Zimbabwe Economic
Policy Analysis and
Research Unit

Contributions and Challenges Facing the Financial Sector in Zimbabwe

income interest revenue money
finance management
debt dollarization government
savings credit bonds
security loan
monetary system mortgage stocks bank

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ABSTRACT

Zimbabwe has a well diversified financial sector. However, the contribution of the sector to economic activity has varied over different periods. This study examines the contribution of the financial sector to economic activity over four economic policy regimes since independence in 1980. These periods include 1980-1989 (controlled regime); 1990-1999 (liberalized regime); 2000-2008 (economic crisis period) and 2009-2011 (multicurrency period). The contribution is measured in terms of contribution to the gross domestic product and formal employment. The choice of these variables was determined by data availability and consistency. The study examines challenges facing the financial sector in the multicurrency period, which commenced in February 2009 and how these challenges have affected the sector's contribution to economic activity. The study used both primary and secondary data sources.

The analysis suggests that the contribution of the financial sector to economic activity has varied over different economic policy regimes since 1980. The financial sector had the largest contribution to economic growth during the liberalized period, 1990-1999 and has had the least contribution in the multicurrency period. In terms of contribution to formal employment, the financial sector has contributed more in the economic crisis period (2000-2008) and in the multicurrency period (2009-2011). The analysis suggests that in the multicurrency period, the financial sector's contribution to economic growth has been negatively affected by lack of affordable long-term lines of credit; weak confidence in the financial sector, the Central Bank and Government; limited roles of the Central Bank and uncertainty in the economy.

ACRONYMS

AfDB	African Development Bank
BAZ	Bankers Association of Zimbabwe
CBZ	Commercial Bank of Zimbabwe
CPPs	Client Protection Principles
CSD	Central Securities Depository
CZI	Confederation of Zimbabwe Industries
DPC	Deposit Protection Corporation
ESAP	Economic Structural Adjustment Programme
FCA	Foreign Currency Account
FDI	Foreign Direct Investment
FIF	Financial Inclusion Fund
GDP	Gross Domestic Product
GMM	Generalized Methods of Moments
GoZ	Government of Zimbabwe
IDBZ	Infrastructure Development Bank of Zimbabwe
IEEP	Indigenization and Economic Empowerment Policy
IPEC	Insurance and Pensions Commission
LOLR	Lender of Last Resort
MFIs	Micro-Finance Institutions
MoF	Ministry of Finance
MOU	Memorandum of Association
NBFIs	Non-Bank Financial Institutions
NPLs	Non-Performing Loans
POSB	Post Office Savings Bank
RBZ	Reserve Bank of Zimbabwe
SECZ	Securities Commission of Zimbabwe
SEDCO	Small Enterprise Development Corporation
SMEs	Small and Medium Enterprises
SSA	Sub-Saharan Africa
TBs	Treasury Bills
TNDP	Transitional National Development Plan
VECM	Vector Error Correction Model
ZAMFI	Zimbabwe Association of Micro-Finance Institutions
Zim Asset	Zimbabwe Agenda for Sustainable Socioeconomic Transformation
ZIMPREST	Zimbabwe Programme for Economic and Social Transformation
Zimstat	Zimbabwe Statistical Agency
ZSE	Zimbabwe Stock Exchange

1. INTRODUCTION AND BACKGROUND

The financial sector in Zimbabwe has gone through various economic policy regimes since independence in April 1980. Over the period 1980-1989, the financial sector was still relatively small and dominated by foreign institutions. It was characterized by controls on interest rates and prices, foreign exchange and credit allocation. While the controls suppressed inflation, they stifled economic growth.

Over the period 1990-1999, the financial sector was liberalized, with entry requirements being relaxed. This resulted in more financial institutions, including indigenous ones, emerging. Controls on foreign currency allocations, credit allocations, prices and interest rates were removed. Inflationary pressures increased as a result of price decontrols and bank financing of the growing fiscal deficits.

Over the period 2000-2008, the economy experienced a crisis in which economic growth declined by a cumulative 40% (MTP, 2011) and inflation peaked at 231,000,000% in August 2008 (Zimstat, 2008). A number of financial institutions were curated, closed and others liquidated. The contribution of the financial sector to economic activity in this period was minimal.

In the multicurrency regime, the financial sector is experiencing various challenges. The major constraints include lack of affordable long-term credit, weak confidence in the financial sector, the Central Bank and Government. These constraints have resulted in a minimal contribution of the sector to economic activity.

This study examines the contribution of the financial sector over the different policy regimes since 1980. The aim is to suggest measures to enhance the contribution of the sector in the multicurrency regime. To do this, the study identifies challenges facing the financial sector in the multicurrency regime. The study recommends measures to deal with the challenges.

2 RELATED LITERATURE AND EXPERIENCES OF OTHER DOLLARIZED ECONOMIES

2.1 Related Literature

Economic literature has shown that financial development has a positive effect on economic growth, but subject to some conditions. For example, in a study by Arcand, Berkes and Panizza (2012), the results showed a positive and robust correlation between financial depth and economic growth in countries with small and intermediate financial sectors. The study also demonstrated that there was a threshold, estimated around 80-100% of gross domestic product (GDP), above which financial development starts having a negative effect on economic growth.

In a study by Cecchetti and Kharroubi (2012), the results confirmed that the level of financial development was good only up to a certain point (closer to 90% of GDP for private credit extended by banks), beyond which it becomes a drag on aggregate productivity growth. Using the share of financial sector employment as a measure of financial sector development, they estimated the optimal financial sector contribution to employment at 3.9%. However, Cecchetti and Kharroubi (2012) also showed evidence that a big and fast-growing financial sector acted as a drag on the entire economy because it competed with other sectors for scarce resources.

Christiansen, Schindler and Tressel (2009) made a simultaneous assessment of the relationship between economic performance and economic reforms in domestic finance, trade and the capital account. They found that domestic financial reforms and trade reforms were robustly associated with economic growth, but only in middle-income countries through improvements in measured aggregate total factor productivity (TFP) growth as opposed to higher aggregate investment. In contrast, capital account liberalization and economic growth did not have any systematic positive relationship. They also found that growth effects of domestic financial and trade reforms were somewhat persistent, raising growth at a horizon of up to 6 years, but became insignificant at a longer horizon. The variation in the quality of property rights explained the heterogeneity of the effectiveness of financial and trade reforms in developing countries.

In a study of 24 Sub-Saharan African countries over the period 1975 to 2005, Acaravci et al. (2009) reviewed the finance-growth nexus and investigated causality between financial development and economic growth. Using panel co-integration analysis, they found no evidence of a long-run relationship between financial development and economic growth. Using a panel generalized method of moments (GMM)

estimation for causality, they found a bi-directional causal relationship between the growth of real GDP per capita and domestic credit provided by the banking sector in SSA. The implication of their findings was that African countries could accelerate their economic growth by improving their financial systems, and vice-versa.

Using a vector error correction model (VECM), Ankinlo and Egbetunde (2010) investigated the long-run and causal relationship between financial development and economic growth in 10 Sub-Saharan African countries. They found a long-run relationship between financial development and economic growth. They also found uni-directional causality running from financial development to economic growth in four of the countries, while one country had uni-directional causality running from economic growth to financial development. They found bi-directional causality between financial development and economic growth in five of the countries.

Alfaro et al. (2003) examined the role financial markets play in the relationship between foreign direct investment (FDI) and economic development. They found out that better financial markets allow agents to take advantage of knowledge spillovers from FDI, magnifying the output effects of FDI. They empirically showed that well-developed financial markets allow significant gains from FDI, while FDI alone plays an ambiguous role in contributing to development.

2.2 Experiences and Lessons from Other Dollarized Economies

Empirical evidence suggests that dollarized countries as a group have statistically grown at significantly lower rates than non-dollarized nations (Edwards, 2001). Dollarized countries have experienced significantly lower rates of inflation. However, there is no evidence that dollarized countries have run more prudent fiscal policies than non-dollarized nations.

Ecuador and Panama are some of the dollarized countries from which Zimbabwe could draw up some lessons. For example, there are some similarities and differences in the case of Zimbabwe and that of Ecuador in the way they have dollarized, conditions that prevailed before dollarization and what has happened after dollarization.

Lessons from Equador

Ecuador officially dollarized in March 2000 after continuous deterioration of economic and political environment between 1997 and 1999. At dollarization, Ecuador stopped printing local currency (Makina, 2009). The currency devaluations that were done resulted in a run on local currency bank deposits. In terms of policy

response, there was a temporary freeze on withdrawals. At that stage, the banking sector was almost collapsing. In addition, the Asian financial crisis of 1997, which affected Ecuador, among other countries, resulted in tumbling of oil prices and a withdrawal of investors from Ecuador. The El Nino weather conditions reduced key agricultural exports, bananas and cocoa. When dollarization was announced in January 2000, inflation had spiked to 107.9%. However, prices stabilized in a few months after dollarization, have averaged 4.7% since December 2001 and stood at 5.41% as at May 2009. The economy recovered from -6.3% growth in 1999 to 2.3% in 2000, and 7.9% in 2004 (Makina, 2009). After dollarization, the economy stabilized. In the case of Equador, economic recovery was led by the financial and retail sectors.

Despite the recovery that Ecuador has experienced after dollarization, some challenges have been faced. These include lack of investment; low levels of technology; high costs of production; high importation of retails goods necessitated by decline in manufacturing and other sectors; and high levels of internal and external debt (Makina, 2009).

However, despite the challenges that have been faced, Ecuador has benefited from some of the strengths that she has as an economy. Ecuador leveraged on its oil reserves to borrow externally. She also borrowed internally from the Social Security Services. In addition, diaspora remittances have remained a significant source of finance for the economy. Another advantage has been that economic stability attracted external lenders to Ecuador. Increased awareness among community pressure groups that as government could not print money in the dollarized regime, there were limits on items that could be added to annual budget using the political influence of the various interest groups. A unique benefit in Ecuador's experience is that there has been confidence in the banking sector, contrary to the Zimbabwean case where weak depositor confidence has characterised the dollarized regime (Makina, 2009).

In the case of Ecuador, as a result of confidence in the banking sector, there was an increase in banking sector deposits from US$3.0 billion in February 2000 to US$4.8 billion in December 2001. In comparison, in the case of Zimbabwe, there was a US$2 billion increase over an equal length of time period from dollarization. In addition, Ecuador was endowed with sufficient foreign exchange reserves at dollarization stage and thereafter. As a result, it became possible to convert 97.4% of sucres in circulation to US$ at the rate of 25,000 by December 2000 after dollarizing in March 2000 (Makina, 2009). In the case of Zimbabwe, the challenge is that there the country has had very low reserves before and after dollarization. Import cover has averaged less than one month in the dollarized period.

In general, there have been mixed outcomes from Ecuador's experience with dollarization. A number of lessons could be derived from this experience. One of the key lessons is that dollarization cannot be a complete panacea, but can only serve as a stop gap measure that lays foundation for future sustainable economic growth. In addition, complementary structural changes need to be introduced to reap full benefits of dollarization. A stable political environment needs to be maintained to reduce country risk premium and to attract investment. Zimbabwe faces similar constraints in productive sectors as Ecuador. In both cases, there is need for a more conducive environment for long-term production required for revival of real sectors (Makina, 2009).

Lessons from Panama

Panama is one of the oldest dollarized countries. The government in that country has been able to issue short-term (Treasury Bills) and long-term debt instrument on the basis of good sovereign country ratings. In addition, in Panama, international banks act as lenders of last resort. The experience of Panama suggests that international banks can be nurtured to support the stability of the domestic financial system. This is partly because Panama allows free entry of foreign banks. Panama is an open economy that allows banks to hold external assets such as the United States Treasury Bills. The main outcome of the measures that Panama has put in place has been the deepened financial markets (Edwards, 2001).

In comparison with Panama, Zimbabwe currently has no short-term debt instruments, it is still a challenge to revive the bond market, has no sovereign ratings, international banks are not acting as lenders of last resort and financial markets still lack depth.

3. METHODOLOGY OF THE STUDY

3.1 Statement of the Research Problem

In Zimbabwe, the financial sector has gone through different economic conditions since 1980. There are periods when the sector had meaningful contribution and other periods when it did not have much contribution. The study examines the contribution of the financial sector to the economy since 1980. It surveys the economic conditions that attained in each of the policy regimes. This is done as an attempt to come up with optimal policy measures to make the financial sector contribute meaningfully to economic growth in the multicurrency system.

3.2 Objectives of the Study

- To examine the contribution of the financial sector in Zimbabwe since 1980;
- To identify current challenges facing the financial sector in Zimbabwe; and
- To proffer recommendations to enhance the contribution of the financial sector to the economy.

The paper examines the contribution of the financial sector in Zimbabwe over the period 1980 to 2013. The study period was split on a policy regime basis, covering 1980-1989; 1990-1999; 2000-2008 and 2009-2013. The period 1980-1989 was denoted as the controlled regime; 1990-1999 as the liberalized regime; 2000-2008 as the economic crisis regime and 2009-2013 as the multicurrency regime. The paper examines the contribution of the financial sector to the economy in terms of economic growth and employment. The choice of the focus variables was determined by data availability and its consistency. The paper identifies challenges facing the financial sector in the multicurrency period. Finally, the paper suggests policy recommendations to address the challenges.

3.3 Methods and Data Issues

Both desk research and survey methodologies were used. Key data sources included papers from World Bank, Zimstat and the Central Bank. Key informants for the survey methodologies included officials from the Central Bank, Zimbabwe Stock Exchange, Securities Commission of Zimbabwe, Insurance and Pensions Commission, National Social Security Authority, Old Mutual, First Mutual Life Assurance, Infrastructure and Development Bank of Zimbabwe and banks, Finance and Banking Committee of the Confederation of Zimbabwe Industries, Bankers Association of Zimbabwe and banks, among others.

4. PRESENTATION AND ANALYSIS OF THE RESULTS

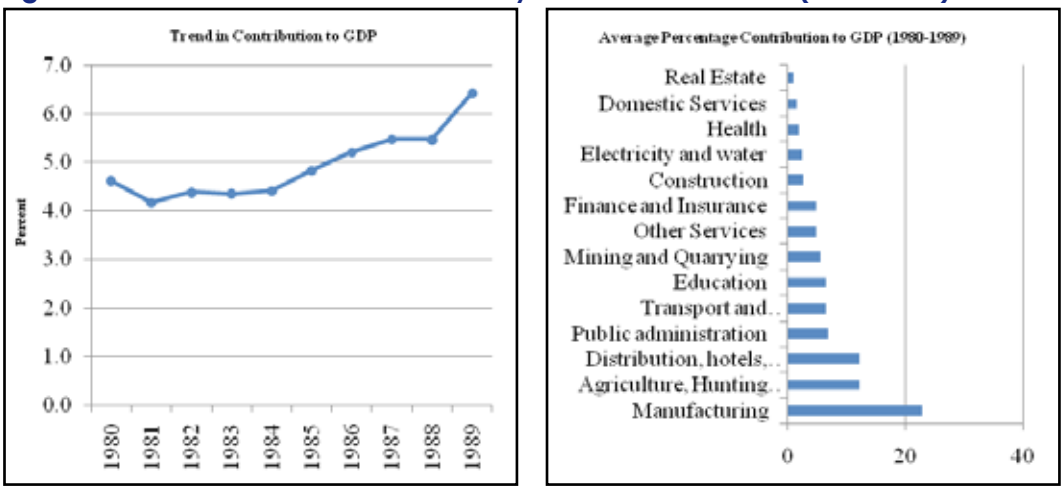
4.1 Contribution of the Financial Sector to the Economy

Financial Sector Contribution to GDP

1980-1989

According to Zimstat (2012), over the period 1980 to 1989, the contribution of the finance and insurance industry to GDP averaged 4.9%. It ranged 4.8% in 1980 to 6.4% in 1989 (Figure 1).

Figure 1: Finance and Insurance Industry Contribution to GDP (1980-1989)



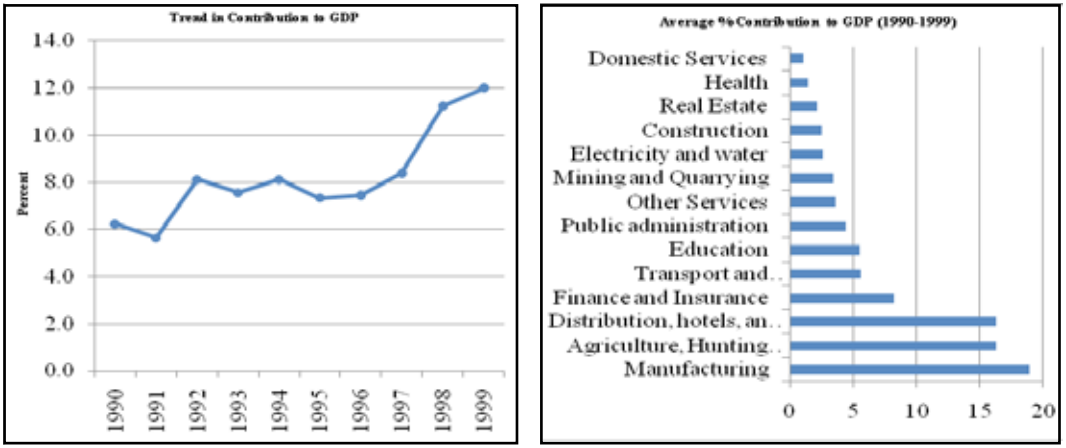
Source: Zimstat, 2012

Over 1980-1989, among other sectors, the finance and insurance industry was the 9th largest contributor to GDP (Figure 1). Manufacturing, agriculture and distribution industries were the top 3 largest contributors, contributing 22.9%, 12.4% and 12.3%, respectively. Over this period, the finance and insurance industry did not receive much attention from policy makers, as evidenced in its exclusion in the First and Second 5-year Transitional National Development Plans (TNDPs). At this stage, the financial sector was still small, dominated by foreign banks and entry conditions into the sector were still restricted. The financial sector was characterized by controls on interest rates, foreign exchange and credit allocations. However, inflation was still low, averaging around 13% per annum (Mabika, 2001).

1990-1999

Over 1990-1999, the contribution of the finance and insurance industry to GDP averaged 8.2%. The highest contribution was 12% in 1999 (Zimstat, 2012).

Figure 2: Finance and Insurance Industry Contribution to GDP (1990-1999)



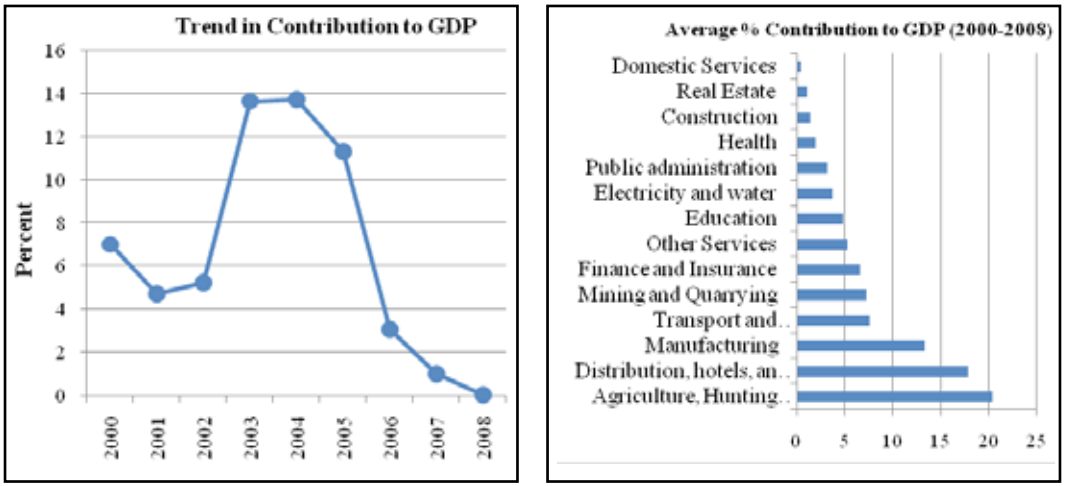
Source: Zimstat, 2012

In comparison with other industries, the finance and insurance industry was ranked 4 out of 14 industries in terms of its average contribution to GDP. Thus, the industry improved from the 9th ranking, which was recorded over the period 1980-1989. Over this period, the financial sector was then liberalized. Controls on interest rates, foreign exchange and bank credit allocation were removed. Entry into the financial sector was enhanced. More indigenous financial institutions emerged. As a result, the number of financial institutions increased. However, inflation increased, peaking at 70% per annum in October 1999 (Mabika, 2001). Market decontrols and bank financing of fiscal deficits, which increased money supply growth, fueled inflation.

2000-2008

According to Zimstat (2012), over the period 2000-2008, the contribution of the finance and insurance industry to GDP averaged 6.6%. This was lower than the average of 8.2% over 1990-1999. The highest contribution was 13.7% in 2004. Since then, the contribution declined persistently to reach its trough of 0.01% in 2008 when the economic crisis in Zimbabwe reached its peak.

Figure 3: Finance and Insurance Industry Contribution to GDP (2000-2008)



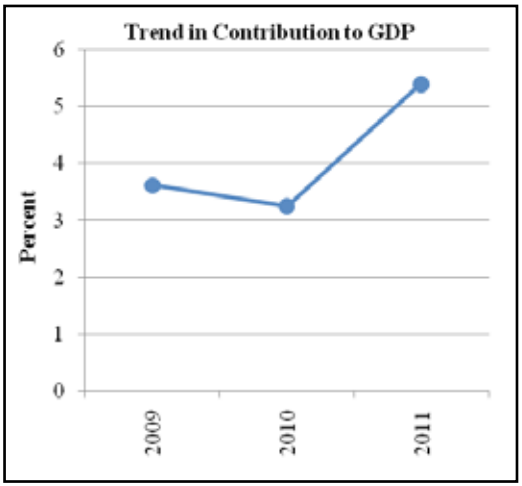
Source: Zimstat, 2012

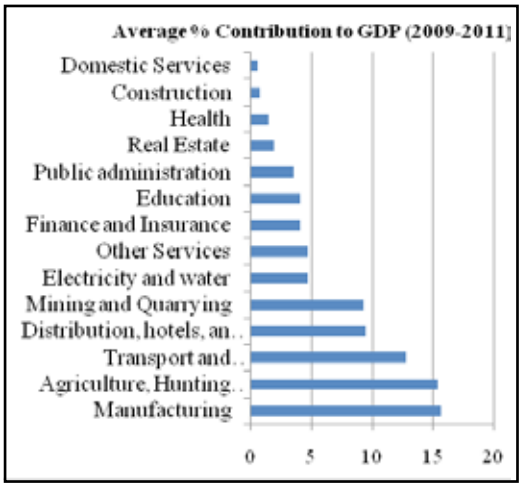
The ranking of the finance and insurance industry in terms of its contribution to GDP deteriorated from the 4th position over the period 1990-1999 to the 6th position over the period 2000-2008.

2009-2011

Over the period 2009-2011, the contribution to GDP of the finance and insurance industry averaged 4.1%. This compares unfavourably with the contributions made in the previous periods. Over the crisis period of 2000-2008, when the economy was declining, finance and insurance contributed 6.6% to GDP on average. The contribution over the multicurrency regime is lower despite that the economy is recovering. Thus, finance and insurance industry has been affected negatively in the multicurrency regime (Zimstat, 2012).

Figure 4: Finance and Insurance Industry Contribution to GDP (2009-2011)





Source: Zimstat, 2012

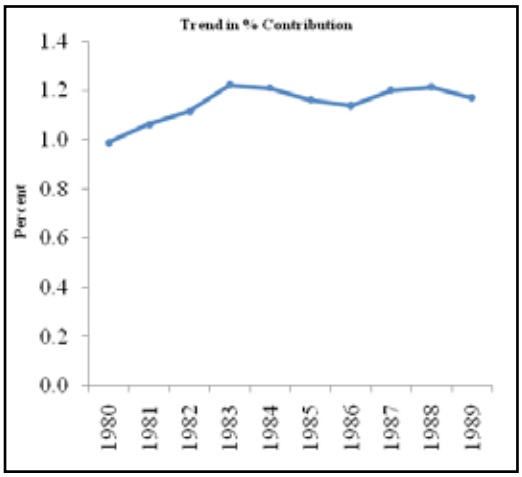
When compared with other industries, finance and insurance ranked 8th in terms of its contribution to GDP, just as in the period 1980-1990. The industry deteriorated form 4th and 6th rank recorded over the periods 1991-1999 and 2000-2008, respectively.

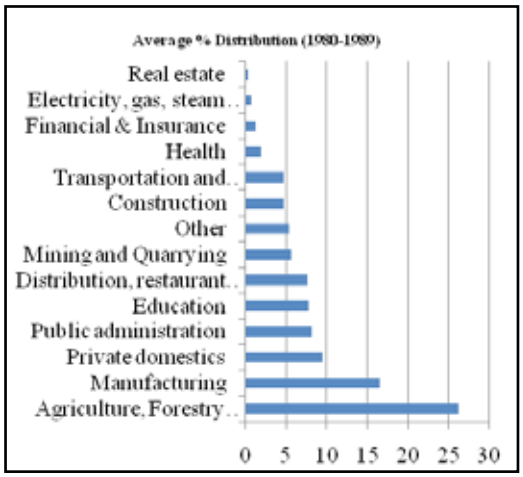
Financial Sector Contribution to Formal Employment

1980-1989

The trend in the contribution of the finance and insurance industry to total formal employment rose persistently from 0.99% in 1980, and reached a peak of 1.22% in 1983 (Figure 2). It then oscillated between 1.14% and 1.21% over the period 1984-1989 (Zimstat, 2012).

Figure 5: Finance & Insurance Industry Contribution to Formal Employment (1980-1989)





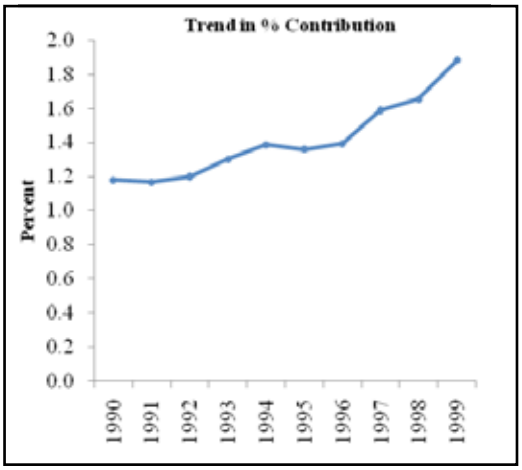
Source: Zimstat, 2012

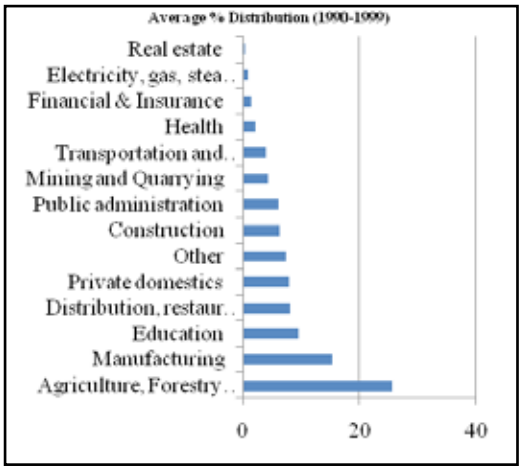
On average, the finance and insurance industry contributed 1.2% to total formal employment over the period 1980-1990. The finance and insurance industry was one of the least contributors to total formal employment (Figure 2). Out of 14 industries, it ranked 12 in terms of contribution to formal employment. Agriculture and manufacturing were the biggest contributors to formal employment, contributing 26.3% and 16.5%, respectively. However, the finance and insurance industry had the highest real average annual earnings per employee over the period.

1990-1999

According to Zimstat (2012), over the period 1990-1999, the contribution of the finance and insurance industry to total formal employment rose persistently from 1.18% in 1990, before leveling-off in 1994 at 1.34% (Figure 4). In 1995, it rose persistently from 1.36% to 1.88% in 1999. The contribution of finance and insurance industry to employment was higher in the period 1996 to 1999, compared to the period 1991 to 1995. The latter period was associated with the Economic Structural Adjustment Programme (ESAP), while the former period is when the ESAP was abandoned and replaced by Zimbabwe Programme for Economic and Social Transformation (ZIMPREST). On average, the industry contributed 1.41% to formal employment over the period 1990-1999, which was an improvement of 0.26% from the period 1980-1989.

Figure 6: Finance and Insurance Industry Contribution to Employment (1990-1999)





Source: Zimstat, 2012

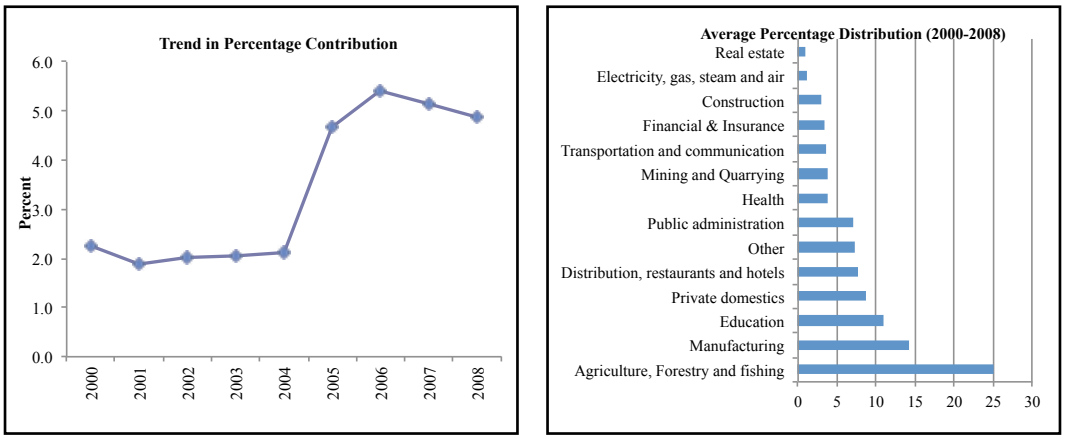
In comparison with other industries, the finance and insurance industry did not change from its ranking of 12 out of 14 industries in terms of average contribution to formal employment (Figure 4). Agriculture and manufacturing industries were the largest contributors to formal employment, just as over the period 1980-1989. Agriculture contributed 25.77%, which was 0.54% lower than the contribution in the period 1980-1989. Manufacturing contributed 15.48%, which was 1.00% lower than the contribution in the period 1980-1989. Thus, while these industries slackened in their contribution to formal employment from the period 1980-1989 to 1990-1999, the finance and insurance industry improved. This could be explained by the opening up of the financial industry to allow for the establishment of new banks and other financial institutions.

2000-2008

On average, the contribution of the financial and insurance industry to total formal employment over the period 2000-2008 was 3.4%. This compares favourably with an average contribution of 1.1% and 1.5% recorded in the periods 1980-1989 and 1990-1999, respectively. This is partly because a reasonable number of banks were opened up during this period. However, over this same period, a number of banks faced challenges, resulting in some of them being curated and others liquidated. Despite the challenges that banks faced, there was a sizable increase in the contribution of finance and insurance industry to total formal employment from 2.1% in 2004 to 4.7% in 2005. In the period 2005-2008, the contribution was higher, about 5.0% on average compared to 2.1% over the period 2000-2004. The

period 2000-2004 is the period when many banks opened, but the contribution to total formal employment was lower compared to the period 2005-2008. This could possibly be explained by growth in the contribution of the non-bank financial sector.

Figure 7: Finance and Insurance Industry to Formal Employment (2000-2008)



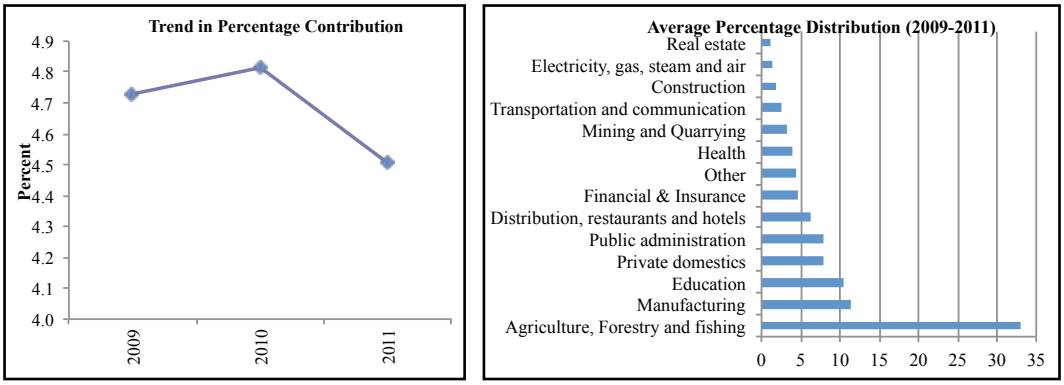
Source: Zimstat, 2012

Comparing with other industries, the contribution to total formal employment by the finance and insurance industry improved to the 11th rank from the 12th rank which was recorded over the periods 1980-1989 and 2000-2008.

2009-2011

In the period 2009-2011, the share of finance and insurance industry to formal sector employment averaged 4.7%. This is the highest average contribution that the industry has made compared to 3.4% over the period 2000-2008, 1.4% over 1990-1999 and 1.2% recorded over 1980-1989. However, the contribution to formal employment declined from 4.8% in 2010 to 4.5% in 2011. This could be explained by liquidity challenges in the multicurrency regime.

Figure 8: Finance & Insurance Industry Contribution to Formal Employment (2009-2011)

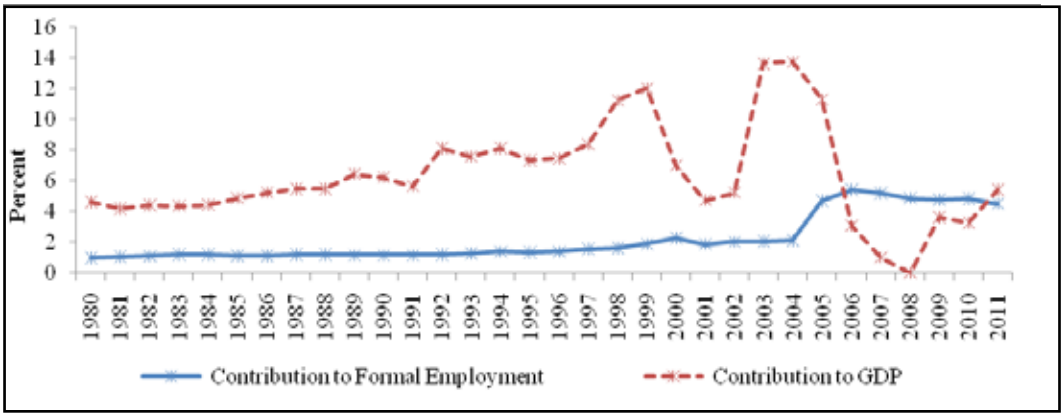


Source: Zimstat, 2012

An industry comparison shows that over the period 2009-2011, the finance and insurance industry was the 7th largest contributor to formal employment, which is an improvement from the 11th position recorded over the period 2000-2008 and the 12th position recorded over the periods 1980-1990 and 1991-1999.

Over the whole period, 1980 to 2013, the contribution of the financial sector to GDP and employment is as summarized in figure 9.

Figure 9: Contribution of the Financial Sector to Formal Employment and GDP



Source: Zimstat and authors' calculations

The financial sector made the highest contribution to GDP in 2004 (13.7%) and the lowest contribution was in 2008 (0.01%) at the peak of the crisis. The contribution to employment was highest in 2006 (5.39%) and lowest in 1980 (0.99%). The average contribution of the financial sector to GDP and formal employment over the years is as shown in Table 1.

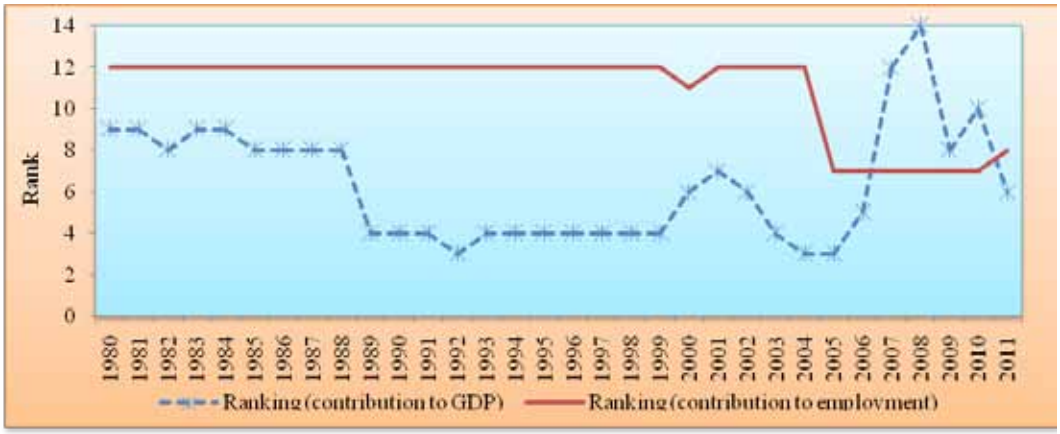
Table 1: Contribution of the Financial Sector to GDP and Formal Employment

Period	Average Contribution to GDP (%)	Average Contribution to Employment (%)
1980-1989	4.9	1.2
1990-1999	8.2	1.4
2000-2008	6.6	3.4
2009-2011	4.1	4.7

Source: Zimstat

To GDP, the financial sector contributed the most to GDP over the liberalized period, 1990-1999 and has had the least in the multicurrency period (2009-2011). The contribution to formal employment has maintained an upward trend over the whole period since 1980. In terms of ranking among other sectors in the economy, the contribution of the financial sector is summarized in Figure 10.

Figure 10: Comparative Rank of the Financial Sector's Contribution to the Economy



Source: Zimstat and Authors' calculations

In terms of contribution to GDP, the financial sector made the most favourable ranking in 1992 (3) and the worst ranking in 2008 (14). In terms of contribution to employment, the most favourable ranking was over the period 2005-2010 (12). It ranked 12 for the most part of the period 1980-2005.

While empirical economic literature estimates the optimal share of financial sector in employment at 3.9%, the share was 4.7% in Zimbabwe over the period 2009-2011. Over the same period, the contribution to GDP was lowest compared to other periods. This could be suggestive of the fact that the optimal share of the financial sector in employment is lower than 4.7%. Thus, the financial sector could be overstuffed in terms of employment, making its contribution to GDP lower. This could also affect the overall economy as the sector would be crowding other sectors that would otherwise benefit from the excess human resources it has.

Economic literature also estimates the optimal range of credit to the private sector as a percentage of GDP at 80-100%. For Zimbabwe, the credit allocated to the private sector is well below the empirical estimates for all the periods. Thus, there could be more room for the financial sector to contribute more to economic growth. From the period 1980-1990 to 1991-1999, credit to the private sector as a percentage of GDP improved from 20.9% to 30.4%. This was followed by the increase in average financial sector contribution to GDP from 5.1% in 1980-1990 to 8.4% in 1991-1999. However, in the period 2000-2008, credit to the private sector was much higher compared to the periods 1980-1990 and 1991-1999 yet the contribution to GDP was lower than in 1991-1999. This could partly be explained by the differences in the allocation of credit between Government and the private sector. In the period 1991-1999 a lesser share of credit as a percentage of GDP was allocated to the Government relative to the private sector compared to periods 1980-1990 and 2000-2008.

When the financial sector opened up for more players in the 1991-1999 period, it was expected that competition would bring efficiency. It was also expected that the relaxation of controls on interest rates would allow banks to compete. However, the changes in the average interest rate spread did not support that there was efficiency. The average spread increased from 7.4% in 1980-1990 to 8.1% in 1991-1999. In the period 2000-2008, the average spread increased to 105%. Some possible reasons why the increase in the number of financial institutions did not translate into competition and increased efficiency include, among others, inadequate regulation and supervision and poor corporate governance.

4.2 Requirements for Economic Recovery in Zimbabwe

The economy is still recovering from the cumulative decline of more than 40% over the period 2000-2008 (MTP, 2011). For speedy recovery and growth, the economy requires the following, among others:

- Affordable long-term funding for productive sectors and infrastructure development;
- Efficient, competitive and adequately capitalized financial institutions;
- Efficient payment systems;
- Wide geographical spread of financial institutions and broad product variety;
- Developed capital markets and other non-bank financial institutions;
- Active role of specialized financial institutions;
- Economic and political stability;
- Policy consensus and consistency in implementation;
- Gender-sensitivity in financial sector policies and products; and
- Financial inclusion and inclusive growth.

4.3 Financial Sector Challenges in the Multicurrency Period

The analysis revealed the following as major challenges facing the financial sector in the multicurrency period.

- Challenges facing Government;
- Challenges facing the Central Bank;
- Challenges emanating from the international monetary system;
- Challenges associated with the dollarized regime;
- Challenges emanating from the macroeconomic environment;
- Challenges associated with the structure and composition of the financial sector;
- Challenges associated with the different financial institutions.

Challenges Facing the Economy

In the multicurrency system, the economy has faced growing liquidity constraints. There is limited access to external lines of credit. External credit is highly priced due to the perceived high country risk. Individuals and corporates have weak balance sheets. Average incomes are low. National savings and investment are also low. There is a slowing down in economic activity, as indicated by the declining economic growth rates (Figure 11) and capacity utilization levels (Figure 12).

While economic growth had recovered from the negative levels of the 2000-2008 economic crisis, peaking at 10.4% in 2011, the growth process is slowing down. Growth is estimated to have declined to 4.4% in 2012 and is projected at 3.4% in 2013 (MoF, 2013). However, according to the new economic blueprint, the

Zimbabwe Agenda for Sustainable Socioeconomic Transformation (Zim Asset), economic growth is projected at 6.1% in 2014, average 7.3% over 2013-2018, and to reach 9.9% by 2018 (GoZ, 2013).

Figure 11: Economic Growth Trends Since 2009

Source: MoF Mid-Term Fiscal Review (2013) and Zim Asset

However, given the prevailing macroeconomic conditions, these economic targets are unlikely to be achieved. The projected targets are overambitious. The economy would require a big push to get to the projected levels. In this regard, adequate and reliable funding sources become critical, among other factors.

According to the CZI (2013), while capacity utilization had improved from 10% in 2008 and reached a peak level of 57.2% in 2011, it declined to 39.6% in 2013 (Figure 12). Industry has been characterized by company closures, companies going under judicial management and scaling down of operations. Given the prevailing economic conditions, it is unlikely that most of such companies would recover.

Figure 12: Average Capacity Utilization Since 2008

Source: Confederation of Zimbabwe Industries Report, 2013

According the CZI (2013), factors underpinning these adverse developments include the following, among others:

- Working capital challenges;
- Depressed local demand;
- Competition from cheap imports;
- Antiquated machinery and machine break-downs;
- Power and water shortages;
- Shortage of raw materials; and
- High cost of doing business.

These capacity utilization challenges suggest challenges in achieving the projected economic growth rates.

Challenges Facing Government

In the multicurrency period, the Government has suffered from a number of challenges. These challenges have resulted in poor mobilization of funding by Government in both local and external financial markets. The Government has a huge external debt, estimated at around US$10 billion and has no reserves. Foreign exchange reserves have averaged at less than one month of import cover. The Government has suffered from perceived high country risk, which has limited access to external lines of credit. Due to the perceived country risk, external credit has become too costly. The Government has low credit worthiness, resulting in investor reluctance to lend to Government. Local and foreign investors have weak confidence in Government. This has resulted in under-subscriptions to Government TBs and Government guaranteed bonds. Divergent views on the indigenization and economic empowerment policy (IEEP) have created uncertainty, resulting in

a wait-and-see attitude by most investors. In addition, experiences of the 2000-2008 economic crisis, in which some individuals and corporates lost money in the financial sector eroded confidence in Government and the Central Bank.

Challenges Emanating from the International Financial System

The global financial crisis has compound liquidity constraints. Zimbabwe has a low international credit rating, resulting in high costs and limited access to external lines of credit.

Challenges Facing the Central Bank

In the multicurrency system, the Central Bank is under-capitalized with a weak balance sheet. The Central Bank has limited roles in the financial sector as there is no domestic currency. There is a lack of monetary policy instruments. The Central Bank is currently relying on moral suasion, which is a blunt instrument. The Central Bank has no policy rates to guide market interest rates in the economy. There is a lack of funds for the lender-of-last-resort (LOLR) facility, resulting in the Central Bank failing to influence activity in the inter-bank market. In addition, there is an absence of short-term debt instruments, further compounding constraints in reactivating the inter-bank market. Attempts to re-introduce Government TBs in October 2012 were unsuccessful (Table 2).

Table 2: Unsuccessful Re-Introduction of Government Treasury Bills in 2012

Auction Details	04 Oct 2012	24 Oct 2012	24 Oct 2012	26 Oct 2012	06 Nov 2012
Amount on Offer (US$ million)	15	15	15	15	30
Bids (US$ million)	7.7	6.5	4.7	11.05	8.65
Number of Bidders	9	6	6	12	13
Uptake (Bids/Offers) %	51.33	43.33	31.33	73.67	28.83
Accepted (US$ million)	0	0	0	9.85	0
Amount Rejected (US$ million)	7.7	6.5	4.7	1.2	8.65
Tenor (Days)	91	91	91	91	91
Minimum Interest Rate (%)	5.5	5	5	5	8.5
Maximum Interest Rate (%)	15	14.5	14.5	13	12

Source: Reserve Bank of Zimbabwe

Poor participation in the TB auctions was largely associated with weak investor confidence in the Central Bank and Government. Investors were also uncertain about the outcome of the harmonized elections that were to be held in 2013.

In addition, it is estimated that there is a significant amount of money circulating outside the formal banking system, resulting from the weak confidence in the formal banking system. Money in the informal financial system is not available for lending in the formal financial systems, and is therefore not available for lending by formal banking institutions. The increased amount of money outside the formal banking sector is associated with the weak confidence in the formal banking system. This is partly associated with the experiences of the Zimbabwe dollar crisis where individuals and corporates lost money. A majority of the population does not consider the formal financial system as safe.

On the basis of these constraints, in the multicurrency system, the Central Bank has very limited capacity to influence economic activity.

Figure 13: Structure and Composition of the Financial Sector

Source: MoF, RBZ, IPEC and SECZ, September 2013

While Zimbabwe has a well diversified financial sector (Figure 13), in terms of activity, the sector is currently dominated by banks. The banking sector is also dominated

by commercial banks. However, commercial banks are not adequate to provide all credit needs in the recovering economy. They are unable to transform the predominant short-term transient deposits into long-term loans that are required in agriculture, mining and other productive sectors of the economy. There is an inadequate number and variety of developmental financial institutions. In the dollarized economy, there is a lack of specialized financial institutions such as leasing companies. Zimbabwe requires more non-bank financial institutions (NBFIs) and specialized financial institutions to cater for long-term finance and other developmental needs of the economy. Some of the banks and developmental financial institutions such as the Infrastructure Development Bank of Zimbabwe (IDBZ) are undercapitalized, and therefore unable to discharge some of their core functions fully. For example, investors do focus on the viability of the bond issuer in planning to participate in bond issues. In this case, the IDBZ currently fails this test.

Urban Bias Challenges

The urban bias associated with most of the financial institutions excludes marginalized groups from participating in economic activities.

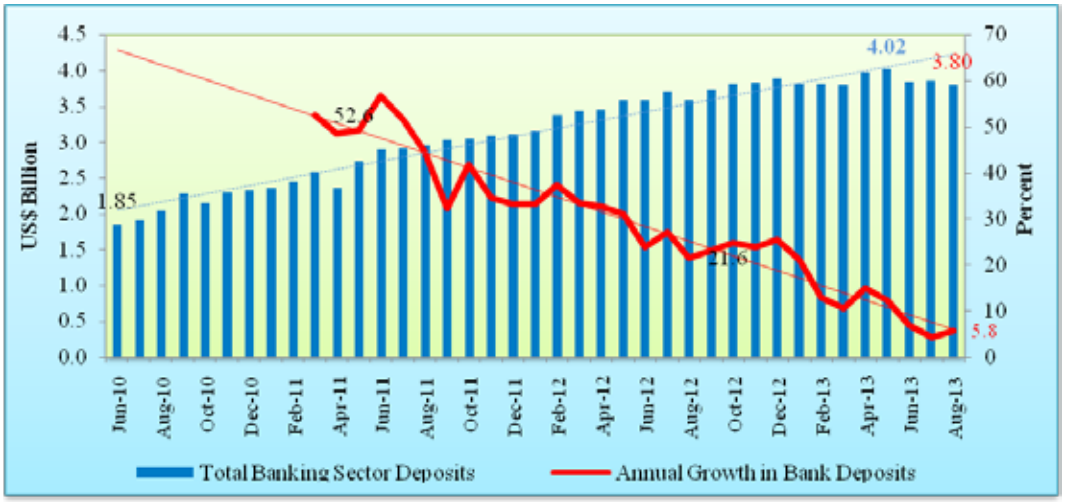
Absence of a National Credit Rating Bureau

Zimbabwe does not have a national credit rating bureau. As a result, it is difficult for financial institutions to access the credit standing of potential clients. This has contributed to the high level of non-performing loans (NPLs) in the banking sector.

Challenges Facing Banks

In the multicurrency system, banks have faced a number of challenges, which make it difficult for them to have meaningful contribution to economic activity. The levels, growth and structure of the total banking sector deposits indicates some of the challenges in the sector.

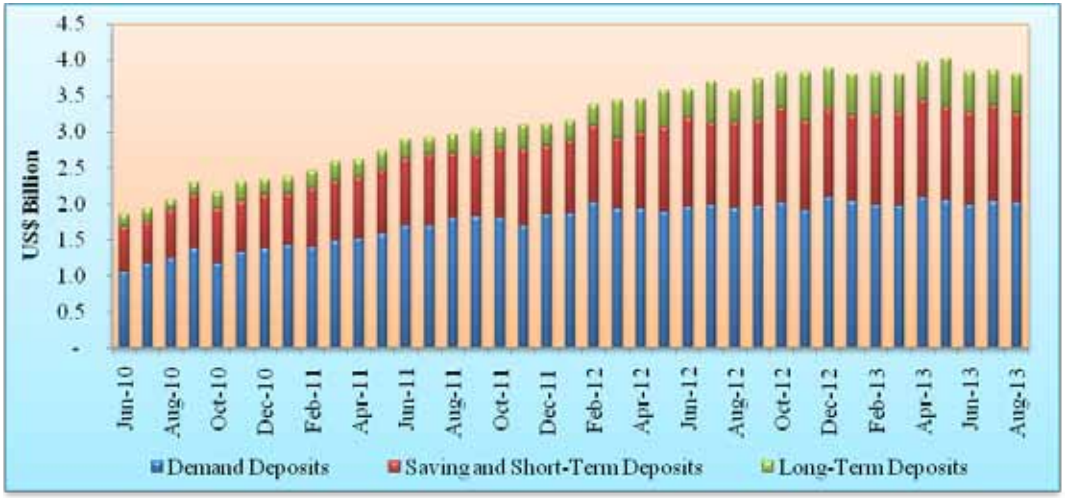
Figure 14: Total and Growth in Total Banking Sector Deposits, August 2013



Source: Reserve Bank of Zimbabwe, September 2013

In the multicurrency system, total banking sector deposits have been increasing in absolute terms from US$1.85 billion in June 2010 to US$3.8 billion in August 2013. However, annual growth in bank deposits has been declining from 52.6% in April 2011 to 5.8% in August 2013. The 5.8% in August 2013 compares with 21.6% in August 2013, further indicating the decline in the annual growth rates. The structure of bank deposits in the dollarized period also raises concern (Figure 15).

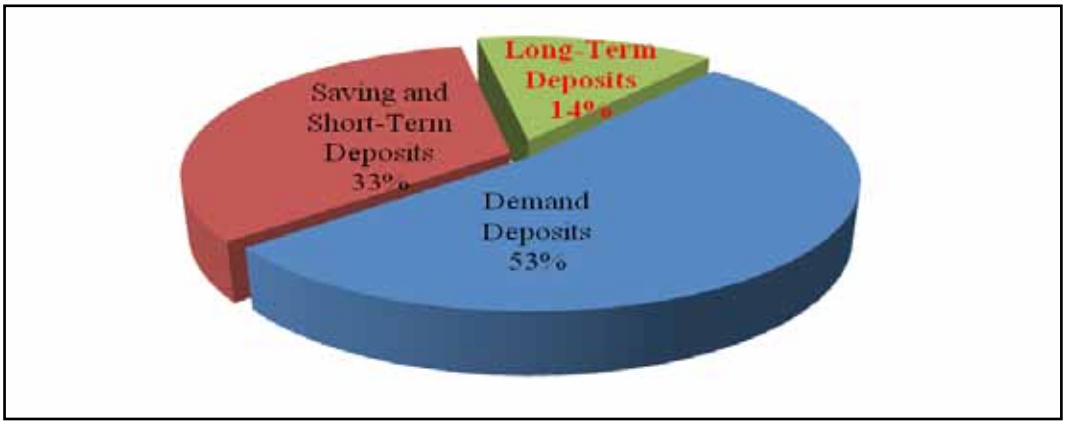
Figure 15: Structure of Banking Sector Deposits, August 2013



Source: Reserve Bank of Zimbabwe, September 2013

In the multicurrency system, total banking sector deposits are predominantly short-term and transient in nature. Banks have limited capacity to transform the short-term and transient deposits into long-term loans that the recovering economic sectors require. Zimbabwe is an agro-based economy, where farmers require at least 18 months loan tenure. Mining, which has been considered as the key driver of economic growth, requires long-term funding. The bank deposit structure therefore does not support the recovery of the productive sectors.

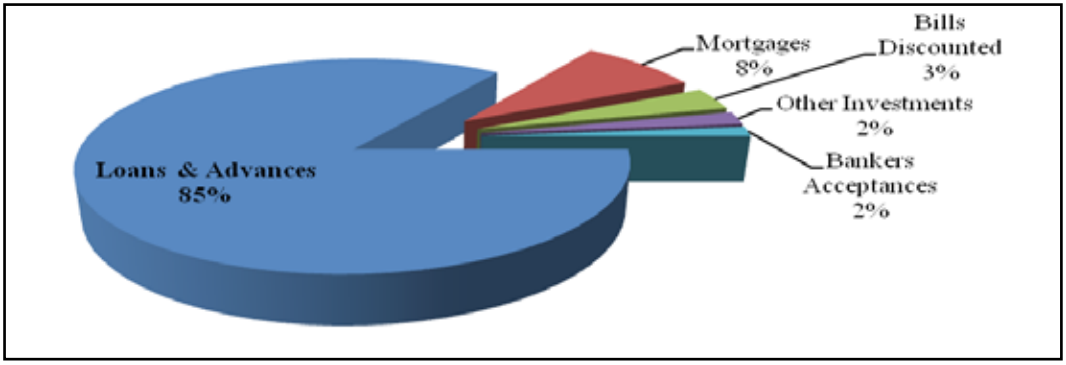
Figure 16: Composition of Total Banking Sector Deposits, August 2013



Source: Reserve Bank of Zimbabwe, September 2013

Long-term deposits, which are critical for long-term investment, are limited.

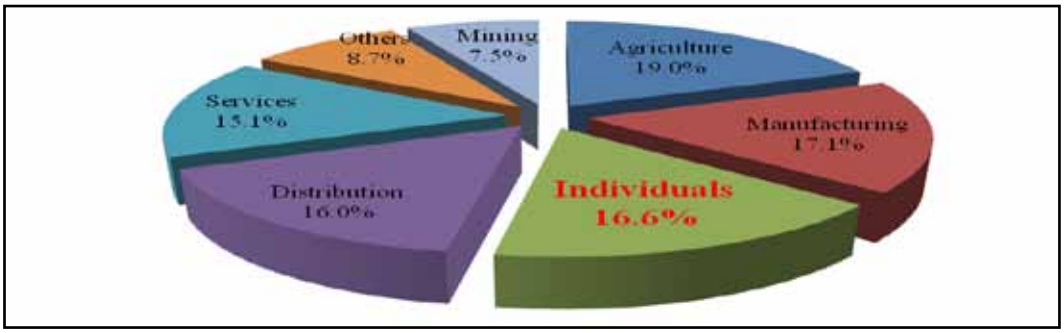
Figure 17: Distribution of Bank Credit, August 2013



Source: Reserve Bank of Zimbabwe, September 2013

In the multicurrency system, the bulk of bank credit constitutes loans and advances, which stood at 85% in August 2013. Mortgage financing has been very limited. Most individuals with low average incomes and savings, are unable to access mortgage funds. Most companies are also not able to afford their employees, mortgage facilities. Other investments are also limited.

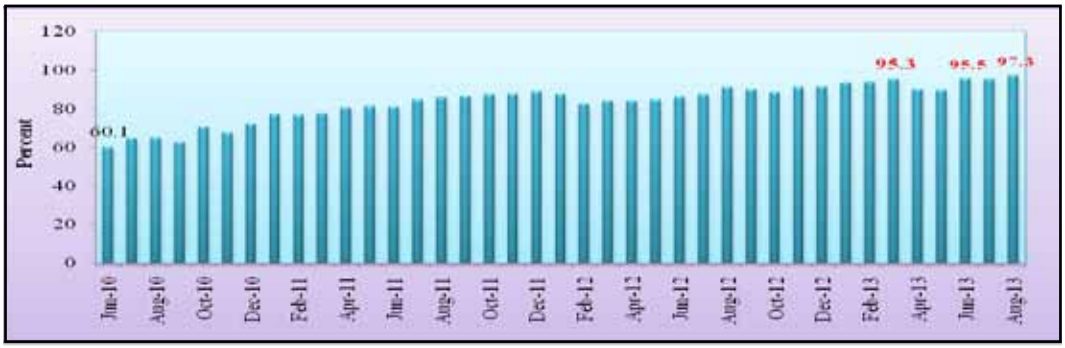
Figure 18: Sectoral Distribution of Bank Credit, August 2013



Source: Reserve Bank of Zimbabwe, September 2013

A disturbing trend is that much of the bank credit has been channeled to individual, taking 16.6% in August 2013. Loans to individuals take the form of salary-based loans. Banks prefer to lend to individuals with a guaranteed monthly salary or wage. These loans attract higher interest rates and are considered less risky by banks. However, in a recovering economy, there is need to channel more funds to the productive sectors. The challenge is that banks are also unable to afford productive sectors, affordable long-term credit.

Figure 19: Bank Loan-to-Deposit Ratio, August 2013



Source: Reserve Bank of Zimbabwe, September 2013

The loan-to-deposit rate increased from 60.1% in June 2010 and has peaked at 97.3% in August 2013, against the recommended threshold of 70-90%. The figures suggest that banks have been lending a greater part of the deposits mobilized. Current levels in the loan-to-deposit ratio suggest that banks either restrain lending or become more aggressive in mobilizing deposits. If these loans are used in unproductive projects, there is high risk of loan repayment default.

Figure 20: Level of Non-Performing Bank Loans, August 2013

Source: Reserve Bank of Zimbabwe, September 2013

The level of non-performing loans (NPLs) has been rising, peaking at 13.8% in March 2013, against the Basel II recommended threshold of 5% of the loan book. According to market indications, contributory factors to the rising level of non-performing loans include the following factors, among others.

- Insider and related party lending;
- Inadequate due diligence on bank loan applications;
- Information asymmetry and moral hazard;
- High average lending rates on short-term loans;
- Low project productivity and low profit margins;
- Droughts and poor harvests;
- Inadequate supervision and monitoring of projects by banks.
- Misuse of borrowed funds;
- Multiple borrowings from different formal and informal sources; and
- Violation of prudential guidelines (e.g. on lending limits).
- Harsh business and economic operating environment.

Some banks have been over lending. However, excessive lending against predominantly short-term transient deposits, coupled with low profit margins is risky. Loan default risk is very high.

Lack of Collateral

Most bank clients lack collateral to pledge as security for borrowing. Collateral security is one of the key criteria for passing a bankable project. Most banks currently require an immovable asset that is two times the value of the borrowed amounts. Women entrepreneurs, a majority of whom, have no property rights, have been facing serious challenges in meeting this requirement.

Figure 21: Interest Rate Levels, August 2013

Source: Reserve Bank of Zimbabwe

For both commercial and merchant banks, individual average lending rates are higher than corporate lending rates. However, in the current environment, most banks prefer to lend to individuals in the form of salary-based loans. Banks prefer to lend to individuals that have a guaranteed monthly salaries and wages as a way of spreading risk and to avoid loan repayment default as salaries go through the respective borrower banks. The increased consumptive lending to individuals is against Government's motive to support productive sectors such as agriculture and mining, among others. The interest levels and the ranges across banks have been of concern in the dollarized period.

Table 3: Interest Rate Levels (Annual Percentages), August 2013

End Period	Commercial Banks Lending Rates			Merchant Banks Lending Rates			3-Month Deposit Rate	Savings Deposit Rate
	Nominal Rate	Weighted Average		Nominal Rate	Weighted Average			
		Individuals	Corporates		Individuals	Corporates		
Mar-12	8.00-30.00	16.04	12.53	14.00-35.00	18.17	13.26	5-20.00	0.01-12.00
Apr-12	8.00-30.00	15.00	13.06	13.00-25.00	18.37	16.36	5-20.00	0.00-12.00
May-12	6.00-30.00	14.98	11.86	15.00-30.00	15.78	14.47	5.20.00	0.00-12.00
Jun-12	6.00-35.00	13.81	11.58	15.00-30.00	17.86	14.04	5-20.00	0.00-12.00
Jul-12	6.00-35.00	14.32	10.88	15.00-30.00	17.92	13.93	5-20.00	0.00-12.00
Aug-12	6.00-35.00	15.65	10.74	15.00-30.00	17.94	13.95	5-20.00	0.00-12.00
Sep-12	6.00-35.00	13.25	11.14	15.00-30.00	17.98	13.92	5-20.00	0.00-12.00
Oct-12	6.00-35.00	13.35	11.03	13.00-30.00	17.98	13.95	5-20.00	0.00-12.00
Nov-12	6.00-35.00	15.25	10.88	13.00-25.00	17.91	14.42	4-20.00	0.15-8.00
Dec-12	10.00-35.00	15.08	10.40	15.00-25.00	17.93	14.43	4-20.00	0.15-8.00
Jan-13	10.00-35.00	15.58	10.81	13.00-25.00	17.96	14.42	4-20.00	0.15-8.00
Feb-13	10.00-35.00	14.83	10.53	13.00-25.00	17.93	14.36	4-20.00	0.15-8.00
Mar-13	8.00-35.00	14.32	10.19	14.00-25.00	17.80	14.35	4-20.00	0.15-8.00
Apr-13	3.00-35.00	14.58	9.66	14.00-25.00	17.77	14.35	4.20.00	0.15-8.00
May-13	9.00-35.00	14.25	9.89	13.00-23.00	17.66	17.02	4-20.00	0.15-8.00
Jun-13	9.00-35.00	14.29	9.46	15.00-22.50	17.78	16.89	4-20.00	0.15-8.00
Jul-13	6.00-35.00	14.39	9.65	15.00-28.00	17.70	16.97	3-20.00	0.15-8.00
Aug-13	6.00-35.00	13.82	9.32	15.00-23.00	18.32	16.92	3-20.00	0.15-8.00
Average		14.60	10.76		17.82	14.89		

Source: Reserve Bank of Zimbabwe

For both commercial and merchant banks, the range in quoted lending rates is very wide. This is reflective of the high differentials in the average weighted cost of funds across banks and the ability of the different banks in the mobilization of funds across different types of banks, the weak and strong banks.

There is wide range across in deposit and savings rates across banks. Small and weak bank try to offer higher rates as an attempt to attract more customers. On the other hand, most big and strong banks offer lower rates and are not aggressive in attractive new customers. The wide range in deposit and savings rates across banks indicates the differences among the banks in their ability to reward depositors and savers, as well as attempts to attract customers.

Negative Effects of the Memorandum of Understanding (MOU) on Interest Rates

In January 2013, the Central Bank and banks signed a Memorandum of Understanding (MOU), which became effective on 1 February 2013. The MOU required that lending rates be capped at 12.5% above each bank's weighted average cost of funds. Banks were required to charge up to 0.5% of cash withdrawal amount subject to a minimum charge of US$2.50. Ledger fees, maintenance and service fees were stipulated at up to US$4 per account. Banks were required to issue debit cards foe free. Incomes of up to US$800 were exempted from bank charges. The MOU was meant to result in a reduction in average lending rates and higher deposit and savings rates. However, so far, no significant improvements have been observed in this regard.

Banks have raised concern that the MOU has resulted in them losing income. According to the Bankers Association of Zimbabwe (BAZ), banks have since 1 February to October 2013, lost about US$70 million in income due to the impact of the MOU. They have estimated that they are set to lose about US$73 million from March to December 2013. For the half-year ended June 2013, local banks reported a total after tax profit decline to US$52 million, from US$63 million. This was also largely attributed to the effects of the MOU. Banks have also argued that the reduction in income has come at a time when they are also supposed to meet the US$100 million minimum capital adequacy requirement and to capitalize the Deposit Protection Corporation (DPC), in an environment with minimal banking business.

The requirement that exempted bank clients from paying bank charges for incomes of up to US$800 has implied that those small banks with a majority of their clientele in the low income categories have lost a significant amount of interest income, which is tantamount to free banking, given their clientele base. The arguments by such banks are valid in the sense that the income categories relating to banks clientele vary widely.

On the basis of the negative developments since the MOU became effective, the banks have asked the Central Bank to review the MOU. Given these challenges, banks have limited ability to support economic activity in the dollarized period.

Challenges Facing Microfinance Institutions (MFIs)

Decline in the Number of MFIs - Due to the economic crisis of 2000-2008, the number of MFIs in Zimbabwe declined from 1,700 in 2003 to 173 by 30 August 2013. In addition, all MFIs were requested to re-register in 2004. Some of them failed to meet registration criteria and had to close down. The decline in the number of MFIs has resulted in some areas having only one MFI.

Funding Challenges - Most MFIs are currently operating on a weak capital base and face dwindling funding sources. The global financial crisis has implied reduced funding to MFIs. The Financial Inclusion Fund (FIF) proposed by Government and RBZ has not yet been set up due to lack of funding.

Urban Bias - Urban bias is still a challenge in the MFI sector. As of 30 August 2013, of the 173 registered MFIs in Zimbabwe, 145 (83.8%) were located in Harare and Bulawayo (RBZ, 2013). Only 28 (16.2%) of the 173 were located in all other towns and growth points (RBZ, 2013). This suggests that a majority of the poor population is still financially excluded by the MFIs.

Table 4: Geographical Distribution of Microfinance Institutions in Zimbabwe

Region	Number of Registered MFIs
Harare	122
Bulawayo	23
Masvingo	8
Mutare	4
Gweru	2
Chitungwiza	2
Kariba	1
Kadoma	3
Kwekwe	1
Chegutu	2
Chinhoyi	1
Rusape	1
Beitbridge	1
Matobo	1
Gokwe	1
Total	**173**

Source: Reserve Bank of Zimbabwe

Access to MFI finance limited to people with guaranteed or regular monthly income. This is because MFIs, like most other lenders, currently prefer to offer salary-based loans, which are associated with low default rates.

Challenges Facing MFI Clients - Like other lending financial institutions, MFIs have been affected by the high loan repayment defaults by some clients. Some of them borrow from multiple sources, formal and informal, resulting in failure to repay and perpetual borrowing.

Collateral Valuation Challenges - Client collateral valuation is commonly done by the MFIs, resulting in overvaluation in most cases. This has become a challenge when clients fail to repay the loans as they resultantly lose property that is many times worth more than the loan amount.

MFI Capacity Constraints - Most MFIs have limited access to ICT due to funding constraints. They also have limited capacity to train and retain skilled staff. The harsh operating business and economic environment has compounded MFI challenges. Most MFIs are characterized by inadequate skills in accounting techniques, credit analysis, record keeping and administration. Only a few MFIs have embraced mobile banking technologies.

MFI Supervision Constraints - The Central Bank MFI supervision department is not adequate to effectively supervise all the 173 registered MFIs.

Absence of a National Credit Rating Bureau - Like other lending institutions, the absence of a national credit rating bureau makes credit rating by MFIs difficult, resulting in loan repayment defaults and client debt traps.

High Interest Rates - MFIs generally charge higher lending rates than banks, with some quoting as much as 25% per month, as compared to 9% per annum at the People's Own Savings Bank (POSB). The high interest rates have negative effects on financial inclusion, economic growth and employment.

Bias towards Consumptive Lending - There has been tendency for MFI clients to use borrowed funds for consumption at the expense of lending to productive sectors and SMEs.

MFIs in Zimbabwe Still Do Not Take Deposits - Plans are underway to allow some MFIs, subject to meeting criteria, to take deposits. To do this, an MFI will be required to have a minimum capital adequacy requirement of US$5 million. In addition, they will be required to operate within stipulated premises. Currently, the minimum capital adequacy requirement for existing MFIs that are not deposit taking is US$25,000 which they are supposed to fully comply with by June 2014.

Given the prevailing macroeconomic challenges in Zimbabwe, it may be a challenges to get a reasonable number of MFIs that will meet the criteria for deposit taking. This may likely reduce the number of MFIs in the economy, with negative effects on financial inclusion. It would further worsen the urban bias associated with MFIs. It would also have negative effects on economic growth and employment. On these grounds, there is need for the Central Bank to reconsider revising the US$5 million downwards. A figure in the range US$3-US$3.5 million would be more reasonable than US$ million.

Challenges Facing the Asset Management Companies (AMCs)

As at 30 September 2013, Zimbabwe had 16 registered asset management companies. The MFIs are now regulated by the Securities Commission of Zimbabwe (SECZ). Effects of liquidity constraints in the economy have reduced business for the AMCs. According to the SECZ, the AMC market is dominated a few big affiliated AMCs, about 3 of 16 that are in operation. According to the SECZ, the few dominant AMCs have a larger share (90%) of the market. Small AMCs that are not affiliated to big viable companies are struggling to increase market share, which is currently about 10%. Small AMCs are competing for the rest of the market share (10%). Due to the poor performance of the economy, there is a thin business market

for the AMCs. A number that are struggling have been affected by their limited ability to make a transition from the effects of the economic crisis of 2000-2008 into the multicurrency regime. AMC business is largely dependent on the overall performance of the economy.

Challenges Facing the Zimbabwe Stock Exchange

The Zimbabwe Stock Exchange (ZSE) is one of the oldest stock exchanges in Africa. It was established in 1896 and started operating continuously in Harare in 1974. However, despite this, the ZSE still faces some challenges, which include the following.

Figure 22: New Listings Drought

Source: Zimbabwe Stock Exchange, 2013

The ZSE has experienced a new listings drought. The number of listings leveled at 80 from 2003 to 2008. Listings had increased to 79 in 2011 but have declined to 69 September 2013. There have been delistings (voluntary and compulsory) and suspensions. In the multicurrency period, it has been difficult for new companies to list on the ZSE. There is a lack of underwriters, who are banks, to assist companies to list on the ZSE, a challenges that emanates from the liquidity constraints in the economy. In addition, most companies have weak balance sheets and therefore fail to attract underwriters and may likely not be attractive counters even after listing.

Small listed companies that were either suspended or voluntarily sought suspension from ZSE in 2012 included Cains, Celsys, Chemco, Gulliver and Interfin. Barbican, Redstar, Steelnet and Trans-Zambezi exited prior to 2012. Tractive Power and Lifestyle sought voluntary suspension in 2013 after they secured shareholder approval. The main challenge has been the liquidity constraints in the economy. Small companies that may survive are those that have managed to attract foreign capital.

The stock market is dominated by a few blue chip companies (Table 4). Small counters have been struggling. In terms of market diversification, out of the listed companies, only four are mining counters and only six are banking institutions. Most of the large and viable mining companies are listed elsewhere.

While the IEEP has reduced investor confidence to some extent, foreign investors have been driving the ZSE. There has been low domestic participation due to liquidity constraints. There has also been a low up-take of rights offers. The ZES still has a limited product range. For example, the ZSE has no bonds and options.

Figure 23: ZSE Mixed Trading Trends

Source: Zimbabwe Stock Exchange, 2013

The ZSE has been characterized by mixed trading, largely in response to the political developments in the economy. Market capitalization peaked at US$6 billion in June 2013, but declined to US$5.4 billion in October 2013 and stood at US$5.5 billion by 13 November 2013.

Table 5: Stock Exchange Market Concentration

Listed Company	Market Capitalization 13 Nov 2013	% of Total Market Capitalization
Delta Corporation Ltd	1,788,742,497.00	32.3
Econet Wireless Zimbabwe Ltd	554,684,248.00	10.0
Innscor Africa Ltd	469,903,043.00	8.5
OK Zimbabwe Ltd	288,499,992.00	5.2
British American Tobacco Zimbabwe Ltd	247,602,204.00	4.5
Hippo Valley Estates Ltd	221,973,649.00	4.0
Seed Co Ltd	192,972,065.00	3.5
Old Mutual Plc.	148,972,198.00	2.7
National Foods Holdings Ltd	147,060,232.00	2.7
TSL Ltd	114,706,960.00	2.1
Total Market Capitalisation	**5,542,173,805.00**	**75.3**

Source: Zimbabwe Stock Exchange, 2013

In addition, only 10 blue chip companies account for 70% of total market capitalization. As at 13 November 2013, the top ten accounted for US$4.4 billion of the US$5.5 billion in total market capitalization. Another top company is the Commercial Bank of Zimbabwe (CBZ). Delta Corporation accounts for about 33% of market capitalization. While the ZSE has 69 listed counters, not much activity is associated with most of the companies listed, outside the top ten. In this case, the large number of listed companies in not crucial for market performance on the ZSE.

Infrastructure and Technology Challenges

The ZSE has limited trading hours, with one and a half hours per day and with one session. The ZSE still operates with manual trading and settlement systems. Plans to automate systems have taken long. The trade settlement period is long at T+7 days, which is against T+3 elsewhere. In this case, the ZSE still has limited capacity to attract global funds.

It critical to note that, in the last two years, significant progress has been made at the ZSE, in terms of programmes and projects that are underway. These include the following:

- Stock exchange bonds;
- Second tier exchange to cater for small-to-medium scale companies (SMEs);
- Strategies to mobilize funds for the SMEs exchange;
- Central Securities Depository (CSD);
- Automation of trading and settlement systems;
- Demutualization; and
- Connectivity and harmonization with other stock exchanges.

The ZSE is set to be automated by the first quarter of 2014. According to the SECZ, some ground work has been made to seek funding from the African Development Bank (AfDB) to assist the SMEs to list on the ZSE. By October 2013, some SMEs had already been identified, although the process is not yet complete. The review of the listing requirements, which includes the listing requirements for the SMEs is nearing completion. The ZSE bonds are targeted to be issued before the end of 2013. However, in consulting with other market players, concerns have been raised that the SMEs may similarly face challenges as is the case with most of the already listed companies. According to MMC Capital, much of the challenges faced by the ZSE have to do with the poor state of the economy.

Challenges Facing the Bond Market

According to the IDBZ, the bond market in Zimbabwe has been seriously affected by liquidity constraints. This market requires long-term deposits, which are scarce in the economy. The low average incomes and savings in the economy has limited participation in the bond market. In addition, there are no Government bonds to serve as a benchmark. There is no yield curve. There has been weak confidence in Government guaranteed bonds. This is associated with weak confidence in Government. There has also been a low up-take of bonds outside private placements. Weak balance sheets and capital base of issuers of bonds like the IDBZ reduces investor confidence. According to the IDBZ, it has also been noted that the purpose of funds to be raised matters in bond market participation. The programme of issuance also matters. Most investors require adequate time to plan their participation strategy. In general, there has been a lack of investor appetite in long-term investments. However, these are the investments that are required to steer growth in the economy.

Challenges Facing Insurance and Pension Funds

In Zimbabwe, insurance companies and pension funds are not allowed to invest assets off-shore. In the multicurrency system, there are limited viable domestic investment options. In other countries, a certain percentage of the assets can be invested offshore. However, some of the insurance companies and pension funds currently have no capacity to invest offshore. They have been negatively affected by liquidity constraints and macroeconomic challenges. Some of the companies

have been failing to meet employer and employee contributions, resulting in employees failing to benefit from their contributions. The adjustment from effects of the economic crisis of 2000-2008 has been difficult for some of the companies. Weak confidence in the economy has also been a challenge. For example, in the run-up to the harmonized elections in July 2013, some investors withdrew their investments because of uncertainty relating to the outcomes of the elections.

Lack of Short-Term Debt Instruments

A re-introduction of TBs in 2012 was unsuccessful. Contributory factors included the following:

- Weak confidence in Government with low credit worthiness;
- Weak confidence in the Central Bank, which is under-capitalized and cannot print money;
- Lack of investor willingness to lend to Government;
- TBs had no buy-back feature;
- TBs were offered only to commercial banks;
- Use of the average bid rate as offer rate was unattractive to banks;
- Purpose of funds to be raised was not obvious to investors, who associated it with national elections that were to be conducted in 2013;
- Liquidity constraints made it difficult for some banks to participate;
- No funds in the LOLR facility where banks expected to use the TBs as collateral security for borrowing;
- No multiple bids and minimum bid amount; and
- Uncertainty surrounding the harmonized elections that were to be held in 2012.

Largely, lack of success in the reintroduction of the TBs indicated weak confidence in Government and the Central Bank.

5 POLICY RECOMMENDATIONS

Most of the challenges facing the financial sector are a result of the poor performance of the economy; weak confidence in the Central Bank; poor credit worthiness of the Government and lack of a domestic currency. Adjustment from the economic crisis of 2000-2008 has not been easy. For the specific financial institutions, the following measures could be considered.

Recommendations: Structure and Composition of the Financial Sector

There is need to capacitate non-bank financial institutions as banks are inadequate in providing all the financial needs of a recovering economy. The capital market and the bond market need to be re-activated to assist in the mobilization of long-term funding. Specialized financial institutions such as leasing companies should be encouraged. There should be incentives to support financial institutions that have a rural bias. The establishment of the national credit rating bureau remains critical.

Recommendations: Central Bank

During the economic crisis of 2000-2008, the Central Bank lost credibility and reputation. To regain credibility, reputation and to function effectively, the following measures could be considered.

- Re-capitalization of the Central Bank;
- Completion of the Central Bank restructuring exercise;
- Mobilization of funding for the LOLR facility;
- More consultations with other financial sector players and other key stakeholders;
- Effective coordination with other financial sector regulators (IPEC and SECZ);
- More confidence building;
- Conclusion of the demonetization issues in which the Central Bank used individual and corporate FCA funds during the economic crisis;
- More information disclosure on bank operations (e.g. level of non-performing loans); and
- Segmentation of the minimum capital adequacy requirements for the different types of banks, large and small.

Recommendations: Banks

Given the challenges facing banks, there is need to consider the following measures:

- Restrain on excessive lending;
- Enhance due diligence on bank lending;
- Enhance deposit mobilization to support increasing credit demand;

- Channel more funding to productive sectors;
- Enhanced support for SMEs;
- Promotion of non-cash transactions; and
- Review of the MOU on interest rates.

Banks require gender lenses. While there is need for credit restraint, banks need to come up with measures that assist women to access funding without stringent collateral security requirements. Most women in Zimbabwe have no collateral security for borrowing. Group lending and co-guaranteeing with advisory and training facilities could go a long way in assisting women access finance from banks.

Recommendations: Microfinance Institutions (MFIs)

- Strengthen financial and technical capacity of MFIs to serve targeted market;
- Enhance mobilization of funding for MFIs;
- Enhance consultations between the Central Bank and Zimbabwe Association of Micro Finance Institutions (ZAMFI) and other related institutions on operations of MFIs;
- Enforce client protections principles (CPPs);
- MFIs should operate with a gender lense to assist women, the majority of whom have no collateral security. Most have no property rights. They have low income jobs and most want to borrow small amounts.
- Encourage group lending and group guarantees to access credit; and
- Train borrowers and supervise their projects to reduce failure, which results in loan repayment defaults.

There is need to consider other strategies in managing MFIs in Zimbabwe. Examples from other countries suggest a number of ways in which this could be done. For example, in Uganda, there is a Minister in the President's Office who is in charge of MFIs. In Senegal, there is a Ministry of SMEs and MFIs. Ethiopia only has 31 MFIs that are all deposit taking. MFIs in Zimbabwe require funding, skills training, effective supervisions and technology. It is still an outstanding issues as to whether MFIs in Zimbabwe would meet the requirements for taking deposits. There may be need to reconsider the amount required as it can easily reduce the number of MFIs, with adverse effects on financial inclusion, poverty reduction and growth.

Recommendations: Zimbabwe Stock Exchange

For the ZSE to contribute more meaningfully to economic activity and to attract global funds, the following measures need to be considered.

- Mobilization of funding to assist SMEs for second tier listing;
- Completion of planned on-going programmes and projects;

1. Automation of trading and settlement systems;
2. Revision of listing requirements;
3. Demutualization;

- Upgrade infrastructure and technology to match requirements of global market investors;
- Expand product range;
- Get country economic policies right to attract more foreign investors;
- Consider strategies and products to make ZSE an attractive investment channel for Diaspora Zimbabweans; and
- Harmomize SECZ legislation with related legislation (e.g. Companies Act of 1962).

Recommendations: Asset Management Companies

The business of asset management companies largely depends on the overall performance of the economy.

Recommendations: Bond Market

Given the prevailing economic conditions in Zimbabwe, for the bond market to be active, the following conditions are required.

- High credit worthiness of Government to guarantee bonds;
- Adequate capitalization of the IDBZ;
- Long-term deposits and savings in the economy;
- Focus on financing viable projects so that there is ring fencing;
- Focus on private placements, which have so far performed well;
- Reasonable time for bond offers to allow investors to plan their participation; and
- Confidence in the economy since this is long-term investment.

Recommendations: Insurance and Pension Funds

There is need to conclude the review of restriction that forbids insurance and pension funds from investing offshore. The review has been going on since 2010. A certain percentage of their assets could be invested offshore for risk diversification, given limited favourable investment opportunities domestically. Examples include Brazil (10%); South Africa (25%); Kenya (15%); Ghana (15%); Botswana (70%); Namibia (70%); Swaziland (70%) and Nigeria (not more than 25%)) of assets are invested offshore. However, also important to note that market conditions differ across these countries. Some of these companies are facing challenges in Zimbabwe. Under the prevailing economic conditions in Zimbabwe, allowing insurance and pension funds to invest offshore could further reduce liquidity in the economy.

Recommendations: Short-Term Debt Instruments

- Offer TBs to a wide spectrum of investors;
- Offer TBs with all standard features for tradability in the market;
- Mobilize funding for the LOLR facility so that TBs can be used as collateral for the facility and in the inter-bank market;
- Do not use the average bid rate as best as the offer rate;
- Explain purpose to which funds are being raised to instill confidence in investors;
- Build confidence in RBZ and Government by working around factors that have eroded confidence levels;
- Consider a multilateral party to guarantee TBs; and
- Build up reserves to give confidence to would-be investors.

6 CONCLUSION

In the multicurrency system, the financial sector has limited capacity to support economic activity. Weak confidence in the financial sector, the Central Bank and Government is still a challenge. Liquidity constraints continue to be a challenge. Short-term views about the economy have compounded the limited ability of the financial sector to mobilize long-term funding.

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