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Does the Global Financial Crisis Play A Role in The Causal Relationship Between Exchange Rates and Stock Prices In South Africa?

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ABSTRACT

This paper examines the causal relationship between the exchange rate and stock prices and the effect of the financial crisis on this relationship using monthly time series data and VAR-based approach. It further analyzes the long-run relationships. The results show that exchange rate and stock prices were unrelated prior to the crisis, yet the interdependence between these markets has increased since the crisis as there is now unidirectional Granger causality from stock prices to the exchange rate. It further confirms that the variables exhibit long-run cointegrating relationships. Also an increase in stock prices leads to an appreciation of the exchange rate. Monetary policy that targets inflation through interest rates will inevitably affect investment which in turn affects capital flows, money demand and thus the exchange rate. The government can strive towards a stable exchange rate and growth in the stock market by avoiding sharp swings in monetary policy.

KEYWORDS Exchange rate; stock price; long run; causality; global financial crisis

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