

Policy Uncertainty Index (PUI)

2Q 2021

EMBARGOED UNTIL

5 July 2021

EXECUTIVE SUMMARY

- The NWU Business School PUI for 2Q 2021 again declined to 50.3 from 55.2 in 1Q 2021 (Baseline 50), bringing it to the brink of positive territory. It was previously in positive territory in 1Q 2018 at the inception of the Ramaphosa Presidency
- The overall global economic outlook continued to strengthen in 2Q 2021. A recent United Nations (UN) report on the world economy revised its 2021 global growth forecast upward from 4.7% to 5.4%
- All credible international forecasts, including the UN and the IMF, still emphasize that the global economic recovery is unevenly spread over countries. It is subject to challenges arising from renewed waves of the pandemic in several parts of the world. However, overall global uncertainty is shown to be declining
- In the US the jury is still out on whether the recent surge in inflation there is transitory, as the US Federal Reserve expects, or will be entrenched. The Fed's GDP growth forecast for 2021 is now raised to 7%. The Fed has indicated that two interest rate increases are likely in 2023 and the Fed Chairman has again told Congress last month that current US inflation 'will wane'
- On the positive side, and reinforced by the global commodity cycle, SA's economy is in 2021 showing a strong 'rebound' from last year's -7% GDP growth. A growth rate of almost 5% in SA now widely expected in 2021. Economic activity may level off in 2H 2021. Despite third wave of Covid-19 - and the return to Level 4 lockdown in late June - the outlook for GDP growth this year as a whole remains positive
- Together with the cyclical economic recovery in SA the major reforms dealing with energy supply, the SAA and Transnet announced in June may have brought the SA economy to a positive tipping point in its reform agenda. As at mid-2021 a tangible improvement in the economic mood is discernible based on the expectation that a wedge had now been driven into the stalemate associated with the structural reform program to date
- However, *negative* factors that still balanced out the *positive* ones in the 2Q 2021 PUI outcome and which has just kept the PUI out of positive territory for now include:
 - (a) further evidence of a continued vigorous *implementation-led recovery* which delivers tangible outcomes and could push the PUI into positive territory again. How the land reform process unfolds from now on remains important. There are still domestic factors which could derail the better prospects for more policy certainty and there are no grounds for complacency
 - (b) the need to reverse the current decline in private fixed capital formation, to which persistent policy uncertainty is related. Investor confidence is the key here. A boost in both domestic and foreign fixed investment is needed, if the current economic recovery is to be converted into higher medium-term job-rich growth
 - (c) continued uncertainties around the latest Level 4 lockdown restrictions and the successful rollout of vaccines in SA which may impact on the 3Q 2021 PUI, rather than be evident in the 2Q 2021 outcomes

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NWU BUSINESS SCHOOL POLICY UNCERTAINTY INDEX (PUI) IN 2Q 2021 SHOWED A FURTHER DECLINE TO 50.3 IN 2Q 2021 FROM 55.2 IN 1Q 2021, THUS BRINGING IT TO THE BRINK OF POSITIVE TERRITORY AGAIN (BASELINE 50)

'I don't know how to explain this anymore.... Economic agents: investors, businesses, consumers, buyers and sellers of goods, farmers, the market etc, need policy certainty. FUNDAMENTAL. I invest because I will harvest in X-years in the forward market. CONFIDENCE!' (Finance Minister Tito Mboweni, 22/11/2020).

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.

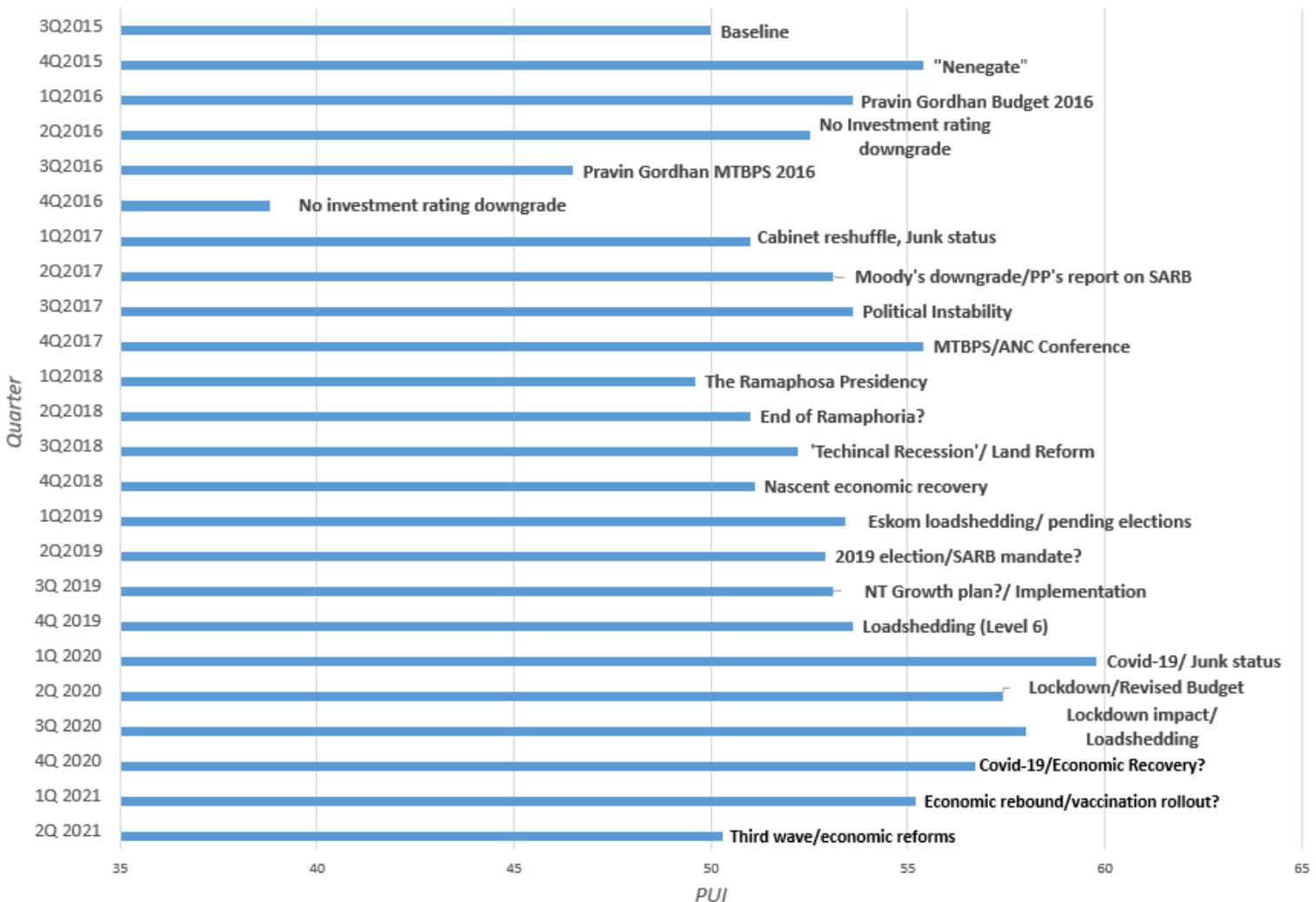
2. PUI RESULTS FOR 2Q 2021 - WHAT DO THEY SAY?

The PUI is the *net* outcome of *positive* and *negative* factors influencing the perceptions of policy uncertainty over the relevant period. The outcome for 2Q 2021 shows an average score of 50.3, compared to 55.2 in 1Q 2021. This bringing the PUI to the brink of positive territory.

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

- 2.1 the media data reflects slight decreases in mentions of policy uncertainty
- 2.2 the *survey of economists* found that the majority felt that uncertainty declined compared to the previous quarter
- 2.3 the University of Stellenbosch’s Bureau for Economic Research *survey of manufacturers* experiencing policy/political uncertainty fell from 80 to 72.

NWU Business School Policy Uncertainty Index



3. NARRATIVE ON SOME FACTORS INFLUENCING ECONOMIC/POLICY UNCERTAINTY

3.1 Global Economic Outlook

The overall global economic outlook continued to strengthen in 2Q 2021 but with key caveats. In its recent mid-2021 World Economic Situation and Prospects Report the United Nations (UN) responded to the strongly rebounding Chinese and US economies by revising its 2021 global economic forecast upwards from 4.7% to 5.4%. The UN forecast of 5.4% global growth this year is more conservative than several other projections, including those by the International Monetary Fund (IMF), which recently revised its 2021 forecast to 6%.

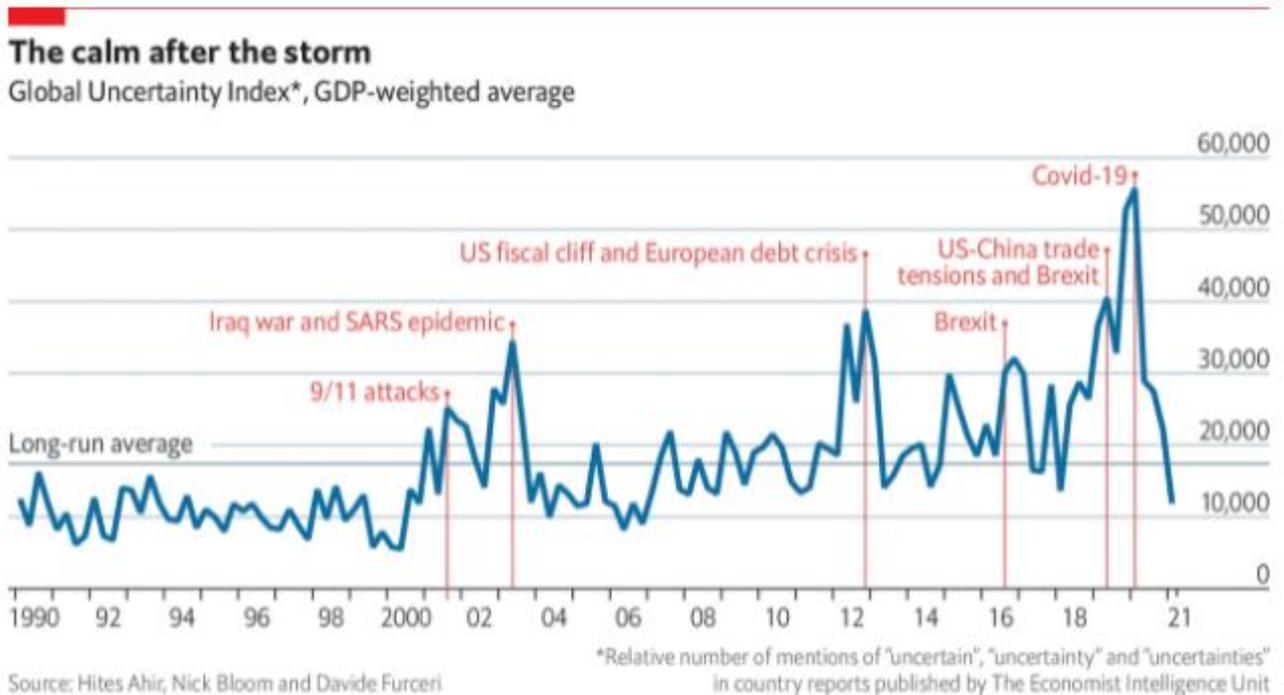
However, the UN expectation for 2022 is that the world economy will grow by about 4.7%, which is higher than the IMF's current projection of 4.4%. Most credible global growth forecasts therefore broadly point in the same direction, but with all emphasizing that better world growth remains uneven and uncertain. However, overall global uncertainty is nonetheless shown to be declining (see chart below)

The UN report also stressed that in the past the rates of economic growth in most developing economies would exceed the global average. This year, however, the average growth rate of many developing economies is lower because of the pandemic. Indeed, the World Bank has recently also referred to the global outlook as a 'tale of two recoveries'. Rich countries, many of whom have vaccinated people relatively quickly, are doing better than in poor countries where vaccination has lagged. Emerging economies that have vaccinated faster than their peers also show superior outcomes, says the World Bank.

In the meantime, at the G7 meeting in mid-June President Biden won support for a 'carry on spending' plan to boost the US economy. It was argued at the G7 summit that that it was right to for the US to spend now to underpin the global economic recovery. And in the US the debate continues as to whether latest surge in inflation will prove transitory, as the US Federal Reserve believes, or will become entrenched. In the US the Fed's GDP growth forecast for 2021 has been raised to 7%, with inflation at 3% this year. The Fed has also now suggested that two small interest rate increases are possible in 2023, although Fed Chairman Powell subsequently again told Congress on June 22 that US inflation was 'expected to wane'.

In the meantime, global commodity prices remain firm in the past quarter on the back of the recent world economic recovery. This outcome has been supportive of several emerging economies, including South Africa. In fact, the rising international commodity cycle has been already a visible driver of SA's recent better economic performance, especially in mining and agriculture. However, it is necessary for an economy like SA to take full advantage of the strong global commodity cycle while it lasts.

Global Uncertainty Index: GDP-weighted average



Source: The Economist May 2021

3.2 The South African Economy

3.2.1 Balance between positive and negative factors influencing the 2Q 2021 PUI

The better economic news both globally and domestically in the past three months has further reduced the 2Q 2021 PUI to 50.3, which is on the brink of positive territory. This is in line with a previous PUI narrative that it is possible for high levels of policy uncertainty to be gradually reversed *provided* appropriate economic, health and other policy actions are credibly and visibly implemented. What, then, were the positive and negative factors influencing this outcome and which again shifted the PUI needle lower in 2Q 2021? Which positive factors nearly balanced out the negative ones in 2Q 2021?

Even with the arrival of the third wave of the pandemic and SA's reversion to further lockdown restrictions on June 16 and June 28 there was gathering evidence over the past quarter on balance of a continued positive cyclical 'rebound'. This had also been reinforced by strong global commodity exports, thus overall putting SA's growth rate back into positive territory from the devastating -7% GDP growth last year. The good GDP growth figures for 1Q 2021 also confirmed the economic recovery 'message' emerging from several recent high frequency data trends.

The latest third wave of Covid-19 infections has nonetheless hit SA badly, especially in Gauteng and the Western Cape. Even though economic activity will probably level off in 2H 2021, it seems likely that a GDP growth rate of close to 5% for the year as a whole is still possible. The SA Reserve Bank (SARB) Monetary Policy Committee (MPC) also again recently raised its GDP forecast for this year from 3.8% to 4.2% and recently the SARB said it sees the latest tight Level 4 lockdown as only a 'speed hump' in SA's economic recovery.

Also on the positive side the most significant breakthroughs recently have been several *reform announcements* by government which in effect seek to liberalize energy supply in SA, put SA Airways (SAA) partly in private hands and create an independent ports authority. There is also tangible if slow progress on the anti-corruption front. Cumulatively these factors have now combined to push the PUI on the verge of positive territory, by driving a wedge into the stalemate which seemed to have assailed the economic reform program for so long.

It is clear that on the energy front encouraging private investment in embedded power generation is now the only way to reduce the continued high risk of load-shedding and eventually provide energy security. The extent to which persistent load-shedding has damaged SA's economic performance is common cause. This kind of new investment also has the potential to promote job-rich growth. And policies which promote greater competition and efficiency at home are also the key to greater competitiveness abroad.

Although spiking, inflation remains within acceptable limits and the May meeting of the MPC again kept interest rates unchanged. Present indications are that borrowing costs are likely to remain low and stable for now. Credit demand, especially from business, is still weak but is expected to strengthen in 2H 2021 according to a recent Nedbank report on credit trends.

Recently the credit rating agencies Standard and Poor, as well as Fitch, also left SA's current low investment rating unchanged for now and will revisit the situation in November. The better growth figures and capacity reforms at SARS are yielding more tax revenue - and if together with hopefully a more pragmatic approach generally to troubled state-owned enterprises - they could provide new pillars on which to build still much-needed fiscal sustainability.

All in all, as SA enters the second half of 2021, the economy is at a decisive *tipping point* regarding its economic prospects and reform agenda. Fresh opportunities are opening up and more things suddenly seem possible. This could enable SA to capitalize on the current economic recovery and convert it into the sustainable higher medium-term job-rich economic growth it needs

3.2.2 Need to guard against complacency

However, complacency must be avoided, as there is still a long way to go. Dealing with the third wave of the pandemic is still with SA, with the return to Level 4 lockdown more relevant to the 3Q 2021, rather than 2Q 2021 outcomes. Nor should a reduction in some existing policy uncertainties now be neutralized or offset by the creation of new ones. *Consistency* and *coherence* in shaping the policy environment therefore remain imperative if policy uncertainty is to be reduced further.

To reduce policy uncertainty further depends on some key factors being well managed from now on such as:

(a) the extent to which the positive decisions about energy liberalization, SAA restructuring and an independent ports authority have a multiplier effect on the investment climate will depend on their *irreversibility* and *sustainability*. There must be no faltering in their implementation or doubt as to whether they should be replicated elsewhere. Implementation risks still exist. Serious missteps must be avoided. The emphasis must therefore strongly remain on an *implementation-led recovery*. Here Operation Vulindlela still has a major monitoring and oversight role to play to help ensure delivery at several levels in terms of commitments made

(b) the latest growth figures for 1Q 2021 published by Stats SA show a decline in *fixed capital formation* by the private sector. The SARB has also drawn attention to this weak link in SA's economic performance chain. This has been related to the persistence of policy uncertainty. How issues like the land reform process, for example, are handled in future will therefore remain important. It is a boost in both domestic and foreign private fixed investment that must underpin the medium-term growth and employment outlook

(c) SA is now grappling with the 'third wave' of Covid-19 infections through additional Level 4 lockdown restrictions. A sensible balance has to be held between lives and livelihoods in taking decisions to deal with these challenging circumstances. The best basic solution from both a health and economic certainty point of view is still the efficient rollout of SA's vaccination program as rapidly as possible.

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