NWU Business School

Policy Uncertainty Index (PUI)

2Q2018

IMMEDIATE RELEASE

4 July 2018

EXECUTIVE SUMMARY

* The PUI for 2Q 2018 rose to 51.0 (baseline 50) compared to 49.6 in 1Q 2018

* The latest rise in the PUI is the result of a blend of economic and political factors over the past three months which have generated a renewed degree of policy uncertainty

* The rise in the PUI may be reversible provided more tangible evidence eventually emerges of tackling the structural reforms needed to enable South Africa to break out of its 'low growth trap'

* How the land reform issue is managed will be an important determinant of future levels of policy uncertainty and investor confidence

* A sustained strengthening in investor and business confidence depends on both economic recovery and structural reform

* South Africa needs to raise its game in a highly competitive world and the official emphasis on rebuilding investor confidence remains the key to that outcome

* The prospects for a global 'trade war' and higher global interest rates may also create headwinds for the South African economy in general and its currency in particular. The more South Africa's house is in order, the better its ability to manage any global economic headwinds

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NWU BUSINESS SCHOOL POLICY UNCERTAINTY INDEX (PUI) RISES FROM 49.6 IN 1Q2018 TO 51.0 IN 2Q2018 (BASELINE 50)

NWU BUSINESS SCHOOL POLICY UNCERTAINTY INDEX (PUI)

1. INTRODUCTION

As outlined when the PUI was launched two-and-a-half years ago, the role of policy uncertainty has loomed large in much of the recent economic debate in SA. It is seen to have important implications for business confidence and the investment climate in the country. Hardly any recent economic assessment or media release from international or local financial institutions, business lobbies, economic analysts, financial journalists or credit rating agencies appears without the inclusion of the words 'policy uncertainty' occurring in them. *The design of a policy uncertainty index for SA has nonetheless been spurred not only by economic circumstances in the country, but also by the increasing academic and policy interest globally around the cause, effect, measurement and definition of policy uncertainty.*

There have been many manifestations of policy uncertainty in SA over the years. The institutional setting and policy making environment clearly influence the extent to which negative shocks and developments lead to bad outcomes and tough policy challenges. It seemed that the time had arrived to craft a more accurate measurement of this recurrent factor in SA's economic outlook. *A deeper understanding of how uncertainty 'shocks' affect the SA economy helps policy makers to assess how future shocks will impact markets and business.* The outcome of this research will now be made regularly available on a quarterly basis to hopefully fill a gap in our monitoring of the economic environment.

Interesting correlations have been found of the policy uncertainty index with economic outcomes. *Empirically it shows that when economic policy uncertainty is strongly present in the environment, it indeed lowers investment, employment and output.* High levels of such policy uncertainty inhibit meaningful investment and consumption. Elevated policy uncertainty in many countries contributes to sluggish growth. Economic policy uncertainty then has actual consequences for the economy.

Research suggests that uncertainty is very different across economies. Developing countries seem to have about one-third more macro-economic uncertainty than developed countries. However, this is now changing with events such as Brexit, the controversial policies of US president Donald Trump as well as other geo-political tensions.

The PUI is published in January, April, July and October of each year. An increase beyond 50 reflects heightened policy uncertainty; a decline in the PUI means reduced uncertainty. *The value of the PUI as a proxy for policy uncertainty will lie in tracking changes in policy uncertainty over time, and as the index settles down over time and builds a track record.*

2. PUI RESULTS FOR 2Q2018 - WHAT DOES IT SAY?

The aggregate PUI for the quarterly period April to June 2018 is the average of:

- a news-based uncertainty,
- economists' views on uncertainty,
- manufacturers surveyed by the BER survey and their views on political/policy constraints.

July – Sept 2015	(Base 50) 50.0
Oct – Dec 2015	55.4
Jan – Mar 2016	53.6
Apr – June 2016	52.5
July – Sept 2016	46.5
Oct – Dec 2016	38.8
Jan – Mar 2017	51.0
Apr – June 2017	53.1
July – Sept 2017	53.6
Oct – Dec 2017	55.4
Jan – Mar 2018	49.6
Apr – June 2018	51.0

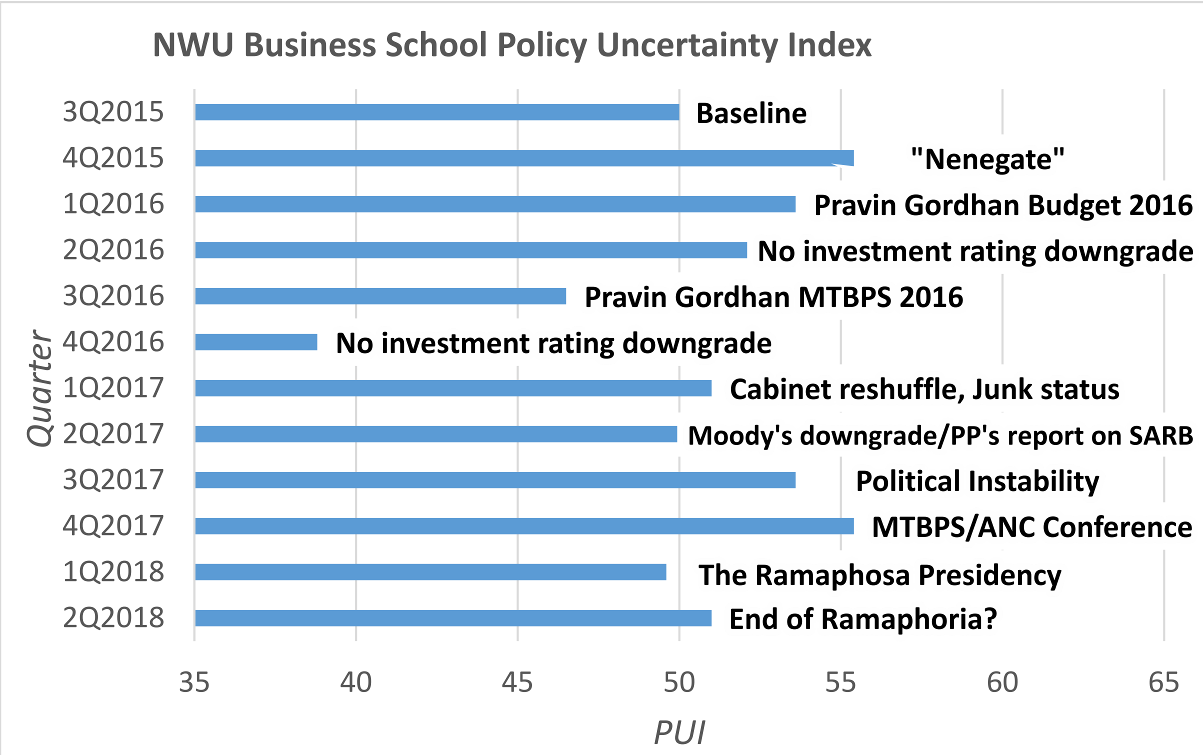
The PUI is the *net* outcome of *positive* and *negative* factors influencing the perceptions of policy uncertainty over the relevant period. The outcome for 2Q2018 shows an average score of 51.0, reflecting an increase over the PUI of 49.6 in 1Q2018. *Hence the PUI has moved back into negative territory.*

Unpacking the three elements of the latest index shows the following:

2.1. In the media data there was an increase in reporting about 'policy uncertainty',

2.2. The survey of the economists shows that their view is that uncertainty was higher for consumers and investors (comparing Q2 of 2018 to Q1 of 2018),

2.3. The Bureau of Economic Research at the University of Stellenbosch's latest number on the proportion of manufacturers who indicate that politics is a constraint on doing business in SA declined from 74 to 72.



3. NARRATIVE ON SOME FACTORS INFLUENCING ECONOMIC/POLICY UNCERTAINTY

3.1 Global Economic Outlook and South Africa

Although in the past couple of months a couple of tectonic plates may appear to have slowly shifted in the international economy, the underlying reality is that the immediate outlook for world economy has not yet been seriously impaired. For the moment the broad statistics still reflect continued strong world growth, especially in the US economy. The performance of the American economy is the main 'locomotive' here, thanks partly to its recent tax cuts and higher government spending. Economic activity in the US remains high, business confidence is positive and unemployment is at historically low levels. However, financial markets, especially equity markets, have been more apprehensive about the outlook.

What, then, might go wrong? Some recent developments which now generate new risks, threats and uncertainties around the global economic outlook briefly are:

* 'A trade war is the worst of many threats to global growth', said *The Economist* (23/6/2018). The serious danger here is that what was earlier perceived as mainly 'shadow boxing' and positioning over tariffs between the US and China may instead now develop into a real trade war in the period ahead. In that event the collateral damage to the world's multilateral trading system would eventually be high if 'beggar-my-neighbour' policies then widely prevail. Negotiations are, however, still pending. A trade war may yet be contained and trade-related confidence global shocks avoided.

* if the US economy expands and the rest of the world economy slows, widening interest rate differentials would likely strengthen the dollar further. The IMF also worries that the US tax cuts and public spending hikes will increase risks to the global economy by boosting debt, potentially encouraging inflation and pushing the dollar yet higher

* the biggest central banks - such as the US Fed and the ECB - are now slowly exiting from the easy monetary policies that helped to stave off the financial crisis of 2008. The goal is to gradually 'normalize' interest rates and monetary policy after a decade of quantitative easing and cheap money. Real yields are rising, though they remain low by historical levels

* as in 2013, when the US originally said it would eventually slow its pace of 'quantitative easing', it caused a so-called 'taper tantrum' in vulnerable emerging markets at the time. The latest developments on this front have elicited a similar negative response in these markets, but not so far on the same scale.

Nonetheless, a number of emerging markets including South Africa have lately again been in trouble with their weakened currencies - some more than others - as investors take flight from riskier assets. Emerging markets that have weak fundamentals, especially in a global context, are more vulnerable when risk aversion strikes. One advantage for South Africa is that its burden of dollar-denominated debt is modest, less than 25% of GDP, a level of foreign currency debt which compares well with several other emerging economies.

But South Africa's public finances are vulnerable by global standards, as well as its lagging economic growth compared with several other emerging market competitors. Rand weakness has been intensified by bond and equity outflows. As the rand recovers from time to time and the gap narrows in relation to other emerging market currencies, so more emphasis falls on the role of the domestic economy and the key factors which influence its performance. *The more South Africa's house is in order, the stronger its ability to deal with any global economic headwinds.*

3.2 South African Growth Outlook

The Governor of the Reserve Bank Lesetja Kganyago warned in a speech in May 2018 that, although South Africa had got off to a positive start this year, it was too early to tell that the country was in a new growth trajectory (Fin 24, 20/5/2018). The MPC statement later in May described the domestic growth outlook as 'challenging', but growth was still expected to outperform recent year outcomes. The SARB forecast for GDP growth was left at 1.7% for 2018 but revised up from 1.5% to 1.7% for 2019. With the much worse-than-expected growth figures for 1Q 2018 now available it will be necessary to see as the year unfolds whether current growth forecasts generally need to be revised downward and whether promised domestic interest rate rises should be postponed for as long as possible.

There were also the decisions by both Standard & Poor Global Ratings and Fitch in the last quarter to leave South Africa at sub-investment grade combined with a stable outlook. Both credit rating agencies recognized the recent positive political changes, but believed that South Africa still faced considerable economic and social challenges. These assessments imply that the negative growth figures for 1Q 2018, while not attributable to the Ramaphosa factor, indeed suggest that South Africa's growth challenges are more formidable than originally supposed. And the continued serious problems at state-owned enterprises like ESKOM, with its financial and management challenges, industrial conflict and renewed load-shedding, have also detracted from the initial euphoria around political change in South Africa.

In the address referred to above the SARB Governor also said that, according to earlier research by the SARB, low levels of confidence in the past few years had essentially shaved about one percentage point off growth in both 2015 and 2016. He also mentioned a National Treasury estimate that the return in confidence could add 0.4 of a percentage point to potential output. 'But a cyclical recovery based on a rebound in confidence, however welcome, is not enough. Raising potential output significantly and sustained way requires not just a commitment to structural reforms, but actual implementation. This should hand in hand with increased fixed capital formation', he said.

Yet since the SARB Governor spoke both business and consumer confidence have again sagged. Why?

3.3 Cross-currents in policy uncertainty

Part of the answer may lie in renewed policy uncertainty. The climate of policy uncertainty has been buffeted by a cross-current of positive and negative factors in the past quarter, which eventually contributed to subsequent lower confidence levels. 'South Africa's growth prospects will be limited by weak business confidence while uncertainty around land and mining reforms remain a concern for investors', said rating agency Moody's in a research report on June 26.

As indicated earlier, on the one hand business and consumer confidence was initially boosted by the political changes that took place and the election of Cyril Ramaphosa as President of

South Africa in mid-February 2018. The national mood generally struck a more positive note. There have also been various actions taken by the new administration in the past few months to address state capture and other forms of widespread corruption. This all led to a so-called 'Ramaphoria' syndrome for a while, which now appears to be wearing off.

While some recent policy developments contain genuine and necessary elements of reform and transformation, several have also overall generated greater uncertainty. They include issues such as land reform, the revised mining charter, the NHI proposals, the continued Eskom saga and political factionalism. These factors are not all of immediate or equal importance to the policy environment. But their *simultaneous* impact might explain the persistence of an undercurrent of policy uncertainty in South Africa and why the PUI has moved back into negative territory.

4. CONCLUSION

It is inevitable that a period of political and economic change will produce an initial ebb and flow in the level of policy uncertainty. The 2Q 2018 PUI move into negative territory could well be temporary and reversible. There remains much goodwill around the Ramaphosa Presidency in the markets and within business. The recent positive investment decisions by companies like Mercedes Benz and Old Mutual show that the policy environment still has its encouraging aspects for businesses.

Yet in the wider picture a reduction in policy uncertainty will depend on tangible evidence that structural reforms are indeed being addressed and that capacity is being developed to implement them. A sustained strengthening in investor and business confidence depends on both economic recovery and structural reform. South Africa needs to raise its game in a highly competitive world *and the official emphasis on rebuilding investor confidence remains the key to that outcome.*

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4 July 2018

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