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THE IMPACT OF EXCHANGE RATE ON TRADE BALANCES IN SOUTH AFRICA: A SECTORIAL ANALYSIS

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ABSTRACT

This paper attempts to explore the J-curve phenomenon in the case of South Africanagricultural, mining and the manufacturing sector in order to examine whether the exchange rate can be taken as a policytool for improving sectorial in South Africa. Panel VAR model, cointegration and the impulse response function has been employed in order to see the relationships between the nominal effective exchange rate index (NEER) and trade balance (TB) as well as the real effective exchange rate index (REER) and trade balance(TB) of South Africa . The study found no evidence of "J-curve" in the case of South African trade. On the contrary to the "J-curve" phenomenon as explained by the classical text books, the findings of the study suggest that depreciation of South African exchange rate rather produces an inverted "L-curve" phenomenon indicating that there is no room for improving South African trade imbalance through acurrency devaluation process. However, the VECM impulse response function has revealed that in the long run all three sectors do not behave in a similar way; while trade balances of both manufacturing and mining has a permanent effect, agricultural sector has a transitory effect.

KEY WORDS: *Trade Balance, Exchange Rate, J-Curve*

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