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THE IMPACT AND LESSONS OF THE 2008 GLOBAL FINANCIAL CRISIS TO ZIMBABWE

Calvin Mudzingiri*

ABSTRACT

The global financial crisis that has its epicenter in the United States of America did not directly affect the Zimbabwean economy. However, the falling commodity prices on the international market result in reduced income from exports in Zimbabwe. The Mining sector was the hardest hit since most of minerals found in the country are exported. Remittances were on the increase this could have been driven by the rising number of people moving out of the country due to political and economic instability. Since financial crisis is a common phenomenon around the globe. The impact of financial crisis can be mitigated by proper financial regulation, 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, Debt management, Capacity utilization

JEL: Global Economics

*Calvin Mudzingiri
Institution: The University of Free State
Postal Address: University of Free State, P Bag X13, Phuthadithjaba, 9866, South Africa
Email: mudzingiric@qwa.ufs.ac.za
Telephone: +27718423680

1.0 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. [1]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. While 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. Many developing countries rely heavily on a single or few commodities for export and as such are exposed to external prices shocks.
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 Zimbabwe since the financial sector is not integrated to the developed countries financial system. It is also difficult to conclude level of impact of the financial crisis since it occurred concurrently with peak of financial instability in Zimbabwe. However, developments in the mining, manufacturing, agriculture and the financial sectors suggest an indirect effect of the financial crisis on the economy.

2.0 REAL SECTOR DEVELOPMENTS

Declining economic activity as a result of the global financial crisis in 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. [2]The financial crisis that took place during the years (2007-2008) happened concurrently with the astronomical inflation that took place in Zimbabwe that was last recorded at 231million percent in July 2008 and is believed to have reached 5 billion by the end of 2008. 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. 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 (see Appendix A Figure 1)

[1] The greater availability of mortgage funding predictably led to greater demand for housing, as people who could not have previously qualified for credit received loans ("sub prime" borrowers) and others qualified for loans far larger than they could have secured in the past ("prime" borrowers).
[2] The inflationary environment is generally blamed on the expansionary monetary and fiscal policies by the Government of Zimbabwe (GOZ).

3.0 MINING

Zimbabwe is a low income fragile economy. During the peak of the global financial crisis there has been very low capacity utilization in almost every industry that supported the economy. However, production trends suggest that the financial crisis roll 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. 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 by the general drop in mineral prices.

3.1 Platinum

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.[3] 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. Platinum prices have since recovered in 2009 (Appendix A Figure 2).

3.2 Nickel

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 Appendix A).

On the other hand, declining oil prices lessened the fuel burden and helped to easy 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

[3] RBZ and Government of Zimbabwe Statistical bulletin (2009)

145USD per barrel in July 2008 and they receded there after (Figure 4 Appendix A).

3.3 Other Commodities

Gold is second biggest mineral foreign currency earner in Zimbabwe. They were some intermittent price decreases in other commodity 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 Appendix A).

4.0 MANUFACTURING

4.1 Ferro-Alloys (HCFC)

Production and exports of ferro-alloys was 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 5 ferro-alloys producers in the country; only ZIMASCO is currently producing and exporting ferro-alloy. 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.

5.0 FISCAL SECTOR

5.1 Domestic and External Borrowing

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.

5.2 Government Revenues

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.

5.3 Grants

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 not affected by the global economic crisis.

6.0 EXTERNAL SECTOR

6.1 Growth in Exports and Imports

Exports were on a downward trend on the back drop 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 (f.o.b) 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 and 7 Appendix A).

6.2 Tourism

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.

6.3 Remittances

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 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 9 Appendix A).

6.4 Foreign Exchange Reserves (Months Of Imports)

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 1.2 as a result of the SDR allocations from the International Monetary Fund (IMF) as well as the advent of multicurrency system.

7.0 SAVINGS, INVESTMENT AND DEVELOPMENT IN CAPITAL MARKETS

The declining economic activity and hyper inflation environment experienced in the country over the years, has 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 extend on savings, investment and in capital markets. Furthermore, the Government through The Reserve Bank of Zimbabwe confiscated much of the foreign currency from various organization the was banked at the Central bank.

7.1 Overall GDP Growth

GDP growth declined by -14.7% in 2008 compared -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.

7.2 Per Capita Income

Economic and political instability in Zimbabwe has led to a free fall of GDP, 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 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.

8.0 MACROECONOMIC POLICY REFORMS and PROGRAMMES

Zimbabwe did not institute programmes 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 (BACOSSI) facility and the farm mechanization programme. This programme, however, led to increased money supply which weighed heavily on inflation causing it to reach astronomical levels in 2007 and 2008. The programme 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 individual benefitting from the schemes. Above all, the policy was ill-conceive and riddled with political patronage. 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.

9.0 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. 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. 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 across economies.

9.1 Regulation

Central banks need to give consideration to changing 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. [4]Due attention should be paid to the stability of the financial system, and its interactions with macroeconomic trends. Volatility in the financial market should be averted as quickly as possible before the effect

[4] Joseph E. Stiglitz(2008) Towards A New Global Economic Compact Principles for Addressing the Current Global Financial Crisis and Beyond

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 II. Central banks should concentrate on performing their core duties such as the lender of last resort.

[5]Usually a financial crisis results in tightening of formal credit as well as also 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. 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.

9.2 Debt management

Zimbabwe is faced with a debt crisis.[6] By April 2010 the debt stood at 5, 8 billion USD with over 3 billion USD already in arrears. 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 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.[7] 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 % of GDP (ie, 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).
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

[5] Lessons from World Bank Research on Financial Crises (2008)

[6] RBZ statistical bulletin (2010)
[7] www.economist.com/blogs/graphicdetail/2012/04/daily-chart-11

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 g 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, ∏. 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 - ∏ - 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.

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.

9.3 Governance

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 with in or externally. Zimbabwe requires strong governance institutions that respect property and intellectual rights. 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.

9.4 Preparedness

Developing countries have lacked preparedness in averting possibility of a national, regional and global financial crisis. This is mainly because the do not have efficient data collecting institution. [8]An important part of crisis preparedness is having made the investments in data and evaluative research (both quantitative and qualitative) that are needed to have a reasonable idea of which public programs will need to be protected at a time of crisis, naturally that investment brings benefits for policy making at normal times.

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 needs to be done in tracking commodities prices to ascertain their impact on individual, firms and national income.

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 need for a diverse investment in import substitution. Over reliance on exports should be reversed in order to avoid effects of global shocks.

10.0 CONCLUSION

The impact of the global financial crisis manifested through falling commodity prices that led to low return on exports in Zimbabwe as well as other developing countries. Low revenue from exports reduced the marginal propensity to import. It also curtails 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 global financial crisis. Zimbabwe should embark on import substitution as well as widening the export base. There is 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.

[8] Amin and Goldstein (2008).

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APPENDIX A

All Graphs are from RBZ Statistical Bulletin (2009)

Figure 1

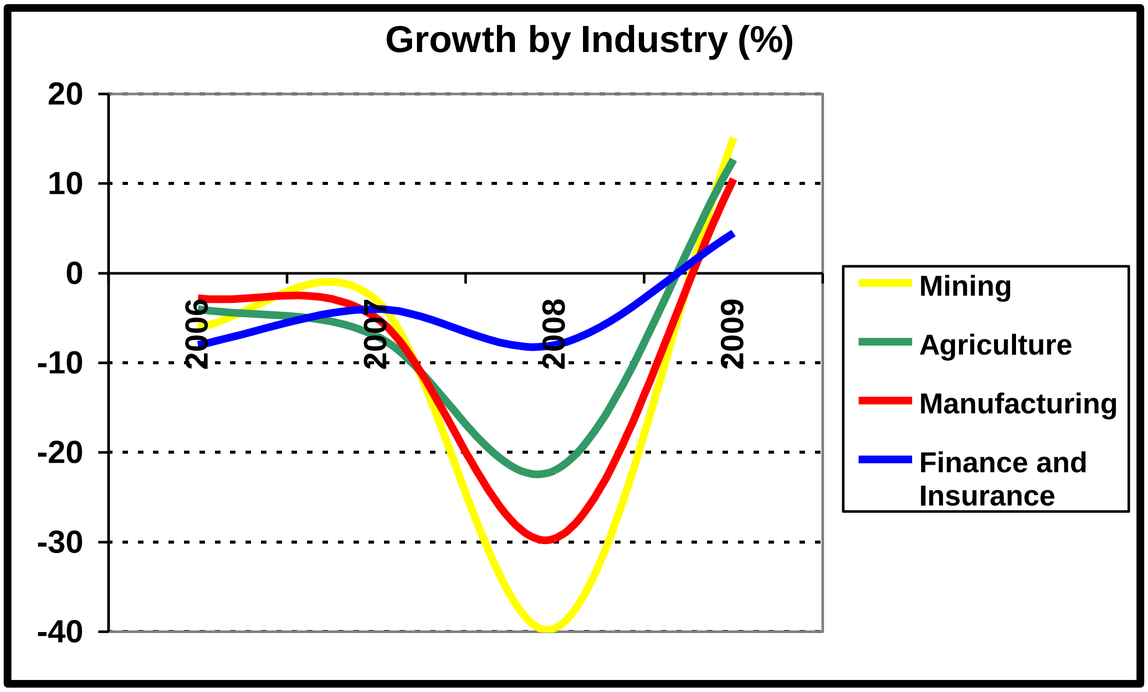

Figure 2: Platinum Prices

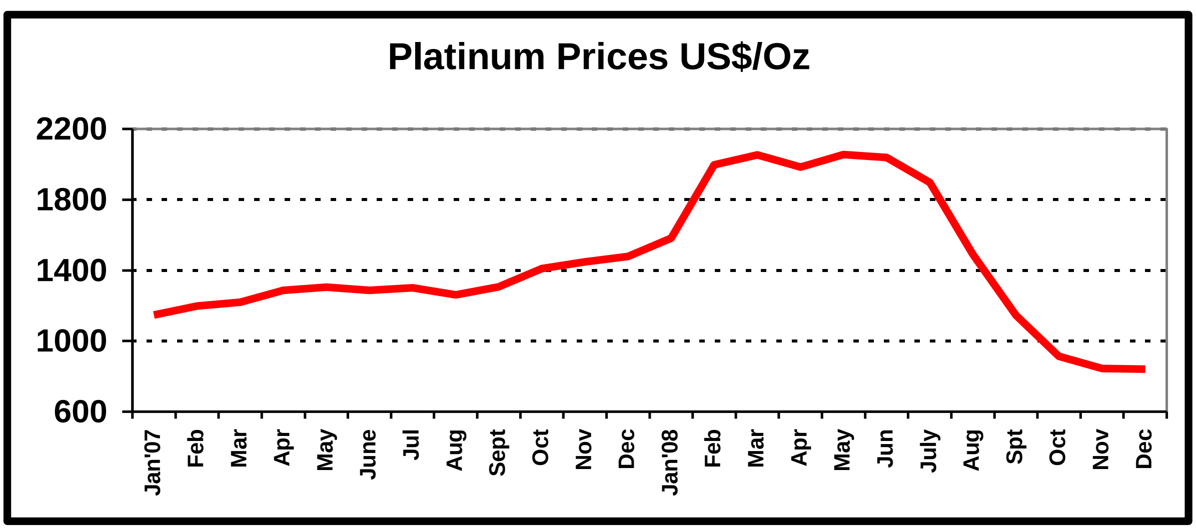

Figure 3: Nickel prices

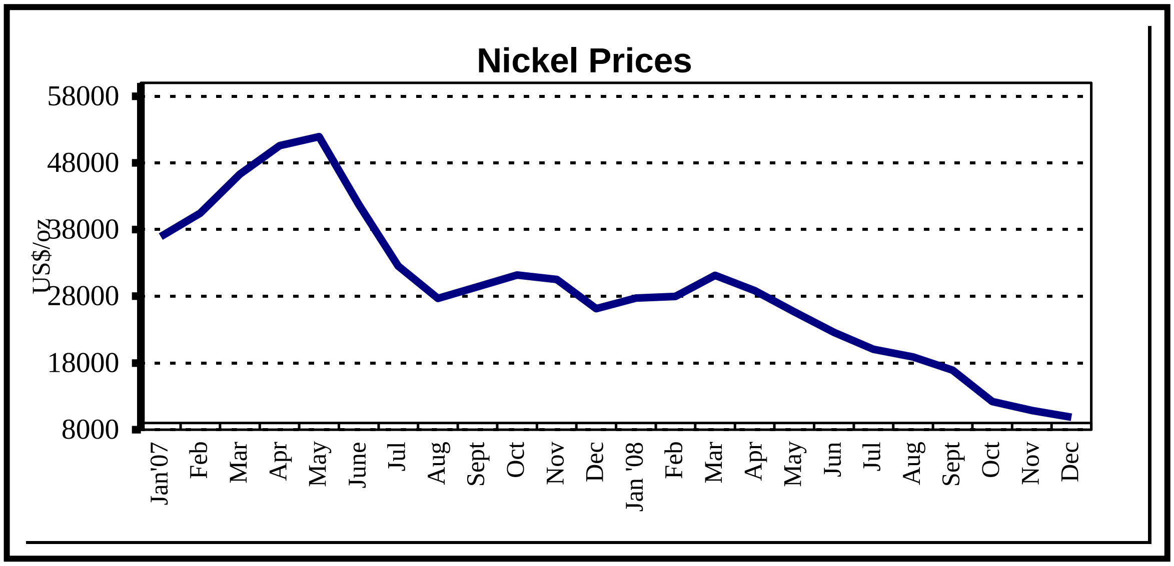

Figure 4

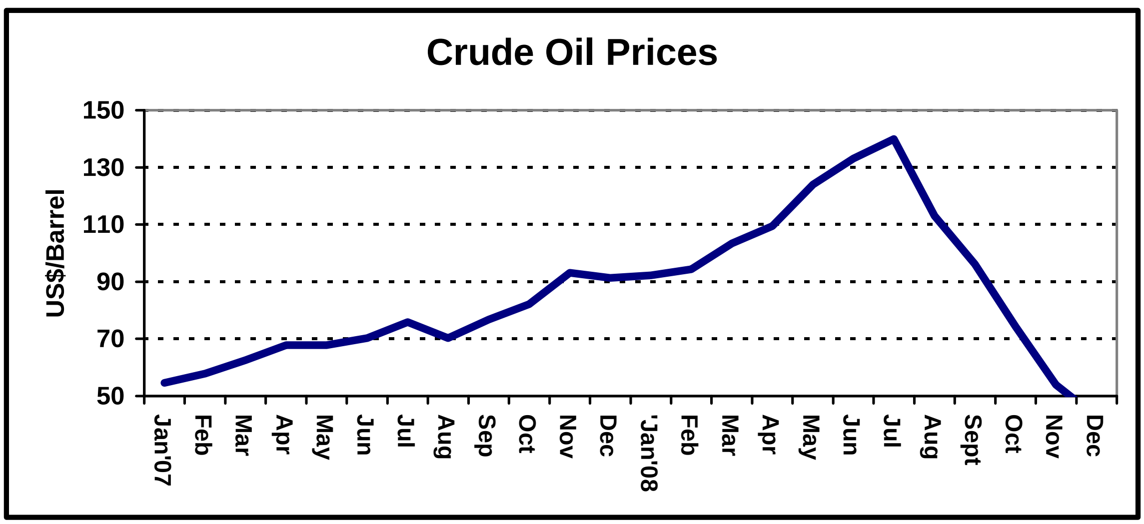

Figure 5

Figure 6

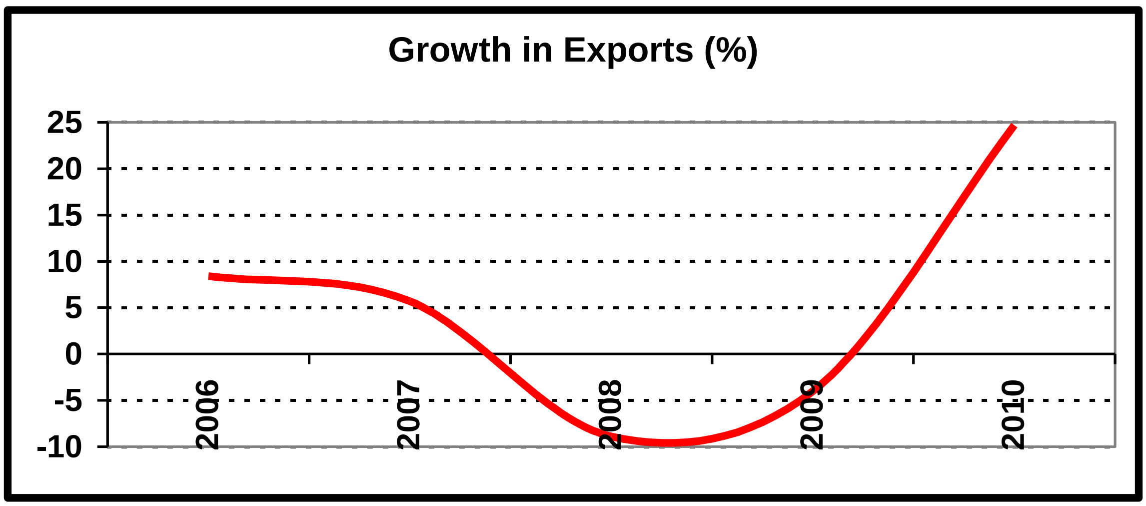

Figure 7

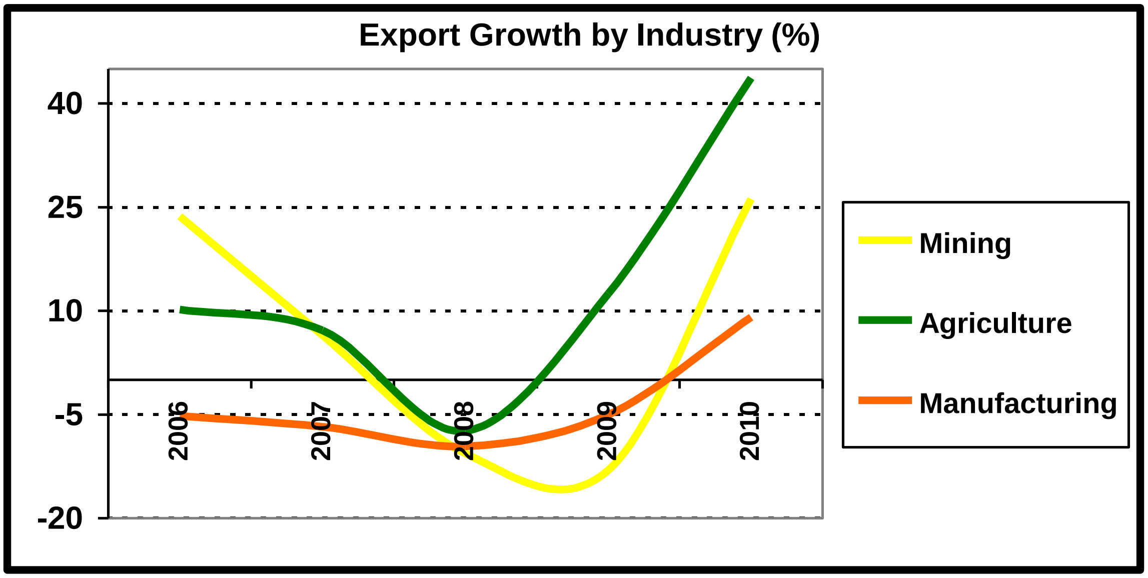

Figure 8

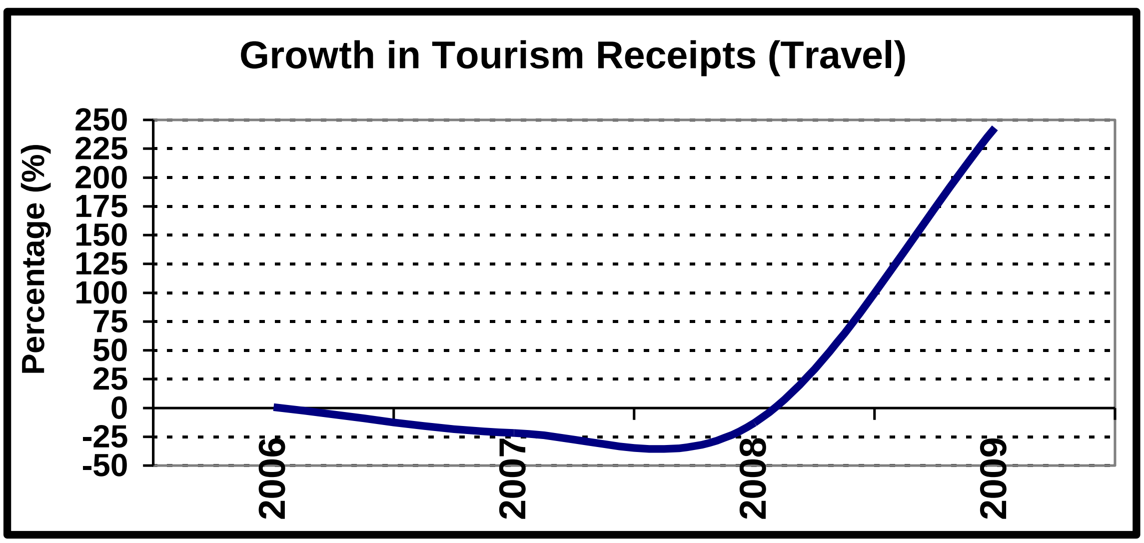

Figure 9

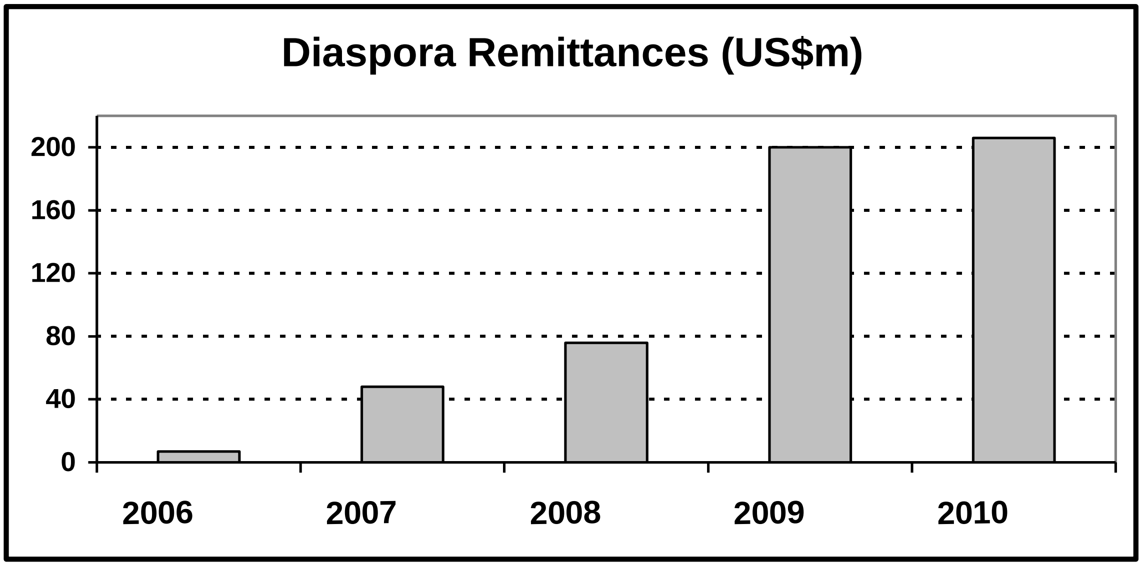

Figure 10

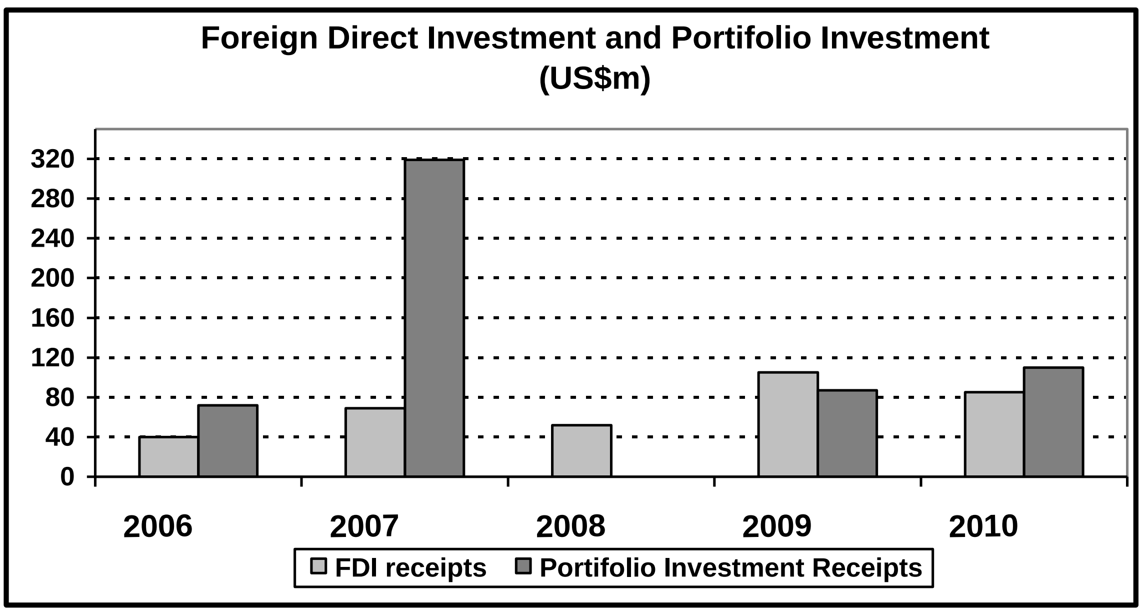

Figure 11