Relationship between Interest Rates and Private Investment in South Africa: A Nonlinear ARDL Approach

Leshoro Temitope Lydia[1*], Wabiga Paul[2]

[1]Department of Economics, University of South Africa
[2] School of Economics, Makerere University – Kampala
*Correspondence Author

Abstract

Conventional economic theory states that higher interest rates reduce investment levels because interest rates represent the cost of borrowing, thereby implying a linear inverse relationship. However, the effects of positive and negative shocks in interest rates on investment may differ and this is what the study investigates. In this paper, we examine the asymmetrical nature of the relationship between interest rates and private investment in South Africa. We utilise annual time series data from 1971 to 2019, while employing the recent nonlinear autoregressive distributed lag (NARDL) technique. Our study finds that interest rates and private investment exhibit short-run and long-run asymmetric relationships, with private investment responding differently to negative and positive shocks in interest rates. A key conclusion from the study findings is that empirical evidence based on linear analyses of the relationship between interest rate and private investment may be insufficiently rich to warrant dependable macroeconomic forecasts. This may lead to misguided policy interventions and management, especially by monetary policy custodians, which ultimately hamstrings efforts towards sustained economic growth and development.

Keywords: private investment, interest rates, asymmetrical relationship, NARDL