News release

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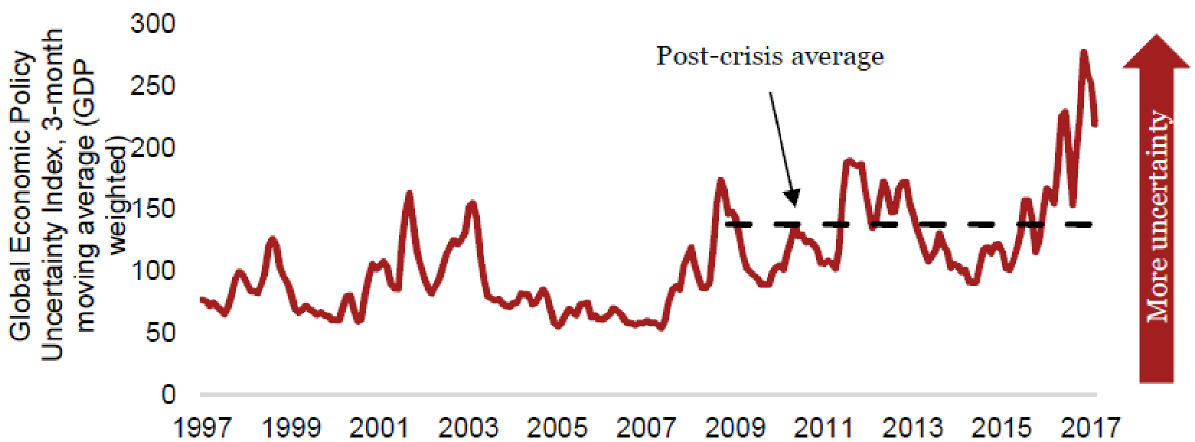
Economic uncertainty levels have hit an all-time high

The current political and economic climate has contributed to some of the highest levels of uncertainty seen for decades, say PwC economists in their latest Global Economy Watch.

Indeed, in recent years, uncertainty has been keeping business leaders busy. CEOs have responded in several ways –from insuring against the potential costs of cyber attacks, to stress-testing their operations and finances under alternative economic scenarios.

PwC Senior Economist Barret Kupelian says: "Businesses that have invested resources in such areas are likely to be better prepared for a future that remains highly uncertain. According to our CEO Pulse Survey, 30% of business leaders expect at least one crisis to hit their business within the next year."

Fig 1: In 2017, uncertainty levels have hit an all-time-high



The Economic Policy Uncertainty Index is comprised of three components. One component quantifies newspaper coverage of policy-related economic uncertainty. The second reflects the number of federal tax code provisions set to expire in future years. The third uses disagreement among economic forecasters as a proxy for uncertainty.

Sources: PwC analysis, Economic Policy Uncertainty, Baker, Bloom & Davis

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The impact of uncertainty cuts across all sectors of the economy, affecting households, businesses and financial markets. The key effects are:

- ***Households***: uncertainty can – at least temporarily – reduce consumer spending to safeguard against potential falls in income. Typically, this also leads to a boost in precautionary household savings. In the US, for example, household savings increased by around 5 percentage points during the financial crisis, from 3% to 8% of personal disposable income.
- ***Businesses***: uncertainty can push businesses to cut back on production, investment and employee compensation. In particular, large capital projects which tend to have a high degree of irreversibility may be particularly sensitive to high levels of uncertainty.
- ***Financial markets***: in uncertain situations, investors require a higher rate of return on their capital through higher risk premia. This means that the cost of credit could increase at times when perhaps the central bank decreases its policy rate, which is the usual action taken when the economy slows down. At times of uncertainty, capital also tends to flow from riskier to safer asset classes.

All of the above have significant cumulative impacts on the economy. The International Monetary Fund estimates that a one standard deviation increase in uncertainty is associated with a 0.4 – 1.3 percentage point decrease in output growth.

The first implication for business is that *known* uncertainties can be planned for and mitigated against. This can be done either by buying insurance or by using other sophisticated methods like financial instruments to insure against these risks.

Secondly, businesses can enhance their preparation for *unknown* uncertainties by simulating hypothetical events and assessing their effects on the balance sheet as well as day-to-day operations. For example, in financial services this is done through scenario planning and stress testing, techniques which are increasingly being used in the non-financial services sector.

Finally, policymakers can also influence levels of uncertainty in an economy. An example is the US Federal Reserve which, since the financial crisis, has been lengthening its analysis with the aim of increasing transparency on monetary policy decisions. It's important that policymakers mitigate market uncertainty by putting in place a coherent, transparent and well-communicated strategy.

Barret Kupelian concludes: “Policymakers have an important role to play as they can reduce levels of uncertainty by ensuring any future changes to the regulatory environment are as gradual and predictable as possible, while retaining the flexibility to act quickly if a major crisis does strike.”

For more details, please see this month’s Global Economy Watch at www.pwc.com/GEW.

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