



MACROECONOMIC FRAMEWORK

2008/09-2010/11

“Promoting Sustained Growth and Improved Public
Services Delivery”

WINDHOEK
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Table of Contents

FOREWORD	iii
EXECUTIVE SUMMARY	iv
A. Global Economic Developments	1
B. Domestic Economic Review	3
III. THE NAMIBIAN ECONOMIC OUTLOOK.....	5
A. The GDP Growth Projection.....	6
B. Risks to the Domestic Economic Outlook	7
IV. FISCAL DEVELOPMENTS	9
A. Fiscal Policy Objectives.....	9
(i) Overall budget outturn for 2006/07	9
(ii) Budget Estimates for 2007/08	10
V. FISCAL AND ECONOMIC GROWTH OUTLOOK.....	12
VII. CONCLUSIONS.....	17
ATTACHMENTS	
Attachment A: Budget Revenue Estimates vs. Outturn, 2006/07	19
Attachment B: GDP Growth Projections under Baseline Growth Scenario	20
Attachment C: Revenue Projections, 2008/09 to 2010/11	21

FOREWORD

The Macroeconomic Framework provides macroeconomic assessment and determines the probable course of future events, which might affect the overall economy. It uses a set of macroeconomic assumptions to guide the projections of macroeconomic aggregates in the short to medium term. The Framework serves to advise government on economic policy decision, towards achieving macroeconomic objectives. It provides guidance with regard to targeting resources towards priority areas of economic policy. Based on the current macroeconomic assessment, the framework provides the economic growth and fiscal projections over the next Medium Term Expenditure Framework (MTEF) period (2008/09-2010/11) for Cabinet consideration.

The Namibian economy performed relatively well during 2004/05-2006/07, supported by a favourable external environment and sound macroeconomic policies. Economic growth was robust, the external current account balance recorded a healthy surplus and the fiscal position was significantly consolidated. Moreover, significant gains were made in reducing poverty and extending important social services such as rural water and electricity supply, and the provision of education and healthcare services to the hitherto un-served and under-served areas and groups.

Notwithstanding these achievements, poverty remains widespread and unemployment levels high. In addition, the strong growth recorded in recent years did not generate commensurate growth in jobs. This year's budget therefore seeks to ensure not only economic growth, but also enhanced gains for the population from such growth. It is against this background that the theme of this year's macroeconomic framework focuses on sustained economic growth and improved public services delivery through a series of reforms, including addressing the skills gaps through the ETSIP programme; improving the delivery of health services and continuing the fight against the HIV/AIDS pandemic; continue the support of vulnerable groups; and investments in strategic growth areas, such as agriculture, aquaculture, tourism, as well as infrastructure development. To enhance public service delivery, emphasis will be placed on increasing the productivity in the public service and improving the performance of state-owned enterprises.

I would like to extend my gratitude to all the institutions that contributed to the preparation of the Macroeconomic Framework, comprised of Ministry of Finance, National Planning Commission and Bank of Namibia.

Saara Kuugongelwa-Amadhila
Minister of Finance

EXECUTIVE SUMMARY

The Namibian economy has performed satisfactorily, supported by strong global growth

Following the international financial market turbulences in August 2007, growth in the advanced economies had to be revised down. Mitigating this negative impact on worldwide economic performance, emerging market economies have become key drivers of global growth. Overall world output is expected to slow to 4.1 percent in 2008, somewhat weaker than in 2007.

The Namibian economy has performed satisfactorily in recent years. Growth has been respectable and the outlook is promising, supported by sound macroeconomic policies and a favourable external environment, although some risks from the global economic slowdown remain. After expanding by 4.1 percent in 2006, real GDP growth is expected to moderate to 4.0 percent in 2007;

Like other net oil-importing countries, Namibia has been confronted with the challenge of inflationary pressures due to higher food and international oil prices. The annual average inflation rate reached 6.7 percent during the first nine months of 2007, compared to an average of 4.7 percent during the first nine months of 2006. The balance of payments continued to register healthy surpluses due to the strengthening of mining exports and the increase in revenue receipts from the SACU Common Revenue Pool.

The economic outlook for Namibia continues to be favourable

According to the baseline growth scenario, the GDP is projected to grow at an annual average rate of 5.1 percent during the MTEF period 2008/09 to 2010/11. This growth rate will be positively affected by key spending programmes on infrastructure and productive sectors, whilst it is also subject to some downside risks, most notably from the international economic situation.

Going forward, the Namibian economic outlook is exposed to several challenges

- i. Inflationary pressures resulting from the volatile and high oil prices, as well as higher food prices would impact negatively on economic growth and the poor;
- ii. Global financial turbulences spinning off from the sub-prime housing market crises in the United States could slow global growth, impacting negatively on world demand for commodities and their prices;
- iii. On the domestic front, a slow-down in diamond mining remains a key challenge to the growth prospects;
- iv. Poorly performing SOEs reduce Government's ability to accelerate growth and to provide quality public services. The establishment of the State-Owned Enterprises Governing Council (SOEGC) to oversee the operations of the SOEs and implementation of the SOE Governance Act should help improve the operations of SOEs;
- v. High interest rates might have dampening effects on growth. The expectation is that interest rates would moderate in the medium term providing impetus to acceleration of growth;

- vi. Appreciation of the Namibia Dollar vis-à-vis the US Dollar may reduce the competitiveness of Namibia's products compared to imports from countries whose currencies are linked to the US dollar;
- vii. Sustainable power supply remains an important challenge for economic growth in the SADC region. Certainty of power supply is important for new investments and for expansion of existing production;
- viii. The possible decline in SACU receipts remains a key risk to the fiscal and balance of payments outlook, underscoring the need to continue strengthening the collection of domestic tax and non-tax revenue and to diversify the tax base away from international trade taxes; and
- ix. A trade agreement between SADC and the EU on the basis of the Doha Principles for Free Trade is important for enhanced trade and growth within SADC.

Fiscal performance has improved considerably with significant budget surpluses

After a high budget deficit of 7.0 percent of GDP in 2003/04, the government successfully consolidated the fiscal position in 2005/06, realizing a budget deficit of only 0.2 percent of GDP. This was followed by a first budget surplus of 4.6 percent, the first of its kind since Independence. Although a budget surplus of 1.1 percent of GDP has been programmed for 2007/08, preliminary indications show that this could increase to 3.1 percent. The budget surpluses in 2006/07 and 2007/08 are a result of increases in tax revenues, consisting mainly of improved domestic revenue collection and SACU receipts. This facilitated increases in expenditure while at the same time reducing the public debt stock.

Implementation of the capital budget exceeded 95 percent in 2006/07, indicating the improved implementation rate of development projects, which are critical for economic development and job creation; the implementation rate of total government expenditure was even higher at 99 percent.

As a result of successful fiscal consolidation, the government significantly reduced the debt to GDP ratio below the benchmark of 25 percent as of July 2007. This will enable the country to better anchor the fiscal position going forward, but a low debt burden also saves on debt servicing costs, thereby creating the necessary fiscal space to put the economy on a higher and sustainable growth trajectory.

The total revenue for 2007/08 is now projected to exceed the budget estimates by 7.3 percent. This is driven by stronger-than expected domestic tax collection, in particular for income tax on individuals, as well as corporate tax on mining companies and VAT.

Debt burden on future generations continues to fall

Under the current fiscal scenario, the total debt stock as a percentage of GDP is expected to drop below 20 percent, which is substantially below the fiscal target of 25 percent of GDP.

The Macroeconomic Framework 2008/09 - 2010/11 provides for an increase in expenditure while observing Government's fiscal targets

There is therefore flexibility to raise expenditure, and still maintain the total debt to GDP ratio below the fiscal target. This is a direct result of the persistent efforts of prudent fiscal policy, which are finally starting to yield the desired benefits. With fiscal sustainability well

anchored, the Government has more fiscal space to propel accelerated pro-poor growth in line with Vision 2030 the objectives.

The Budget priorities are informed by Vision 2030 objectives

The macroeconomic framework is informed by the priorities set out in Vision 2030. In a nutshell the framework aims to enhance the welfare of all Namibians by:

- i. Supporting macroeconomic stability through implementation of sound and prudent fiscal policies;
- ii. Investing in the growth of the economy through investment in critical economic infrastructure and the productive sectors, including the promotion of SME development;
- iii. Expanding agricultural production and improving productivity both in the commercial and subsistence subsectors;
- iv. Improving the quality of education and health, which are crucial for poverty reduction;
- v. Intensifying the fight against HIV/AIDS; and
- vi. Alleviating poverty among vulnerable groups.

Fiscal strategy to focus on improving expenditure efficiency, enhancing tax collection and maintaining debt sustainability

The main areas of emphasis include the following:

- i. Ensuring that public expenditures are utilised in the most efficient manner and provide value for money;
- ii. Monitoring expenditures through optimal use of existing systems;
- iii. Continued broadening of the revenue base, whilst paying attention to lightening the burden on the poor and not stifling investment;
- iv. Refining further the fiscal policy framework including debt management practices;
- v. Promoting regional integration with attention to its benefits and costs to Namibia;
- vi. Ensuring that the level of public debt remains sustainable. This includes that the cost of debt is minimised subject to an acceptable degree of risk; and
- vii. Private sector development, including the deepening of the capital market.

Conclusions

- i. Fiscal prudence, including the sustainability of expenditure, will remain a priority;
- ii. Efforts will continue to improve revenue mobilisation through improved revenue collection, identifying new revenue sources, and the consolidation of revenue management;
- iii. Priority targeting of public resources, and efficiency in their use shall continue to receive the utmost attention during the MTEF period;
- iv. Output oriented budgeting will be promoted in order to ensure value for money;
- v. Budget support of economic growth and poverty reduction will be achieved by balancing budget allocations between social and economic sectors.

I. REVIEW OF ECONOMIC DEVELOPMENTS

1. Namibia is a small open economy, highly dependent on international trade, with the value of exports and imports together exceeding the GDP. Thus, the global economic developments have a significant impact on the Namibian economy.

A. Global Economic Developments

Economic growth has been stronger than expected

2. The world economy recorded a satisfactory growth rate of 5.0 percent in 2006. Despite tight monetary conditions world-wide and financial turbulence caused by the US sub-prime market, the global economy continued to expand at a favourable pace, which is estimated to remain above 5 percent during 2007. The main drivers of this global expansion are emerging market economies, particularly China, India, and Russia that accounted for one-half of the global growth over the past year. Accelerated growth in these countries counterbalanced moderate growth in the US as continued turmoil in the US housing market applies a considerable drag. The recent high and less volatile global growth is a feature in common with other countries (see Table 1).

Growth in advanced economies is slowing down

3. Annual real GDP growth in the United States is expected to slowdown to 2.2 percent in 2007 from 2.9 percent in 2006. This is mainly due to the downturn in the housing market, which continued to exert considerable downward pressure on the economy. Further, private consumption and residential investment continued to suppress economic growth during the first half of 2007. In 2008, the growth of the US economy is forecasted to slow further to 1.6 percent. Downside risks to the outlook remain, primarily due to the continuing turmoil in the financial markets, the downturn in the sub-prime mortgage market, as well as the recent slowdown in productivity growth attributed to structural factors.

4. The slowdown in the US economy is being felt across the Atlantic, where after two years of solid economic performance in the Euro zone, forecasts for 2008 had to be cut by half a percent to 1.6 percent. The Euro zone had expanded at an increased pace since mid-2006, aided by an upswing in investment (particularly in Germany) and growth in exports. Growth had been expected to remain strong as improved job market conditions support household spending, but the reverberations of the banking crises, felt also in European stock markets at the beginning of 2008, indicate a slower expansion going forward.

Table 1: Real GDP Growth in Selected Economies

Regions/countries	2005	2006	2007	2008
World Output	4.4	5.0	4.9	4.1
Emerging markets	7.0	7.7	7.8	6.9
Sub-Saharan Africa	5.9	5.8	6.0	7.0
USA	3.1	2.9	2.2	1.5
Euro-zone	1.5	2.8	2.6	1.6
UK*	1.8	2.8	3.1	2.3
Japan	1.9	2.4	1.9	1.5

Angola*	20.6	18.6	23.1	27.2
Brazil*	2.9	3.7	4.4	4.0
China	10.4	11.1	11.4	10.0
India*	9.0	9.7	8.9	8.4
Russia*	6.4	6.7	7.0	6.5
South Africa*	5.1	5.0	4.9	4.5

Source: IMF World Economic Outlook Update, January 2008

* from IMF WEO, October 2007

5. The growth of the Japanese economy is expected to have moderated to 1.9 percent in 2007 from 2.4 percent in 2006 with consumption and investment being the main drivers for growth, supported by income gains and healthy profits.

Robust growth in emerging market and developing economies offset a modest slowing of growth in advanced economies

6. Economic growth in Angola is projected to continue at a brisk pace driven by high oil prices, increasing from 18.6 percent in 2006 to 23.1 percent in 2007 and 27.2 percent in 2008.

7. Growth in Brazil is expected to increase to 4.4 percent in 2007 from 3.7 percent in 2006 as a result of monetary policy easing after inflation was brought on track.

8. China's economic growth rate eased to 11.5 percent year-on-year in the third quarter of 2007 from 11.9 percent recorded during the second quarter of 2007. Inflation eased to 6.2 percent in September 2007, from a more than decade high of 6.5 percent in August 2007 due to slower gains in food prices. Overall, the Chinese economy is projected to expand by 11.4 percent in 2007. Strong exports and accelerated investment account for this robust growth rate.

9. The Indian economy registered a year-on-year annual growth of 9.3 percent during the first half of 2007 largely due to strong gains in domestic investment. It is expected that the economy will expand by 8.9 percent in 2007 and 8.4 percent in 2008.

10. Russia registered a year-on-year growth of 7.8 percent during the second quarter of 2007. It is expected that for 2007, the Russian economy will grow by 7.0 percent as a result of tightening credit conditions and a weakening external environment. However, high commodity prices and rising fiscal spending would continue to support activity in the net-energy-exporting country.

11. South Africa's economic growth is projected to slow down slightly from 5.0 percent in 2006 to 4.9 percent in 2007 and to 4.5 percent in 2008.

Oil producing countries and high commodity prices driving better economic performance in Sub-Saharan Africa

12. Sub-Saharan Africa continued to record better economic performance with overall growth projected to rise from 5.8 percent in 2006 to 6.0 percent in 2007 and 7.0 percent in 2008. This growth is mainly driven by oil producing countries and high commodity prices; as well as the structural reforms implemented by many African countries. Indeed, the IMF has pointed out that African growth appears to be most resilient to the recent turbulences in the world financial markets, perhaps thanks to the lack of financial integration of our continent.

13. Private capital flows into emerging markets and developing countries are expected to rise from US\$ 220.9 billion in 2006 to a peak of US\$ 495.4 billion in 2007, but moderate to 291.3 billion in 2008; with the bulk of these in the form of private (foreign) direct investment or FDI. Private direct investment (net) into Africa is projected to rise from US\$ 20.4 billion in 2006 to US\$ 27.1 billion in 2007 and US\$ 27.7 billion in 2008. Official flows (net) into Africa are projected to reverse the trend of net outflows during 2004-2006 and reach US\$ 5.5 billion per year during 2007 and 2008.

14. Although there might be a slight slowdown in global growth, the demand for Namibia's exports, especially minerals including diamonds and uranium, should continue to be strong. While the world prices of minerals including diamonds and uranium have moderated from their all time highs in late 2006 and early 2007, they are expected to continue at or near current levels over the next three years. Foreign direct investment (FDI) flows into Namibia should continue at recent levels during the next three years; and the high oil prices may continue in spite of some slowdown in global growth.

B. Domestic Economic Review

Sound macroeconomic policies and high commodity prices contributed to positive growth in the domestic economy

15. Sound macroeconomic policies, global growth and high commodity prices contributed to positive growth in the Namibian economy in recent years. The economy expanded at a relatively robust pace of 6.6 percent in 2004, but slowed down to 4.8 percent in 2005 and to 4.1 percent in 2006. For 2007, economic growth is expected to decelerate to 4.0 percent mainly on account of weaker performance of the primary industries, in particular mining.

Diamond mining remains a key driver of growth

16. The real sector developments during the period 2004-2006 was characterized by a relatively high average growth in GDP of 5.2 percent per annum. The overall GDP growth rate during the period 2004-2006 was favourably affected by the growth in diamond mining, which expanded at an annual average rate of 20.2 percent; the construction sub-sector with an average growth rate of 12.2 percent; as well as the sub-sectors in the tertiary industries, notably transport and communication at 13.7 percent, financial intermediation at 12.0 percent, and wholesale and retail trade and repairs at 8.2 percent. The data on GDP growth by industries during 2004-2006 is presented in Table 2.

Table 2: GDP Growth by Industries, 2004-2006
(percentage changes)

Industry	2004	2005	2006	Average
Primary Industries	13.2	1.9	7.9	7.7
Secondary Industries	2.5	3.6	0.3	2.1
Tertiary Industries	7.1	7.0	4.4	5.6
GDP at market Prices	6.6	4.8	4.1	5.2

Source: CBS, National Accounts: 1996-2006

17. The **primary industries** recorded an average growth rate of 7.7 percent, which was mainly a result of the increases in diamond mining followed by the agriculture and forestry sub-sectors. However, the fishing sub-sector contracted during the period.

18. The performance of the **secondary industries** during 2004-2006 recorded an average growth rate of 2.1 percent, which was a significant decline from that during the preceding three years (7.4 percent during 2001-2003). The decline has been particularly pronounced in the manufacturing sub-category of fish processing.

19. The **tertiary industries** recorded an average growth rate of 5.6 percent during 2004-2006. The main driving forces under the tertiary industries were post and telecommunications, transport and storage, financial intermediation and wholesale and retail trade and repairs.

Inflationary pressures remained strong

20. During 2007, persistent inflationary pressures were witnessed in Namibia as a result of rising and volatile international oil prices, supported by rising domestic food prices. The annual average inflation rate for 2007 is estimated at 6.8 percent, higher than the annual average rate of 5.1 percent recorded for the preceding year. The major contributors to the rising inflation were the categories of *food and non-alcoholic beverages* and *transport*. The increased food prices could be attributed to escalating production costs, resulting from rising fuel prices, and other factors such as global milk shortages and high wheat prices experienced during the year.

21. Since June 2006, the Bank of Namibia (BON) has raised the bank (base) interest rate from 12.75 percent to 15.25 percent or by a cumulative total of 350 basis points. This should in time lead to a moderation of domestic demand and contain inflation expectations. Nevertheless, the external factors such as oil price developments and adverse exchange rate movements will continue to pose a challenge to the outlook.

Healthy balance of payments position

22. The external sector of Namibia, as measured by developments in the balance of payments continued to show positive results during 2006; and this is expected to continue in 2007. The balance of payments is estimated to record a surplus of N\$ 3.5 billion in 2007, which is a notable improvement over the N\$ 1.1 billion achieved in 2006. This continuous surplus in the overall balance of payments will mainly arise from a significant current account surplus following sizeable inflows of income from the Southern African Customs Union or SACU receipts. Nevertheless, there is a need to diversify and strengthen the export oriented sub-sectors of the economy and strengthen the non-tax revenue streams.

III. THE NAMIBIAN ECONOMIC OUTLOOK

23. The MTEF growth projections are based on an analysis of the factors that contributed to the sub-sector growth performance during 2004-2006, as well as current and emerging developments. A baseline growth scenario is projected building on recent sub-sector growth rates, the continuation of existing policies and programmes, domestic interventions and current international market developments. This scenario serves as a benchmark, and Government is aiming to improve on its growth projections through significant new policy/programme interventions. Namibia being a small open economy, the growth scenario is further sensitive to changes in the world economic outlook.

24. The general assumptions underlying the projections are presented in Table 3.

Table 3: General Assumptions underlying the Forecasts

<p><u>International Assumptions¹</u></p> <ul style="list-style-type: none">• International inflation is assumed at 2 percent per annum• World trade is assumed to grow at 7 percent per annum• USA long-term interest rate is assumed at 5 percent per annum• Oil prices expected to average at US\$ 68.52 per barrel in 2007 and US\$ 75 in 2008.• Slow growth in the US economy (2007-2008) at 1.9 percent <p><u>Namibia Assumptions</u></p> <p><i>Monetary Stance:</i></p> <ul style="list-style-type: none">• Money supply (broad money or M2) assumed to grow at 15 percent per annum under the baseline growth scenario• Inflation projected at 7 percent per year• Exchange rate - The Namibia Dollar is projected to depreciate at 3 percent per year <p><i>Demography:</i></p> <ul style="list-style-type: none">• Population growth 1.9 percent per annum• Labour force growth 2.6 percent per annum. <p><i>Government:</i></p> <ul style="list-style-type: none">• The tax rates are assumed to remain unchanged• Tax collections are expected to be strengthened due to more intense efforts to enforce compliance, the introduction of withholding tax on interest, and the taxation of the unit trust returns.• The Government's material consumption and investment are assumed to follow the growth in the labour force (2.6 percent) plus inflation (7 percent) to increase at 9.6 percent per annum• Employment in the Government is assumed to follow the labour force growth (i.e. increase at 2.6 percent per annum)• The salaries and wages (wage rate) in the Government are assumed to follow the consumer price index (CPI) or inflation with a one year lag.
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Source: Macroeconomic Working Group

¹ Source: IMF, World Economic Outlook, October 2007.

A. The GDP Growth Projection

Moderate growth is expected under the baseline growth scenario

25. Under the baseline growth scenario, the Namibian economy is estimated to have grown by 4.0 percent during 2007. The GDP growth is projected to accelerate to 4.7 percent in 2008, driven by, among others, other mining and quarrying due to the expected increase in uranium production by Langer Heinrich; but reduce to 4.0 percent in 2009, primarily due to a significant decline in diamond mining. The GDP growth is projected to accelerate to 6.2 percent in 2010, due in part to a recovery in diamond mining, and acceleration of growth in wholesale and retail trade, hotels and restaurants, transport and communications and other subsectors resulting from a moderation of interest rates and the major sports events including the 2010 World Cup in South Africa. It is projected to moderate to 5.8 percent in 2011, again due to a significant decline in diamond mining. Growth is projected to average 5.2 percent during the MTEF period 2008/09 to 2010/11. The key drivers of this growth are the expansion in the secondary industries, particularly in the construction sub-sector; and the recovery in the sub-sectors in the tertiary industries.

26. A summary of the GDP growth projections under the baseline growth scenario are presented in Table 4 and the details by sub-sector are provided in Attachment B.

Table 4: GDP Growth Projections under Baseline Growth Scenario
(percent)

	2004	2005	2006	2007	2008	2009	2010	2011	2008-2011
Industry	Actual	Actual	Actual	Est.	Forecast	Forecast	Forecast	Forecast	Average
Primary Industries	13.2	1.9	7.9	1.7	5.8	-1.5	4.6	-0.6	<u>2.1</u>
Second. Industries	2.5	3.6	0.3	5.5	6.1	7.3	7.4	7.4	<u>7.1</u>
Tertiary Industries	7.1	7.0	4.4	4.9	4.7	5.6	7.4	8.1	<u>6.5</u>
Real GDP Growth	6.6	4.8	4.1	4.0	4.7	4.0	6.2	5.8	<u>5.2</u>

Source: Macroeconomic Working Group

27. From the sub-sectoral point of view the baseline growth scenario assumes that GDP growth in Namibia is to occur mainly through growth in secondary and tertiary industries. Given the importance of mining in the Namibian economy, the performance of the mining sub-sector has a significant impact on overall GDP growth. The forecast performance in production by the mining industry is lower due to technical bottlenecks (as in the case of Langer Heinrich uranium mining), and the slowdown in diamond production (the diamond mining companies are assumed to reach only 90 percent of their production targets).

New Programme Interventions and Upside Risk to Growth Projections

28. Higher growth can be envisioned, driven by effective new policy interventions and upside risks to sectoral growth. New policy interventions include the construction of key economic infrastructure, which would boost output in mining and quarrying and construction. In the energy sector, the commencing of major projects such as the Kudu gas field would accelerate growth in construction, transport and communication. Upside risks to the economy stem from a possible moderation of interest rates and major sporting events, including the

2010 World Cup in South Africa. These could give impulses to accelerate growth in construction, wholesale and retail trade, hotels and restaurants, transport and communications and other subsectors. The mining sector would benefit from the discovery and exploitation of new deposits on- and offshore.

B. Risks to the Domestic Economic Outlook

29. The main downside risks to the domestic economic outlook are inflationary pressure due to high and rising oil prices and a reduction in commodity (minerals) prices. On the domestic front, a slowdown in the diamond mining sub-sector remains a key challenge to the growth prospects. Also, the higher interest rates and appreciation of the Namibia Dollar against the US Dollar adversely affect (in the next two years) the domestic and foreign demand for Namibian goods and services, investment and overall growth of the economy.

Inflationary pressures resulting from high oil prices remain

30. The persistently high and volatile international oil price continues to pose a risk to the global economic outlook. Thus far, high oil prices did not impact negatively on overall growth, partly because the increase in oil prices has been largely demand driven, reflecting robust global growth performance. This is unlike the oil shocks of the 70s and 80s which were supply side driven. Nevertheless, with oil prices having exceeded US\$100 dollar per barrel, there is increasing concern about its impact on global growth. For instance, the net oil-importing countries find it much more difficult to manage the impact of high oil prices. It is worth mentioning that due to persistent high oil prices alternative sources of energy such as bio-diesel have increasingly become economically more attractive. The downside, however, is that the diversion of agricultural land to producing raw materials for bio-diesel are putting upward pressure on agricultural commodities such as maize and wheat, products predominantly consumed by the poor.

Commodity prices expected to soften due to an expected slowdown in demand

31. Strong global growth, especially the rapid expansion of output in emerging markets and developing economies, has been largely responsible for the rise in commodity prices over the past several years. Fortunately for Namibia, the minerals sub-sector has been performing quite robustly due to the increased global demand. Given that Namibia's main trading partners are projected to witness a slowdown during 2008, the demand for commodities may be lower and commodity prices may experience a reduction, leading to subdued growth for commodity producers. There are already signs of mineral prices tapering off due to the slowdown in global demand.

32. In the wake of the global credit crunch that was triggered by the US subprime crisis, in January 2008 the IMF revised global economic growth for 2008 down to 4.1 from 4.8 percent previously. However, Africa appeared to be the one region that is projected to be least affected by the fallout, with growth still expected to pick up to 7.0 percent in 2007. Namibian exports may still be affected by slowing demand in industrialised countries.

33. Another risk to the domestic economic outlook is the non-performance of some state-owned enterprises (SOEs) that drain the public coffers without creating jobs and growth. In addition to other measures, the establishment of the State-Owned Enterprises Governing

Council (SOEGC) to oversee the operations of the SOEs and implementation of the SOE Law should help improve the operations of SOEs.

34. The relatively high interest rates pose a risk to the economy in the next two years. The expectation is that interest rates would moderate in the medium term providing impetus to acceleration of growth.

35. The electricity supply situation poses a risk to the economy in the next two to three years, which should be eliminated with the commissioning of various energy projects over the next few years.

36. The employment situation in the economy continues to pose a serious challenge. Government is addressing the issue in numerous ways. On the supply side, education is to receive a boost through ETSIP, which has a strong component of vocational training that shall facilitate job seekers to find employment. On the demand side, Government will invest heavily in those sectors with potential for employment creation, such as tourism, fisheries, infrastructure construction and the Green Scheme in agriculture. The Development Bank of Namibia and Agribank will receive additional capital to promote private sector development, in particular in the SME sector.

IV. FISCAL DEVELOPMENTS

A. Fiscal Policy Objectives

37. The main objectives of the government's fiscal policy have been to maintain macroeconomic stability, while at the same time promoting economic growth and improved welfare of Namibians. Namibia's prudent fiscal policy implemented in previous years continued to produce good results. The government has managed to achieve improved fiscal outcomes during the financial years 2004/05, 2005/06 and 2006/07.

38. During the same period, public expenditure increased and expenditure control measures were introduced by the government. At the same time, tax revenue collection improved, not least due to improved compliance following the introduction of forensic audits. This situation, also supported by the N\$648 million from the sale of shares of the Mobile Telecommunication Company (MTC), led to a budget surplus of N\$2,224.6 million in 2006/07.

(i) Overall budget outturn for 2006/07

Government revenue outturn in 2006/07 outperformed the budget

39. Government's overall revenue outturn for 2006/07 has outperformed the budget estimates by 8.3 percent. The strengthening of revenue collection measures has played an important role in the strong outturn. Most of this performance was due to buoyant corporate tax collections, in particular from mining companies, which benefited from strong world commodity prices. Most tax categories performed well, while non-tax revenue showed mixed results (see Attachment A).

Tax revenue remains the backbone of government revenue

40. In terms of weight, tax revenue continues to be the backbone of government revenue, with its proportion to total revenue and grants hovering at 90.6 percent during 2006/07. **Tax on income and profits, and tax on international trade** exceeded the budget estimates by 21.1 percent and 3.5 percent, respectively. The improved performance in **Income tax on individuals** was partly brought about by better enforcement and compliance by taxpayers as a result of forensic audits in the northern regions of Namibia. The audits have now been extended to the central region and will be rolled out to cover the whole country during the MTEF.

Due to high commodity prices, mining company tax contributed significantly to overall revenues

41. **Company tax** performance was attributed to a substantially higher outturn of tax from the mining sub-sector as a result of higher world market prices for diamonds and other minerals such as gold, uranium and zinc. A higher outturn from **non-mining companies** was attributed to higher profits earned by financial institutions and a few trading companies. This sub-category was also positively affected by strengthened compliance enforcement.

Public expenditure Outturn for 2006/07 only marginally above budget

42. The budget expenditure outturn for 2006/07 reflects an encouraging fiscal discipline, exhibiting over-expenditures above budget estimates of less than 1 percent. **Personnel expenditure** and **subsidies and other current transfer** remained the largest line items in Government expenditure; both increased by 1.1 percent, while **other statutory** expenditures surpassed estimates by 28.5 percent. Net lending also turned out higher at 8 percent (or by N\$ 46.8 million) above the budget estimates. This was due to slower repayment of on-lent loans, which fell short of the estimated schedule by N\$ 48.7 million.

Implementation rate of development budget improved

43. A total amount of N\$ 1,875.5 million was allocated to development expenditure in the 2006/07 fiscal year. The actual spending amounted to N\$ 1,806.2 million. This means that an amount of N\$69.3 million was not spent, which represents a variance of 3.7 percent. This is the lowest variance since Independence, indicating the improved implementation rate of development projects which are critical for economic development and job creation.

Budget balance improved significantly

44. The improved revenue performance led the budget balance to turn from an N\$ 84.9 million deficit in 2005/06 into a surplus of N\$ 2,314 million in 2006/07. The improved budget surplus outturn in 2006/07 was mostly due to better-than-expected revenue collection, while expenditure was broadly in line with what had been budgeted.

Government debt declined

45. Total debt was projected to reach 33.7 percent of GDP at the end of the 2006/07 financial year. However, the more favourable revenue turnout – coupled with an upward revision in GDP – enabled the debt stock to be reduced to 28.3 per cent of GDP.

Contingent liabilities remained in check, while defaulted guarantees increased

46. The total Government Contingent Liability commitments increased from N\$3.5 billion in 2005/06 to N\$3.8 billion in 2006/07. Total guarantees as a percentage of GDP stood at 8.9 percent in 2005/06 and 8.6 percent in 2006/07, below the set benchmark of 10 percent. The total guaranteed amount defaulted increased from N\$ 21.6 million in 2005/06 to N\$ 212.5 million in 2006/07 due to the need to pay off the guaranteed loans of Air Namibia and the Windhoek Country Club.

(ii) Budget Estimates for 2007/08

Improved government revenue

47. Total revenue is estimated to increase to N\$ 19.7 billion during 2007/08 compared to the projection of N\$ 18.4 billion in the 2007/08 budget. This comes almost entirely as a result

of stronger domestic tax collections. As of November 2007, virtually all tax categories were exceeding estimates. The lion share of the increase in terms of value was attributed to income tax on individuals and non-mining companies, as well as VAT.

Expenditure estimate to remain unchanged

48. Halfway through the financial year, it appears that expenditure is broadly on track to meet the budget, as it is slightly lower than the original estimates. This is due to lower-than-expected interest payments following accelerated debt redemption, while spending by the votes exhibits a marginal under spending so far, which might even out in the remainder of the financial year.

Debt stock shows a decline

49. Given the strong fiscal position, the Government has been able to reduce its domestic debt stock substantially during the fiscal year. At the beginning of 2007/08 domestic debt stood at N\$ 13.4 billion, which was reduced to N\$ 11.7 billion by July 2007. This reduction is mainly due to redemption of the Government bond GC07 (N\$ 1.2 billion) in July 2007 and a gradual reduction in T-365 Treasury Bills since the beginning of the financial year. This means the fiscal target of total debt not to exceed 25 percent of GDP had been achieved as of July 2007.

V. FISCAL AND ECONOMIC GROWTH OUTLOOK

A. Government Budget and Economic Growth

50. As in many other developing countries, the Government of the Republic of Namibia is an important actor in the economy and public expenditure accounted on average for about a third of the GDP in recent years. The GDP growth projections include the “providers of government services” as one of the sub-sectors. The sub-sector outputs in the National Accounts are compiled using the proxy of the number of people employed in the government. The GDP growth projections presented in Tables 4 and 5 in Section III of this paper utilized the past trends and other information to estimate the “providers of government services” sub-sector growth rates during 2007-2011.

B. Fiscal Outlook Baseline Scenario

51. The Fiscal baseline scenario assumes that the expenditure ceilings for 2008/09 and 2009/10 in the 2008/09-2010/11 MTEF equal the ceilings as stipulated in the previous MTEF 2007/08 - 2009/10, adjusted for by 7 percent inflation. For 2010/11, the budget expenditure has been increased by a nominal rate of 9.6 percent as per the assumptions underlying the GDP growth forecasts. **This scenario serves merely as a benchmark as to what the implications of maintaining last year’s ceilings with inflation adjustments would be.**

Table 6: Fiscal Outlook under Baseline Scenario
(N\$ millions unless otherwise specified)

	2008/09	2009/10	2010/11
GDP	59,516	64,590	70,017
Total Revenues	20,873	21,753	22,640
Total Expenditure (excl interest)*	17,149	17,416	19,087
Primary Surplus (Deficit)	3,724	4,337	3,553
<i>As a % of GDP</i>	6.3%	6.7%	5.1%
Total Interest	982	781	375
Budget Balance	2,742	3,555	3,178
<i>As a % of GDP</i>	4.6%	5.5%	4.5%
CENTRAL GOVT DEBT (end of year)			
TOTAL	10,725	9,151	7,758
<i>As a % of GDP</i>	18.0%	14.2%	11.1%

Source: Macroeconomic Working Group

Current ceilings would lead to high surpluses and rapid debt reduction

52. If the ceilings were maintained as stipulated above, the strong upward revision in revenue would result in budget surpluses in excess of 3 percent of GDP on average for the three-year period 2008/09 to 2010/11. This following the surpluses already realized in 2006/07 and expected in 2007/08. Under this scenario, the total debt stock would reduce to 11.1 percent of GDP at the end of 2010/11, which is substantially below the fiscal target of 25 percent.

Using the created fiscal space to accelerate development

53. Given the significant fiscal consolidation, more fiscal space has become available to support increased expenditure without jeopardising fiscal sustainability. There is an opportunity therefore to strengthen allocations to the priority sectors identified in the MTEF in order to accelerate public service provision and achieve consolidation and expansion of development.

VI. BUDGET PRIORITIES AND FISCAL STRATEGY FOR 2008/09 TO 2010/11

A. Budget Priorities

54. The macroeconomic framework promotes increased public expenditure, made possible by the years of prudent fiscal policy that are finally starting to yield the desired benefits. With fiscal sustainability well anchored, the Government has more fiscal space to pursue increased pro-poor growth.

55. Expenditure will expand strongly over the next three years, in line with Government's strategy of pro-poor and pro-growth budgets. The focus will be on sustainable economic growth through investment in human resources and physical infrastructure. Increased attention will also be given to improved and efficient public service delivery, especially in crucial social services.

56. Key spending priorities include the following:

- Increasing power supply, both in terms of reliability as an input in economic production and as a basic household need. Reliability will be improved through increased investment in electricity production and import infrastructure. Supply to households will be boosted through the rural electrification programme.
- Upgrading and extension of key road and railway networks that will link Namibia to the SADC region and support the country's vision to become a hub for the provision of transport and related services in SADC;
- Expanding agricultural production and improving productivity both in the commercial and subsistence subsectors. Given that the majority of the population is dependent on agriculture, this is a key sector for employment creation and poverty reduction. Land reform is to be accelerated in order to achieve a more equitable distribution and promote secure and sustainable livelihoods.
- Improving the quality of education, health and other social sectors, not only as means to reduce poverty, but also as key growth enhancers.
- The fight against HIV/AIDS will be intensified in order to prevent the further spread of the disease and mitigate its impact.
- Vulnerable Groups – orphans and elderly receive increased support in line with Government's pro-poor aim to improve their basic living conditions.

B. Fiscal Strategy

57. The fiscal strategy of Government is to plan and execute public expenditure efficiently, improve revenue collection and maintain sustainable public finances. It further aims at promoting the private sector and regional integration for sustainable economic growth. The policies to achieve the fiscal strategy include the following:

- i. Priority targeting in budgeting shall continue to receive considerable attention to ensure the limited resources are used on priority areas which generate maximum impact on economic growth and poverty reduction.
- ii. Budget monitoring will be scaled up to ensure optimal utilisation of budget resources and to prevent the diversion of funds. In addition, data from the Integrated Financial Management System (IFMS) shall be relied on to enhance scrutiny of expenditure.
- iii. Public procurement policies offer great potential for local SME development and economic empowerment. The focus will be on obtaining value for money while upholding Namibian enterprise promotion.
- iv. Public expenditure is closely linked to the performance of SOEs. Government is committed to further improve their productivity. One strategy in this regard is to pursue rating of parastatals by agencies or international institutions such as the World Bank or the Millennium Challenge Account. Such ratings improve transparency and enforce accountability, while at the same time giving incentives for better performance. They may therefore help with Government's plans to move the financing of SOEs off the budget, for example by enabling them to raise their own debt in the market.
- v. Continued improvement in revenue collection through strengthened compliance enforcement, the broadening of the revenue base and capacity building for tax laws administration
- vi. During 2007/08, the tax threshold on personal income tax was revised in order to relieve the tax burden on low income earners. Individuals earning below N\$36,000 a year are now tax exempted, up from the previous threshold of N\$24,000. Further tax concessions were granted to taxpayers with tax arrears, where the interest calculations are changed from compound to simple interest. These measures will provide relief to the poor, contribute to the reduction of inequalities in income and encourage production.
- vii. Tax policies will continue to be oriented towards supporting economic growth through mobilising public revenue to finance public programmes that encourage private sector growth.
- viii. Namibia has benefitted from a positive external environment. However, the current commodity price boom may not last forever. It is necessary to use the opportunity to fast-track structural reforms.

ix. Namibia is a small open economy, and efforts will continue to promote regional integration to ensure market access for the country's products and to enhance its participation in the globalization process. The regional integration initiatives/measures should consider both the benefits and the costs and choose an optimal mix that best suits the interests of Namibia.

x. Government's borrowing strategy will continue to aim at mobilising additional resources to implement government programmes and to promote the development of the domestic capital market, which is a requirement for economic growth. In following that strategy, care will be taken that cost of government debt is minimised, given an acceptably low degree of the associated risk.

xi. Prudent fiscal policy will also have mitigating effects on inflation and consequently interest rates. This is an indirect form of private sector support.

xii. Private sector development will include reforms of the financial sector. This includes strengthening and streamlining of the supervisory functions of Namfisa and the Bank of Namibia and implementation of the Financial Sector Charter. The capital base of DBN and Agribank will be strengthened to support credit accessibility and entrepreneurial activity. The amendments to Regulations 28 and 15 regarding domestic asset requirements were gazetted in 2007/08 and will further promote domestic investment.

VII. CONCLUSIONS

58. Although the international outlook has become less favourable since August 2007, the global economy is expected to perform relatively well due to strong performance of key emerging market economies such as Brazil, China, India, Russia and South Africa. Consequently, it is expected that the demand for Namibia's minerals will remain robust in the medium term, although there will be moderate slowdowns over time.

59. Underpinned by sound and prudent macroeconomic policies, economic growth in Namibia averaged a respectable 5.2 percent between 2004 and 2006. Due to improved revenue collection and expenditure controls – and aided by the solid economy – government managed to achieve a significant budget surplus in 2006/07. Based on current revenue and expenditure trends, another surplus is expected in 2007/08 and the medium term outlook seems favourable. The strong performance has enabled the Government to significantly reduce the debt stock to below the target of 25 percent of GDP.

60. Despite the positive economic performance, there are enormous social and economic challenges that need urgent attention. Growth has not brought with it a commensurate creation of employment. Moreover, the challenge to roll out and maintain physical infrastructure remains.

61. Based on the revenue outlook, there is flexibility to significantly scale up expenditure through investment in growth-enhancing areas, including human capital formation through education and health, infrastructure development and the productive sectors. Fiscal sustainability will, however, remain a key policy objective of the Government going forward.

ATTACHMENTS

Attachment A: Budget Revenue Estimates vs. Outturn, 2006/07

HEAD OF REVENUE	Revised 2006-07	Actual 2006-07	Variance %
TOTAL REVENUE AND GRANTS	16,209	17,593	8.5%
TAX REVENUE	14,592	15,843	8.6%
Taxes on Income and Profits	4,689	5,676	21.0%
Income Tax on Individuals	3,286	3,374	2.7%
Company Taxes	1,302	2,161	66.0%
Diamond Mining Companies	45	360	699.8%
Other Mining Companies	7	351	4909.4%
Non-Mining Companies	1,250	1,451	16.1%
Other Taxes on Income and Profits	101	141	39.6%
Non-Resident Shareholders Tax	82	118	44.2%
Tax on Royalty	8	12	46.8%
Annual Levy on Gambling Income	11	11	0.4%
TAXES ON PROPERTY	122	142	16.5%
DOMESTIC TAXES ON GOODS AND SERVICES	3,186	3,197	0.3%
Value Added Tax	2,925	3,001	2.6%
Levy on Fuel	92	86	-6.2%
Fishing Quota Levies	157	98	-37.9%
Other	12	12	-1.5%
TAXES ON INTERNATIONAL TRADE AND TRANSACTIONS	6,471	6,698	3.5%
OTHER TAXES	123	130	6.0%
NON-TAX REVENUE	1,480	1,683	13.8%
ENTREPRENEURIAL AND PROPERTY INCOME	1,049	1,264	20.5%
Interest Receipts for Loans Extended to -	52	21	-59.9%
Interest on Investments	0	0	0.0%
Dividends and Profit Shares	696	692	-0.4%
Interest on State Account Balances with Bank of Nam.	13	39	206.7%
Compensation for the use of the Rand	30	29	-3.4%
Diamond Royalties	258	482	86.6%
Other Mineral Royalties	0	0	
FINES AND FORFEITURES	24	19	-20.4%
ADMIN. FEES AND CHARGES AND INCIDENTAL SALES	407	400	-1.7%
RETURN OF CAPITAL FROM LENDING AND EQUITY PARTICIPATION	66	17	-73.7%
EXTERNAL GRANTS	72	50	-31.1%
TOTAL EXPENDITURE AND NET LENDING	15,288	15,279	-0.1%
Personnel expenditure total	6,145	6,214	1.1%
Total goods and other services	2,199	2,165	-1.5%
Subsidies and other current transfers	2,718	2,749	1.1%
Interest and related Charges	1,313	1,263	-3.8%
Acquisition of capital assets	152	152	0.0%
Capital Transfers	68	68	0.2%
Total Other Statutory	165	213	28.5%
Total Lending and Equity participation	652	651	-0.3%
Total Development expenditure	1,876	1,805	-3.8%

Source: Ministry of Finance

Attachment B: GDP Growth Projections under Baseline Growth Scenario

Sub-Sector/Industry	2007	2008	2009	2010	2011	Average 2007- 2011
Agriculture and forestry	3.7%	3.7%	3.7%	3.7%	3.7%	3.7%
- Commercial	3.7%	3.7%	3.7%	3.7%	3.7%	3.7%
- Subsistence	3.7%	3.7%	3.7%	3.7%	3.7%	3.7%
Fishing	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%
Mining and quarrying	0.2%	8.2%	-5.9%	5.9%	-4.4%	0.8%
- Diamond mining	0.0%	6.1%	-12.7%	4.3%	-8.3%	-2.1%
- Other mining and quarrying	0.9%	16.1%	17.8%	10.1%	5.1%	10.0%
Total Primary Industries	1.7%	5.8%	-1.5%	4.6%	-0.6%	2.0%
Manufacturing	4.3%	5.0%	5.0%	5.0%	5.0%	4.9%
- Meat processing	3.2%	3.7%	3.9%	3.9%	3.9%	3.7%
- Fish processing	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%
- Other food products and beverages	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%
- Other Manufacturing	4.6%	6.5%	6.5%	6.5%	6.5%	6.1%
Electricity, Gas and water	3.4%	3.4%	3.4%	3.4%	3.4%	3.4%
Construction	9.3%	9.5%	13.5%	13.5%	13.0%	11.8%
Total Secondary Industries	5.5%	6.1%	7.3%	7.4%	7.4%	6.7%
Wholesale and retail trade, repairs	6.5%	5.0%	6.2%	10.5%	12.0%	8.0%
Hotels and restaurants	5.0%	6.5%	6.5%	11.5%	11.5%	8.2%
Transport and communication	10.0%	10.6%	11.5%	12.6%	12.6%	11.4%
- Transport and storage	8.0%	7.6%	8.5%	9.4%	9.4%	8.6%
- Post and telecommunications	12.0%	13.5%	14.5%	15.7%	15.7%	14.3%
Financial intermediation	5.0%	4.5%	5.0%	11.0%	15.2%	8.1%
Real estate and business services	3.6%	3.5%	3.8%	4.0%	4.0%	3.8%
- Owner-occupied dwellings	4.2%	3.5%	4.0%	4.5%	4.5%	4.1%
- Other real estate and business services	3.0%	3.5%	3.5%	3.5%	3.5%	3.4%
Community, social and personal services	2.8%	3.0%	3.0%	3.0%	3.0%	3.0%
Producers of government services	2.3%	1.9%	2.8%	2.7%	2.7%	2.5%
Other producers	2.0%	2.0%	2.5%	2.0%	2.0%	2.1%
Total Tertiary industries	4.9%	4.7%	5.6%	7.4%	8.1%	6.2%
Less: Financial services indirectly measured	15.7%	15.8%	16.6%	16.0%	16.1%	16.0%
GDP at Basic prices	4.2%	5.0%	4.2%	6.6%	6.2%	5.2%
Taxes less subsidies on products	2.7%	2.6%	2.5%	2.5%	2.5%	2.6%
GDP at market prices	4.0%	4.7%	4.0%	6.2%	5.8%	5.0%

Source: Macroeconomic Working Group

Attachment C: Revenue Projections, 2008/09 to 2010/11

HEAD OF REVENUE	Actual 2006-07	Estimate 2007-08	Forecast 2008-09	Forecast 2009-10	Forecast 2010-11
TOTAL REVENUE	17,593	18,387	20,873	21,753	22,640
TAX REVENUE	15,843	17,042	19,383	20,144	20,899
<u>TAXES ON INCOME AND PROFITS</u>	5,676	5,201	6,637	7,101	7,431
Income Tax on Individuals	3,374	2,983	3,728	3,989	4,185
Company Taxes	2,161	2,070	2,674	2,867	2,992
Diamond Mining Companies	360	250	355	433	437
Other Mining Companies	351	350	461	483	506
Non-Mining Companies	1,451	1,470	1,858	1,951	2,049
Other Taxes on Income and Profits	141	148	236	245	254
Non-Resident Shareholders Tax	118	125	207	214	221
Tax on Royalty	12	12	17	18	19
Annual Levy on Gambling Income	11	11	12	13	14
<u>TAXES ON PROPERTY</u>	142	134	166	185	208
<u>DOMESTIC TAXES ON GOODS AND SERVICES</u>	3,197	3,488	3,933	4,209	4,505
Value Added Tax	3,001	3,263	3,756	4,030	4,324
Levy on Fuel	86	93	93	93	95
Fishing Quota Levies	98	73	73	74	74
Other	12	59	0	0	0
<u>TAXES ON INTERNATIONAL TRADE AND TRANSACTIONS</u>	6,698	8,085	8,502	8,500	8,600
<u>OTHER TAXES</u>	130	134	146	150	155
NON-TAX REVENUE	1,683	1,118	1,315	1,324	1,578
<u>ENTREPRENEURIAL AND PROPERTY INCOME</u>	1,264	663	816	897	992
Interest Receipts for Loans Extended to -	21	68	59	57	55
Interest on Investments	0	0	1	1	1
Dividends and Profit Shares	692	66	63	84	108
Interest on State Account Balances with Bank of Nam.	39	28	50	40	40
Compensation for the use of the Rand	29	0	0	0	0
Diamond Royalties	482	271	443	465	488
Other Mineral Royalties	0	229	200	250	300
<u>FINES AND FORFEITURES</u>	19	24	24	24	24
<u>ADMIN. FEES AND CHARGES AND INCIDENTAL SALES</u>	400	432	476	403	563
RETURN OF CAPITAL FROM LENDING AND EQUITY PARTICIPATION	17	24	34	30	29
EXTERNAL GRANTS	50	204	141	255	133

Est: Estimate, F: Forecast; Source: Ministry of Finance