NATIONAL BUDGET REVIEW 2018/19

2018/19 - 2020/21

08 March 2018

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Key Points in the Speech

- Real GDP growth for 2017 is estimated at a mild contraction of 0.4%.
- Real GDP growth is forecast at 1.2% for 2018, and 2.1% in 2019.
- The budget deficit has been reduced by a cumulative 3% or 1½ percentage points annually over the past two years, from 8.2% in FY2015/16 to an estimated 5.4% by FY2017/18.
- Budget expenditure as a proportion of GDP has reduced from 42.8% in FY2015/16 to an estimated 38.7% in FY2017/18.
- Financing such large budget deficits has led to the rise in debt metrics, from 29.5% of GDP in FY2015/16 to an estimated 42.1% in FY2017/18.
- The public wage bill now stands at 50% of total revenue, and 16% of GDP.
- The development budget is increased by 30.0% (in 2018/19) relative to the revised allocation for the previous year.
- In the social sector the resource allocation to education, health, housing and land servicing are scaled-up to enhance increased access to services.
- Social safety nets will continue to be strengthened in quality and coverage as the first line of defense against vulnerability.
- Non-core expenditure reduction and the moratorium on non-productive capital projects such as construction of office blocks have been implemented and remain critical for the fiscal consolidation measures to free up resources for reallocation to best productive alternative uses.
- The Integrated Tax System (ITAS) will be rolled out in July 2018, and the Namibia Revenue Agency (NAMRA) will be established on 1 March 2019.
- The Ministry of Industrialization, Trade and SME Development is overseeing the implementation of the National Single Window facility in collaboration with Namport and the finalization of amendments to the **Investment Promotion Act** and the repeal of the Export Processing Zones Act this year.
- the **New Equitable Economic Empowerment Bill**, is set for finalization this year under the leadership of the Office of the Prime Minister.
- The anticipated Land Conference this year will give certainty with regards to land reform, land ownership and tenure as well as land utilization in both rural and urban settings.
- Revenue expectations for 2017/18 have been revised upward by a further 1% to N$56.8bn.
- For FY2018/19, total revenue is estimated at N$56.70bn, about 1.3% decline from the estimated outturn for 2017/18.

- Over the MTEF, revenue growth is projected to average 3.4%, at N$57.7bn in FY2019/20.

- The most significant downside risks to revenue regards SACU receipts, which are projected to decline sharply by a cumulative of 18% during the next two years.

- The revised expenditure of N$66.5bn for FY2017/18 comprised 3.5% once-off increase in original budgeted expenditure to correct for spending arrears from the previous year. This was a 6.9% increase from N$62.2bn actual spending during FY2016/17.

- The budget deficit for FY2017/18 is estimated at 5.4%, in line with the Mid-Year Review.

- The total debt stock for FY2017/18 is estimated at N$74.5bn, equivalent to 43.3% of GDP.

- The budget for 2018/19 is to amount to N$65.0bn, 2.3% down from 2017/18.

- While reducing total expenditure this budget proposes to increase the size of the revised development budget from N$5.6bn in FY2017/18 to N$7.3bn in 2018/19 and reach N$8.2 billion by FY2020/21. This is enhanced by off-budget financing such as N$4bn from the AfDB, N$10bn – N$15bn to be funded through bilateral concession loan arrangements (over the next 5 years), etc.

- Transfers to Public Enterprises have reduced by an average of 20% since FY2016/17, reducing from N$7.4bn (FY2015/16) to N$6bn in FY2016/17 and further to N$4bn by FY2017/18.

- The budget deficit is estimated at 4.5% of GDP in FY2018/19.

- By considering overall financing requirements, the total debt stock is estimated at N$84.6bn or 45.8% of GDP in FY2018/19. Over the MTEF, total debt is projected to stabilize at 46.5% and average around 46.1%.

- The lowest income tax bracket for Individual Income Tax will be lowered to 17% (currently 18%).

- New tax rates of 39% and 40% will be established for individuals earning over N$1.5m and N$2.5m respectively.

- A 10% dividend tax for dividends paid to residents will be established.

- The current practice of a conduit (flow through) principle in the taxation of trusts will be abolished.

- Namibian residents will have to declare income earned from foreign sources on their annual tax returns.

- VAT on income of listed asset managers will be introduced.

- VAT on proceeds on the sale of shares or membership in a company owning commercial immovable property will be introduced.

- The fuel levy will be increased by 25 cents per litre.
- An additional 5% national "sin" tax on alcohol and tobacco products will be introduced.
- Income tax changes will come into effect in 2019 after drafting and tabling of the specific tax proposals. Excise duties will become effective upon the tabling and gazetting of the schedules.
- Tax policy proposals are expected to generate an additional N$500m annually.
- Basic Education receives N$13.5bn, 4.0% more than the revised allocation for FY2017/18. Over the MTEF, the allocation stands at N$40.8bn.
- Higher Education, Training and Innovation receives N$3.2bn and about N$9.8bn over the MTEF.
- Health and Social Services receives N$6.5bn and about N$19.6bn over the MTEF.
- The Public Safety Sector is allocated an amount of N$12.7bn in FY2018/19, and about N$38.7 billion over the MTEF, making it the second largest budget allocation.

Growth Environment

The Ministry of Finance has revised its 2017 growth expectation down to a contraction of 0.4% from growth of 1.6% expected in October last year. Growth for 2018 has been revised substantially down to 1.2% from 3.7% expected with the tabling of the mid-year review. These figures are much more closely aligned with IJG's growth forecasts of -1.3% in 2017 and 0.9% growth for 2018. The ministry of Finance also expects lackluster growth of 2.1% in 2019.

Real GDP Growth Expectations

	MoF - 2017 Mid-Year Review	MoF - 2018 Budget	IJG Outlook Update - August 2017	IJG Outlook 2018
2017	1.60%	-0.40%	-0.60%	-1.30%
2018	3.70%	1.20%	3.00%	0.90%
2019		2.10%	2.50%	2.30%

The recovery in 2018 is largely set to stem from the mining sector as commodity prices have improved. Weak rainfall was cited by the minister as a threat to the recovery. We at IJG tend to agree that the mining sector will be the major driver of growth in the coming year. Our 2018 Outlook expands on our expectations for the economy in 2018.

The minister noted that the low growth environment Namibia currently finds itself in insufficient gains in per capita incomes or quality of life. He noted that "supportive policy interventions" are necessary to drive growth in this regard. This constitutes an acknowledgement of the role of counter-cyclical fiscal policy in mitigating some of the negative effects of economic downturns. At present fiscal space with which to enact such policy is limited.

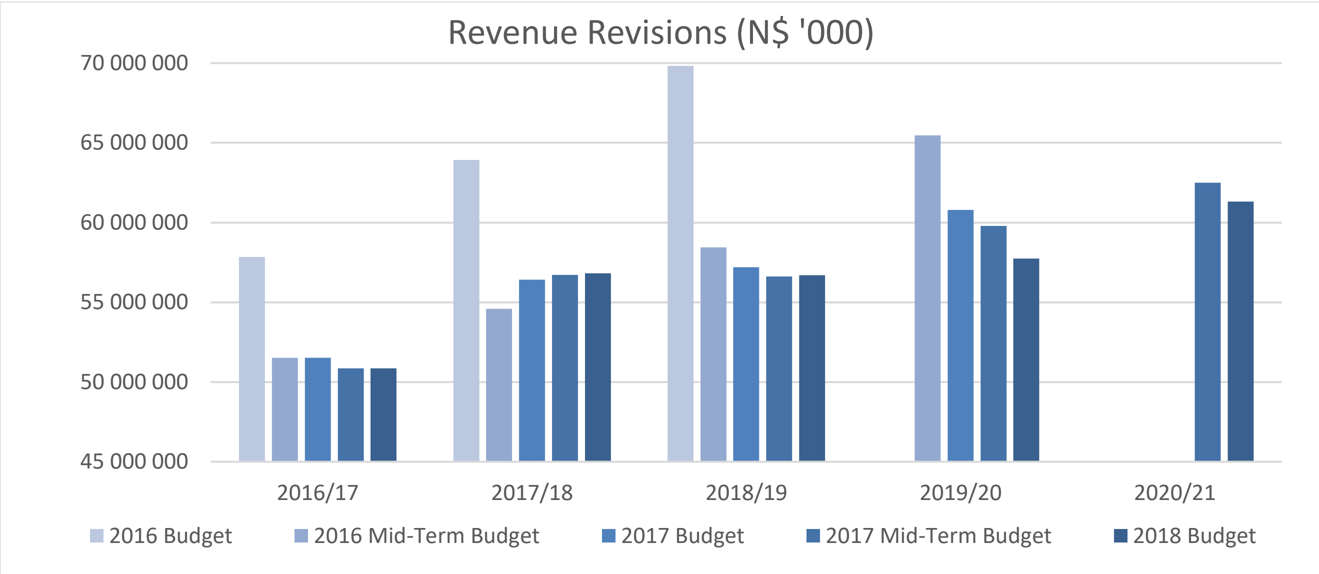
The budget speech does go some way to point out what the Ministry of Finance aims to do to create fiscal policy space. Various tools are laid out, notably bilateral concession loan arrangements which will go to funding development projects. This off-budget financing is expected to lead to further increases in debt to GDP to 46.5%. This is envisioned to be a temporary measure through which to stimulate economic growth. We at IJG feel that should the right types of projects be undertaken then such measures could drive sustainable growth (without delving into what those projects might be), but transparency will be key.

Real GDP growth has been depressed for longer than we at IJG had expected and the Ministry of Finance has been slow to acknowledge just how low growth for 2016 and 2017 would be. Growth expectations for 2018 remain low and as such the pro-growth fiscal discipline set forth in this budget is justifiable to some extent. It is however imperative that projects financed through tax increases and the above-mentioned loan arrangements add to the productive capacity of the country as the projects to be funded will once again likely be transitory in nature.

Revenue

2017/18 Outturn

Revised revenue collection for 2017/18 is estimated to have come in at N$56.81bn, 1% higher than expected in the October mid-term review. While this is well below the March 2016 budget estimate it constitutes an upward revision from every subsequent budget estimate.



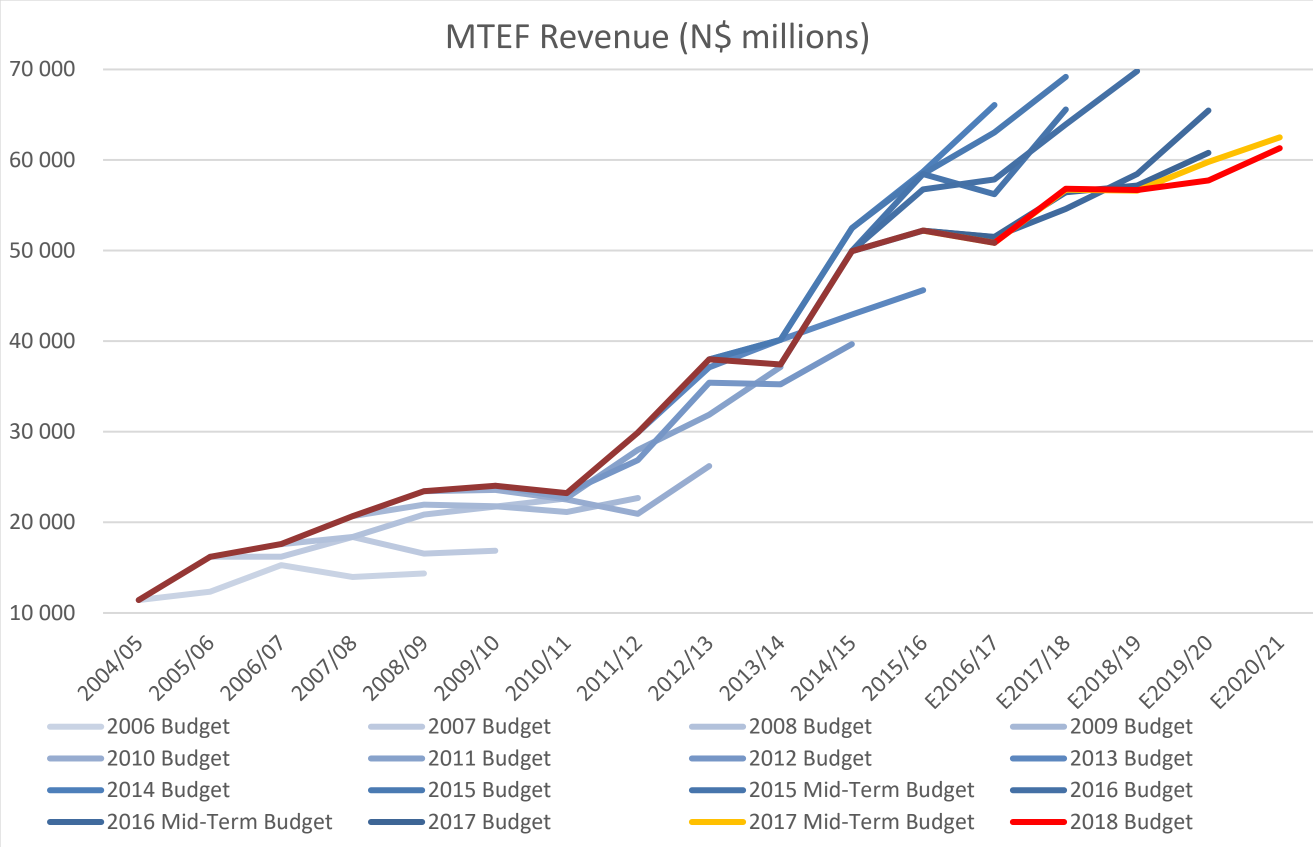
Source: MoF, IJG Securities

The minister noted in his speech that the preliminary revenue outturn for 2017/18 stood at 92.3% of the 2017/18 mid-year budget target. This is above the 89.0% historical average of this measure and hence the upward revision noted above. Also stated in the budget speech was the fact that N$972m was collected through the Tax Arrear Recovery Incentive Program initiated last year. Non-mining company tax and individual income tax showed some improvement compared to the October estimates.

The slight upward revisions note another positive feature of the last four budgets, the conservative and accurate estimation of future revenue collection. We noted this previously as well and it is worth mentioning that this trend seems to be continuing.

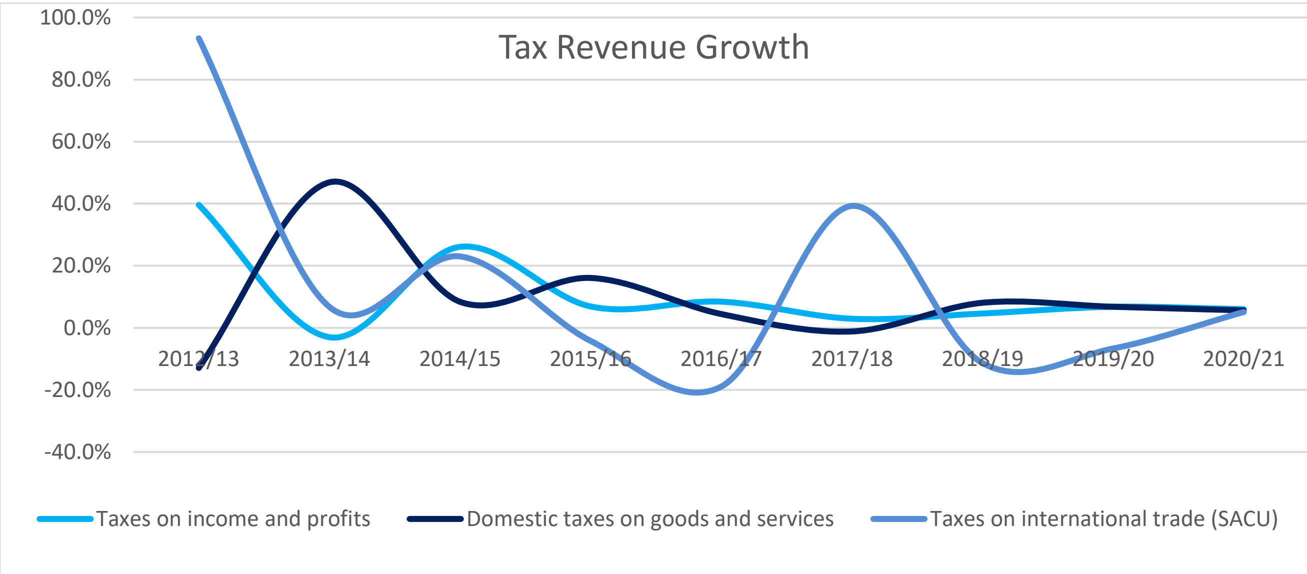
The large increase in revenue in 2017/18 versus the prior year stems from taxes on international trade (SACU revenues) for the most part. The repayment of SACU revenues in 2016/17, due to the overestimation of the size of the revenue pool in prior years, did provide a low base for revenue growth in 2017/18 and as such the N$56.81bn expected is an increase of 11.7% on the prior year's actual revenue collection.

2018/19 Budget Review



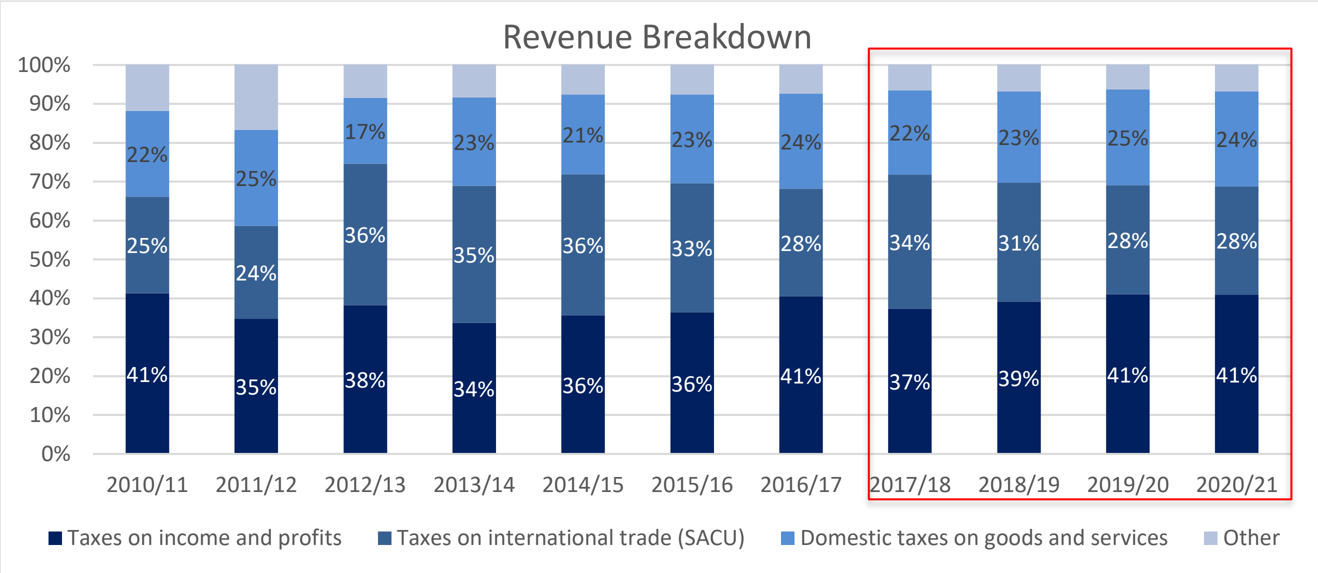
Source: MoF, IJG Securities

Revenue collection for 2018/19 is expected at N$56.70bn, 0.2% lower than estimated collection in 2017/18. This is a 0.1% increase from the revised expectation for the 2018/19 budget year in the October mid-year review, although down from the March 2017 budget. Once again here we see a more conservative estimate for revenue growth which is reflective of Namibian economic performance which does skew the risks to the upside instead of the downside as was the case a few short years ago.



Source: MoF, IJG Securities

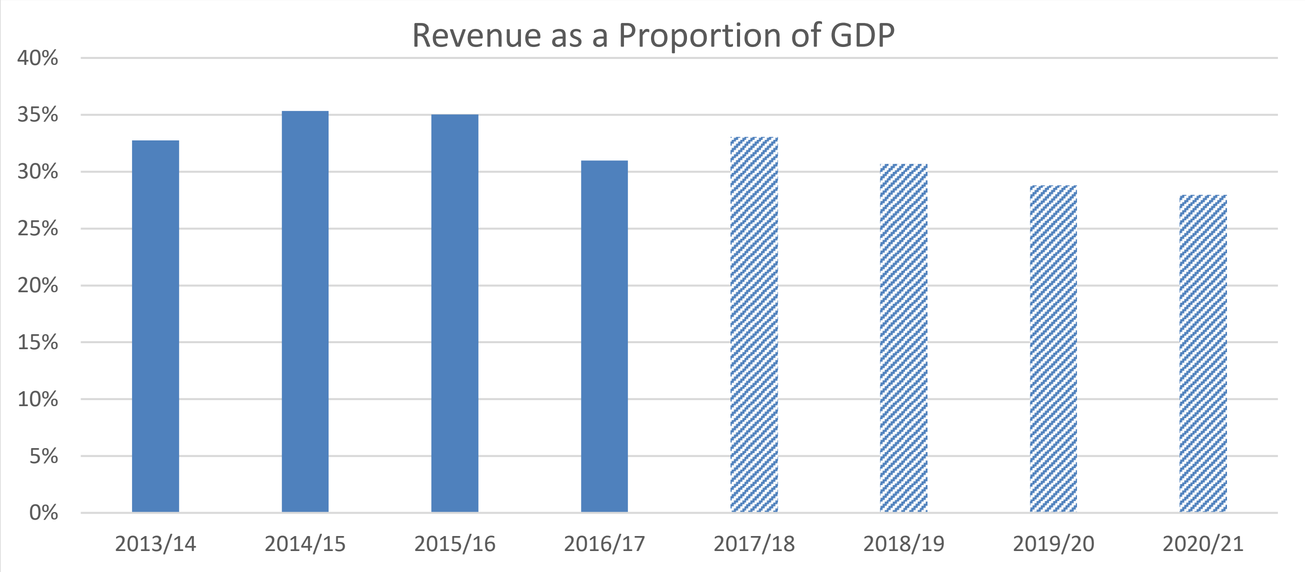
The subdued outlook for revenue growth is due to SACU revenues being lower in 2018/19 than in 2017/18. SACU revenues for the coming fiscal year are set to fall by 11.3% from N$19.60bn to N$17.37bn. SACU revenues remain volatile (as is illustrated above and below) and make up a large percentage of government revenues and as such they do introduce an element of unpredictability to the forecast for future revenue. The estimate of SACU revenue for the year will be very close to what Namibia receives, but as in the past, over or under performance of the SACU revenue pool during the year, could affect the 2019/20 expectations. As South Africa is the major source of pool revenues, demand in that market will drive pool performance.



Source: MoF, IJG Securities

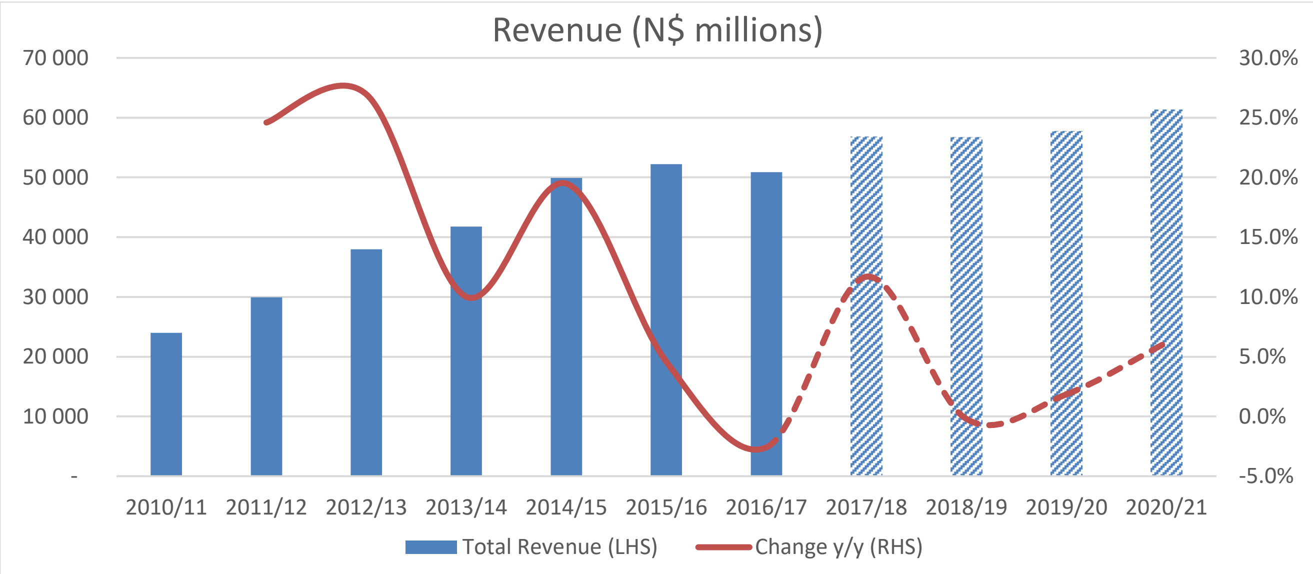
Tax revenue as a percentage of total revenue has averaged over 90% since 2010 and is set to increase further over the MTEF. The bulk of tax revenue come from taxes on income and profits (companies and individuals) and this is set to become more prominent during the next few years. This source of government revenue is less volatile than SACU revenues and is estimated to increase by an average of 5.8% from 2018/19 to 2020/21. Taxes on income and profits are expected to increase from N$21.21bn in 2017/18 to N$22.19bn in 2018/19. Most of this increase in the current year (2018/19) will come from income tax on individuals and non-mining company taxes. Taxes on diamond mining companies are estimated to decline by roughly N$0.5bn in 2018/19 despite expectations that diamond production will be higher than last year. This is likely to be due to pressure on diamond prices and a stronger currency but is not clarified in the budget documents (as far as we could tell at the time of publication).

Domestic tax on goods and services (VAT) is expected to increase by 8.1% in 2018/19 to N$13.28bn (depending on which figures are used, as the budget documents show a decrease to that figure in different parts of the text). Further increases are expected over the MTEF and together with taxes on income and profits these account for the increase in overall revenues despite expectations for SACU revenues to disappoint further over the MTEF. As illustrated in the figure above taxes on income and profits and domestic taxes on goods and services are expected to relieve some of the dependence on SACU revenues going forward. This is positive due to the volatile nature of the SACU revenues.



Source: MoF, IJG Securities

Revenue as a proportion of GDP is set to decrease from 33.1% to 28.0% over the MTEF. In the minister's speech he attributed this to the expected decline in SACU revenues over the period. This still leaves Namibia with a relatively high revenue-to-GDP ratio, well above countries such as South Africa, Australia and China.



Source: MoF, IJG Securities

MTEF Revenue Estimates

The outlook for revenue collection growth remains poor. Revenue collection is expected to grow by an average of 2.6% over the 2018/19 to 2020/21 period. The decline expected in SACU revenues is estimated to be countered by increases in domestic taxes on goods and services as well as personal and non-mining company taxes. Most of the upside in revenue growth is estimated to take place in 2020/21, the outer year of the MTEF period. While this year is the most unpredictable, an increase in revenue growth in the outer years becomes ever more likely as the economy forms a relatively modest base off of which to grow.

Risks to the ministry of finance's estimates lie in the 2018/19 and 2019/20 years in our view. It is in these years that a slower than expected rebound in the economy could lead to revenue disappointment again. Should the economy languish further in 2018 it is likely to flow through to VAT and personal and company taxes. The risks are however muted in comparison to prior years due to much improved revenue forecasting by the ministry of finance.

Tax Policy and Tax Administration Reforms

The minister's speech proposed a number of tax policy changes in order to fund the fiscal policy goals. The minister proposed phasing out the preferential tax treatment of some existing manufacturers. While it is not exactly clear what is meant by this statement it is assumed that the corporate tax arrangement whereby manufacturers are taxed at 18% for the first 10 years of operations may be phased out. As well as this the minister proposed repealing the Export Processing Zone (EPZ) Act. The argument here is likely to be that the existence of these incentives has not led to sufficient growth in the manufacturing sector to be justified. These changes, should they become a reality, are likely to be applicable to new companies and phased out for companies already in existence in order to cause minimal harm to the sector.

The minister further proposed changes to the current tax brackets for Individual Income Tax. The proposal is to reduce the lowest bracket to 17% while adding two additional brackets to the top end, making income tax more progressive. The two top brackets would be 39% for individuals with an income of over N$1.5m per annum and 40% for individuals earning more than N$2.5m per annum. We do not expect much resistance to these changes as they are generally positive for most of the population, especially those in lower income tax brackets. Gains in terms of revenue collection are likely to be relatively small though as the number of people benefitting from the slight reduction in their income tax bill is far larger than those paying more due to the creation of the top two brackets.

A 10% dividend tax for dividends paid to residents was proposed, which will include dividends paid from private and listed companies. Not much further detail was given on this proposal. The aim of the proposal is to enhance fairness of the tax system according to the minister. At the time of writing of this report a detailed analysis of the impact of this proposal was not done.

Other proposals include:

- The abolition of a flow through principle in the taxation of trusts.
- Taxing all income earned from foreign sources.
- Exploration of a profit tax of 37% on betting and gaming entities.
- The introduction of VAT on income of listed asset managers.
- Increasing the fuel levy by 25c per litre for all levied fuel products.
- Expanding coverage of the export levy to include products currently not covered.
- Introduce an additional 5% national "sin" tax on alcohol and tobacco products.

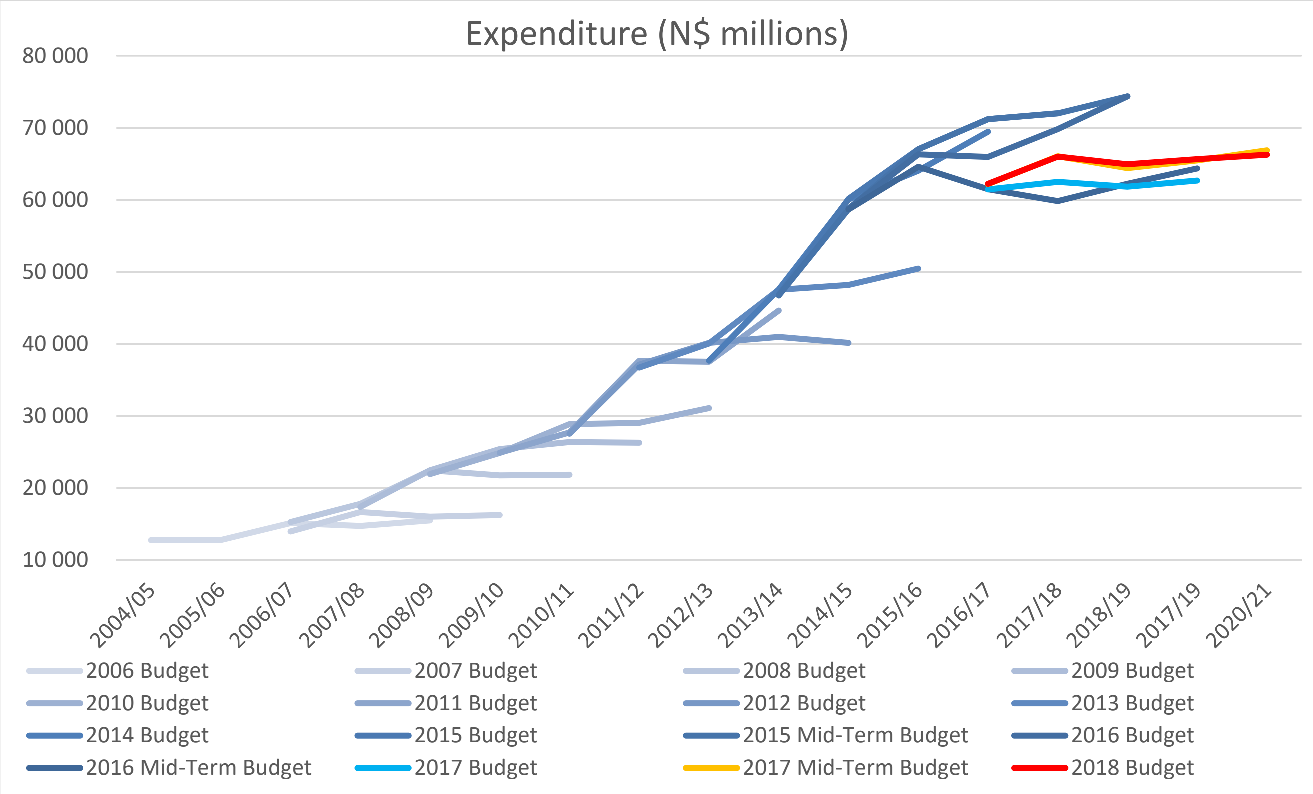
These tax proposals are expected to generate approximately N$500m in additional revenues for government. An indication was not given whether these revenues were included in the revenue estimates elaborated on above.

The budget speech noted that alongside tax policy changes, tax administration reforms are to be implemented during the year ahead and over the MTEF. These will include (amongst others):

- Transitional arrangements for the establishment of the Namibia Revenue Agency (NAMRA) by 1 March 2019.
- The roll-out of the Integrated Tax System (ITAS) by July 2018.
- Developing guidelines and regulations to give effect to voluntary or forced registration of all small businesses that are currently not registered for tax purposes and to determine the rates payable by such businesses.
- Leveraging regional and international tax cooperation as a mechanism to enhance national technical capacity in various areas of tax administration, specifically in respect of transfer pricing.
- Scaling-up the programme for targeted recovery of tax arrears for different categories of tax and non-tax revenues, after the expected lapsing of the Tax Arrears Recovery Program on 11 March 2018.

The establishment of NAMRA and ITAS are sure to be welcome improvements and are likely to lead to improved efficiency in the management of tax affairs of the country as well as making it easier for citizens to submit tax returns. The systems should make tax evasion more difficult and lead to improved revenue collection with time. Of course, the possibility exists that these systems and the Agency will be further delayed as they may not be that easy to set-up. Implementing them prematurely could lead to new inefficiencies or challenges unforeseen at the time of the tabling of the 2018/19 budget. Further details regarding NAMRA and ITAS are sure to follow in the coming months.

Expenditure



Source: MoF, IJG Securities

2017/18 Outturn

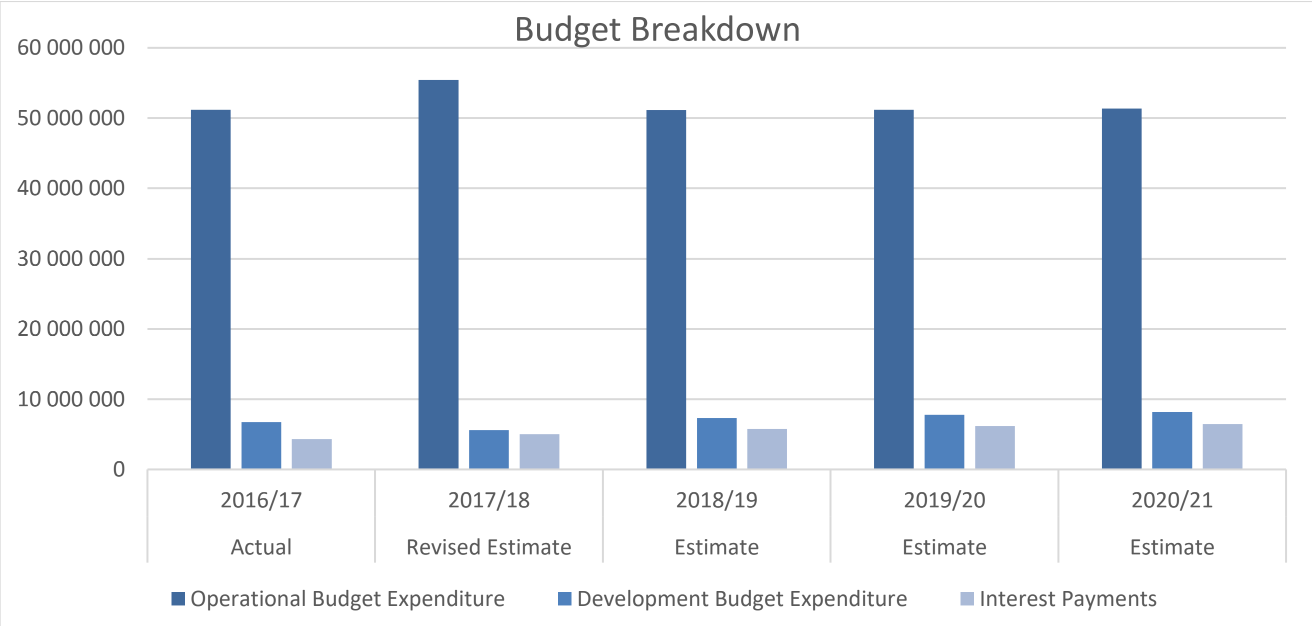
Expenditure for 2017/18 is estimated to have been N$66.05bn, 0.1% down from the October mid-year review. This constitutes a 6.1% increase over the 2016/17 budget. The development budget made up only 10.2% of non-interest expenditure during the year. This is largely due to the cuts made in the October 2016 mid-year review as drastic measures were needed and the easiest place to reduce expenditure was the development budget.

The 2017/18 year was a trying year for the ministry of finance who tabled a budget of N$62.5bn in March 2017, which failed to factor in the large sums of private sector invoices owed by government. Our October 2017 mid-year budget review document details this and provides some insight to the additional allocations made. The unplanned expenditure led to a N$3.5bn adjustment to the March budget, eradicating some of the gains made through the fiscal consolidation measures implemented over the prior budget period.

The preliminary expenditure outturn was satisfactory at 87.4% by the end of February 2018. The development budget expenditure outturn however is quite concerning at only 64.1%. The minister noted that the opportunity costs associated with this include the foregone benefit to the country. The reasons behind this poor expenditure outturn are not explored in the speech but could very well include some drag attributable to the public procurement act tabled last year. Namibia, a country with a growing infrastructure deficit, should be prioritising development projects and this outturn points to the opposite.

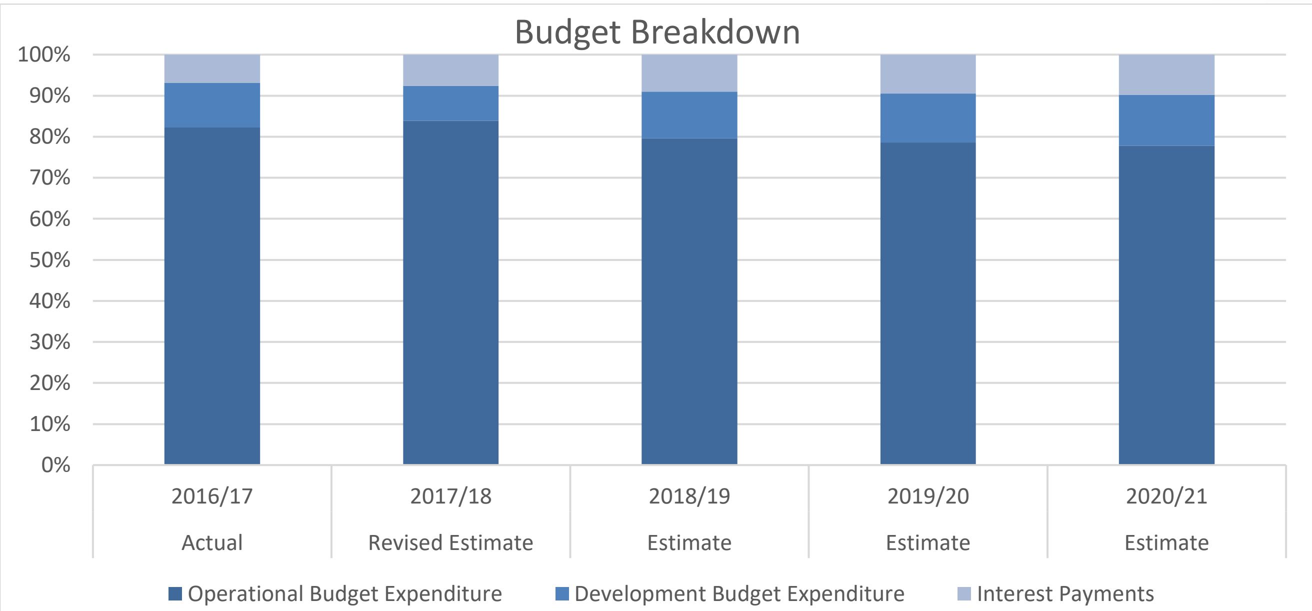
2018/19 Budget Review

Expenditure is expected to decrease by 1.6% to N$65.00bn in 2018/19, from N$66.05bn in 2017/18. This is an upward revision of 0.8% in expenditure from the 2017 mid-term budget, and 5.1% from the March 2017 budget speech. For the remainder of the MTEF expenditure ceilings of N$65.68bn in 2019/20 and N$66.37bn in 2020/21 are expected. Expenditure over the MTEF seems to have been shifted around with little net change from the October mid-term review.

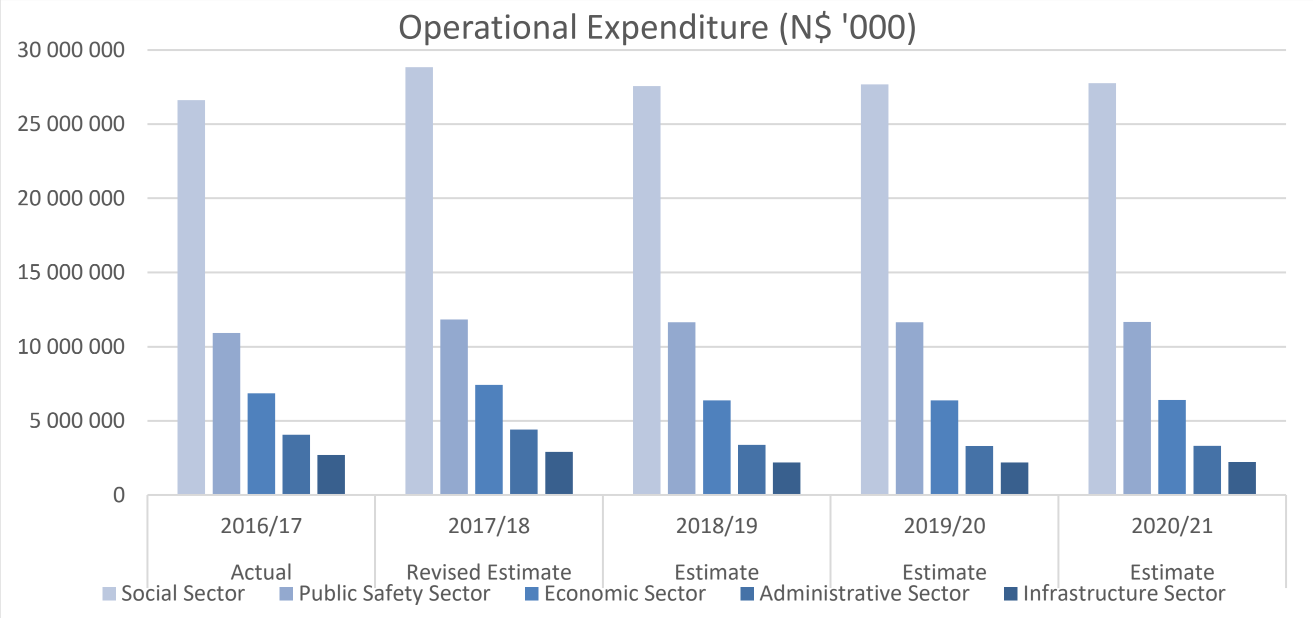


Source: MoF, IJG Securities

The 2018/19 budget remains one with a heavy operational bias. The operational budget makes up 79% of the budget expenditure over the period (including interest payments, excluding guarantees). The development budget is set to account for around 11% of the total budget in 2018/19 and average around 12% over the MTEF. Interest payments make up the remainder, a fairly large amount compared to 3 or 4 years ago, averaging over 9% of total expenditure.



Source: MoF, IJG Securities



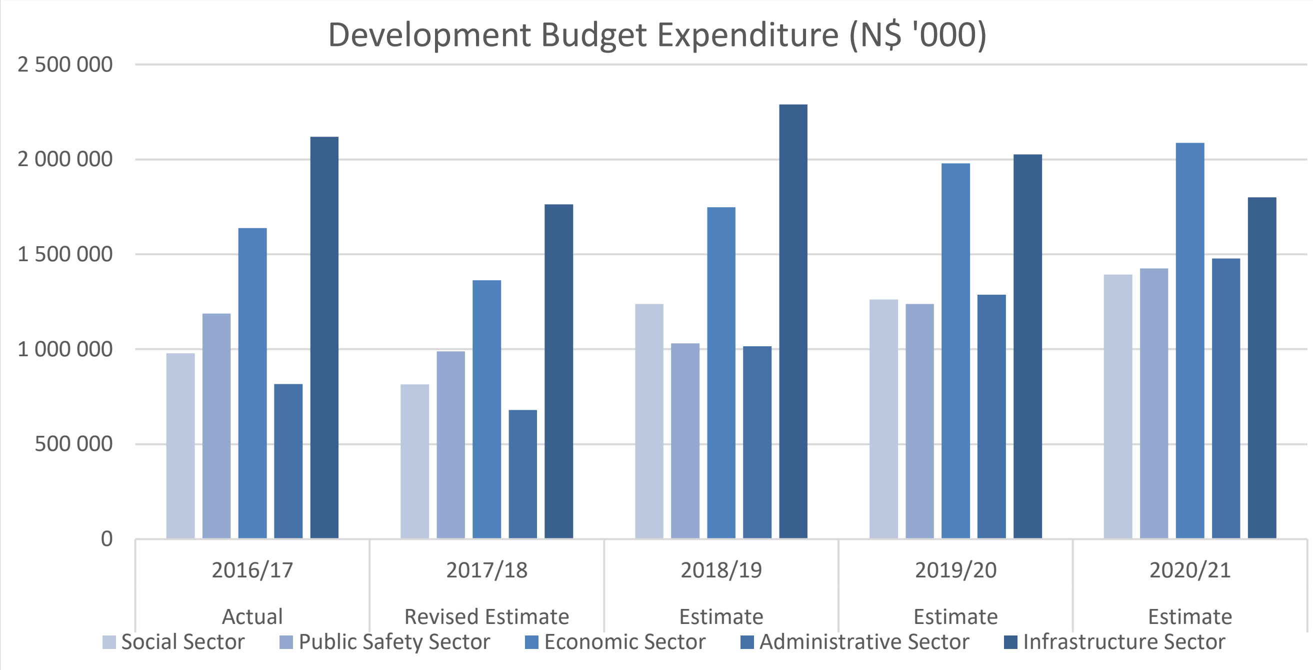
Source: MoF, IJG Securities

Operational budget expenditure retains a heavy weighting toward the social sector which includes education and healthcare. By far the largest single budget allocation goes to the basic education which receives N$13.5 billion, an increase of 4.0% over the 2017/18 allocation. The minister did point out that in relation to the amount spent per student the quality of outcomes was poor. Namibia spends more than 3 times as much as the global average per learner and the high failure rates and low requirements to pass point to a system in dire need of reform.

Higher education, training and innovation receives N$3.2bn in 2018/19, largely funding UNAM, NUST and the NSFAF. In total 28.5% of total expenditure for the coming year goes to education. Health and social services receives N$6.5bn during the 2018/19 budget year. This is another budget commitment which is suffering from inefficiencies and poor checks and balances resulting in leakages. Finally, poverty eradication and welfare has been allocated N$3.4bn for the year in an attempt to maintain the real value of grants. An increase of N$50.00 in the old age pension is a reflection of this commitment, although well below annual inflation for 2017.

Expenditure allocated to the economic sector is largely due to N$2.5bn allocated to PSEMAS (Public servants medical aid). Further allocations within the sector go to the Development Bank of Namibia (DBN) in support of SME financing, and AgriBank to support its loan book and lending activities.

Transport receives a budget allocation of N$3.5bn for 2018/19 which is earmarked largely for the completion of on-going road capital projects. The Road Fund is required to provide funding to the tune of N$2.6bn in addition to the amount budgeted by government, and a further N$2bn from the AfDB will support this further. All said this is a relatively large increase in funding to transport. Over the MTEF this amounts to almost N$25bn (N$9.7bn from the budget, N$13bn from the Road Fund, N$2bn from the AfDB), with a possible additional N$2bn of AfDB funding flowing into the works. This may be seen as a stimulus package, aimed at establishing Namibia as a logistics hub in the region. The Ministry of Agriculture, Water and Forestry will receive N$2.1bn, rounding out the majority of the infrastructure funding.



Source: MoF, IJG Securities

The public safety sector receives the second largest share of the budget expenditure with N$12.7bn allocated to this sector in 2018/19. Defence receives almost half of this allocation at N$6.0bn, an increase of 4.9% on last year. Safety and security is allocated N$5.2bn, a 3.0% increase over 2017/18. Smaller allocations go to the Ministry of Home Affairs and the Judiciary.

The previous two figures show that all sectors have a development budget component, with infrastructure being the largest of these. Much of the development budget expenditure does support the operational budget activities as such.

The large boost in spending on infrastructure is a positive development when viewed solely as a means to an end. The projects to be undertaken and completed should breathe some life into the struggling construction sector, creating jobs, and expanding the productive capacity of the country (hopefully). This budget analysis does not further explore the nuances of this stimulus package and as such refrains from taking an overly positive stance on it for the time being. There are certainly risks surrounding such projects. Worth mentioning is the fact that much of the Road Fund financing will be off-budget in nature possibly adding to future obligations. As well as this, these projects will be transitory in nature and thus the stimulus created will be temporary and could result in a similar impact on the economy as that which we have already gone through. The fact that most of this expenditure will go towards increasing the productive capacity of the country is positive.

Budget Balance and Financing

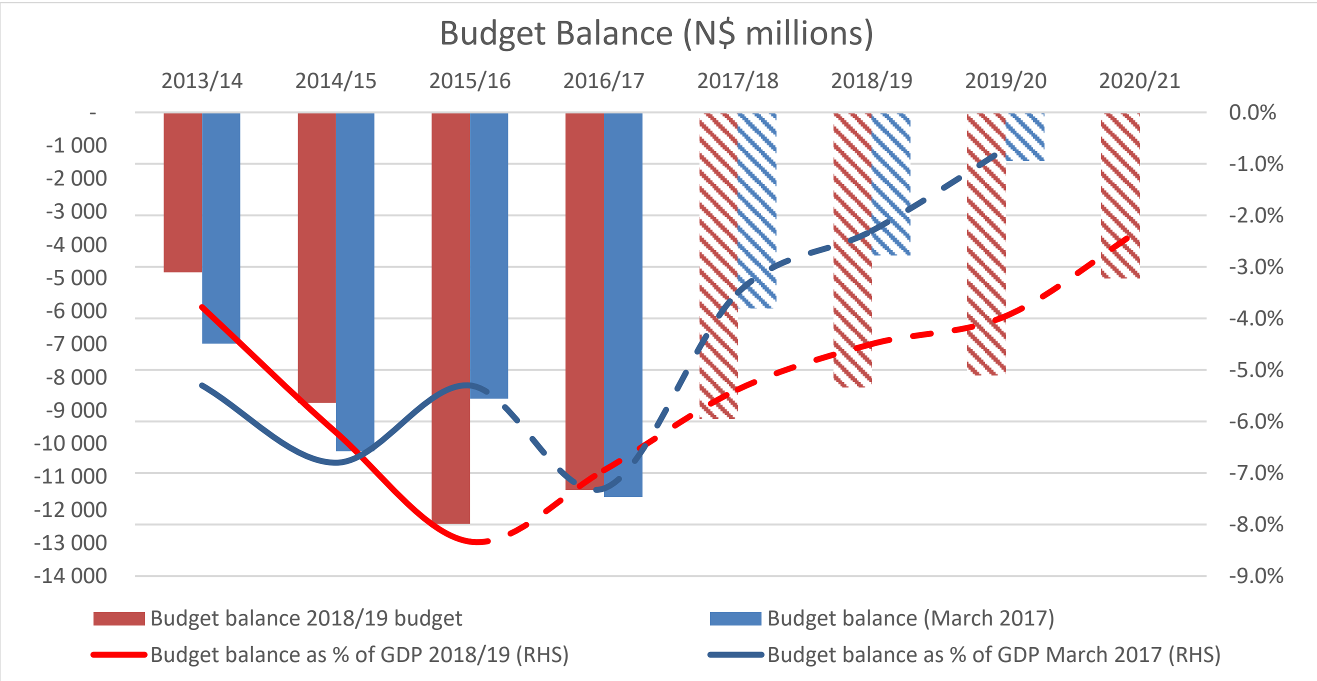
2017/18 Outturn

The total revenue for the 2017/18 is expected to come in at N$56.8bn according to the 2018/19 budget speech tabled in parliament on the 7th of March 2018. This is an 11.6% increase from N$50.9bn collected in 2016/17 due largely to improved SACU receipts. The minister pointed out that the preliminary revenue outturn for 2017/18, as at the end of February, stood at N$52.4bn with a collection rate of 92.3%. This according to the minister is better than the historical average of 89%, and on the back of that revised revenue for 2017/18 is up by a marginal 0.1%.

Expenditure for 2017/18 was revised upwards to N$66.1bn in October and included the outstanding invoices government owed the private sector. At the end of February total expenditure stood at N$58.2bn, representing an execution rate of 87.4%. The budget deficit for 2017/18 edged down to 5.4% or N$9.2bn from a N$11.4bn deficit in 2016/17, although significantly higher than the 3.6% expected in March last year.

The expected deficit at the beginning of the 2017/18 year was N$6.1bn, with two subsequent amendments to the domestic borrowing plan in order to fund the revised deficit.

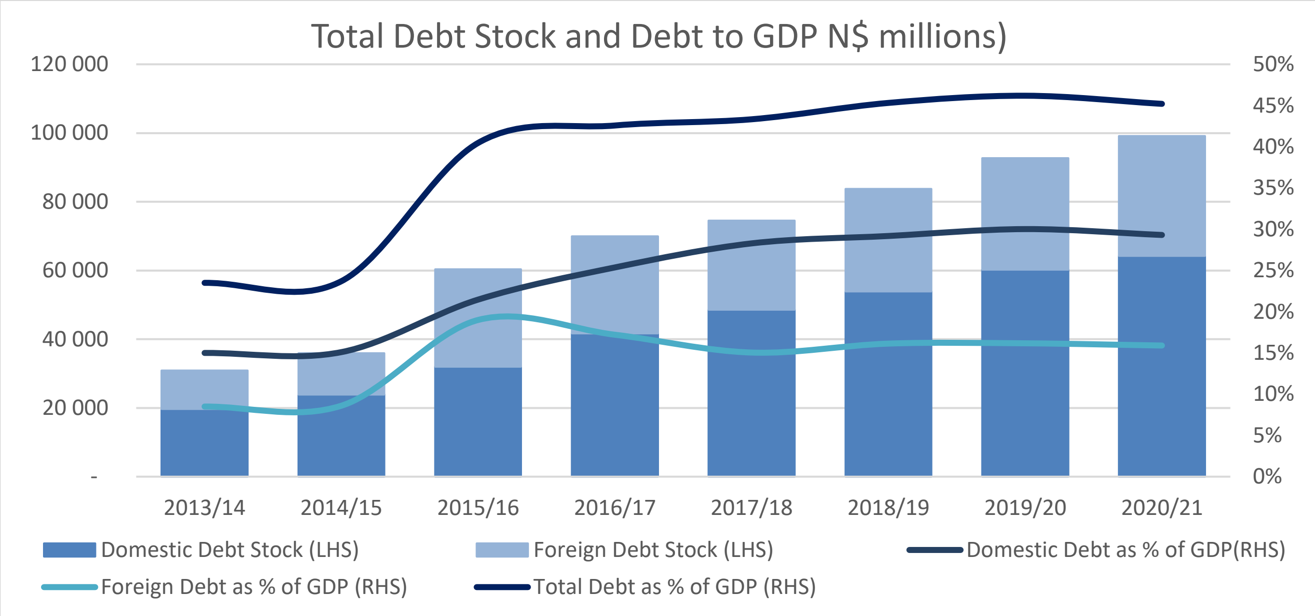
The debt stock for 2017/18 is expected to have reached N$74.5bn and will effectively bring Namibia's debt to GDP ratio to 43.3% according to the ministry of finance. Debt levels have been rising considerably over the last three years and it is forecast that the debt to GDP ratio will continue to rise over the MTEF, reaching 46.5% in 2019/20 before slowing to 45% in 2020/21.



Source: MoF, IJG Securities

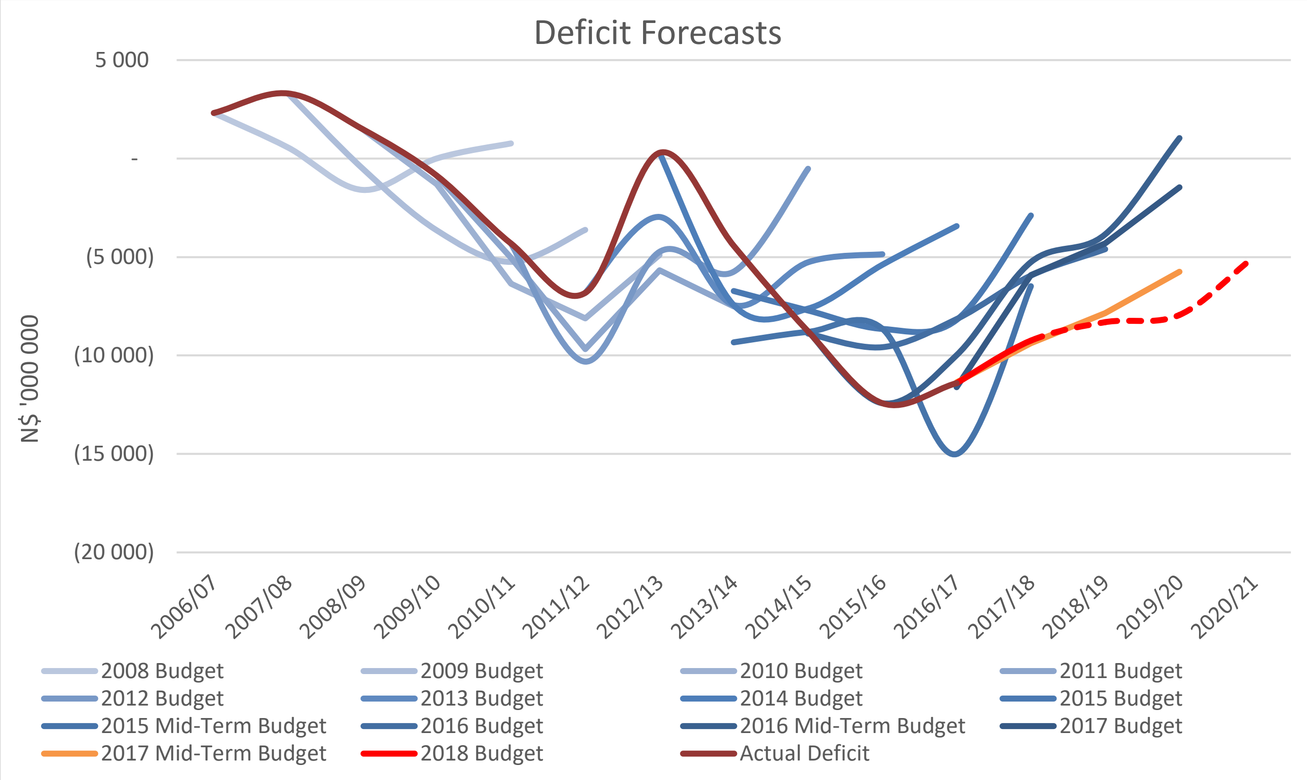
2018/19 Budget Review

Revenue for the 2018/19 has been revised downward to N$56.7bn, from the previously budgeted N$57.2bn (March 2017). SACU revenues are projected to decline by a cumulative 18% over the next two years, and as a result, total revenue as a percentage of GDP will moderate to 30.7% in 2018/19. Expenditure will increase by 0.8% in 2018/19 to N$65.0bn.



Source: MoF, IJG Securities

The budget deficit is forecast to be N$8.3bn, or 4.5% of GDP in 2018/19, improving on the expectations for 2017/18 of N$9.24bn. The 2018/19 deficit will be funded through domestic debt issuance and the AfDB operational budget support loan and as such brings Namibia's total debt to N$84.6bn, which translates to 45.8% of GDP in 2018/19. The net borrowing requirement for the FY2018/19 budget tabled on 7 March, was N$9.3bn, a difference of N$947.5m from the deficit according to the numbers released.



Source: MoF, IJG Securities

Namibia's credit rating was cut to below investment grade by two major ratings agencies last year. The consequence of these ratings downgrades is that it makes it more expensive for Namibia to raise funding in international capital markets as well as increasing the cost of borrowing when refinancing the current foreign debt. As per the budget policy statement, the majority of the deficit will be funded through domestic debt issuance with the remaining 43% coming from foreign funding.

The funding from the AfDB's operational budget facility to Namibia constitutes N$6bn of foreign financing, with the first tranche of N$3bn already received in 2017/18. As per the MTEF, N$950m of the foreign financing in 2018/19 relates to the technical and financial cooperation projects extended by the German government.

Numerous off-budget funding initiatives are being undertaken, that if added to debt levels significantly increase the debt to GDP levels. N$4bn from the AfDB is spread over two years and is earmarked for developmental and infrastructure projects. N$10 – N$15bn will be funded over the next five years through bilateral concessional loans that will be used to finance industrial and logistics hub infrastructure. The Road Fund Administration will extend around N$13bn over five years that will go toward road infrastructure maintenance and rehabilitation.

The ministry of finance continues to run expansionary budgets, albeit now at time when it is necessary as counter cyclical policy in order to stimulate economic growth. The risk herein lies in the fact that the budget deficits are funded through debt issuance and revenue growth is expected to be muted over the MTEF. Debt to GDP is expected to average over 45% over the period making it imperative that the funds raised are spent in a transparent manner in order to increase the productive capacity of the country.

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