Institute for Public Policy Research
14 Nachtigal Street PO Box 6566 Ausspannplatz Windhoek Namibia Tel: +264 61 240514 Fax: +264 61 240516 economist@ippr.org.na www.ippr.org.na

Economy Watch Namibia – May 2014

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Inflation rate trends

Inflation – price increases in per cent for goods and services compared to the previous month (monthly inflation rate) or the same month in the previous year (annual inflation rate).

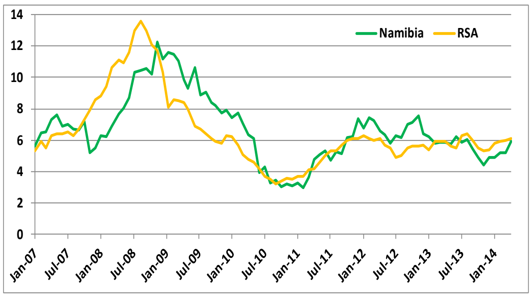
Inflation has continued its **upward trend** in Namibia and the region. The inflation rate for Namibia climbed to 5.9 per cent in April up from 5.2 per cent a month earlier and a low of 4.4 per cent in November 2013. **Food and transport price** increases were the **main drivers** for this increase. These two components account for 16.5 per cent and 14.3 per cent of the consumption basket. Prices are also picking up for the largest component of the consumption basket: housing, water, electricity etc. accounting for 28.4 per cent. While the inflation rate for these items remains with 3.5 per cent below the average inflation rate, food price increases have climbed to 8.9 per cent and transport inflation to 9.4 per cent. Meat prices have seen the **strongest rise** since beginning of the year with 13.9 per cent in April compared to 7.7 per cent in December. The price increases can be attributed to improving grazing conditions, a restocking of herds and subsequently lower supply. The introduction of stringent veterinary requirements by the South African authorities on meat imports – virtually banning Namibian meat from the South African market – will not necessarily increase the supply of meat to the domestic market and hence ease the price pressure. It is mostly weaners that are exported to South African feedlots and not slaughterable cattle. **Vegetable prices rose** also at double-digit speed (14.2 per cent); a trend that started one and a half years ago in October 2012. The prices for bread and cereals increased by 9.7, for fruits by 7.6 and for milk and cheese by 7.2 per cent.

Transport inflation was fuelled to a large extent by **higher prices for vehicles** (up by 10.5 per cent) and the costs for public transport (plus 10.8 per cent), while utility price increases were responsible for the slightly higher inflation rate for housing etc. Prices for water went up by 12.1 per cent and for electricity by 10.3 per cent. This trend is expected to continue.

High inflation rates are usually **not good for the economy**, since they create uncertainties about future input costs and profits for producers. They also hit the consumers and in particular the poor and low-income earners who do not own assets and whose income, including social benefits (if there are any), are not regularly adjusted for price increases.

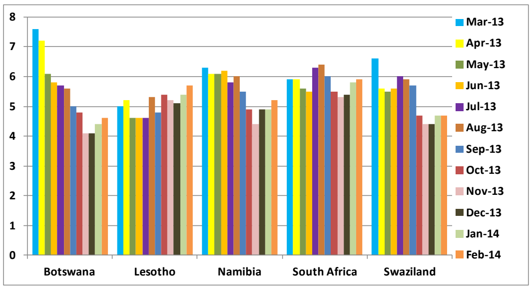
However, **low inflation** and in particular deflation is **not necessarily good for the economy either**. Japan has battled for a decade with negative inflation rates, which contributed to the under-performance of her economy. The fear of low inflation and low growth has recently surfaced in the USA and the EU as well. The European Central Bank (ECB) has set a target of 2.0 per cent for the Euro zone inflation rate – a target the countries

Namibian and South African inflation rates



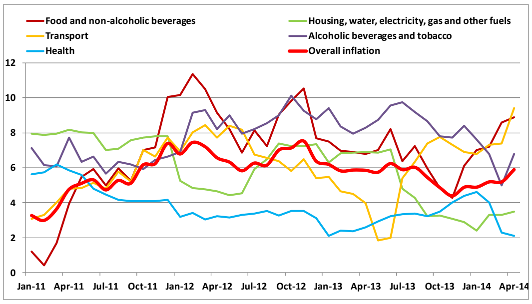
Source: Namibia Statistics Agency

SACU inflation rates, Mar '13 to Feb '14



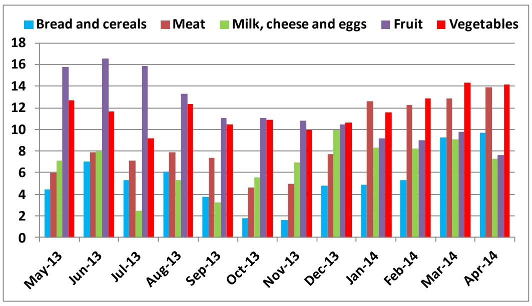
Source: SACU Secretariat

Inflation rates for main components



Source: Namibia Statistics Agency

Inflation rates for selected food items

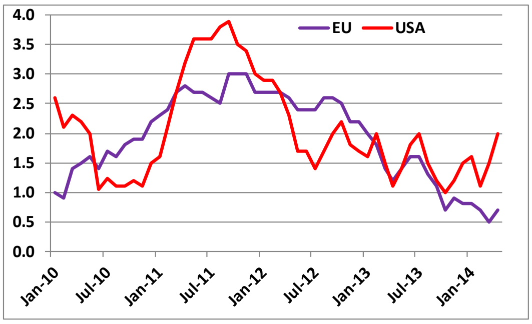


Source: Namibia Statistics Agency

have not achieved since January 2013. Inflation has been below 1 per cent since October 2013, but increased slightly from 0.5 to 0.7 per cent in April 2014. The ECB is weighing its monetary policy instruments to stimulate the appetite for loans from private households and producers. Among the instruments under discussion are negative interest rates as well as liquidity injections, similar to the policy of the Federal Reserve Bank in the USA that embarked on a bond-buying programme worth USD85bn per month before it has started to scale back the magnitude in December 2013 to USD45 bn in April 2014. Low and in particular negative inflation rates dampen consumer demand, since consumers postpone non essential purchases on the expectation of even lower prices in the coming month(s). Since consumer demand declines, production slows down as well, while producers face lower prices and profits in addition. Hence, the economic recovery path in developed countries could be threatened, which results in monetary policy interventions. However, these instruments will only succeed if they result in increased demand for goods and services and do not result in the additional liquidity seeking high returns in financial markets.

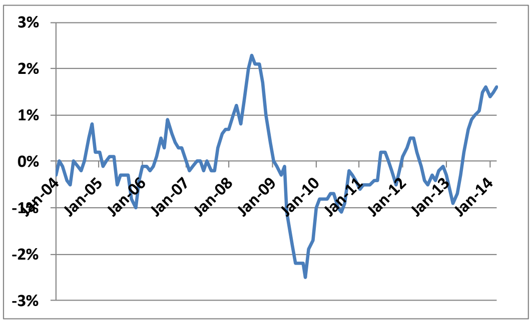
Last, but not least, inflation on the other hand benefits anyone who has borrowed money, since it reduces the real value of the debt burden. Governments benefit from higher tax income owing to increasing prices and salaries – unless tax brackets are adjusted – and are in a more comfortable position to repay their debts.

Euro area and USA inflation rates, Jan. 2010 to April 2014



Source: European Central Bank, Bureau of Labor Statistics (USA)

Inflation rate for Japan, 2004 to 2013



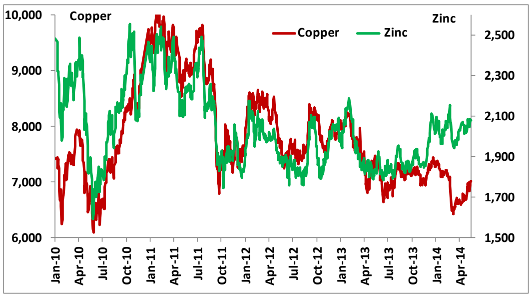
Source: Rate Inflation

Commodity prices

Price for unprocessed minerals

Copper prices have recovered from an almost four-year low in March, when copper was sold at USD6,434 per tonne compared to USD6,290 on 10 June 2010. At the end of May, copper was traded at USD7,015 per tonne, which is still 5.1 per cent below prices at the beginning of January and 3.1 per cent below prices a year ago. **Zinc prices performed better** climbing 14.2 per cent compared to a year earlier and remains on par with prices at the beginning of the year. Zinc prices stood at USD2,081 per tonne.

Copper and zinc prices in USD per ton, Jan. 2010 to March 2014

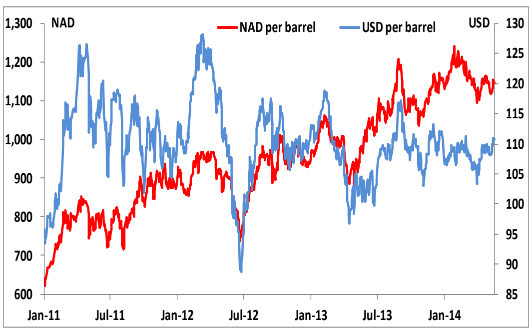


Source: London Metal Exchange, daily data

Barrel of oil – 158 litre

Oil prices are on an **upward trend** surpassing the USD100 per barrel mark in the middle of May. Geopolitical factors have contributed to the upward movement, such as the ongoing crises in Ukraine, South Sudan and Libya. However, the election results in Ukraine have helped easing the price pressure in recent days. Compared to beginning of January the oil price was 0.8 per cent higher at USD110.80 and 6.0 per cent above the price level in the middle of May 2013. The slight strengthening of the Namibia dollar versus the US dollar (see below) has resulted in a drop by 0.4 per cent of the oil's value in the local currency. This led, in addition to over recoveries for diesel of the National Energy Fund, to fuel prices remaining unchanged in May for the second consecutive month. Petrol and diesel prices remain 5.3 and 4.4 per cent respectively higher since the beginning of 2014, but 13.0 and 15.6 per cent above May 2013 levels.

Oil prices in USD and NAD per barrel, Jan. 2010 to March 2014

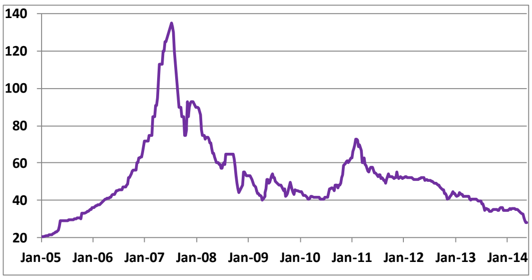


Source: EIA daily data, authors' own conversion into NAD based on SARB daily exchange rates

The uranium price dropped further to levels last seen nine years ago – in May 2005. A pound of uranium was traded at

USD28.25 at the end of May 2014 representing a drop by 18 per cent and 30 per cent compared to the beginning of 2014 and end of May 2013 respectively. Nine years ago, the price started rising from USD20.70 in January 2005 to USD29.00 in the second half of May 2005. The yellow cake continued its unprecedented climb and broke the USD100 mark about two years later (16 April 2007), before reaching its peak at the beginning of July 2007 at USD135.00. The steep rise was followed by a steep drop for almost two years. Hopes for a return of prices to USD80 to USD90 were based on planned additional nuclear power plants in order to curb CO_2 emissions. However, these hopes were slashed when Japan was hit by an earthquake and tsunami resulting in the disaster at the Fukushima nuclear power plant. This resulted not only in a rethink of nuclear power in Japan, but also in other countries, most notably in Germany. Germany decided on an exit strategy from nuclear power in favour of increased use of renewable energy sources. The decline in demand resulted in falling prices. The coming on-stream of the Husab mine, one of the largest uranium mines in the world once operating at full capacity, will add further on the supply side. Without demand picking up at the same path, prices are doomed to stay at low levels. This will force mining companies to cut costs further (and jobs) in order to survive, if not to cease production. The low price levels have, however, not only implications for existing operations, but also for the development of new uranium deposits and for exploration activities.

Uranium prices in USD per pound, Jan. 2005 to May 2014



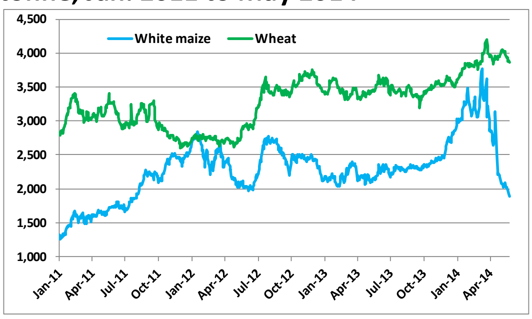
Source: Ux Company daily data

Crop prices

Futures contracts are contracts between parties to buy or sell commodities at a specified price and future date, e.g. December.

Wheat prices have eased compared to March when they reached almost ZAR4,200 per metric tonne. However, compared to the beginning of the year they are 8.2 per cent higher and 9.7 higher compared to the same time in 2013. Wheat is traded at ZAR3,862 per metric tonne, which is in line with future prices traded in March for delivery in May. The US Department of Agriculture's **forecast** for the World's **wheat production** for the year 2014/15 indicates a drop by 2.4 per cent to 697 million metric tonnes compared to 2013/14. The largest producers are the EU with 144 million metric tonnes followed by China with 123 million. Ukraine ranks ninth with 20 million metric tonnes or 2.9 per cent of global wheat production. Wheat production in Ukraine is expected to be lower owing to a reduction in the area planted. Furthermore, since Ukraine contributes about 5.6 per cent to global wheat exports any disruptions of supplies from there will push prices up.

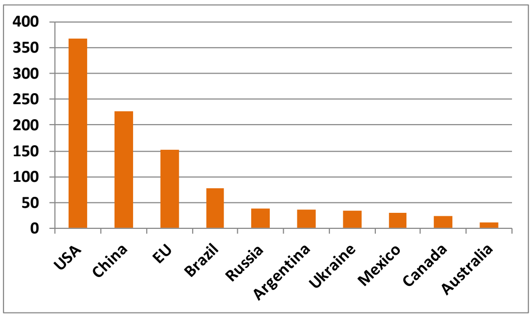
White maize and wheat prices in ZAR per tonne, Jan. 2011 to May 2014



Source: SAFEX daily data

Maize prices have declined significantly compared to January 2014 (-35.5 per cent) and compared to a year ago (-13.6 per cent) to ZAR1,898 per metric tonne end of May and are below maize futures traded in March for delivery in May. If regional and global production forecasts hold, prices could remain at current levels or even ease slightly. **Global maize production** is estimated at 979 million tonnes and hence remains unchanged from last year's production. However, since stocks remain at high levels, total maize supplies could reach a record of 1,461 million metric tonnes. Ukraine's production is estimated at 34.3 million metric tonnes representing a decline by 4.9 per cent

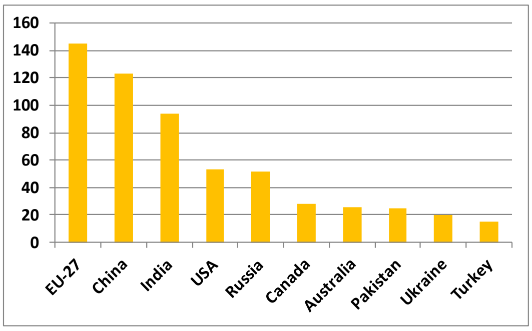
Major maize producers in million metric tonnes – May forecast for 2014/15



Source: USA Department of Agriculture – World Agricultural Supply and Demand Estimates, May 2014 owing to higher input costs because of the devaluation of the currency and consequently a drop in the use of inputs such as fertilisers. Still, Ukraine is expected to contribute more than 12 per cent to global maize exports. Closer to home, South Africa expects a record harvest this season of about 13.3 million metric tonnes. Likewise, the Namibian Agronomic Board estimates white maize production at 68,213 metric tonnes for this season, almost double the production figure of about 35,000 tonnes last year, when the country was hit by a devastating drought. This is good news for national food security, but there are still areas in Namibia where household food security is precarious owing to insufficient rainfall.

Going forward, maize prices are expected to increase slightly again in the second half of the year to about NAD2,000 per metric tonnes, while wheat prices are expected to drop slightly to below NAD3,700 per metric tonne in the last quarter 2014.

Major wheat producers in million metric tonnes – May forecast for 2014/15



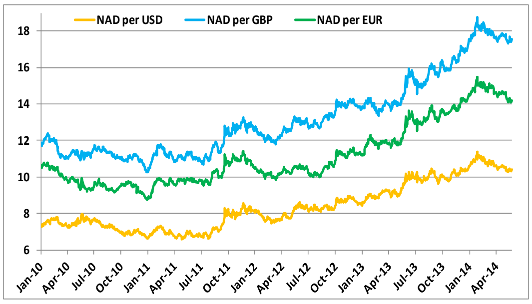
Source: USA Department of Agriculture – World Agricultural Supply and Demand Estimates, May 2014

Exchange rates

Price in Namibia dollars for one unit of a foreign currency

The **Namibia dollar** moved in different directions vis-à-vis the US dollar, British pound and Euro. The currency has **gained slightly** against the USD and Euro by 0.6 and 1.6 per cent respectively while losing value against the British pound by 1.4 per cent since beginning of January 2014. Compared to end of May 2013 the Namibia dollar lost substantial ground in particular vis-à-vis the British pound (22 per cent) and the Euro (15 per cent), while it kept losses against the USD at single-digit level (9 per cent). While political uncertainties ahead of the elections in South Africa at the beginning of May contributed to the depreciation, the just recently released disappointing growth projections for 2014 have wiped out any gains made shortly after the elections. Output in the South African mining sector is estimated to have fallen by 25 per cent in the first quarter because of ongoing industrial actions in particular in the platinum mining sector. Platinum mining workers have been on strike for about five months and there is no end to the wage negotiations in sight. Output in the manufacturing sector contracted as well resulting in a negative growth rate of 0.6 per cent for the first quarter 2014 – the first contraction since the 2Q 2009.

Selected exchange rates: NAD per foreign currency, Jan. 2010 to May 2014



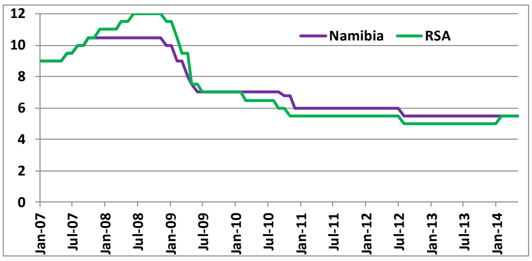
Source: SARB daily data

Interest rates

Repo rate - Interest rate charged by the Central Bank to commercial banks. It determines the cost of credit.

In previous years, monetary policy was to a large extent determined by the inflation rate. However, this view has changed since the economic crisis gripped the world. The US Federal Reserve Bank focuses on an acceptable level of the unemployment rate in their monetary policy discussions. South Africa continues to target the inflation band of 3 to 6 per cent, but pays a lot attention to economic growth as well. The Bank of Namibia uses monetary policy predominantly to maintain the currency peg to the South African rand by accumulating sufficient foreign currency reserves. Expectations at the beginning of the year of interest rates hikes during 2014 might have received a blow with the unexpected poor performance of the South African economy during the first quarter (-0.6 per cent), which calls for an accommodative monetary policy.

Repo rate of the Bank of Namibia and the South African Reserve Bank, Jan. 2007 to May 2014



Source: Bank of Namibia, South African Reserve Bank (SARB)

Hanns Seidel Foundation

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