NWU Business School

Policy Uncertainty Index (PUI)

1Q 2022

EMBARGOED UNTIL

Monday

4 April 2022

EXECUTIVE SUMMARY

- The NWU Business School PUI for 1Q 2022 rose dramatically to 59.7 from 53.2 in 4Q 2021 (Baseline 50), the highest recorded since the inception of the PUI in 2016. This seems to have been mainly driven by the big shock and heightened global economic unpredictability arising from the Russian-Ukraine conflict, which also reinforced some continued domestic uncertainties. Unsurprisingly, therefore, negative factors greatly outweighed positive ones in 1Q 2022 - but the PUI may recede from its present abnormally high point in the months ahead as different perspectives unfold.

- The combination of war, sanctions, supply chain disruptions and geopolitical factors has impacted on global growth and inflation, together with heightened market uncertainty and volatility. The US Federal Reserve has raised interest rates, with further increases expected during the year. The rand has so far remained resilient.

- While the real SA economy so far has been largely unaffected, it is unlikely to escape the global trends of rising energy and food prices. Producer Price Inflation (PPI) already accelerated by 10.5% in February, much higher than market forecasts. Inflation risks have risen. Consumer confidence in 1Q 2022 in particular was already negatively influenced by adverse perceptions about the global economic fallout from the Russian-Ukraine war.

- The 'rebound' in SA's GDP growth in 2021 was officially confirmed as +4.9% after the big -6.4% growth loss the previous year. The 2022/23 Budget anticipated an average GDP growth of only 1.8% over the next three years. The SARB has revised its growth forecast this year from 1.7% to 2%. Borrowing costs are likely to continue to increase for business and consumers, as interest rates rise further during the rest of the year.

- Positive news in 1Q 2022 included a well-received State-of-the-Nation-Address (SONA), a supportive and credible Budget, a 2050 National Infrastructure Plan finalized by the Cabinet, a positive fourth Presidential Investment Conference, wide support for the Zondo Commission recommendations on state capture, and a successful radio spectrum auction.

- Growth in SA has been too low for too long. The challenge remains to further reduce domestic policy implementation risks and uncertainties to levels where total private and public fixed investment will eventually rise significantly to power much higher rates of job-rich growth, as well as ensure fiscal sustainability.

- 2022 could still be a turning point for the SA economy. Accelerated economic reforms, building state capacity, improving delivery, higher total fixed investment and stronger business confidence are affirmative factors still urgently needed to boost economic performance. SA must concentrate on the factors over which it *has* control. The ball therefore remains in SA's court.

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NWU BUSINESS SCHOOL POLICY UNCERTAINTY INDEX (PUI) IN 1Q 2022 ROSE SIGNIFICANTLY TO 59.7 FROM 53.2 IN 4Q 2021 (BASELINE 50)

"Among the FUNDAMENTAL structural reform items is POLICY CERTAINTY. Simple but fundamental to the investor community. Remember that you cannot force people to invest, but you can create an environment which makes it easier to invest, create jobs and, hey presto, develop the country" (former Finance Minister Tito Mboweni, 16/12/2021)

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.

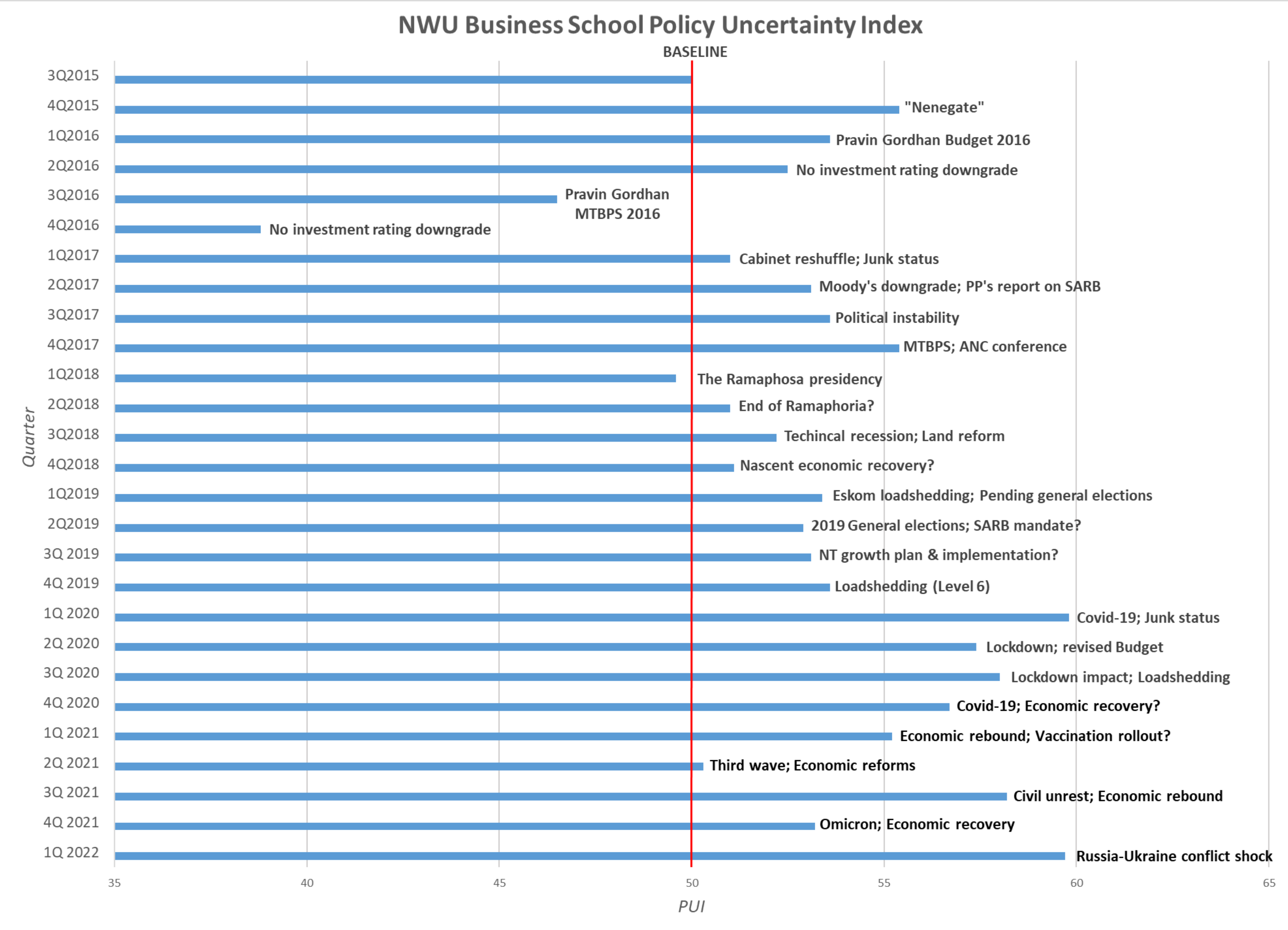
The PUI is published in January, April, July and October of each year. An increase beyond 50 reflects heightened policy uncertainty; a decline in the PUI means reduced uncertainty. The value of the PUI as a proxy for policy uncertainty will lie in tracking changes in policy uncertainty over time.

2. PUI RESULTS FOR 1Q 2022 - WHAT DO THEY SAY?

The PUI is the *net* outcome of *positive* and *negative* factors influencing the calibration of policy uncertainty over the relevant period. The outcome for 1Q 2022 shows a much higher average score of 59.7 compared to 53.2 in 4Q 2021.

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

i. *media data* showed an increase in references to economic/policy uncertainty
ii. *survey of economists* saw uncertainty for consumers in particular as having risen
iii. University of Stellenbosch's Bureau for Economic Research *survey of manufacturers* experiencing policy/political uncertainty declined from 79 to 76



3. NARRATIVE ON FACTORS INFLUENCING ECONOMIC/POLICY UNCERTAINTY

3.1 Global Economic Outlook

The overall global economic outlook in the first quarter of 2022 has inevitably been considerably reconfigured by the Russia-Ukraine conflict. Among other forecasters the SARB has cut its expectation for 2022 global economic growth from 4.4% to 3.7%. The world is also facing its most serious inflation challenge in a generation and eventually bread-and-butter issues may well trump crises in faraway countries. There remains huge uncertainty about the course of the war as well as President Putin's intentions, and the capacity of European countries to sustain long term economic pressure on Moscow.

'War in Ukraine is a huge setback for globalization' said Prof Brian Kantor (*Business Day,* 17/3/2022*).* 'Confrontation with Russia highlights a growing tension between free trade and freedom' opined the *Economist (*19/3/2022). Indeed, the world has already experienced several years of what has been described as 'slowbalisation', with capital and trade flows gradually declining relative to global GDP. New forces that will shape the future of world trade are now emerging and are presently intertwined with high levels of supply chain disruptions, market volatility and uncertainty. The current zero-tolerance Covid-19 lockdown in China has also created economic uncertainty.

On the economic front the hostilities are also likely in particular to make many countries prioritize domestic energy sources, as well as some other key commodities, which are perceived as strategically important in a more uncertain and dangerous world. It is also possible that the recent shift towards renewable energy may be reviewed as countries revert to fossil fuels such as coal and gas, and even nuclear power, in the search for energy self-sufficiency.

Several European countries that have depended on Russia for gas and oil have indeed already made it clear that they will now mobilize more of their own sources of energy, including coal, nuclear, shale gas and renewables to enhance self-sufficiency. They will, however, also pursue diversification as an additional strategy to secure supplies in a world of shifting opportunities and allegiances. Several countries will need to reassess their comparative advantage against a broadly changing global economic landscape.

While there nonetheless inevitably remain several uncertainties in the global economic outlook, Africa will not be entirely immune from the economic fallout that the Russia-Ukraine conflict is generating. Africa's dependence on global markets for the bulk of its petroleum products leaves it vulnerable to cost-push inflation, particularly in fuel and food. In sub-Saharan Africa as many as 38 out of 45 countries are net oil importers. Much higher oil prices may also precipitate balance of payments problems for several vulnerable African economies.

The few African countries that do produce oil, such as Nigeria and Angola, would be in a more favourable position to benefit. Africa's overall foreign trade involvement with Russia and Ukraine may not be large but it includes key strategic commodities. If there is any serious disruption of important supply chains it could have a significantly negative economic impact on many African economies - unless offsetting policies or strategies can be devised.

Whatever short term remedies might nevertheless be available, but with an eye to the future, Africa needs to expedite the development of regional value chains - such as through the African Continental Free Trade Agreement (ACFTA) - to lessen the vulnerability of the continent to global 'shocks'. A greater emphasis now needs to be placed on the promotion over the longer term of intra-African trade to develop regional supply chains that will facilitate a diversification of sources of supply.

In the meantime, rising prices for almost everything from wheat to nickel have also raised red flags for monetary policy. Interest rates have been steadily rising in several economies. In March the US Fed also announced an initial 25 basis points rise in interest rates. A growing number of economists believe 'the Fed will make jumbo 50 basis points increases during the rest of this year to step up efforts to reduce the highest US inflation in 40 years' (*Financial Times, 28/3/2022).*

But most central banks seem to be adhering for now to their 'pre-war' pace and plans for monetary tightening. The big test here is to assess and judge the extent to which the cost increases presently spurred by the Russia-Ukraine war may ultimately feed into wage-price spirals in the longer run. Wage growth and core inflation are the usual indicators to watch as the year further unfolds around global monetary policy decisions.

3.2 The South African Economy

3.2.1 Balance between positive and negative factors influencing the 1Q 2022 PUI

Until the recent strong global 'shock' intervened a number of evolving domestic factors might well have tipped the balance of the 1Q 2022 PUI in a more favourable direction to below the 53.2 in 4Q 2021. One positive element was the Medium Term Budget Statement (MTBPS) in November, which delivered a credible message about SA's growth and fiscal metrics. This augured well for the main Budget in February. Towards the end of 2021 the credit-rating agency Fitch also raised its outlook for SA from negative to stable.

It was then also apparent that SA was likely to conclude 2021 with a strong 'rebound' in the economy of about 5% in GDP growth, compared to the pandemic impact of a -6.4% growth loss in 2020. SA also seemed to surmount the fourth Omicron pandemic wave as 2021 drew to a close, but it is not yet certain what the future trajectory of Covid-19 may still bring. Although the further relaxations to the Level 1 lockdown restrictions came only at the very end of 2021, they were positive for business and consumer confidence. Economy-linked Covid-19 rules were further relaxed on March 22.

February 2022 saw a well-received SONA message from President Cyril Ramaphosa that recognized the private sector as the main driver of investment, growth and job creation in SA. Ramaphosa undertook to promote a policy environment which would make this possible, including a reduction in 'red tape' on business through the creation of a special unit in the Presidency. There has also been the recent successful long-delayed radio frequency spectrum auction. The fourth Presidential Investment Conference on March 24 appeared to have created positive investor perspectives.

The main 2022/23 Budget in February was also broadly supportive of the economy, including a commitment to 'tough love' for dysfunctional state-owned enterprises. Corporate tax was reduced from 28% to 27% and additional assistance to SMMEs was made available. The subsequent 2050 National Infrastructure Plan accepted by the Cabinet is intended to hold the government accountable for developments in this sphere. The work and outcome of the Zondo Commission on state capture and corruption has also enjoyed wide support. The rand remains resilient so far.

3.2.2 Why did the 1Q 2022 PUI escalate so much further into negative territory?

Given the recent new big global 'shock' of the Russia-Ukraine war, unsurprisingly the 1Q 2022 PUI was pushed much further into negative territory. Consumer confidence in 1Q 2022 was already negatively influenced by adverse perceptions about the potential global economic fallout from the Russian-Ukraine conflict. Retailers' business confidence also declined marginally in the first quarter. The inflation expectations of analysts, business people and trade unions have increased slightly. In addition, domestically both the Consumer Price Index (CPI) and the Production Price Index (PPI) became elevated in the 2nd half of 2021.

The SARB's Monetary Policy Committee (MPC) therefore initiated an interest rate-raising cycle in November 2021. After the MPC's latest 25 basis points repo rate rise on March 24 the cost of borrowing to business and consumers is now 75 basis points higher since last November. Borrowing costs are set to rise further in the months ahead, with forecasts suggesting that the next MPC meeting is likely to see another increase of 50 basis points.

Inflation risks remain on the upside. The latest PPI accelerated to 10.5% in February. "Producer inflation was more pronounced in February than the market anticipated, which points to the impact of the conflict in Eastern Europe, combined with China's zero-tolerance Covid policy and associated lockdown, being worse than anticipated. The level of uncertainty is high, with much depending on the duration and severity of these issues." Nedbank (31/03/2022)

And although the MPC raised its growth forecast for 2022 from 1.7% to 2%, it nonetheless listed the persistent constraints on potential growth as still being mainly (a) load-shedding (b) weak investment by government and (c) policy uncertainty. Another key source reflecting much of the persistent concern about implementation risks was best summarized in the outcome of the International Monetary Fund's (IMF) most recent annual consultation with SA.

Although the IMF sees SA being able to lift its economic growth rate to above 3% *if* it implements a strong package of reforms and repairs its public finances, the IMF's own economic forecasts suggest it does not yet anticipate such positive economic outcomes. The IMF sees only a 1.4% average GDP growth over the next few years, with the public debt-to-GDP ratio still rising. The IMF said it expected 'a lacklustre medium-term performance capped by structural constraints, weak confidence and less favourable terms of trade'.

While the IMF report suggested that the gains from reforms could occur quite rapidly, it also believed that it would need 'a particularly swift, deep and comprehensive reform package cutting across all key areas, to improve the business environment and cut the costs of key inputs'. These would seem to be highly ambitious goals, especially at time when the business cycle in SA is coinciding with a particularly important ANC political cycle of electoral deadlines and internal party factionalism. Unemployment in 4Q2021 remained at record high levels.

Irrespective of recent global developments, therefore, it remains a major internal challenge for SA to get total private and public investment much higher - *unless* domestic policy implementation risks and uncertainties can be further reduced. The latest SARB Quarterly Bulletin (March 2022) shows that, although there has been some recovery in private fixed investment, total fixed capital formation declined from 13.7% of GDP to 13% in 2021. To support the growth rates of 4%-5% needed to substantially reduce unemployment total fixed investment in SA is required to eventually approximate about 25% of GDP.

3.2.3 Conclusion - SA and a new era of economic conflict

As outlined above war usually generates instability in expectations. The 1Q 2022 PUI now being elevated much further into negative territory largely reflects the present heightened uncertainty and volatility in the global economic landscape - but this is likely to recede from its abnormal current high point over the rest of the year as different perspectives unfold. The new global challenges now nonetheless need to be smartly navigated by SA.

At a practical level, if SA is to take advantage of the current shifts in the world economy, it must remain globally competitive by providing, for example, energy security as well as ensuring an efficient rail and port system that enables exporters to successfully access foreign markets. What 2022 must see is for SA to speedily implement a wide range of half-forged policies and projects that will help to create a growth environment that is solid and coherent.

2022 could therefore still be a positive turning point for the economy. If SA wants to successfully manage the balance of risks, absorb the pressures, and exploit the opportunities that may emerge from the Russia-Ukraine conflict, the basic narrative is still unchanged, namely, that SA must get its economic house in order. SA must concentrate on factors over which it *has* control. The ball therefore remains in SA's court.

North-West University Business School
4 April 2022