Demystifying Insurance Part 27

Welcome to part Twenty Seven of Demystifying Insurance, a continuation of the Life Offices Association (LOA)'s ongoing National drive to make insurance easily understood by all. Today's article tackles some of the questions that are often raised about life insurance in relation to hyperinflation.

In this week's article on the causes and effects of hyperinflation, we are going to look at possible questions raised by policyholders and pensioners about hyperinflation and the currency conversion of their values.

Is Zimbabwe's hyperinflation experience unique?
Zimbabwe is not the only country to experience hyperinflation. Thirty-two countries have experienced this phenomenon over the past 100 years. However, Zimbabwe was the first country to experience hyperinflation in the twenty-first century.

What caused hyperinflation in Zimbabwe?
There were various contributing factors as discussed in earlier articles, but fundamentally all such factors led to the withdrawal of foreign direct investment resulting in the collapse of the value of the local currency.

This collapse made imports more expensive, pushing up prices of local produce. In addition, the subsequent closure of various entities in the chain of production caused shortages. The ensuing shortage both of goods and foreign currency led to the emergence of the black market and speculative trading, which became major hyperinflation-accelerating factors.

Just how bad did hyperinflation get in Zimbabwe?
During the worst of the hyperinflation period, while no official inflation information was released, some economists estimate that month-on-month inflation rose as high as 79.7 billion percent. In this scenario, a car priced at 10 thousand dollars at the beginning of the month would be priced at about 8 trillion dollars by month end.

How did hyperinflation erode the value of assets?
Using policyholder funds, insurers purchased growth-type assets such as shares and property that delivered some value to our clients. However 30% of contributions and premiums were used to purchase prescribed assets (mainly government bonds).

With the exception of the prescribed assets, the assets held tend to be a good hedge against inflation but not against hyperinflation. Insurers could not fully protect their policyholders and pensioners against the decline in value caused by the economic meltdown during the hyperinflation period.

No assets can fully protect against hyperinflation. The reason for this is that the value of equities is derived from the company's ability to make profits. During the hyperinflation period, cash inflows from sales lost value before restocking or recapitalisation causing companies to make massive losses and consequently, some of them to close down.

As a result, the value of the shares held by insurers declined. The value of property is derived from the rental income expected to be received throughout its lifetime, which in turn is used to pay out benefits. Due to voids arising from the closure of many companies that rented premises, and the inability of other tenants to pay appropriate levels of rentals, the value derived from property fell.

Also the value of prescribed assets, such as fixed interest bonds, was wiped out since (as the name indicates) income and capital values do not increase in line with inflation. All these factors lead to a loss of value in the asset holdings of insurers. This left a smaller pot of assets to be shared amongst the same number of policyholders and pensioners resulting in a smaller share for each of them.

Conclusion
We have explored just some of the questions that individuals may have had concerning hyperinflation and the currency conversion process.

Join us next week for the concluding chapter on the cause and effect of hyperinflation, as we question the process that determined the values of policyholder funds.

The Life Offices Association of Zimbabwe
4 Josiah Tongogara Ave
Tel: +263 4 29 33 655-6 / 0712339305 / 0713033519
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