Impact of South Africa’s Monetary Policy on the LNS Economies

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Abstract

The countries in the Common Monetary Area (CMA), South Africa, Lesotho, Namibia and Swaziland, have harmonised their monetary and exchange rate policies in a quasi-monetary union since 1990. Lesotho, Namibia and Swaziland (LNS) have pegged their currencies to the South African Rand thus effectively surrendering monetary policy to the South African reserve bank. The arrangement has resulted in benefits in the form of lower prices, economy on trading costs, and a large increase in trade volume and cross-border financial transactions. However, one cost that has confronted the LNS economies in this monetary arrangement is the loss of independent monetary policy decision-making for stabilisation purposes. This study applies VAR to trace the impact of South Africa Reserve Bank’s (SARB) monetary policy on the LNS economies. Specifically, the study examines how a change in the policy instrument of the Reserve Bank of South Africa affects money, credit and level of prices in the LNS economies and consequently assesses the capability of these economies to undertake independent monetary policy. Both the impulse response functions and the cumulated forecast errors show that the lending rates, level of prices and money supply respond instantaneously to changes in the repo rate by the South African reserve bank. Our analysis confirms that the South African repo rate is the relevant policy instrument.

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for these economies as opposed to the LNS countries’ central bank rates. The study concluded that under the existing monetary arrangement, the LNS economies may not be able to undertake independent monetary policy.

- **JEL Classification:** E41, E51, E52, E58
- **Key Words:** Monetary Policy, Transmission Mechanism, Monetary Integration

### I. Introduction

Over the past decades, the countries in the Common Monetary Area (CMA), South Africa, Lesotho, Namibia and Swaziland, have harmonised their monetary and exchange rate policies. South Africa as a dominant and a bigger economy in the arrangement has been responsible for setting the pace and terms of changing policies in the arrangement. This arrangement has prevented the LNS (Lesotho, Namibia and Swaziland) countries from exercising any discretionary monetary policy. However, monetary policy is undertaken in South Africa with the domestic economy as the main target and to a lesser extent economic circumstances in the LNS countries. The precinct of policy has been that so long as the exchange rates of these countries are pegged to the South African Rand and as long as South Africa pursues a policy of stable and low inflation, the impact of policy will be transmitted to the LNS countries without delay and these economies will experience economic growth.

There is consensus that, over the years, the CMA arrangement has resulted in benefits in the form of lower prices, economy on trading costs, and a large increase in trade volume and cross-border financial transactions (Guma 1985, Van de Merwe 1997, Tjirongo 1998, Abedian and Matshego 2003). However, one cost that has confronted the LNS economies in this monetary arrangement is the loss of independent monetary policy decision-making for stabilisation purposes. Even as countries in this arrangement move towards deeper integration, the recurring issue on the minds of the LNS countries is their inability to target their monetary policy to their domestic disturbances, since they are forced to accept the policy chosen by the anchor currency country *i.e.*, South Africa. In principle, the cost from the loss of independence in monetary policy formulation is greater the less correlated a country’s disturbances are with the anchor country. From the Optimum Currency Area (OCA) literature, a necessary condition for the formation of a monetary union is that countries must have similar production structures so that they are affected