The Effect of stock market wealth on private consumption in Zimbabwe

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ABSTRACT

The study seeks to examine stock market wealth effects on private non-durable consumption for Zimbabwean households using quarterly data from 1994(1) to 2008(2). The bounds testing approach to cointegration is employed to test the long run relationship between stock market wealth and consumption. An autoregressive distributed lag model (ARDL) analysis is implemented to examine the relationship among the variables both in the short-run and the long run. The empirical findings suggest significant wealth effects for Zimbabwe, a developing country. This contradicts the commonly held view that LDCs should have insignificant wealth effect since the financial system is still underdeveloped. The dynamic short run error correction model also shows a speedy convergence to long run equilibrium.

Key words: wealth effects, consumption dynamics, income effect, convergence

JEL classification: E21, E44

1. Introduction

The study seeks to determine the extent to which household non durable consumption expenditure is affected by changes in stock market wealth for Zimbabwean households using an autoregressive distributed lag (ARDL) bounds test framework. Most studies on stock market wealth effects have been confined to developed countries which have well established financial markets, while very few are based on less developed countries (LDCs). The argument for underplaying the case for LDCs has been that since most of them have inefficient financial markets, stock market wealth effects cannot be expected to be significant. Above all, most researchers argue that since stock market wealth account for a small percentage of household wealth in LDCs, they are not important (Funke, 2004; Ahumada et al., 2003). However, following the revelation by African Stock Exchanges

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