

Development Finance Working Paper Series¹

Liberalisation of capital controls: A review of South African exchange controls and their impact on exchange rate stability

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No. DEFWPS170004

December 2017

¹ **Note:** The findings from this working paper does not in any way reflect the views of the Development Finance Centre (DEFIC). The views are only representative of the authors.

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Published by:

The Development Finance Centre (DEFIC),
Graduation School of Business, University of Cape Town,
9 Portswood Rd, V & A Waterfront, Cape Town, 8002
Centre webpage: <http://www.gsb.uct.ac.za/s.asp?p=791>

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Abstract

The 2007/08 global financial crisis, including pre- and post-crisis reform, led economies to re-examine the concept of capital controls. Theoretical and empirical literature has been divided regarding their effectiveness. This research paper assesses the impact of capital controls on exchange rate stability in South Africa (particularly exchange restrictions¹ used to insulate economies from excessive currency volatility) using time series analysis and employs event study methodology (Kothari & Warner, 2006; MacKinlay, 1997) to measure the impact of the capital control actions. More specifically, this research paper evaluates the impact of capital controls on (a) exchange rate returns, (b) volatility and (c) liquidity in South Africa for the period commencing 1 January 1999 to 31 December 2014 including the period during the 2007/08 financial crisis. The research paper applies methodology from empirical research on capital controls and currency stability (Pandey, Pasricha, Patnaik, & Shah, 2015), volatility using standard deviation and the GARCH (1,1) model (Abdalla, 2012; Bollerslev, 1986; Farrell, 2001) and liquidity (Karnaukh, Ranaldo, & Söderlind, 2015). In addition, it attempts to determine the effect on exchange rate movements directly attributable to capital controls i.e., the local factors, by removing the dollar risk factor that constitute a significant portion of exchange rate time series as noted by Verdelhan (2015), which serves as the base model for the event study. The research paper finds that overall the key capital controls selected do not have a significant impact on the ZAR/USD exchange rate with limited evidence of an effect on returns, volatility and liquidity.

Keywords: Capital Controls | Exchange Rate | South Africa |