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Economy Watch Namibia – February 2015

Oil prices slump

Oil prices hit their lowest level in over five years on 13 January 2015 when Europe Brent was traded for USD45.13 per barrel (NAD518.53 per barrel). On 16 March 2009 oil was traded at USD44.12 per barrel and on 3 September 2009 oil cost the equivalent of NAD518.32 per barrel based on the daily exchange rate. Compared to a high of USD115.19 pb on 19 June 2014, prices slumped by 61 per cent and are currently some 56 per cent lower than a year ago and 54 per cent in Namibia dollar terms. However, prices recovered slightly towards the end of January to USD46.07 per barrel, which is still 58 per cent below prices a year ago. There appears to be consensus among most experts that oil prices will remain at these levels during 2015 while some expect such price levels to prevail over the next two to three years.

Global oil demand

The oil price developments are caused by supply and demand as well as the politics of the Organisation of the Petroleum Exporting Countries (OPEC). Global oil demand increased on average by 1.5 per cent annually between 2009 and 2013 from 84.8 million barrel per day (mb/d) to 90.0 mb/d, but slowed down to 1.1 per cent between 2013 and 2014. Demand is expected to grow by some 1.3 per cent in 2015 to 92.3 mb/d. Subdued global economic growth is one of the contributing factors to the slow growth in oil demand, along with technological advances, concerns about climate change, and a shift from primary and secondary sector activities to the service industries. Globally in 1990 USD5.40 in value addition per kilogram of oil was created; this value increased to USD7.20 and USD7.30 in 2010 and 2011 respectively indicating increased efficiency in the use of energy and a shift to less energy-intensive sectors.

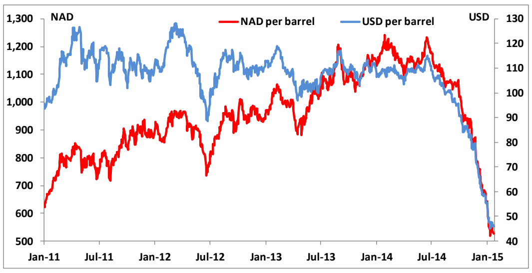
Global oil supply

Oil supply, on the other hand, rose faster than demand, increasing by 2.2 per cent from 90.1 mb/d to 92.1 mb/d between 2013 and 2014 turning an undersupply in 2013 of 0.1 mb/d into an oversupply of 0.9 mb/d. This is to a large extent credited to the boom in shale oil production in the USA and Canada. Oil production in the USA rose by 39 per cent between 2009 and 2013, making the country the third largest oil producer behind Russia and Saudi Arabia. Oil production in the USA is almost on par with total oil production in Africa. Oil production in African OPEC member countries dropped by 10 per cent between 2009 and 2013 due to supply disruptions in Libya and Sudan/South Sudan and lower output in Nigeria and Angola.

OPEC politics

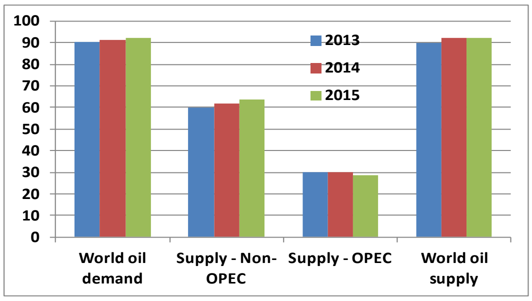
In previous years the 12-member OPEC cartel agreed on price targets that they tried to maintain through agreed outputs. Often Saudi Arabia, accounting for some 30 per cent of OPEC output, shouldered the burden, while other OPEC members did not abide by production cuts. This has changed and Saudi Ara-

Oil price development over past year



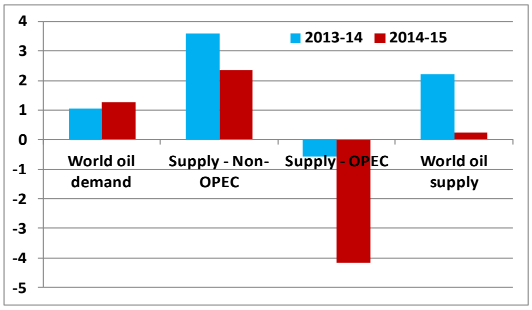
Source: EIA, daily data (USD), converted into NAD by the authors based on SARB daily exchange rates

World oil demand and supply in mb/d, 2013 to 2015



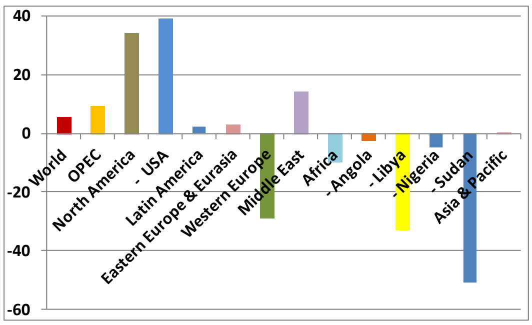
Source: OPEC, Monthly Oil Market Report, Jan. 2015

Global oil demand and supply changes between 2013 and 2014 and 2014 and 2015



Source: OPEC, Monthly Oil Market Report, Jan. 2015

Change in oil production by selected countries and regions between 2009 and 2013



Source: OPEC, Annual Statistical Bulletin 2014 bia announced that it is no longer willing to lose market shares. This policy is not expected to change despite the passing on of the King of Saudi Arabia on 22 January 2015. His successor announced that he will continue the policies of his predecessor and retained the oil minister in his position. The rivalry with the second largest producer within OPEC, Iran, can certainly be seen as a contributing factor.

Impact on oil exporting countries

Even if current prices are below production costs it is almost a matter of who blinks first and risks losing market shares to competitors by cutting production. Hence OPEC has not agreed on a production cut despite member countries depending substantially on oil exports as a foreign exchange earner and the provider of government revenue. On average, oil exports account for 70 per cent of total exports within OPEC. Quite a number of OPEC members depend on oil accounting for more than 90 per cent of their exports, including Angola (99.5 per cent) and Nigeria (93.9 per cent). Even if these countries devalue their currencies in order to mitigate the shock on the local economy, they will be hard hit unless they have built up savings like Saudi Arabia. Lower revenue from oil production could also worsen the security situation in Nigeria since less funding is available for security operations. On the other hand, this is an opportune time for governments to cut often wasteful oil subsidies that drag on national budgets.

…and on net importers

Obviously, net oil importing countries are benefiting from the low oil prices since they reduce production costs, lower inflation rates and increase the disposable income of consumers. The lower prices also strengthen the Balance of Payment position. Oil imports accounted for 9 per cent of total imports in Namibia in 2013 amounting to some NAD7 billion. Oil imports ranked as the third largest import item after transport equipment and chemicals. Hence lower oil prices will reduce Namibia's trade deficit and improve foreign exchange reserves. Motorists are benefiting from substantially lower fuel prices that have dropped in February 2015 to some 20 per cent below pump prices a year ago - levels last seen in the middle of 2012.

Potential impact on the Namibian economy

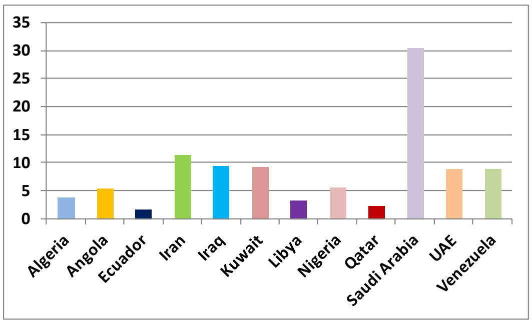
However, low oil prices are not only good news. Depending on how long they will prevail, they can have a negative impact on oil exploration activities in the country in the medium to long term. In addition, demand from Angolans living in Namibia or coming for shopping could decline once the lower oil prices impact on salary levels, economic activities in Angola, and the value of their currency. Furthermore, since gas prices are linked to oil prices the price decline can have an impact on the development of the Kudu Gas project, the financial viability of which has been questioned by some experts recently.

A little bit further away, but no less relevant for the Namibian economy, the low oil prices are one of the contributing factors to deflation in the Eurozone that has forced the European Central Bank to embark on Quantitative Easing (see below).

…and the environment

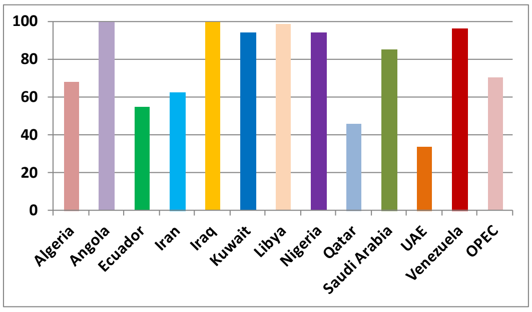
Last but not least, the loser could be the environment if low oil prices persist, since there will be less financial pressure to invest in more energy-efficient production equipment including

OPEC countries' contribution to total oil output by OPEC, 2013



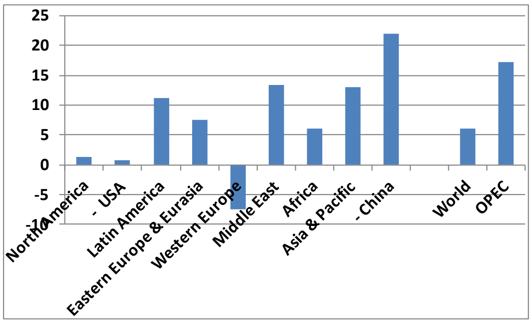
Source: OPEC, Annual Statistical Bulletin 2014

Oil exports as share of total exports for OPEC countries, 2013



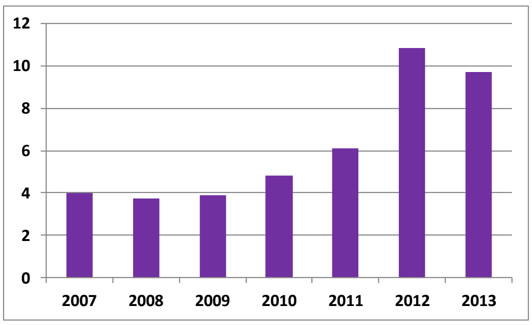
Source: OPEC, Annual Statistical Bulletin 2014

Change in oil demand for selected regions and countries between 2013 and 2014



Source: OPEC, Annual Statistical Bulletin 2014

Contribution of Mineral Exploration to Gross Fixed Capital Formation, 2013



Source: NSA, Annual National Accounts 2013 cars and in renewable energy, even though this would be short sighted.

Quantitative easing in Euro Area

Low growth

Deflation

High unemployment

Pressure was mounting on the European Central Bank (ECB) to ease monetary policy in order to stimulate economic growth and fight off deflation. The Eurozone narrowly avoided a technical recession in 2014 with growth rates of 0.0 and 0.2 per cent in the second and third quarter 2014. The IMF expects economic growth of 1.2 per cent for 2015 in its latest World Economic Outlook of January 2015, down from 1.3 per cent predicted in October 2014 and 1.5 per cent in July 2014. It is, however, not only sluggish economic growth that worries the ECB but also low inflation, which has been below the ECB target of 2.0 per cent since January 2013, and entered into negative territory in December 2014 with prices declining on average by 0.2 per cent and in January 2015 by 0.6 per cent. Deflation has also reached Germany with prices declining by 0.5 per cent in January 2015 compared to a year ago. The markets therefore expected some kind of Quantitative Easing (QE), but the ECB eventually surprised financial markets with a larger than expected stimulus package. While some analysts expected a minimum injection of EUR500bn others considered EUR1tr as necessary, but not very likely.

ECB stimulus package

The ECB decided in their meeting on 22 January 15 to start buying bonds in March 2015 at least until September 2016 or even beyond to the tune of EUR60bn per month, which equates to an initial injection of EUR1.14tr. The impact of the stimulus package depends on market responses, whether consumers borrow more money and spend more, and whether investors borrow more and invest in the real economy. The European economies are less homogenous than the economies of countries such as Japan, the UK and the USA, which all embarked on Quantitative Easing over the past couple of years, and hence there is more uncertainty concerning market responses. Therefore, there is a need to supplement monetary policy with other policy measures, such as fiscal policy initiatives.

Additional policy measures needed

-Fiscal policy

While it made sense at the beginning of the financial crisis to tighten budgets in order to increase confidence in the Euro and instil fiscal discipline in countries that were rather relaxed concerning their adherence to the Maastricht criteria, it is now time to embark on an expansionary fiscal policy in particular in those countries that have accumulated budget surpluses (such as Germany) or are well within the agreed upon budget deficits. An expansionary fiscal policy would have positive spin-offs for the Eurozone labour market that is still characterised by high unemployment rates (11.4 per cent in Dec. 2014), in particular among the youth (23.0 per cent).

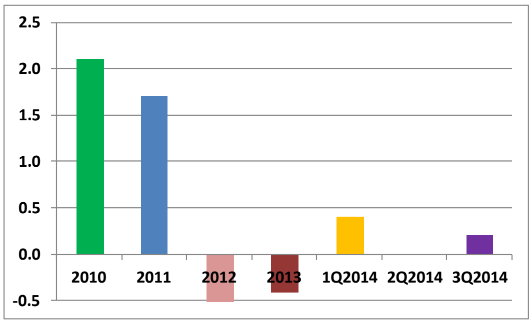
-Social policy

Last but not least these measures have to be accompanied by social policies that address the widening gap between the rich and the poor within countries and also within the Eurozone in order to avoid a further disintegration of societies and a drift to the political far right with negative impacts on the openness and tolerance of societies.

Looming currency war?

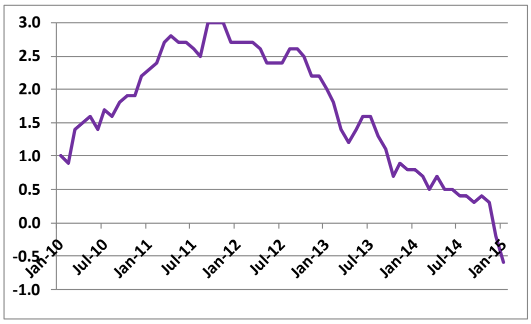
When the Federal Reserve Bank of the USA embarked on QE

GDP growth rates in the Euro Area, 2010 to 3Q2014



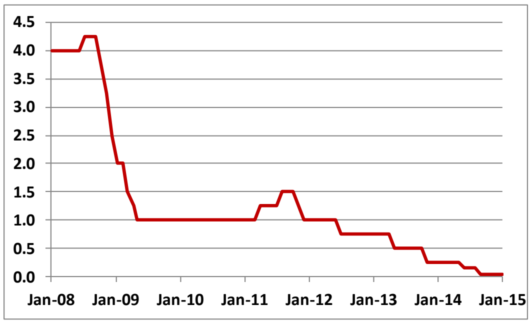
Source: ECB Euro Area Statistics

Inflation rates in the Euro Area, Jan. 2010 to Jan. 2015



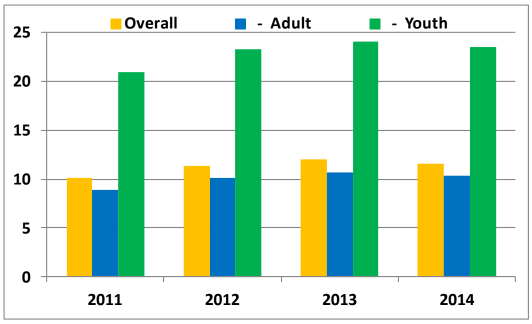
Source: ECB Euro Area Statistics

Interest rates in the Euro Area, Jan. 2008 to Jan. 2015



Source: ECB Euro Area Statistics

Unemployment rates in the Euro area, 2011 to 2014



Source: ECB Euro Area Statistics

there was much talk about a looming currency war, meaning countries would devalue their currencies in order to strengthen their competitive position. This has not really happened. However, the topic was on the agenda again before the ECB announced its stimulus package. The Swiss Franc (SFR) was pegged to the Euro for some years, but the Swiss Central Bank decided to unpeg the SFR, since it would have been very challenging and costly to defend the peg in light of the expected ECB decision. The SFR soared immediately by up to 30 per cent against the Euro raising fears in Switzerland about the competitiveness of its industries. Soon after the ECB announcement, the Danish Central Bank – Denmark is part of the EU but not of the Eurozone – cut interest rates fearing financial investors pulling out of the Euro would invest in the Danish Krone and push it up, which would not only make it difficult for the central bank to maintain the exchange rate band to the Euro, but impact negatively the economy's competitiveness. The central bank has just cut its interest rate for a second time in a week to -0.5. Denmark, like Germany, Switzerland and other countries has introduced negative interest rates on commercial banks' deposits that exceed certain amounts, meaning the depositor has to pay the central bank for keeping the money instead of earning interests on the deposit. The fear of losing competitiveness is not limited to other European countries but spread around the world forcing, for instance, Hong Kong to announce that they are not going to unpeg the Hong Kong dollar from the USD. The current fears indicate the lack of coordinated responses by central banks across the world to the current economic challenges.

Possible impact on the NAD

The Namibia dollar has appreciated by 6.6 per cent against the Euro since 1 Jan. 15; much stronger than against the USD (0.6) and GBP (3.5). Once the ECB actually starts buying bonds, it can be expected that 'cheap' money is looking for better returns in emerging markets as well, as it was the case during the QE in the USA. This could put further upward pressure on the recipient countries' currencies, such as the ZAR/NAD.

Commodity prices

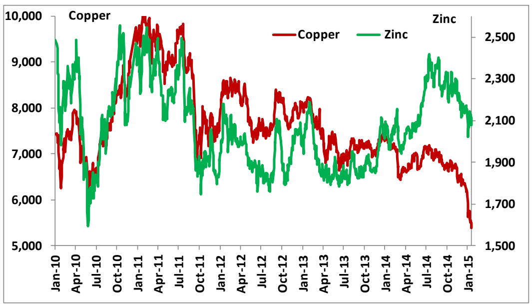
Copper prices declined sharply

Copper prices like oil prices have been especially hard hit recently, but have been on a downward trend since the second half of 2013 with some fluctuations along the way. The price for copper dropped to its lowest level since 22 July 2009, when it traded at USD5,340 per tonne on 29 January 2015. The metal has lost a quarter of its value over the past twelve months, which is not good news for the Namibian copper mine in particular the commencement of production at the new Tschudi copper mine that is expected towards the end of the first half of 2015. The drop in prices is a reflection of declining demand because of lower economic activities in particular in China.

Uranium and gold prices slightly up compared to Jan. 14

Uranium prices have lost some ground again after reaching an almost two year high on 17 November 2014 at USD44.00 per pound. Uranium was traded at USD36.75 per pound end of January 2015, representing a gain of 5 per cent over Jan. 2014.

Zinc and copper prices in USD per ton, Jan. 2010 to Jan. 2015.



Source: LME, daily data

Hanns Seidel Foundation

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