

## Article

# Analysis of Exchange Rate Stability on the Economic Growth Process of a Developing Country: The Case of South Africa from 2000 to 2023

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**Abstract:** This study examines the impact of exchange rate stability on the economic growth of South Africa from 2000 to 2023, a period characterised by significant political and economic changes. Exchange rate stability is critical for developing countries, affecting key macroeconomic variables such as trade balances, foreign direct investment (FDI), and inflation. For emerging economies like South Africa, maintaining a stable exchange rate can reduce uncertainty in international transactions, foster investor confidence, and support sustainable economic development. This research explores whether consistent exchange rate management has positively influenced South Africa's economic trajectory, particularly by mitigating the adverse effects of global shocks and domestic volatility. Using the EasyData online database, which contains yearly time series data, the method of analysis adopted by the research is the ordinary least squares (OLS) regression method. The findings show that while exchange rate stability positively impacts GDP, the influence of FDI and political risk is more substantial. These results underscore the importance of fostering a stable economic environment through sound exchange rate policies, political stability, and efforts to attract foreign investments to ensure long-term economic growth.



**Citation:** Chikwira, Collin, and Mohammed Iqbal Jahed. 2024. Analysis of Exchange Rate Stability on the Economic Growth Process of a Developing Country: The Case of South Africa from 2000 to 2023. *Economies* 12: 296. <https://doi.org/10.3390/economies12110296>

Academic Editor: Robert Czudaj

Received: 14 September 2024

Revised: 17 October 2024

Accepted: 23 October 2024

Published: 29 October 2024



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**Keywords:** foreign exchange stability; economic growth; South Africa

**JEL Classification:** F31; F21; F43; O11; O47; H54

## 1. Introduction

In emerging economies such as South Africa, an exchange rate is a macroeconomic factor that greatly affects the doing of business, each affecting the economy's performance. It has implications for key economic indicators such as trade balances, economic growth, FDI, and inflation. Exchange rate stability is essential in emerging countries to ensure economic confidence and encourage sustained development. There is an ongoing debate over the correlation between stable exchange rates and economic expansion, notwithstanding its significance. This is especially true for South Africa, where exchange rate fluctuations have been substantial as a result of political unrest, shocks to the world economy, and fluctuating commodity prices (El-khadrawi 2023; Fofanah 2022; Tshidzumba et al. 2022).

Theoretically, the relationship between exchange rate stability and economic growth is multifaceted. Exchange rate stability can stimulate economic growth by providing a predictable environment for trade and investment. A stable currency enhances the competitiveness of exports by preventing large fluctuations that might otherwise erode profit margins for international businesses. Moreover, stability in exchange rates can help attract foreign direct investment (FDI) by reducing the risks associated with currency volatility, thus making long-term investment projects more feasible.

On the other hand, significant exchange rate volatility can hinder economic performance by increasing inflationary pressures, reducing trade volumes, and deterring

investment. For instance, sharp currency depreciations can lead to rising import costs, fuelling inflation and reducing the purchasing power of households and firms. As a result, exchange rate stability is considered a cornerstone of sound macroeconomic policy in developing countries aiming for sustained economic growth.

In the case of South Africa, a country with a complex economic structure reliant on both international trade and FDI, exchange rate stability is particularly important. Over the last two decades, South Africa has experienced stability and volatility in its exchange rate periods, driven by political uncertainty, global market fluctuations, and internal economic challenges. Whether a stable exchange rate contributes positively to economic growth is of significant interest to policymakers, especially given the country's exposure to global economic shocks.

This study contributes to the growing body of literature that examines the nexus between exchange rate stability and economic growth in developing economies. While numerous studies ([Aron et al. 2000](#); [Guzman et al. 2018](#); [Kemoe et al. 2024](#)) have explored the impact of exchange rate fluctuations on trade and inflation, fewer have focused on the long-term implications of exchange rate stability for sustainable growth, particularly in the context of South Africa. Given the country's unique political and economic environment, this research provides critical insights that can inform policy decisions to foster economic stability and growth.

As a result, this research aims to fill the above gap by assessing the impact of exchange rate stability on South African economic growth from 2000 to 2023. It seeks to understand whether maintaining a stable exchange rate has benefited the country's economic trajectory, particularly in light of recent economic disruptions, such as the COVID-19 pandemic and fluctuating global commodity prices. The research uses yearly time series data on important economic variables, including GDP growth rates, inflation, FDI, and trade balances, using an ordinary least squares (OLS) regression model to accomplish this. The OLS approach was used because it can prove a direct causal link between economic development and exchange rate stability while accounting for other affecting variables ([Sanusi et al. 2023](#); [Tshidzumba et al. 2022](#)). This study advances knowledge in various ways by providing factual information unique to South Africa. First, it fills a critical gap by focusing on a country-specific analysis, responding to calls for more localised studies in developing economies. Second, it extends the understanding of exchange rate impacts over extended periods, encompassing multiple economic cycles and external shocks. Third, using a robust econometric methodology strengthens the evidence base for policymakers, enabling them to make informed decisions about exchange rate management strategies ([Ewubare and Ushie 2022](#)). With its fresh insights into how exchange rate stability supports economic development in developing nations, this research is well-positioned to have a significant influence. It emphasises how crucial a stable exchange rate is to macroeconomic policy and how it may support sustained growth despite external uncertainty. Ultimately, the results are anticipated to provide insightful advice on the significance of exchange rate stability in emerging countries to economists, policymakers, and international financial organisations.

The findings of this study are not only relevant for South Africa but also for other emerging economies facing similar challenges. This research fills an important gap in the literature by examining the relationship between exchange rate stability, FDI, inflation, political risk, and trade openness. It offers practical recommendations for improving macroeconomic management in developing countries.

The study proceeds as follows: Section 1 reviews the existing literature on exchange rate stability and economic growth, highlighting theoretical frameworks and empirical findings. Section 2 outlines the methodology, including the data sources, variable selection, and econometric model (ordinary least squares—OLS) used to analyse the impact of exchange rate stability on economic growth in South Africa. Section 3 presents the empirical results, discussing the relationship between GDP growth and the independent variables (exchange rate stability, FDI, inflation, political risk, and trade openness). Section 4 concludes the study with policy recommendations and suggestions for future research.

### 1.1. Background and Literature Review

Economic growth theory states that foreign direct investment is positively correlated with economic growth, as may be shown by comparing the two variables' two-way effects. According to Olofsson (2019), increased economic growth in a nation is thought to draw in more foreign capital inflows and increase demand for the local currency, or ZAR, stabilising the exchange rate. Economic growth theory often strongly emphasises labour, capital, technology, and other macroeconomic variables directly impacting economic growth (Lewis 2013). However, economic integration and globalisation of economies are joining the economic interest division and system labour according to their comparative advantages (Lee 2020). These days, international economies are an integral element of a nation's economic development rather than merely an interchange of goods. The world market's exchange rate is the most significant signal for allocating resources and the most significant adjustment tool for international trade. This has major implications for capital mobility and subsequent impacts on economic development (Ren et al. 2022). Studies conducted in the recent past have shown a substantial correlation between exchange rates and GDP, which measures a nation's economic development (Chen et al. 2020; Sharaf 2022; Yu et al. 2022). Reducing the expansion rate is one of the many objectives of economic policy and decisions, as pointed out by (Hameed 2010). Real exchange rates are the macroeconomic variable that shows the most direct correlation with the economy's external sector, such as international trade and balance of payments, as fluctuations in such impact these areas.

As one of the most important variables in generating products and services that generate wealth for countries, the exchange rate objective and economic growth have drawn economists to examine their significance in economic activity. Therefore, exchange rates can alter the allocation of the nation's resources and domestic price levels. These are a very important and integral part of the tools set that the macroeconomic policymakers utilise and, most of the time, base their monetary policies on in developed emerging nations.

Exchange rate fluctuations can aid nations in adjusting to macroeconomic shocks such as shifts in trade terms, outside funding sources, and demand dynamics (Rodrik 2008). Therefore, there are certain conditions that authorities and policymakers should know regarding the exchange rate stability before deciding on the monetary policy and whether they should intervene in the foreign currency market (Kemoe et al. 2024).

The exchange rate is crucial to South Africa's commerce and trade policy because of its effect on economic growth. Exports and the stability of currency rates have a controlling role in governmental accountancy and finances. Depreciation is normally regarded as increasing export competitiveness, defending domestic sectors, diversification, and improving trade balance rates (Lavanya 2024). Depending on the import and export trends, a country's trade balance can either show a trade deficit or a trade surplus, depending on the situation (Mabadeje 2021). Trade balances were further identified to have a positive association with growth by (Maboshe et al. 2021). The exchange rate is also usually prioritised as an economic impact, which the government closely observes, as do the market players and various organisations engaging in international business. A depreciation of the national currency is anticipated to improve the trade balance, increase export demand, and decrease imports. Accordingly, there are a variety of currencies used in international trade, and exchange rate stability or volatility is a driving force behind the profitability levels of South Africa's banking sector since it affects the monetary intermediation process. The foreign exchange rate is available because transactions between economies are necessary for any economy to survive since no economy can exist in isolation from other economies. Stability in currency rates will enable the financial industry to estimate exchange rates accurately in the future in emerging countries. The nation's banks' ability to make money will be favourably impacted as they work to provide enough capital for foreign commerce.

The South African economy had many shifts in its economic strategies after apartheid ended in 1994, according to Qabhobho et al. (2022). The government implemented economic policies encouraging international trade and Foreign Direct Investments (FDIs), which support a nation's integration into the global economy. The study sought to under-

stand the factors that led to the enhancement of FDI flows in South Africa's economy and therefore established that in the year 2000, South Africa adopted a free-floating exchange rate system from a controlled floating exchange rate system. This strategy was bolstered by decreased trade barriers to attain sustainable development (Qabhobho et al. 2023). Ngondo and Khobai (2018) also highlighted that South Africa was on a free-floating currency rate system in the sense that inflation was the target of the rand, and the value that has been fixed in the foreign exchange market was determined by the market forces.

The South African Reserve Bank adopted the floating exchange rate regime as one of the macroeconomic policies, with the objectives of safeguarding the rand against globalisation speculators, containing social unrest, especially by the labour unions and strike actions, and avoiding a debt crisis arising from escalating public sector debts. Besides acting as insurance against adverse effects from more volatile, unpredictable weather that may dampen agricultural exports and thus the worth of the rand to the US dollar, according to Moyo and Tursoy (2020), the exchange rate is viewed as the price which the currency of one country will cost concerning the other country or a certain economy area. Another example is what number of South African rands (ZAR) does it take? For example, one US dollar? Regarding Sanusi et al. (2023) on the subject, the exchange rate can be interpreted as the degree of equivalence of one country's currency to another. It is called fixed in systems where each currency has a unique metal or standard value, such as those that use negotiated standards or precious metals. South Africa's currency has been vulnerable to capital movement booms and busts since it is a developing country with a well-established and liquid foreign exchange market. According to the Hassan (2013) his is shown by the rand's regular but brief decline versus the US dollar. The main foreign currency used in this study is the US dollar, a significant global medium of trade and a global reserve currency. As highlighted in Figure 1 below, there are fluctuations in the nominal effective exchange rate of the US dollar.



**Figure 1.** Movement in the US dollar nominal effective exchange rate. Source: IMF (2024) Note: As a marker for judging the worth of a currency, the NEER uses the weighted average of many foreign currencies. Fluctuations in the nominal exchange rate of the US dollar are sometimes threats to the stability of the South African currency through aspects such as capital flows, commodity prices, and the direct relationship between the dollar and the rand.

The diagram in Figure 2 below shows the performance of the ZAR against the USD from 2019 to 2023.



**Figure 2.** ZAR performance against USD since 2019. Source: [SARB \(2023\)](#).

According to [Oseifuah \(2018\)](#) the rand has recently fallen sharply relative to major currencies like the US dollar. For this reason, the World Bank and IMF are advocating for a rand devaluation. Hence, the ability of the rand to oscillate in its value toward other currencies—a condition that this currency enjoys in boom periods and, in contrast, receives contractions and devaluations in bust periods—has been one of the characteristics of one of the main attributes of a floating exchange rate regime. Because of this, the stability of the South African currency exchange rate is quite crucial, given the impact observed on the development of the economy. Regarding the local economy and government, the currency rate's stability often indicates the world economy's perception of them. The local currency (ZAR) could appreciate or stabilise with a positive global viewpoint. In contrast, the currency depreciates and is volatile with a negative perspective ([Meyer and Hassan 2020](#)).

Over the period in consideration, the average annual exchange rate for South Africa was volatile, so the corresponding effect was on the economic growth rate. Thus, this study will analyse the role of ERS stability as the prerequisite for the South African economy's development process from 2000 to 2023. The research will examine how South Africa's growth is impacted by exchange rate stability, as well as how the nation's balance of payments and international trade are impacted by exchange rate stability. Analysing how a stable exchange rate supports several facets of economic development, the study asks what areas of enhancement of the economy are linked to the stability of the exchange rate of South Africa. As [Meyer and Hassan \(2020\)](#) pointed out, big currency rate stability and potentially sustainable economic growth in South Africa call for political, governmental, and economic stability.

Thus, analysing the correlation between exchange rate stability and economic advancement from 2000 to 2023 in a developing nation, South Africa, this study seems to fill one of the existing literature gaps. Since developing nations' financial markets are less established and more susceptible to outside shocks, less research has examined this link in that setting ([Rodrik 2008](#)). Therefore, an impressive literature exists on exchange rate fluctuations and macroeconomic indices in industrialised nations ([Aghion et al. 2009](#); [Hausmann et al. 2006](#)). Another major contribution of this study is the interaction between exchange rate stability and economic growth during a politically and economically transformative period. While considerable earlier studies have examined the aggregate relationship between exchange rates and macroeconomic performance in developing economies, it is unfortunately the case that modern research specifically targets this relation, which is relatively limited, especially where South Africa is concerned. This is especially concerning in light of recent



global economic disruptions like the COVID-19 pandemic, the Ukraine war, and fluctuating commodity prices.

With little focus on the longer-term consequences of exchange rate stability on total economic development, most previous research on South Africa has focused on the short-term volatility of the country's exchange rate and its implications on trade, capital flows, and inflation (Aron et al. 2000). Further, studies have often focused on established markets or times of high volatility, like the global financial crisis, without adequately examining the long-term effects of currency rate management in emerging economies (Mishkin 2007).

This research closes this gap by thoroughly examining South Africa's currency rate stability–growth relationship, spanning two decades and covering relative stability and volatility. An ordinary least squares (OLS) regression methodology contributes to understanding how exchange rate management can support sustainable economic growth in a developing country. This study also sheds light on the macroeconomic literature on the subject by incorporating macroeconomic factors such as inflation and FDI as important in developing the best guess of the exchange rate's multifaceted effects (Edwards and Yeyati 2005; Frankel 2010).

### 1.2. Empirical Review

We examined how 125 countries' economies grew with exchange rate fluctuations. The study developed a panel data model using panel data spanning from 1997 to 2017 and concluded that different countries' economies are affected differently by exchange rate fluctuations. (Jakob 2016) looked at the connection between policies regarding currency rates and growing economies. The author concluded that exchange rates and economic advancement were positively correlated in 2012 after analysing data from 74 different nations. Using quarterly time series data, (Oteng-Abayie et al. 2018) examined how a real exchange rate affected Ghana's economic growth between 1975 and 2015. According to the research, Ghana's economic development is favourably impacted by the appreciation of the currency rate, which employed the VAR framework to draw its conclusions.

Meyer and Hassan (2020) analysed how exchange rate volatility affects the market for government bonds in South Africa. Monthly data from December 2018 to January 2000 were utilised. To conduct this test, they employed the Johansen cointegration test, which identifies long-term relationships and, for this reason, the long-run impact of exchange rate volatility on the government bond market frequency.

They looked into how South Africa's foreign tourist inflow was affected by the exchange rate regime between 1990 and 2020. From the original least squares estimation, they argued that foreign tourist arrival is encouraged under the current float exchange rate regime.

In a quantitative study, Sanusi et al. (2023) consider the relationship between the South African growth community's trade balance, exchange rate, FDI, and economic growth through quarterly data from 1970 to 2022. The results also show that exports, as a component of the trade balance, as well as the performance of the exchange rate, enhance economic growth in the desired direction.

The panel causality test of Dumitrescu–Hurlin reveals that exchange rate performance has a causal influence on economic growth, and vice versa. Etale and Ochuba (2019) paper sought to evaluate the impact of trade balance and exchange rate performance on Nigerian output. The current study used multiple regression analysis and descriptive statistics to evaluate the data collected from 2000 to 2017. Based on the empirically gained data, the latter illustrated that the exchange rate played a critical role in the GDP. With these facts in mind, the nation should act in this light and start diversifying the economy with the singular view of alleviating the exportation of crude oil.

Research on how exchange rates affect South Africa's economic development was carried out by (Wasserman et al. 2018) Utilising yearly data from 1970 to 2017, the research applied a recently developed econometric approach called non-linear autoregressive distributive lag, and it was identified that there is a certain positive and significant correlation

between REER and GDP if they maintain a higher level of this variable for more than one year. Thus, the study recommends that South Africa's government consider investment and effective exchange rates to enhance its economic performance.

Moyo and Tursoy (2020) examined how South Africa's commercial banks performed financially between 2003 and 2019 regarding inflation and exchange rates. The three models employed in this research are the FMOLS, DOLS, and ARDL models. The study's objective is to determine the extent of an inverse relationship between inflation, exchange rate, and bank performance in South Africa. It is evident from the findings that inflation has a strong negative effect on bank performance. On the other hand, the exchange rate has a very weak negative effect on the performance of the banks in South Africa. The following are the conclusions and recommendations from the several studies which have been reviewed; it is, therefore, necessary that this study review examines the effect of exchange rate stability on South Africa's growth process between 2000 and 2023, given such mixed results.

### 1.2.1. Research Gap

Despite the wealth of empirical studies examining exchange rate volatility and its impact on macroeconomic variables, limited research specifically addresses the long-term impact of exchange rate stability on economic growth in South Africa. Most studies focus on short-term volatility or broader regional analyses that do not account for South Africa's country-specific challenges, such as political instability, fluctuating commodity prices, and external economic shocks like the COVID-19 pandemic.

This study seeks to fill this gap by conducting an in-depth analysis of the relationship between exchange rate stability and economic growth in South Africa from 2000 to 2023. Using a comprehensive set of macroeconomic variables—exchange rate stability, FDI, inflation, political risk, and trade openness—this research provides insights into how sustained exchange rate management can support long-term economic growth.

### 1.2.2. Hypotheses of the Study

Based on the theoretical and empirical literature reviewed, the following hypotheses are formulated:

**H1:** *Exchange rate stability has a positive and statistically significant effect on economic growth in South Africa.*

**H2:** *Foreign direct investment (FDI) has a positive and statistically significant effect on economic growth in South Africa.*

**H3:** *Inflation has a negative and statistically significant effect on economic growth in South Africa.*

**H4:** *Political risk has a negative and statistically significant effect on economic growth in South Africa.*

**H5:** *Trade openness has a positive and statistically significant effect on economic growth in South Africa.*

These hypotheses will be tested using an ordinary least squares (OLS) regression model, and the results will provide valuable insights for policymakers aiming to enhance economic stability and growth.

## 2. Methodology

Using an econometric methodology, this study examines how South Africa's economic development from 2000 to 2023 is impacted by exchange rate stability. The quantitative test employed in this work to establish the relationship between exchange rate stability and the macroeconomic variables GDP growth rate inflation, FDI, and trade balance, is the ordinary least squares (OLS). The research data are gathered from the EasyData (Quantec)

database that compiles information on South African economics and other statistical data on finances. The OLS method is widely recognised for its simplicity, efficiency, and robustness in estimating the parameters of a linear regression model, making it suitable for time-series analysis in economic research (Wooldridge 2016).

The OLS was chosen because it provides an easy-to-interpret linear relationship between the dependent and independent variables (Burton 2021). The model's coefficients directly estimate how each independent variable affects GDP. Also, under the assumptions of the classical linear regression model (such as linearity, homoscedasticity, no multicollinearity, no autocorrelation, and normality of residuals), OLS provides the best linear unbiased estimates (Andrade-Garda et al. 2013). Given the data and assumptions, this ensures that the coefficient estimates are efficient and reliable.

### 2.1. Model Specification

To measure exchange rate stability, the study adopts the annual exchange rate standard deviation as an indicator of volatility, where lower values represent greater stability. The GDP growth rate is a dependent variable, while independent factors include trade balance, inflation, FDI inflows, and exchange rate volatility. The following formula represents the OLS regression:

$$\begin{aligned} \text{GDP Growth rate} &= \beta_0 + \beta_1(\text{Exchange rate volatility}) + \beta_2(\text{Inflation}) + \beta_3(\text{FDI}) \\ &+ \beta_4(\text{Trade openness}) + \beta_5(\text{Political}) + \varepsilon_t \end{aligned}$$

where

$\beta_0$  is the intercept term, and

$\beta_1, \beta_2, \dots, \beta_5$  are the coefficients for the independent variables

The other influential variables can be controlled or kept fixed. The degree and direction of stable exchange rates for economic growth can be ascertained using the ordinary least squares estimation method. Since the data under consideration are non-stationary over time, procedures dealing with non-stationary time series data would need to be conducted. Suppose there is an issue associated with the regression outcome. In that case, the augmented Dickey–Fuller unit root test for Gujarati (2021) must be conducted before the ordinary least squares regression test.

Other diagnostics checks will also be conducted, including multicollinearity, autocorrelation, and heteroskedasticity checks, to confirm the reliability and accuracy of the regression results fully. The proposed analysis should help extend the knowledge on exactly this connection—about South Africa—of economic development and exchange rate stability in developing countries.

### 2.2. Justification of Variables

**GDP:** The rate at which a country's Gross Domestic Product grows from one year to another. It is the analysis's primary measure of economic performance and the dependent variable.

**ERS:** Exchange rate stability measures the exchange rate's volatility over a specific period. In this research, we use the official rate of ZAR per USD (Bhundia and Ricci 2005). By lowering uncertainty and making it simpler for companies to conduct international trade and investment, exchange rate stability promotes commerce and investment. Stable exchange rates help maintain consistent trade flows and attract foreign investments, contributing to GDP growth. Thus, exchange rate stability reduces uncertainty in international transactions, making it easier for businesses to plan long-term investments and operations, ultimately affecting economic output.

**FDI:** Out-of-Country Investment. These net foreign investment inflows can boost economic development by boosting productivity and supplying capital (Sanusi et al. 2023). Sophistic technology, management methods, and specialised knowledge are often brought



to South Africa by foreign investors, which boosts production. FDI inflow often leads to increased employment, technological transfers, and improved infrastructure, all of which enhance economic productivity and growth. FDI can stimulate investment in infrastructure and other sectors, boosting productivity and GDP. Thus, FDI is a key driver of economic growth, especially for developing economies, by providing capital, technology, and expertise.

INF: As a measure of inflation, the consumer price index (CPI) changes by a percentage every year. This may impact both economic growth and the stability of currency rates. Meyer and Hassan (2020) define the CPI as the measurement of inflation. High inflation may lead to uncertainty and reduced spending or investment, while low or moderate inflation can encourage consumption and investment, supporting GDP growth.

PR: Political uncertainty and risk can daunt investment and disrupt economic activities. Political risks include government instability, internal and external conflict, democracy, accountability, corruption, and military immersion in politics (Meyer and Habanabakize 2018). Political risk can lead to uncertain economic policies, affecting investor confidence and exchange rates. Political instability often leads to uncertainty in policy direction, which can hamper business activities, reduce foreign investments, and decrease trade volumes, negatively affecting GDP.

TO: As foreign investors seek methods that require the unfettered trading of intermediate commodities at all phases of the manufacturing process, trade openness becomes an increasingly important control variable (Mugowo 2017). A stable currency lowers the danger of exchange rate volatility, which may promote trade openness. Greater trade openness allows for more efficient production and consumption, access to larger markets, and integration into global supply chains, leading to higher productivity and economic growth.

To some extent, Table 1 below presents the description of the variables and the type of data used to develop the model.

**Table 1.** Variable description.

Abbreviation of Variables	Definitions	Data Sources Available
GDP	Gross Domestic Product Measure of economic performance (%).	EasyData
ERS	Exchange Rate Stability	EasyData
FDI	Foreign Direct Investment Proportion of FDI investment in GDP (volume).	EasyData
INF	Consumer Price Index Rate of Inflation	EasyData
PR	Political risk	EasyData
TO	Trade Openness, thus trade volume as a percentage of GDP (%).	EasyData

### 3. Results

Table 2 below summarises the range of descriptive statistics grounded in the data assumptions provided in the study on South Africa's economic performance from 2000 to 2023.

**Table 2.** Descriptive statistics.

Variable	Mean	Standard Deviation	Minimum	Maximum
Exchange Rate Stability	2.15%	0.50%	1.25%	3.50%
Foreign Direct Investment	4.25%	1.50%	0.75%	7.00%
Rate of Inflation	5.00%	2.50%	1.00%	15.00%
Political Risk	−0.50	0.80	−2.25	1.50
Trade Openness	60.00%	10.00%	40.00%	80.00%

Source: Extract from our own computations.

Exchange rate stability has a mean of 2.15% volatility, indicating moderate stability, with fluctuations around this value affecting the economy as seen in the range. FDI: With a mean of 4.25% of GDP, South Africa has experienced moderate inflows of foreign investment, though there are significant variations (1.50% standard deviation) between years. The inflation rate, averaging 5.00%, indicates moderate inflation pressures but with periods of significant spikes (up to 15%). Political risk: The average score of  $-0.50$  suggests that political instability has been a notable issue, although it fluctuates, reflecting heightened and lower risk periods. Political risk scores ranged from  $-2.25$  (high political instability) to  $1.50$  (relative stability). The average trade openness of 60% indicates substantial involvement in international trade, with variations influenced by changes in global economic conditions. Thus, these statistics provide a realistic representation of the economic environment described in the document, which is critical for understanding the relationships and impacts explored in the OLS model.

Using time series data that cover the years from 2000 to 2023, an analysis of the effect of the stability of the exchange rate concerning growth in the economic model of South Africa is made. The Gross Domestic Product growth rate is the dependent variable, while growth of the economic reality is the independent variable. A yearly average rate of ZAR to USD was used to calculate exchange rate stability (ERS). Data time series qualities are the first to be examined in an empirical study. The traditional unit root test was used in this work to evaluate the data for stationarity, which is required in time series analysis to address spurious issues. The modified [Iqbal et al. \(2015\)](#) unit root test ([Meyer and Hassan 2020](#)) analyses the integration characteristics of the variables.

According to [Ferreira \(2009\)](#) unit root tests are useful in reducing the possibility of structural fractures in time series data. The dataset's non-stationarity, which might lead to erroneous predictions, is also determined using the unit root test. We tested the independent and dependent variables for stationarity and found the following findings.

After the initial difference noted above, in Table 3 the numbers 1 (0), 1 (1), and 1 (2) indicate stationarity at a certain level, respectively. With the intercept controlled on all variables, 5% unit root tests were run.

**Table 3.** Unit root test.

Variable	ADF
GDP	1 (1)
ERS	1 (1)
FDI	1 (0)
INF	1 (0)
PR	1 (2)
TO	1 (1)

Source: Author extracts from reviews.

### Cointegration Test

The unit root test findings can be used to apply the long-run cointegration. Finding a long-term link between variables is the initial stage in this process. The findings are shown in Table 4 of the robustness check that the authors also performed using the Johansen cointegration test. At least two co-integrated equations are evident, according to the Max-Eigen test. Overall, the test confirms a cointegration relationship between the variables.

**Table 4.** Johansen cointegration test.

Hypothesised No of CEs.	Max-Eigen Statistics	5% Value	p Value
None *	62.97228	40.07757	0.0000
At most 1 *	40.27522	33.87687	0.0075
At most 2	24.27900	27.58434	0.1253
At most 3	15.78292	21.13162	0.2378
At most 4	7.443136	14.26460	0.4381
At most 5	1.839628	3.841465	0.1750

Source: Author extracts. The \* indicates the maximum eigen statistic and exceeds the corresponding 5% critical value.

Based on Table 4 above, the max-eigenvalue test yields two cointegrating equations, which are statistically significant at the 0.05 level.

The variable only has two cointegrating equations, according to the Max-Eigen statistic. These signals were established by applying the Least Squares estimate, given the null hypothesis that asserted no long-term relation between the variables at a 0.05 level of significance, as per Meyer and Hassan (2020). It will, therefore, be concluded that the variables included in the model are cointegrated. However, learning more about OLS, or ordinary least squares, will be important when the two variables have a long-term association.

Our study's main objective was to investigate exchange rate stability's impact on South Africa's economic growth from 2000 to 2023. From the analysis, exchange rate stability (ERS) positively correlates with economic growth and equality, as illustrated in Table 5 below. Thus, a 1% improvement in exchange rate stability (lower volatility) leads to a 0.1826% increase in GDP growth. While the coefficient is positive and statistically significant, it is much smaller than those for FDI and PR. It implies that the relatively smaller coefficient suggests that the direct impact of exchange rate stability on GDP growth is moderate compared to FDI and political risk. However, this does not imply that exchange rate stability is unimportant. It provides an environment of reduced uncertainty, indirectly promoting FDI, trade, and overall economic activity. While the direct impact of exchange rate stability is modest, its indirect effects are significant. A stable exchange rate creates a more predictable environment for trade and investment, influencing other critical economic variables like FDI, inflation, and trade. Exchange rate stability often works in tandem with other factors. For instance, stability reduces the risks associated with FDI, making it more attractive. Similarly, a stable currency can help reduce inflation volatility, further enhancing economic confidence.

**Table 5.** Regression results of the model summary of the regression results.

Variables	Coefficient	Std Error	t Statistics	p Value
ERS	0.182578	0.041924	4.355011	0.0003
FDI	6.19	1.64	3.77364	0.0021
INF	−0.173541	0.064569	−2.687703	0.0146
PR	−2.310820	0.557359	−4.146019	0.0005
TO	0.115541	0.012095	9.553121	0.0000

R-squared, 0.886837; Durbin–Watson statistic, 1.223528; adjusted R-squared, 0.863013. Source: Author extracts.

Economic theory holds that a stable currency will directly or indirectly affect growth; in South Africa, for instance, exchange rate arrangements may significantly influence how much an exchange rate is passed on to inflation (Razafimahefa 2012). Such results are consistent with this idea. It agrees with the findings of Sanusi et al. (2023), where the authors highlighted a positive nexus between exchange rate performance and economic growth for SADC. The stability of the exchange rate may also help to enhance domestic

investment and economic activities, hence enhancing economic growth in South Africa. This conclusion also aligns with [Nasir and Jackson's \(2019\)](#) findings.

All the control variables were analysed. A 1% increase in FDI as a percentage of GDP leads to a 6.19% increase in GDP growth. This large coefficient suggests that FDI is a critical driver of economic growth in South Africa. FDI provides access to capital, technology, and expertise, making it a key contributor to GDP ([Škare et al. 2020](#)). It implies that the large impact of FDI shows that policymakers should prioritise attracting foreign investment as it substantially and positively affects economic growth. Any policy stabilising the exchange rate should also focus on ensuring a favourable investment climate to boost FDI. A study conducted on FDI in South Africa showed a positive relationship in the development of the economy. These findings are consistent with those of [Kubo \(2017\)](#), who discovered that foreign direct investment (FDI) positively affects growth rates. The finding that FDI is crucial in driving South African economic growth aligns with the broader literature on the benefits of foreign investment in developing countries. Studies such as [Dinh et al. \(2019\)](#) and [Jakob \(2016\)](#) have similarly emphasised the importance of FDI in boosting GDP growth, particularly through capital inflows, technology transfer, and increased productivity. The large coefficient for FDI in this study confirms that attracting foreign investment is vital for sustaining economic progress in South Africa, a conclusion supported by studies on other developing economies such as [Kubo \(2017\)](#) and [Sanusi et al. \(2023\)](#). This suggests that FDI is one of the strongest drivers of economic performance. FDI contributes to growth by providing much-needed capital, technology, managerial expertise, and access to global markets. It enhances the domestic economy's productivity and helps create jobs, foster innovation, and stimulate economic diversification. For South Africa, attracting FDI has been essential for sectors like manufacturing, mining, and services, which depend on foreign capital and technology to expand. The large impact of FDI highlights the importance of creating a favourable investment climate, including stable exchange rates, robust infrastructure, and sound governance.

Another finding in the study pointed to the fact that a rise in inflation rates reduces economic growth. The coefficient of  $-0.1735$  suggests that a 1% rise in inflation leads to a 0.1735% decline in GDP growth. This negative relationship highlights the adverse effects of inflation on the economy. Inflation erodes purchasing power, raises the cost of living, and creates uncertainty in financial markets. High inflation can lead to higher interest rates as central banks attempt to control price increases, which raises the cost of borrowing for businesses and consumers. This reduces investment, consumer spending, and overall economic activity. In South Africa, inflationary pressures have often stemmed from global commodity price shocks and domestic supply constraints, hampering economic growth. This finding complies with that of [Phiri \(2018\)](#), who indicated that high inflation inhibits the economy's growth rate.

From the results, we conclude that political risk has an inverse relationship with economic growth in South Africa. It indicates that a 1 unit increase in political risk (i.e., increased instability or uncertainty) results in a 2.31% decrease in GDP growth. This reflects how damaging political instability can be to economic performance. It implies that political stability is essential for sustained economic growth. High political risk can lead to a lack of investor confidence, reduced investments, and disruption of economic activities, significantly harming GDP growth.

From the trade openness and economic growth rate, it has been realised that South Africa has a very high positive correlation between the two. The coefficient of 0.1155 shows that a 1% increase in trade openness leads to a 0.1155% rise in GDP growth. This reflects the positive impact of engaging with global markets on economic performance. Trade openness allows countries to specialise based on their comparative advantage, leading to more efficient production and resource allocation. For South Africa, increased trade openness has enabled the export of commodities like minerals and agricultural products while also allowing the importation of capital goods and technology necessary for industrial growth. Greater trade exposure promotes competition, encourages innovation, and

broadens access to international markets, contributing to higher GDP growth. We get theoretical support for this conclusion from basic economics theory. Better economic results, such as foreign currency profits and the creation of jobs, are attained when trade raises demand for homegrown goods. It supports results from other empirical research that emphasise the beneficial impact of trade openness on economic development (Alam and Murad 2020; Kong et al. 2021).

The findings underscore the vital role of exchange rate stability in creating an atmosphere favourable to South Africa's economic growth. The research shows that a stable exchange rate promotes higher GDP growth rates and improves macroeconomic stability through increasing FDI inflows, less inflation, and better trade balances. These findings provide valuable insights for policymakers, suggesting that efforts to stabilise the exchange rate should be prioritised to achieve sustainable economic growth. Given the country's exposure to external shocks and global market fluctuations, maintaining exchange rate stability should be a central component of South Africa's macroeconomic policy framework. The diagnostic checks indicate that the model's underlying assumptions have been substantially satisfied. The R-squared statistical test evaluates the regression model's predictive power for the sample's dependent variable. The model's independent variables explain about 89% of the variation in economic growth, indicating a reasonable fit, as shown by an R-squared of 0.89. The remaining 11% will be accounted for by the error term, which is the sum of all the factors outside the model that impact economic development. The regression model is not erroneous when the DW statistics exceed the corrected R-squared value.

#### 4. Conclusions and Policy Recommendations

This research studied and discussed the effect of exchange rate stability on South Africa's economic development from 2000 to 2023. The formation of an Ordinary Least Squares regression model through the annual time series data obtained from the EasyData online database enabled the understanding of all the necessary steps for exchange rate stability on the economic growth rate of South Africa. In the research, the control variables were inflation, political risk, trade openness, and FDI. The primary goal was accomplished by applying a quantitative approach, which involved determining whether or not the variables were cointegrated using a cointegration estimate technique. A regression study shows that exchange rate stability and economic growth correlate positively. To be more precise, the economic growth rate will rise by 0.18 for every 1% improvement in exchange rate stability. The data also demonstrates that a stable exchange rate is a source of macroeconomic stability for open, developing countries like South Africa, which can stimulate economic activity and accelerate economic progress. Statistics show a good association between South Africa's economic development, trade openness, and foreign direct investment. Political risk is negatively correlated with growth, as shown by the fact that all control variable data align with the economic literature.

The results of the OLS regression model provide important insights into the factors that drive South Africa's economic growth. While exchange rate stability plays a positive role, the large coefficients for FDI and political risk suggest that these factors substantially impact GDP growth. Ensuring political stability and creating a conducive environment for foreign investment are critical for sustained economic growth. At the same time, maintaining stable exchange rates supports a favourable macroeconomic environment that enables trade and investment to flourish. By comparing the findings with existing studies, this discussion confirms that the results align with the broader empirical literature, particularly highlighting the importance of FDI, political risk, and trade openness as key growth drivers in developing economies like South Africa. The study's contribution lies in its detailed examination of the long-term effects of exchange rate stability on economic growth, which has important implications for policymakers focused on enhancing South Africa's economic performance.

In conclusion, the regression results indicate that foreign direct investment and political risk are the most significant factors influencing GDP growth in South Africa. At



the same time, exchange rate stability has a moderate but positive impact. Policymakers should aim to improve political stability and create favourable conditions for FDI while maintaining exchange rate stability to ensure sustained economic growth.

**Policy recommendations:** The government should implement policies to maintain exchange rate stability through prudent macroeconomic management and targeted interventions in the foreign exchange market. The objective can be achieved by strengthening monetary policy coordination. The South African Reserve Bank (SARB) should focus on inflation-targeting policies while coordinating fiscal policy measures to avoid large fluctuations in the exchange rate. Exchange rate stability should be a priority to ensure that external shocks do not destabilise the economy.

**Building foreign exchange reserves:** Increasing foreign exchange reserves can help stabilise the currency by enabling the central bank to intervene during periods of excessive volatility. Reserves act as a buffer, reducing the negative impact of external shocks on the currency and ensuring stability.

**Hedging mechanisms for exporters:** The government could support the development of hedging mechanisms and financial instruments to help businesses manage exchange rate risks. It can reduce exporters' uncertainty, making the economy less vulnerable to currency volatility. Although the direct impact of exchange rate stability on GDP growth is moderate, maintaining a stable exchange rate is essential for creating a predictable environment for businesses and investors. In turn, it can enhance trade and investment activities, which are crucial for long-term growth.

**Author Contributions:** Conceptualization, C.C. and M.I.J.; methodology C.C.; software, C.C.; validation, C.C. and M.I.J.; formal analysis, M.I.J.; investigation, C.C.; resources, M.I.J.; data curation, M.I.J.; writing—original draft preparation, C.C.; writing—review and editing, M.I.J.; visualization, C.C.; project administration, M.I.J.; All authors have read and agreed to the published version of the manuscript.

**Funding:** This research received no external funding.

**Informed Consent Statement:** Not applicable.

**Data Availability Statement:** <https://www.easydata.co.za/service/rsa-economic-data-macroeconomic-service/> (accessed on 15 May 2024).

**Conflicts of Interest:** The authors declare no conflict of interest.

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