NWU Business School

Policy Uncertainty Index (PUI)

1Q 2019

IMMEDIATE RELEASE

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EXECUTIVE SUMMARY

- In 1Q 2019 the PUI rose to 53.4 from 51.1 in 4Q 2018, thus moving much further into negative territory, negative factors having outweighed positive ones over this period
- Although a global recession is not expected, tangible evidence is emerging of a slowdown in world economic growth in 2019 - but the more SA's economic house is in order, the better its ability to manage any global headwinds
- The danger of the U.K. 'crashing out' of the EU without a Brexit deal on April 12 carries risks for SA-UK trade links and creates trading uncertainties
- Renewed and widespread Eskom load shedding was a significant shock to the economy during 1Q 2019 and aggravated economic and policy uncertainty
- SA's growth outlook had deteriorated in the recent past due to the impact of load-shedding and a slowing world economy
- Levels of policy and political uncertainty are expected to remain elevated until the markets and business have absorbed the outcome of the watershed elections in SA in May 2019
- Both positive and negative factors are now likely to put the SA economy largely into a 'holding pattern' until after the pending elections
- On present trends SA growth is now expected to be about 1% in 2019

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NWU BUSINESS SCHOOL POLICY UNCERTAINTY INDEX (PUI) ROSE FROM 51.1 IN 4Q 2018 TO 53.4 IN 1Q 2019 (BASELINE 50), THUS MOVING MUCH FURTHER INTO NEGATIVE TERRITORY

NWU BUSINESS SCHOOL POLICY UNCERTAINTY INDEX (PUI)

1. INTRODUCTION

As outlined when the PUI was launched in early 2016, 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.

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 1Q 2019 - WHAT DOES IT SAY?

The aggregate PUI for the quarterly period January to March 2019 is the average of:

- a news-based uncertainty;
- economists' views on uncertainty;

- and manufacturers surveyed by the BER survey and their views on political/policy constraints.

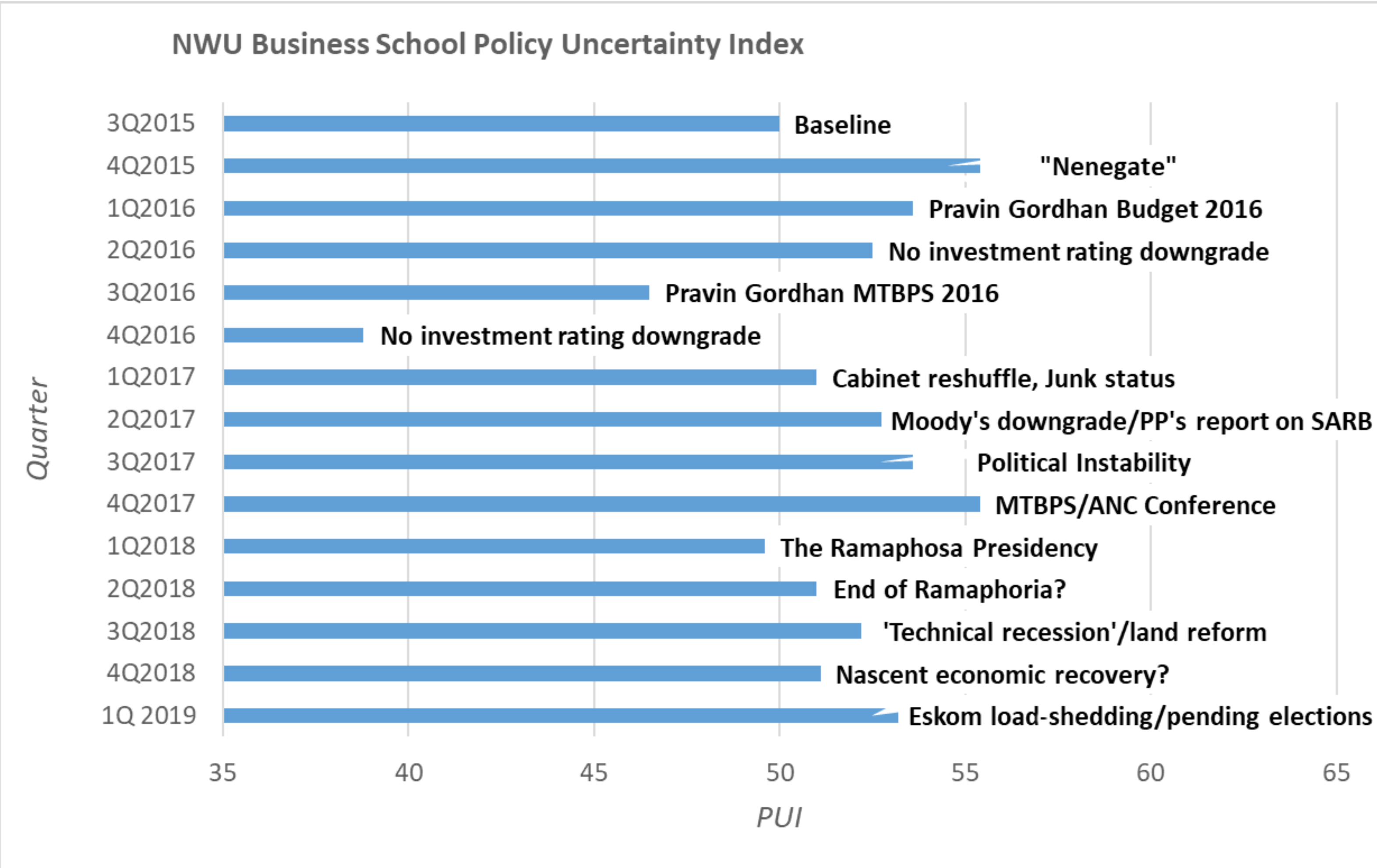
The PUI is the net outcome of positive and negative factors influencing the perceptions of policy uncertainty over the relevant period. The outcome for 1Q 2019 shows an average score of 53.4, reflecting a sharp rise over the PUI of 51.1 in 4Q 2018. *Hence the PUI has moved much further into negative territory*.

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

2.1. In the *media data* there were similarly high levels of reporting about uncertainty compared with 4Q 2019.

2.2. The *survey of economists* shows that their view is that the level of uncertainty was much higher compared with 4Q 2018.

2.3. The *Bureau of Economic Research* at the University of Stellenbosch's survey of manufacturers and their views on how political uncertainty influences business showed similar high levels to 4Q 2018.



3. NARRATIVE ON SOME FACTORS INFLUENCING ECONOMIC/POLICY UNCERTAINTY

3.1 Global Economic Outlook and South Africa

As mentioned in the 4Q 2018 narrative previously released on 18 January 2019 the global economy had an inauspicious start to 2019, given that confidence in the international economic outlook had lost steam during 2018. In the first weeks of 2019 key markets initially reacted badly to the latest reports of escalating US-China trade tensions which undermined global economic confidence, increasing evidence of a slowdown in the EU and Chinese economies, and the negative impact of an American government apparent locked in an interminable lockdown at that stage.

This, however, soon shifted to a more benign outlook as better news trickled through to markets and the outlook changed. As 2019 has progressed the global situation played out more positively than market and business perceptions had initially expected might be the case. America and China appeared to be finding more common ground on controversial trade conflicts; government in Washington reopened; it began to look as if interest rates in the US might remain stable at least in 2019; and China introduced a modest economic 'stimulus' package.

Yet it would be wrong to be too sanguine about certain other recent trends in the world economy, which still point to a downward shift in certain economic indicators since the more positive outlook a year ago. Global manufacturing activity has continued to slow over this period. Key economies that particularly depend heavily on trade, like Germany and Japan, have felt the effects. Industrial production in the euro area has declined over the past twelve months. Both Korea and Japan have experienced recent falls in exports There are also still major uncertainties around the eventual outcome of Brexit and for those countries doing business with the UK and EU.

The World Trade Organisation's global trade outlook also declined over the past year. Although the US economy is less dependent on world trade, economic growth there has also seen a recent levelling off. US business economists foresee a sharp slowdown in US economic growth over the next year or so, in sharp contrast to the Trump administration's more positive outlook. Although a global recession is not expected, present forecasts therefore suggest a slowing in overall world economic growth in 2019. This pause in international economic activity may well prove temporary, as the IMF has recently suggested. But there are external vulnerabilities and risks not there before that now need to be taken into account.

So as 1Q 2019 drew to a close, markets and traders again registered concerns and uncertainties about emerging evidence of faltering world economic growth. In this context it is also interesting to note the convergence of elections in several emerging markets during the course of this year, including South Africa. These will, to a greater or lesser extent, obviously have consequences for factors such as policy uncertainty, investor perceptions and financial volatility arising from these various election outcomes.

Convergence of 2019 elections in emerging markets

Source: Bloomberg

As mentioned earlier, there will inevitably remain trade uncertainties for countries like SA arising out of the on-going Brexit saga until the next deadline date of April 12. A 'no deal' Brexit now remains a high risk, with the widespread economic disruption it would inevitably entail. The DTI, business associations, and SA businesspeople with links to the U.K. economy will need to continue to monitor Brexit developments and be protective of future SA-UK economic relations. It is obviously in SA's economic interests to minimize any interruption of SA-UK trade and to ensure continuity of business with Britain as a major trading partner.

3.2 The South African economy

Negative factors influencing the level of policy uncertainty in 1Q 2019 outweighed the favourable ones, hence the rise in the latest PUI. But among the positive developments in the policy environment earlier in 1Q 2019 was the State-of-the-Nation Address (SONA) to Parliament on February 7. Although there was nothing unexpected in its contents and the SONA inevitably trod warily on some key issues, it was nonetheless broadly well-received as a reassuring message. Compared to where SA was a year ago, it ticked most of the boxes where progress had been made on certain major matters and had a positive impact on markets and business at the time.

Fiscal sustainability remained a key factor in market and business perceptions. The Budget Speech of February 20 was a frank and realistic assessment of the extent to which the economic and fiscal challenges facing SA had escalated since the Medium-Term Budget Policy Statement (MTBPS) or 'mini-Budget' was presented in October 2018. Finance Minister

Tito Mboweni nonetheless sought in a consistent and coherent way to add financial and fiscal dimensions to the broader vision outlined earlier in the SONA, striking what was broadly viewed as the right balance between prudence and populism.

But there was limited fiscal 'space' within which to manoeuvre, due mainly to muted economic growth on the one hand, and the additional annual Eskom commitments in particular, on the other. Red flags were raised in the Budget Speech itself. While fiscal consolidation remained the overarching goal, the key deficit ratios still appeared set to deteriorate from what was originally outlined in the MTBPS. Borrowing repetitively to finance government consumption spending can only make SA poorer in the longer run. More than ever before, there remain long term risks in the fiscal outlook, unless SA can raise its growth rate considerably.

Subsequently, the renewed and widespread Eskom load-shedding in the latter part of 1Q 2019 came as a shock to economic and policy certainty and was probably the single most negative factor in the first quarter of 2019. Intensive load-shedding (plus the prospect of yet higher electricity tariffs) reinforced recent falls in business confidence, as disruption and economic costs steadily mounted for businesses and consumers alike. Small businesses in particular felt the brunt of prolonged load-shedding.

It was also feared in 1Q 2019 that black-outs and lack of energy security might derail SA's investment drive. It was noteworthy that FDI into SA actually rose in 2018, according to the SARB's latest Quarterly Bulletin. The economic impact of load-shedding therefore also meant that already modest growth forecasts of about 1.3% or 1.4% in 2019 would now need to be reviewed downward, with suggested cuts among several economists ranging from 0.1% to 0.4%. In addition, several high frequency indices in 1Q 2019 – such as new vehicles sales and the ABSA PMI – in any event showed the economic recovery to be weak and patchy.

In its statement on March 28 the Monetary Policy Committee (MPC) of the SARB again cut its 2019 growth forecast, this time from 1.7% to 1.3%. The SARB saw this as mainly driven by Eskom load-shedding, declining business confidence, weak capital formation, and constrained disposable income. This forecast may still prove too optimistic, as the emerging consensus among several private sector economists now is for growth of about 1% this year. The MPC also emphasized the need for urgent structural reforms to put the economy on a much higher growth trajectory.

Moody’s decision to leave SA’s investment rating and outlook unchanged for now came too late in the quarter to seriously influence the 1Q 2019 PUI one or the another. In a subsequent credit opinion released on April 2 Moody’s expected SA’s public finances and debt profile to further deteriorate and economic growth to recover only slowly over the next two years. The credit rating agency warned that a downgrade could follow if state debt rose, if risks from state-owned enterprises were not contained, and if economic growth was not boosted.

4. CONCLUSION

The level of economic and policy uncertainty in SA will inevitably remain elevated until the broader consequences of the forthcoming May elections have been absorbed by the markets and business. Both positive and negative trends currently appear to largely put the SA economy in a 'holding pattern' until then. The nature of the political mandates emerging from the elections will to a large extent determine whether policy uncertainty will substantially decline and the necessary reforms will materialize to put the SA economy on a higher growth path.

North-West University Business School
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