

The Need for Financial Stability in Zimbabwe: Use of Derivatives Securities

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Abstract: Financial stability contributes to the stability and growth of a nation. There has been a sharp growth in use or trading of derivatives in both mature and emerging markets. The Zimbabwean financial sector is still not trading in derivatives security, yet Zimbabwe Stock Exchange is among the oldest and largest in Africa. The trading of derivatives is done in two types of markets: organized exchanges and over the counter. Investors generally use derivatives for three purposes: risk management, price discovery, and reduction of transaction costs. Apart from generating cash in the adverse states of the world, derivative instruments also can smooth cash flows through its interaction with the operating decisions. The study rallies behind the development of derivatives market in Zimbabwe in the face of liquidity challenges currently facing the economy. The impact of market risk on corporate activities should never be undermined and hence the corporate sector should be aided in the elimination of market risk. The study is a policy prescription, which examines the importance of derivatives and their suitability in Zimbabwe, to strengthen the financial sector. The study identified the derivatives sector as the missing link to viable financial sector and hence economic growth.

Key Words: Financial Markets, Financial Stability, Economic Stability, Economic Growth, Derivatives, ZSE, Hedging, Forward Contracts, Futures, Swaps.

JEL Codes: A23, E44, E58, E62, F21, F36, G15, G18, G28, G38.

I. Introduction

Derivatives securities are of great importance in the stability of the financial system and hence the economy. As indicated by Singh and Rajeev (2015), when all the major asset classes saw a downturn post-financial crisis of 2008, only commodity derivatives exhibited a stable performance. During the last decade, derivatives markets became an asset class of their own and influenced the financial landscape strongly, Haiss and Sammer (2010). The corporate use of derivative financial instruments such as forwards, futures, options and swaps has been subject to rapid growth, both in terms of the extend of use and complexity of the instruments used, Barnes (2001). There is a common relationship between financial market development and economic development despite that many researchers have been debating on the causal relationship of the two, Bonga (2010). Emphasizing the need for derivative market in Zimbabwe, Njanike (2015) indicated that, asset managers need to be in a market where they are able to actively manage and devise mechanisms that promote fund growth and managing the risks they are exposed to.

Derivatives are financial instruments in the form of contracts, the value of which is derived from the value of an underlying asset, Apanard *et al.* (2014). The underlying entity can be an asset, index, or interest rate, and is commonly called the "underlying". Derivatives can be used for a number of purposes, including insuring against price movements (hedging), increasing exposure to price movements for speculation or getting access to otherwise hard-to-trade assets or markets, Koehler (2011). An important feature of derivatives exchanges is the interposition of a clearinghouse that serves as a counterparty to reduce the default risk of parties engaged in the contract, Apanard *et al.* (2014). Some of the more common derivatives include forwards, futures, options, swaps, and variations of these such as synthetic collateralized debt obligations and credit default.

There is need for derivatives markets in developing nations and their growth is witnessed in some countries. This has been supported by Apanard *et al.* (2014), when they indicated that, while the major derivatives exchanges are located in mature economies (e.g., CME Group, Deutsche Borse AG, NYSE Euronext), the development of the global marketplace indicates expanding opportunities and demand in emerging economies. The use of derivatives has grown remarkably since the introduction of foreign exchange and interest rate products in the 1970s, Bartram *et al.* (2009). The development of derivative markets in emerging markets plays a special role in this context as more institutional money is dedicated to emerging markets, which requires the availability of financial instruments to manage market, credit and interest rate risks in largely underdeveloped local capital markets, Jobst (2007).

Popular theories of financial risk management indicate that nonfinancial corporations may use derivatives to lower the expected costs of financial distress, to coordinate cash flows with investment policy, or

because of agency conflicts between managers and owners, Bartram *et al.* (2009). Derivatives markets are populated by four main types of contracts: forwards, futures, options, and swaps. The general concepts are similar, with their value derived from the price of an underlying asset.

While the primary users of derivatives are financial institutions such as banks, insurance companies, and investment managers, the use of derivatives by nonfinancial firms is considerable. Silber (1985) provides a sound explanation for the economic contribution of financial futures and indicates that increased liquidity and risk reduction facilities available to portfolio managers and other investors reduce the cost of capital to businesses, which ultimately translates into greater capital formation for the economy as a whole. Peck (1985) demonstrates both theoretically and empirically the direct effect futures markets have on commodity prices, and their indirect impact on production, consumption and storage decisions.

This paper seeks to analyse the economic importance of derivatives in developing nations with special reference to Zimbabwe. The Zimbabwe Stock Exchange is ranked one of the most active stock exchanges in Africa, with the biggest being the Johannesburg Stock Exchange in South Africa. The derivatives have been offered by Barbican bank, which later closed. Barbican Bank before it was placed under curatorship was trading call options which some quarters believe it was the source of its financial demise, Njanike (2015).

Since then, the securities have never been introduced in the financial market despite their crucial importance. This paper is a policy prescription, with the aim of deriving attention to policy makers to create a conducive environment and legal framework so as to enable investors to trade in derivatives. Risk management is of crucial importance to the success of business, however, managing of market risk requires the use of derivatives. Without derivatives market, institutions are still exposed and hence there is no stability for development.

The crucial need for a stable financial system was highlighted in the wake of the Asian financial crisis of the late 1990s as well as the recent the global financial crisis (2007 - 2009) and the Eurozone crisis of 2011. In Zimbabwe, the financial system has been significantly tested in recent years by the effects of the hyperinflation environment, volatile global commodity prices, and the resulting slowdown in domestic economic activity since the adoption of multicurrency system in 2009.

The recurrence of financial crisis and their negative spill-over effects has brought to the fore the importance of financial sector soundness as a prerequisite for sustained economic growth. Liquid markets can lead to more investments, improve the allocation of capital, thereby enhancing prospects for long-term economic growth. Countries with better-developed financial systems tend to grow faster over long periods of time. Zimbabwe financial sector has been affected by persistent illiquidity, capital erosion and associated financial sector risks, limited lender of last resort function, and deterioration in asset quality.

II. Functions Of Financial Markets

Financial markets do perform great roles in the economy at large. Shallow financial markets and inadequate access to finance are major sources of concern in African countries generally, Adelegan (2009). Volatile international capital flows have the tendency to destabilize shallow markets and precipitate a crisis if there is a change in investors' appetite.

Top 10 most active stock markets in Africa in 2014



The ZSE is ranked as number four in terms of weekly trading volumes in Africa, hence it is one of the active markets in the continent. The Johannesburg Stock Exchange is the only one in Africa that offers derivatives. This shows that a lot has to be done in the continent to boost investment and help firms manage market risk and all other risks that needs derivatives for efficient management.

The financial sector comprises of lenders, financial intermediaries, financial markets and borrowers.

RELATIONSHIP BETWEEN LENDERS AND BORROWERS			
Lenders	Financial Intermediaries	Financial Markets	Borrowers
Individuals Companies	Banks Insurance Companies Pension Funds Mutual Funds	Interbank Stock Exchange Money Market Bond Market Foreign Exchange	Individuals Companies Central Government Municipalities Public Corporations

A well viable financial sector transforms into a stable economy. Financial markets facilitate the transfer of real economic resources from lenders to ultimate borrowers. Financial markets allow lenders to earn interest or dividend on their surplus invisible funds, thus contributing to the enhancement of the individual and the national income. There is enhanced productive usage of borrowed funds. Capital formation is necessitated through financial markets when they provide a channel through which new savings flow to aid capital formation of a country. Financial markets allow for the determination of price of the traded financial assets through the interaction of buyers and sellers. They provide a sign for the allocation of funds in the economy based on the demand and to the supply through the mechanism called price discovery process. Financial markets do provide a mechanism for selling of a financial asset by an investor so as to offer the benefit of marketability and liquidity of such assets. Also the activities of the participants in the financial market result in the generation and the consequent dissemination of information to the various segments of the market. Hence, the financial markets help in the reduction of the cost of transaction of financial assets.

In summary, financial markets provides liquidity in the market so as to facilitate trading of funds, provides liquidity to commercial banks, facilitate credit creation, promote savings, promote investment, facilitate balanced economic growth and improves trading floors. Research pertaining to launching derivatives exchanges in emerging markets consists primarily of survey results or descriptive studies. Bricheux, Savre and Tachon (1992) describe the important factors for developing a successful futures contract: Conditions for creating a futures market [legal, regulatory, political and economic environments], Conditions for creating a futures contract [price volatility, underlying asset's risk, large cash market, maturity of the spot market, and existence as well as involvement of dealer community], and Conditions for futures contract success [futures market environment, well-designed contract, and exchange perseverance].

III. A Glimpse On The Zimbabwean Financial Sector

Zimbabwe's financial sector is relatively sophisticated, consisting of a Reserve Bank, discount houses, commercial banks, merchant banks, finance houses, building societies, the Post Office Savings Bank, numerous insurance companies and pension funds and a stock exchange. Zimbabwe's current financial regulation and supervisory architecture was inherited from the Rhodesian Government at independence in 1980, Nhavira *et al.* (2014). The Reserve Bank of Zimbabwe, the Commissioner of Insurance and Pension Funds, the Zimbabwe Stock Exchange, Ministry of Finance and Deposit Protection Board¹ are regulators of the financial markets. The Ministry of Finance is the ultimate supervisor of the financial system. As a result of the liberalization of the financial sector in 1991, the establishment of local banks has grown considerably, Machona and Kaseke (2013). Since then, the financial system has undergone several changes in recent years.

The liberalisation of the financial sector in Zimbabwe was an integral part of the Economic Structural Adjustment Programme (ESAP), a programme which was introduced by the government in 1991. It was aimed at restructuring the economy from a predominantly state interventionist type of economic management towards a more market-driven system.

Prior to reforms, Zimbabwe's financial system comprised the Reserve Bank of Zimbabwe (RBZ), five commercial banks, two discount houses, four merchant banks, three building societies, six finance houses and the Post Office Savings Bank (POSB), a statutory corporation, prior to liberalization. The government through the Ministry of Finance and the RBZ began issuing out new licences to financial players such that between 1993 and 2003, there was an upsurge of banking institutions, Nhavira *et al.* (2014).

¹ The Deposit Protection Corporation came into being through Act 7 of 2010 is tasked with the responsibility of protecting depositors thereby ensuring safety and soundness of the banking system by preventing bank runs.

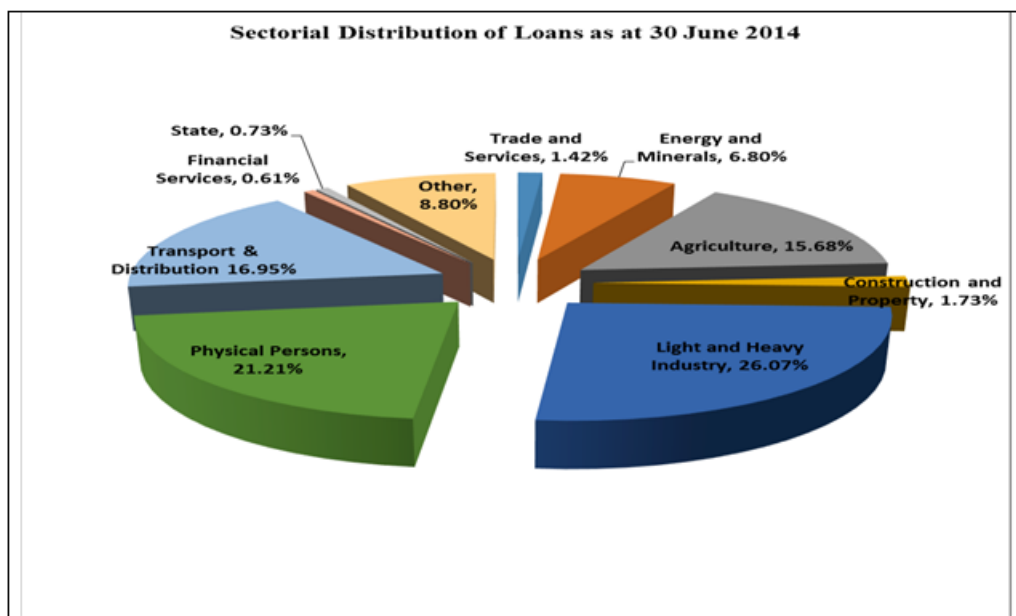
As of December 2009, the banking sector consisted of 27 institutions, including 17 commercial banks, 4 merchant banks, 4 building societies, 1 discount house and 1 savings bank. 16 asset management companies also operated in the country. The banking sector remains heavily concentrated; with the three largest banks accounting for over 90 percent of total deposits in 2006.

Zimbabwe's financial system came under great stress in 1998 with the collapse of the United Merchant Bank. One response by RBZ was to increase the capital adequacy requirement for banks, compared to the internationally accepted minimum ratio of 8%. This has also brought about a greater awareness of the importance of credit policies and the need for regular assessment of assets. Political and economic circumstances have negatively impacted the Zimbabwean microfinance industry, causing the sector to contract in recent years.

Microfinance institutions have always had difficulty raising funds on the local market because it is a sector which is regarded as high risk because of the domination of the poor on the portfolio of the industry. This has not changed with reforms. Policies should be designed in order to eradicate the largely negative perceptions about this sector. Policy should adopt a more positive and supportive strategy which recognizes that microfinance is in reality an integrated part of the development process. There is a need to review rules on zoning, registration, access to land, taxation and fees so that they are designed in a way which promotes rather than obstructs microfinance.

Currently, Zimbabwe is said by many analyst to be overbanked with a total of 26 banks sharing a paltry \$3.3bln deposits base among them. However, the philosophy of overbanking is subject to debate, given the population size of the country, the situation only calls for some factors to be addressed.

About 80% of the financial sector is dominated by banks. The banking sector attract funds from small savers and allocate it to the deficit investment users of funds, hence transforming into economic growth.



Source: Reserve Bank of Zimbabwe, 2014.

The banking sector loan portfolio is dominated by the industrial sector, household, transport and agriculture, constituting 26.07%, 21.21%, 16.95% and 15.68 of total credit, respectively. The remaining sectors contributed less than 10% each.

IV. Market Risk

Financial systems all over the world are prone to periods of instability, and Zimbabwe is no exception to the rule. Investment risk is mainly in two categories; market risk and specific [unsystematic] risk. Specific risk is born from the performance of the individual security and hence can be eliminated through diversification. Market risk [systemic] cannot be eliminated through diversification of assets, however it can only be hedged. Market risk arises from the overall factors that affect the whole financial market system. Sources of market risk includes business cycles [recessions], political factors, interest rates changes, natural disasters among others. Market risk is therefore defined as the risk that the value of an investment will decrease due to moves in market factors. In other words, it encompasses the risk of financial loss resulting from movements in market prices. Mehta et al. (2012) define market risk as the risk of losses in the bank's trading book due to changes in equity prices, interest rates, credit spreads, foreign-exchange rates, commodity prices, and other indicators

whose values are set in a public market. There are commonly five standard market risk factors include: Equity risk [the risk that stock prices will change], Interest rate risk [the risk that interest rates will change], Currency risk [the risk that foreign exchange rates will change], Commodity risk [the risk that commodity prices will change], and Equity index risk [the risk that stock or other index prices will change].

Market risk is rated based on an assessment of the firm's sensitivity of earnings [economic value of capital] to adverse changes in interest rates, foreign exchanges rates, commodity prices, or equity prices. What matters as well is the ability of management to identify, measure, monitor, and control exposure to market risk given the institution's size, complexity, and risk profile. The impact of market risk is also based on nature and complexity of interest rate risk exposure arising from non-trading positions. And lastly, for some institutions, the nature and complexity of market risk exposure arising from trading and foreign operations.

To manage market risk, banks deploy a number of highly sophisticated mathematical and statistical techniques. Chief among these is value-at-risk (VAR) analysis, which over the past 15 years has become established as the industry and regulatory standard in measuring market risk.

The issue of getting rid of market risk, calls for the use of derivatives. There is no any other solution that firms can use, other than through hedging. The Zimbabwean regulatory framework should consider the introduction of such markets so as to give the corporate world a fresh breath in the management of funds and risk improvement. Derivatives allow risk-averse market participants (such as banks, farmers, processors and traders) to offset risk among themselves or transfer it to other market participants willing to accept the risk-return ratio (Abken, 1994). the process, derivatives attract additional participants who in turn increase the volume of transactions, thus contributing to the creation of a liquid market, Njanike (2015).

V. Hedging

Hedging is often considered an advanced investing strategy, and the practice of hedging is becoming widespread. The principles of hedging are too simple, and the most common hedging is insurance, when individuals insure themselves against death and damage to their vehicles or houses. Hedging has grown to encompass all areas of finance and business. Besides protecting an investor from various types of risk, it is believed that hedging makes the market run more efficiently.

The basic function of hedging [whether in one's portfolio, business or anywhere else] is about decreasing or transferring risk. Hence, hedging is a valid strategy that can help protect one's portfolio, home and business from uncertainty. A hedge is an investment position intended to offset potential losses/gains that may be incurred by a companion investment. A hedge can be constructed from many types of financial instruments, including stocks, exchange-traded funds, insurance, forward contracts, swaps, options, many types of over-the-counter and derivative products, and futures contracts. In investment terms, hedging is a transfer of risk without buying insurance policies.

Hedging strategies include; forward exchange contract for currencies, currency future contracts, money market operations for currencies, forward exchange contract for interest, money market operations for interest, future contracts for interest, covered calls on equities and short straddles on equities or indexes.

Hedging employs various techniques but, basically, involves taking equal and opposite positions in two different markets (such as cash and futures markets). Hedging is used also in protecting one's capital against effects of inflation through investing in high-yield financial instruments (bonds, notes, shares), real estate, or precious metals. Choosing appropriate hedging techniques depends on both the type of derivative and assumptions placed on the underlying stochastic process, Rheinländer and Sexton (2011).

The continuing exponential growth of derivatives markets; the development of new derivatives instruments; their impact on financial markets generally; the rapid transformation of traditional institutional arrangements; and occasional operational, liquidity, and credit problems have all focused attention on what happens after the trade—the post-trade practices, structures, and arrangements that ensure the smooth and efficient functioning of these markets, Bliss and Steigerwald (2006).

VI. Economic Function Of The Derivative Market

Using various empirics from the developing and developed world, derivatives have been identified to have various economic benefits to the economies.

- Financial derivatives can be used in risk management, hedging, arbitrage between markets, and speculation.
- Derivatives assume economic gains from both risk shifting and efficient price discovery by providing hedging and low-cost arbitrage opportunities, Jobst (2007).
- Derivatives catalyze entrepreneurial activity.
- Determination of current and future prices. Prices in a structured derivative market not only replicate the discernment of the market participants about the future but also lead the prices of underlying to the professed future level. On the expiration of the derivative contract, the prices of derivatives congregate with

the prices of the underlying. Therefore, derivatives are essential tools to determine both current and future prices.

- Risk allocation. The derivatives market reallocates risk from the people who prefer risk aversion to the people who have an appetite for risk. Hence, derivatives allow the sharing or redistribution of risk.
- Derivatives can allow businesses to manage effectively exposures to external influences on their business over which they have no control.
- Increased trade volumes. The intrinsic nature of derivatives market associates them to the underlying Spot market. Due to derivatives there is a considerable increase in trade volumes of the underlying Spot market. The dominant factor behind such an escalation is increased participation by additional players who would not have otherwise participated due to absence of any procedure to transfer risk.
- Speculation controlled. As supervision, reconnaissance of the activities of various participants becomes tremendously difficult in assorted markets; the establishment of an organized form of market becomes all the more imperative. Therefore, in the presence of an organized derivatives market, speculation can be controlled, resulting in a more meticulous environment.
- Uncertainty. Third parties can use publicly available derivative prices as educated predictions of uncertain future outcomes, for example, the likelihood that a corporation will default on its debts.
- Debt Management and Domestic Debt Market Development. Well-developed derivative markets may benefit public debt managers, even when they are not direct users of such instruments. Derivative instruments contribute to overall market efficiency and liquidity. These benefits include the ability for market participants to hedge positions effectively, the ability to trade in and out of markets at any time, continuous price updates and market intelligence through trading in the derivative asset class and, last but not least, the maintenance of market liquidity, OECD (2007).
- Hanson (2003) asserts that derivatives markets contribute to the integration of global capital markets, hence improving the global allocation of savings and fostering higher investment levels.
With derivatives, there is increase in savings and investment in the long run due to augmented activities.

VII. Types Of Derivatives, Contract Types And Underlying Assets

Most African countries have no derivative markets, with the exception of South Africa and the North African economies of Morocco, Egypt and Tunisia, where the volume of derivative transactions is small but growing, [Making Finance Work for Africa, 2014]. Where derivative markets exist, they are largely in their infancy and mostly focused on foreign-exchange derivative contracts.

Derivatives come in various types and forms depending on the type of contract and how risk has to be managed. The following table summarizes the contracts which investors enter and the underlying assets they use.

UNDERLYING	CONTRACT TYPES				
	Exchange-traded futures	Exchange-traded options	OTC swap	OTC forward	OTC option
Equity	DJIA Index future Single-stock future	Option on DJIA Index future Single-share option	Equity swap	Back-to-back Repurchase agreement	Stock option Warrant Turbo warrant
Interest rate	Eurodollar future Euribor future	Option on Eurodollar future Option on Euribor future	Interest rate swap	Forward rate agreement	Interest rate cap and floor Swaption Basis swap Bond option
Credit	Bond future	Option on Bond future	Credit default swap Total return swap	Repurchase agreement	Credit default option
Foreign exchange	Currency future	Option on currency future	Currency swap	Currency forward	Currency option
Commodity	WTI crude oil futures	Weather derivative	Commodity swap	Iron ore forward contract	Gold option

Source: Adapted from Wikipedia

Transactions in financial derivatives should be treated as separate transactions rather than as integral parts of the value of underlying transactions to which they may be linked. The value of a financial derivative derives from the price of an underlying item, such as an asset or index. The risk embodied in a derivatives contract can be traded either by trading the contract itself, such as with options, or by creating a new contract

which embodies risk characteristics that match, in a countervailing manner, those of the existing contract owned.

Financial derivatives contracts are usually settled by net payments of cash, often before maturity for exchange traded contracts such as commodity futures. Cash settlement is a logical consequence of the use of financial derivatives to trade risk independently of ownership of an underlying item.

The value of the financial derivative derives from the price of the underlying item: the reference price, IMF (1998). Because the future reference price is not known with certainty, the value of the financial derivative at maturity can only be anticipated, or estimated. Derivatives markets in emerging markets, however, remain small compared to those in advanced economies. Derivatives in EMEs are used mainly to hedge or speculate on exchange rate and, to a lesser extent, equity market risk, Dubravko and Packer (2010). The largest emerging market derivatives markets are now located in Korea, Brazil, Hong Kong and Singapore.

VIII. Futures And Forward Contracts

Four most common examples of derivative instruments are Forwards, Futures, Options and Swaps. A forward contract is a customized contract between two parties, where settlement takes place on a specific date in future at a price agreed today. Futures are exchange-traded contracts to sell or buy financial instruments or physical commodities for a future delivery at an agreed price.

The main differences between futures and forwards is as shown in the table below;

Basis	Futures	Forwards
Nature	Traded on organized exchange	Over the Counter
Contract Terms	Standardized	Customised
Liquidity	More liquid	Less liquid
Margin Payments	Requires margin payments	Not required
Settlement	Follows daily settlement	At the end of the period.
Squaring off	Can be reversed with any member of the Exchange.	Contract can be reversed only with the same counter-party with whom it was entered into.

Swaps are private agreements between two parties to exchange cash flows in the future according to a prearranged formula. They can be regarded as portfolios of forward contracts. Common swaps include interest rate and currency swaps.

Options are of two types; calls and puts. Calls give the buyer the right but not the obligation to buy a given quantity of the underlying asset, at a given price on or before a given future date. Puts give the buyer the right, but not the obligation to sell a given quantity of the underlying asset at a given price on or before a given date.

Many researchers have shown that the institutional environment has an important impact on the functioning of the financial sector (Tressel and Detriagiache 2008, and Demetriades and Fielding 2009). La Porta (La Porta, et al 1997 and La Porta *et al.* 1998) argues that legal origin determines the level of financial development. He suggests that common law-based systems, originating from English law, are better suited for development of financial markets than civil law systems, arguing that common law has been instrumental in protecting private property than civil law, which aims at addressing corruption in the judiciary and improving the power of the state.

Demetriades and Fielding (2009) address the lack of information on borrowers, corruption and political instability as main challenges for financial development in eight countries of West Africa. McDonald and Schumacher (2007) point to financial liberalization, stronger legal institutions, legal origin, lower inflation, and increased sharing of information as key contributing factors for financial sector development in SSA.

Another consideration in SSA is the heavy dependence on foreign aid, both financial and technical assistance, from various international and/or foreign organizations/donors, Anayiotos and Toroyan (2009). Nkusu and Sayek (2004) demonstrate that development of the local financial market positively enhances the impact of aid, which is significantly larger when local financial markets are more developed.

IX. Conclusion

In an environment in which investors are continuously exposed to a broad range of dynamic risks, derivatives have become a valuable tool used in the risk management practices of institutions. Theoretical literature indicates that derivatives provide users with efficiency benefits in the form of reduced transaction costs and improved risk control. The short paper seeks to clarify on the need to strengthen the financial sector stability in developing nations, with special reference to the Zimbabwean economy. Financial sector development is expected to be brought through the introduction of derivatives. Derivatives markets are expected

to improve the liquidity status of the economy, and guarantee the elimination of market risk. By introducing derivatives, more traders are expected and hence more activity in the sector.

This study suggests that a potential benefit of derivative usage comes from its ability to allow a firm to maintain smooth operating policies in the event of external shocks. Apart from generating cash in the adverse states of the world, derivative instruments also can smooth cash flows through its interaction with the operating decisions. The policymakers should consider the role of derivative instruments in setting monetary policies and evaluating their effects on the credit channels.

The paper seeks to notify the policy makers on the need for a financial sector reform, which does not necessarily change the status quo of the current dealings in the market, but as an additional tool to harness funds and improve trade volumes and elimination of market risk. The role of derivatives on the transmission of monetary policy must be analyzed more thoroughly to further enrich our understanding of the frictions in the capital markets and their potential impact on the overall capital allocation in the economy.

Worth to note is that in the banking sector, financial intermediation often exposes banks to interest rate risks by creating mismatches in the maturity structure and re-pricing terms of their assets and liabilities. To solve such there is need to use interest rate derivatives, to manage these risks. Diamond's (1984) model implies that banks should hedge all market risks in which they don't have any special monitoring advantages. The goal of policymakers is to create an environment in which market mechanisms can evolve to provide greater societal benefits while containing systemic risks.

In conclusion, financial derivatives are valued at their market price on the recording date, and changes in prices between balance sheet recording dates are classified as revaluation gains or losses. If market value data are unavailable, other fair value methods to value derivatives, such as options models or discounted present values, may be used, and this makes derivatives the most preferred in any economy. Derivatives make it more likely that risks are borne by those best able to bear them. This makes it possible for individuals and companies to take on more risky projects with higher promised returns and hence create more wealth by hedging those risks that can be hedged.

Emerging market countries can benefit from derivative products. Zimbabwean policymakers should be well aware that derivatives turnover in emerging markets is becoming more and more global, and hence the economy should move with others rather than lag behind. Investors need to be able to translate their views on financial conditions into transactions in order to protect themselves from anticipated changes that might harm their positions. Derivatives can provide this protection and help prevent minor changes, such as in monetary policy, from turning into systemic shocks. In addition, derivatives can reduce the cost of issuing bonds and help lengthen the yield curve. They can also be a way to address the lack of investible assets and provide more investment opportunities. In many emerging market countries, the growth of institutional investors, including pension funds and insurance companies, has outstripped issuance of investible domestic assets creating a supply/demand imbalance [derivatives can fill this gap].

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