Demystifying Insurance Part 18

Welcome to part eighteen 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 continue the story of Zimbabwe's descent into hyperinflation.

In the previous article we explored how events including two serious droughts, non-budgeted compensation for war veterans and conflict in the Democratic Republic of Congo began to eat away at the foundations of Zimbabwe's economy. We rejoin *Causes of Hyperinflation: The Zimbabwe Story* as the exodus of foreign investors begins to exert real pressure on the country's currency.

Withdrawal of foreign investors

In the panic resulting from the suspension of the World Bank's line of credit, foreign investors began pulling their investments out of Zimbabwe. In order to repatriate their funds, these investors needed foreign currency. Naturally, some investors purchased foreign currency using their Zimbabwean dollar proceeds.

Furthermore, fewer new foreign investors were injecting new funds. These two factors contributed to a net outward flow of hard currencies from investors, exerting a downward pressure on the value of the local currency.

Decline in exports and increase in imports

Around the same time, a plethora of problems hit the agricultural sector, including droughts, livestock diseases (such as foot-and-mouth) and a transformational period for new start-up farmers adjusting to the land redistribution exercise.

These problems either resulted in reduced quantity of output (caused by drought and land reform in particular), poor quality farm produce or a cancellation of export contracts, such as for beef following the foot-and-mouth outbreak.

The shortage in local food products resulted in sharp rises in their prices and consequently inflation. Looking at the wider picture, exports of agricultural produce declined and Zimbabwe became a net importer of food and hence a net foreign currency outflow. The repeated purchase of foreign currency — needed to import food and other basic commodities — further weakened the Zimbabwe dollar. As the dollar got weaker, the cost of imports climbed, resulting in an increase in inflation.

Decline in tourism

Political upheavals, especially during elections, combined with negative publicity propagated by overseas governments, added to the problems that were besetting the economy. Resulting from this was a decline in the number of tourists coming into the country, which in turn led to a fall in tourism-related foreign currency inflows.

Closure of industries

Many industries closed as they could not access working capital, especially in the form of foreign currency to import raw materials. This reduced the workforce and hence the demand on other products, consequently resulting in a closure of companies due to the falling customer base. As companies collapsed, an inward-spinning spiral of destruction began to penetrate deep into industry, while increasing the demand for goods and services by the then unemployed masses.

Closure of industries meant increased imports of basic commodities such as medicines. This resulted in an increase in the demand for foreign currency. Most companies and individuals resorted to sourcing the foreign currency on the black market at relatively punitive rates.

These costs were recovered by passing on the burden to consumers in the form of higher prices. Some of these consumers were the black market foreign exchange traders, who would then pass back the cost to purchasers of hard currency by increasing its value relative to the Zimbabwe dollar.

This also caused the value of the Zimbabwean dollar to further decline, resulting in another inward-spinning spiral as suppliers of goods and black market foreign exchange traders passed an increasing cost to each other.

Emigration

As industries closed and unemployment mounted, a large exodus of skilled but jobless workers followed. This meant an increase in the purchase of foreign currency needed to relocate, from airline tickets to visa charges. The repeated use of foreign currency for such purposes contributed to reducing the value of the Zimbabwean dollar. On the positive side, some of those who emigrated sent money into the country which helped to sustain the population.

Balance of payments

Having very little foreign currency trickling into the government coffers due to the problems just outlined — and with the World Bank and IMF's line of credit shut — the government then failed to raise enough money to meet its balance of payment obligations.

Government then resorted to printing money and purchasing foreign currency wherever it could. This resulted in a massive fall in the value of the Zimbabwean dollar and contributed to rise of hyperinflation.

Conclusion

The factors listed above outline the events that speeded up inflation, toppled the key pillars holding up the Zimbabwean currency and ushered in a period of hyperinflation.

Thank you for reading today's article and be sure to join us next week as we examine the effect of hyperinflation on Zimbabwe's citizens.

The Life Offices Association of Zimbabwe

4 Josiah Tongogara Ave
Tel: +263 4 29 33 655-6 / 0712339305 / 0713033519