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Economy Watch Namibia – November 2016

The Minister of Finance tabled the much-anticipated mid-year budget review for the Financial Year 2016/17 on 27 October 2016. The review came amidst a slowdown of the domestic economy, mainly due to significantly slower growth in construction as well as the impacts of the prevailing drought; a slower recovery of the world economy and increasing uncertainties caused by Brexit and the US American elections; rising public deficit and public debts in Namibia; and the adjustment in Fitch's investment rating for Namibia from stable to negative. These factors put pressure on government to pursue a much tighter course of fiscal consolidation than planned in the initial budget presented on 25 February 2016.

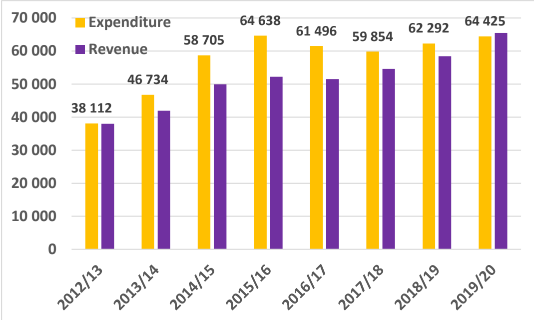
The **operational budget was slashed** by NAD1.8 billion from NAD52.1 billion to NAD50.2 billion, while the development budget was cut by NAD2.7 billion from NAD9.1 billion to NAD6.4 billion. These adjustments represent cuts of 3.5% and 29.8% of the originally budgeted amounts. In addition, savings of NAD1 billion were realised for interest payments; some NAD400 million for domestic interest payments reportedly owing to lower than expected additional domestic debts and owing to savings of some NAD600 million on foreign interest payments because of the appreciation of the Namibia dollar (NAD) against the US dollar (USD). The NAD had reached a low against the USD in January 2016 of NAD16.39 on average vis-à-vis the USD, but the domestic currency recovered in particular in the second half of 2016. The NAD traded 13.95 on average in October against the USD representing an appreciation of 17.7%. This has had a positive impact on interest payments for the two Eurobonds of USD500 million in 2011 and USD750 million issued in 2015.

The **Ministry of Public Enterprises took the hardest knock** with allocations cut by 47%, followed by the Ministry of Industrialisation and Trade (37%) and the Ministry of Mines and Energy (28%). All but four ministries have to do with less for the remainder of this year. The Office of the Attorney General escaped with rather minor downward adjustments (1.4%) followed by the Ministry of Poverty Eradication (1.9%) and the Police (2.8%).

The **total suspensions** of NAD5.5 billion were mitigated by re-allocations of NAD1 billion to address the impacts of the drought (NAD150 million), the support for Orphans and Vulnerable Children (NAD150m), the construction of the Neckartal Dam (NAD350m) and further re-allocations to the tune of NAD350m. The re-allocations benefitted the Ministry of Gender Equality and Child Welfare the most that is responsible for the OVC grants. The ministry's budget allocation increased by 14.5% followed by the Ministry of Agriculture (9.7%) and the Office of the Prime Minister (5.1%) that is responsible for drought relief.

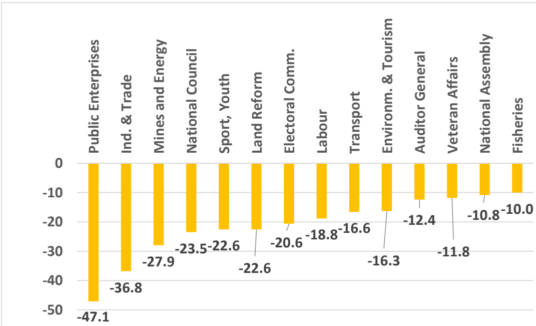
Under the operational budget, expenditure for furniture and other office equipment was reduced by 34%, followed by cuts for operational equipment, machinery and plants (27%), travel and subsistence allowances (22%) and vehicles (13%). In nominal terms, allocation for construction under the development budget was cut the most (NAD1.5 billion or 27%), although NAD350m were re-allocated for the Neckartal Dam. Allocation for feasibility studies were reduced by NAD425.3m or 57% and for operational equipment by NAD146.7m (25%).

Revised expenditure and revenue in NAD million, 2012/13 to 2019/20



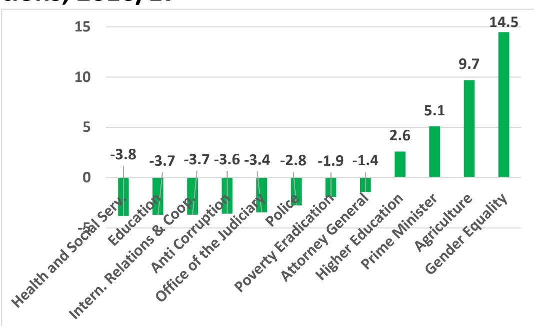
Source: Republic of Namibia, 2016/17 Mid-Year Budget review and Medium-Term Budget Policy Statement for the FY 2017/18 – 2019/20 MTEF.

Budget cuts in percent of initial budget for most affected votes, 2016/17



Source: Republic of Namibia, ibid.

Budget changes in percent of initial budget for least affected votes, including re-allocations, 2016/17



Source: Republic of Namibia, ibid.

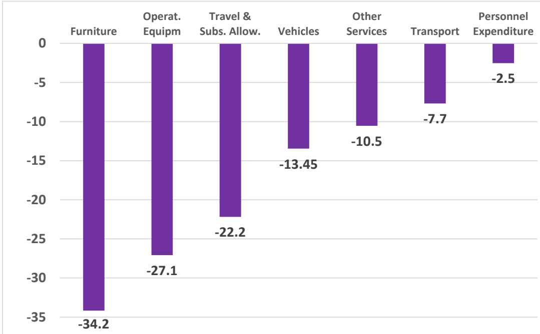
Revenue has been adjusted downward as well owing to the slowing down of the economy. Overall revenue is expected to decline by NAD6.3 billion or 10.9%. Income tax on individuals is expected to drop by 27.9% (NAD4.3 billion) and company taxes by 12.5% (NAD1.1 billion), mainly caused by lower tax payments from non-mining companies (NAD518m). In contrast, more revenue is expected from diamond royalties (NAD546m) and other mineral royalties (NAD119m). However, mineral royalties remain more or less on the level seen in 2015/16, namely at NAD319m (2016/17) compared to NAD309m in 2015/16. Moreover, government expects revenue from mineral royalties to increase by only NAD6m and NAD7m over the next two years before almost tripling to NAD932m in 2019/20. This would imply that government does not expect Swakop Uranium, which operates the Husab uranium mine, to start with any meaningful production in the next two years, which is reasonable given the historically low uranium prices at the moment (see Page 4). This in turn will have an impact on GDP growth prospects for the next two years, since higher growth rates are to some extent based on the assumption that the Husab mine will commence production. Finally, the environmental tax that has been introduced this year is expected to rake in NAD450m.

The **budget deficit** for 2015/16 turned out to be actually 8.3% of GDP, up from 5.2% previously estimated. Likewise, the budget deficit for 2016/17 is now estimated to reach 6.3% rather than the estimated 4.3% as per the budget tabled in February 2016. The higher budget deficit combined with lower economic growth has pushed total public debt beyond the 40% of GDP mark compared to Namibia's fiscal target of 35%. Total public debt amounted to 40.1% of GDP in 2015/16 and is expected to rise further to 42.4% in the current financial year, before it starts declining to 41.3% next year and to below 40% in 2018/19. However, total public debt is expected to exceed the fiscal target of 35% over the next few years. The reduction in the budget deficit and public debts will only be achieved if fiscal discipline is enforced and if economic growth turns out to be in line with the forecast.

Obviously, such drastic cuts will have a **dampening impact on the Namibian economy** and consequently on the society. However, the Namibian economy will not suffer the full impact of the NAD5.5 billion suspensions, because NAD1 billion is re-allocated to other activities and some NAD600m are interest payments to foreign creditors. The downward adjustment in allocations to operational equipment, vehicles and to a large extent furniture has less of an impact on the domestic economy, since the goods are imported, than a reduction in construction activities will have, if Namibian construction companies are contracted. The lower allocation to vehicles etc. will reduce imports and save scarce foreign exchange reserves.

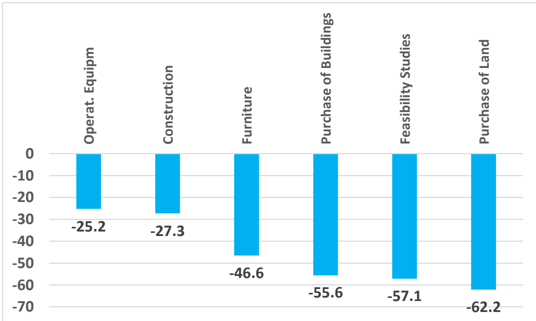
In order to **estimate the economic and social impact** of the budget cuts including the re-allocations, we have applied the Social Accounting Matrix 2013. The results suggest that nominal GDP could decline in the range of 2.5%. This will affect in particular the income of high-income households, because business profits are expected to drop by 2.3%. Lower-income households are least affected, in particular because it is assumed that low-income households in rural areas will benefit from the additional allocation to drought relief and to OVC grants. Overall income distribution in Namibia will shift slightly in favour of low-income households. Finally, the budget adjustments will affect unskilled labour more than skilled labour, in particular because of the strong reductions in labour-intensive construction activities.

Budget cuts in percent of initial budget for most affected items in the operational budget, 2016/17



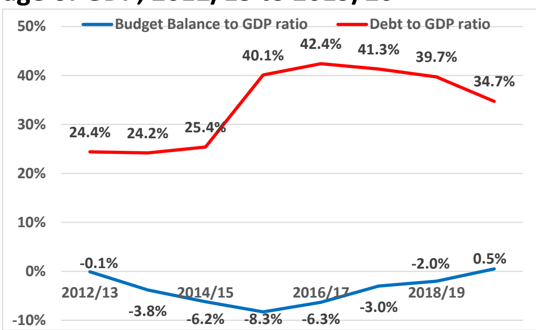
Source: Republic of Namibia, ibid.

Budget cuts in percent of initial budget for most affected items in the development budget, 2016/17



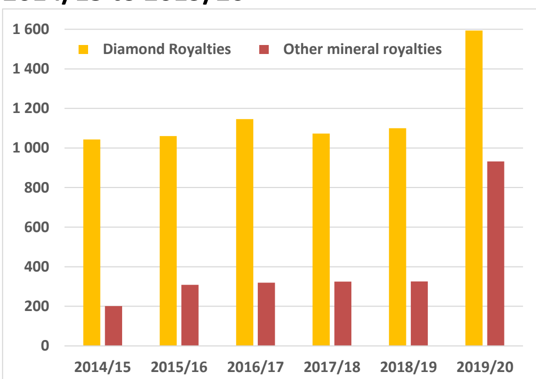
Source: Republic of Namibia, ibid.

Budget balance and debt stock as percentage of GDP, 2012/13 to 2019/20



Source: Republic of Namibia, ibid.

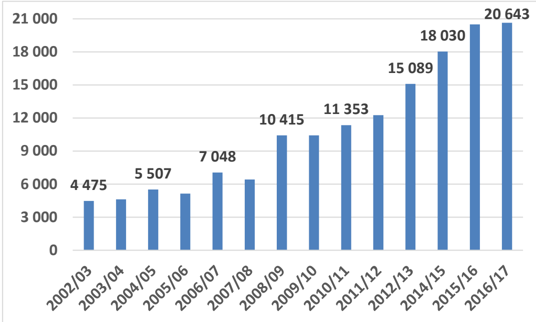
Actual and estimated revenue from diamond and mineral royalties in NAD billion, 2014/15 to 2019/20



Source: Republic of Namibia, ibid.

However, these are **necessary adjustments** that will help avoid more painful adjustments in future. Furthermore, challenging times also offer the opportunity to do business differently in order to enhance efficiency and effectiveness of service delivery and to cut costs further. Government could consider streamlining ministries and aligning ministerial responsibilities. A case in point are the social assistance and welfare services that are the responsibility of at least four ministries: The Ministry of Gender Equality and Child Welfare is responsible for the Orphans and Vulnerable Children grant including the Disability grant for children and social welfare services for children, while the Ministry of Health and Social Services is responsible for family welfare services. The Ministry of Poverty Eradication is responsible for the old age and disability (for persons older than 16 years of age) grants and the Ministry of Veterans Affairs takes care of the War Veteran allowance, but also provides assistance to dependents of war veterans. Housing all these responsibilities under one roof could increase efficiencies and ensure that fewer persons in need of assistance will be left out.

Contribution to government's medical aid scheme per filled position in the public sector, in NAD



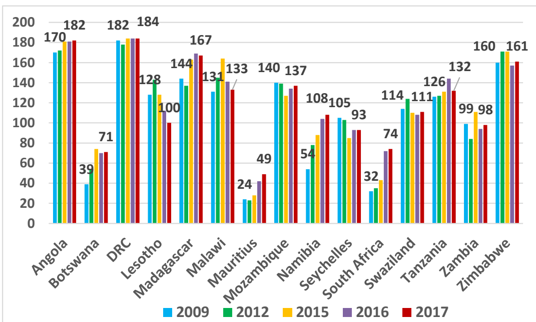
Source: Republic of Namibia, ibid.

Furthermore, government's contribution to the **medical aid scheme** has increased from NAD130m in 2000/01 to NAD2.1 billion in 2016/17. Based on the filled positions, government contributed on average NAD4,475 per filled position in 2002/03, but NAD20,643 per filled position in 2016/17. Currently, public servants contribute a lump sum to the medical aid scheme irrespective of their income. Government could consider changing this to a percentage contribution, which would lessen the burden on low-income earners. At the same time, government could set the percentage contribution at such a level that would allow it to recoup more of the actual costs.

The government introduced **zero-rated Value Added Tax** (VAT) in 2010 for some basic food items in order to reduce the financial burden on the poor. However, it can be assumed that the poor in particular in rural areas do not have (easy) access to some of these items, such as fresh milk and bread. Hence, government could consider re-introducing VAT on these products, since the zero-rating benefits the better-off urban population more than the poor. This will push up inflation and might reduce demand in the short term, but could generate income for more targeted pro-poor policy interventions.

At the end of October 2016, the World Bank released its annual **Doing Business Report 2017** which measures the ease of doing business. Compared to the corrected and adjusted results of the 2016 report, Namibia dropped a further four ranks to 108 out of 190 countries. The country has moved from being among the best performing 30% of countries to the last 40% since 2009, when it held rank 54. It is not comforting that ten out of 15 SADC member states slipped in the ranking as well, including Africa's best performing economy, Mauritius. Mauritius is ranked 49; down by 25 places compared to 2009. South Africa lost 42 places since 2009 and ranks now 74. In contrast, Lesotho gained 28 places to rank 100, while Seychelles improved by 12 ranks to 93. Namibia ranks now 7th within SADC compared to 4th in 2009.

SADC member state's ranking in the Doing Business Report, selected years between 2009 and 2017



Source: World, Bank, various years, Doing Business Report

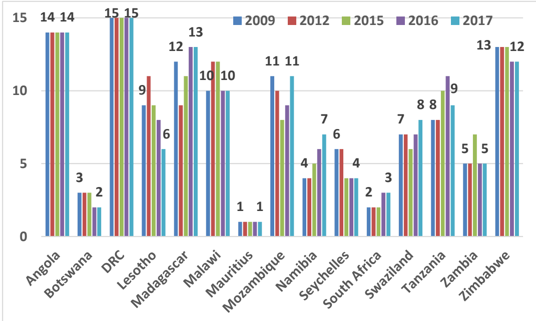
The Doing Business report consists of ten components. Namibia has shown **improvements in two** of them since 2010, namely in 'paying taxes' and in 'trading across borders'. Since Namibia aims to become a regional logistics hub, the improvement by 24 ranks in 'trade across borders' since 2010 to rank 127 is important. However, the ranking indicates that more needs to be done to reduce time and costs of cross-border trade. Without further, significant improvements it will remain challenging to become involved in regional and global value chains that require among others smooth cross-border flows or to attract investments focusing on the Southern African region as a market.

Ranking within SADC, selected years between the 2009 and 2017 Doing Business Report

On the other hand, **Namibia is moving backward** in respect of the other eight components, most notably in respect of 'enforcing contracts'. While it took 270 days in 2010 to enforce a contract, the time increased to 460 days now. Consequently, Namibia dropped from rank 41 to 98. The deterioration in other components is of a similar magnitude. Although neither the number of procedures nor the time it takes to start a business has changed and the costs are even lower, Namibia slipped by 47 places over time to rank 170. This is a clear indication that other countries have streamlined their procedures. In SADC, the average time to start a business is 33 days, while the time ranges between 6.5 days in Mauritius and 91 days in Zimbabwe with Namibia requiring the second longest time of 66 days. The number of procedures to start a business does not matter, since ten procedures are required in Mozambique, Namibia and Zimbabwe. However, these procedures take only 19 days in Mozambique, but significantly longer in the other two countries.

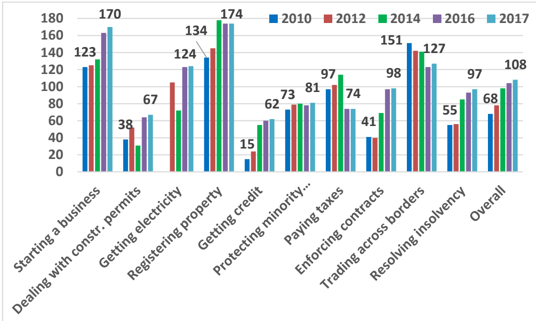
Namibia slipped also 47 places regarding **getting credit** from one of the best performing countries in 2010 (rank 15) to 62. A lower legal rights index explains the deterioration in part, while it can be assumed that other countries embarked on reforms that eased the access to credit. Registering property takes now 52 days compared to 23 days in 2010, which resulted in a drop by 40 places to rank 174 out of 190 countries.

Namibia has set ambitious targets in the Fourth National Development Plan (NDP4) and the Harambee Prosperity Plan (HPP) regarding the competitiveness of the economy. According to NDP4, Namibia aimed at being the most competitive economy within SADC by 2017, while one of the HPP objectives is to become the most competitive African economy by 2020. Considerable efforts are required to reverse the current trend of declining competitiveness. Neighbouring countries demonstrate that it is possible to finalise bureaucratic procedures in a much shorter period of time than in Namibia. Namibia needs to move aggressively towards a one-stop shop that deals with most if not all necessary applications for starting a business. The speedy implementation of the Business and Intellectual Property Authority Act is the first step. At the same time, additional red tape, such as visa requirements for foreign business people or investment approvals by the minister, need to be reduced to the absolute minimum if not scrapped altogether.



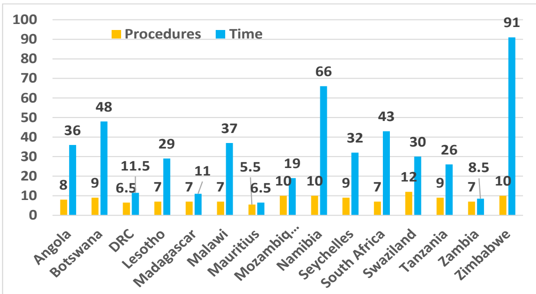
Source: World, Bank, various years, Doing Business Report

Namibia's ranking in the ten components, 2010 to 2017



Source: World, Bank, various years, Doing Business Report

Number of procedures and days to start a business in SADC, 2017

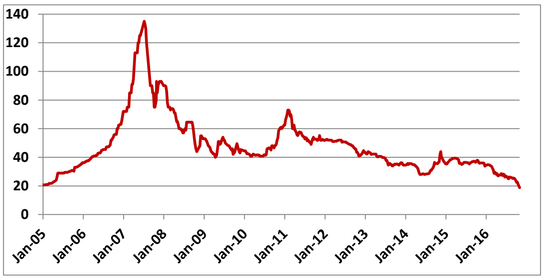


Source: World, Bank, 2016, Doing Business Report 2017

Uranium prices dropped by 45% this year to USD18.75 per pound, the first time they have been below USD20 per pound. Nuclear power plants usually hold sufficient stocks of nuclear fuel in contrast to other power plants that use fossil fuels that can easily be sourced. Therefore, a speedy recovery of uranium prices is not expected. As production costs at Namibian uranium mines are reportedly about USD50 per pound, further cost cutting measures can be expected. The low prices further place a question mark over assumptions that the Husab uranium mine will start any significant production soon. Since the Husab mine will be one of the largest globally, reaching full production would add further price pressure on the yellow cake, because of the depressed demand.

In contrast, **gold prices** passed the US1,300 per ounce mark on November 9, up from 1,275, after the results of the US American elections were announced. Donald Trump's victory adds further uncertainties to the direction of the global economy and about a US interest rate hike, which drive investors to safe havens.

Uranium price in USD per pound, 2005 to Nov. 2016



Source: UX Company, weekly data

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