 PAF score of 50 percent.

IV. ISSUES NEEDING PARTICULAR ATTENTION

The Government has taken bold steps in dismantling subsidies this year, but at the same time public spending overruns is cause for concern. The budget deficit has slipped from the planned 4.3 to over 8.5 percent of GDP as mentioned above. There will be a need for the Government to strengthen budget control to avoid further overruns, as well as to increase budget transparency if the national budget is to remain credible. Unplanned and continued large deficits increase the risk of cuts by the international credit rating bureaus.
ZIMBABWE

HIGHLIGHTS

- Economic data for the third quarter indicates a further slowing economy. GDP growth is projected to register 3.4 percent in 2013 against the initial projection of 5.0 percent, following poor performance in agriculture and weakening global commodity prices.

- The position regarding balance of payments continued to deteriorate. The economy is struggling to generate exports at a time when economic agents are importing heavily.

- The fiscus remains severely constrained due to the poor performance of domestic revenue inflows (particularly mine-related revenues) against the background of rising recurrent expenditure.

- The annual rate of inflation is subdued, registering 1.28 percent in August 2013.

I. MACROECONOMIC MANAGEMENT OVERVIEW

Economic Growth: Real GDP growth for 2013 is projected at 3.4 percent compared to 4.4 percent registered in 2012, largely due to underperformance in agriculture and mining. Furthermore, the economy continues to suffer from a number challenges including: low capital inflow, declining industrial capacity utilization and the high cost of utilities. To this effect, the Government has affirmed its commitment to ongoing macroeconomic management policies and institutional reforms.

Monetary Policy and Banking System: Annual growth in broad money supply (M3), defined as total banking sector deposits (net of interbank deposits), declined from 27.2 percent in July 2012 to 4.3 percent in July 2013. On a month-on-month basis, M3 increased marginally from -4.5 percent in June 2013 to 0.4 percent in July 2013. Annual total banking sector deposits increased to USD 3.85 billion from USD 3.70 billion in July 2012. Confidence in the financial system still needs to be nurtured and boosted in order to ensure and harness further growth in deposits. The loan-to-deposit ratio, calculated on the basis of total bank deposits, as well as external and domestic sources of funding, decreased marginally from 95.5 percent in June 2013 to 95.3 percent in July 2013. The level in July 2013 compares to 87.5 percent in July 2012. However, banks still need to lend cautiously, given the high level of non-performing loans, which is well above the recommended threshold of 5 percent.

Zimbabwe's year-on-year consumer inflation increased for the first time in seven months to 1.28 percent in August 2013 from 1.25 percent recorded a month earlier. On a month-on-month basis, inflation dropped 0.15 percent against 0.38 percent decline in July. Inflationary pressures during the month of August largely emanated from the increase in the prices of transport (by 5.04 percent) and alcoholic beverages and tobacco (by 4.44 percent). Year-on-year inflation has remained below 5 percent following the adoption of the multicurrency system. In the short to medium term inflation will continue to be affected by movements in international oil prices, the USD/rand exchange rate, world food prices, as well as the level of aggregate demand.

Commercial bank weighted average lending rates for both individuals and corporates firmed from their June 2013 levels of 14.29 percent and 9.46 percent to 14.39 percent and 9.65 percent in July 2013, respectively. Over the same period, merchant bank-weighted average lending rates for corporates also firmed from 16.89 to 16.97 percent. However, merchant bank-weighted average lending rates for individuals softened from 17.78
to 17.70 percent over the same period. Overall, lending rates remained high, in the backdrop of deep-seated liquidity shortages as a consequence of limited access to external credit lines and adverse balance of payments developments. As a result, borrowing for investment purposes continues to be expensive.

The range in commercial bank savings rates for July 2013 has remained within the November 2012 range of 0.15-8 percent. However, the three-month deposit rate range changed from 4-20 percent in June 2013 to 3-20 percent in July 2013. Deposit and savings rates failed to improve despite the Memorandum of Understanding signed between the central bank and banks in January 2013, which encourages banks to increase these rates in a bid to attract more savings and deposits into the formal banking system.

Fiscal Policy: Fiscal space remains severely constrained due to the poor performance of domestic revenue inflows (particularly mine-related revenues) against the background of high recurrent expenditure, with employment costs accounting for 47 percent of total expenditure. Total expenditure for July 2013 amounted to USD 397.73 million against a revenue outturn of USD 323.03 million. Cumulative expenditure to July 2013 amounted to USD 2.181 billion compared to the cumulative revenue outturn of USD 2.131 billion. This resulted in a cumulative deficit of about USD 50 million. The deficit is largely being financed by incurring domestic arrears, which at the end of June 2013 amounted to USD 101.44 million. This poses a significant risk to the SMP’s quantitative benchmark of a reduction in domestic arrears. Capital expenditure amount to about 7 percent of the total expenditure. Enhancing Zimbabwe’s budget overall productivity requires significant scaling up in financing of essential infrastructure investments and social services, while at the same time downsizing non-productive recurrent expenditure.

External Sector: Reflecting the country’s continued demand for imports and overreliance on export commodities, the country’s balance of payments remains in a precarious position. During the period January to July 2013, total imports of about USD 4.5 billion were recorded against very low exports of about USD 1.8 billion during the same period. The overall trade deficit increased by about 41 percent in 2013 compared to the same period in 2012. A widening trade deficit does not augur well for an economy that is desperate for an improvement in the liquidity position and building of reserves. It is also worrying to note that, while imports were generally showing a positive trend, exports were actually declining in 2013 compared to the same period in 2012. As a result, imports cumulatively increased by about 18.8 percent during the period under review while exports decreased by about 3.4 percent revealing an urgent need for value addition industries to increase export values. Policy incentives that encourage exports could, thus, bring positive changes to these trends.

Micro-Finance Bill – The Bill will provide for the regulation of deposit taking micro-finance institutions, non-deposit taking MFIs and also includes a code of conduct which enforces good ethical standards within the micro-finance sector. It will also enhance the mobilization of small and irregular savings from the informal sector, thereby promoting financial inclusion. The enforcement of the code is expected to enhance consumer protection and bring some sanity to the sector.

The Securities Amendment Bill – The main objective is to align the supervisory framework with the International Organisation of Securities Commissions (IOSCO) principles of securities regulation.

Money Laundering and Proceeds of Crime Bill – a Money Laundering and Proceeds of Crime Act was promulgated to align the country’s AML/CFT legal and institutional framework with the Financial Action Task Force (FATF) standards. Zimbabwe is a member of the Eastern and Southern African Anti-Money Laundering Group (ESAAMLG). By virtue of its membership to ESAAMLG and ultimately to the FATF, Zimbabwe is obliged to implement the FATF standards on Anti-Money Laundering and Combating of Financing of Terrorism (AML/CFT).

III. DONOR COORDINATION

The Zimbabwe Field Office continued to participate in a number of donor coordination activities during the review period, in particular, the Field Office participated in thematic sessions including: the monthly meeting between the World Bank and the AfDB to discuss current activities undertaken by the two institutions in policy advisory, knowledge work and technical assistance; the public financial management (PFM) meeting between the donors and the the Accountant General’s Department, etc. The MMU of the ZIMFUND continued to hold a number of technical meetings on the ZIMFUND-financed projects.

The Bank hosted a number of partner consultation meetings during the quarter including with: the International Division of the Japan Economic Research Institute (JERI), whose objective was to explore areas of potential future partnership; Researchers from the South African Institute of International Affairs (SAIIA) to discuss South Africa’s foreign policy in the SADC region, with special reference to Zimbabwe; and the Peace Building Network of Zimbabwe, whose aim was to gather information on the impact of peace-building efforts and reconciliation on the economic turnaround and growth of the Zimbabwean economy, and to solicit recommendations for creating a peaceful environment for businesses to operate.

IV. ISSUES NEEDING PARTICULAR ATTENTION

Due to poor performance of agriculture, the country is facing an acute grain shortage, owing to poor harvests experienced during 2012/2013 agricultural season. To this end, arrangements to import 150,000 tons of maize from Zambia at a cost of USD70.6 million have been made. This is meant to augment stocks in the Strategic Grain Reserves. To complement Government efforts, the Grain Millers Association has indicated its commitment to import up to 160,000 tons of maize to meet demand on the local market.
III. THEMATIC ANALYSIS: PROGRESS TOWARD MACROECONOMIC CONVERGENCE IN SOUTHERN AFRICA
PROGRESS TOWARD MACROECONOMIC CONVERGENCE IN SOUTHERN AFRICA

1. INTRODUCTION

In 2004, Southern African countries that were members of the Southern African Development Community (SADC) adopted the Regional Indicative Strategic Development Plan (RISDP). One of the objectives of the RISDP was to achieve macroeconomic convergence within the region to create an enabling environment for financial sector integration and capital flow, and to minimize the risk of experiencing regionally destabilizing macroeconomic shocks. Macroeconomic convergence is also considered a key building block of the planned SADC Monetary Union. Table 1 outlines the targets across four macroeconomic indicators, and the timeline for reaching these targets.

SADC member countries, through the 2006 Protocol on Finance and Investment, agreed to monitor and ensure convergence to these macroeconomic targets. The section evaluates performance across the 11 out of the 15 SADC countries which form the African Development Bank’s Southern Africa region – Angola, Botswana, Lesotho, Malawi, Mauritius, Mozambique, Namibia, South Africa, Swaziland, Zambia and Zimbabwe. The analysis is a follow-on to the one conducted in the Fourth Quarter of 2011, and compares performance then and now. It also evaluates performance against the 2012 convergence targets to measure the extent to which these targets are being met. Finally, it surveys the factors explaining performance, and provides broad policy recommendations.

2. CONTEXT

The region has maintained a good track record in macroeconomic management. It registered an average GDP growth rate of 5.1 percent during 2000–2008, which fell to -1.4 percent in 2009, in line with global recessionary trends, and rebounded thereafter to reach 4.9 percent in 2011. The region is estimated to have grown at 4.2 percent in 2012, and is projected to reach a 4.9 percent growth rate in 2013. Growth has been strongest in Angola, Mozambique and Namibia, on the back of a progressive increase in commodity prices (Angola and Namibia), and large foreign capital inflows supporting capital investments (Mozambique). On the other hand, globally integrated economies, particularly South Africa and Botswana, were the worst affected by the global economic crisis and went into recession in 2009. The Zimbabwean economy rebounded in 2009 having gone through nearly a decade of negative growth, but has since 2012 been stabilizing into subdued growth of less than 5 percent, reflecting a restrictive debt overhang and limited space to apply monetary policy tools, among other structural constraints.

3. PERFORMANCE IN MEETING MACROECONOMIC CONVERGENCE TARGETS

3.1 REGIONAL TRENDS

The region’s current account balance is regarded as sustainable. On the back of rising commodity prices, the region posted a current account deficit of 1.1 percent of GDP over the period 2004–2007, with individual countries broadly staying within the SADC macroeconomic convergence target of less than 9 percent of GDP. Between 2008 and 2012, divergence from the targets was observed in some countries – Lesotho, Malawi, Mauritius, Mozambique, and Swaziland – when the global financial crisis constrained trade flow and other financial transactions. A widening of the current account deficit (up to 9.1 percent of GDP) for the region was also observed over the same period. However, 2012 estimates indicate that the current account remains within target for all but 4 countries (Lesotho, Mauritius, Mozambique and Zimbabwe); with resource-rich countries Angola and Botswana posting surpluses of 9.6 percent and 5 percent respectively.

Most countries in the region have achieved low fiscal deficits in line with the macroeconomic convergence target of less than 5 percent of GDP by 2008, and 3 percent of GDP by 2012. From a period of fiscal surplus (2005 to 2008) contributed mostly by resource-rich countries (Angola, Botswana, Namibia and South Africa), the fiscal position worsened slightly between 2009 and 2011 in line with the expansionary fiscal policies adopted in response to the crisis, as well as lower fiscal revenues also attributed to a slower global economy. For instance, volatile Southern Africa Custom Union (SACU) customs revenues had adverse effects on the fiscal positions of Lesotho and Swaziland. Fiscal deficits broadly remain within the macroeconomic convergence targets, reflecting strong fiscal discipline across the board.

<table>
<thead>
<tr>
<th>Table 1: SADC Macroeconomic Convergence Targets</th>
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<tr>
<td><strong>Inflation (annual rate)</strong></td>
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<tr>
<td>Single digits</td>
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<tr>
<td>Fiscal deficit (percent of GDP)</td>
</tr>
<tr>
<td>Public debt (nominal, percent of GDP)</td>
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<tr>
<td>Current account deficit (percent of GDP)</td>
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The region attained price stability especially during the latter part of 2000s, in line with the convergence targets. At regional level, inflation averaged 7.4 percent from 2009 to 2012; recovering from an anomalous peak of 11.5 percent experienced in 2008 against the backdrop of high global energy and food prices. Mauritius and Zimbabwe were the best performers over this period with inflation rates of 4 percent on average, whereas in Angola, Malawi and Mozambique inflation rates periodically exceeded 10 percent.

Different economic structures of member states imply different performance of countries in meeting convergence targets. These differences will be explored further in Section 3.2.

Performance in public debt management has been good across countries, with the Multilateral Debt Relief Initiative playing a significant role in sustaining the debt level at less than 40 percent of GDP for beneficiary low-income countries (LICs), while middle-income countries (MICs) have benefited either from the commodities boom or conservative debt policies. Between 2008 and 2012 some countries, especially the MICs, increased borrowing to support expansionary fiscal policies during and after the crisis (Botswana from 6 percent of GDP in 2008 to 14 percent in 2012, and South Africa from 28 percent in 2010 to 42 percent in 2012). Excluding Zimbabwe, which is an anomaly with public debt of 60-92 percent of GDP over the same period, public debt increased from a regional average of 30 percent of GDP in 2008 to 35.3 percent in 2012.

Southern Africa: Selected Macroeconomic Indicators
(Average 2004-13)

Source: IMF, October 2013
3.2 COUNTRY ANALYSES

Resource-based middle-income countries

Southern Africa’s resource-rich countries – Angola, Botswana and Namibia – performed well in terms of current account balance prior to the 2009 crisis, largely explaining the positive trends in fiscal balance and debt levels (Figures 5-8). These countries show significant susceptibility to global economic spillovers. For instance, high variance in the current account (where the standard deviations over the 2004-2012 were between 5-9.7 percent of GDP) reflects an overreliance on pro-cyclical exports; while the fiscal balance fluctuations highlight the importance of the same exports in fiscal revenues. For these countries, the main challenge is meeting some of the secondary targets such as improving the structure of the current account.

Angola outperformed all countries in the region on current account balance, reflecting a comparative advantage arising from being the second largest oil exporter in Africa. However, the current account remains far from being balanced and highly dependent on one product which contributed 90 percent of export earning, 80 percent of fiscal revenues and almost half of GDP. The vulnerability of the economy to shocks in the global oil market is evident from the negative current account balance recorded in 2009 when oil prices contracted, and the ensuing contraction in reserves and a migration from a fiscal surplus to a deficit in 2008 and 2009. Aside from the narrow tax base, pressure on the fiscal position also arose from the large fuel subsidies bill which affected 90 percent of public investments in 2011. Public debt has evolved with the fiscal position, being lowest during the oil boom years of 2006/7, and increasing between 2009/10, but remained below 40 percent of GDP and well below the SADC convergence target. Inflation in Angola is converging to the SADC targets, but remains the second highest in the region, reflecting challenges in managing broad money, and imported inflation fueled by the narrow production base. Angola has successfully completed a Stand-by Arrangement Program (2009-2012) with the IMF which is expected to have corrected some underlying sources of vulnerability such as an overvalued and unstable exchange rate, high inflation, and lack of fiscal transparency and accountability. However there is need to build in resilience by diversifying the growth sectors, fiscal revenue sources and the export revenues basket.
Botswana had maintained a current strong account surplus prior to the 2009 crisis, slipping into a deficit in 2009, and recovering modestly thereafter. This reflects an economic structure similar to that of Angola, i.e. high dependence on one main export, diamonds, which contribute 60-70 percent of export revenues, half of fiscal revenues and about 30 percent of GDP. Botswana’s fiscal balance also migrated from positive over the period 2004 to 2007, to a negative balance between 2008 and 2011, reflecting a prolonged effect of the crisis on revenues from mining and the SACU customs pool. A bigger public service bill and more spending on development also weighed in on the fiscal deficit. Inflation exceeded the SADC convergence ceiling in 2008 in line with rising global food and oil prices but generally stayed in the single-digit zone between 2009 and 2012, reflecting the Bank of Botswana’s relatively tight monetary policy stance maintained in the post-crisis period. The debt stance also remained conservative, shifting only marginally between 2009/11 in response to the fiscal deficit.

Namibia experienced a current account deficit in 2009 for the first time since 1990, and aside from the minimal surplus in 2010, has been in deficit since. Subdued recovery of mining exports, particularly diamonds and uranium, which contribute about 35 percent of Namibia’s foreign exchange earnings, explains this performance. Unlike other resource-rich countries, Namibia’s economy is relatively more structurally balanced. This has supported more subdued responses to cyclical booms and busts in the mining sector, for example, the current account surplus sustained in Namibia during the pre-crisis period was far smaller than that enjoyed by Angola and Botswana and likewise, the post-crisis deficit has stayed below 2 percent of GDP, well within the convergence target. Namibia’s fiscal balance has also been negative since 2009, exceeding the convergence target in 2011. This is explained by trends in the mining sector, fluctuations in SACU revenues, and ongoing fiscal expansionary policies, particularly the 2011-2014 Targeted Intervention Program for Employment and Economic Growth. Although debt increased substantially from 16 percent of GDP in 2009 to 26 percent in 2012, it remains within Namibia’s statutory limit of 30 percent and is well within the SADC convergence target. Inflation in Namibia has remained within the convergence targets overall, getting into the double-digit zone only in 2008, reflecting mostly imported oil and food price inflation.

Source: IMF, October 2013
3.2.2 NON-RESOURCE BASED MIDDLE-INCOME COUNTRIES

The economies of the reminder of the region’s MICs – South Africa, Mauritius and Swaziland – exhibited different performances across the convergence indicators, which underscore fundamental differences in the economic structures (Figures 9-12). South Africa has a large economy which contributes 68 percent of the region’s GDP and is more broad-based than those of the resource-rich MICs discussed above. Mauritius’s economy is also broad-based, but is smaller than that of other MICs and highly integrated into the global economy. Swaziland is a MIC by measure of GDP per capita, but has a very small economy (less than USD 4 billion in annual GDP), which is highly integrated into the South African economy. This means that for South Africa, both domestic and global phenomena affect performance. Mauritius’ performance is susceptible to global economic cycles. And economic trends in Swaziland respond significantly to developments in South Africa. The ideal policy responses therefore differ among these non-resource based MICs.

**South Africa** has maintained a moderate current account deficit well within the convergence target over the past decade, although a mild worsening of the balance was observed in 2008. Mining contributes up to 60 percent of South Africa’s exports but accounts for less of the country’s GDP compared to that of resource-rich countries (about 6 percent) and has an even smaller share of fiscal revenues. However, structural constraints held back mining activities during the commodities boom before the crisis, while in the post-crisis period the sector was plagued with labor unrest. A significant worsening of the fiscal position was observed between 2008 and 2009, sustained through 2012, as a result of intensive fiscal expansion policies adopted in response to the crisis and in support of the 2010 FIFA World Cup. Debt has consequently increased from about 30 percent of GDP in 2007 to 42 percent in 2012, placing South Africa’s debt-to-GDP ratio above the region's average. So far, debt is within the convergence target and according to the IMF, within the debt ratios observed in other emerging markets. Inflation has generally stayed within the Central Bank’s target band of 3-6 percent since recovering from uncharacteristic highs between 2007 and 2009, when high global fuel and food prices and an expansive fiscal policy fueled inflation into the double digit zone. South Africa has been caught in moderate growth trap for close to a decade and will most likely continue with expansionary fiscal policies, taking advantage of the remaining fiscal space, to unlock structural constraints to growth.

**Southern Africa: Selected Macroeconomic Indicators for Low Income Countries**

- **Annual Inflation (percent)**
- **Public Debt (percent of GDP)**
- **Fiscal Balance (percent of GDP)**
- **Current Account Balance (percent of GDP)**

Source: IMF, October 2013
Mauritius has one of the most globally integrated economies and has since 2008 failed to meet the SADC convergence target on current account balance. This is explained mainly by a deteriorating trade balance due to decreasing sugar exports, and the effects of a sluggish global economy on financial market flow and tourism. The fiscal balance has remained stable at a deficit of less than 4 percent of GDP since 2008 thanks to expenditure management measures such as lower transfers to state-owned enterprises, and measures to broaden the tax base. Debt levels have not changed much from the pre-crisis levels and remain at around the national ceiling of 50 percent of GDP. Inflation in Mauritius responds mostly to global trends in fuel and food prices and broad money supply, and to a lesser extent, trends in administered prices. While responding to these factors, inflation has stayed within the SADC convergence target over the past decade, and Mauritius is one of the few countries that met the 2012 convergence target of 5 percent. This performance also reflects the presence of a low implicit inflation target of about 5 percent maintained through Bank of Mauritius repo operations. Although still within the convergence targets, Mauritius is in the top 3 countries on debt-to-GDP ratio in the region. The limited fiscal space supports a neutral fiscal policy stance in the medium term.

Swaziland’s current account balance has fluctuated considerably over the past decade. Large deficits were registered in both the current and fiscal accounts in 2009 and 2010: the current account reached a deficit of 14 percent of GDP in 2009 from about 2 percent in 2007, while a fiscal deficit of 11.5 percent was registered in 2010 from 1.6 percent in 2007. This trend is attributed to the effects of the global economic slowdown on the trade balance, FDI flows, and SACU receipts. To avoid an impending fiscal crisis, in 2010 Swaziland adopted a Fiscal Adjustment Roadmap (FAR), operationalized by an IMF Staff Monitored Program in 2011, to consolidate public expenditure and broaden the tax base. These programs, and a recovery in SACU receipts, explain recovery in both the current account and fiscal balance to surplus in 2012. Debt grew mildly over this period to reach 19 percent in 2012, staying well below the convergence targets and Swaziland’s own ceiling of 40 percent of GDP. Inflation has stayed in the single digits for most of the past decade (except in 2008) in line with inflation trends observed in the main trading partner, South Africa. To stabilize the fiscal balance Swaziland should enhance efforts to clear public sector arrears on the domestic market and further consolidate Government expenditure.

3.3.3 LOW-INCOME COUNTRIES

The performance of low-income countries improved over the period 2004-2012 (Figures 13-16). Generally, countries run current account deficits wider than those observed in MICs, and consistent with the smaller production capacities. These countries have mostly failed to meet the current account convergence targets over the past decade, although for some, current account deficits are assessed to be sustainable considering the pattern of flows and how the deficit is funded. Most countries have run fiscal deficits, but deficits are mostly sustainable and within the convergence target. Debt levels have also migrated to sustainable levels. These two indicators map the outcome of structural adjustment programs and debt forgiveness for some countries. The effect of the global economic crisis was milder, reflecting weaker linkages to the global economy. Exceptions to these trends are discussed below.

Lesotho had maintained a current account surplus for nearly a decade before 2009, when the surplus was eroded by a decline in exports of textiles and diamonds, and as of 2011, a sharp decline in SACU revenues. The current account deficit reached a low of 22 percent of GDP in 2011. Recent improvements are attributed to improvements in SACU revenue flows and an expanding mining sector. The fiscal balance followed suit, migrating from a six-year surplus to a deficit of about 4 percent in 2009 and 10.5 percent by 2011. On the expenditure side, increased recurrent expenditure and the rehabilitation of flood-damaged infrastructure contributed to the deficit. The fiscal surplus was restored in 2012 as SACU revenue flows recovered and a number of fiscal consolidation measures were implemented with IMF assistance. Public debt increased from 37 percent in 2009 to 42 percent in 2012 and remains below the convergence target.

Inflation trends in Lesotho are similar to those observed in its major trading partner, South Africa. The inflation rate has stayed in the single-digit range over the past decade, aside from 2008 when inflation reached double digits due to the increasing global prices of oil and food. As a small economy in the SACU region, Lesotho is highly vulnerable to developments in the South African economy. It is also linked to global markets through its key exports – diamonds and textiles. The country must therefore create adequate buffers to external shocks. This means adopting a more conservative public expenditure and debt stance, and better management of SACU revenue flows and potentially larger diamond export revenues in the medium terms.

Mozambique is currently a net importer of goods and services and has maintained a current account deficit over the past decade. The deficit is large and generally falls outside of the convergence target. It has also been increasing, from about 12 percent of GDP in 2009 to 26 percent in 2012; and is expected to continue on an increasing trend. The trend is attributed to investment-related imports and oil imports which have grown much faster than the traditional agriculture and forestry exports. The deficit is financed mainly through FDI which surged over the same period. The fiscal balance was negative but generally sustainable over the past decade, averaging 3.7 percent of GDP. The fiscal deficit fell within the convergence target in 2012 at less than 3 percent. Debt levels have migrated to more sustainable levels, from 80 percent of GDP in 2005 to 42 percent in 2008. Debt has increased gradually since and was 46 percent in 2012. Inflation has been high over the past decade, exceeding the single-digit inflation convergence target more often than not. The exceptional performance in 2012 (2.2 percent) is attributed to local food price trends, stable price administered prices and a stable currency. The Government’s move toward more expansionary fiscal and monetary policies should be supported by efforts to direct debt to productive expenditure and the cautious monitoring of inflation.

Malawi has run a current deficit over the past decade, but a distinct improvement is evident in the later half of the decade. The deficit improved from about 11.3 percent in 2006 to 3.7 percent in 2012, and though volatile, has remained well within the convergence target since 2009. Performance
reflected developments in the agricultural sector, especially trends in prices of the main export commodity – tobacco – which accounts for up to 60 percent of export revenues, as well as fertilizer and fuel imports. Fluctuations in foreign aid flows have also contributed to the current account trends. The fiscal deficit has trended around the convergence target for most of the past decade, exceeded convergence targets in both 2011 and 2012, and was among the highest in the region in 2012. Malawi was highly indebted prior to the debt relief program implemented in 2006 which lowered debt levels from 140 percent of GDP to 36 percent. Debt levels are now on an upward trend, reflecting both increased borrowing and a devaluation of the kwacha which increased debt by nearly 13 percent of GDP in 2012 and takes Malawi’s debt level close to the convergence ceiling. The devaluation also fueled inflation to an annual average of 21.3 percent in 2012, the highest inflation recorded in the region. Ongoing fiscal and debt consolidation measures are expected to ensure sustainability of the fiscal position and public debt levels in the medium term. The Reserve Bank is also tightening monetary policy to curb inflation pressures.

Zambia registered a current account surplus between 2009 and 2011, reflecting growth in copper exports previously hamstrung by low prices and supply-side constraints. Over this period, copper accounted for between 75 percent and 80 percent of export earnings. Copper, however, contributes a small share of fiscal income (6 percent) and the fiscal balance has broadly stayed in deficit over the past decade, though within the convergence targets for the most part. Zambia has maintained debt at a moderate level of on average 25 percent since debt relief in 2000, when external debt was 192 percent of GDP. In 2012, Zambia had the 4th lowest debt level in the region. Inflation is decreasing from trending above the convergence target in the pre-crisis period, to single-digit inflation since 2009. This is in line with the Central Bank’s inflation target of 7 percent. A recent move toward an expansionary fiscal policy to support growth in non-traditional sectors, using the 2012 sovereign bond proceeds to fund higher Government expenditure, will allow Zambia to take advantage of its fiscal space, but caution is required to ensure the adequate targeting of expenditure that will support product. Likewise, a tighter monetary policy stance is succeeding at managing inflation.

Zimbabwe’s economy is still in recovery from nearly a decade of a devastating recession. The adoption of a multicurrency regime in 2009 was instrumental in halting hyperinflation; while a debt overhang (as high as 92 percent of GDP in 2008) prevented borrowing and de facto supported a balanced budget fiscal stance. Therefore an above-average performance was registered in terms of inflation and fiscal balance between 2009 and 2012; while debt levels (60.5 percent in 2012) and the current account deficit (24 percent GDP in 2012) still fall short of the convergence targets. Zimbabwe is currently implementing special short-term IMF staff-monitored program, aimed at improving public finances and strengthening public finance management. This includes increasing transparency in mineral resource revenues management. Innovative measures such as resource securitization are also being explored to support the rehabilitation of strategic infrastructure and new constructions.

4. CONCLUSION

In 2012, the Southern Africa region met the SADC macroeconomic convergence targets with respect to debt-to-GDP ratio, fiscal deficits and current account deficits. Although nearly all countries met the 2008 convergence target on inflation, only a quarter of the countries met the 2012 target. The analysis of performance over the past decade indicates sustained improvements in the management of debt and inflation. On the other hand, some of the current account and fiscal balance gains achieved prior to the crisis have been eroded by the significant negative effect of global economic trends on these accounts.

These trends highlight three key areas that require review or action by SADC and member countries. First, there is a need to further reflect on whether or not the 2012 5 percent inflation target remains relevant in the current context where growth rates fall short of the levels required for significant poverty alleviation, and given that inflation ceilings pursued domestically generally exceed 5 percent. Second, there is need to harmonize domestic and regional targets with respect to debt ceilings. For a number of countries, legislative ceilings and current debt levels fall far below the SADC convergence target, which raises the question of what the optimal debt-to-GDP ratio ought to be for the region, and indeed, whether or not it makes sense to set the same target for all SADC countries. Third, there is a need to buttress current and fiscal accounts through better management surpluses and strengthened public expenditure management. SADC’s RISDP includes diversification of exports (to increase the share of non-traditional exports) and sustainable exports growth (to achieve a rate of at least 5 percent annually), as regional development targets. There is merit in monitoring performance of countries with respect to these targets which aim to improve the structure of the current account.