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Threshold Cointegration and Nonlinear Causality Test between Inflation Rate and Repo Rate

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Abstract

The current study investigated a cointegration and nonlinear causality relationships between inflation and repo rates of South Africa using the data spanning the period of January 2002 to March 2016. We used a threshold vector error correction model (TVECM) and nonlinear Granger frameworks causality to carry out the analysis. Preliminary analysis of data revealed the expected properties of the data such as nonlinearity, non-stationarity and co-movement of the variables. The two variables confirmed to be moving together in the long-run according to the observed supWald test statistic. Finally, the Diks-Panchenko nonlinear Causality test revealed a strong bidirectional nonlinear causal relationship between repo rate and inflation rate. The results imply that the use of repo rate to target the inflation rate during the target period did not address the financial problem in South Africa. Consequently, the study concluded that repo rate may not be a good measure to use for controlling inflation rates of South Africa.

Keywords: Threshold Cointegration, nonlinear causality test, financial data

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