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Asymmetric effects of policy uncertainty on real sector variables in emerging markets: evidence from Brazil, India, China and South Africa

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Abstract

Purpose – This study investigated the asymmetric effects of changes in policy uncertainty on real sector variables in Brazil, China, India and South Africa.

Design/methodology/approach – The study used the nonlinear autoregressive distributed lag (NARDL) modeling framework.

Findings – The results showed that both in the long run and short run, rising uncertainty not only increases consumer prices significantly in these economies, but also impedes aggregate and sectoral output growths, and deters investment, employment and private consumption. Contrary to economic expectation, the results also showed that in the long run, declining uncertainty impedes aggregate and sectoral output growths in these economies, and significantly hinders employment in South Africa and Brazil. This suggests that in the long run, economic agents in these economies somewhat behave as if uncertainty is rising. The authors also found significant asymmetric effects in the response of real sector variables to uncertainty both in the long run and short run, which justifies the choice of NARDL framework for this study.

Research limitations/implications – The sample is limited to Brazil, India, China and South Africa. While Brazil, India and China are three of the most prominent large emerging market economies, South Africa is the largest emerging market economy in Africa.

Practical implications – To lessen the adverse effects of policy uncertainty observed in the results, there is need for sound institutions and policy regimes that can promote predictable policy responses in these economies so that policy neither serves as a source of uncertainty nor as a channel through which the effects of other shocks are transmitted.

Originality/value – Apart from using the NARDL framework to capture the asymmetric effects of policy uncertainty, this study also accounted for the sectoral effects of uncertainty in emerging markets.

Keywords Asymmetry, Policy uncertainty, Real sector variables, Nonlinear ARDL, Emerging markets

Paper type Research paper

1. Introduction

The real sector of an economy can be described not only as the main driving force of the economy but also as the engine of economic growth and development. This is because the real sector is where goods and services are produced and distributed through the utilization of raw materials and other factor resources like labor, land and capital, in order to satisfy aggregate demand in the economy (Sanusi, 2011; Folarin, 2020) [1]. The importance of the real sector in an economy cannot be over stressed. Apart from the production and distribution of goods and services, the effectiveness of macroeconomic

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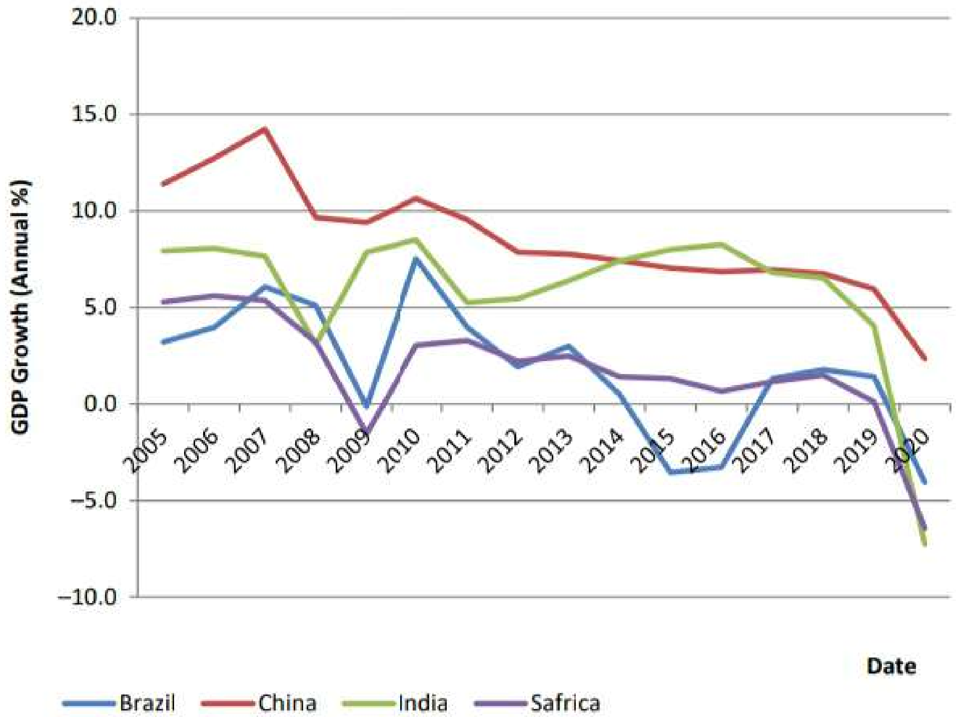
policies can be assessed through the performance of the sector. Besides, the real sector also contributes to employment creation, income generation and capacity building, and helps in bringing about economic linkages. In recent decades, the real sector in emerging market economies has transformed into an industrial powerhouse, such that these economies have become prominent on the global economic map due to their significant contributions to global output and international trade (Kose and Prasad, 2010). Their impressive growth performance has also attracted global attention in recent decades. For instance, China's economic growth and its capacity to move from underdevelopment and extreme poverty to an emerging global economic power had attracted the attention of many countries (Anyanwu, 2014). According to Kose and Prasad (2010), emerging markets' share of world output, investment, consumption and trade have almost doubled in a space of less than 20 years.

The rising prominence of emerging market economies in world economic order questions the conventional wisdom that the rest of the world catches a cold whenever the US economy sneezes. However, the rapid integration of emerging market economies into the global economy suggests that their real sectors may be prone to policy uncertainty shocks. For instance, the decline in economic activities in the selected emerging market economies around year 2020 as shown in Figure 1 may be attributed to the uncertainty shock due to COVID-19 pandemic [2]. Following the seminal work of Baker *et al.* (2016), an emerging literature has investigated the effects of economic policy uncertainty, especially in the highly advanced economies in Europe and Americas. Economic policy uncertainty may be explained in terms of ambiguity with respect to who will make economic policy decision as well as what and when economic policy decision should be made (Baker *et al.*,



Note(s): This figure illustrates the decline in aggregate GDP growth rate for Brazil, China, India and South Africa during the Global Financial Crisis and the ongoing Covid-19 Pandemic. The huge decline around the Pandemic period may be somewhat attributed to uncertainty shock occasioned by the Pandemic

Figure 1.
GDP growth (annual %), 2005–2020