

National University of Science and Technology Zimbabwe



DISSERTATION

**ZIMBABWE IS FINANCIALLY DOLLARISED: DOES THIS MEAN AN END
TO FINANCIAL INSTABILITY?**

KATERERE GERALD GEORGE

P007 4203B

**IN PARTIAL FULFILLMENT FOR MSc. IN FINANCE & INVESTMENTS
DEGREE**

SUPERVISOR: A. MUZVUWE

BULAWAYO, ZIMBABWE

LIBRARY		
NATIONAL UNIVERSITY OF SCIENCE AND TECHNOLOGY		
P.O. BOX 246 BULAWAYO ZIMBABWE		
DATE	ACCESSION	CLASS No.

2009

ABSTRACT

This paper studied dollarisation and financial instability experienced by Zimbabwe from the year 1999 to 2008 (a ten year period) with hyperinflation, volatile exchange rates, declining real economic growth, shortage of foreign currency and undermined confidence in the financial sector, marking the hallmark of the financial meltdown. The last official recorded inflation was 231 million percent in July 2008, with the Hanke Hyperinflation Index for Zimbabwe (HHIZ) estimation of an astronomical 89.7 sextillion percentage by November 2008. In this regard, the paper was anchored upon investigating the following objectives: investigating dollarisation; evaluating the link between dollarisation and financial stability; investigating performance of the central bank and identifying the appropriate de dollarisation strategy for Zimbabwe.

Exploratory methodology utilized qualitative and quantitative methods drawn from secondary economic data and complemented by interviews with knowledgeable individuals. The analysis was therefore hinged upon a statistical analysis of relationships using the Pearson Correlation coefficient between dollarisation and various economic indicators and a hypothesis testing on the aforementioned relationship of stability and dollarisation. The findings of the investigation suggested that economic agents shunned the local currency in favor of stable and alternative foreign currencies, chiefly because the local currency failed to meet the basic functions of money. This led to loss of confidence in the local unit, resulting in currency and or asset substitution - a gradual

process starting off with unofficial dollarisation and full dollarisation as stated in the January 2009 National Budget.

The paper adopted deposit dollarisation as a measure of financial dollarisation (ratio of foreign currency deposits to total deposits or M3 in the banking sector). The paper concluded that ignoring foreign currency in circulation outside the banking sector seriously undermined dollarisation in Zimbabwe, given the extent of the informal market. A weak inverse Pearson correlation relationship with economic fundamentals suggested dollarisation improved stability albeit in suppressed magnitude– thus accepting the Null Hypothesis. The operational capacity of the RBZ has been greatly curtailed as indicated by the undercapitalization of the central bank and its failure to administer the function of lender of last resort. Financial dollarisation increases the chance of financial fragility in the absence of lender of last resort, let alone a fund set out solely to insure market liquidity. It is extremely difficult for the central bank and the government to sustain dollarisation in the absence of international assistance and foreign currency reserves. The paper recommended for policies that promote confidence building, consistent policy making and improvement in the financial sector.