September 2018

MINISTRY OF FINANCE

DIRECTORATE: ECONOMIC POLICY ADVISORY SERVICES

TOPIC:

NAMIBIA'S CREDIT RATING BY FITCH

The credit ratings report that was compiled by Fitch Ratings Agency on 03 August 2018, affirmed Namibia's rating status of **BB$^+$ (with a stable outlook)** and, amongst others, highlighted the following key findings:

Strengths

- World Bank governance indicators are higher than 'rating category medians, reflecting low levels of corruption, strong rule of law and accountability, and a track-record of political stability.
- Namibia has a wealth of natural resources, including uranium, diamonds, gold, copper and other industrial metals, as well as large fish stocks. This helps to attract steady inflows of foreign investment.

Weaknesses

- GDP per capita is well below the historical 'rating category medians and UN development indicators are low.
- Income inequality is among the highest in the world. The unemployment rate very high, at 37% in 2017.
- Namibia's dependence on the mining sector (13.2 % of GDP in 2012-2016) leaves the economy vulnerable to fluctuations in commodity prices.
- The wage bill is very high and absorbed 51% of revenues, equivalent to 16.3% of GDP in FY14-FY17, causing fiscal rigidity.
- Dependence on SACU receipts (33% of the total) increases the volatility of budget revenues.
- Current account deficits are wider than "rating category medians" reflecting a narrow domestic manufacturing base and sustained investment to bridge the country's significant infrastructure gap.
- Household debt of 83% of disposable income is high given Namibia's level of development.

Country Ceiling

Under the CMA treaty, member countries commit to align exchange controls and restrictions on capital flows outside the CMA with those applied in South Africa. In case of external financial pressure, the Bank of Namibia can access financing in rand under an existing ZAR1.2 billion loan facilities with the South African Reserve Bank, but it has to pledge FX collateral to draw on the credit line.

Public Debt to Rise Further as Deficit Only Gradually Narrows

Fiscal consolidation is advancing only slowly as the government has shifted away from frontloaded adjustment and now strives to protect growth while attempting to stabilize and eventually reduce public debt/GDP.

The authorities plan to improve domestic revenue mobilization by closing tax loopholes, raising some excise and other indirect taxes and enhancing collections by creating a semi-autonomous tax agency and strengthening controls.

The government has also cut non-priority operational spending and is reallocating budget resources to high-multiplier expenditures. It targets savings of 0.5% of GDP by improving the efficiency of health spending and expects to reduce personnel cost through hiring restraint and incomplete adjustment of salaries to inflation.

Fitch projects CG debt to rise to 51.4% of GDP in FY20 from 43.3% in FY17, as the CG deficit overshoots budget projections, narrowing from 5.7% of GDP (on a cash basis) in FY17 to 5.5% in FY18, and further to 4.3% in FY20, against an official target of 2.3%.

Fitch projects that current spending/GDP will decline albeit at a slower pace than projected by the government, due to higher personnel, interest and other recurrent expenditures than assumed in the budget projections, while capital spending/GDP (including foreign-financed outlays) will stabilize. Tax revenues will somewhat rise as domestic demand recovers. This will offset a decline in transfers from SACU reflecting lackluster regional growth and overpayment in FY17.

Refinancing risks are moderate but would rise starting 2020 should the budget deficit remain wide, as substantial amounts of market debt reach maturity. Two thirds of public debt is held domestically by a captive investor base and liquidity has been bolstered by the rise in the regulatory domestic asset requirement for institutional investors from 35% from to 45% of total assets by January 2019.

The disbursement of the second and last tranche of the ZAR 6 billion budget support loan from the African Development Bank is expected shortly and an additional ZAR 4 billion loan will finance investment projects over five year. Rollover risks arise from the upsurge in the stock of treasury bills at 12% of GDP in June 2018, double its level five years earlier, due to the low market appetite for long-term sovereign notes. Increasing reliance on domestic financing raises risks of crowding-out private investment and undermining growth.

High Budget Cost, Contingent Liabilities from SOE Sector

Transfers to loss-making SOEs of around NAD 5 billion (2.7% of GDP) per year are a burden for the budget. The government's plan to "leverage the assets" of some profitable SOEs and increase their involvement in the execution of public investment could weaken fiscal discipline and undermine the balance sheets of the concerned enterprises.

High SOE debt presents a significant contingent liability for the sovereign, with a stock of 24% of GDP at end-FY17, of which 7.5% of GDP is government guaranteed. Additional contingent liabilities for the budget arise from the possible need to restructure some troubled SOEs, including Air Namibia and the railway company Transnamib.

The expected liquidations of the distressed SME Bank and Road Contractor Company are still pending judicial approval but will generate only modest costs for the budget. A capital injection of around 0.3% of GDP is also expected in the public Agribank.

The approval of the Public Enterprise Governance Act Amendment in Parliament is likely in 2018. The new law will improve the governance of commercial enterprises under the supervision of a dedicated ministry.

The partial privatization and listing on the domestic stock exchange of the telecoms operator MTC is expected in the coming months. Additional privatizations of major government-owned assets seem unlikely in the medium term.

Low Uranium Prices, Drop in SACU Receipts Weakening External Finances

The CAD improved to 3.3% of GDP in 2017 from 15.7% in 2016, due to higher SACU transfers and a fall in imports reflecting the completion of investment projects and lower domestic demand due to fiscal consolidation. We project it to widen to 5.4% of GDP in 2020.

Stronger exports of metals will be largely offset by durably low uranium prices which are dampening domestic production as well by higher imports due to the rise in the cost of energy imports and a modest recovery in domestic demand while SACU receipts will decline.

Net external debt turned positive, implying a net debtor position in 2016 and we project it to rise further to 15% of GDP in 2020. Although inflation is hovering in the lower band of its target interval of 3-6%, we expect the BoN will maintain higher policy rates than the SARB to protect FX reserves. Fitch nonetheless expects FX reserves will decline to 3 months of current account payments, from 4.4 months in 2017.

The repayment of the principal due on the sovereign 2021 Eurobond from the earmarked resources deposited at the dedicated sinking fund would lead to a sharp drop in FX reserves, should the government decide against a rollover of the instrument.

Weak Economic Growth Prospects; Eroding Bank Profitability

Following a two-year recession, the economy will experience a shallow recovery driven by the pick-up in mining and other tradable sectors, amid subdued domestic demand. We expect GDP will rise by 0.6% in 2018 and 1.8% in 2019 after contracting by 0.8% in 2017. Renewed delays in the ramping-up of the Husab uranium mega-mine production to full capacity would raise downside risks for the outlook. The economy's susceptibility to external risks and weather hazards is compounded by the lack of fiscal space to cushion exogenous shocks while monetary policy is constrained by the exchange rate peg.

Despite Namibia's ample and diversified mining resources, medium-term growth prospects are modest reflecting structural bottlenecks, including low education outcomes and a business climate that is somewhat weaker than rating peers.

Meanwhile, high dependence on sectors with low labour intensity results in low elasticity of employment to economic growth. Consequently, unemployment is elevated and policymaking and public finances are subject to pressures to redress inequality which is among the highest in the world.

The banking sector's capitalization is adequate according to BoN and the IMF but its profitability has been eroded by the weak economic environment. The NPL ratio has inched up to 2.9% in March 2018 from 1.5% in 2016.

The BoN believes that NPLs might be slightly understated due to classification issues that are currently being investigated by the regulator. The strong interconnectedness of banking and non-banking financial institutions (NBFI) is a source of liquidity risk as banks are highly dependent on wholesale funding from the latter.

Banks would be exposed to the risk of further substantial drop in real estate prices which have moderately fallen since the end of 2017, with mortgage loans accounting for 38% of their assets, equivalent to 28% of GDP.

Sharp falls in domestic and foreign equity markets would affect banking liquidity through the NBFI channel as 65% of assets of pension funds' equivalent to 58% of GDP are invested in shares. The ongoing transition to a risk-based regulatory regime for NBFI would lead to better capturing of these risks in the calculation of capitalization ratios.

Lower Policy Uncertainty, Lingering Policy Risks from Inequality

Policy uncertainty has somewhat eased following the November 2017 congress of the governing SWAPO party, in line with our expectations. The party elections were won by the incumbent president's slate and were followed by a minor government reshuffle. We do not expect the 2019 presidential elections to lead to a significant shift in public policies given SWAPO's dominant position in the political landscape.

The government has abandoned the controversial provision of the National Economic Equitable Empowerment (NEEE) draft bill imposing a 25% stake in the capital of private companies to "previously disadvantaged persons". We expect a revised NEEE draft bill to be submitted to Parliament ahead of the 2019 presidential election. A land reform conference is scheduled to be held in October 2018, and might lead to some policy uncertainty amid calls for expropriation without compensation, a measure that is opposed by the government. These demands and the withdrawn controversial provisions of the NEEE draft bill illustrate the lingering policy risks resulting from Namibia's high inequality.

Public Debt Dynamics

CG debt will rise to 51.4% of GDP in FY20 and stabilize around 50%of GDP over the medium term, under our baseline scenario. These projections are premised on the assumption of gradual implementation of fiscal consolidation bringing the primary deficit to balance in FY2020, slow economic recovery with growth picking up to 3% over the medium term and 2-3% depreciation of the NAD against the USD per year. The debt trajectory is mostly vulnerable to fiscal slippages, as a primary deficit of 2.5% of GDP over the projection horizon would prompt CG debt to rise to 70% of GDP by 2027. A shock on interest rates would lead debt to rise to 60% of GDP in 2027, reflecting the high share of short-term treasury bills.