STOCK MARKETS AND ECONOMIC ACTIVITY IN ZIMBABWE

Shadreck Matindike, Nashville High School, Gweru, Zimbabwe
Francis Mhere, Midlands State University, Gweru, Zimbabwe

ABSTRACT

The study evaluates the nexus between stock markets and economic activity in Zimbabwe for the period February 2009 to February 2012 using monthly data. Supporters of the stock market's predictive ability argue that the stock market is forward looking and current stock prices reflect future profitability. Cointegration and Granger causality tests are used to examine the causal relationships between stock prices and economic activity, and to see if they are consistent with theory. The study specifies a bivariate model in a VAR framework with the Volume of Manufacturing Index (VIM) as a coincident indicator of economic activity and Zimbabwe Industrial Index representing stock market performance. The Johansen cointegration test suggests that there is a long-run relationship between the stock market performance and economic activity. The results of Granger causality test suggest that there is a uni-directional relationship between the variables with causality running from economic activity to stock market performance. This study provides evidence in favour of the 'demand following' hypothesis. Therefore, it can be inferred that the movements in real economic activity cause movements in stock prices and stock market performance does not play a role as a leading economic indicator of future economic activity in Zimbabwe's dollarization era. The study recommends policy makers to propose strategies that develop Zimbabwe's real sector first to improve financial markets' performance and also investors are encouraged to look at other leading indicators of economic activity other than the stock market such as changes in business inventories and new construction (new housing).

Keywords: *Stock Market, Economic Activity, Volume of Manufacturing Index, Industrial Index, Granger causality, Johansen Cointegration*