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NWU Business School

Policy Uncertainty Index (PUI)

4Q 2023

FOR IMMEDIATE RELEASE
8 JANUARY 2023

EXECUTIVE SUMMARY

- Although still remaining well in negative territory, the NWU Business School PUI for 4Q 2023 declined to 65.5 from 71.8 in 3Q 2023 (baseline 50). While several contrary factors kept the PUI elevated, there were enough positive ones to again make the PUI less elevated in 4Q 2023.

- While generally the world economy remained resilient, risks of slower global growth in 2024 remained on the upside. Geopolitical tensions and conflicts have heightened global uncertainty, including the recent danger to one of the world's major trade arteries in the Red Sea because of Houthi militant action against shipping there.

- World economic growth is now forecast by the IMF to be 3% in 2023 and slightly lower at about 2.9% in 2024, but with wide divergences between regions and countries. Uncertainties persist around the Chinese economy, with growth there now being anticipated to be only about 4.5% in 2024. The US economy continues to surprise on the upside.

- Global inflation is easing but underlying (core) inflation is projected to decline more slowly. World interest rates seem to have peaked, with key central banks such as the US Fed, the ECB and the Bank of England now all leaving interest rates unchanged at their recent meetings in mid-December.

- SA's economy continued to grapple with domestic and global headwinds during 4Q 2023. On the positive side recent inflation rates are now moving well within the SARB's 3%-6% target range. In another 'hawkish pause' the MPC unanimously decided on November 23 to again keep borrowing costs unchanged. Interest rates in SA may now also have peaked and, barring shocks, borrowing costs could begin to ease later in 2024.

- On the foreign trade front, following on the successful BRICS summit in August, the positive top-level AGOA gathering in Johannesburg in November injected more certainty into the prospects for the eventual renewal of the AGOA arrangements in 2025.

- Negative developments affecting the 4Q 2023 PUI included the worse-than-expected 3Q 2023 GDP growth outcome of -0,2%, intensified Eskom blackouts, Transnet bottlenecks, a contraction in household finances, and other weak high frequency economic data, including the FNB/BER's recent consumer confidence index at its lowest Festive Season reading in decades. On present trends GDP growth in 2024 could now be about 1% and the economic recovery will be uneven.

- SARB Governor Lesetja Kganyago and others have highlighted the coming elections as among the key risks now facing the SA economy. Global research indicates that policy uncertainty indices tend to spike when elections are due, and SA is also moving into uncharted political waters as 2024 unfolds.

- Negative trends in the PUI nonetheless remain reversible, if the right steps are taken. The domestic challenge largely remains to see that the reform initiatives and projects already emerging in major areas, such as energy, logistics and transport, are steadily implemented. It lies mainly in SA's hands to ensure that tailwinds will prevail over the headwinds in shaping the country's economic performance in 2024.

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NWU BUSINESS SCHOOL POLICY UNCERTAINTY INDEX (PUI) IN 4Q 2023 EASED TO 65.5 COMPARED TO 71.8 IN 3Q 2023 (BASELINE 50) BUT 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 4Q 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 small decline in references to policy uncertainty
ii. the *survey of economists* gauged that the level of uncertainty remained broadly unchanged but believed that the political outlook had become more uncertain
iii. the University of Stellenbosch's Bureau for Economic Research *survey of manufacturers* experiencing policy/political uncertainty was slightly lower at 82, compared to 84 in 3Q 2023

3 NARRATIVE ON FACTORS INFLUENCING ECONOMIC/POLICY UNCERTAINTY

3.1 Global Economic Outlook

As 2024 drew to a close the world economy, although still resilient, had a subdued outlook in which a number of economic and political uncertainties were still pervasive. In late December, for example, as Houthi militants escalated attacks on global shipping flows in the Red Sea, several big shipping companies have paused or suspended their services there. This has created uncertainty about one of the world's major trade arteries, as well as again highlighting the present constant and rising risk of the Israeli-Hamas war having global economic implications.

In the meantime, the International Monetary Fund (IMF) saw global growth as slowing in 2023 as a whole to 3% and slightly to about 2.9% in 2024 – but amidst wide divergences of economic performance among regions and countries. Advanced economies were expected to slow from 2.6% in 2022 to 1.5% in 2023 and 1.4% in 2024. Emerging markets and developing economies were projected to see a marginal decline from 4.1% in 2022 to 4% in both 2023 and 2024.

There was, on the other hand, also increased evidence of global inflation easing. Several central banks have lately left interest rates high, but unchanged. The SARB recently assessed the longer-term world economic outlook as still very uncertain. In its 23 November 2023 statement the Monetary Policy Committee (MPC) cited a number of familiar global economic and geopolitical factors it saw as keeping financial markets and asset prices volatile, dampening investor appetite and capital flows. Taking these factors and other considerations into account – such as global interest rates being kept high for longer

– the MPC's forecast for global growth in 2023 was broadly unchanged at 2.7% (from 2.6%) and also at 2.6% in 2024.

Although China has recently adopted stimulatory measures to support its economy, the consensus forecast for Chinese growth in 2024 is now about 4.5%. China's growth prospects are now widely seen as 'structurally' weaker, partially reflected in the recent warning by Moody's rating agency that it may have to cut China's credit rating in the medium term. 'Will China leave behind its economic woes in 2024?', asks a leading economic publication (Economist 7/12/2023). Commodity exporters are especially exposed to China's economic slowdown (as SA has also experienced).

A slowing Chinese economy was therefore also partly reflected in lower international oil prices at a time when it might have been expected that current Middle East tensions would have outweighed overall weaker global demand, as well as offsetting the impact of recent divisions within OPEC about oil production levels. A possible wider regional escalation of the Israeli-Hamas war nonetheless remains a big uncertainty in this international oil price scenario. 'The Middle East economy', says the Economist (4/11/2023) 'is caught in the crossfire'.

The Eurozone economy still has had within its ranks its 'leaders' and 'laggards', but the overall economic picture is an increasingly challenging one. Inflation is still seen as a serious problem, with the European Central Bank (ECB) committed to setting interest rates at a sufficiently restrictive level for as long as necessary to get inflation back to its 2% target. However, as previously mentioned, at its latest meeting mid-December the ECB left interest rates unchanged, along with several other key central banks.

The US economy remained a positive 'locomotive' for global growth. In 4Q 2023 the US Fed on the inflation front was still determined to keep interest rates high for longer. At its meeting in December the Fed again also held borrowing costs unchanged and it may be that US interest rates have now peaked. Financial markets are now anticipating rate reductions during the course of 2024. Expert opinion is still divided on whether the US economy will experience a 'soft landing' as 2024 unfolds. The US economy continues to surprise on the upside.

Many economies in Sub-Saharan Africa are still grappling with serious inflation and public indebtedness problems. According to the World Bank's October Africa Pulse report, the Sub-Saharan Africa's economic outlook 'remains bleak amidst an elusive economic recovery'. Economic growth in the region is forecast to decelerate to 2.5% in 2023 from 3.6% in 2022. Despite the overall poor growth outlook, the report nonetheless also saw inflation in the region in 2023 as coming down to 7.3% from 9.3% in 2022. Additionally, fiscal balances were said to be improving in some of the Sub-Saharan African economies.

A recent IMF regional report warned that China's slowing economy may affect Sub-Sahara Africa's growth prospects. China has forged deep economic ties with the region over the past 20 years. China's engagement with the region has thus been gradually evolving, with implications for growth, trade and investment. It buys one-fifth of the region's exports – metals, minerals and fuel – and provides most of the manufactured goods and machinery imported by African countries.

The IMF estimates that a one-percentage-point decline in China's growth rate could reduce average growth in the region by about 0.25 percentage points within a year. The IMF therefore advises sub-Saharan African countries to finesse these new realities by steadily building resilience through increased inter-African trade and by strengthening other economic buffers. Successfully exploring these policy options will also help to reduce economic uncertainty in the region.

3.2 South African Economic Outlook

Although remaining well in negative territory, the 4Q 2023 PUI showed a welcome easing to 65.5 from its 71.8 in 3Q 2023 (baseline 50). While negative factors shaping the PUI were still strong enough to keep the PUI highly elevated, there were enough positive factors to slightly reduce the PUI level in 4Q 2023. Only when affirmative forces strongly outweigh negative ones will the PUI eventually be in positive territory. The presence of elevated policy uncertainty therefore remains, for now, a significant factor in the economic environment for business and consumer decision-making in SA.

On the positive side, in another 'hawkish pause' the Monetary Policy Committee (MPC) on November 23 unanimously decided to again keep borrowing costs unchanged. There is increasing evidence that interest rates in SA may now, barring shocks, have peaked and could begin to ease later in 2024. The much lower CPI and PPI figures in November offered the real prospect that inflation in SA may now be beginning to unwind. There is also the prospect of much lower fuel prices in the early months of 2024. The period of stability in borrowing costs since May last year has also been a reassuring factor in business and consumer confidence in present difficult economic circumstances.

On the foreign trade front the good news at the successful African Growth and Opportunity Act (AGOA) summit in Johannesburg in early November was the widespread championing by all participants of the extension of AGOA beyond 2025. The US Administration pledged its support for the renewal of these tariff concessions for Africa in due course. In particular, US-SA economic diplomacy also now seemed to be put back on a more constructive basis. The AGOA summit injected more certainty into the prospects for an eventual renewal of the AGOA arrangements, even though some US Congress resistance may still be anticipated.

On the negative side, however, the economic outlook for the rest of 2023 was described by a recent Nedbank survey as ‘bleak’, citing a cumulative combination of well-known global and domestic headwinds towards year end. The latest FNB/BER consumer confidence index was the lowest Festive Season reading in more than two decades. Various contrary factors, such as escalating job losses and high borrowing costs, have converged to severely dent household spending and credit demand.

The SARB’s QB Personal Finance Survey (December 2023) confirmed that household incomes contracted for the third consecutive quarter and real disposable income had declined considerably. Weak retail sales and disappointing new vehicle sales have therefore confirmed these trends in household finances. A better outlook for 2024 will depend largely on the pace at which inflation continues to decline and the extent to which interest rates indeed begin easing later in 2024.

The decline in 3Q 2023 GDP growth to -0,2% from 0.5% in 2Q 2023 was worse-than-expected, negative factors having dominated positive ones to a greater extent than anticipated in that period. The decrease in private fixed capital formation in that quarter was also a red flag. Similar broad economic trends are also likely to have prevailed in 4Q 2023. In any event, it seems likely that previous consensus forecasts of about 0.8% in GDP growth for 2023 as a whole may now need to be revised downward, perhaps to about 0.6%. GDP growth in 2024 is currently forecast to be about 1%. The performances across various business sectors will vary and economic recovery in 2024 will be uneven.

Looking ahead it is therefore clear that growth expectations in SA remain especially heavily dependent on load-shedding being steadily phased out and a higher level of energy security being achieved as promised. The appointment on December 8 of a new Eskom CEO is a positive step in the right direction. A promised memorandum of understanding between the Minister of Electricity, Kgosientsho Ramokgopa, and the Minister of Public Enterprises, Pravin Gordhan, is also necessary to clarify the roles of each department in resolving load-shedding. The expected publication of the draft (revised) Integrated Resource Plan (IRP) in the government gazette nonetheless needs to be critically interrogated. However, there remained serious bottlenecks in Transnet’s rail and port services that imposed widespread disruption and heavy additional costs on the economy during 4Q 2023, and for which urgent solutions are still needed.

An additional source of recent policy uncertainty has been the serious deterioration in SA’s public finances during the course of 2023 and which was outlined in the Medium-Term Budget Policy Statement (MTBPS) on November 1. While some decisions were announced in the MTBPS several of the key risks to the fiscal outlook still await to be addressed in the main Budget in February. The fiscal balance needs to be restored in the Budget without having to resort to unsustainable borrowing or damaging tax increases.

Looming over the calibration of policy uncertainty in SA nevertheless are the risks arising from the pending general elections in 2024. SARB Governor Lesetja Kganyago and others have highlighted the elections as among the key risks now facing SA's economy. 'Politicians adopting a populist tone ahead of the presidential and legislative vote may create uncertainty among foreign investors, undermining the case for investing in SA', Governor Kganyago said in an interview with City Press newspaper (Bloomberg 4/12/2023). Global research has shown that, in many countries, policy uncertainty indices tend to spike when elections are due and SA will not be immune from this trend.

Except, though, that there are two key distinctive features that differentiate the possible impact of the 2024 elections on the uncertainty profile of the SA economy. Firstly, the prospect of political change or shifts after 30 years of dominance by the ANC governing party opens up several new areas of uncertainty not experienced in SA since the 1994 democratic elections. Secondly, the PUI has been highly elevated for some time and has been well in negative territory for an extended period, driven by other well-known domestic and global factors. It remains to be seen how the PUI will respond as SA moves into uncharted political waters in 2024.

3.3 Summary and Conclusion

Although slightly less elevated in 4Q 2023, the PUI remained well in negative territory as 2023 drew to a close. That a wide range of 2024 election outcomes seem plausible to political pundits is also strong testament to the elevated level of uncertainty that currently exists. These negative PUI levels can, however, be gradually reversed if the right policies and projects are implemented. Stronger GDP growth in 2024 requires multi-tiered good news to underpin and strengthen SA's economic performance.

There are a number of reform initiatives already emerging in major policy areas, such as in energy, logistics and transport, that could still become important tailwinds for this year's growth prospects. The domestic challenge therefore largely remains to expedite the implementation of agreed half-forged policies and projects that could help to further reduce policy uncertainty by ensuring that the tailwinds outweigh the headwinds in 2024.

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