Macrothink Institute™

Business and Economic Research
ISSN 2162-4860
2020, Vol. 10, No. 2

Economic Uncertainty and the Demand for Broad Money in South Africa

Wen-Hsien Tan

Faculty of Economics and Business, Universiti Malaysia Sarawak

94300 Kota Samarahan, Sarawak, Malaysia

Chin-Hong Puah (Corresponding author)

Faculty of Economics and Business, Universiti Malaysia Sarawak

94300 Kota Samarahan, Sarawak, Malaysia

E-mail: chpuah@unimas.my

Shirly Siew-Ling Wong

Faculty of Economics and Business, Universiti Malaysia Sarawak

94300 Kota Samarahan, Sarawak, Malaysia

Mei-Teing Chong

Faculty of Economics and Business, Universiti Malaysia Sarawak

94300 Kota Samarahan, Sarawak, Malaysia

Received: March 2, 2020 Accepted: April 9, 2020 Published: April 15, 2020

doi:10.5296/ber.v10i2.16577 URL: https://doi.org/10.5296/ber.v10i2.16577

Abstract

This paper scrutinised the impact of economic uncertainty on the broad money demand in South Africa using quarterly data from 2001 to 2018. Generalized Autoregressive Conditional Heteroscedasticity (GARCH) model is employed to capture the volatilities of selected components in order to construct an economic uncertainty index (EUI) for South Africa. The constructed index is then used as a regressor along with real income, interest rate and exchange rate in determining South African demand for broad money. The empirical finding using the Autoregressive Distributed Lag approach notably shows that the EUI is negatively affecting South Africa's demand for broad money in the long term. This reveals that economic agents tend to hold real or safer assets than riskier assets, thus reduce broad money demand during times of heightened economy in South Africa. The model is cointegrated in the long-run and stable with the inclusion of EUI in the broad money demand function for South Africa. The findings are able to assist policy makers in using suitable determinants as stabilisation tools and targeting a more effective monetary policy framework refined by appropriate monetary aggregates in South Africa.

Keywords: Economic uncertainty index, Money demand, GARCH, ARDL, South Africa

1. Introduction

South Africa is the second-largest economy among the 54 African countries after Nigeria in terms of gross domestic product (GDP). It has been categorized as one of the upper-middle income economies in Sub-Saharan Africa, along with Botswana, Equatorial Guinea, Gabon, Mauritius and Namibia following the World Bank list of economies as of June 2018. Nevertheless, this resource-intensive country is highly vulnerable to turbulence in foreign exchange markets and economic volatility due to its vast capital market exposure. According to Statistics South Africa (2017), the country encountered few significant recessions since the year 1961. In 1990-1992, it faced double-digit inflation as well as deficit on the balance of payments due to capital flight and debt repayment issues. Moreover, South Africa's economic growth experienced several slumps in the aftermaths of the Asian Financial Crisis (1997), South African Currency Crisis (2001), and Global Financial Crisis (mid 2007-early 2009), to name a few.

In 2012, the South African economy was negatively affected by the underperforming economic condition of a neighbouring country, Zimbabwe, and some political issues (Redl, 2018). In fact, Zimbabwe is recognized as important trading partner with South Africa and they have conducted strong bilateral trade since 1964. The main exports of South Africa are machinery products, mineral fuels and oils while the import items from Zimbabwe are gold, platinum and raw tobacco. The growth rate of GDP in 2013 was driven by the manufacturing sector. In 2015, the rand depreciated due to the replacement of the finance minister by President Jacob Zuma. Notably, a depreciation of currency led to inflation and financial uncertainty (Chan et al., 2019). In this case, the confidence of investors was shaken, which further induced an extensive withdrawal of financial assets from South Africa. Based on the report from United Nations Economic Commission for Africa (2017), South Africa faced unfavourable economic conditions including increasing account deficit, slump of oil and commodity prices and the drought issue in 2016. Meanwhile, the report also highlighted that the rand was greatly affected due to the shocks from domestic policy as well as tightening monetary policy.

As one of the leading emerging economies, South Africa is widely vulnerable to exceptional levels of uncertainty in developed countries or other emerging economies (Simo-Kengne et al., 2017). To cope with the economic fluctuations and to achieve price stability, the implementation of a monetary policy targeting monetary aggregates requires a money