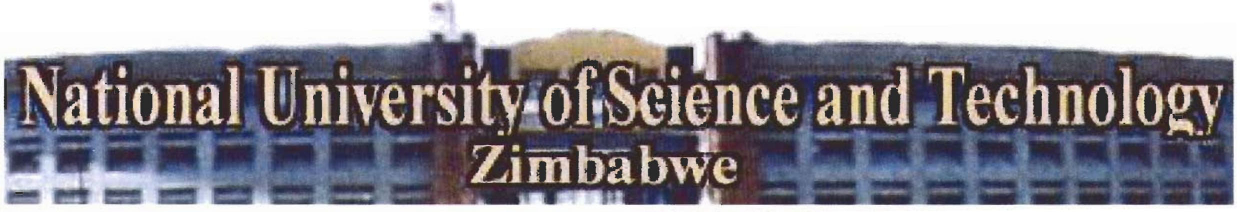

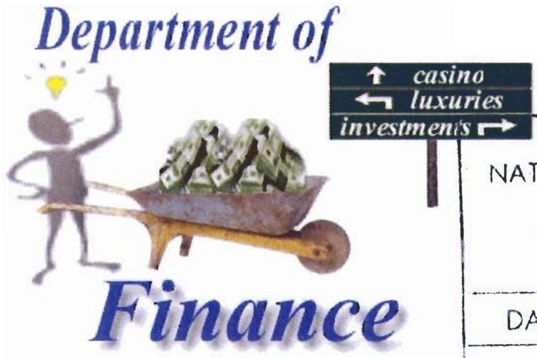

AN ECONOMETRIC ANALYSIS OF THE RELEVANCE AND RELATIONSHIP BETWEEN EMERGING STOCK MARKETS AND REAL ECONOMIC PERFORMANCE: THE CASE OF THE ZIMBABWE STOCK EXCHANGE

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EXECUTIVE SUMMARY

This study was prompted by the paradox being observed in Zimbabwe that whilst the general economy is on the decline, ZSE activities have remained bullish over the study period seemingly contradicting financial theory. Against the background of economic meltdown and financial turmoil, the period 2000-2008 has seen the Zimbabwe stock exchange capitalization (as measured in the local currency, Z$) mushrooming to highs not yet recorded in the trading history of the stock exchange, a phenomenon referred by Gono (2008) as "irrational exuberance." The study was carried to evaluate the significance of the primary market of the stock exchange in discharging its duties of raising capital for production. This research sought to address the question of whether the Zimbabwe Stock Exchange is effective in playing its major developmental role of mobilizing and allocating scarce capital resources for economic growth in context of Zimbabwe.

Furthermore the paper also aimed to examine whether the envisaged relationship between stock market growth and real economic activity holds in Zimbabwe using formal test of causality developed by C. J Granger (1969) and yearly Zimbabwean data for the period 1990-2006. The relationship between economic growth and stock market performance was set in a multiple regression model in which economic growth as proxied by %gdp was regressed against three measures of stock market development which are turnover ratio (liquidity), market capitalization ratio (size) and percentage change in listed companies (financial deepening).

The major finding from this research is that companies in Zimbabwe place little reliance on the stock market as a source of capital for growth. Listed companies in Zimbabwe resort to equity finance through the stock exchange infrequently, with the result that very little of the growth of assets of Zimbabwean companies have been financed through the exchange. Resultantly, the contribution of the stock exchange to financing of gross capital formation and savings mobilization has been low implying that the growth of investment, industry and the economy has not been much dependent on the primary market activity of the ZSE. The regression results, which

were obtained using the Ordinary Least Square (OLS), show that measures of stock market development are positively correlated with GDP growth for the period 1990 to 2006.
Although the relationship reported is statistically significant, it is weak highlighting the ineffectiveness of the stock market in raising capital, inefficient allocation of resources, lack of liquidity and failure to attract foreign savings. Despite the dismal performance of the primary market in mobilizing resources our findings suggested that there is a long run relationship stock market development and economic growth in Zimbabwe. The results are vigorous and robust and indicate that stock market development is an important wheel for economic growth. The Granger causality test confirms the bi-directional causality between stock market development and economic growth in case of Zimbabwe over the study period 1990-2006.

The major implication of the findings is that if the Zimbabwe Stock Exchange is to significantly contribute to rapid economic growth, policies must be fashioned out to eliminate those factors that blur the effectiveness of the vehicle or transmission mechanism through which stock market activities influence economic growth. Based on the findings, it was recommended that there should be an improvement in the attractiveness of the market as a major source of raising capital through developing a second tier market for the small-medium enterprises. Improvements in the financial infrastructure, deregulation of pricing of shares, development of a bond market, more efficient share transfer and delivering system and provision of adequate and timely information on the market are also considered. Also, there should be improvement in the regulation, supervision and surveillance of the operation of the stock market such that a balance is maintained between the soundness and safety of the market.