Life Offices Association of Zimbabwe

Demystifying Insurance Part 17

Welcome to part seventeen of Demystifying Insurance, a continuation of the Life Offices Association (LOA)'s ongoing National drive to make insurance easily understood by all. This week, we begin the story of Zimbabwe's harrowing descent into hyperinflation.

In last week's article, we examined the various pillars that support a country's currency. Today, we explore how those pillars were toppled in late 1990s Zimbabwe.

Causes of hyperinflation: The Zimbabwean story
Hyperinflation is widely defined as beginning in the month when the rise in price exceeds 50% — and ending when the monthly inflation rate drops below 50% and stays that way for at least a year. Following this definition, Zimbabwe entered the hyperinflationary trend in February 1999, when month-on-month inflation reached 50.54% and year-on-year 2,200% in March 2007.

Contributory factors
A number of factors contributed to the hyperinflationary trend. In 1997 the government announced that approximately 60,000 veterans of the liberation war would each receive, as compensation for participating in the war, an immediate lump sum of ZW$50,000 (roughly equal to US$3,000) plus a monthly pension roughly equal to US$125.

The payments, which equaled around 3% of Gross Domestic Product, had not been budgeted for in the original 1997 budget and had the effect of increasing the budget by 55% against the 1996 budget.

World Bank suspension
A month after the government's announcement, the World Bank suspended Zimbabwe's standing line of credit. The Bank requested that government demonstrate that the payments would not result in a budget deficit higher than 8.9%, projected for the 18 month period to December 2008 as a precondition for lifting the suspension.

As there were no funds specifically earmarked for the payments to the war veterans, investor panic ensued amid escalating concerns about the fiscal position of the Zimbabwean economy. Such concerns were exacerbated by the uncertainty created by the government's land reform programme, the costs of which were also not budgeted for.

Black Friday
Foreign investors began to pull their money out of Zimbabwe resulting in crashes in both the money market and the capital markets, and a severe depletion of The Reserve Bank of Zimbabwe (RBZ)'s foreign currency reserves. The culmination of the economic turmoil was the total crash of the Zimbabwe dollar on 14 November 1997—a day Zimbabweans dubbed 'Black Friday'—when the local dollar lost 75% of its value against the United States dollar.

Money printing
The government had very few options for raising money to meet its obligations and promises. Borrowing domestically and abroad, or running down foreign currency reserves, would not raise much money. As a result, the government turned to the one viable option available to it: printing money.

In addition to the payments to war veterans and the costs of the land reform programme, the government needed money to meet the costs of Zimbabwe's intervention in the war in the Democratic Republic of Congo (beginning in 2000), to fund parliamentary (2000/2005) and presidential (2002) elections, and to fund a new branch of government—the 66-member senate.

So starting in 1997, the RBZ began a massive money printing operation. As inflation, and later hyperinflation soared, the bank could not print money faster than the rate at which it was losing value.

Foreign currency shortages
Another important factor of production costs for the country has been imported raw materials. Given the severe shortages of foreign currency to import necessary raw materials and inputs since 2000 (due to, and not limited to, decline of exports, closed donor community, dried-up foreign currency reserves and reduced financial aid from the International Monetary Fund and the World Bank), most companies and individuals resorted to sourcing foreign currency from the black market at relatively punitive rates.

As such, these costs were recovered by passing on the burden to consumers in the form of higher prices.

Reduced production in industry
The country suffered from two serious droughts in 1992 and 1995, which negatively affected agriculture, Zimbabwe's primary economic industry.

The impact on agriculture was further worsened by a production slowdown caused by the land reform programme. This decline in agricultural production also negatively affected the manufacturing sector, which was mainly agriculture based.

Shortages of basic commodities such as mealie-meal, cooking oil, flour, fuel and sugar resulted in an increase in overall prices.

Effect of price controls
The price controls that were put in place in a bid to curb inflation only worsened the situation. Controlled prices were often below production costs, forcing many companies to close, contributing to a decline in employment in the formal sector and driving up prices in the informal market sector.

Fighting back
Time magazine reported at the end of last year (Africa Rising, 3 December 2012), that Sub-Saharan Africa has the second fastest growing regional economy in the world—pronouncing the continent 'the world's next economic powerhouse'.

As the wheel of industry begins to turn again for local manufacturers and investor confidence continues to grow unabated, there are clear signs that Zimbabwe is moving from economic bust to boom.

Thank you for reading today's article and be sure to join us again next week as we continue to explore hyperinflation in Zimbabwe.

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