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A Zimbabwe rally effect?

Posted by **Izabella Kaminska** on Sep 07 17:18.

When is an equity rally actually symptomatic of an inflationary environment to come?

That would be when it happens in Zimbabwe.

As Hinde Capital, a gold-focused hedge fund, notes in a recent report entitled "Aurophobia" (our emphasis):

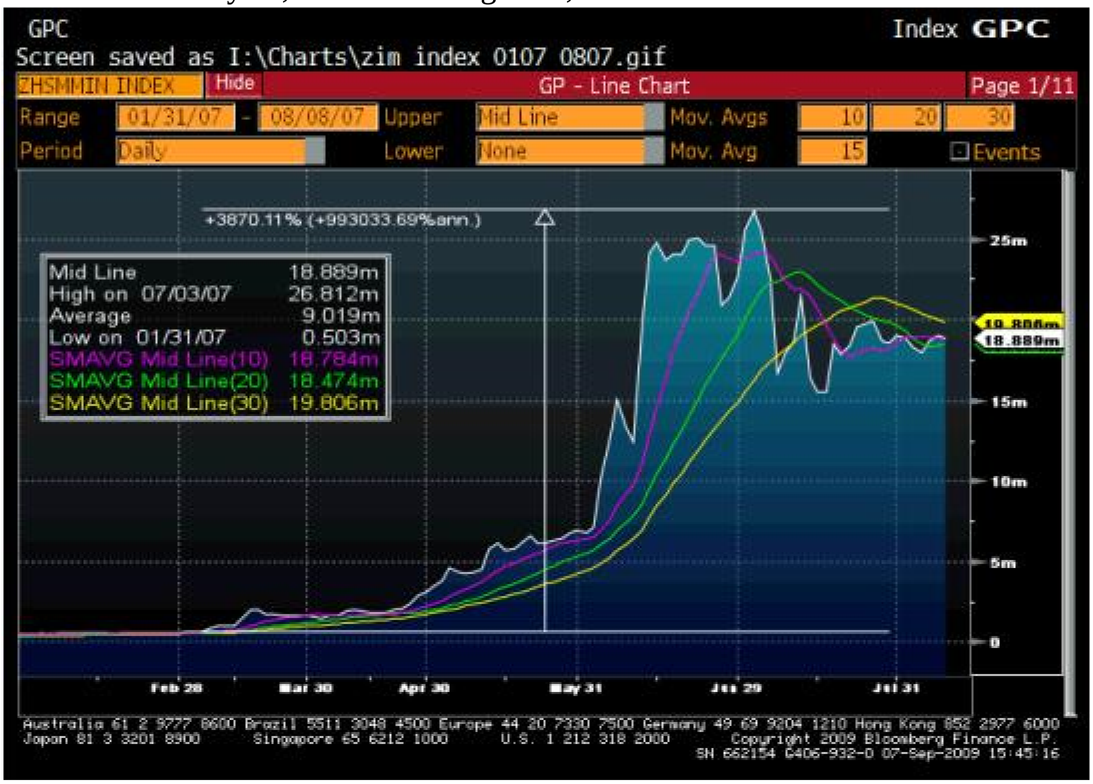
> *The Zimbabwe (ZSE) was the best performing stock market in 2008. It rose over 30,000% in the next 12 months, a rise far in excess of the CPI rates, and despite an economic collapse. How come? Zimbabwe (Zim) followed the classic tenets of Austrian business cycle theory.* ***Excess growth in money supply and credit sees money transfer initially (unfairly) to a few (connected with government) and their purchases cause certain items or goods to rise relative to others.*** *It is not distributed equally to everyone but later it leaks out everywhere via the Cantillon effect. It should be noted after the Zimbabwe Dollar had been re-based (revalued), i.e. a few zeros were chopped off the bank notes, eventually inflation rates of over 231mm% were recorded, numbers we cannot comprehend.*

They go on:

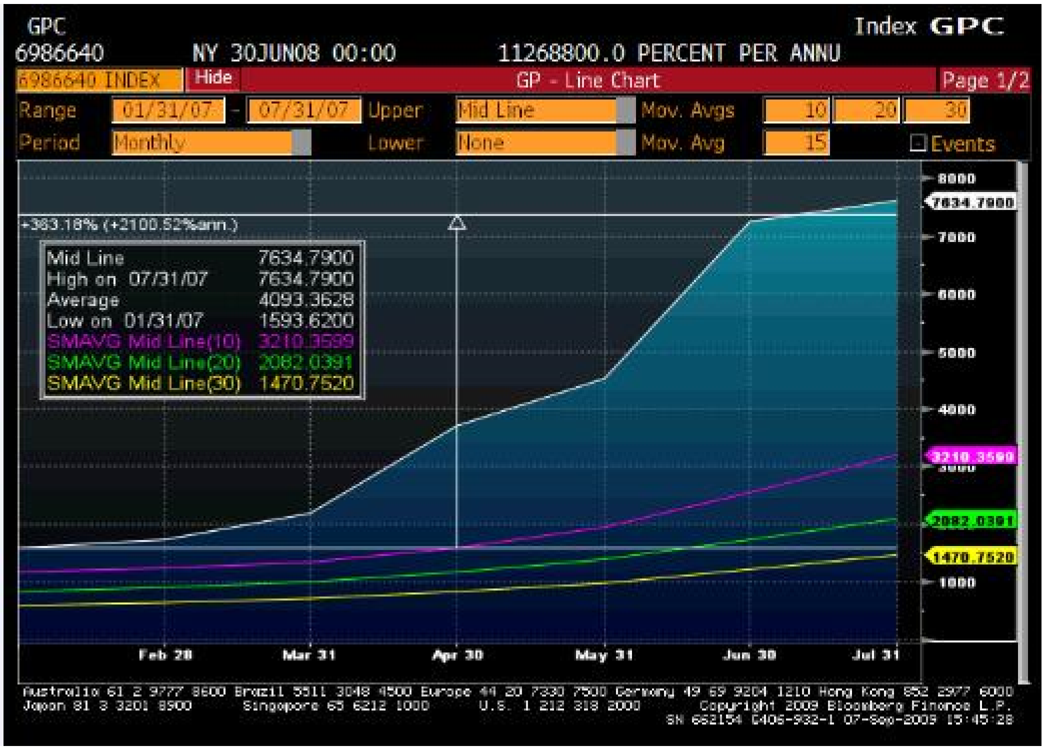
> ***Often a nation's stock market will become the main beneficiary of 'fresh' money.*** *It enters first by the banks who loan it to other institutions and who "loan it cheaply" to entrepreneurs, who then respond to initial goods price increases by producing more goods. Others observe such production, and the owners purchase stock. Many instead of increasing their own production speculate with this money or other entrepreneurs. Whilst the value of money is plummeting in real terms as goods prices rise, stock prices are outstripping these gains. This leads to yet more misalignment of prices and bad decision-making.* ***'Wealth' is momentarily with a few who own the assets that are rising in value, but for the majority relative income is collapsing.*** *So what does the government do. It meets the shortfall by issuing yet more currency to pay for the budget short fall. The amount of money issued so overwhelmed the existing share issuances of the Zim. Industrial Index that prices exploded. It's all illusionary. In Zimbabwe there were very few safe havens to hide one's money and people chose equities with real claims on assets that were rising.* ***Incidentally some bought 'gold' mobile phone chips as a source of money to barter for other goods with.***

What Hinde is saying, therefore, is that mega-hyperinflation in Zimbabwe might first have been perceptible in equity prices rather than the CPI index. This, they say, could be explained by the fact that investors (even a small number) would opt to dash into closed-end assets like equities or gold upon any boost to the money supply — rather than easy-to-multiply assets like government debt or cash.

Here, for example, are the gains in the Zimbabwe Industrial Index, which show a 3870 per cent rise between January 31, 2007 and August 8, 2007:



To compare, here are the gains in the CPI Index, which at a 383 per cent rise between January 31, 2007 to July 31, 2007 are ten times smaller.



An effect that may, or may not, be being repeated on a global scale now say Hinde:

> *Globally we have every nation issuing bonds to meet budget shortfalls, we have monetisation of credit and government assets globally. If you are Japanese, Swedish, Latvian or American you are not sure which currency is a better alternative and gold is increasingly hard to source (even if you have contemplated it yet - most have not). Those with disposable income buy assets which benefit from the goods price rises you are seeing. You stock up early on winter lumber and food if you have no spare income. You ask for wage increases from your by now government employed car worker or banker because you cannot afford the bus in. Absurd. It all seems rather similar. A global issuance of currency as we are seeing makes it very difficult to find ways to protect your wealth.*

More to the point, what investors should takeaway from the Zimbabwe example, say Hinde, is the fact that when inflation does feed through from equity prices into CPI it might do so rather quickly:

> ***The major point to take away from the Zim example is initially inflation is almost universally imperceptible with prices rising invisibly through the stock market mechanism. Later goods price increases explode higher at a greater rate and there is almost no in between. One morning you wake up to a cup of tea costing £1 the next it is £5 and so on and so on..***

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This entry was posted by Izabella Kaminska on Monday, September 7th, 2009 at 17:18 and is filed under Capital markets, Commodities. Tagged with Equities, gold, Hyperinflation, inflation, zimbabwe.

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Comments

Itzman *Sep 7 23:29*

@cabnin fever..of couyrse there was job creation. Loads of armed militia running around beating people who voted Tory..and wanted to hold onto their land..oops wrong country.

Growler *Sep 7 19:21*

Accounts from central bankers in countries afflicted by hyperinflation; [sadly, no autobiography from Gideon Gono, yet] share a striking similarity, in that they all express surprise at the speed at which hyperinflation hit. "There was no warning - it came from nowhere."

They thought that everything was under control and the visible [price] inflation risk was minimal - without understanding that hyperinflation is the exponentially-increasing collapse in confidence in a currency. Once panic set in, they lost all their levers.

Hyperinflation isn't a general increase in prices, perhaps caused by rising demand or a supply shortage - it's a collapse of the buying power of a particular currency. Zimbabwe didn't experience rising prices in gold or US dollars.

Cabin Fever *Sep 7 19:11*

@SUT(gambler)
Er, so there was 'mucho job creation' in Zimbabwe? I must have been reading the wrong newspaper.

praxis22 *Sep 7 18:36*

You learn something new every day, never heard of Cantillon before :) That said I never trusted gold, like the man said, "by the time you can use gold, you'll need lead more" I'm always amazed that people don't know that the US Govt outlawed the holding of gold during the depression. ah the lessons of history, it's good the learn :P

Socially Useless Trader (Gambler) *Sep 7 18:11*

Unless the Central *ankers can engineer rising property prices and mucho job creation there will be no hyper-inflation. "Skewflation" is far more probable: Deflating asset prices + Cost of living inflation. The debt-junkies are exhausted and their ability to ramp up the debt is pretty minimal. Socially useless gamblers in the equity market are not a harbinger of hyper-inflation.