NWU School of Business and Governance

Policy Uncertainty Index (PUI)

4Q2017

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NWU-SBG POLICY UNCERTAINTY INDEX (PUI) RISES FROM 53.6 IN 3Q2017 TO 55.4 IN 4Q2017 (BASELINE 50)

NWU-SBG POLICY UNCERTAINTY INDEX (PUI)

1. INTRODUCTION

As outlined when the PUI was launched last year, 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 in the period ahead and builds a track record.*

2. PUI RESULTS FOR 4Q2017 - WHAT DOES IT SAY?

The aggregate PUI for the quarterly period October to December 2017 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

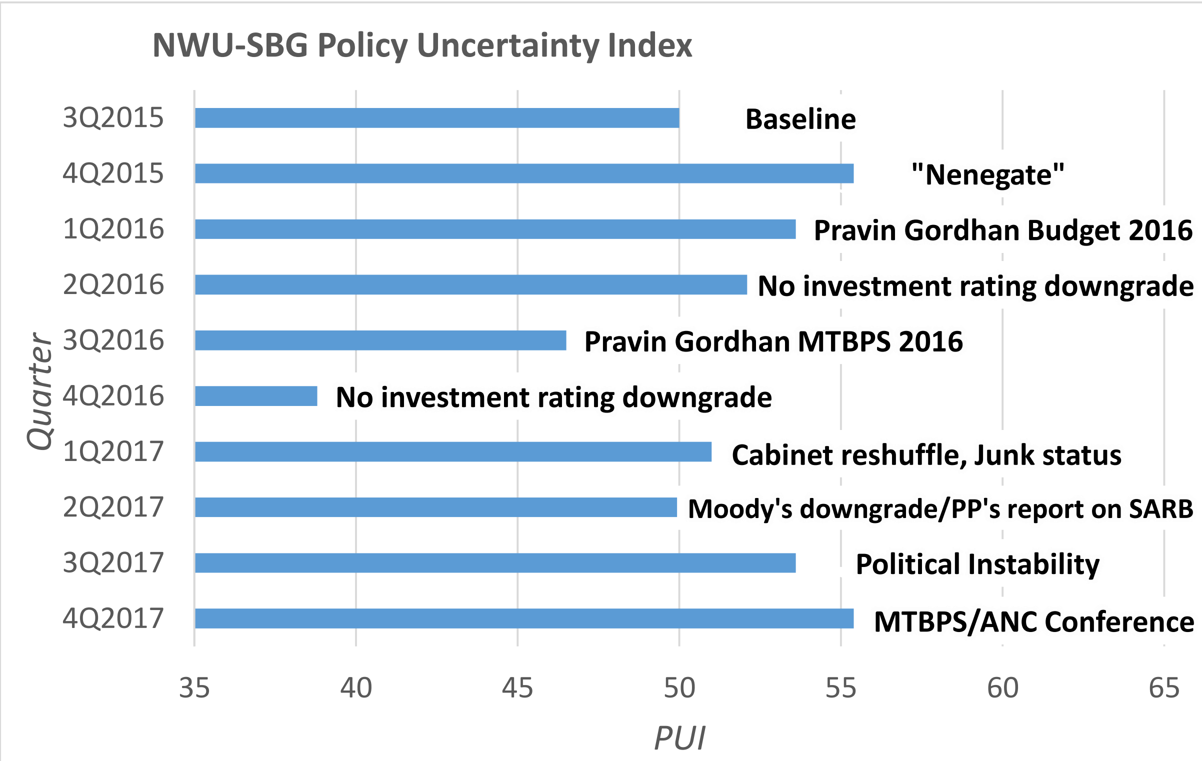
The PUI is the *net* outcome of positive and negative factors influencing the perceptions of policy uncertainty over the relevant period. The results for 4Q2017 show an average index score of 55.4, reflecting a further rise over the PUI of 53.6 in 3Q2017. *Hence the PUI has edged further into negative territory and is back at 'Nenegate' level.*

Unpacking the three elements of the index shows the following:

2.1. In the media data there was an increase in reporting about 'policy uncertainty' – much of it related to the shock of the MTBPS in October and the political uncertainty around the ANC elective conference in December,

2.2. The survey of the economists shows that their view is that uncertainty remained the same (comparing Q4 to Q3) for consumers and investors, but that there was more uncertainty about politics in Q4,

2.3. The Bureau of Economic Research at the University of Stellenbosch's latest statistic on the proportion of manufacturers who indicate that politics is a constraint on doing business in SA was at a high level of 89, compared with 86 in the previous quarter



3. NARRATIVE ON SOME FACTORS INFLUENCING POLICY UNCERTAINTY

3.1. Global Economic Outlook

Global economic activity continued to recover in the fourth quarter of 2017 and the world growth outlook for 2018 is positive. International analysis confirms the prospect of broad, synchronised growth of between 3.5% and 4% in 2018. The latest IMF forecast has world growth of 3.9% this year and next. That reflects an upgrade of 0.2% for each year. It constitutes faster expansion than in previous years.

In 2018, growth is expected to come from most developed *and* developing economies. Emerging economies are anticipated to achieve growth of up to about 4.5% in 2018. India is seen to be the world's fastest growing economy, with a projected growth rate of 7.8%. China is expected to make grow by 5.8% (a full percentage point slower than in 2017). South-East Asian economies are also anticipated to perform well.

There are still geo-political and other risks in the world economic outlook. 'Political leaders and policymakers must stay mindful that the current economic momentum reflects a confluence of factors that is unlikely to stay long' cautions the IMF.

And U.S. monetary policy remains relevant. The Fed's new chair, Jerome Powell, is expected to continue with the normalisation of monetary policy by gradually raising interest rates further and shrinking the Fed's balance sheet. Major central banks are likely to follow, while global inflation rates remain subdued. These forces are expected to sustain capital flows to emerging markets in the near future.

Global commodity prices have strengthened, which is helpful to SA, although a rising global oil price is less favourable for SA's inflation outlook. As a whole, however, the current outlook for the world economy remains broadly supportive of the SA economy and of the global markets in which SA has economic interests.

3.2. South African Economic Outlook

The South African economy spent the best part of 2017 recovering from a 'technical recession' earlier in the year and growth prospects are now improving. The Reserve Bank forecasts higher GDP growth of 0.9% for 2017 and 1.4% for 2018. This growth, from a low base, is ascribed mainly to the recovery of agricultural and mining output during the course 2017. As mentioned in the previous PUI report we emphasise the difference between a limited business cycle recovery and the structural reforms needed for *sustained* growth – South Africa cannot rely only on the weather and the world economy for its growth. *Domestic policies* are the key to sustained growth and employment.

In contrast, the IMF has now cut SA's growth rate for the next two years to below 1%. This forecast may, however, have been done before the latest political developments in SA offered better prospects. Following the positive developments on the domestic front and the continued support from a growing world economy, GDP forecasts for SA could well be raised – possibly to 1.5% in 2018.

The latest MPC Statement showed that there was modest increase in real gross fixed capital formation at the end of 2017. The growth in household consumption expenditure has been restrained, but the Reserve Bank believes that the outlook for households has strengthened.

The inflation outlook has also improved. At its meeting on January 18 the MPC left interest rates unchanged.

The MPC nonetheless warned of two key risks to the South African economic outlook. One was the rising international oil price, the other was that of a universal sovereign credit rating downgrade after the forthcoming Budget. This second risk is associated with “the extent to which the recent political developments impact on confidence and lead to greater policy certainty and credibility”.

3.3. Politics and the SA Economy

Apart from the MTBPS, political uncertainty around the ANC Conference obviously played a key part in the latter half of 4Q2017 up to December 31 (closing date for the 4Q2017 PUI).

The impact on political and policy uncertainty arising from the conference was also driven towards the end of 4Q2017 by the:

* narrowness of the ANC leadership victory by Deputy President Ramaphosa and questions around the solidity of his mandate. His candidature was largely favoured by the markets and most of business in SA

* risks of uncertainty that might arise from the ‘two centres of power’ factor

* ‘populist’ policy decisions and announcements emerging from the ANC Conference on the (a) expropriation of land without compensation (although hedged around conditions) (b) ‘free’ higher education (now said to be financed over eight years) and (c) the ‘nationalisation’ of the SARB.

Subsequent developments suggest that SA’s political leadership indeed appears to be changing gear, with positive factors pointing towards prescient indicators of change. The election of Deputy President Cyril Ramaphosa as ANC President has seen key moves – especially regarding ESKOM and in other related matters – to start effectively tackling the phenomena of state capture and widespread corruption in SA. The SA delegation to the WEF meeting in Davos earlier in January 2018 also met with encouraging responses from potential investors.

There are thus new grounds for cautious optimism about the general outlook. Yet Standard & Poor’s Konrad Reuss recently warned that none of the major issues of concern outlined in its November downgrade had disappeared. The present positive market responses in 1Q2018 to political developments therefore have a limited shelf-life until more decisive action emerges. The challenge is how rapidly the SA economy can turn around to take advantage of the above developments.

3.4. The 2018/19 Budget on February 21

The Medium Term Budget Policy Statement (MTBPS) in October 2017 showed worrying uncertainties about both the revenue and spending sides of SA's public finances. Much lower economic growth has consequently also seen declining tax revenues. The so-called tax buoyancy measure fell from 1.47 to 0.88 - as tax revenues grew slower than the economy. Tax revenue was expected to fall short of the 2017 Budget estimate by about R50.8 bn. The consolidated budget deficit will widen to about 4.3 per cent of GDP in 2017/18, against a 2017 Budget target of 3.1 per cent of GDP. The Finance Minister promised a mix of expenditure cuts and revenue increases to be elaborated on in the 2018 Budget speech.

Government spending needs to be prioritised within the competing demands of 'big ticket' items such as 'free' higher education, nuclear power and the public sector wage bill to clearly demonstrate how SA's public finances will now be stabilised. In an effort to 'balance the books' in 2017, personal taxes and the fuel levy were the principal tax increases in that Budget. But tax revenues still declined on the back of a weak economy.

There is a real prospect that individuals and business will face substantial uncertainty from a host of tax decisions in the coming Budget, some of which may emanate from the on-going work of the Davis Committee on tax reform. The tax agenda for the 2018/19 will also be influenced by political factors, bearing in mind that by then SA will be another year closer to the general election of 2019. There have been official hints of a 'tough budget' on February 21.

This difficult balancing act will therefore not only be between the future burden of different taxes, but also between the fiscal consolidation required by the credit rating agencies, on the one hand, and what is needed for inclusive economic growth and job creation, on the other. Unless SA is going to drift into a negative 'tax-and-spend' cycle it needs to implement the *structural reforms* required to promote sustained growth and employment. Above all, Finance Minister Gigaba must ensure that the message of the Budget is credible and builds confidence in the road ahead for the SA economy in ways which reduce policy uncertainty and avoids universal junk status.

4. CONCLUSION

In summary, although the PUI rose again in 4Q2017, there are undoubtedly positive economic and political factors subsequently emerging about SA's economic prospects in the period ahead that create the potential for a reduction in policy and political uncertainty. This is already apparent in the encouraging market reaction so far. These prospects should be built upon in the months ahead through decisive and prompt action. Difficult policy decisions still lie ahead. With new leadership has come new hope but it needs to be backed by real reforms which change the realities of doing business in SA.

There is now a real opportunity to begin to dissipate the clouds of political and policy uncertainty which have been hanging over the economy. Policy certainty needs to be restored in the economy. This could be cumulative, just as its decline has been, and therefore beginning the process will be half the battle – if economic recovery in SA is to be sustainable.

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