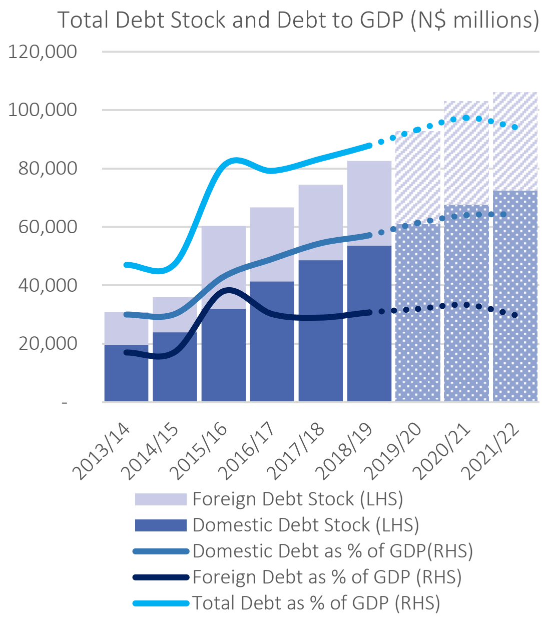
Economic Update

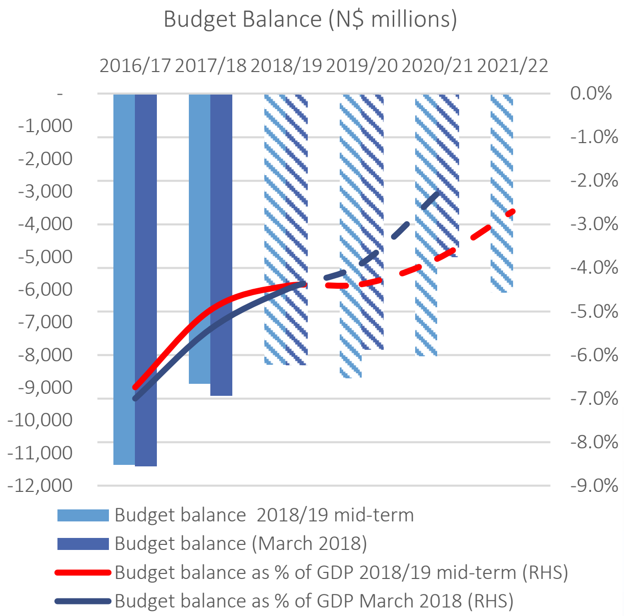
Fitch Ratings Revises Namibian Outlook

Fitch Revises Namibia's Outlook to Negative; Affirms at 'BB+'

On Thursday the 21st of February Fitch Ratings revised Namibia's Long-Term Foreign Currency Issuer Default Rating (IDR) outlook to negative from stable. In the interest of clarity, this was a revision to the credit rating outlook and not a credit rating downgrade. Fitch maintained the credit rating at BB+. In August 2018 Fitch confirmed Namibia's credit rating at BB+ with a stable outlook, indicating that the ratings agency is now more concerned about Namibia's creditworthiness than half a year ago.

Fitch agency cited weaker than expected growth in 2018 and a downward assessment to its future growth estimates for Namibia as its main concern. An implication of the sluggish growth environment is the negative impact that lower growth is likely to have on the public debt trajectory. In other words, Fitch is concerned that, given slow tax revenue growth and a growing operational budget, government expenditure is likely to continue to grow relative to revenue, necessitating the further use of debt to fund budget deficits. Growth in the operational budget is difficult to contain as roughly half this budget is made up of the wage bill, and wage bill growth is driven by inflationary or possibly even inflation plus salary negotiations. Government revenue growth is highly correlated with economic activity, thus, the longer the Namibian economy languishes, the more likely it is that revenue growth will not keep pace with expenditure growth. A weak South African economy impacts SACU revenues which makes up about a third of Namibia's government revenues, which effectively then has the same impact as slow domestic growth on government revenues.





Source: Ministry of Finance, IJG

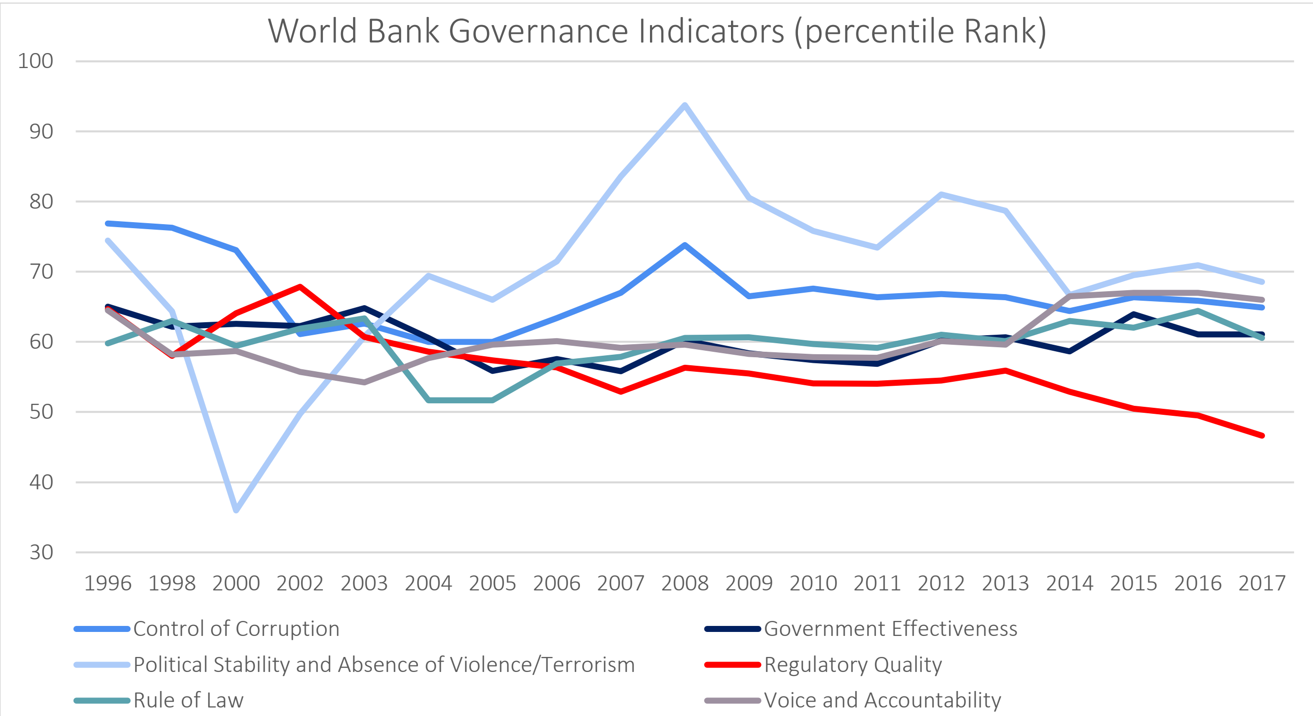
Fitch's downward revision to Namibia's credit rating outlook comes at a crucial time as Namibia prepares for elections in November and the finance ministry prepares for the March budget. Fitch points out that political stability is a source of support for the credit rating. Fitch also expects policy continuity despite the elections as SWAPO is under less pressure to make changes (whether populist or otherwise) due to a very healthy majority. Fitch did not specifically mention whether fiscal consolidation is expected to be unencumbered by the election but IJG suspects not. Our view is that limiting salary increases to below inflationary levels will be very challenging in an election year. Transfers to SOE's is another expenditure item which seems to be outside of government's control. This is unsurprising as many SOE's are unable to produce financials on time, or at all, which means that it is near impossible to know what is going on internally. It is very difficult to control that which is unknown.

Fitch mentioned SOEs as a potential source of risk in their review note, stating that SOE debt reached 25% to GDP in 2017/18. Government guaranteed SOE debt stood at 6% to GDP. These figures are worth a relook. In August 2018 the IMF noted that SOE liabilities totalled 25% to GDP at the end of 2017, with NamPower accounting for the majority of this. As various media picked up on the IMF report, this figure eventually morphed into debt-to-GDP instead of the original liabilities-to-GDP. The difference between liabilities and debt is often quite large in the SOE context. NamPower for instance had non-current liabilities of N$9.66 billion as at the financial year ending in June 2018. Of this amount, only N$1.82 billion was debt, with deferred tax liabilities making up the bulk of the remainder. As this liability is owed to government it does not constitute a government guaranteed debt to an external party and does therefore not carry the same risk to the fiscus.

Government guaranteed SOE debt is the more important statistic mentioned in Fitch's rating revision. At an estimated 6% to GDP, or approximately N$11 billion and rising, government guaranteed SOE debt is a worthy risk to be concerned about. In the IMF's Technical Assistance Report (August 2018) it notes that, of the ten SOEs with the largest liabilities, five pose "high financial risk". Of these five entities four have government guaranteed debt, thus posing not only a risk to the survival of the entity but also a risk to government's financial position. A lack of timely financial information from these entities adds significantly to these risks and rightly weighs on Namibia's credit rating.

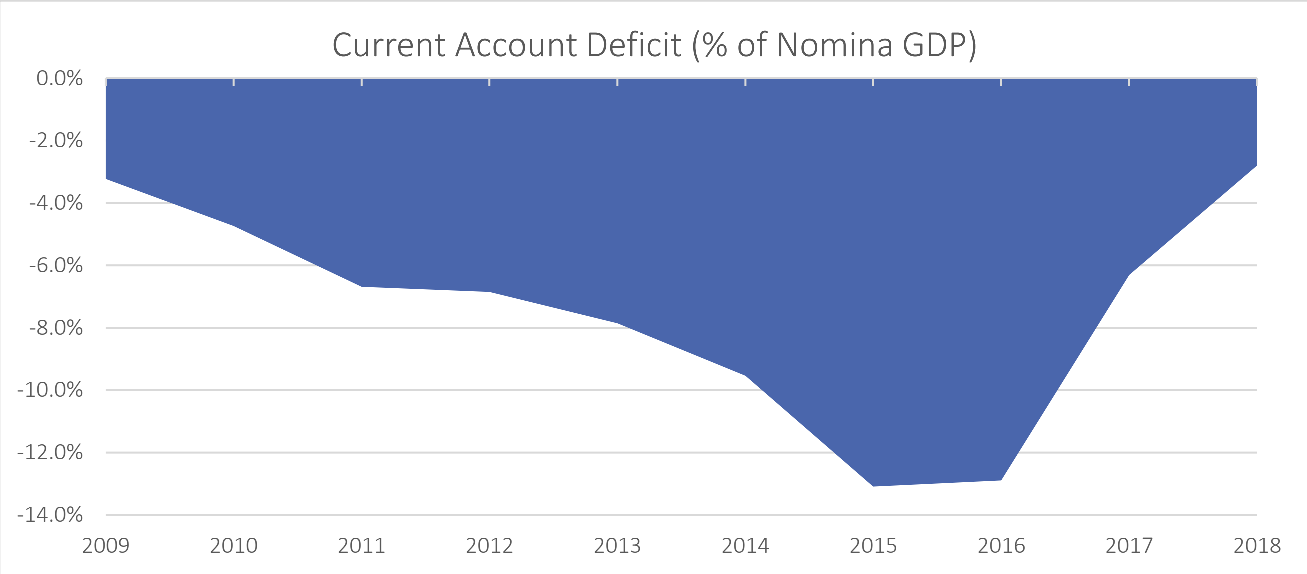
Fitch also noted a number of positive aspects of the Namibian economy to remain optimistic about. The ratings agency notes that despite the "weak operating environment" the banking sector remains healthy. While liquidity risks remain a structural factor due to "high bank dependence on wholesale funding from non-banking financial institutions", non-performing loan (NPL) ratios remain within comfortable levels (despite ticking up over the last two years) and the four key banks are more profitable than peers in similarly rated countries. Fitch also noted that exposure to the property market is a further risk to the banking sector. We agree with this assessment. While the protracted recession has been well managed by the banking sector thus far, as is evident in impairment and NPL ratios remaining within manageable levels, further stagnation in the economy is likely to see these ratios continue to tick up.

A further positive point noted by Fitch is Namibia's high scores on various Word Bank governance indicators such as political stability, rule of law, voice and accountability, and control of corruption.



Source: World Bank

Fitch notes that Namibia's current account deficit has been improving consistently over the last three years, narrowing from 14.6% in relation to GDP in 2016 to an estimated 2.0% in 2018 (Fitch's estimate). Fitch notes that while this is positive, it is due to depressed domestic demand and a decrease in capital investment related imports. In other words, the narrowing current account deficit is due to the slowing economy and not structural changes to the economy.



Source: Bank of Namibia, IJG (2018 est 2.8%)

IJG cannot disagree with Fitch's revision to Namibia's credit rating outlook given the information discussed above. There is clearly a lot to be concerned about and the timing of Fitch's announcement serves as a reminder that government is on a knife edge leading up to the March budget. Fiscal prudence is of the utmost importance in order to rein in the budget deficit and maintain debt levels and debt service costs within sustainable thresholds. In our outlook document we speculate that government will be tempted to increase its expenditure ceiling slightly and that much of this increase will likely go toward the wage bill and not investment into improving the productive capacity of the economy. Fitch's credit rating outlook revision should be seen in this context. Increasing the wage bill will lead to a larger budget deficit and the issuance of more debt. While this is likely to stimulate some consumer activity it is not high multiplier activity and will likely impact the current account negatively (although only marginally). The impact of such spending is thus short-term in nature, and puts further pressure on the fiscal position over the medium- to long-term.

Officially Namibia has experienced ten consecutive quarters of negative growth. With growth expected at a paltry 0.9% in 2019 (IJG's forecast) this year will mark the fourth in which GDP per capita has declined. Long-term solutions should be government's focus now more than ever. We believe that removing the policy uncertainty created by the revised, but yet to be promulgated, Namibian Investment Promotion Act and New Equitable Economic Empowerment Framework, would be a good start. Namibians and potential investors into Namibia are yet to know the final structure and content of these policies and this will create a drag on economic activity in Namibia until these policies are promulgated.

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