NATIONAL BUDGET REVIEW
2017/18 - 2019/20
09 March 2017

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Key points in the speech

- Economic growth has slowed in 2016 to an estimated 1.3%.

- Growth is projected to be 2.5% in the 2017/18 financial year and average approximately 3.5% over the MTEF.

- The 2017/18 budget will further reduce the budget deficit to approximately 3.6% of GDP, down from an estimated 6.3% in 2016/17, while stabilizing public debt at around 42% of GDP, thus strengthening macroeconomic stability.

- As announced in the Mid-Year Budget Review, total revenue for 2015/16 stood at N$52.22 billion, 10.7% lower than the budgeted revenue, and an increase of 4.6% from the previous year.

- The preliminary revenue outturn for the FY2016/17 stands at N$46.94 billion by the end of February 2017. This is 91.1% of the revised budget revenue of N$51.51 billion. MoF expects to fully meet, or moderately surpass the revised revenue collection targets.

- Total spending for FY2015/16 amounted to N$64.64 billion, representing a budget execution rate of 96.4% of the N$67.08 budget, compared to 97.5% in the previous year.

- For 2016/17, the total preliminary expenditure by the end of February 2017 stood at N$58.16 billion, out of the revised budget of N$61.50 billion, a preliminary execution rate of 94.6%.

- The total debt stock stood at 40.1% of GDP in 2015/16 and rose to 42.1% in 2016/17, or some N$66.75 billion.

- Overall debt servicing cost stood at an estimated N$3.88 billion in 2016/17, equivalent to 7.5% of total revenue.

- Revenue for the 2017/18 budget year is projected at N$56.43 billion, 3.5% better than estimated in the Mid-Year Budget Review and a 9.5% year-on-year increase from an estimated N$51.51 billion in 2016/17. This is due to higher than anticipated SACU receipts and improvements in some of the domestic revenue streams.

- Expenditure of N$62.54 billion is budget for 2017/18 financial year. This proposed expenditure outlay is equivalent to 36.6% of GDP and an increase of 1.7% from the revised budget of N$61.50 billion for the previous year.

- For the MTEF, total spending is projected to remain relatively flat, with indicative allocation for 2018/19 set at N$61.86 billion and N$62.72 billion for 2019/20.

- Statutory payments, which represent the Government obligations on debt servicing, are budgeted at N$5.0 billion in 2017/18 or some 8.9% of revenue.

- Deficit financing, amounting to N$6.12 billion will be will sourced from the domestic and regional capital markets.

- Contingent liabilities are projected to increase to an average of 6.2% over the MTEF, as Government extends support to SOEs for project financing based on the strength of their balance sheets.

- The public-sector wage bill, which now stands at 49% of total non-interest expenditure, has been a major driver for increased public expenditure.

- 15.8% of total non-interest expenditure or some N$9.09 billion is allocated to the economic and infrastructure development part of the budget.

- N$11.98 billion is allocated to the Ministry of Basic Education and Culture.

- N$3.07 billion is allocated to the Ministry of Higher Education, Training and Innovation.

- The Ministry of Health and Social Services receives the second highest allocation of N$6.51 billion.

- N$3.28 billion is allocated to the Ministry of Poverty Eradication and Social Welfare for the provision of Social Safety Nets and other anti-poverty intervention measures.

- The Public Safety Sector is allocated an amount of N$12.45 billion.

- Regarding tax policy, the Minister did not propose general tax rate increases or introduction of new taxes at this stage.

- Tax proposals for curbing base-eroding tax exemptions and deductions on the Income Tax and VAT will be proposed through a stakeholder consultation process.

- A further increase of the fuel levy administered under the Customs and Excise Act is proposed at rates to be determined during the determination of the taxation proposal.

- The provisions of tax on Capital Gains will be expanded to provide for wealth-based taxation on certain categories of capital assets.

- A phased roll-out of the new Integrated Tax System will commence during the year, with full deployment of the system by 2018.

- The transitional modalities for the establishment of a Semi-Autonomous Revenue Agency will commence with the expected tabling of the enabling legislation during this session of Parliament. To provide for the seamless transition process, the expected “Day One” of the Agency will be 1 April, 2018.

Growth Environment

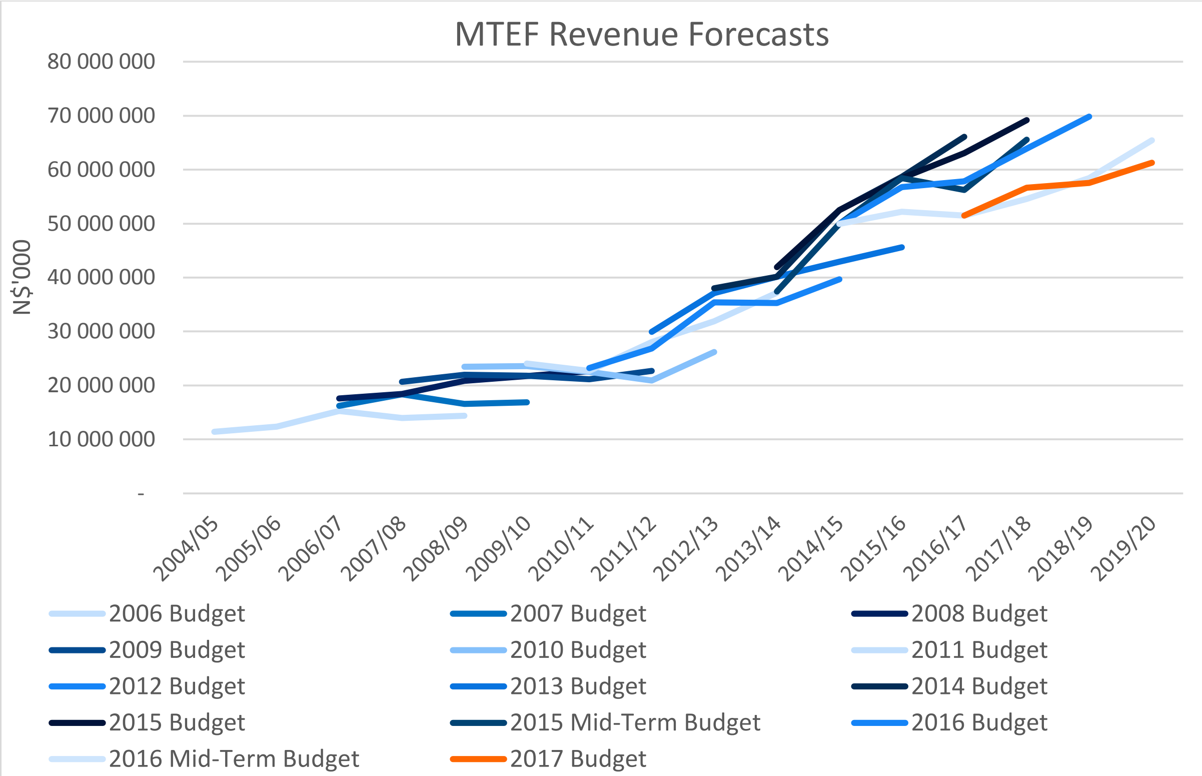
The Ministry of Finance is forecasting growth of 1.3% for 2016 and 2.5% for 2017. Both of these figures are notable downward revisions when compared to last year's budget and also the mid-year budget tabled in October. These figures are more in line with IJG's own growth expectations from October last year. Our recently revised expectations are for a contraction of 1.5% in 2016 and growth of 2.1% in 2017 off of this lower base. The minister noted that, "The economy is emerging from a perfect storm." A sentiment we share. Commodity price declines have put pressure on sub-Saharan African growth in general, while tempered global growth has further impacted the region negatively. The recent drought, one of the worst in recorded history to strike Namibia, exacerbated these difficulties.

It was not only external factors that put pressure on the Namibian economy, but also internal factors. Counter-cyclical fiscal and monetary policy, aimed at limiting the shock of the global financial crisis on the Namibian economy, were not reversed once the threat of recession had passed and became decidedly pro-cyclical. This ramped up the business cycle leading to abnormally high growth and growth expectations. Government revenue and expenditure expectations reached unsustainable levels resulting in a ballooning of the budget deficit when revenue growth normalised suddenly in 2015/16.

With the onslaught of external factors dampening Namibian growth there is a current need for fiscal stimulus, but sources of stimulus are now all but exhausted. There is not space to sustainably increase debt at the rate that has taken place over the last two years. In addition, the speed at which government debt has ramped up has effectively increased interest rates through a natural monetary tightening process whereby government debt crowds out bank's sources of finance and reducing liquidity in the system, which has further dampened economic growth.

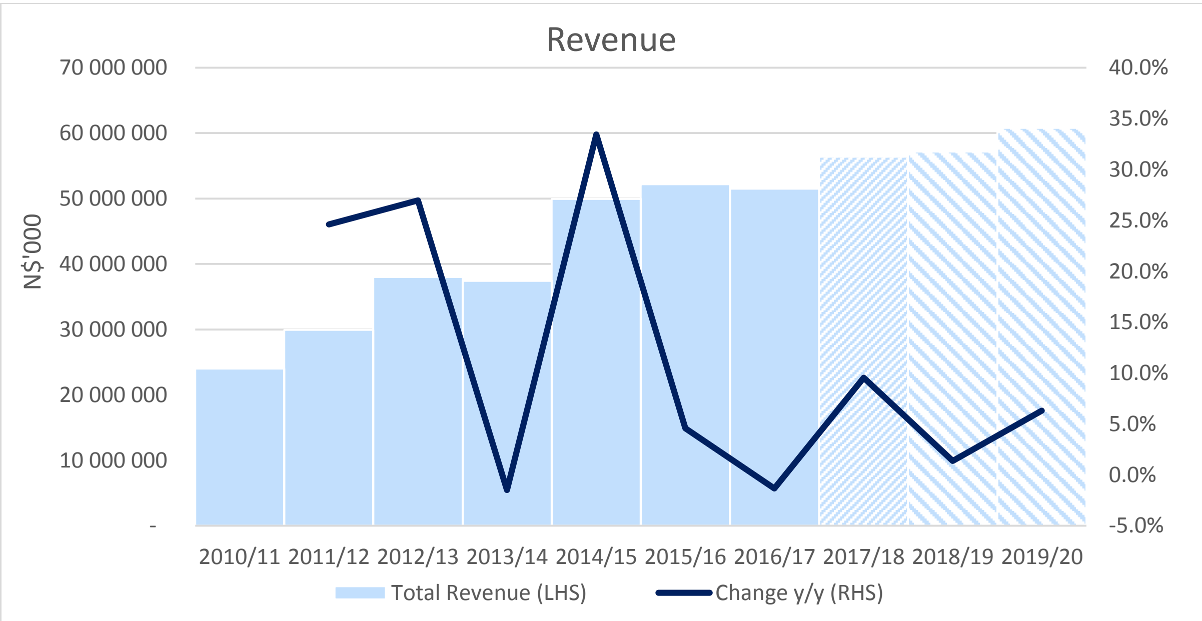
It is in this challenging economic climate that we see the tabling of the FY2017/18 budget. A fine balance will need to be toed between excessive consolidation and unsustainable expansionary policy. Only time will tell whether the current budget effectively finds this balance.

Revenue



Source: MoF, IJG Securities

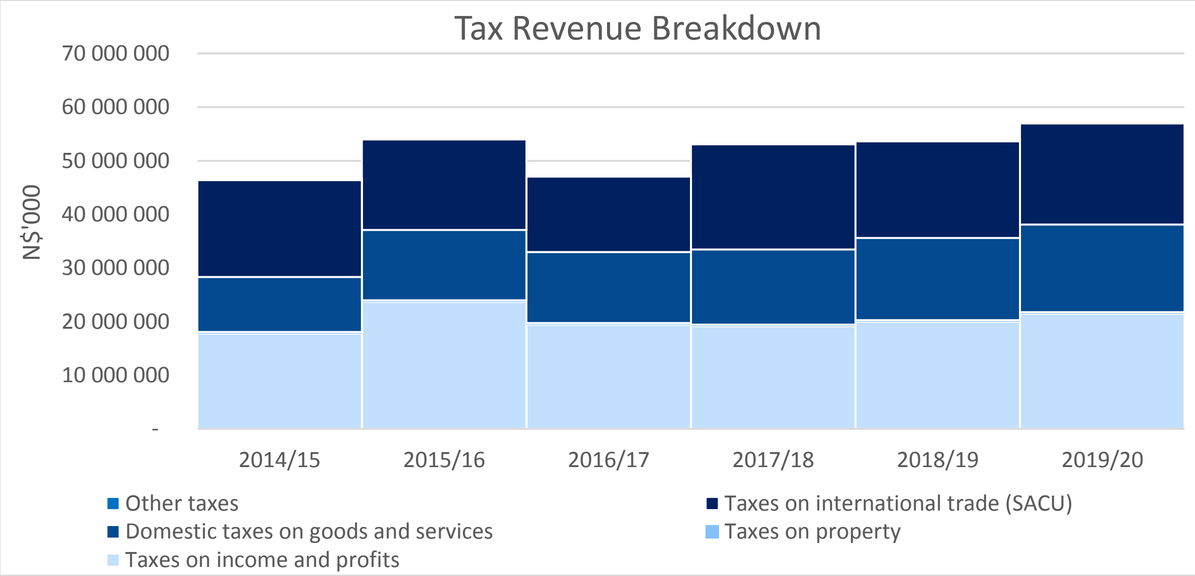
According to the Ministry of Finance, revenue for FY2016/17 is expected to come in at N$51.51 billion, which is line with the expectations in the FY2016/17 mid-year budget review. However, N$6.3 billion or 11.0% less than the amount budgeted for in the FY2015/16 budget. The preliminary revenue outturn for FY2016/17 stands at N$46.94 billion at the end of February 2017. This is 91.1% of the revised budget revenue of N$51.51 billion. Government expects to meet, or moderately surpass the revised revenue collection targets.



Source: MoF, IJG Securities

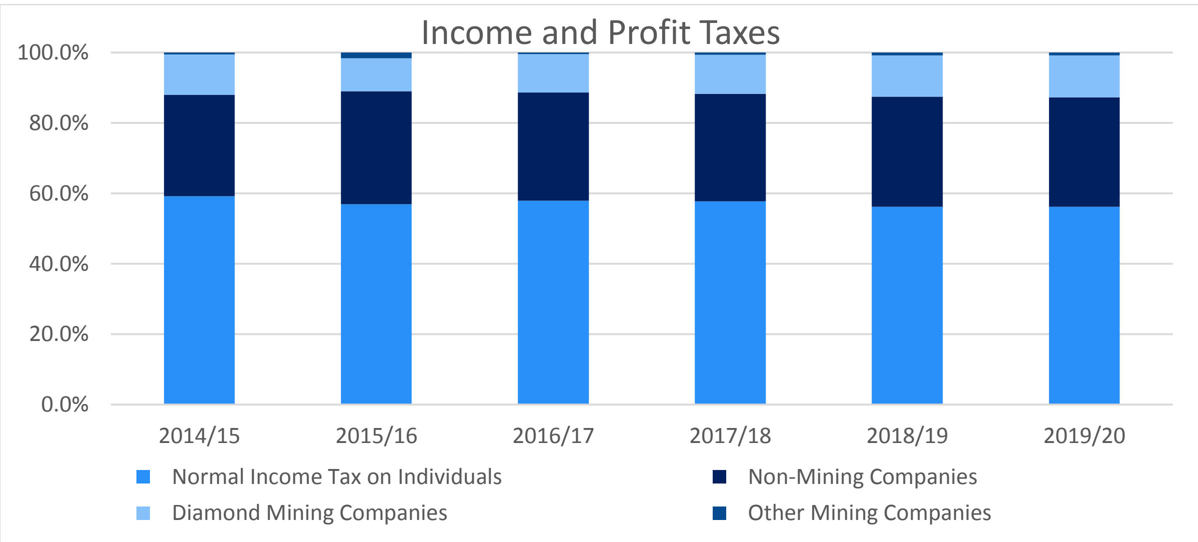
In FY2017/18, revenue growth is expected at 9.5%, and as such total revenue for the year is expected to be N$56.6 billion, a N$5.1 billion increase when compared to the number budgeted for in the FY2015/16 budget.

As is usually the case, taxes make up by far the largest component of total revenue, representing some 94.3% of total revenue in the FY2017/18 financial year. Within non-tax revenue, diamond and other mineral royalties, and dividends from SOEs, represent the lion's share.



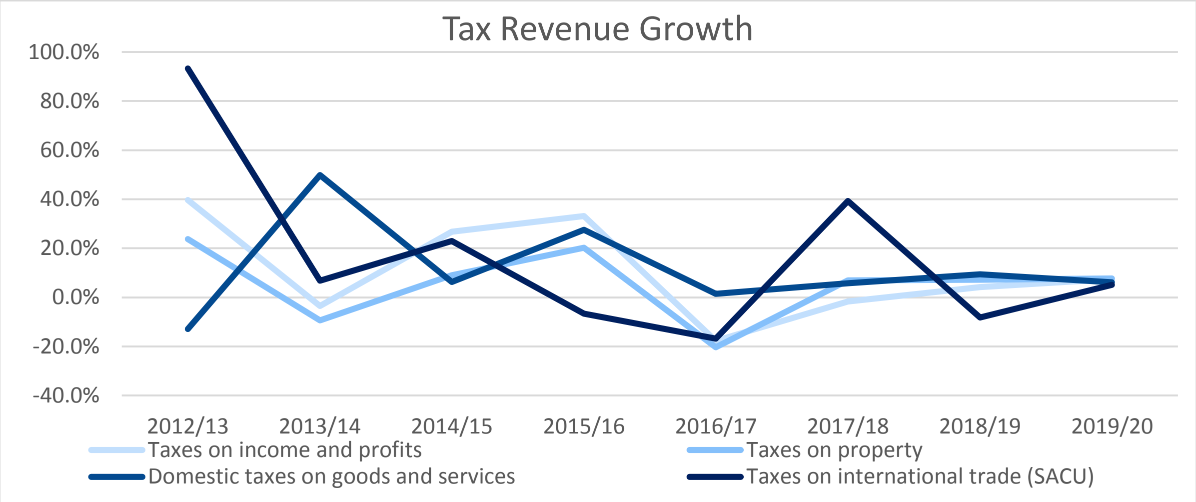
Source: MoF, IJG Securities

Within tax revenue, taxes on income and profit represents the largest revenue source, at N$19.2 billion in FY2017/18, followed by SACU receipts (N$19.6 billion) and VAT (N$13.7 billion). The increase in revenue for the FY2017/18 budget year in comparison to the FY2016/17 mid-year budget review, is due to higher than anticipated SACU receipts and improvements in some of the domestic revenue streams.



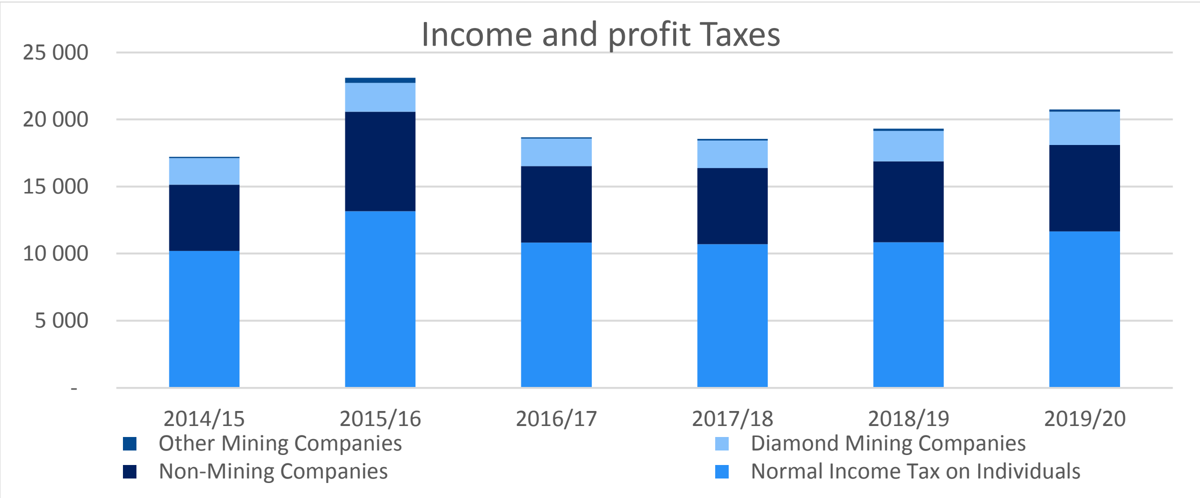
Source: MoF, IJG Securities

Given the fact that Namibia was overpaid by SACU in FY2014/15, the country was obligated to repay just under N$3 billion over the course of two years. As a result of the SACU repayment, SACU revenues contracted in FY2015/16 and are expected to have contracted in FY2016/17. While the Ministry of Finance does not expect to see contractions in other revenue lines in FY2017/18, taxes on income and profit is expected to slow by 1.7%. For the most part tax revenues are expected to improve.



Source: MoF, IJG Securities

Personal income tax makes up by far the largest portion of taxes on income and profits, and is expected to represent some N$10.7 billion in FY2017/18 (18.9% of total revenue). Thereafter, taxes on non-mining corporates form the second largest source of income and profit taxes, at N$5.7 billion in FY2017/18, followed by diamond mining company taxes at N$2.1 billion.



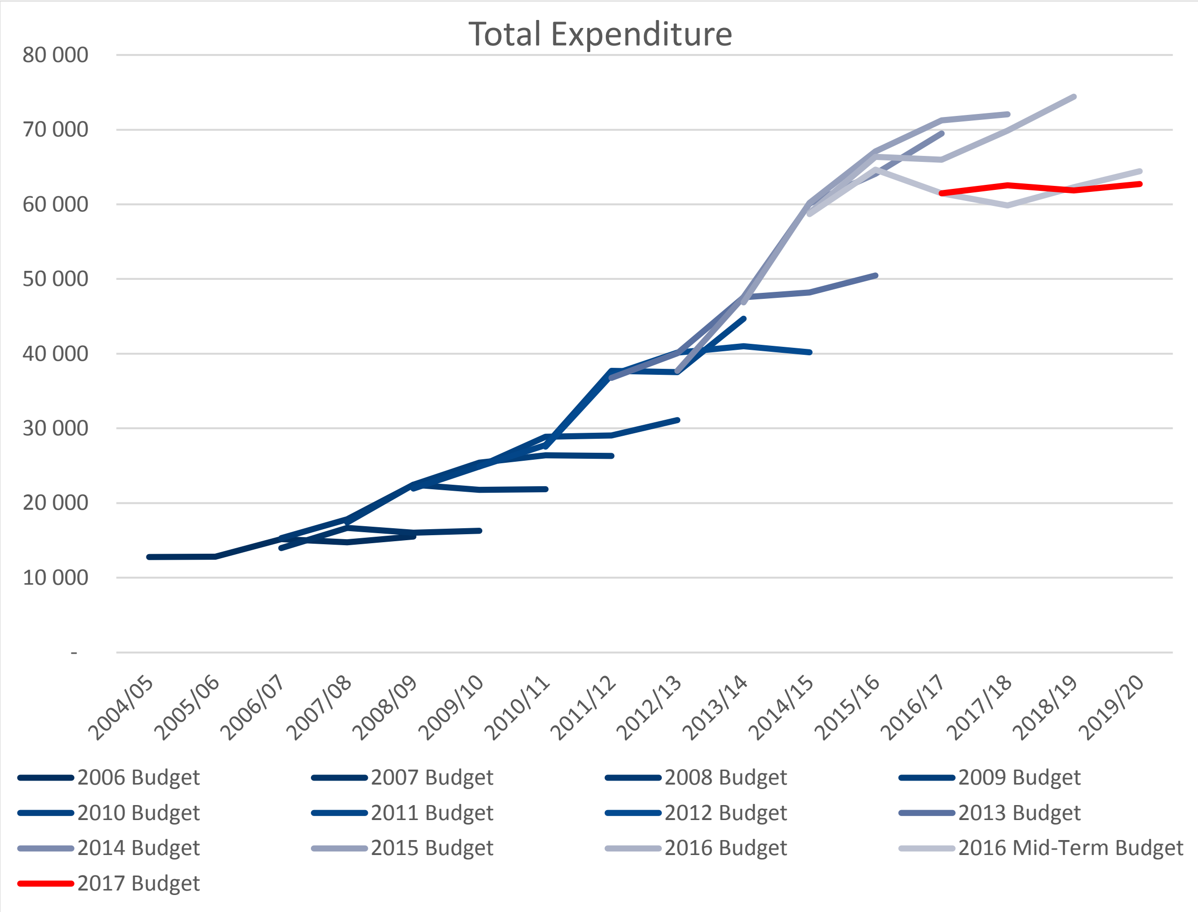
Source: MoF, IJG Securities

Between FY2016/17 and FY2017/18, growth rates for all of the major line items pertaining to taxes on incomes and profits are expected to see growth accelerating, except for non-mining companies.

On the back of what we believe to be overly confident growth forecasts, we feel that revenue won't achieve the levels of growth that the Ministry of Finance is forecasting. This stems from the fact that we believe that the growth figures used by the Ministry of Finance for 2016 and 2017 are too high. Based on our view that the local economy is set to slow off the very high base created over recent years, we believe that growth in many of the revenue lines mentioned, remains highly ambitious. This is true of personal income tax, corporate tax, and VAT.

Expenditure

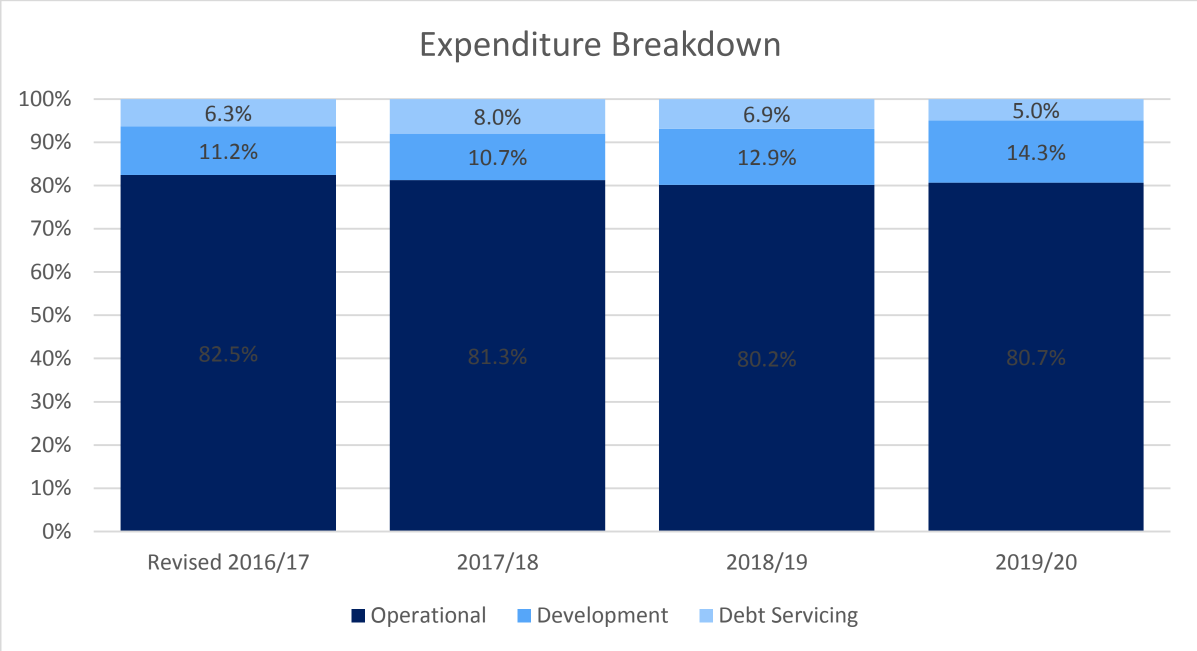
The FY2017/18 budget aims to continue on the path of fiscal consolidation as set out in the mid-year Budget Review. Over the MTEF, the absolute level of expenditure is set to remain relatively stable and expenditure as a percentage of GDP is set to gradually decrease from the current 39% to 31% by the 2019/20 financial year. This being said, total expenditure is set to increase by 1.7% from N$61.50 billion in FY2016/17 to N$62.54 billion in FY/2017/18, which is 4.5% higher than budgeted for in the 2016/17 mid-year review.



Source: MoF, IJG Securities

Of the N$62.54 billion expenditure budgeted for in FY2017/18, N$57.54 billion is non-interest in nature and N$5.00 billion is earmarked for interest payments. Our debt servicing costs as a percentage of revenue has increased from 8.4% in FY2016/17 to 8.8% in FY2017/18, highlighting the fact that Government's debt servicing cost is quite sizable in nature, although still below the statutory limit of 10%. Despite government planning to finance the budget deficit using debt stock, which will likely increase from the current N$66.75 billion to N$75.22 billion by FY2019/20, debt servicing costs are expected to decrease from N$4.19 billion to N$3.13 over the same period. We find this very strange.

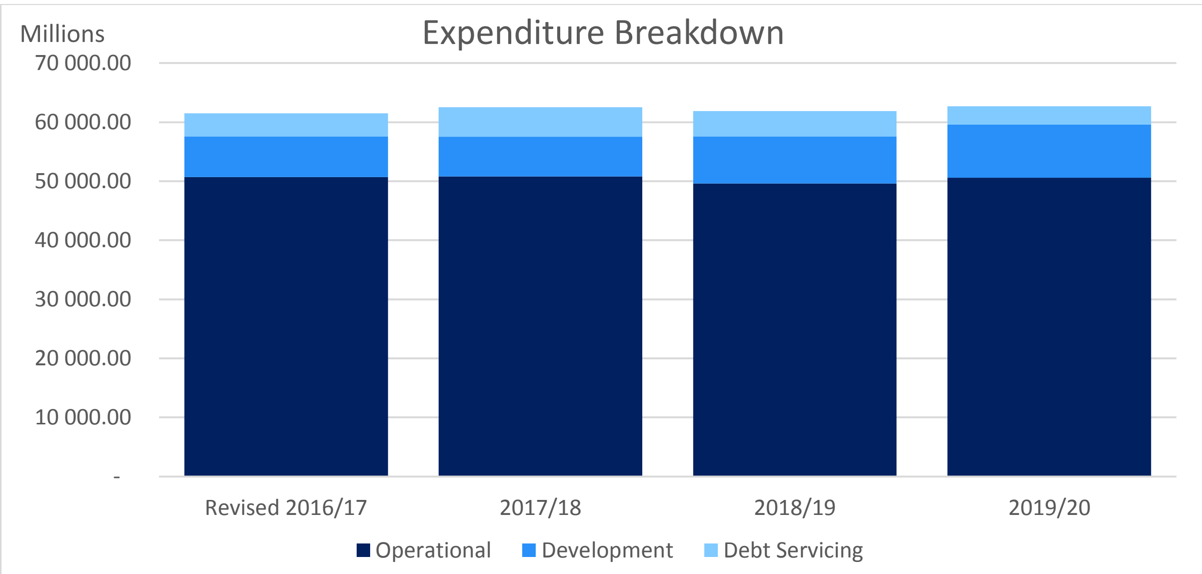
The current budget expenditure breakdown remains heavily weighted towards the operational budget over the development budget, with the former receiving a total allocation of N$55.84 billion (including debt servicing costs), while the latter received just N$6.7 billion. As such, for FY2017/18 the development budget represents only 10.7% of total expenditure. Over the MTEF the ratio is expected to improve slightly to 14.3%, which is still well below the 20.0% target.



Source: MoF, IJG Securities

The civil service wage bill received some attention in the minister's speech, where he claimed it is "unsustainably high". Nearly half of total revenue is currently committed to the wage bill which has led to the disproportionately large operating budget. Government has proposed several measures to prevent the further growth of the wage bill and related personnel expenditure. These include freezing the size of the civil service, streamlining of multiplicity bonuses and allowances and reviewing of medical aid coverage.

For the next three years, expenditure is expected to remain relatively constant, with total expenditure expected to decline by 1.1% between FY2017/18 and FY2018/19 and increase by 1.4% between FY2018/19 and FY2019/20. However, if history is any predictor of the future, it is unlikely that such low rates of expenditure growth will be seen, and future budgets are likely to see expenditure increasing over current forecasts.



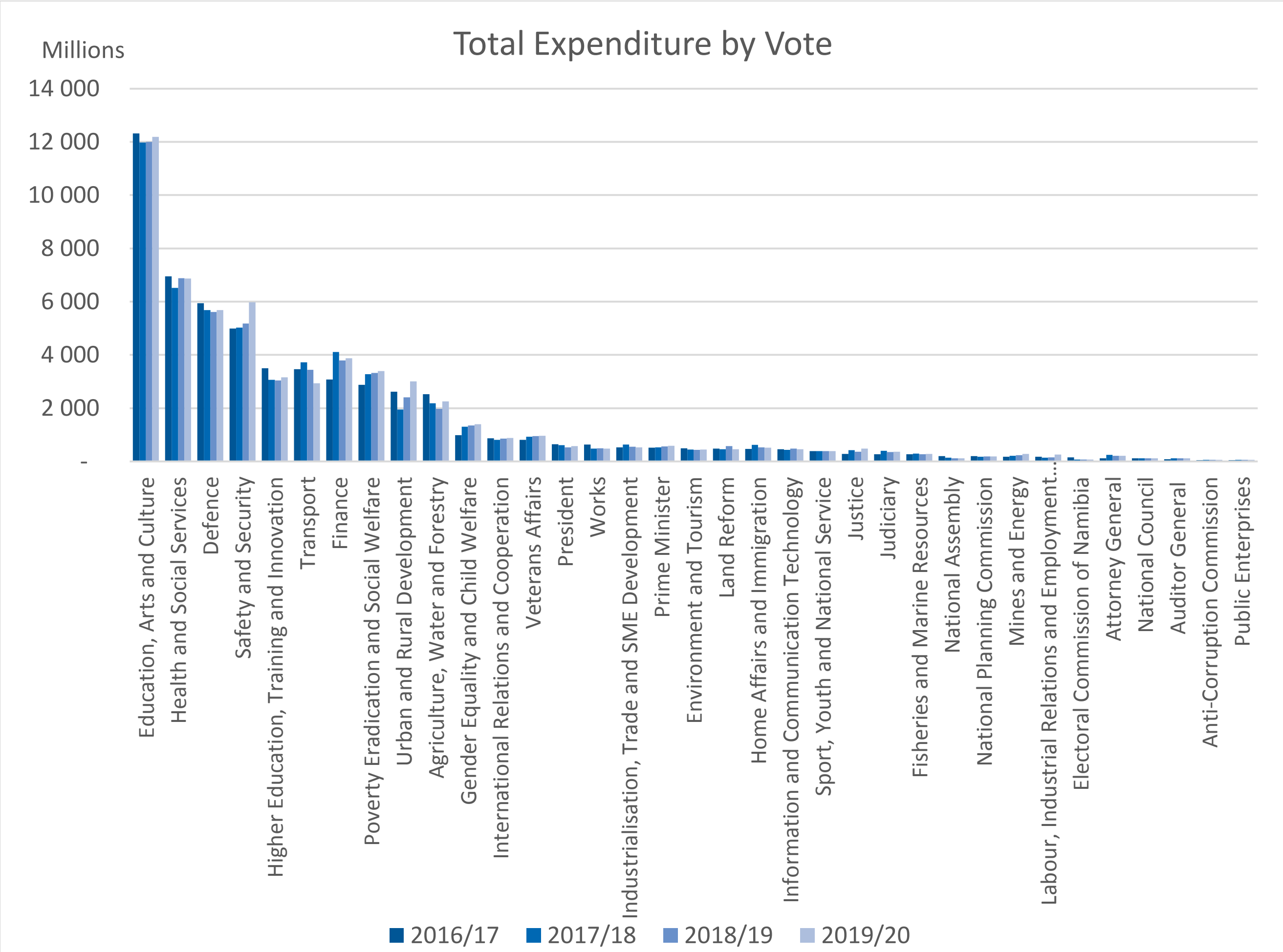
Source: MoF, IJG Securities

From a ministerial point of view, provisions to the education sector has been increased relative to the mid-year budget review to support the provision of free primary and secondary education and expand access to tertiary education and vocational training for improved skills development in the economy. Thus, N$12.0 billion is allocated to the Ministry of Basic Education, Arts and Culture. A further N$3.1 billion is allocated to the Ministry of Higher Education, Training and Innovation.

Contributions to the Ministry of Health and Social Services have also been increased relative to the mid-year budget, to support the provision of basic services and pharmaceuticals to the public. N$6.50 billion has been allocated, the second highest allocation to any ministry. However, compared to the FY2016/17 budget, contributions to this sector have decreased by N$441.0 million.

Defence spending has also decreased relative to the 2016/17 financial year, from N$5.95 billion to N$5.68 billion. Nevertheless, defence spending is still expected to make up 9.9% of expenditure and 3.3% of GDP. N$5.0 billion is allocated to the Ministry of Safety and Security, encompassing both the Police and the Correctional Service and N$3.3 billion is allocated to the Ministry of Poverty Eradication and Social Welfare for the provision of social safety nets and other anti-poverty measures. Of this amount, N$2.4 billion will provide for the old-age pension, which will increase by N$100 to N$1,200 per month per senior citizen.

The majority of allocations to Ministries decreased in FY2017/18 when compared to FY2016/17, as we saw tabled in the mid-year budget review. However, they are broadly in line with historic allocations and set to remain around current levels, which implies that most ministries' budgets will likely shrink in real terms over the MTEF.

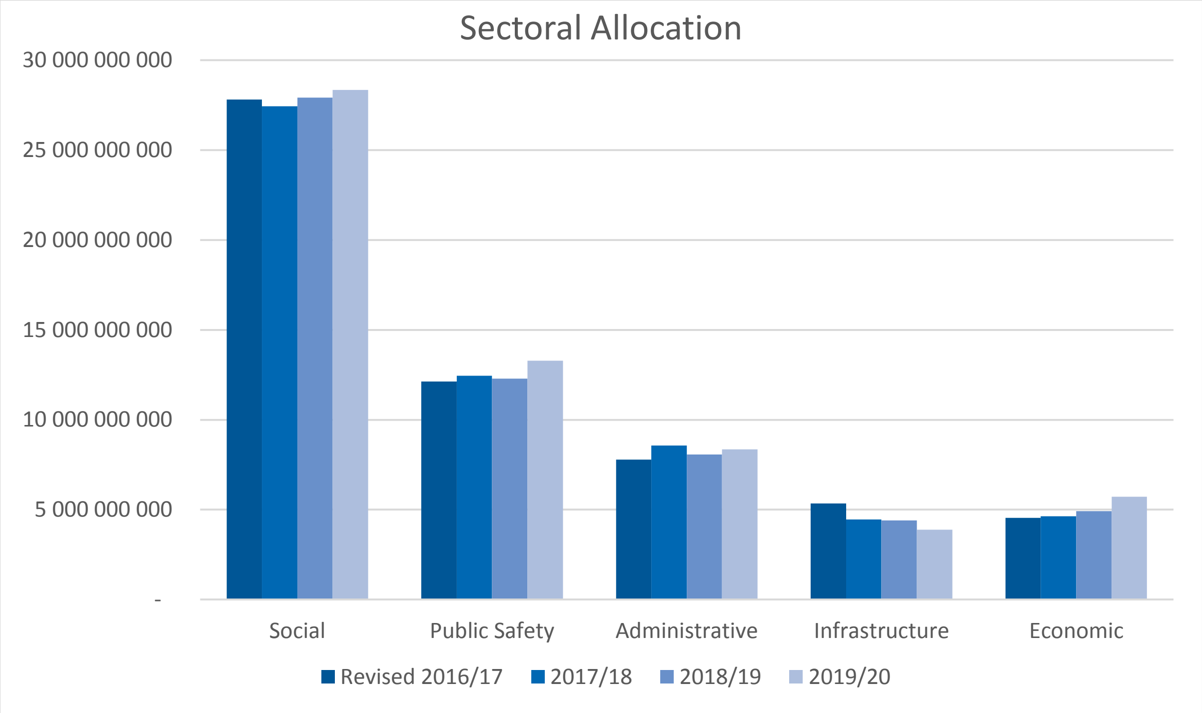


Source: MoF, IJG Securities

From a sectorial perspective, social spending continues to represent the lion's share of expenditure, illustrating the strong focus on poverty alleviation and social support under the current president and government. In this regard, a number of social spending initiatives have been launched or extended, most notably the increase in the old age pension grant and improved coverage in respect of orphans and vulnerable children to keep the vulnerable above the poverty line and protect them from the effects of inflation.

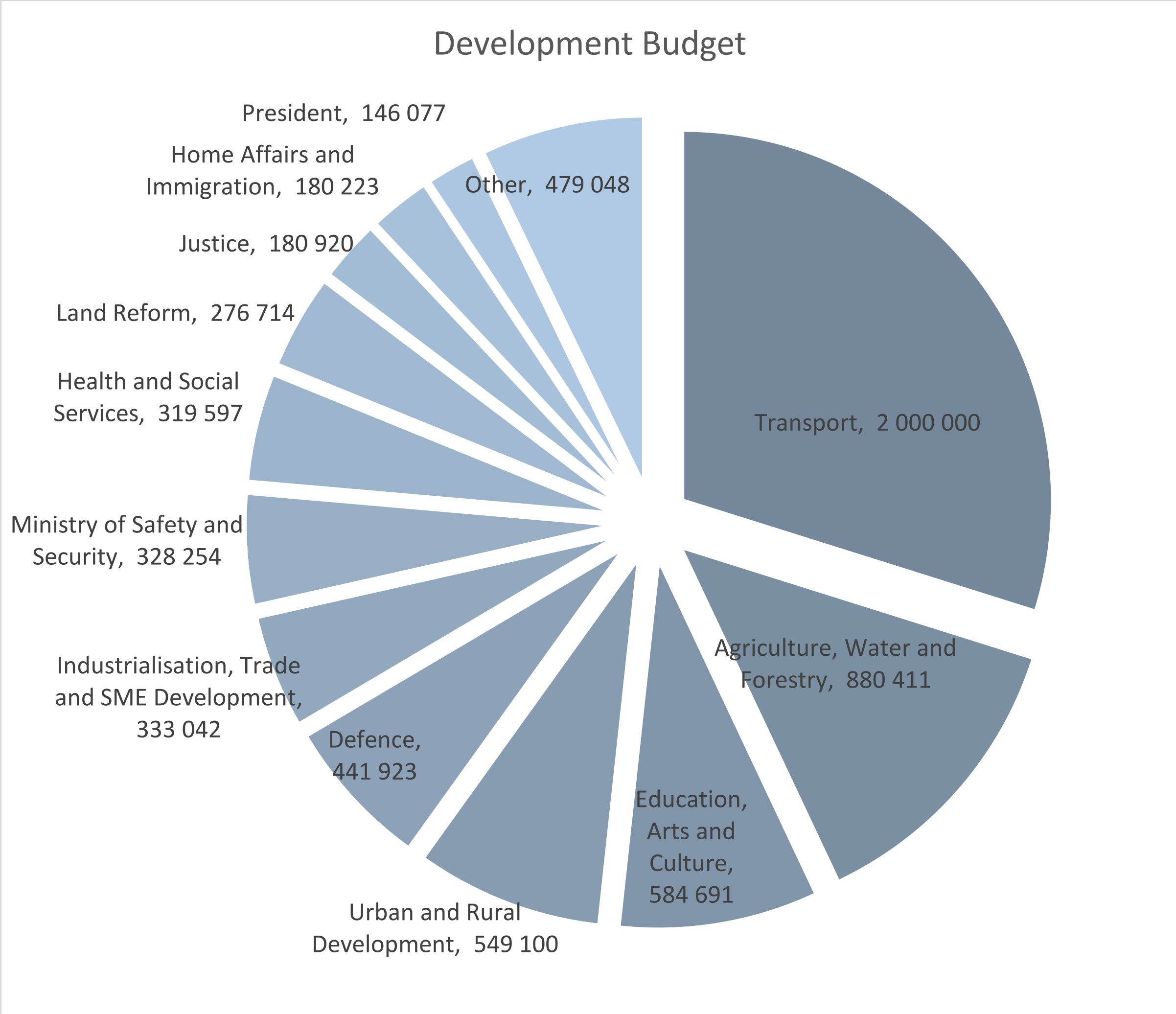
The Public Safety Sector is allocated an amount of N$12.45 billion in FY2017/18 and N$38.02 billion over the MTEF, representing the continued investment in peace, public safety and rule of law. he Judiciary and Attorney General's Office were allocated additional resource of N$85.0 million and N$40.0 million respectively, while the Anti-Corruption Commission has received additional resources of N$5.0 million to fulfil its mandate. However, defence spending makes up nearly 45.6% of this sector.

Over the MTEF, expenditure on public safety and administration are set to increase by 2.7% and 10.1%, respectively, in the current fiscal year, while spending on economic activities is set to increase by 1.9%. Infrastructure expenditure, however, is set to decrease by 16.8% as a result of the deep cuts in the development budget witnessed in the mid-year review.



Source: MoF, IJG Securities

In the Development Budget, Transport makes up the single largest recipient of funds, receiving a total of N$2.0 billion in the current year. These funds will be used primarily for the provision and upgrading of the railway and road networks. Second to this is expenditure on Agriculture Water and Forestry, totalling N$880.40 million, which will be used primarily for water supply and sanitation. These activities entail the construction of water supply pipeline networks which includes inter alia digging of trenches, laying of pipes, back filling of trenches, installing of air valves, construction of pump houses and construction of water reservoirs. Finally, closing out the three largest allocations is Education, Arts and Culture, which will receive N$584.7 million in the current financial year, which spending focuses primarily on the construction of extra learning facilities and upgrading of schools. Together, these three votes make up 51.7% of the development budget.



Source: MoF, IJG Securities

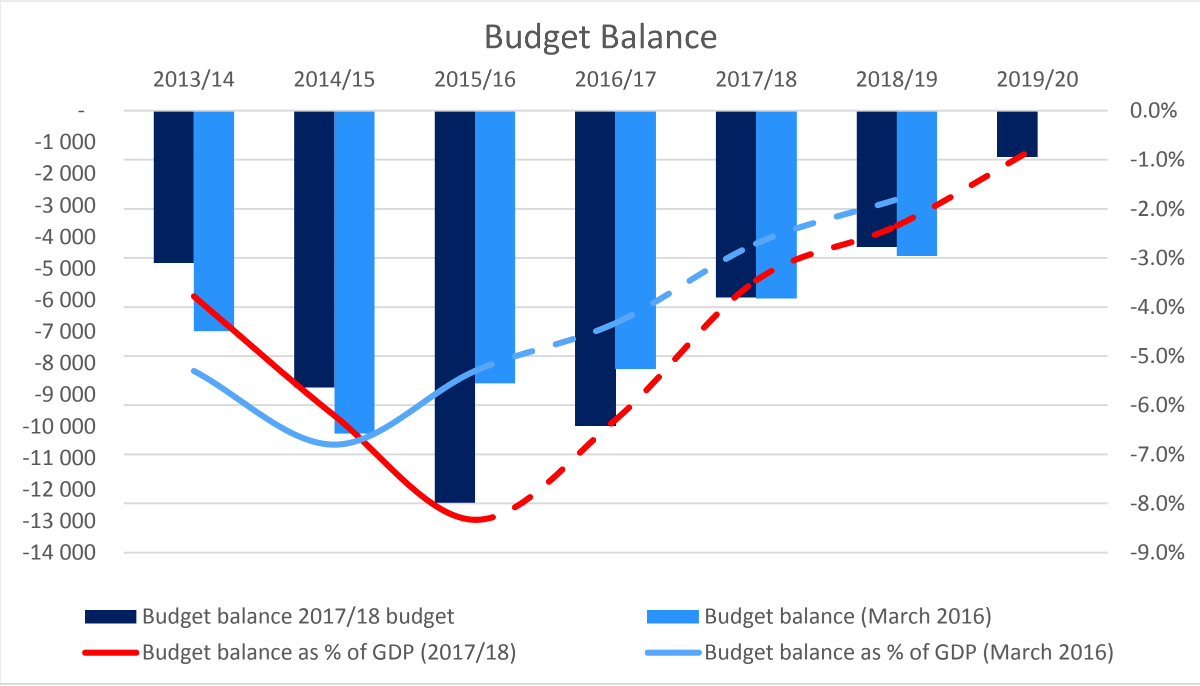
Budget Balance and Financing

2016/17 Outturn

The total revenue for FY2016/17 is expected to come in at N$51.51 billion according to the FY2017/18 budget speech tabled on the 8th of March 2017. However, the MTEF document estimates revenue of N$50.20 billion and the minister mentioned that by the end of February only N$46.94 billion had been collected, and that the full N$51.51 billion was expected to be collected. These differences highlight the uncertainty with regards to actual revenue collection and obscures the size of the budget deficit for FY2016/17. Total expenditure for FY2016/17 was N$61.496 billion with a preliminary execution rate of 94.6%.

The minister stated that the estimated deficit ratio for the year was 6.3% of GDP which roughly equates to the N$9.984 billion deficit estimated in the FY2016/17 mid-year budget review tabled in October 2016. The nominal value of debt raised to date is currently N$9.968 billion, corresponding to the aforementioned estimated deficit value considering that there are still debt auctions to take place in FY2016/17. We conclude that the mid-year review figure of N$9.984 billion is likely to be closer to the correct deficit figure (also the figure used in the Estimates of Revenue Income and Expenditure book).

The deficit was financed for the most part through local debt issuance of N$9.476 billion (nominal) as well as foreign debt issuance of N$492 million on the JSE. A decision was taken to fund the deficit through domestic and regional debt issuance as pricing in these market was deemed to be favourable and not subject to foreign exchange rate risks. Debt issuance over the last two financial years has risen sharply, propelling the debt-to-GDP ratio to 42.1% in FY2016/17. This is well in excess of the self-imposed prudential limit of 35% debt-to-GDP. This level, as well as the budget deficit, will be watched closely by the ratings agencies.



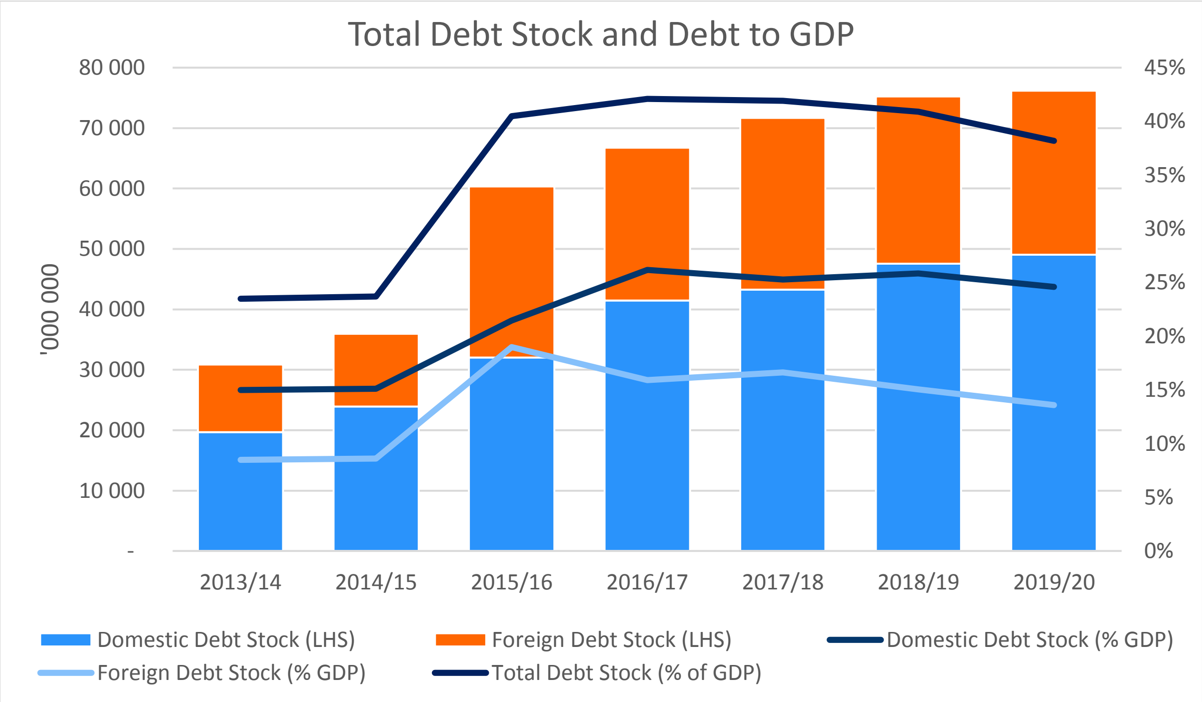
Source: MoF, IJG Securities

2017/18

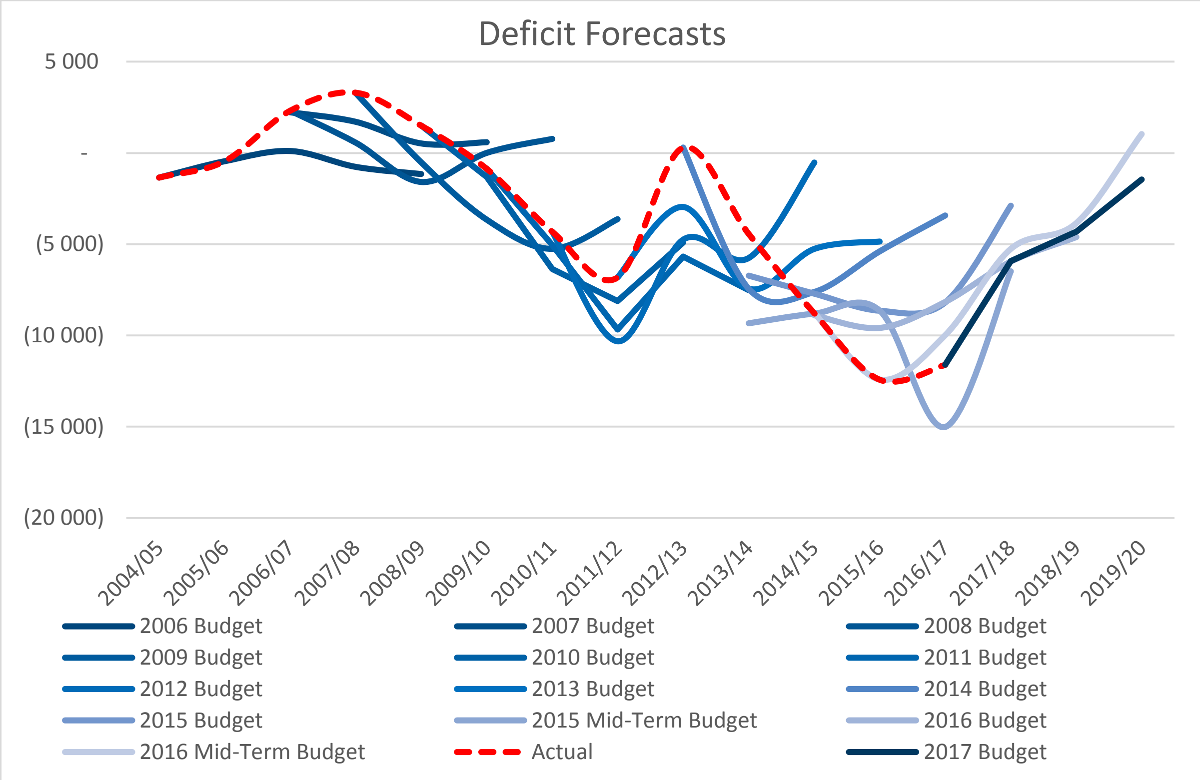
Revenue for FY2017/18 was revised up by 3.4% from the medium-term review to N$56.43 billion, still well below last year's budget forecast of N$63.92 billion. This revision to revenue, a 9.5% increase over the previous financial year, is largely due to an increase in expected SACU revenues. A corresponding adjustment has been made on the expenditure front with the budget for FY2017/18 set at N$62.54 billion compared to N$59.85 billion forecasted in the mid-year review last year. While both revenue and expenditure are budgeted to increase, the increase in revenue is significantly larger and will result in the budget deficit narrowing to 3.6% according to the minister.

The FY2017/18 budget deficit of 3.6%, or N$6.12 billion, will see a sharp decrease in the growth rate of public debt. This is positive given that approximately N$20 billion in debt has been raised over the last two years, much of which has ended up funding consumptive expenditure which is unlikely to yield future returns. Ratings agencies will surely look favourably on the reduced total deficit, almost eradicated primary deficit, and determination to follow through on promises of fiscal consolidation. Whether enough has been done to avert a ratings downgrade remains to be seen though.

The borrowing requirement for FY2017/18 will be N$6.12 billion according to the minister. The minister indicated that the borrowing requirement would be raised in domestic as well as regional capital markets. If last year is anything to go by the vast majority of this issuance will be placed domestically. We eagerly await the announcement of the borrowing plan to determine exactly how the deficit will be funded in FY2017/18.



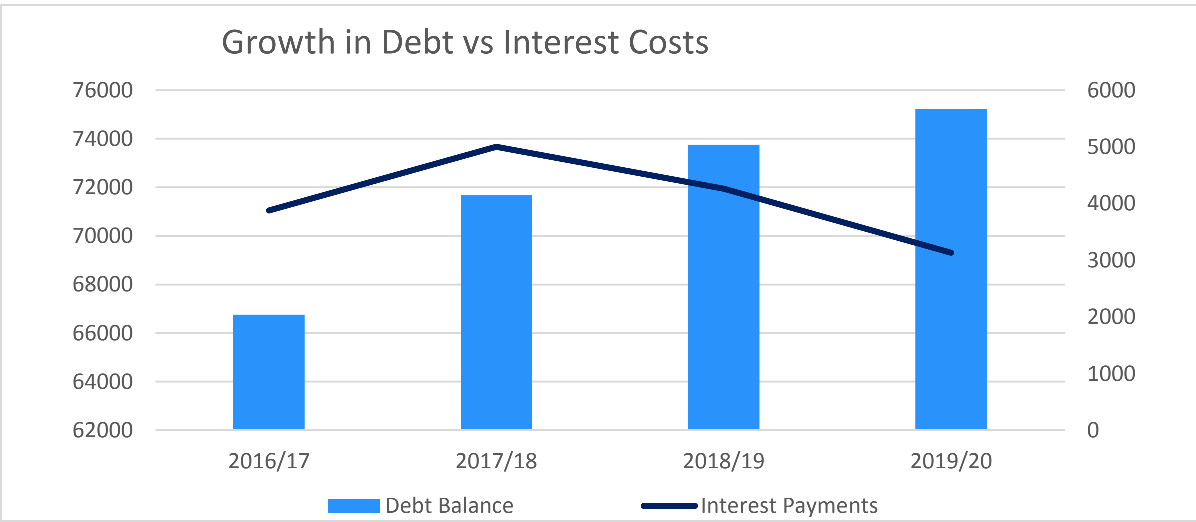
Source: MoF, IJG Securities



Source: MoF, IJG Securities

Conclusion

The above figure illustrates how over the last four years, budget deficits toward the outer MTEF years have been forecast to contract, or move toward a more balanced budget, with almost every new budget tabled. The exception being the FY2015/16 mid-year budget review where a larger deficit was expected. Bar that year, actual deficits have been larger than forecasted for all budgets tabled during the last four years. This leads to scepticism regarding whether the forecasted primary budget surplus in FY2019/20 will materialise. That said, the ministry of finance and the minister are moving in the right direction and last year's mid-year budget cuts restores much credibility to the current MTEF forecasts in our view.



Source: MoF, IJG Securities

The growing debt burden remains a concern and here there are some anomalies in the budget figures. While the debt stock is forecast to grow further, the interest burden is expected to decrease significantly over the MTEF (as seen in the above figure). This would suggest that government expects to roll a large portion of its debt into much cheaper funding, an unlikely scenario.

Should we adjust interest costs for the increased debt stock at current rates then the budget deficit increases by billions. Thus we do expect to see larger than expected deficits in FY2018/19 and FY2019/20 when compared to current forecasts. This will in turn lead to a larger debt balance in each year which would further increase interest costs. Should Namibia lose her investment grade credit rating at any point during the MTEF it could exacerbate this further. We hope that this issue is addressed in the mid-year budget review.

Managing the deficit is crucial to maintaining the investment grade credit rating that Namibia enjoys at present. Losing this rating will lead to longer term debt sustainability issues as it will greatly increase the cost of refinancing Namibia's current foreign debt. The FY2017/18 budget strives toward fiscal consolidation which is what is needed to ensure that government plays a sustainable role in the Namibian economy. Should this consolidation be implemented as planned, it would greatly improve the outlook for Namibia.

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