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Economy Watch Namibia – August 2016

The role of the deflator in calculating GDP growth rates

The Namibia Statistics Agency (NSA) released the final **National Accounts for 2015**. The preliminary Gross Domestic Product (GDP) in current prices was revised downward from NAD147.3 billion to NAD146.6 bln, while the final GDP in constant prices was lower at NAD108.0 bln than in the preliminary accounts (NAD108.3 bln). In 2015, the final nominal GDP for 2014 was also revised downward, but the final real GDP went up because of substantial adjustments in the deflator (see below). **Real per capita income** rose by 3.3 percent, down from 3.7 percent in the preliminary report. GDP growth benefited employees more than owners of capital. The share of wages and salaries over GDP rose from 43.3 percent to 47.3 percent between 2007 and 2015.

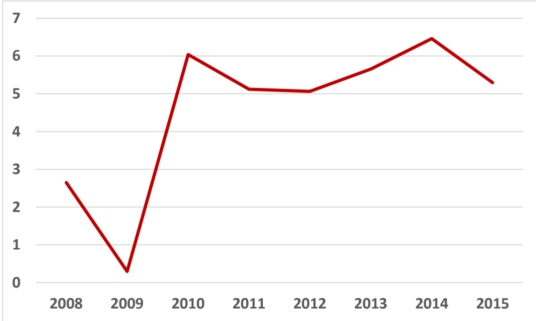
Primary industries lost ground over the past nine years and contributed 18.7 percent to GDP in 2015, down from 21.3 percent in 2007. All three main sectors (agriculture, fishing and mining) contributed less than in 2007. The **contribution of manufacturing** to GDP had been declining since 2011 from 13.7 percent to 8.3 percent in 2015, which can be largely attributed to a decline in the manufacture of basic non-ferrous metals (down from 3.9 percent to 0.8 percent) and to diamond processing (down from 0.9 per cent to 0.3 percent). The **construction sector** gained in importance contributing 6.1 percent to GDP in 2015 compared to 3.5 percent in 2007. The **service sectors** accounted for a larger share of GDP in 2015 (58.3 percent) than in 2007 (53.0 percent), mainly because of increased contributions from public administration and defence, and from education. Likewise, the contributions of wholesale and retail trade, hotels and restaurants as well as transport and communication all increased over the same period.

The **mining sector** remained the single most important sector in the economy contributing 12.5 percent to GDP owing to diamond mining that accounted for 72 percent of the mining sector's value addition. The wholesale and retail trade sector and public administration and defence followed with 11.8 percent and 11.4 percent. The sector 'hotels and restaurants' only partly reflects the importance of tourism to the economy since tourism benefits other sectors such as transport and financial services as well. **Foreign tourists** contributed 7.1 percent or NAD4.6 bln to **total export earnings** in 2015. The share, however, dropped by more than 31 percent since 2007 (10.3 percent).

Metal ores showed the **strongest growth** in 2015 (60.0 percent), because the new gold mine started production. The construction sector continued its strong performance and grew by 33.7 percent. These two sectors combined contributed about 60 percent to the overall growth of 5.3 percent in 2015. Otherwise, economic activities slowed down considerably. **Primary industries contracted** by 3.2 percent led by the agricultural sector with 10.3 percent. The drop in output in primary industries spilt over into the manufacturing sector that contracted by 6.6 percent, mainly because of lower output of diamond processing (-47.0 percent), basic non-ferrous metals (-13.7 percent) as well as other food (-11.7 percent) and meat processing (-9.1 percent). The service sector expanded by 5.4 percent, but at a slower pace compared to 2014 (7.7 percent). Growth in the tertiary sector was mainly driven by public administration and defence (13.1 percent) and the wholesale and retail trade sector (5.7 percent).

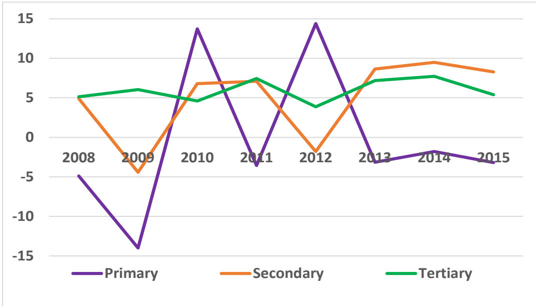
Growth rates are based on value addition in constant prices. Constant prices are calculated by dividing current prices by a deflator in order to eliminate in-

GDP growth in percent, 2008 to 2015



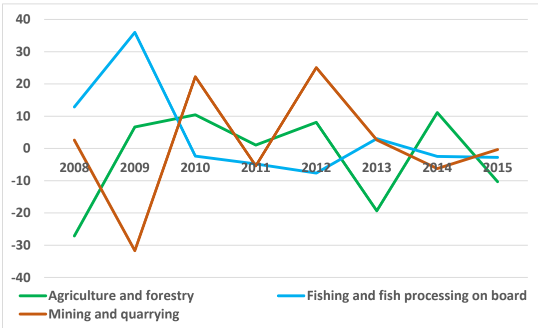
Source: Namibia Statistics Agency, 2015 National Accounts

GDP growth for the three main economic industries in percent, 2008 to 2015



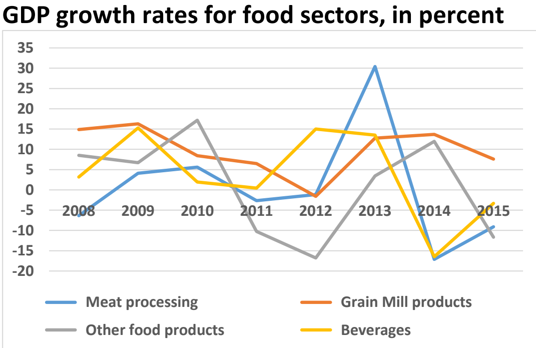
Source: Namibia Statistics Agency, 2015 National Accounts

GDP growth rates for the primary sectors, in percent



Source: Namibia Statistics Agency, 2015 National Accounts

GDP growth rates for food sectors, in percent



Source: Namibia Statistics Agency, 2015 National Accounts flationary impacts. Hence, the use of the deflator determines the final growth rate. As pointed out last year, although the nominal GDP for 2014 was lower in the final national accounts than in the preliminary, the growth rate was higher because a lower deflator was used.

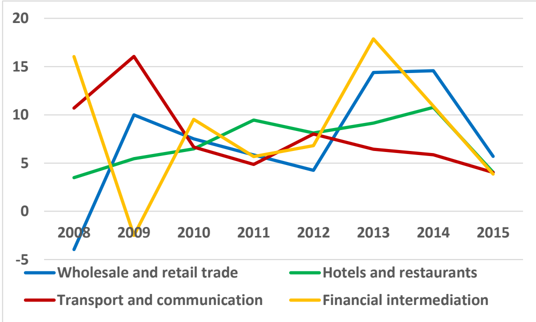
The **deflator** used for calculating the real GDP for 2015 **declined by 0.2 percent** compared to 2014. As IJG reported, this was only the second time since 1981 that the change in the deflator was negative. A negative change in the deflator implies that on average production costs in the economy declined. This is possible in a situation of deflation (decreasing prices) as in Japan. However, although Namibia experienced the lowest annual inflation rate in 2015 (3.4 percent) since 2005 (2.3 percent), consumer prices still increased. Despite the low inflation in 2005, the change in the deflator in 2004 was 1.9 percent and in 2005 it was 5.5 percent. Furthermore, while inflation rates in Namibia and South Africa were fairly similar over the years and the change in the deflator as well (with the exception of 2012) South Africa's deflator increased by 4.0 percent to 131.4 in 2015 compared to the decline by 0.2 percent to 135.7 in Namibia. Quite a number of the economic sectors showed declining deflators including the electricity and water sector for which the deflator declined by 22.0 percent to 108.8 while it increased by 3.4 percent a year earlier to 139.4. Declining energy prices could explain a decline of the deflator for the electricity sector that uses in part coal and oil to generate electricity. The decline has not filtered through to the consumers who are confronted with higher utility costs. Likewise, the deflator for grain milling dropped by 14.5 percent although crop prices in particular white maize prices rose substantially on the South African stock exchange in 2015. The value of crops accounts for roughly a third of total production costs of the grain milling industry. The deflator for other food products dropped by 13.0 percent. However, these lower production costs have not resulted in lower food prices for the consumer. NSA explains in detail the compilation of the Consumer Price Index and could provide a similar explanation for the deflator.

Economic growth figures are relevant for investors who base their investment decisions among others on the performance of the economy and economic prospects in the country; for sovereign rating agencies that base their ratings on economic growth and last but not least for government's revenue expectations that depend on the performance of the economy. It is therefore important that economic growth rates are calculated as accurately as possible.

Namibia achieved an average 5.6 percent economic growth between 2010 and 2015. However, the **economy will not maintain momentum** because of global, regional and domestic headwinds. The demand for commodities will remain subdued. Low oil prices pose serious challenges for oil-exporting countries - even for Saudi Arabia with her substantial foreign exchange reserves. Namibia is feeling the impacts through the **drop in demand from Angola** that cuts across in particular the service sectors from health, education, financial and transport services to accommodation, real estate and retail trade. The completion of the development of new mining sites – Tschudi copper mine, B2 gold mine and Husab uranium mine – as well as the suspension of the mass housing scheme will result in a substantial slow-down in construction activities. The cuts in government expenditure, the severe drought and the water crisis are having a substantial negative impact on the domestic economy. Anticipated job losses because of the slow-down in various sectors coupled with increasing interest rates will have an adverse impact on the wholesale and retail trade sector.

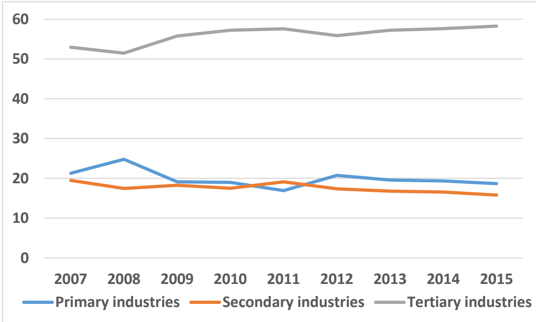
Although an increase in the arrival of tourists from overseas owing to the depreciation of the Namibia dollar will benefit the economy it will not offset the decline in economic activities in the other sectors mentioned above. Official

GDP growth rates for selected service sectors, in percent



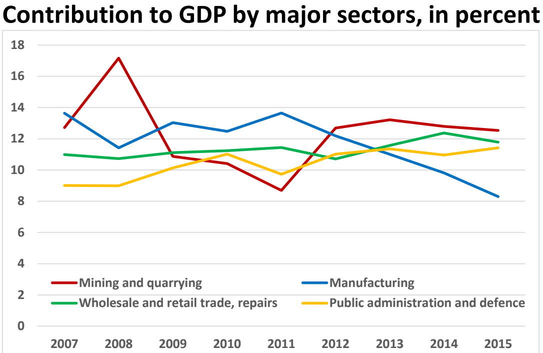
Source: Namibia Statistics Agency, 2015 National Accounts

Contribution to GDP by main industries, in percent



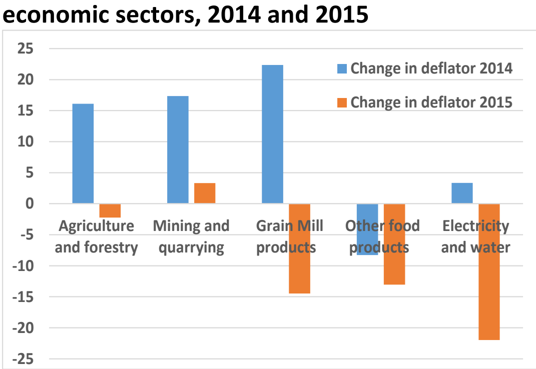
Source: Namibia Statistics Agency, 2015 National Accounts

Contribution to GDP by major sectors, in percent



Source: Authors' own calculation based on 2015 National Accounts

Change in the deflator in percent for selected economic sectors, 2014 and 2015



Source: Authors' own calculation based on 2015 National Accounts growth prospects of more than 4 percent for 2016 are therefore overly optimistic. Such over-confident economic growth expectations will result in unrealistic revenue forecasts even though new government initiatives to enhance tax compliance are expected to increase revenue somehow. If GDP ends up lower than expected, the public debt to GDP and the budget deficit to GDP ratios will increase further beyond our domestic fiscal targets.

While economic growth and total GDP are relevant macro-economic indicators they are not sufficient to assess socio-economic conditions in the country. Therefore, national account data have to be supported by frequent labour market and household income and expenditure data in order to assess how broad-based the gains from economic growth are. The Namibia Statistics Agency should therefore consider re-introducing the annual labour force surveys it conducted from 2012 to 2014 in order to provide up-to-date information on employment that in turn has an impact on poverty. It is expected that with the slowdown in employment-intensive sectors such as construction and in the services sectors such as wholesale and retail trade job opportunities will decline.

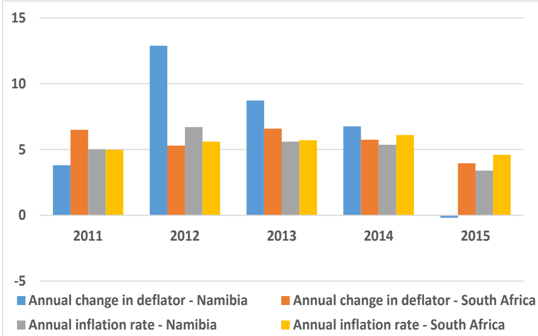
Converting wealth into well-being

As explained above, GDP and economic growth by themselves are insufficient indicators and have to be read with other indicators such as employment statistics and the Human Development Index. The discussion about the limitations of GDP as an indicator for development is old and resulted in the construction of the Human Development Index or the Gross National Happiness developed in the Kingdom of Bhutan in 1972. More recently, the Boston Consulting Group developed the **Sustainable Economic Development Assessment** (SEDA) and published the first results in 2012. They released the 2016 SEDA recently. The SEDA tries to capture how well countries convert their wealth into the well-being of their citizens. They use 44 indicators grouped into ten dimensions such as income, employment, health, education and governance and clustered into three elements: economics, investments and sustainability. In addition to the current status it measures the recent progress made by countries. The current level score and the recent progress score are on a scale of 0 to 100 (best possible score).

Namibia scores 29.9 in the current level score, below Mauritius (62.8), Botswana (37.4) and South Africa (30.6). Although the 56.5 in the recent progress score indicates that Namibia is making progress, it is below other countries in the region, such as Zambia (79.1), Angola (76.2), Lesotho (63.3) and Zimbabwe (60.2). However, these countries are starting from a much lower basis and, therefore, progress has a stronger impact. Namibia's **wealth is not well converted** into the well-being of her citizens as the wealth-to-well-being coefficient of 0.77 emphasises. The wealth-to-well-being coefficient compares the current level score to the score that can be expected given the country's per-capita GDP. Namibia performs better in terms of the growth-to-well-being coefficient (1.0) that indicates that the recent progress score is in line with GDP growth.

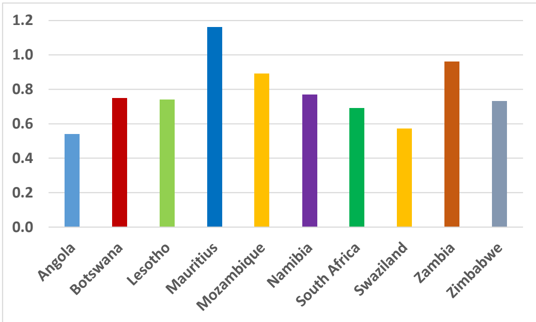
Namibia's weaknesses in education and health outcomes as well as unemployment weigh on the performance in the SEDA as they do in the country's performance in other international rankings such as the Global Competitiveness ranking. The causes for high mortality rates and incidences of tuberculosis for instance need to be addressed and innovative ways of reducing unemployment explored. It is, however, encouraging to note that **Namibia scored best** in the **sustainability element** that includes dimensions such as civil society (including gender equality), governance (rule of law, corruption, press freedom etc.) and environment indicators (protected areas, share of renewable energy, etc.). The

Comparison of change in deflator and inflation rates for Namibia and South Africa, in percent



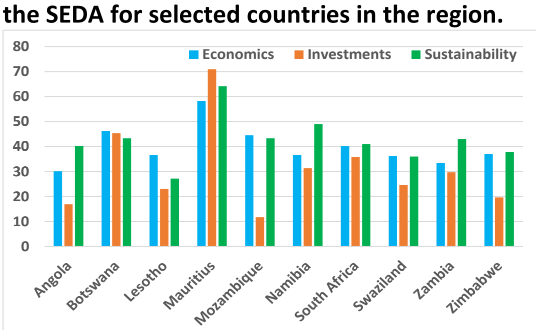
Source: Authors' own calculation based on 2015 National Accounts, NSA Consumer Price Index Report, South African Reserve Bank (inflation, deflator)

Wealth-to-well-being coefficient for selected countries in the region



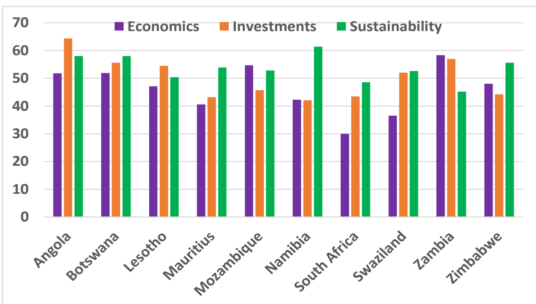
Source: Boston Consulting Group, The 2016 Sustainable Economic Development Assessment.

Current level score in the three main elements of the SEDA for selected countries in the region.



Source: Boston Consulting Group (ibid.)

Recent progress score in the three main elements of the SEDA for selected countries.



Source: Boston Consulting Group (ibid.)

SEDA analysis has shown that countries with strong progress in the sustainability element are on the path to achieving overall high progress. Namibia is already well known for her conservation efforts and can become a leader in the use of renewable energy sources once new policies such as the Independent Power Producer Policy, the Renewable Energy Policy and the Energy Policy are approved and implemented. These will have positive spin-offs for other indicators, such as air pollution and employment.

Investment growth slowed down

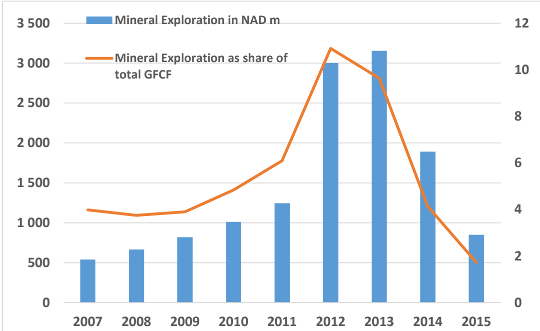
Investment growth, as measured by Gross Fixed Capital Formation (GFCF), slowed down in 2015 to 9.8 percent compared to an increase by 32.8 percent in 2014. Total GFCF amounted to NAD49.2 bln in 2015 or 33.6 percent of GDP. The lower growth in investment was due to a substantial slow-down in private sector investment from 35.1 percent (2014) to 6.8 percent. **Private sector investment** amounted to NAD37.5 bln accounting for 76.1 percent of total investment. The completion of new mining developments was certainly a contributing factor for the lower growth. After strong increases in 2010 and 2011 investment by State-owned Enterprises had been on the decline and reached NAD2.4 bln contributing 4.9 percent to total investment; the lowest share since 2007.

Mineral exploration was at its lowest point in 2015 (NAD851 million) since 2009 (NAD820 mln) and only roughly a quarter of the investment we saw in 2013 (NAD3.2 bln). The downward trend can to a large extent be attributed to the lull in offshore oil exploration owing to excess supply and hence low global oil prices. Mineral exploration accounted for 10.9 percent of total investment in 2012, but the contribution dropped to 1.7 percent in 2015. The bulk of investment benefited construction works (41.6 percent) followed by machinery and other equipment (21.1 percent).

The **mining sector attracted the largest share** of investment (36.8 percent) followed by the public sector (19.1 percent) and transport and communication (12.1 percent). The manufacturing sector accounted for 9.6 percent, but investment grew at a slower pace in 2015 (2.6 percent) than in 2014 (25.8 percent). The fishing sector recorded the strongest growth rates in 2014 (238.8 percent) and 2015 (127.2 percent) albeit from a low basis – NAD169 mln in 2013.

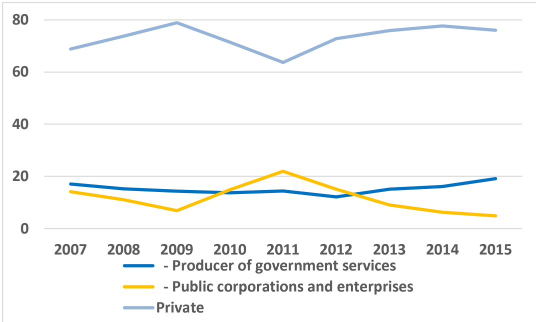
In order to achieve our ambitions as outlined in Vision 2030, the Harambee Prosperity Plan and the Fourth National Development Plan, Namibia needs to attract more investment in particular to the transport sector since we aim at becoming the logistics hub for Southern Africa, to the manufacturing sector in order to reduce import dependency and diversify our exports, and into agriculture. A prerequisite for becoming an attractive investment destination for foreign and domestic direct investment beyond the natural resource sectors is a conducive investment climate. This includes not only political, social and macro-economic stability, but also a legal framework that strikes the balance between the benefits for society and for investors who carry investment risks. Current draft legislation such as the New Equitable Economic Empowerment Bill will not make Namibia a more favourable investment destination for manufacturing and service sector companies, even though most likely everyone supports the overall objectives of the bill, namely to address skewed income and ownership distribution. As a way forward, we should analyse the impacts of voluntary charters in the financial, mining and retail trade sectors, develop these charters further and expand them to other sectors.

Investment in mineral exploration, in NAD m (left-hand scale) and in percent of total investment (right-hand scale)



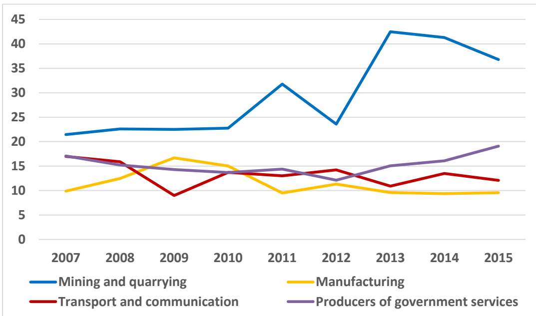
Source: Namibia Statistics Agency, 2015 National Accounts

Contribution to GFCF by the public and private sectors, in percent of total GFCF



Source: Namibia Statistics Agency, 2015 National Accounts

Contribution to GFCF by selected economic sectors, in percent of total GFCF



Source: Namibia Statistics Agency, 2015 National Accounts

Hanns Seidel Foundation

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