# The Impact of Global Risk Aversion and Domestic Macroeconomic Factors on the Dynamic Conditional Correlations of South African Financial Markets

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## Abstract:

This study aimed to ascertain the impact of global risk aversion and domestic macroeconomic factors on the dynamic conditional correlations between stock, bond, and foreign exchange (FX) markets in South Africa. The study uses the DCC GARCH model to ascertain whether correlations are dynamic and the OLS regression model to assess the impact of global risk aversion and domestic macroeconomic factors on these dynamic correlations. Results from the DCC GARCH model show that the SA stock-bond, stock-FX, and bond-FX correlations are significantly dynamic over time. Considering these findings, this study recommends the adoption of dynamic asset allocation and diversification strategies to enable continuous alignment of asset allocation and diversification with changing asset correlations. Investors should be aware that any changes in asset correlations necessitate the reconstruction of optimal portfolio weights, asset allocation, and diversification strategies for portfolios to remain fully diversified over time. Furthermore, results from the OLS regression models demonstrate that global risk aversion, current account balance, domestic market uncertainty, treasury bill rate, and savings have a heterogeneous impact on dynamic conditional correlation pairs, consequently affecting the diversification benefits across asset classes in SA. These findings highlight the need for active portfolio risk management strategies that respond promptly not only to changing levels of asset correlation but to global risk aversion and domestic macroeconomic factors as well. This study provides valuable insights and policy recommendations to investment practitioners, policymakers, and academia

## Keywords:

Risk aversion, Dynamic Conditional Correlations, GARCH.