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MINISTRY OF FINANCE

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TOPIC:

NAMIBIA'S CREDIT RATING BY MOODY'S

The credit ratings report that was compiled by Moody's Investors Services on 23 August 2018, affirmed Namibia's rating status of **Ba1 (with a negative outlook)** and, amongst others, highlighted the following key findings:

The credit profile of Namibia reflects its small and relatively diversified economy. Gradually improving, though moderate, medium-term growth prospects – we expect real GDP growth of 0.9% in 2018 and 2.1% in 2019 – are supported by the country's primary industries, as major mines (uranium, gold) begin to produce closer to optimal capacity, and solid foreign direct investment flows. Namibia's profile also reflects moderate institutional strength, which balances favourable governance indicators against limited policy effectiveness in addressing fiscal challenges. In addition, the country's stable political landscape and tradition of political and institutional consensus-building are conducive to supportive macroeconomic policies and structural reforms.

Credit challenges include a rapid rise in public debt, which stood at slightly above 40% of GDP in FY2017-18 compared with 16.7% in 2010, and external vulnerabilities stemming from persistent current account deficits and relatively low international reserves. The sovereign is also susceptible to a further tightening of domestic funding conditions should fiscal slippages persist, which could cause debt servicing costs to rise.

The outlook could return to stable if the government demonstrates commitment to fiscal consolidation that results in a deceleration of debt accumulation and an eventual decline in debt levels. A structural improvement in the twin balances, a sustained easing of funding conditions in the domestic market and a permanent increase in foreign-exchange reserves would also be credit positive.

We would be likely to downgrade the rating if fiscal consolidation fails to contain rapid public-sector debt accumulation. A sustained decline in foreign-currency reserves to below three months of import cover, increased funding pressure reflecting reduced market appetite for government securities, leading to a material increase in borrowing costs, or both, would also put downward pressure on the rating.

This credit analysis elaborates on Namibia's credit profile in terms of economic strength, institutional strength, fiscal strength and susceptibility to event risk, the four main analytic factors in our Sovereign Bond Ratings methodology.

Small but resource-rich and relatively diversified economy

The economy is small, with GDP of around $13 billion in 2017, and a population of 2.3 million. With estimated per capita GDP on a purchasing power parity basis of $11,312 in 2017, the World Bank classifies the country as "upper middle income". However, while per capita GDP has more than doubled since independence in 1990, it remains below the median for Ba-rated peers and well below the median for Baa-rated sovereigns.

Namibia's economy has grown quickly since 1990, even compared with fast-growing regional peers. Although this growth has partly been underpinned by the capital-intensive mining sector, the economy is relatively well-diversified, particularly compared with neighbouring Botswana (A2 stable) and other commodity exporters in the A2-Ba2 rating range.

Recovery to be very gradual following 2016-17 economic slowdowns

Despite a relatively stronger economic base, real GDP grew only by 0.7% in 2016 from 6.1% in 2015, before contracting by 0.8% in 2017. The sharp decline represented a significant deviation away from the high growth seen between 2010 and 2015, when it averaged 5.7% per year, driven by the construction of large mines and an expansionary government fiscal stance that boosted investment.

The two key drivers of the downturn were: (1) falling government spending, reflecting the start of a fiscal adjustment; and (2) a sharp decline in investment, predominantly driven by a slowdown in construction in both the public and private sectors. Adverse external factors, including slow growth at the regional level, a severe drought and lower commodity prices also weighed on the economy.

In particular, the weak performance in 2017 reflected a contraction in the construction and wholesale and retail trade sectors, as well as a slowdown in growth in manufacturing, electricity and water. Construction contracted by more than 25% due to the completion of major mining projects and continuing fiscal consolidation, primarily cuts to capital spending.

Primary industries recorded solid growth in 2017, mainly due to a strong recovery in agriculture and mining. Agriculture rebounded on the back of more favourable weather conditions following several years of drought, while diamond mining recorded double-digit growth after contracting in 2016.

Real GDP growth improved slightly in the first quarter of 2018 while remaining in negative territory (lower by 0.1% year-over-year). The weak performance was driven primarily by the government sector, hotels and manufacturing. At the same time, economic indicators have pointed to an improvement across a number of sectors, including construction, supported by higher public and private construction works, transportation (rising cargo volumes) and the retail trade while growth in agriculture and mining output continues, albeit at a lower pace.

We expect economic activity to gradually recover, with real GDP growth of 0.9% and 2.1% in 2018 and 2019, respectively, though growth will remain below Namibia's estimated long-term potential of around 3.5%.

The economic recovery hinges on continuing buoyant, though moderating, growth in agriculture and mining (particularly uranium due to increased production at the Husab mine) and gradually improving manufacturing, which should offset the continued contraction in the construction sector.

We do not expect a return to the strong growth seen in the first half of the decade in the medium term, as this partly reflected transitory factors. Although mines are operating closer to optimum capacity, volatility in the construction and commodities sectors is likely to remain a key constraint on the sovereign's economic performance.

High unemployment, skills shortages and a deteriorating business climate constrain economic strength

Namibia continues to suffer from very high unemployment despite government efforts to address the issue. Official estimates for 2017 put unemployment at more than 37%, with youth unemployment significantly higher. Creating productive and/or well-paying jobs remains a challenge.

The mining and manufacturing sectors account for less than 10% of employment, while low-earning subsistence agriculture accounts for almost a third. However, there have been societal improvements, including a significant decline in levels of both poverty and extreme poverty since independence.

Targeted government and private programmes have also reduced the prevalence of HIV and tuberculosis, though rates remain high. Challenges to doing business also dampen overall productivity. Namibia's ranking on the World Bank's Ease of Doing Business index has fallen from 39th out of 155 countries in 2006 to 88th out of 189 countries in 2015 and 106th out of 190 countries in 2018.

Although Namibia remains relatively well-positioned among sub-Saharan African peers – only South Africa (Baa3 stable) ranks above it in 82nd place in the 2018 index – its decline in the rankings reflects a lack of improvement in the business environment compared with other countries globally. In particular, Namibia received very low scores in the categories of starting a business, registering a property and trading across borders.

According to the World Economic Forum's 2017-18 Global Competitiveness Report, skill shortages stemming from weaknesses in the education system remain the key constraint on the economy's competitiveness. The report also identified poor healthcare and ineffective macroeconomic environment as leading constraints.

Although the government has sought to address skill shortages by improving education and training, such programmes have achieved limited results to date despite substantial outlays. Resolving this inefficiency remains an important challenge given the scale of Namibia's socioeconomic problems.

Strong performance on the Worldwide Governance Indicators

According to the WGIs, Namibia compares favourably with most of the other sub-Saharan countries we rate, as well as other Ba-rated sovereigns. It ranks close to the 50th percentile of all Moody's-rated sovereigns in the category of government effectiveness, which assesses the quality and independence of public services, the quality of implementation of public policies, and government credibility in implementing announced policies. The score is comparable with that of Jordan (B1 stable) and Saudi Arabia (A1 stable).

Namibia also ranks in the 60th percentile among Moody's-rated sovereigns in the categories of control of corruption and rule of law, and has moved up the control of corruption indicator over the past decade. Namibia also performed well in Transparency International's Corruption Perceptions Index for 2017, maintaining its ranking of 53rd out of 180 countries surveyed. The ranking is similar to that for sovereigns such as Slovakia (A2 positive), Rwanda and South Korea (Aa2 stable).

The IMF has classified data provision in Namibia as "broadly adequate for surveillance", having dropped its previous caveat surrounding shortcomings in data provision. To enhance the government's capacity to collect and compile statistics, the Namibia Statistics Agency has been made fully autonomous – the agency compiles a nationwide CPI that provides an "adequate presentation of spending patterns of citizens and their experience of inflation" – while Namibia since 2016 has subscribed to the IMF's enhanced General Data Dissemination Fund. However, shortcomings exist, as reflected by sizeable revisions to GDP and fiscal data.

Limited policy effectiveness in responding to shocks and addressing long-term structural fiscal rigidities

Our assessment of institutional strength also reflects a lack of an effective policy response to shocks and fiscal challenges, which points to weaker institutional capacity than the WGIs suggest. In the last three fiscal years, Namibia has posted deficits above the government's original targets, highlighting the challenges to effective fiscal consolidation. Most of the spending cuts were introduced late in the last fiscal year.

Namibia's room for policy manoeuvre to address its fiscal challenges is constrained by long-term structural fiscal rigidities, which a sizeable increase in the public-sector wage bill in recent years has exacerbated: according to various metrics, Namibia has one of the highest wage bills in Africa and among middle-income countries globally. In addition, only limited structural changes have been made on the revenue side. These developments have reinforced existing fiscal rigidities and further eroded the government's capacity to respond to shocks.

Membership of Common Monetary Area supports macroeconomic stability

Namibia benefits from predictable monetary and exchange-rate policies in the context of the Namibian dollar's unitary peg to the South African rand, which has provided the currency with an important degree of credibility since its introduction in 1993. The arrangement contributes to financial and price stability, despite the rand's volatility. Namibia's inflation tracks that of South Africa relatively closely, reflecting the large share of South African products in its import basket.

Although inflation in both Namibia and South Africa declined in the first quarter of 2018, Namibian inflation fell below that of South Africa for the first time in two years, as a result of falling housing inflation and weak domestic demand. However, consumer price inflation accelerated to 4.5% in July 2018 from 3.9% in June driven by transport inflation.

We expect inflation to accelerate further in 2018, reflecting exchange rate pressures, while remaining below the average of 6.2% in 2017.