NWU Business School

Policy Uncertainty Index (PUI)

4Q 2021

EMBARGOED UNTIL

Monday

10 January 2022

EXECUTIVE SUMMARY

- The NWU Business School PUI for 4Q 2021 declined to 53.2 from 58.2 in 3Q 2021 (Baseline 50), but is still well in negative territory. The negative factors that caused the big spike in the 3Q 2021 PUI diminished in 4Q 2021. Structural impediments to a strong economic recovery remain, unless economic reforms are prioritized.
- Towards the end of 4Q 2021 overall global economic growth rate forecasts, although still positive at about 5%, were being trimmed as a result of the impact of Omicron restrictions in several countries.
- Lower growth and higher inflation, together with costly supply chain disruptions, were increasingly features of the global economy in the fourth quarter of 2021. Emerging markets (EM) like SA became vulnerable to the gradual tightening of US monetary policy and a sharp slowdown in Chinese economy. In 4Q 2021 interest rates rose in several countries to deal with inflation.
- The overall global economic outlook at the end of 2021 medically, economically and politically was therefore embedded in higher levels of uncertainty.
- Despite a more-than-expected contraction of -1.5% in 3Q 2021 GDP growth, the ‘rebound’ in SA economy for 2021 as a whole is still expected to be about 5% (or slightly less) after the big -6.4% GDP growth loss experienced in 2020. But the bulk of the rebound is now in the past. Growth forecasts for 2022 range from 1.4% (IMF) to 2% (Fitch). Growth in SA has been too low for too long.
- In 2022 the opportunity exists to reduce policy uncertainty further and enhance inclusive growth by expediting and implementing a wide range of existing half-forged policies and shovel-ready infrastructure projects where long-standing commitments already obtain. Accelerated economic reforms, better service delivery, higher fixed investment and stronger business confidence are therefore needed in 2022.
- Use key platforms such as the State-of-the Nation address in early February, the main Budget Speech later next month and the next Presidential Investment Conference in March to create a consistent and coherent policy environment that is conducive to inclusive, job-rich growth in 2022.

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NWU BUSINESS SCHOOL POLICY UNCERTAINTY INDEX (PUI) IN 4Q 2021 DECLINED TO 53.2 FROM 58.2 IN 3Q 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.

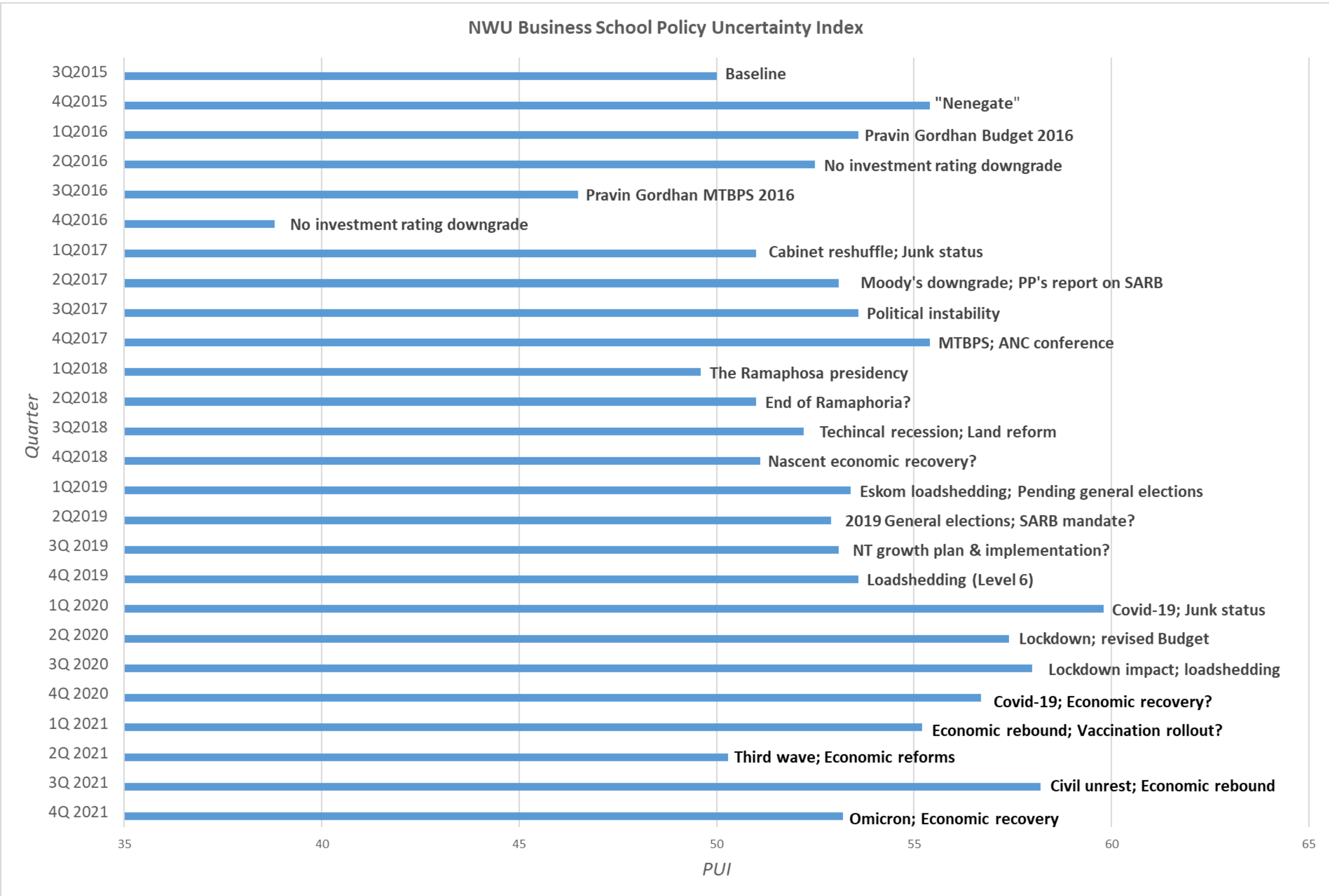
The PUI is published in January, April, July and October of each year. An increase beyond 50 reflects heightened policy uncertainty; a decline in the PUI means reduced uncertainty. The value of the PUI as a proxy for policy uncertainty will lie in tracking changes in policy uncertainty over time.

2. PUI RESULTS FOR 4Q 2021 - WHAT DO THEY SAY?

The PUI is the *net* outcome of *positive* and *negative* factors influencing the perceptions of policy uncertainty over the relevant period. The outcome for 4Q 2021 shows an average score of 53.2 compared to 58.2 in 3Q 2021.

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

i. The media data showed a slight increase in references to policy uncertainty.
ii. The survey of economists, on average, believed policy uncertainty was the same, or a little lower.
iii. The University of Stellenbosch's Bureau for Economic Research survey of manufacturers experiencing policy/political uncertainty declined from 84 to 79.



3. NARRATIVE ON FACTORS INFLUENCING ECONOMIC/POLICY UNCERTAINTY

3.1 Global Economic Outlook

As 2021 drew to a close and notwithstanding significant concerns surrounding the current Omicron variant, the major global economic challenge now became how to deal with lower growth and higher inflation - as we saw many countries grappling with recent economic cross-currents and costly supply chain disruptions. Interest rates rose in several countries in 4Q 2021 to combat emerging inflation. In a world that has grown weary of Covid-related restrictions, new lockdown measures and travel bans were also recently again imposed by many countries. Earlier predictions of strong global growth rates in 2021, although still positive at about 5%, have been systematically trimmed in various quarters.

Apart from Omicron and its accompanying challenges, two additional reasons for emerging markets like SA to feel vulnerable as the year ended were the intended gradual tightening of US monetary policy and a sharp slowdown in the Chinese economy. The prospect of hawkish US monetary policy and a strong dollar usually go hand in hand with a declining global risk appetite. Those economies with a big stake in China as an export market need to grasp the new reality that, even as the Chinese government proceeds stimulate its economy, the country's growth rate has fallen to about 5% - the lowest in about 30 years. The evolution and restructuring of that economy *may* mean lower growth levels in future as a 'maturing' economy.

To provide an additional perspective The Economist (4/12/2021) gathered data relating to key macroeconomic variables for 40 large emerging markets (EM) within the context of tighter US monetary policy and slower growth in China. It combined factors such as large current account deficits, high levels of debt (especially foreign debt), chronic inflation and inadequate forex into what it called a 'vulnerability index' for certain emerging economies. In the index, higher scores reflect greater economic fragility. Argentina tops the list, followed by Sri Lanka, Egypt, Brazil and Turkey. SA ranks midway on the list, in 19th place.

The Economist nevertheless expects a 'rocky ride' for most of these emerging economies this year, especially in terms of their currencies (will the bell toll again for a volatile rand in 2022?). How emerging economies are impacted and how they will respond will, of course, therefore largely depend on their domestic economic circumstances and resilience. The centrality of inflation and how it can be handled in existing circumstances dominated global economic debate as 2021 drew to a close. A recent IMF report (3/12/2021) emphasized that such responses must now be calibrated to the unique circumstances of individual economies.

But as the world and SA move into the third year of the pandemic, it is *not* necessarily all gloom and doom. Adaptive behaviour on the part of people, firms and governments – as well as more vigorous vaccination drives – help to alter the future trajectory of the contagion. Lessons have been learned. As the fourth quarter of 2021 ended there were also tentative signs that supply bottlenecks might be easing, while manufacturing hubs like Taiwan and Vietnam were reporting quicker delivery times.

And even in the face of some predicted worst-case scenarios, the world economy is not expected to experience another massive contraction in GDP growth, as was witnessed at the height of the pandemic in 2020. Stock markets have also thus far taken the latest developments in their stride. Yet, threats to the global economic outlook remain. The downside risks of the new, highly transmissible Omicron variant have increased, thus weakening the chances of strong economic recovery in several countries this year.

Moreover, the speed with which certain countries recently again imposed travel and other restrictions may presage volatility ahead. In any event, the prevailing balance of risks suggests that central banks will over the coming months need to assess monetary policy decisions carefully in the light of growth and inflation trends in their respective economies. At this juncture what the first quarter of 2022 will usher in – medically, economically and politically – remains shrouded in greater uncertainty.

3.2 The South African Economy

3.2.1 Balance between positive and negative factors influencing the 4Q 2021 PUI

It will be recalled that in the previous 3Q 2021 negative factors greatly eclipsed positive ones to push the PUI needle much higher. These included developments such as the serious civil unrest in July, the move to lockdown 3, Eskom load-shedding, record high unemployment figures, uncertainty around the pending local elections and continued implementation risks around various policies and projects, such as energy policy. This was eventually also reflected in the worse-than-expected -1.5% GDP economic contraction in the third quarter of 2021.

The good news is that, though the PUI remains well in negative territory, policy uncertainty in 4Q 2021 was lower than it was in 3Q 2021. Some of the factors causing the 3Q 2021 PUI to strongly spike subsequently began to diminish. One positive element was the key Medium Term Budget Policy Statement (MTBPS) in November, which delivered a positive message about SA's growth and fiscal metrics. Then the SARB's composite leading business cycle indicator rose marginally in October. The SA stock market also ended 2021 with its best performance in 12 years, with all its components higher for now.

The bad news is that, as the real economy enters 2022, the 4Q 2021 PUI remains elevated in negative territory. This can be partly ascribed to the initial uncertainty stemming from the recent emergence of Omicron and the precipitate imposition of travel bans on SA by about 30 countries. Although eventually a few of the travel bans have been lifted, considerable economic damage had already been done. Yet given various structural impediments SA's economic recovery is expected to be weak compared to peer countries, unless economic reforms are prioritized.

On the positive side it is likely that SA will see a 5% (or slightly less) economic 'rebound' for 2021 as a whole. This compares with the big -6.4% GDP growth loss in 2020, which was a much larger drop than the EM average of 2.2%. The momentum behind the rebound in the economy is, however, is now largely behind SA. High frequency economic data in 4Q 2021 have been mixed. Fortunately, the ongoing strong performance of the agricultural sector is a major bright spot on SA's economic horizon in 2022.

On the inflation front, domestic costs have risen over the past few months. Both the CPI and PPI levels have become elevated, driven mainly by the recent surge in fuel and raw material costs and higher food and electricity tariffs. At its November meeting the SARB's Monetary Policy Committee (MPC) decided to raise interest rates by 25 basis points because of concerns about the upside risks to inflation. This came after a prolonged period of relatively low interest rates. The MPC also signalled the likelihood of a collective hike of 100 basis points by the end of 2022. Borrowing costs for businesses and consumers are, therefore, destined to rise this year.

Although the further relaxations to the Level 1 lockdown restrictions only came at the very end of 2021, they are positive for business and consumer confidence. More importantly, though, in unpacking the latest economic trends in SA, the flat-line performance of total fixed capital formation (i.e., private and public sector investment) remains of special concern. It is on higher fixed investment that future growth now mainly rests and where elevated levels of policy uncertainty matter. Together with the multi-faceted impact of Omicron, these mixed trends inevitably pose a question mark over growth forecasts for 2022 - but which nonetheless remain in positive territory.

Recent growth expectations for SA in 2022, for example, have ranged from a pessimistic 1.4% (IMF) to a more optimistic 2% (Fitch). The official Medium-Term Budget Policy Statement (MTBPS) in November projected an average growth rate of 1.7% over the next three years. But the reality is that most of these latest conservative growth prognostications are in any case barely above the population growth rate and are therefore inadequate for a developing economy like SA. Policies in 2022 must be geared towards doing better in the face of the socio-economic red flags raised by these low growth forecasts.

Growth in SA has therefore been too low for too long. In 2021 the level of fixed investment dropped to an 18-year low (SARB Financial Stability Review, November 2021). Given SA's immense socioeconomic challenges it needs a more robust, inclusive growth over the next few years - faster than the MTBPS average of 1.7% growth - and powered by much higher levels of private and public investment. Greater policy certainty needs to play a critical role here. The PUI has not been in positive territory since 1Q 2018, at the inception of the Ramaphosa Presidency.

Policy uncertainty permeates economic activity and development at the local level as well, where serious service delivery failures have had a corrosive impact on business costs and viability. There is mounting evidence of where business operations have been badly impaired as a result of chronic uncertainty about the cost-effective provision of basic services and infrastructure at local level. In some worst-case examples firms have been eventually compelled to 'disinvest' from towns where the certainty of essential support services no longer exists.

Policy predictability also interacts with the mobilization of corporate cash balances. Many big corporate balance sheets in SA are currently looking strong, with cash reserves available for potential real investment. ‘For as long as you have that heightened policy uncertainty you will have companies sitting on cash balances and not investing’, said SARB Governor Lesetja Kganyago (October 2021). The National Treasury’s recent program to expand and enhance the role of public-private sector partnerships in infrastructural projects should be expedited.

Gross fixed capital formation in South Africa as a percentage of GDP

3.2.2 Summary and Conclusion

The challenge in 2022 is therefore to reduce policy uncertainty further. Confidence-building is said to be the cheapest form of economic stimulation. For example, an acceptable existing growth roadmap - the Economic Reconstruction and Recovery Plan - still awaits full recognition and implementation. What 2022 must therefore see is for SA to mobilize and implement a wide range of existing half-forged policies and shovel-ready infrastructure projects to help create a growth environment that is solid, coherent and employment-friendly.

Accelerated economic reforms, higher fixed investment and stronger business confidence therefore need to be ultimately backed by policy certainty, as highlighted in the earlier recent quote on the subject from former Finance Minister Tito Mboweni. To promote policy consistency and coherence, key platforms - such as the State-of-the-Nation address in early February, the main Budget Speech later next month and the next Presidential Investment Conference in March - must be used in 2022 to create an economic environment that is conducive to inclusive, job-rich growth.

North-West University Business School
10 January 2022