NWU Business School
Policy Uncertainty Index (PUI)
2Q 2022

EMBARGOED UNTIL

Monday

4 July 2022

EXECUTIVE SUMMARY

- NWU Business School PUI for 2Q 2022 rose to 60.9 from 59.7 in 1Q 2022 (baseline 50), which is the highest recorded since the inception of the PUI in 2016. The further elevation in the 2Q 2022 PUI following on the sharp rise in the previous 1Q 2022 PUI was driven by the continued and heightened global economic unpredictability arising from the Russia-Ukraine war, which also reinforced some persistent domestic policy uncertainties. It has kept the PUI well in negative territory for now.

- Globally, the combination of war, sanctions, supply chain disruptions and shifting geopolitical forces have continued to impact on global growth and inflation, together with heightened market uncertainty and volatility. The International Monetary Fund, the World Bank and the Organization for Economic Cooperation and Development have all reduced their 2022 global growth forecasts to about 3%. The IMF's World Uncertainty Index has risen sharply so far this year.

- Central banks are racing to adapt to a world of high inflation and weak growth with tighter monetary policies. Dominant among the number and variety of central banks which in mid-June announced interest rate increases was the US Federal Reserve which decided on a 75 basis points rise to combat inflation. It was the biggest single rise in many decades.

- Clouds are therefore gathering over several economies. Global economic uncertainty remains high, as it seems no one yet has a sufficient grip on how strong these unique inflationary pressures will eventually be, or their ultimate effect on growth, trade, jobs, and income. Towards the end of the 2Q of 2022 economists have grown more pessimistic about the likelihood of economic contraction in the US and Europe. The risks of social instability in the wake of food and fuel price hikes have also risen. Generally, the global environment is now less favourable to domestic growth.

- The SA economy showed much better-than-expected GDP growth in 1Q 2022, thus confirming the previous strong economic recovery post-pandemic in 2021. Revised growth forecasts for GDP growth in 2022 are now more likely to be in the region of 2.2%, rather than the previous 1.7%. Other high frequency data in 2Q 2022 have been mixed, with recent manufacturing and mining production figures being disappointing. Retail sales in April, on the other hand, were positive beyond market expectations.

- However, apart from global headwinds, recent local storm signals reinforcing economic uncertainty included chronic and persistent Eskom load-shedding, the impact of escalating food and fuel prices, economic damage from the KZN floods, continued local government delivery failures and progressively higher borrowing costs for business and consumers as interest rates rise. With CPI inflation in May being higher-than-expected at 6.5%, a more aggressive SARB monetary policy can now be anticipated in 2H 2022.

- Amidst elevated uncertainty, and even as a small open economy SA can nonetheless craft economic strategies to help to mitigate global setbacks, based partly on better public finances to support anti-cyclical policies that promote economic resilience. SA must build on available remedies and growth positives by implementing existing half-forged policies and projects that can assist in reducing economic uncertainty and ensuring that the present overall GDP growth expectations for 2022 of about 2.2% are indeed realized.

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NWU BUSINESS SCHOOL POLICY UNCERTAINTY INDEX (PUI) IN 2Q 2022 WAS 60.9 COMPARED TO 59.7 IN 1Q 2022 (BASELINE 50), HAVING FURTHER RISEN AND STILL WELL IN NEGATIVE TERRITORY

"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.

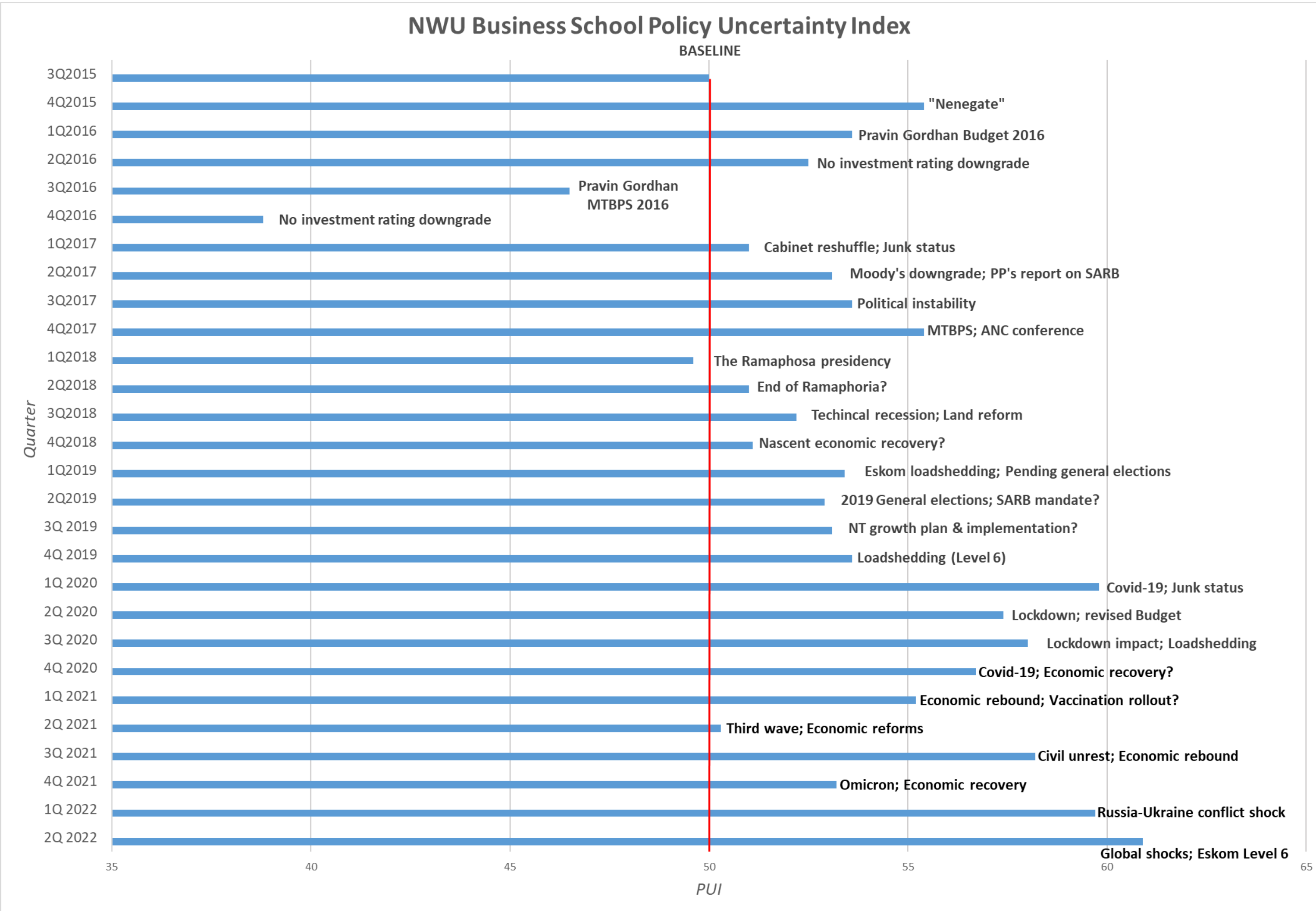
The PUI is published in January, April, July, and October of each year. An increase beyond 50 reflects heightened policy uncertainty; a decline in the PUI means reduced uncertainty. The value of the PUI as a proxy for policy uncertainty will lie in tracking changes in policy uncertainty over time.

2. PUI RESULTS FOR 2Q 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 shows that the PUI at 60.9 in 2Q 2022 is higher than the 1Q 2022 PUI at 59.7 (Baseline 50) and remains well in negative territory for now.

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

i. *media data* showed an increase in references to economic/policy uncertainty
ii. the *survey of economists* also indicated that they believe uncertainty had risen
iii. University of Stellenbosch's Bureau for Economic Research *survey of manufacturers* experiencing policy/political uncertainty advanced from 76 to 78



3. NARRATIVE ON FACTORS INFLUENCING ECONOMIC/POLICY UNCERTAINTY

3.1 Global Economic Outlook

The general global economic outlook in the second quarter of 2022 has continued to be largely reconfigured by the protracted Russia-Ukraine war and its implications for most economies around the world. There are also question marks over the performance of the Chinese economy. The International Monetary Fund (IMF), the World Bank and the Organization for Economic Cooperation and Development (OECD) are among the various international institutions that have substantially reduced their global growth forecasts for 2022 as a whole to about 3%.

Global inflation, especially in food and energy costs, remains widespread – except for some Asian economies – and the world is facing its most serious inflation challenge in a generation. Interest rates have been steadily raised by many central banks in an effort to come to grips with escalating inflation. Both the European Central Bank (ECB) and the Bank of England (BoE) have recently again increased borrowing costs for consumers and business. Where 'quantitative easing' (QE) has formed part of previous monetary policy in several economies, it is now being tightened.

And in the key global 'locomotive' US economy inflation recently topped 8%, which clearly required a further response from the monetary authorities. The most prominent recent decision on monetary policy was therefore on June 15 when the US Federal Reserve again raised interest rates – this time by 75 basis points (the biggest single rise since 1994) – with the promise of another 50 basis points at the Fed's next meeting in July. With this more aggressive Fed approach fears have escalated of a possible US recession developing next year.

US Fed Chairman Jerome Powell nonetheless still hopes to engineer what he hopefully has called a 'softish landing' for the US economy in the period ahead. The outstanding question for business and markets indeed now remains as to what the eventual outcome will be as the US economy collides with high inflation and high interest rates. The chances of now avoiding a US recession seem low. As 2Q 2022 drew to a close economists grew more pessimistic about the likelihood of economic contraction in the US and Europe.

In the meantime, 'central banks are racing to adapt to a world of high inflation and weak growth', said the *Financial Times (*(18/06/2022). 'Furthermore', the FT added, 'uncertainty is unusually high.... economic policymakers' strategies ought to be data-dependent, not dogmatic'. And in similar vein the *Economist* opined that 'as competing goals make the course ahead harder to predict, central banks would do well to stay nimble' (18/06/2022). It remains uncertain whether the central banks will get the balance right.

Of continued relevance of the global economic situation to Africa in particular is a recent United Nations (UN) warning of the destabilizing potential of disrupted supply chains and surging food, fuel and fertilizer prices, especially for many poorer economies. This should be seen in the context of Russia and Ukraine representing about 30% of the world's supply of wheat. In sub-Saharan Africa as many as 38 out of 45 countries are net oil importers. If there is any serious disruption of important supply chains it will have a significantly negative impact on many African economies – unless offsetting policies or strategies can be devised and implemented soon.

The Economist (25/06/2022) recently built a statistical model to assess the relationship between food and fuel price inflation and unrest. It found that rises in food and fuel prices were a strong portent of political instability, even when controlling for demography and changes in GDP. It cited an IMF working paper which concluded that – where unrest had both political and socioeconomic motivations – the damage to GDP was worst of all. The rioting in SA in July last year was given as an example here, when GDP shrank by 1.5%.

Overall, then, what have been the wider implications of these various converging geopolitical 'shocks' in recent months for global economic uncertainty? The *cumulative* impact of recent socioeconomic blows on the world economic outlook has inevitably meant that global uncertainty has escalated considerably. In fact, in mid-April the IMF (IMF Blog 15/04/2022) already reported that, as the Russia-Ukraine war was then unfolding, global uncertainty was surging. (The NWU BS 1Q 2022 PUI released on 4 April had also captured this trend).

The IMF survey added that, as the uncertainty related to the war steadily spread across the globe, its World Uncertainty Index (WUI) had therefore climbed again (after a post-pandemic fall last year). The IMF saw war-related uncertainty as accounting for about 40% of the total fresh rise in the WUI. It thus appears likely that the WUI will remain well elevated for now. It can be expected do so – at least until the current global economic uncertainties are ameliorated, either through appropriate political or economic solutions being found, or with the effluxion of time.

3.2 The South African Economy

3.2.1 Balance between positive and negative factors influencing the 2Q 2022 PUI

The further elevation in the 2Q 2022 PUI is the outcome of a combination of negative global and domestic factors which outweighed the positive ones and drove the PUI deeper into negative territory over the past quarter. Externally, the Russia-Ukraine conflict is now likely to be a protracted one and the immediate global implications for the SA economy appear divided in three broad uncertain ways: the expected slowdown in the world economy, the negative impact on food and energy costs, and the net advantage that higher commodity prices may have for SA.

It will also be recalled that, after the highly negative gross domestic product (GDP) growth of -6.4% in 2020, the domestic economy bounced back in 2021 with an economic recovery of 4.9% in GDP last year. The better-than-expected GDP figures for the first quarter of this year *reinforced* the renewed growth trend, confirming that the economy was then almost back to its pre-pandemic output levels. Unemployment also appeared to have stabilized at a very high level in 1Q 2022 but remains unacceptably high.

The better 1Q 2022 GDP figures thus now require that previous growth forecasts of about 1.7% GDP growth for 2022 as a whole be revised upwards. In particular, the welcome but modest recovery in fixed capital formation has the potential to promote further growth and job creation. The agricultural sector in particular continues to perform well. Based on the stronger GDP performance referred to earlier, growth in 2022 will probably reach a higher figure in the region of 2.2% this year. This is still very inadequate for SA's socioeconomic needs, yet does nevertheless offer a positive growth platform.

Against this background domestic demand in the SA economy is likely to continue (see SARB QB *Personal Finances, June 2022)* but the upside *will* be constrained by rising inflation and interest rates. Recent high frequency economic data like manufacturing and mining production figures have been disappointing. Nonetheless, as economic activity has been steadily normalized post-Covid-19, and the remaining Covid restrictions having been removed on June 22, further recovery in the tourism and hospitality sectors will occur. Retail sales in April also exceeded market expectations by a large margin.

But as 2022 has unfolded serious storm signals have now also been raised – both externally and internally – which have created downside risks to the economic outlook. Globally, these include growing concerns about global 'stagflation' (i.e., high interest rates combined with slow growth and high inflation), the continued economic impact and disruption of supply chains resulting from the Russia-Ukraine war, and the current pace of tighter US monetary policy with the possibility of a serious recession there. Generally, the global environment is indeed less favourable to domestic growth

Domestically, recent downside risks to the growth outlook have arisen from uncertain elements such as: persistent Eskom load-shedding, escalating cost-inflation, on how quickly the economic damage caused by KwaZulu-Natal's devastating floods in April would be repaired, persistently weak business and consumer confidence, and heavier borrowing costs for business and consumers as the SARB's interest rate-raising cycle continues. CPI headline inflation at 6.5% in May is likely to elicit a more aggressive monetary policy stance from the SARB later this month. Eskom's load-shedding in particular continues to loom large over SA's economic activity.

On the political front another source of uncertainty may flow from political developments arising from factionalism and related developments in the governing ANC party leading up to its electoral conference in December. The concern here is that volatile ANC politics over this period may delay the implementation of key economic reforms.

3.3 Summary and Conclusion

The 2Q 2022 PUI outcome reflects the present high level of uncertainty arising from negative global and domestic factors that dominated the positive ones. If SA wants to better manage the new balance of risks, absorb the pressures, exploit any new opportunities, and offer a clear sense of economic direction, it must concentrate mainly on the factors *within* its control. The challenge now will be for economies like SA to craft and implement economic strategies that build resilience and can help to offset global headwinds. 'It is the set of the sails', suggested US entrepreneur Jim Rohn, 'not the direction of the wind, that will determine which way we will go'.

Even as a small open economy SA has some cards to play. Government finances are in better shape now to underpin the economy with appropriate anti-cyclical policies and projects which can strengthen economic resilience. Escalating fuel costs can be further tempered whilst simultaneously tackling a review of the fuel price structure. And with the remaining Covid-19 restrictions also lifted on June 22, there are gains for the important tourism and hospitality sectors. Persistently disruptive Eskom blackouts nevertheless now remain the biggest single strategic threat to SA's economic performance.

SA must therefore build on the remedies and growth positives that *are* available. 'A shift from talk to action is starting to show in the infrastructural landscape', suggests a *Business Day* analysis (27/06/2022). The rest of 2022 must thus see SA expedite the implementation of existing half-forged policies and projects that will assist in reducing economic uncertainty, strengthening investor confidence, and facilitating a policy environment that is solid, coherent and consistent.

North-West University Business School
4 July 2022