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NWU Business School

Policy Uncertainty Index (PUI)

1Q 2024

EMBARGO:
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EXECUTIVE SUMMARY

- The NWU Business School PUI for 1Q 2024 edged further into negative territory, to 65.8 from 65.5 in 4Q 2023 (baseline 50). In addition, and not unexpectedly, the uncertainty around SA's 2024 election dynamics and outcomes next month is now also weighing on investors and the markets.

- The IMF forecast for world economic growth at 3.2% in 2024 is slightly higher than its October 2023 expectation. The IMF still sees wide divergences between regions and countries. The main players in the global economy of the US, the EU and China presently offer varying economic performances. Global inflation is expected to continue to ease this year, but with 'core' inflation in some economies declining more slowly, with implications for the pace at which interest rates may be eased.

- The well-known geopolitical risks and uncertainties continued to persist. In particular, in the first two months of 2024, Red Sea shipping disruptions caused Suez Canal trade to drop by 50% from a year earlier, while trade through the Panama Canal fell by 32%, obstructing supply chains and disturbing macroeconomic indicators.

- The World Bank sees GDP growth in Sub-Saharan Africa (SSA) accelerating to 3.8% in 2024 and firming to 4.1% in 2025. Growth in the largest economies in SSA (e.g., Nigeria and SA) is expected to lag behind the rest of the region. There remain, however, well-known downside risks for the SSA region also identified by the Bank.

- The SA economy continued to grapple with well-known domestic and global headwinds during 1Q 2024. GDP growth is likely to be about 1% in 2024 (after 0.6% in 2023) but the economic recovery will be uneven. Household finances remain under strain. Surveys by Nedbank and Absa indicate that recent fixed capital formation (GFCF) trends have also been weak. Nedbank, however, expects GFCF to accelerate in 2025 based on renewable energy investment, stronger global growth and firmer commodity prices.

- The South African Reserve Bank's Monetary Policy Committee (MPC) again decided on March 27 to keep borrowing costs unchanged for now, with inflation risks still seen on the upside. However, interest rates seem to have peaked and barring shocks, rates could begin to ease in the second half of 2024.

- The 2024/25 Budget was also seen as providing evidence of the National Treasury's determination to keep a 'debt trap' at bay through a combination of spending decisions, debt management steps, and tax adjustments in order to 'balance the books'. The Budget Speech acknowledged that there remained 'a high sovereign credit risk' challenge to be wound down over the next few years.

- There are a number of important reform initiatives already evident in some key policy areas, such as energy, logistics and transport, that could still be key tailwinds to drive this year's growth prospects. While there is still a long road ahead, the B4SA partnership in these priority areas is reported to be achieving sustainable momentum.

- Not unexpectedly, prevailing uncertainties around the 2024 election and its outcome have now also contributed to business confidence being brittle in 1Q 2024. The uncertain political outlook has led to a tangible precautionary stance among investors and the markets.

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NWU BUSINESS SCHOOL POLICY UNCERTAINTY INDEX (PUI) IN 1Q 2024 EDGED UP TO 65.8 COMPARED TO 65.5 IN 4Q 2023 (BASELINE 50) AND 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 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 and 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 1Q 2024 – 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 the following:

i. *media data* reflected a decline in references to policy uncertainty

ii. the *survey of economists* assessed that uncertainty had increased, specifically caused by politics and uncertainty facing consumers

iii. the University of Stellenbosch's Bureau for Economic Research *survey of manufacturers* experiencing policy/political uncertainty rose from 82 to 85

3 NARRATIVE ON FACTORS INFLUENCING ECONOMIC/POLICY UNCERTAINTY

3.1 Global Economic Outlook

As 2024 unfolded, there were slightly more positive forecasts for world economic growth prospects for this year from the International Monetary Fund (IMF). The IMF is now forecasting global growth of 3.1% in 2024, up two-tenths of a percentage point on its October 2023 expectations. It anticipated unchanged growth in 2025, at 3.2%. This compares with global growth averaging 3.8% over the period 2000-2019 and is therefore below historical growth performance.

The IMF continued to see inflation easing more quickly than expected (although 'stickier' in some key economies) and that a 'soft landing' was in sight. However, the IMF cautioned that key risks remained, including continued geopolitical tensions arising from the Ukraine-Russia conflict, the Hamas-Israel war and the shipping disruptions in the Red Sea.

In the first two months of 2024, Suez Canal trade dropped by 50% from a year earlier, while trade through the Panama Canal fell by 32%, disrupting supply chains and distorting key macroeconomic indicators. The volume of trade transiting around the Cape surged by 74% last year, with associated delays and costs arising from these shipping detours.

The World Economic Forum (WEF), in its Chief Economists' Survey in January, described global economic prospects this year as subdued and fraught with uncertainty. The global economy was expected to remain uncertain throughout 2024. Like the IMF, the WEF survey also saw high inflation being pared back in most regions. Regional growth varied widely, and no region was expected to show very strong growth in 2024, the WEF survey added.

Political factors appear in 2024 to be a more general source of global uncertainty. This year, general elections are taking place in about 50 countries (also in South Africa) including the US Presidential elections in November. Global research has shown that economic uncertainty normally tends to rise when elections are pending. Analysts worry, however, that especially where closely run elections are anticipated and the electorate is highly polarised, there could be unpredictable consequences for geopolitics, trade and investment in present volatile global circumstances.

In the meantime, at a regional level, Europe's economic outlook, although mixed, seems to have weakened in recent months, with several countries bordering on recession. A leading German Economic Institute forecasts the country's GDP will grow by only 0.1% in 2024. Italy seems to be the best economic performer. At its latest meeting in mid-March, the European Central Bank (ECB) again left interest rates unchanged. The United Kingdom economy has been in recession but the UK Budget on March 13 sought to give the economy more support at a time when an election is also pending in that country. With UK inflation easing the BoE recently also kept rates unchanged for now.

At the annual meeting of China's Parliament in early March, Prime Minister Li set a GDP growth target of 'around 5%' for 2024 and outlined some policy steps to support that outcome. The average of economists' growth forecasts is, however, presently only about 4% and then only provided the Chinese government introduces several more positive measures (other than those announced so far) to overcome the current economic headwinds and structural challenges. Commodity exporters are particularly vulnerable to any China economic slowdown.

The US economy continues to surprise on the upside and remains a strong driver of global growth. The unexpected increase in US inflation to 3.2% in February (the Fed's target is 2%) nonetheless highlighted the challenge still faced by that economy in dealing with rising prices and costs. On March 20, the Fed kept interest rates unchanged but hinted at possible rate cuts in the 2H of 2024. Former Treasury Secretary Lawrence Summers criticised the Fed for already signalling future rate cuts when the US economy continued showing projections of still-too-high inflation (Bloomberg, 21/3/2024).

The IMF is positive about Sub-Saharan Africa's (SSA) future economic prospects. The World Bank (WB) also sees growth in Sub-Saharan Africa accelerating to 3.8% in 2024 and to firm further to 4.1% in 2025. This is primarily the outcome of inflationary pressures fading and financial conditions easing. Growth in the largest economies in SSA (e.g., Nigeria and South Africa) is expected to lag the rest of the region. However, the regional outlook is subject to several well-known downside risks, adds the WB.

3.2 South African Economic Outlook

3.2.1 Balance between positive and negative factors influencing 1Q 2024 PUI

The 1Q 2024 PUI edged further into negative territory to 65.8 from 65.5 in 4Q 2023 (baseline 50) and remains highly elevated. A cross-cutting number of events and trends converged to influence economic perceptions in the first quarter of 2024. These included the SONA, the Budget, two MPC meetings, the poor 4Q GDP growth figures, and, importantly, the pending elections on May 29. The rise in the 1Q 2024 PUI was, therefore, the outcome of negative factors that, on balance, outweighed the positive ones to edge the index further into negative territory.

The SARB's MPC on March 27 decided for the fifth time to again leave borrowing costs unchanged. Until inflation falls to the mid-point of the SARB's target range of 3%-6%, interest rates will stay high for longer. Inflation still appears 'sticky' but is expected to wind down later in the year. Interest rates in SA nonetheless seem to have peaked and, barring shocks, could begin to ease in the second half of 2024, probably by 25 basis points as a start. 'A longer wait for fewer cuts', says Business Day (28 March).

The 2024 Budget on February 21 recognised the overall need to slow the growth of national debt and lower its cost. Debt service costs now absorb more than 20% of revenue, which much exceeds spending on other socioeconomic priorities. In dealing with the medium-term fiscal challenges, the Budget embodied several financial 'buffers' across a broad spectrum of spending decisions, debt management steps and certain tax adjustments aimed at 'balancing the books.'. The Budget nonetheless rightly acknowledged that 'the size of the pie is not growing rapidly enough to meet our development needs' and that there was still 'a high sovereign debt risk'.

On the infrastructure front, twelve key infrastructure projects were recently announced to promote both public and private sector-driven development across various sectors, including transport, energy and agriculture. The projects are part of the 2024/25 infrastructure pipeline. Revealed during the Sustainable Infrastructure Development Symposium 2024 in Cape Town on March 19, these projects will receive backing from Infrastructure South Africa.

Successful business-government collaboration on the implementation front also has the potential to reduce policy and project uncertainty. There appears to be positive traction emerging from the latest top-level cooperation between senior businesspeople and government in the high-priority areas of energy, logistics and transport, and crime and corruption. 'While there is still a long road ahead, the B4SA partnership has now achieved sustainable momentum', says an authoritative update (Business Day, March 28).

In the meantime, 'the growth outlook for SA in 2024 remains murky, ' according to Nedbank's Guide to the Economy earlier this year. For well-known reasons, Nedbank believed that underlying business conditions are likely to remain weaker in the first half of 2024 before recovering moderately in the second half of the year. Subsequently, other high-frequency data have confirmed that business confidence is at a low ebb in the early months of 2024. Retail sales continue to weaken as household finances come under increasing strain. The SARB's composite leading business cycle indicator decreased by 0.5% in January 2024. Although the consensus forecast among many analysts still expects about 1% GDP growth this year, the economic recovery is likely to be a very uneven one.

Particularly concerning is the recent poor performance of gross fixed capital formation (GFCF), especially that of private fixed investment. SA needs strong investment-led growth to drive its economy. Various surveys, including a recent ABSA manufacturing sector survey, confirm the recent loss of momentum in private fixed investment activity. This is where economic uncertainty, eroded business confidence and delayed or postponed investment decisions intersect to weaken the growth outlook. However, the good news is that Nedbank, in its recent 2023 Capital Expenditure Project Listing Survey, expects GFCF to accelerate in 2025, supported by renewable energy investments, stronger global growth, and firmer commodity prices.

Looming over the usual calibration of policy uncertainty, nevertheless, are now the risks arising from the pending SA general elections next month. Global research shows that, in many countries, policy uncertainty indices tend to spike when elections are due. But there are distinctive features that differentiate the extent to which the 2024 elections in SA will impact the uncertainty profile of the economy. The prospect of political shifts in SA after 30 years of dominance by the ANC governing party has opened up several new areas of uncertainty not experienced since 1994.

Five specific factors combine to raise the level of uncertainty surrounding the 2024 election outcomes:

1. according to several recent authoritative opinion-based surveys, support for the ANC governing party is likely to dip below 50% nationally and provincially
2. the political environment is generally more competitive and volatile due to new opposition formations
3. individual candidates may now participate in the proportional electoral system without belonging to a political party
4. current support patterns suggest a governance shift into coalition territory at both national and provincial levels, which has (so far) brought much unpredictability and instability to local government and metro-politics
5. Political analysts and recent opinion surveys remain strongly divided on the likely election outcomes

The real prospect of yet further coalition arrangements at various levels of governance is new political terrain for South Africa. The challenge nonetheless requires to be successfully addressed and governance frameworks need to be reimagined. It remains to be seen what governance solutions could emerge to deal with a likely shift in South Africa's political economy. Although the economy will still nevertheless continue with its daily activities, political factors have now induced a tangible precautionary stance among investors and the markets.

3.2.2 Summary and Conclusion

On the positive front, there are a number of reform initiatives already evident in some key policy areas, such as energy, logistics and transport, and crime and corruption, that could become important tailwinds to drive this year's growth prospects. The role of the private sector here remains indispensable. If steadily and visibly implemented, the reforms are the steps now needed to build SA's economic resilience, irrespective of the 2024 elections.

Not unexpectedly, the prevailing uncertainties around the pending South African election and its outcome have now also contributed to business confidence being brittle in 1Q 2024. Although, as the political dynamics unfold, the economy will continue with its daily activities, the uncertain political outlook is now also weighing on investors and the markets as to possible election outcomes.

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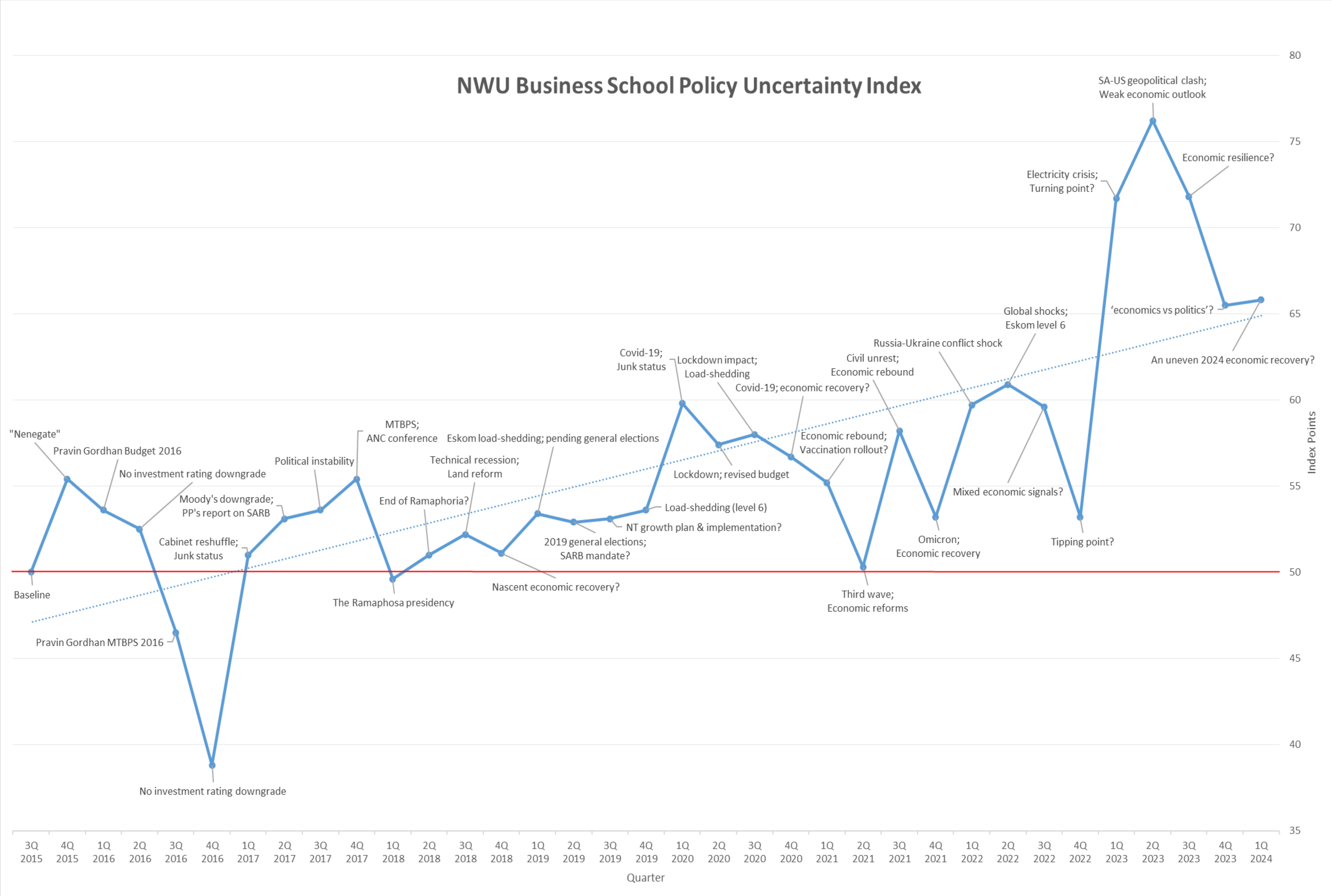
3 April 2024



NWU Business School Policy Uncertainty Index
SA-US geopolitical clash; Weak economic outlook
Economic resilience?
Electricity crisis; Turning point?
'economics vs politics'?
An uneven 2024 economic recovery?
Global shocks; Eskom level 6
Russia-Ukraine conflict shock
Civil unrest; Economic rebound
Covid-19; Junk status
Lockdown impact; Load-shedding
Covid-19; economic recovery?
Economic rebound; Vaccination rollout?
Lockdown; revised budget
Mixed economic signals?
Load-shedding (level 6)
NT growth plan & implementation?
Omicron; Economic recovery
Tipping point?
Third wave; Economic reforms
"Nenegate"
Pravin Gordhan Budget 2016
No investment rating downgrade
Political instability
MTBPS; ANC conference
Eskom load-shedding; pending general elections
Technical recession; Land reform
Moody's downgrade; PP's report on SARB
End of Ramaphoria?
Cabinet reshuffle; Junk status
2019 general elections; SARB mandate?
Nascent economic recovery?
Baseline
The Ramaphosa presidency
Pravin Gordhan MTBPS 2016
No investment rating downgrade
80
75
70
65
60
55
50
45
40
35
Index Points
3Q 2015
4Q 2015
1Q 2016
2Q 2016
3Q 2016
4Q 2016
1Q 2017
2Q 2017
3Q 2017
4Q 2017
1Q 2018
2Q 2018
3Q 2018
4Q 2018
1Q 2019
2Q 2019
3Q 2019
4Q 2019
1Q 2020
2Q 2020
3Q 2020
4Q 2020
1Q 2021
2Q 2021
3Q 2021
4Q 2021
1Q 2022
2Q 2022
3Q 2022
4Q 2022
1Q 2023
2Q 2023
3Q 2023
4Q 2023
1Q 2024
Quarter