

AFRICA RISK CONSULTING**Country briefing – Zimbabwe****25 September 2014**

1 Summary

As the economy falters and links with Western economies remain strained, Zimbabwe looks to long-time allies China and Russia for investment. The Reserve Bank of Zimbabwe (RBZ) establishes a special purpose vehicle to buy the banking sector's non-performing loans as a lackluster economy, poor business conditions and slow profit growth prompt a liquidity crisis. President Robert Mugabe (1980-present) appears set to use First Lady Grace Mugabe's position in the Zimbabwe African National Union Patriotic Front (Zanu-PF) Women's League as a pretext to draw out dissenters in the ruling party.

1.1 Zimbabwe looks to China, Russia

President **Robert Mugabe** (1980-present) has turned to liberation-struggle allies **China** and **Russia** as the country's huge external debt – estimated at \$9,9 billion as of December 2013, or 54% of gross domestic product – continues to weigh down the struggling economy. Ties with **Western** economies have remained strained since Mugabe's re-election in 2002, 2008 and 2013.

China and Russia have promised to invest in Zimbabwe's infrastructure and mining sectors as part of agreements signed between Mugabe and the two governments over the past month. China and Russia have been allies of Zimbabwe since funding and supporting Zimbabwe's liberation movements in their struggle for independence. Mugabe has made 13 visits to China since he came to power in 1980. In 2008, both China and Russia vetoed a **United Nations (UN)** resolution seeking sanctions against Zimbabwe. The resolution called for an arms embargo which would have affected Russian and Chinese weapons exporters.¹

Mugabe hopes old political ties will help forge economic links. During a meeting in **Harare** with Russian foreign affairs minister **Sergey Lavrov** on 15 September, Mugabe said China and Russia remain Zimbabwe's biggest allies.

¹ The Guardian, 11 Jul 2008.



"These are the two main pillars of support of our revolution yesterday and they remain the two pillars of our support in international law and so we say to them great thanks for standing with us in perpetuity." ²

Russia has been widening its involvement in the Zimbabwe economy. In September, Russia and Zimbabwe announced an agreement to set up a \$3 billion platinum mine in **Darwendale**, about 70 km (43 miles) west of the capital Harare. In May this year, a consortium of Russian investors took over **Tetrad**, a struggling Zimbabwean bank. Russian trade minister **Denis Manturov** also announced on 15 September that Russian diamond mining firm **Alrosa** has begun prospecting for diamonds in Zimbabwe.³ Alrosa accounts for more than a third of global rough diamond production.⁴

The Zimbabwe government says it needs \$27 billion to fund its recovery programme but finance minister **Patrick Chinamasa** said China is unlikely to give Zimbabwe budgetary support.

"No country sets aside a lump sum payment for no specific projects. You will not come to China to ask for money to invest in a project that won't pay for itself. That would not make economic sense." ⁵

Zimbabwe already owes China \$700m.⁶ Chinamasa acknowledged that Zimbabwe's failure to service debts remains a major hurdle in its attempts to get more investment.

"We had abandoned our duty to pay our debts. We would borrow money and never come back, even to explain to them (China) what was happening. Since January [2014] we have had to pay a total of \$180 million to show good faith and to unlock additional funding." ⁷

Among the key deals Zimbabwe secured in the Mugabe-led delegation to China in September were \$2 billion worth of energy and water projects, loans worth close to \$320m to fund state telecoms networks, and rail construction agreements. In addition, three Chinese firms plan to build a coal mine and a 1,200 MW thermal power station in Zimbabwe.

To pay off the loans, Zimbabwe may set aside a portion of its future earnings from mineral resources.⁸ This has led to criticism that Zimbabwe is "mortgaging" its assets to China and Russia.

² President Robert Mugabe quoted in Zimbabwe Herald newspaper 17 Sep, 2014

³ Reuters, 15 Sep 2014.

⁴ Alrosa website

⁵ Patrick Chinamasa, quoted by the Herald newspaper, 25 Aug 2014.

⁶ Zimbabwe Treasury Report, March 2014

⁷ Patrick Chinamasa addressing business leaders in Harare, 12 Sep 2014.

⁸ Patrick Chinamasa addressing business leaders in Harare, 12 Sep 2014.

“The Chinese are in Zimbabwe already and now the Russians too are coming; and they are coming for one purpose; to join in the pillage of the country.”⁹

While domestic hostility towards “mortgaging assets” is growing, there is little public disclosure of the deals or how the government will pay for the contracts. With the country already in deep debt, economists predict the deals will be at a heavy cost to the Zimbabwean economy.¹⁰ The **International Monetary Fund (IMF)** estimates Zimbabwe’s external debt will stand at \$12.8 billion (94.5% of GDP) by the end of 2014, of which \$5.6 billion will remain in arrears. The IMF forecasts external debt to grow to \$22.5 billion (122% of GDP) by 2019.¹¹

The government is desperate for job-creating investment to arrest a worsening economic decline which has seen GDP output for 2014 slashed to 3.1% from earlier predictions of 6.1%, while unemployment now exceeds 90%.¹² Most recently the government has sought to impose a raft of tax increases on goods ranging from foodstuffs to mobile phones as the latest attempt to raise revenue to run the government. The civil service wage bill alone consumes \$76 of every \$100 collected in taxes.¹³

1.2 Central bank vehicle to acquire non-performing loans of struggling banks

The **Reserve Bank of Zimbabwe (RBZ)** has established a new unit to take over the non-performing loans of distressed banks. The move mirrors **Nigeria’s** decision to create a special purpose vehicle to quarantine loss-making banks. Central bank governor **John Mangudya**, who started a new five-year term in May, announced in his maiden monetary statement on 26 August that he had established the **Zimbabwe Asset Management Corporation (ZAMCO)**.¹⁴ He has also introduced a three-tiered capital structure for banks, an acknowledgement that his predecessor’s capital thresholds were unrealistic given the liquidity crisis facing the banking sector.

ZAMCO’s establishment underlines the central bank’s alarm about the potential instability to the country’s banking system as a result of non-performing loans and particularly of small banks which have borne the brunt of the liquidity crisis. Customers have fled smaller banks to larger, foreign-owned banks due to concerns about small banks’ survival prospects. Rising non-performing loans (NPLs) also reveal the extent of the economic crisis facing Zimbabwe, which has since forced the government to slash its GDP forecast for 2014 by half to 3.1%, as companies struggle to keep afloat in

⁹ Political commentator, Wilbert Mukori, writing on New Zimbabwe web site, Sep 15 2014

¹⁰ Economist John Robertson, Harare, Sep 19 2014.

¹¹ IMF Country Report, July 2014

¹² The Herald, 10 Dec 2013.

¹³ The Independent, 26 Sep 2014.

¹⁴ Reserve Bank of Zimbabwe Monetary Policy Statement, 26 Aug 2014.

the face of waning demand, rising costs and slowing profitability. Non-performing loans reached \$705 million as of June 2014, an increase of 18.5% since June 2009, according to figures from the central bank.

Mangudya says the central bank can no longer continue to be a by-stander as banks continue to lurch from crisis to crisis. ZAMCO has already bought non-performing loans worth \$45 million as of August, without saying what price it paid for them.

“(The) increase in non-performing loans in Zimbabwe is causing banks to cut on lending to business at a time when companies require working capital and funds for retooling. This is now having a huge bearing on the economy as reduced credit is leading to a decline in economic growth, private consumption, job losses and decrease in government revenue.”¹⁵

Bank executives and market commentators welcomed Mangudya’s move saying it could signal the first step towards restoring profitability in the banking sector. As of June 2014, the aggregate net profit of all the banks was \$13.84m, compared with \$4.9m during the corresponding period in 2013.

“Market driven securitisation of (non-performing loans) would be the most efficient mechanism of cleaning up bank balance sheets. A precondition of this approach would be an absolute transparency on the size and source of the soured loans. A central bank intervention that does not include the market in pricing these assets will likely trigger concerns of moral hazard on the part of banks at fault.”¹⁶

The central bank has been coy about the price ZAMCO would pay for the loans, save to say these would be acquired under commercial terms. The unit itself would be funded by non-funded credit lines, bonds and treasury bills.

“Granted adequate transparency and fair pricing of the NPLs, it is possible for the market to have appetite for some of these assets. Instead of straining itself, the central bank could push this inconvenient burden onto the market. Admittedly, a commercially driven transfer mechanism will likely to be more severe on pricing these assets relative to an approach by the Central bank.”¹⁷

¹⁵ Reserve Bank of Zimbabwe Monetary Policy Statement, 26 Aug 2014.

¹⁶ Ray Chipendo, Emergent Capital Management analyst, South Africa

¹⁷ Ray Chipendo, Emergent Capital Management analyst, South Africa

1.3 Zanu-PF factional fighting escalates

The **Zimbabwe African National Union Patriotic Front (Zanu-PF) Women's League** endorsement on 15 August¹⁸ of first lady **Grace Mugabe** for the position of Secretary for Women's Affairs presents a new battleground for wider factional fights. Rival factions are being forced to come out in support of Grace Mugabe's ascendancy in the party for fear of being seen as opposed to her new role as leader of the Women's League, a position which her husband Robert Mugabe is likely to confirm at the party's congress in December 2014. The position is traditionally a stepping-stone for senior office within the ruling party. It will also allow Grace Mugabe to sit in the **Politburo**, the top council of Zanu-PF.

President Robert Mugabe appears ready to use his wife as a pretext to draw out dissenters within the ruling party and root out any ambitious officials from the ranks. The drama is already playing out: members of a rival faction assaulted a party youth leader ahead of Zanu-PF's **Harare Province** leadership contest.¹⁹ Following the incident, Zanu-PF's top leaders made a public statement that "*First Lady Grace Mugabe is our choice*".²⁰ A senior official in the party confirmed a campaign by those around Mugabe to weed out any potential opposition to his plan to tighten his grip on power by appointing his wife to an influential post in Zanu-PF.

*"Any accusation that you are not in full support of the First Lady will see you get sidelined, and there will be nobody to support you since everyone will be scared of being labeled in the same way."*²¹

Those within Zanu-PF who hold contrasting opinions risk accusations of attempting to destroy the party. President Mugabe's nephew, **Patrick Zhwawo**, wrote an opinion piece in the state-run **Sunday Mail** on 15 September in which he accused those opposed to Grace Mugabe's ascendancy of causing ruptures.

*"Factional conflict and strife may escalate to levels that may cause fissures in the organisation that, in turn, cause ruptures. These ruptures can lead to the party failing to operate efficiently such that it is in danger of breaking up."*²²

However, a senior Zanu-PF official warned that those publicly expressing support for Grace may not be genuinely in support of Mugabe.

¹⁸ See ARC Zimbabwe August 2014 Briefing

¹⁹ Herald, 25 Aug 2014

²⁰ Zimbabwe Mail, Aug 2014

²¹ Zanu-PF official interviewed, 19 Sep 2014.

²² Sunday Mail, 14 Sep 2014.

*“Indeed we must all be wary of elements that feign love for President Mugabe and Zanu-PF yet their real agenda is to divert President Mugabe’s attention from the core business of government in order to create problems for the party and for President Mugabe in 2018 when elections are due.”*²³

As the faction fights escalate, government attention will be turned even farther away from the economic crisis, although Chinamasa has insisted that the Politburo will now put the economy on the agenda.²⁴

2 Implications

Continued, albeit limited, EU and US sanctions continue to bite Robert Mugabe, forcing him to scout for new investment and trade deals with remaining friendly nations. China and Russia have stepped up to fund deals in key sectors such as mining and energy. However, these countries’ support comes at a price and with re-payment commitments that the Zanu-PF government is unlikely to be able to meet easily.

The RBZ’s unusual step to stem losses in the banking sector and restore balance sheet strength is a desperate attempt to improve bank liquidity and kick-start economic recovery. The central bank is alarmed that the stability of the banking sector – and by implication the stability of the already shaky economy – is being threatened by widening bank losses stemming from non-performing loans as companies and individual customers struggle to repay loans owing to the stunted economic performance. The central bank also acknowledged that a one-size fits all approach to bank capital requirements will not work, and its decision to introduce a tiered capital structure for banks could provide the breathing space smaller banks need to clean up their balance sheet and scout for new investors.

The battle for leadership of the ruling Zanu-PF continues to intensify with wider factional fights in prospect. What is clear, however, is that President Mugabe remains firmly in charge of the party, and whoever emerges as his successor will be someone he has indirectly anointed and endorsed. This will become clearer as the party moves towards its elective congress in December, seen by many as a watershed event that will shape the leadership of the party.

²³ Herald, 1 Sep 2014.

²⁴Patrick Chinamasa, addressing breakfast meeting of business leaders in Harare, 12 Sep 2014.