Real Exchange Rate Volatility and Employment Growth in South Africa: The Case of Manufacturing

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South Africa has one of the highest unemployment rates in the world. This remains one of the key concerns to the policymakers in South Africa. Although there is a vast literature that examines the cause of high unemployment rates from a microeconomic perspective, there is limited work on this issue from a macroeconomic perspective. Exchange rate movements are expected to impact employment (and, indirectly, unemployment) through the profitability of the sector in export-oriented activities. This is so because exchange rate volatility changes the production costs of firms, and thus, causes uncertainty of future earnings. This affects investment decisions as well as employment because hiring workers represents an investment in the sense that there are costs incurred to reversing this decision.

The study investigates the effect of real exchange rate volatility on employment growth in South Africa, a country that is characterised by high rates of unemployment and relatively high exchange rate volatility. The study focuses on manufacturing sector because it is a major source of employment expansion in South Africa given that it has a large number of unskilled workers. As such, the poor performance of the manufacturing sector contributes significantly to South Africa's unemployment problem. Employing the Autoregressive Distributed Lag (ARDL) cointegration approach over the period 1995 to 2015, results show that the increase in real exchange rate volatility reduces manufacturing employment growth and that the appreciation of the real exchange rate level reduces manufacturing employment growth. So, the findings suggest that the negative developments in South Africa's labour market can be partly attributed to the exchange rate fluctuations. The results also show that manufacturing exports have a significant negative effect on manufacturing employment growth. Furthermore, manufacturing output, manufacturing wages and long-term interest rates have significant effects on manufacturing employment growth.

The findings of the study have important implications for future policy design. One of the policy conclusions based on the results in this paper is that suppressing exchange rate volatility should bring substantial benefits in the manufacturing sector in South Africa. The results between manufacturing exports and employment growth, suggest that South African government would benefit in re-structuring its exports to have positive effects on manufacturing employment growth in the long-run.

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