Policy Uncertainty Index (PUI)

1Q 2021

EMBARGOED UNTIL

6 April 2021

EXECUTIVE SUMMARY

- The NWU Business School PUI for 1Q 2021 again declined slightly to 55.2 from 56.7 in 4Q 2020 (Baseline 50) but remained elevated and well in negative territory.
- Global GDP growth is predicted by various international analysts to exceed 5% in 2021. Despite renewed concerns on the Covid-19 health front, the outlook for world economic recovery is strongly positive, although the anticipated recovery will be at an uneven pace this year and in 2022
- The 'big ticket item' in the higher global economic growth scenario is the recent massive US fiscal stimulus as well as a strongly accommodative monetary policy there. The US Federal Reserve Board expects US GDP growth to reach 6.5% this year
- From SA's perspective expected higher global growth, progress in vaccinations abroad, a low cost of capital and high commodity prices are supportive of domestic economic performance. In SA there is now a firm economic 'rebound' expected this year after the disastrous -7% contraction in GDP growth in 2020. The economic recovery is nonetheless still brittle
- Apart from dealing effectively with the vaccine rollout, *sustained* economic recovery in SA depends on the tangible implementation of the Economic Reconstruction and Recovery Plan (ERRP) and on the key role of Operation Vulindlela (OV) as a 'delivery unit' supporting the implementation of priority structural reforms.
- SA needs an *implementation-led recovery* which reduces policy uncertainty, promotes investment and boosts job-rich growth
- Negative factors still dominating the positive ones in the 1Q 2021 PUI therefore included:

  (a) continued perceived implementation risks around key official policy commitments and projects, such as the public sector wage bill issue

  (b) impact of a possible third Covid-19 wave on the economy

  (c) persistent uncertainties around the access and rollout of vaccines in SA

  (d) continued Eskom load-shedding and lack of energy security

  (e) the interplay between factionalism within the governing ANC and the pace of certain much-needed structural reforms
- Prospects for getting the PUI back into positive territory.

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NWU BUSINESS SCHOOL POLICY UNCERTAINTY INDEX (PUI) IN 1Q 2021 DECLINES AGAIN SLIGHTLY TO 55.2 FROM 56.7 IN 4Q 2020 BUT REMAINS ELEVATED AND WELL IN NEGATIVE TERRITORY (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! (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 1Q 2021 - WHAT DOES IT SAY?

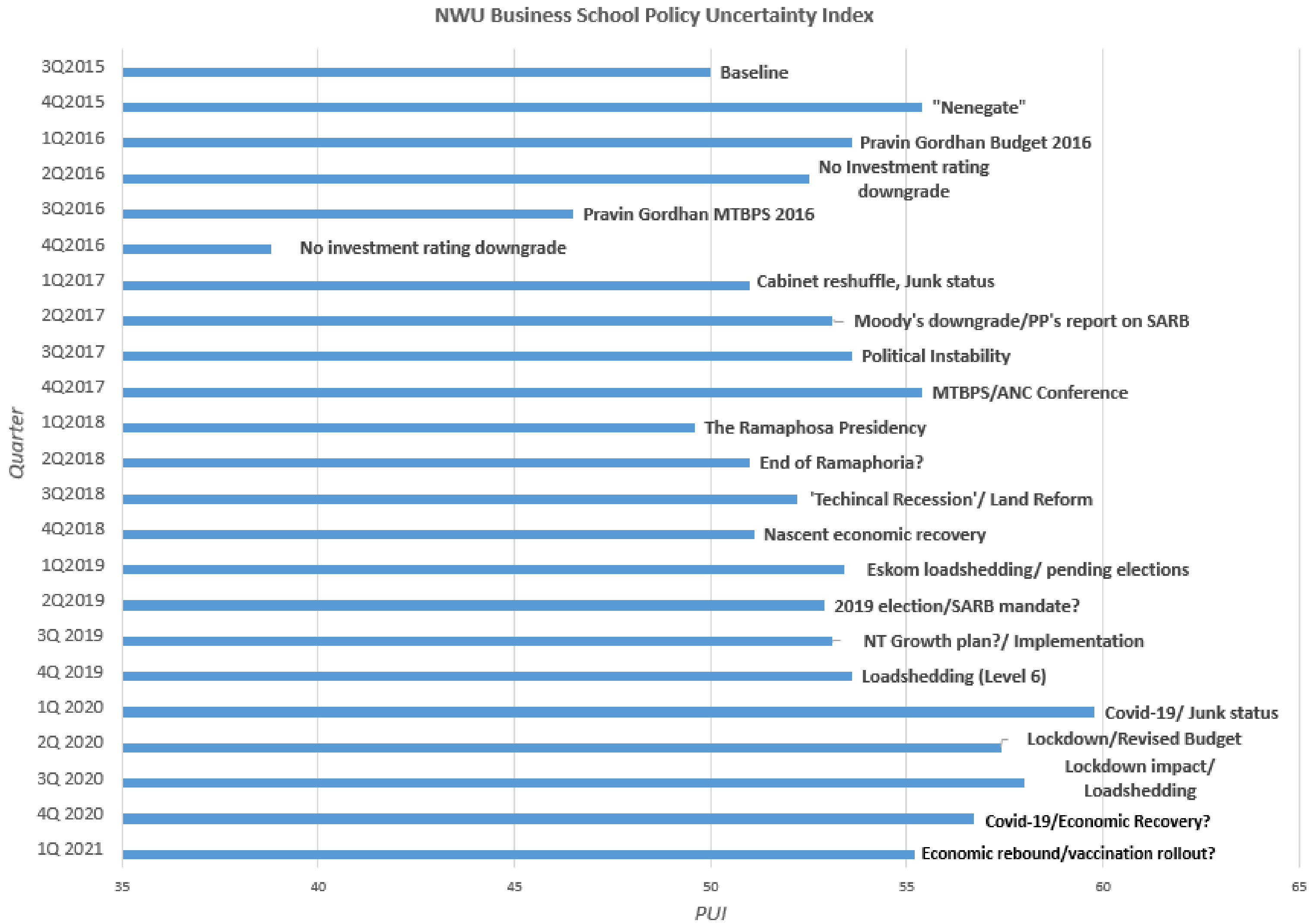
The PUI is the *net* outcome of *positive* and *negative* factors influencing the perceptions of policy uncertainty over the relevant period. The outcome for 1Q 2021 shows an average score of 55.2, compared to 56.7 in 4Q 2020. Thus, although levelling off further, for now the latest PUI remains elevated and well in negative territory.

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

2.1 in the *media data* there was a slightly higher level of reference to policy uncertainty compared to 4Q 2020

2.2 the *survey of economists* reflected a marginal decline from previous levels of uncertainty

2.3 the University of Stellenbosch's Bureau for Economic Research *survey of manufacturers* experiencing policy/political uncertainty declined from 81 to 80



3. NARRATIVE ON SOME FACTORS INFLUENCING ECONOMIC/POLICY UNCERTAINTY

3.1 Global Economic Outlook

The overall global economic outlook continued to strengthen in 1Q 2021. World GDP growth is projected by several authoritative sources to now exceed 5% this year. The International Monetary Fund (IMF) January forecast for global GDP growth, for example, was revised up to 5.5%. Governments on the whole are currently slowly easing lockdowns where circumstances permit (with some exceptions) and where vaccines are being successfully rolled out.

Despite further expected waves of infection the global economic outlook remains positive. Economic data, such as from China, have increasingly showed renewed and better GDP growth in the past quarter. Increasingly in the past quarter attention has turned to the likely *shape* and *size* of the world economic recovery, although there remain several ongoing Covid-19 uncertainties. There is therefore likely to be an uneven pace of global economic recovery in 2021 and 2022.

Global economic uncertainty has been reduced to some extent. 'The World Uncertainty Index - a quarterly measure of global economic and policy uncertainty covering 43 countries - shows that, although uncertainty has come down by about 60% from the peak observed at the outset of the Covid-19 pandemic in 1Q 2020, it remains at about 50% above its historical average during the 1996-2010 period.' (IMF Blog 19/1/2021).

The 'big ticket item' shaping these enhanced expectations of a stronger global economic recovery in 1Q 2021 and beyond was the big US fiscal stimulus signed into law by President Biden in mid-March. Together with other steps on the monetary front, including keeping interest rates at near zero, the total economic impact vastly exceeds anything that was previously done in the US to combat the 2008 'Great Financial Recession'.

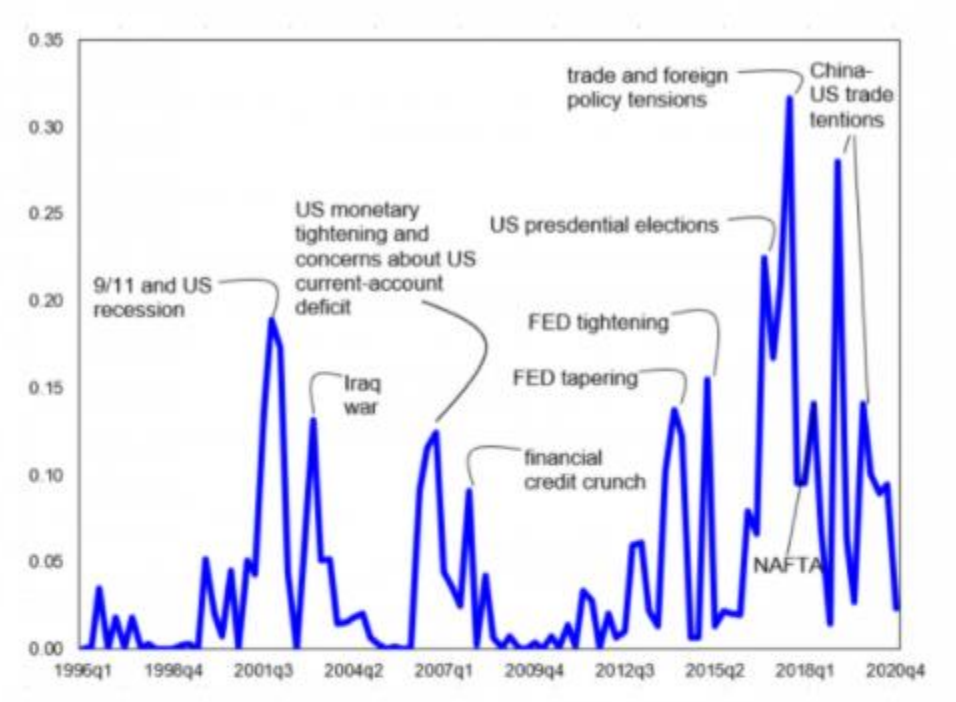
The Organisation for Economic Cooperation and Development (OECD) therefore now predicts that, more than it originally forecast, the US economy by the end of 2022 will be much larger than it was just before the pandemic. World demand for goods is likely to be boosted. The US trade deficit is now 50% larger than before the pandemic as that economy draws in more imports. Generally, the latest US fiscal 'package' augurs well for most American consumers.

Apart from the fact that the SA economy has already benefited from stronger international commodity prices, as the US is SA's second largest partner the expected strong expansion in the American economy is good news. The scale of the anticipated economic surge in the US would seem to justify SA business with interests there to update their market opportunities in that country. An economy which, according to the US Federal Reserve should now grow at 6.5% this year, could be advantageous to SA exporters if they remain globally competitive.

The sheer magnitude of the US stimulus package is, however, a *calculated risk* that assumes that nothing will go seriously wrong and downplays the danger that the American economy may strongly overheat. Nothing on this scale has been attempted before and policy makers are therefore in uncharted waters. The US financial markets and some economists have already registered unease at the possibility that the inevitable outcome may soon be higher inflation and higher interest rates.

In view of the pivotal role of the US in the global financial system - and the ripple effects of key US economic policy decisions on exchange rates and interest rates elsewhere - both developed and developing economies (including SA) will keenly watch whether the optimists or the pessimists turn out to be right. Mr Biden's gamble', opined *The Economist* recently (19/3/2021), is better than inaction. But no one should doubt the size of his bet.'

US Spillovers - uncertainty related to the US has been a source of uncertainty for other countries



Source: H.Ahir, N.Bloom and D.Furceri (IMF Blog 19/1/2021)

3.2 The South African Economy

Although there was some recent better economic news both globally and domestically the 1Q 2021 PUI, while again slightly lower, stayed elevated and continued to languish well in negative territory. What then were the *positive* and *negative* factors influencing this outcome? On the *positive* side both the state-of-nation address (SONA) and the Budget in February sought to nudge the policy framework towards a more growth-oriented stance within the new Economic Reconstruction and Recovery Plan (ERRP), as well as dealing with the on-going pandemic.

Even with the renewed partial lockdown in early January, there was accumulating evidence recently that SA's economic growth would firmly 'rebound' back into positive territory in 2021 from its devastating -7% GDP growth last year. Exports have also been doing well. Various authoritative analysts have begun to revise their forecasts of GDP growth for 2021 upwards, with a recent private sector one even as high as 5%. The SA Reserve Bank's Monetary Policy Committee (MPC) at its meeting on March 25 also raised its GDP forecast for 2021 from 3.6% to 3.8%.

With inflation contained and the MPC again keeping the repo rate unchanged, present indications are that borrowing costs are likely to remain low and stable for now. In a recent note (30/3/2021), however, Nedbank cautioned that 'the slow recovery in credit demand indicates that the private sector is still reluctant to borrow, with the impact of uncertainty outweighing low interest rates'. And the latest ABSA Purchasing Managers' Index (PMI), while generally expanding for a third month in a row in March 2021, also showed that purchasing managers were less optimistic about business conditions in six months' time. The economic recovery must therefore still be seen as brittle.

There have been potentially positive developments on the energy front, with additional scope being granted to independent power producers. Increasing private sector investment in embedded generation is the only way to reduce the continued high risk of load-shedding in the short term. The latter has had a highly negative impact on investor and business confidence, especially the disruption of small businesses.

There are other moves on the infrastructural front which promise positive outcomes in due course, as public and private investment need to move in tandem to promote higher levels of growth and job creation. The MPC statement on March 25 warned that 'sharply lower public and private investment last year and continued weakness in 2021 would weigh on growth prospects'. And a recent Business Leadership SA study confirmed that the key to lifting declining levels of investment in infrastructure was to boost public-private sector partnerships

The efficacy and success of Operation Vulindlela as a 'delivery unit' to support the President and the Cabinet to accelerate the implementation of priority structural reforms is therefore an essential requirement. It remains necessary to create an investment-friendly policy environment to underpin future growth, based on an *implementation-led recovery.* The challenge now is to convert the anticipated short-term economic recovery in 2021 into *sustained* job-rich growth in the period ahead.

The *negative* factors which kept the 1Q 2021 PUI in negative terrain included the following pervasive uncertainties:

- the extent to which there are still perceived implementation risks around certain key policy commitments in the SONA and the Budget, such as the public sector wage bill issue, remained significant
- what global credit rating agencies will decide to do next about SA's international investment grading in view of expressed doubts by Moody's Investors Service and Fitch Ratings about SA's fiscal trajectory as outlined in the recent Budget
- the risk of a resurgence in infection rates resulting in stricter lockdown measures
- uncertainty about the adequate supply and roll out of vaccines needed to inoculate the bulk of the SA population within definitive timelines
- persistent constraints on domestic electricity supply through continued load-shedding (recently said by the Eskom CEO Andre de Ruyter to be likely for another five years) and a general lack of energy security
- the interplay between current political factionalism within the governing ANC party and the pace of certain much-needed structural reforms

3.3 Summary/Conclusion

The good news is that this is the second successive quarter since 3Q 2020 in which the PUI has declined slightly. The bad news is that the 1Q 2021 PUI remained elevated and well in negative territory. It nonetheless confirms that it is possible for high levels of policy uncertainty to be gradually reversed provided appropriate economic, health and political actions are steadily and visibly implemented. Reducing policy uncertainty requires creating a credible macro-economic environment that provides a stable outlook for investors, consumers and workers.

The PUI can potentially therefore respond positively to policy shifts that build certainty and renew confidence. Especially from a business point of view, the more the ERRP and its key components are seen to be *consistently* and *coherently* implemented as a definitive 'growth plan', the more it becomes possible to move the PUI closer to positive territory. The ERRP now gives SA its best opportunity to improve the investment climate and get the economy on a higher job-rich growth path in the years ahead.

North-West University Business School
6 April 2021