NWU Business School

Policy Uncertainty Index (PUI)

2Q 2019

IMMEDIATE RELEASE

2 July 2019

EXECUTIVE SUMMARY

- The PUI decreased slightly from 53.4 in 1Q 2019 to 52.9 in 2Q 2019 (base line 50). Policy uncertainty therefore remained strongly elevated and stayed well in negative territory during this period. There is still potential to reverse the trend in the months ahead.

- Global economic activity, although still positive, is assessed by the World Bank as having slowed to its lowest pace in three years with downward risks. However, a global recession is not expected. The World Bank has nonetheless urged developing economies to reinforce policy buffers and implement policy reforms that boost growth

- The Conservative Party leadership election in the UK and the stances taken are currently widely seen as raising the risks of a 'no deal' Brexit and of the UK unilaterally 'crashing out' of the EU by the next deadline of October 31. If this occurs it will create widespread disruption and uncertainty in existing trading relations of third countries with the UK and the EU, including for SA

- Given the overhang of the worse-than-expected large contraction in GDP growth of -3.2% in 1Q 2019, as well as subsequent mixed economic data in 2Q 2019, economic growth for this year as a whole is now expected to only average between 0.7% and 1%. On certain favourable economic and political assumptions growth next year could still be about 1.6%, which remains inadequate to meet SA's socio-economic challenges

- The biggest single factor negatively affecting the PUI in this period was probably the ANC controversy around the status and role of the SA Reserve Bank, which injected palpable uncertainty into the markets and the economy in the past quarter

- The wide-ranging SONA on June 20 offered an overall aspirational vision of the urgent socio-economic challenges requiring to be addressed in SA, but many details about implementation plans to achieve the stated goals were seen as inadequate and uncertain. The SONA reaffirmation statements on the importance of the National Development Plan (and a new five-year Medium-Term Strategic Plan) and the role and status of the SARB were, on balance, favourable for future policy certainty

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NWU BUSINESS SCHOOL POLICY UNCERTAINTY INDEX (PUI) DECLINES SLIGHTLY FROM 53.4 IN 1Q 2019 TO 52.9 IN 2Q 2019 (BASELINE 50), BUT REMAINS IN 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.

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 2Q 2019 - WHAT DOES IT SAY?

The aggregate PUI for the quarterly period April to June 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.

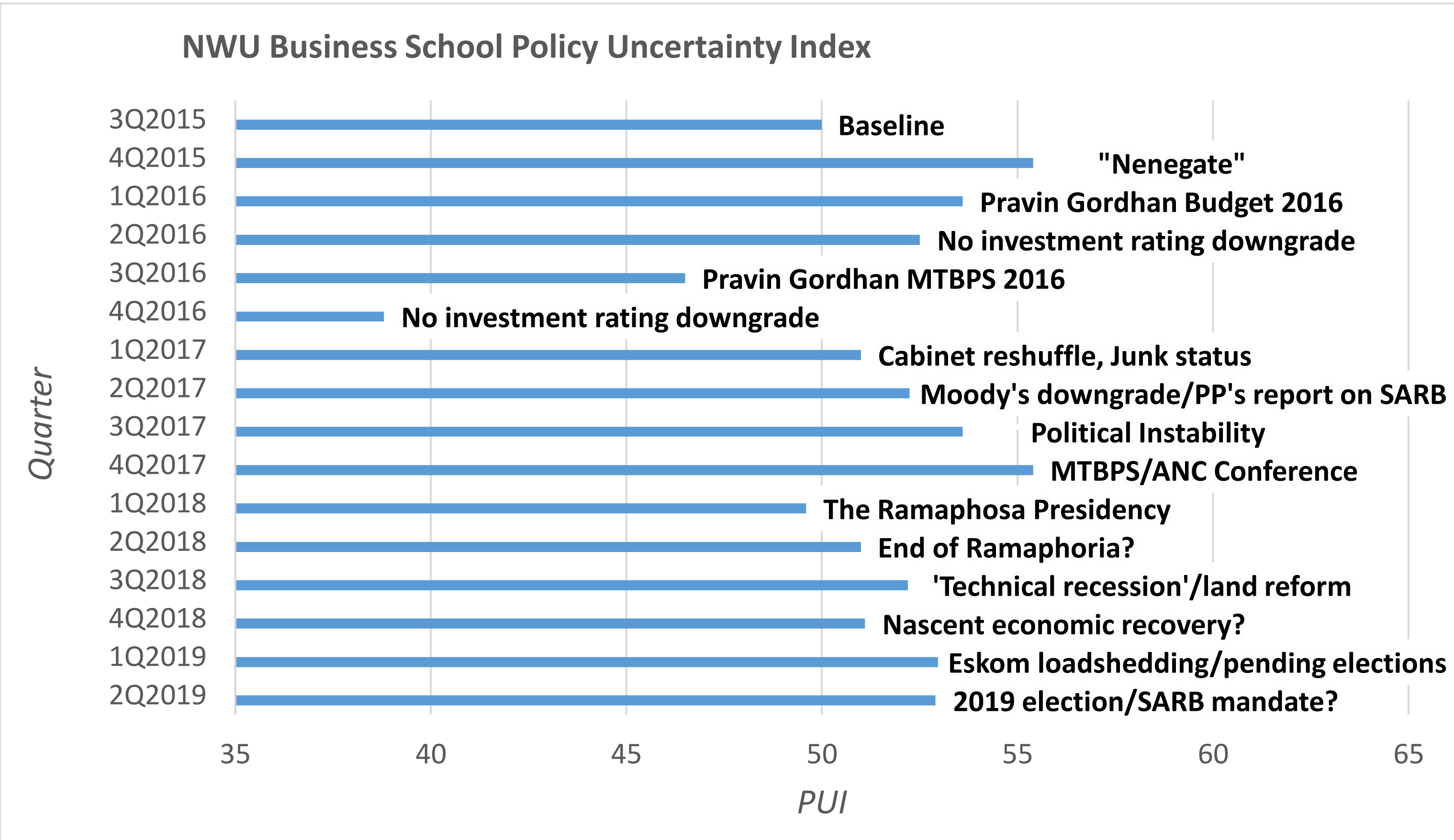
The PUI is the *net* outcome of *positive* and *negative* factors influencing the perceptions of policy uncertainty over the relevant period. The outcome for 2Q 2019 shows an average score of 52.9, reflecting a slight decline over the PUI of 53.4 in 1Q 2019. *Hence the PUI remains well in negative territory for now.*

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

2.1. In the *media data* there was a small decrease in the level of reporting about policy uncertainty.

2.2. The *survey of economists* showed that their view is that the level of uncertainty was more or less at the same high level compared with 1Q 2019

2.3. The *Bureau of Economic Research* at the University of Stellenbosch's *survey of manufacturers* and their views on how political uncertainty affects business remained at elevated levels in 2Q 2019.



3. NARRATIVE ON SOME FACTORS INFLUENCING ECONOMIC/POLICY UNCERTAINTY

3.1 Global Economic Outlook and South Africa

Recent surveys, such as by the World Bank, broadly indicate that global economic activity, although still positive, has slowed to its slowest pace in three years. According to the World Bank, international economic growth this year appears to be stabilising on a plateau at about 2.6%, but with downside risks. These include intensified trade tensions, rising protectionism and simmering geo-political conflicts. Both international trade and global investment levels have been lower in 2019 than originally anticipated.

Global foreign direct investment in particular has fallen to its lowest level since the 2008 financial crisis, according to a recent UN report. Hence major advanced economies and some large emerging economies have seen weaker economic growth than expected so far this year and to that extent may be regarded as less supportive of the world economic outlook.

The World Bank nonetheless expects world economic growth to gradually rise to 2.8% by 2021, assuming continued benign global financing, as well as an anticipated modest recovery in several emerging market and developing economies. Latest statements by the US Fed indicate a willingness to cut interest rates if the US economy should falter. In passing, it is interesting to again note that generally concerns about uncertainty have risen all round the world since the global financial crisis of 2008.

The IMF country reports, for example, have increasingly cited 'uncertainty' as a key factor in the weaker economic performances of many economies. Hence, in October 2018, a group of economists from the IMF and Stanford University constructed and released the *first World Uncertainty Index (WUI)* for 143 countries on a quarterly basis from 1996 onwards. The new global WUI finds that the level of uncertainty is considerably higher in developing countries and is positively associated with economic policy uncertainty and stock market volatility, and negatively with GDP growth.

That said, given its own latest global economic assessment, the World Bank has urged developing economies in particular to reinforce policy buffers and to implement policy reforms that boost growth prospects. This is relevant to SA's current policy challenges and the need to get the economy on a much higher growth path. The more SA expedites its pro-growth reforms and projects, the better it would be able to manage any global headwinds that may emerge.

Then for SA there is also the question of *Brexit*. The possibility of a 'hard' *Brexit*, with the UK 'crashing out' of the EU without a deal later this year, remains a high risk for countries like SA which have major trade ties with both the UK and the EU. An abrupt 'no deal' *Brexit* outcome on October 31 has a significant potential for disruption and uncertainty affecting existing trade relationships and would have a negative ripple effect on the world trading system. SA therefore has a vital stake in the prospects for a smooth and orderly Brexit.

Choices made now around this issue will reverberate for decades. Brexit remains an overriding matter about which the UK must ultimately decide its own economic future, whatever the negative or positive collateral consequences for other countries. SA can only continue to monitor the Brexit developments in the months ahead and prepare contingency plans to ensure continuity and predictability in its future trading relations with key economic entities like the UK and the EU.

3.2 The South African Economy

The consensus expectation had been that the post-election period would hopefully begin to see a marked reduction in policy uncertainty and a substantial recovery in business and consumer confidence. However, this has not yet occurred and the PUI remains strongly in negative territory for now, with several adverse factors still dominant. *The potential is still there to reduce policy uncertainty in the period ahead*.

It was not all bad news in the past three months. Among the positive factors in 2Q 2019 was the holding of a peaceful, free and fair election on May 8 to solicit new political mandates, especially about the economy. The election campaign was a powerful reminder that the challenges of unemployment, poverty, and inequality still remain to be successfully addressed in the post-election period, and therefore understandably dominated it.

Acknowledging the inevitable balance of forces and factions within the governing ANC party that had to be accommodated, the reconfigured and leaner Cabinet that was eventually selected remains potentially a positive one for business and the markets. The fact that Cabinet Ministers will sign performance agreements is also a step in the right direction. The post-election Cabinet will nonetheless also need to be supported by a stable and competent cohort of Directors-General to help ensure policy coordination and consistency. The turnover and instability in these senior appointments in recent years has also significantly contributed to the persistence of policy uncertainty.

Another useful development in 2Q 2019 was the widely-expected but welcome decision by the credit rating agency Standard & Poor to keep its investment rating unchanged and maintain the outlook for SA as 'stable'. This signalled an overall a 'wait-and-see' stance for now. However, this was linked with a clear message (also echoed by other recent serious analyses of the SA economy, including by Moody's) as to what pro-growth reform policies are now urgently needed to turn the SA economy around.

The Monetary Policy Committee (MPC) decision on May 23 to again leave interest rates unchanged nevertheless left the door open to a rate cut later. Inflation is stabilizing, especially in a weak economy. And with a split 3-2 vote at the MPC May meeting - now also coupled with the subsequently released highly negative GDP figures for 1Q 2019 - the prospects of a rate cut soon have risen. The SARB has indeed already signalled its willingness to drop rates and conceded that monetary policy has not been as accommodative as it could have been in recent months (Business Day, June 18).

In the meantime, key retail sales and manufacturing output in April 2019 also showed positive trends, confirming that the risk of a 'technical recession' (two successive quarters of negative growth) in 1H 2019 had receded. In the background it should also be noted that FDI in SA in 2018 made a significant recovery after several years of low inflows, although the surge has been largely attributed to intra-company transfers by established companies.

The SONA on June 20 gave an overall aspirational vision of the urgent socio-economic challenges facing SA, but details of implementation plans to achieve the stated goals remained inadequate and uncertain. The reaffirmation of both the role of the National Development Plan (NDP) (and a new five-year Medium-Term Strategic Plan) and the constitutional mandate of the SARB were on balance favourable for future policy certainty. Despite these favourable factors, negative developments continued to weigh heavily on the PUI.

These included the impact of the worse-than-expected contraction of -3.2% in 1Q 2019 growth, the highest quarterly growth setback in SA in a decade. The downward trend in SA's business cycle has continued since 2013, with recent weak capital formation trends evident in particular. The likelihood that growth in 2019 was now likely to only average between 0.7% and 1% also has implications for the Medium-Term Budget Policy Statement in October. Budget projections earlier in February were predicated on an official forecast of an expected 1.5% growth rate this year.

Uncertainties in 2Q 2019 also continued to surround the operations, debt management, and restructuring prospects of key state-owned enterprises, especially Eskom. Even after the SONA there appeared to be persistent unknowns as to how Eskom was looking to be restructured or unbundled in order to stabilize the situation. And the land reform issue still required clarification as the post-election period unfolded.

But the biggest single factor affecting the 2Q 2019 PUI was probably the ANC controversy in early June around the role and status of the Reserve Bank. One prominent economist well described it as 'a case study as to what policy uncertainty looks like' (Financial Mail, 13-19 June, 2019). The focus on the SARB and monetary policy then became a highly divisive matter.

It was clear that the combined issues of expanding the SARB's mandate - as well as its proposed 'nationalization' - together with the desirability of adopting 'quantitative easing' in SA, injected palpable uncertainty into the markets and economy. The subsequent reaffirmation of the constitutional mandate of the SARB in the SONA has been widely welcomed but could not yet entirely erase the previous negative impact.

Constant internal political factionalism may yet still aggravate policy uncertainty and undermine or delay growth-friendly reforms. Key pro-growth reform policies, including at local government level, remain imperative if the economy is to successfully break out of its 'low growth trap', as well as protect and rebuild its global investment ratings.

4. CONCLUSION

Policy uncertainty remains elevated for now. Following on the latest SONA, therefore, a priority-led action agenda for economic recovery is now urgently needed to reverse this trend. A sustained focus on a small number of priorities remains essential. And the quality of leadership at all levels is decisive if implementation of policies and projects is to be expedited. A week may be a long time in politics but five years is incredibly short in which to deliver.

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2 July 2019
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