



Policy Uncertainty Index (PUI)

3Q 2021

EMBARGOED UNTIL

Monday

4 October 2021

EXECUTIVE SUMMARY

- The NWU Business School PUI for 3Q 2021 rose to 58.2 from 50.3 in 2Q 2021 (Baseline 50). It is therefore highly elevated again after being on the brink of positive territory in the second quarter of 2021. It was previously in positive territory in 1Q 2018 at the inception of the Ramaphosa Presidency.
- The overall global economic outlook continued to be positive, with the latest global growth forecasts from UNCTAD and the OECD averaging 5% in 2021. The OECD has reduced its 2021 economic growth forecast for the US from 6.9% to 6% but left its growth expectations for China unchanged at 8.5%.
- All credible international growth forecasts still emphasize 'a tale of two recoveries', with the global recovery unevenly spread over countries - depending on their progress with the vaccination rollout and their pace of economic recovery.
- Continued high international commodity prices in 3Q 2021 reflected both global supply shortages and strong demand, which have also provided the SA economy with a robust tailwind. The better-than-expected growth forecasts for 2021 as a whole now indicate that SA's GDP growth could exceed 5% this year.
- However, the bulk of the 'rebound' in the economy is widely seen as being in the past and it is now necessary to look ahead to growth prospects beyond 2021.
- At its meeting in September 23 the SARB's Monetary Policy Committee (MPC) reduced its growth forecasts for 2022 and 2023 respectively to below 2%. Such low growth rates will not make a big dent on the SA's present high level of unemployment, which needs a growth rate of at least 3% to make a real difference.
- Higher total fixed capital formation, especially private fixed investment, is needed to translate the present economic 'rebound' into sustained job-rich growth in the years ahead, based on solid, coherent and consistent policies.
- The well-known constraints on higher inclusive growth, such as the absence of energy security, lack of policy coherence, weak confidence and slow progress with structural reforms, still require urgent attention to shrink policy uncertainty.
- The next Medium Term Budget Policy Statement (MTBPS) on November 4 needs to embody a credible message about future policy direction.

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NWU BUSINESS SCHOOL POLICY UNCERTAINTY INDEX (PUI) IN 3Q 2021 ROSE TO 58.2 FROM 50.3 IN 2Q 2021 (BASELINE 50)

'I don't know how to explain this anymore.... Economic agents: investors, businesses, consumers, buyers and sellers of goods, farmers, the market etc., need policy certainty. FUNDAMENTAL. I invest because I will harvest in X-years in the forward market. CONFIDENCE! (former Finance Minister Tito Mboweni, 22/11/2020).

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.

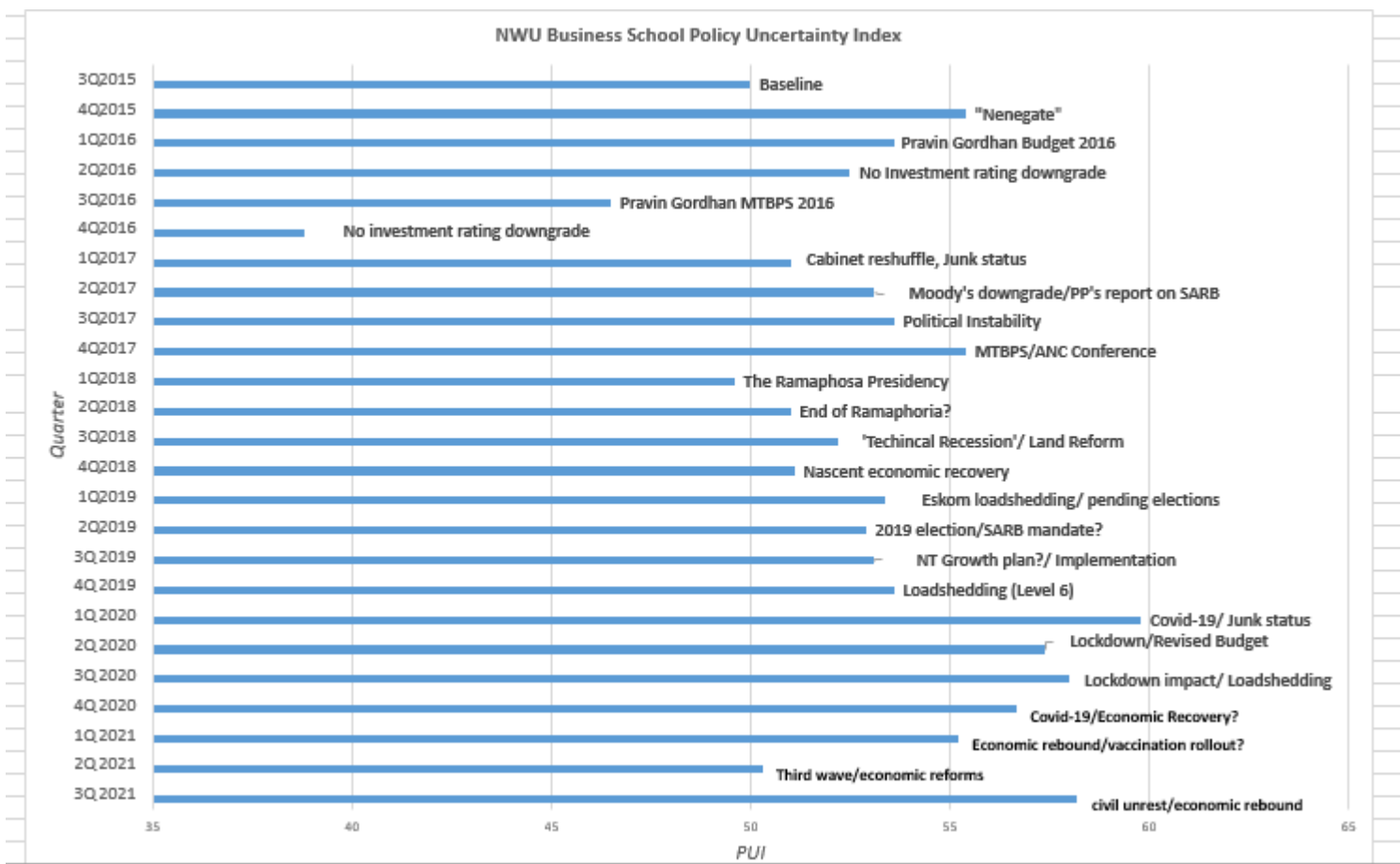
The PUI is published in January, April, July and October of each year. An increase beyond 50 reflects heightened policy uncertainty; a decline in the PUI means reduced uncertainty. The value of the PUI as a proxy for policy uncertainty will lie in tracking changes in policy uncertainty over time.

2. PUI RESULTS FOR 3Q 2021 - WHAT DO THEY 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 2021 shows an average score of 58.2, compared to 50.3 in 2Q 2021.

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

- 2.1 the media data showed a slight decrease in references to policy uncertainty.
- 2.2 the *survey of economists* reflected elevated perceptions of policy uncertainty.
- 2.3 the University of Stellenbosch’s Bureau for Economic Research *survey of manufacturers* experiencing policy/political uncertainty rose from 72 to 84.



3. NARRATIVE ON FACTORS INFLUENCING ECONOMIC/POLICY UNCERTAINTY

3.1 Global Economic Outlook

The global economic outlook continues to be uneven in the third quarter of 2021, with forecasts being adjusted by country and region. The recent UNCTAD Trade and Development Report expects overall global growth to be 5.3% this year. The IMF’s current global growth forecast is 6% but it will be updated in early October. The big global picture continues to be ‘a tale of two recoveries’. There are economies currently seen by analysts as ‘leaders’, as opposed to those perceived as ‘laggards’ - both in terms of progress with vaccination roll-out and in their pace of economic recovery.

In its September interim review, the Organization for Economic Cooperation and Development (OECD) lowered its 2021 growth forecasts slightly for the world and the US, while raising it for Europe. The OECD said the world economy continued to broadly 'rebound' this year driven by economic stimulus measures, the steady rollout of effective Covid vaccines by many countries and the rapid resumption of several economic activities. Global GDP growth has now exceeded its pre-pandemic level following on last year's Covid-induced recession, said the OECD.

Global growth is therefore now expected by the OECD to expand by 5.7% in 2021, down by 0.1% from the organization's previous forecast this year. Output and employment 'gaps' remained in many countries, especially in emerging-market and developing economies where vaccination rates are low. According to the OECD the growth prospects of Argentina, Brazil, South Africa, South Korea and Turkey have improved, while those of Australia, Britain and Russia have weakened.

Regarding the two main 'locomotives' of growth in the global economy - the US and China - the OECD lowered its growth outlook for the US from 6.9% to 6%, whereas its forecast for China remained at 8.5% for now. But sizeable uncertainty remains in parts of the world economy, warned the OECD. The impact of the Delta variant of the coronavirus has until now been relatively mild in countries with high vaccination rates, but has lowered economic momentum elsewhere and added pressures to global supply chains and costs.

We also need to add to the OECD assessment the much-debated questions of (a) the outlook for inflation in the US (b) when the US Fed will begin tapering off 'quantitative easing' and (c) at what point interest rates will rise there? Latest official Fed statements indicate that the winding down of bond purchases may now begin by the end of the year, but that US interest rates may only begin to move upward in the first half of next year. The SARB sees SA as in a better position to deal with the situation than it was in 2013 when similar decisions led to the so-called 'taper tantrum' that upset emerging market currencies then.

In terms of the global trade outlook 3Q 2021 trends indicate that international commodity prices remain high. Commodity prices have reflected both supply shortages and strong demand. 'With growing scarcity across physical markets', says the Goldman Sachs Group, 'prices are expected to rise....as markets are being increasingly exposed to any type of supply disruption or unexpected demand rise'. Yet, says *The Economist*, 'global supply chains are adapting, not failing'.

The strong global commodity cycle has already been a visible driver of SA's economic recovery this year, especially in mining and agriculture. SA must therefore remain globally competitive to take further advantage of the current global commodity situation, especially in the operation of its rail and port network so as to access export markets expeditiously. It is necessary for SA to take full advantage of the positive global commodity cycle while it lasts.

3.2 The South African Economy

3.2.1 Balance between positive and negative factors influencing the 3Q 2021 PUI

The PUI in the first and second quarters of 2021 brought the level of policy uncertainty to the brink of positive territory. This seemed at the time to suggest this could be a favourable turning point towards a more positive trend. It was hoped that, as the year progressed, policy uncertainty could be still be further reduced and returned to positive territory, where it was last in 1Q 2018 (see chart). It suggested that high levels of policy uncertainty *could* be reversed - provided appropriate economic, health and other policy actions were credibly and consistently implemented.

Not unexpectedly, policy uncertainty has now risen again. Negative factors in 3Q 2021 greatly outweighed positive ones to instead push the PUI needle much higher. The reduction in some existing policy uncertainties in the second quarter of 2021 was strongly neutralized or offset by the creation of new ones in 3Q 2021. These included the serious civil unrest at the end of July, the move to lockdown level 3, conflicting policy announcements (e.g. on energy) and the continued perceived implementation risks at various levels. Insolvencies have risen sharply. Downside risks to growth include another wave of virus infections and further lockdowns.

On the positive side, despite the likely negative impact on 3Q 2021 GDP growth of the civil unrest and the previous level 3 lockdown, there is now the prospect of a better-than-expected growth performance for 2021 as a whole. The global economy has also continued to provide a significant tailwind for the domestic economy. The third wave of the virus infection has peaked for now and South Africa has moved to adjusted alert level 1. The MPC statement on September 23 revised its 2021 growth forecast up strongly to 5.3%. It also kept interest rates unchanged for the fourth consecutive meeting, which means stable low borrowing costs for now. The SARB nevertheless warned that most of the present 'rebound' in the economy was now in the past.

The MPC also revised its economic growth forecasts for 2022 and 2023 respectively to 1.7% (down from 2.3%) and 1.8% (down from 2.4%), which are only marginally above population growth. SA needs an average growth rate of at least 3% p.a. to make a significant dent in its present high unemployment rate. The current 'bounce-back' in the economy therefore needs to be translated into *sustained job-rich growth* through rising *total* fixed capital formation, especially private fixed investment. To support long-term growth in the years ahead overall fixed capital formation therefore needs to get closer to about 25% of GDP from its current 13% of GDP.

While low borrowing costs are generally supportive of the economy, weak credit demand by business still seems to have persisted. While there are tentative signs that private fixed investment may be recovering this year, it is still off a low base. There is also still a high degree of surplus capacity in some sectors of the economy. 'Investment', said the MPC, 'will remain constrained by still limited energy supply and ongoing policy uncertainty'. It will also be an advantage to economic and business plans know the outcome of the local elections being held on November 1.

The next important policy event that can help to reduce policy uncertainty is the Medium Term Budget Policy Statement (MTBPS) on November 4. It provides another significant opportunity to give more policy direction and reduce negative perceptions. Since the

February Budget developments on both the growth and public finance fronts have on balance now become more positive. The SARB's latest Quarterly Bulletin confirms the better news on the fiscal front. No big changes to the overall fiscal framework are expected from newly-appointed Finance Minister Enoch Godongwana in the forthcoming MTBPS.

But South Africa is not yet 'out of the fiscal woods'. The rating agency Fitch and other analysts recently again cautioned that government would still face challenges in the MTBPS to stabilize debt ratios, despite better-than-expected growth and tax revenues. Debt servicing costs, social dependency and public sector remuneration are still sources of fiscal risk. A credible MTBPS - supported by other growth-friendly actions - may encourage credit-rating agencies like Moody's and Fitch to consider shifting SA's outlook from 'negative' to 'stable' later. The next Presidential Investment Conference in November must also have a confidence-building agenda.

3.2.2 Summary and Conclusion

Policy uncertainty in SA remains a serious challenge. Reducing policy uncertainty therefore still requires creating a credible macroeconomic environment that is solid, coherent and consistent. The normal rhythm of a fixed capital formation cycle to support growth must be restored in SA. The decline in the PUI in the first and second quarters of 2021 demonstrated that policy uncertainty levels *can* respond positively to policy shifts which build certainty and renew investor confidence.

The good news of a much better-than-expected higher economic growth 'rebound' in 2021 requires to be converted into sustained job-rich growth in the years ahead, driven by fixed investment. The well-known constraints on higher inclusive growth, such as the absence of energy security, lack of policy coherence, weak confidence and slow progress with structural reforms, still need urgent attention to boost investment and put the SA economy on a much higher growth path.

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