NWU Business School

Policy Uncertainty Index (PUI)

3Q 2019

IMMEDIATE RELEASE

2 October 2019

EXECUTIVE SUMMARY

- The PUI increased slightly to 53.1 in 3Q 2019 from 52.9 in 2Q2019 (baseline 50). Policy uncertainty therefore remained strongly elevated and stayed well in negative territory during this period. However, there is still potential to reduce it in the months ahead, if the right policies are now decided and steadily implemented

- The overall global economic outlook indicates that, although the world economy continues to show positive growth, the geo-political environment has become increasingly risky and uncertain, especially for business investment

- Brexit still remains an immediate major source of uncertainty for world trade, depending on whether October 31 brings a 'hard' Brexit or a 'soft' one. Fortunately, SA has now concluded a trade agreement with the UK in advance to ensure continuity in its trade arrangements with that country in the post-Brexit phase. But logistical challenges and disruption will still arise end-October in the event of the UK 'crashing out' of the EU without deal

- The biggest single positive factor in 3Q 2019 was probably the publication of the National Treasury's (NT) 'growth plan'. It embodies pragmatic solutions to enable SA to break out of its 'low growth trap'. If properly implemented, it offers the prospect of creating a more stable and predictable policy environment for investor confidence and job-rich growth

- Contradictory factors in SA which kept policy uncertainty in negative territory during the past quarter included a still weak economy, vulnerable public finances, crime and violence, political factionalism, the Eskom dilemma, the Moody's economic review in November, and the risk that the NT's growth plan may not be successfully implemented

- The latest PUI again confirms that the most important contribution government can make now remains to minimize the uncertainty created by its policies and actions. Policy drift remains the enemy of delivery. The NT growth plan, the economic signals coming from the MTBPS on October 30 and the next Presidential investment 'summit' in November are opportunities for enhancing policy certainty in SA

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NWU BUSINESS SCHOOL POLICY UNCERTAINTY INDEX (PUI) RISES SLIGHTLY TO 53.1 IN 3Q 2019 FROM 52.9 IN 2Q 2019 (BASELINE 50), AND 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 is now a ‘World Uncertainty Index’ (WUI) created recently by the IMF and Stanford University to calibrate rising levels of policy uncertainty in the global economy.

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 3Q 2019 - WHAT DOES IT SAY?

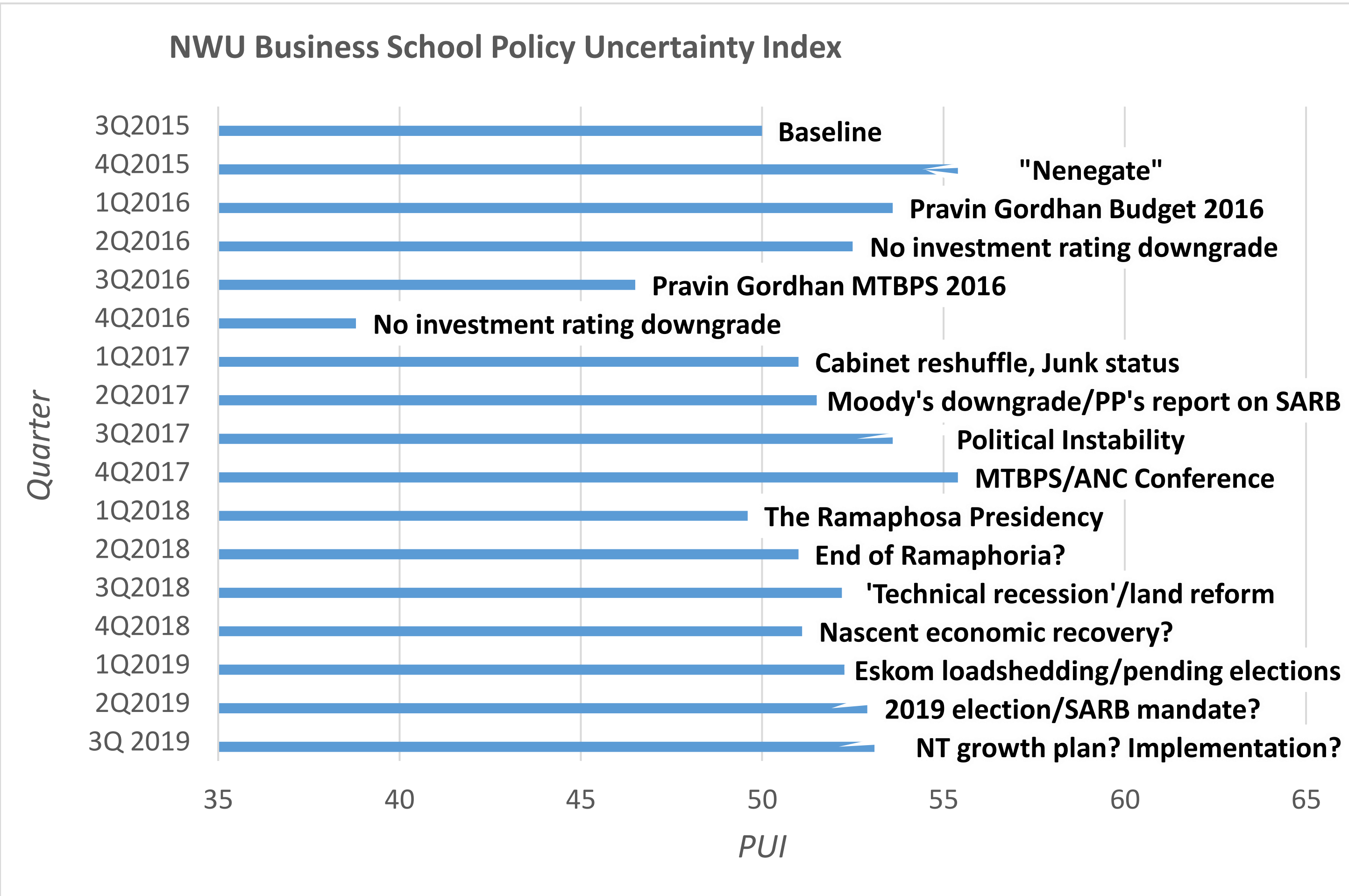
The PUI is the *net* outcome of *positive* and *negative* factors influencing the perceptions of policy uncertainty over the relevant period. The outcome for 3Q 2019 shows an average score of 53.1, reflecting a small rise over the PUI of 52.9 in 2Q 2019. *Hence the PUI remains in negative territory for now.*

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

2.1. In the *media data* there was an increase in the previous significant level of reporting about uncertainty.

2.2. The *survey of economists* indicated that they saw policy uncertainty at more or less the same high level compared with 2Q 2019.

2.3. The *Bureau of Economic Research* at the University of Stellenbosch's *survey of manufacturers* and their views about political/policy constraints were still elevated but at a slightly lower level.



3. NARRATIVE ON SOME FACTORS INFLUENCING ECONOMIC/POLICY UNCERTAINTY

3.1 Global Economic Outlook and South Africa

By 3Q 2019 the US economy had been growing for about 123 months, the longest run since records began in 1854. Average GDP growth during this expansion has nonetheless only been 2.3%, much lower than the 3.6% seen in America's three previous expansions. History suggests there *may* be a recession soon. Yet despite mixed economic signals, the US economy currently remains the 'locomotive' of world economic activity, especially given more pessimistic data from elsewhere. The negative international trends outlined in the 2Q 2019 PUI have continued to be evident in 3Q 2019 and have in some ways intensified.

On-going trade conflict, geo-political tensions and faltering global economic growth have seen many businesses cut back on investment so far this year. In manufacturing, production and capacity utilization have been falling since the end of 2018. Although the US economy still appears to be doing reasonably well, to keep growth going these broader concerns prompted the US Fed in September to lower interest rates by 0.25 basis points for the second time this year.

There have been increasing worries about slowing EU economic activity, especially in the German economy. To bolster the EU economy, the European Central Bank also announced monetary easing in September, in line with a broad global trend in recent months towards lower interest rates. China's economy in the third quarter of 2019 was the weakest it has been this year, according the *Chinese Beige Book*. However, a world recession so far is a fear, *not* a reality, with the world economy still growing, albeit at a lesser pace.

The immediate threat is that the global economy continues to have a dangerous trade war on its hands, apart from other geo-political tensions. The US-China relationship appears broken, and even a trade truce may not necessarily repair it. Trust between the two countries is minimal. It seems that both sides will work to make themselves less vulnerable to the other by reducing the economic commitments that bind them together, irrespective of collateral damage to any other countries. Such 'beggar-my-neighbour' polices between the two biggest economies in the world like the US and China will inevitably have a negative impact on many other third countries.

In a worse-case scenario the IMF estimates that the US-China trade conflict could shave about 0.75%-1% off expected world economic growth (3.2%) in 2019. And the African Development Bank believes that these escalating trade tensions could reduce Africa's expected 2019 GDP (4%) by approximately 0.7%-1%. About 60% of Africa's exports go to the US, China and Europe. To restore more stability and certainty it remains necessary that the world finds its way back to a '*rules-based' multilateral trading system*, instead of generating bilateral trade wars.

The overall global economic outlook therefore suggests that, although the world economy continues to show positive growth, the geo-political environment has become increasingly risky and uncertain. *Uncertainty*, not so much tariffs, from the US-China trade conflict appears so far the greatest threat to international business sentiment and future world growth prospects. There are external vulnerabilities and uncertainties not there before that are now being taken into account by investors and also result in a declining risk appetite.

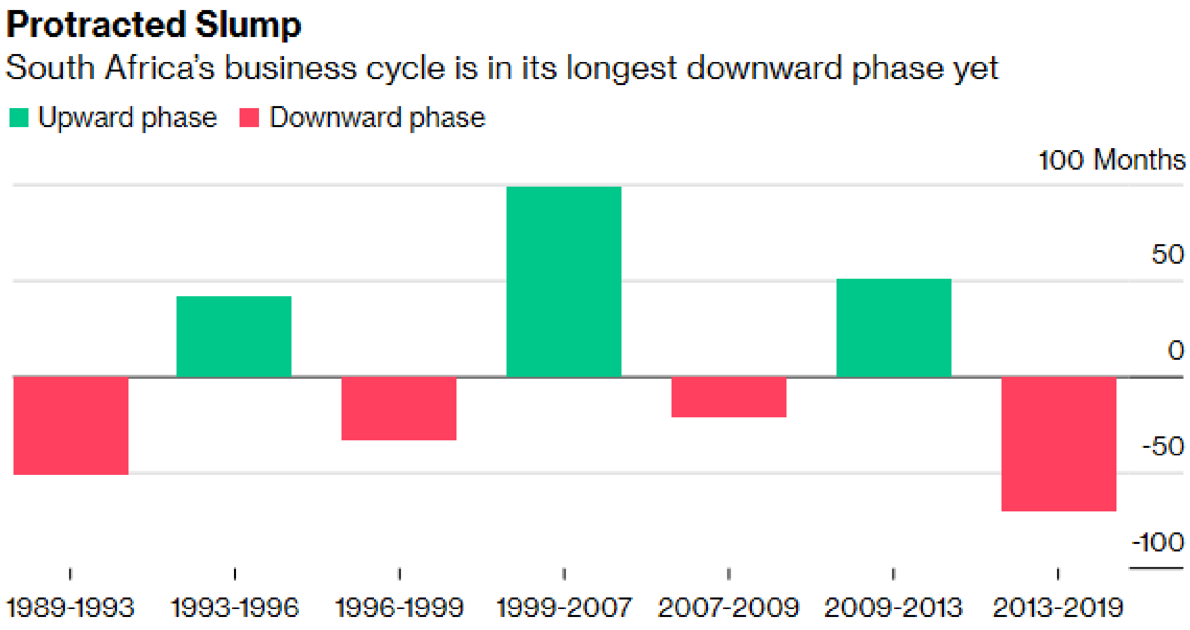
Brexit still remains a major immediate source of economic uncertainty for the world trading system. Despite the recent UK Supreme Court ruling on the 'unlawful' proroguing of Parliament it is still unclear as to whether it will be a 'hard' Brexit or a 'soft' Brexit by the next deadline of October 31. The good news for SA is that, given its vital stake in both the UK and EU economies, it has been recently agreed that the existing tariff arrangements with the UK will continue for the time being, whatever happens at the end of October. This injects much needed predictability and continuity into SA's trade relations with the UK post-Brexit.

However, irrespective of the renewed trade agreement with the UK, SA business should nonetheless in any case prepare for a serious period of logistical dislocation in the UK and EU in the event of the UK 'crashing out' of the EU without a deal on October 31. The governments of both the EU and the UK, together with their respective business communities, are preparing contingency plans to minimize the immediate disruption that will occur in the event of a 'hard' Brexit. SA business should liaise with their counterparts in the UK and the EU to update on the situation.

3.2 The South African Economy

Negative factors slightly outweighed positives ones in determining the level of policy uncertainty in 3Q 2019 and keeping it in negative territory in the past quarter. However, although there remain a number of uncertain factors in the economic and political environment, it was not all bad news over this period. One good example was SA successfully issuing bonds on international markets in September on favourable terms, which was also seen by many as an expression of investor confidence in the country. Growth also rebounded slightly in recent months.

The appointment of an 18-member Economic Advisory Council by President Cyril Ramaphosa came too late in the quarter to seriously influence the policy environment but offers future potential. On the other hand, the economy has entered its 70th month of a weakening business cycle, according to the latest SARB Quarterly Bulletin. The number of quarters with negative growth has increased markedly since 2014. *Business confidence levels are at an all-time low.* Two business confidence surveys in September drew a very negative picture of the current business mood.



Source: South African Reserve Bank/Bloomberg

The potential remains to push the PUI back into positive territory. *But this clearly requires that strategy be turned into delivery.* Policy drift remains the enemy of delivery. The overall message is still one of demonstrating *successful implementation.* And an important component of this scenario is reflected in the fact that recent weak capital formation is largely due to *a fall in public investment,* rather than private capex. Higher *total* investment is required to underpin growth.

Leaving aside the welcome SA-UK trade agreement to deal with Brexit referred to earlier, the biggest single positive factor in the 3Q 2019 policy environment was probably the publication of the draft National Treasury (NT) 'growth plan' at the end of August. Drawing heavily on the National Development Plan, the 77-page NT document offers an updated, coherent and pragmatic economic strategy to put the SA economy on a higher growth path.

The NT sees SA's current economic trajectory of low growth and high unemployment as 'unsustainable'. The NT plan builds its remedies on the three main pillars of inclusive growth, economic transformation and competitiveness. It was broadly well-received by business and several other key stakeholders, though not by all of them.

The plan comprehensively outlines the policies and projects urgently required for SA to break out of its present 'low growth trap'. The NT plan also recognizes the importance of *creating a more stable and predictable policy environment in SA* to strengthen investor confidence and to develop the job-rich growth that the country needs.

However, *despite in whatever form the NT plan is eventually finalized, there is still a way to go to establish more policy certainty in SA.* The *cumulative* effect of other negative factors offset the favourable initial impact of the NT growth plan and some other elements for the

PUI in 3Q 2019. These include a still weak economy, vulnerable public finances, political factionalism, the Eskom dilemma, crime and violence, and the possibility of further load-shedding

It was a pity that the Monetary Policy Committee (MPC) of the SARB did not take the opportunity to cut interest rates again, by say 0.25 basis points, at its September meeting, when there was room to do so. The hope of lower rates is now deferred to the MPC November meeting. The MPC also reduced its growth forecasts for 2020 and 2021. But it remains wrong to think that monetary policy can do more for structural growth and employment than it can in reality. *Pro-growth structural economic reforms* remain the road ahead for SA.

4. CONCLUSION

The latest PUI again confirms that the most important contribution government can make is to minimize uncertainty created by its policies and actions. There needs to be a greater sense of urgency about what is *implementable.* And reducing uncertainty continues to require the adoption and maintenance of stable and mutually consistent policies, and a minimum of ad hoc interventions or 'shocks' which create needless uncertainty for investors. This is a key element in the mandate given to the new Economic Advisory Council.

Business can usually adjust to almost any regime except one subject to continued unpredictable change. This is very corrosive of investor and business confidence. Hence the outcomes of factors such as the NT growth plan, economic signals emerging from the MTBPS on October 30 and the next Presidential investment 'summit' in November will be among the key opportunities to enhance and strengthen policy certainty in SA. There needs to be urgency and resolve in stabilising the policy outlook.

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2 October 2019

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