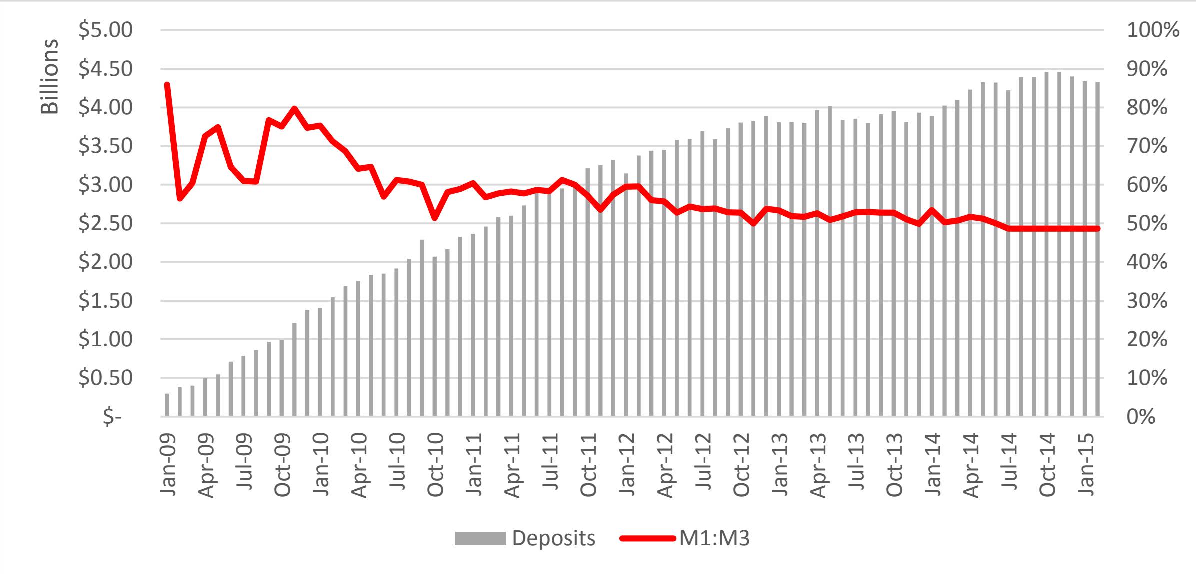
16 April 2015

Zimbabwe equity markets feeling the effects of economic malaise.

Academics and market practitioners alike often agree that in the long run a country's equity market tends to reflect the broader macroeconomic conditions of that particular nation. When Zimbabwe formally dollarized the economy early 2009, the economy and the stock market soared. Between 2009 and 2012 real GDP growth averaged 10.5% per annum and in like fashion the equity market went up by an annual average of 13%.

The euphoria quickly wore off as the poor macroeconomic conditions became apparent. As can be seen from the chart below, deposit accumulation has been slowing down. More worrying is the fact that the bulk of the deposits have remained relatively short-term in nature. In part this is indicative of the lack of trust in the banking system which has resulted in more and more people choosing to use informal channels to manage and move their money. It is currently estimated that over $3 billion circulates outside the formal banking system.

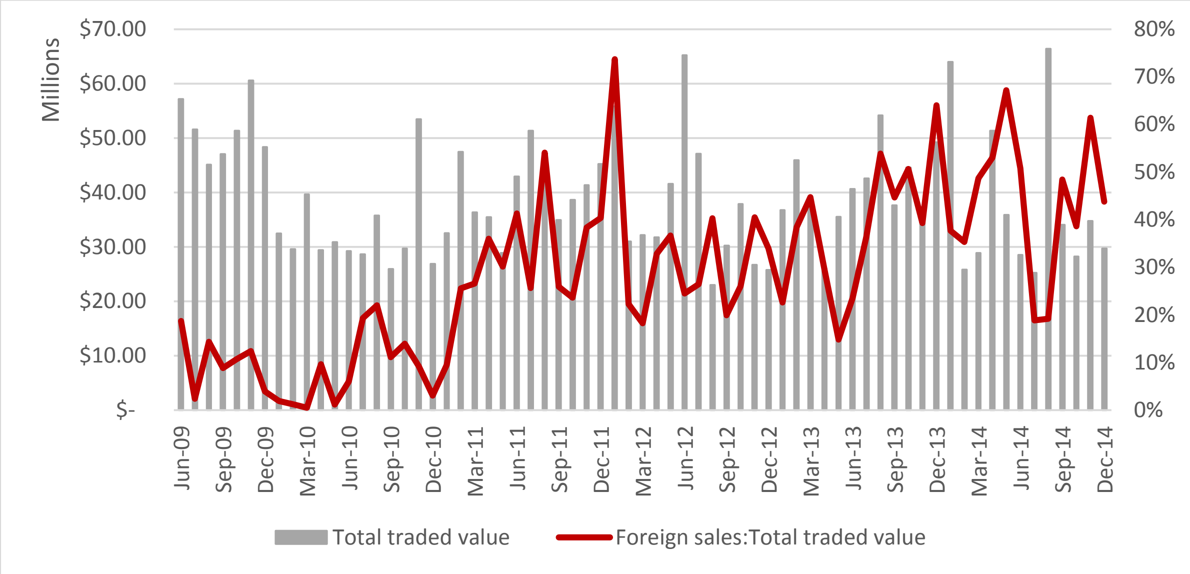


Data source: Reserve Bank of Zimbabwe, Zimstats

Post-dollarization firms were left with the need to modernize their equipment in order to compete with increasing imports from South Africa and China. As the demand for loanable funds increased relative to supply, interest rates have been rising astronomically. Corporates are therefore left with no choice but to borrow at rates that are close to 15% per annum. Very few businesses can afford to borrow at such rates especially in US dollars. Such increases in the cost of capital mean that local industry is unable to compete with relatively cheap imports. As a result it is estimated that since 2011, more than 4500 companies have shut down adding over 50 000 workers to the unemployment line.

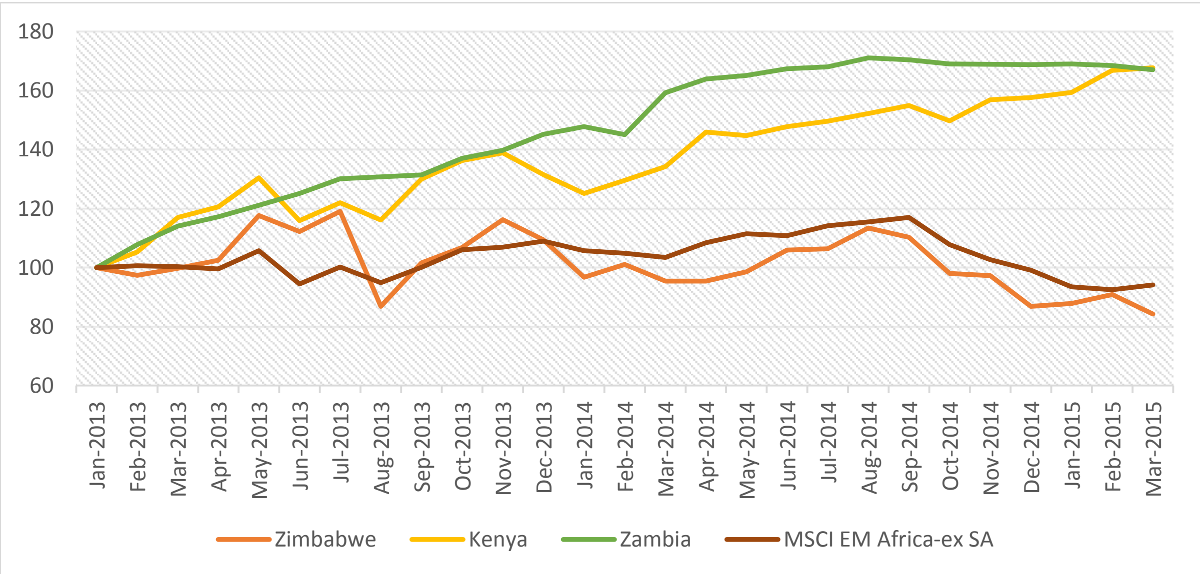
Listed companies have felt this pinch and we have seen 15 companies delisted from the local bourse since dollarization and by all indications, this number is set to grow.

The culmination of these conditions has resulted in the equity market taking a severe knock, especially from foreign institutional investors who had been strong buyers between 2009 and 2012 and who have now turned net-sellers.



Data source: Imara Edwards Securities.

As the chart above shows, the share of foreign sales relative to the total value traded has been on the rise which is indicative of the fact that foreigners are selling Zimbabwean stocks in favour of other African Frontier markets.



Data source: CapitalIQ

The reality is that Zimbabwe is losing momentum at a time when neighbouring nations are taking advantage of foreign investors hunting for yield. Across the continent many economies are seeking to enter the Eurobond market and most new issues are oversubscribed, while their markets continue to tick up. When the Fed eventually pulls the trigger and raises interest rates, many emerging and frontier markets are likely to feel the effects of capital outflows and, given the current downward trajectory, holders of Zimbabwe equities may have to brace themselves for more pain.

Comment piece by the Macroeconomic strategy team at Atria Africa, an asset management and corporate advisory firm, focused on Sub-Saharan Africa.

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