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Impact of Financial Liberalisation on the Financial Development of Eight Countries Member of SADC

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Abstract

This study analyses how financial liberalisation affects the financial development in eight countries member of SADC for the year of 1980 to 2012. Financial liberalisation refers to the removal of the intervention a government imposes on key variables like interest rate. Therefore, it refers to the removal of various constraints in the financial sector. We will be examining the impact of some macroeconomic variables on the financial development of eight countries. We then will be using three measures for financial development which are bank credit to the private sector, bank deposits and stock market capitalization. Explanatory variables will be used to determine financial development and estimations are based on random-effect panel regressions. Random effect supposes that the difference across countries impact the level of financial development: for the banking development variable, inflation has a significant and negative impact on credit to private sectors and bank deposits. However, Portfolio investments and remittance have not impacted bank credit to private sector, bank deposit and stock market capitalization. Stock market capitalization appears not to be affected and do not improve by any other variable. Per-capita income has a positive impact on bank deposit, but a negatively impacted by stock market capitalization. The Trade variable is negatively correlated with credit to private sector. Net private investment has a positive impact on financial development through the banking deposits but negatively to the stock market capitalization.

Keywords: Financial liberalization; Financial development; SADC, Bank credit to the private sector; Bank deposits; Stock market capitalization

Introduction

In 1980, nine countries, namely Angola, Botswana, Lesotho, Malawi, Mozambique, Swaziland, Tanzania, Zambia and Zimbabwe formed the Southern African Development Coordination Conference (SADCC) to decrease their external economic dependence on South Africa and to promote regional cooperation in project developments [1]. Namibia joined shortly after its independence in 1990 and these ten countries established the Southern African Development Community (SADC) in August 1992 when they signed the SADC Treaty. The Republic of South Africa joined later in August 1994 and Mauritius became the twelfth member in August 1995. The Democratic Republic of Congo and Seychelles joined in 1997 then Madagascar in 2005. Therefore, SADC currently consists of fifteen member states and its headquarter is in Gaborone, Botswana. The members differ based on the levels of education, health provisions and other socio-economic development. However, they have similar trade patterns and trade between themselves [2].

It is highly observed that the financial system in most of sub-Saharan Africa is under developed and diversified compared to other regions of the world (World bank, 1994). From Table 1 below, six countries member lagged in their financial development except Mauritius and South Africa. The interest rate spread in the region, which is one measure of the financial efficiency is equally high compared to other regions except for Zimbabwe with huge gap. The three countries with single digit figures are Botswana, South Africa and Swaziland. Until the implementation of the reforms in most African countries in the mid 80s, the banking system was dominated by commercial banks and large majority of them were state owned.

The reforms in 1980s created new structures resulting first in the increase of number of banks in the region. The number of commercial banks increased from 213 in 1982 to 245 in 1992. In addition, government ownership of the bank has decreased in most SADC countries. Moreover, non-bank financial institutions have begun to play an increasingly important role in saving mobilization. However, owning to limited range of financial instruments and opportunities, their assets have typically been concentrated in government securities or deposited at banking institutions, where they have not been mediated for productive investment owing to banks' limited lending operation and portfolio management.

Most governments in the region embarked on a financial sector liberalization in the mid-80s as their financial sector were highly repressed before the reform with selected credit controls and fixed interest rates. African countries are currently working towards integrating with the world economy with liberalized financial system as the key policy instrument for engendering high growth performance. However, in spite the massive liberalization program embarked upon in many African countries, the fruits of liberalization are yet to be realized in many of these countries. This could be attributed to their failure to meet the basic prerequisites for successful financial reforms that resulted not only in high and increasing inflation but also deteriorating economic performance.

Indeed, for some of these countries it has been extended and recurrent banking crisis, e.g., Nigeria and Kenya. The study by Anthony and Egbetunde [3] showed that most of the indicators of financial development were declining from their peaks in the early 90s. Only

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few countries in SADC have experienced growth in Money and quasi money (M2) as percent of GDP over the period 2000-2005. Many of the countries had negative growth in one or two years or even throughout the entire period (Table 1).

Literature Review

The theory of financial liberalisation is greatly explained by the works of Shaw [4]. Financial liberalisation refers to the removal of government ceiling on interest rate and other controls on financial intermediaries. This regards macroeconomic aggregates (interest rate, saving and investment) [5]. In contrast, financial repression refers to distortions of financial prices such as interest rates. Their main argument of their work is that liberalisation enhances growth in an economy by allowing domestic and international firms to access their financial markets, and by improving the efficiency and corporate governance in domestic financial system. Through financial liberalisation, it is expected that real interest rate increase which stimulates savings as consumers forgoes current consumption in favor of future consumption. This releases more funds for investments thereby leading to higher economic growth. Increasing competition resulting from financial liberalisation leads to the quality improvement and financial services abundance and proliferation in the domestic market.

Increasing bank competition and the use of more sophisticated banking techniques and technology improve the efficiency by reducing funding fees [6]. Rising financial openness would lead to a general shift of the less efficient and inefficient institutions to a general efficiency improvement in the financial system, that should be accompanied with reforms in the financial infrastructure to reduce problems of information asymmetry, adverse selection and moral hazard.

Nevertheless, other literature concludes that financial liberalisation may result in a pressure that drives banks to seek for riskier portfolios and indulge high failure probabilities of their deals. Allen and Gale [7] went further by stating that financial openness might result in bubbles that may burst into bank crisis and recessions.

Different studies were conducted to split the impact of the financial liberalization into a short-run effect: Market stabilization where some tensions will develop within emerging markets; and a long-run effect: When financial liberalization deepens and institutions improve as result of a more solid and an agency-free financial system. For these reasons, the conclusion of their studies where that it will not be fair to assign an A-priority to the effect of financial openness on domestic financial development [8].

The contribution of FDI on the growth of the economy has been treated extensively in other literature to analyze the quality of capital inflow. FDI enhance technology through spillover effects of knowledge and new technology, matched with a strong and developed financial system. FDI is expected to induce economic growth in the host country from one hand; and the financial institutions can also affect the speed of technological innovation, thereby enhancing economic growth on the other hand [9]. We expect a positive coefficient, as greater investment shares have been positively affecting economic growth. FDI may capture the degree of integration in world market as well. A positive coefficient is expected, for greater investment shares that have shown to be positively related with economic growth [10].

Financial liberalisation in SADC countries was assessed and as results, for those countries to become successful in promoting economic growth, it must be accompanied within other supporting policies. In the absence of such policies, the impact of financial liberalisation is likely to be relatively insignificant, thereby no the economic success [9].

Other economists studied the impact of international financial liberalisation and economic growth. Their empirical analysis employed annual data of forty countries, consisting of twenty developed and twenty emerging countries in Asia, Latin America and Africa. The study covered the period of 1976 to 1995. They investigated the link between international financial integration and economic growth. They examined this issue with an emphasis on the composition of capital flows. They found that foreign direct investment and portfolio inflows enhance growth. In contrast, bank inflows appeared to have a negative effect on growth.

For the South African economy, the liberalisation of the capital account is necessary but not sufficient for economic growth [11].

The impact of trade liberalisation, which is the openness, on the long run economic growth of Mexico using data from 1980-2008 was analyzed, cointegration and error correction methods were utilized for their study. The empirical results suggest that long run economic growth of Mexico is largely explained by trade liberalisation (openness) and the level of capital (investment). The contribution of labor force and human capital were found to be minimal [12].

For the economy of Ghana, found a positive long-run relationship between financial liberalisation and economic growth. The Annually Standard of Living Index (SLI) from 1970-2007 was derived in the process using different policy measure and components. The financial

	Domestic credit provided by banking sector (% of GDP)	Domestic credit to private sector (% of GDP)	Liquid liabilities (M3) as % of GDP	Broad money (% of GDP)	Interest rate spread (lending rate minus deposit rate, %)
Botswana	-5	20	-	44	6
Malawi	17	8	21	17	22
Mauritius	107	75	143	102	14
Mozambique	8	12	-	29	12
South Africa	186	144	43	70	5
Tanzania	12	10	25	27	11
Zimbabwe	55	16	49	45	145
Swaziland	17	21	-	21	7
Middle East & North Africa	44	41	-	59	4
Latin America & Caribbean	49	26	34	40	8
South Asia	56	38	-	62	6
East Asia & Pacific	213	148	-	164	5
Sub-Saharan Africa	81	64	-	42	12

Table 1: Financial depths and efficiency.

liberalization index was constructed using the Principal Component Analysis (PCA). Techniques employed in his study include the Johansen cointegration approach as well as the Granger causality test [12].

In the following, the impact of financial liberalization in developing countries was analyzed with Zambia, South Africa, Tanzania and Lesotho. Their findings show that although financial liberalization leads to financial development, it Granger-causes economic growth only in Zambia. In other countries, economic growth induced the development of the financial sector. The results tell us that the relationship between financial liberalization and economic growth is at best ambiguous, and may be sensitive to a country's level of financial development.

Furthermore, the relationship between financial liberalization and economic growth in Nigeria found that monetary policies as well as financial development does not impact the growth process of the Nigerian economy. The financial liberalization development was proxied by ratio of liquidity that is liabilities to GDP, real interest rate, and total deposit while the economic growth that was measured by the real GDP [13].

The impact of financial liberalizations on economic growth in Pakistan for the period 1971-2007 was also analyzed, the Auto-Regressive Distributed Lag technique and a financial liberalization index (FLI) developed by Hye and Wizarat [14] were used. It was concluded that whereas there was a positive relationship between financial liberalization and economic growth in the short run, FLI was statistically insignificant in the long run. It was concluded that the impact of real interest rate on economic growth is negative and significant in the long-run.

Methodology

The aim of this paper is to investigate the impact of financial liberalization on the financial development in the SADC region. Therefore, the third section of this work describes the methodological approach chosen to determine what causes financial development. For this, we are going to use a proficient model that can assist us to have a better understanding by choosing eight developing countries from SADC.

Econometric analysis of the determinants of financial development

Empirical specification: This study examines the impact of macroeconomic and institutional variables on financial development of eight countries member of SADC. The econometric model, which follows the treatments as below:

$$\frac{FD_{i,t}}{FD_{i,t-s}} - 1 = \alpha_0 + \gamma FD_{i,t-s} + \beta' X_{i,t-s} + \varepsilon_{i,t} \quad (1)$$

Where:

X is a vector of control variables;

FD is the financial development proxy;

t is time and s is the number of lag.

To avoid problems of endogeneity and to remove the impact of short-term cyclicality, the model is specified as a growth rate over level regressions $\frac{FD_{i,t}}{FD_{i,t-s}}$ with non-overlapping periods, each comprising of S+1 years, $\varepsilon_{i,t}$ is the error term.

Eqn. (1) then identifies the growth of the level of financial development as a function of the initial level of financial development and other time-variant explanatory variables. The estimations are based on random-effect panel regressions.

Hausman tests on the orthogonality of the fixed error terms with the covariates were also run to ensure the appropriateness of the random-effects specification.

Data

In this study, the financial development measures are extracted from the dataset of Beck et al. [6]. The dataset for banking development range from 1980 to 2012. Table 2 provides an overview of variables used in this analysis as below.

Measures of financial development

The study focuses on three measures of financial development:

- Bank credit to the private sector (as a percentage of GDP) represents the general level of development in the banking sector. Private credits are used to capture the activity of the financial sector in banks and other financial institutions. It excludes credit given to the public sector (firms and agencies) and credits by the government issued by the central bank. The higher the bank credits given to private sector, the higher the level of financial services and hence the more developed the financial sector [6].

- Bank deposits (as a percentage of GDP) provide the extent of access and deposit mobilization that the financial system offers. Used to seize the structure of financial intermediaries, the ratio of money deposits' bank domestic assets plus central bank domestic assets is used as financial development measure. Baliamoune [15] consider the relevance of this indicator since the importance of a central bank is sensitive to the income level across countries: the higher the income level, the lower the importance of the central bank in the financial sector.

Variable	Source	N	Mean	S.Dev.	Min	Max
Domestic credit to private sector (%GDP)	Beck et al.(2009)	246	31.85	37.21	1.58	167.53
Bank deposits (%GDP)	Beck et al.(2009)	226	29.27	19.2	3.3	92.32
Stock market capitalization (%GDP)	Beck et al.(2009)	116	46.33	62.58	0	265.62
Log real GDP per capita ($)	WDI	264	6.94	1.27	4.94	8.74
Total trade (%GDP)	WDI	256	70.16	33.6	11.23	183.02
Financial openness index	Chinn-Ito (2008)	256	-0.53	1.3	-1.87	2.43
Inflation (%GDP)	WDI	254	17.5	22.52	-0.97	181.45
Net FDI (%GDP)	IFS	256	2.82	3.86	-6.89	36,77
Net portfolio investments (%GDP)	IFS	246	-0.33	10.43	-102.44	101.07
Remittances (%GDP)	IFS	219	732.44	1753	0	6269

Table 2: Descriptive statistics.

Therefore, this indicator is a good proxy for financial intermediary development.

- Stock market capitalization (as a percentage of GDP) provides an estimate of the size of the equity market. The share of stock market capitalization in the gross domestic product is generally interpreted as a measure of the effort for stock market capitalization and used in some studies as the basis for cross-country comparisons. Such comparison is more meaningful to establish trends across countries with a similar economic structure and a similar level of income. Each country show different stock market characteristics: while developed countries have well-established stock markets, these are relatively new for most of developing countries, they mostly evolved through the globalization and financial liberalization process during the 1980s and 1990s.

Explanatory variables

Some explanatory variables were used to define the level of financial development.

- GDP per capita (in constant US dollars) was included to control for wealth effects in our regressions. Several studies highlighted that per-capita income could serve as a good proxy for the general development and sophistication of institutions [6].

- Lagged financial development variable was included in each regression. This lagged value is used to cope with the endogeneity issue.

- Inflation that measured the annual growth of the GDP deflator is an important determinant of banking sector development and equity market activity. There indicated a significant and negative relationship between inflation and both banking sector development and equity market activity. Therefore, the inflation is expected to negatively impact the financial development.

- Financial openness (index) further deepen and broaden the domestic financial markets and improve the efficiency of financial intermediation trough the elimination of financial repression and shifting interest rates to even more competitive levels, leaving the cost of capital in low levels. The capital openness index KAOPEN measures the degree of the financial openness and the intensity of capital control. This de-jure measure of openness is preferred than the other de-facto proxies, as discussed the latter nullifies the expected. Developed by Chinn and Ito (2002; 2008), measures the extent of capital controls based on information from the IMF's Annual Report on Exchange Arrangements and Exchange Restrictions.

Lastly, capital flow variables, controlling for net foreign direct investment (FDI), net portfolio investment and remittances, were included one by one. They were obtained from the most recent version of the IMF's International Financial Statistics database.

Panel Regression Results

The results for bank credit to the private sector, bank deposit and stock market capitalization are reported in Tables 3-5, respectively. Therefore, random effect and fixed effect estimation is being analyzed.

Hausman tests confirm the validity of the random effect for bank credit to the private sector, bank deposit and stock market capitalization since the Hausman test has a probability value for F-statistic strictly inferior to 5 percent. This means that difference across countries impact the level of financial development, therefore estimations are sensitive to differences across countries.

For banking development variables, inflation has a negative and significant impact on credit to private sectors and bank deposits as indicated from Tables 3 and 4. These results are consistent following both the fixed and random effect models.

Portfolio investments appeared not having much of impact on bank credit to private sector, bank deposit and stock market capitalization for those countries.

Remittance also appeared not having much of impact on bank credit to private sector, bank deposit and stock market capitalization for selected countries of SADC.

For other estimations of stock market development reported in Table 5, beyond the positive impact of the Net Portfolio investment, stock market capitalisation appears to be slightly affected.

Per-capita income has a positive and significant impact on bank deposit, but a negative impact on stock market capitalisation implying 'catching-up' effects as less developed countries has higher growth indicators than industrialized countries. Conversely, having an open capital account during inflationary periods also inflates market capitalisation, possibly because of the rapid arbitrage possibilities facing countries with high inflation and real interest rates.

	Random Effect				Fixed Effect			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
L.cps	0.989***	0.993***	0.993***	0.985***	0.925***	0.924***	0.928***	0.534***
rgdppc	0.000**	0.000	0.000	0.000	0.001	0.000	0.000	-0.005
trd	-0.021**	-0.020**	-0.022**	-0.037	-0.006	-0.004	-0.012	-0.035
infl	-0.052***	-0.090***	-0.100***	-0.187	-0.055***	-0.120***	-0.142***	-0.222
kaopen	-0.108	0.372	0.311	0.649	0.100	1.043*	1.208*	-2.262
c.infl#c.kaopen		-0.032	-0.036	-0.078		-0.055**	-0.062**	-0.096
fdiinf		-0.036				-0.028		
remit			0.000				-0.002	
npinv				-0.015				-0.022
_cons	2.464***	3.163***	3.219***	6.139*	2.573	4.412*	7.527**	37.754***
N	229	229	195	55	229	229	195	55
R^2 with.	0.93	0.93	0.92	0.36	0.93	0.93	0.92	0.40
R^2 overall	0.99	0.99	0.99	0.99	0.99	0.99	0.98	0.65
Hausman Chi^2	18303	18300	16271	4687				
Hausman p.	0.00	0.00	0.00	0.00				
*p<0.10, **p<0.05, ***p<0.01								

Table 3: Determinants of bank credit to the private sector.

	Random Effect				Fixed Effect			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
L.bd	0.997***	0.990***	0.982***	0.915***	0.870***	0.859***	0.838***	0.774***
rgdppc	0.000	-0.000	-0.000	0.000	0.002***	0.002***	0.001***	-0.003
trd	-0.004	-0.006	-0.011*	0 .000	0.033***	0.036***	0.036***	0.090
infl	-0.035***	-0.095***	-0.102***	-0.354***	-0.038***	-0.095***	-0.119***	-0.350***
kaopen	0.016	0.590***	0.734***	1.276**	-0.158	0.525*	0.944***	1.793
c.infl#c.kaopen		-0.041***	-0.046***	-0.147***		-0.039***	-0.046***	-0.125**
fdiinf		-0.018				-0.007		
remit			0.000				-0.004***	
npinv				-0.017				-0.019
_cons	1.472***	2.777***	3.491***	6.251***	-1.494	-0.000	3.728**	14.409*
N	218	218	185	53	218	218	185	53
R^2 with.	0.94	0.94	0.88	0.70	0.94	0.95	0.90	0.73
R^2 overall	0.99	0.99	0.99	0.99	0.97	0.97	0.89	0.89
Hausman Chi^2	15179	15946	13134	3667				
Hausman p.	0.00	0.00	0.00	0.00				
*p<0.10, **p<0.05, ***p<0.01								

Table 4: Determinants of bank deposits.

	Random Effect				Fixed Effect			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
L.stmktcap	0.956***	0.965***	0.955***	0.945***	0.798***	0.802***	0.799***	0.815***
rgdppc	0.001	0.000	0.001	0.000	-0.001	-0.001	-0.001	-0.048**
trd	-0.059	-0.056	-0.059	-0.086	-0.023	-0.037	-0.014	0.070
infl	-0.067	-0.101	-0.080	-0.244	-0.223	-0.275	-0.257	-0.150
kaopen	-0.254	0.653	-0.177	0.645	2.478	2.817	2.802	-4.681
c.infl#c.kaopen		-0.033	-0.025	-0.058		-0.016	-0.019	-0.048
fdiinf		-0.435				-0.310		
remit			0.000				-0.002	
npinv				0.029				-0.020
_cons	6.345	9.024	6.046	10.351	17.496	19.466	19.008	198.128**
N	100	100	98	34	100	100	98	34
R^2 with.	0.72	0.72	0.71	0.24	0.73	0.73	0.72	0.43
R^2 overall	0.96	0.96	0.96	0.96	0.96	0.96	0.96	0.00
Hausman Chi^2	2464.29	2433.40	2346.71	628.40				
Hausman p.	0.00	0.00	0.00	0.00				
*p<0.10, **p<0.05, ***p<0.01								

Table 5: Determinants of stock market capitalization.

Trade is also found to be significant and negatively linked to the credit to private sector.

Net private investment has a positive impact on financial development through the banking deposits but negatively the stock market capitalization.

Sensitivity Analysis

To verify the panel ordinary least square estimators (OLS), a generalized method of moments (GMM) panel study is conducted henceforth. The GMM goes back to the works of Arellano and Bond (1991) and Blundell and Bond (1998). Then, Levine et al. (2000) supplied arguments for the application in the context of studies that deal with financial development and GDP growth. The GMM adjusts the endogeneity not only at the level of financial development but also in the other explanatory variables thorough the introduction of series of lagged instrument.

This method does not correct the endogeneity in the strong sense, but in the weak sense. Specifically, it is assumed that the explanatory variables are weakly exogenous they may be affected by the current and past growth rates levels and must be uncorrelated with future realizations of the error terms. Thus, the assumption of exogenous variables in the weak sense implies that future innovations in the growth rate do not affect the current level of financial development. The exogeneity in the weak sense does not mean that economic agents do not consider future expectations of growth in their decision to develop the financial system, it simply assumes that unanticipated future shocks in the growth rate do not affect the current level of development.

Table 6 shows the results of the GMM estimation. As there are only eight countries in the sample, the results of the GMM should be considered inferior to the previous panel OLS estimation. The GMM generally works best for large number of countries N and small T data sets, which is not the case here. The criteria of the fitness of a GMM model are generally expressed in the combination of three test: The Arellano-Bond test of serial correlation in the first differences (AR1), Arellano-Bond test of serial correlation in the second differences (AR2), and the Sargan-Hansen test of over-identifying restrictions. A well-fitted GMM model is assumed if AR1 p-value is below a 10% threshold, the AR2 p-value above a 5% threshold and the p-value of the Sargan test is above 5%. Due to the limited number of countries, the two prevalent options: two step and robustness of standard errors, i.e.,

	cps			bd			stmktcap		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
l_dep_var	0.435***	0.553***	0.906***	1.059***	1.003***	0.985***	1.096***	0.862***	0.517*
rgdppc	0.007**	0.004	-0.006	-0.000	-0.000	-0.001	-0.006	0.003	0.005
trd	-0.258	-0.354***	-0.445***	0.163***	-0.008	0.067	-0.441	-0.926*	0.124
infl	-0.681**	-0.677**	-0.080	-0.088	-0.022	-0.372***	-0.400	-2.190	-0.180
kaopen	20.870***	17.776***	-8.667*	1.376	0.362	1.858**	48.383**	39.203*	-4.017
infl_kaopen	-0.489**	-0.425**	0.158	-0.052	-0.003	-0.160***	-1.664	-2.455	-0.080
fdiinf	-0.664			-0.534**			-5.223		
remit		-0.002			-0.001			0.017	
npinv			-0.006			-0.021			0.037
_cons	37.996**	46.061***	54.350***	-9.461*	2.046	2.735	64.528	77.126	9.798
N	229	195	54	218	185	53	100	98	34
AR1	-2.13	-2.06	-1.97	-2.76	-3.02	1.59	-1.94	-1.54	1.42
p-value	0.03	0.04	0.05	0.01	0.00	0.11	0.05	0.12	0.16
AR2	-0.42	-0.93	-1.46	-0.46	-1.56	0.83	0.53	-1.29	1.09
p-value	0.67	0.35	0.15	0.65	0.12	0.41	0.60	0.20	0.28
Sargan	33.64	36.76	35.85	34.40	36.24	33.36	25.44	19.27	5.67
p-value	0.12	0.06	0.07	0.10	0.11	0.83	0.06	0.25	0.93
interaction term between inflation and kaopen is denoted as infl_kaopen; l_dep_var lagged depending variable. *p<0.10, **p<0.05, ***p<0.01									

Table 6: Determinants of financial development: General Method of Moments estimation.

Windmeyer-corrected standard errors were discarded in favor of a one-step approach, that generally performs better in small samples sizes.

The resulting equation present overall good GMM model characteristics; except for equation (6), (8), and (9), where the AR1 condition are not fulfilled.

The sensitivity analysis can confirm the previous results of the OLS estimation. The lagged dependent variable (l_dep_var) is positive in all equations. As expected, high inflation has a negative impact on financial development and capital openness has a positive impact on financial development. Also, the interaction term, infl_kaopen, can have a negative impact on the financial development.

Conclusion

This paper analyzed the determinants of financial developments using an empirical study applied on the eight countries member of SADC for the years of 1980 to 2012. It aimed to assess three financial development indicators, which are bank credit to the private sector, bank deposits and stock market capitalization to explain lagging development in SADC region. As resulted from the banking development variables, inflation had negatively impacted credit to private sector and bank deposits. Macroeconomic stability would be improved if these SADC member countries have a currency-linked savings account that could prevent losses in deposits during inflationary pressures. Their central banks need to tightly control on inflation through monetary policies to lessen the negative impact on financial development. Improvement of Portfolio investments can be interpreted as improvement of the financial market because of inflow of capital due to income-effect that increase households' incomes and firms' earnings, which are then deposited into bank accounts and become available for lending which is positive for stock market capitalization. This can also be also interpreted as a positive openness for the local stock market to the foreign capital. Remittance can be beneficial for stock market capitalization due to extra earnings that are not deposited into bank accounts but are rather channeled for lending to investors in the stock market. Local institutions, lower government expenditures and financial sector reforms in the regulations and supervisions can lead to the improvements in the functions of banks and development of stock markets in the SADC countries. Financial liberalization then is an extremely important component of a successful development strategy. If financial deregulation is implemented in isolation, it is unlikely to promote growth and may, in fact, impede economic development. The importance of achieving macroeconomic stability prior to reform, yet structural reform and institutional development in the financial sector, accompanied with prudent financial supervision as liberalization proceeds.

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