Causes of Liquidity Crisis in Zimbabwe after the Adoption of the Multicurrency in 2009

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Abstract:-**The study examined the real causes of the liquidity crisis in the banking sector since the introduction of the multicurrency in Zimbabwe. The liquidity crisis continued to harm string the Zimbabwean economy despite the growth in the aggregate money supply (M3) from US$300 million in 2009, following the adoption of the use of multicurrency. During the period under review, the economy registered a peak of 11.9% growth in 2011. However, despite high economic growth rates, banks still failed to supply cheap loans to the productive sectors, a significant indicator of the liquidity crisis. This was worsened by the shortage of cash in 2016. The investigation on the real causes of liquidity crisis adopted a qualitative research method. Data was collected using in-depth interviews. The research concluded that liquidity crisis in Zimbabwe was caused by poor performance of the external sector, mainly the net exports, foreign direct investment, portfolio investment, diaspora remittances as well as foreign borrowing. Failure by the Reserve Bank of Zimbabwe to provide the lender of last resort function, the growing informal sector were also considered to have had a negative impact on the liquidityin the country. To improve the liquidity in the country, the study recommended that the government revert back to the principle of cash budgeting and that there should be an increase in production of local products which should be exported.**

Key Words: **Liquidity Crisis; Multi-Currency Regime; Cash Crisis**

I. INTRODUCTION

Zimbabwe is facing an acute shortage of cash, which has been characterized by long queues in every bank. Financial institutions have not been able to avail cheap long term loans to the productive sectors, suggesting that the country is facing a liquidity crisis. According to Chagwiza (2014), the Reserve Bank of Zimbabwe re-emphasized the need for liquidity, after the 2003 to 2004 liquidity crisis. Therefore, liquidity became very important for the functioning of financial markets and the banking sector. Mkhitaryan (2014) indicated that economic development and growth depends to a large extent on a well-functioning, stable and sound managed banking sector.

II. BACKGROUND TO THE STUDY

During the hyper inflationary period, a total of six banks were put under curatorship before their licenses' were withdrawn by the Reserve Bank of Zimbabwe. The banking sector in Zimbabwe is composed of 14 operating commercial banks, 4 deposit taking microfinance and 164 credit non deposit taking micro-finance. The financial sector is regarded as a well-developed due to constant supervision by the reserve bank. Liquidity challenges are not a new phenomenon to the Zimbabwean economy. In 2003, 2007 to 2009 the country experienced the same challenges. During this time, the country faced liquidity challenges which led to long queues at the banks as some banks failed to pay depositors on time. Economic growth declined as a result of many factors with the liquidity crisis being a prominent causal factor of that decline. This led to an erosion of the Gross Domestic Product (GDP) by nearly 40% (ZEPARU, 2012).

The January 2009 National Budget legalized the use of a basket of multiple currencies as a medium of exchange, and subsequently in February, the Zimbabwean dollar was demonetized. Five currencies were granted official status: The United States Dollar, the South African Rand, the Botswana Pula, the British pound and the Euro. According to the RBZ Report (2016), the use of the United States Dollar rose from 49% in 2009 to 95% in 2016. Despite moving away from the Zimbabwean dollar as a way of improving liquidity, it appears that the cash crisis has even worsened as at June 2016. According to the RBZ Report (2016), the composition of deposits as at June 2016 indicated that demand deposits constituted 50.75%, interbank deposits 12.5%, time deposits 22.33%, savings deposits 5.8%, foreign deposits 5.2% and other deposits 3.37%. this composition of deposits, which is short term in nature, does not allow for long term borrowing, which resulted in shortage of capital for the manufacturing companies to borrow from.

The current cash crisis in Zimbabwe started around December 2015 when queues started forming outside the banking halls, while other banks placed moderate withdrawal limits. The broad money supply (M3) weakened in December 2015, creating shortages of cash in circulation. The Reserve Bank of Zimbabwe attributed the cash shortage to leakages, compounded by declining injections into the banking system as people preferred to keep the US Dollar under their mattresses. Following a realization that the banking sector had been hit by cash shortages, there was a run on banks as people scampered to withdraw their money, suggesting proffered by the Reserve Bank of Zimbabwe as the causes of the liquidity crisis were superficial.

During the second quarter of 2016, banks started to run out of cash, and withdrawal limits were introduced. The cash shortages were largely as a result of the macroeconomic challenges that were facing the country. In a move to reduce the liquidity crisis in the country, the Reserve Bank of Zimbabwe introduced the bond notes. The bond notes faced resistance as the general public and the business community saw this move as the re-introduction of the Zimbabwean dollar. People began to withdraw their cash balances from the banks. Hence, this study sort to investigate the actual causes of the liquidity crisis in Zimbabwe in order to explore strategies which needs to be implemented to bring sanity in the banking sector.

III. STATEMENT OF THE PROBLEM

The liquidity crisis continues to harm string the economy despite the growth in the aggregate money supply (M3) from US$ 300 million in 2009 to US$ 6.5 billion in 2016. The country's financial sector indicators such as the total deposits, core capital, net profits, capital adequacy and liquidity ratios have been increasing since the adoption of the multicurrency system. Furthermore, the banking sector average prudential liquidity ratio of 52.47% as at 30 June 2016 was above the minimum requirement of 30%, suggesting that the sector was highly liquid (RBZ, 2016). However, despite these notable developments, there is still deterioration in cash position of the country.

IV. RESEARCH QUESTIONS

The study was guided by the following questions:

- What are the causes of liquidity crisis in Zimbabwe since the adoption of the multicurrency?
- What are the challenges faced by the reserve bank of Zimbabwe in addressing the liquidity crisis in Zimbabwe?
- What strategies should be applied to address the liquidity crisis in Zimbabwe?

V. REVIEW OF RELATED LITERATURE

In a dollarized economy, liquidity is a function of exports, imports, remittances, external loans, foreign direct investment and fiscal deficit (Zinhumwe, 2017).According to the RBZ (2016), the function of liquidity is defined as:

Liquidity = f (Exports – Imports + Remittances + External Loans + Foreign Direct Investment – Fiscal Deficit)

Illiquidity is a national problem associated with markets in developing countries because of limited access to world capital markets. Barnejee and Mio (2017) pointed out that during the international financial crisis which started in mid-2007, liquidity in short-term money markets dried up and banks suffered severe funding problems. Empirical evidence suggests that there is a link between banking crisis and currency crisis (Allen and Gole, 2000). According to Allen and Gole (2000), the major causal factor of a liquidity crisis is a weak economy. Chikoko (2013) observed that a rise in non-performing loans increased liquidity risk and hence leads to liquidity crisis. Other researchers identified flawed government policies as an explanation for currency crisis (Allen and Gole, 2000; Food and Marion, 1998). In Zimbabwe, liquidity crisis has been attributed to a widening trade deficit (Mugano, 2016).

The current study sort to determine the causes of the liquidity challenges in Zimbabwe during the period 2009 to 2017 with a view to suggest strategies that should be implemented to address the crisis in the country.

VI. METHODOLOGY

The study adopted a qualitative research methodology in order to understand the participants' thoughts, feelings and viewpoints on the causes of the liquidity challenges in Zimbabwe (Creswell, 2013; Marshall and Rossman, 2011). Qualitative research methodology allowed the researcher to use interviews and open-ended questionnaires to generate suitable data from a small size for this research (Creswell, 2014; Marshall and Rossman, 2011; Creswell, 2009). The qualitative research methodology also enabled the generation of a lot of data relating to the genuine concerns and viewpoints on the causes of the liquidity challenges affecting Zimbabwe.

An interpretivism research paradigm was adopted because the study was influenced by the fact that reality is socially constructed and fluid (Cohen and Cradtree, 2006). Hence, the interpretivism research paradigm enabled the researcher to have an access to reality on the causes of the liquidity challenges faced by Zimbabwe through social construction (Cohen and Cradtree, 2006). The interpretivism paradigm was significant to this study because it helped the researcher to understand and interpret the reality from human experiences on the causes of the liquidity challenges in Zimbabwe.

A case study research design was used because it facilitated a holistic and in-depth investigation of the causes of the liquidity challenges in Zimbabwe (Creswell, 2007). The population of the study comprised of all the financial institutions in Zimbabwe because they were a rich source of data or information relevant for describing the causes of the liquidity challenges in the country. A purposive sampling technique was used in which the researcher focused only on those participants who had expert knowledge. The study was limited to ten financial institutions in Bulawayo in which a small group of managers were used to gather data from (Creswell, 2014; Johnson and Christenson, 2014). The managers were chosen because they are knowledgeable and informative about the causes of liquidity problems in the banking sector.

Data generation procedure was done through conducting of semi-structured interviews with ten managers from ten different financial institutions in Bulawayo. The researcher used a thematic analysis approach to analyse the data. This involved identifying patterned meaning across data set that provided an answer to the research questions being addressed.

Credibility of the data was checked in line with the findings by Trochin (2006). According to Trochin (2006), credibility creation involves establishing that the results of the study are credible from the perspective of the participants. In this study, the researcher took the preliminary analysis consisting of themes from findings back to the participants to solicit their views of the written analysis as well as indicating was missing.

VII. FINDINGS AND DISCUSSION

The study unearthed the following findings:

7.1 Causes of liquidity crisis in Zimbabwe

The research revealed that the money supply in Zimbabwe was mostly determined by the performance of the external sector, mainly the net exports, foreign direct investment, portfolio investment, diaspora remittances as well as foreign borrowing. The study identified that that transposition of the United States dollar from being a medium of exchange to a store of wealth contributed to the liquidity crisis in Zimbabwe. Economic agents preferred to keep the physical cash as store of value, rather than transacting in the United States dollars, especially the larger denominations. This was motivated by the fact that the country could not get any funding from the United States of America.

The study also established that the liquidity crisis in Zimbabwe were to a larger extent a result of the dollarization. When Zimbabwe dollarized its economy in 2009, it did not get US Treasury's support, unlike in other countries which dollarized. Zimbabwe's version of dollarization was unofficial in that there was no agreement between Zimbabwe and United States of America, hence no support could be obtained from the US Treasury.

The research also identified that lack of meaningful foreign direct investment was one of the biggest factors that contributed to the liquidity crisis in Zimbabwe.

The study revealed that unorthodox measures of printing money through issuing TBs, and settling obligations to banks using RTGS in the absence of cash equivalents by the Reserve Bank of Zimbabwe contributed to the liquidity crisis in the country. The depletion of the nostroaccounts resulted in banks failing to honour importers' foreign obligations. This had a double impact on liquidity in that settlement of the Reserve Bank of Zimbabwe's obligations through transfers or through TBs resulted in cash shortages at banks leading to crowding out effect on the private sector borrowing.

7.2 Challenges faced by banks in addressing the liquidity crisis

The study revealed that Zimbabwe relied on imports to augment its low production. The country's exports are mainly primary commodities which do not fetch enough in the international market. The low production of primary products by Zimbabwe are negatively affecting its exports, hence creating a negative balance on its balance of payment account. The study revealed that the use of electronic payment systems and mobile banking in the country could have alleviated the cash crisis if the costs associated with these new developments were not too high. In-addition, the economy of Zimbabwe has remained highly informal to such an extent that the majority of the people are not financially literate enough to be able to use plastic money or banking applications, hence their uptake has remained lower than expected.

VIII. CONCLUSIONS

The following conclusions were made from the findings of the study:

- The absence of the Lender of Last Resort (LOLR) function of the Reserve Bank of Zimbabwe remained a big constraint in addressing the liquidity challenges. The study revealed that even though the Afrexim facility took over this role, it was constrained by limited resources as only US$200 million was available under the facility AFTRADES. The liquidity challenges are further motivated by the limited interbank market which also relied on the AFTRADES facility for overnight accommodation.
- The United States dollar notes have been vanishing from the market in tandem with the Gresham's law of monetary principles which states that bad money chases good money. This is shown by the dwindling levels of the US dollar available in the market during the period of the study.
- The cash deposit ratio is too low. Research findings pointed to the fact that a cash deposit ratio of around 15% was necessary to prevent liquidity problems in Zimbabwe. As of December 2016, the country had only US$6.4 billion in deposits implying that the ideal cash requirement should have been US$960 million to cover for cash in circulation, and nostro account balances. However, as at that date Zimbabwe had only US$140 in cash, US$250 million in nostro accounts and US$94 million in bond notes. This means that cash requirements for the country fell short by US$484 million, hence creating a cash shortage situation in the country.

IX. RECOMMENDATIONS

The study recommends the following to be done to address the liquidity crisis:

- There is need to monitor the activities of businesses which are handling large amounts of cash such as retailers, wholesalers and fuel stations among others with a view to ensure that daily cash collections are banked.
- The government should revert back to the principle of cash budgeting in order to eliminate the effect of creating macroeconomic imbalances in the economy.

- The country should adopt the Rand as an anchor currency considering that South Africa is Zimbabwe's major trading partner.
- The Reserve Bank of Zimbabwe should come up with confidence building measures in order to attract long term deposits by lowering interest rates and lowering bank charges.
- The government and the Reserve bank of Zimbabwe should come up with policies that will encourage the informal sector players to formalize their operations.

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