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Exchange Rate Movement and Stock Market Performance in South Africa

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Abstract

This study is an analysis of symmetric and asymmetric impacts of shocks on the South African stock market focusing on currency, inflation and equities. The interest in the stock market has taken centre stage due to its importance in enhancing savings in the domestic economy, through investment, and growth of the economy. Currency movements induce inflation, foreign direct investment (FDI) and affects profits of net exporters raising uncertainty in stock market. The interaction between the exchange rate, inflation targeting, and the stock market performance is vital as it affects the effectiveness of the monetary and fiscal policy. The focus of this study was to look at how developments in the currency market and inflation targeting influence developments in the equity market. The South African Reserve Bank (SARB) is in limbo as it aims to boost FDI, raise profits for net exporters, implement inflation targeting, uphold proper monetary policies and on the other hand allow the stock market to operate independently. The study applied a Vector Error Correction Model (VECM), an Autoregressive Distributed Lag Model (ARDL Model) and a Non-linear Autoregressive distributed Lag model (NARDL). The study found significant linear and non-linear relationships between exchange rates, inflation targeting and stock markets suggesting policy reforms for the SARB to assist in FDI, inflation targeting and strategic intervention on the stock market without disturbing its independence.

Keywords: Exchange rates, inflation targeting, stock market, ARDL, NARDL and VECM