

# Economics

## Namibia: Annual economic outlook

### Commodity prices to the rescue?

15 April 2010

Jan Duvenage

### Projections for 2010:

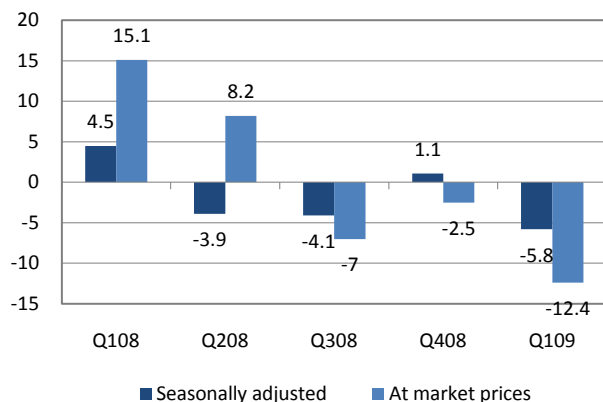
- Real GDP expected to grow by about 3.2%
- Annual inflation expected to average 6.6%
- Exchange rate expected to average NAD7.54/USD
- Trade deficit of 10.7% of GDP anticipated
- Fiscal deficit of 7.1% of GDP anticipated

### Recent trends

#### Production

The global financial crises that struck in 2008 impacted negatively on Namibia as well as the rest of the sub-Saharan African region. Namibia's quarterly real GDP growth data – available from the Central Bureau of Statistics (CBS) up to the first quarter of 2009 - shows that the economy started to contract in the third quarter of 2008, with the first quarter of 2009 showing the largest contraction.

Figure 1: Real quarterly GDP growth (%)



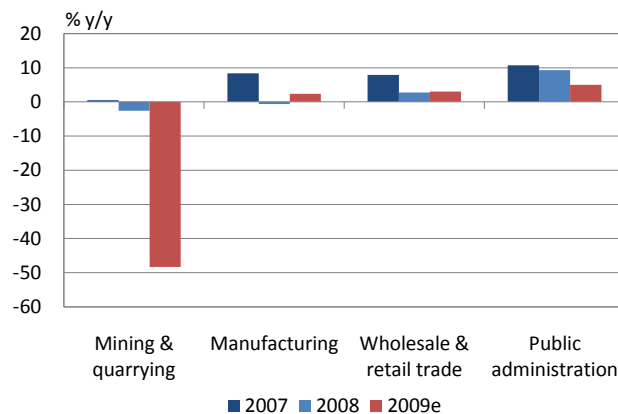
Source: Central Bureau of Statistics

In real terms, the economy contracted by 5.8% in the first quarter of 2009. This is largely explained by the sharp drop in diamond export volumes and relatively low diamond prices (see Figure 3).

The Bank of Namibia (BoN, the central bank), in its *Economic Outlook* of February 2010, estimates that the overall economy contracted by 1% in 2009.

The steep fall in most commodity prices in the last quarter of 2008 and into 2009 impacted negatively on Namibia's important mining and quarrying industry (Figure 2). In 2009 mining output contracted by an estimated 48.3%, and diamond mining by 58.2%, according to the *Economic Outlook*. Mining and quarrying contributed 15.8% of Namibia's real GDP in 2008, with diamond mining contributing about half (51%) and other mining and quarrying the remainder. Other minerals produced are gold, zinc, uranium and copper.

Figure 2: Real growth of the four largest sectors

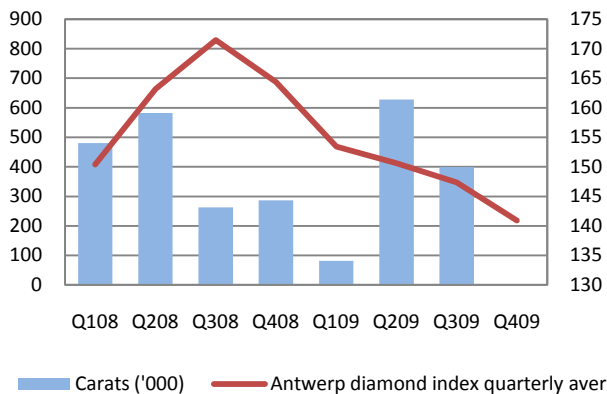


Source: Bank of Namibia

According to the *Antwerp Diamond Index* (published by the Bank of Botswana), prices dropped by 12% between January and December 2009, and by 17.4% from the peak in July/August 2008 and December 2009, in US dollar terms. The weak US jewellery market, which purchases about half the world's diamonds, is partly to blame, as US households are intent on rebuilding their devastated balance sheets, increasing their savings and avoiding luxury purchases.

Namibia's quarterly diamond production volumes dropped steeply between the second quarter of 2008 and the first quarter of 2009, but recovered in the second and third quarters of 2009, whereas quarterly diamond prices have continued to fall from the third quarter of 2008 to date.

**Figure 3: Diamond export volumes and prices (quarterly)**



Source: Bank of Namibia, Bank of Botswana

Other commodity prices also fell dramatically. The *Reuters/Jefferies CRB* index (a general commodity price index) has dropped by 57.5% from the peak in July 2008 to the low in March 2009. The index recovered by about 37.8% from the March 2009 low to March 2010.

Namibia's growing uranium mining sector increased output by over 50% in 2008 (4 366 tons) compared to 2007 (2 879 tons), according to the *World Nuclear Association (WNA)*. In 2008 Namibia was the world's fourth largest uranium producer with production of 4 366 tons, equivalent to 10% of global production, according to the WNA. Uranium prices peaked in June 2007 at about US\$136/lb, but has since dropped to about US\$42/lb. According to the Bank of Namibia's *Quarterly Bulletin* of December 2009, the uranium production index (Q1 2006=100) was just over 250 in the first two quarters of 2009, rising to about 300 in the third quarter of 2009, which was the highest index level since the first quarter of 2006. The Bank of Namibia does not publish uranium export volumes. Earnings in 2009 were negatively affected by lower uranium prices compared to 2008 and a relatively strong exchange rate.

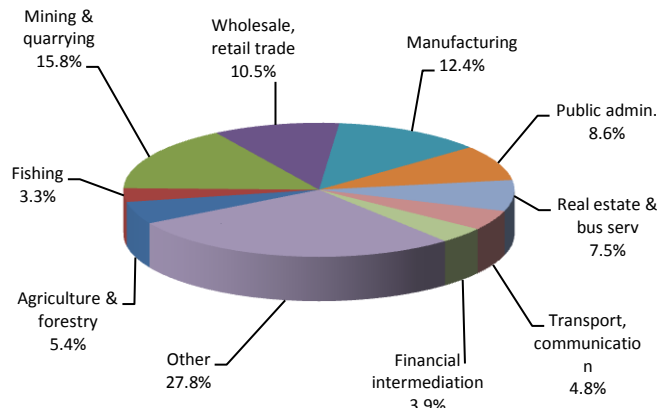
Gold export volumes fell between the last quarter of 2008, with 1 009kg exported, and the third quarter of 2009, with only 342kg exported. During the first three quarters of 2009, 1 298kg was exported compared to 2 181kg in the same period of 2008. Annual export volumes increased from 2 640kg in 2007 to 3 190kg in 2008. The gold price has risen steadily over the past few years and is currently over US\$1 100/oz.

Copper export volumes fell from 20 416 tonnes in 2007 to 16 314 tonnes in 2008. However, during the first three quarters of 2009 volumes were 15 777 tonnes compared to 11 901 tonnes over the same period in 2008, a 32.6% improvement. Fewer technical problems at the Namibia Custom Smelters aided the output increase. Copper prices also rose during 2009, from about \$3 000/MT in January to over

\$7 000/MT in December, after falling steeply in 2008. In 2009 copper prices have held above \$7 000/MT. Other mining activities include silver, lead and zinc mining.

The manufacturing sector's contribution to GDP has been relatively stable and contributed 12.4% in 2008. Manufacturing is the second largest sector after general government services. Manufacturing comprises meat processing; on-shore fish processing; the manufacturing of food products (other than meat and fish) and beverages; and other manufacturing sub-sectors (such as copper blister production and refined zinc processing).

**Figure 4: Gross domestic product by activity (2008)**



Source: Bank of Namibia

Textile and clothing manufacturing exports to the US under the African Growth and Opportunity Act (Agoa) amounted to US\$28.6 million in 2007, but collapsed to almost zero in 2008 and 2009 after the closure of the Ramatex plant located in Windhoek.

Government is a significant economic agent and general government services (public administration, education and health) contributed 18.8% of GDP in 2008. Spending on education amounted to 7% of GDP in 2008, a very high figure.

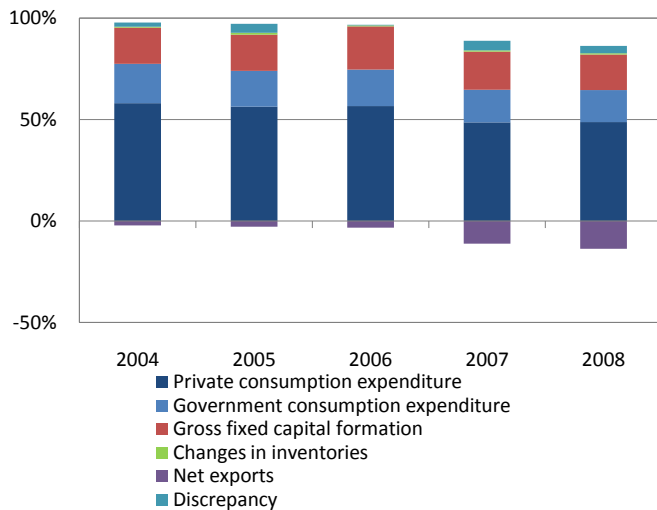
The hotels and restaurants sub-sector, which is usually taken as a proxy for the tourism industry, contributed 1.7% to GDP in 2008, almost unchanged since 2003. The tourism sector's full contribution to GDP is not directly measured in the system of national accounts (SNA), but its total contribution (through transport, accommodation, catering, recreation, other services, etc.) can be estimated by means of the satellite accounting system. The SNAs therefore underestimate tourism's full economic impact on output and employment and its contribution to GDP is measurably larger than what the hotels and restaurants sub-sector captures. The *World Travel & Tourism Council (WTTC)* provides estimates of the travel and tourism industry as well as the broader travel and tourism economy.

### Domestic expenditure

In 2009 private consumption is expected to have slowed, as the global economic recession started to take its toll, with the Namibian economy expected to have contracted by an estimated 1.1%. The mining and quarrying, and tourism sub-sectors are expected to have

been the most severely affected. Private consumption expenditure growth, which accounts for 70.6% of overall domestic expenditure, rose by 10.7% in real terms in 2008, from 9.1% in 2007. The agriculture, wholesale and retail trade, education, and the public sector are the largest employers, according to the *Labour Force Survey* of 2004, with 26.6%, 14%, 8.1% and 8% of total wage employment respectively. Mining and quarrying employed only 2% and manufacturing 6.2% of the work force. This employment distribution gives some support to private consumption as the slowdown was felt mostly in the mining sector, whereas the manufacturing, trade and public administration sectors are expected to have grown in 2009 (see Figure 2).

**Figure 5: Expenditure on GDP**



Source: Bank of Namibia

General government expenditure is expected to have grown in 2009 as the government adopted counter-cyclical and expansionary fiscal policies to counteract the economic slowdown. Monetary policy too was accommodative to support the economy, as reflected in falling interest rates. Government spending, at 22.6% of domestic expenditure, rose by 6.8% in 2008, from a 13.2% increase in 2007. This higher fiscal expenditure trend continued in 2009, according to the 2010 budget speech. Individual and business taxpayers also enjoyed generous tax concessions to stimulate consumption and investment. The fiscal stimulus could be achieved as SACU revenue remained buoyant and Namibia's tax collection had improved.

Investment spending or gross fixed capital formation is expected to have increased in 2009 from 2008. Real investment, at 25.4% of domestic expenditure in 2008, rose by 3.2% in 2008, from 12.1% in 2007. Producers of government services received the largest investment allocation of N\$2 649 million, followed by mining and quarrying with N\$2 500 million. Finance, real estate and business services (N\$1 698 million), manufacturing (N\$1 671 million) and transport and communication (N\$1 647 million) were also significant investment destinations. Construction, machinery and other equipment, and buildings were the biggest types of investment assets, and made predominantly by the private sector.

Net exports are expected to continue the same negative trend in 2009 as in 2008. Exports were negatively affected in 2008 as commodity prices and export volumes suffered declines because of the onset of the global economic crisis and plunge in commodity prices, particularly from the second half of the year. Imports rose in 2008 over 2007 as energy prices soared in the first half of the year, pushing imported fuel prices higher. In 2009 net exports are expected to have remained negative, as the food and energy imports and capital imports are expected to have remained robust, but the principal mineral export earnings to have slackened to lower levels (see Figure 5). Negative net exports are therefore expected to have continued to subtract from economic growth in 2009.

### Monetary policy

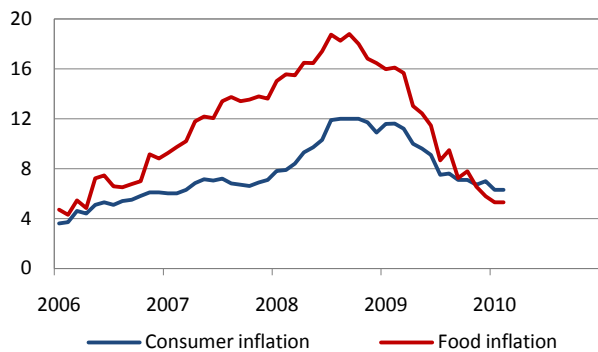
Namibia's monetary policy focuses on maintaining the Namibian dollar's peg to the ZAR under the Common Monetary Area (CMA) agreement by maintaining adequate foreign exchange reserves. The agreement stipulates that "all currency in circulation should be backed by international reserves".

Namibia's inflation is largely imported from South Africa through close trade links. Namibia's consumer inflation averaged 8.8% in 2009, below 10.3% recorded in 2008. Lower food inflation aided the downward trend.

Food inflation is the main driver of overall consumer inflation in Namibia as the food group comprises 29.6% of the overall basket in the consumer price index (CPI). Food inflation decelerated to an average of 10.8% in 2009 from 17% in 2008. Food prices have risen faster than the overall inflation rate since October 2005, peaking at 18.8% in September 2008, but in November 2009 food inflation fell to below the overall inflation rate. Housing, water, electricity and maintenance costs (which make up 20.6% of the CPI) also contributed to price pressures in 2009. This group recorded an average inflation rate of 7.8% in 2009, up from 4% in 2008. Namibia provides nearly half of its own electricity needs. The bulk of the balance is imported from the Southern African Power Pool (SAPP) and South Africa's Eskom.

Transport prices (which constitute 14.5% of the CPI) were significantly lower in 2009 at an average of 6%, compared to 12.9% in 2008 on the back of the lower average international crude oil price. The Organization of the Petroleum Exporting Countries (Opec) basket price averaged US\$61.06 per barrel in 2009, below the 2008 average of US\$94.45 per barrel, during which the oil price peaked.

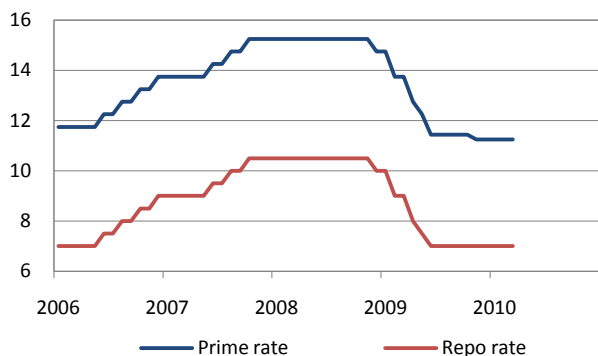
**Figure 6: Consumer price inflation (%)**



Source: Bank of Namibia

In 2009 interest rates declined in line with lower inflation. The bank rate, the official policy interest rate, fell from 10% in January to 7% in June 2009, a 300 basis points drop, where it remains. The prime rate fell by a larger magnitude, 350 basis points, from 14.75% to 11.25% over the same period. The spread between the bank and prime rates narrowed from 475 basis points in the period preceding January 2009 to 425 basis points from February 2009 to date. This is the result of the central bank exerting “moral suasion” on commercial banks to narrow the differential between Namibia’s bank and prime rates as well as Namibia’s and South Africa’s prime rates.

**Figure 7: Interest rates (%)**



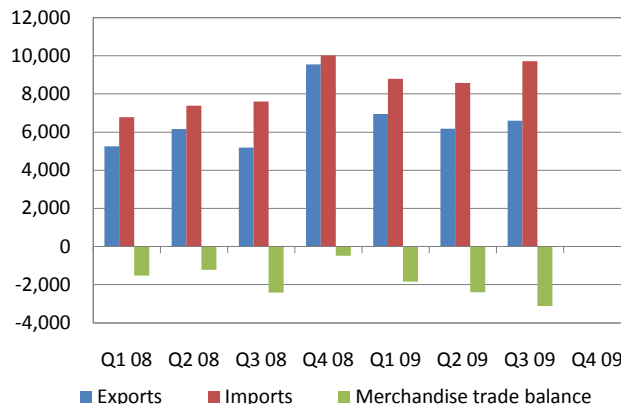
Source: Bank of Namibia

**International trade**

Mineral exports, at 61% of total exports, are the backbone of the export sector. Exports amounted to N\$19 728 million in the first three quarters of 2009, despite weaker diamond export earnings. In comparison, exports amounted to N\$16 608 million over the same period in 2008. Exports of diamonds amounted to only N\$430 million in the first quarter of 2009, a particularly weak period (see Figure 3), but recovered to N\$1 430 million in the second quarter and N\$1 428 million in the third quarter, bringing the total over this period to N\$3 288 million. Exports of other mineral products, such as uranium, dropped from N\$1 976 million in the first quarter to N\$1 182 million in the third quarter. The composition of mineral exports in 2006 in US\$ terms were diamonds: 70%, uranium: 15%, zinc: 7%, gold: 3%, copper: 3% and other: 2%, according to the IMF. Namibia’s main

export destinations are South Africa with 31.8%, European Union with 28.8% and Angola with 8.6% of total exports (2008), according to the World Trade Organisation (WTO).

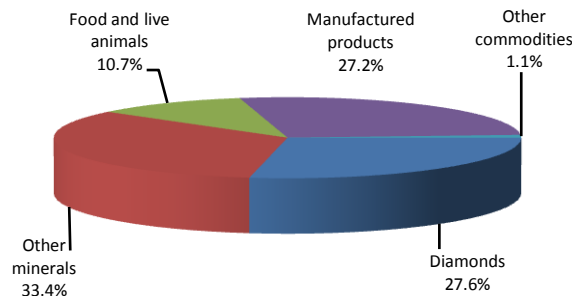
**Figure 8: Quarterly merchandise trade (N\$ million)**



Source: Bank of Namibia

Exports of manufactured products, food and live animals and other commodities were relatively stable. The stronger exchange rate negatively affected export earnings (see Figure 7) and the global economic downswing resulted in softer global effective demand for mineral and other commodities throughout this period.

**Figure 9: Composition of merchandise exports (2008)**



Source: Bank of Namibia

Imports remained high during the first three quarters of 2009 on account of high private sector imports of capital goods for construction, particularly in the third quarter. Over the three quarters period imports amounted to N\$27 086 million, compared to N\$21 766 million in the first three quarters of 2008. Namibia’s fuel imports were underpinned by the rising cost of crude oil, which doubled from about US\$40 per barrel in January to nearly US\$80 per barrel in December 2009.

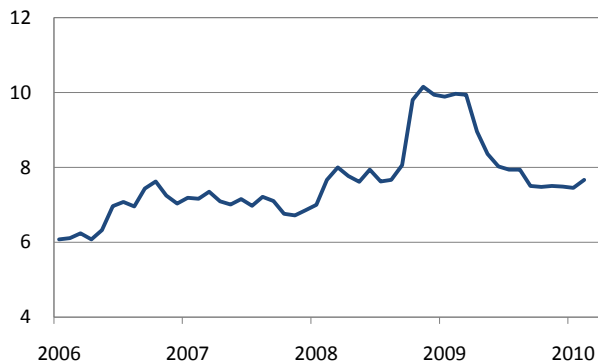
Imports are largely sourced from South Africa, whence 67.8% of total imports originated, followed by the European Union with 15.8% and India with 3.5% (2008), according to the WTO. The two countries’ close trade ties are further enhanced by regional membership of the Common Monetary Area (CMA) and Southern African Customs Union (SACU), discussed below.

Lacklustre exports and increasing imports resulted in rising trade deficits in the first three quarters of 2009. In the first quarter the merchandise trade deficit was N\$1 846 million, rising to N\$2 392 million in the second and N\$3 120 million in the third.

### External sector

Namibia's quarterly merchandise trade deficits were offset by strong inflows on the services, income and transfers (SIT) accounts, resulting in large current account surpluses during the first nine months of 2009. A dominant share of SIT emanates from Southern African Customs Union (SACU) revenue, classified as a current transfer. Transfers (mostly from the SACU) rose in the first three quarters of 2009 compared to the same period in 2008, but was relatively stable during 2009 (N\$2 666 million in the first quarter, N\$2 674 million in the second and N\$2 656 million in the third of 2009). The positive SIT accounts pushed the current account into small surpluses of N\$370 million in the first, N\$337 million in the second and N\$196 million in the third quarter of 2009. SACU receipts remained strong throughout the first nine months of 2009, despite a slowdown in intra-SACU trade, an important component of the SACU receipts and the revenue-sharing formula. This is the case because SACU payments in 2009 were based on over-optimistic trade projections. It has been suggested that SACU revenue over-payments may have to be refunded, which will put additional fiscal strain on the smaller members.

**Figure 10: Exchange rate, monthly (NAD/USD)**



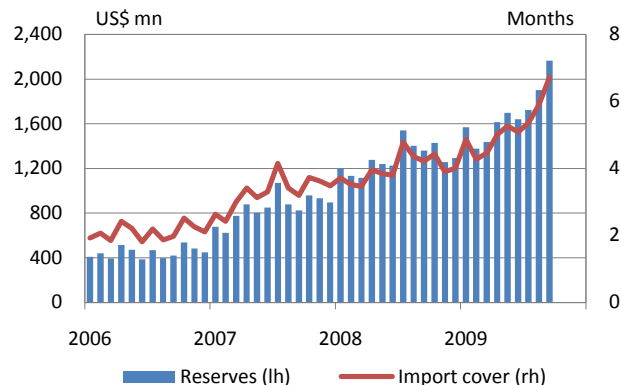
Source: Bloomberg

The strengthening of the Namibian dollar during 2009 – from a monthly average of NAD9.89/USD in January to NAD7.48/USD in January 2010 – is a consequence of global risk appetite for emerging market assets reviving in 2009 after suffering a severe curtailment during the global financial crisis in 2008. In terms of annual averages, the currency traded at NAD8.22/USD in 2008, weakening marginally to NAD8.42/USD in 2009.

Namibia's balance of payments surpluses have enabled government to build up foreign exchange reserves. Reserves amounted to US\$1 957.4 million in September 2009, the latest available, equivalent to about 5.6 months of imports. This is significantly higher than the reserves in the year before, which amounted to US\$1 359.7 million and with import cover of 4.2 months. Namibia's international

reserves were bolstered by the IMF's global liquidity injection of August and September 2009 to supplement members' foreign exchange reserves. The Special Drawing Rights allocation amount is based on the relative size of the economy. Namibia received a total of SDR130.4 million (about US\$192 million), resulting in an increase of US\$214.7 million in its international reserves in September.

**Figure 11: Gross foreign exchange reserves and import cover**



Sources: Bloomberg, Bank of Namibia

Namibia's Fitch rating of BBB- (awarded in 2005) has remained unchanged despite the global economic slowdown and some other neighbouring countries receiving downward rating adjustments. This may change as the full impact of the global downturn on Namibia may have been delayed, but a major downgrade is unlikely.

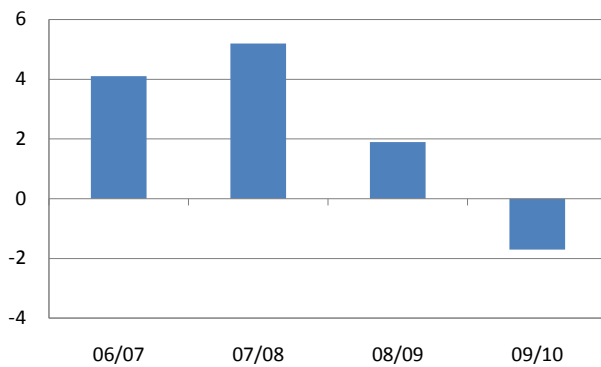
### Public and external solvency indicators

Namibia's government accounts, like other Southern African Customs Union (SACU) members, excluding South Africa, will continue to be negatively affected by the global economic slowdown, because fiscal revenue from this source is expected to be well below the windfall levels enjoyed in previous years.

The budget surplus in 2008/09 is largely the result of strong SACU receipts. SACU receipts are equivalent to 36% of total tax revenue, including grants. The steep rise in SACU receipts during the boom period up to 2007 is largely based on South Africa's high economic growth rate, as it accounts for about 60% of intra-SACU imports, according to the IMF. The change in the revenue-sharing formula also boosted the receipts of the smaller SACU members, such as Lesotho, Namibia and Swaziland.

The Ministry of Finance in the latest *Medium Term Expenditure Framework* (MTEF) for the period 2009/10 – 2011/12, estimates the budget deficit of 1.6% of GDP (revised) for 2009/10. The deficit in 2009/10 follows three years of budget surpluses. The 2009/10 deficit can be attributed to the deepening global financial crisis negatively affecting revenue collection from internal sources, mainly domestic taxes on goods and services, as well as external sources, mainly from taxes on international trade (SACU).

Figure 12: Budget balance (% of GDP)



Source: Ministry of Finance, MTEFs, budget speeches

## National policy assumptions and the international environment

Namibia's long-term economic development is shaped by *Namibia Vision 2030 – Policy Framework for Long-Term National Development*, published by the Office of the President in 2004. Vision 2030 envisages “A prosperous and industrialised Namibia, developed by her human resources, enjoying peace, harmony and political stability”. It is built on the first *National Development Plan* (NDP1), which covered the period 1995 to 2000.

According to *Vision 2030*, the Gini coefficient, a measure of income inequality, is also programmed to decline from 0.69 in 2001 to 2005 to 0.3 in 2026 to 2030. Similarly, the fiscal balance should improve from a deficit of 3.2% of GDP in 2001 to 2005 to a balanced budget in 2026 to 2030. The trade balance, however, is projected to remain negative at 3.6% of GDP over the full period 2001 to 2030.

The current development plan is NDP3, published in 2008 by the Office of the President, and runs from 2007/08 to 2011/12. The theme is “Accelerated Economic Growth and Deepening Rural Development”. NDP3's main objective is to establish an industrialised country. NDP3 projects an average real GDP “baseline” growth rate of 5% per annum over the five-year period. NDP1 recorded average economic growth of 3.5% and NDP2 growth of 4.7%. Total public, private and foreign investment of N\$76.3 billion is required to achieve the baseline growth target. Socio-economic targets include poverty reduction, higher primary school enrolment, achieving gender parity in school enrolment, improving adult literacy, better access to potable water, etc. Baseline growth of 5% is expected to result in average employment growth of 2.6% a year during NDP3.

Presidential, national assembly and local elections were held in November 2009. The ruling party, SWAPO, obtained three quarters of the popular vote. Namibia follows a proportional representation system. Some eight political parties have not accepted the results and voiced their dissatisfaction with the Electoral Commission of Namibia for contravening the electoral law. However, observers have regarded the elections as generally free and fair.

## Monetary policy

Namibia's membership of regional organisations is important to understanding its economy. Namibia is a member of the Common Monetary Area (CMA) together with Lesotho, South Africa and Swaziland. Namibia's monetary policy is effectively determined by the South African Reserve Bank's (SARB) monetary policy. The SARB's inflation target range of 3-6% is therefore of relevance to Namibia's monetary policy objectives. Although the Bank of Namibia's Monetary Policy Committee (MPC) no longer meets on the same days as the SARB's MPC, signalling a degree of policy independence, Namibia's monetary policy is largely circumscribed by the SARB's monetary policy.

Because over 80% of Namibia's imports were sourced from South Africa and CMA membership, Namibia's inflation rate closely tracks South Africa's. According to a Bank of Namibia research paper, about 65% of Namibia's inflation is imported from South Africa. Differences in the CPI weights, for example, food, high transport costs and other domestic cost factors result in Namibia's inflation differing from South Africa's.

Namibia's interest rates cannot diverge by a large margin from South Africa's rates, as the CMA permits the free transfer of funds for current and capital transactions between its members. Funds could therefore flow to the country with higher interest rates if the differential becomes favourable. This does not imply that interest rates need to be identical. The BoN monitors interest rate differentials to ensure that fund outflows do not occur, and which may threaten the currency peg.

The Namibian dollar is pegged at par (1:1) to the South African rand under the CMA agreement. Foreign exchange reserves are used mainly to support the Namibian dollar's peg to the rand. Namibia's monetary policy focuses on maintaining the Namibian dollar's fixed peg to the rand by maintaining adequate foreign exchange reserves. The interest rate spread between Namibia's and South Africa's rates need to be at a level that support the fixed peg; that is, narrow enough to prevent an outflow of funds from Namibia.

## External sector

Namibia is also a member of the Southern African Customs Union (SACU), a free trade area, whose other members are Botswana, Lesotho, South Africa and Swaziland. The SACU, which is a century old this year, has promoted fiscal stability and prosperity for its members. Several modifications to the agreement have been implemented since inception and the most recent changes were introduced in 2002. Negotiations are ongoing to continue the modernisation process. The revenue-sharing formula, which determines the member country's revenue allocation, is based on three components: customs revenues, excise revenues and level of economic development. SACU payments are based on projected variables and actual payments to members do not as yet reflect the sharp deceleration in trade in 2008.

The pegged Namibian dollar's exchange rate is directly dependent on the underlying economic factors determining the South African rand's exchange rate, whereas Namibian economic factors do not affect the value of the currency. The rand, however, is a liquid, market-determined and floating currency. The exchange rate is therefore determined by global market forces, which are extremely difficult to forecast. The rand is also legal tender in Namibia, but not vice versa.

Namibia is one of a few countries with an investment-grade sovereign credit rating in SSA. It attained its first sovereign rating by Fitch Ratings in December 2005, which was affirmed in October 2007. Namibia's investment-grade sovereign ratings are: BBB- under Long-Term Issuer Default Rating with a stable outlook; BBB under Local Currency Long-Term Issuer with stable outlook; and F3 under Short-Term Issuer Default Rating. A Country Ceiling rating of A captures the dynamics of Namibia's CMA membership.

### Fiscal policy

The *Medium Term Expenditure Framework* (MTEF) guides the country's fiscal policy, objectives and targets for two-year periods. Some fiscal targets set by the MTEF for 2009/10 – 2011/12 were to maintain 1) public expenditure at an average of 30% of GDP, 2) a budget deficit not greater than 3% of GDP; and 3) public debt not exceeding 25% of GDP. Generally, the MTEFs aims to target sectors with high growth and employment potential and infrastructure development, and strengthen the social safety nets.

The latest *Medium Term Expenditure Framework* (MTEF), released in March 2010, guides the country's fiscal policy, objectives and targets for the period 2010/11 to 2012/13. MTEF 2010 projects economic growth to average 3.8% in 2010, 4.2% in 2011, 4.8% in 2012 and 4.2% in 2013. The economic growth rate required to meet the Millennium Development Goals for the MTEF period, however, is 7% per year, whereas actual growth achieved has been below this target. The MTEF projects budget deficits of 1.6% of GDP in 2009/10 (revised), 7.1% in 2010/11, 8.2% in 2011/12 and 4.4% in 2012/13.

The total public debt is projected at 15.1% of GDP in 2009/10 (revised), 20% in 2010/11, 26.8% in 2011/12 and 29% in 2012/13. Total public debt is largely composed of domestic debt. In 2009/10, for example, the total public debt stock of N\$12 173.1 million was made up of domestic debt stock of N\$8 785.9 million (a 72.2% share) and foreign debt stock of N\$3 387.2 million (a 27.8% share). This leaves room for some additional external borrowing, as the foreign debt share is relatively small and Namibia has an investment-grade sovereign credit rating.

The projections made in the MTEF mostly fall short of the targets set, which are fully explicable under current global and regional circumstances. The MTEF targets are unlikely to be met in the short or medium term, given the severity of the global recession, and notwithstanding the positive global and regional growth outlook envisioned by international donor organisations.

### International environment

World economic growth is expected to recover in 2010 to 3.9% after suffering from one of the most severe global recessions in 2009 and contracting by 0.8%. The advanced economies suffered greater contraction from the credit crunch than the emerging and developing economies; the former group of countries contracted by a massive 3.2%, whereas the latter group grew by 2.1% in 2009, supported largely by high growth in China and India. Africa and sub-Saharan Africa (SSA) fared less well than other developing regions, growing by 1.9% and 1.6% respectively. The main reason for the slower growth in SSA is the commodity-intensive nature of the region's exports, which suffered severe cutbacks, excluding oil, because of a sharp drop in commodity prices at the end of 2008, and which remained relatively low in 2009, and a contraction in global trade. South Africa, the regional powerhouse, contracted by 1.8% in 2009.

Looking ahead, the global economy is expected to return to positive growth in 2010 and 2011. Africa and sub-Saharan Africa are expected to grow by 4.3% in 2010 and 5.3% in 2011. China, which is becoming an important destination for SSA's commodity exports, is expected to grow by 10% in 2010 and 9.7% in 2011. Standard Bank forecasts that South Africa will grow by 2.6% in 2010 and 3.7% in 2011.

**Table 1: Global economic outlook**

	Real GDP growth % (year-on-year)			
	2008	2009	2010p*	2011p*
World	3.0	-0.8	3.9	4.3
Advanced economies	0.5	-3.2	2.1	2.4
United States	0.4	-2.5	2.7	2.4
Euro-area	0.6	-3.9	1.0	1.6
United Kingdom	0.5	-4.8	1.3	2.7
Japan	-1.2	-5.3	1.7	2.2
Emerging and developing economies	6.1	2.1	6.0	6.3
China	9.6	8.7	10.0	9.7
India	7.3	5.6	7.7	7.8
Brazil	5.1	-0.4	4.7	3.7
Russia	5.6	-9.0	3.6	3.4
Africa	5.2	1.9	4.3	5.3
Sub-Saharan	5.6	1.6	4.3	5.5
Developing Asia	7.9	6.5	8.4	8.4

\* p = projection

Source: IMF

However, there are substantial downside risks to the optimistic growth forecasts as structural imbalances persist on global as well as national economic levels, particularly in the developed countries. In the US and other developed countries, high unemployment, high fiscal deficits and rising domestic debt levels are threats to macroeconomic stability and fiscal sustainability. These are new problems that these governments will need to address, but which do not have a quick remedy.

## Forecast summary

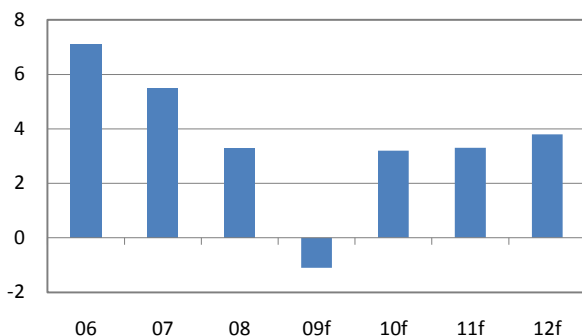
### Growth outlook

As a relatively open economy and commodity exporter, Namibia cannot escape the global economic as well as commodity cycle trends. According to the Bank of Namibia's *Economic Outlook* (EO), published in February 2010, the economy is expected to grow by 4.2% in 2010. The Minister of Finance, in her March budget speech, projected that the economy will grow by 3.8% in 2010 and by an average of 4.4% between 2011 and 2013. These relatively robust growth rates are therefore predicated on a global economic recovery and sustained increase in commodity prices.

According to the BoN's EO, the mining and quarrying sector (15.8% of GDP) is expected to grow by 15.2%, whereas the diamond mining sub-sector (7.5% of GDP) is expected to grow by 18.8% in 2010. The base effect is evident, as the two sectors crashed by 48.3% and 58.2% respectively in 2009. In real terms, mining and quarrying output is projected at N\$2 752 million in 2010, whereas output was significantly higher at N\$4 621 million in 2008, before the crash. The calculated percentage changes mask the extent of the damage done to output levels. Diamond mining output is similarly affected, potentially halving from N\$3 830 million in 2008 to a projected N\$1 904 million in 2010 in real terms.

Manufacturing (12.4% of GDP) is projected to grow by 2.9% and wholesale and retail trade (10.5% of GDP) by 3.6% in 2010. The relatively small construction sector (4.1% of GDP) is expected to be the strongest performer in 2010 and is projected to grow by 12%, continuing the strong growth shown over the past few years.

Figure 13: Real GDP growth



Sources: Bank of Namibia, Standard Bank est.

Our forecasts are that the economy will grow by 3.2% in 2010, 3.3% in 2011 and 3.8% in 2012, which is below the projections outlined above. These forecasts are less sanguine than the BoN and the MoF, because we maintain that the global recovery is fragile and new problems are emerging that could scupper a full economic recovery and which may impact negatively on global economic growth for many years. For example, high unemployment, rising fiscal deficits and high levels of sovereign indebtedness in many developed countries, among other factors, could moderate and delay the

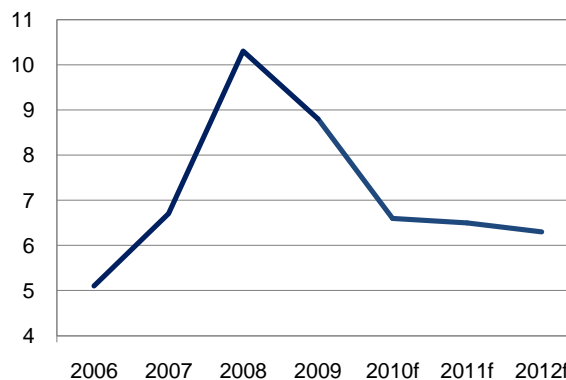
economic recovery. Fiscal sustainability could become an overriding concern in many developed and developing countries alike and sovereign debt defaults may occur, which could destabilise global financial markets. Deflation – which has afflicted the Japanese economy since the early 1990s – is also a threat in some mature economies, such as the US. High-growth emerging economies, such as China, are unlikely to fully compensate for the weakness in the industrialised economies. Therefore, commodity exports could be impacted negatively through subdued price levels and low volumes, an important source of growth for many SSA countries and Namibia in particular. Slower economic growth in China, which is reported to consume a third of the world's base metals, could be a setback to the strong metals prices seen in recent months.

Significant investments in Namibia's electricity sector are in the pipeline. This will boost the country's energy-intensive mining as well as manufacturing sectors and raise their productive capacity in the longer term. These investments are the installation of a fourth unit at the Ruacana Hydro Power Station on the Kunene River, the Caprivi Link Interconnector (linking the Namibian, Zambian and Zimbabwean transmission networks), the gas-to-power Kudu Power Project and the emergency diesel power plant at Walvis Bay. Other potential power projects are the coal-fired power station at Walvis Bay, the Orange River mini hydro power stations and the Baines hydro station, to meet the rising demand for electricity, particularly in the mining sector.

### Monetary policy

Inflation in Namibia is expected to fall in line with South African trends as consumer inflation is largely imported from South Africa. Standard Bank expects South Africa's consumer price inflation to fall to an average of 5.4% in 2010, 5.4% in 2011 and to 5.5% in 2012; that is, to within the South African Reserve Bank's inflation target range of 3-6%.

Figure 14: Consumer price inflation (% annual average)



Sources: Bank of Namibia, Standard Bank est.

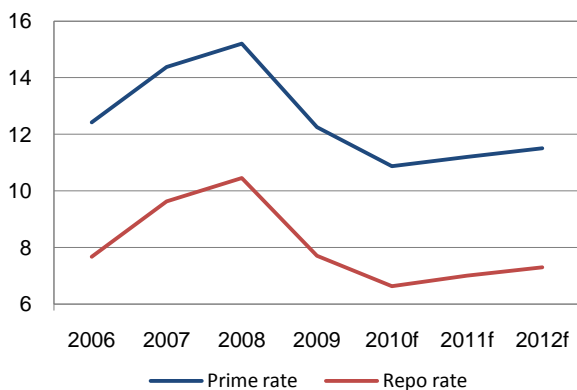
A relatively benign crude oil price, which averaged US\$61.1 per barrel (Opec basket) in 2009 from US\$94.5 per barrel in 2008 and which is currently trading at about US\$80 per barrel, will help contain price

pressures. Food price changes are also expected to remain at low levels. The strong currency has generally supported the easing of price pressures.

Namibia's consumer inflation is expected to fall to an average of 6.6% in 2010 from 8.8% in 2009. Thereafter, prices could drop marginally to 6.5% in 2011 and 6.3% in 2012. Our forecast for Namibia's CPI is somewhat higher than South Africa's, because some firms have comparatively stronger pricing power in Namibia and prices therefore tend to be sticky downwards. Transport costs are also higher compared to South Africa, as Namibia is relatively under-populated with an extremely low population density. Namibia's population density of two per square kilometre (pop/km<sup>2</sup>) is the lowest in Africa, with an average of 30 pop/km<sup>2</sup>, and well below South Africa's 39 pop/km<sup>2</sup> (in 2005).

South Africa's prime interest rates are expected to remain unchanged for the rest of 2010, but start rising in 2011, possibly as early as the first quarter the year. In March the SARB surprised financial markets by dropping the repo rate, the policy rate, by 50 basis points to 6.5%, the lowest in almost 30 years. South Africa's prime rate is 10% with a 350 basis points spread over the bank rate, the policy rate.

**Figure 15: Interest rates (% annual average)**



Sources: Bank of Namibia, Standard Bank est.

As the BoN's next MPC meeting is on 21 April, no bank rate announcement has yet been made (the BoN's MPC meeting dates no longer coincide with the SARB's MPC dates), but the BoN is expected to follow suit with a 50 basis points cut. As mentioned, Namibia's interest rates cannot diverge by a large margin from South Africa's, because the CMA agreement permits the free transfer of funds between members.

Namibia's bank rate is currently 7% (on par with South Africa's repo rate) and the prime rate is 11.25%, a 425 basis points spread. Since the end of 2009 the spread has narrowed by 50 basis from 475 basis points. The narrower spread is a consequence of the central bank's "moral suasion" campaign to lower the cost of funds to the public. Namibia's prime rate is expected to average 10.9% in 2010, 11.2% in 2011 and 11.5% in 2012.

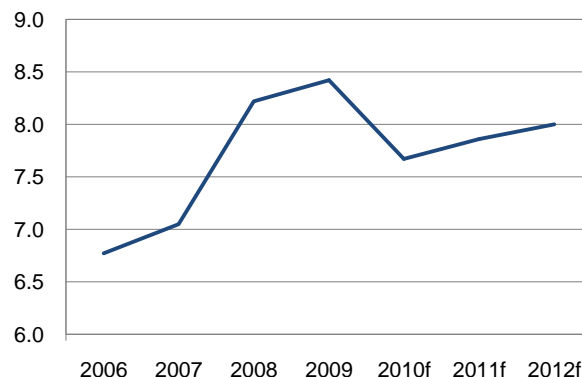
An overriding concern for the central bank is likely to be supporting economic growth rather than combating inflation. Excess capacity in the economy is most likely a concern for the authorities. However, the interest rate cycle has probably bottomed and interest rate increases could be expected, as inflation is expected to settle at above 6% over the next three years. Although the growth objective is expected to outweigh the price stability objective for some time to come, the central bank will raise interest rates if inflationary pressures reappear.

### External sector

The exchange rate is expected to strengthen in 2010 to average NAD7.67/USD, compared to NAD8.42/USD in 2009, according to Standard Bank forecasts. In 2011 and 2012 a weaker trend is expected. The Namibian dollar is expected to trade at an average of NAD7.86/USD in 2011 and NAD8/USD in 2012.

The weaker Namibian dollar/rand is largely based on expectations of greater risk appetite towards emerging markets. The positive inflation differential vis-à-vis the main trading partners also tends to weaken the exchange rate over time. However, the gold price has held on to recent gains, trading at above US\$1 100 per ounce, with the precious metal being perceived as a safe haven for investors in uncertain times. The platinum price has also supported the rand. These factors will help prevent a sharply weaker exchange rate.

**Figure 16: Exchange rate, NAD/USD (annual average)**



Sources: Bloomberg, Standard Bank est.

The weaker currency in 2011 and 2012 will boost export earnings and could support economic growth. Unlike some developing countries that manage their currencies at weak levels to promote exports, such as China, it is unlikely that the free-floating and market-determined rand will be managed lower by the South African authorities to support the export sector.

Diamond and other mineral export earnings are expected to be lower over the next few years, thus the trade account is expected to come under pressure. Lower domestic economic growth will reduce demand for consumer imports, but investment goods imported for power infrastructure and construction could underpin import growth.

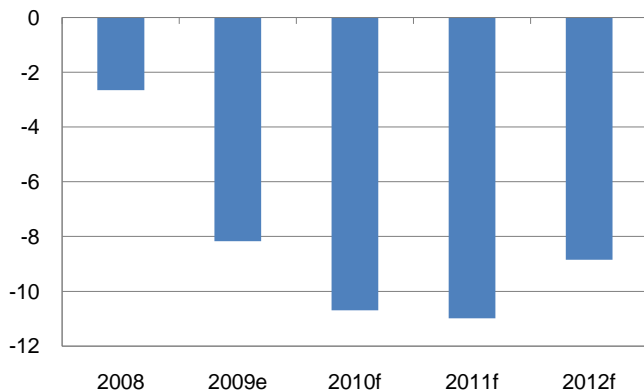
The tourism sector could experience an improvement in 2010, as the decline in international arrivals and tourist spending is expected to

have been reversed. Namibia's tourism sector, as a long-haul destination, is expected to only recover gradually, because consumers in the developed countries are rebuilding their household wealth. The Soccer World Cup being hosted in South Africa in June/July could boost tourism spending to some extent, but economic spin-offs on neighbouring countries are expected to be subdued.

Exports of food (fish and meat) may be affected by a decline in overall consumer demand in the main export markets, such as Spain, the UK and South Africa. The fishing industry may experience some relief from lower fuel prices, a weaker exchange rate and higher fish prices on the back of declining global fishing stocks.

Relatively large trade deficits could therefore be expected in 2010 and 2011, but from 2012 onwards the deficit is expected to start improving as commodity prices and hence export earnings recover.

**Figure 17: Trade balance (% of GDP)**



Sources: Bank of Namibia, Standard Bank est.

### Fiscal policy

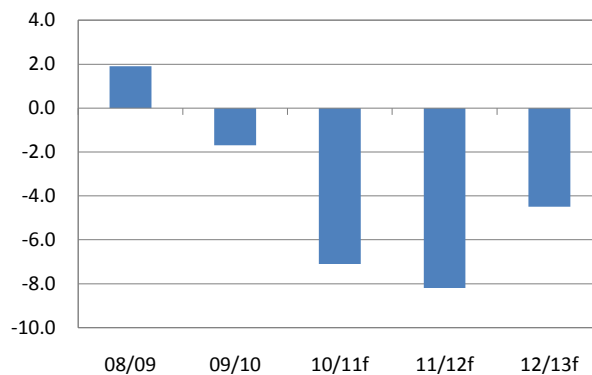
In anticipation of the revenue cutbacks, South Africa's Minister of Finance recently announced that SACU transfers to members will be reduced by about 20%. Also, any overpayment of distributions to SACU members will need to be repaid, as the sharp drop in SACU revenue was not anticipated.

The fall in SACU revenue is worse than had been anticipated. Namibia's Minister of Finance, Saara Kuugongelwa-Amadhila, who delivered the 2010 budget speech on 30 March, projected that Namibia's SACU income will plunge by 47% in 2010/11 and by a further 45% in 2011/12. At the same time, the *Medium Term Expenditure Framework* (MTEF) for 2010/11 to 2012/13 was also released. The MTEF shows that "Taxes on international trade" (largely SACU revenue) are expected to drop from an estimated N\$8 585 million in 2009/10 to N\$5 975 in 2010/11 (a 30% drop), to N\$2 828 million in 2011/12 (a further 53% drop). In 2012/13, however, taxes on international trade are projected to rise to N\$5 939 million (a 110% increase). Despite this large expected increase, SACU receipts in 2011/12 will still be significantly below 2009/10 levels.

The minister projected that the fiscal deficit will escalate to 7.1% of GDP in 2010/11, from a smaller deficit of 1.7% of GDP in 2009/10. In 2011/12 a larger deficit of 8.2% is expected.

As with the many countries adversely affected by the credit crunch and whose fiscal accounts are in disarray, Namibia will need to deal with fiscal sustainability over the next decade or longer. A gradual but arduous path to more sustainable fiscal accounts can be expected. Total public debt is projected to rise to almost 30% of GDP in 2012/13, according to the MTEF (see above), with foreign borrowing possibly increasing its share in relation to domestic borrowing, particularly if concessional terms can be arranged.

**Figure 18: Fiscal balance (% of GDP)**



Source: Ministry of Finance, MTEFs, budget speeches

### Outlook

Namibia did not escape the severe global economic downturn. However, its sound banking system was not directly affected by the subprime crisis, as Namibian banks were not holders of subprime-related instruments. The impact of the downswing was felt indirectly through the transmission mechanism of a slowing global economy, low effective global demand and commodity prices falling to well below their 2008 peaks. The recovery anticipated over the next few years will be built primarily on Namibia's dynamic export sector, that is, on external factors, rather than domestic demand factors, the internal factors, although the latter will help boost growth in the long term (for example, the power sector).

Inflation has fallen to more acceptable levels and is expected to remain relatively subdued over the forecast period. It is not, however, expected to fall to within the upper limit of the *de facto* 3-6% target range, but to stay marginally above the upper limit.

Interest rates dropped in 2009 in line with South African trends. Moreover, the central bank has persuaded commercial banks to narrow the spread between the policy and prime rates to 425 basis points, bringing it closer to South Africa's narrower margin of 350 basis points, thus lowering the cost of credit. Interest rate increases are expected to be subdued in 2010.

The exchange rate of the rand to which the Namibia dollar is pegged, is one of the most liquid and traded currencies in the world. The

exchange rate should weaken marginally over the next three years, bringing some relief to the important export sector. By itself, however, a weaker currency is not a substitute for improving the overall productivity and efficiency in the economy.

Lower SACU receipts, which will result in lower current account inflows (i.e. lower transfers) as well as lower fiscal revenues, is one of the country's main economic vulnerabilities because other sources of revenue cannot be found in the short term to offset the lower SACU income. This may imply fiscal tightening at a time when monetary and fiscal policies must be mutually supportive to stimulate the flagging economy. So far the authorities have managed to avoid such a scenario. The fiscal balance is expected to peak at a deficit of just over 8% of GDP in 2011/12, but revert to more stable levels over time. The large fiscal deficits are not unexpected under current economic circumstances; a number of other emerging markets as well as developed countries are facing even larger deficits to support their own economies.

Commodity prices are also expected to remain at relatively subdued levels compared to the peaks reached in the middle of 2008, but growth in emerging markets such as China, if sustained, will underpin commodity prices, particularly metals and minerals. Therefore, the trade balance could remain under pressure over the forecast period.

National elections, which were held in November 2009, were won by the ruling party, Swapo, by a large margin. This sweeping victory should enable the authorities to continue with their macroeconomic plan to maintain and ensure prudent policy, fiscal sustainability and macroeconomic stability.

## Namibia

### Forecasts

	2006	2007	2008	2009e	2010f	2011f	2012f
<b>National Accounts</b>							
Gross domestic product (millions of constant N\$)	46,853	49,432	51,073	50,511	52,128	53,848	55,894
Real GDP growth (%)	7.1	5.5	3.3	-1.1	3.2	3.3	3.8
Final consumption expenditure of households (% change)	8.7	9.1	10.7	-3.0	3.1	4.0	4.5
Gross fixed capital formation (% change)	29.8	12.1	3.2	-1.0	5.5	6.0	6.5
<b>Prices</b>							
Inflation (%)	5.1	6.7	10.3	8.8	6.6	6.5	6.3
<b>Monetary sector</b>							
Interest rate (%) - prime rate (average)	12.4	14.4	15.2	12.2	10.9	11.2	11.5
Exchange rate (NAD/USD)	6.77	7.05	8.22	8.42	7.54	7.63	8.00
<b>External sector</b>							
Trade balance (% of GDP)	3.9	-1.3	-2.6	-8.2	-10.7	-11.0	-8.8
<b>Public sector (fiscal years)</b>							
Fiscal balance (% of GDP)	4.1	5.2	1.9	-1.7	-7.1	-8.2	-4.5

Sources: Bank of Namibia, Ministry of Finance, IMF, Standard Bank est.

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