NWU Business School
Policy Uncertainty Index (PUI)
2Q 2023

EMBARGOED UNTIL
NOON FRIDAY
30 JUNE 2023

EXECUTIVE SUMMARY

- The NWU Business School 2Q 2023 PUI at 76.2.(baseline 50) rose to a new historical high after its previous record of 71.7 in 1Q 2023. The continued high elevation of the 2Q 2023 PUI was the outcome of a convergence of negative global and domestic factors, which still greatly outweighed the positive ones in the period under review. Although some of the 'bad news' may well abate in 3Q 2023, the PUI remains deep in negative territory for now.

- Globally, geopolitical factors such as the Russia-Ukraine war and ongoing tension between the US and China, together with mixed economic trends, continued to underpin the uncertainty, which still largely pervades the world economic outlook. Global monetary policy is likely to stay restrictive for longer. Growth and interest rates remain the two key variables to watch globally in the second half of 2023.

- The risks of a worldwide recession have nonetheless receded. However, consensus forecasts of overall global economic growth in 2023 and 2024 remain modest in the range of 2.5% to 3%. Global rates of headline inflation are expected to ease. In the US economy, although recession has so far been avoided or delayed, economic growth there is still anticipated to be positive but slowing for the year as a whole.

- SA successfully, if narrowly, avoided a 'technical recession' earlier this year with GDP growth of 0.4% in 1Q 2023, following on -1.1% growth in 4Q 2022. Headline inflation in May has declined further. Other positive developments included proactive developments around the role of the Minister of Electricity in seeking to steadily phase out Eskom's rolling blackouts and a closer collaborative relationship being forged between government and business to urgently tackle key problem areas.

- On the contrary side, the two strongest twin negative factors in 2Q 2023 were the diplomatic conflict between SA and the US over the Russia- Ukraine war and the persistent heavy Eskom load-shedding in most of the quarter. The economic and business outlook for the rest of 2023 is also weak. Business and consumer surveys show downbeat economic expectations over the next few months. Present GDP growth forecasts converge on 0.1% to 0.3% for the year as a whole, with downside risks.

- Given current economic headwinds, SA's weak growth prospects have renewed uncertainties, including lately from the International Monetary Fund (IMF) and the Organization for Economic Cooperation and Development (OECD), about the sustainability of SA's public finances and the risks of rising deficit and debt ratios.

- Highly elevated policy uncertainty remains a serious obstacle to much higher investment, growth and job creation. If SA is to avoid high policy uncertainty becoming strongly entrenched as the 'new normal', it should speedily and effectively implement necessary remedies and reforms, especially around energy, logistics, local government and crime.

- The second half of 2023 must therefore see SA urgently expedite the existing half-forged policies and projects that can reduce policy uncertainty, strengthen investor confidence and facilitate a policy environment that is solid, coherent and consistent. There remains potential to regain lost economic ground and rebuild confidence.

Professor Raymond Parsons
NWU Business School
083 225 6642

NWU BUSINESS SCHOOL POLICY UNCERTAINTY INDEX ROSE FURTHER TO 76.2 in 2Q 2023 FROM 71.7 IN 1Q 2023 (BASELINE 50), THUS REACHING A NEW HISTORICAL HIGH

"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 policymakers 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 between 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 each year in January, April, July, and October. 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 2023 – 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.

Unpacking the three elements constituting the latest PUI shows converging trends as follows:

i. *media data* reflected a further substantial rise in references to policy uncertainty

ii. the *survey of economists* assessed that the level of uncertainty for local investors was broadly unchanged from its previous 1Q 2023 high level but that it had increased for foreign investors and consumers

iii. University of Stellenbosch's Bureau for Economic Research *survey of manufacturers* experiencing policy/political uncertainty was slightly lower at 86, compared to 91. However, they caution that most of their respondents answered their survey before the statement by the US Ambassador and the currency shock that followed the Lady R Simonstown revelation

3. NARRATIVE ON FACTORS INFLUENCING ECONOMIC/POLICY UNCERTAINTY

3.1 Global Economic Outlook

The International Monetary Fund (IMF) has forecast global growth as declining from 3.4% in 2022 to 2.8% in 2023 and later stabilising at about 3% in 2024. The SA Reserve Bank (SARB) revised its forecast for global growth higher in 2023 and 2024 to 2.4% (from 2.0%) and 2.7% (from 2.5%). In many economies, weak growth is presently still accompanied by uncomfortable inflation. Global growth is recently projected by the World Bank (WB) to decelerate from 3.1% in 2022 to 2.1% in 2023 and edging up to 2.4% in 2024. The WB believes the world economy remains 'frail' and at risk of a deeper downturn this year and in 2024.

While overall global headline inflation has begun to ease, it remains elevated in many countries. Global headline inflation is broadly expected to fall from 8.7% in 2022 to 7.0% in 2023 on the back of lower commodity prices. However, underlying (core) inflation is anticipated to decline more slowly in various economies and is described as 'sticky inflation'. Global monetary policy is likely to stay restrictive for longer. World economic prospects are, therefore, still being shaped to a large extent by stubborn inflation and high interest rates, as well as influenced by well-known geo-political uncertainties.

Another uncertainty is the sustainability of the much-heralded recent Chinese economic recovery. Even as China's recovery from its prolonged lockdown exceeded expectations in the early months of the year, the uneven recovery so far has failed to lift the overall mood. Weak spots in the economy have included lacklustre imports, soft inflation, the failure of manufacturing output to equal the strength in services, and jobless youth – which on June 15 led to an interest rate cut by the Bank of China. China's official growth target for 2023 is, in any event, only a modest yet positive 5%.

The smaller 20-member Eurozone itself experienced a 'technical recession' (two successive quarters of negative growth) of -0,1% growth in Q1 2023. However, revised forecasts by the European Commission (EC) of the larger EU's 27-member countries as a whole expects growth to be faster than previously thought – but with 'leaders' and 'laggards'. The EC said that, despite high inflation and high interest rates, the EU's members would grow at an average of 1% in 2023, slightly up from an earlier forecast of 0.8%. The European Central Bank (ECB) raised interest rates by another 25 bps on June 15, the highest level in more than two decades. Interest rates in the United Kingdom, Switzerland and Norway were again increased in the second half of June.

US headline inflation rate in May fell to its lowest annual rate in two years, although 'core' inflation still rose compared with a year ago. On June 15, the Federal Reserve decided to keep interest rates unchanged for now but warned of a further two possible rate hikes later. A recession in the US economy has so far been avoided or delayed, but a plausible view is that economic growth there in 2023 is likely to remain positive but slowing. The risk of the US defaulting on its sovereign debt, and throwing global markets into chaos, was avoided by the Congress endorsing the last-minute deal agreed by their political leaders and US President Joe Biden.

The stresses and strains of indebtedness remain apparent in Africa. Public debt as a share of GDP reached an average of 56% in sub-Saharan Africa in 2022, the highest level since the early 2000s, exacerbated partly by Covid-19 and the Russia-Ukraine conflict. While this may not appear severe by developed economy standards, it is barely affordable in Africa, where inflation and interest rates are much higher and also embody significant socioeconomic challenges.

While not all African economies are equally worse off in this respect, this year, sub-Saharan African countries spending on servicing external debt is expected to be 17% of government revenues, the highest level since 1999. Painful austerity and economic adjustments await several of these economies as they grapple with rapidly rising public debt. Recent studies have also outlined the extent to which unreliable electricity supply in SA and Nigeria, the two largest economies in Africa, impede the continent's economic and business activity when it can least afford it.

3.2 The South African Economy

3.2.1 Balance between positive and negative factors influencing the 2Q 2023 PUI

At 76.2 the 2Q 2023 PUI has risen to a new historical high, compared to its previous record of 71.7 reached in 1Q 2023. Several aggressive negative factors again kept the 2Q 2023 PUI at a highly elevated level. The calibration of the latest PUI reflects the extent to which negative global and domestic considerations still greatly outweighed positive ones during the past quarter. While some of the 'bad news' may well abate in the 3Q of 2023, the PUI remains deep in negative territory for now. Investment and hiring plans may well be postponed in response to higher uncertainty, but many can be quickly reinstated if uncertainty dissipates.

On the positive side, the good news was that SA was able to avoid a 'technical recession' (two successive quarters of negative growth) earlier in the year. Stats SA revealed that GDP growth had been 0.4% in 1Q 2023 after a (revised) -1.1% in 4Q 2022 generated recession fears in some circles. The Spectator Index of Recession Probability Forecast for 2023 recently put SA's chances of recession at 45%. Yet despite the negative impact of intensified rolling blackouts and other economic headwinds during that period, the economy proved resilient enough to narrowly avoid a recession in 1Q 2023.

Headline inflation in May also continued to show a declining tendency, from 6.8% to 6.3%. Although food costs remained high, the overall further easing in the rate of headline inflation by more than expected was a welcome development. Core inflation, however, remained stubborn. Global inflation has also receded, thanks to lower world oil and food prices. If benign trends regarding the inflation outlook continue, it may suggest a case for the SARB's Monetary Policy Committee to consider a 'hawkish pause' in its interest rate-raising cycle at its next meeting in late July.

Although heavy load-shedding continued to exact an economic toll during most of 2Q 2023, there has nonetheless been official clarification of the job description and role of the Minister of Electricity in ameliorating the economic impact of the Eskom rolling blackouts. As intended short-term measures become successfully implemented, the prospect is heightened that load-shedding may be steadily reduced and minimised by the end of 2023. The rating agency Moody's has welcomed the official plans for Eskom's debt relief. And the National Treasury announced it would reverse its decision to exempt Eskom from accounting for wasteful and unauthorised spending in its financial statements.

On the balance of payments front, the deficit on the current account showed an unexpected narrowing in 1Q 2023. Exports rose at a faster pace than imports over the period to generate this performance on the external trade front. While for both cogent global and domestic reasons, this is likely to have been only a temporary positive trend, it was encouraging to see the higher arrival of tourists adding to revenues as international travel recovers in the post-Covid 19 phase.

Another welcome development in this period has been the renewed collaboration between business and government to urgently tackle key current challenges. At a meeting on June 6 between President Cyril Ramaphosa and a top-level Business 4SA delegation, it was agreed that a number of urgent 'crisis committees' would be created to address major problem areas such as in energy, infrastructure and transport logistics, and in combating crime. If successful, it can help to reduce policy uncertainty and promote a more predictable economic environment.

A major new and negative development influencing the 2Q 2023 PUI was SA's geopolitical conflict with the US over this country's perceived support for Russia in its war with Ukraine. It sent shock waves through the financial markets and caused a rand collapse in early June at a time when the economy is most vulnerable. Fortunately, both SA and the US are seeking to reset their relationship, especially around AGOA. But investment sentiment has nonetheless already been negatively affected. There is a heightened risk premium which investors now attach to SA, which is being repriced in new circumstances.

The bad news also is that the 2023 GDP growth outlook remains weak, with most forecasts for growth converging on only 0.1% to 0.3% for the year as a whole, with downside risks. The SARB's leading business cycle indicator fell again in April and, on an annual basis, declined by 9.1%. And in its recent 'Industry Insights', Nedbank warned that the aggressive rise in interest rates (the SARB decision of another 50 bps rise on May 25) would worsen the financial strain on households, dampen demand for credit and may ultimately trigger another wave of job losses.

Other recent high-frequency data have also been negative. Retail sales have been contracting for several months, suggesting waning consumer resilience. Retail confidence also fell in 2Q 2023, as well as seeing the emergence of a significant deterioration in retail profitability in the face of rising operational costs, mainly as a result of rolling blackouts. Retailers now expect weakening business conditions in the second half of 2023. And the RMB-BER business confidence index in 2Q 2023 declined for the fifth successive quarter to a three-year low.

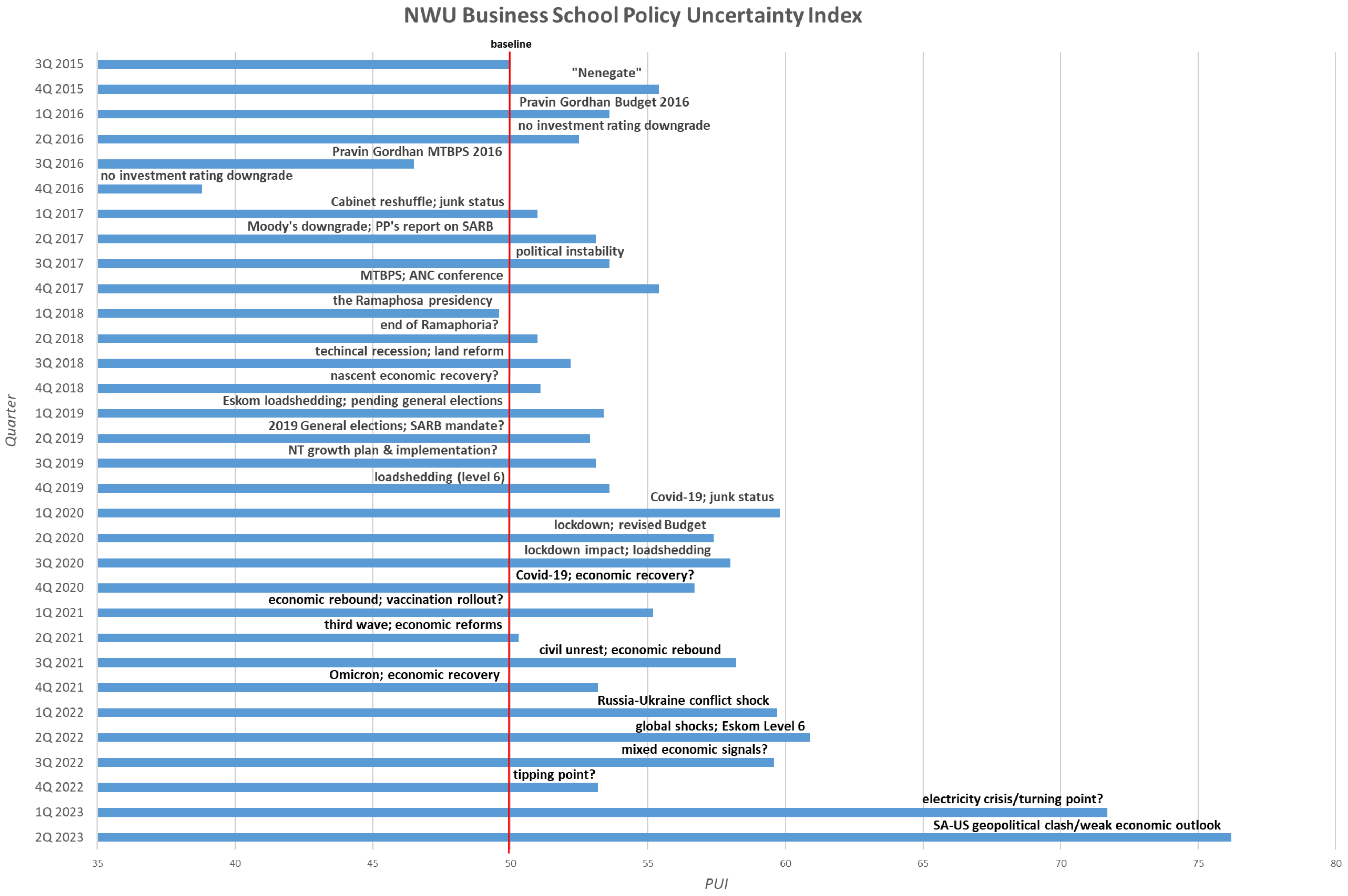
There is renewed uncertainty around SA's public finances. The Budget in February, although positively presented and well-received, did warn of 'significant risks' to the fiscal outlook, including weaker-than-projected growth, higher interest rates and increased spending pressures. Finance Minister Enoch Godongwana has lately expressed concern about the state's low tax revenues in 1Q 2023. And recently, both the IMF and the Organization for Economic Cooperation and Development (OECD) also raised red flags about the country's deteriorating public finances and higher debt service costs.

3.2.2 Summary and Conclusion

At 76.2 the 2Q 2023 PUI has risen to a new historical high compared to the previous record of 71.7 in 1Q 2023. Policy uncertainty, therefore, remains a serious obstacle to reaching much higher levels of investment, growth and job creation. If SA is to break out of its present 'low growth trap', it must speedily implement the remedies and reforms to which it is committed in key problem areas. Operation Vulindlela, for example, needs to have a better success rate than 45% if it is to maximise its impact on SA's economic performance.

If highly elevated policy uncertainty is allowed to become entrenched as a 'new normal', the danger is that SA will fail to eventually reach the 3% plus economic growth needed to alleviate high unemployment and poverty. The second half of 2023 should see SA expedite half-forged policies and projects that will help to reduce economic uncertainty, strengthen investor confidence and facilitate a policy environment that is solid, coherent and consistent. There remains potential to recover lost economic ground and rebuild confidence.

North-West University Business School
30 June 2023



NWU BUSINESS SCHOOL