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Policy Uncertainty Index (PUI)

4Q 2019

EXECUTIVE SUMMARY

- The 4Q 2019 PUI increased to 53.6 from 53.1 in 3Q2019 (baseline 50). Negative factors outweighed positive ones in the fourth quarter of 2019. Policy uncertainty therefore remained strongly elevated and stayed well in negative territory during this period.

- Global financial markets finished the year on a high note as the immediate risks of a US-China trade conflict and uncertainties around Brexit receded. Although the world economy continued to show positive growth, the geo-political environment in some areas had become increasingly risky and uncertain, especially for business investment

- Domestically, inflation declined to well within the target range of 3%-6% and the rand strengthened considerably towards the end of 2019, with the prospect of lower petrol prices. Retail sales appear to have been buoyant in November/December 2019

- Adverse factors in SA which kept policy uncertainty in negative territory during 4Q 2019 included in particular weak mining and manufacturing data, the Eskom blackouts, vulnerable public finances, crime and violence, political factionalism, the Moody's likely downgrade of SA’s investment rating in 2020, and the perception that the National Treasury’s growth plan may not be successfully implemented. Business and consumer confidence remained at low levels

- High levels of policy uncertainty are reversible. The latest PUI again confirms that the most important contribution government can make now remains to minimize the uncertainty created by its policies and actions. If policy uncertainty is to be lessened concrete signals about SA’s future economic direction need to emerge from both the State-of-the-Nation Address (SONA) and the Budget next month. There needs to be urgency and resolve in stabilizing the policy outlook.

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NWU BUSINESS SCHOOL POLICY UNCERTAINTY INDEX (PUI) RISES TO 53.6 IN 4Q 2019 FROM 53.1 IN 3Q 2019 (BASELINE 50), AND REMAINS WELL IN NEGATIVE TERRITORY

NWU BUSINESS SCHOOL POLICY UNCERTAINTY INDEX (PUI)

1. INTRODUCTION

The NWU Business School PUI is now in its fifth year.

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 in 2019 by the IMF and Stanford University to calibrate the rising levels of policy uncertainty in the global economy that have become apparent in recent years.

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.

Research suggests that uncertainty is very different across economies. Developing countries seem to have about one-third more macro-economic uncertainty than developed countries. However, this is now changing with events such as Brexit, the controversial policies of US president Donald Trump as well as other geo-political tensions.

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, and as economic and political events unfold.

2. PUI RESULTS FOR 4Q 2019 - WHAT DOES IT SAY?

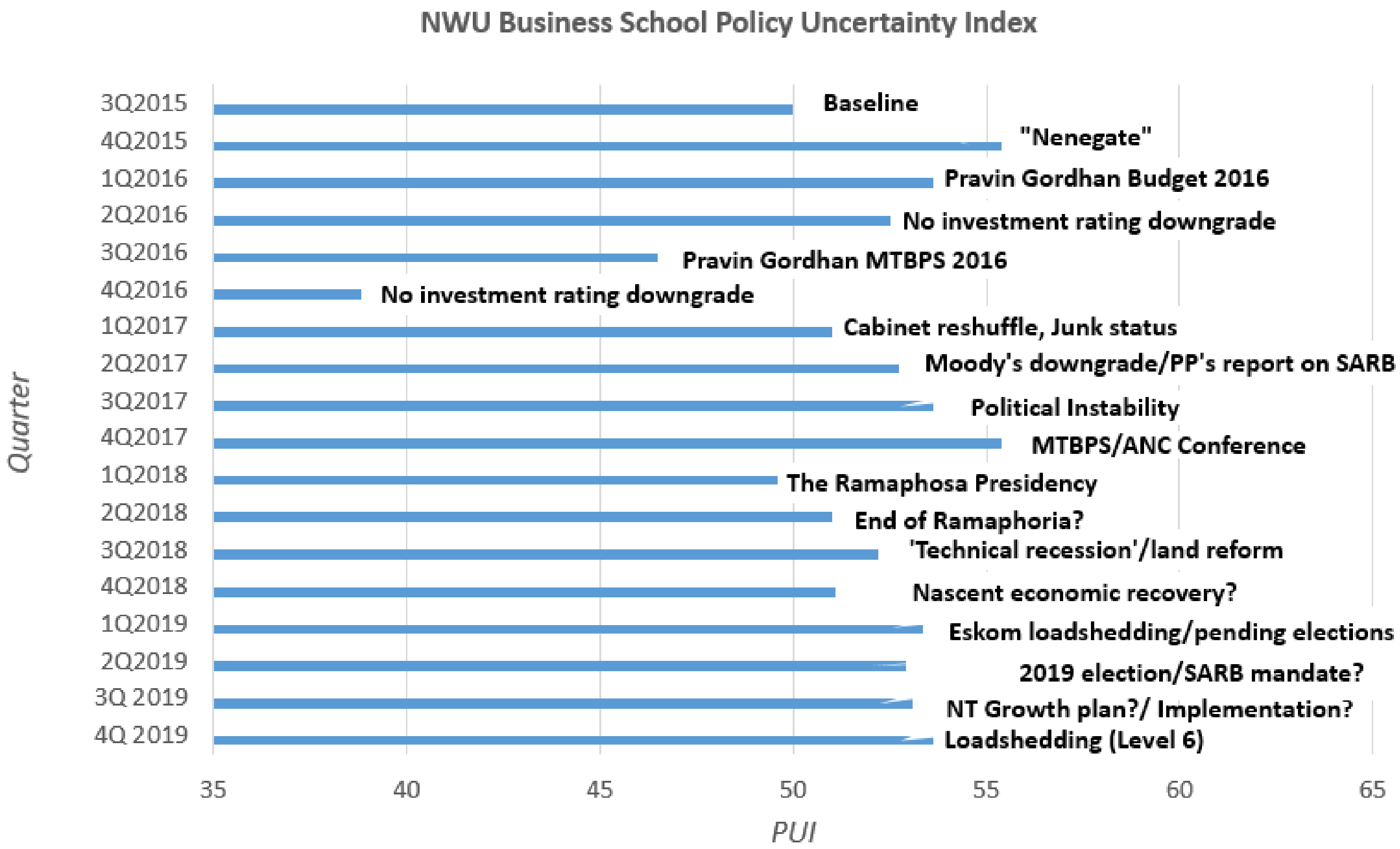
The PUI is the *net* outcome of *positive* and *negative* factors influencing the perceptions of policy uncertainty over the relevant period. The outcome for 4Q 2019 shows an average score of 53.6, reflecting a rise over the the PUI of 53.1 in 3Q 2019. *Hence the PUI remains well in negative territory for now.*

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

2.1. In the *media data* the references to economic uncertainty remained at a high level.

2.2. The *survey of economists* perceived similar or elevated uncertainty.

2.3. The *Bureau of Economic Research* at the University of Stellenbosch's *survey of manufacturers* still reflected a high level of policy/political uncertainty, declining only slightly from 83 to 82.



3. NARRATIVE ON SOME FACTORS INFLUENCING ECONOMIC/POLICY UNCERTAINTY

3.1 Global Economic Outlook

By 4Q 2019 the US economy had been growing for about 129 months, the longest run since records began in 1854. Average GDP growth during this expansion has nonetheless only been 2.3%, much lower than the 3.6% seen in America's three previous expansions. History suggests there *may* be a recession soon. Yet despite mixed economic signals, the US economy currently remains the 'locomotive' of world economic activity. US consumer spending is the main pillar there. A recent authoritative survey puts the chance of a US recession this year at only 20%. And, although the Chinese economy was expected at growth at about 6% in 2019, in line with expectations, in that case it would still be the country's weakest growth in nearly three decades.

The US-China relationship appears broken, and even the latest truce may not necessarily repair it. Trust between the two countries is minimal. It seems that both sides will work to make themselves less vulnerable to the other by reducing the economic commitments that bind them together, irrespective of collateral damage to any other countries. 'Were superpower rivalry to spiral out of control, the costs would be vast', said the *Economist* (January 4-11, 2020).

More broadly, global political trends are generally putting the multilateral trading system under great strain, as is reflected in the increasing dysfunctionality of the World Trade Organization (WTO). 'The WTO is facing its deepest crisis since its creation', said Phil Hogan, the European Trade Commissioner recently. If the rules governing international trade can no longer be enforced 'we'd have the law of the jungle', he said. An effective rules-based international trading system especially remains in the interests of small open economies like SA.

The major global financial markets nonetheless finished 2019 on a high note as the immediate risks of a US-China trade conflict and uncertainties around Brexit receded. Regarding Brexit, it should be remembered that, although Britain will formally leave the EU on January 31, there remains a year of transition and negotiation which, if not successfully completed, may bring new uncertainties by the end of 2020. Although SA's trade interests are protected in the post-Brexit phase, it will therefore remain necessary to carefully evaluate the trade implications of the Brexit transition process as it unfolds to evaluate any new risks as well as opportunities.

On the overall international economic outlook, the broad consensus is that, although the world economy will continue to show positive growth, the geo-political environment has become increasingly risky and uncertain, especially in the light of the latest tensions in the Middle East. The world economy is seen as poised for a modest rebound in 2020 but there are downside risks. Last month Nomura saw 2020 more as a year of 'consolidation' than one of a full-fledged recovery. It believed that the prospects for the world economy still rested on fragile foundations, in the light of factors such as the weakened outlook for the Chinese economy and the possible resurgence of a US-China trade conflict this year.

The IMF World Economic Outlook Update will be released from Davos on January 20.

3.2 The South African Economy

Negative factors outweighed positive ones in shaping the level of policy uncertainty in 4Q 2019 and keeping it well in negative territory in the past quarter. Although the former were dominant, however, it was not all bad news over that period.

The good news included the decline of inflation to well within the target range of 3% to 6%, the marked strengthening of the rand towards year-end, which promised lower petrol prices, as well as the possibility of a cut in interest rates. Welcome summer rains over several regions of SA offering potential higher agriculture output in 2020. SA's victory in the Rugby World Cup in November also made a positive contribution to lifting the national mood in the fourth quarter of last year. The second Presidential investment conference in November was also seen as a successful one in generating further investment commitments.

On the negative side, however, the poor GDP growth of -0.6% in 3Q 2 was followed in 4Q 2019 by very weak manufacturing and mining data, meagre new vehicle sales as well as continued low business and consumer confidence. The SAA saga persisted. Then came the shock to the economy and business of renewed Eskom load-shedding in December, which was the single most important factor causing the spike in policy uncertainty in 4Q 2019. The shadow cast over economic prospects by further power blackouts then inevitably led to economic growth forecasts being reduced all round.

These developments therefore suggested that SA would struggle to even reach the previously low growth forecasts of O.5% in 2019, and which may eventually be found to have sunk further. Negative economic trends in 4Q 2019 then inevitably presaged lower growth expectations for 2020. The World Bank has now cut its growth forecast for this year to 0.9%, the SARB to 1.2%, and Nedbank to 0.7%. Certainly SA can now no longer even take the possibility of a 1% growth rate for granted in 2020. The World Bank predicts that over the next three years SA's economic growth rate will be lower than any other Sub-Saharan African country, except Sudan. The Bank’s forecast for growth in the region as a whole in 2020 is about 3.5%.

Another source of uncertainty in 4Q 2019 was the vulnerable state of SA's public finances. Weak growth had hit tax revenues badly. But the Medium Term Budget Policy Statement (MTBPS) in October 2019 also frankly and realistically acknowledged that, unless more progress was made in reducing the cost-drivers of government as well as those of state-owned enterprises like Eskom and SAA, SA was in serious danger of falling into a 'debt trap'. Despite the agenda of remedies proposed by the MTBPS, they fell far short of preventing escalating public debt trends up to 2022/23. How in fact SA's public finances were going to be brought under better control remained an important contributor to higher policy uncertainty in 4Q 2019, with increasing risk of further fiscal ‘shocks’ in the forthcoming Budget.

The gamut of factors aggravating levels of uncertainty in 4Q 2019 therefore ranged from poor electricity supply to heavily constrained fiscal space as well as factional battles within the governing ANC party. In addition to these trends and developments in 4Q 2019 there also remained Moody's pending decision about SA's investment rating hanging like the Sword of Damocles over the economy and the more-than-even chance of SA descending into universal junk status this year. It was still an open question to what extent this bad news was already being priced in by the markets. As 2019 drew to a close, it was nevertheless clear that contours of the economic and financial landscape in SA dictated that a pivotal year lay ahead for the economy.

4. CONCLUSION

The National Treasury's (NT) growth plan in August 2019 recognized the importance of creating a more stable and predictable policy environment in SA to strengthen investor confidence and to promote the job-rich growth that the country needs. To remedy the situation, the NT growth strategy made a number of key reform proposals that need to be urgently implemented. For as SA enters 2020 it is clear that, unless decision-makers can reduce policy uncertainty, it will be difficult for SA to break out of its current ‘low growth trap’ and put the economy on a higher growth path.

High levels of policy uncertainty in SA are reversible. The determining factors are largely under SA’s control if the right domestic policy choices are made and implemented. The economy therefore needs positive ‘game-changers’ this year to make a real difference. The State-of-the-Nation Address (SONA) and the Budget next month both represent major opportunities to provide concrete messages about SA’s future economic path in ways that build confidence. There needs to be urgency and resolve in stabilizing the policy outlook.

North West University Business School