THE IMPACT OF INFLATION ON STOCK MARKET PERFORMANCE IN ZIMBABWE BETWEEN 1980 AND 2008: AN EMPIRICAL INVESTIGATION

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ABSTRACT

Empirical literature fails to agree on how the performance of the stock market and inflation are related as explained by Fama (1981) and Fisher (1930). The relationship had been mixed and this research makes an empirical investigation on this relationship using Zimbabwean data from 1980-2008. The study employed VECM approach to test the dynamic relationship in the short and long term and to understand the key drivers of each variable. Findings support the Fisher hypothesis but stocks did not offer perfect protection from the effects of inflation over the long period. Each variable was mainly driven by its own lagged variable while the importance of one variable in explaining the variation in the other variables was moderate. Investors should not hold and view equities as long term investments providing them with compensation for loss of purchasing power. They can hold equities as good buys in the short to medium term.

Keywords: Inflation, stock market, Vector Autoregression (VAR), Vector Error Correction (VEC), Forecast Error variance decomposition (FEVD), Impulse response function (IRF)