NWU Business School
Policy Uncertainty Index (PUI)
3Q 2022

EMBARGOED UNTIL

Monday

3 October 2022

EXECUTIVE SUMMARY

- The NWU Business School 3Q 2022 PUI eased to 59.6 from 60.9 in 2Q 2022 (Baseline 50), the latter having been the highest on record since the inception of the index in 2015/16. This, together with the elevated 1Q 2022 PUI, had been mainly driven by the big shock of the Russian-Ukraine conflict in February and the global economic uncertainties it subsequently generated. But positive factors have nonetheless been able to marginally outweigh negatives ones in the past quarter to slightly reduce the 3Q 2022 PUI, although it remains well in negative territory.

- The global economic outlook and elevated uncertainty continues to be driven by stubborn inflation, recession fears, hawkish central banks and geopolitical tensions. Interest rates have been steadily raised by many central banks, including the US Fed, in an effort to come to grips with inflation and inflationary expectations.

- For SA the main global factors influencing the level of uncertainty have been the interaction between prospects for world recession or 'stagflation'; the outlook for energy and food prices; the emergence of dearer money; possible lower commodity prices; and the impact of a strong US dollar.

- There have been mixed domestic economic trends in 3Q 2022 following the 'bad news' of the 2Q 2022 resulting in a -0.7% GDP growth. Business and consumer sentiment has remained vulnerable in an economy that struggles to gain momentum. Borrowing costs have again risen and continued Eskom 'blackouts' hang like a Sword of Damocles over SA's economic performance.

- Domestic spending is expected to grow at a slower pace, constrained by inflation and higher borrowing costs. On present trends the GDP growth outlook is now likely to be 1.7% in 2022 and 1.2% in 2023 respectively, with risks to the forecasts on the downside. Nedbank anticipates that the gradual recovery in fixed capital formation will continue. The underlying economic assumptions and priorities previously shaping the Medium Term Budget Policy Statement (MTBPS) later this month will now need to be revisited.

- Despite the lower 3Q 2022 PUI, therefore, the potential exists for several sources of renewed policy and economic uncertainty to assert themselves domestically in the period ahead. There are downside risks to the growth outlook. These range from the persistent lack of energy security to weak policy and project implementation, to the impact of higher borrowing costs, as well as political leadership factors such as the outcomes of the ANC elective conference in December.

- The challenge that now remains for decision-makers in both the public and private sectors is to successfully navigate poorly charted waters to avoid rocks of uncertain location. The country must therefore speedily implement growth-supporting economic and business strategies that build resilience in ways that can still help to offset global headwinds. Confidence-building is said to be the cheapest form of economic stimulation.

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NWU BUSINESS SCHOOL POLICY UNCERTAINTY INDEX (PUI) IN 3Q 2022 WAS 59.6 COMPARED TO 60.9 IN 2Q 2022 (BASELINE 50), HAVING DECLINED SLIGHTLY BUT STILL REMAINS 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 3Q 2022 - WHAT DO THEY SAY?

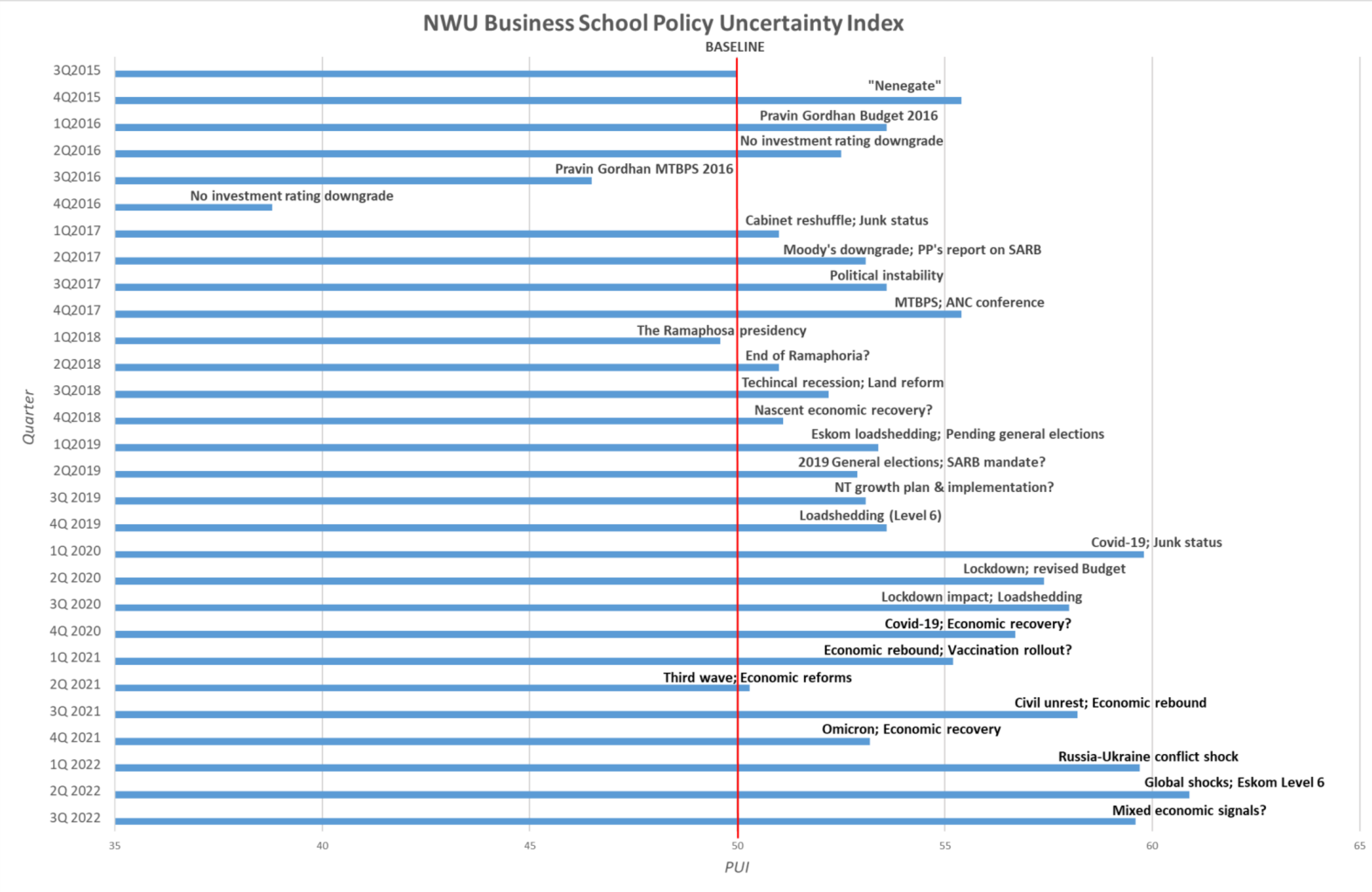
The PUI is the *net* outcome of *positive* and *negative* factors influencing the calibration of policy uncertainty over the relevant period. The results show that the PUI at 59.6 in 3Q 2022 was marginally lower than the 2Q PUI at 60.9 (baseline 50), but remains well in negative territory.

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

i. *media data* reflected a small decrease in references to economic/policy uncertainty

ii. the *survey of economists* indicated that a strong majority believed that uncertainty had risen

iii. University of Stellenbosch's Bureau for Economic Research *survey of manufacturers* experiencing policy/political uncertainty declined from 78 to 76



3. NARRATIVE ON FACTORS INFLUENCING ECONOMIC/POLICY UNCERTAINTY

3.1 Global Economic Outlook

The overall global economic outlook continued to be driven by stubborn inflation, hawkish central banks, recession fears and geopolitical tensions. While the global outlook is becoming increasingly negative and some countries may slip into recession, the IMF believes it is too early to say whether a widespread world recession will develop. The IMF's latest forecasts for global economic growth are 3.2% in 2022 and 2.9% in 2023.

On the other hand, the World Bank believes the world economy is closer to a general recession next year as hawkish central banks simultaneously continue to strongly raise interest rates to combat persistent inflation. As the world's three "locomotive' economies – the US, China, and the Eurozone – are slowing sharply the World Bank thinks that 'even a moderate hit to the global economy over the next year could tip it into recession'. Forecasts of China's GDP growth in 2022 are now down to about 3%, compared to earlier expectations of 5.5%.

On the EU front Russia's increasing 'weaponization' of its fossil fuels has forced European governments to take drastic action, unthinkable only a few months ago, to blunt the Russian pressure and shield energy markets from the impact. G7 powers on September 2 also agreed to impose a global price cap on Russian crude oil, which is a bigger source of revenue for the Kremlin than gas, although it may be difficult to implement widely.

EU leaders are aware of the pain that will inevitably come with soaring energy bills this winter as well as the escalating costs to EU governments of cushioning households and businesses from sky-high costs. With inflation expected to remain high for now – and interest rates also still rising – living standards are expected to take their biggest knock there in a generation. In the UK consumer confidence fell to its lowest level since records began in 1974 and it has also plunged to a near record low in the Eurozone.

The latest S&P PMI showed business activity contracting in both the Eurozone and the UK. In fact, the UK economy already started to contract in 2Q 2022 and even the much-heralded government aid announced by the new Prime Minister Liz Truss on September 8 has not dispelled the Bank of England's forecast of a possible recession in the final months of 2022. The UK economy is particularly dependent on gas. The European Central Bank (ECB) now expects the Eurozone to stagnate in the last quarter of the year and to shrink in 2023.

It is likely that several EU governments will need to consider even larger support packages, as the so-called 'winter of discontent' unfolds in the EU and the UK. However, a highly expansionary 'mini-Budget' of spending, tax cuts and a much-inflated deficit introduced by the UK Chancellor of the Exchequer towards the end of September was badly received by the financial markets and pushed sterling to record lows.

Towards the end of September several central banks, including the US Federal Reserve, again raised interest rates. The latest Fed decision to increase rates again by 75 basis points, although not unexpected, reinforced the tough message about bringing US inflation back within target range. The resultant stronger US dollar has negative consequences for most of the world economy, especially emerging markets. There is also a growing expectation that the US economy will experience a recession in 2023.

Further afield it needs to be recalled that the poorest economies – especially in Africa – are particularly dependent on food imports from Russia and Ukraine. They are also economies struggling with high debt levels in recent years. They remain particularly vulnerable to current global economic challenges, unless offsetting strategies can be implemented soon to provide necessary assistance.

It is evident that that the world economy is now much less supportive of domestic economic growth. The likely geo-economic shifts require that domestic economic strategies recalibrate the new balance of global risks and opportunities in ways that ultimately enables the SA economy to remain internationally competitive.

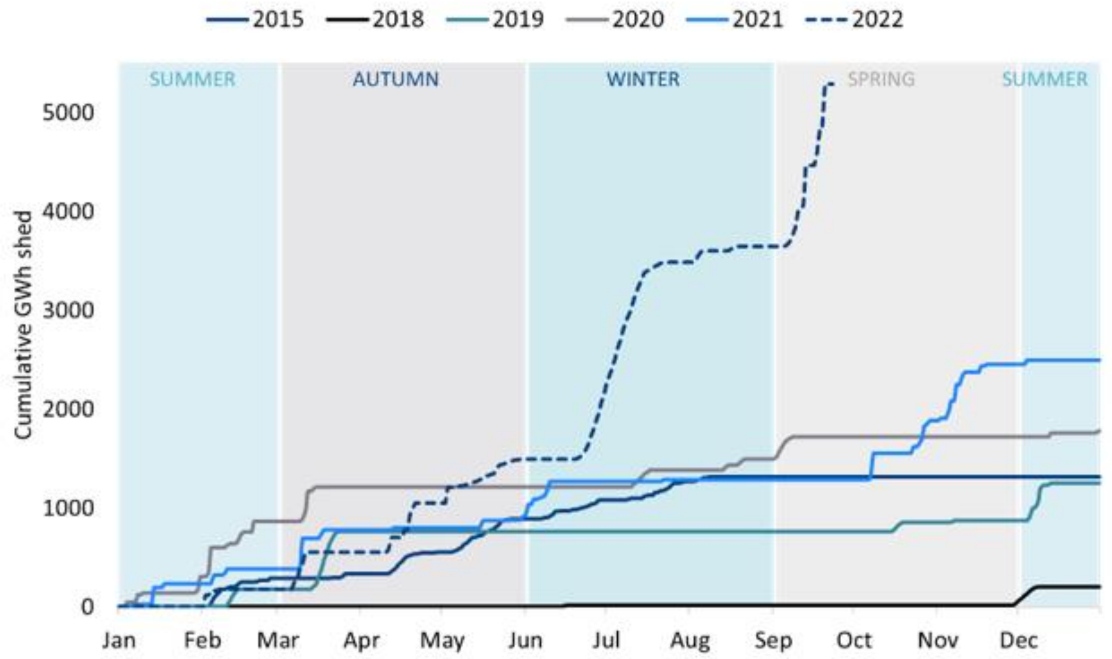
3.2 The South African Economy

3.2.1 Balance between positive and negative factors influencing the 3Q 2022 PUI

The NWU Business School 3Q 2022 PUI eased slightly to 59.6 in 3Q 2022 after rising to 60.9 in 2Q 2022, which was its highest since the inception of the index in 2015/16. Although the PUI remains well in negative territory it seems that positive factors have marginally outweighed negative ones in the third quarter of 2022. However, there clearly remain global headwinds to be navigated, and as with many other economies that have now to cope with economic setbacks, much also depends on how SA 'sets its sails' in domestic policy to maximize any 'tailwinds'.

Globally, it is clear that the Russia-Ukraine war is now likely to be a protracted one. For the SA economy the immediate global implications of the conflict and other international economic factors continue to appear divided into four broad uncertain ways: the prospects for global recession or 'stagflation'; the outlook for energy and food costs; the possibility of lower commodity prices for SA; and a world that has moved into a phase of 'dearer money'.

On the economic growth front the loss of GDP growth in the second quarter of 2022 was a broad-based -0.7%, following a positive rise of 1.7% in the first quarter. Negative factors then were the severe flooding in KwaZulu-Natal, the acute Eskom blackouts and the destructive strikes in some sectors (including Eskom), which seriously adversely affected output in key economic sectors. The cumulative impact of these developments has weighed heavily on business and consumer confidence, including renewed Eskom load-shedding which hangs like a Sword of Damocles over SA's economic performance.



Source: EskomsePush, BER calculations (data up to 23 September)

'The chart shows the cumulative quantity of #loadshedding in 2022 so far compared to earlier years. The amount already far exceeds even the worst prior year, with more expected. This detracts from the expected recovery in quarterly GDP growth during 2022H2' (*Bureau for Economic Research, September 26).*

On the positive side the BER-ABSA Purchasing Managers' Index (PMI) rose from 47.6 to 52.1 in August. The expectation was that manufacturing output would now pick up in the months ahead on the basis of supportive business activity. Retail confidence has proved surprisingly resilient, says a recent BER survey for 3Q 2022. The latest S&P SA PMI indicated that, although output may be slowing, business remained optimistic about the next 12 months. Nedbank expected that modest recovery in capital formation should also continue, particularly based on gradually higher spending on infrastructure. (*Nedbank Guide to the Economy, August 2*).

The SARB's composite leading business cycle indicator for July, which provides a projection of SA's economic growth cycle for the next six to 12 months, nonetheless fell 1.0% month on month. This trend suggests that 3Q 2022 GDP growth may expand at a smaller percentage than originally expected. Household spending is under increased strain (see both the *SARB QB Personal Finances* and *Full Quarterly Bulletin for September 2022*). The GDP growth outlook is now likely to be 1.7% in 2022 and 1.2% in 2023 respectively, with downside risks to these forecasts. These developments also have implications for the economic assumptions that have hitherto underpinned the anticipated Medium Term Budget Policy Statement (MTBPS) later this month.

The SARB's Monetary Policy Committee (MPC) on September 22 conveyed an understandably hawkish message about the inflation outlook in the economy in the midst of several global and domestic uncertainties. With the MPC seeing inflationary risks on the upside it was inevitable that the Bank's interest rate-raising cycle would now continue, now again by a further 75 basis points. The SARB may well have been too optimistic in its assessment of still seeing the risks to growth as 'balanced' – given that downside risks, such as the Eskom crisis, may now indeed have modified the growth outlook.

On the political front there are also uncertainties that may arise from the leadership and policy outcomes of the ANC's elective conference in December. The big challenge in unlocking SA's economic potential remains the successful implementation of key domestic reforms on a scale that will ignite *confidence*.

3.2.2 Summary and Conclusion

The challenge now remains for decision-makers in both the public and private sectors in SA to successfully navigate poorly charted waters to avoid new rocks of uncertain location. 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, the country must implement economic and business strategies in ways that build resilience and can help to offset global headwinds.

Growth-supporting policy options do exist for SA. The PUI can potentially respond positively to policy shifts that build certainty and which can realistically mobilize 'tailwinds'. The recent Organization for European Cooperation and Development (OECD) report on SA again emphasized that business confidence is still 'vulnerable' to domestic policy developments. Confidence-building, as several economists have emphasized, is the cheapest form of economic stimulation.

North-West University Business School
3 October 2022