

The Impact and Lessons of the 2008 Global Financial Crisis to Zimbabwe

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Abstract

The global financial crisis that had its epicenter in the United States of America affected economies across the globe at varying degrees. Using Zimbabwean national data from The Reserve Bank of Zimbabwe, the study concludes that there is adverse effect of the global financial crisis on exports. An analysis on the graphical trends indicates that the falling commodity prices on the international market resulted in reduction of income from exports. The mining sector was the hardest hit since most of the minerals extracted in the country are exported. Quantifying the total effect of the global financial crisis in Zimbabwe cannot be precisely estimated since the crisis occurred concurrently with economic instability in the country. Since financial crisis is a common phenomenon around the globe, the impact of financial crisis can be mitigated by proper financial regulation, financial development, debt management, good governance, and preparedness of such eventualities. The paper looks at economic events that transpired between years 2007 to 2009 in Zimbabwe.

Keywords: financial crisis, financial development, debt management, financial regulation, hyper inflation

1. Introduction

The global financial crisis that had its epicenter in the USA has had widespread ripple effects across the world with varying impacts from country to country. The crisis that followed after the burst of the housing bubble in the USA has generally destabilized not only the developed economies but the emerging markets too. The crisis in developed countries has generally been centered on "liquidity crunch", the crunch cascaded into falling commodity prices and reduced demand for raw materials (Rudd, 2009; Shiller, 2008). Many developing countries rely heavily on a single or few commodities for export and as such are exposed to external prices shocks.

Plummeting stock markets in the highly globally integrated economies have wiped out 33% of the value of companies, \$14.5 trillion. Taxpayers bailed out banks and financial institutions with large amounts of money. US taxpayers alone spend some \$9.7 trillion in bail-out packages and plans. The UK and other European countries also spent some \$2 trillion on rescues and bail-out packages (Gangadharan and Yoonus, 2012). This problem could have been averted (in theory) as people had been pointing to these issues for decades. However, during boom, very few want to hear such pessimism. Does this crisis spell an end to the careless forms of banking and finance and will it herald a better economic age, or are we just doomed to keep forgetting history and repeat these mistakes in the future (Shah, 2009)? What are the lessons that can be derived from this crisis with regard to developing economies?

In Zimbabwe, the impact of the global financial crisis has been felt mostly in the mining sector which has been affected by low commodity prices. However, there was no reported incidence of financial instability linked to the global financial crisis in the country since the financial sector is not highly integrated to the developed countries' financial systems. It is also difficult to conclude the level of impact of the financial crisis since it occurred concurrently with the peak of economic instability in Zimbabwe. However, developments in the mining, manufacturing, agriculture and the financial sectors suggest an indirect adverse effect of the financial crisis on the economy.

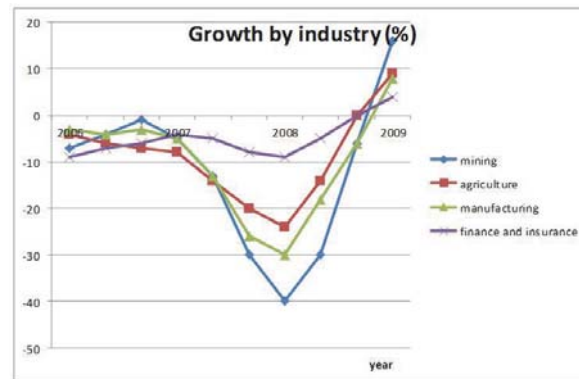
The paper profiles economic trends in Zimbabwe during the peak of the global financial crises period 2007-2009 in Section 2. Section 3 looks at the lessons learnt and suggests mitigating policies for future financial crises. Concluding remarks are in section 4.

2. Real Sector Developments in Zimbabwe

Declining economic activity as a result of the global financial crisis in the US and other developed economies reduced the global aggregate demand causing the international commodity prices to dip steeply. The resultant low commodity prices affected the viability of some mining houses and reduced export revenues. Although other sectors continued to decline,

this was a result of other viability problems stemming from poor governance and the economic instability in the country. The financial crisis that took place during the years (2007-2009) happened concurrently with the astronomical inflation that took place in Zimbabwe, which was last recorded at 231million percent in July 2008 and was believed to have reached 5 billion by the end of 2008 (Mankiw, 2014, p. 484). The condition has been worsened by declining mineral prices, prohibitive export tariffs, and restrictive exchange control measures that were put in place by the Government of Zimbabwe (Elich, 2002). The condition has been exacerbated by the growing domestic debt that stood at USD 5.8 Billion by the end of March 2010. Mining, agriculture, financial and manufacturing industries experienced negative growth (Figure 1)

Figure 1



RBZ Statistical Bulletin (2009)

Zimbabwe is a low income fragile economy. During the peak of the global financial crisis, there was very low capacity utilization in almost every industry that supported the economy. However, production trends suggest that the financial crisis roller coaster affected growth in the agriculture, manufacturing, finance and insurance, with the mining sector becoming the biggest casualty. The scenario has been worsened by poor economic policies that prevailed during the economic crisis (Clemens and Moss, 2005). The effect of the global financial crisis in the mining sector in Zimbabwe can not be easily traced since the economy was struggling from a hyper inflationary environment. However exports from minerals plunged deeply at the peak of the crisis. This could have been driven in part by the general drop in mineral prices.

Platinum is the leading mineral foreign currency earner in Zimbabwe. Platinum prices slipped steeply from a peak of US\$1 746 per ounce in August 2008 to an average of US\$824 per ounce by December 2008 (RBZ and Government of Zimbabwe Statistical bulletin, 2009). The declining platinum prices compelled Zimplats, the country's leading producer and exporter of platinum group of minerals (PMGs) to abandon its open cast mining operations in favour of underground operations as the price was not enough to absorb the high cost of production at the open cast mine. In addition, Zimplats had to cancel several of its capital projects as it could not access credit for the completion of the expansion project in Ngezi. The fall in platinum prices is linked to the declining demand for platinum by developed countries due to liquidity crunch that took place during the financial crisis. However platinum prices recovered in 2009.

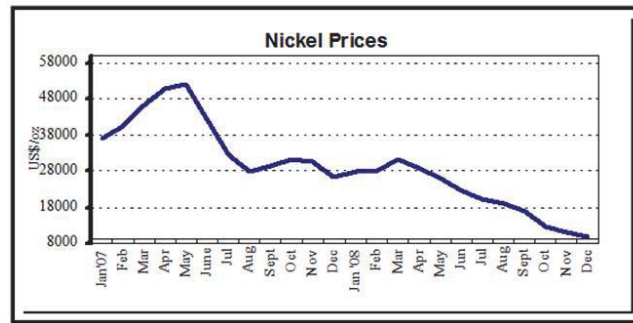
Figure 2



RBZ Statistical Bulletin (2009)

The declining global demand for nickel led to increased stockpiles and a steep decline in nickel prices. New mines in China and India which began operations in 2008 continued to boost nickel supplies, causing nickel prices to further decline. As a result, the country experienced dwindling export orders. Against this background, Bindura Nickel Corporation downsized the mining operations by closing down two of its major mines, the Trojan Mine and Shangani Mine. The scaling down of mining operations coupled with the closure of the other two mines forced the mining house to lay off workers, thus contributing to increased unemployment.

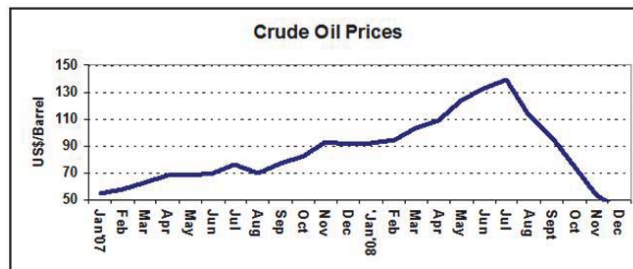
Figure 3



RBZ Statistical Bulletin (2009)

On the other hand, declining oil prices lessened the fuel burden and helped to ease the inflationary pressure in the country. It reduced the cost of production which hand a potential to boost output. Oil prices were at highest level of 145USD per barrel in July 2008 and they receded thereafter (Figure 4).

Figure 4



RBZ Statistical Bulletin (2009)

Gold is second biggest mineral foreign currency earner in Zimbabwe. There were some intermittent price decreases in other commodities from September 2007 to December 2008, the prices remained high on average compared to the ruling prices in the pre-crisis era. Thus, the declining exports largely reflected production bottlenecks arising from the presence of severe foreign exchange shortages, power outages, dilapidated and antiquated machinery and productive infrastructure, as well as the economic recession in general. For instance, the gold sector was already facing severe operational and viability challenges due to economic instability within Zimbabwe. Thus, the impact of the global financial crisis was only of a limited extent, since the price of the metal was fairly stable at the peak of the financial crisis (Figure 5).

Figure 5



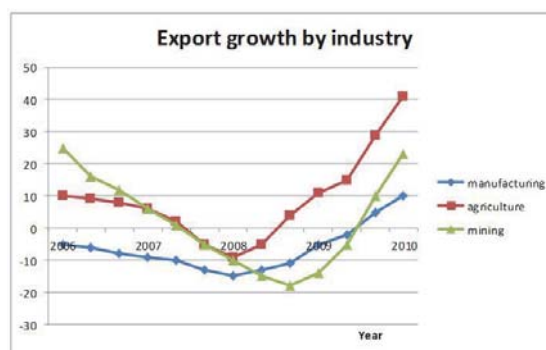
RBZ Statistical Bulletin (2009)

Production and exports of ferro-alloys were severely affected by the global financial crisis. While viability challenges affected production on the local front, international ferro-alloys slumped reflecting the adverse effects of the global recession. Out of the five ferro-alloys producers in the country; only ZIMASCO was producing and exporting ferro-alloys in 2010. As a result, exports of ferro-alloys declined from 190 million kg in 2007 to 152.9 million kg in 2008 and to 81.5 million kg in 2009.

The global economic crisis has put extra pressure on fiscal balances of most countries in the region, potentially compromising progress these countries had made in reducing their fiscal deficits. The crises compelled governments to borrow both externally and domestically to mitigate the effects of the crisis. This led to the faster build up of public debt. In Zimbabwe the Reserve Bank borrowed about US\$1.2 billion on behalf of government to mitigate the effects of the global financial crisis. The amount has been used to support depressed firms and the procurement of farming inputs. On the other hand, the Government of Zimbabwe could not meet its debt obligations owed to domestic and foreign institutions. The slow real GDP growth and the resultant low exports of goods as a result of depressed demand and low commodity prices also weighed heavily on tax revenue. Grants continued to trickle in to support the social sectors such as health particularly after the emergence of the cholera epidemic in 2008. As such, grants were less affected by the global economic crisis.

Exports were on a downward trend on the backdrop of low capacity utilization and closure of companies due to viability problems. On the other hand, the shortage of basic commodities pushed up imports resulting in deterioration of the current account balance. The impact of the global financial crisis, however, was mainly reflected in the declining exports of commodities such as platinum, nickel and ferro-alloys due to low prices. Overall, the exports (free on board) declined from US\$1.82 billion in 2007 to US\$1.66 billion in 2008 and to US\$1.59 billion in 2009 reflecting a decline of 8.9% and 4.0% respectively (Figure 6).

Figure 6

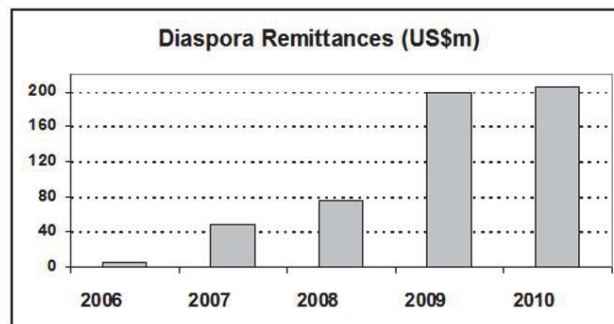


RBZ Statistical Bulletin (2009)

The Tourism sector has been declining over the years as a result of political and economic instability coupled with negative publicity of the country. The sector continued to decline in 2008 as the global economic crisis took its toll. In 2009, tourism receipts improved significantly following the introduction of the multicurrency system and the formation of the inclusive government.

Despite the global economic crisis, remittances from the diaspora continued to rise over the period. From 2006 to 2008 the increase in remittances was precipitated mainly by an increase in the number of people in the diaspora. In 2009, however, there was a huge increase in foreign currency remittances. The increase was due to the fact that more and more remittances were coming through the formal channels after the introduction of the multicurrency system. The multicurrency systems enabled the recipients to receive their cash in hard currency. Previously the people could have avoided the formal channel as a result of the overvalued exchange rate and the money did not get through the formal channel. The rise in remittances could have been driven by increasing political and economic stability in Zimbabwe. The rising inflation, price controls, exchange rate restriction, and political tension forced a number of Zimbabwean people to flee to neighboring countries who are estimated at 3 million people (Figure 7).

Figure 7

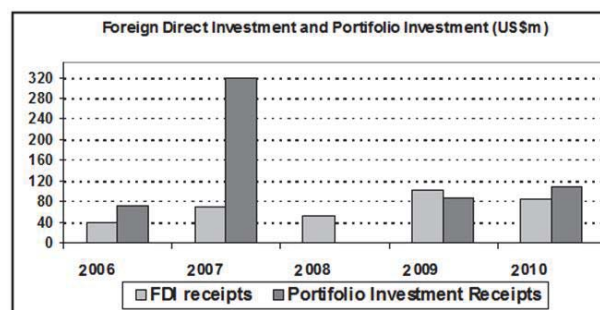


RBZ Statistical Bulletin (2009)

Reflecting declining exports and the increased demand for food imports, the foreign exchange reserves remained very low. The months of import cover averaged at 0.4% in 2007 and declined to 0.3% in 2008. In 2009, the months of import cover increased to 1.25 as a result of the SDR allocations from the International Monetary Fund (IMF) as well as the advent of multicurrency system.

The declining economic activity and hyper inflation environment experienced in the country over the years have led to low national savings. As a result investment also declined reflecting the signaling economic activity. Capital inflows also remained depressed as a result of economic instability. As such, the global economic crisis was of a limited extent on savings, investment and in capital markets. Furthermore, the government through The Reserve Bank of Zimbabwe confiscated much of the foreign currency from various organizations that banked with the Central bank. In what could be a clear sign of the effect of the global financial crisis, Zimbabwe did not receive any portfolio investment in the year 2008. Again it is difficult to ascertain the magnitude of the financial crisis due to the market conditions that existed during the period in question.

Figure 8

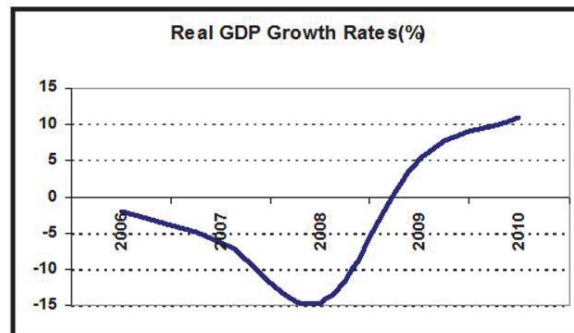


RBZ Statistical Bulletin (2009)

GDP growth declined by -14.7% in 2008 compared to -6.2% in 2007. Although the global financial crisis contributed to some extent to the economic decline, the effects largely emanated from other factors such as economic and political instability as a result of the presidential elections, power outages, and foreign exchange shortages among others. As a

result, it is not possible to quantify numerically the full impact of the global economic crisis.

Figure 9



RBZ Statistical Bulletin (2009)

Economic and political instability in Zimbabwe has led to a free fall of GDP and per capita income continued to decline over the period. The per capita income declined from US\$537 in 2006 to US\$314 in 2007 and to US\$242.1 in 2008. Although this decline cannot be directly linked to the global economic crisis, the crisis has had an indirect effect on the per capita income as it leads to slowed economic activity. In 2009, however, the per capita income improved significantly to US\$383 reflecting increased economic activity following the formation of the inclusive government coupled with the introduction of the multicurrency system.

More so, the Government of Zimbabwe has constantly blamed targeted sanctions imposed on the ruling ZANU PF party. Although this can be partly to blame, it has been difficult to quantify the effect of the sanctions. The qualitative psychological effect of the targeted sanctions makes it difficult to quantify the impact. In addition, the country recorded increasing growth figures when the ZANU PF and MDC parties entered into a Government of National Unity. This suggests that part of the economic free fall can be attributed to poor governance (Clemens and Moss, 2005).

2.1 Macroeconomic Policy Reforms and Programs

Zimbabwe did not institute programs specifically targeted at mitigating the global economic crisis because of its limited impact on the economy. The country, however, continued to support the industry and the agriculture sector in 2007 and 2008 through the Reserve Bank under the Basic Commodities Supply Side Intervention (BACOSI) facility and the farm mechanization program. This program, however, led to increased money supply which weighed heavily on inflation causing it to reach astronomical levels in 2007 and 2008. The programs increase government debt as those who benefited from the schemes did not pay back the loans advanced to them. Furthermore, the limited capital availability compounded by poor loan recovery by government resulted in only small number of individuals benefitting from the schemes. Above all, the policy was ill-conceived and riddled with political patronage as well as corruption (Bonga et al., 2014). The donor community also played a pivotal role by availing inputs in the communal agricultural sector. Besides the support, output in the Agricultural Sector has remained depressed due to structural reorganization that is, the fast track land reform that the Government of Zimbabwe embarked on in the year 2000 and has continued up to 2010.

3. Lessons from the Financial Crisis

Events that led to the global financial crisis provide sterling lessons to emerging economies especially on issues pertaining to financial stability. The financial sector forms the cornerstone of economic growth and development in any economy. It is against this background that developing economies should strive towards maintaining a stable and sound financial system that should form the heart that propels the economy. To ensure sustainable growth, Zimbabwe should espouse financial development. There is very strong connection between the exogenous components of financial development and long-run economic growth (Beck et al., 2000; King and Levine, 1993; Levine et al., 2000, 2000).

More so, conditions that resulted in global crisis may not necessarily lead to world wide crisis if they originate in emerging economies but may have a regional contagion effect, for example, Asian crisis (Goldstein, 1998; Johnson et al., 2000; Tobin, 1998). It therefore calls for the preparedness by emerging economies to ensure that performance of the

financial markets does not result in detrimental outcomes that may have contagion effect on economies.

Central banks need to give consideration to changes their mandates, recognizing that price stability is not sufficient to maintain economic stability and prosperity, and an excessive focus on price stability may actually contribute to slower and more unstable growth. Due attention should be paid to the stability of the financial system and its interactions with macroeconomic trends (Stiglitz, 2008). Volatility in the financial market should be averted as quickly as possible before the effect has spread. The Central bank should have constant surveillance of the financial sector and should ensure that financial institutions implement internal control systems, for example, those based on BASEL III. Central banks should concentrate on performing their core duties such as the lender of last resort.

Usually a financial crisis results in tightening of formal credit as well as limiting the scope for households and firms to buffer themselves. Credit growth slows substantially, and recovers more slowly than output. Banks, including healthier ones, reallocate their asset portfolio away from loans (Group and others, 2008). Other sources of credit are also affected. In the absence of sources of loans that are critical in reviving an economy, which has become a common phenomenon in most developing countries, central banks should play a pivotal role.

The year 2009 has seen full dollarization of Zimbabwean economy. This has been followed by massive credit crunch with the Reserve Bank of Zimbabwe failing to play its role as the lender of last resort. Prior the multi-currency period, the Reserve Bank of Zimbabwe has been involved in Quasi Fiscal activities that virtually crowd out other financial intermediaries that the central bank was supposed to be monitoring and supervising. The empirical performance of non-core duties may result in destabilizing the financial markets which has been the scenario in Zimbabwe (Kairiza, 2009; Noko, 2011; Pilosof, 2009; Sikwila, 2013).

Zimbabwe is faced with a debt crisis. By April 2010 the debt stood at 5, 8 billion USD with over 3 billion USD already in arrears (RBZ statistical bulletin, 2010). The country has failed to service the domestic and external debt since 2005. Debt management is vital if an economy is to survive any future financial crisis. External debt is sensitive to foreign exchange volatility, which makes it critical for the country to prudently monitor and manage it.

National debt problem in Zimbabwe can also be surmounted if the economy's resources are fully utilized. The resources range from minerals, human capital, good climate, fertile soils, underutilized water bodies as well as other natural resources (Keefer, 2007). There are two things that matter in government-debt dynamics: the difference between real interest rates and GDP growth ($r-g$), and the primary budget balance as a percentage of GDP (that is, before interest payments). In any given period, the debt stock grows by the existing debt stock (d) multiplied by $r-g$, less the primary budget balance (p) (King and Levine, 1993).

The simple $r-g$ assumption is one of the most important in debt dynamics: an $r-g$ of greater than zero (when interest rates are greater than GDP growth) means that the debt stock increases over time. An $r-g$ of less than zero causes debt to fall. This asserts that if there is full capacity utilization in Zimbabwe, will grow resulting in reduction in debt.

The interactive model uses the nominal interest rate (i)—approximately equivalent to the ten-year bond yield—and allows us to input our own inflation rate, π . Inflation helps reduce the total debt stock over time, by reducing the real value of debt. In the model and using approximations, $r-g$ becomes $i - \pi - g$. The greater the inflation rate, the lower $r-g$ becomes.

The second consideration is the primary budget balance. A primary budget surplus causes the debt stock to fall by allowing the government to pay off some of the existing debt. A primary deficit needs to be financed by further borrowing. However, borrowed money should be channelled into highly productive sectors ensuring g is greater than r , which is critical for debt reduction. This is a delicate balancing act as European peripheral countries have found out to their cost, interest rates increase when governments run large budget deficits and as they do it becomes increasingly difficult to reduce $r-g$ to a sustainable level (King et al., 1988).

In reality, these variables are all related. When inflation rises, for instance, bondholders will expect a higher nominal interest rate on new debt. If a country runs a larger primary surplus, the interest rate it is forced to pay may fall. Adjustments in countries' deficits will also affect their growth rates. To simplify matters, the evolution of a government's debt stock is based directly on the values for inflation, growth, interest rates, and the primary deficit.

At the moment Zimbabwe may require debt scheduling or debt forgiveness since the capacity to service the debt is very low. However, these measures should be followed by monetary and fiscal policy discipline. There is urgent need to cut government expenditure and ensuring that parastatals provide services based on cost build up (Bond and Manyanya, 2003; Bracking and Sachikonye, 2009; Kanyenze, 2011; Nondo et al., 2010).

A stable environment is the pillar for growth and development of any economy. Well managed economies are not easily exposed to financial crisis either from within or externally. Zimbabwe requires strong governance institutions that respect property and intellectual rights (Schlager and Ostrom, 1992). The institutions of governance should encourage investment in the country. Growth in investment will increase export competitiveness of Zimbabwe. If the country had a

wide range of exports, the impact of a fall in the commodity prices could be minimized. This will help the country meet its consumption requirements since it is a net importer of commodities.

Developing countries have lacked preparedness in averting the possibility of a national, regional, and global financial crisis. This is mainly because they do not have efficient data collecting institution (Amin and Goldstein, 2008; Dreze and Sen, 1999; Malecki, 1997). An important part of crisis preparedness is the investment in data collection and evaluative research both quantitative and qualitative. The data bank can go a long way in informing possible public policies that may assist in mitigating future financial crisis. Ensuring frequent national data collection helps in improving policy direction from an informed position. The capacities to collect national data in Zimbabwe like any other developing economy is not up to standard and sometimes either the data is poorly estimated or is not available at all.

Constant research should be carried on how the financial sector is performing in order to take the best move that will ensure maximum growth and development. A lot need to be done in tracking commodities prices to ascertain their impact on individual, firms and national income, for example, Stock markets may stimulate the production of information about firms which is essential for allocating capital across the economy (Peress, 2010). Developing countries lack a wide variety of investments. They usually rely on imports and exports that have prices determined in the international market. There is a need for a diverse investment in import substitution. Over reliance on exports should be reversed in order to avoid effects of global shocks.

4. Conclusions

The impact of the global financial crisis manifested through falling commodity prices that led to low return on exports in Zimbabwe. Low revenue from exports reduced the marginal propensity to import. It also curtailed the source of income critical for external debt servicing. The huge debt compared to the GDP means that the country should structure its debt especially the external debt which is usually susceptible to global financial crisis shocks. Zimbabwe should embark on import substitution as well as widen the export base. There is a need to fully utilize resources in the country so that capacity utilization reaches the maximum. Developing economies should devise early warning systems for financial crisis. This will in future help mitigate effects of financial crisis nationally, regionally as well as worldwide.

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