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Can Conventional Push and Pull Factors Explain South African Portfolio Capital Flows ?

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PROBLEM STATEMENT

Private capital flows to and from emerging market countries is an important but poorly understood component of the international financial system. The aim of this paper is to analyze the determinants of foreign portfolio investment flows in a South African context for the period 1990-2003. In this regard, we discuss the relevant factors identified in economic literature in explaining capital flows, specifically portfolio flows, to emerging market countries. One of the central questions in the literature is whether capital flows are driven by push factors (external to the country) or pull factors (domestic forces). Our analysis contributes to the existing literature by extending the estimation period. A further distinguishing factor of this analysis is that purchases of SA bonds and shares by foreigners are analyzed separately. A separate analysis of bond transactions is especially significant in the light of the magnitude, as well as the highly volatile nature of capital flows related to bond transactions.

RESEARCH METHOD

We empirically investigate the determinants of total portfolio flows, assets, liabilities, share transactions by foreigners and bond transactions by foreigners. In modeling portfolio flows quarterly data are employed. As possible explanatory variables the following were considered: interest rate differentials, SA Rand per US$ exchange rate, real GDP growth (SA) and percentage change in SA industrial and commercial share prices. We also consider the impact of the terms structure of interest rates and total bond returns on bond transactions. We use the Johansen approach to cointegration.

RESULTS AND CONCLUSIONS

Our results indicate that portfolio flows to South Africa during this period cannot be adequately explained in terms of conventional push and pull factors identified in the literature. A possible explanation is that companies listed on the JSE (and especially shares bought by foreigners) are not representative of the overall South African economy. Furthermore, our results are indicative of pull factors dominating push factors in attracting portfolio flows to South Africa. We found that share prices are influenced by expected exchange rate depreciation and inflation. The most significant determinants of bond purchases by foreigners are interest rate differentials, and to a lesser extent, exchange rates and inflation.